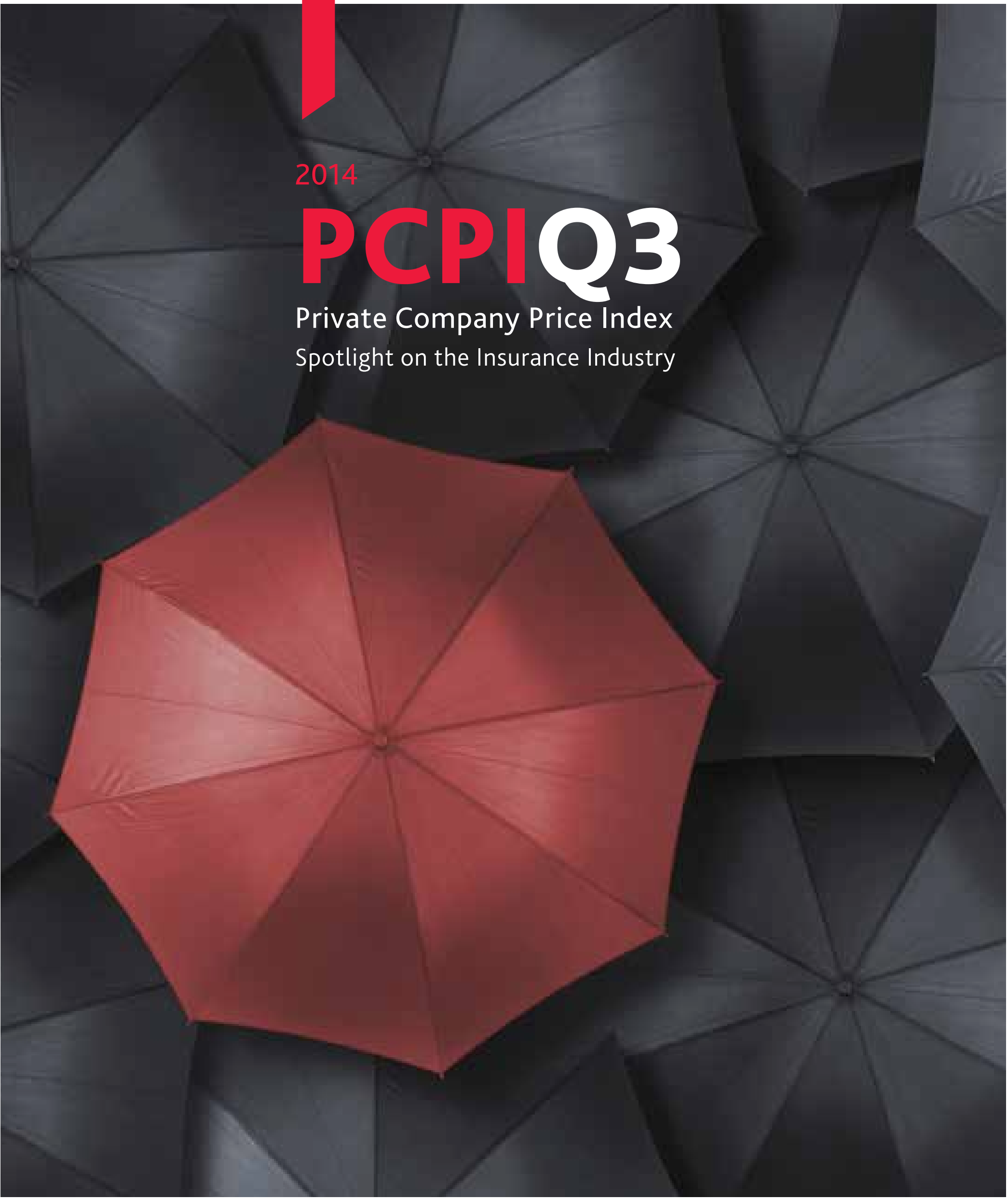
2014

PCPIQ3

Private Company Price Index

Spotlight on the Insurance Industry



BDO

PCPI/PEPI - PE DEAL VOLUMES HIT THE HIGHEST NUMBER SINCE 2009

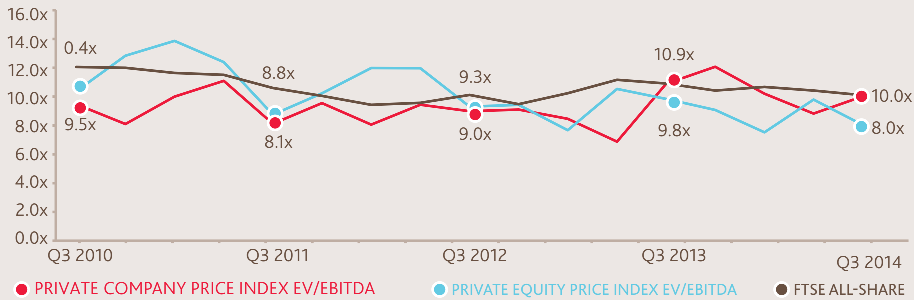
Following a lacklustre first half of the year, UK M&A activity rocketed back in the third quarter with private equity recording its highest activity level since 2009. The quarter's activity reflects the pent up demand for M&A from buyers as well as excellent selling conditions.

The third quarter of 2014 saw a remarkable uptick in trade and private equity deal volumes. Trade deals jumped by 36% from 296 to 404 deals from last quarter's rock bottom figures. Private equity acquisitions were up from 81 in Q2 2014 to a five-year high of 107, a 32% increase. Trade multiples have continued their rise (from 8.8x to 10.0x) simultaneously with deal volumes, indicating corporates are not only prepared to start buying again, but are also prepared to spend top premiums to ensure their acquisitions are the perfect strategic fit.

