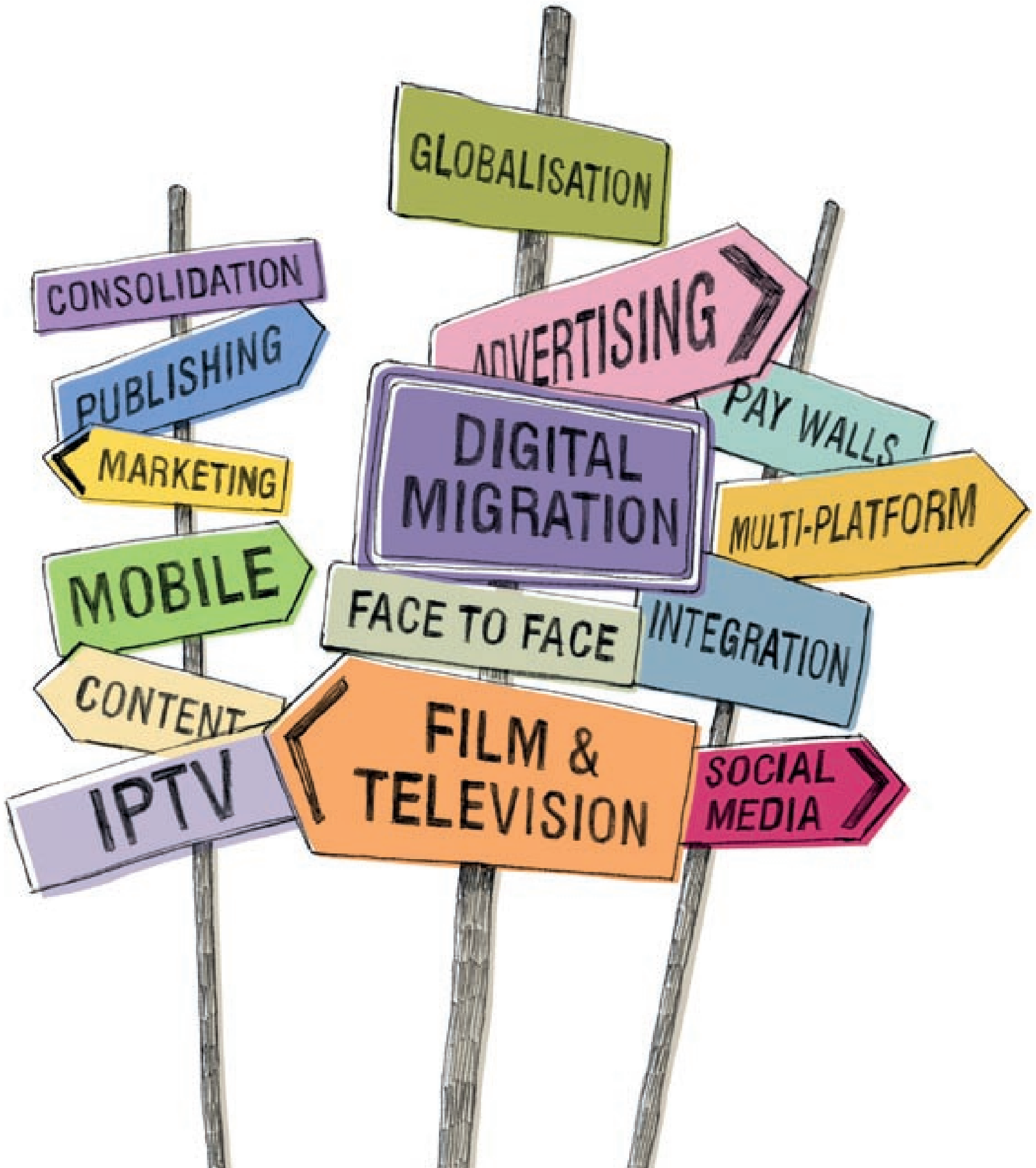
Grant Thornton

PRIVATE EQUITY
MEDIA SECTOR

Where is the smart money going in Media?



mergermarket

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Methodology

Over the course of the second quarter of 2010, Remark, the research and publications arm of The Mergermarket Group, canvassed the opinions of 40 private equity practitioners with experience of investing in the UK Media sector. Respondents were asked to give their opinion on a number of issues, including the impact of the economic downturn on the Media sector, the key growth areas going forward, as well their own firm's investment strategy over the coming months. All answers were confidential and the results have been reported in aggregate.

The deal data in this report is accurate up to the end of the third quarter of 2010.

Introduction

Private equity investors have been Media shy in recent years. The feeding frenzy of highly leveraged deals up to and including 2007 has slowed to a trickle as the combination of the macro economic environment, closed debt markets, the 'advertising' cycle and structural shifts have conspired against Media sector investment. Yet now, there are more than signs of life; repaired balance sheets, bolder management teams, the challenges of delivering organic revenue growth and finding the skill sets to monetise new business models/technologies seem to be driving more corporate M&A activity. But will this environment create a more compelling investment proposition for private equity investors?

The level of UK M&A activity in the sector has rebounded strongly in 2010 and, despite a smattering of private equity participation – largely in portfolio buy and builds and the odd strategic exit, this has been driven by corporates. Yet the survey finds private equity respondents expecting their level of overall investment to increase by two thirds and nearly all plan to undertake an investment in the UK Media sector in the coming months. They too recognise that the sector is facing structural challenges, and that managing the transition to profitable and sustainable digital solutions represents both a threat and an opportunity. And herein lies the challenge for investors. The rapidity of developments in the likes of paid-for content, new delivery mechanisms, social media, etc. makes it hard to keep on top of the changes and spot the winners. Nearly a quarter of respondents are honest enough to say they don't understand the sector, perhaps not surprising when venture capital (not private equity) has traditionally been the source for funding the growth of earlier stage technology companies. So, given investors' requirement for proven, robust and profitable revenue streams, the survey addresses whether digital media companies will represent suitable investment targets.

Much of the recent consolidation in the mid-market has centred around more recessionary distressed assets (eg regional newspapers, TV distribution and post production) and structurally fragmented sub-sectors (eg financial regulation and compliance, database marketing). The survey looks at whether the outlook for investor involvement in consolidation appears to be more positive in the near term and whether accessing new markets and geographies is a key driver to media investors.

The basic economics of supply and demand drive M&A activity. Given the repaired balance sheets and strategic imperatives of the larger corporates, together with the reopening of the credit markets to private equity, that can mean only one thing – competition for assets. The survey comments on the difficulty of finding attractive assets and, even then, at the right price. There is now increasing evidence of double-digit multiples being paid for those assets (into the mid-20s at the top end of the market). Secondary and tertiary activity may be driving UK private equity activity in 2010, but does that sit well with those respondents who are invested in media? The survey comments on whether there is an expectation for exits to drive this activity.

And so, the multi-million £ question: where to invest in Media? Where indeed, given its diversity, fragmentation, structural challenges, technological changes (and some signs of government led liberalisation). Which sub-sector will attract investor investment? The survey may confirm that digital will be the most attractive segment, but will that interest be converted into actual investment? A number of sub-sectors are addressed in the survey in terms of their relative attractiveness to investors: music, consumer publishing, marketing/communications, B2B publishing and events. Perhaps most revealing is what private equity is not looking to invest in over the next 12 months.

Dominic Bolton

Corporate Finance Advisory Partner
Grant Thornton UK LLP

What are private equity investors telling us?

