

# Private Equity Barometer

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February 2010

Welcome to the latest edition of Grant Thornton's Private Equity Barometer – the quarterly survey of over 100 leading Private Equity (PE) fund directors and managers, which canvasses the views of the UK PE community, examining the issues, trends and the hot investment sectors.

## The quarterly snapshot

Unsurprisingly, our latest survey revealed PE houses were still facing some significant challenges by the close of 2009 – more than a quarter did not complete a single transaction throughout the year, securing finance remained a key issue, and nearly two-thirds still expected to breach loan covenants. In 2010, we expect the outlook for PE in the UK to improve in relative terms, but we will not see a significant recovery of PE before 2012, as the picture continues to be marred by the uncertain economic outlook.

- **26%** of PE houses did not close a single deal in 2009
- **45%** expected to encounter refinancing difficulties
- **66%** conceded some of their portfolio companies will breach loan covenants
- **58%** are set to change their sector focus over the next 12 months
- **71%** predict an increase in the volume of new investments in 2010



### PE volume expected to increase following drop

In our quarterly PE Barometer, 26% of respondents did not make any investments in 2009, with vendor pricing and a dearth of opportunities being named most frequently as the main reasons for poor deal flow.

The survey results are supported by data on announced deals which suggests that 2009 has been the worst year for PE since 1997 when it comes to deal values and volumes.

However, 71% of respondents to the PE Barometer expected to see an increase in the volume of new investments over the coming 12 months, including 36% which expected an increase by 50% or more.

Indeed, PE sponsors are trying to shake off their hangover. They have money to invest and will need to invest it before they can raise new funds. As the market stabilizes, we expect to see more companies coming to market in the coming months. Key stakeholders, like banks, want them sold, while

vendors are worried that there might be an increase in Capital Gains Tax. We have also seen an uptick in private company sale mandates since September as some vendors just don't believe that valuations are going to increase dramatically over the next 2-3 years.

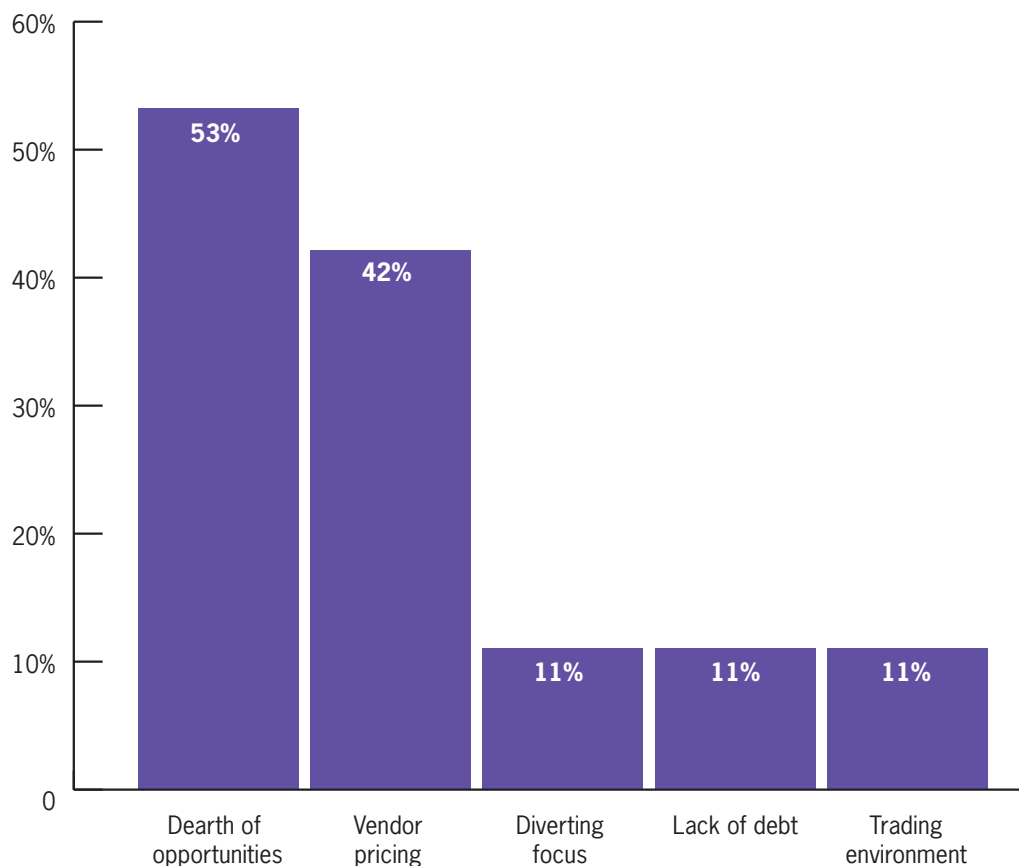
**“We have a strong appetite to invest as we believe there are attractive investment opportunities.”**

