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Still got it

The UK remains highly attractive for US dealmakers

US/UK M&A Deal Monitor, 2H 2016 Update

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M&A

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Methodology

Data in the US/UK M&A Deal Monitor are based on deal volumes and values in Thomson One Banker and Deloitte analysis. Deal value calculations are based on M&A deals for which value is disclosed – values are not disclosed for a significant proportion of M&A deals. Volume calculations are based on all announced deals whether or not value is disclosed. Some announced deals included in the data may not proceed to completion. The Deal Monitor includes volume and value data for the most recent eight quarters; in this edition data run from Q1 2015 to Q4 2016 inclusive.

In this publication, references to Deloitte are references to Deloitte LLP, the UK member firm of DTTL.

Preface

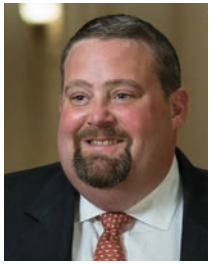
The flow of US/UK deals is a bell-weather of business vitality in two of the most important economies in the world. Companies acquire when they feel an underlying confidence about the future in the markets they select – whatever the current uncertainties in those markets. Six months ago we forecast that M&A dealmakers would continue to look beyond the uncertainties of Brexit and the US political cycle, and do business at record rates in the second half of 2016. That is what has happened. Companies have looked at the turning world, and decided to continue to invest in a cross-border future.

It would be idle to pretend there are not many reasons for heightened caution about the medium-term future. There is uncertainty on regulatory change, on tax reform and tariff changes, and on the final terms of the UK's exit from the EU. Any of these could alter the calculus that drives transatlantic M&A.

But what is unlikely to change is that the US and UK are leading innovation economies, with a commonality of outlook that is almost unrivalled by any other bilateral trading and investing relationship. That is a standing invitation to cross-border dealmaking.

Add to that the fact that the driving fundamentals of M&A have rarely been more favourable: borrowing costs remain low, capital reserves are high, and competition to find ways to grow and ways to capture the convergence of technologies and industries is fierce. That is why we believe that the current high rates of transactional activity are likely to continue.

Cahal Dowds
UK Head of US/UK M&A Corridor



Andy Wilson
US Head of US/UK M&A Corridor

The Deloitte US/UK M&A Deal Monitor

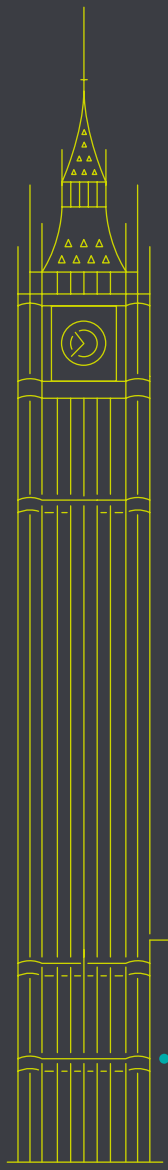
Welcome to the third edition of the Deloitte US/UK M&A Deal Monitor. The Deal Monitor follows trends and analyses underlying driving forces in the most significant merger and acquisition arena in the world economy today. The data focuses on the latest half-year of M&A activity (July 2016 to December 2016) between the US and the UK, set in the context of the most recent eight quarters of M&A activity in the US/UK 'corridor'.

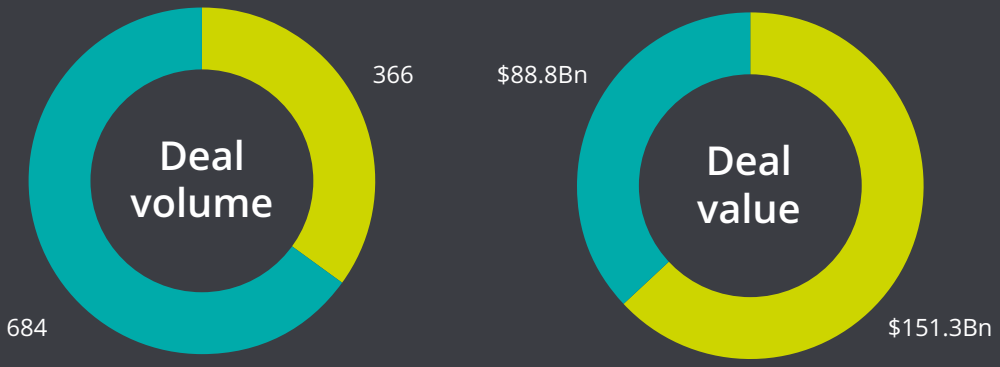
Each edition of the Deloitte US/UK M&A Deal Monitor looks at M&A activity and developments within the most active business sectors and the relative volumes of corporate-backed and private equity-backed deals, together with the regional dimensions of M&A within both the US and the UK. In this issue we focus on manufacturing, a leading sector in the US/UK corridor.

Data in the Deloitte US/UK M&A Deal Monitor are based on deal volumes and values in Thomson One Banker and Deloitte analysis. Deal value calculations are based on M&A deals for which value is disclosed – values are not disclosed for a significant proportion of M&A deals. Deal values are also highly volatile quarter to quarter, while deal volumes normally show only incremental changes from quarter to quarter.

For these reasons Deloitte considers deal volumes to be the more valuable short- to medium-term indicator; volume calculations are based on all announced deals whether or not value is disclosed. A small number of announced deals included in the data do not proceed to completion. Changes in deal volumes in the second half of 2016 are calculated on an annualised basis, comparing 2H 2016 to 2H 2015 in order to exclude seasonal effects. The Deloitte US/UK M&A Deal Monitor includes volume and value data for the most recent eight quarters; in this edition data run from Q1 2015 to Q4 2016 inclusive.

