Prochem Services Limited

Valuation Report

April 2016

HURST
CORPORATE FINANCE

Contents

Introduction and Scope

HURST Corporate Finance has been engaged by Prochem Services Limited (“Prochem” the “Company” or the “Business”) to prepare a valuation of the Company as at 31 January 2016 in relation to the loan to be provided to Prochem Services (Holdings) Limited (the “Holding Company”) by the 1850 Pension Scheme. The Business, based in Congleton, Cheshire, is a privately owned designer and manufacturer of specialist corrosion resistant valves and fluid handling equipment.

Valuation

Having considered the nature of the Business, the industry in which it operates and the various valuation methods available to us, our approach to valuing the Business has been as follows:

- Value the Business using an earnings valuation technique;
- Use EBITDA (earnings before interest, tax, depreciation and amortisation) as the basis for earnings;
- Base recurring EBITDA on adjusted EBITDA of £331,574 being adjusted EBITDA for the forecast results year ending 31 March 2016; and
- Apply a multiple of 4.4 times to the recurring EBITDA of the Business;

We have then taken the resulting enterprise valuation of £1,458,926 and adjusted this for net debt of £105,678 and included a working capital surplus of £83,002 resulting in an equity valuation for the entire share capital of Prochem of £1,436,250.

Basis of Valuation

To undertake our valuation, we have relied upon the following information:

- statutory accounts for the three years ended 31 March 2015;
- management accounts for the ten months ended 31 January 2016;
- forecast for the year to 31 March 2016;
- management information provided to us; and
- discussions with Management regarding the strategy and operations of the Business.

We have valued the Business on the basis of fair value. The concept of the fair value of shares incorporates the following key principles:

- the value is that which could be achieved by way of a sale on the open market;
- such a sale is assumed to be between a willing buyer and a willing seller;
- both the buyer and seller have equal knowledge of the business and the market in which it operates; and
- a reasonable time period is assumed to effect an orderly sale.

The valuation is required by the Trustees of the 1850 Pension Scheme and this report must not be shared with any third party without our prior written consent.

We have not undertaken any due diligence or audit of the information provided to us. The accuracy of such information is the sole responsibility of the directors of the Business who are responsible for the preparation of the results and forecasts provided to us.

A draft of this report has been reviewed by Tom Fleming who has confirmed that facts stated, so far as he is aware, are accurate in all material respects and that he is not aware of any material matters relevant to our terms of reference which have been excluded.

We consider the values set out in this report to be reasonable and supportable based on the information provided to us and the assumptions made. We recognise that there is a degree of judgement in arriving at these values and that other valuers may not arrive at the same results.

This valuation report is not a provision of any investment advice and cannot be relied upon for making investment decisions. No other party is entitled to rely on our report for any purpose whatsoever and we expressly disclaim a duty of care or liability to any third party who is shown or gains access to our report.

Should any further information become available which would have a material impact upon our valuation, we reserve the right to amend our opinion of value in the light of additional relevant information but are under no obligation to do so.

Background

Prochem is a privately owned designer and manufacturer of corrosion resistant valves and other equipment and are leading suppliers to major industrial organisations throughout the UK, Europe and the Rest of the World. The Business was founded in 1984 by Roger and Cynthia Lawrence who retired from the Business in 2013.

Group Structure

Prochem Services (Holdings) Limited owns 100% of Prochem Services Limited, the trading Company.

Shareholding Structure

Ordinary Shareholders	Class	Number of Shares	Nominal Value	Aggregate Nominal Value	Ordinary Shareholding %
Prochem Services (Holdings) Limited	Ordinary A Shares	100	£1.00	£ 100.00	100%
		100		**£ 100.00**	**100%**

Source: Annual Return dated 4 January 2016

The Holding Company has 80 ordinary shares currently in issue with nominal values set out below.

Ordinary Shareholders	Class	Number of Shares	Nominal Value	Aggregate Nominal Value	Ordinary Shareholding %
Infinity Assest Management Fund LP	Ordinary A Shares	20	£1.00	£ 20.00	25%
Thomas Fleming	Ordinary B Shares	20	£1.00	£ 20.00	25%
Gary Bell	Ordinary B Shares	20	£1.00	£ 20.00	25%
David Smith	Ordinary B Shares	20	£1.00	£ 20.00	25%
		80		**£ 80.00**	**100%**

Source: Annual Return dated 4 January 2016

Valuation Techniques

There are a number of valuation techniques that can be adopted to value the shares in a private company. These are set out below:

Net Assets Valuation Approach

Using this technique, shares are valued based on the company's net asset value. The book value of the net assets should be adjusted to reflect the market value of those assets as appropriate. This may be particularly relevant for freehold property and plant and equipment, where the book value is based on historical cost and the company's depreciation policy. The book value of net assets should also be adjusted to include the value of intangible assets, if appropriate. The valuation of intangible assets (e.g. brands, intellectual property etc.) may require specialist advice.