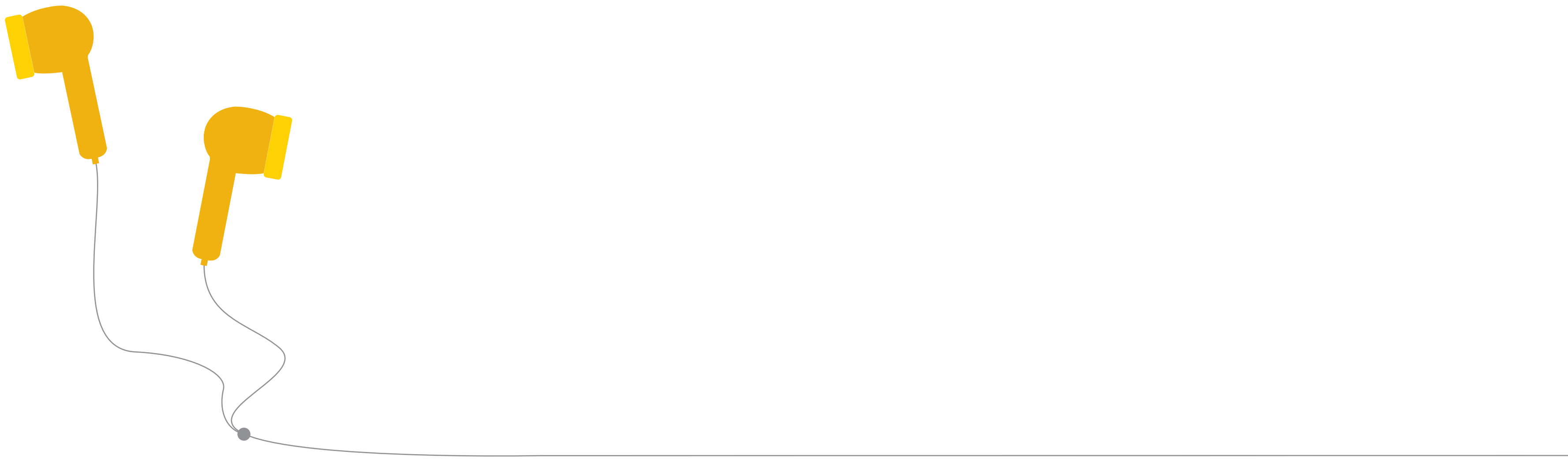
The survey highlighted the view that private equity investors are bullish about future investment activity in the UK Media sector, recognising the critical structural shift being imposed by digital technologies.

Key findings from the research include:

- Nearly all respondents (90%) plan to undertake an investment in the UK Media sector in the next 12 months
- 65% expect the level of overall private equity activity in the space to increase going forward
- Over half of respondents (57%) believe that UK Media firms have navigated the downturn at least as well as other industry sectors
- However, respondents recognise that the sector is facing structural challenges and that managing the transition to digital solutions represents both a challenge and an opportunity for corporates and investors
- 87% expect investors to most aggressively target businesses operating in the digital niche over the next 12 months
- However, traditional factors such as consolidatory pressures and increasing market share were expected to be the second most important objectives for doing a deal
- The shift to new digital market segments is identified as a significant growth area for the sector by almost all respondents (88%)
- Looking forward, 87% of respondents expect the lower end of the market (<£100m) to witness most private equity activity
- Exit horizons for media investee companies are expected to be extended in an attempt to deliver more positive portfolio returns
- A sale to a trade player is considered the most likely exit route for private equity, cited as such by 55% of respondents
- The least attractive sub-sectors to private equity investors are music, consumer publishing and TV/film

UK Media in review

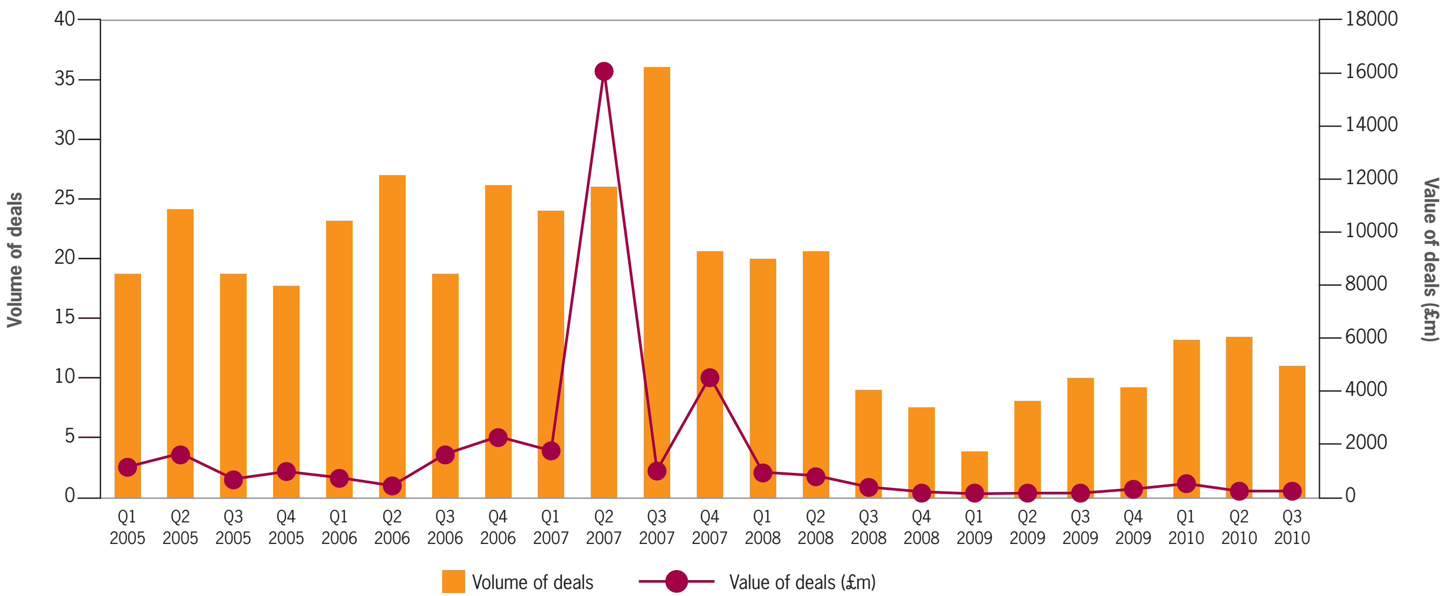
In line with other sectors, M&A activity in the UK's Media sector declined sharply during the recession, with deal values down 75% in 2009. However, the first three quarters of 2010 have seen a much stronger appetite for deal-making, notably from corporates, with their improved balance sheets, seeking to overcome structural issues.



In 2009, the UK's GDP declined 4.9%, but advertising expenditure fell by 12%. A combination of the wider recession and subsequent closure of credit markets, plus the sector's overweight reliance on advertising revenues, saw a sharp decline in M&A activity in the sector.

The number of reported deals fell 46% during 2009 to 31, while the impact on deal values was even starker, with a 75% decline to £370 million.

Overall M&A trends in the UK Media sector



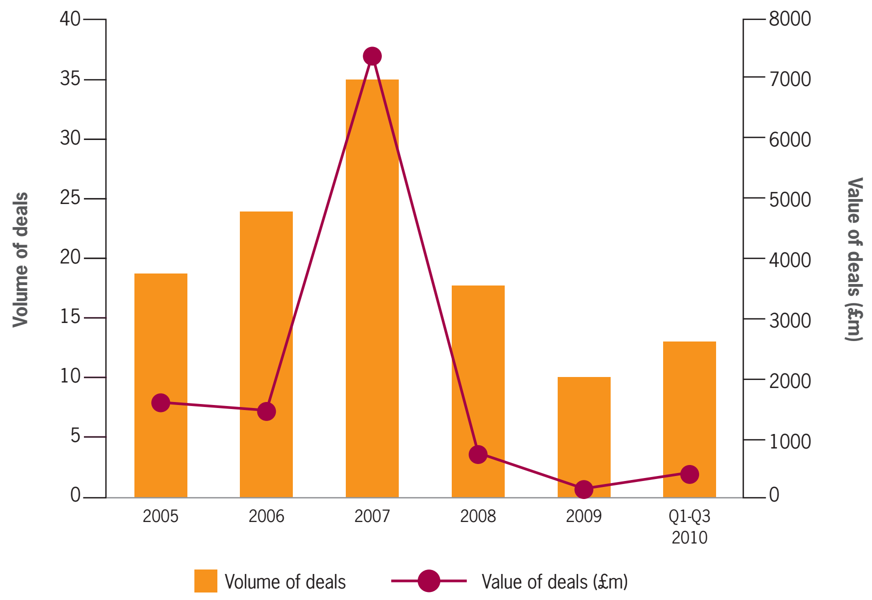
Reflecting trends in the wider market, the level of M&A activity in the sector has rebounded strongly in 2010. By the end of the third quarter, there had been 36 deals for £904 million – both metrics have already surpassed the 2009 totals. It is deal flow in the mid-market which is driving the current activity. The largest reported transaction in the UK is BSkyB's £160 million acquisition of Virgin Media Television, the pay-TV channel portfolio of Virgin Media.

Dominic Bolton
Corporate Finance Advisory Partner, Grant Thornton UK LLP

M&A is back on the agenda for media corporates with repaired balance sheets. Management teams are now prepared to put their heads above the parapet. The challenges of delivering organic revenue growth against the backdrop of new business models and skill sets are beginning to drive this M&A activity.

Activity in the private equity community mirrored the overall sector during the downturn, with a 41% decline in deal volume during 2009 to 10, and a 78% decline in value to £118 million. Forty per cent of the reported deals were exits. 2010 has seen an increased level of activity, with 12 deals announced by the end of quarter three with an aggregate value of £322 million. The adjoining chart portrays these trends, as well as highlighting the significant amount of (over) leverage that was placed into the sector during 2007.

