

Q2 2008



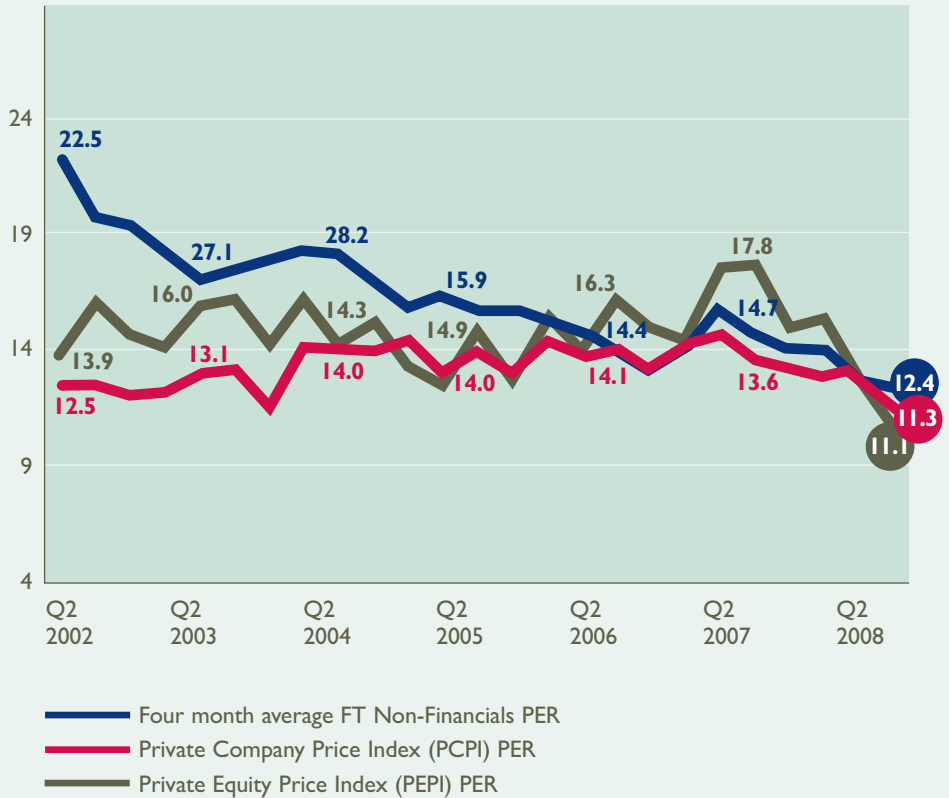
PCPIQ2

Private Company Price Index



BDO Stoy Hayward

PCPI v PEPI Q1 2002 - Q2 2008



Private company prices fall 14% to lowest for six years as volumes drop sharply

The latest Private Company Price Index (PCPI), which tracks price/earnings (p/e) multiples paid by trade buyers for private companies fell by 14 per cent in Q2 to 11.3 times from 13.2 times in the previous quarter.

The Private Equity Price Index (PEPI), showing comparable multiples on sales to private equity buyers also fell 14 per cent from 12.9 times last quarter to 11.1 times in Q2. This comes as private equity houses continue to face difficulties in raising debt for new investment as the banks concentrate their limited lending capacity on facilities for existing customers.

The trading p/e ratios of companies in the FTSE Non-Financials Index for Q2 2008 were 12.4 times their historic after tax profits, down 3 per cent from 12.8 times in the first quarter of 2008 and 22 per cent from their peak of 15.8 times a year ago. Much of the negative economic and business sentiment had already been factored into public company multiples earlier in the year.

The surge in deals before 5th April 2008 (as vendors rushed to beat the 10 per

cent CGT deadline) created a vacuum in the market in Q2 with a steep decline in the number of deals completed. The volume of deals in Q2 2008, at 810, was down 12 per cent on the total of 921 in Q1. Of this total in Q2, 422 deals (over 50 per cent) completed in April with 150 of those in the first week to beat the deadline. Deal volumes in May and June saw a sharp drop of over 35 per cent against the monthly average in Q1.

