

**Deloitte.**

Northern Private  
Equity Confidence  
Survey 2010  
*Cautious optimism*



March 2010

# Introduction

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Last year M&A market conditions proved very challenging. However, with the economy now showing tentative signs of recovery, the private equity community is feeling cautiously optimistic about what 2010 will bring. How long will it take for a recovery to be established? Should we expect a marked uptick in deal activity? How will debt funders respond in terms of quantum and pricing?

In an attempt to answer these questions and gauge current confidence levels, Deloitte has surveyed over one hundred leading professionals in the 3rd Northern Private Equity Confidence Survey. A sample of private equity investors (50%), bankers (33%) and lawyers (17%) from the North East and North West responded to a series of key questions, providing a valuable insight into how views differ between the regions.

## The market

34% of those surveyed reported they had considered in excess of 40 opportunities over the past year, which is down from the 40% reported last year. This implies, unsurprisingly, a slower market than in 2008. As in 2007 and 2008, however, most investors reported completing less than five transactions.

2009 was still dominated by activity in family owned/private businesses and subsidiaries of groups as in 2008. Secondary buy-out activity in the Northern market was higher than in 2008 (16% compared to 2%), but the number of respondents who have considered public to private opportunities has fallen from 23% to 10% last year – a reversal of last year's trend. Surprisingly, given the economic conditions, receiverships accounted for only 2% of respondent activity in 2009, in line with 2008. 15% however, of the opportunities considered by our respondents were considered to be in 'stressed' circumstances.

In terms of transaction size, the focus in 2009 was the mid-market, with 69% of respondents reporting an average deal size of between £10 million and £50 million. However, the number reporting their average deal size being less than £10 million increased to 23% compared to only 5% last year showing the trend to smaller deals, perhaps reflecting the types of deals completed in the adverse economic climate.

## Key findings:

- The number of opportunities considered, deals completed and average deal size fell sharply during 2009 compared with the previous year.
- 2009 was still dominated by activity in family owned/private businesses and subsidiaries of groups as in 2008. Perhaps surprisingly, only 15% of the opportunities considered by our respondents were considered to be in 'stressed' circumstances.
- All the respondents expect deal volumes and conversion rates to at least remain the same in 2010 and 97% expect prices to rise or at least remain stable.
- 83% of bankers expect senior debt margins to be between 400 and 450 bps, compared to only 33% of VC's and all expect debt multiples to be between 2.5x and 3.5x EBITDA.
- Top sectors for deals in 2010, as in 2009, are manufacturing, healthcare and technology, media and telecommunications, with respondents seeing retail coming back into favour.
- 80% expect investors to be net buyers this year.
- 56% expect recovery to be established in 18 months or longer and 69% of respondents expect a change in government this year to have little or no effect on transactions volumes.
- As last year, the North East is generally more bullish on the overall climate and more optimistic on both deal volumes and average deal size.
- However in a turnaround from last year's results, private equity investors are the most optimistic with bankers being the most bearish about economic recovery.

### The Deloitte view

With 2009 deal volumes widely reported as being the lowest since 1994, the Northern private equity market has clearly not escaped the impact of the recession. The consensus across the private equity community, however, appears to be that we are over the worst and that the current economic conditions will remain the same during 2010. They believe recovery will not be established until well into 2011. There is a sense of cautious optimism in the region as despite the significant economic and political challenges the UK market faces, there is a healthy pipeline of opportunities.

The expectations for the year ahead are for average deal sizes and volumes to largely remain the same or improve, with the market still being cautious, particularly around the availability and pricing of debt funding. As the banks continue to face considerable challenge around rebuilding their capital, strengthening earnings and reducing dependence on Government support, investors are increasingly turning towards the bond market.

There appears to be an expectation gap on pricing, with 83% of bankers expecting senior debt margins to be between 400 and 450 bps compared to only 33% of VCs; the majority of whom see pricing at between 350 and 400 bps. However there is a consensus that debt multiples will remain the same (at between 2.5x and 3.5x) and the equity components of deals will remain between 45% and 65%.