Whilst we are seeing capital markets take a pause for breath, the appetite for deals in the private company arena is undiminished. There is a large amount of cash chasing good quality deals and private equity firms continue to take advantage of the strong conditions during 2014. As expected, last quarter's low trade deal volumes have proved to be an anomaly and they have risen back to normal historical levels. We continue to see good businesses receiving frequent enquiries from potential buyers.

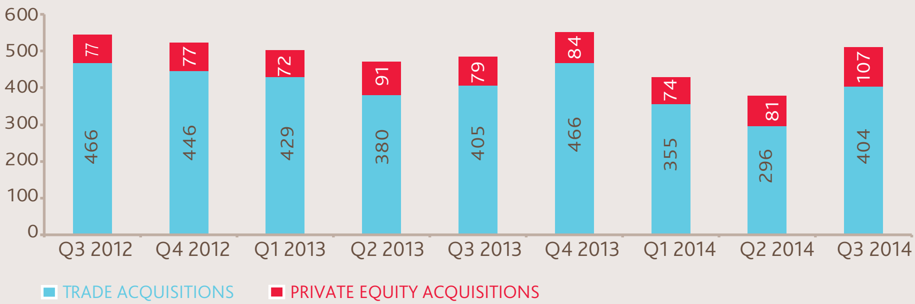
What we are not seeing however are prices being lowered to get deals completed ahead of the impending General Election which is somewhat surprising. There seems to be a working assumption in the market that the Capital Gains Tax rate will not change in the next Parliament and pricing therefore remains resilient. We expect this to continue up to the election based on the cash in the market and investor appetite.

PCPI v PRIVATE EQUITY | Q3 2010 - Q3 2014



Source: Capital IQ and BDO research

VOLUME OF DEALS COMPLETED | Q3 2012 - Q3 2014



Source: Corpfin

THE WINDS OF CHANGE CONTINUE TO BLOW THROUGH THE INSURANCE INDUSTRY

FROM THE OUTSIDE LOOKING IN IT MUST APPEAR THAT THE INSURANCE INDUSTRY HAS SAT AT THE HEART OF A DECADE LONG TEMPEST AS THE WINDS OF CHANGE FUNDAMENTALLY CHANGED THE LANDSCAPE OF THE INDUSTRY.