The net assets valuation technique is most commonly used in the following circumstances:

- property companies;
- capital intensive companies which generate a low return on capital; or
- loss making or insolvent companies.

Discounted Cash Flow Valuation Approach

The Discounted Cash Flow ("DCF") technique calculates the present value of a company's future projected cash flows. A discount rate is applied to the projected cash flows to reflect:

- the time value of money; and
- the inherent risk associated with the achievability of the cash flows.

There are often a number of practical issues involved in applying the discounted cash flow technique to independent businesses, including:

- the availability of reliable cash flow forecasts for a minimum of five years;
- quantifying the risks of the business in calculating the appropriate discount rate; and
- calculation of the terminal value of the business (the value of the business remaining at the end of the forecast period).

Earnings Valuation Approach (EV / EBITDA)

Under this technique a company is valued by applying a multiple to its recurring profits. Recurring profits can be calculated by reference to reported profits and / or forecast profits, adjusted for the following:

- exceptional / one off income or costs;
- costs associated with departing shareholders and directors; and
- costs incurred at non market rates.

Projected results should be considered if the company has demonstrated progression towards this forecast.

The appropriate multiple is typically obtained from either a review of transactions involving similar businesses in the sector, and / or from similar publicly quoted companies, discounted to reflect:

- the inability to trade shares freely on a recognised market;
- the typically smaller size of a private company; and
- the higher risks attached to a private company.

Arriving at an appropriate level of discount involves an element of judgement, although there are quarterly surveys published by BDO which track the discount between the multiples of publicly quoted companies and transactions involving the sale of private companies.

As most businesses are bought on a cash free / debt free basis, an adjustment is typically made for any surplus cash or debt in the business to arrive at a true equity value.

Conclusion

We consider the most appropriate technique to value the Company is the earnings valuation methodology (EV / EBITDA), adjusted on a cash free / debt free basis.

The Business is not reliant on its physical assets to generate its profits; therefore we believe a net assets valuation is inappropriate.

We consider the discounted cash flow technique to be inappropriate in valuing the Business as the Company does not prepare reliable cash flow forecasts over a time frame long enough to produce a meaningful valuation.

Introduction

Measures that can be used to assess appropriate multiples for use when valuing businesses include reviewing the BDO Private Company Price Index ("PCPI"), which is a quarterly report that tracks average EV / EBITDA multiples from the sale of private companies.

BDO Private Company Price Index

The latest BDO PCPI (Q4 2015) indicated that the average multiple of historic EBITDA paid for private companies during the fourth quarter of 2015 is 10.9 times.

This multiple is reflective of the published results of private companies with no adjustment made to reflect that reported results of such companies tend to be suppressed by various expenses that a new owner would consider non-recurring (e.g. shareholders' remuneration in excess of market rate). It also reflects a broad spectrum of deal sizes across many different sectors and industries. The mean enterprise value of transactions over the past five years has been £69.8m with a median enterprise value of £16.0m.

Given the smaller scale of Prochem we believe that a discount factor of 60% should be applied to the BDO PCPI EBITDA multiple of 10.9. We would therefore consider an EBITDA multiple of 4.4 as a reasonable multiple to apply to the calculated recurring profitability of Prochem.

Conclusion on Multiples

In conclusion, we have applied the following multiple to Prochem recurring EBITDA:

	EV / EBITDA Multiple
Discounted BDO Private Company Index	4.4
Multiple	**4.4**

Financial Performance

The following table summarises the financial performance of the Company for the three years ended 31 March 2015 and the outturn for the year to 31 March 2016:

P & L Summary	FY13 Year Ended 31 March 2013 Statutory £'000	FY14 Year Ended 31 March 2014 Statutory £'000	FY15 Year Ended 31 March 2015 Statutory £'000	FY16 Year Ended 31 March 2016 Forecast £'000
Turnover	857	807	782	834
Cost of Sales	(269)	(261)	(254)	(260)
Gross Profit	**588**	**547**	**528**	**574**
Gross Profit%	*69%*	*68%*	*68%*	*69%*
Administrative Expenses	(442)	(369)	(371)	(376)
EBIT	**146**	**178**	**157**	**198**
EBIT %	*17%*	*22%*	*20%*	*24%*
Depreciation & Amortisation	4	2	3	2
EBITDA	**150**	**180**	**160**	**200**
EBITDA %	*18%*	*22%*	*20%*	*24%*

Source: Statutory Accounts and Management Information

[1] *FY16 Forecast includes actual results for the 10 months to January 2016 and 2 months forecast results to 31 March 2016.*

Normalisation Adjustments

The table below illustrates the detailed normalisation adjustments in each financial period:

	FY13 Statutory £'000	FY14 Statutory £'00	FY15 Statutory £'000	FY16 Forecast £'000
EBITDA	**150**	**180**	**160**	**200**
Normalisation Adjustments:				
Consultancy fees	48	80	72	72
Management fees	138	33	40	60
Normalised EBITDA	**336**	**293**	**272**	**332**
Normalised EBITDA %	*39%*	*36%*	*35%*	*40%*

Directors' remuneration is included in administrative expenses and equalled £60,000 in FY16. This relates to Mark Chapman, Managing Director and we believe this reflects a reasonable market value cost and hence have not made an adjustment to EBITDA.