US/UK Cross Border Deals (Q1 2015 – Q4 2016)
Highlights





Sectors driving deal activity

TMT, BIPS, Consumer Business & Manufacturing

The majority of UK Outbound deals originate from **London**

California is the most attractive destination for UK Outbound deals

Geographical focus US Outbound UK Outbound

London is the most attractive destination for US Outbound deals

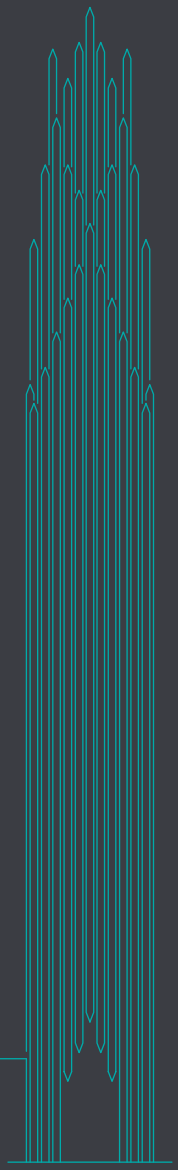
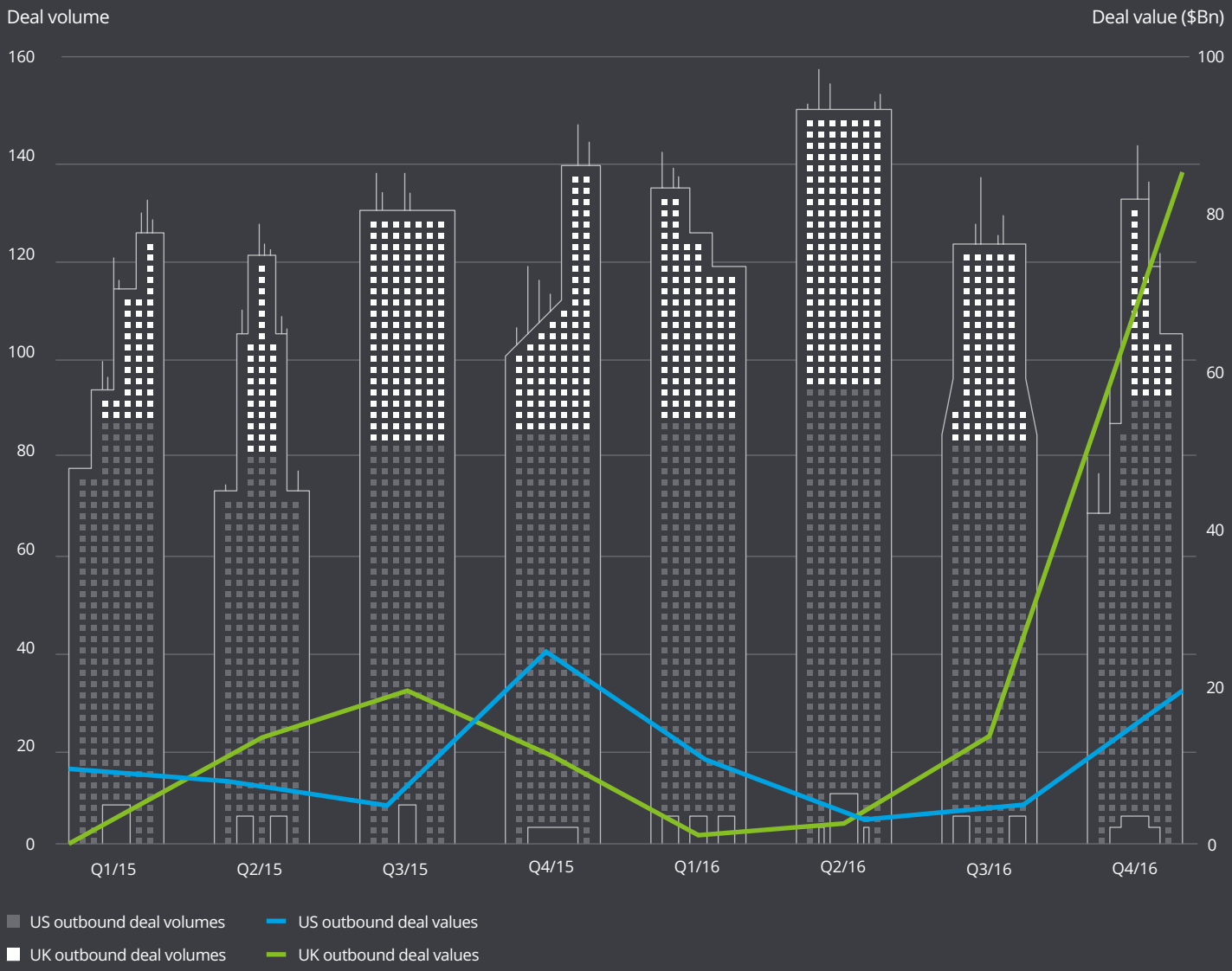


Figure 1: US/UK Cross Border M&A Deals



Source: *Thomson One Banker*

The US Takes the Lead

- US dealmakers deliver a vote of confidence in the UK in the second half of 2016.
- Some UK corporates and private equity have put M&A on hold in the second half of the year.
- Full year US/UK dealmaking rises slightly on 2015.

The US/UK M&A deal corridor has performed roughly in line with global M&A in the second half of 2016, as the total of US/UK deals fell 5.6%, against a global fall of 4.4%. Although US/UK dealmaking fell in the third quarter it recovered in the final quarter, making 2016 overall deal activity slightly stronger than 2015. This should be seen in the context of an overall fall in global activity in 2016 compared to 2015.

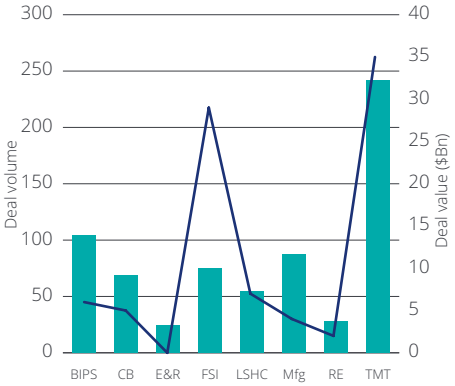
Two trends stand out in the second half 2016 US/UK data – the strength of US outbound dealmaking, and a decline in UK outbound dealmaking. Expectations of a collapse in US outbound dealmaking following the UK's Brexit vote have not come to pass – on the contrary, US buying of UK assets has outperformed when compared to 2015, and all of the second half fall in total deals is accounted for by the slowdown of UK buying of US assets.

US outbound deal totals rose 3.6% in the second half on an annualised basis, while UK outbound deals fell by 20.4%. Although UK outbound value leapt to $86.4 billion in the final quarter of 2016, the rise was accounted for by a number of very large deals, such as British American Tobacco acquiring Reynolds American.

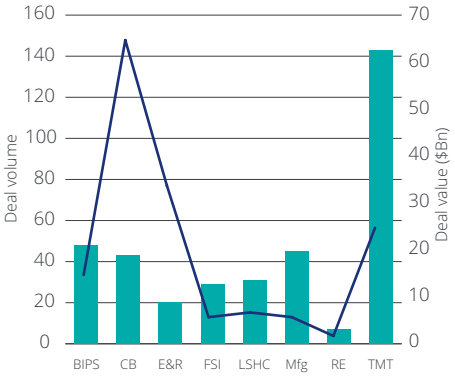
The volumes of M&A deals are an indication of underlying confidence levels in a world where certainties can seem hard to find. Overall dealmaking remains at historical high levels. Given a macro-economic background of a slowdown in the Chinese economy, continued sub-trend performance in many of the OECD economies, continued weakness in industrial demand and industrial commodity prices, and the uncertainty following results in the UK's EU membership referendum and the US presidential election, M&A volumes remain remarkably resilient.

Figure 2: Deal Value and Volume by Industry Q1 2015 – Q4 2016

US Outbound



UK Outbound

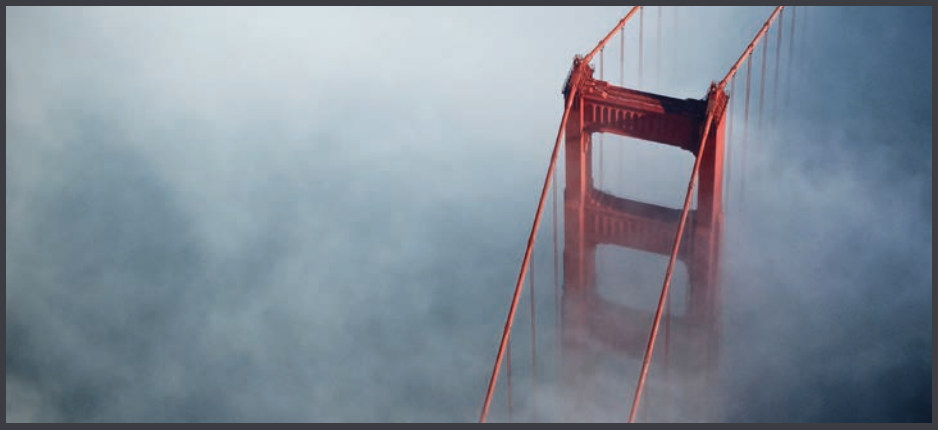


Deal volume — Value

Key:

BIPS:	Business, Infrastructure & Professional Services
CB:	Consumer Business
E&R:	Energy & Resources
FSI:	Financial Services
LHSC:	Life Sciences & Healthcare
Mfg:	Manufacturing
RE:	Real Estate
TMT:	Technology, Media & Telecoms

The US View



In a year of uncertainties, the US M&A market is exceptionally strong says Dallas-based partner Jamie Lewin, responsible for Deloitte's US private equity coverage and for M&A execution. *"I don't see any signs of weaknesses in US M&A,"* says Jamie. *"There is much more capital available than there are businesses to buy. When a quality company comes to market buyers will pay up for such an asset. In this way it resembles a commodity market, in that the threat of not being able to obtain future supply results in premiums being assigned in the present."*

But Jamie acknowledges that UK companies face a steeper climb than their US counterparts when it comes to securing M&A deals in the US/UK corridor. One reason for that is lender caution. *"Uncertainty in the UK impacts lenders more than investors,"* says Jamie. *"They suffer more from the downside. If banks are lending at 6%, their upside is capped relative to investors, which have the prospect of generating a multiple on their capital. Simply put, fixed returns within an uncertain environment make people cautious."*

For US investors looking for UK deals, Jamie sees lender caution as the primary reason why the share of deals won by US private equity has been falling. *"Strategic goals have not changed. Investor groups are making five to ten year investments in one of the most important markets in the world. So what is the independent variable? Access to and cost of capital. If you ask what would drive PE to primacy in deal share, the answer is when banks get more comfort with allocating capital into the UK."*

But all bidders, corporate and PE, face fierce competition in 2017 for quality corporate assets, especially in the US, says Jamie. *"The level of competition and the prices that are paid are unusual. The terms that are arranged relating to limited indemnification, speed of execution, and very rapid due diligence in deals involving well-run businesses is extraordinary. The flight to quality is beyond that which I have seen in my career, in that there is a fervour around great companies when they come to market."*

"There is much more capital available than there are businesses to buy. When a quality company comes to market buyers will pay up for such an asset. In this way it resembles a commodity market, in that the threat of not being able to obtain future supply results in premiums."

