2010

PCPIQ4

Private Company Price Index

THE CHOPPY RECOVERY

In total 1,928 deals were completed in 2010, of which 83% were trade deals and 17% were private equity deals. The total number of deals completed in 2010 was slightly lower than the 2,174 deals completed in 2009, however, there has been a positive shift in the type of deals.

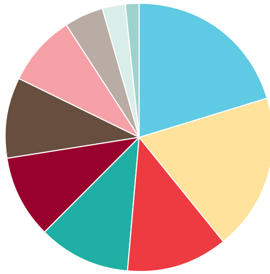
Throughout 2010 we have seen that the quality of deals is improving, and the steady recovery of the economy means that overall there are fewer 'distressed' transactions than in 2009 and more 'traditional' transactions. Higher multiples are being paid for these more traditional transactions and this has led to a general increase in market optimism.

The Private Companies Price Index ('PCPI'), which tracks the price/earnings (p/e) multiples paid by trade buyers for private companies rose from an average multiple of 11.2 times in 2009 to 11.7 times in 2010. This is broadly consistent with the Private Equity Price Index ('PEPI'), which shows comparable multiples on sales to private equity, which rose from an average of 11.6 times in 2009 to 12.2 times in 2010. Although both indices have fluctuated over the past year, the overall trend shows an improvement which is promising. Increasing buyer confidence and a shortage of good businesses for sale has led to buyers paying higher multiples, albeit at the expense of lower transaction volumes.

This steady improvement in multiples is expected to continue as the economic conditions improve. The results from our recent BDO Private Equity Survey 2010/2011 show that both corporates and private equity managers are expecting to see a modest, but steady increase in p/e multiples and transaction volumes. The results show that 24% of corporates and 30% of PE managers expect p/e multiples to increase by 10-20% next year while 58% of corporates and 62% of PE managers expect p/e multiples to increase by 10-20% in two years time.

Total completed deals for 2010 by sector

Source: Corpfin

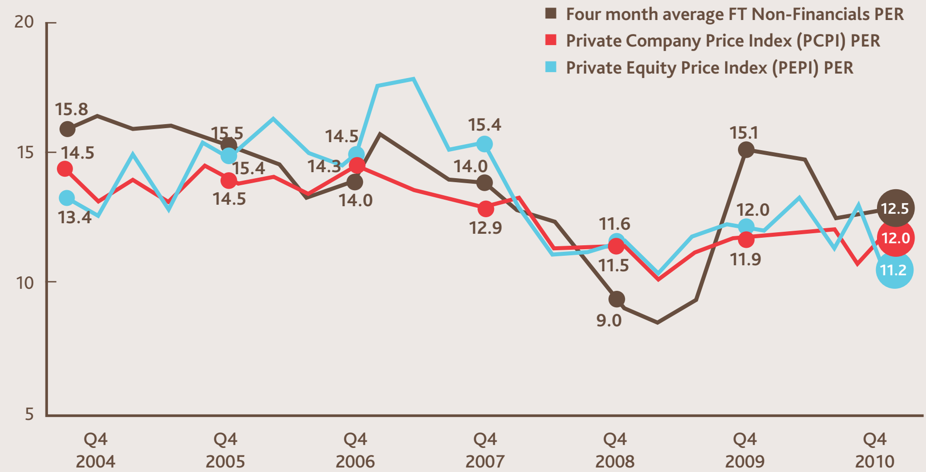


During 2010, the manufacturing, business services, media & communications and retail sectors accounted for more than half of all deals completed as shown above.

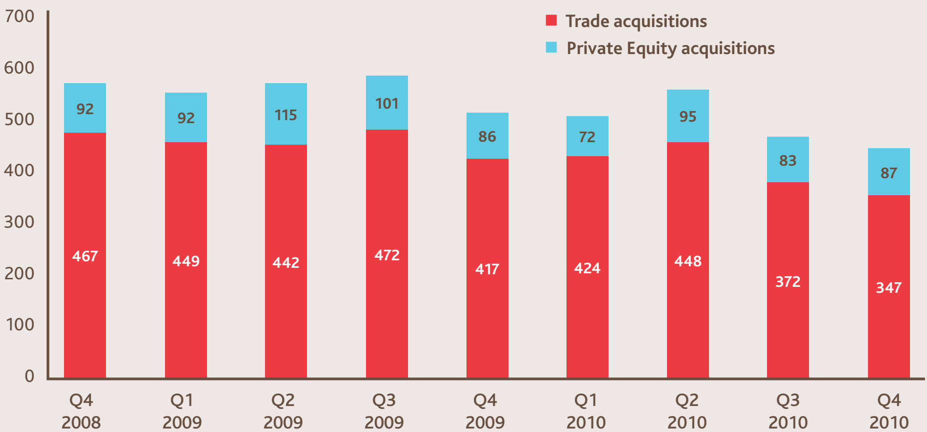
Interestingly, the healthcare and education sector experienced the fastest growth in deal volumes increasing by 26% between 2009 and 2010 and the sector is expected to remain attractive, particularly to private equity firms. Other sectors expected to attract higher valuations include energy and manufacturing, reflecting government policies focused on addressing energy needs and encouraging a rebalancing of the economy.

Overall, there is still uncertainty over the speed and health of the UK economic recovery. Cuts to public spending, the impact of the new VAT rate, rising inflation and the possibility of interest rate rises are all likely to strain the recovery and impact upon market confidence. Despite these challenges, pricing appears to be improving as the number of distressed deals falls, perhaps hiding the trend for improvements in the number of traditional M&A transactions. After a prolonged period of reduced deal volumes, both trade and private equity have the funds to invest and appear more prepared to do deals implying a greater level of optimism at the start of 2011 than at the same time a year ago.

PCPI v PRIVATE EQUITY Q4 2004 – Q4 2010



Q4 2008 TO Q4 2010 VOLUME OF DEALS COMPLETED



Source: Corpfin

**Christopher Clark,
M&A Partner commented**

"2010 will be remembered as the year the UK economy tentatively emerged from one of the most severe recessions in modern times. Over the course of the year there have been several landmark events including a change of government, the emergency budget and the crisis in the Eurozone.

Whilst the 0.5% contraction in the UK economy during Q4 2010 surprised most economists, the Governor of the Bank of England argued this reflected his earlier prediction that the recovery would be 'choppy'. With an open economy the UK can expect to benefit from the robust growth forecast in the global economy and this should bode well for M&A transactions.

There appears to be a greater focus by management teams on growing their businesses than the same time a year ago. Trade and private equity buyers appear to be gearing up to make further acquisitions and improvements in pricing are likely help tempt sellers back into the market."

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 11.2 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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