Consultancy fees totalling £72,000 in FY16 relate to Tom Fleming's role as Chairman of Prochem who is not involved in the day to day operations of the Business. As a result we have added these costs back to the adjusted EBITDA value.

Management fees totalling £60,000 in FY16 relate to management charges due to Corilla Plastics Limited, a related party company with a common directorship. These are non-trading expenses and have hence added these costs back to the adjusted EBITDA value.

Maintainable EBITDA

The Business is on track to achieve adjusted EBITDA of £331,574 for the year to March 2016 as a result of known sales and orders that the company will complete. We believe that this is representative of maintainable EBITDA and have hence used £331,574 as the basis for recurring profitability for the purpose of this valuation.

Financial Position

The Company's latest three year end statutory balance sheets along with the latest management account balance sheet as at 31 January 2016 are presented in the table below:

Balance Sheet	FY13 As at 31 Mar 2013 Statutory £'000	FY14 As at 31 Mar 2014 Statutory £'000	FY15 As at 31 Mar 2015 Statutory £'000	FY16 As at 31 Jan 2016 Management £'000
Fixed Assets				
Tangible Assets	7	10	15	13
Total Fixed Assets	**7**	**10**	**15**	**13**
Current Assets				
Stocks	129	136	138	137
Debtors	1,199	1,358	1,270	1,394
Cash	9	14	10	12
Total Current Assets	**1,337**	**1,508**	**1,418**	**1,543**
Current Liabilities				
Trade Creditors	(171)	(164)	(141)	(39)
Other Creditors	(174)	(195)	(192)	(203)
Total Current Liabilities	**(346)**	**(360)**	**(334)**	**(242)**
Net Current Assets	**991**	**1,149**	**1,084**	**1,301**
Net Assets	**998**	**1,158**	**1,099**	**1,314**
Capital and Reserves				
Called-Up Share Capital	-	-	-	-
Profit and Loss Account	998	1,158	1,099	1,314
	998	**1,158**	**1,099**	**1,314**

Source: Statutory Accounts and Management Information

6. Valuation

Company Valuation

As discussed above we believe maintainable EBITDA to be £331,574.

The table below provides a summary of our enterprise valuation workings based on a multiple of 4.4 times as concluded on in Section 5 of this report:

EV / EBITDA	£'000
Recurring EBITDA	332
Adjusted EV / EBITDA Multiple	4.4
	1,459

Businesses are most often bought and sold on a cash free / debt free basis. This means that a business's enterprise value is increased for any 'surplus' cash remaining in the business on completion and decreased in relation to any non-working capital financial debt.

As at 31 January 2016 the Company had the following cash and non-working capital financial debt balances:

Net (Debt) / Cash	£'000
Cash at Bank	12
Invoice Discounting Facility	(92)
Corporation Tax Provision	(26)
	(106)

In addition we have analysed the latest monthly working capital position as at 31 January 2016. This is calculated as Intercompany Loan, Stock, Trade Debtors and Prepayments less Trade Creditors, Accruals and Social Security & Other Taxes. The balance at this date is £83,002 more than the average working capital position for the previous twelve months. Hence, as at 31 January 2016, the Business has a surplus of working capital compared to a normalised level. We have added back this working capital surplus to arrive at an equity valuation.

After adjusting for net debt and the working capital surplus this results in an equity valuation as follows:

	£'000
Enterprise Valuation	1,459
Net Cash / (Net Debt)	(106)
WCAP Surplus / (WCAP Requirement)	83
Equity Value	**1,436**

In conclusion, we believe the entire share capital of Prochem to be valued on a cash free / debt free valuation as at January 2016 of £1,436,250.

7. Glossary

Business	Prochem Services Limited
Company	Prochem Services Limited
DCF	Discounted Cash Flow
Directors	Tom Fleming, Mark Chapman
EBIT	Earnings before Interest and Tax
EBITDA	Earnings before Interest, Tax, Depreciation and Amortisation
EV / EBITDA	Enterprise value to EBITDA multiple
FY13	Financial year ended 31 March 2013 (Unaudited Statutory Accounts)
FY14	Financial year ended 31 March 2014 (Unaudited Statutory Accounts)
FY15	Financial year ended 31 March 2015 (Unaudited Statutory Accounts)
FY16	Financial year ending 31 March 2016 (Outturn)
Group	Prochem Services (Holdings) Limited and Prochem Services Limited
Holding Company	Prochem Services (Holdings) Limited
Hurst	HURST Corporate Finance
Management	Tom Fleming, Mark Chapman
MI	Management Information
P/E	Price Earnings
PCPI	Private Company Price Index
Stat	Statutory Accounts
Trustees (1850 Pension Scheme)	Tom Fleming, David Smith, Gary Bell
We	HURST Corporate Finance

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