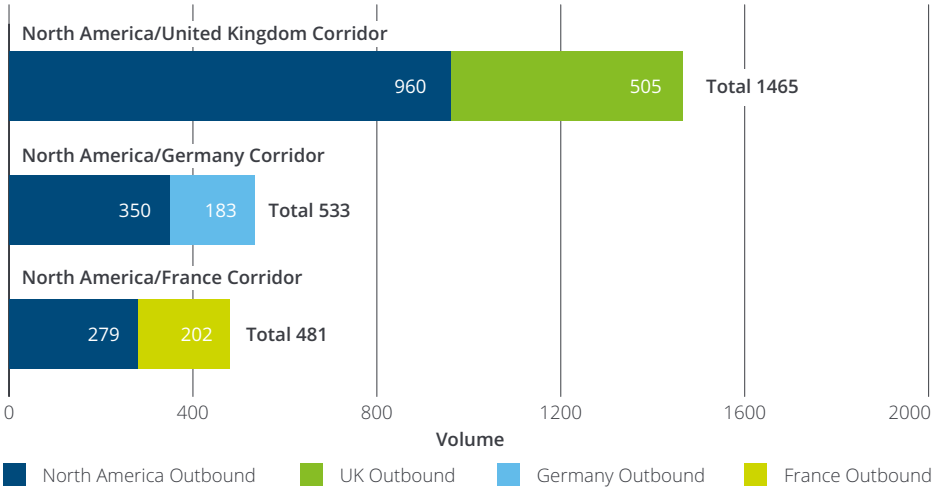
Jamie Lewin

Behind these strong performance figures lie several driving factors that have propelled US/UK M&A activity over the last two years:

- **The US and UK share a common understanding of corporate investment priorities and have comparable business environments.**

  The US remains the biggest and most dynamic market among the advanced economies; for UK companies seeking growth and sophisticated technology, M&A in the US is a must. For US investors, the UK remains a source of innovation, skills, and remains a bridge to the globalised world. The US investor perspective is that the UK remains the first port of call. *"I have ongoing confidence that the UK is going to be an economic centre,"* comments Jamie Lewin. *"Brexit is suggestive of change, but not a long-term dislocation. US deal makers share values with the UK, values in business practice, culture and language. And let's not forget, UK assets have got cheaper."* For the UK corporate or financial investor the depreciation of Sterling may have altered the outlook, but the fundamental imperative of US investing remains intact. *"For corporate buyers in particular strategy is very important, and buying in the US is the surest way for UK companies to create businesses that are global in scope,"* says Richard Parsons, Head of UK Private Equity coverage.

Figure 3: Top Three Bilateral M&A Corridors by Volume (Q1 2015 – Q2 2016)



These factors continue to provide long-term support for US/UK dealmaking, with the result that North America (US plus Canada) and the UK remains the largest bilateral M&A deal channel in the world.

- **Investors on both sides of the Atlantic have large reserves of undeployed capital and easy access to borrowing.**

  US and UK companies are often cash rich, and many US companies hold large reserves of undeployed capital outside the US. Borrowing terms are relatively easy especially in Europe, where 'Reverse Yankee' bonds, (bonds issued by a US Company outside of the US and denominated in a currency that is not US Dollars), are allowing US corporations to raise debt on historically attractive terms. At the same time growth rates in many economies outside the US are stuck below the long-term trend rate, making top-line corporate growth hard to find and encouraging more companies to buy market share and product diversification. These are the conditions for a continued M&A boom. *"Interest rates are low, corporate cash reserves are high, and the supply of capital for corporates and private equity is massive,"* says Cahal Dowds. *"In a world where there is a scramble for market share, the fundamentals for M&A have never been better."*

- **Rapid evolution of technology is driving dealmaking in both directions, and not just in the TMT sector.**

  Technology, media and telecoms (TMT) remains by far the most active M&A sector in both US and UK outbound deals – but even that predominance does not capture the full impact of technology. Many M&A deals in other sectors including manufacturing, healthcare and financial services also have technology drivers at their heart, as companies seek to add new value and incorporate technological innovations in their existing business lines. *"Technology now goes beyond the tech sector,"* says Andy Wilson. *"Companies everywhere are being tested on their ability to deal with technology convergence, and if you have a technology need in your product lines today there is a great opportunity to go out and find the company that can solve that. If you are not investing in those solutions organically then you have to buy those solutions, and quickly. This is going to create a lot of future dealmaking."*

Figure 4: M&A Deal Volumes Sorted by Discounted Values

Brexit Six Months On

The UK's June 2016 vote to leave the European Union – or 'Brexit' – has had unexpected effects in corporate asset markets. Although the vote echoed around financial markets with volatility in equity and currency values, a widely anticipated fall in incoming investment has not materialised. Total M&A investment into the UK has performed in line with global totals for all countries, with a very modest fall in the second half of 2016. In the US/UK corridor, US investment into the UK rose in the second half. The only hit to confidence visible in the data has been among UK outgoing investors, who have cut their US and global dealmaking by a fifth.

Dealmaking professionals are in agreement: the fall in the value of Sterling against major currencies is one factor behind the fall in UK outbound investment, but only one. *"Companies seldom think in terms of simple currency cost,"* says Andrew Rogers, UK Transaction Services Director and Manufacturing specialist. *"Currency cost may be a factor, but the real issue is what the target acquisition is worth over time. M&A is about the opportunity and delivery on strategy, and where companies see those opportunities the currency issue will not affect their thinking."*

"In the wake of Brexit we saw several US clients disappearing off the radar for a short time as they considered the situation, but they were soon back in the market and happy to proceed. If you look at corporate deals a lot of activity is driven by strategic M&A – they are not speculative or driven by short-term return."

Paul Wiszniewski

Alongside the fact that non-UK assets have become more expensive for UK buyers, some M&A specialists say that continuing uncertainty over the terms of Brexit, and how it will play out for UK businesses, may have raised a new barrier for UK acquirers in today's highly competitive scramble for corporate assets. *"For some, a perception may exist that UK buyers are increasingly focussed on the potential impact of Brexit on their business, to the detriment of their M&A strategy, but that doesn't tally with what we're seeing right now – there are plenty of UK companies trying to do US acquisitions"*, comments Paul Wiszniewski. *"However, you may see greater scrutiny being applied by a US seller when considering a UK bid versus a home-grown US bid. US buyers also don't want UK buyers trying to push adverse foreign exchange movements onto them".*

The last six months have shown that strategy remains central for corporate buyers. Does the same apply to more financially-driven private equity investors? Richard Parsons thinks that the number of financial investors changing their UK investment plans is small. *"There are US/Global sponsors who don't like Brexit, and at the moment they are cautious about deals in the UK," he says. "Then there are those who do not see it as an issue as they have been focused on the type of deals that should be resilient to the type of shock caused by Brexit for a number of years. And finally there are those who are saying that this is an opportunity, because of prices and because disruption in the market always creates opportunities."*