Survey respondent

**“In terms of deal activity, the clouds are lifting slightly but against a background of a very slow year for private equity activity.”**

David Ascott, Partner for Grant Thornton UK LLP

### Why have you not completed any transactions?



### Difficulties in debt financing remain, but will ease in 2010

In Q4 2009, 45% of respondents agreed that they would encounter difficulties refinancing some of their portfolio companies. However, these responses were slightly more optimistic than Q3 results, when 52% expressed concern.

Looking ahead, surprisingly only 51% of the responses indicated that difficulty in raising debt financing to support new investments would be one of the main obstacles to closing deals in 2010. This is compared to 81% who named unrealistic vendor pricing, and 66% who named difficulty in sourcing quality business for investment as one of the main obstacles. This indicates that the debt market may be beginning to thaw.

Indeed, Grant Thornton is seeing the financing side improving, with banks showing a growing interest in supporting transactions. However, lenders continue to be very selective in terms of what transactions and what PE houses they are supporting. Many banks have drawn up a shortlist of PE houses that they would like to work with.

Grant Thornton UK LLP has recently worked on a transaction funded by debt amounting to more than

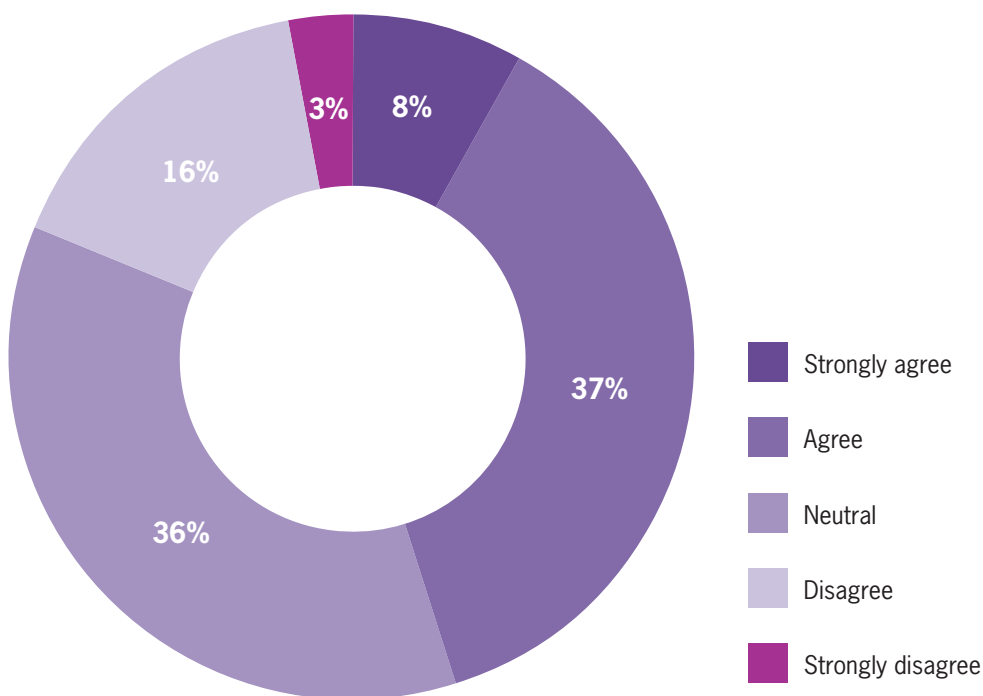
four times EBITDA, a debt multiple we have not seen in the previous 18 months. At the same time, the target was a great business with great assets and good visibility of long term earnings.

80% of respondents to the PE Barometer said they still needed to invest more than 25% of their latest fund. A total of 27% still needed to invest more than three quarters of their latest fund.

