Corbett Keeling | Corporate Finance

Q4 2008: private equity hits wall but opportunities on the up

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 concludes that times are tough but opportunities will be on the increase.

At the end of our last commentary, for Q3 2008, we said we would be fascinated to see what the current quarter brought – well it has certainly been interesting, but not, on the face of it, with the sort of results we and others in the private equity sector would have chosen. Investment activity has not just, as we anticipated, slowed down, it has hit the wall. The preliminary fourth quarter statistics show it all:

- Most dramatic is the picture for larger buy-outs (>€150m), where the quarter's result is a straight zero, the first time we have reported a nil score since we started commenting on the sector five years ago. Following a miserly seven deals completed in the third quarter, the total for the year is just 34, exceeding only 2002 and 2003 out of the last ten years. Aggregate values for the year, at €18bn, are the second lowest in the ten year record.

- A similar, though not quite so stark, result is seen for smaller buy-outs (<€150m). Q3 was already weak with the final count showing just 29 deals at an aggregate value of €1.3bn for the three months, but that was nothing compared to the decline in the generally stronger fourth quarter: the normal pre-Christmas rush to complete deals has been almost completely absent with the preliminary quarter four result showing just ten deals at an aggregate value of €300m. As for larger deals, total numbers and values for the year are around the 2002/03 nadir.

- Even in the early-stage and expansion capital category where one might have hoped to see more activity with rescue, turnaround and re-capitalisation deals, the pattern is the same as for smaller buy-outs: a disappointing Q3 has been followed by an even weaker final quarter. To put this in perspective, the average number of deals per quarter in 2007 in this category was 72 compared to 36 in the fourth quarter of 2008. Average aggregate values per quarter in 2007 were €1.3bn compared to €600m for the latest quarter. So volumes and values of early-stage and expansion capital deals are both around half the 2007 average.

This last statistic highlights what has been going on. Funders have been hesitating even to step in with capital to defend companies they already own, let alone to support new ventures. There is so much uncertainty that, by and large, they have preferred to wait and see how things will develop even where this risks existing investments deteriorating further.

As a result, investment activity has ground to a halt in the fourth quarter. The key question is how long will this last? The slowdown became apparent in the third quarter and was in full effect during the fourth, but how quickly will 2009 shrug it off?

The survey of future expectations is mainly gloomy. Lower mid-market activity is expected to stick at current weak levels. Respondents, who were surveyed in mid December, obviously did not realise how bad things were for larger buy-outs predicting things would get worse – from what turned out to be a zero base! Prices at which deals are done are predicted to fall even further and the UK economy to shrink.

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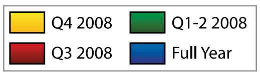
But can it all be bad? Can the hesitancy about investing continue indefinitely? Our view is that the situation we face is like a dam across a river. The stream continues to flow, the water builds up and eventually the dam breaks. In the same way, the underlying need to do deals, as owner-managers age or investors want to move on, builds up. At the same time, equity money is in good supply as private equity funds are generally backed by ten year commitments so acquirors' funding has not dried up. Therefore the deal dam will, we believe, prove to be temporary and eventually the flood-gates will open.

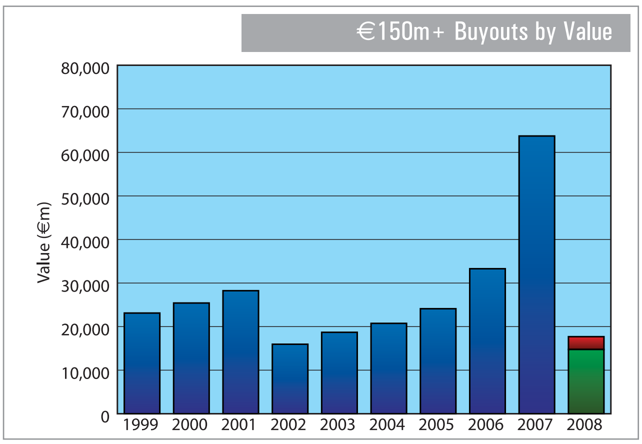
This will initially be through more equity-only deals which, as our new chart this quarter shows, have been dramatically increasing. But we should also in due course see a return to more widespread debt funding as well.

