BUSINESS KEEPS ON KEEPING ON

First Brexit, now Trump. Corporate finance has been dealing with a challenging year but business goes on, reports **Ian Harper**

THESE ARE interesting times for M&A. If the UK election slowed deal activity in 2015, then what of Brexit and now Donald Trump? And has all the talk of regional economic "rebalancing" influenced activity?

According to Ally Scott CA, partner and head of transaction advisory services in Scotland with EY, 2016 has generally been flatter year on year. He says: "Going into 2016 across the EMEIA [Europe, Middle East, India and Africa] region, there was a significant reduction in M&A activity. This was compounded following the Brexit vote, particularly in relation to deals dependent on public markets which were subjected to extra volatility, but that is hardly surprising given the complexity of the situation."

Rick Ballard, head of transaction services for Deloitte in Scotland, agrees: "In the UK in 2016, M&A activity was slower from the outset – particularly inbound – and that trend was generally interpreted as a 'wait and see' approach by investors pending the outcome of the EU referendum."

Ballard says: "Although some M&A plans may be on hold, and there is a prevailing sense of caution as corporates consider the implications of Brexit, deals are still happening and investor appetite continues to be there for the right opportunities."

Dane Houlahan, corporate finance partner at KPMG, says that while activity slowed across all sectors as the Brexit vote loomed: "Activity levels overall have not been as bleak as some perhaps predicted, and indeed a weaker pound has led to optimism in some quarters about the prospect of increasing inbound activity for many parts of the UK. The key thing to note is that activity is currently steady, but as Brexit uncertainty continues to prevail, we may see a stronger ripple effect on deals of all types."

However, according to Ewan Grant, RSM's head of transactions in Scotland: "Corporate finance activity within the middle market has remained strong across the UK over the last 12 months. There's a lot of money available for investment within the private equity community – the key is to find the quality opportunities. It's no surprise that much of the fire power is still located in London and the south of England."

Alan Maudsley, head of corporate development at Barclays, says confidence returned in 2015 and continued throughout 2016, despite the period of unprecedented political uncertainty: "We're seeing strong growth in the SME market. The launch of our £500m loan fund earlier in 2016 is a clear signal of both our confidence in Scotland's SMEs and our commitment to providing the support and guidance they will need to navigate the current economic change."

Scottish Equity Partners (SEP) also completed a successful fundraising for its SEP V fund. MD Calum Paterson says: "It closed at £260m and is one of the largest venture capital funds raised in Europe this year. It was over-subscribed and closed above target."

At the end of June, the *Financial Times* reported that dealmakers were warning that uncertainty over Europe and fears of a Trump presidency would further slow M&A activity.

"The flotation of Clydesdale Bank was the most structurally important transaction this year for the Scottish deals market"
Paul Mason

The LSE's merger with Deutsche Boerse was a big deal, especially in light of Brexit uncertainties

But, says Scott: "Despite a bumpy start to the summer, UK M&A activity seems to have taken Brexit-related uncertainty in its stride so far. Businesses are getting accustomed to sustained low growth, low interest rates and cheap debt. For M&A activity this means a move away from the so-called mega deals of the past two years to a more balanced approach that sustains healthy levels of activity."

He adds: "According to EY's Capital Confidence Barometer, 58 per cent of UK respondents expect no change in capital expenditure levels post Brexit."

While the full effects of Brexit won't be known until there's clarity over single market access and the free movement of people, SEP's Paterson says: "Brexit has had no immediate impact in terms of how we plan to invest SEP V, as things stand."

Andy Morgan, partner and TMT sector leader at Grant Thornton, says the impact further out is less clear: "New trading relationships and focus on the growth markets globally must create opportunities. The weakening of sterling is creating some short-term benefits – the challenge is turning these into longer term and sustainable growth."

SoftBank's Masayoshi Son

The impending Trump presidency is creating more uncertainty and may well hit confidence. But, like Brexit, who would rule out the prospect of new trade deals sharpening M&A appetites, especially US ones?

