Corbett Keeling | Corporate Finance

Third quarter 2010 – is the M&A recession over?

In its regular quarterly commentary on UK private equity investment activity, Corbett Keeling gives a practitioner's view of trends in the number, value and financing of deals and asks: "Is the M&A recession over?" The response from the market is positive, accompanied by a visible easing of credit.

unquote” preliminary statistics for private equity investment in the third quarter of 2010 paint a picture of increasing activity. But the question going around the market is: will this last? Or is it just a temporary phenomenon, caused by the coincidence of a handful of larger deals? Let's look at the facts, as usual examining first larger UK buyouts of more than €150m enterprise value, then UK buyouts of less than €150m and finally early-stage and expansion capital deals.

- The aggregate value of larger UK buyouts (€150m or above) in the quarter just finished was, at €8bn, the fourth highest of the 12 years on record. The total number of deals for the year to date, at 24, is already more than double that for the whole of 2009. So the case for optimism, at least as far as the larger deal-makers are concerned, appears to be strong. If a fair wind produces deal volumes and values in the final quarter at the same rate as the year so far, the outcome for the whole of 2010 will be close to the annual 12-year average and well above the level of recent, leaner years.

- After the credit crunch – if that is where we are – you might have expected smaller deals to recover more quickly on the basis that, by nature of their size, they require less of the crunched debt in their funding structures. But that does not seem to be the case. The recovery for smaller UK buyouts (below €150m) is not as convincing as for their larger cousins. Deal volumes, at 15 for the third quarter, are markedly down on the previous two quarters, which came in at an average of 27 completed deals each. Aggregate values for 2010 already exceed those in the record-breakingly weak 2009. At the current run rate, though, they would in the full year only just reach what is otherwise the nadir of 2001-2003 in our charts.

- Yet there is comfort for smaller deal-makers from the statistics for UK early-stage and expansion capital deals: they have just had their strongest quarter yet this year, at €1.3bn of funds provided. At the same time, even if this strong quarter is followed by a weaker one, the full year 2010 should reach the average of the last 12 years in terms of both numbers of deals and aggregate value.

So the picture for deal-makers so far this year is one of moderate performance in smaller buyouts sandwiched between stronger activity in larger deals and venture/development capital.

Across the board, this is accompanied by a noticeable increase in the willingness of banks to lend against buyouts. The proportion of all-equity funded buyouts to all buyouts has fallen dramatically, from almost 40% in the second quarter to just 10% in the quarter just past. That is the lowest level since mid-2007 – a very positive indicator that the supply of money for buyouts is freeing up.

But what are the deal-makers – whether focused on larger or smaller deals and whether those deals are oiled by an easing of credit or otherwise – telling us about their views of the coming quarters? The *unquote”* survey of their future expectations gives us some helpful pointers:

- Regardless of the historic trend, optimism about smaller deals has continued from the preceding quarter, with a large majority of respondents to the survey still predicting that activity will rise – and none thinking it will fall.

- The prediction for larger deal activity is likewise consistent with the last quarter, the proportion of pessimists being far smaller than those who think deal activity will either increase or be maintained (at what is already a reasonable level compared with historic activity).

- The response to the question "Have entry prices fallen sufficiently to reflect the current outlook for UK businesses?" seems to hint that we are getting past the bottom of the downturn in valuations: the tide is turning in favour of those who think prices have fallen far enough.

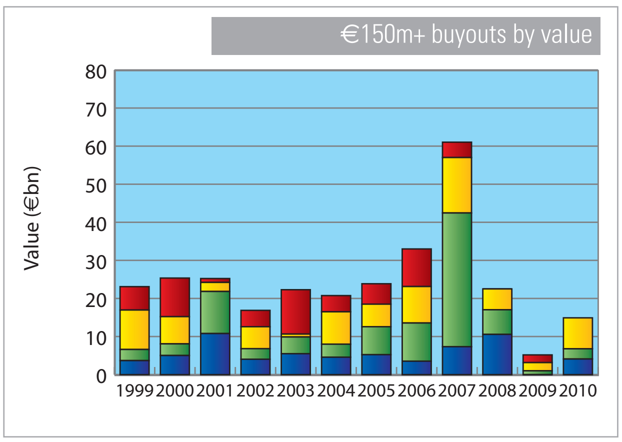
- Interestingly, the news about credit easing does not seem to have reached all parts of the market as, despite the rising proportion of debt funded buyouts, many survey respondents thought UK deal activity is still being hampered by the limited availability of leverage. Perhaps, though, this is simply a signal that there is more leverage on its way.

