SHAW & CO

THE SHAW REPORT: *Manufacturing & Engineering*

Prepared by:
Colin Burns, Director Debt Advisory, Shaw & Co

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October 2021

FOREWORD

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Welcome to our first ever 'Shaw Report' into the Manufacturing & Engineering (M&E) sector which provides the industry's SME business leaders with a powerful benchmarking tool to aid their decision making.

In this report we have segmented over 3,900 M&E businesses with earnings of more than £1m by size and subsector to track their performance, profitability, debt levels and M&A activity.

Larger blue-chip corporates have regular access to this type of analysis from investment banking advisers. However, it is our mission to provide SME business leaders with free access to the same market intelligence in a clear, concise and easy-to-use way.

This report will help you benchmark your performance relative to the sector. It will also provide you with valuable insight regarding your relative creditworthiness and attractiveness from a M&A point of view.

We hope you find this a useful tool. If there are any emerging themes that resonate with you, please feel free to get in touch.

Colin Burns
Director, Debt Advisory, Shaw & Co

AT A GLANCE

Data Sources

- Companies House.
- Zephyr.
- Mark-to-Market.

Businesses Analysed

- 3,917 UK SMEs with earnings (Ebitda) over £1m.

Data Point

- 30 June 2021.

COVID-19 IMPACT

10% decline in output in 2020 but looking to bounce back strongly with pent-up demand now being satisfied. Nevertheless, it will take until well into 2022 before there is a realistic chance of output matching pre-pandemic levels.

LONGER TERM BORROWING

There is now a significant opportunity for alternative lenders to bridge the gap left by the traditional lenders by providing longer term loans for SMEs.

GROWTH FUNDING CAPACITY

If you are a good business with solid growth plans you could be borrowing up to 3.5 or even 4 times your earnings (Ebitda) for growth projects and capital investment.

SUPERTAX DEDUCTIONS

Support incentives, such as the Super Deduction tax to encourage capital investment, will help businesses bring forward their investment plans and potentially upgrade technology and improve margins.

HOW DOES MY BUSINESS PERFORMANCE COMPARE TO THE INDUSTRY?

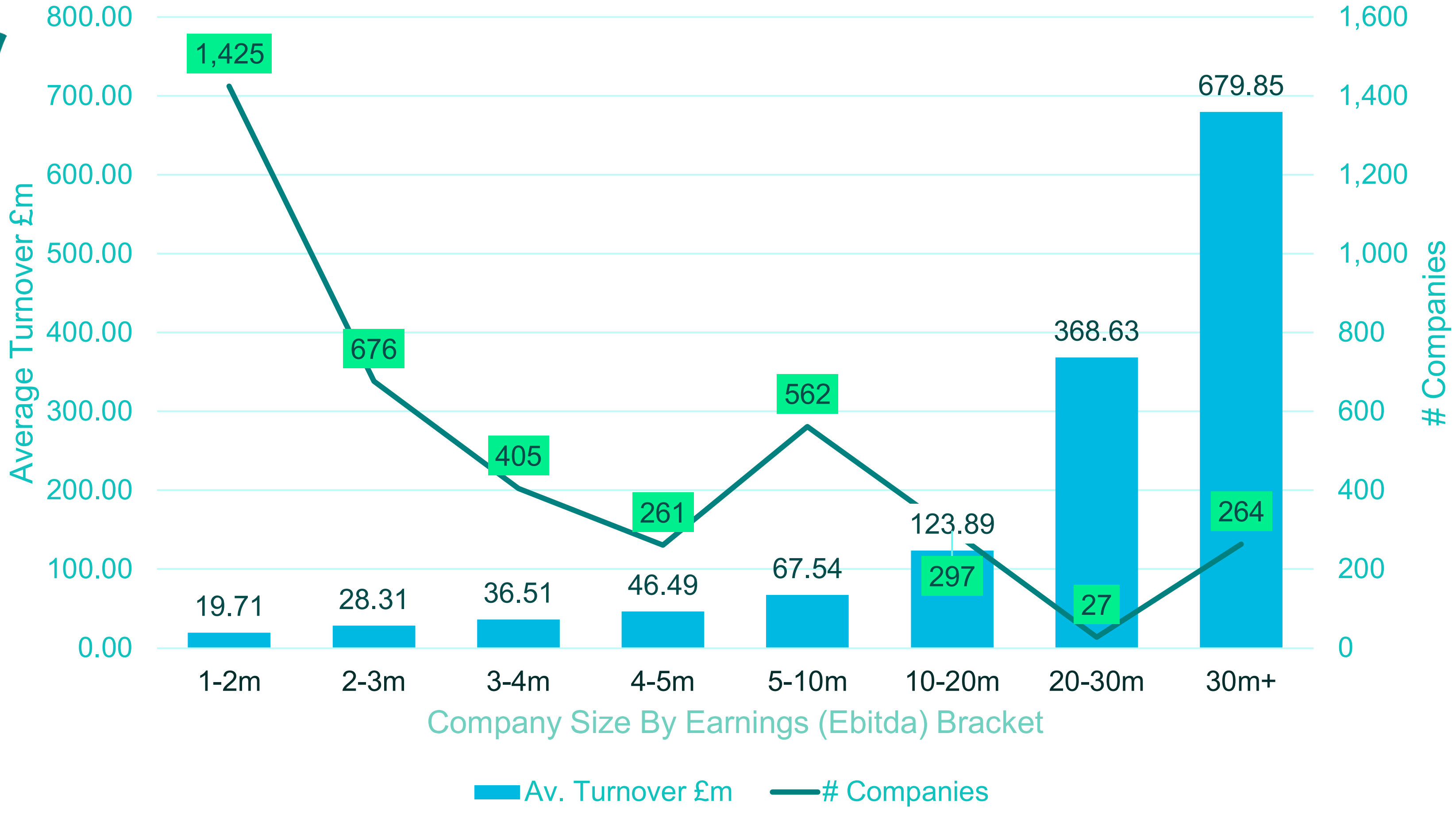
TURNOVER BY SIZE OF BUSINESS

Commentary

This chart shows average sales across the sector based on company size measured by earnings (last reported Ebitda).

- While representing the whole market range, less than 7% of companies represented account for the top £30m+ Ebitda bracket (averaging T/O of £680m) while 64% of all manufacturing companies generate Ebitda of less than £4m with average T/O below £36.5m.
- 36% of all companies analysed deliver Ebitda in the £1m-£2m range with an average T/O of £20m. This segment is twice the size of its closest rival, in terms of individual companies, based on their Ebitda performance.

In our next report, the evolution of data will be presented to measure 'Turnover Growth Rate', an additional indicator to compare each business against and to observe how the smaller businesses are growing compared to the larger ones.



