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Dealmakers Expect Strategic Investing to Lead Pickup in M&A Activity in 2010

ACG-Thomson Reuters Year-End 2009 DealMakers Survey Reveals Obstacles and Opportunities for M&A and Private Equity Investing

CHICAGO, December 8, 2009 – Merger professionals say the current M&A environment remains moribund, yet express guarded optimism about a pickup in the first half of 2010, with strategic investors and distressed sales leading the way.

The latest twice-yearly survey by the Association for Corporate Growth (ACG) and Thomson Reuters reveals that negative sentiment about the dealmaking environment has not changed during the last year, with 87% of dealmakers saying the current M&A environment is fair or poor, compared to 88% at mid-year 2009, and 86% in December 2008.

Over the next six months, however, the percentage of dealmakers who expect an increase in merger activity jumped to 82% from 56% six months ago.

The ACG-Thomson Reuters Year-End 2009 DealMakers Survey polled 921 investment bankers, private equity professionals, corporate development officers, lawyers, accountants and business consultants in October and November 2009.

80% of survey respondents identified the current environment as a buyer's market. 74% of respondents said the current market favors strategic investors. And, 94% of respondents expect strategic investments to accelerate in 2010. A majority of private equity respondents (54%) are actively pursuing distressed and undervalued companies.

In addition, dealmakers expect the following percentage of M&A deals to be distressed in the first half of 2010:

- 0-10% (6%)
- 11-25% (46%)
- 26-50% (40%)
- More than 50% (8%)

“Dealmaking continues to be caught in the doldrums with limited activity outside of distressed sales and select strategic investments, but the fact that merger professionals express heightened optimism about 2010 is a hopeful sign that a freshening wind will arise,” said Dennis J. White, ACG Chairman and Senior Counsel, McDermott, Will & Emery LLP.

While the credit crunch has decreased in importance as the biggest obstacle to M&A activity (29% today vs. 33% mid-year, and 43% this time last year), the gap between the prices at which companies are willing to sell and the prices that buyers are willing to pay has been rising in importance (37% today vs. 27% mid-year, and 22% this time last year).

Although average middle-market EBITDA levels have fallen to 8.4 today from a high of 10.1 in 2007, according to Thomson Reuters, dealmakers are still looking for bargains. In fact, 80% expect to pay no more than 5x EBITDA for companies over the next six months.

“Business owners are slowly realizing that valuations will not return to what they were several years ago. Private equity and strategic buyers are all too aware of this and are patiently waiting for sellers to come to grips with the new valuation paradigm and to take some money off the table,” said Harris Smith, ACG Immediate Past Chairman and Managing Partner of Private Equity and Strategic Relationships at Grant Thornton.

Dealmakers expect the following sectors to experience the most merger activity in the first half of 2010:

- Healthcare/life sciences (23%)
- Manufacturing and distribution (18%)
- Financial services (14%)
- Technology (11%)

They expect the following sectors to experience the most organic growth:

- Healthcare/life sciences (28%)
- Government-related (16%)
- Energy (13%)
- Technology (12%)

According to Thomson Reuters, the volume of all worldwide mergers and acquisitions totaled \$1.8 trillion in announced deals through November 30, 2009, a decrease of 33% over the comparable period in 2008. Of this total, M&A deals in the mid-market, defined by Thomson Reuters as transactions under \$500 million, fell 31% from the 2008 level, totaling \$461.9 billion.

Through November 30, 2009, strategic M&A activity totaled \$1.7 trillion, a 32% decline from the comparable period in 2008. Overall, strategic merger activity accounts for 94% of total announced M&A this year, the highest percentage since 2001.

Dealmakers See Improved Debt Markets, But Plan on Increased Equity

Dealmakers are optimistic that the debt markets will continue to rebound, with 74% saying they will improve over the next six months, 22% saying they will remain the same and only 5% saying they worsen.