Overall private equity trends in the UK Media sector



The largest disclosed private equity deal of 2010 so far has been the merger of The Carlyle Group's bigmouthmedia with its digital marketing agency peer, the Netherlands LBi International, for £91m. However, Complinet's sale to Thomson Reuters was rumoured to be worth in excess of £100 million.

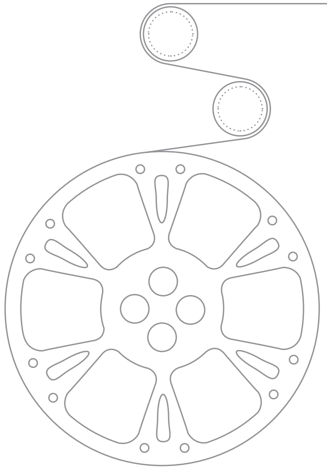
On the buy-side, notable deals included Better Capital's MBO of Reader's Digest, ISIS Equity Partner's MBO of Encore Tickets, and Alcuin Capital's AudioGo acquiring an 85% stake in BBC Audiobooks.

From a global perspective, there is a growing sense of a return of the 'mega' buyout in the Media sector. Pearson's recent sale of its 61% stake in Interactive Data Corp (IDC) for £1.3bn to Silver Lake and Warburg Pincus currently represents the largest leveraged buyout deal of the year – and was concluded for 24 x earnings with reportedly over 7 x EBITDA debt leverage; while EQT Partners and GIC successfully completed a secondary buyout of Springer Science+Business Media from Cinven and Candover for £2.1bn at the start of the year. In contrast to the UK's post-recession focus on small and mid-market deals, it appears US and international investors have already set their targets much higher.

Target company	Bidder company	Seller company	Deal type	Deal Value (£m)
bigmouthmedia Ltd	LBi International AB	The Carlyle Group LLC	Merger	91
Optomen Television Ltd	All3Media Ltd (Permira)		Bolt on	40
Gorkana Ltd	Durrants Ltd (Exponent Private Equity)		Bolt on	25
Encore Tickets Ltd	ISIS Equity Partners		MBO	>20
Xtreme Information Services Ltd	Ebiquity plc	Veronis Suhler Stevenson	Exit	18

Since 2005, 71% of private equity-related deals have been in the £5m-£100m range, while over the past 18 months this ratio has increased to 90%. The wider economic issues have certainly played their part in this trend, as has the reality that the UK media industry is a fragmented industry, but it is also in part due to the sector's structural issues: companies in the digital arena tend to be of a smaller size.

The UK Media sector today

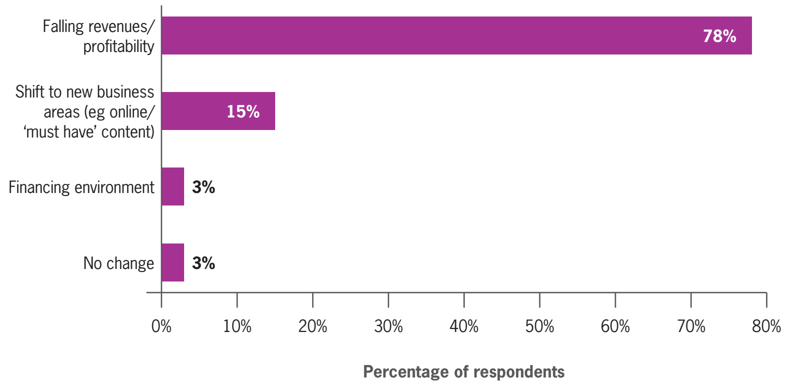


While the wider economic recovery is boosting the operating performance of most companies in the Media sector and decreasing balance sheet leverage, it is the longer-term, structural issues which are the significant drivers of corporate finance activity today. Strategic investments are being made by corporates, and to a lesser extent private equity, to counter and also embrace the opportunities and threats posed by digitalisation and globalisation. Consolidation has played almost a secondary role to this broader theme.

At a macro level, the operating performance of almost all companies in the Media sector deteriorated during 2009. However, for many companies operating in the digital sub-sector it was another growth year. While overall advertising expenditure declined 12%, spend on digital advertising rose 6%. Many 'old media' corporates took the 'opportunity' presented by the recession to strategically cut costs and realign business units in a manner that accelerated their embrace of a digital future.

While the majority of respondents to the survey (78%) unsurprisingly believed that the main impact of the recession on Media companies was to reduce revenues/profits, 15% said that it was to transition the companies into new business areas eg online.

What has been the main impact(s) of the economic downturn on UK Media companies?



Mark Henshaw
Head of Media & Entertainment, Partner, Grant Thornton UK LLP

With respect to many other sections of the UK economy (including the public sector following the recent spending review), few have experienced the turbulence that the Media sector has over the last three years. Not only is Media spend seen by many as discretionary and therefore one of the first to be cut by business as a whole – which was reflected in the savage write down of listed media stocks in 2007 and 2008 – but the sector has faced this at a time when its business models are having to adapt to the now established online world more rapidly than others. This report therefore is not only timely, but extremely welcome in helping those of us who work in, and advise the sector, to understand the sentiment of private equity firms.

There is a still a criticism that some business models are moving too slowly, and there will still be casualties along the way – those who resist the move to embrace digital will undoubtedly be at the forefront of those failures. What the industry and investors need to remember of course, is that it is about embracing technology, and not jettisoning the underlying skill sets that have made the business successful in the first place. Innovation in the sector is less about the competition and market structures (they are tools), but it is about leading consumer habits and tastes – it is the creative spark that is important, and this shouldn't be ignored.

At Grant Thornton we have continued to invest in the Media team and our clients throughout the downturn, and it is one of the firm's investment sectors for very good reasons.

The digital paradigm is challenging the business models of many companies operating in the Media sector, particularly in consumer media. The arrival of new, frequently disruptive technologies, at an alarming rate, is reshaping consumers' expectations about service levels and the value of content. The latest trend is for newspaper and magazine publishers to launch paid-for iApp versions of their titles, but will any of them be profitable?

The paywall went up on the websites of The Times and The Sunday Times in July 2010 and consumers must now pay £1 a day or £2 a week to access thetimes.co.uk. News Corp is also now charging £1 a day or £1.99 a month to access the News of the World's website. News Corp has yet to release subscription data, but many website traffic monitoring services suggest that visitor numbers have dropped 90% – broadly as News Corp executives had forecast.

Nick Page
Assurance Partner
Media & Entertainment,
Grant Thornton UK LLP

It is understandable that the digital paradigm is challenging Media businesses – Media businesses have always had to be flexible as to the revenue model, but in the offline world have been able to operate for a number of years under stable and well understood business models. The proliferation of platform technologies, together with the propensity for the consumer to view digital content as free at source, means that the traditional business models do not work efficiently in an online world.

Indeed, there is still a lack of clarity about which is the right model to pursue, with many media businesses choosing to try a variety of business models online (eg paywall, advertiser supported, subscription...) across their content portfolio in order to assess which model will gain most traction. It is most likely that a flexible hybrid model will emerge which is specific and tailored for the type of content and users that the business has.

A twist that creates further uncertainty is that the online customer acquisition model is evolving rapidly – where once it was adequate to use an optimised search-based model (eg Google) as a route to market, the increasing desire of the consumer to connect with and identify with content creators and brands means social media is playing an increasingly important role in reaching out to and monetising new customers.

Lorna Tilbian
Executive Director,
Numis Securities

The Media sector has made more operational progress than has been reflected by share prices and, in the absence of a double-dip, is substantially undervalued and attractive to PE investors.

B2B and professional media are also experiencing the double-edged sword of digitalisation. The provision of keyword-searchable, deep archive access to databases and journals over the internet (anywhere, any time) makes academic journal subscriptions more valuable to end users. But, at the same time, Google provides a free news aggregator service, while some academic libraries are questioning ever-increasing subscription rates and pushing for self-publishing via the internet. However, in B2B it is notable that the events sector has experienced little digital impact, while the education market has seen little but upside: 31% of Pearson's revenues now come from digital sources.

