FOCUS ON THE UK BUY-OUT MARKET

MIKE WRIGHT, **ROD BALL** AND **ANDREW BURROWS** OF THE CENTRE FOR MANAGEMENT BUYOUT RESEARCH (CMBOR) EXPLORE THE STATISTICS AND DATA BEHIND THE TRENDS THAT ARE SHAPING TODAY'S UK BUYOUT MARKET.

Having experienced several years of strong growth the UK buyout market by the end of September 2001 looked set to end the year below the 2000 record value of £23.4bn. Total value of buyouts stood at £16.9bn, having slowed considerably due to the deteriorating macroeconomic and political environment. The volume of buyouts, which had held up reasonably well in the first half of 2001, also began to slow in the third quarter and is forecast to fall further in the last three months of the year. The extent and depth of the current period of uncertainty is as yet unclear but there are signs that private equity providers are reluctant to finalise buyouts that had been under negotiation since before 11 September. In the UK, ABN AMRO pulled out of the WH Smith distribution division buyout, having had second thoughts on the £215m asking price.

OVERALL TRENDS. At £23.9bn, the value of buyouts completed in 2000 was virtually 40% above the 1999 figure, which had been a record (See *Figure1*). However, this level of growth is unlikely to be maintained in 2001. The total of £16.9bn reached at the end of the third quarter is less than the £17.8bn total for the same period in 2000. Average deal sizes rose from £25.9m in 1999 to £40m in 2000. This figure increased further in 2001, albeit at a slower rate, reaching an average of £41.4m in the first nine months.

The past four years have seen substantial funding availability and market entry from US players. A further £7.4bn of equity funds for buyout investments had been raised in the first three quarters of this year. These funds have fuelled the recent growth in buy-outs and buy-ins with a value greater than £100m. These mega deals rose in number from only 10 in 1996 to 45 in 2000.

INDUSTRIAL SECTOR TRENDS. The most prominent industry sector in terms of deal numbers continues to be business services. The next largest industry sectors in 2001 have been mechanical and instrument engineering, general manufacturing and hotels, catering and leisure. Although business services has remained the largest sector in terms of deal numbers, it is only second when ranked by value with £3.3bn worth of deals. The sector has been dominated by the divestment by British Telecom of Yell Group to Apax and Hicks, Muse Tate & Furst for £2.1bn. This is the third largest deal ever recorded in the UK. This sector has also provided a further three £100m-plus deals, including the secondary buyout of amusement machine company Leisure Link.

Up to the end of September the biggest sector in terms of value was hotels, catering and leisure, with just over £5bn worth of completions. The majority of this came from three deals: the institutional buyout of Meridien Hotels from Compass for £1.9bn, the institutional buyout of Whitbread Pubs from Whitbread for £1.6bn, and the divestment by Bass of its pubs chain for £625m.

SOURCE OF DEALS. The share of buyouts from family/private businesses has continued to decline during 2001 and at 22% is now at its lowest point since 1986. The anticipated reversal of this trend, based on the introduction of taper relief, has so far failed to materialise. Consequently, local parent divestment remained the largest source of deals in the first three quarters of the year. However, at 39% of the market, this is a little lower than its share in 2000. Foreign parent divestments increased slightly to account for 8% of the total market. Reflecting increasingly difficult economic conditions, buyouts from receiverships increased dramatically during 2001, providing nearly 10% of all UK buyouts – easily the highest level since the last recession. The employee buyout of the National Design Consultancy from the Post Office in February 2001 was the first privatisation buyout since 1999.

Public to private buyouts still account for a substantial part of the market, providing 6.4% of all buyout activity. The 26 public to private deals recorded by the end of September accounted for 27% of the total buyout value. Although this is well below the previous year's figure, the £4.6bn worth of public to private deals completed is already on a par with the full 1999 total.

The average value of public to private buyouts decreased by the third quarter of 2001 from £223m in 2000 to £176m. This figure remains at more than four times the average value for the market as a whole and emphasises the continuing development of public to private deals beyond the small market capitalisation sector where they initially took off. There were 13 deals with a transaction value of more than £100m in the first three quarters of this year,

TABLE 1

NUMBER OF EXITS, 1998-2001.

