Polestar

2022 SECTOR OUTLOOK

2021/2022 MACRO OUTLOOK

It is impossible to look ahead at the global outlook for 2022 without considering inflation. For the last few decades, global markets have avoided price growth in part due to slack being taken up by offshoring to areas of low-cost production, finely tuned supply chains and a world working towards lower trade barriers. However starting with the Trump administration trade war, the UK leaving the EU and most impactfully COVID shockwaves, these supply chains are not working efficiently. Your new car being built in Germany cannot be finished because a chip is not available in Taiwan as one of the raw materials is en-route from Australia. This disruption was less of an issue when the world was in lockdown but there is now suddenly a surge in demand which cannot be met; add to this labour shortages and the increasing cost of employment in previously low-cost countries and we have the perfect inflation storm.

In the UK, inflation has been predicted to reach anywhere between 4.3% and 4.8%, expected to peak and retreat by more than two percentage points over the course of the year as monetary policy is tightened and the impacts of new waves of Covid potentially unfold. The older amongst us fear that these projections will prove to be optimistic. The effects of all that quantitative easing may have a nasty tail as the velocity of money returns to normal.

December of last year marked the first change in monetary policy with the Bank of England voting unanimously to increase the bank rate by 0.15 percentage points to 0.25% as they aim to achieve the benchmark of 2% inflation. Policy adjustment may also become more aggressive in February and May with rates rising to 1% by the end of 2022 (still historically low) as the central bank continues a path of cautious and gradual normalisation. Remember, we never really got back to pre-2008 rates.

Nevertheless, the questions for this year will be "is this the right approach and is it too late?" and "has inflation already run away from the BoE?" With the CPI (Consumer Price Index) rising to 4.2% in October, fuel and gas prices at all-time highs and tax changes on the horizon, consumers might expect to see a considerable downturn in their purchasing power over the coming twelve months.

Despite inflationary fears and declines in overall consumption, the UK is expecting to see some net growth in GDP. S&P Global predicts GDP to grow by 4.6% in Q1 of 2022 after 6.9% in 2021 as the overall economy continues to recover. This high but decelerating pace is expected to bring the UK back to pre-pandemic levels over the course of the year. However, it relies heavily on other economic factors and events such as the aforementioned continuing labour shortages and supply-chain issues, staggered rises in interest rates up to 1-1.25% by the end of 2023 and everyone's favourite black sheep - Brexit.

Sources: Morgan Stanley, KPMG UK Economic Outlook, S&P Global, ONS, Bank of England

PUBLIC MARKET OUTLOOK

UK equities remain strong heading into 2022, perceived as cheap due to the significant political and economic risks of Brexit, which continue to linger and depress listed valuations. This has translated into the ratings of all variety of UK-listed companies being depressed as well.

The result of this downgrading is companies continuing to be picked off for acquisition and takeover by overseas private equity houses, evidenced by the waves of M&A activity and record dealmaking fees among investment banks.

Internationally, a backdrop of low bond yields, shaky macro-economic conditions due to reduced policy support and stretched valuations in international markets offers further cause for concern creating a challenging environment despite solid fundamentals.

Modelling by Vanguard Capital Markets continues to reveal a global equity market drifting close to overvalued territory driven primarily by US equity prices. Vanguard’s analysis offers a reduced risk premium for the coming period, while still positive, between the range of 2-4% over bond returns. US-equity outperformance has also only strengthened conviction in non-US equities providing a driver to the flood of foreign money pouring into the UK Capital and Equity Markets.

Sources: Schroders, Vanguard

- Within our data collected includes the most recent listed valuation multiples obtained through Valutico. Individual multiples reflect available data published through the S&P CapIQ platform and may not include all historical data.
- Listed comparables can nonetheless provide some indication of value, particularly in relation to forward multiples for both revenue and EBITDA.

2022 M&A AND DEALMAKING OUTLOOK

M&A Outlook 2022

The established pattern of deals surging after an economic downturn is predicted to continue into 2022 as favourable conditions are encouraging companies to actively consider M&A activity, divestures, and other transactions. One recent survey by Ansarada revealed widespread conviction that the number of M&A deals in the UK will surge in the next 12 months, driven by an uptick in distressed deals as well as an expected flurry of activity in the software and technology sector.

This matches the critical focus on value creation: while consolidation and growing scale remain the key drivers of many, some non-tech companies are opting for digital transformation through the acquisition of technology-enabled businesses. These deals are attributed to the re-evaluations of business models due to COVID as consumer demand has shifted.

