PERDa
Price Earnings Ratio Database

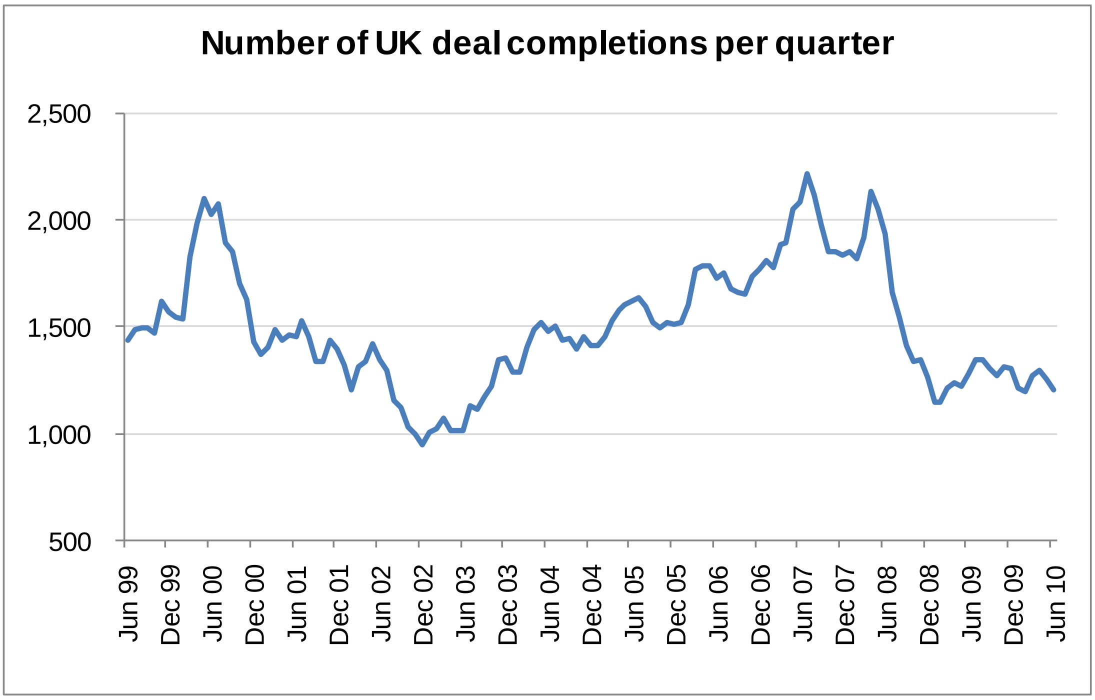
Issue 5: Summer 2010 UK Edition

INTRODUCTION

Welcome to the Summer 2010 issue of PERDa, the newsletter that summarises and provides commentary on the data contained in the private companies' Price Earnings Ratio Database. This data is used to highlight changes in the average value of private companies as shown by recent transactions. For the first time we have compiled a UK version of this edition, concentrating on the UK deals recorded in our database.

DEAL VOLUMES

The last two years have seen a dramatic decrease in UK deal volumes compared to their peak in 2007/8, and we contrast below (using data from Corpfin/Experian) the recent trend with the collapse and subsequent recovery in deal volumes following the dotcom crisis:



