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Insights into facilities management

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Insights into facilities management

The FM sector continues to attract overseas interest while homegrown businesses await Brexit and the general election

International buyers drove deal activity in the FM sector through Q4 2016 and Q1 2017, seemingly unconcerned by Brexit. However, on the domestic front uncertainty over the European Union (EU) negotiations, particularly around the soft FM sector's future access to EU workers, is a worry for UK-focused companies.

The triggering of Article 50 at the end of Q1 was the first major step towards the UK's departure from the EU, signalling the start of the two-year negotiation period. Nobody knows what the UK's relationship with the EU will look like after March 2019, nor how it will affect individual companies.

Labour uncertainty

The FM industry employs almost 10% of the UK workforce and is heavily reliant on EU workers. The soft sector is particularly dependent on this source of labour and restricted access post-Brexit could have significant implications. FM businesses, particularly those with EU contracts, will be measuring their exposure and Brexit-proofing against potential changes to migrant labour, the supply chain and regulations.

There have been widespread calls from industry for a measured policy on immigration post-Brexit. With more than 60,000 EU nationals working in the English NHS and around 90,000 in adult social care, the Commons Select Committee for Health, for example, recently stressed the importance of a pragmatic approach to recognising professional qualifications and keeping channels for staff from the EU open.

The public sector has started to demand longer-term contracts from FM suppliers, but the lack of certainty over future costs of labour and materials is making them riskier propositions.

Manifesto for a vibrant economy

The general election on 8 June will help shape the UK and future business environment outside the EU. Government policy is key to unlocking the UK's potential and creating a vibrant and prosperous economy for everyone. Grant Thornton's draft Manifesto for a Vibrant Economy (PDF), based on more than 1,000 interactions with leaders from the public, private and not-for-profit sectors, considers a number of recommendations to government, including on international trade, finance for innovation, and infrastructure and connectivity.

One key manifesto recommendation is that the government addresses current and future skills needs. Many hope the immigration issue becomes less about numbers and more about ensuring the UK has the skilled workers it needs as the government considers its options. While in the short-term immigration may go up, over the longer-term, depending on the types of visa restrictions imposed, there is a danger that the UK may become a less attractive destination for the migrant workers on which the FM sector depends.

Scenario planning

FM businesses will clearly need to be pragmatic and prepare for a range of possible outcomes, including investing in homegrown talent to plug any gaps. Some will be using the prospect of Brexit as an opportunity to review their business models, optimise processes and controls, explore new international markets and trade deals, and capitalise on new domestic prospects. The sector is also well-placed to take advantage of the training opportunities offered by the new apprenticeship levy.

Apprenticeship levy

As part of its drive to train three million new apprentices by 2020, the government's apprenticeship levy came into force on 6 April this year.

The levy is set to cost large employers a total of £2.6 to £2.8 billion per annum and is the cornerstone of the government's skills agenda. Levy funds can be used for new and existing employees, including degree and master's degree qualifications, and represents a significant opportunity to invest in skills development.

Earlier this year, City and Guild's found that a third of business leaders surveyed are still unaware of the apprenticeship levy and this has been mirrored in our own experience advising employers. Grant Thornton has supported more than 800 employers to prepare for the levy and make use of the funds available. In particular, there has been low awareness of the scope for training and further financial incentives.

The definition of 'apprenticeships' has been extended and there are opportunities to use apprenticeship schemes for graduate programmes and existing employees, in addition to the more traditional roles the FM sector is likely to be familiar with. For example, management apprenticeships for existing employees have not commonly been seen before and can include master's degrees. Grant Thornton has partnered with Cranfield University to offer its Executive MBA to clients, as a master's degree apprenticeship, utilising levy funds and up-skilling management teams.

There is clearly a broad range of preparedness among employers and FM businesses should be taking a holistic view of their future training plans to take the levy into account.

Facilities management M&A update, Q4 2016 and Q1 2017

M&A activity in the UK facilities management market remains steady, with strong investment from overseas companies despite uncertainties around the UK's future.

