

COVID-19: THE UK LOGISTICS SECTOR: FUTURE M&A TRENDS IN A POST-PANDEMIC ENVIRONMENT

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INTRODUCTION

Nothing focuses the mind more than when you cannot obtain food which, as Maslow's hierarchy of needs tells us, is the first building block of humanity's motivation (although it's currently unclear where toilet roll fits into this). There has long been a need for efficient and effective logistics networks and supply chains but, in recent months, the COVID-19 pandemic has brought their importance into sharp focus and to the forefront of the minds of businesses, consumers and the government alike in the UK, and worldwide.

This article considers the factors that are driving change in the UK logistics and distribution sector (the Logistics Sector), particularly in response to the COVID-19 pandemic, and trends that we expect to see in the industry's M&A activity in the coming months.

DRIVERS OF CHANGE IN THE LOGISTICS SECTOR

While the COVID-19 pandemic has negatively impacted many sectors and has forced many businesses to cease operations for a number of months, the Logistics Sector has generally remained resilient throughout the outbreak, demonstrating an adept capability to adapt to fast-changing consumer needs and demands, whether that be the delivery of PPE equipment to NHS workers or basic household essentials to self-isolating consumers.

The following are areas where we have seen the greatest drivers of change in the Logistics Sector in recent months, both as a result of the pandemic and more generally:

- **Increase in e-commerce & technology:** online shopping is becoming increasingly prevalent, particularly in response to the pandemic when non-essential shops were required to close and consumers were restricted from leaving their homes. Even prior to the pandemic, the UK high streets were struggling, with more people turning to online shopping rather than visiting physical stores. The pandemic has brought a wider range of businesses within the scope of e-commerce, including grocery delivery businesses, with some major supermarkets leasing, or re-leasing, additional warehouse space to cope with the new levels of online demand. This demand is expected to continue, even post-pandemic, as witnessed by the online grocery delivery service, Ocado, having more than a million customers on its waiting list. With increased demand comes the need for greater innovation and integration - technology plays, and will continue to play, a key role in the development of the Logistics Sector in the coming months and years to ensure that businesses can continue to develop and meet consumer demands in innovative, yet cost-efficient ways.

- **"Just in case" logistics:** in response to the COVID-19 outbreak and the need for greater contingency, businesses are starting to move away from the more traditional "just in time" supply chain model (where companies store as little stock as possible, replenishing it only exactly when needed to meet consumer demand so as to avoid stock perishing or becoming obsolete), to "just in case" supply chains. Companies adopting the "just in case" model are maintaining larger inventories of stock to reduce the risk of supply and demand issues. While this model provides greater contingency, it also requires greater warehouse space. Businesses who are choosing to shift strategies will likely need larger warehouses that can cater for their specific needs. This will result in more development and change of use applications to not only ensure that sufficient warehouse space is available, but also that such space meets a business's specific requirements.
- **Sustainability:** as a major contributor to the global carbon footprint, businesses operating in the Logistics Sector are facing increasing pressure from consumers and government authorities to engage with Environmental, Social and Governance issues and objectives, and this pressure is likely to grow as fulfilment and logistics companies become more prominent in peoples' lives. Whether that be the use of clean energy sources (such as solar power) to power their operations, sustainable materials in their packaging and in the construction of their distribution centres, reducing food or air miles and/or turning to electric / hybrid vehicles as part of their transportation network, companies operating in the Logistics Sector will need to balance sustainability with economic-feasibility; managing their fuel and packaging costs whilst minimising their environmental impact.
- **International trade & tariffs:** in response to COVID-19, as well as the UK's exit from the European Union ("Brexit") and the trade war between China and the US earlier this year, countries may look to impose stricter requirements and regulations on imports, including greater levels of bureaucracy and increased tariffs. Such restrictions would likely result in increased costs for logistics companies, most of whom already operate on tight margins, and may make international trade less attractive or unfeasible for some businesses, thereby shifting the focus to domestic trade.

FUTURE M&A TRENDS IN THE LOGISTICS SECTOR IN A POST-PANDEMIC ENVIRONMENT

While M&A activity in the UK has generally quietened down as a result of the COVID-19 pandemic, the profile of the Logistics Sector has been raised and, while there will be casualties due to wider economic difficulties, the industry is expected to come out of the current crisis healthier and stronger than businesses operating in some other sectors. Stronger balance sheets will enable logistics companies to deploy capital on expanding and consolidating their businesses so that they can continue to grow and meet ever-increasing consumer demand. The following list sets out the main M&A trends that we expect to see in the Logistics Sector as the UK emerges out of the COVID-19 pandemic:

- **Consolidation:** the Logistics Sector is often recognised as being a highly fragmented industry, and consolidation has been important in recent years as companies seek to improve the efficiency of their supply chains. Consolidation is likely to become more prevalent going forwards as logistics businesses look to localise their supply chains at a national level to increase their resilience and contingency capabilities in response to the pandemic. This will become even more crucial if and when countries

impose greater restrictions on imports. This in turn will lead to M&A activity becoming more domestic in nature.

- *Financial Investments & opportunistic acquisitions:* financial investors, such as private equity houses and venture capital funds, are continuing to invest in the Logistics Sector and the level of investments is expected to increase, particularly given the sector's raised profile in recent months and the record levels of 'dry-powder' held by investors. Following the economic uncertainties caused by the pandemic, as well as Brexit, investors are looking to invest in businesses that have income-producing assets that provide regular returns, with asset-backed logistics and fulfilment companies now potentially being seen as 'safer bets' due to the industry's generally strong performance during the current crisis. In the shorter term, as some countries (particularly in Asia) emerge out of the COVID-19 pandemic sooner than others, there is likely to be an increase in interest from cash-rich overseas buyers who are looking for a 'bargain' through the acquisition of distressed or undervalued, but otherwise sound, assets. In light of this increased competition for investment into the Logistics Sector, it is expected that the greater levels of demand will lead to increased multiples / valuations for sound businesses in the sector.
- *New players:* the increasing importance of technology and efficient integration within the Logistics Sector (whether that be data analytics systems and artificial intelligence to assist with 'last mile distributions', or payment security via block-chain technology), means that technology companies are becoming valuable commodities in the sector (as shown by the acquisition of Digital Applications International Limited by Kion Group AG in March 2020). There is an increased opportunity for new players with innovative technology solutions to enter the market. This is likely to lead to an increase in acquisitions in this field, whether that be established technology businesses acquiring complementary logistics companies, or existing logistics and fulfilment companies acquiring smaller, technology companies via bolt-on acquisitions in order to expand their pre-existing technological capabilities.
- *Real Estate Assets:* with high street retail suffering, and offices potentially becoming obsolete as many businesses embrace the 'working from home' culture, institutional investors looking to invest in property portfolios that have secure, cash-generating tenants will likely move their focus to real estate assets within the Logistics Sector, in particular industrial parks and distribution centres (as demonstrated by SEGRO's recent acquisition of a portfolio warehouse estate from Federated Hermes). While primarily involving property assets, this may also provide new opportunities in the M&A sphere, particularly in relation to the sale and purchase of mixed real estate assets packaged as portfolios.

CONCLUSION

Many investors have been operating a 'wait and see' approach during the COVID-19 pandemic but, as the UK emerges out of lockdown, M&A activity is starting to pick up. While there is still uncertainty around when things will return to the "new normal", one thing is for certain - the COVID-19 pandemic has raised the profile of the Logistics Sector and, although there will undoubtedly be casualties along the way, the industry will emerge out of the pandemic stronger than ever and that will have a noticeable impact on M&A activity in the sector.

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