TURNOVER BY SUB-SECTOR

Commentary

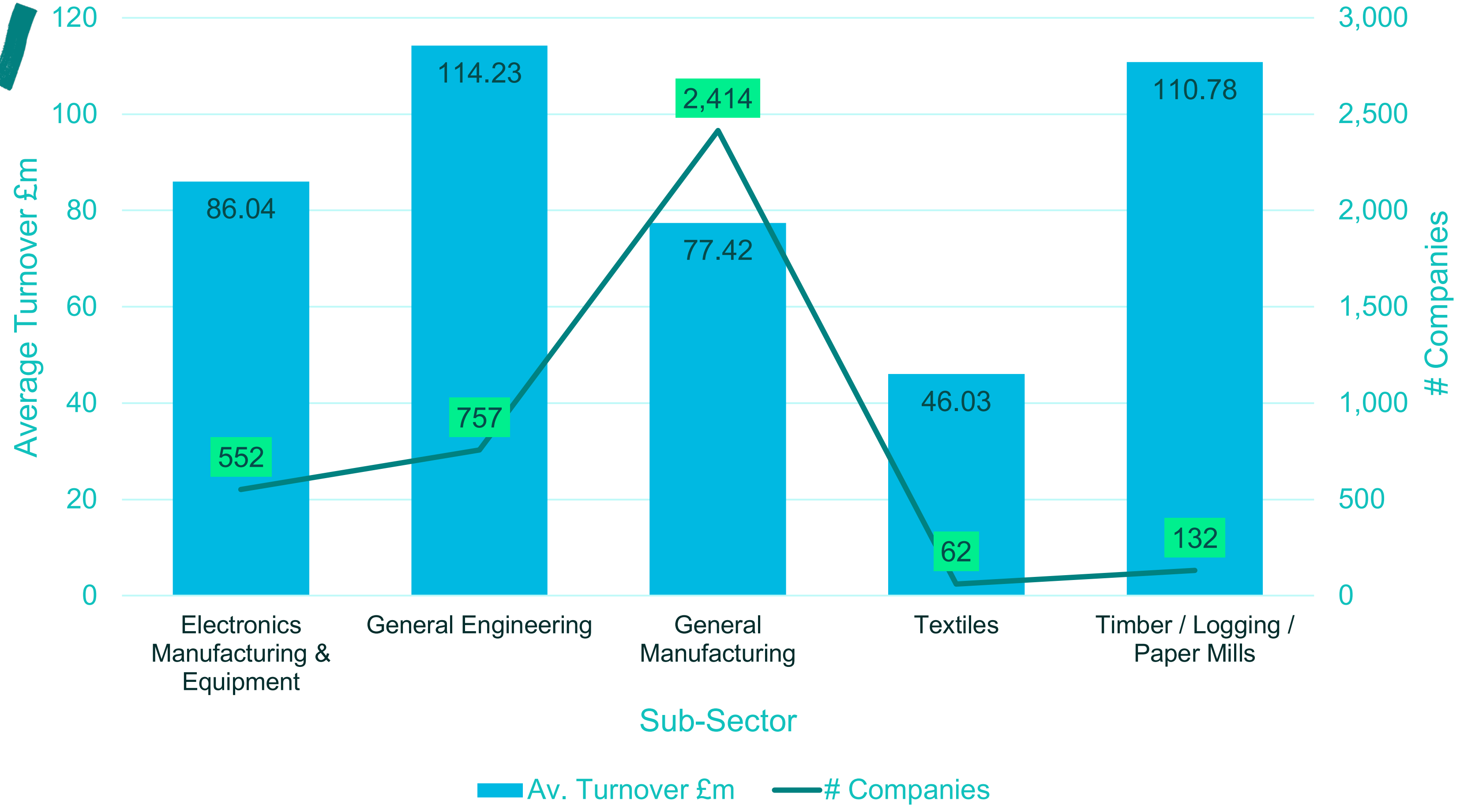
Here, M&E turnover has been segmented by sub-sector.

Again, representing the whole market range, the average T/O is inflated by the largest players within each subsector.

While the Textiles and Timber subsets account for less than 2% of companies, the largest subsector by far is General Manufacturing which does present a fair reflection of the concentration of activity.

It is also worth mentioning that certain subsectors (mainly General Engineering and General Manufacturing) feature prominently on a geographical basis most notably in the Midlands, the Southeast and the North. The Southeast also attracts a disproportionately high level (43%) of all Electronics Manufacturing.

When benchmarking your performance with this data, it is important to remember that the figures contain major manufacturers or international engineering companies. So, if you are reading this as a relatively small manufacturer with a £5m turnover, for example, don't be disheartened. In fact, the data also demonstrates that you have plenty of large potential acquirors for when you're ready to exit!



BENCHMARKING AVERAGE GROSS PROFIT MARGIN

Commentary

This graph gives a range for sales relative to direct costs within sub-sectors.

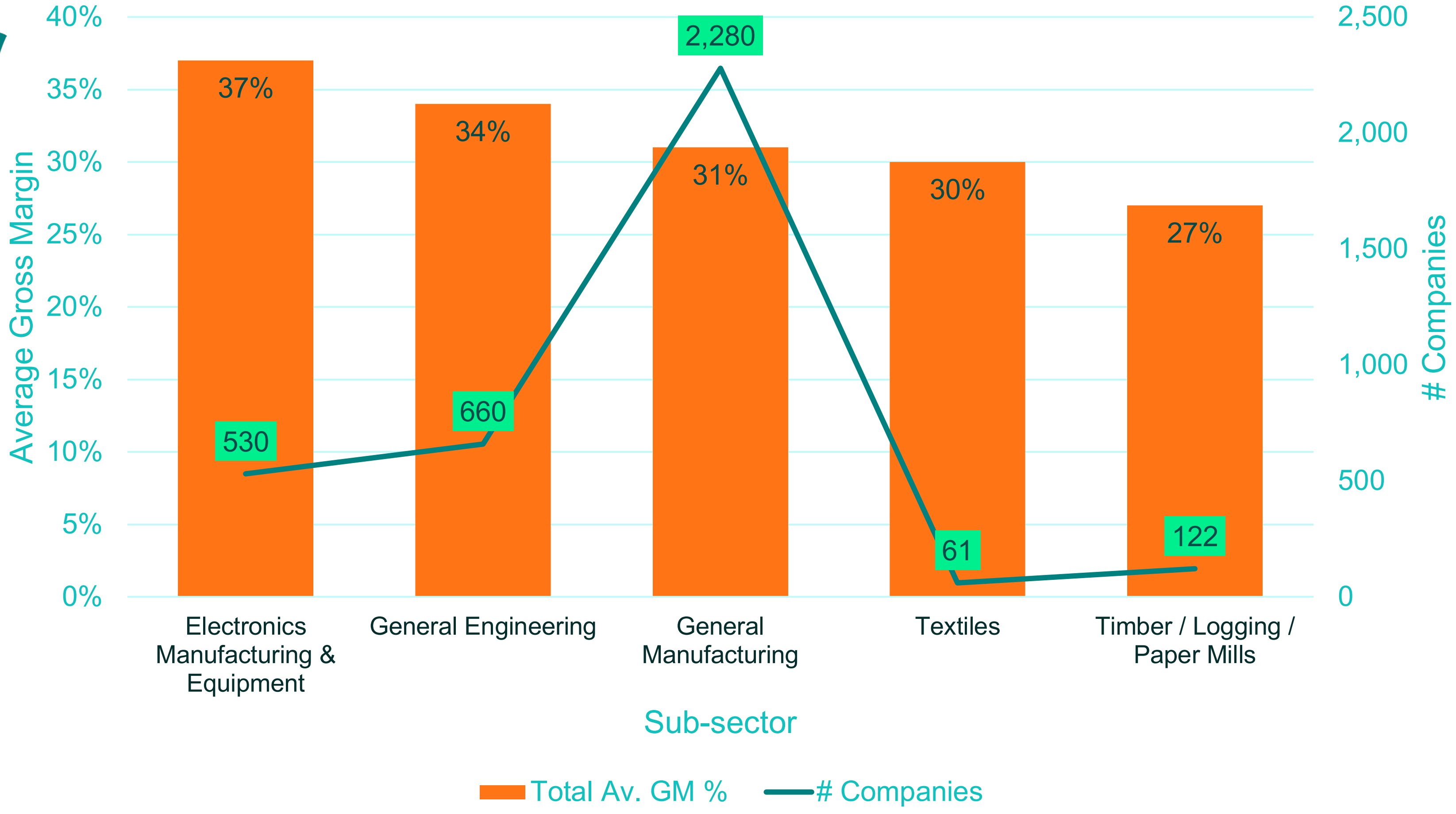
The graph shows that, similar to the Ebitda margin, a higher gross margin is achieved from businesses where technological added value is able to deliver a premium compared to less advanced technologies.