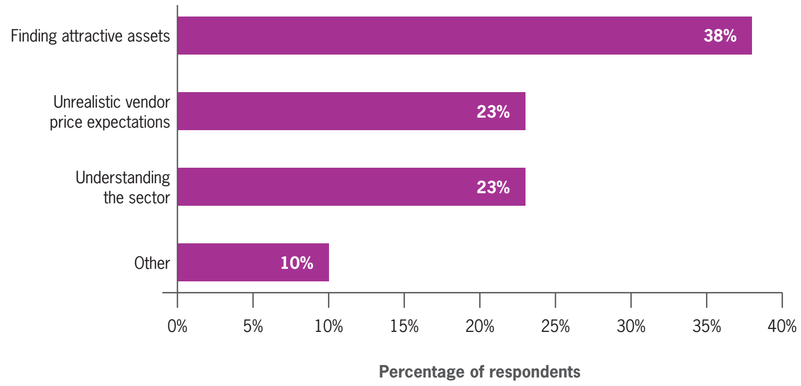
The marketing services sector is perhaps the key beneficiary from the current turmoil. Brand owners need expert advice as they struggle to stay relevant in this fast-moving, fragmented environment, and, because consumer behaviour is changing so rapidly, they need advice and services on a more frequent basis than previously.

WPP stated at their Digital Day earlier this year: "Overall, [there is a] greater need for our advice and services in a more complex and fragmented media landscape."

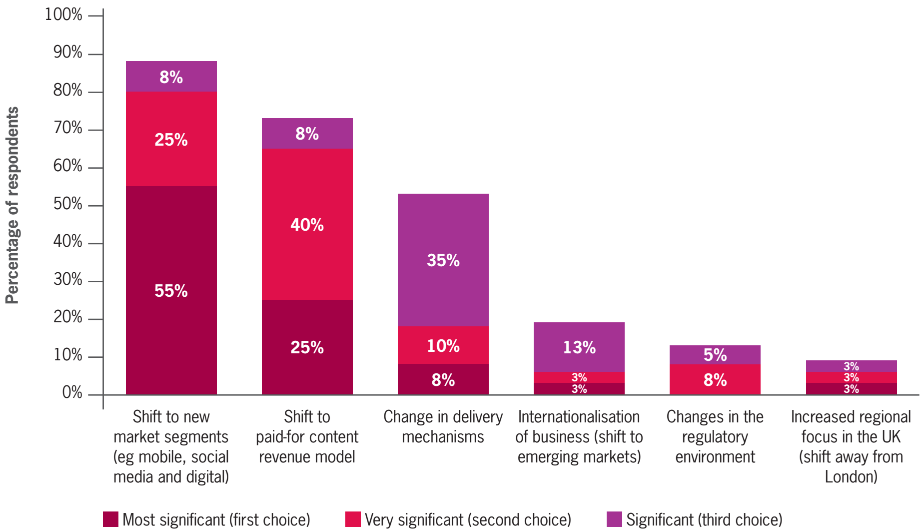
The rapidity of developments in the sector, combined with the notoriously questionable business models of digital start-ups, is also leaving the private equity experts questioning who or what will be the future of the sector. As one respondent described: "The key issue is keeping on top of the changes caused by technology and freely available online content." While finding attractive or reasonably priced assets would rank highly on a list of the difficulties facing investors in almost any sector, few would have 'understanding the sector' ranked at number two, as the Media survey does.

Despite the challenges in predicting the future for the Media sector, 88% of respondents ranked the transition to online – including paid-for content and new delivery mechanisms – as the most significant key growth areas for UK Media. Many respondents perceived the corporate demand for digital know-how as a competitive threat in making digital acquisitions. As one replied: "Companies realise that they must have a digital strategy and many are looking to buy-in that expertise via M&A."

What do you find most difficult about identifying potential investments in the UK Media space?



Which of the following do you consider to be the key growth areas for UK Media companies going forward? (Please rank top three)



Given the tumultuous impact of digitalisation on the Media sector, and the subsequent increase in demand from clients for marketing services that this has created, it is not surprising that this sub-sector is leading the digital M&A activity. Of WPP's nine transactions so far this year, seven have been companies providing digital services. Last year, Publicis acquired the digital agency Razorfish from Microsoft for £320 million, and earlier this year, to build scale, LBi International merged with its digital agency peer, bigmouthmedia. Meanwhile, there is reportedly a bidding war at present for the last remaining independent digital marketing agency of notable scale, General Atlantic's majority-owned AKQA.

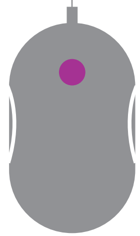
The trend to digital is expected to be so rapid in the marketing services sector that WPP expects two-thirds of its business to be digital-related in three to four years, up from 27% in 2009. But, it is not just about top-line growth. According to WPP, its digital revenues in 2009 delivered margins "at or higher than 'traditional'".

And it is not just traditional marketeers who have sought growth via digital agency acquisitions. Last year, the US publisher Hearst, spent £222 million on iCrossing, a digital agency with a history in search advertising. Even industry heavyweights appear to be questioning the stand-alone future of the consumer publishing market.

However, reflecting the concerns of the survey group about understanding the sector, even investing in a digital agency does not guarantee a high exit multiple. Earlier this year i-level, which two years ago was one of the UK's largest independent digital agencies, was liquidated by its majority-owner, ECI Partners.

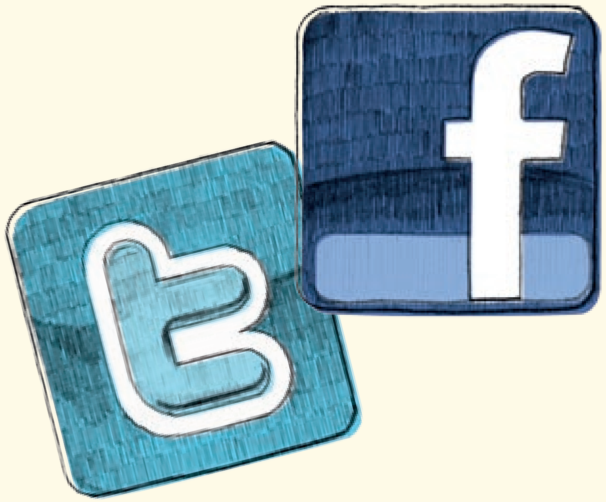
The relative absence of the UK's private equity community from transactions in the digital arena can be attributed to a couple of factors. In addition to the aforementioned concern about a lack of understanding of the sector, there is also the issue that many high-growth digital companies are at the stage of their development cycle when they require venture capital, not private equity financing. Given private equity's requirement for proven, robust and profitable revenue streams (78% cited this either the most important, or a very important consideration) – a requirement that has become even more stringent since the recession, according to the survey – many digital media companies do not represent suitable investment targets.

That is not to say that private equity has been completely absent in digital media. In 2009, Barclays Private Equity acquired the parenting club and marketing portal Bounty.com from Kaboose Inc for £54 million. Meanwhile, earlier this year, Exponent Private Equity's media monitoring portfolio company, Durrants, acquired Gorkana, the UK's leading PR website portal, for £25 million.



Spotlight on digital

Continued digital growth is a certainty; however the timing and selection of investment opportunities are as tricky for investors as ever.



Seventy per cent of UK homes have internet access, 84% of these served by fast broadband. While penetration growth is levelling out (until government inclusion schemes begin), time spent online continues to grow, and users' engagement with digital products becomes more sophisticated.

At the same time, the ingenuity of hardware and software builders produces a volume of new ideas which continually reshape the digital experience. Barriers to entry for digital products are very low, engendering a bewildering array of tiny suppliers sporting business plans mirroring Facebook's growth rate. A tiny proportion of them will achieve their ambitions, but identifying them at start-up is no simple task. Meanwhile, large-scale and well-funded inventions such as YouView which takes the internet to the TV, and Microsoft's Kinect which allows computer control without a keyboard, will enhance and increase digital engagement.

Current digital hotspots are social media, online video, data management and the long-anticipated transfer of much online activity to mobile devices. Few sectors illustrate the trouble with timing as clearly as mobile advertising, considered a cert by investors for the best part of the last decade. Only now are advertisers getting interested, but years of thin-stretched funding have left a highly fragmented industry of underweight companies. A clean-up has begun, but the scope for consolidation here is significant.

However, there is an important factor of which investors should be aware. For many years commercial media companies have complained about the BBC's elephantine impact on the smooth operation of their market. However, operations such as Google and Facebook repeatedly kill start-up business plans by identifying the same user need and providing a solution free of charge. Last year, Jeff Jarvis published a book called 'What would Google do?'; it's a good question for investors.

The greatest risk for corporates is that their digital investment is defined by analysts and fund managers, and not by their customers.

Richard Eyre
Chairman of the Eden Project, the Internet Advertising Bureau and Rapid Mobile

An increasingly global industry

The structural challenges of globalisation have been accentuated by digitalisation. Consumers have historically shown little interest in foreign-language programming, yet they will happily watch a YouTube clip created in, say, Vietnam. Similarly, there is little appetite for foreign-language newspapers, but celebrity gossip websites, such as TMZ, have a substantial international readership, while Google Translate enables consumers and professionals to read previously inaccessible stories and company information on foreign websites.