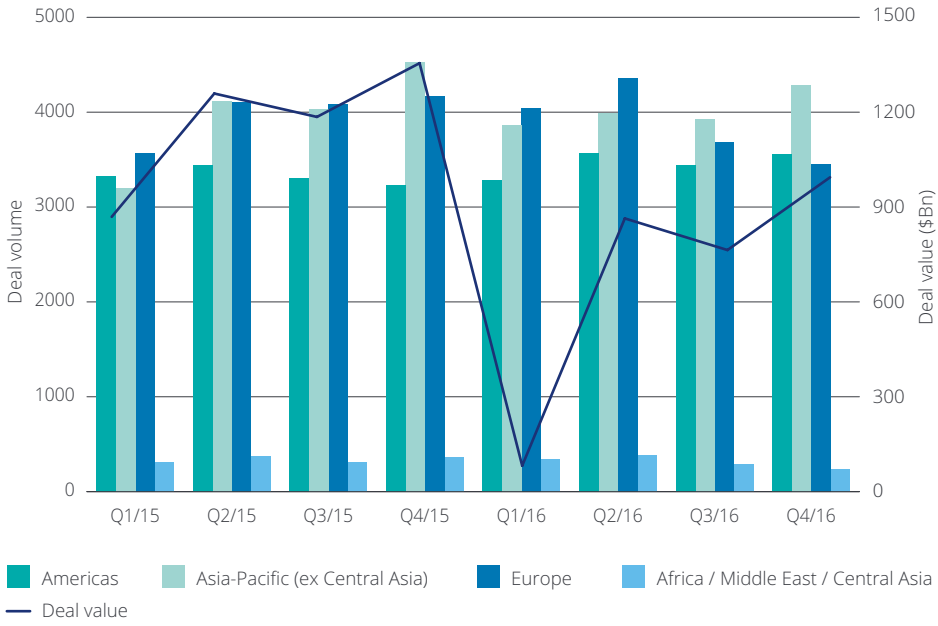
The market's verdict on Brexit so far points to UK resilience. As Vince McCarthy, Senior Vice President of Corporate Development and Strategy, Verisk Analytics puts it: *"the nature of M&A decision making is intrinsically long term. When you have a situation like the UK and Brexit where a lot of things remain to be determined, you don't look at the politics, you don't look at interest rates, you look at underlying, basic themes."*

The Global Context: US Outbound to UK Deals Defy Global Slowdown

The volume of global dealmaking fell by 4.4% in the second half of 2016 on an annualised basis. While US/UK total dealmaking roughly tracked that fall declining by 5.5% in the second half, the decline was concentrated in UK outbound deals. Outbound deals from the US into the UK outperformed, rising by 3.6%. The US has effectively signalled a strong vote of confidence in the continuing vitality of the UK economy, while some UK dealmakers have put M&A on pause.

- Global M&A dipped slightly in 2H 2016.
- US global outbound fell, and UK global outbound fell further.
- US outbound to UK continues to grow.

Figure 5: Global M&A Activity Since Q1 2015



"Successful dealmaking is about a deep understanding of your sector. That is the only way to get value. And that is why clients are spending a lot more time using industry expertise, and spending more time relationship-building with Boards – even when they don't have a specific deal in mind."

Paul Wiszniewski

The strong performance of US outbound to the UK is all the more striking as it comes against a background of falling global deal volumes out of the US. Outbound deal volumes fell by 10.3% in the second half of 2016 on an annualised basis (inbound deal volumes were little changed). The US also did fewer deals in Europe as a whole in the second half, making the preference for UK deals more marked.

"We rarely see our clients acting as if constrained by national boundaries. They see the UK as a stable, understandable market."

Andy Wilson

For the UK, the global story is an uncertain one in outbound M&A in the second half of 2016. On an annualised basis UK dealmaking in the rest of the world fell by 20.7%. Inbound M&A fell too, but only by 4.6%, which is very close to the 4.4% fall in total global activity. The figures suggest strongly that global dealmakers have not changed their view of the attractiveness of UK corporate assets, but that UK dealmakers are pausing until Brexit uncertainty resolves itself.

Although 2016 has been a year of uncertainties and surprises, with the potential for more unexpected change in 2017 with national elections in France, the Netherlands and Germany, the climate of uncertainty has not played out in the M&A market as many expected.

"The fall in UK outbound dealmaking is partly a currency effect, but only partly," says Paul Wiszniewski. *"It is also the case that UK clients are being a little more cautious – not by discounting M&A as a longer term value creation strategy, but a lot of companies are thinking hard about their own businesses and that makes them less focussed on pursuing the M&A route in the short term."* Pauline Biddle, UK Midlands practice senior partner adds, *"Some UK corporates are saying let's hold fire for now and see what happens in 2017. This is particularly true for those companies which might make acquisitions in the US which do a lot of government-related business, such as aerospace and defence, and there is a lot of uncertainty and mixed signals in those sectors."* Jamie Lewin concludes *"For UK outbound investors I don't think it's the currency that has depressed deals, it is confidence. It is prudence. I mean, why not allow more cards to be turned over before committing yourself to a course of action?"*

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New Visitor

Case Study: Verisk Analytics

"The UK Remains the M&A Destination of Choice" says Verisk Analytics.

Verisk Analytics is a New Jersey based data analytics provider with a long record of successful cross-border acquisitions. Verisk became a public company when it launched the largest US stock market flotation of the year in 2009, and in 2016 the company was included on the Forbes magazine list of the World's Most Innovative Companies. Verisk's latest UK acquisition came in November 2016 with the buyout of the Cambridge-based GeoInformation Group.

Verisk's Senior Vice President of Corporate Development and Strategy Vince McCarthy, says that despite the uncertainty created by the UK's decision to leave the European Union, dealmakers will continue to see the UK as a prime hunting ground for acquisitions. *"In our world the politics are not the issue,"* says Vince McCarthy. *"What matters to us is whether there is an ecosystem of innovation. To have that you need to have a deep connection with customers, and you need a true sense of entrepreneurship. That is what we find in the UK. That was true six months ago, and it is still true today."*

The rate of US dealmaking in the UK has been strong in the second half of 2016 and some have suggested that the fall in the value of Sterling may be behind this. But Vince McCarthy believes that deeper factors are at work: *"business always tries to keep decision making separate from the moment-by-moment changes in the environment,"* he says. *"If you are talking about very large deals, yes perhaps the value of Sterling against the Dollar does make a difference, but even then only at the margin. What really counts is that people want to deploy capital in environments that are rational. And you can see from the continued flow of investment into the UK that businesses consider that this is a rational economy, where you can make investments that make sense."*

Verisk says it believes that 2017 will be a strong year for US outgoing investment, adding that the company is fully committed to deploying more capital outside the US. As Vince McCarthy explains *"I'm not surprised at the level of M&A investment into the UK from the US. Remember that the US economy is fairly healthy, balance sheets are strong, stock markets are at high levels. Businesses have confidence that they can deploy capital efficiently outside the US if the price is right."* And he adds *"we will continue to look for places where ideas can embed themselves in the economy. That is the case in the UK. Nothing has changed the fact that there are no two nations that have more in common than the US and the UK."*

"We will continue to look for places where ideas can embed themselves in the economy. That is the case in the UK."

Vince McCarthy, Verisk Analytics

Funding M&A: New World, New Rules?

Funding is the oxygen of the M&A flow. Long-term change factors like technology and market evolution set the direction of dealmaking, but that is an incremental process. Events that figure hugely on the world stage often have small effects on activity in corporate asset markets. But funding conditions are critical: when funding becomes tight, M&A can falter.

- Financial markets open 2017 highly confident.
- QE continues to support low cost capital raising in Europe.
- Euro-denominated 'Reverse Yankee' bonds assisting US coporates to raise capital.

"Companies will live with a measure of uncertainty. None of our M&A clients have mentioned uncertainty about the US. They do talk about uncertainty about the UK's relationship with the EU."