But these margins could easily be eroded with commodity price swings, such as steel, creating further raw material cost pressure. For example, manufacturers saw steel and copper up by 66% within the past year, with iron ore alone up by over 80%.

When comparing your performance with this data, if your gross profit margin is below the sector average, you will need to evaluate your business model, pricing and cost structure.

If your gross margin performance is significantly above the sector average, you may want to consider lowering your price to sell more volume and achieve scale.

To grow, your priority needs to be differentiation of product quality and innovation to reduce costs.



AVERAGE GROSS MARGIN & SCALE

Commentary

Here we show how the average gross margin varies with the scale of the business as measured by earnings (Ebitda).

In terms of average gross margin across the Ebitda scale range this broadly varies between 29% and 33% with the lower end of this scale impacted in the £20m - £30m Ebitda range predominately in the South East where salary and occupational costs can be disproportionate.

Similar to Slide 7, when comparing your performance with this data, if your gross margin is below the sector average, you will need to evaluate your business model, pricing and cost structure.

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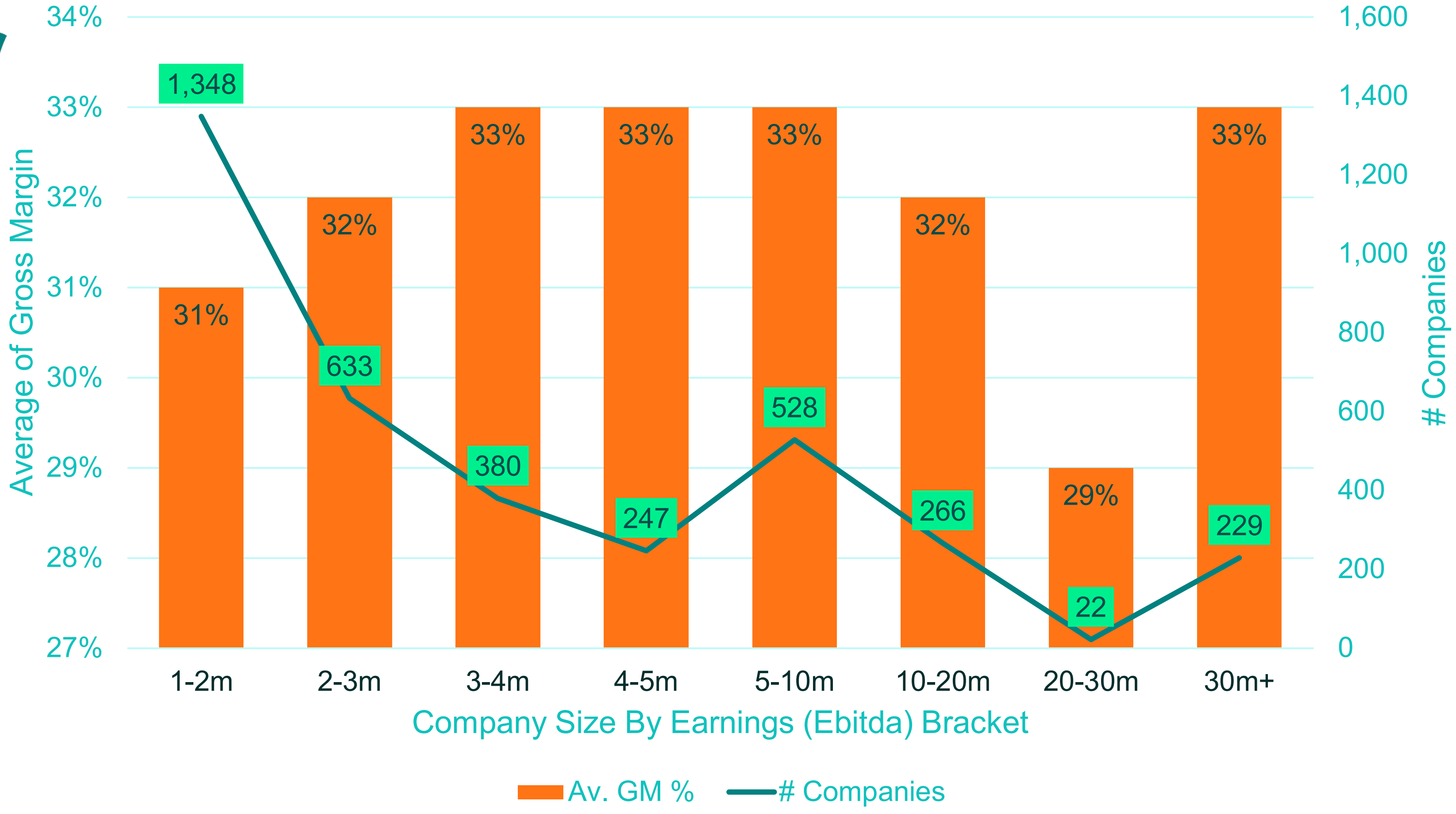
To grow, your priority needs to be differentiation of product quality and innovation to reduce costs.



