2016

PCPIQ3

PRIVATE COMPANY PRICE INDEX

Spotlight on Life Sciences

BDO

BREXIT: A BUMP IN THE ROAD, NOT A CAR CRASH

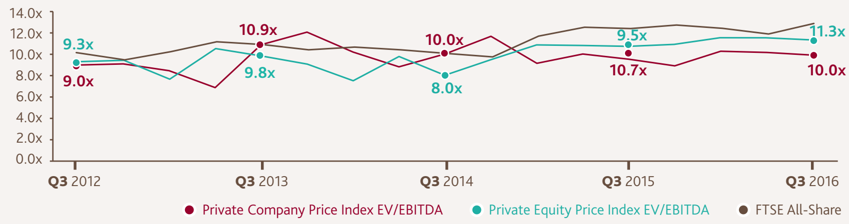
The first quarter since the Referendum saw the record number of 707 M&A deals completed in the second quarter of 2016, slow to 578 deals in quarter 3.

Despite the slowdown, the number of deals is not out of line with recent levels and in general the market has taken Brexit as a bump in the road rather than a car crash. Indeed we continue to see more buyers than sellers in the M&A market.

The PCPI/PEPI index, which tracks multiples paid by trade and private equity buyers for private companies saw both trade (10.0x) and private equity (11.3x) prices decline marginally. However despite the movement, the market has proved resilient in terms of value and we expect future multiples to reflect the significant firepower available to corporates and Private Equity. Strong appetite for good quality businesses remains intact and for a good strategic fit, buyers continue to pay a premium.

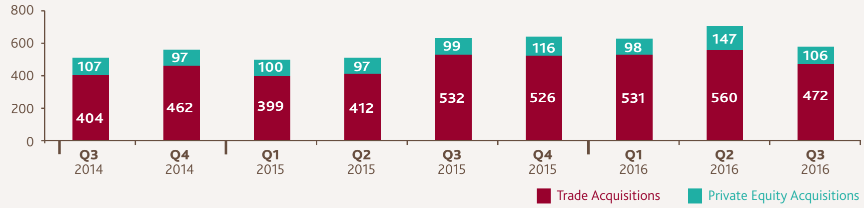
This quarter has continued to see international buyers from North America, Europe and Asia attracted to UK assets. The c20% depreciation of sterling has markedly reduced the upfront cost of acquisition for many international buyers. Overall, we expect M&A activity to remain robust.

PCPI V PRIVATE EQUITY | Q3 2012 – Q3 2016



Source: Capital IQ and BDO Research

VOLUME OF DEALS COMPLETED | Q3 2014 – Q3 2016



Source: Corpfin

BDO UK

18 Offices
250 Partners
3,500 Staff

No.1 for exceptional client service[1]

95% of our clients would recommend us[2] | 77% already have[2]

BDO INTERNATIONAL

US$7.3 billion 2015 REVENUE

154 Countries
1,400 Offices
64,500 Staff

1. Independent research (Mid Market Monitor 2012-2015) undertaken by Meridian West shows BDO has the highest client satisfaction rating among its peers
2. Client Listening Programme 2014/15

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 ON THE BACK)

MAKING THE MOST OF THE PCPI/PEPI

The PCPI has been updated 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 11.3x 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 four years to September 2016, the included deals for the PCPI have had a mean Enterprise Value of £78.4m and a median Enterprise Value of £15.6m. The included deals for the PEPI have a mean Enterprise Value of £101.9m and median Enterprise Value of £32.5m.

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.

LIFE SCIENCES M&A: STAYS RESILIENT AFTER TWO RECORD YEARS

As reported previously the record number of deals seen in Life Sciences in 2015 off the back of a record 2014 had already led to speculation that a bubble was building in the Life Science market. Expectations and commentary agreed that an implosion was on the horizon and that 2016 could be the year it all fell apart.

The uncertainty in the run up to, and the shock outcome of, the Brexit vote in the UK has added further uncertainty across Global markets and has already had a marked effect in other sectors. There is also concern that this could further supress the M&A market, especially in the EU, as decisions are delayed as countries, as well as companies, try to work out the implications of a 'hard' or 'soft' UK Brexit.

Globally we can see that there has indeed been approximately a 6% slowdown in Life Science mid-market M&A deal volumes, with the main weakness seen in the UK and Ireland, the DACH region and the Benelux countries. However, this is in relation to other M&A sectors that have seen larger slowdowns in deal volume indicating the Global nature of the Industry and the ongoing furious activity we have seen in the past two years.

Despite the apparent slowdown in volume the Life Science M&A markets have been seeing higher deal value in 2016 than in the same period of 2015 in Europe (USD 35.2bn in the first 6 months vs USD 32.9bn for the whole of 2015). One reason for increased deal value seen is due to a number of large cross-border deals such as the acquisition of Baxalta by Irish headquartered Shire and the transfer of the animal health arm of Sanofi, Merial valued at €11.4bn, to Boehringer Ingelheim in exchange for their Consumer Healthcare business plus a cash payment.

Opposed to the numbers reported however is the sentiment in the market. Far from a slow down there remains great appetite for M&A activity. One of the drivers behind this being the increasing interest in Life Sciences of numerous Private Equity houses due to the perceived defensive nature of the sector compared with stalwarts such as construction and healthcare which have been hit by Brexit fears and rises in minimum wages respectively.

Most of these PE houses have successfully raised new funds at the height of the recent cycle off the back of successful exits of key assets. with an £50bn remaining unspent in the UK market alone needing to be deployed over the next 3 to 5 years. Life Sciences companies in the services sector are seen to be attractive targets for buy-and-build models further fuelling the M&A market. Added to this a scarcity of such businesses in the £3-10M EBITDA range fuelling some very aggressive pricing in the market, pushing deal values much higher, examples that we have worked on in that regard include Hg Capital's acquisition of Kinapse in January at a reported return to Synova Capital of over 16x.

This scarcity of assets of scale in the market is also driving many PE houses, especially those in the UK, which usually have tight geographical restrictions, to look further afield for their targets. Two recent examples that we have worked on include Sovereign Capital's acquisition of Xendo, a regulatory compliance business in Holland, and Kester Capital's acquisition of Factory CRO, a medical device CRO also in Holland. In both cases neither Target Company has significant operations in the UK, but this did not deter either from completing the deals. Conversely, while UK based PE houses are starting to look to the continent, US investors, such as Water Steet and The Riverside Company, are increasingly interested in UK based targets.

When we look at the overall M&A markets, far from a bursting bubble we appear to be experiencing, at most, a short pause for breathe in the Life Science M&A markets following on from two consecutive years of record activity. We continue to see strong positive indicators of the health of the market, albeit with the caveat that there may be fewer assets of scale being chased by more sources of capital. While the recent Brexit vote in the UK does not yet appear to have had any negative effects it remains to be seen if there will be any impact on the Life Sciences M&A market in the future – whether negative or positive.

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