PERDa
Price Earnings Ratio Database

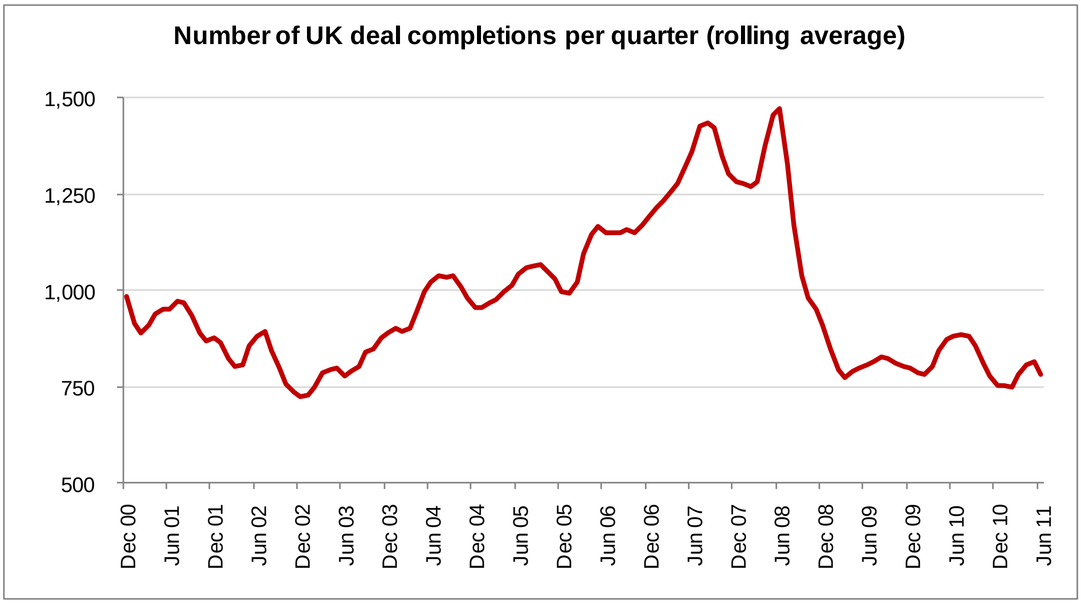
Issue 7: Summer 2011 UK Edition

INTRODUCTION

Welcome to the Summer 2011 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, with this edition concentrating on UK companies and deals.

DEAL VOLUMES

UK deal volumes remain at a historically low level but are still volatile. There were signs of a recovery in Q1 2011, but completions then decreased in Q2, as shown below (data from Corpfin/Experian):