A good start to 2017

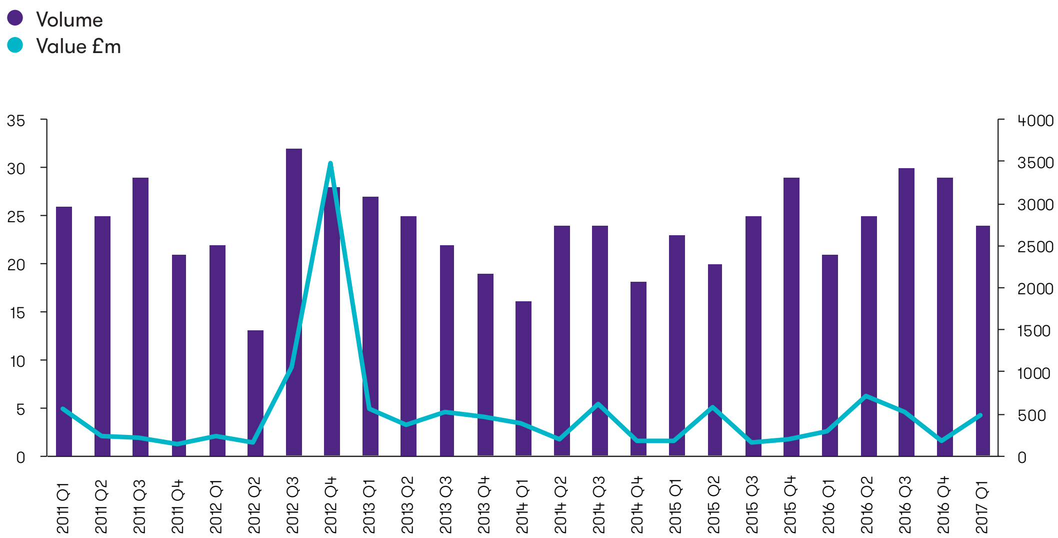
With a total of 105 completed deals, 2016 was a strong year for M&A activity in the UK FM sector. But it has also been a period of increased fluctuations in market activity. Q2 2016 was quiet on the deal front as the sector waited for the referendum, but bounced back in Q3 and Q4 due to increased interest from international companies drawn to the UK by the devalued pound.

The year ended on a high note with 29 deals in Q4 – above the 8-quarter rolling average of 24 deals. Q4 2016 also witnessed the 1,000th deal in the sector since Grant Thornton started recording FM deal data in 2007. The deal, in November, saw French civil engineering and facilities services giant Vinci acquire Doncaster-based high voltage installation specialist, Powell Engineering. It was fitting to see an international acquirer for such a landmark deal – this was just one of 122 overseas acquisitions over the past ten years. The trend continued into Q4 2016, which saw eight overseas deals – the most in a quarter since 2007.

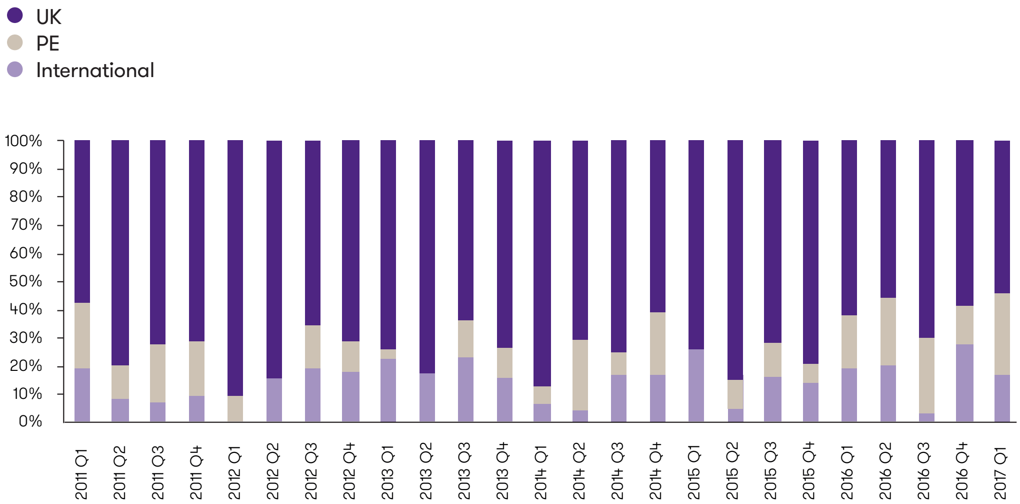
Although in Q1 2017 there were just 24 deals, 17% fewer than in Q4 2016, this was 14% higher than in the first quarter of 2016. Despite the continuing uncertainty around the terms of the UK's exit from the EU, Q1 2017 also saw the highest volume of deals in the first quarter since 2013. However, in Q1 2017 international transactions were back in line with the three-year average, with just four deals.

