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M&A Perspectives

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M&A for growth: Restarting the UK's SME engine

On Wednesday, 20 March the Office for Budget Responsibility scaled back UK growth figures for 2013 to just 0.6 per cent while the Chancellor of the Exchequer unveiled his fourth Budget. The thrust of the Chancellor's announcements was to help spur the recovery through aggressive monetary policy, support for the housing market and tax cuts for companies. A number of measures were introduced aimed at reinvigorating the United Kingdom's 4.8 million small-and medium-sized enterprises which remains a focus for the Government and it is this segment, more than any other, which will play an integral part in the UK's return to sustained growth. In this first edition of *M&A Perspectives*, we consider how some of the UK's fastest growing SME companies have used M&A to grow in tough economic conditions and propel their companies' fortunes.

The UK's small- and medium-sized enterprises (SMEs), defined as companies with no more than 249 employees, are an integral part of the economy accounting for over 99.9 per cent of all private sector companies. At the start of 2012, they employed an estimated 14.1 million people (47 per cent of the UKs employed workforce)[1] and had an estimated combined annual turnover of £1,500 billion.[2] The success of the UK's SMEs brings with it the tacit benefits of wealth and job creation and provides the foundation of economic prosperity. However, like so much of UK plc, they have been mired in sluggish growth over the past few years while those that have flourished have seen their traditional exit opportunities diminished by cautious investor sentiment. It is for this reason that a number of measures were introduced aimed at boosting the competitiveness of the UK's SMEs including:

- The introduction of Legislation in Finance Bill 2013 to **reduce the main rate of corporation tax for non-ring fence profits** from 22 per cent to 21 per cent for the financial year commencing 1 April 2014 and from 21 per cent to 20 per cent for the financial year commencing 1 April 2015.
- A new £2,000 allowance to support businesses and charities with ambitions to take on new staff. From the next tax year all such employers will be entitled to a **£2,000 Employment Allowance towards their employer NICs (National Insurance Contributions) bill estimated to benefit 2.5 million employers,** with over 90 per cent of the benefit going to small businesses.[3]
- **An increase in government procurement from small businesses** from £40 million in 2012-13 to over £100m in 2013-14 and £200m in 2014-15.
- **Introduction of the R&D expenditure credits** for companies claiming relief under the 'large' scheme, and increased the headline rate from 9.1 per cent to ten per cent – designed to make R&D relief more visible to those making investment decisions by reflecting the benefit in a company's operating profit rather than in the tax line. Loss-making companies will be particularly pleased because the redrawn relief allows for repayable cash tax credits for the first time.
- Additional measures around **increased capital spending,** the **cancellation of the fuel duty rise** and the **removal of stamp tax on shares in companies** quoted on growth markets such as the Alternative Investment Market (AIM) will help small businesses across the UK and in almost all sectors.

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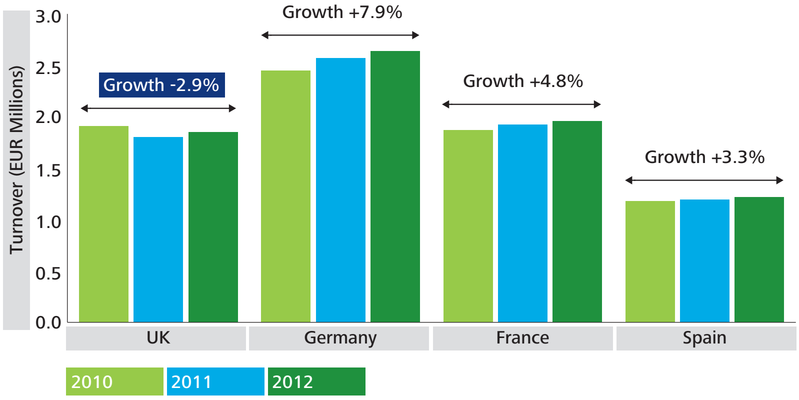
Figure 1. UK vs. Germany, France and Spain SME turnover (2010 – 12)



Source: Department for Business, Innovation & Skills; European Commission; Deloitte analysis

M&A activities can boost growth significantly. Of the sample, 23 per cent of the companies had used M&A in the past ten years, acquiring a total of 106 companies with disclosed deal values of almost £3 billion.