For the most part, however, media companies have sought to expand beyond their UK base because the local market is too small and mature. The buy-and-build marketing services groups have been global operators for many years. Only 12% of WPP's 2009 revenues came from the UK, and four of its nine transactions this year have been in the key BRIC territories of Brazil and China, while a fifth was in Singapore. Earlier this year, Aegis acquired Australia's largest marketing company, Mitchell Communication Group, for £208 million, principally to enhance its presence in the Asia-Pacific region.

Christine Corner
Assurance Partner,
Media & Entertainment,
Grant Thornton UK LLP

This report refers to recent deals with Warner Television's acquisition of Shed and Zodiak's acquisition of RDF. This demonstrates a continuation of the interest from US and European studios in purchasing UK TV production companies which our clients have seen over the past few years. NBC Universal was the first studio to declare an intention to set up in the UK, and to do this by acquisition, in acquiring Carnival in August 2008.

We noted this interest as a result of the dollar and euro strengthening, making the UK once again an attractive place to set up local production. The common language helps, but also the ability for UK TV production companies to control their rights; something which is not the case in other European countries, such as Germany, and also in many genres in the US. This, combined with the creative talent in the UK, which has been extremely successful at exporting formats and completed shows around the world, and the growth of the six super-indies has meant that the US studios can quickly acquire scale.

Other sub-sectors have also embraced the changing global dynamics with outbound investments. In the B2B publishing and events sector, notable deals include United Business Media's (5% of its revenues are from the UK) recent acquisition of the US tradeshow operator, Canon Communications from Apprise Media LLC and Spectrum Equity Investors, for £185 million. In addition were Pearson's (9% of its revenues are from Asia-Pacific) two English language school investments – in 2009 it acquired Wall Street English in China from The Carlyle Group for £97 million, and then in 2010 it also acquired its international parent, Wall Street Institute, for £59 million from The Carlyle Group and Citi Private Equity.

There have been two sizeable inbound deals in the television production sector. Warner Bros' (Time Warner) £108m acquisition of the independent producer ('indie') Shed Media (whose board had rejected two recent MBO attempts) was an attempt to expand its production base outside Hollywood, as well as gain control of intellectual property rights. While Zodiak Media (owned by Italy's media conglomerate, De Agostini) acquired RDF Media – for a rumoured £150 million – as it sought greater access to the UK and US markets.

Ian D. Cookson
Director, Investment Banking, Grant Thornton Corporate Finance LLC, United States

View from across the Atlantic

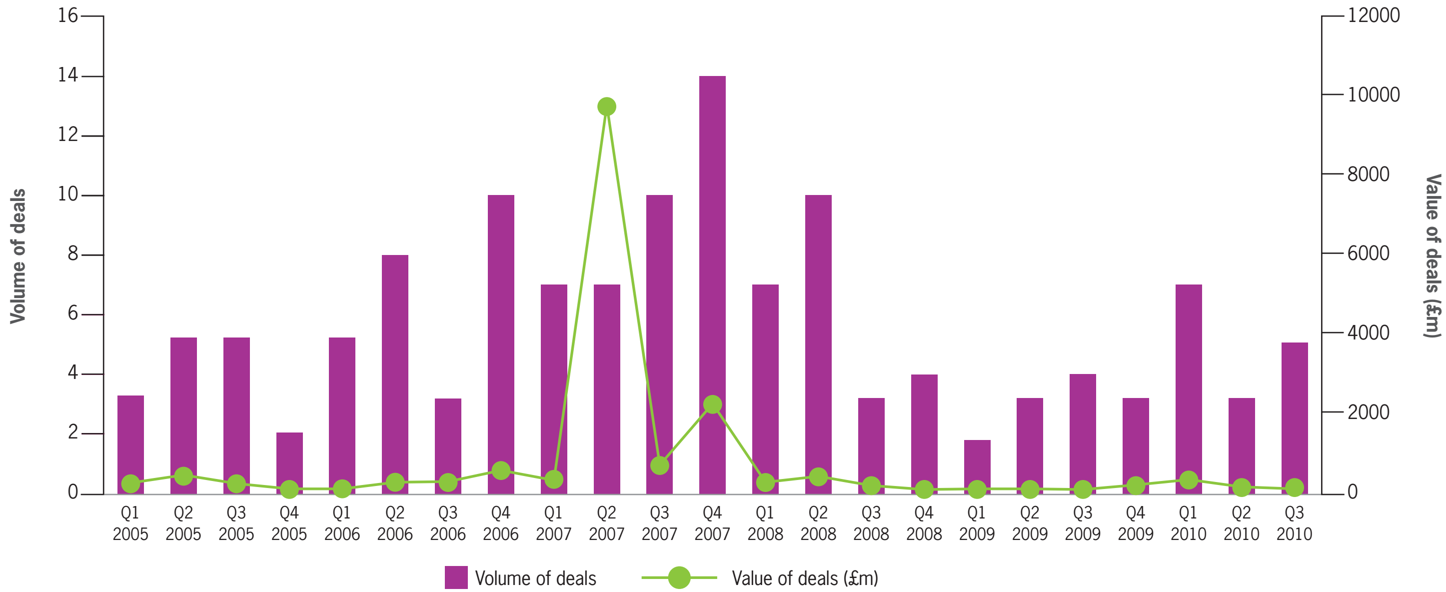
The prevalence of large, highly acquisitive global marketing services conglomerates headquartered in the UK has meant acquisitions by these players have traditionally had a very significant impact on US marketing services M&A activity. More recently these firms have focused their sights on emerging markets, with US acquisitions generally limited to fill-in digital transactions.

Despite reduced activity by UK acquirers, US M&A sector activity in has seen a significant rebound in the number if not the size of transactions, with many acquisitions comprising smaller transactions between local firms. Larger acquisitions can generally be characterised as: strategic purchases of digital marketing firms by players from adjacent media and technology areas (such as Adobe and Google), and traditional direct marketing firms being acquired by private equity groups.

As digital marketing has become increasingly mainstream and most firms have gained digital capabilities, we have seen the divergence in valuations between digital and traditional marketing firms reduce substantially.

Given the acquisitive nature of some of the UK Media's larger corporates, it is little surprise that outbound cross-border investment activity exceeds inbound. Since 2005, there have been 179 outbound transactions, as opposed to 131 inbound deals. However, it is notable that inbound deal activity has recovered far more rapidly than outbound. Over the first three quarters of 2010, inbound deals accounted for 44% of all M&A activity, in comparison to only 32% over the preceding four years. This is perhaps a reflection of the relative recovery of investor confidence between the UK and North America – the largest inbound Media investor (80% of all deals since 2005) and the increase in inbound deals is in part a consequence of the

Overall inbound cross border M&A trends in the UK Media sector



depreciation of sterling versus the dollar (albeit the dollar has been declining sharply recently). For both corporate and private equity investors, a 10% relative decline in the price of a UK asset based purely on foreign exchange fluctuations, has a material impact on an investment decision. Given the wider economic growth issues and the prospect of further quantitative easing, the price of sterling could have a material impact on the levels of inbound versus outbound investments over the near term.

The list of the largest disclosed M&A deals only partly reflects the significance of the inbound investor, as a number of the larger deals have not had their prices officially disclosed. Of the five largest disclosed deals, two involved investors from overseas: Time Warner and LBi International.

Target company	Bidder company	Seller company	Deal Value GBP (m)
Virgin Media Television Ltd	British Sky Broadcasting Group	Virgin Media Inc	160
Shed Media plc	Time Warner Inc		108
Five Group	Northern & Shell Network Ltd	RTL Group SA	106
bigmouthmedia Ltd	LBi International AB	The Carlyle Group LLC	91
GMG Regional Media	Trinity Motor plc	Guardian Media Group plc	49

Consolidation in the mid-market

Due primarily to the recession and credit markets closure, there has been little sign of consolidation at the top end of the market. The largest reported deal this year has been BSkyB's £160 million acquisition of Virgin Media Television. However, the sector has had a busy period of small and, primarily, mid-market consolidation.

Not surprisingly, much of the consolidation has centred around recessionary-distressed assets and structurally weak sub-sectors. Corporates have been the key buy-side participants, with less evidence of private equity roll-up strategies, although some have taken the opportunity to exit investments.

