2014

PCPIQ2

PRIVATE COMPANY PRICE INDEX

SPOTLIGHT ON PHARMACEUTICALS & BIOTECHNOLOGY

BDO

PCPI/PEPI – DEAL VOLUMES LOWEST EXPERIENCED SINCE THE DEPTHS OF THE RECESSION

A booming IPO market and sellers staying away from the marketplace have played their part in UK private company M&A activity having its worst quarter since PCPI records began. This is in stark contrast to the surge in UK growth which recently prompted the IMF to raise its economic forecasts for the second time this year.

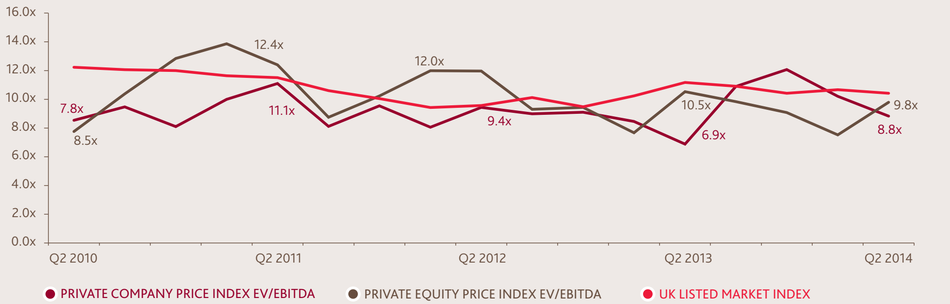
The second quarter of 2014 saw deal volumes plunge lower than those experienced in the depths of the recession. Trade deals continued their descent from 355 to 296 (17% decrease) which represents a 28% decline in deal volume when comparing 2014 to 2013. So, what has happened to the wave of owners looking to sell their businesses given the positive economic outlook?

The Private Company Price Index (PCPI) may be down this quarter to 8.8x from 10.2x however it is the opposite for the Private Equity Price Index (PEPI) which is up at 9.8x compared to 7.5x last quarter. So, it may be as simple as owners don't realise good sale valuations are being achieved. A feature of the current market is that Private Equity funds are selling, which usually means one thing – it is a good time to sell.

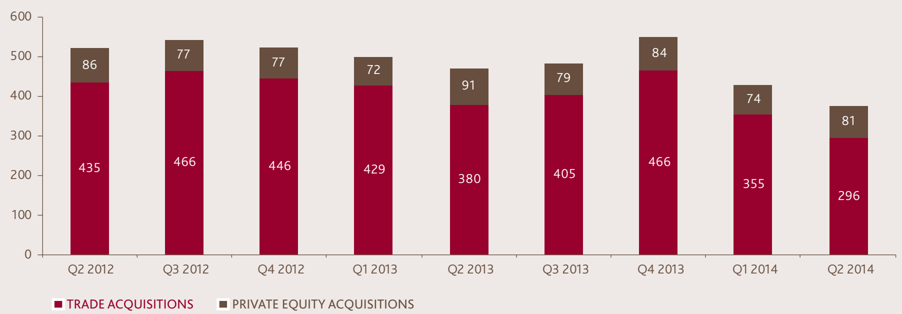
There are shortages of quality businesses coming up for sale and both trade buyers and Private Equity funds are actively looking to deploy cash reserves. The struggle to find the right acquisition looks set to remain. Whilst there is a long tailback of companies hoping to achieve an IPO listing, people are already talking about next year's election being perhaps the 'closing of the window' for the IPO market. Then there may be a number of companies seek an M&A solution to replace the IPO option. We shall see… but meanwhile we expect M&A volumes to remain constrained and multiples to remain strong for the remainder of 2014.

Dependent upon the fallout from the 2015 general election, we suspect that a number of sellers may have wished that they'd taken advantage of the 2014 market.

PCPI v PRIVATE EQUITY | Q2 2010-Q2 2014



VOLUME OF DEALS COMPLETED | Q2 2012-Q2 2014



Source: Corpfin

M&A WITH A SCALPEL – OR A SLEDGEHAMMER?

The Pharma, Medical & Biotech sector proved the exception to the rule in 2013. Unlike the global M&A market as a whole, its deal volume showed remarkable consistency with previous years since the financial crisis. Then in the first quarter of 2014 this deal volume rose significantly – hand-in-hand with rising confidence in that sector and many others. All signs therefore point towards a strong current year.