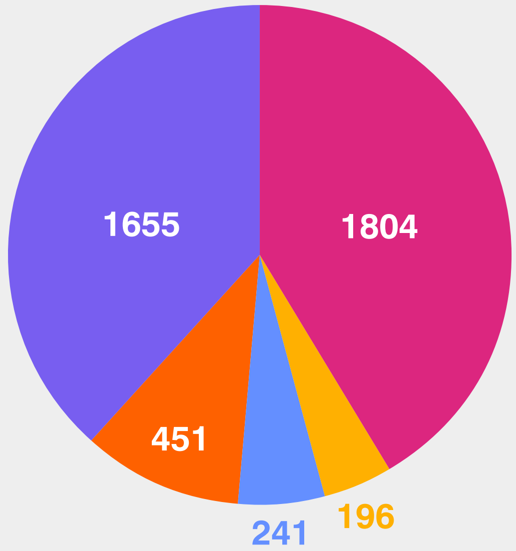
An abundance of investment capital funded through healthy balance sheets and strong market positions is also being seen across the market as record levels of private equity dry powder, corporate cash and unused credit continue to be utilised coming into the new year. The all-important question is now how will value be delivered and how will deals continue to integrate acts of corporate strategy rather than opportunistic land grabs made possible by the hot market?

2021 in Reflection

Alongside the huge surge in deals, 2021 saw landmark transactions such as the sale of Refinitiv to the London Stock Exchange Group, a joint venture between Liberty Global and Telefonica to create Virgin Media O2 and the sale of retail giant ASDA to TDR capital. These deals in isolation account for over £70 billion in enterprise value and, while they mark just headlines in what has been an incredibly busy year, they reinforce both the health and value of UK businesses. Polestar has been just as busy over the past twelve months, and we are looking forward to what the new year will bring. The sector analysis in the following pages is a brief overview of key trends and drivers we have noticed across the markets.

Number of Deals Per Sector

The following chart shows the number of various transactions in each of Polestar's sectors over the past 12 months.



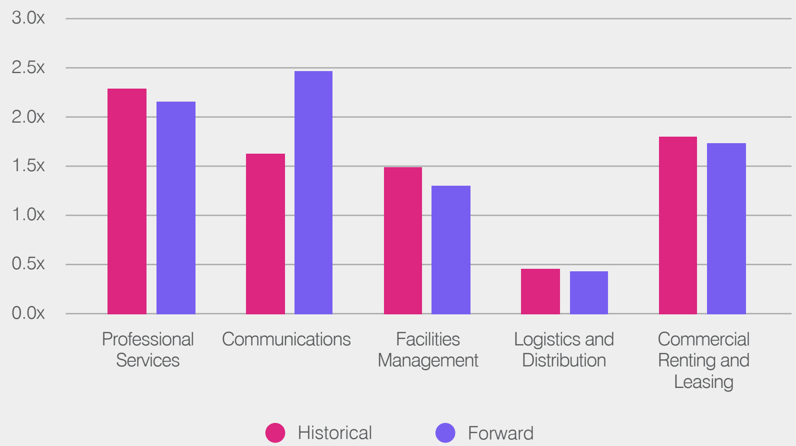
- Business Services
- Food & Leisure
- Education & Healthcare
- Manufacturing & Industrial
- Software & Technology

