

Human Capital Market Outlook 2020



Following a year of mixed fortunes for the Human Capital sector in 2019, we expect activity in 2020 to be buoyed by the return of greater political and economic certainty to the market. With strong recruitment fundamentals in the UK and an improvement in the investment sentiment of corporates, we expect to see deal volumes and valuations trend upwards in 2020.



Geraint Rowe
Partner, Human Capital

2020 Outlook Summary

- Corporates face an increasingly competitive landscape in 2020 in which M&A activity becomes a critical factor in countering the insufficient level of organic growth opportunities available.
- The market's concerns around IR35 persist, with the low level of preparedness likely to lead to acquisition opportunities within subsector niches which will reduce the administrative and legislative burden.
- Further clarification on the implications of IR35 from the UK government will contribute to more long-term investment decisions being taken, driving increased appetite for UK M&A transactions in sectors heavily reliant on contractors.
- We expect acquirers to look to diversify their portfolios in 2020, in an attempt to insulate their business models against the widely debated IR35 changes.
- Greater certainty around Brexit will improve decisiveness, with the hesitation in the market observed in 2019 rebounding in 2020 as M&A pipelines containing UK assets are converted.
- The historically predictable seven-year-cycle is entering its ninth year, extended by the uncertainty that has surrounded issues such as Brexit and IR35 delaying the peak in the market into late 2020 or early 2021.
- There is a growing impetus for sellers looking to realise value to do so whilst the market is still favourable, while buyers face an opportune moment to engage in M&A activity before valuations rise further.
- With unprecedented levels of capital available to acquirers, we expect a heightened level of M&A activity in 2020, with high quality assets attracting enhanced valuations.
- The review of Entrepreneur's Relief and its cost to the Treasury will disrupt the market in the short-term, with concerned sellers expediting their sale plans into early 2020.



Simon Marsden
Director, Human Capital

“With corporates under increasing pressure to deliver growth, unprecedented levels of capital available and a peak in the market approaching, conditions are optimum for a significant increase in M&A activity in 2020”

IR35

Brexit

Overview:

- IR35 looks set to be implemented in the private sector, as planned, in April 2020, despite the concerns expressed by key industry figures.
- The changes have been widely criticised for the potential negative effects for the industry and wider economy.
- IR35 has been cited as the top medium-term concern to private sector businesses using independent contractors.
- As UK government's focus is now on successful implementation rather than revocation, corporates are acting to expedite their mitigation plans.

Overview:

- M&A activity in the latter stages of 2019 was hindered by hesitant corporates awaiting the outcome of the general election.
- Following the Conservative party's victory in December, director's confidence reached its highest level since the 2016 referendum.
- The UK government has recently declared that it will reject any trade deal with the EU that includes "high alignment".
- The market's focus has now shifted to an orderly exit from the European Union taking place once the transition period ends on 31 December 2020.



of businesses in the UK are unprepared for IR35

Source: APSCo

4 in 10

companies are considering dropping contractors

Source: Be Digital UK



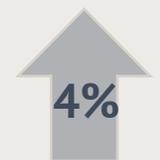
of freelancers admitted to being uncertain of the full scope of IR35

Source: TalentDesk



of the UK workforce comes from EU migrants

Source: ONS



rise in employers' confidence in making hiring and investment decisions since the general election

Source: Recruiter



of employers expect to find a shortage of workers for permanent roles due to immigration policy changes

Impact on M&A in 2020:

- Outsourced payroll and tax system providers will continue to attract heightened attention as acquirers look to reduce the effects of the changes.
- Corporates are likely to utilise M&A as they seek to rebalance their temp/perm portfolios and avoid overexposure to the changes.
- 2020 will see an increase in market consolidation, as operational synergies are seen as a means to manage the near-term uncertainty.

Impact on M&A in 2020:

- As corporates have gained further certainty on the key legacy issue of Brexit, 2020 is expected to be a year of heightened dealmaking activity.
- Subsectors with higher proportions of EU migrant workers such as general staffing and healthcare will experience near-term volatility, benefitting those with secure candidate availability.
- Acquirers in Continental Europe are likely to become wary of divergence, focusing on domestic opportunities.
- Political stability will see trading conditions improving in the UK, leading to corporates making longer-term hiring decisions, improving valuation multiples.

Seven-Year-Cycle

Capital Availability

Overview:

- The historically predictable seven-year-cycle is entering its ninth year, with concerns around issues such as Brexit and IR35 delaying the peak in the market.
- Valuations have continued to rise due to a shortage of available assets in the market.
- Cyclicity within the Human Capital sector remains a key factor affecting the strategic decisions of corporates.
- The cycle provides a barometer for demand that is otherwise intrinsically connected to variable elements such as the economic cycle and confidence levels.

Overview:

- Central banks have continued to adopt 'easy' monetary policies, incentivising both financial and strategic acquirers to grow their capital base to fund growth strategies.
- Corporates continue to raise debt at a low cost of capital, with the majority of issuance used for M&A.
- The general easing of central bank policy has buoyed equity markets and has created a benign environment for business growth
- Mainstream lenders have committed to significant lending targets in 2020 and this trend is set to continue drive M&A volumes in the sector in 2020.



The current cycle is likely to peak towards the end of 2020 or early in 2021



Private equity funds are sitting on \$1.5tn of committed capital

Source: Financial Times



Year on year rise in EV/EBITDA multiples in 2019

Source: Gambit Human Capital Index.



Annual growth rate of lending to corporates in 2019

Source: Bank of England



As we near the end of the current cycle, timing of M&A activity is critical



of European debt issuance is used to fund M&A activity

Source: Gambit Analysis

Impact on M&A in 2020:

- As the cycle extends into 2020 corporates will have a window of opportunity in which to engage the M&A market.
- Valuations will continue to rise as the market looks to capitalise before the next peak in the cycle.
- Sellers will be encouraged by the current upward trend, with those considering an exit well positioned to act at short notice or wait for the next cycle which could be five years away.
- Acquirers with capital to deploy are advised to act quickly before valuations rise further and the market peaks.

Impact on M&A in 2020:

- Recruitment companies will utilise the low interest rate environment to fund acquisition growth strategies.
- Listed corporates need to deploy the significant amounts of cash on their balance sheets in 2020 in an effort to maintain share prices through strategic M&A activity.
- As corporates struggle with organic growth prospects, the abundance of capital will precipitate a period of heightened M&A in 2020.
- As private equity funds seek to deploy record amounts of dry powder, we expect deal values to trend upwards in 2020, driving consolidation.

Gambit Corporate Finance



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Gambit Corporate Finance

Established in 1992, Gambit is an independent corporate finance advisory firm specialising in advising private and public companies on mid-market transactions in the UK and overseas. With offices in London and Cardiff, Gambit is widely recognised as a market leader in M&A advice in the Human Capital sector having built up detailed industry knowledge and an enviable track record in deal origination and execution.

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