PERDa

Price Earnings Ratio Database

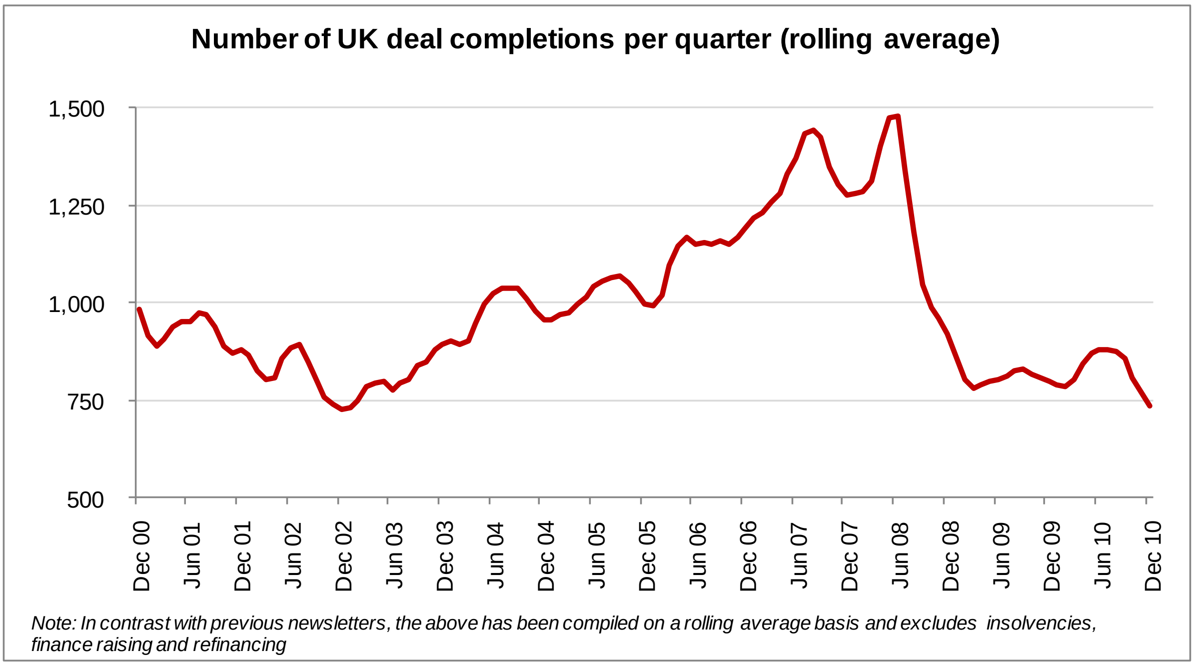
Issue 6: Winter 2010/11 UK Edition

INTRODUCTION

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

DEAL VOLUMES

The last two years have seen a dramatic decrease in UK deal volumes compared to their peak in 2007/8. Volumes started to recover in late 2009 but this trend reversed in late 2010, as shown below (data from Corpfin/Experian):



Overall annual deal volumes for 2010 were very similar to 2009, but have been decreasing since June 2010, with Q4 showing the lowest number of completions for many years.

Any analysis of this trend, and whether the Q3/Q4 decrease will continue into 2011, is difficult. 2010 was an extremely complex year, with 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 in the UK followed by the unprecedented public cuts outlined in the Comprehensive Spending Review.

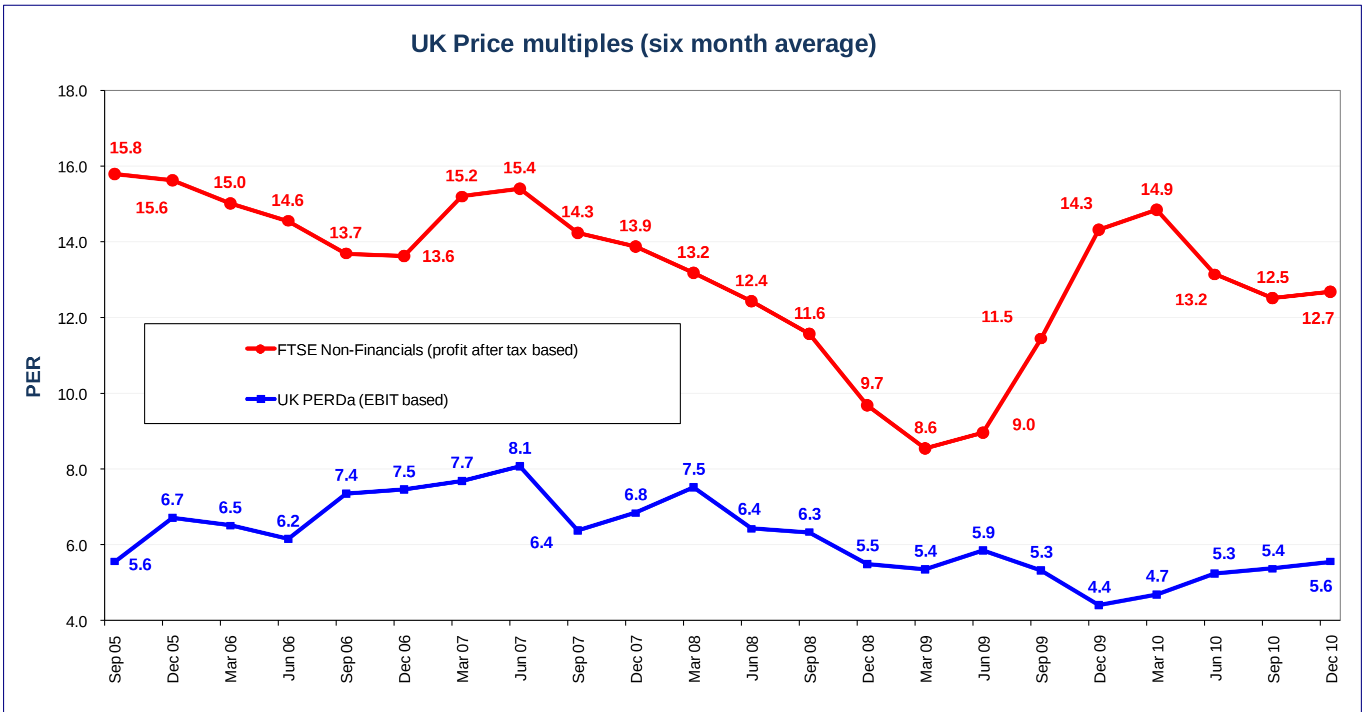
In addition, deals are currently taking at least six months from inception to completion, and often longer. Therefore the volumes reflect not only the conditions at the commencement of the deal, but are also affected by any change in those conditions over its lifetime.

