

Private Equity Barometer

October 2009

Welcome to the latest edition of **Private Equity Barometer** – our 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

Portfolio firms expect to default on banking covenants, yet acquisitions are likely to increase. Our latest survey revealed PE houses are still facing some significant challenges, but there is genuine optimism as the economy heads towards recovery.

- 81% of PE firms to see some of their portfolio firms default
- More than 73% of respondents expect an increase in the number of companies in their portfolio over the next twelve months
- 64% are set to change their sector focus over the next 12 months



The vast majority of PE firms expect to see some portfolio firms default

In our quarterly PE Barometer, 81% conceded that some of their portfolio companies would breach banking covenants – a result that will come as little surprise as managing debt exposure continues to be a major issue to UK-based PE firms.

These challenges are likely to result in an unprecedented wave of financial restructuring of PE-backed companies – for some, this will be a necessary measure to avoid the banks ultimately taking ownership and control.

Given the ongoing weak economy, many will expect refinancing to be less

than easy. Indeed 52% of respondents agreed that it would be difficult for their portfolio companies. This indicates a significant shift in PE firms' acceptance of the reality of the situation facing their portfolio companies.

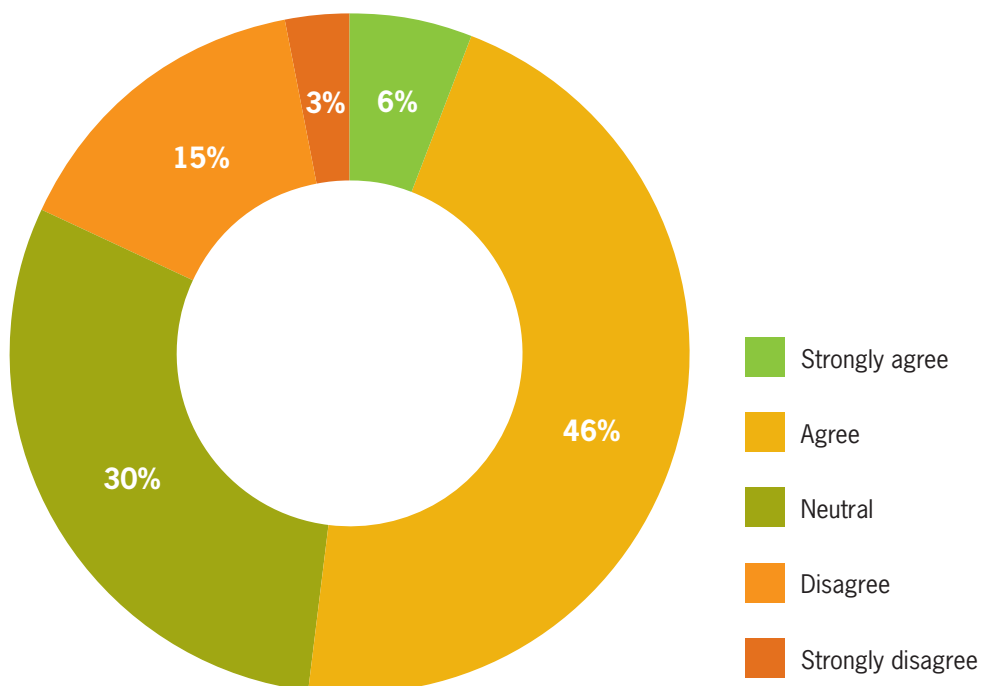
In response to their views relating to lenders only 18% of respondents believe their lenders have been

unsupportive. Despite this, 86% of respondents felt that lenders are imposing high fees to reset covenants and high margins on renegotiated debt (6% disagreed and 8% were neutral). Tellingly, one respondent even commented that “Lenders have the power and we have to get used to it!”

“Banks are only now slowly starting to return to the mid and lower mid-market but at extremely conservative levels. There remain viable deals that they are not supporting even at sub 2.5x EBITDA multiples.”

