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Insights into facilities management

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"The underlying trend of consolidation has continued undeterred despite the prospect of Brexit. The devaluation of Sterling has in turn provided overseas buyers with a generational buying opportunity. Looking forward, labour supply and supply chain pricing will be key areas of focus for the sector."

Has Brexit hit home yet?

There were continued high levels of deal activity in the FM sector throughout Q2 and Q3 2016 suggesting that Brexit has had little impact for strategic M&A. Whilst many are adopting a business-as-usual approach and maintaining their growth agendas, the full impact of the vote to leave the EU could still have implications for some in the sector.

Europe accounts for over a third of the global FM market, with the £11.3 billion-plus UK market being the largest revenue generator.

The most immediate issue for FM companies in the post-referendum environment has been the devaluation of sterling and uncertainty over access to labour, and their impact on soft FM in particular. For companies with long term global or European-wide contracts there may now need to be discussions on specific terms for the UK segment.

Workforce impact

Brexit raises the possibility of severe restrictions on EU migrant labour for a sector that employs almost 10% of the UK workforce.

Prior to the referendum, a recent BIFM confidence survey found that 42% of FM companies said that they anticipated an increase in their workforce in 2016/17, compared to just 13% who believed they would decrease workforce numbers.

The Confederation of British Industry, the British Chambers of Commerce and the Institute of Directors all agree that the government's proposals to impose visa restrictions on low-skilled migrants entering the UK could cause problems for companies who rely on their labour and raise prices for consumers.[1]

Since the referendum, we have already seen signs of wage inflation, in part driven by the inflationary effects of higher-cost imports.

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[1]http://www.independent.co.uk/news/uk/politics/brexit-business-immigration-clampdown-eu-migrants-cbi-philip-hammond-amber-rudd-a7365681.html

The government continues to debate options for immigration systems but adopting an 'off the shelf' model from other non-EU countries (for example Switzerland or Norway) is not their preference, whilst any system is likely to limit the entrance of migrants for low-skilled jobs. If current visa requirements for non-EEA migrants were applied to those from the EU, it is thought 88% of EU workers would be ineligible for a UK visa, although who will be allowed to remain in the UK is yet to be clarified.

Regardless of the type of restrictions eventually applied, the UK may simply become a less attractive prospect for the migrant workers on which the FM sector depends.

Sector differences

Restrictions on migrant labour are likely to affect some sectors more than others. The UK cleaning industry, for example, relies heavily on migrant labour, with 24% of workers having a non-UK nationality. Around 15,000 (4%) of the 371,000+ licenses issued by the Security Industry Association are to those with EU passports.

By contrast, in a recent survey the Electrical Contractors Association found that 92% of electrical contractors said they did not rely on EU migrant workers.

Employment law

Theresa May has announced that the repeal of the 1972 EU Act will enshrine all EU legislation into UK law, acknowledging the complexities of unpicking the two, whilst giving the government power to change laws as its relationship with the EU evolves. Previous calls for changes to workforce legislation could be adopted in full, altered for the UK, or reversed entirely. There is a possibility that the 48-hour limit in the Working Time Directive will be scrapped but what this would be replaced with is unclear - employers may be operating without concrete limits.

The European Court of Justice rulings on commission, overtime and holiday pay could be reversed. Although the EU Acquired Rights Directive led to TUPE (transfer of undertakings) regulations, the UK's version of the regulations is actually more onerous on UK businesses than the original directive intended and may not change at all.

Contract uncertainty

Companies that are drawing up term contracts will need to ensure that supply chain and salary issues are accounted for. Companies pitching for contracts "today", may not know what their labour and material costs will be in the future and may need to renegotiate. This will have an impact across the sector. There are strong echoes in this of the uncertainty the sector faced in the aftermath of the 2008 financial crisis.

As companies lay down their plans for the next few years, it's crucial that they account for these eventualities in their contracts and ensure they are agile enough to react if the need arises.

Looking ahead

Beyond the impact on currency movements and workforce restriction, the wider impact of Brexit on the FM sector is more difficult to predict until negotiations get under way next year.

The trend towards outsourcing is currently estimated to add £2 billion in productivity gains to the UK economy each year. Whether clients will look for further efficiencies through greater outsourcing or to cut their external FM costs in the future remains to be seen.

Although there is no immediate evidence yet of the impact of Brexit on London's financial services sector, this could be dramatic if there is a significant trend in major institutions relocating from the Square Mile to continental European HQs.

On the other hand, if the London FM market remains strong, it is likely to soak up much of the available labour force, leaving other regions with a potentially serious shortfall.

Trump effect

In addition to the result of the EU referendum, the impact of Donald Trump's victory in the US presidential election may add further uncertainty to the global FM sector. International players have pursued a global FM strategy due to clients adopting a global procurement strategy. However, many speculators believe that the new American administration may move to a de-globalisation strategy. This could potentially impact the large international and globally diversified players in the FM sector.

