2010

PCPIQ2

Private Company Price Index

RESOLVING UNCERTAINTIES LEADS TO INCREASED M&A?

The last quarter has seen a number of significant events take place that have influenced economic performance and expectations. The general election, emergency budget, Greek bailout and the hotly debated issue concerning whether now is the right time to withdraw the fiscal stimulus and implement austerity measures are all events that feed through to M&A activity.

The consensus view of economists such as the IMF indicates that despite the budget cuts, the UK economy will continue to grow. Actions in the budget to tackle the deficit and to provide greater clarity over corporate tax policy during this government were considered to provide greater stability for the business community. Furthermore, the relative weakness of Sterling combined with the strong stance to tackle the deficit has meant that UK companies are now proving attractive to overseas buyers. All these factors bode well for transactions, allowing companies and investors to look ahead with greater certainty and plan acquisitions to drive the next phase of growth.

There was much anticipation of what changes would be made to CGT by the Chancellor that led to hesitation from some vendors on starting or completing a sale. Whilst the changes were not as drastic as many commentators feared, the immediate imposition of the changes has removed the potential for a 'mini-M&A boom' that we saw in Q1 2008 where volumes peaked at 1,159. Crucially however, it has provided a degree of certainty for vendors.

As suggested at the end of Q1 2010, activity levels did rise during Q2 with total transactions increasing from 496 to 543. However, with a typical deal taking up to six months to complete we would expect the full impact of the events noted above to be reflected in completions towards the back end of this year and into 2011.

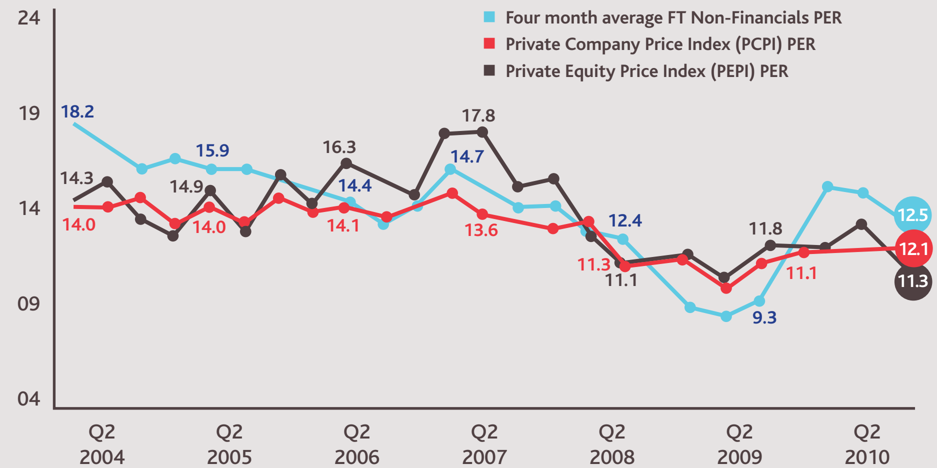
Pricing for private transactions has remained largely unchanged since Q2 2008. The Private Companies Price Index (PCPI) fell to 12.0x from 12.1x in the previous quarter, whereas the Private Equity Price Index (PEPI) fell from 13.3x to 11.3x reflecting the absence of any mega deals that attracted significantly larger multiples during Q1 2010.

More interestingly, the FTNF (Financial Times Non-Financials Index) has fallen from 14.8x in Q1 2010 to 12.5x in Q2 moving back in line with private company pricing. High volatility in the stock market since Q2 2008 has led to large swings in values for public companies, and made predicting valuations based on public companies extremely challenging.

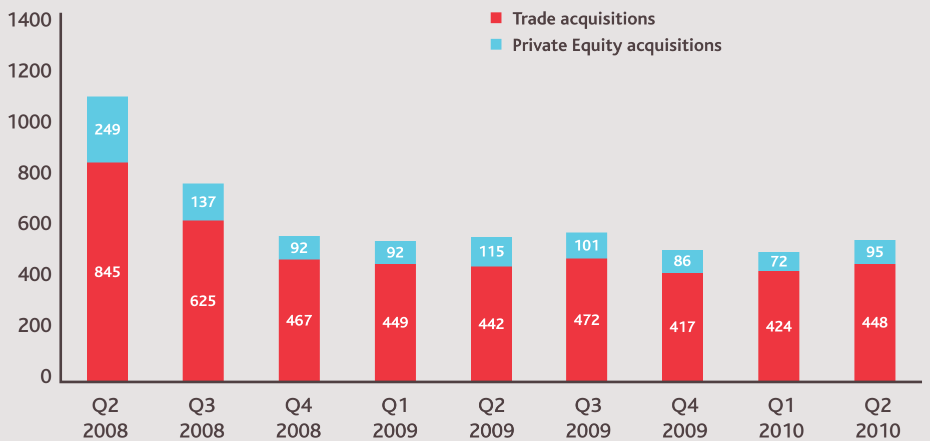
With current economic conditions making organic growth difficult, our recent M&A survey indicated 79 per cent of companies were looking to make acquisitions. Most were targeting gains in market share or improved product offerings, however a reasonable number were focusing on larger transformational deals. Whilst the PCPI remained flat for Q2, increasing demand from corporate buyers could push up pricing and help to reduce the pricing gap that exists between buyers and sellers that has kept deal volumes at historic low levels.

Overall, stability in pricing for private companies means there remains grounds for cautious optimism within the M&A market. The general election has passed and whilst budget cuts and tax increases will dampen economic activity, the coalition is focussed on a private sector-led recovery.

PCPI v PRIVATE EQUITY Q2 2004 – Q2 2010



Q2 2008 TO Q2 2010 VOLUME OF DEALS COMPLETED



Source: Corpfin

Christopher Clark,
M&A Partner commented

"With the general election out of the way, and an emergency budget that was broadly supported by the business community, the outlook for companies appears a little more certain than during Q1 2010.

Despite a fragile recovery and cuts in public spending, leading forecasters are suggesting that growth will continue allowing businesses to be more certain in their own future and providing confidence to commence acquisition plans.

These conditions, together with another quarter of stabilised pricing and pent up demand from both private equity and trade to acquire, should improve the outlook for transactions as business leaders look to plan the next phase of growth."

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 12.1 times their historic after tax profits. The PEPI indicates that, on average, private companies are being sold to private equity buyers for 11.3 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.

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