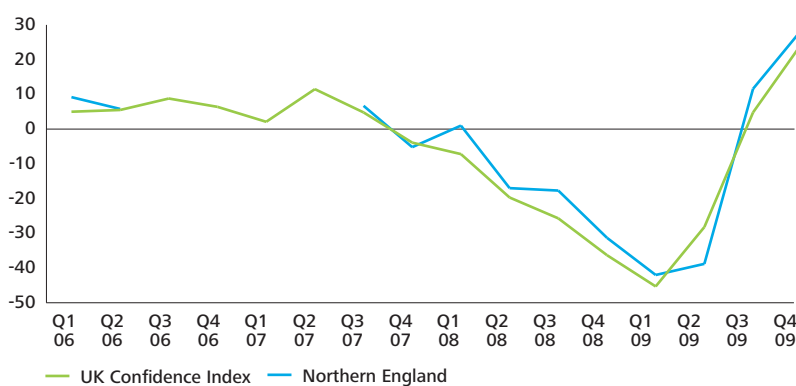
The survey respondents expect 2010 to see the return of private in terms of new investments after a year of focussing on their portfolios. Top sectors for deals in 2010, remain the same as in 2009: are manufacturing, healthcare and technology, media and telecommunications, with respondents seeing retail coming back into favour.

Whilst the overall trends are broadly consistent between the North East and North West, there remains a noticeably higher level of caution in the North West with regards the economic climate and recovery. The North West is also more bearish on the prospects for deal volumes and average deal sizes.

### Economic climate

The clear view of the Northern private equity market is that we still have a long way to go with 56% of respondents expecting recovery to be established in 18 months or longer. Confidence in Northern England has consistently improved over 2009 but there is caution around the prospects for the economy. This was reinforced by the message released in January that the UK's economy has finally found its way out of its deepest recession since the 1930s in the fourth quarter of 2009, but it only managed to expand by a much weaker-than-expected 0.1%.

Chart 1. Confidence Index trend – Northern England

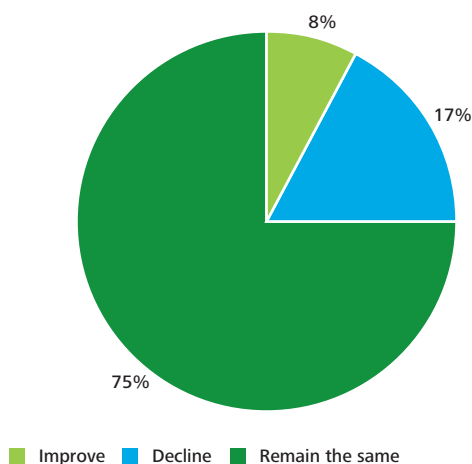


Source: ICAEW

### Prices expected to remain stable

The survey indicates a general consensus that entry multiples are likely to remain the same over the coming months. This conclusion likely reflects similar expectations of the debt market with 80% of respondents also anticipating a status quo.

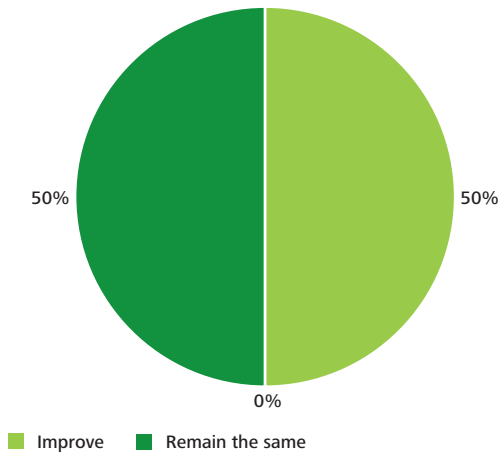
Chart 2. I expect entry multiples on transactions to:



### Deal volumes to at least remain the same

Views around future trends of deal volumes are a reversal of the experience of last year, with 50% of the respondents anticipating volumes to rise and 50% predicting volumes remaining stable.