Sources: Zephyr, PWC, Ansarada, CityAM

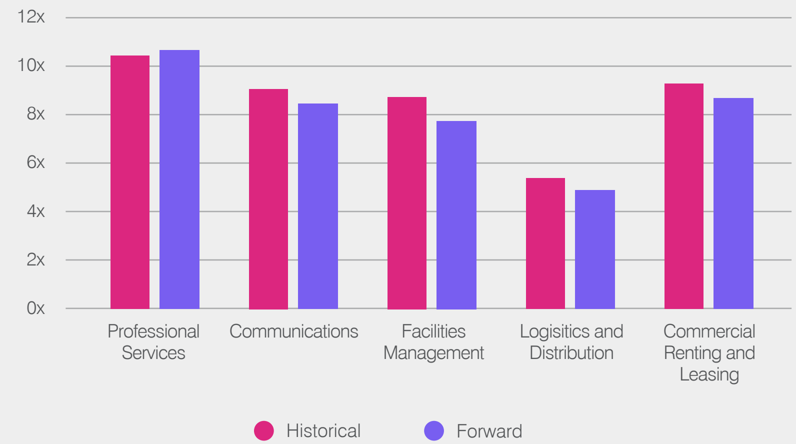
Business Services on the Listed Markets

- Revenue multiples across Business Services continue to show long-term growth trends in all sectors except Communications where current valuations are a higher multiple of projeted revenyes compared to released data. This is indicative of sharp declines in revenue across the sector of c.40% as participants struggle to bounce back from cuts in marketing and external communications budgets.
- Sector valuations and profitability have, however, remained healthy across most sectors. Professional Services has seen continued demand growth but faces headwinds from increasing personnel costs. Firms are continually having to deal with disruptions due to employee health, taxation and dwindling ability to hire non-resident workers all while dealing with ongoing business model evolution.
    - In the short term this can be expected to continue as staffing shortfalls continue to hamper performance. In the longer term, as technology is increasingly integrated into services, stimulated wage growth attracts more experienced staff from the UK and visa promotion to countries outside the EU all build the pool of qualified personnel. This trend can be expected to reverse, with the UK reasserting its position as a global service hub.
- Business Services' long-term growth is offering some broad lessons on the use of technology and the nature of outsourcing. With demand surging, historically mothballed industries such as Transport and Logistics have pivoted to meet the demand in the Consumer Goods, Grocery and Health and Pharmacy sectors.
- The relative agility of different firms has been driven by economic shock and a healthy dose of financial realism, leading to some considerable service rethinks among industry participants. The remodeling of business operations has been streamlined through the industry agnostic trend for digital transformation.

Historical vs Forward Revenue Multiples

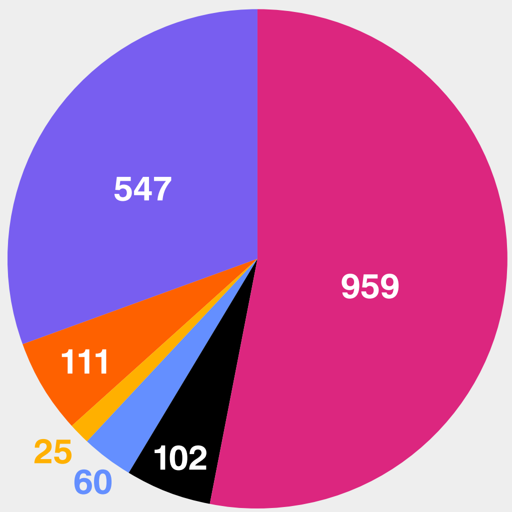


Historical vs Forward EBITDA Multiples



Sources: Valutico, Consultancy.UK, Strategy&

M&A Activity 2021



- Professional Services
- Communications
- Facilities Management
- Commercial Renting and Leasing
- Logistics and Distribution
- Business Process Outsourcing

Business Services M&A Activity

Transaction Outlook: Business Services

The Business Services sector has been extremely active in the UK over the past year showing the aggressive growth actions being taken by many companies both listed and private. This has translated into the following number of deals per subsector:

- 959 Professional Services
  (H1 – 503, H2 – 456)
- 547 Business Process Outsourcing
  (H1 – 275, H2 – 272)
- 111 Logistics and Distribution
  (H1 – 68, H2 – 43)
- 102 Communications
  (H1 – 51, H2 – 51)
- 60 Facilities Management
  (H1 – 34, H2 – 26)
- 25 Commercial Rental and Leasing
  (H1 – 16, H2 – 9)

The Future of Business Services

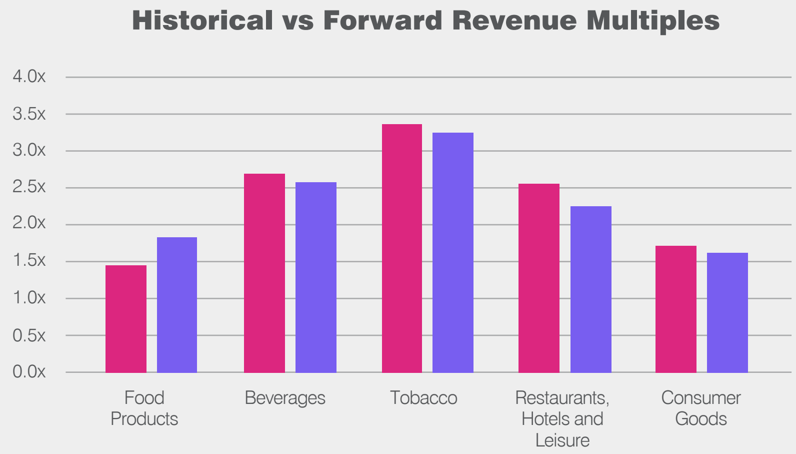
- Successful businesses will be positive in their response to the crisis. Examples of this include the reassessment of the role technology plays in business, the automation of manual processes and greater efficiencies brought about by the data age. This creates detachment from a single location: what may be seen as simple continuity of service may in reality result in cost efficiencies and service transformation, releasing businesses from geographical constraints.
- Outsourcing has accelerated through COVID and will continue to open opportunities as businesses seek ever-increasing third-party support. The challenge many may face is to demonstrate resilience and readiness to meet end-user requirements and expectations if the outsourced services fail; an issue at large in the logistics market.