Duncan Johnston

In the second half of 2016 yields on both US treasuries and global corporate bonds rose, reflecting political uncertainties. Overnight, the borrowing that fuels M&A became more expensive. But initial effects can deceive. Short-term uncertainties do not necessarily reflect underlying sentiment, cautions Deloitte's Chief Global Economist Ira Kalish; *"We have seen a rise in the yields of US treasuries, but you also have to consider that they are considered a very safe asset, and demand tends to be high,"* says Ira. *"There is no issue in terms of risk of default, and it is likely yields will remain fairly muted even in a fiscally expansionary scenario. Low inflation expectations are still quite ingrained in the market."*

As uncertainties recede, Deloitte expects that the trend of historically high levels of capital raising and increasing reliance on European debt markets for both US and UK deal-makers will continue in the short to medium term.

2017 opened with a strong forward pipeline on both sides of the Atlantic reflecting strong confidence in the debt markets and liquidity. *"In a low European interest rate environment there is a tremendous amount of institutional money looking for yield and lending opportunities in 2017"* says Fenton Burgin, Head of Deloitte UK's Debt Advisory team. In Europe, the ECB's ongoing quantitative easing program continues to 'pump prime' the market with most commentators anticipating a continuation of its corporate bond purchase programme at a rate of around €60bn per month from April to at least the year end. Despite some widening in corporate spending at the beginning of the year, 2017 looks set to be another strong year for European bond issuance with investor demand and favourable pricing attracting US corporates into the European capital market. These 'Reverse Yankee' bonds have allowed a growing list of blue-chip US corporates to raise Euro-denominated debt in some instances at up to 40-50 basis points

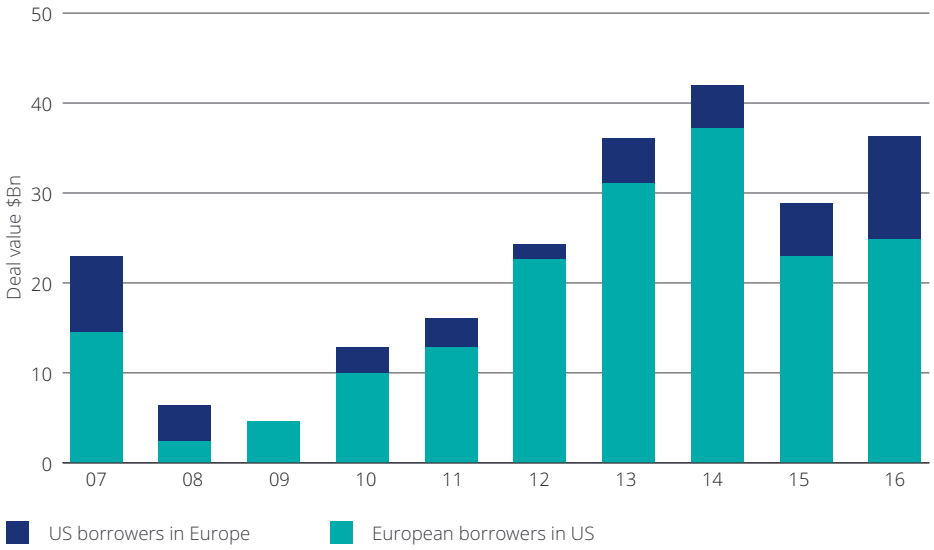
cheaper than in the US, even after accounting for Dollar conversion costs (the advantage is even greater where US corporates are using the money for Euro-denominated acquisitions or capital expenditure).

Such capital raising is 'reverse' in more than name: US markets have long been deeper than European equivalents, tending to make them the cheaper first stop for corporates looking for capital. In the first half of 2016 it was already apparent that fundraising by European alternative lenders had overtaken the US equivalent. Now it appears that the corporate bond market in Europe will be increasingly attractive to US corporates looking to diversify their funding or to finance European investment.

This year in the UK, the Bank of England continues with its £10bn corporate bond buying programme as part of its own extended quantitative easing programme, recharging the market for Sterling bond issuance which paused mid-year in the run-up to the UK's 'Brexit' vote. Together with the fact that Europe as a whole is likely to remain behind the US interest rate curve, this gives the entire European market for corporate debt further to run in 2017.

"We think we will see a high level of US corporates continuing to raise capital in Euros, diversifying their funding base, so long as this very attractive window remains open," says Fenton Burgin. He concludes *"the big question for the US/UK M&A corridor this year is at what point the Bank of England and ECB follow the US FED and start to normalise interest rates?"*

Figure 7: Yankee & Reverse Yankee Loan Volume



Source: *LCD, an offering of S&P Global Market Intelligence*

Figure 8: Corporate & PE Deals by Volume

Source: *Thomson One Banker*

Private Equity: Playing Corporate Catch-Up

Corporate buyers continue to take the lion's share of M&A deals. In the US private equity did 33% of all outbound deals to the UK in 2016, a fall from the 36% share in 2015. In the UK, where the private equity sector is smaller relative to the total economy, and often geographically constrained by mandate, private equity did 24% of all outbound deals to the US in 2016, up from the 14% PE share in 2015.

- Private equity accounts for no more than a third of M&A.
- US private equity share of M&A has fallen slightly.
- Corporates are bidding more aggressively.

The relatively low share of dealmaking currently captured by private equity is the result of numerous factors, including the synergy advantages that corporate buyers enjoy, the increased willingness of corporates to move quickly, and private equity's need to focus on returns over a shorter period compared to corporates. *"The irony of the situation is that there has never been as much PE money as there is today,"* says Darren Boocock, UK M&A Partner, Advisory Corporate Finance.

"But if you have a strategic trade buyer who is prepared to pay a big price for assets, they are going to win. Ultimately PE is limited by their return requirements."

"Corporates are more driven by the business cycle, while PE has to deploy capital no matter where the cycle is," adds Richard Parsons. *"Corporates have money on their balance sheets, they have trapped cash abroad, and this has been the case for a number of years. They have a need to demonstrate growth and holding cash does not drive your earnings per share. So we have seen corporates bidding more aggressively and winning some big deals."*

According to Andy Wilson, private equity buyers are also likely to display more sensitivity to currency changes than strategic buyers; *"Most of our corporate buyers take a very long term view. It may be a positive or a negative that the Pound has weakened, but that doesn't drive deals. For private equity it is more of a factor, albeit often not the most critical one. Currency assumptions and exit timeframes are more prevalent in discussions with private equity investors than corporates who aren't faced with the need for a liquidity event."* Yet despite the fall in Sterling, US private equity has lost some market share in the M&A corridor over the last eight quarters. *"The likely cause is that the banks that support US private equity are more cautious than before,"* says Jamie Lewin. *"It is not so much that there are more competitive corporate buyers. The independent variable that has changed is the debt-equity ratio they are willing to apply."*

Sector Focus: The Hidden Strength of Manufacturing

The TMT sector remains the most active in the US/UK M&A corridor, as it has been for the last eight quarters when it accounted for 385 out of a total of 1,050 US/UK deals. But the concentration on the TMT sector to the exclusion of others may be misleading: technology-based initiatives are now driving deals in most business sectors, including manufacturing.