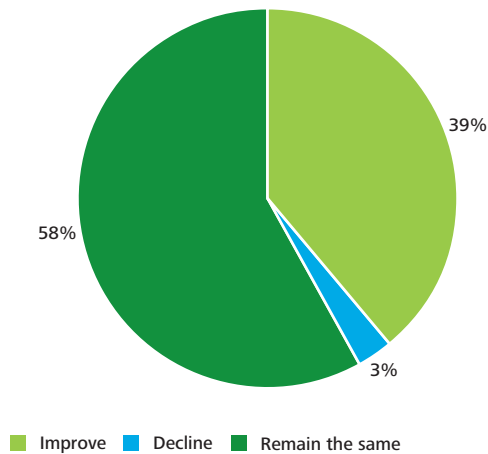
Chart 3. I expect the volume of transactions to:



### Optimism around average deal size

There are increasingly optimistic views around future trends in average deal size with 58% of respondents expecting average deal size to remain the same and 29% even expecting an increase. This compares with 68% last year predicting that average deal size would decline.

Chart 4. I expect the average deal value to:

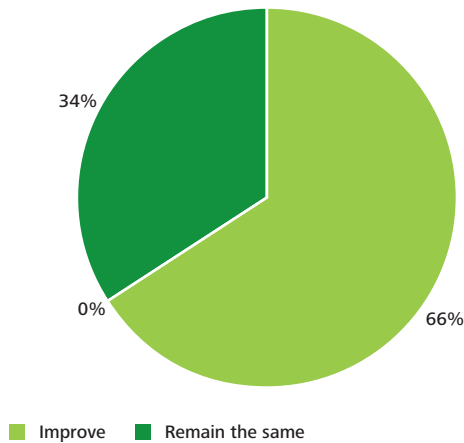


### Market activity

Most respondents (80%) predicted that private equity firms are likely to be net buyers, despite the fragile economic recovery in line with 2009. As with last year, a significant number of respondents (74%) anticipate keeping team numbers unchanged however none of the respondents expect their team size to contract, compared to 12% last year.

There was a consensus of views on the level of corporate activity with 66% predicting an improvement, compared to the broader range of views last year. In addition, easier conclusions on transactions are expected; a reversal of these opinions given in 2009. 43% anticipate a rise in transaction conversion rates compared to only 4% last year.

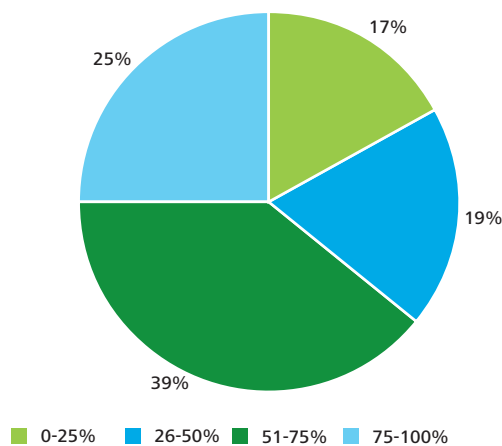
Chart 5. I expect corporate activity to:



### Geographic focus

Last year respondents experienced a contraction in geographical spread of transactional activity, however this is expected to broaden slightly with 64% of the respondents expecting to spend more time in their principal location in the coming year, compared to 74% last year.

Chart 6. Percentage of my transactional activity in my principal location will be:

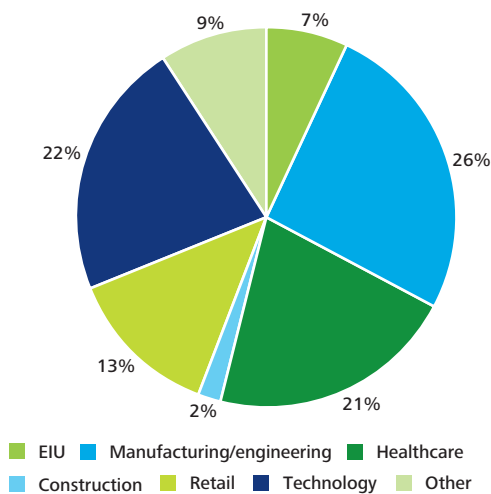


**Sector focus**

During 2009, 37% of respondents concentrated on the manufacturing sector with healthcare (15%), retail (8%) and technology, media and telecommunications (8%) also being particularly popular areas of focus. In addition however a number of respondents have focussed on financial services and support services.