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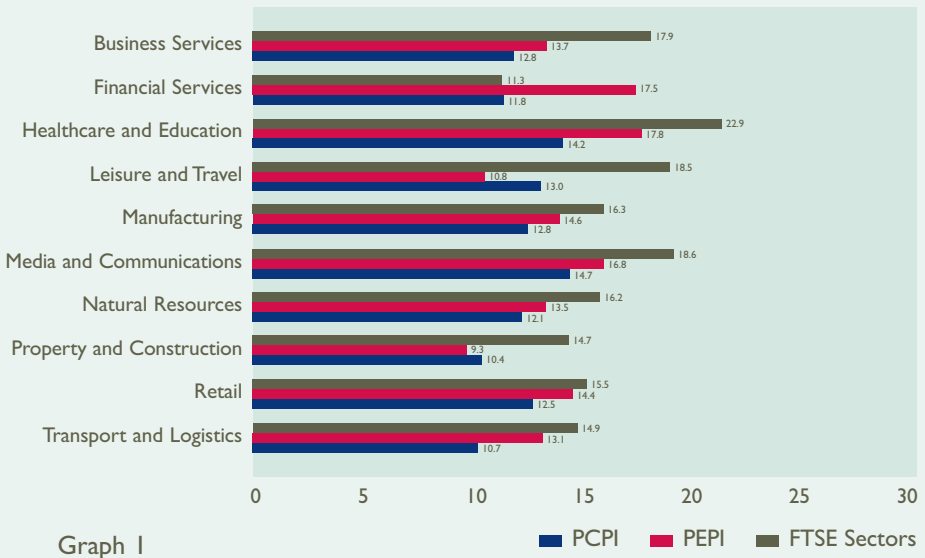


“We knew that April’s CGT deadline would create an artificial blip in the M&A market but nobody anticipated that it would be on such a scale or that the aftershock would be so dramatic – a 14 per cent quarterly fall in prices was coupled with a sharp drop of 35 per cent in the monthly volume of deals.”

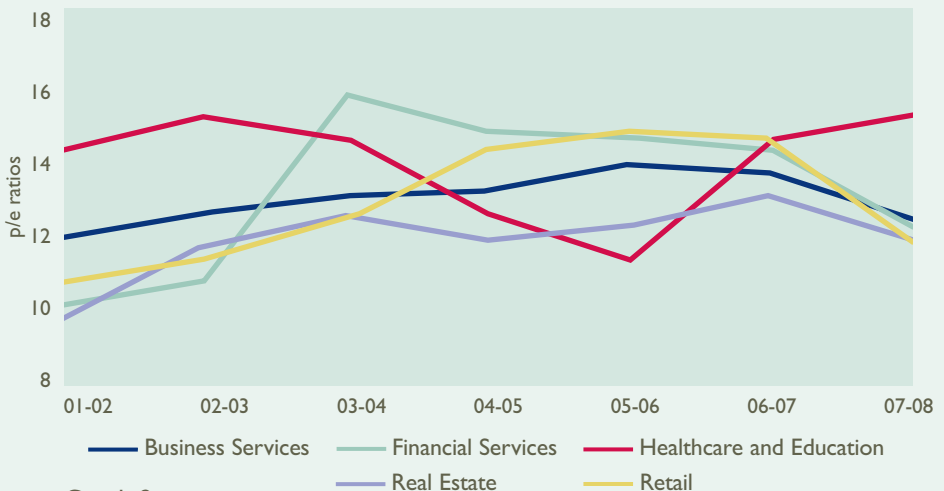
Jon Breach, Editor

Sector valuations uncovered

Q3 2007 to Q2 2008 sector-by-sector average p/e ratios



PCPI two-year rolling average of p/e ratios by sector



Industry focus

In our third annual review of multiples by industry sector, we take a look at the relative p/e ratios paid across different sectors on the sale of private companies to private equity and to trade buyers and compare these with public company trading multiples. Despite the difficult economic conditions in the UK, there has been a steady flow of M&A activity in the last year. Sectors of particular interest to private equity buyers (Graph I) are Healthcare and Education, Financial Services and Media and Communications where the PEPI is outstripping the PCPI. In contrast to last year, Leisure and Travel and Property and Construction have lost their appeal to private equity buyers – sectors most affected by the economic downturn. Financial Services remains a hot sector for private equity where uniquely, private multiples have been greater than those of the public comparables.

