Chesham Amalgamations

April 2009

The annual ritual of putting forward the clocks brings lighter evenings and, for those of us who have been suffering from the economic equivalent of Seasonal Affective Disorder, the future somehow and rather intangibly, it must be admitted, already feels brighter! Although there are still many somewhat gloomy articles in the press we have noticed a modicum of more encouraging reports.

M&A activity is reported to be down 36% year on year nonetheless the sums are still impressive with some 250 deals struck in the first quarter with a value of 700bn$. These are of course deals quite outside the usual scope of a firm such as Chesham. In the community of private businesses with potential values in the region of £10m-£25m where we normally operate, we can report that we are having very interesting conversations. The effective PE ratio or the Pre-Tax Multiple at which these firms might sell is not as volatile as the news might suggest so while prices may have weakened, they have not shrunk by as much as one might expect. This is the fundamental difference between the market for large deals involving two high profile protagonists and our market where, on the whole, smaller quoted companies, private equity houses and private buyers, both individual and corporate, purchase private companies. It is difficult to make general statements when discussing the fortunes of a private firm; size, management issues, sector of activity, all these play a part in reaching a view on value. All we can report is that, depending on the size of the business, its profile and the sector, multiples of 4.5-5.5 times EBITDA are being proposed by buyers on a debt free basis; some 12-18 months ago these multiples might have touched 6 or 7 depending on circumstances. Generally speaking, in the months prior to a crash, valuations overheat indeed this is often a good warning precursor.

We have been visiting a variety of businesses during the month with some interesting results. One topic which is always broached at these initials meetings is the value of the business. Chesham are not valuers and therefore we cannot and do not give a formal view, however and because we operate on a purely contingent basis we must ensure that there is a reasonable meeting of minds on the matter before we commence work. Ultimately of course it is the market which decides value and no amount of desktop work can gainsay what a serious buyer with good reason to buy would propose. This somewhat emotive subject can and we believe is, used as lever when talking to a potential vendor. As a result we are, from time to time, faced with incredulous owners surprised at our view on likely market price. We are of course always happy to learn from and discuss valuations performed by professionals; it is impossible for us to comment on documents that appear to have more marketing spin than substance. When we have lost out to a more bullish competitor we have kept an eye on the business out of professional curiosity – sometimes it has changed hands, sometimes it has not. Whether the price achieved approached, however, the levels that may have been suggested is of course an unknown. Chesham does not take up-front fees; we consider them simply a reward or insurance if you will, for failure. As a result we must ensure we are talking about do-able deals.

For some people in a variety of sectors with whom we have spoken business is relatively slow, others have good forward order books and although cautious about the future, are by no means as gloomy as one might expect. It is to be hoped that while senior politicians wrangle about political and economic matters this week in London they will give more emphasis to economic solutions rather than political fixes. Let us see.