



2011

PCPIQ2

Private Company Price Index

▶ PRICE EXPECTATION GAP CONTINUES TO NARROW

The Private Companies Price Index (PCPI) which tracks the price/earnings (p/e) multiples paid by trade buyers for private companies rose sharply this quarter from 9.0 to 10.8, however the number of trade acquisition deals has fallen. The previous quarter saw a 27% rise in trade acquisitions, however this coincided with a fall in the PCPI to 9.0 highlighting the interaction between pricing and deal volumes.

The uplift in the PCPI brings it in line with the Private Equity Price Index (PEPI) which remained unchanged at 10.8. Private equity deal volumes were down on Q1 2011 when the number of deals was higher than the preceding five quarters.

With fewer private equity than trade deals occurring, the relative variation from quarter to quarter tends to be higher, however a comparison of deal volumes over six month periods suggests that the private equity deal volumes have stabilised. There have been 166 private equity deals in the first half of 2011 compared to H1 2010 and H2 2010 where there were 167 and 161 deals respectively.

Over the last 12 months, trade deal volumes have ranged from 330 (Q4 2010 – PCPI 12.0) to 419 (Q1 2011 – PCPI 9.0) indicating that there is significant appetite to complete deals where companies are fairly priced. Deal volumes for this quarter were 371 and were similar to Q3 2010 (372 deals) when the PCPI was also at a similar level (10.7 compared to 10.8 for the current quarter). This suggests that at constant pricing, trade acquisitions are also likely to be relatively stable.

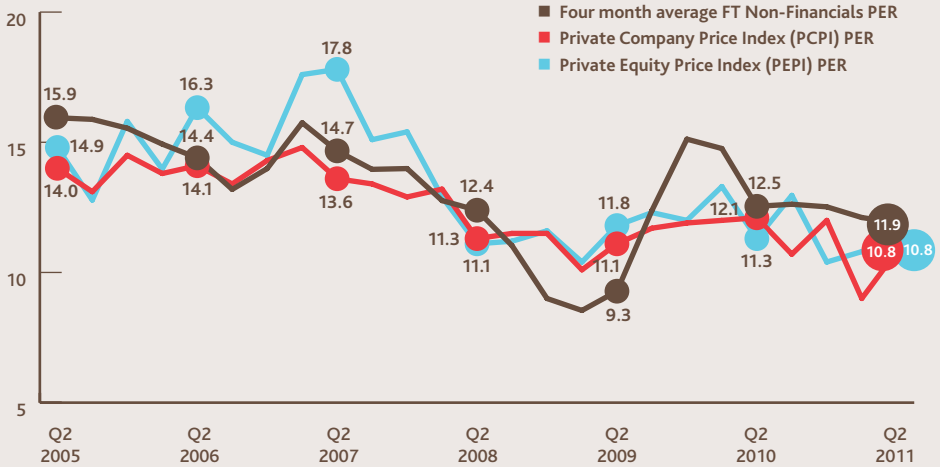
Despite the fall in overall deal volumes, the proportion of deals in the lower mid-market (deals up to £50m) continued to increase. The strong correlation between the movements in the PCPI, PEPI and deal volumes in recent quarters implies a closing of the price expectation gap between the buyers and sellers which appears particularly apparent in the lower mid-market.

Following peak pricing in 2006 and 2007, the following two years have seen a widening of price expectations between buyers and sellers, with sellers seeking to reach p/e multiples achieved around the peak of the market. This gap has been narrowing in the past year as sellers' and buyers' views on pricing continue to converge.

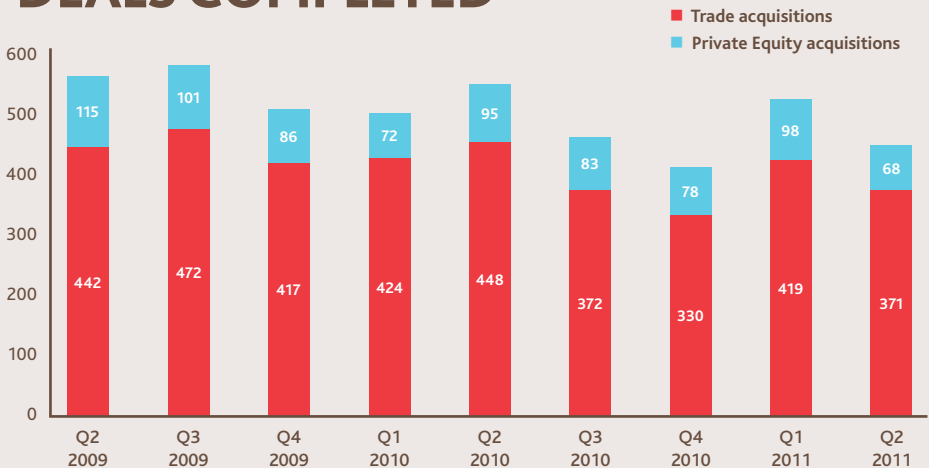
Deal volumes for both trade and private equity deals have proved resilient despite the prevailing economic headwinds. Growth in the UK economy is likely to remain weak in the near term as the impact of the cuts to public spending, high inflation and the VAT rise all take hold.

Despite this economic backdrop, certain sectors still continue to do well with manufacturing deals representing a notably high proportion of deals compared to the same point in the prior year. The overhang of private equity money raised during the boom years and trade buyers focusing on acquisitive growth strategies means that there are certainly deals to be done at realistic pricing multiples.

PCPI v PRIVATE EQUITY Q2 2005 – Q2 2011



Q2 2009 TO Q2 2011 VOLUME OF DEALS COMPLETED





Christopher Clark,
M&A Partner commented

“With stabilising deal volumes and lower volatility in pricing, the scene is set for the continued reduction in the price expectation gap between buyers and sellers. Following the PCPI and PEPI highs achieved during 2007 and the recession that followed, the price expectations widened hampering deal completions.

The return of the PCPI and PEPI to longer term averages has meant that while full price multiples are still being achieved for high growth businesses, price expectations are becoming less of a barrier to the successful completion of deals.”

▶ 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 10.8 times their historic after tax profits. The PEPI indicates that, on average, private companies are being sold to private equity buyers for 10.8 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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