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DEVELOPMENTS IN THE UK BUYOUT MARKET

BETWEEN 1996 AND 2000, THE UK BUYOUT MARKET WAS BOOMING – BUT SINCE THEN IT HAS STRUGGLED TO REGAIN ITS PREVIOUS PEAKS. A STRONGER 2003, HOWEVER, INDICATES THE MARKET MAY BE ABOUT TO TURN A CORNER, WITH POSITIVE DEVELOPMENTS FORECAST FOR 2004 AND 2005. **MIKE WRIGHT**, **ROD BALL** AND **ANDREW BURROWS** OF THE CENTRE FOR MANAGEMENT BUYOUT RESEARCH PROVIDE AN OVERVIEW.

After seven years of strong growth, the UK buyout market stalled in 2001, when its value fell from £23.9bn to £19.5bn (see *Figure 1*). The total market value then dropped further in 2002 to £15.3bn, mainly because of reduced activity in the large deal sector, compounded by a slowdown in public-to-private (PTP) deal activity. Last year saw a reversal of these trends, as the buyout market value stabilised, with the year-end total matching the 2002 figure and the number of deals rising from 620 to 671.

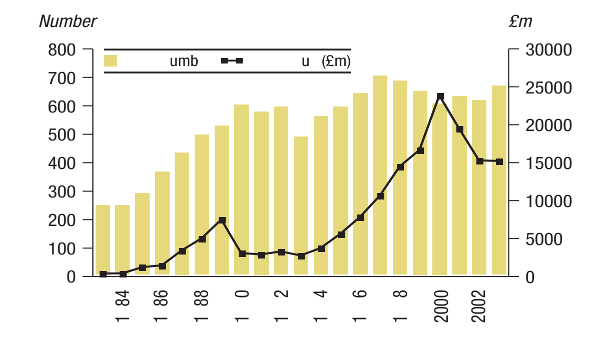
The difficulties in realising gains in buyouts that affected the market in 2002 barely eased off in 2003. There were only seven flotations last year, with this exit route remaining problematic. The number of trade sales continues to be disappointing, with only 63 in 2003 and the total falling further from the peak of 137 reached in 2000. Reflecting the difficulties in exiting through the traditional routes, secondary buyouts continued at relatively high levels, with the total of 59 almost matching the trade sales figure. There were also fewer receiverships, with 93 recorded last year.

Between 1996 and 2000, one of the most significant features of the market was the growth in buyouts and buy-ins with a value greater than £100m. However, since the second half of 2001, this growth has been reversed. In 2000, more than three quarters (78%) of the total market value was provided by the 45 £100m-plus deals, although they amounted to only 7% of the total buyout volume. By 2003, only 20 £100m-plus deals were completed at a total value of £10.1bn, equivalent to just 66% of market value and 3% of volume.

The top three deals of 2003 were the £2.5bn Spirit Amber pub chain transaction, the £1.7bn Debenhams PTP buyout, and the £1.2bn tertiary buyout of Gala Clubs. The fundraising environment has remained relatively resilient. Several new funds were initiated in 2003, as well as a large amount of private equity capital raised from further rounds of funding from earlier funds. Last year, an additional £9.3bn of UK-based equity capital was raised, with 11 new funds targeted at the UK and European markets.

FIGURE 1

TRENDS OF BUYOUTS/BUYINS. 1983-2003



Source: CMBOR/Barclays Private Equity/Deloitte & Touche

TABLE 1

PUBLIC TO PRIVATE BUYOUTS/BUY-INS. 1994-2003

Year	Number	Number (% of all deals)	Value (£m)	Value (% of all deals)
1994	3	0.5	187	5.0
1995	3	0.5	48	0.9
1996	4	0.6	32	0.4
1997	7	1.0	390	3.7
1998	26	3.8	2,524	17.4
1999	46	7.1	4,620	27.7
2000	42	6.9	9,363	39.2
2001	33	5.2	4,903	25.2
2002	22	3.5	2,691	17.6
2003	36	5.4	3,838	25.2

Source: CMBOR/Barclays Private Equity/Deloitte & Touche

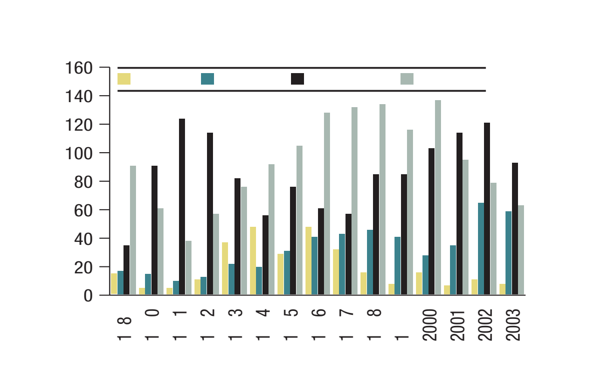
INDUSTRY SECTOR TRENDS. Business services remained the largest sector in terms of volume of buyouts completed during 2003, with a total of 100 deals, up a third from the previous year. General manufacturing continued to improve, with 69 buyouts. There was also a healthy level of activity in the retail sector, which saw 42 buyouts finalised during 2003, an increase of 27% on 2002. The leisure sector showed a slight improvement, at 40 deals, which included two of the three largest deals of the year. The close to £6bn invested in the leisure sector last year was above the previous record of £5.6bn in 2001 and brought total investment in the sector in the past five years to £21.8bn. The retail sector was the second largest by value in 2003, with the £1.7bn Debenhams buyout helping to increase sector value to a record of about £2.5bn. These two sectors made up more than half of the total UK buyout value last year. In contrast, the medical healthcare, food and property sectors were all sharply down in terms of deal value.

