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PRIVATE EQUITY

Takeover activity expected to remain 'sluggish'

BY LORI McLEOD

Caution and discipline are expected to prevail in the world of Canadian private equity this year as deal makers wait for turbulence in the capital markets to subside, according to a study released yesterday.

Fewer takeovers are expected as the industry awaits a turnaround in the credit and buyout markets, which could take the better part of two years, says the study compiled by Thomson Reuters and consultants McKinsey & Co.

"In the near term ... deal activity will likely be sluggish as the economy works its way through a recession and clears the backlog of leveraged loans," the report states.

The global debt crisis and fears of a U.S. recession have caused uncertainty about corporate stability and growth prospects, making it tough for private equity firms to calculate takeover valuations, it adds. The report looks at the performance of the country's private equity and venture capital industries, and outlines expected future trends and other issues of interest.

The current environment is vastly different than at this time last year, when record merger and acquisition activity peaked with the Ontario Teachers' Pension Plan's $35-billion bid for telecom giant BCE Inc., the largest leveraged buyout in history.

While activity has slowed since, deal flows and values remain at the same relatively strong levels reached in 2006.

The good news for well-capitalized private equity firms is that there are still lots of companies out there that need money but are having trouble finding any, said Rick Nathan, managing director at Kensington Capital Partners Ltd.

"They go to door number one, the banks, and they're closed. Door number two is the public markets and they're closed. Door number three is private equity, and we're still open," he said.

This year there should be less of a rush to make deals and more time for due diligence, something that should result in higher-quality transactions that generate strong returns, Mr. Nathan said.

Sellers sidelined for months waiting to see if prices would rebound to last year's levels are also likely to give up and enter the market, he added.

Some changes resulting from economic and credit market jitters include an increase in mezzanine and distressed debt investing, a greater focus on the emerging and middle markets, and an increase in energy and alternative energy funds, the report states.