**“A shortage of debt still prevents many private equity firms from selling portfolio firms on to other financial sponsors in secondary or tertiary buyouts.”**

Ali Sharifi, Partner for Grant Thornton UK LLP

### We will encounter difficulties refinancing some of our portfolio companies



### A significant number will still breach loan covenants

Grant Thornton's PE clients are definitely feeling less pessimistic than they were three months earlier – reflected by a large drop in the number of respondents expecting to see portfolio companies breaching loan covenants.

In Q4 66% of PE respondents conceded that they expected some of their portfolio companies to breach conditions on their loans. Approximately a third of these indicated that more than half of their portfolio companies would fall foul of covenants. By contrast, Q3 had recorded 81% of respondents saying that some of their portfolio companies would breach banking covenants.

### Majority of PE firms expect to change sector focus

The survey revealed 58% of PE firms expect to change their sector focus somewhat in 2010 with the sector group comprising business support, infrastructure and logistics continuing to be the most popular choices.

This is understandable as PE houses are increasingly choosing to invest in sectors that offer themselves for an exit via trade sale. Moreover, acquisitive PE firms need to get various banks to agree on club deals, which is why they favour sectors that offer steady cash flows. Healthcare, business support services and infrastructure are all fairly safe bets.

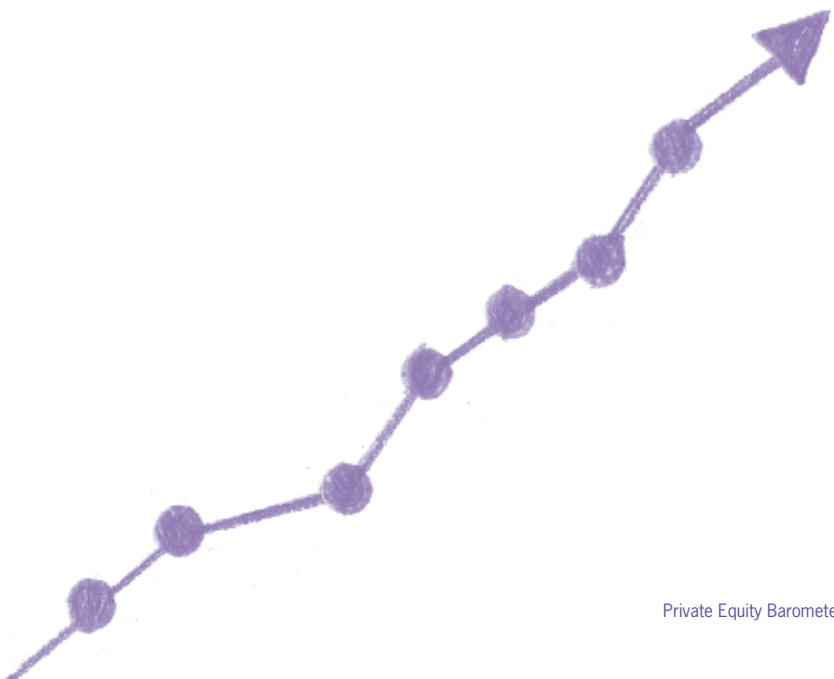
Meanwhile, the results suggest that the sector group including industrials, manufacturing and engineering is also one to watch for PE investments in the coming months, with almost 41% expecting it to be one of their most active sectors in 2010. By contrast, only

29% named industrials as one of the sectors that they had been most active in during the previous twelve months.