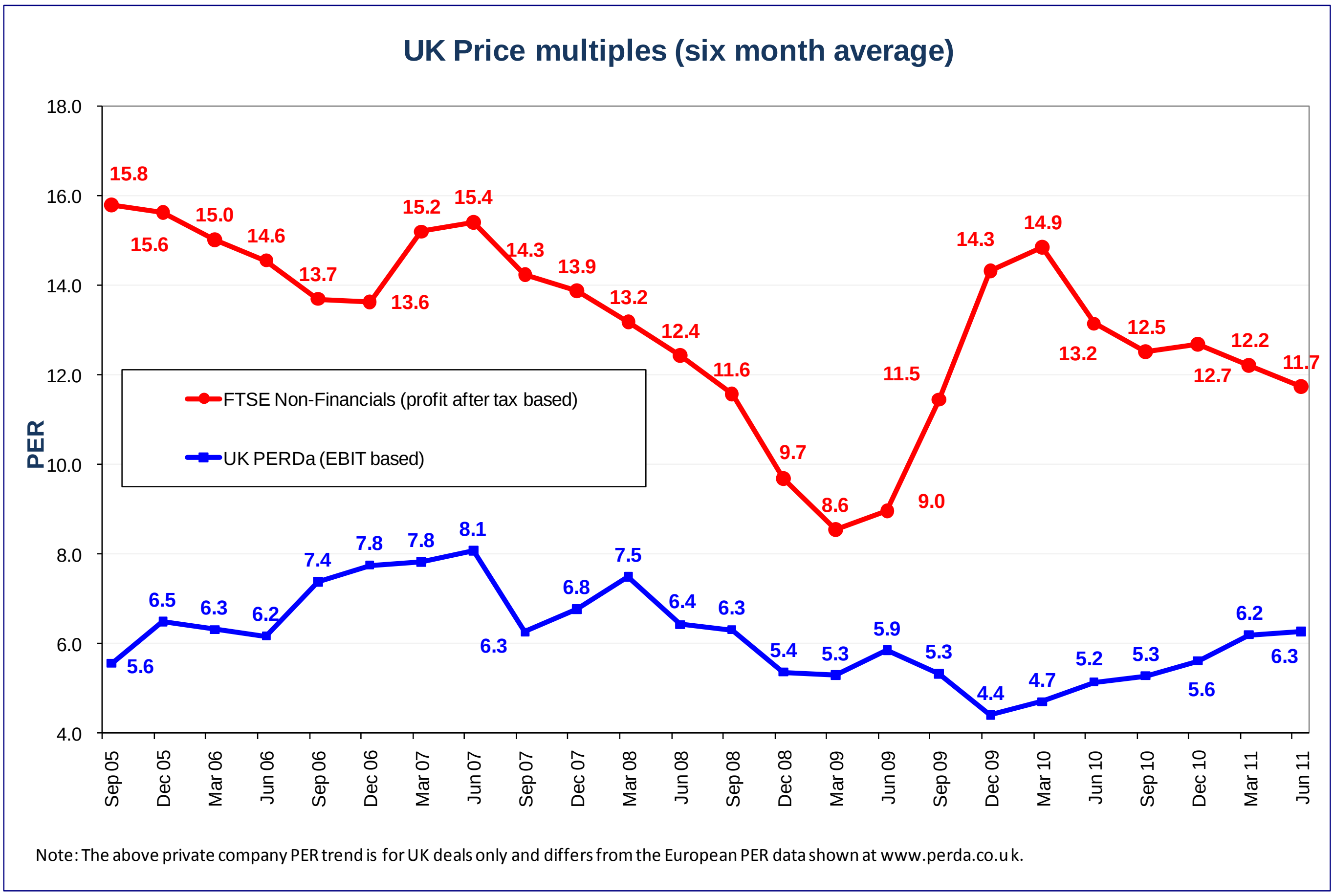


Obviously the first six months of 2011 were extremely complex in terms of economics and politics, both within the UK and on a European/global basis. The continued Sovereign crises (even encompassing the USA according to one credit rating agency) and political uncertainty make business and financial forecasting very difficult. However, the past three years do enable any deal funder to make a full assessment of management's ability to survive or thrive in an unfriendly environment. Therefore we see a trend developing of lower volumes but higher quality deals being undertaken.

Volumes have also been very variable when looked at between industry and size. Small deals (value less than £10m) volumes have remained relatively steady although still at historically low levels, whilst mid market deals (£10m to £100m) have become extremely volatile. This highlights that the smaller deals are driven by factors such as retirement, which still need to be addressed regardless of the economic climate.

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 consideration to Profit After Tax multiple for FTSE Non Financial companies.



Average PERs have recovered to their long term average, but based on much lower volumes. As noted overleaf, we would see this as reflecting the better quality of deals in this average, with lower levels of distressed sales. It will be interesting to see what happens to the level of distressed sales in the next six to 12 months given the gloom emanating from sectors such as retail, hotel and leisure and various European countries.

We still see some (albeit narrowing) disparity in price expectations between vendors and acquirers, but this seems to be more driven by the increasing amount of the vendor's price deferral needed to complete deals in the small and mid market sector.

The other key feature hidden in the above average is the difference between sectors. Opposite we look at the manufacturing and renewables/energy sectors separately. In addition to these, construction sector deals remain (unsurprisingly) at low volume and lower PERs, whilst the healthcare sector deals are still being undertaken at a premium, although said premium has decreased significantly over the last three years.

SECTOR ANALYSIS

Renewables/Energy

The UK renewables sector has been very active as the sector attracted new capital, particularly on smaller deals driven by the recently introduced Feed-in-Tariff. Some of the larger utilities continue to conserve their balance sheet strength for significant future investment in nuclear or traditional thermal electricity generation plant. However, VCTs and EISs have raised noteworthy funds targeted at acquiring smaller renewable schemes, especially wind, solar photovoltaic and anaerobic digestion power plants.

Proposed changes both to the Feed-in-Tariff regime and VCT/EIS regulations suggest that this pattern will not continue next year, with a growing reliance on conventional bank debt likely. The availability of such debt will require conventional lenders becoming more comfortable than they currently are with the risks of the sector.

It is difficult to track PERs in isolation in this sector, but the relevant deals do seem to be at a premium to the market, reflecting the ability to have long term contracts underwritten by government.

Manufacturing

UK manufacturing has been at the heart of the UK Coalition government's policy. As a percentage of GDP, its output has halved nationally over the last two decades. Major initiatives are now being discussed in terms of stabilising manufacturing's current share and then growing it in compensation for the slowdown in the Retail and Financial Services sectors: the former as a result of consumer credit scarcity, the latter arising from the need for balance sheet strengthening driven by BASEL 3 and new regulations proposed by the Vickers Commission.

Given the major tidal forces that have been sweeping around UK manufacturing in recent years, the distribution of firms is awkward. UK's manufacturing 'middle ground', which was the backbone of the country, is weak. Should Government help (such as corporate lending, tax credits, procurement, R&D grants, etc) be focused on building-up smaller firms or underpinning the few remaining globally dominant UK players like Rolls Royce and BAE Systems?

This current policy climate continues to influence sector M&A trends. Fundamentally, is the UK a good place to make things? The remaining UK listed mid-caps are under scrutiny from both US trade players and global institutional private equity. Bids and rumours have circulated over the summer around London Stock Exchange listed engineers like Charter, Invensys and Bodycote. Over and above these larger potential deals, regional players, and small owner managed businesses, will continue to look at their relative exposures to non core activities in difficult trading conditions. These trends should act as a major stimulus to the regional M&A disposals market in the coming months.

In terms of pricing, long term PERs for the wider manufacturing sector has matched the averages shown in the PERDa database. However, we are aware of a number of niche manufacturers that continue to benefit from premium prices, reflecting the more favourable exchange rate and the ability to undertake profitable UK manufacturing in certain sectors.

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. Over the period the database has been operating, we have received a number of late submissions that have been excluded from the derived average. For the H2 2011 update, we have included those late submissions, which has altered some of the historic averages from previous newsletters, although not to a material extent.

The PERDa data represents companies from across Europe, with an average Enterprise Value of £10m and average EBIT profit of some £1.5m. 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.