ACG-Thomson Reuters Year-End 2008 DealMakers Survey

Association for Corporate Growth and Thomson Reuters

The latest twice-yearly survey of middle market merger professionals by the Association for Corporate Growth (ACG) and Thomson Reuters reveals the most negative outlook in the history of the survey, with 86% of dealmakers saying the current M&A environment is fair or poor. The percentage of those who say the current deal environment is good or excellent has fallen to 14% in December 2008, from a high of 93% in June 2007. The percentage has steadily dropped to 72% in December 2007, and to 43% in June 2008.

Most do not see it getting better any time soon. Looking out six months, dealmakers expect the M&A environment to be:

- Worse (44%)
- The same (31%)
- Better (24%)

The 970 middle market investment bankers, private equity professionals, corporate development officers, lawyers, accountants and business consultants polled say the greatest obstacle to M&A activity is:

- Credit crunch (43%)
- Sellers unwilling to sell at multiples offered (22%)
- Weak economy (16%)

The latest data from Thomson Reuters supports the survey findings. The volume of all worldwide mergers and acquisitions totalled US$2.4 trillion in announced deals during the first three quarters of 2008, a decrease of 28% over the record-breaking first three quarters of 2007, according to Thomson Reuters. Of this total, M&A deals in the mid-market, defined by Thomson Reuters as transactions under US$500 million, fared better. Less reliant on the global credit markets, they declined only 16%, with a total value of US$569.6 billion.

As for which sectors will experience the most M&A activity in the next six months, dealmakers are most bullish on:

- Financial services (30%)
- Healthcare/life sciences (20%)
- Energy (12%)
- Manufacturing and distribution (12%)

"While the large sector buyout deals all but shut down in the second half of 2007, M&A activity in the middle market was more resilient up until recently," said Harris Smith, ACG chairman and managing partner of private equity and strategic relationships at Grant Thornton. "Middle market deals were getting done primarily because they were not dependent on securing debt. Now that credit has dried up, there has been virtually no activity since late summer 2008 in the middle market with the exception of some distressed situations, carve outs of non-core assets by public companies and limited activity by strategic buyers."

Private Equity Firms' Greatest Threats, Best Strategies

Among survey respondents, private equity professionals say the sectors with the greatest opportunities for buyout investments over the next six months are:

- Manufacturing and distribution (20%)
- Healthcare/life sciences (19%)
- Financial services (17%)

Private equity professionals believe today's greatest threats to their business are:

- Credit crunch (65%)
- Overall economy (46%)
- Lack of exit opportunities (35%)

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"Beyond dealmaking, the credit crunch is also having an impact on private equity portfolios," said Jim Beecher, publisher of *Buyouts Magazine*, a Reuters Media publication. "Private equity firms are trying to shore up performance of their portfolio companies in the wake of a global recession, and in certain cases, are dealing with highly leveraged companies where refinancing their debt will be very difficult in this credit environment."

More private equity professionals say they are modifying their investment strategy (38%), versus 28% in June 2008. They say the best strategies for success in the current environment are:

- Focus on portfolio companies (38%)
- Focus more on add-on acquisitions than platform acquisitions (33%)
- Cut costs at portfolio companies (30%)

"Given the current deep freeze affecting the credit markets, private equity firms are spending less time pursuing new deals, and more time performing triage on their portfolio companies," said Dennis J White, ACG vice-chairman and partner, McDermott, Will & Emery LLP. "They will have to make some difficult decisions as to which of those companies will survive, which will be sold in distressed conditions, and which will be left to expire."

The lack of acquisition financing has affected 91% of private equity professionals, and 58% expect to put more equity into their deals in the next six months. They are primarily securing debt financing from:

- Commercial banks (63%)
- Mezzanine lenders (53%)
- Seller debt (46%)

Six months from now, private equity professionals expect the debt markets will be:

- Better (65%)
- The same (22%)
- Worse (13%)

"An unprecedented confluence of events is driving the substantial reduction in middle market M&A volume," said Mark Jones, chairman of ACG InterGrowth 2008, and partner, River Associates Investments LLC. "Initially triggered by mortgage related write-downs, the trifecta of an across-the-board repricing of risk, a shrinking universe of credit providers, and a pervasive lack of confidence in near-term corporate sales and earnings projections, has caused many companies to delay or reconsider altogether accessing capital markets. The potential good news is that dealmakers expect the debt markets to improve, which is an integral step towards reviving M&A activity."

Most private equity respondents say they have not adopted fair value accounting standards consistent with FAS 157.

- Have adopted (40%)
- Plan to adopt (26%)
- Do not plan to adopt in near term (34%)

Many private equity firms plan to mark down their portfolio company values in their next quarterly statements.

- Plan to mark down (40%)
- Plan to hold steady (55%)
- Plan to mark up (4%)

Survey Methodology

The twice-yearly survey, conducted in November 2008, was completed by 970 ACG members and Thomson Reuters customers. Respondents were comprised of private equity, venture capital and buyout firm members (19%); investment bankers, intermediaries, brokers (26%); lenders, finance providers (12%); corporate professionals, entrepreneurs (13%); hedge funds (1%); limited partners (2%); and service providers, such as lawyers, workout specialists, accountants and consultants (28%). The majority of respondents were from the US (926), where 42 states were represented. Internationally, executives from 11 countries completed the survey.

For a copy of the full survey results, please go to: www.acg.org. The mid-year 2009 survey results will be released at ACG InterGrowth at the Wynn Las Vegas, 12-14 May 2009 (www.acg.org/Conferences/InterGrowth).

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