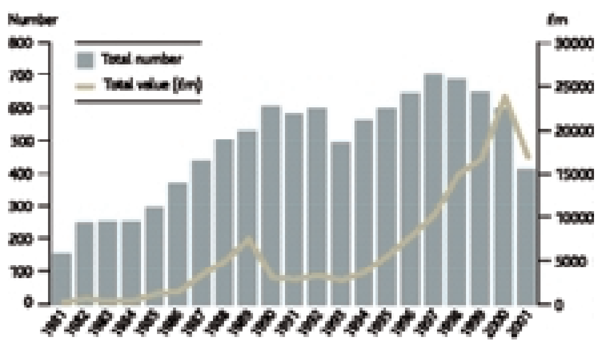
	1998			1999			2000			2001		
Exit Type	Buyout	Buy-in	Total	Buyout	Buy-in	Total	Buyout	Buy-in	Total	Buy out	Buy-in	Total
Trade Sale	94	38	132	78	36	114	88	45	133	34	22	56
Flotation	12	3	15	6	2	8	9	6	15	4	2	6
MBO/MBI	35	10	45	30	11	41	17	11	28	14	8	22
Receivership	48	34	82	55	25	80	55	44	99	44	26	70
Total	189	85	274	169	74	243	169	106	275	96	58	154

Year 2001 figures are for first nine months only

Source: CMBOR/Barclays Private Equity/Deloitte & Touche

FIGURE 1

TRENDS OF BUYOUTS/BUY-INS, 1981-2001.



Year 2001 figures are for first nine months only

Source: CMBOR/Barclays Private Equity/Deloitte & Touche

'INSTITUTIONAL INVESTORS HAVE BECOME RELUCTANT TO INVEST IN SMALLER COMPANIES IN SECTORS WITH ONLY MODERATE GROWTH PROSPECTS'

amounting to a total of about £4bn. The remaining buyout delistings ranged from £13m to £84m.

The largest public to private buyouts came from the real estate sector, featuring the £920m Burford deal and a number of £100m plus buyouts, including Bradford Property Trust, Frogmore, Delancey Estates and Asda Property. The largest non-property delisting was automotive parts supplier Britax, at £441m.

EXIT TRENDS. The main feature of buyout exits for the first nine months of 2001 is the substantial fall in the number of trade sales. Only 56 have been recorded, compared with the 133 exits by this route in 2000 as a whole. However, the sale of publishing company IPC to AOL Time Warner for £1.15bn is the biggest trade sale ever recorded. The flow of former buyouts joining the stock market has now been slow for four years.

Flotations of former buyouts account for less than 3% of all new issues compared with the peak figure of 19% in 1993. Institutional investors have become reluctant to invest in smaller companies in sectors with only moderate growth prospects, which is reflected in the growth of public to private transactions. A further indicator of more difficult conditions is the recent rise in the number of buyouts entering receivership.

OUTLOOK. The fall-off in buyout activity during the third quarter of 2001 was hardly surprising given the awaited economic slowdown brought into even sharper focus by events in the US. However, it is still not fully clear whether buyout plans have been abandoned completely or merely put on hold until the present complicated economic and political picture becomes a little clearer. Better than expected third quarter gross domestic product figures showed that the UK economy grew at an annual rate of 2.2%, with forecasters predicting that Treasury targets of between 2.25% and 2.75% are likely to be met for 2001.

Paradoxically, the recent lowering of interest rates aimed at sustaining UK growth has coincided with a period in which banks are increasingly looking to reduce levels of debt in buyout structures. The average percentage of debt used in buyout funding steadily increased throughout the last decade from 36% in 1990 to reach a peak of 49% in 1998. This figure has since fallen sharply, such that debt provided only 40% of total funding in the first half of 2001. Mezzanine funding increased to 7%, the highest figure since 1992, with subordinated funding now looking set to increasingly fill the gap left by the reduction in senior debt.

Overall, the pricing of buyouts measured by historic profit before interest and tax (PBIT) multiples has remained relatively unchanged in 2001, with those owners not under pressure to sell seemingly reluctant to lower asking prices. With buyout funds totalling €13bn raised in the first nine months of 2001 still available for investment, any major recovery in activity appears to depend heavily on the removal of this mismatch between the prices sought by vendors and the prices private equity players are prepared to pay.

Professor Mike Wright and Andrew Burrows are Directors of the Centre for Management Buyout Research (CMBOR). Rod Ball is a Researcher with CMBOR. CMBOR is based at Nottingham University Business School and is sponsored by Barclays Private Equity and Deloitte & Touche.
andrew.burrows@nottingham.ac.uk
www.cmbor.org