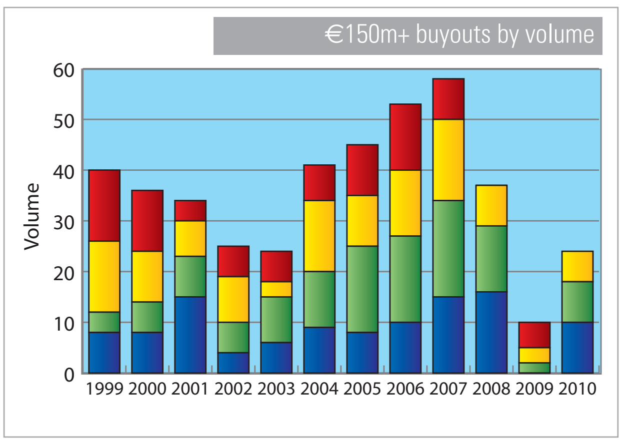
One swallow does not make a summer. Nor do a couple of good quarters and a dose of optimism among survey respondents guarantee an upturn in M&A activity. But deal-makers can certainly take comfort from the historic transaction statistics and easing of credit. So it is maybe reasonable that expectations across the market are for conditions to improve. If they are right, the coming months should prove fruitful for getting deals done – whether you are looking to buy or sell.

Jim Keeling, joint chairman
Corbett Keeling
www.corbettkeeling.com

VALUE & VOLUME

Q1 Q3
Q2 Q4





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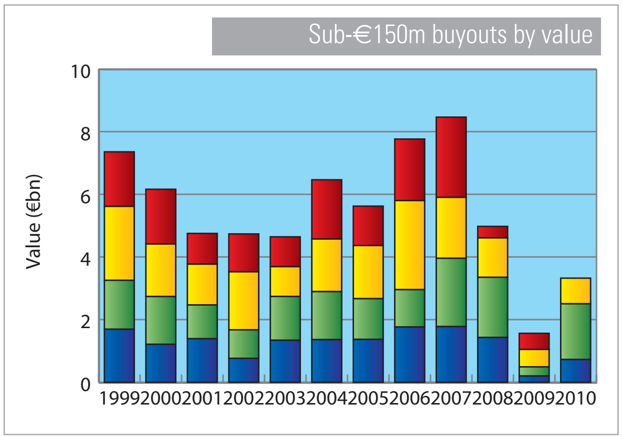
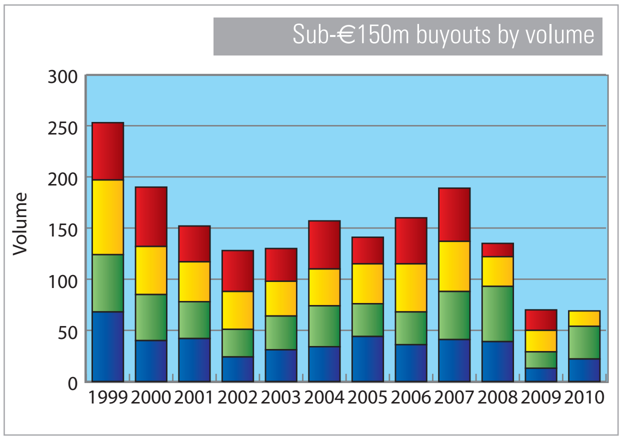
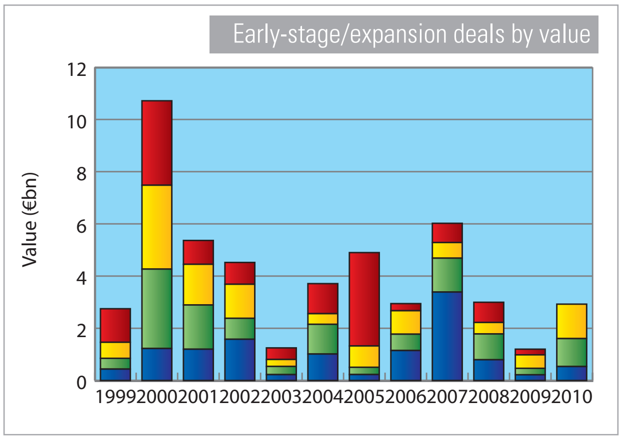
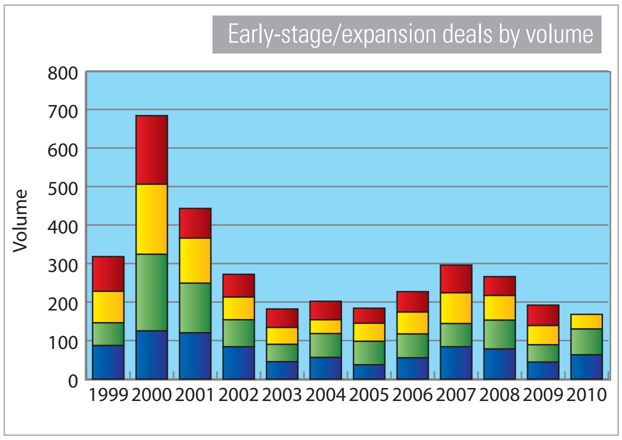
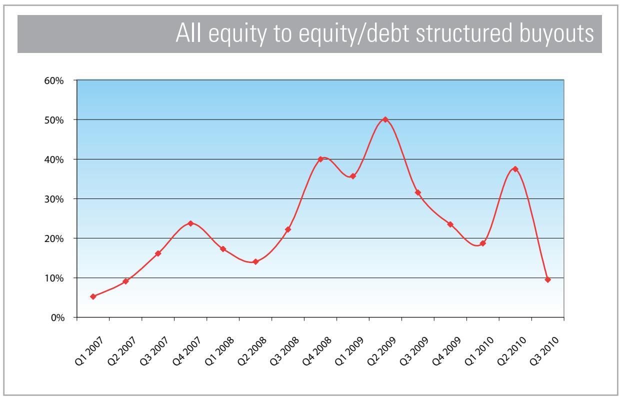