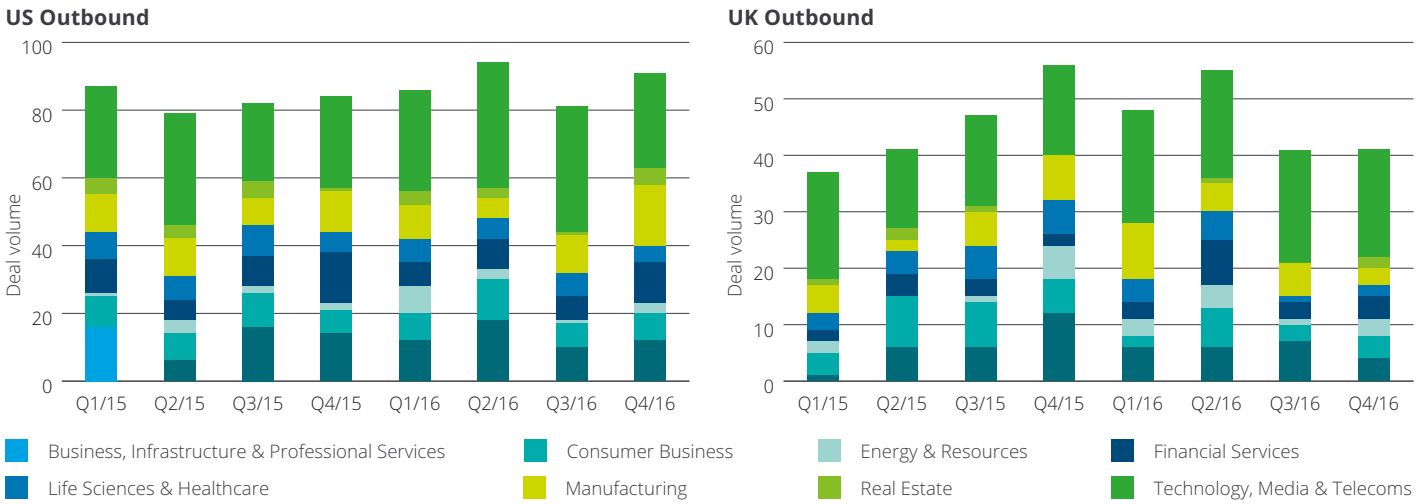
- TMT is the largest M&A sector, accounting for 37% of deals.
- Business services and manufacturing in second and third place.
- Many manufacturing deals involve technology.

"Tech in particular is now literally everywhere," says Paul Wiszniewski. *"In the TMT sector we are not restricted to acting for tech clients, there are also industrials, healthcare and services clients looking to invest in tech assets. These companies are growing in the US and in the UK."*

"Growth is the strategic focus in manufacturing," says Will Frame, leader of the Industrial Products Group for Deloitte Corporate Finance in the US. *"Almost every strategic deal is about growth on all levels. Blunt cost-cutting is not sufficient to justify value in this market."*

Dealmaking in manufacturing should come as no surprise. The US is the world's second largest manufacturing economy and the UK is the world's 11th largest. The US sector is particularly strong; output has doubled over the last three decades, and the 2016 Manufacturing Competitiveness Index from Deloitte and the US Council on Competitiveness shows that the US is the second most competitive manufacturing economy in the world (the UK is sixth), and that by 2020 on current trends the US will be the world's most competitive manufacturer.

Figure 9: Deal Volume by Industry



The US did 45 outbound manufacturing deals in 2016, with the deal rate rising 45% in the second half. Dealmaking in this sector from the UK in 2016 totalled 24, with a second half fall of 36%, following the pattern of falling second half UK outbound dealmaking overall. Total 2016 manufacturing dealmaking was up 9.5% on the previous full year.

The migration of technology into all business sectors is helping to create a new generation of deals in manufacturing. *"Technology has become very important to manufacturing companies today, especially technology that enables the internet of things,"* says Duncan Johnston, UK Industrial Products lead. *"Manufacturers are also very interested in companies that can provide analytics to support such businesses. They tend to be smaller companies but there are many more such acquisitions compared to a few years ago."*

But technology is not the only driver. The rising rate of US manufacturing acquisitions in the UK during 2016 also reflects the UK's access to other global markets, says Daniel Schweller, US Manufacturing M&A Leader. *"The US looks at the UK as a bridge into Europe in ways that are not limited to EU membership,"* he comments. *"In manufacturing the shipping cost is often a very important factor, and physical proximity to Europe is very important. Add to that the cultural commonality, the common language, and the UK is still seen as a great place to invest."*

But there are also sound reasons for UK acquirers to look for manufacturing deals in the US says Will Frame. *"The US market remains a very attractive environment for manufacturing,"* he says. *"Flexible labour, low energy pricing and the culture of innovation provide a great platform. Many European acquirers are seeing value in acquiring platforms to leverage their technology in the US market. This trend is likely to continue in the short term, especially as the political environment favours US domestic production."*

"Technology is being applied to manufacturing in a way that has never happened before. But it is not happening in a way that makes PE focus on manufacturing exclusively."

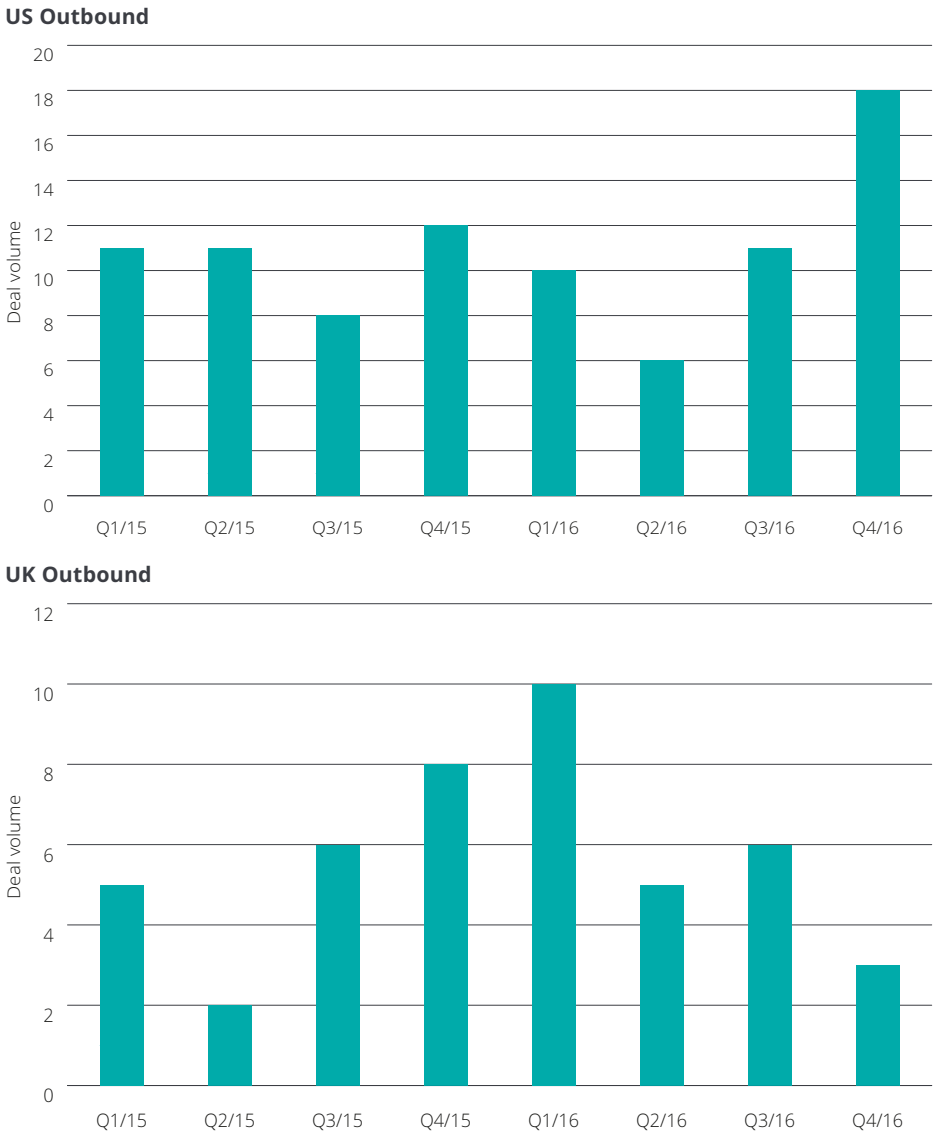
Jamie Lewin

The majority of buyers in manufacturing deals are corporates, rather than financial investors. Will PE become part of the manufacturing M&A story? *"Technology is being applied to manufacturing in a way that has never happened before,"* says Jamie Lewin. *"But it is not happening in a way that makes PE focus on manufacturing exclusively."*

"Private equity may have made the running on valuation for the last few years," says Will Frame, adding *"but 2016 was the year of the strategic/corporate deal in many sectors – including manufacturing."*

That is something that may change. Private equity operates in the same competitive environment as corporate bidders, and the shortage of quality assets and intensity of competition in M&A auctions often favours corporate acquirers, says Daniel Schweller. *"PE does not have synergy opportunities to offset higher deal prices unless they are attaching an acquisition to an existing portfolio business"* he says. *"Manufacturing tends to be capital-heavy, and many PE prefers businesses that are asset-light. But we are beginning to see PE looking at capital intensive deals in steel and chemicals."*

Figure 10: Manufacturing Deal Volume



By Region: UK Regional Diversification Will Change Deal Patterns

The UK economy remains highly concentrated: the kinds of businesses that are growing fast, that add value, and engage in the high-skills/high-tech sectors of the economy tend to be concentrated in and around London and the high-tech corporate corridor that extends from London westwards through the South East region around the M4 motorway. Accordingly most M&A deals are located in London and the South East.

