BDO

Q3 2009

PCPIQ3

Private Company Price Index

SIGNS TO BE OPTIMISTIC?

Prices continue to rise for the few deals that complete

Q3 2009 evidenced the seventh successive quarterly decline in M&A activity; only 518 deals completed, down marginally (4 per cent) on the previous period and 32 per cent on Q3 2008. As no significant political or economic corporate stimuli have been introduced since Q2 – interest rates remained static and no further lending catalyst has been provided – we would not have expected material movement in the statistics, in fact Q3 volumes have historically been suppressed due to the European summer vacation.

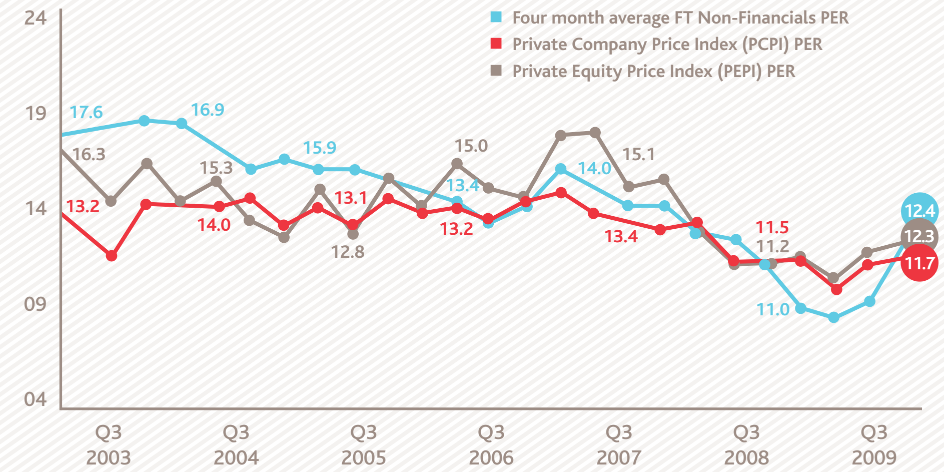
Despite this small drop in the total number of deals, the average prices at which they transacted rose for a second successive quarter. The Private Company Price Index showed a 5 per cent increase to 11.7 times (sold for 11.7 times their historic after tax profit), whilst The Private Equity Price Index showed 4 per cent growth in value from 11.8 to 12.3 times.

The marginal increase in the volume of corporate bank debt available has been countered by the tightening of the terms on which leveraged deals can take place. This is a prime driver behind the sustained suppression of deal volumes and is certainly the case for Private Equity ('PE') deal flow. PE's inability to find sufficient transactional debt is highlighted in the number of larger (>£250m) deals completed during the course of the year. Of the 26 large deals in 2009, only three had PE involvement – with nine being trade sales in the last quarter alone.

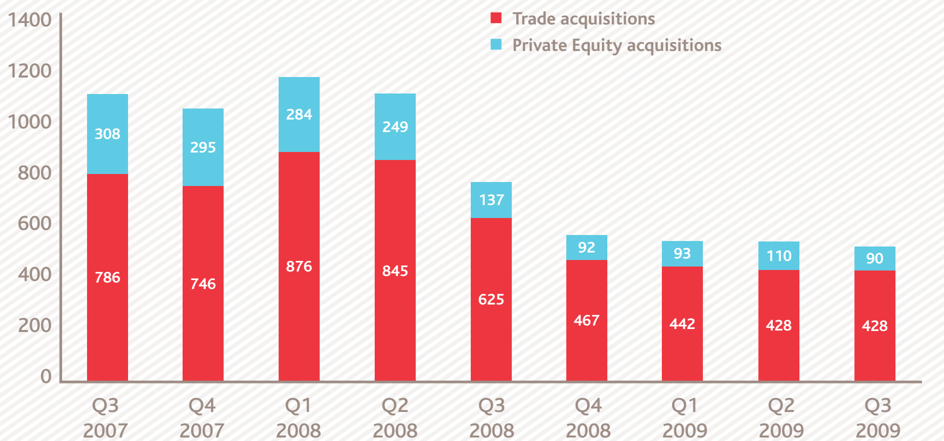
The public markets' valuation of listed companies has seen a staggering rise since early 2009. The FTNF (Financial Times Non-Financials Index) was up 33 per cent between June and September 2009 alone and is actually 13 per cent higher than September of last year. Whilst this suggests that institutional investors are attributing greater value to the underlying businesses than they have been since the beginning of the credit crunch, there is little direct correlation between this and the value at which private companies change hands.