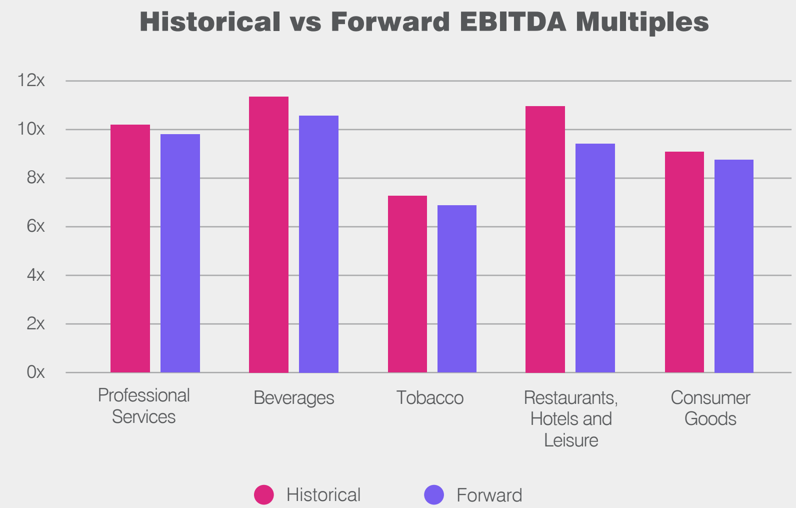
Professional Services personnel remain highly in demand with people having moved to other areas over COVID.

Source: Zephyr

Food & Leisure Sectors on the Listed Markets

- Across the Food and Leisure sector revenues continue to show steady growth with only Food Products deviating from the trend. Despite pandemic-induced work from home orders and lockdowns, revenues are returning to pre-Covid levels as the UK returns to bars, restaurants and hotels.
    - In the Hotel, Restaurant and Leisure sector, we will need to see if Omicron has had any significant impact on revenues and valuations with all the cancellations over the Christmas/New Year period.
    - High EBITDA margins across the Food and Leisure sector offer robust valuations that have risen significantly since the start of the pandemic, some as much as trebling since the beginning of 2020.
- A focus on core business is evident as market participants navigate the harsh terrain of post-Brexit Britain and the crippling issues that it has been causing among supply chains and the national labour supply. Rampant inflation will also be in the minds of both consumers and producers as price increases are passed on.
    - An executive at the Food and Drink Federation predicted inflation within the UK hospitality sector may be running as high as 14-18% placing the largest burden on low-income households.
- However, if the past year has been any indication then, despite various geopolitical and economic constraints, consumer demand for leisure is higher than ever. The question now becomes: can the current infrastructure stay afloat, or will we have to go back to rationing pasta and canned goods?

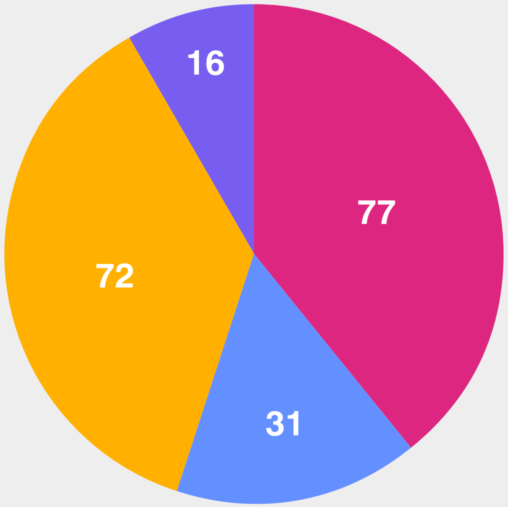




Sources: Valutico, PWC, The Guardian

Food and Leisure M&A Activity

M&A Activity 2021



Transaction Outlook: Food and Leisure

The various subsectors of Food and Leisure have posted a strong year for M&A with large expansions within the Hospitality sector which are passed down onto the Food, Beverage and Tobacco sectors. This has translated into the following number of deals per subsector:

- 77 Food, Beverage and Tobacco (H1 – 44, H2 – 33)
- 72 Hotels and Restaurants (H1 – 44, H2 – 28)
- 31 Consumer Goods (H1 – 23, H2 – 8)
- 16 Agricultural Business (H1 – 7, H2 – 9)

The Future of Food and Leisure

In 2022 we can expect three external forces to put pressure on the Food and Leisure industry:

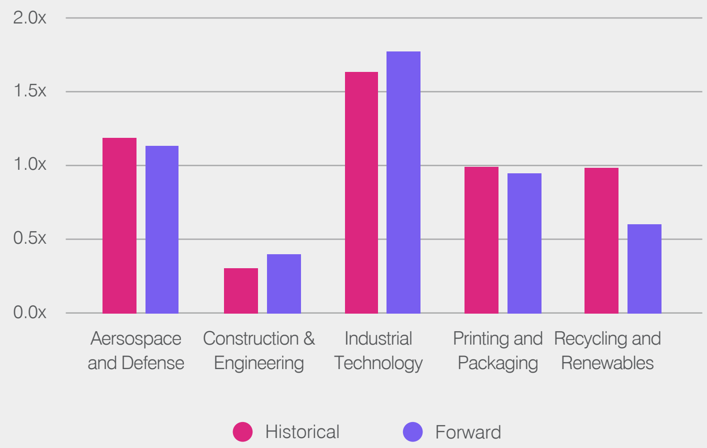
1. **Hospitality industry staff shortages** – the continuing recruitment issues and labour shortages as staff remain off ill or isolating with COVID will reduce the number of accepted bookings passed onto suppliers in the short term
2. **Retail price wars** – the recent takeovers of Morrisons and ASDA demonstrate the strong interest in the sector, and it is more than likely businesses will continue to try to reduce costs, which in turn affects suppliers.
3. **UK National Food Strategy** – introduction of salt and sugar taxes and the aim to cut national meat intake by a third continue to drive consolidation and the search for targets with unique offerings that are resistant to price pressure.

Sources: Zephyr, Grant Thornton

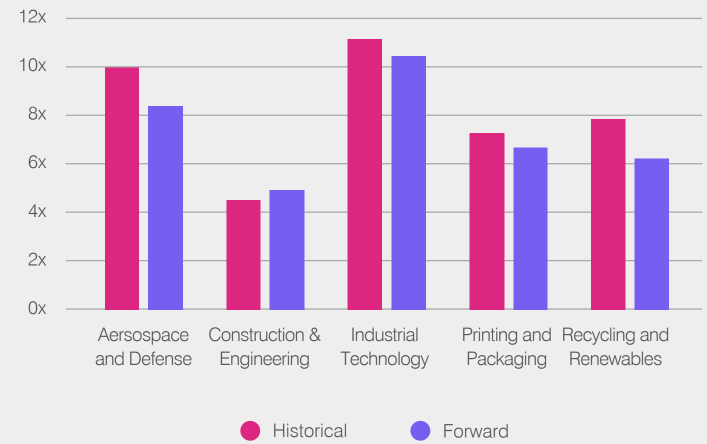
Manufacturing & Industrial Sectors on the Listed Markets

- The Manufacturing and Industrial subsectors have all been impacted over the past year with key issues such as inflation, labour shortages, raw material shortages and supply change issues causing the most concern.
  - Construction and Engineering is being plagued by these issues as while demand remains high, delays, increased costs and shortages of skilled labour constrains potential production.
  - Industrial Technology follows a similar trend as demand remains high but supply chain issues limit sector productivity.
- Recycling and Renewables are expected to see a sharp increase in revenues following on from large events such as COP26. This expectation is also reflected in EBITDA multiples as businesses continue to raise prices and improve margins as services aligning with net zero and the energy transition are in more demand.
- The success of the Recycling and Renewables sector, alongside increasing ESG investment, is repositioning sustainability at the top of the agenda. Stakeholders are now future proofing their organisations through emphasis on community engagement, worker health, and a sustainable or "net zero" transition. Regulators are moving the focus of this towards required disclosure for more nonfinancial metrics.
- Long-term growth across the sectors will also be linked to the continuing digital transformation such as smart factories offering the introduction of efficient and predictive processes. The scale-up of in-house production lines, robotics, automation platforms, and AI-enabled services will transform market participants, creating breathing room in the already high levels of demand.