Survey respondent

We will encounter difficulties refinancing some of our portfolio companies



PE volume to increase following drop

In spite of their refinancing difficulties, PE firms appear to be optimistic about investment levels moving forward. Nearly three quarters of respondents expect an increase in the number of companies in their portfolio over the next twelve months, even though some may need to write off existing investments.

In line with the expected increase in portfolio size, 70% of respondents expect the volume of PE transactions in the UK to pick up in the next twelve months.

While this may be hardly surprising given the lows in transaction volumes reported recently, the results do show that respondents are significantly more optimistic than in previous quarters.

In Q1 a majority of 64% had expected a decrease in the number of deals, while in Q2 the number of respondents expecting a decrease was still at 20%, whereas only 3% expect a decrease in Q3.

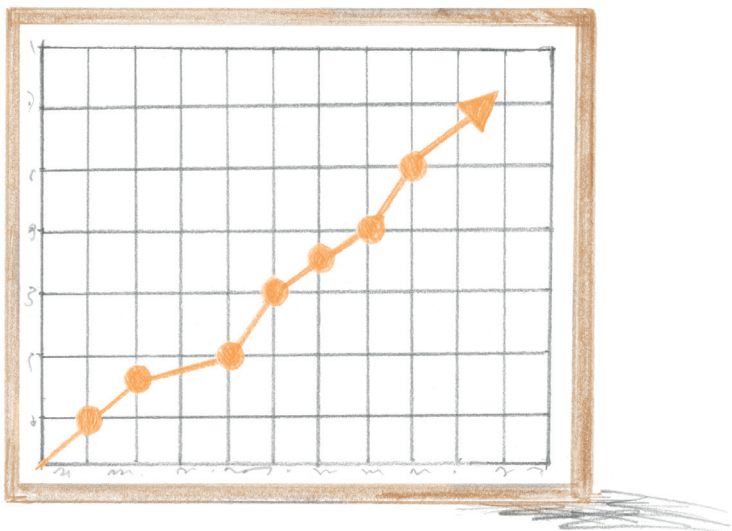
Regarding the year-to-date, 68% of respondents conceded that the number of transactions have decreased compared to the first three quarters of 2008, while 19% said that the number of transactions stayed the same and only 13% have recorded an increase.

“Lenders have the power and we have got to get used to it!”

Survey respondent

Staff levels at portfolio companies to remain steady

- **51%** of respondents expect the number of employees to remain unchanged in the coming twelve months
- **28%** expect an increase in the number of staff
- **21%** expect the number of employees to fall



Poor exit prospects don't quash hopes on returns

About three quarters of respondents admitted that they are delaying the sale of their portfolio companies and that they expect the prospects for exits to remain poor in the coming months. However, at the same time, almost a third of respondents expect to achieve annual returns of more than 25% in the next three years. This clearly indicates a positive outlook on existing investments and more importantly strongly suggests that private equity firms will look to invest in new opportunities and generate substantial returns on those.

Only 7% of respondents expect to generate annual returns of less than 10% for their investors in the next three years, while 61% expect to generate annual returns between 11% and 25%.

Majority of PE firms expect to change sector focus

The survey revealed 64% of respondents expect to change their sector focus somewhat in the coming 12 months. This is understandable as PE firms are feeling compelled to shift their focus to those sectors that are popular with the institutional investors. Indeed, many of our clients are now looking towards sectors that offer steady cash flows, such as outsourcing, infrastructure and healthcare companies.

Only 36% of respondents did not make any changes when asked to identify the three main sector groups in which they have been most active in the previous twelve months and those in which they expected to be most active in the year ahead.