PROFITABILITY

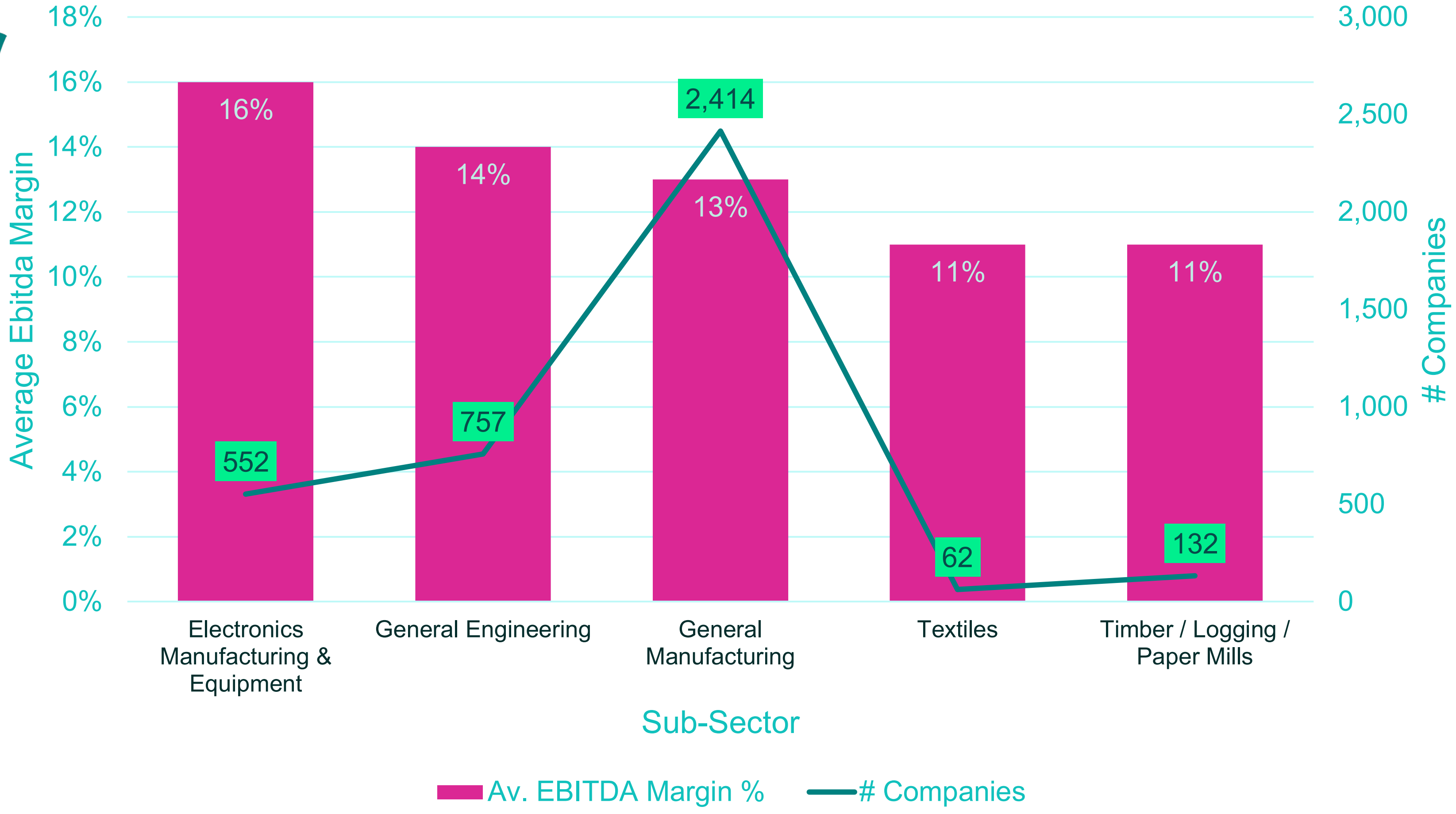
Commentary

Here we show the profitability margin across the sub-sectors.

Ebitda margins broadly vary between 11% and 16% with, unsurprisingly, higher margins being evidenced in those companies where technology features strongly.

Note that the Electronics sub-segment's margins will be higher due to the higher prices usually commanded by any products aimed at the consumer market.

How does this compare with your own business and are there plans afoot to invest in margin-enhancing technology?



ECONOMIES OF SCALE

Commentary

This graph shows average Ebitda margin by size of company.

It is clear that sheer size can create economies of scale which in turn enhance margins.

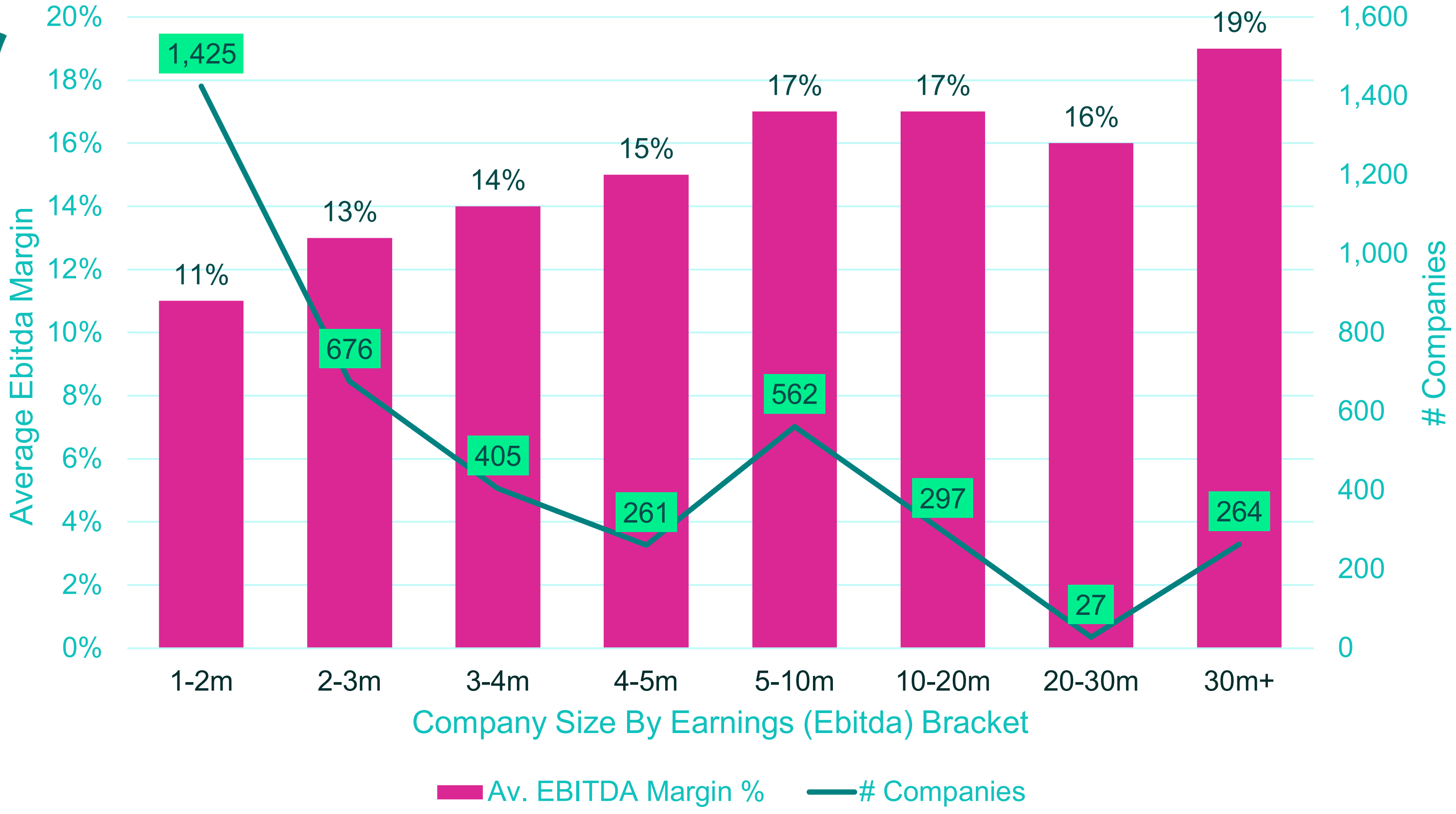
When comparing your performance with this data, if your profitability (Ebitda) margin is higher than sub-sector average, you may be carrying a leaner cost structure. You may want to consider reinvesting your profits to scale your business or consider an exit.

If you are looking to achieve greater profitability, then the logical routes are:

- Achieving scale through acquisitions,
- Achieving higher efficiency through investment in technology.

We see a lot of consolidation acquisitions and so-called 'buy & build' activity driven purely by scale, especially towards the smaller end of the SME spectrum.

We also see plentiful debt funding supporting technology projects and a lot of larger firms' acquisition activity driven by buying SMEs with technology that could be scaled across their business.



PERFORMANCE SUMMARY

KEY POINTS

- There has been reported 10% decline in output during 2020 with the sector looking to recover a significant amount of this during 2021. However, general expectations are that it will be late into 2022 before the sector returns to pre-pandemic levels.
- Support incentives such as the Super Deduction tax to encourage capital investment will help businesses bring forward their investment plans and potentially upgrade technology and improve margins.
- Post-Covid headwinds remain which will affect profitability and potentially business liquidity, particularly raw material price volatility, Brexit, Covid related accrued liabilities and net zero aspirations but opportunities will present themselves and new markets beckon.

WHAT IS THE LEVEL OF BORROWING IN THE INDUSTRY?