Respondents say the maximum leverage level in today’s environment is:

- 1-2x (19%)
- 2-2.5x (46%)
- 2.5-3x (24%)
- 3-3.5x (9%)
- More than 3.5x (2%)

Most deal professionals (53%) do not expect leverage levels to increase in the next six months.

Despite an expected improvement in access to credit, 56% of dealmakers expect to put more equity into deals over the next six months, with more than half (54%) saying they expect to invest 40% or more equity in companies in the next six months.

Private Equity Eyes Opportunities

Private equity professionals say the best strategy for success in the current environment is:

- Focus more on portfolio companies (20%)
- Stick to their original strategy (20%)
- Focus more on deal sourcing/marketing (15%)
- Focus more on add-on acquisitions than platform acquisitions (12%)

“With access to debt still somewhat constrained, private equity professionals are having to commit more equity as a percentage of total capital, in order to close deals. This is contributing to the downward pressure on valuations,” said Michael A. Carr, Vice Chairman of ACG.

Industries that present the best opportunities for buyouts are:

- Manufacturing and distribution (25%)
- Business services (18%)
- Healthcare/life sciences (15%)

Industries that present the best opportunities for distressed investing are:

- Manufacturing and distribution (34%)
- Real estate (16%)
- Consumer products and services (15%)
- Financial services (13%)

Private equity respondents say they have written down their portfolio company values in the last 12 months by:

- 15% or less (32%)
- 16-25% (16%)
- More than 25% (9%)
- Held steady (36%)
- Marked up (7%)

The majority (61%) of private equity professionals say they expect to maintain portfolio company values at year-end 2008 levels; while the remainder forecast write-ups over 2008 year-end levels of:

- 15% or less (25%)
- 16-25% (8%)
- More than 25% (4%)

Nearly half (47%) of private equity respondents say that 50% or more of their portfolio companies are performing below their prior year in EBITDA.

In 2010, private equity will change in the following ways:

- Significant consolidation, winnowing out (41%)
- Increased need for PE firm differentiation (37%)
- No change (18%)
- Rapid growth, innovation (2%)
- Other (2%)

“Fundraising by private equity firms has taken a beating in 2009, which is also contributing to the feeling that consolidation is coming,” said Jim Beecher, publisher of *Buyouts*, a Thomson Reuters publication. “Private equity firms need to validate their point of differentiation in a market like this.”

Some 47% of private equity respondents are concerned about the public’s perception of private equity.

“The value of middle market private equity comes through loud and clear in this survey,” said Gary A. LaBranche, CAE, ACG President & CEO. “Even as the growth community works to recover from the Great Recession, dealmakers are confident in the future of free enterprise and the job growth and opportunity that it provides to society. That speaks volumes about why middle market private equity is so vital to our economy.”

Survey Methodology

The twice-yearly survey, conducted in October and November 2009, was completed by 921 ACG members and Thomson Reuters customers. Respondents were comprised of private equity, venture capital and buyout firm members (20%); investment bankers, intermediaries, brokers (27%); lenders, finance providers (9%); corporate professionals, entrepreneurs (12%); Limited Partners (2%); hedge funds (1%); and service providers, such as lawyers, workout specialists, accountants and consultants (28%). The majority of respondents were from the United States (876), where 40 states were represented. Internationally, professionals from 14 countries completed the survey. For a copy of the full survey results, please go to: www.acg.org. The mid-year 2010 survey results will be released at ACG InterGrowth at the Fontainebleau Hotel, Miami Beach Florida, May 4 - 6, 2010 (<http://chapters.acg.org/global/intergrowth2010.aspx>).

About ACG

The Association for Corporate Growth (ACG) is the global community for middle market M&A dealmakers and business leaders focused on driving growth. ACG members have access to data, content and networking opportunities to find the opportunities, capital and knowledge they need to drive and sustain corporate growth. Founded in 1954, ACG has grown to more than 12,000 members organized in 54 chapters throughout North America, Europe and Asia. For more information, please visit www.acg.org.

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