BUYOUT SOURCES. Local parent divestment continued to be the largest source of buyouts in 2003, at just under a third (30%) of the market. Buyouts from foreign parent divestment fell from being a tenth of the market in 2002 to less than 8% market share last year, back in line with the 2000 level. Buyouts from private sources have remained relatively stable over recent years, with the total in 2003 at just over a quarter of the market. Receiverships, again, provided a larger proportion of buyouts than in earlier years, with around a tenth of all buyouts coming from this source in each of the past three years. Corresponding to the increase in secondary buyouts as an exit route, these deals continued to account for a healthy share of new offerings last year. After providing more than a tenth of total market volume in 2002, their share eased to about 9% last year, but this is still almost double the share recorded in the two previous years. After falling for three consecutive years, the number of PTP buyouts rebounded in 2003 to reach the highest level since 2000. With the main global stock markets showing their first annual rise since 1999, the total value of UK delistings through buyouts also rose. Nevertheless, the total value still remains well below the market peak reached in 2000 of £9.4bn.

The number of PTPs ended last year at 36, after falling to just 22 in 2002 (see *Table 1*), although the latest figure is still some way short of the record 46 delistings in 1999. Total PTP value in the UK rose two-fifths last year to £3.8bn, yet this was only 40% of the record figure of £9.4bn in 2000. The £1.7bn buyout of Debenhams was the first £1bn-plus PTP transaction since 2000 and the third highest in the history of the market after the £3.5bn MEPC transaction in 2000 and the 1989 Gateway transaction at almost £2.2bn.

FIGURE 2

TRENDS OF BUYOUTS/BUY-INS. 1989-2003



Source: CMBOR/Barclays Private Equity/Deloitte & Touche

EXIT TRENDS. By the end of 2003 there were few signs of improvement in the exit market, with the number of exits falling by around a fifth to 222. Trade sales continued the downward trend of recent years, with just 63 completed in 2003 compared with 2000's peak of 137 (see *Figure 2*). Secondary buyouts, at 59, eased from the record 65 the previous year. This exit type has, to a certain extent, replaced the flotation exit route, with many of the larger exits now being sold as secondary deals, rather than as new stock market listings. Six of the top 10 non-float exits in 2003 were secondary deals, with Gala Group, at £1.2bn, being the largest of these, followed by the £600m purchase of Hurst Publishing/Trader Media Group by the Guardian Media Group.

Only seven former buyouts joined the stock market in 2003, although there were some large-scale initial public offerings (IPOs) in the second half of the year. December saw the listing of the UK operations of holiday park operator Center Parcs for £285m, in a transaction that involved stockbroking firm Collins Stewart buying the company in order to place the equity with institutions to complete the float exit.

Also in December, Wellington Re floated for £941m, with the reinsurance business having been bought out for £448m in 2002. Nevertheless, the largest of the new listings from former buyouts remained the IPO of telephone directories business Yell Group in July. The June 2001 buyout had a market capitalisation of £2bn at the time of flotation and is now part of the FTSE 100.

The level of receiverships in 2003 was a more encouraging aspect of the market, with a decline of over a fifth to 93. Many of these failures were from smaller buyouts, with more than four-fifths having an initial buyout value of less than £10m.

GOING FORWARD. Low inflation and interest rates continue to stimulate consumer borrowing. This, along with increased government spending, has contributed to UK growth remaining above many of its European counterparts. Government GDP estimates also anticipate healthy growth in 2004 and 2005, but concerns over personal debt and possible increased government borrowing persist. In this environment, the market should continue to perform relatively well, with fundraising remaining fairly robust last year. However, a significant part of new fundraising is now being directed at deals in continental Europe. In total, the region saw an all-time record of 55 buyouts of more than £100m last year.

The PTP market showed renewed strength during 2003, but as the stock market recovers, valuations of many companies have increased markedly. It may be that potential targets now seem more fully valued and therefore suitable PTP deals may be more difficult to come by during 2004. Exits through trade sales and flotations remain problematical. It is hard to see flotations recovering significantly as increasingly more companies question the viability of a stock market listing. Since 1998, the number of quoted companies has fallen by nearly a quarter, according to the London Stock Exchange. Therefore, in order for the buyout market to regain its confidence these current impediments to exit need to be overcome.

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