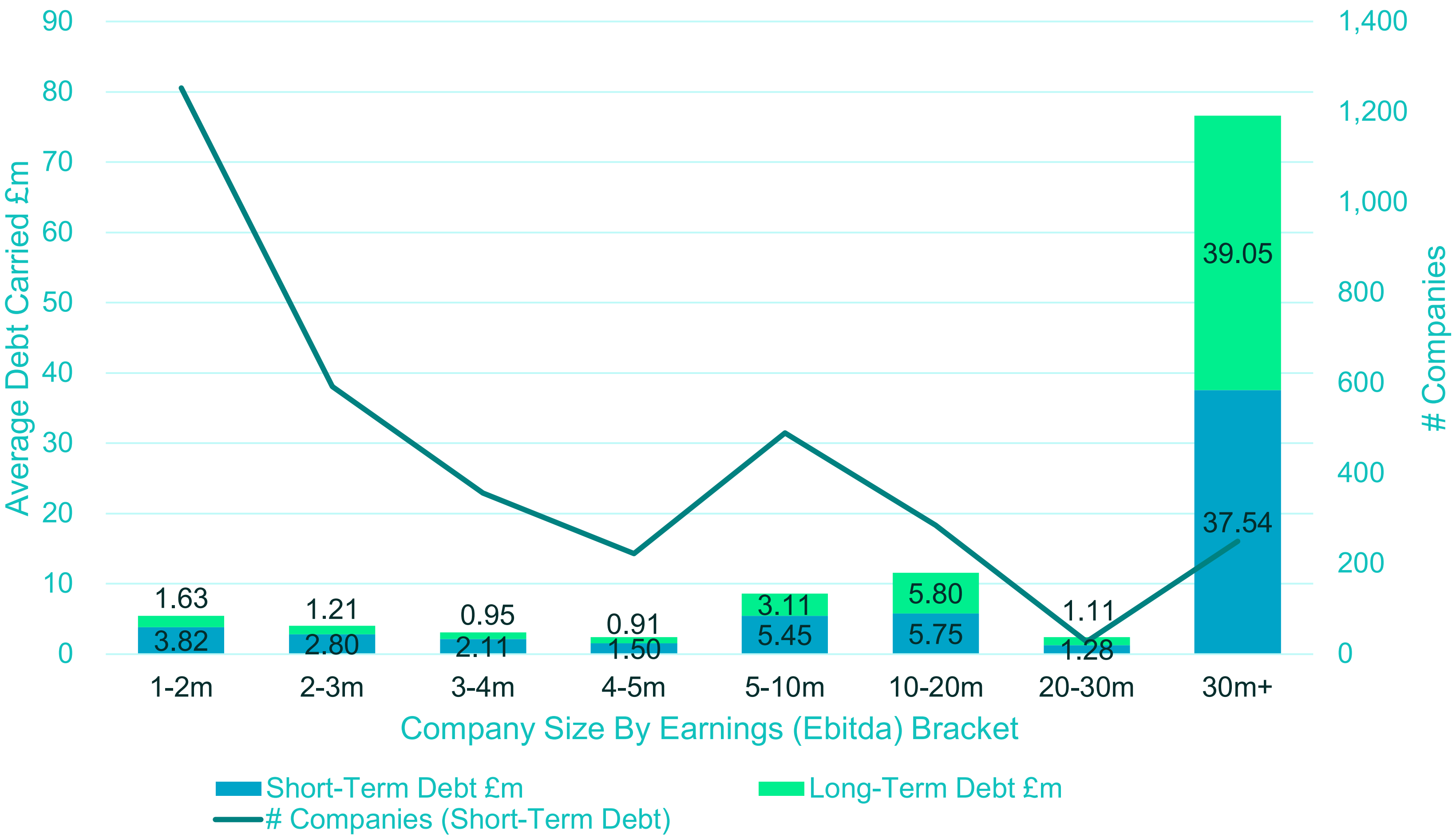
SHORT VERSUS LONG TERM BORROWING

Commentary

Here we show how much short and long-term debt is being carried by businesses of various sizes.

For SMEs with Ebitda of under £10m, the long-term/short-term debt on average splits 30-70. However, as businesses acquire greater critical mass and a desire to demonstrate to key stakeholders that they are not reliant on the vagaries of the short-term funding markets, longer term funding can be easier to secure. This in turn provides greater confidence in longer term business stability which we can see in SMEs with Ebitda over £10m where the long-term/short-term debt splits 51-49 in favour of the long-term.

Among many conclusions from this data, one is that bond markets accommodate larger borrowers much more cost-efficiently, allowing them a more permanent structure to their liabilities compared to smaller competitors having to rely on shorter terms borrowing to finance their businesses. This also speaks to the restricted availability to SMEs of longer-term facilities from banks, with bank lending rarely seen for tenors of longer than 3-4 years unless supported by tangible security.



