

The Gresham Monitor

A survey of UK middle market companies

January 2002

UK middle market managers are expecting to undertake more transactions this year than last – a welcome signal that the sharp slowdown in mergers and acquisitions activity in recent quarters is set to reverse.

The slowdown was apparent well before September 11. Since then, the marketplace has continued to be very quiet. The slowdown in volume and value of private equity deals has in part reflected investors' reluctance to pay unrealistic prices. The downturn in activity has also created pent-up demand for financing.

At the same time, the boom in technology investment flattered the overall figures in previous years. This diverted the focus away from the core of the private equity market – businesses in less fashionable sectors but with ambitious management keen to benefit from private equity financing.

Cycle poised to turn

Encouragingly, half the companies interviewed for this Monitor plan to undertake a transaction this year – and a quarter are more likely to do so this year than in 2001. These first concrete signs of impending activity echo Gresham's view that 2002 will be a good year for transactions.

Companies in the middle market sector still need funding and, with more realistic prices, there is scope for substantial growth. Previous Monitors highlighted the dampening effect of tax burdens. Against that background, the Government's

initiatives on Capital Gains Tax, and managers' growing awareness of these changes, are doubly welcome as a further spur to activity.

Mixed performance and prospects

Mixed responses on corporate prospects and the economy make it premature to call the upturn. Optimism about business growth prospects is little changed since the previous survey, a heartening flattening of the trend after 12 months of steady decline. But turnover trends have deteriorated over 18 months.



Private Equity Solutions

Deal prospects higher in 2002

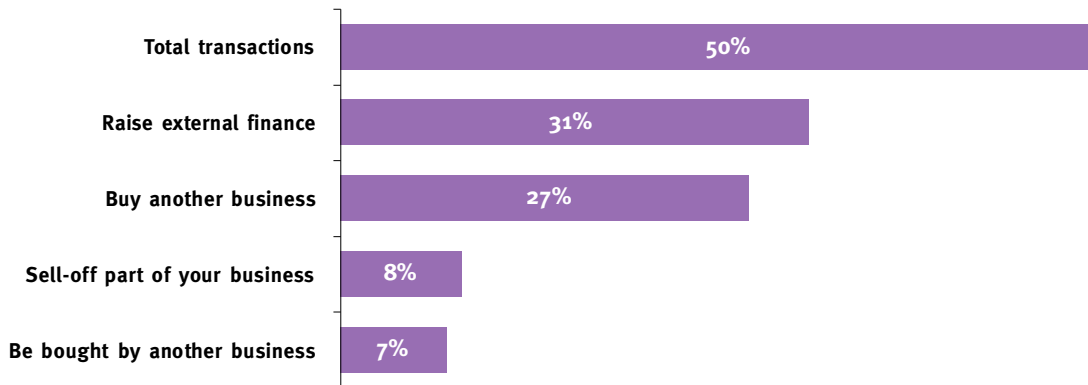
The potential for deal activity is accelerating. Half of the middle market companies surveyed anticipate undertaking a transaction in 2002. More than a quarter of companies consider that this is more likely to happen this year than last, another pointer to an upturn in overall activity this year.

In terms of the types of transactions planned, more than a quarter said they

anticipate buying another company. A third expect to raise external finance – a proportion of which presumably will be used to finance an acquisition.

Privately owned companies are more likely to undertake a transaction in the current year than subsidiaries of public companies – two-thirds of the private companies surveyed against a third of the subsidiaries.

Business transactions – expectations for 2002

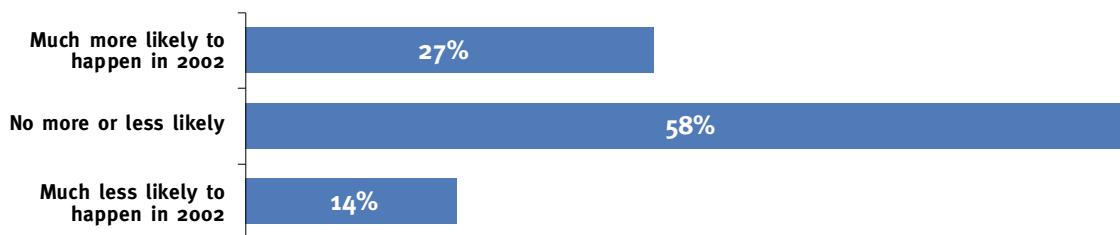


Manufacturers are even keener – a third say they are more likely to carry out a transaction this year than last against a fifth of service firms. And a third of manufacturers are likely to be looking for external finance against 29 per cent of service firms.

CGT may affect deals

Awareness is emerging of the reductions in or exemptions from capital gains tax on business asset disposals from April. Some 28 per cent feel these will influence their decision to do a deal this year. More Government publicity could boost this figure.