Historical vs Forward Revenue Multiples

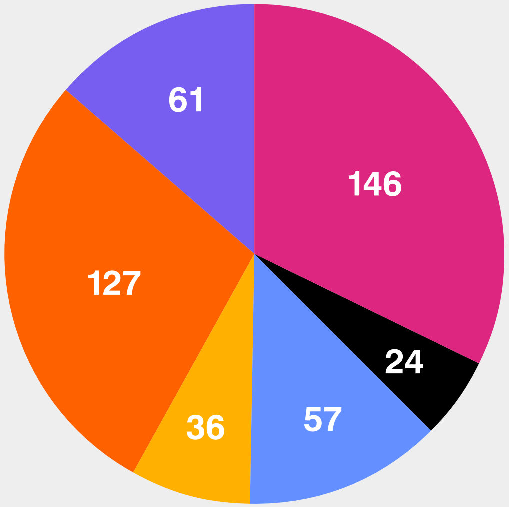


Historical vs Forward EBITDA Multiples



Sources: Valutico, Clean Energy Wire, Deloitte

M&A Activity 2021



- Construction
- Printing and Packaging
- Recycling and Renewables
- Aersospace and Defense
- Industrial Technology
- Specialist Manufacturing

Manufacturing & Industrial M&A Activity

Transaction Outlook: Manufacturing and Industrial

The Manufacturing and Industrial sector has seen high transaction volumes over the past year as many companies seek to capitalise on new demand and digital offerings from existing and emerging businesses. This has translated into the following number of deals per subsector:

- 146 Construction (H1 – 88, H2 – 58)
- 127 Industrial Technology (H1 – 68, H2 – 59)
- 61 Specialist Manufacturing (H1 – 24, H2 – 37)
- 57 Recycling and Renewables (H1 – 33, H2 – 24)
- 36 Aerospace and Defense (H1 – 15, H2 – 21)
- 24 Printing and Packaging (H1 – 14, H2 – 10)

The Future of Manufacturing and Industrial

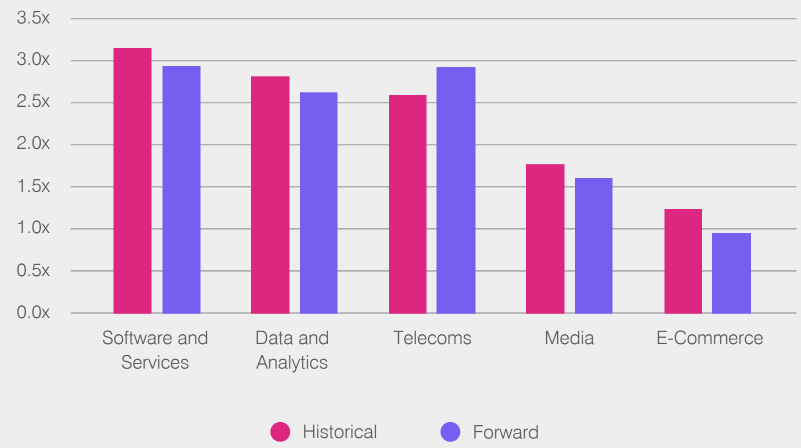
- Despite significant headwinds, manufacturers are accelerating growth and the sector's key trends are likely to continue into the new year. Adoption of future of work strategies, supply chain resilience, and digital maturity will help participants maintain pace and drive performance amid strong economic demand.
- How the industry maintains margins and captures growth in the near term is yet to be seen. Elevated risk will need to be navigated while sustainability priorities are developed to ensure resiliency to future economic downturn.

Source: Zephyr

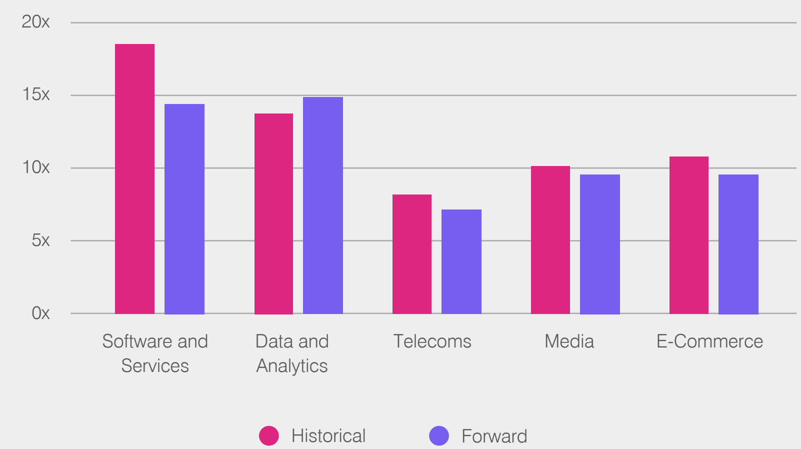
Software & Technology Sectors on the Listed Markets