55% expect healthcare, pharmaceuticals and medical to be the most active sector group in the next twelve months, up from 47% which

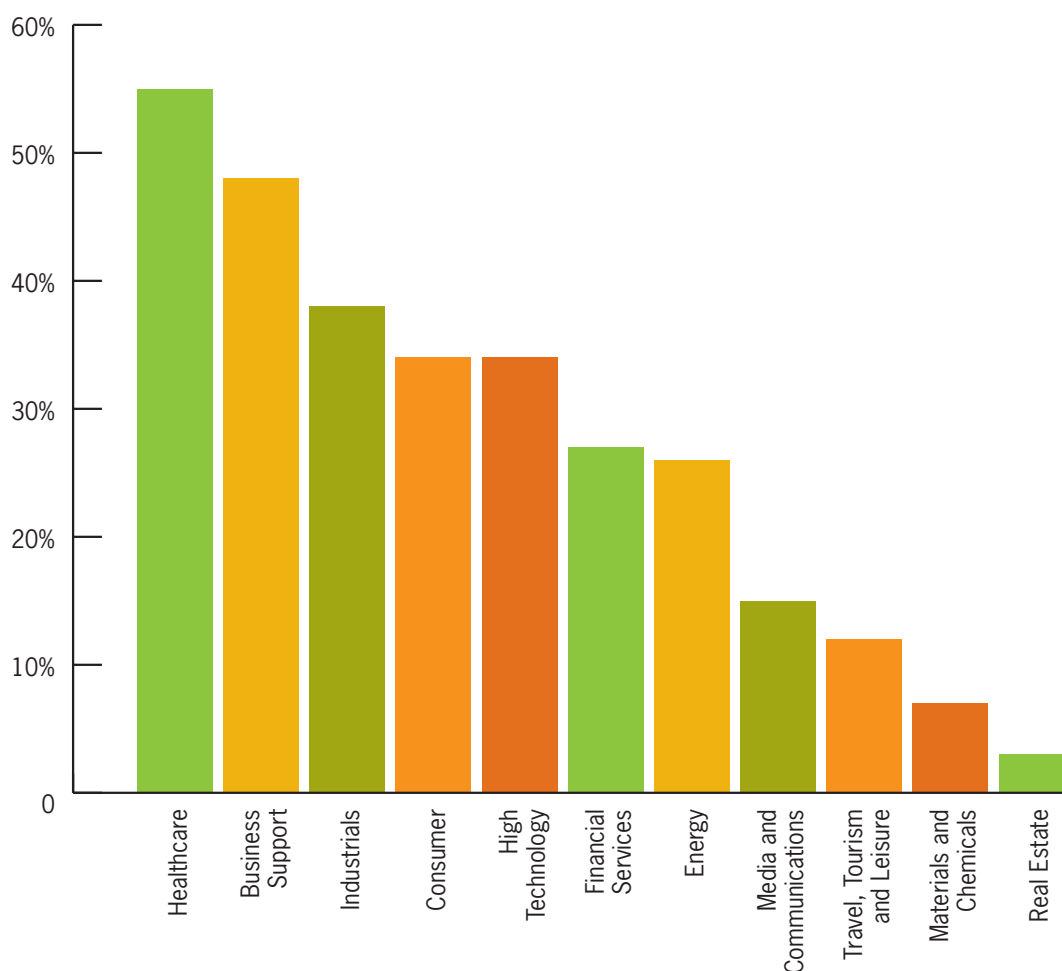
had been most active here in previous quarters. 48% expect to be most active in the sector group comprising business support, infrastructure and logistics, compared to 41% that had focused on it in previous months.

Meanwhile, the results suggest that the sector group including industrials, manufacturing and engineering will replace consumer retail and food as the third most active sector for PE investments in the coming months, with votes of 38% and 34% respectively.

“As we come out of recession (our investments will be in) those businesses that require capital to grow and thus require private equity. The banks will not be receptive to providing ‘permanent capital’ dressed up as a working capital need.”

Survey respondent

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 as prices fall slightly

PE respondents suggest that prices will get lower in most sectors in the coming months. At the top, average price earnings ratios are expected to amount to 7.3 for healthcare and 6.9 for high technology, where previous ratios were slightly higher at 7.6 and 7.0 respectively. Real estate investments are expected to have the smallest price tag with a price earnings ratio down to 4.7 from 5.3 in previous months.

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

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