Faced with the continually changing shape of the UK's regulatory environment and the compliance requirements laid down by the latest incarnation of the industry's governing body; catastrophic weather events and global disasters or the impact of the emerging markets on global demand; the industry has moved headlong through a period of unparalleled change.

And as the storm has raged across the industry as a whole, nowhere have the winds of change been felt so acutely than in the general insurance, broking and distribution markets. The complete revolution of personal insurance distribution led by the aggregators and the price comparison sites, along with mass market consolidation and M&A activity has completely reshaped the sector.

Over the last 10 years consolidation and M&A activity has been a constant theme across all sectors of the industry but has been spectacularly prevalent in broking.

During this time the emergence of major UK industry consolidators such as Towergate, Giles, Oval and more recently Gallagher has fuelled market transactional activity to record levels. In the case of both Giles and Oval much of their M&A activity was in part funded by private equity investors who were early converts to the merits of consolidation in the broking sector and the profit arbitrage that could be achieved with scale.

Whilst transactional activity and valuation multiples peaked in 2007, prior to the onslaught of the global recession and the economic downturn, activity levels since then would suggest that the industry was merely entering the eye of the M&A storm.

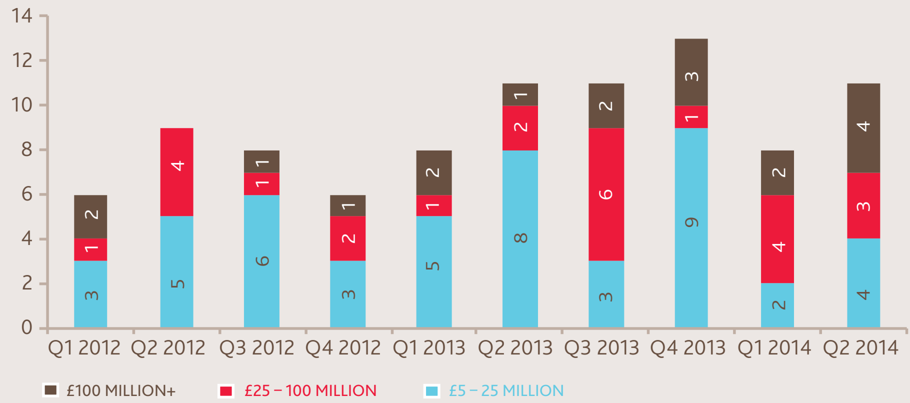
Since 2008 there has been a continuing fall in the level of FCA authorised intermediaries with total numbers falling by 20%. Although the rate of this decline has softened in the latter years it still reflects the continuing trend of consolidation across the industry which significant outpaces the new market entrants.

Over the last 3 years deal volumes have continually increased since the low point of the global recession and 2013 saw a number of high profile deals with average values increasing significantly compared to the previous year.

Whilst we have yet to see a return to the height of the M&A market, 2014 has seen a continuation of this trend with notable transactions such as the £2.1bn IPO of Saga, the £1.1bn acquisition of OAMPS by the voracious Gallagher and the investment in Brightside Group by AnaCap valuing the business at £127m.

However despite the huge volume of transactions in recent years a large element of the market remains fragmented, under independent ownership and drivers for further change remain strong.

DEAL VOLUMES IN INSURANCE



Announced transactions on a quarterly basis representing UK based business sales with a value in excess of £5 million – sales of individual books of business have been excluded from the above data.

Source: IMAS Corporate Finance LLP

Forecast

Although so much has changed in the industry over the last ten years there is little hope for any respite from the turbulent conditions. Insurers, brokers and alike will need to continue to embrace a continuing period of change, including a flood of new regulations and increased public scrutiny whilst ensuring they maintain their focus on customer service and retention.

Whether the industry is prepared or not, the next stage of its evolution is on the horizon, with new product development, changes to distribution channels and the widespread acceptance of new transformational technologies which have already been vital in the growth and emergence of next generation companies.

As always M&A activity will be a key component to any period of change.

In the year ahead M&A activity amongst insurers and underwriters is expected to heat up as they seek to leverage on their strong capital foundations to enter new markets, acquire enhanced technology platforms and divest of non-core operations. All with the aim of securing profitable long term growth.