STANDOUT DEALS

The year's standout UK deal was undoubtedly the sale of technology gem ARM to Japan's SoftBank, but SVM CEO

Colin McLean adds that LSE was also a big deal, particularly after the Brexit vote. "They point to the TMT [technology, media, and telecommunications] flavour of activity and also cross-border deals in the case of LSE," he says.

Morgan and Gavin Hood, head of corporate finance advisory for Deloitte in Scotland, agree. Morgan says: "The acquisition of a genuine UK leader in a truly global industry – and a great success story from spin-out to FTSE 100 – really illustrated the rapid impact on the perception of value in UK assets from overseas."

He adds: "The impact of the depreciation in sterling and the view from overseas on UK assets is the most dramatic feature of the 2016 deal landscape."

For Hood, ARM is a "totemic deal" for several reasons: "Firstly, it was the first major deal to be announced post-EU referendum and was seen by many as a significant vote of confidence in the UK economy. Secondly, ARM represents a leader in one of the UK's, and Scotland's, fastest-growing spaces – TMT – and is one of the types of businesses that we need to grow and foster."

In Scotland, the standout for RSM's Grant was the investment in Direct Ferries by Livingbridge: "It showed that private equity investors, despite economic and political turbulence, are keen to invest in ambitious businesses to support future growth. Market uncertainty can slow down activity but this deal highlighted a vote of confidence for Direct Ferries, the travel sector and the UK market as a whole."

Maudsley's "deal of the year" was: "The £50m private placement for the University of Stirling with Barclays securing funding from two blue chip institutional investors as the sole placement agent."

Over in the financial sector, an especially important deal, says Paul Mason, head of corporate finance at Chiene + Tait, was the flotation of Clydesdale Bank last February. "This was the most structurally important transaction this year for the Scottish deals market. It puts Clydesdale in control of its own destiny," he says.

LIFE IN THE OLD OIL AND GAS DOG YET

A troubled sector last year was oil and gas, one we suggested faced a gloomy outlook following the oil price slump. However, sector M&A has started to motor and David Leslie, head of deals Scotland at PwC, notes that, despite the problems, "there's evidence of significant transactions emerging in that space".

Sector specialist Douglas Martin, corporate finance partner at Anderson Anderson & Brown (AAB), says: "More and more larger trade players are looking to take advantage of a depressed market and are increasingly likely to acquire businesses they have maybe had their eye on for some time. We're working with a number of private investors viewing oil and gas services as an attractive sector to invest in at the current time and are actively looking at businesses that still require some growth capital or are in a stressed – if not distressed – financial position."

According to EY's Scott: "We're starting to see a pattern emerging in terms of consolidation in the oil and gas market. Some of that has been forced consolidation amongst upstream companies, some of it is strategic consolidation within the oilfield services sector."

Deloitte's Ballard agrees: "From an Aberdeen oil and gas sector perspective, we've seen a number of M&A opportunities arise from distress situations, with opportunistic buyers keen to take the opportunity to acquire niche businesses at attractive prices. We've also seen 'cashless' merger transactions in the oil and gas service sector and would expect to see more of those in future, where businesses combine or merge to strengthen balance sheets and streamline costs through synergies. Private equity interest in North Sea assets has also recently increased, particularly supported by US dollar funds, which have benefited from the recent devaluation in sterling."

SURPRISES – OR LACK OF THEM

For Hood, the big surprise was "the lack of surprises" (although he did speak to us before Trump's victory). He says: "Given the economic and political backdrop – a slowing Chinese economy, instability in the Eurozone, Brexit, and the US elections – UK M&A, particularly in the mid-market, has proved very resilient."

Morgan's surprise stems from the way the market is "becoming more polarised". He explains: "The lower mid-market has remained resilient in terms of deal activity, whilst there continues to be a steady flow of mega-deals to keep the headline writers busy. The upper mid-market has been a tougher place to deploy capital in 2016, due to both availability of assets and the competition to secure those that are in play. The current volatility in pricing and institutional appetite in the IPO market may make trade or private equity solutions more attractive in this deal size range for the immediate future."