However, as reflected in the decrease in volumes, it did become clear in the second six month of 2010 that any recovery was going to be very fragile and take far longer than anyone hoped for. This has obviously had an effect in deferring or cancelling deals.

It was, however, notable that there were significantly different trends in deal volumes depending upon sector. M&A activity in some parts of the media sector increased significantly in Q4 2010 (albeit from a low base) and the UK healthcare sector continued its trend towards consolidation by acquisition, often at higher than average multiples. In contrast, the renewable sector has not yet produced the forecast boom in M&A.

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 recovery in multiples from the first half of 2010 has continued in the second half, with prices returning towards the norm, although still lower than the long term average of 6 to 7. This partly reflects the low multiples recorded in 2009 were unsustainable, with vendors often choosing to retain ownership and the future profits/risks rather than sell at such low prices.

The market has also now started to adapt to the new M&A environment, which has then facilitated this increase in multiples. Whilst debt funding is still difficult to obtain for all but the best, larger deals, equity has started to filter through and the professional advisers are becoming more creative is bridging the gap between buyers and vendors, often through proper structuring of vendor deferrals.

Historically, 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). However, this difference reduced significantly in the second half of 2010, with both ratios at 5.6 for Q4 2010.

The FTSE Non Financial PERs continue to show extreme volatility, reflecting the lower profits declared in 2010 and market sentiment reflecting the economic uncertainty in 2010 commented on previously.

THE FUTURE

Given the current economic and political uncertainty in the UK (and most of the developed world), any forecast for deal volumes and prices is extremely difficult. In our summer 2010 newsletter, we suggested that price multiples would continue to recover (which they have) and volumes would stabilise (which they haven't). It is unlikely that prices will return to the lows of 2009, as vendors have already shown that they are prepared to simply maintain their ownership at such low prices.

Volumes are far more difficult to forecast. It is not certain as to whether the current deal volumes (which are still below the long term average of UK volumes over the last decade) are the new norm, or they might fall further in light of the continued economic difficulties. Anecdotal feedback from the market shows a significant increase in deal commencement, but it remains to be seen if this activity will increase deal completions.

If 2011 does see a rebound in volumes, then it is likely to be led by private equity investors (with a supposed "wall of money") and foreign acquirers - one notable trend in 2010 was the increase in Indian acquisitions of UK companies especially in the technology sector.

THE MBO DISCOUNT

In the first PERDa newsletter, we analysed the deal multiples between transaction types to examine the concept that MBOs were always done at a discount to trade sale prices.

We repeat that table below although focused on UK deals over the last 5 years.

Deal Type	Average PER (EBIT)	Average PER (EBITDA)	Average Enterprise Value - £'000
Acquisition/Sale	6.5	5.2	11,814
MBI	6.2	4.6	3,336
MBO	5.5	4.2	6,756
All deals	6.3	5.0	10,229

Again, this suggests that MBOs are being completed at an average 15% discount on the price multiple for a trade sale. This is obviously a general average, and may be partly due to the smaller MBO deal size.

However, the lack of funding and inability to realise trade synergies from an acquisition are always going to result in a lower price for an MBO. Conversely, with the increasing use of vendor deferrals, some recent deals could result in more being payable to vendors in an MBO, but over a much longer period of time.

In addition, MBOs can provide value for vendors in terms of requiring a lower level of due diligence and warranties/indemnities. These deals can also often be achieved more quickly and with less risk of a confidentiality breach.

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 £7.4m and average EBIT profit of some £1.1m. 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.