Certainly in terms of deal value, the year to date looks very strong indeed. More than USD 200 billion has been slated for the first half of the year alone, when the value for the whole of 2013 was just USD 130 billion . What's more, we can observe an interesting pattern: when pharma deal values are higher, biotech deal values stay lower, and vice versa. This is driven by the fact that most biotech deals are driven by pharma acquisitions – so if pharma is too busy spending its cash on merging with or strategically partnering with other pharma companies, then biotech tends to be quieter with fewer, lower value deals.

However, we must sound a note of caution when citing this year-to-date deal value, as it currently includes the much-discussed Abbvie proposed acquisition of Shire. This stands at USD 55 billion and accounts for nearly half the estimated deal value, but at the time of writing is by no means a certainty. This is the latest in a line of so-called inversion deals where an aggressive take over approach is instigated in order to take advantage of a more generous tax regime in another locality. Another well-covered example of this was the USD 100 billion Pfizer attempted take-over of Astra Zeneca earlier this year.

M&A WITH A SCALPEL – OR A SLEDGEHAMMER?

The overwhelming number of M&A deals are trade based, either pharma to pharma or pharma to biotech. This year is seeing the return of large pharma mega deals, such as Pfizer's bid for AstraZeneca and, more recently, Abbvie's for Shire mentioned above, as well as the much more elegant approach taken by Novartis and GSK with their £11 billion swap of assets in oncology and vaccines, which was announced in late April. What makes this asset swap deal clever is that it represents a much more surgical approach to M&A, whereby both parties make a deal on those areas of the portfolio that are going to add the most mutual value. In other words, this means that the shareholders don't have to spend even more to acquire assets and technologies that they really don't need or want. When we look at Pfizer's string of mergers over the past five years, one of the main reasons for the lack of perceived return on investment is that their market cap and sales have not grown commensurately, due to the colossal waste of resources that such mega mergers bring, not to mention the accompanying distractions. Indeed, it is estimated that Pfizer has shed some 56,000 jobs since 2005 and instituted a reduction of USD 3 billion per annum in the aggregate former R&D expenditure, all while continuing to see a decline in sales.

It has been a quiet time for private equity in the sector in both 2013 and 2014 to date. This can largely be explained by the recent focus of private equity capital on the clinical research services sector, with major acquisitions and roll ups. Notable examples included the acquisition of PRA by KKR in June 2013 for USD 1.3 billion (having been acquired by Genstar for £790 million in 2007) and the amalgamation of PharmaNeti3 into Inventiv Health in January 2013 to make an enlarged group. In September 2013 Quintiles, the world's largest CRO, made a strategic acquisition of Novella Clinical Group for an undisclosed sum to bolster its oncology offering to smaller companies. With the largest global CRO still accounting for only 15% of all clinical outsourcing spend in the market, the CRO sector is clearly slated for further consolidation.

LOOKING AHEAD

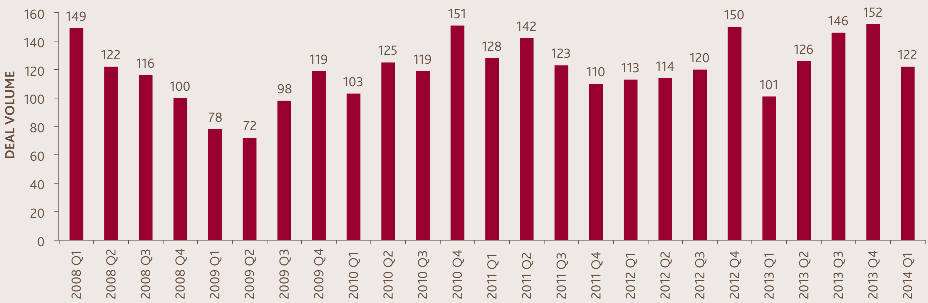
The year ahead promises to be very interesting with the current crop of inversion deals headlining the sector. At the other end of the scale, we can expect substantially more activity in the niche CRO services sector, much of it driven by both trade and private equity. The larger trade players will be seeking points of diversification in the market, or taking advantage of new technology approaches to drive greater speed and efficiencies in their operational systems. Such deals can drive very strong valuations.

A recently announced example of the above is the cross border acquisition of Pharmalink, a regulatory consultancy and outsourcing provider, by US/India-based business Genpact for an undisclosed sum after a highly competitive bid process. It is thought that the acquisition will expand Genpact's capabilities when providing solutions in growth areas like the Life Sciences industry, and will allow Pharmalink to meet market demand for more end-to-end regulatory affairs solutions.