What's surprised Chiene's Mason, though, is the continued prudence from equity funders in terms of valuations. He says: "In the long term, this is no bad thing as it helps create a sustainable deals market with fewer extreme peaks and troughs."

Ballard notes that the latest Deloitte CFO Survey confirms that Brexit concerns are key to the corporate agenda. He says: "It found that CFOs remain cautious and are clearly focusing on navigating the uncertainties of the post-Brexit business environment. However, it also saw some return of confidence, in that 39 per cent of CFOs identified new products and services or market expansion as strong priority areas, relative to 27 per cent immediately after the referendum."

SECTORS AND HOTSPOTS

TMT has without doubt been the year's favoured sector. "TMT, business services, and industrials have all been active sectors in 2016," says Ballard.

Scott notes: "There's a trend of technology stars starting to emerge across the UK. Quite a few of these businesses can be characterised as 'scale-ups' and are beginning to look attractive to the capital markets. The flip side of that is that technology companies are showing some concern over their ability to attract labour and talent into UK-based business models from overseas. This is due to the uncertainty surrounding the UK's place in the single market but also its future attractiveness in the eyes of investors."

Maudsley agrees: "The tech sector continues to thrive and this was one of the drivers behind our InnovFin agreement with the European Investment Fund to provide £100m in finance to innovative SMEs and small mid-caps in the UK over the next two years. In excess of 30 deals have been supported by the fund in 2016."

There are some notable hotspots, according to Morgan. "Fintech specifically, and technology more broadly, remain really strong for us," he adds.

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>
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ALTERNATIVE FUNDING

Grant says: “The year kicked off with the sale of Camden Town Brewery to Anheuser-Busch InBev – highlighting the power of crowdfunding as the craft brewery attracted interest from AB InBev after raising growth capital from Crowdcube in July 2015.”

But, he cautions: “Crowdsourcing has arrived, but the regulatory constraints are likely to be significant. We understand that the Financial Reporting Council is watching this space closely.”

Scott notes: “There is an amazingly wide source of deep and broad funding markets available. The US private placement market has been a very good source of long-term capital for corporates throughout the UK.”

He adds: “Crowdsourcing and crowdfunding is an industry which has a good place in the market in terms of funding earlier stage businesses. It is still a relatively new funding option but it is becoming increasingly ‘professionalised’. In retail, for example, the bond market will be put to the test as more and more transactions are done and the retail investor appetite is properly established.”

Maudsley says: “There have been some high-profile examples of successful crowdfunding initiatives this year and it looks like it’s here to stay as a viable form of finance.”

More broadly, says Alan Hamilton, director, restructuring services at Deloitte: “There are now a significant range of options available to borrowers looking to raise finance. Many of the high street banks are concentrating on growing their lending book again, following a period of restructurings and balance sheet repair. There are a number of challenger banks and alternative lenders in the UK market operating across the full spectrum, from large corporates to SMEs.”

He adds: “In the corporate space, there are an increasing number of fund managers moving down the risk curve to target the senior loan market, which historically has been captured by the banks. So-called direct lending solutions, or ‘unitranche’, where lenders can combine debt, subordinated debt, and minority equity to provide a one-stop-shop solution to management teams, are being increasingly used to support M&A, growth, and refinancing activity.”

As for the traditional banks, Maudsley says: “Increasingly banks are having to demonstrate their ability to provide financial solutions that work in tandem with alternative funding sources and even facilitate access to, for example, venture capitalists or business angels. We have also referred several companies to Funding Circle, a global lending platform targeted at small businesses.”

LOOKING AHEAD

While Brexit has dominated the past few months, its longer-term impact is up in the air. According to James Kergon, transaction services partner at KPMG: “Until we know the terms of Brexit, it’s impossible to assess its long-term impact. However, one opportunity could be increased activity and partnership with buyers from countries such as China, South Africa, Australia and Canada, where a strong pound might have previously been more of a constraint.”

Now, we have Donald Trump. As Grant says: “There are just too many variables at play here, and really you can argue any way. Personally, I think we will see pretty much business as usual for the next three years and in the life of corporate finance that is a long time.”

Let’s hope so.

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