



2011

PCPIQ3

Private Company Price Index

► M&A MARKET BEGINS TO STABILISE BUT MACROECONOMIC FACTORS DRAMATICALLY AFFECT LISTED MULTIPLES

The Private Companies Price Index (PCPI) which tracks the price/earnings (p/e) multiples paid by trade buyers for private companies remained steady with a marginal decrease this quarter from 10.8 to 10.6. Looking back at the PCPI's performance since the recession began in 2008 multiples have fluctuated between 9.0 to 12.0, and the consistency seen in the last two quarters indicates that private company pricing is now beginning to stabilise.

In contrast, the Private Equity Price Index (PEPI) has increased considerably this quarter from 10.8 to 15.0. This has been influenced by a higher proportion of deals in the technology sector, where private equity firms have paid higher multiples to acquire technology related companies. PEPI is not expected to continue at this level longer term. The following factors this quarter have driven up the index by c. 40 per cent:

- Private equity firms are willing to pay higher values for good quality assets operating in unique and interesting niche sectors
- The nature of these businesses being high growth where underlying profitability can be significantly higher
- The limited availability of these top quality companies combined with the large sums of private equity money available to be invested means that numerous private equity houses are often competing against each other to acquire assets, which can influence the prices being paid.

Total deal volumes (trade and private equity) have increased by 27% compared to the previous

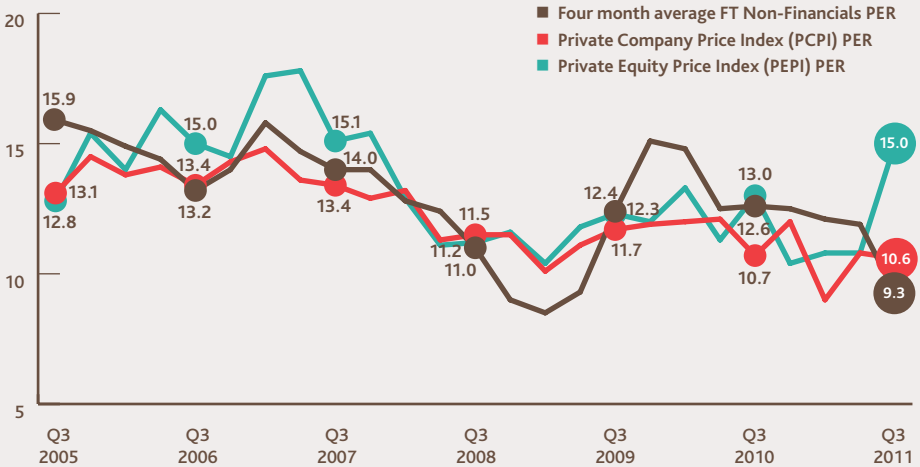
quarter (560 deals in Q3 compared to 439 in Q2), and are at the highest level seen over the previous four quarters. However, much of this uplift is likely to have occurred because deals are taking longer to complete and a number of Q2 deals have rolled forward into Q3, and not because of a true upward trend in market.

Although the PCPI and PEPI are performing well in the tough economic climate, the macroeconomic events we have experienced over the last quarter have had a dramatic effect on consumer confidence in the quoted market and the listed companies non financial index decreased dramatically this quarter from 11.9 to 9.3, which is the biggest fall in this index since Q3 2002.

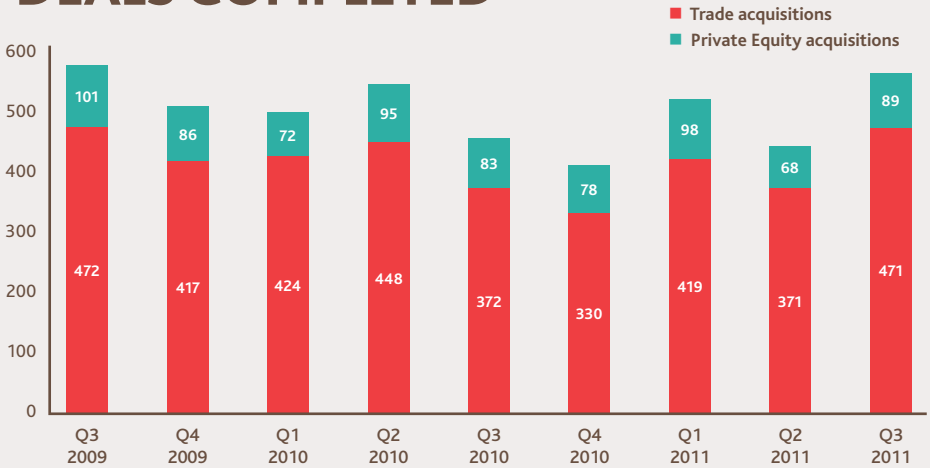
The increase in debt levels in the USA, the degradation of the credit ratings for Greece and Italy and the ongoing Eurozone crisis have all caused uncertainty in the market, which means investors are acting more cautiously.

In summary, the M&A market remains delicate. Top performing companies which have built up large cash reserves are now looking to pursue acquisitive growth strategies and private equity firms with large uninvested funds are keen to make investments. This makes predicting deal volume and pricing in the next two quarters difficult as there remains a huge uncertainty over the wider economy but this is balanced by M&A appetite from both private equity and cash rich corporates. However, current experience illustrates that there can be large volatility in pricing and deal completions are being delayed.

PCPI v PRIVATE EQUITY Q3 2005 – Q3 2011



Q3 2009 TO Q3 2011 VOLUME OF DEALS COMPLETED





Christopher Clark,
M&A Partner commented

“Current investor sentiment in the market is one of uncertainty owing to the many destabilising factors such as the degradation of Italy and Greece’s credit rating and the wider Eurozone crisis. These factors have caused a dramatic fall in the listed companies non financial index. However, despite the challenging and uncertain operating environment, trade companies have built up strong cash balances and private equity firms have large fund balances which they need and want to invest. This provides confidence that there is a will to undertake M&A but provides little visibility on pricing and timing.”

▶ 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 10.6 times their historic after tax profits. The PEPI indicates that, on average, private companies are being sold to private equity buyers for 15 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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CONTACT US:

BIRMINGHAM

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

BRISTOL

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

EASTERN REGION

Cambridge, Chelmsford and Hatfield

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.mcgill@bdo.co.uk
0141 249 5232

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



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