UK loses shine as continental Europe attracts dealflow – comment

Stuart Brinkworth is a partner and head of leveraged finance at Mayer Brown in London

Stuart Brinkworth, Mayer Brown

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Private equity still looks to the UK for finance, but the deals now go elsewhere in Europe, writes Mayer Brown's leveraged finance specialist Stuart Brinkworth

The UK has done disproportionately well out of what the government calls foreign direct investment (FDI) since the 1980s, and the trend was sustained even through the first year or two of the post-Brexit referendum period. The numbers have been steady for a while at 25% over the last decade, though they peaked at some 40% in the 1980s. Much of the investment included takeovers of mature and major British companies, and even one or two duds as recent court

cases perhaps attest. But a huge amount included investment into growth companies, and much of that was broadly private-equity financed.

The story is now changing, with a thematic, or maybe strategic, switch into inward investment into Europe, accounting anecdotally for over two thirds of private-equity-financed transactions, whereas it was consistently half before. We are now seeing clients with a conscious bias towards growth and mature mainland European businesses, despite the relative strength of UK economic growth and forecasts, which are on par with Germany for this current calendar year and ahead of France and Italy.

In its 2019 *UK Attractiveness Report*, EY stated that foreign direct investment projects in the UK fell by 13% in 2018, to some 17% of the European total; it remained the leading destination, but France and Germany have been narrowing the gap. On some estimates, Germany actually overtook the UK in 2017. The trend has had resonance in private equity, with a fall disproportionately heavy on the regions (London was only down 1%), reflecting a 35% fall in manufacturing FDI post-referendum. A significant number (42%) of investors surveyed by EY expected the UK's attractiveness to further decline over the next three years, and this correlates well with the anecdotal feedback from our clients. The government's Office of National Statistics (ONS), in what theatre-goers would call a "mixed review", reported that 2017 had incurred a "negative FDI" investment position of £23.2bn, the first time such a position has ever been recorded.

Political headwinds

The reasons for the switch, despite the macro UK picture, is perhaps explained by uncertainty around Brexit; in all likelihood the radicalisation of options under new leadership in the Conservative government by the autumn; and, further down the line, perceived risks in increased corporate tax rates under any administration, including the current one (after all, Boris Johnson has said on the record: "Fuck business"). Some of our clients, corporate and institutional, are also beginning to factor in the risks of a Labour government, pure or in coalition, with an advertised agenda of significant increases in personal and corporate taxation, which may further deter some FDI and indeed domestic entrepreneurship.

There is still health in the UK within the overall picture, of course. The three-year trend to date has more than doubled in terms of PE transactions to €10bn per annum since 2013, and quadrupled by number of deals, indicating the health of

the "up and comings" in terms of scale of average transaction.

The "fuel mix" of leveraged finance coming into Europe is now largely funded by ever-growing private credit funds, in both size and number, rather than the traditional banking suppliers (the top 10 non-bank lenders have grown their market share by 60% in six months).

There is no sign that the UK (but really meaning London) is losing significantly in terms of higher-level professional and banking employment, with – in our view - 3% of the M25 banking and finance staff base under consideration for continental deployment. That the largest segment of Deutsche Bank's redundancies in the closure of its equities business hits London is perversely a sign of the strength of the City's share of wholesale capital markets business internationally. Paris is the strongest alternative location to London, attractive – ironically - because it is not far from London, where overwhelmingly overseas-posted staff would prefer to live as their first choice.

But the money for investment is beginning to talk, and time will tell whether this is a tactical or strategic shift.

Stuart Brinkworth is a partner and head of leveraged finance at Mayer Brown International in London

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