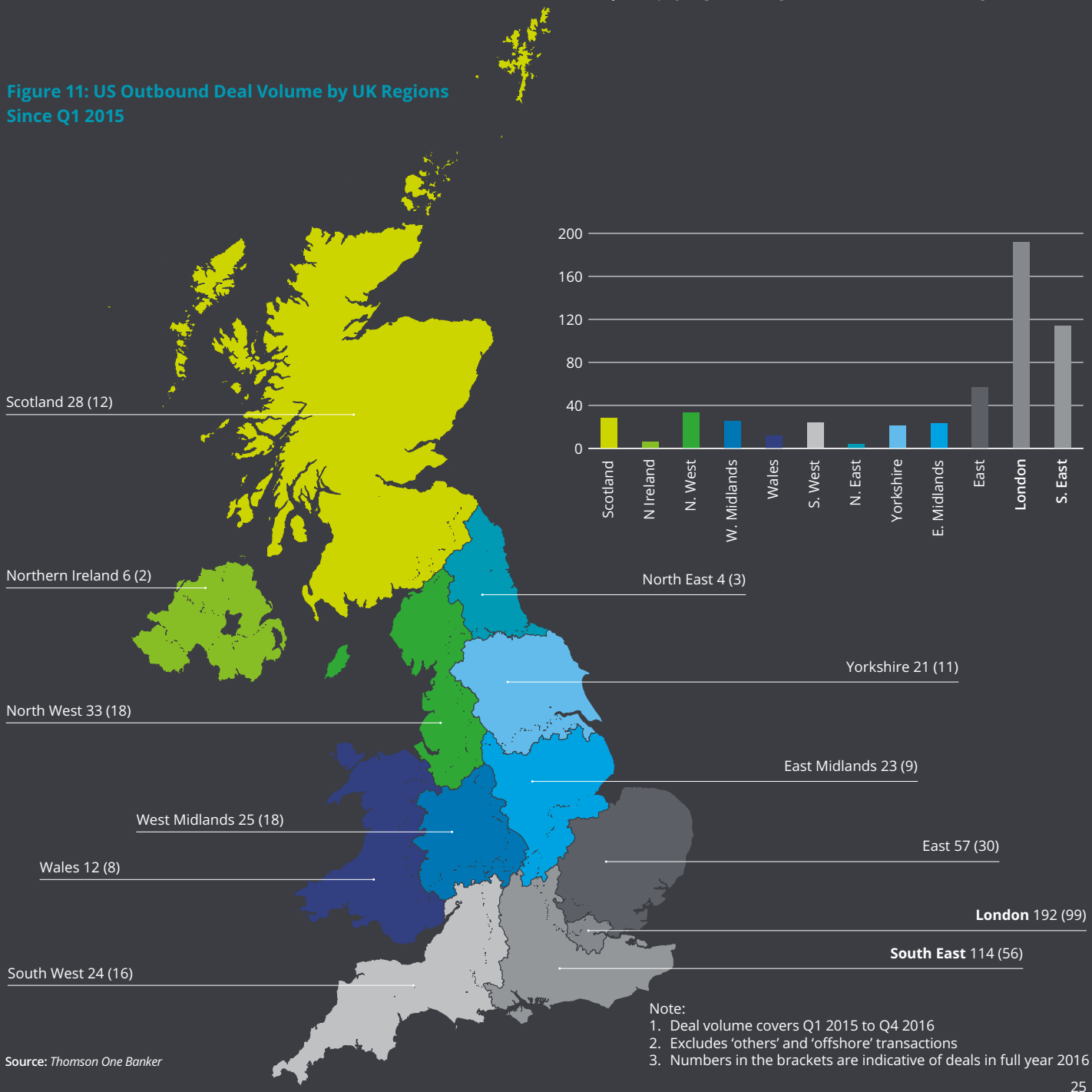
- US outbound M&A concentrates on London but regional deals growing.
- California and New York remain the primary locations for UK outbound M&A.

But there is life beyond London and the South East, says Pauline Biddle. *"The regional pattern does not contain any surprises, because it mirrors the industrial and commercial demographic of the country,"* she says. *"That means more industrial companies in the West Midlands, more technology in the East Midlands and the East, and more services in the South East."*

One of the non-London concentrations of corporate value is in the East of England, where an ecosystem of high-tech companies has developed around the city of Cambridge, home to one of the world's leading universities. But there are signs of business innovation seeding itself further afield, says Pauline Biddle.

"It is true that the TMT sector in the East is to a large extent the effect of the Cambridge tech industry," she says. *"But in the East and West Midlands we are seeing quite a lot of small scale tech incubator companies, and they will eventually grow large enough to appear in the regional dealmaking."*

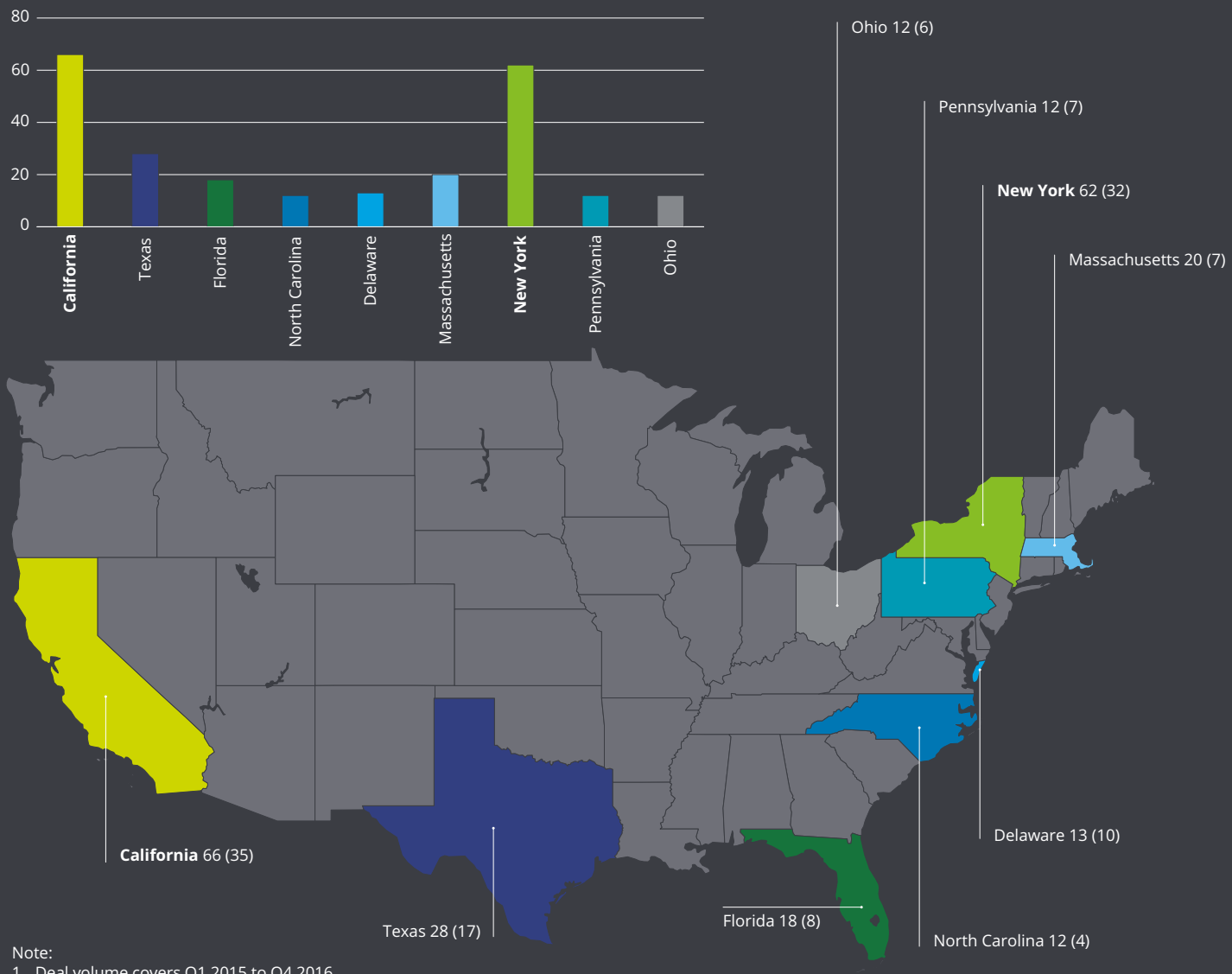
Figure 11: US Outbound Deal Volume by UK Regions Since Q1 2015



