A second wind

The second half of 2017 produced the strongest six months for deal making activity since the global financial crisis, and it was always going to be hard to sustain that momentum. However, after a brief pause for breath in this year's first quarter, the market re-accelerated between April and June. Jim Keeling of corporate finance advisor Corbett Keeling examines the data and explains why conditions remain favourable for potential sellers – for now, at least.

In April's issue of this newsletter, we warned that, while deal making activity remained robust, the market backdrop wouldn't always be similarly benign. Quite apart from all the headlines about the perils of Brexit and possible Trump trade wars, rising inflation had brought the risk of rising interest rates from the Bank of England, as well as actual rate increases from the US Federal Reserve. The end of the economic cycle was drawing nearer, and the threat loomed of a new, less business-friendly government in the UK at some point.

In terms of values, the market recorded its strongest first six months of the year since 2008

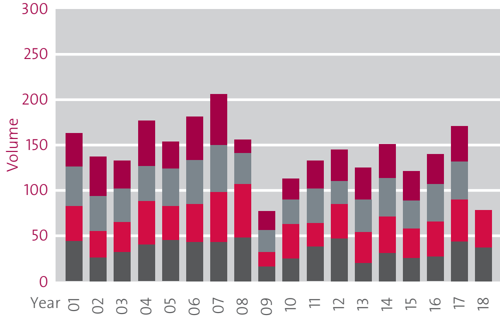
None of those concerns have gone away. But it seems as if the market has either shrugged them off or collectively decided to make the most of things. Certainly, the transaction numbers for the second quarter of the year showed a marked pick-up in activity from the previous three months. In fact, in terms of values, the market recorded its strongest first six months of the year since 2008.

Let's look at the deal data for the different segments of the market.

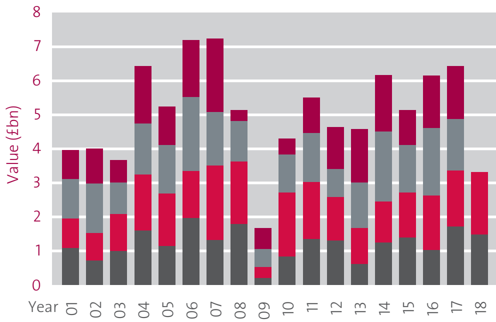
- The **smaller buy-outs** sector (transactions with enterprise value of less than £150 million) had a solid three months. The volume of deals rose to 41, up from 37 in the first quarter, while the value rose from £1.5 billion to over £1.8 billion. In fact, the value of transactions in the first half of the year matched the total for the same period last year, which was the highest since 2008.

Q1 Q2 Q3 Q4

Sub £150m Buy-outs by Volume



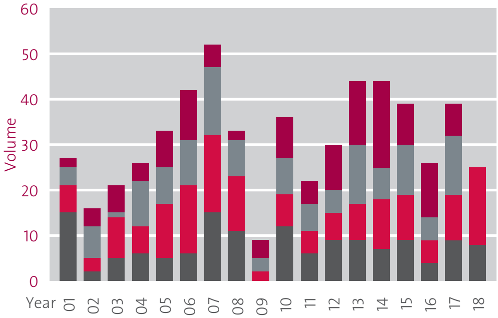
Sub £150m Buy-outs by Value



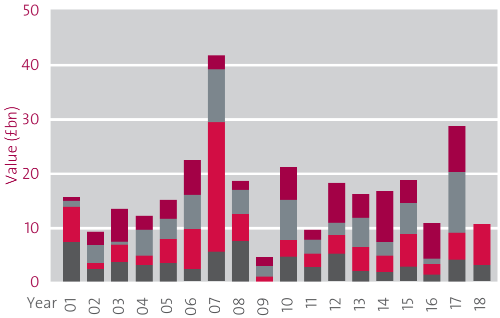
The larger buy-outs sector deals rose from 8 in the first quarter to 17, the highest for nearly four years, and their value soared from £3.0 to £7.5 billion

- Activity increased sharply in the **larger buy-outs** sector (enterprise value of £150 million or above). The volume of deals rose from 8 in the first quarter to 17, the highest for nearly four years, and their value soared from £3.0 billion to £7.5 billion. While that was not quite up to the heady pace in the last two quarters of 2017, it still added up to comfortably the strongest first half of the year since 2008.

£150m+ Buy-outs by Volume

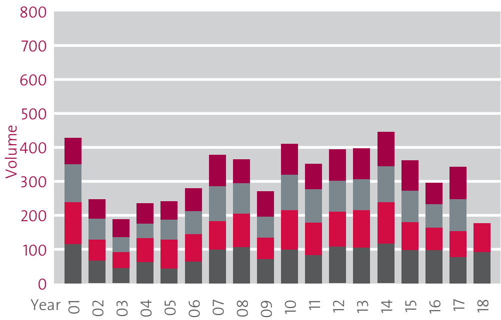


£150m+ Buy-outs by Value

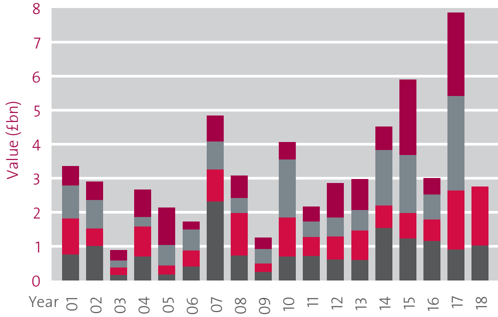


Early stage and expansion capital deals climbed to £1.7 billion. The total value for the first six months of 2018 was the second-highest level for 11 years