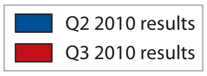


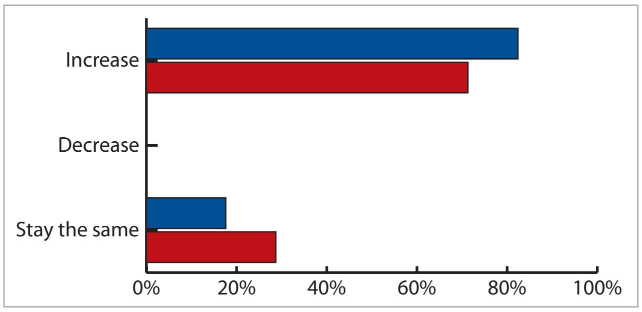
Figures are based on all deals that were confirmed, at the time of going to press, as having an institutional private equity or mezzanine investor as a lead or syndicate partner investing in a UK-based business. Sourced from Private Equity Insight.

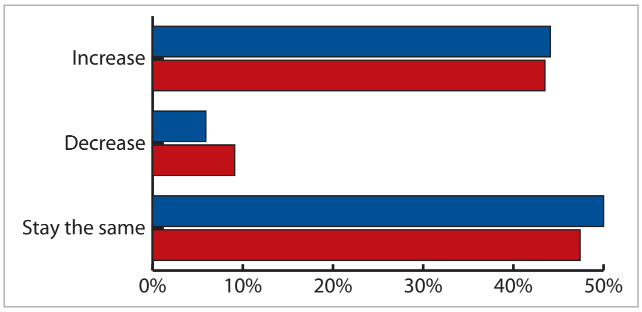
In order to produce these statistics, more than 500 key players in the UK private equity and venture capital markets were surveyed.

1 Over the next six months do you expect activity levels in the lower mid-market buyout segment (less than €150m) to increase, decrease or stay the same?

2 Over the next six months do you expect activity levels in the upper mid-market and larger buyout segment (more than €150m) to increase, decrease or stay the same?

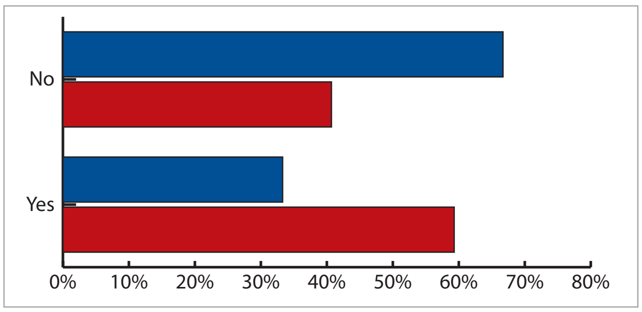


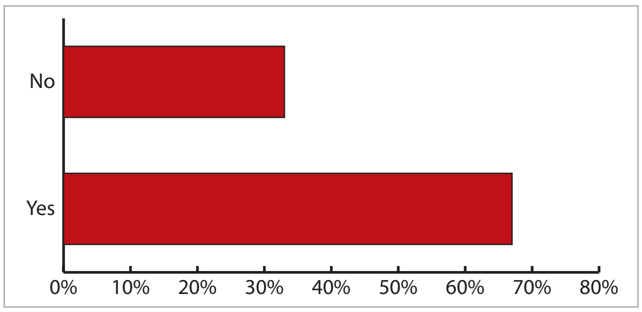




3 Have entry prices fallen sufficiently to reflect the current outlook for UK businesses?

4 Is UK deal activity still hampered by limited availability of leverage?





5 Which sector offers the most attractive investment opportunities over the next six months?

6 What proportion of UK exits in the next six months do you expect to be achieved through secondary buyouts?