Notable consolidation-for-survival deals included Trinity Mirror acquiring the Regional Media division of Guardian Media Group for £49 million – regional advertising expenditure actually declined again in H1-2010, in contrast to the growth in the overall market. The film distributor Metrodome acquired the television distributor Target Entertainment Group (42% owned by Acuity Capital), which had suffered, like all independent television distributors, from rising costs and falling prices. And in outdoor advertising, France's JCDecaux acquired certain assets of one of the leading UK players, Titan Outdoor, from administration for £8 million.

There is no doubt that M&A activity in the UK mid market is becoming increasingly polarised, which is impacting the multiples being paid for Media businesses. Of the five transactions the Grant Thornton Media team advised on over the summer, at one end of the spectrum there were the 'stressed' disposals of the Picture Production Company and the Independent Television Facilities Centre, and then, at the other extreme, Complinet which Thompson Reuters paid a frothy multiple for.

Dominic Bolton
Corporate Finance Advisory Partner, Grant Thornton UK LLP

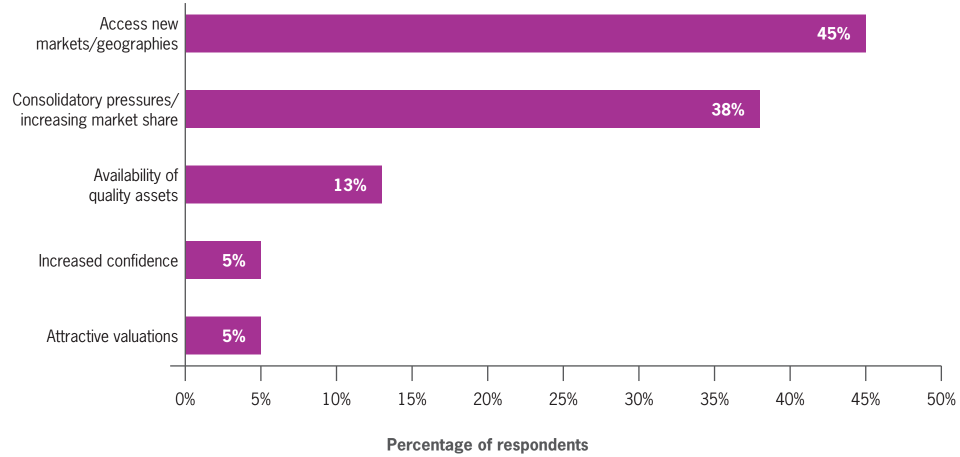
On a more positive perspective, there has been consolidation in the financial regulation and compliance sector, which is viewed by many investors as a long-term growth market. Thomson Reuters acquired, for a rumoured £100 million+, the financial compliance information solutions provider, Complinet (Canter Equity had a minority stake), while Wilmington recently acquired Axco Insurance Information, the provider of compliance and regulatory information to the insurance industry for £22 million.

Further examples include the printing group St Ives, which continued to implement its strategy of seeking value-add products and services, with the acquisition of the marketing database company, Occam DM (ISIS Equity had a minority stake). And in marketing services, Ebiquity bolted on the media monitoring company, Xtreme Information for £18 million as Veronis Suhler Stevenson exited its controlling stake.

The most notable private equity roll-up transaction was Permira's super-indie All3Media continuing to consolidate the indie market with its acquisition of Optomen Television (the producer of Gordon Ramsay's programmes) for a rumoured £40 million.

The outlook for private equity involvement in a consolidation process appears to be more positive in the near term. 'Consolidatory pressures and/or increasing market share' is the second most important objective for doing a deal, according to the survey.

What is the primary objective for doing a deal in the UK?



An interview with David Levin, Chief Executive, United Business Media (UBM) Limited

UBM is a leading global business media company and serves professional and commercial communities, bringing them together at events, online, in print and provides them with the information they need to do business successfully. UBM employs more than 6,000 staff and operates in more than 30 countries.

What does UBM look for in Media businesses/ what are your acquisitions criteria?

Over the last five years we have made more than 80 acquisitions principally of tradeshow and database businesses. In abstract we are looking for businesses that match up to the following:

- businesses which can generate a rate of return in excess of their acquisition's cost of capital in their first year of ownership by UBM;
- businesses that provide or can extend an existing UBM market-leading position, serving a specific professional or commercial community;
- businesses that are operating in markets or sectors that we know well – most likely markets we are already operating in and in which we want to build our presence;
- businesses that would contribute to and benefit from access to the expertise and experience we share across UBM's more than a dozen businesses. UBM uses a wiki social networking technology platform to support collaboration and share knowledge of information and best practices across all UBM's different businesses worldwide.

How does UBM source its acquisitions?

Today we are very proactive in identifying acquisition targets, rather than waiting for third parties to bring them to us. We have sourced approximately 80% of our recent acquisitions directly, including Canon Communications with which we were in dialogue for three years prior to doing the deal. In terms of the smaller deals, more recently I would say they have been coming to us.

Which countries and geographies are UBM focusing on?

Rather than choose specific countries, we aim to invest in markets where we see opportunities for profitable growth. Some of those markets are developed economies – such as with our recent acquisition of US-based Canon Communications – but we also see immense opportunities for profitable growth in fast-expanding economies such as China, Brazil and India.

Private equity activity expected to rise

Despite the dearth of activity in the Media sector by private equity funds over the past 18-24 months, the survey suggests that there will be a notable uptick over the next 12 months.

The recession not only curtailed the scale of acquisitions – prohibiting the large, highly-leveraged deals of 2005-07 – but it also reduced company valuations. With little access to cheap debt, private equity participants were not able to structure large-scale deals, and nor was there a rush to exit portfolio holdings given lowered asset valuations. But, with the wider economic growth, expectations are now robust for a more active next 12-month period. It has become apparent in deals both rumoured and officially announced, that good quality assets, in strategically important sub-sectors, are already able to attract near bull-market valuations, particularly from corporates.

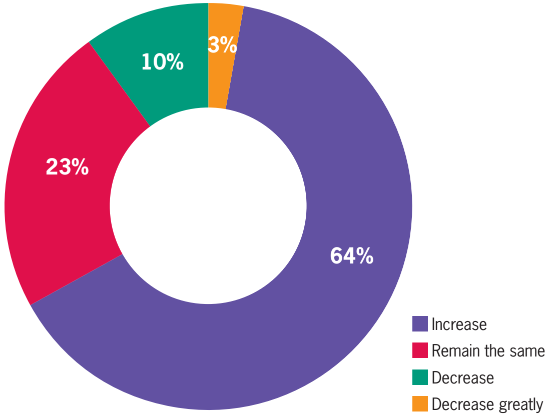
Of the respondents, 64% expect an increase in activity in the upcoming period. However, many expressions of interest were caveated by, as one investor put it: "We will be opportunistically, but not actively, looking." Another based their expectations of an uptick on: "It will increase, but only because things have been pretty dead of late."

Given the more positive attitude, it is not surprising that most respondents are experiencing more, or significantly more, competition from their peers for assets. However, it is interesting that investors have not experienced a discernible increase in competition from trade players – despite corporates having been the key buyers in recent months.

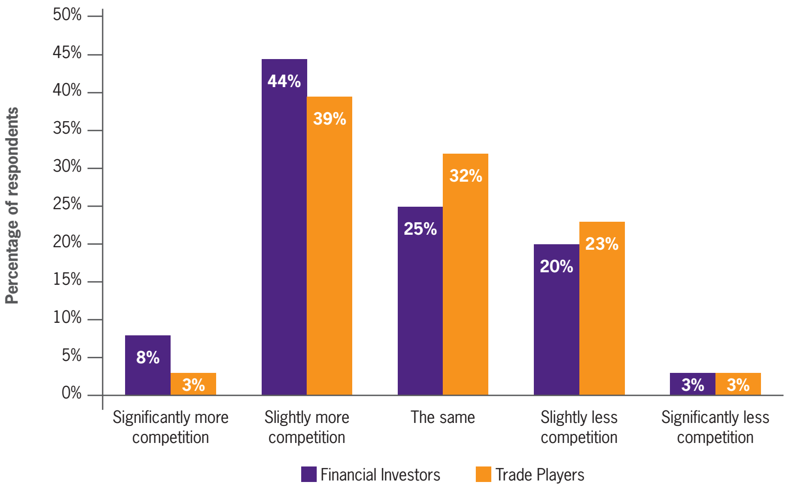
Mark Smith
Finance Director, Chime Communications PLC

The increasing interest in Media businesses by private equity investors may be attributed to an under-valued Media sector. The media sector goes in a cycle and we are not seeing the high multiples we saw five years ago, so now is a good time to invest.

What do you expect to happen to the overall level of private equity activity – both exits and acquisitions – in the UK Media sector over the next 12 months?