Graph I sets out the average multiple of earnings paid for private companies by trade buyers (PCPI) and private equity buyers (PEPI) compared to the trading multiples of public companies by sector for the period Q3 2007 to Q2 2008.

Graph II focuses on the p/e ratios over the last five years in sectors where we have seen significant volumes of transactions.

Healthcare and Education

Investor interest in quality healthcare and education opportunities remains buoyant in spite of weakness in the debt markets and other economic sectors. The strong defensive qualities of this sector make it a natural area for continued investment.

The sector's popularity is primarily due to its government-backed revenue streams. Industry consolidation platforms are sought-after opportunities in healthcare businesses. The opportunity to benefit from the inevitable increase in outsourcing to the private sector of healthcare services historically provided by the NHS is also attractive. Additionally, the ageing population of the UK continues to fuel demand for the provision of specialist care.

We have observed an upward trend in the amount of deal origination by generalist equity houses in the healthcare arena, while healthcare sector specialists are enjoying more favourable conditions as interest in the sector has improved and financiers return to a bricks-and-mortar approach. The difficulties in the debt markets have generated an increase in the number of client enquiries relating to funding solutions with companies often seeking to raise funds via the sale of minority equity stakes.

Business Services

There remains a steady flow of M&A activity in the business services sector despite the difficult economic conditions in the UK. Acquirers and investors continue to be attracted to the trend to corporate and government outsourcing of services and the relatively long-term nature of contractual relationships.

Several large groups and mid-caps remain acquisitive, as they seek to diversify the services they offer and they have the cash to do deals. Private equity investors remain positive about niche services, especially in specialist areas of facilities management and business process outsourcing.

While it is far tougher for recruitment and training providers, deals are still being done – driven by the need for consolidation – although valuations across business services have fallen to more sustainable levels.

Retail

The consumer is clearly now feeling the effects of the credit crunch. Banks have shown reluctance to lend to the sector at the levels experienced in 2007 which has impacted the price acquirers can pay for retail assets. In addition, profitability has been hit by a combination of rising costs and lower levels of consumer spending. Consumers are becoming increasingly savvy in their purchasing decisions, researching products and prices on the internet and focussing spending on the real 'must haves'. We therefore expect robust performance from strong brands which give the shopper a reason to part with their cash, with weaker brands likely to suffer.

Real Estate, Property and Construction

In contrast to last year, the waves resulting from the failure of the US sub prime market have had a huge impact on the fortunes of the UK real estate market.

The biggest challenge is the change in attitude of the banking market. Principally, the market must decide how to overcome the equity funding gap caused by the banks retreating to historic levels of lending last seen in the early 1990s.

Lending on purchase cost (as opposed to value) is the new reality for the market. With senior debt levels averaging 70 to 75 per cent of purchase price, and private investors backing away, where will the equity come from? Mezzanine funding could

plug part of the gap, although in this new environment the financing cost will reflect the real risk of sitting behind the senior debt provider.

On a positive note, the sharp decline in values in the commercial market over the past year has allowed the market to return to more affordable position resulting in the fundamentals for investing in property becoming more favourable.

Once the cost of debt in the banking market settles, after the 'short sharp shock', we should see the market recover as investor confidence in sustainable pricing levels is restored.

Financial Services

There has been a marked slow down of mid-sized corporate M&A activity in the financial services arena in the past year as the credit crunch has thrown the banking, insurer and finance provider acquirers into turmoil making them almost exclusively internally focused.

Despite this, the financial services sector has offered attractive opportunities for private equity houses where multiples increased 13 per cent to 17.5 times from 15.5 in Q2 2007. However, where they were able to, trade buyers desperate to secure successful brands used their financial firepower to trump private equity bids resulting in the only sector in our data (Graph I) which shows both the PCPI and the PEPI at higher multiples than that of the listed companies in the sector:

Given recent events, we expect the outlook in this sector to be one of significant consolidation at the large corporate level with opportunities presenting themselves for flexible innovative service providers at the smaller end of the scale.

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 11.3 times their historic after tax profits. The PEPI indicates that, on average, private companies are being sold to private equity buyers for 11.1 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 £21m and a median deal size of some £6m. And the included deals for the PEPI have a mean deal size of £30m and median deal size of £16m. 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 Stoy Hayward representative.

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