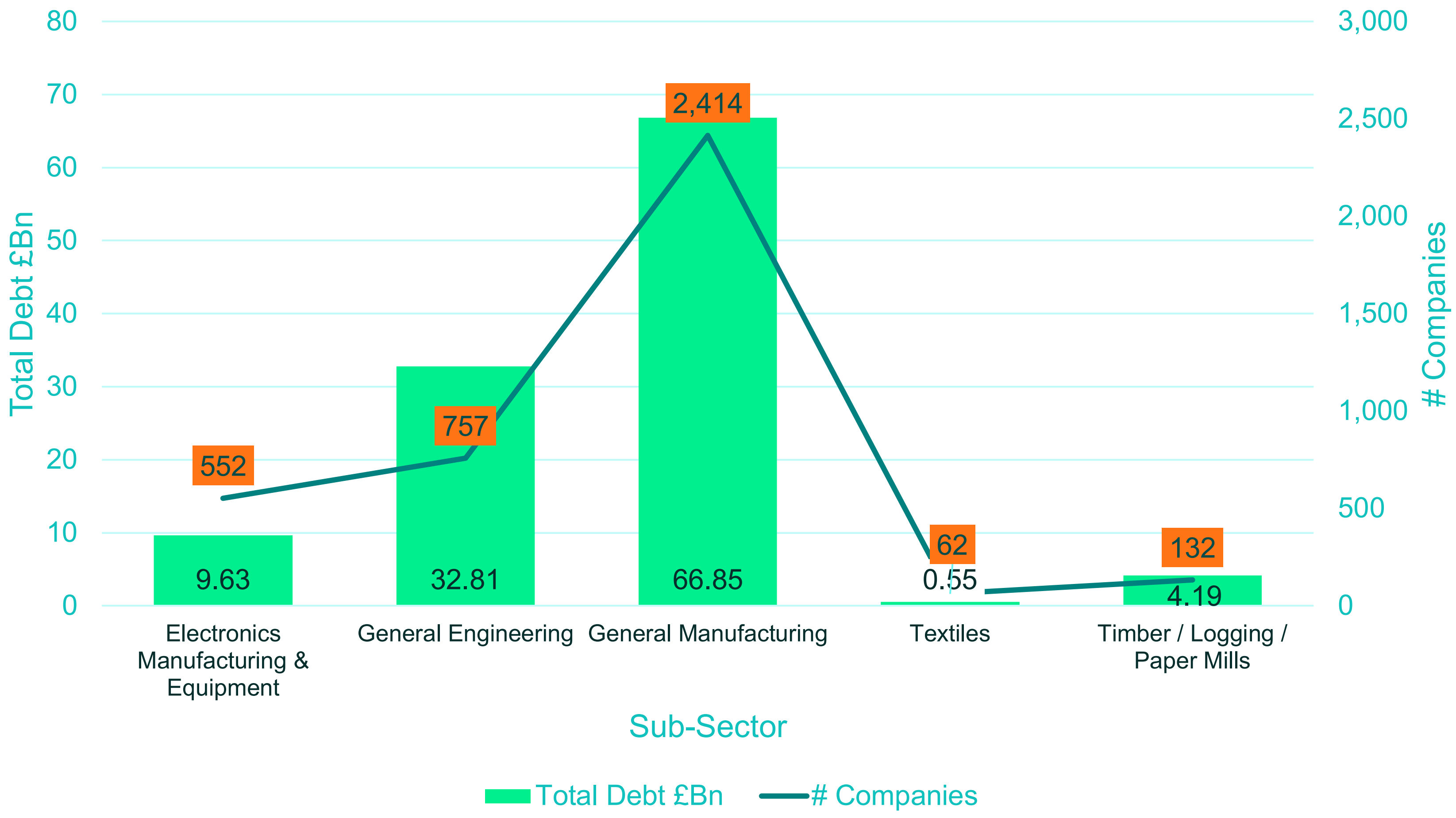
DEBT BY SUB-SECTOR

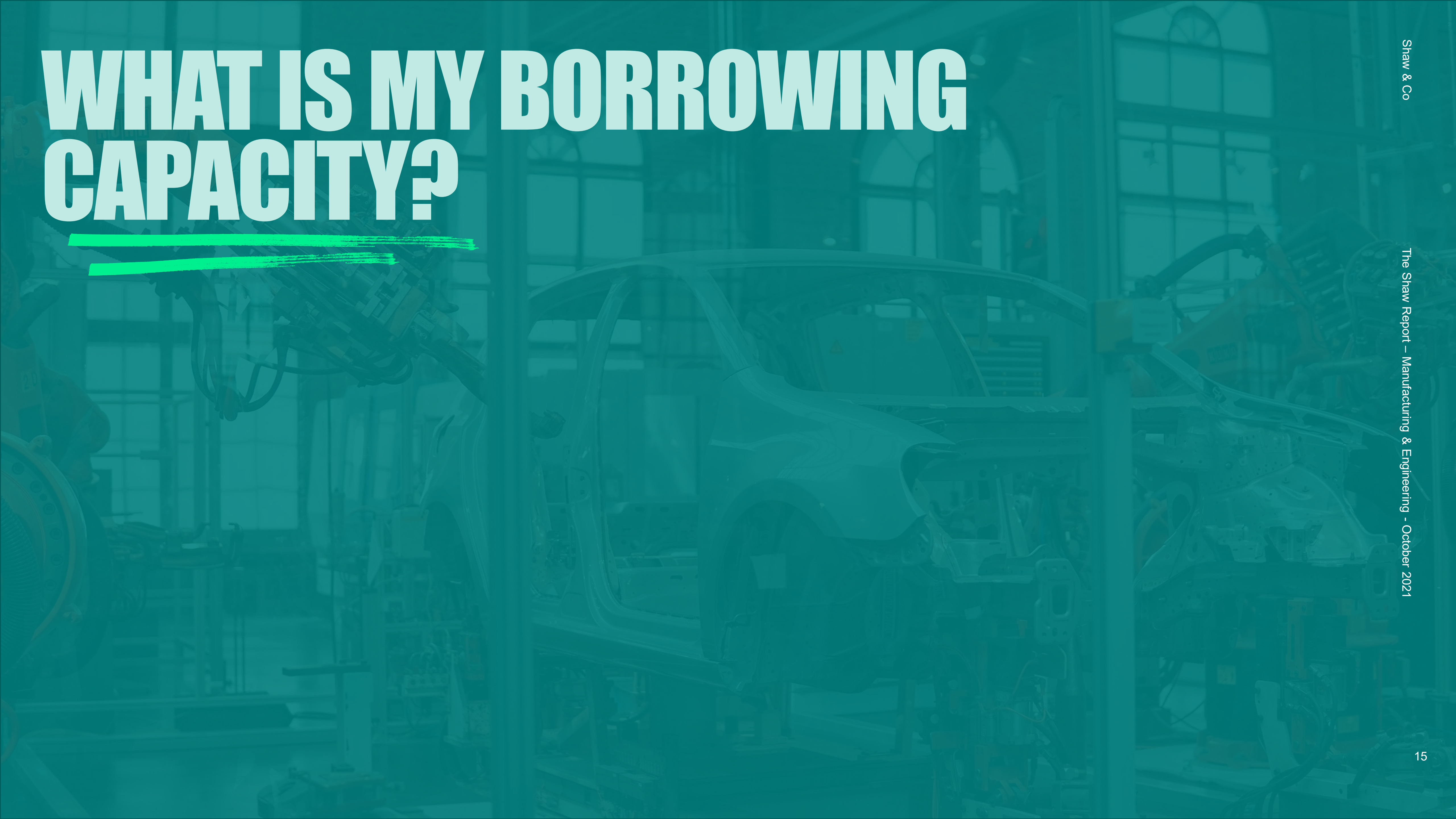
Commentary

Here we show how much debt is being carried by the M&E sub-sectors.

Approximately 60% of total sector debt is carried by the 2,414 General Manufacturing firms. Within this, 65% of sector debt is carried by the top 7% of businesses with Ebitda in excess of £30m.

The chart broadly suggests that the lending community (banks and alternatives) is generally prepared to lend to businesses across M&E.





WHAT IS MY BORROWING CAPACITY?

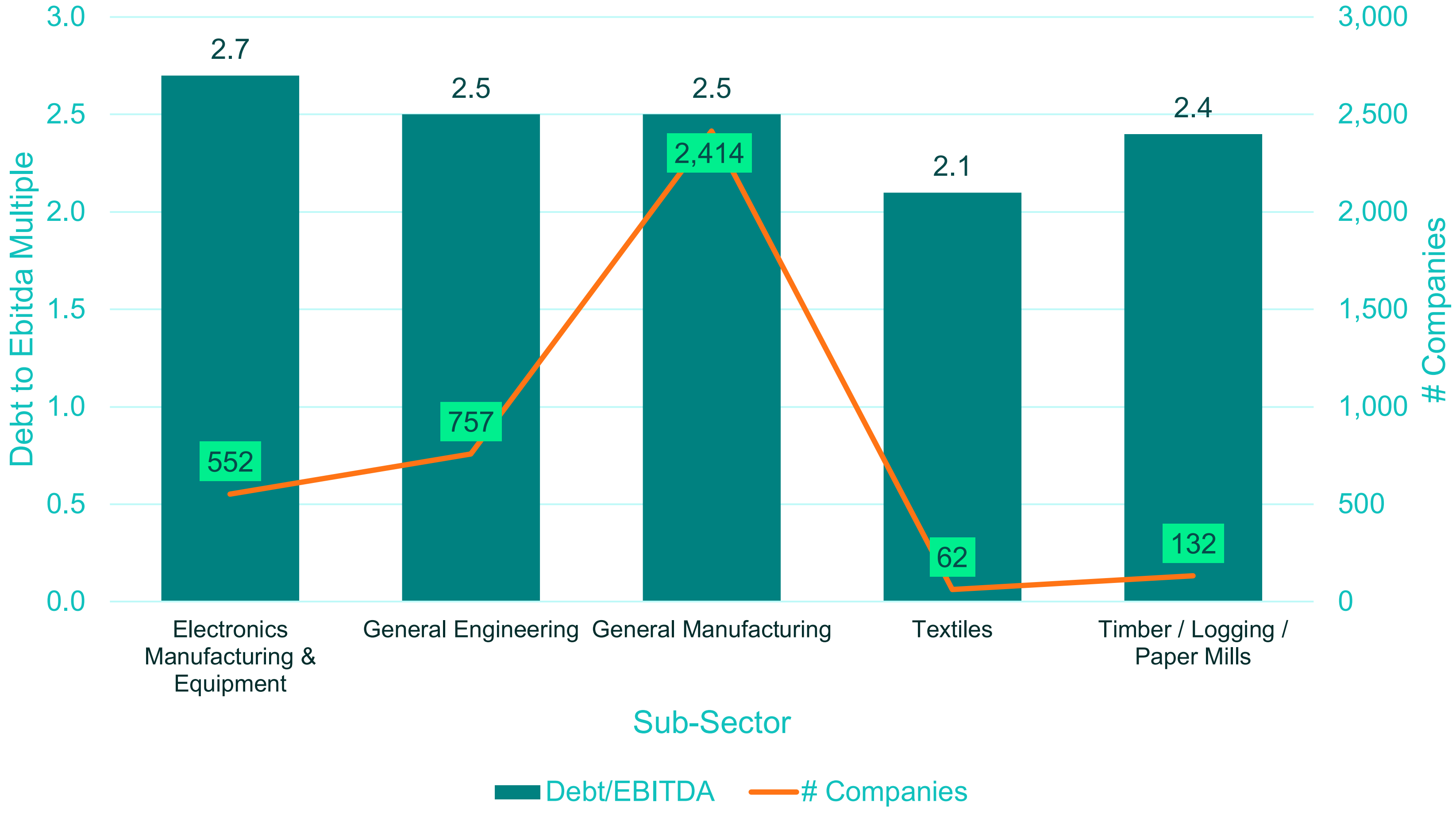
BORROWING CAPACITY BY SUB-SECTOR

Commentary

Here we show the borrowing capacity by sub-sector.