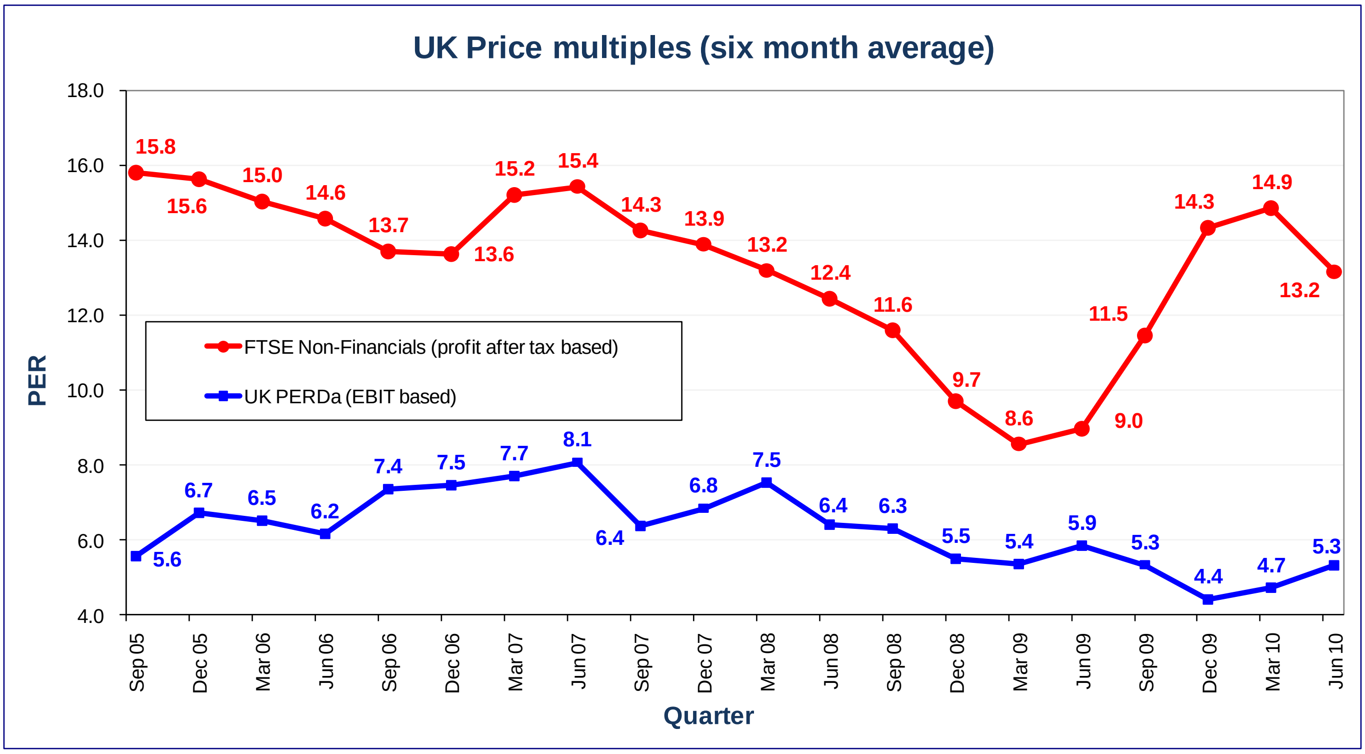
The figures above highlight the double peak of the deal boom in 2007/8, with the second peak in March/April 2008 driven by the Capital Gains Tax change made at that time. This change not only increased overall volumes at that time, but also advanced deals from mid 2008 to before 6 April. These factors resulted in a very steep decrease in volumes in mid 2008 that contrasts with the fall after the 2000 dotcom crisis, which was less pronounced initially, but continued for over two years before starting to recover. The early 2008 peak also hid the underlying trend where, by the end of 2007, the record high multiples being demanded by vendors (see below) and the restrictions on bank finance were beginning to substantially reduce volumes.

The recent figures above are set against a fairly complex background. The first six months of 2010 was a period of intense uncertainty in the UK. Fears of the European sovereign crises spreading, continued (potentially unsustainable) government assistance to the economy, the election/emergence of a coalition government and the emergency budget led to many deals being deferred.

It is, therefore, not unexpected that deal levels have remained at historic low levels, and indeed perhaps surprising that they did not fall further. However, the recent stabilisation in deal volumes is echoed in other recent market surveys and anecdotal market feedback.

PRICE EARNINGS RATIO

Below is a summary of the latest UK data from PERDa, showing the movements in the average Price Earnings Ratio ("PER") between consideration (price paid) for private companies and their profits (on an Earnings Before Interest and Tax "EBIT" basis). This is contrasted with the price to profit multiple for FTSE Non Financial companies.



Note: The above private company PER trend is for UK deals only and differs from the European PER data shown at www.perda.co.uk.

The average UK PERs are more volatile than the Europe wide data shown in our European newsletter, peaking higher in mid 2007 (8.1 v 7.3) and falling further in 2009/10 (4.4 v 4.8).

It is interesting to note the second peak in average UK PERs in the March 2008 quarter that was not evident in the FTSE index. This was influenced by the significant tax change made at that time, and drove the increased volumes noted above. The timing of many of the deals done during that period was influenced by the tax change, with vendors providing significant finance towards deals to ensure their timely completion. This is reflected in the higher price multiples shown in this quarter, supported by this vendor finance.

