



2010

PCPIQ1

Private Company Price Index

► SIGNS OF OPTIMISM

Quarterly transaction volumes have remained at historic low levels. This is not a surprise and perhaps offers a sign for optimism. Transaction volumes have been supported – even at the consistently low levels since the second half of 2008 – by increased volumes of deals driven by financial distress. Despite this driver, and after some high profile business failures in late 2008 / early 2009, what has been surprising is how few bank-driven transactions have occurred since then. The bank's ongoing support to businesses has set this recession apart from others. Along with the radical, unprecedented government action, stability has returned to the market relatively quickly.

This brings us to the subject of more traditional transactions. Before examining trade and private equity acquisitions in turn it is important to bear in mind the typical lead time for a deal to close. Before the Credit Crunch, from the initial decision to sell a business until closure of the successful deal usually took between four and six months. In the current economic environment, buyers of businesses and providers of finance are far more cautious than before and this has extended the timeframe to complete a transaction. With this in mind for a transaction to complete in Q1 2010, they would probably have had to have started around Q2/Q3 2009 – or earlier. At that point in the cycle, valuations were at the bottom of the market (in Q1 2009).

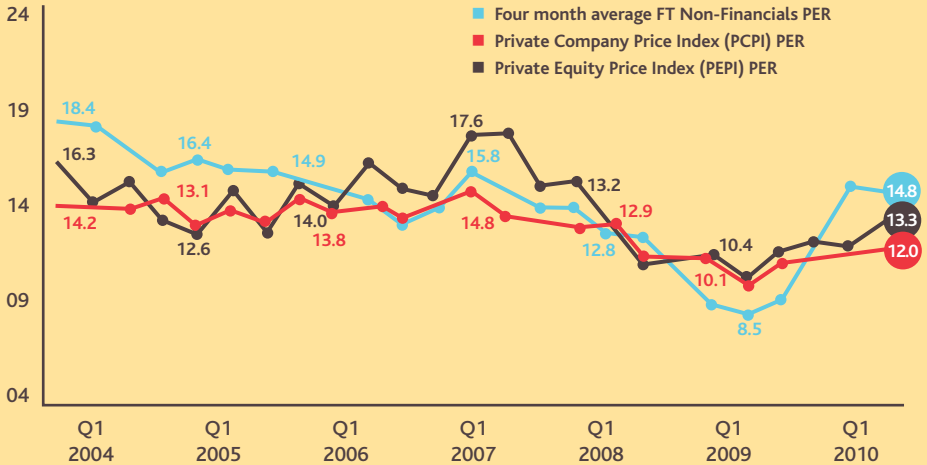
As identified in our recent M&A survey, most trade buyers fund acquisitions either through existing cash reserves or within existing banking facilities. As expected, over the past 18 months most companies have been focussed internally, ensuring their long term stability and maximising their financial flexibility, accordingly drawn away from M&A activity. Importantly the survey points to far greater confidence with nearly 80 per cent of companies seeing acquisitions as part of their corporate strategy going forward, with over three-quarters of those expecting to see some in the next 12 months.

On the private equity side, there is a far greater reliance on bank debt to fund the transactions. With bank focus on supporting their existing customer relationships the availability of new debt has been greatly reduced. However, pressure from the government on the banks – in particular those where it is the majority or key shareholder – has improved lending more recently.

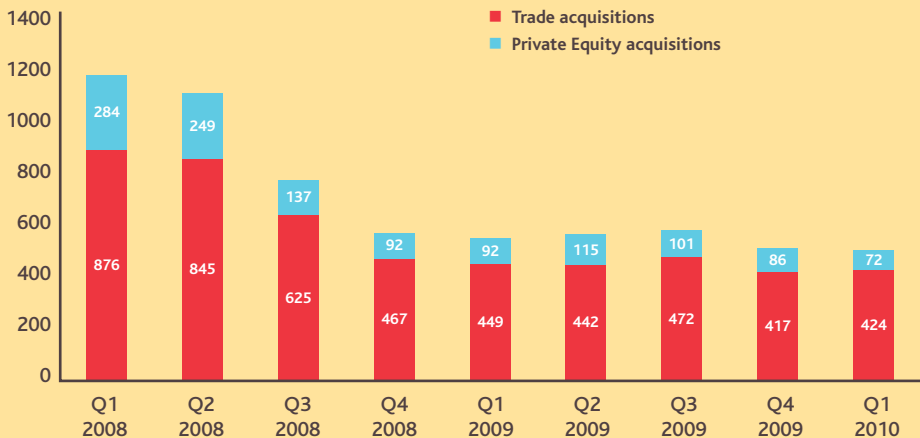
The final piece in the jigsaw is the attitude of vendors. A lack of supply of high quality businesses for sale has meant that those deals in the market, like Pets at Home, have commanded premium multiples. This can be seen in the Private Equity Price Index (PEPI) which has shown an increase to 13.3x from 12.0x in Q4 2009. The prices paid for private companies have remained broadly flat for the third quarter in a row. The PCPI, which tracks price/earnings (p/e) multiples paid by trade buyers for private companies is at 12.0x compared to 11.9x in Q4 2009. What this means is as prices remain stable for extended periods, vendor and purchaser price expectations narrow, finally unlocking the supply of companies for sale. This is further supported by the average public company price : earnings multiple for the FTNF (Financial Times Non-Financials Index) which has fallen marginally from 15.1x to 14.8x ending a four quarter rally. This will be on the back of greater political uncertainty as the outcome of the General Election became less clear in the last six weeks and the prospect of a hung parliament a more realistic possibility.

With the Election so soon, many vendors and purchasers will be waiting on the outcome to give a better understanding of its impact on their businesses. Once settled (providing it is) we would expect activity levels to start picking up quite rapidly. Transaction lead times will however mean that we are unlikely to see any significant increase in completions until Q4 2010.

PCPI v PRIVATE EQUITY Q1 2004 – Q1 2010



Q1 2008 TO Q1 2010 VOLUME OF DEALS COMPLETED





Christopher Clark,
M&A Partner commented

“Despite seeing historically low deal numbers in Q1 of 2010 there is now a feeling of cautious optimism.

Following a period of internal focus and consolidation, there is a renewed confidence in the market with some 80 per cent of companies now seeing M&A as a key part of corporate strategy.

The continued improvement in the availability of debt coupled with a stabilisation in pricing leading to an alignment of vendor and purchaser expectations looks set to bring a significant supply of attractive businesses to the market.

However, the continued political uncertainty and possibility of a hung parliament suggests that companies will await the outcome of the election before embarking upon a transaction. With a typical deal taking up to six months to complete it is anticipated that an improvement in deal numbers will be seen towards the end of 2010.”

▶ 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 12.0 times their historic after tax profits. The PEPI indicates that, on average, private companies are being sold to private equity buyers for 13.3 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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