The next two graphs presents the extent of debt leverage within the noted subsectors. By way of a guide, and based on our current knowledge of the funding landscape, we would normally expect to see a business generating Ebitda of up to say £3m to be able to readily secure borrowing of up to 3.5 or even 4 times your Ebitda. The dataset below not only confirms this position but also that similar metrics apply even to the larger entities in the sector.

In our experience, we see many SMEs with solid growth plans and modest borrowing get rejected by banks. There are many reasons, other than your creditworthiness, why a bank may have said no. Numerous alternative funding options exist that don't require you to change banking. So don't let a 'No' impede your growth.



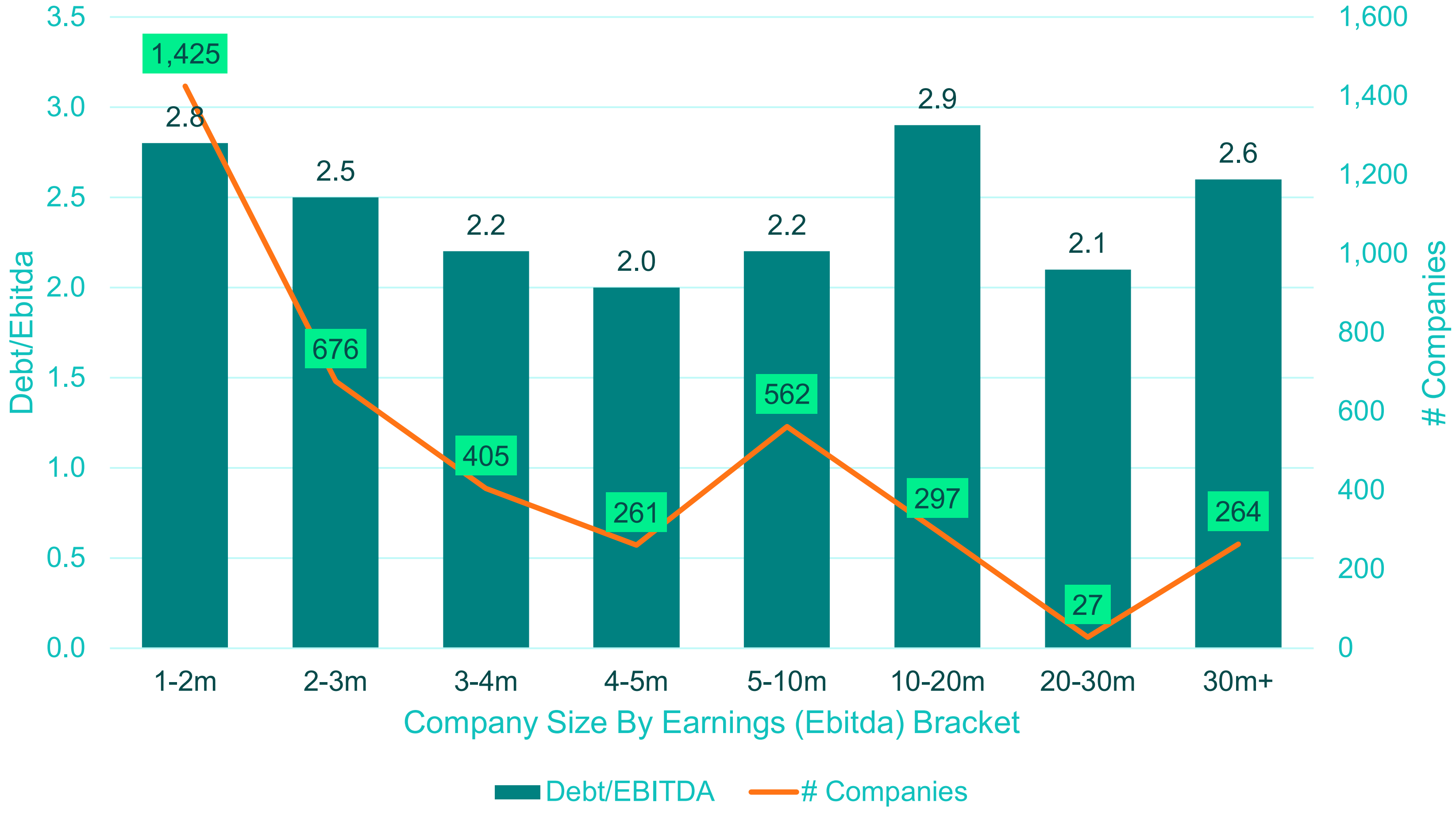
BORROWING CAPACITY BY SIZE

Commentary

This graph shows borrowing capacity by company size.

As in the previous slide we see the leverage variance in line with our own experience in raising debt irrespective of Ebitda size.

What is interesting is that a relatively high reported leverage is in the £1m - £2m Ebitda range. This could be a result of a stronger desire to leverage up for growth, or perhaps those businesses which may be less resilient to a pandemic and had to take on higher borrowing to alleviate cash pressure. Or, more likely, it could simply be due to reduced reported Ebitda as a result of Covid.



BORROWING SUMMARY

KEY POINTS

- The key priority for businesses in ‘survival mode’ with accumulated deferred liabilities is to extend the maturity profile of their borrowings. This is most likely achieved through the alternative funding market.
- During the pandemic, the banks lent 3-4 decades worth of lending in just one year. Whilst this is a hugely commendable effort by the banks, it has naturally affected their current lending appetite. Again, to maximise your borrowing capacity, you might have to explore the alternative funding market.
- The cash flow impact of your borrowing is more important than the absolute interest cost. Unfortunately, SMEs are generally unaware of alternative growth funding options, including those with repayment terms of 7-10 years. This leads to them using their own equity to fund growth or, sadly, abandoning growth initiatives completely.

M&A ACTIVITY - ARE BUSINESSES LIKE MINE IN DEMAND?

WHO IS BUYING WHO IN THIS SECTOR (SELECTED DEALS)

Commentary

There have been 65 deals in the Manufacturing and Engineering sector in the quarter. Half of the published deals were in the engineering sub-sector with 18% in the electronics engineering and general manufacturing sub-sector. Of note is that just over half of the acquisitions were by UK buyers (52%) with US buyers being the most active internationally with 20%.

16 of the deals have a published or estimated deal value that is publicly available with an average deal value of £92m. The wide range suggests some of the activity in this sector has been driven by rescue deals for smaller companies still struggling coming out the pandemic.