It appears that the appetite among globally diversified FM players for good quality UK investments continues unabated, thanks in part to the devalued pound. The market is also seeing continued interest from the global property players in innovative new technologies in areas such as security monitoring. CBRE's recent purchase of real estate tech start-up Floored may suggest the direction of some future deal activity.

UK facilities management transactions



UK facilities management transactions by acquiror type



Private equity

Conversely, private equity activity in the FM market was buoyant in Q1 2017 with seven PE deals, compared with four deals in Q4 2016 and in Q1 2016.

The cleaning and M&E sectors both continue to attract PE interest, plus we have seen some interesting PE deals in the utilities space. In the largest disclosed deal in Q4 2016, US PE firm First Reserve acquired G4S Utility Services, a provider of energy metering and outsourcing services in the UK for £52 million. First Reserve also recently acquired Morrison Utility Services, a provider of utility infrastructure services.

Elysian Capital acquired Fastflow, a provider of maintenance services to the owners of water, gas and social housing for an undisclosed sum.

Foresight Group Ltd (GB) acquired Tudor Contract Cleaners Ltd (GB) for an undisclosed sum during Q1 2017. We can expect to see further consolidation in both the cleaning and security sectors, with economies of scale seen as the best route to improve margins in these largely commoditised sectors. We can also expect interest in utilities to continue as many operators enter new revenue cycles.

According to our data, over the past ten years 16% of FM deals have been backed by PE. These latest deals reflect well-capitalised PE investors' continued appetite for FM across both the hard and soft sectors, attracted by relatively low risk assets, long-term contracts and stable, recurring revenues, for example in the social housing sector.

UK trade deals

After a strong show of post-Brexit confidence in the sector from domestic buyers in H2 2016 with 38 deals, Q1 2017 has fallen back to match the quarterly three-year average of 13 deals – the same number of deals tracked in Q1 2016.

Grant Thornton advised on Styles & Wood's £7.1 million buy-out of Kent-based M&E consultants GDM Group as the company looks to diversify its service offering and bring M&E design services in-house.

Marlowe PLC acquired two fire installation and maintenance companies, Alpha Peerless Fire Systems Ltd and BBC Fire Protection Ltd, during Q1 for a combined £9 million, as the company pursues its consolidation strategy in the fire protection sector.

> “We expect M&A activity to continue but at a somewhat slower pace due to the macro geo political environment. M&A activity will continue to be driven by overseas corporates, well capitalised PE funds and UK groups divesting non-core assets.”

Towards the end of Q1 Vertas Group, the soft FM provider owned by Suffolk County Council, acquired Diamond View Cleaning Solutions to expand its services in East Anglia.

AIM-listed securities and FM company Mortice Ltd has agreed to pay up to £6.1 million for Manchester-based property services group Elite Cleaning & Environmental Services Ltd.

Overall, however, the UK’s FM corporates appear to be waiting for greater clarity before making M&A a priority, with some currently more focused on resolving internal issues, such as the significant board changes at the outsourcing group Mitie for example.

International deals

The key driver of growth and the most significant deal in Q1 was French company ENGIE’s purchase of Keepmoat’s regeneration business for a reported £330 million.

With an existing sizeable platform in the UK, this latest acquisition by ENGIE is a strong signal of its intention to continue its commitment across the Channel. The company hopes to extend its reach into local authorities and support its growth ambitions for decentralised energy networks and home energy solutions.

In Q1 US firm ABM picked up 8 Solutions, a specialist technical cleaning and data centre healthcare services business. The acquisition builds on its existing foothold in the UK and forms part of the company’s focus on becoming a fully integrated services provider.

The highlight of Q4 2016 was South Africa’s Servest acquiring building services contractor Arthur McKay & Co Ltd as part of its ambitious growth and diversification strategy.

Also in Q4 2016, France’s Spie bolstered its FM presence in the UK with the acquisition of Triosgroup, a provider of facility and property related services based in Birmingham.