Early-Stage/Expansion Deals by Volume



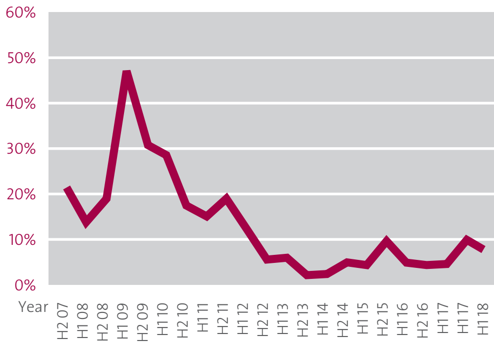
Early-Stage/Expansion Deals by Value



- **Early stage and expansion capital deals** joined in the general re-acceleration. While the volume of deals so far reported was slightly down on the first quarter (84, versus 92), the value climbed substantially to £1.7 billion, from £1.0 billion. That took the total value for the first six months of 2018 to the second-highest level for 11 years.

All equity buy-outs remain a comparative rarity in the current market. Only five were recorded in the second quarter, representing less than 9% of buy-outs.

All Equity Funded Buy-outs to All Buy-outs



We are by nature optimists, but even we were a little surprised by the strength of the transaction data in the second quarter. What of the outlook for the rest of the year? If the results of our latest survey are any indication, we see little reason to expect any imminent slowdown in the pace of deal making activity.

- Half of our respondents think deal volumes will increase for the smaller value segment, while a third predict little change either way. Only 17% suggested that volumes could actually decrease.
- For the larger value segment, it is perhaps no surprise, given the abnormally high number of deals recorded in the second quarter, that the proportion forecasting a rise in volumes falls to 33%, with half expecting little change.

Our respondents remain confident about the availability of debt for funding transactions

- Our respondents remain confident about the availability of debt for funding transactions. While the percentage predicting an increase in availability fell once more (from 29% to 17%), the remainder expected it to remain broadly at current levels. None forecast that funding would become any less readily obtainable.
- Asked how a global trade war might affect the M&A market, our respondents were relatively sanguine. Not surprisingly, none expected it to bolster activity. However, while half of the respondents predicted a negative impact, the other half thought it would not have any effect. Let's hope a trade war is avoided and we never find out whether the second half's confidence is misplaced.

Should we be worried about over-heating in the market, given the current pace of activity? Are participants showing signs of complacency? We don't think so.

It's only sensible to have a sanity check when the market reaches levels last seen before the previous downturn.

But the current market backdrop is very different from how it was back in 2008, and we see no signs of excessive optimism. Far from it. As both our survey and our every-day dealings in the market suggest, the mood is more one of business as usual, with market participants expecting neither a deal bonanza nor an imminent slowdown.

Business owners contemplating an eventual exit would do well to explore their options while it remains a sellers' market

Nevertheless, we stand by our comment in April that buyers will not always have this much cash at their disposal or this much debt available. Business owners contemplating an eventual exit would do well to explore their options while it remains a sellers' market.

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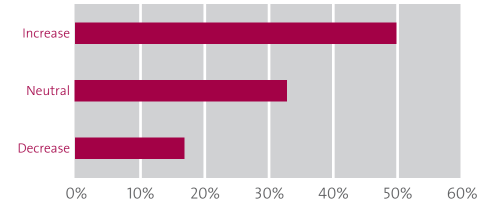
Source: Transaction statistics supplied by unquote

Survey of market expectations

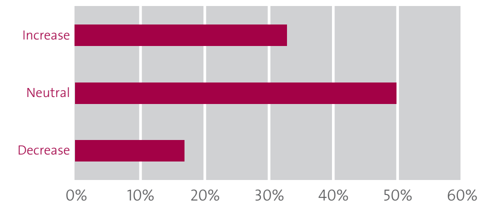
In order to produce these statistics, key players in the UK private equity and venture capital markets were surveyed.

Q2 2018 predictions

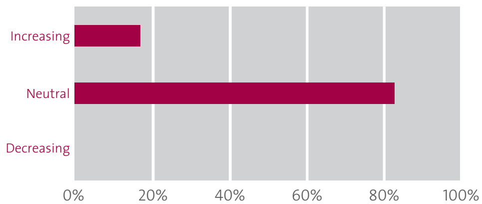
1 Do you expect deal volumes (less than £100m) to increase or decrease over the next six months?



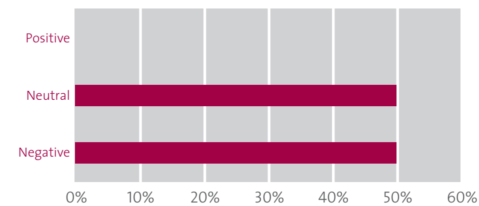
2 Do you expect deal volumes (greater than £100m) to increase or decrease over the next six months?

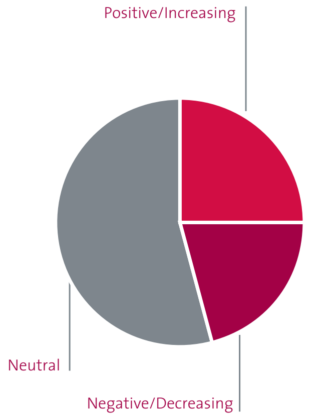


3 Is debt availability increasing, decreasing or neutral over the next six months?



4 How would a global trade war affect the M&A market?





Average of 1, 2, 3 and 4 questions surveyed.