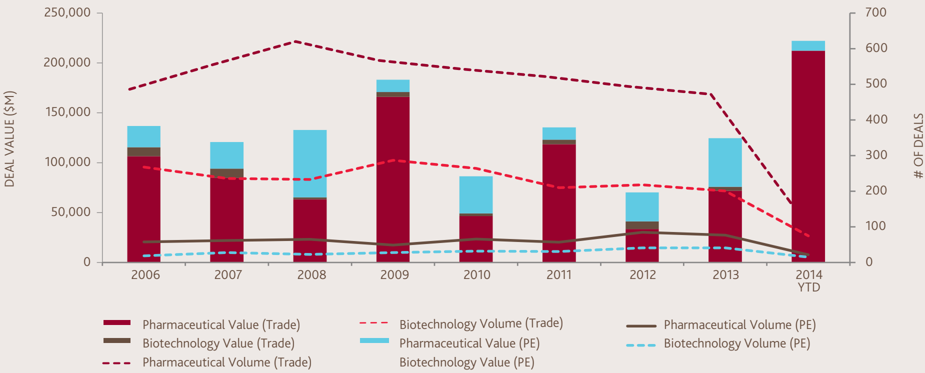
Other niche service areas also look set for growth. These include ePharma consultancies that use online approaches to improve patient recruitment in trials, medical device CROs, therapy area specific CROs, CMOs and discovery research services. A good example of this was the recent acquisition of Phlexglobal by Bridgepoint Capital for £42 million. Phlex is a technology and clinical; services business that leads the eTMF field.

We can expect more technology driven activity in the sector as mobile technologies and health tracking devices converge as well as the larger scale inversion and niche CRO roll ups noted above.

PHARMACEUTICAL, MEDICAL & BIOTECHNOLOGY
GLOBAL



ANNOUNCED PHARMACEUTICAL & BIOTECHNOLOGY
M&A ACTVITY



Announced deals between 1 Jan 2006 and 29 Apr 2014 PE deals defined as those involving a Financial Sponsor*.
Trade deals defined as those not involving a Financial Sponsor

Source: Thomson Reuters

*Buyside: Financial Sponsor Activity: This data item will retrieve M&A transactions that satisfy any one of the following conditions:

1. If the Acquirer, Investor, Immediate or Ultimate Parent of Acquirer, Immediate or Ultimate Parent of Investor, is a Financial Sponsor.
2. If the Acquirer, Investor, Immediate or Ultimate Parent of Acquirer, Immediate or Ultimate Parent of Investor is a Financial Sponsor or a portfolio company regardless of ownership stake (includes undisclosed, minority ownership of less than 50% and majority ownership of 50% or more).

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 8.8x historic EBITDA. The PEPI indicates that, on average, private companies are being sold to private equity buyers for 9.8x 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 £52.0 million and a median Enterprise Value of £14.4 million. The included deals for the PEPI have a mean Enterprise Value of £90.4 million and median Enterprise Value of £33.5 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)

CONTACT US

BIRMINGHAM

roger.buckley@bdo.co.uk
0121 352 6213

john.stephan@bdo.co.uk
0121 265 7264

BRISTOL/CARDIFF

laura.shaw@bdo.co.uk
0117 930 1629

GATWICK

jonathan.allen@bdo.co.uk
0129 384 7844

GLASGOW

neil.mcgill@bdo.co.uk
0141 249 5232

IPSWICH

keith.ferguson@bdo.co.uk
0147 332 0755

LEEDS

jason.whitworth@bdo.co.uk
0113 204 1237

LONDON

jamie.austin@bdo.co.uk
0207 893 3805

LONDON

john.gilligan@bdo.co.uk
0207 893 3676

peter.hemington@bdo.co.uk
0207 893 2344

michael.ware@bdo.co.uk
0207 893 3354

MANCHESTER

ruth.percival@bdo.co.uk
0161 833 8345

NORTHERN IRELAND

barry-john.kelly@bdo.co.uk
0289 043 9009

NOTTINGHAM

john.bryant@bdo.co.uk
0115 962 9260

READING

gareth.davies@bdo.co.uk
0207 893 3885

SHEFFIELD

patrick.abel@bdo.co.uk
0114 224 1703

SOUTHAMPTON

paul.russell@bdo.co.uk
0238 088 1796

HB06494

www.bdo.co.uk