- The Software & Technology sector is thriving in the UK, especially within Software and Services and E-commerce which are showing strong revenue growth as consumer behaviours have changed. COVID has accelerated existing trends towards automation, in particular boosting areas such as communications for remote working and automation in tradtionally slower-to-change sub-sectors such as Healthcare & Education. As part of the continuing digital transformation, businesses are adopting technological solutions in order to face challenges such as supply chain logistics and operational hurdles caused by reduced face-to-face interaction.
- Innovation across the sectors is also driving profitability in other areas such as Data and Analytics as a host of new technologies simplify the mechanics of data sharing across and between organisations. Consumers are unlocking value-leveraging insights from externally sourced data that was historically off limits.
- Cloud-based data offered through hyper scalers and SaaS vendors are working with global system integrators and clients offering modular services that can be tailored for unique differentiation.
- Modular SaaS services offer high EBITDA margins and, as software businesses continue to scale up, services can be rolled out to new customers with minimal setup cost. The reimagination of IT organisations and identification of manual, repetitive processes allows for automation, accelerated value delivery and more accessible/stable IT across the board.
- Revenues across the telecomes space are impacted by long-term downward trends in pricing but profitability is improving through a combination of consolidation and associated cost reduction and increased atuomation linked to higher margin innovation.

Historical vs Forward Revenue Multiples



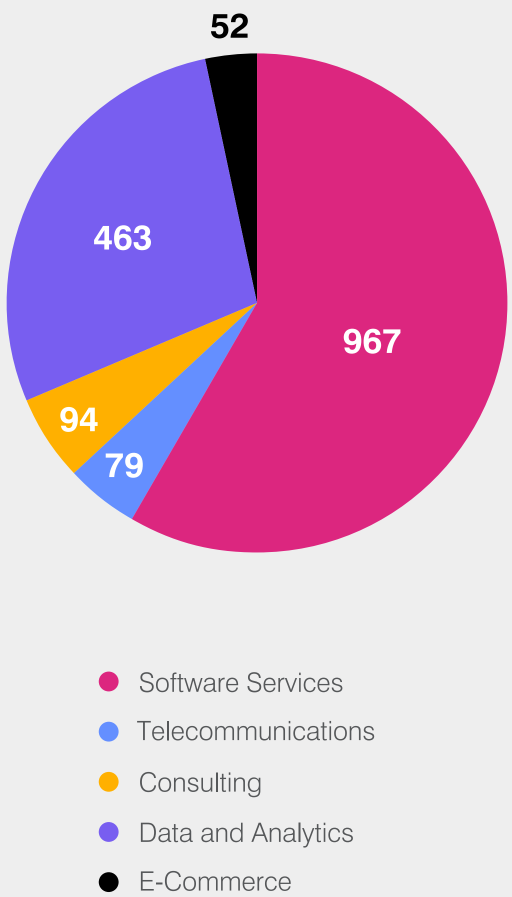
Historical vs Forward EBITDA Multiples



Sources: Valutico, Deloitte

Software & Technology M&A Activity

M&A Activity 2021



Transaction Outlook: Software & Technology

The Software & Technology sector has been one of the busiest sectors over the last year as companies increasingly opt for integration of digital solutions. This has translated into the following number of deals per subsector:

- 967 Software Services (H1 – 486, H2 – 481)
- 463 Data and Analytics (H1 – 326, H2 – 137)
- 94 Consulting (H1 – 53, H2 – 41)
- 79 Telecoms (H1 – 37, H2 – 42)
- 52 E-commerce (H1 – 25, H2 – 27)

The Future of Software & Technology

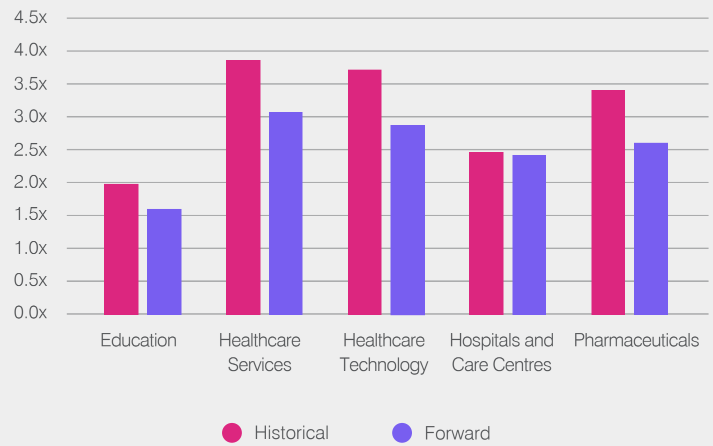
- Over the next six to twelve months, alongside the areas already considered, a large proportion of capital can be expected to be funneled into disruptive technology across a wide ranges of industries. Companies are seeking to lower costs, grow revenues and scale and regain competitive advantage across stagnant industries. Across the Atlantic, businesses like Amazon and Tesla continue to disrupt the status quo and the same is being seen among UK market participants.
- Outside of disruptive technology, artificial intelligence's acceleration suggests increased adoption among sectors such as cybersecurity, workflow management, sales and customer support. The emergence of other industries such as Healthtech, Fintech, and CleanTech also demonstrate the level of success that new market participants can achieve with digitally transformative solutions.