Note:
1. Deal volume covers Q1 2015 to Q4 2016
2. Excludes 'others' and 'offshore' transactions
3. Numbers in the brackets are indicative of deals in full year 2016

Source: *Thomson One Banker*

Figure 12: UK Outbound Deal Volume by US States Since Q1 2015

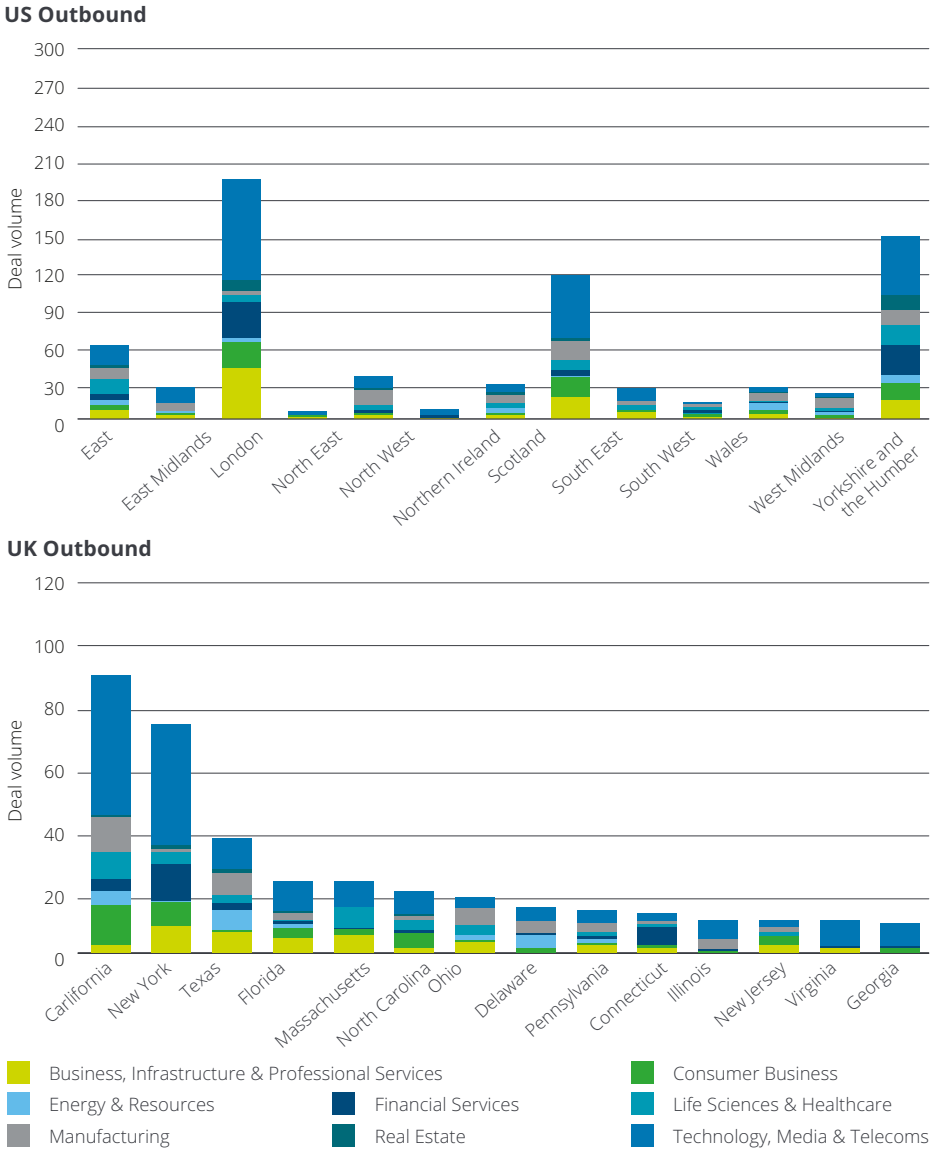


Note:
1. Deal volume covers Q1 2015 to Q4 2016
2. Excludes 'others' and 'offshore' transactions
3. Numbers in the brackets are indicative of deals in full year 2016

Dealmaking by UK corporates and private equity reflects the less concentrated nature of US business by sector, with a relatively wide geographic spread of investment. California has taken over from New York as the primary location for UK dealmaking, but the race is close (UK buyers did 66 deals in California over the last two years, compared to 62 in New York State).

UK dealmaking reflects the regional structure of the US economy, and the predominance of TMT deals in the M&A totals. California is the biggest tech economy in the US, accounting for just over a fifth of technology output by value. The Texas tech economy is second in size although output is only half of that of California. The high volume of UK deals in New York reflects the diversity of the New York economy, with substantial dealmaking in financial services and business services.

Figure 13: Cross Border M&A Volumes by Sector



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Conclusion: Investors Are Looking Beyond Uncertainty

The US/UK M&A deal corridor is a unique measure of global business vitality: in the second half of 2016 the trends revealed by the Deloitte US/UK M&A Deal Monitor suggest three strong conclusions.

- **The fundamentals of M&A have seldom been stronger.**

  Low borrowing costs, high cash reserves, and relatively low organic top-line growth for companies all argue for a continued growth in the world's strongest bilateral deal corridor. *"Uncertainty is always with us, but as long as uncertainty isn't amplified by something like a financial crisis, deals will continue,"* says Darren Boocock. *"In this low global growth environment the only real way to secure substantial revenue growth is to buy it"* says Cahal Dowds.

- **Technology continues to drive M&A in many sectors.**

  The TMT sector has seen the most M&A deals in every quarter for the last two years, but now it is becoming clear that tech needs are driving dealmaking in other sectors as well. There is also a trend for trade buyers to become active in the kind of technology investments that used to be the preserve of private equity, says Paul Wiszniewski. *"We are seeing a lot of industrial clients investing in technology, and especially in robotics. Private equity always used to be ahead of the curve on technology, but now the corporates get it too."*

- **The conviction of US investors on the UK economy has not yet been negatively affected by Brexit.**

  Dealmaking by US buyers has outperformed in the second half of 2016, rising at a time when global M&A volumes have been falling. *"The commonality between the US and UK is extraordinary,"* says Jamie Lewin. *"The currency changes just make it easier for US buyers. It will take a lot more than a referendum to meaningfully change the importance of the UK for US investors."*

The coming year may hold as many uncertainties as the year just past. But the results of the Deloitte US/UK M&A Deal Monitor suggest that dealmakers are much less affected by uncertainty than in the past. Uncertainty is now built into their investment models. *"We live in a world where there is a lot of economic and social disruption,"* says Paul Wiszniewski. *"Companies and private equity are much more attuned to absorbing shocks and changes than they were ten years ago. They have to prepare for shocks, they know it. Uncertainty no longer limits the deal flow."*

Notes

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