Region	ACQUIROR	TARGET NAME	BUSINESS	DEAL TYPE	DEAL VALUE £	TARGET Ebitda £
Midlands	Van Elle Holdings PLC	Screwfast Foundations LTD	Manufacture of other fabricated metal products	Acquisition 100%	£3.6m	N/A
North	MBO Team	North West Roller Services LTD	Manufacturer of other special purpose machinery	MBO 100%	£1.5m	N/A
North	Generac Holdings Inc	Deep Sea Electronics Ltd	Manufacture of electronic measuring, testing equipment, not for industrial process control	Acquisition 84.2%	£242.2m	£17.4m
North	AMS Holdco 2 Ltd	Scapa Group PLC	Manufacture of other plastic products	Acquisition 100% Bid 2 – Increased offer	£412.6m	£40.2m
Scotland	VITEC SA	Exterity Ltd	Manufacture of telegraph and telephone apparatus and equipment	Acquisition 100%	N/A	N/A
Southeast	M&G Investment Management Ltd	Survitec Group Ltd	Manufacture of other special-purpose machinery	Institutional buyout 100%	£270.0m	-£13.1m
Southwest	Brady Corporation	Magicard Ltd	Manufacture of printed labels	Acquisition 100%	N/A	£5.1m

M&A BY LOCATION

Deals across the UK

Most of the manufacturing and engineering sector M&A deals in the quarter were in England (93%) with a clear concentration in the Southeast.

Of the four deals in Scotland, two were acquired by French companies. Exterity, which produces encoder equipment, was acquired by Vitec SA, while Design LED Products, which is a LED lighting manufacturer, was acquired by Faurecia. This illustrates that there is an active international market of acquirors if the strategic fit is right.

The Southeast had the largest concentration of deals in England with companies specialising in everything from contact lens manufacturing to precision engineering for F1. Captured within our data set for the Southeast is the institutional buy-out of Survitec Group by M&G as part of a £270m refinancing of the company led by Searchlight Capital Partners. This shows the space is also active for larger companies and deals as it is excepted the majority of the refinancing funds will be used to fund future acquisitions.

No manufacturing and engineering M&A deals were reported in Northern Ireland or Wales in the quarter.

IS NOW A GOOD TIME TO BUY OR SELL A BUSINESS?

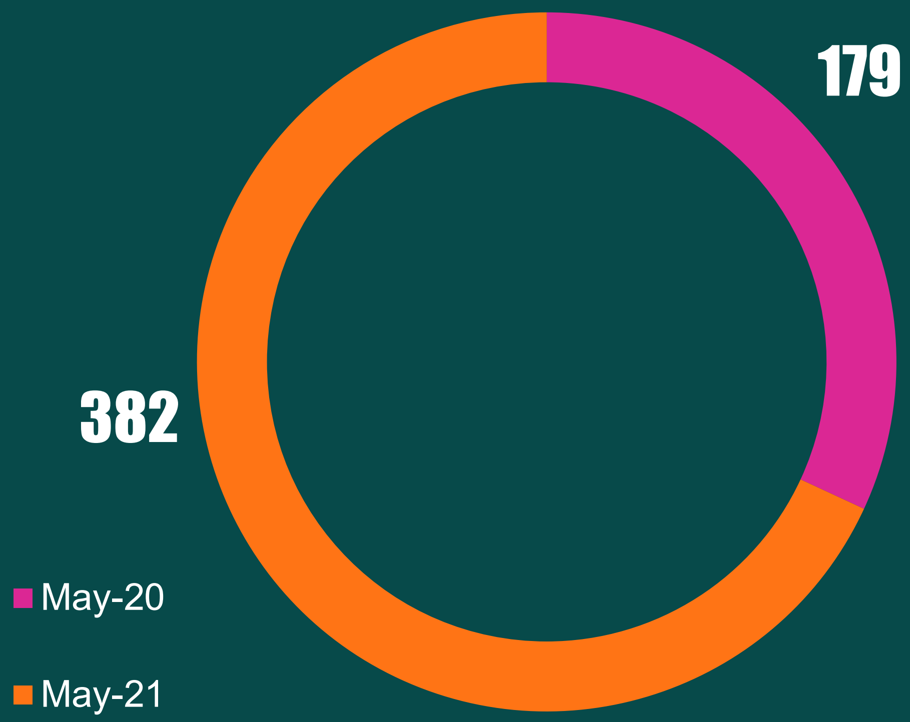
HIGH LEVEL OF DEAL ACTIVITY

Analysis of wider M&A data shows that UK deal volumes across all sectors were more than double those of last year in the month of May (Source: *Mark-to-Market*).

This data supports our experience at Shaw & Co that M&A activity is buoyant with strong buyer appetite across most sectors. Although COVID-19 has hit some businesses hard, others have seen a strong boost in activity. In either case, the pandemic does not appear in general to have dented M&A activity and if anything, there appears to be a pent-up demand.

There is clearly appetite for deals at the smaller end of the market both for thriving businesses and those who have struggled to get through the pandemic unscathed. The deal valuations will vary greatly depending on which description your business fits but there is currently strong buyer appetite.

UK M&A DEAL VOLUMES



OUR CREDENTIALS.

OUR SECTOR EXPERTS

Colin is funding specialist in our Debt Advisory team and is a fully qualified Chartered Banker and Green Finance Certificate holder.

He provides funding advice to UK SME clients across a range of sectors including manufacturing & engineering, automotive and logistics, TMT and leisure, tourism and sport.

His typical mandates include all types of growth funding, acquisition, MBI or MBO financing with facilities ranging from £1m to £100m.

COLIN BURNS

Director

Click for bio & contact details

Daisy is a mergers and acquisitions specialist in our M&A team and is a fully qualified Chartered Accountant.

Her corporate finance advisory and transactional support includes business valuations, exit planning, buying or selling a business, mergers, MBIs and MBOs.

Daisy's clients typically come from a range of sectors including leisure, tourism and sport and TMT.

DAISY MACKAY

Manager

Click for bio & contact details

SOME OF OUR DEALS IN THIS SECTOR

ENSILICA UK
Manufacturing & Engineering

£ 3.7M RAISED
Financing business growth

CAPLE
Lender

EnSilica UK is a leading fabless designer of application specific integrated circuits (ASIC) supplying multiple markets. EnSilica came to us to help raise funding for its strategic growth projects.

"THIS FUNDING OPPORTUNITY WAS BROUGHT TO US BY SHAW & CO AND THEIR MANAGEMENT OF THE PROCESS WAS CRITICAL FOR OUR SUCCESS."

Mark Hodgkins
Chairman, EnSilica UK

TRUNKI
Manufacturing & Engineering

£ 3.9M RAISED
Raising equity funding

BGF
Lender

Having famously failed to raise money on the BBC's Dragons' Den, Trunki's owner Rob Law MBE wanted to drive his company forward. With his sights set on international expansion, he asked us to help him make it happen.

"THE TEAM AT SHAW & CO REALLY CREATED VALUE FOR ME IN THIS TRANSACTION THAT MIGHT HAVE OTHERWISE BEEN LEFT ON THE TABLE."

Rob Law MBE
Founder & CEO, Trunki

NATIONAL REACH

FIVE UK LOCATIONS

We help the business leaders of UK privately-owned SMEs to achieve their greatest ambitions. Whether it’s buying or selling a business, funding growth, or understanding the funding landscape, we make it happen.

We have easily accessible locations to support clients from across the UK. You can find us here:

• **BIRMINGHAM**	20 Colmore Circus, Birmingham B4 6AT	**0121 314 9410**
• **BRISTOL**	22-24 Queen Square, Bristol BS1 4ND	**0117 325 8510**
• **GLASGOW**	9 George Square, Glasgow G2 1QQ	**0141 280 0410**
• **LONDON**	33 St James’ Square, London SW1Y 4JS	**0207 183 5010**
• **MANCHESTER**	3 Hardman Square, Manchester M3 3EB	**0161 505 2010**

CONTACT

Make it happen
shawcorporatefinance.com

@ShawCorpFin

Shaw & Co

Call us 0330 127 0100