Source: Zephyr

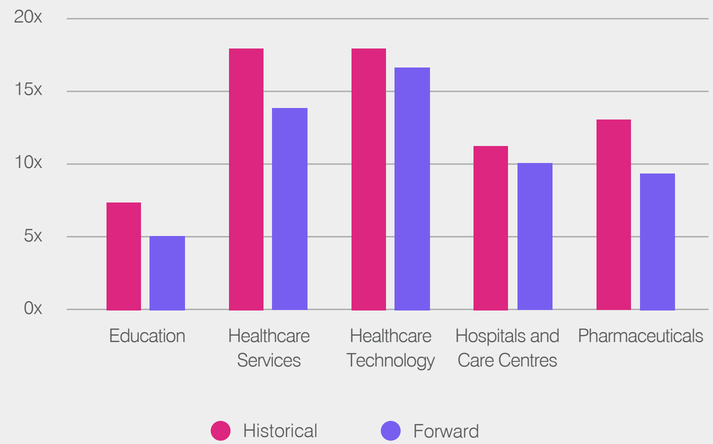
Healthcare & Education Sectors on the Listed Markets

- The Education sector is showing strong growth as we move into the new year with significant drops in both projected revenue and EBITDA multiples signaling strong demand growth for Edu-tech is already priced in. Strong balance sheets and cash reserves generated through COVID will continue to fuel future M&A activity within the sector, in turn creating value for market participants.
- Overall, the Healthcare sector is positive; expectations of continued growth have been fuelled by delayed treatments providing a further period of opportunity for players over and above the COVID spend.
- Long-standing demographics and trends continue to drive up healthcare expenditure globally, supporting the wider sector outlook. The development of new treatments addressing different conditions is expected to accelerate, supported by:
    - Strong cash reserves generated over the past 18 months are available for investment.
    - A stronger pharmaceutical investment rationale has been proven as the success and speed of development of the COVID vaccines has established a shorter development timeline.
- Healthcare Technology's strong performance shows continually increasing revenues and EBITDA as medical device innovation continues alongside remote consultation solutions and other software advances.
- Hospital and Care Centres are expected to show flat revenues looking forward as the new variant scares may discourage attendance. This may be expected to change as the warmer months set in and COVID begins to subside.

Historical vs Forward Revenue Multiples



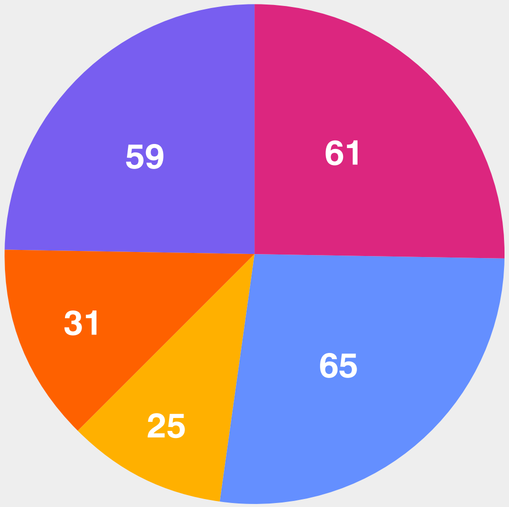
Historical vs Forward EBITDA Multiples



Source: Valutico

Healthcare & Education M&A Activity

M&A Activity 2021



Transaction Outlook: Healthcare & Education

The Healthcare and Education sectors have seen busy activity in the UK over the past year as private businesses began to utilise their strong cash reserves and sellers have taken advantage of a favourable tax landscape. This has translated into the following number of deals per subsector:

- 61 Education (H1 – 39, H2 – 22)
- 65 Healthcare services (H1 – 39, H2 – 26)
- 25 Hospitals and Care Centres (H1 – 13, H2 – 12)
- 31 Healthcare Technology (H1 – 21, H2 – 10)
- 59 Pharmaceuticals (H1 – 30, H2 – 29)

The Future of Healthcare & Education

- Valuations within the Healthcare & Education sectors have remained high as investors seek to capitalise on the transitioning markets. The ongoing adoption of digital technologies is affecting everything from distance learning and early years education to patient-care delivery and the development of advanced precision therapeutics.
- The vulnerabilities accentuated by the pandemic require new digital-age solutions and a combination of transactions and innovation will be required in both sectors meet demand reach a new long-term equilibrium.

Source: Zephyr