< Deloitte UK's analysis suggests the Chancellor's focus on the UK's SME population is well grounded with the average turnover for SME population down one per cent over the past two years. While this incremental drop in turnover can be understood at a time when economic output and spending has contracted across the board, it amounts to a reduction in real terms of £33,114 million in turnover, when the number of SMEs in the UK increased by nearly 310,000.

Traditionally, SME networks are often considered more resistant to economic volatility, making the contraction in turnover all the more worrying. A look across the channel at our neighbours on the continent also points to a more resilient SME population with gross value add increasing by 2.7 per cent (€9.45 billion) from 2010 to 2012.[4]

With the UK's SMEs struggling to achieve organic growth, M&A offers an opportunity for companies to boost revenues, grow market share, capture greater efficiency savings and expand their offerings to clients. M&A need not be the prerogative of just the largest firms, but a means of stimulating and increasing growth for companies of all sizes.

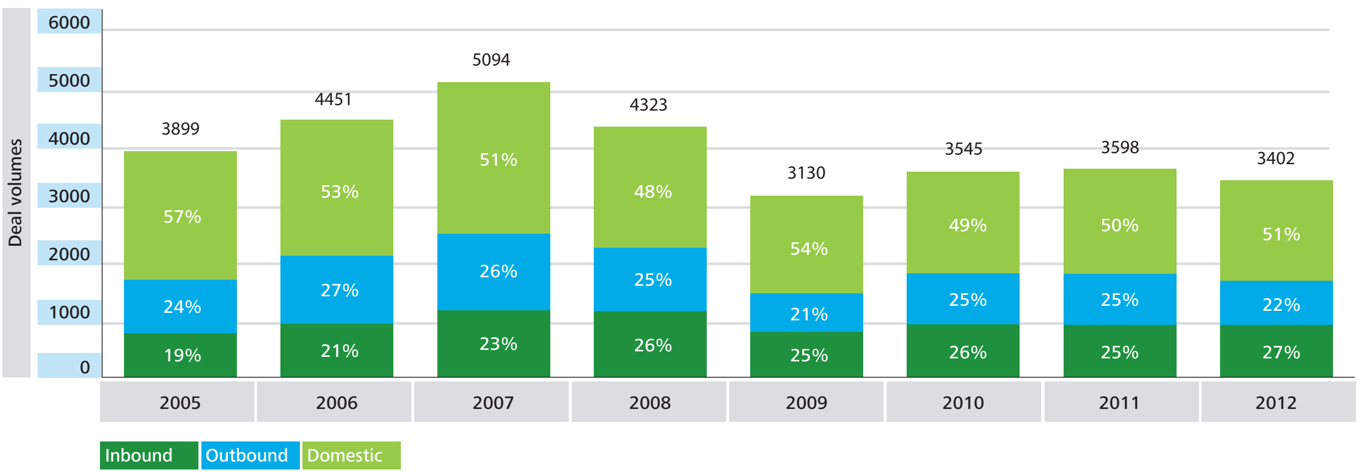
However, with only an estimated £120 billion[5] of cash on their balance sheets, representing just eight per cent of their combined turnover, companies cannot afford to get it wrong. How then can these companies use M&A most effectively for growth? Deloitte reviewed the M&A activity of some of the UK's fastest growing companies to consider what lessons could be drawn.

M&A in the *UK Futures 1000*

Deloitte UK has analysed the *UK Futures 1000*, the UK's fastest growing companies, with revenues of £30 million to £1 billion between 2008 and 2011. Deloitte UK examined what was driving their success and how they have used M&A to accelerate momentum. A company's growth is largely driven by the overall growth in the market segments where it competes. However, in the current sluggish conditions our findings suggest that M&A activities can boost growth significantly.