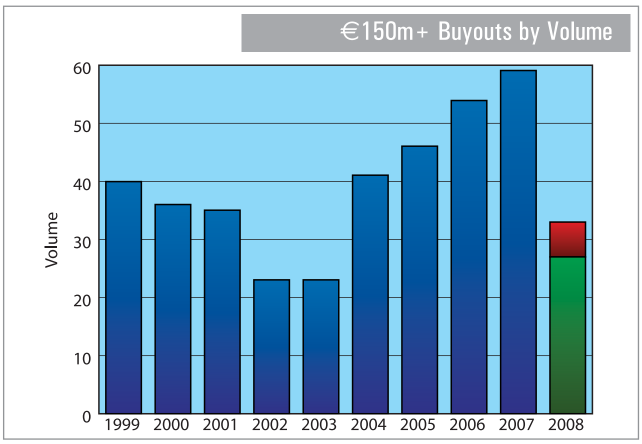
With deal prices falling, 2009 and 2010 should be great vintages for investment. Just as with wine in vintage years, it will suddenly become easy again to be a successful producer, or in this case investor. So, rather than despair at the inactivity of the last quarter, we look forward to a time of opportunity for those who can hold their nerve. Roll on 2009!

Jim Keeling,
Joint Chairman, Corbett Keeling
www.corbettkeeling.com

VALUE & VOLUME







Corbett Keeling is a corporate finance advisory firm focused on the private equity sector. We specialise in:

- RAISING FUNDS FOR MANAGEMENT BUY-OUT TEAMS
- DEBT ADVISORY
- SELLING BUSINESSES

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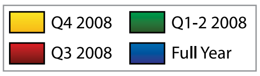