The increase in multiples paid for the few transactions that are completing reflects the general increase in optimism in the Corporate Finance community. It is acknowledged that there has been a shift in the sentiment of private vendors, likely for a number of reasons. One in particular being the expected future rise in income and capital gains taxation rates. The net realisations available to sellers are likely to be materially affected during the course of next year and as it typically takes between three and nine months to source and execute a deal, exit reviews, pitches and proposals are on the increase.

PCPI v PRIVATE EQUITY Q3 2003 – Q3 2009



Q3 2007 TO Q3 2009 VOLUME OF DEALS COMPLETED



Source: Corpfin

Christopher Clark,
M&A Partner commented

"It is no surprise that transaction volumes are broadly in line with last quarter, but we are all pleased to see a second successive rise in valuations. No one really expects what is happening in the public markets to feed through to the private sector – especially as acquisition finance remains difficult to source – however it does contribute to the generally more up-beat nature of the CF community.

Nevertheless we can't ignore the fact that non-disclosed deals remain a significant proportion (69 per cent) of all transactions, as this is widely accepted to suggest that they are distressed or turnaround deals. Business remains very tough for most sectors but we must take confidence from a number of these indicators."

MAKING THE MOST OF THE PCPI/PEPI

The PCPI/PEPI tracks the relationship between the current four month rolling average FTSE Non-Financials price/earnings ratio (p/e) and the p/es currently being paid on the sale of private companies to trade and private equity buyers. The FTSE Non-Financials p/e is calculated from the p/es published in the FT. The private company p/e is calculated from publicly available financial information on deals that complete in the quarter. At the moment, the PCPI indicates that, on average, private companies are being sold for 11.7 times their historic after tax profits. The PEPI indicates that, on average, private companies are being sold to private equity buyers for 12.3 times their historic after tax profits.

As private companies are generally owner-managed, reported or disclosed profits tend to be suppressed by various expenses that may be non-recurring under a new owner. This will have been factored into the price the purchaser paid, but may not be reflected in the profits declared to the public. The effect of this is that the p/e paid as calculated from the publicly available information may be over stated.

The PCPI/PEPI tracks the discount between how public and private companies are being valued. This discount enables us to use valuation techniques which are only relevant to public companies and apply them to private companies in the same sector.

The PCPI/PEPI is calculated as the arithmetic mean of the p/es for deals where sufficient information has been disclosed. Over the last six years, the included deals for the PCPI have had a mean deal size of some £13m and a median deal size of some £12m. And the included deals for the PEPI have a mean deal size of £37m and median deal size of £20m. Therefore, if a company is smaller than this, then a further discount should be applied.

The PCPI/PEPI is an average measure and guide, not an absolute measure of value, as there are many other factors that can have an impact on value.

If you would like to know more about how to use the PCPI/PEPI to value your company, please contact your local BDO representative.

If you would like to know more about how to use the PCPI/PEPI to value your company, please contact your local BDO representative.

CONTACT US:

BIRMINGHAM
roger.buckley@bdo.co.uk
0121 352 6213

BRISTOL
gayle.bowen@bdo.co.uk
0117 930 1578

EASTERN REGION
john.barker@bdo.co.uk
01707 255 940

EPSOM
paul.smith@bdo.co.uk
01293 591 151

GATWICK
jamie.austin@bdo.co.uk
01293 591 193

GLASGOW
neil.craig@bdo.co.uk
0141 249 5234

LEEDS
tim.clarke@bdo.co.uk
0113 204 1211

LONDON
christopher.clark@bdo.co.uk
020 7893 2395

MANCHESTER
gordon.lane@bdo.co.uk
0161 817 7504

NORTHERN IRELAND
johnny.webb@bdo.co.uk
02890 439 009

READING
john.parkinson@bdo.co.uk
0118 925 4433

SOUTHAMPTON
paul.russell@bdo.co.uk
023 8088 1796

www.bdo.co.uk

‘Audit Team of the Year’ 2008‘
Tax Team of the Year’ 2008‘
Corporate Finance Deal of the Year’ 2008’

This document is printed on 9lives 80, a paper containing 80 per cent recycled fibre and 20 per cent virgin Totally Chlorine Free (TCF) fibre sourced from sustainable forests. 9lives 80 is produced by an ISO 14001 accredited supplier.