Outlook for Q2 2017 and beyond

We can expect a fairly quiet Q2, particularly on the big-ticket deal front. With a general election on June 8 companies, both international and domestic, may well put major decisions and investments on hold for a few weeks, in spite of the widely anticipated result. Meanwhile the lower end of the deal market is likely to remain fairly resilient.

Looking at the deal data from the past ten years we’ve seen a very consistent pattern of overseas investment. The countries with the most active overseas acquirers in the UK market have been the US, Germany and France and this is likely to continue for the foreseeable future. The most active specialist sub-sectors by deal volume over the decade have been M&E, maintenance and fit-out, and security.

For the foreseeable future we are unlikely to see new global players coming to UK. We are much more likely to see overseas FM corporates with an established UK presence building on their existing foothold, following the recent examples of ENGIE, Spie and ABM. A major upsurge in Asian FM players buying in the UK directly seems less likely, given their preference for a joint venture approach with existing operators from the more established FM markets.

The share prices of our peer group of UK quoted FM companies have settled back down to more ‘normal’ levels of performance now they are over the shock of the EU referendum result.

Quoted FM tracker

In the nine months from 30 June 2016 to 31 March 2017 the share prices of our peer group of quoted companies were up an average of 11.5%. However, this increase should be looked at in the context of FM company share prices taking a battering immediately after the EU referendum on 24 June last year. Share prices in our peer group were depressed at the start of Q3 2016, but gained an average of 9.8% over the course of that quarter. Once some of the initial volatility had abated and markets had got over the shock of the leave result, the six months from 1 October 2016 to 31 March 2017 were more settled, with our peer group up an average of 1.3%.

However, overall FM share values have dropped compared with the period in the run up to the referendum, with prices 0.7% lower than a year ago. In comparison, the FTSE 100 All Share, rose by 17.5% over the year, mainly due to constituent companies' greater overseas focus and ability to benefit from the depreciating pound.

Companies in our peer group with significant overseas exposure were not adversely affected by the referendum result, with share prices rising by an average of 8.1% over the year, and by 6.5% in the nine months to 31 March 2017.

By comparison, the share prices of FM companies focused on the UK fell by 10.5% over the year, many seeing a relatively strong position at the end of Q1 2016 eroded in the aftermath of the referendum. Although in the nine months since 30 June 2016 these companies have seen average gains of 14%, they remain below their Q1 2016 level.

Notable performers

Several FM companies in our peer group have taken some big share price hits. Looking at companies with a mainly UK focus, the biggest losers over the past six months have been Bilby PLC with a 60% decrease (down 72.6% since March 2016) and Interserve PLC whose share price fell by 34.9% in the last two quarters and by 48.7% since March 2016, as a result of contract write-offs in its environmental division. Accounting and labour issues at MITIE Group PLC have seen its share price yo-yo in recent months, with an overall drop of 13.7% since Q1 2016.

On a more positive note, two FM companies with a UK focus have bucked the recent trend of share price decline with strong double-digit growth. Premier Technical Services Group PLC has seen gains of 68.6% in the last six months, while Lakehouse PLC's shares have gone up 50.8% over the same period despite recent profit warnings.

Johnson Service Group PLC's share price has increased by 8.5% in the six months to March 2017, and Kier Group PLC is up by 4.2%.

Looking at companies with significant overseas revenues, the leader of the pack by some margin has been G4S PLC. It's share price has risen by 33.6% in the past six months and by 66.4% since March 2016. Rentokil Initial PLC's share price has seen a gain of 11% since October 2016 and Compass Group PLC has seen a rise of 0.7%.

The biggest loser among our peer group companies with mainly overseas exposure has been Berendsen PLC, whose share price has fallen by 41.1% in the past two quarters. Meanwhile, Balfour Beatty PLC's share price has dropped by 3.6% over the last two quarters, Carillion PLC has gone down by 10% and London Security PLC has fallen 7.8%.

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Grant Thornton Facilities Management – subsector map

Hard FM

- Fabric maintenance
- Fit-out
- Mechanical & Engineering
- Fire Protection
- Grounds Maintenance
- Utility Maintenance
- Reprographics

Soft FM

- Security
- Cleaning
- Catering
- Washroom hygiene
- Textile/Laundry
- Pest Control
- Space planning

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