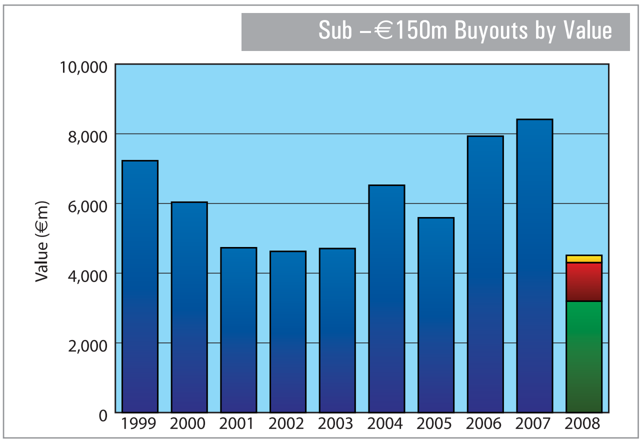

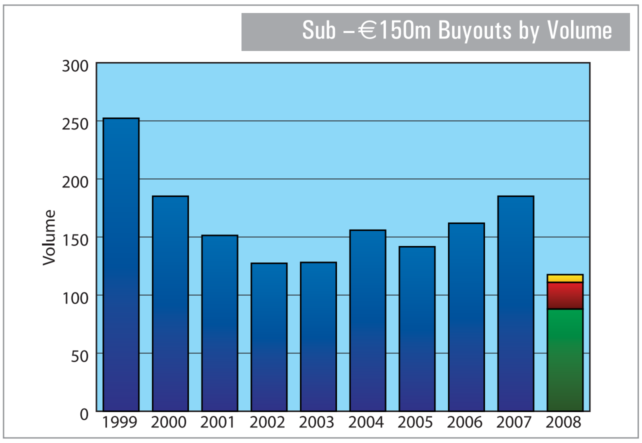

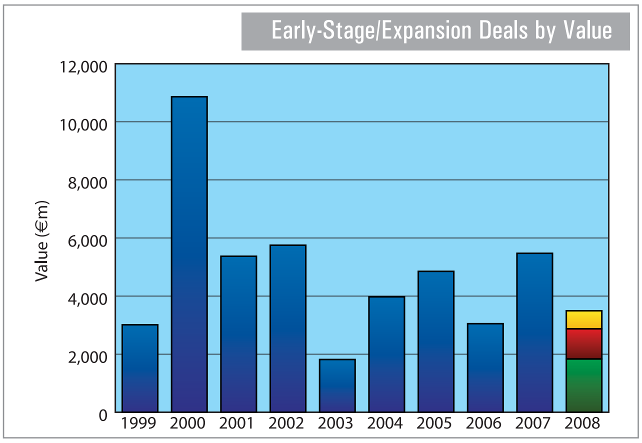

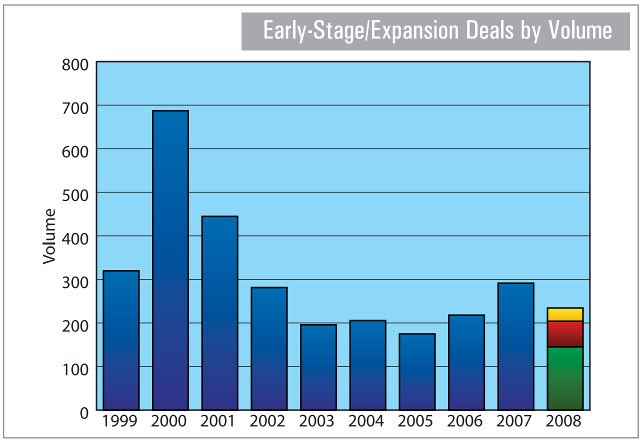

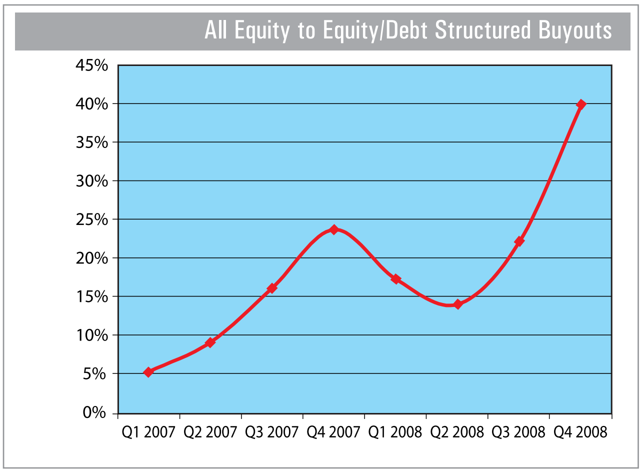

Figures are based on all deals that were confirmed, at the time of going to press, as having an institutional private equity or mezzanine investor as a lead or syndicate partner investing in a UK-based business. Sourced from Private Equity Insight.

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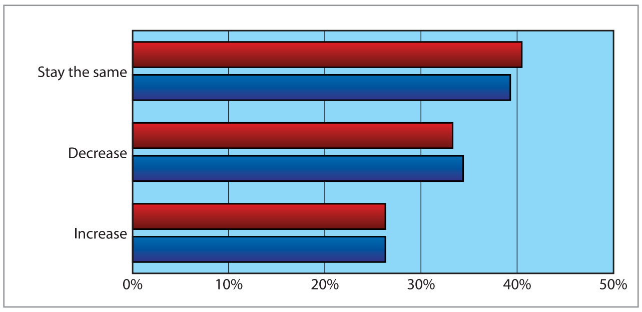
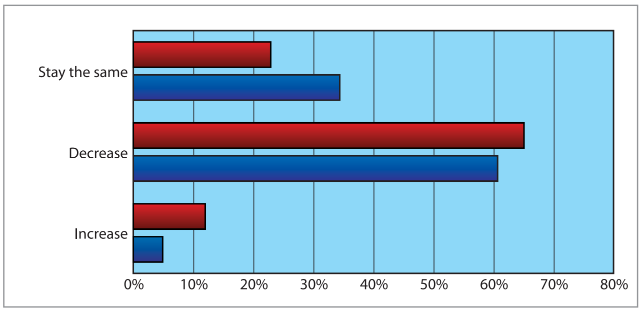
In order to produce these statistics, more than 500 key players in the UK private equity and venture capital markets were surveyed.