Looking ahead to 2010 respondents are anticipating a broader sector focus on manufacturing (26%), healthcare (21%) and technology, media and telecommunications (22%) sectors. EIU appears to be a greater area of focus for the North West.

**Chart 7. I expect to focus on opportunities in the following sectors:**

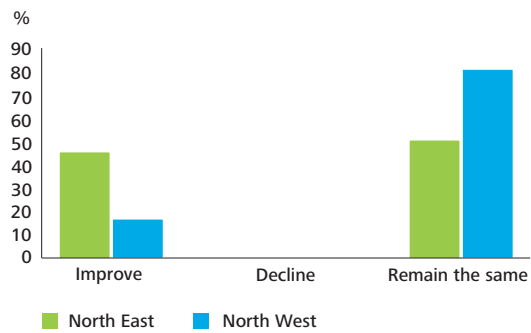


**Sentiment differs across the Pennines**

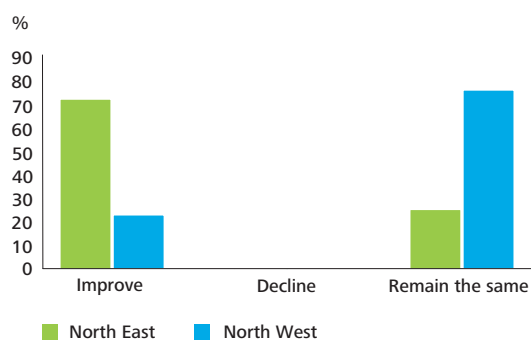
As last year, the North East is generally more bullish on the overall climate and more optimistic on both deal volumes and average deal size. In addition, the North East overall appears to have a slightly more positive outlook on the private equity market with:

- 47% predicting conditions to improve compared to only 18% in the North West;
- Only 35% of North West respondents anticipate a rise in average deal value compared to 43% in the North East; and
- 74% of North East respondents anticipating that the volume of transactions will rise compared to 24% in the North West.

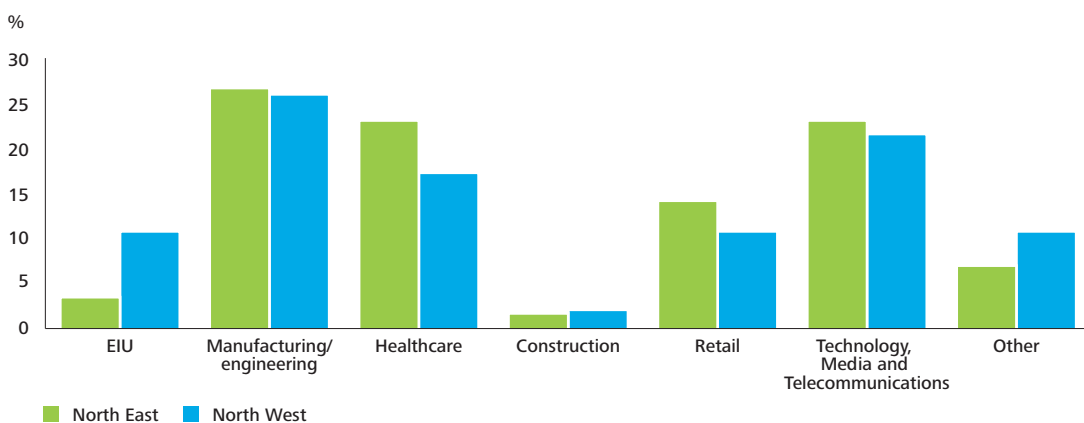
**Chart 8. I expect the overall economic climate to:**



**Chart 9. I expect the volume of transactions to:**



**Chart 10. I expect to focus on opportunities in the following sectors:**



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