Facilities management M&A update, Q3 2016

M&A activity in the facilities management market picked up over Q3 despite Brexit, and Q4 could see the 1,000th deal since we started recording data in 2007.

A strong Q3

Q3 2016 has seen an impressive 30 deals announced in the FM sector – the highest since 2012 Q2. The first nine months of 2016 have seen a total of 76 deals, the highest level of activity since 2011. Q3 2016 was 25% up on the number of deals seen in both the previous quarter and the same quarter of 2015.

Despite a sense of uncertainty in the lead up to the referendum, activity in Q2 2016 was up on that seen in the same period of 2015. The continued positive trend in Q3 activity has been in a period of cautious optimism. Annecdotally we are aware of some companies adopting a 'wait and see' stance with others regaining confidence to move on deals that they had put on hold before the vote.

If we see an active Q4, it is possible deal volumes will exceed the 97 recorded in 2015. If Q4 activity runs above the 8-quarter rolling average of 24 deals then we'll see activity hit the 100 deals mark for the year, last achieved in 2011.

Notable deals

International

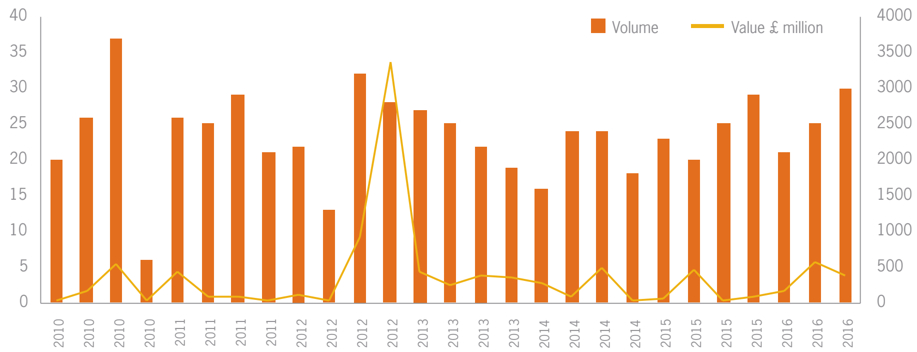
The only international deal in Q3 was Elior UK Holding Ltd's purchase of the Warrington-based catering services provider, Waterfall Catering Group Ltd, for a reported 7x EBITDA at £40 million. The deal provides an exit for Lloyds Development Capital, the investing arm of Lloyds Banking Group plc.

In Q2, global property group Jones Lang LaSalle acquired mechanical and electrical property maintenance provider, Integral, as part of its strategy to provide a one-stop property service for its clients. The acquisition has a total valuation of $330 million and closed in August.

Although a pan-European rather than UK target, it's worth noting that in Q3, German engineer Bilfinger's building and facilities business was acquired by EQT VII Private Equity in a mammoth deal, valued at 1.4 billion.

The devaluation of the pound since the referendum has created something of a once-in-a-generation buying opportunity for overseas companies. We expect German and French companies in particular to be looking to increase their UK foothold through acquisitions over the next few quarters. However, it is important to note that the UK's FM sector is highly regarded internationally, and the devaluation may result in additional overseas buyers looking for a quality investment.

UK Facilities Management transactions



Source: Zephyr

Private equity

Private equity saw its most active Q3 since the start of 2010 with eight deals.

Energy infrastructure and services investment house First Reserve Fund XIII LP acquired £600m+ revenue Morrison Utility Services Group Ltd, a Stevenage-based utility network and infrastructure services company, for an undisclosed sum. The transaction recently completed and represents an exit for Bregal Capital and Motion Equity Partners and a secondary buy-out for Morrison Utility Services.

MML Capital's CH&Co Catering Ltd acquired The Brookwood Partnership Ltd, an independent schools catering services provider based in Walton on Thames, from its co-founders Kate Martin and Sue Parfett in a transaction described as a merger, for an undisclosed sum.

Equistone Partners Europe Ltd picked up office printer and repairs consolidator, Apogee Corporation Ltd, for £185 million.

Lyceum's Bellrock Property & Facilities Management Ltd picked up RBK Mechanical Ltd, a Pontefract-based heating and ventilation equipment installation firm, for an undisclosed sum.

These private equity deals appear to reflect investors' appetite for FM as a broadly defensive sector that benefits from long-term contracts and stable, recurring revenues, as well as the relative strength of the debt market in more uncertain times.