The FTSE Non Financial PERs have usually been more volatile than PERs for private companies, and the changes in this index over the last 18 months emphasise this factor. The recent data perhaps reflects that the price increases (as a multiple of profits) seen in many FTSE companies in late 2009/early 2010 were overdone, with decreasing prices in the first half of 2010 also reflecting world events such as the sovereign crises and the disruption to air transport caused by the Icelandic volcanic ash, together with factors affecting individual companies such as the BP Gulf of Mexico oil leak.

The recent UK PERDa data shows a gentle recovery in average prices (as a multiple of profits) in 2010 against the historic average lows of 2009. This reflects that average prices for deals were at unsustainable lows in 2009 with few quality businesses being sold for full value.

THE FUTURE

In terms of deal volumes, as mentioned above, there seems to be some anecdotal evidence that a large number of UK deals were deferred from the first half of 2010 due to the uncertainty caused by the election and the potential for another emergency budget.

Whilst a coalition government was not the most desired outcome, their initial actions seem to have settled the markets and financial community, although we may still be in the honeymoon period. The emergency budget was broadly welcomed by the business community and seems to have been accepted by the markets (at least for now) in reducing the prospect of a sovereign debt crisis here.

The financial and economic outlook therefore is less uncertain than it was in the first half of 2010, and this seems to have resulted in more deals being started, although it still remains to be seen how many of these can be funded and completed. With even relatively straight forward deals now taking up to six months to complete, it is possible any increase in volumes may not occur until early 2011.

As to prices, there will still be a considerable number of distress deals done at lower prices, especially as HMRC continues to tighten up on their Time to Pay scheme.

For non distress deals, private company prices are likely to gradually recover towards the historic normal price range (as a multiple of profits), which has always been a balance between how many year’s profits a vendor is willing to accept and the rate of return required by a buyer. Historically this has generally settled at an average (for the size of companies in PERDa of £5m to £10m enterprise value) at around 5 to 7. The key question is how long it will take for prices to return to these levels, and that will depend on the availability of funding to drive the deal sector.

Bank funding, especially cashflow funding, remains difficult. However, there are some signs of a relaxation of the effective total ban on cashflow lending at some banks. To be fair to the bank’s credit committees, the uncertainties of 2009 and the early part of 2010 have made the business case assessment process far more difficult, hence reducing approval rates.

However, any business that performed even moderately well in 2009 and 2010 has obviously demonstrated its ability to weather a storm, and perhaps the “perfect storm”. This must be taken into account by the funders, and there is early, anecdotal evidence of an acceptance of this by some banks.

In contrast, the supply of equity has increased significantly over recent months, both at the smaller VC end of the market and from the larger PE funds. This has helped in a small way to offset the limited availability of debt, with some equity providers continuing to undertake deals without bank debt.

In addition, the deal market is likely to be increased by the sale of PE backed businesses that were originally scheduled for an exit between late 2008 to date, but were deferred. These companies are likely to be seeking an exit over the next 18 months in order to provide cash/return for their backers now that some limited form of normality seems to be returning to prices and funding.

DATA COMPILATION

The database contains data submitted by members of the Leading Edge Alliance ("LEA"). The LEA is an international professional association of major, independently-owned accounting and consulting firms.

Financial data recorded for each deal is adjusted by the submitter to reflect the underlying basis of the deal. Graphs in this newsletter are based on the contents of the database at the time of compilation. The database is being constantly updated as deals complete and members submit new deal data.

The PERDa data represents companies from across Europe, with an average Enterprise Value of £6.4m and average EBIT profit of some £1m. The FTSE data is taken from the Financial Times.

The two profit multiples taken from PERDa and FT are not directly comparable for each quarter as, amongst other factors, the PERDa data is based on profits before tax and interest, whilst the FT line is based (broadly) on adjusted, post tax profits. We therefore concentrate in this newsletter on trend comparison.

The information in this newsletter is based on averages derived from the PERDa database and is not intended to be an absolute guide to private company valuations as there are significant other factors involved. Due to the nature of the data, the subjective nature of the adjustments made and the constant process of updating, no responsibility is accepted by the Leading Edge Alliance or any of its members for the use of the data in the PERDa database or this publication.

MORE INFORMATION

Should you wish to discuss the details of this newsletter, or obtain a current market valuation report for your company using the data in PERDa, please contact your local LEA member at www.leadingedgealliance.com.