Of the sample, 23 per cent of the companies had used M&A in the past ten years, acquiring a total of 106 companies with disclosed deal values of almost £3 billion. Twelve per cent of companies themselves got acquired while the remaining 65 per cent undertook no M&A activity. The average three-year growth rate of the acquisitive firms was 26.2 per cent compared with 20.9 per cent for companies who undertook no acquisitions.

Figure 2. Inbound, outbound and domestic UK M&A volumes



Source: ThomsonONE Banker; Deloitte analysis

Companies of all sizes in the UK need to be bolder and more aggressive in their growth strategies and use M&A to help achieve this. Though economic volatility and uncertainty remain, there are genuine value creation opportunities out there if companies have the confidence to take them.

Using M&A to accelerate growth

There are several ways that the *UK Futures 1000* companies accelerated their growth rates through M&A:

Watson Fuels has been delivering fuels throughout UK for the last 50 years. Fuel distribution in the UK is a fragmented sector fraught with low margins, price volatility and credit issues. Watson Fuels addressed these by making five acquisitions between 2007 and 2010, expanding their network across the South East by adding new depots and commercial-only fuel suppliers to their business. These acquisitions contributed to a 70 per cent increase in turnover over the period and propelled Watson Fuels to become the number two distributor in the UK.[6]

2 Sisters Food Group was established in West Bromwich in 1993 as a frozen retail cutting operation. In these 20 years it has grown significantly through a combination of organic growth and ambitious acquisitions. Its CEO, Ranjit Singh Boparan, set a bold vision to achieve £3 billion in sales by 2015, which would see them become the largest food company in UK. Towards that goal, in 2011 they acquired Northern Foods and Brookes Avana, making them the fourth largest food retailer in UK.

There have also been several transformational and innovative M&A transactions that provide compelling stories for the use of M&A. The current market conditions are forcing many industries to consolidate and in those industries M&A activities are a matter of survival for some companies. This new reality is forcing some companies to use M&A to reinvent themselves completely.

Once more companies are taking to M&A to respond to this new reality and this is best illustrated by **Coral Products'** £4.1 million acquisition of Interpack. Coral is the largest UK manufacturer of video, CD and DVD boxes, but digital and on-demand business models have all but destroyed its core business and it delisted from the London Stock Exchange. Following their delisting, Coral though went ahead and bought Interpack – a fast growing food packaging business, whose growth story was hampered by capacity constraints. Coral refitted its under-utilised plant and equipment assets to bolster Interpack's capacity and this turnaround is now allowing them to list on the AIM.[7]

Bottom-line: Restoring UK plc to growth

M&A is a viable option for many of these companies to expand, add products and services, consolidate or in some instances, completely reinvent themselves. Companies of all sizes in the UK need to be bolder and more aggressive in their growth strategies and use M&A to help achieve this. Though economic volatility and uncertainty remain, there are genuine value creation opportunities out there if companies have the confidence to take them.

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About *UK Futures 1000*
UK Futures is Deloitte UK's initiative to chart the future of the UK's economy and business culture, understand what makes British business tick, and capture and communicate our insights to UK business leaders. Our *UK Futures 1000* group of companies demonstrated what British business can achieve: a staggering 55 per cent growth in revenues in the worst of the recession from 2008 to 2011. Between them, the *UK Futures 1000* created nearly 170,000 jobs and not just in London and the South East, but in every region in the UK.

Notes
1 Office for National Statistics, Deloitte analysis, 2012
2 Department for Business, Innovation and Skills, Deloitte analysis, 2012.
3 http://www.hm-treasury.gov.uk/d/budget2013_growth_infographic.pdf
4 SME Performance Review 2010-2012, European Commission, Deloitte analysis.
5 http://www.telegraph.co.uk/finance/businessclub/9626178/Banks-need-to-charge-more-for-SME-loans.html
6 http://fueloilnews.co.uk/top-fuel-oil-distributors/
7 http://www.ft.com/cms/s/0/b415dcb4-cd86-11e0-b267-00144feabdc0.html#axzz2OB0Zoc8l

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