Business transactions – 2002 versus 2001



Too soon for optimism

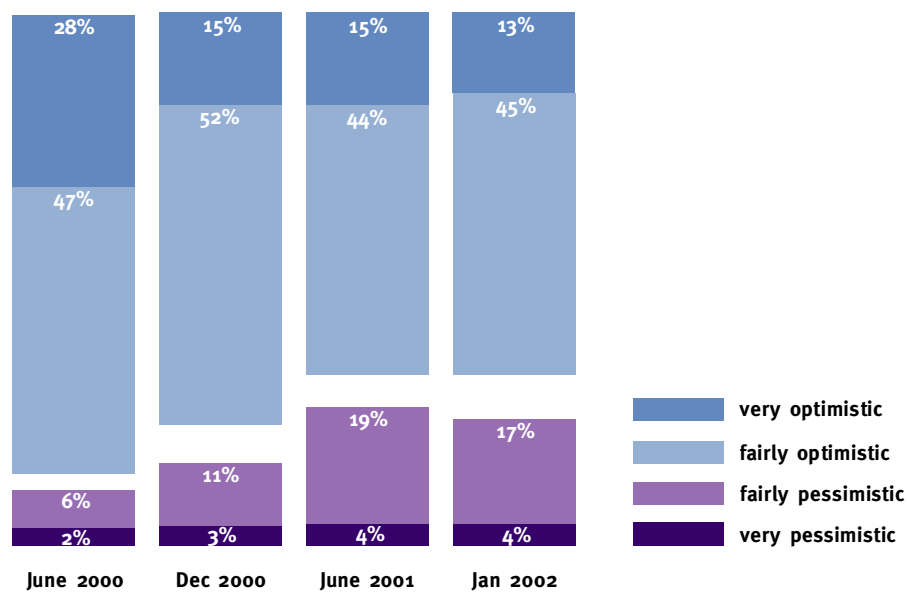
The Monitor shows that the level of confidence middle market companies have in the growth prospects for their business is little changed from June 2001.

After 12 months of declining optimism, this is an encouraging flattening of the downward pattern. But it would be premature to confirm the trend has turned. With marginal decreases both in those who

are either very optimistic or very pessimistic, more companies are sitting on the fence.

The Monitor highlights the differences in financial performance and outlook experienced between the manufacturing and service sectors. Manufacturers are more pessimistic about growth prospects for their businesses than service companies (25 per cent compared to 16 per cent of companies in the service sector).

Business prospects – the next 12 months



Companies split on economic prospects

Mixed predictions from the pundits and the marketplace on prospects for the UK economy are mirrored by the middle market sector. Companies are equally split on whether or not they are basing their business plans on an expectation of economic growth in the UK.

As might be expected, more service companies (57 per cent) than manufacturers are drafting their plans with a view to economic growth. But given the length of time manufacturers have been in recession, it is heartening that 42 per cent are basing their plans on economic growth.

Performance still under pressure

Trading conditions are still tough. Middle market companies report a marginal decline in turnover over the last 12 months, compared to the previous Monitor. Over the past 18 months there has been an overall decline in the percentage of companies reporting higher turnover and a comparable rise in those recording lower turnover. Manufacturers are once again reporting tougher conditions than service companies with 27 per cent experiencing lower turnover against 22 per cent of service sector companies.

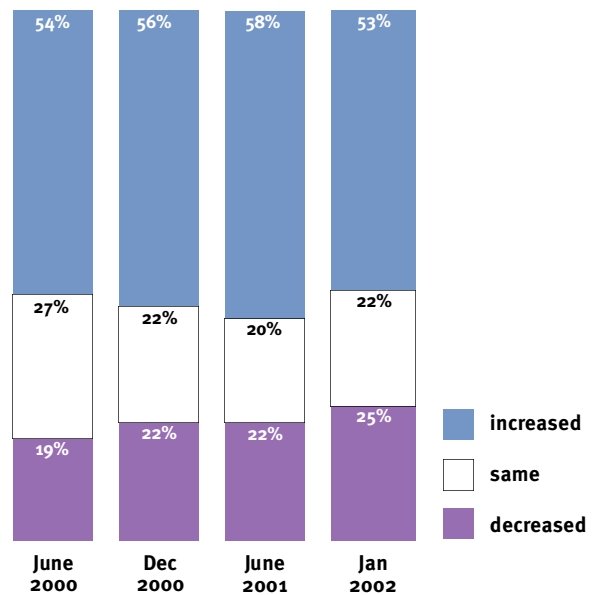
Although 28 per cent of companies are planning job cuts in the next 12 months, it appears the trend has not worsened from

About the Gresham Monitor

Gresham Trust is a private equity house that specialises in middle market companies.

The Gresham Monitor is a regular survey of the UK middle market sector. This is the fourth issue and was conducted by NOP's Business Unit in January 2002. It sought a 'snapshot' view of the level of transaction activity in the sector and monitored select aspects of respondents' outlook and financial performance. The survey comprised board

Turnover



previous surveys. Two-thirds of those now predicting lower staff numbers envisage a decline of between 1 and 10 per cent.

level interviews with directors of 100 middle market companies balanced between the service and manufacturing sectors, broadly reflecting the UK business population.

Middle market companies typically have a turnover of between £10m and £100m and employ between 50 and 500 people. They account for nearly a third of UK plc's presence in terms of employment, turnover, goods produced and gross margin.



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