Compared to 12 months ago, how much competition is there currently for assets in the UK Media sector from Financial Investors/Trade Players?



Even with the post-2007 decline in company valuations, survey respondents were cautious about finding suitable targets. Of the respondents, 38% highlighted ‘finding attractive assets’ as the most difficult aspect of identifying new potential investments, while 23% stated it was due to ‘unrealistic vendor price expectations’.

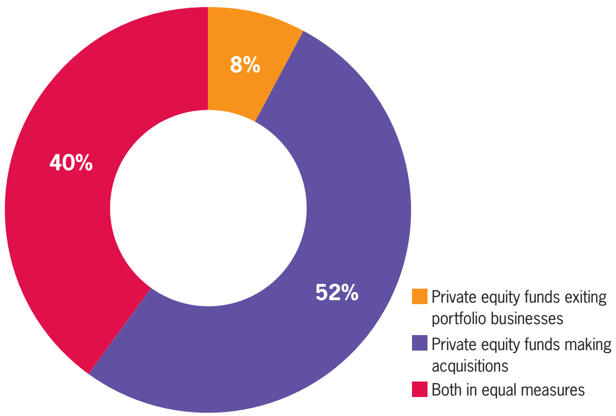
Double-digit multiples into the mid-20s were common at the top end of the market before the recession, and although there has been a stark and steep decline in the intervening period, some deals are already back to these levels. Silver Lake and Warburg Pincus reportedly paid 24 x earnings for IDC.

Dominic Bolton
Corporate Finance Advisory Partner, Grant Thornton UK LLP

Structural changes and cycle aside, the exit timetable for over-leveraged private equity media deals in 2005 to 2007 has to be extended by at least one to two years, if only because it will take longer to unwind that leverage or any intervening restructuring.

In terms of the type of deal activity foreseen, there are expectations of a general shake-up of portfolio holdings with both exits and entrances. However, with a nod to the divergence in corporate valuations since the last deal cycle, there are limited expectations (8%) for exit transactions alone to drive the activity. Many observers expect the typical three-year exit horizons to be extended, in an attempt to deliver positive portfolio returns. As one respondent stated: “It is not a particularly great time to exit unless you really must.” Counter to this, and reflective of today’s still lowered valuations and improving credit markets, is the high expectation for acquisitions to be the key activity driver over the next 12 months, as noted by 52% of respondents.

In terms of deal type, what do you expect to drive this activity over the next 12 months?



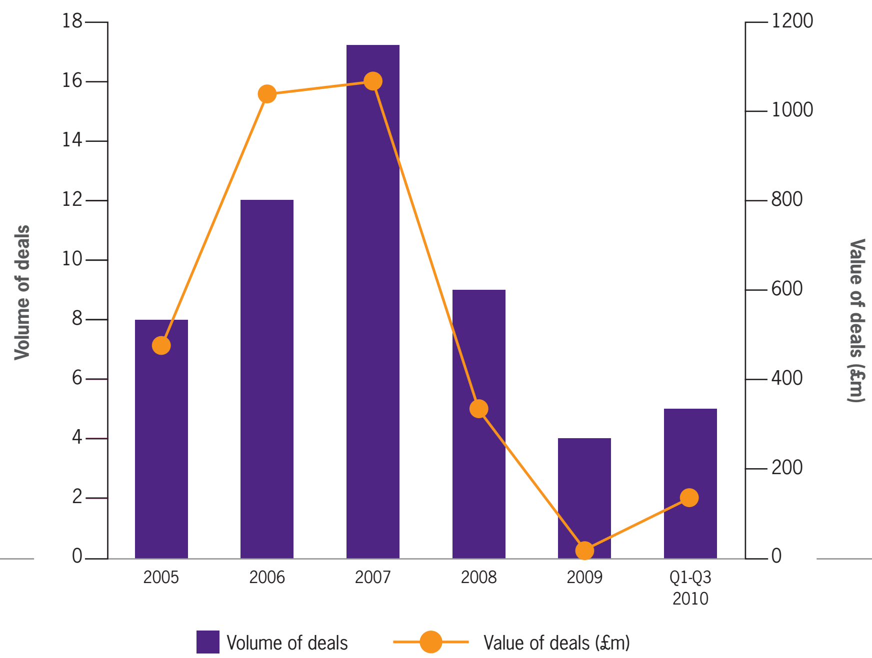
As evidenced in the chart below, exit activity has been low in recent periods. But exits in the first three quarters of 2010 (5) have already surpassed the volume in 2009 (4), and could match 2008 levels (9) by year-end, despite concerns about lower exit multiples.

Ben Johnson
Principal,
Vitruvian Partners

Private equity allows Media entrepreneurs to remain independent while also accessing equity capital to grow. The best UK Media businesses have the leadership and potential to become international champions – either organically or through acquisition. A period of private equity ownership can allow a window of time, away from the glare of a public listing, to develop a business into a strategically valuable leader in its market.

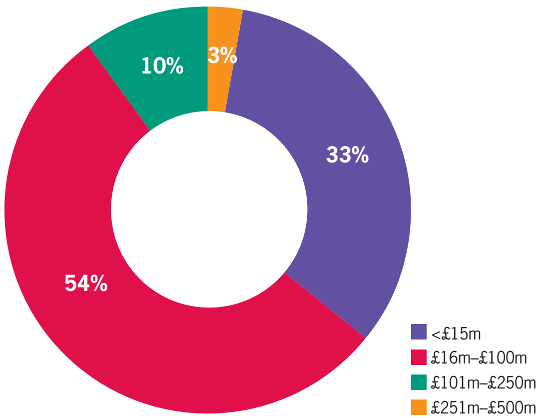
Reflecting the low volume of large UK Media assets, almost 90% of respondents expect any activity to be transacted in the small/mid-market (<£100 million). Not a single respondent expects a £500 million+ deal in the UK during the next year. Almost a quarter of respondents based their position on the opinion that 'the mid-market offers the best growth opportunities'. One respondent also noted that it is reflective of the fact that 'there are many mid-market funds which have already raised funds and are out there now looking for deals.'

UK Media private equity exit trends



Where is the smart money going in Media?

Which deal size range do you expect to witness the bulk of private equity activity in the UK Media sector over the next 12 months?



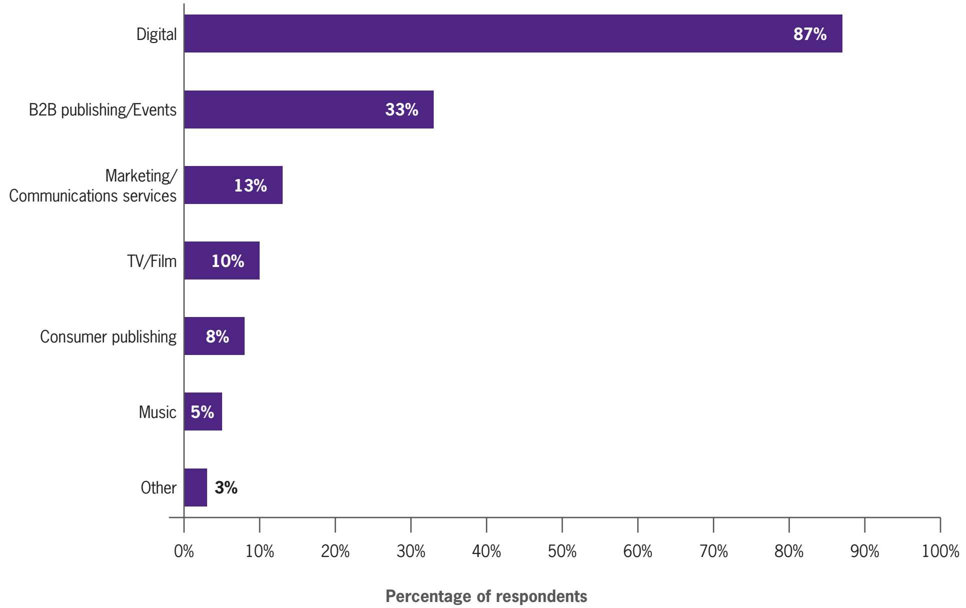
While companies operating in the digital sub-sector are expected to attract the most significant levels of investor interest, it is notable that this sub-sector is followed by the more defensive plays of B2B publishing/events and marketing services companies. As one respondent declared: "I'll look at anything with defensive revenue streams."

The lack of interest in the music recording industry is hardly surprising. Digital piracy remains unchecked, and new services such as Spotify encourage consumers to think that music can be entirely ad-funded. Even robustly contrarian investors are forewarned of the industry's challenges by Terra Firma's troubled £4.2 billion acquisition of EMI. However, the music publishing industry, long the preserve of specialist banks, hedge fund investors and special purpose vehicles, remains a key sector for smaller private equity players, due to its reliable cash flows.