Trade deals

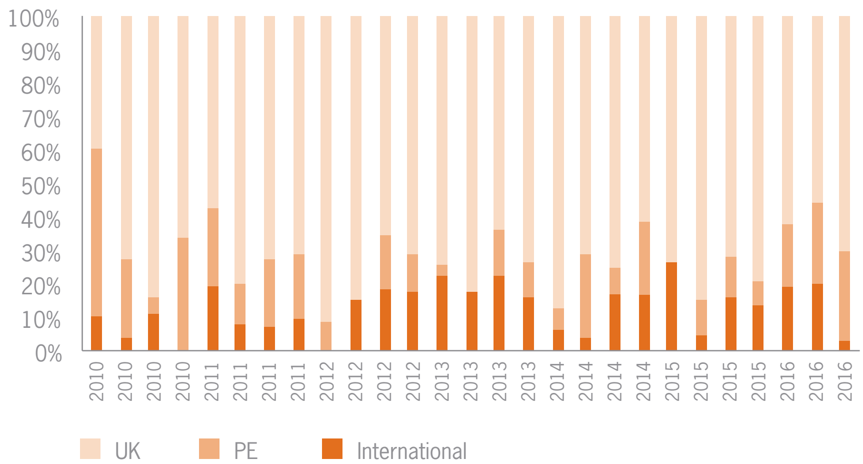
Grant Thornton advised on Orton Electrical and Mechanical Group Ltd's takeover of NPower Business and Social Housing Ltd, a Swindon-based building heating installation services provider from Npower Ltd.

Styles & Wood expanded its fit out portfolio with Keysource Ltd, a business data centre design consultancy services provider based in Horsham, from its founder Mike West and the firm's senior management. The consideration is up to £7 million by December 2018.

Restore Data Solutions Ltd picked up PHS Data Solutions Ltd, a Caerphilly-based document copying, shredding and management services provider from Personnel Hygiene Services Ltd, as the latter continued its non-core divestments strategy. The deal was valued at £83.1 million on a debt and cash free basis.

UK PLCs have been less active as deals outside the UK are currently looking costly and although M&A will be on their list of priorities, some will be focusing on divesting non-core assets within the UK while others have well-documented internal issues to be resolved first.

UK Facilities Management transactions by acquiror type



Source: Zephyr

Outlook for Q4

While the underlying trend towards greater outsourcing is likely to continue across both the private and public sector, the government's announcement that it is abandoning its deficit reduction plan may loosen public sector purse strings. This could see a rebalancing of interest towards the public sector from both domestic and overseas buyers.

However, now that the UK government has set out plans for triggering Article 50 and commencing Brexit negotiations by the end of March, it is unclear how markets, and businesses, will react.

Quoted FM Tracker

Positive overall performance by our peer group of UK quoted FM companies, led by those with overseas exposure

A look at Q3 share price movements shows surprisingly positive results for the FM sector's PLCs. The companies in our peer group of quoted companies have seen an overall 9.8% increase in share price compared to a 6.8% rise in the FTSE All Share.

Those companies in the peer group with significant overseas revenues have seen an overall share price gain of 12.6% for the quarter, and a 21% increase compared to the same period last year.

The overall increase in share price for those companies focused on the UK has been lower, at 7.4%, for the quarter. Year-on-year this segment of our peer group has seen a 20.4% decline.

Businesses with significant overseas operations have clearly benefited from a depreciating pound, with their wider geographic exposure going some way to limiting the impact of Brexit.

Notable performers

Several companies experienced double-digit share price growth over the quarter.

Looking at companies with overseas exposure, the frontrunner this quarter was Balfour Beatty with a 30% increase.

G4S PLC's shares rose by 24.6% in Q3, and rose 19.5% since Q2 suggesting the devaluation of the pound provided a boost in Q3. Shares in Serco Group PLC rose by 17.3% while Rentokil Initial PLC saw a gain of 15%.

The outlier in this group was London Security PLC, whose shares slipped by 6%, continuing a downward trend seen over the last two quarters.

Of the UK-focused companies in our tracker, Interserve PLC was the biggest winner, with an increase of 41.4%, bucking the trend of recent share price decline.

Kier Group PLC's share price increased by 24.7%. Johnson Service Group PLC saw gains of 22.5%, with Lakehouse PLC not far behind at 21.5%. Carillon PLC's shares increased by 6% this quarter. These strong performances over the quarter are tempered by the market shock of the Brexit vote at the end of Q2 giving companies a lower base from which to return from. As the market settles we are starting to see dips in the performance of some of these companies as we enter December. Almost all of the UK-focused companies in our peer group had seen double-digit falls in share price in Q2, the vote on the 23 June being the significant contributor.

MITIE Group PLC (-23%), Bilby PLC (-23%) and Premier Technical Services Group PLC (-12%) were the biggest losers this quarter. MITIE's profit warning on 19 September and another by Capita on 29 September do not appear to have had a major impact on their peers overall for the period.

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Grant Thornton Facilities Management – subsector map

Hard FM	Soft FM
Fabric maintenance	Security
Fit-out	Cleaning
Mechanical & Engineering	Catering
Fire Protection	Washroom hygiene
Grounds Maintenance	Textile/Laundry
Utility Maintenance	Pest Control
Reprographics	Space planning
Relocation and Storage	Reception/ Concierge

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