The regulatory and economic landscape will also continue to change and will remain as an accelerant for international M&A, with the UK and in particular London the international centre of the global insurance market.

After a recent resurgent period of transaction levels in the UK broking sector, further growth in M&A is anticipated. Whilst the UK led acquisitions of Oval and Giles by Gallagher were major market transactions which cannot be easily repeated, increasing valuations and the improved accessibility of both debt and private equity finance will be key transactional catalysts in the UK mid-market.

THE WINDS OF CHANGE CONTINUE TO BLOW THROUGH THE INSURANCE INDUSTRY

Despite the consolidation seen in the broking sector, a significant proportion of the mainstream commercial market remains under the control of independent and regional brokers. The ageing demographics of the sector along with improved access to funding could lead to a new wave of acquisitions and regional consolidation amongst independent brokers.

Overseas trade buyers, particularly from the US, will continue to be a force although many already have an established presence in the UK. The sale of Doodson Broking Group, a UK based international broker with a specialist entertainment division, to Integro Inc is a good illustration of a major US broker seeking to expand its growing UK business by the acquisition of a complementary niche business.

Businesses which can demonstrate strong sector credentials and a differentiated service offering will continue to command enhanced valuations as acquirers focus more heavily on quality rather than pure scale.

With significant capital and a track record of profitable investments, the Private Equity community will become an increasingly active participant in the industry. The recent Management Buy Out of residential property risk specialists Avantia, funded by ECI partners, was secured against stiff competition and could mark the start of a flood of investment into the sector.

Whilst the exact long term forecast remains uncertain, we expect M&A to be vital in helping brokers and underwriters navigate through the continuing storm and the industry changes that lie ahead.

FCA AUTHORISED ENTITY TREND

Source: IMAS Corporate Finance LLP and the FCA

MAKING THE MOST OF THE PCPI/PEPI

The PCPI has been updated for 2014 to incorporate Enterprise Value to EBITDA multiples as the method of valuation, replacing the previously used Price to Earnings ratio. These changes have been made to incorporate the level of debt in deals and to use a less subjective measure of profitability. Historical data has been incorporated to ensure comparability and to identify trends.

The PCPI/PEPI tracks the relationship between the Enterprise Value (EV) to Earnings Before Interest Tax Depreciation and Amortisation (EBITDA) multiple (EV/EBITDA) paid by trade and private equity buyers when purchasing UK private companies.

The private company EV/EBITDA is calculated from publicly available financial information on deals that complete in the quarter. At present, the Private Company Price Index (PCPI) indicates that, on average, private companies are being sold to trade buyers for 10.0x historic EBITDA. The PEPI indicates that, on average, private companies are being sold to private equity buyers for 8.0x historic EBITDA.

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 EV/EBITDA paid as calculated from the publicly available information may be overstated.

The PCPI/PEPI is calculated as the arithmetic mean of EV/EBITDA for deals where sufficient information has been disclosed. Over the last four years, the included deals for the PCPI have had a mean Enterprise Value of £54.2 million and a median Enterprise Value of £14.2 million. The included deals for the PEPI have a mean Enterprise Value of £82.4 million and median Enterprise Value of £32.0 million.

The PCPI/PEPI is an average measure and a 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 VALUE OR UNDERSTAND M&A MARKET DYNAMICS FOR YOUR COMPANY, PLEASE CONTACT A BDO REPRESENTATIVE (SHOWN OVERLEAF)

Scan this QR code to view more information on the Private Company Price Index (PCPI)

BDO UK

21 Offices

300 Partners

3,500 Staff

No.1 for exceptional client service[1]

92% of our clients would recommend us[2]

76% already have[2]

BDO INTERNATIONAL

US$7 billion[3]

2014 REVENUE

151 Countries

1,350 Offices

60,000 Staff

1. Independent research (Mid Market Monitor 2012, 2013 and 2014) undertaken by Meridian West shows BDO has the highest client satisfaction rating among its peers
2. Client Listening Programme 2013/14
3. US$7bn (€5.62 bn) combined fee income 2014

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