The limited growth prospects for the consumer publishing industry are also reflected in investor interest levels. The most recent ABC data reported an overall UK circulation of magazines of 24.5 million – down from 32 million in 2005. However, the strength of the BBC Magazines portfolio, which, uniquely boosted by onscreen promotion and brand-awareness, saw overall circulation increase 3.1% year-on-year, is expected to see BBC Worldwide sell a majority stake in the business. The National Magazine Company and Hachette Filipacchi are being tipped as the early favourites by industry insiders, but a private equity approach should not be ruled out. Meanwhile, IPC continues to offload a number of its niche and specialist consumer titles.

In the television production sector, much of the consolidation has already been completed during the past five years, with the few opportunities that do remain unlikely to attract new private equity interest; while the film production market, with its high failure rate, is too uncertain for most private equity investors.

What is the primary objective for doing a deal in the UK?



Exit strategies are expected to heavily favour trade sales. Fifty five per cent of respondents expect portfolio investment exits to be to trade players, while 33% foresee a secondary buyout. This ratio mirrors the historical average in the UK Media sector of almost twice as many trade exits as secondary buyouts. Not surprisingly, few expect exits via an IPO.

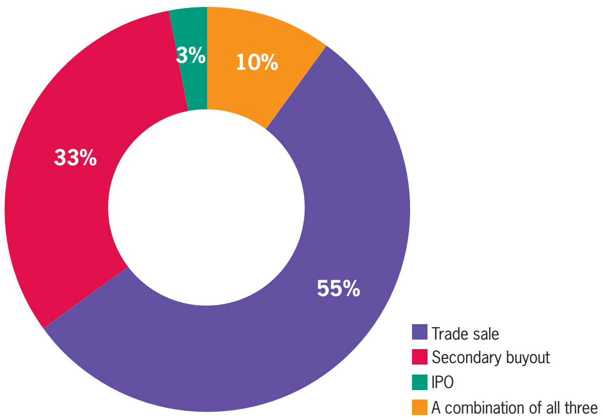
Mark Smith
Finance Director,
Chime Communications PLC

In terms of our acquisition strategy, we are interested in disciplines that we are not currently in, for example, media buying. We are interested in acquiring digital businesses, but this is likely to be restricted to those that can be integrated into mainstream marketing services offerings, rather than as a specialist digital business. Additionally, we don't like to hold competing businesses in our portfolio. Acquisitions in the UK are likely to remain difficult for the next 2-3 years. If one is expecting 10% or more returns, one must grow market share. Otherwise, one needs to look abroad for investment opportunities.

Within Media, those sub-sectors that can demonstrate secular growth characteristics, enhanced by a global market opportunity, are the most obvious areas of interest. In particular, businesses benefiting from platform shifts, changes in customer behaviour or attractive economics and growth in a digital environment, will see enhanced buyer interest.

Ben Johnson
Principal,
Vitruvian Partners

How do you expect private equity firms to predominantly exit UK Media investments sector over the next 12 months?

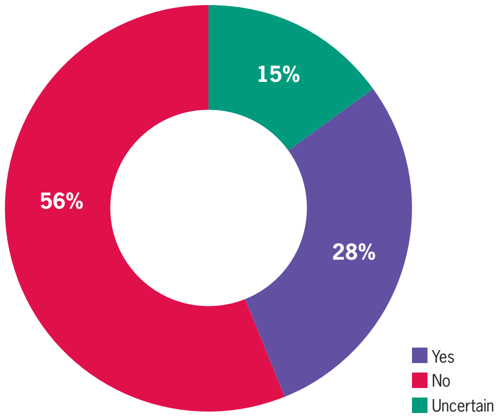


Media and the political landscape

Respondents' expectations of the impact of the coalition government reflect the broad spectrum of potential outcomes. Many respondents expect that cuts to the government's advertising expenditure – it is the largest advertiser in the UK – will have a chilling effect on smaller, UK-specific marketing agencies and, subsequently, advertising-funded sub-sectors such as broadcasting and consumer publishing. In contrast, other respondents believe that curbs in government expenditure will open new opportunities for private companies. One respondent noted: "Cuts may create a vacuum into which entrepreneurial companies can expand."

It is interesting to note that none of the respondents mentioned the plans of Jeremy Hunt, the Culture Secretary, for more localised television and online media services. The plans still lack structure, and have been dismissed by some observers as commercially unfeasible, but Mr Hunt is in a position to force open the local media market to a wide group of new corporates and entrepreneurs.

Do you expect the new political landscape to positively impact upon private equity investment in the UK Media sector over the next 12 months?



The recent turmoil in global equity markets slammed the door closed on public markets being used as an exit option for private equity investments. A recovery in confidence has grown during 2010, albeit fragile with institutional investors backing only the very strongest growth stories. An IPO can at last be considered a credible exit option for the right story. Institutional investors, however, continue to struggle to match trade buyer valuations which are underpinned by synergistic benefits.

Philip Secrett
Partner, Capital Markets,
Grant Thornton UK LLP

An industry ahead of private equity?

The nature of deal flow activity over the past 12-18 months combined with the responses from the survey, suggest that there is almost a disconnect between corporate and financial investors. Media corporates have led the investment activity, while private equity funds have largely stood on the sidelines.

During the recession, many Media companies aggressively cut costs and repaired balance sheets, leaving them on a strong financial footing. Many also took this period to accelerate their transition to digital product offerings.

Arguably, management teams at public corporates acted with the financial discipline and strategic rigour more commonly associated with private equity investors. Had the credit markets not been closed, there would almost certainly have been many more acquisitions in the past 12 months from trade players. But, with the increasingly positive private equity sentiment today, have the corporates missed their window of opportunity?

Fundamentally, one would expect so, but in contrast to the abundance of recent trade acquisitions to offset the structural issues, private equity appears to be suffering from indecision: 23% of respondents struggle to identify new investments because they do not understand the sector.

However, the financial strength and strategic imperative of the larger corporates should provide private equity with a robust list of exit opportunities. And the reopening of the credit markets is beginning to provide private equity with some of the leverage that they require to structure larger-scale acquisitions.

Mo Merali
Head of Private Equity, Grant Thornton UK LLP

Media has traditionally been a strong sector for private equity investors, with fragmentation and growth prospects being particularly attractive features. While recent macro-economic factors coupled with leverage have resulted in a significant reduction in deal activity and impacted upon short-term performance in the sector, it is very encouraging to see renewed focus and attention on the sector, in particular in the mid-market. However, with increasing focus and migration to the 'digital world', the key issue most investors and corporates are grappling with is how to spot the winners in this fast-moving environment. To generate real value, the approach of private equity to the Media sector needs to be driven much more by a deeper understanding of the individual sub-sectors, the different business models including key drivers, than the more traditional consolidation/leverage/arbitrage models. Media continues to be a primary focus for Grant Thornton, and as the market-leading adviser in the sector we are very excited with what the future holds.

About us

About Grant Thornton

Grant Thornton UK LLP is a leading business and financial adviser with offices in 28 locations nationwide. Led by 235 partners and over 4,000 of the profession's brightest minds, we provide personalised assurance, tax and specialist advisory services to over 40,000 individuals, privately-held businesses and public interest entities.

Our market-facing business units are supported by relevant sector specialists who share their expertise and insight across our firm, resulting in an agile and innovative environment. We're flexible to respond to our clients' increasingly discerning requirements and meet the challenges posed by our rapidly changing marketplace.

Taking everything into account, Grant Thornton UK LLP strives to speak out on issues that matter to business and are in the wider public interest. We focus on being a bold and positive leader in our chosen markets and within the accounting profession.

About Grant Thornton Media & Entertainment

The Grant Thornton Media & Entertainment team is a national team of dedicated industry specialists from Audit, Tax, Corporate Finance and also industry consultants who work together on a daily basis.

Our service offering includes:

- audit compliance and accounting advice
- royalty audits
- production/DCMS audit
- acquisitions and disposals
- raising finance
- flotations
- international growth and related tax issues
- direct and indirect tax services
- employment issues

We act for medium to large private companies, AIM listed and venture capitalist and private equity backed businesses within film and television production and distribution, publishing, advertising and marketing services, music and computer gaming companies.

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Remark is the market research, publications and events division of The Mergermarket Group. Remark publishes M&A and private equity reports, industry sector and country insights, and thought leadership studies on a range of extant topics affecting corporations and their service providers. The Mergermarket Group is a division of the Financial Times Group, publisher of the Financial Times newspaper and FT.com

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