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PRIVATE EQUITY SHOWS SIGNS OF REVIVAL IN SOUTH WEST

Bob Henry, Partner at Matrix Private Equity Partners (MPEP), the small buyout specialist, shares his view on the markets: "After a year or so in the doldrums the Private Equity market is starting to show signs of life, particularly in the South West. The reasons for the dearth of transactions are evident. There were few buyers/investors hungrily looking for investments (many have and had portfolio problems that have been taking up their time) and neither buyers nor sellers really knew what the market price for their business was. And generally the banks have been less than keen to waive their cheque books!

So what is driving the modest revival?

Bob Henry believes that there are three distinct influences. "Firstly, the business environment appears to be nearing a stabilisation point. This simply means that things are worsening far more slowly than before. The rate of change has slowed sufficiently so that businesses can start to plan. We may not like the new starting point, but we can plan. So businesses are once again working on new product launches, customer acquisitions, planned expansion into overseas markets etc. rather than having all of management focus on redundancies, business re-structuring and managing cash on an hourly basis. These new developments are likely to require cash investment and many management teams are considering raising new equity, both to cover these cash requirements, but more generally to rebuild balance sheets now that they can once again demonstrate profitable trading."

Henry continues: "We are seeing quite a lot of "forced consolidation" in fragmented industries. This is particularly true in consumer products and even more so when the intermediate customer is a strong retailer. This forced consolidation has been most noticeable in fresh produce, meat and wine merchants. These are traditionally often relatively small, family or lifestyle businesses. They have suffered the triple whammy of lower volumes, lower margins and forceful customers demanding improved credit terms. Banks (not unreasonably) have been reluctant to provide additional facilities to such companies. This has driven them into the arms of stronger competitors who are looking to increase scale (more contribution through a fixed overhead) either to improve profitability or to remain competitive and to broaden their customer base. These consolidators will need financing.

Finally, there is some revival in the Management Buy Out (MBO) market. Many market participants had expected that there would be a swathe of “distressed assets” emerging from the bank portfolios that would be ripe for management buy outs. This simply hasn’t happened. However MBOs and other “management succession” based transactions are emerging, but largely from other forms of distress: divorce, death, fallings-out (management or family) and there are some companies selling non-core subsidiaries or assets both to generate cash, but also to enable management to focus on core activities.”

Why now?

Henry comments: “It has taken some time, but there is a greater consensus between buyers and sellers about price. Vendors are realising that the frothy valuations seen in 2007 are unlikely to be experienced again (at least until the current recession has drifted out of folk memory) and buyers have realised that there is a proper price to pay for good assets.”

What do you predict will happen in 2010 and beyond?

“We think that transaction volumes are likely to be quite high in 2010. Owners and managers, especially those at or near retirement age who have been through the last year or so will breath a sigh of relief and accept a reasonable price. There were very many MBOs (both Private Equity and debt funded) between 2002 and 2007, where the owners will now want to cash in. One big potential incentive is tax. There is a growing worry that the huge gap between income and capital tax rates (especially with Entrepreneurs’ Relief) will not last forever.. Whilst we can hope otherwise, my prediction is not on a reduction in income tax! So for a business owner, the question is, if I trade for a while longer, with all the attendant risks, will my after tax return be higher or lower than it is now. And many won’t take the risk, causing them to consider selling now.”

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NOTES FOR EDITORS

Matrix Private Equity Partners LLP ['MPEP']

MPEP is a leading VCT Manager in the UK, advising £120 million VCT Funds under Management across five Income & Growth VCTs. Its MBO focus and success was recognised at the unquote" British Private Equity Awards 2008, where MPEP won the award for "VCT Manager of the Year". MPEP is a stable, experienced team with an excellent record of realisations. Over the past two years, seven separate cash realisations have been achieved by MPEP, returning £35.8m, a 3.1 X multiple of the £11.5m cost. They are Holloway White Allom (5.0x), BBI (3.3x), Ministry of Cake (2.5x), Ruskin (3.0x), Apollo Lifts (3.0x), Gyro (3.0x) and Tottel (4.0x). Since 2004, MPEP has raised £85m for its Income & Growth VCTs. MPEP LLP is jointly owned by its investment team and Matrix Group.

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Matrix's staff of around 200 are based in the West end of London, at One Vine Street, W1.