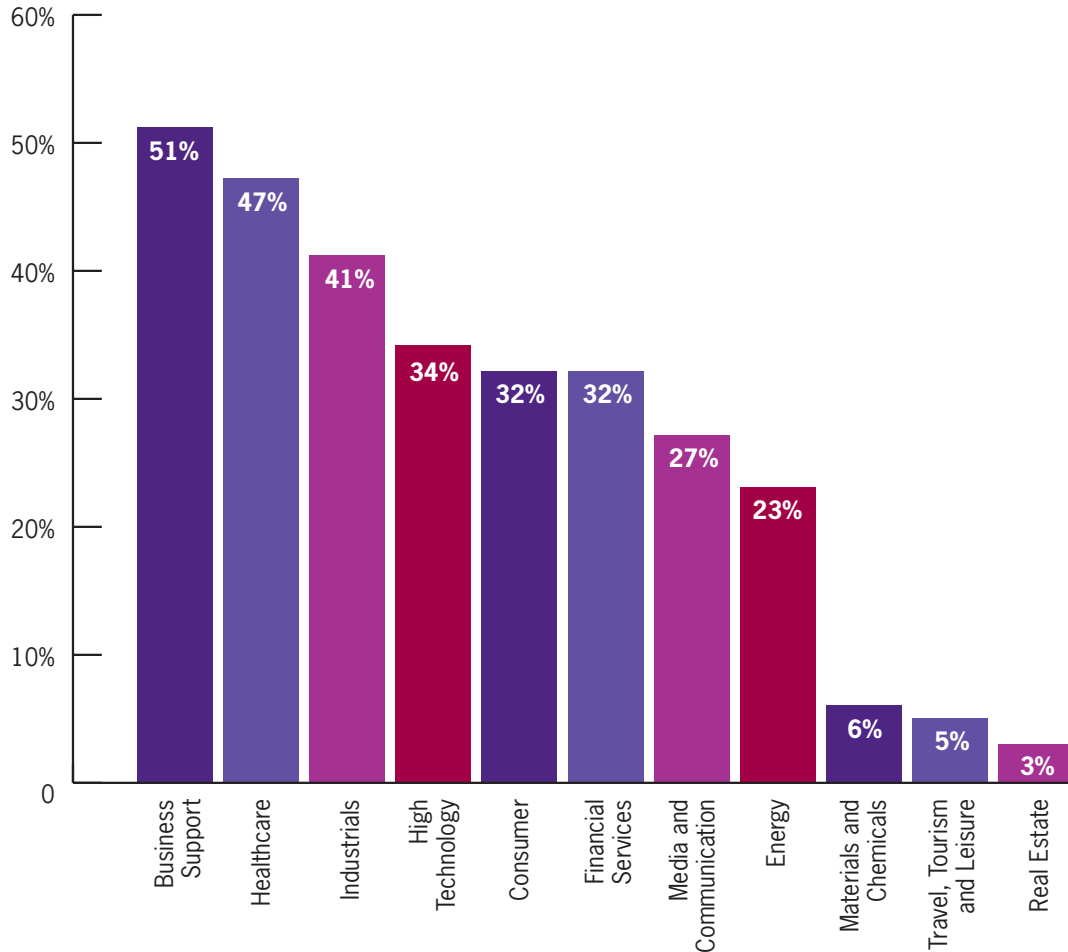
The survey also reveals both the high technology and the consumer sector are being knocked off the pedestal, with only 34% and 32% of PE respondents expecting to be most active in these sectors. In 2009, these sectors had been the second and third most active sectors, with 41% of respondents saying they had been most active in high technology, followed by 37% in the consumer sector.

**“Sector expertise will continue to be of crucial importance, as private equity firms will not be able to rely on financial engineering to generate returns on their investments in the foreseeable future.”**

Ali Sharifi, Partner for Grant Thornton UK LLP



### In which sectors do you expect to be most active in the next 12 months?



#### Healthcare and high technology expected to remain most expensive targets

Our survey also shows that PE respondents continue to pay higher prices for healthcare and high technology firms than for any other sector.

In 2010, respondents expect average price earnings (PE) ratios to amount to 7.2 for high technology and 7.1 for healthcare. Respondents suggested that in 2009, they paid average PE ratios of 7.0 and 6.8 respectively for high technology and healthcare assets. Real estate investments are expected to have the smallest price tag in 2010 with a PE ratio down to 4.9 from 5.1 in 2009.

Our next PE Barometer Survey will be released in May 2010. The next few months will continue to be a testing time for the economy, with ongoing speculation on the sustainability of the recovery. It will be interesting to see how sentiment and attitudes amongst PE executives change, and whether the swing towards greater optimism will continue.

### **Where is the Smart Money Going?**

Our Private Equity team have just released their first in a series of 'Where is the Smart Money Going?' reports. These reports will explore the hot sectors for investment. The first report, looking specifically at the ICT sector, is based on research gathered through interviews conducted with private equity investors, combined with the views and predictions of our own sector experts, and acts as a 'forward looking' analysis of what investors are genuinely looking for from ICT businesses and also hypothesizes about where the ICT hot spots are likely to be over the next 12-18 months. The report can be downloaded from our website, but is also available in hard copy. For a hard copy, please email [lucy.canning@gtuk.com](mailto:lucy.canning@gtuk.com)

The next in the series will look at the Business Support Services sector, and will be available in April.

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