October 2008 predictions
December 2008 predictions

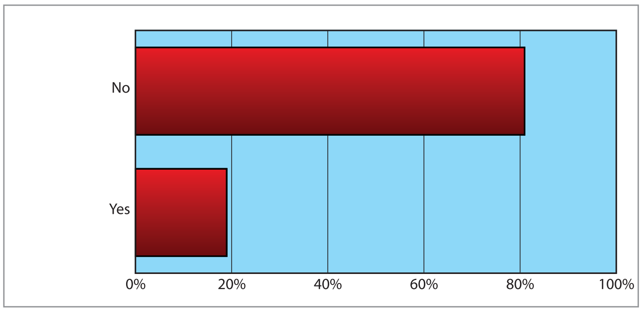
1 Over the next six months do you expect activity levels in the lower mid-market buyout segment (less than €150m) to increase, decrease or stay the same?



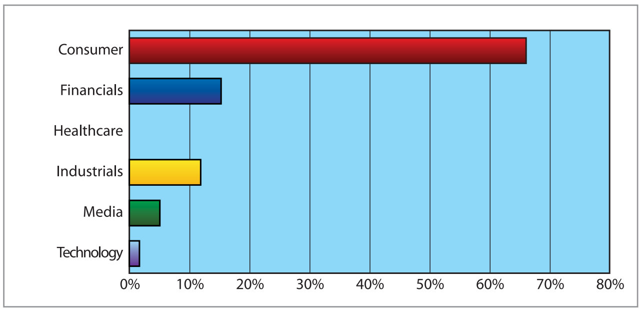
2 Over the next six months do you expect activity levels in the upper mid-market and larger buyout segment (>€150m) to increase, decrease or stay the same?



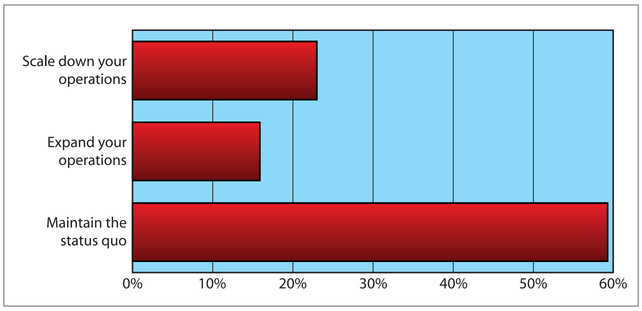
3 Have entry prices fallen sufficiently to reflect the current outlook for UK businesses?



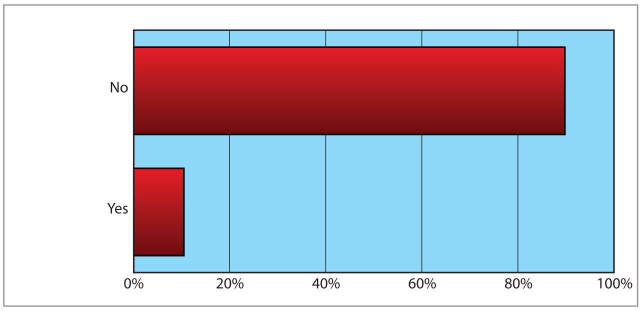
4 Which one of these sectors do you expect to suffer most from a recession?



5 Given the challenging macro economic environment, are you most likely to:



6 Will the UK economy see positive growth in 2009?



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