Optimising Business Sale and Acquisition – Scancorp's "5 Pillars" Executive Summary

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Selling a Business for Optimal Value – Maximising the Outcomes at Exit

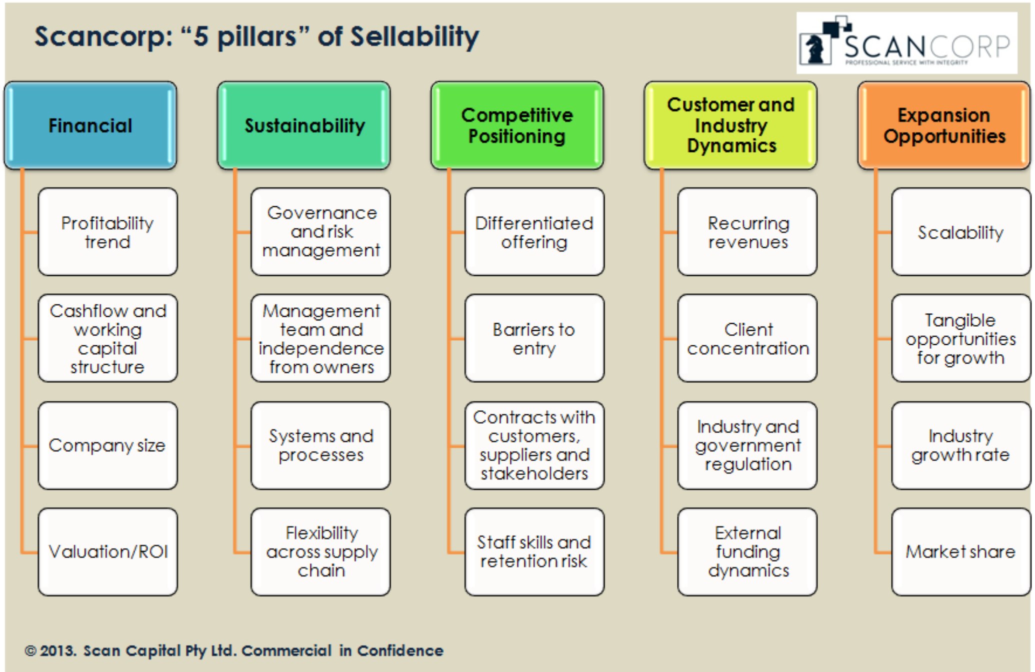
Overview

Drawing on its 26 years of experience in divestment, mergers and acquisitions, Scancorp has identified 20 key characteristics that determine the attractiveness of private and unlisted public companies to potential acquirers.

We have identified the 20 key characteristics based on our experience of the criteria used by strategic buyers (such as a trade sale to industry participants) and financial buyers (such as an acquisition or a leveraged buyout through an investment syndicate or private equity fund). We often see these criteria expressed as part of a buyer's analysis and due-diligence process.

Scancorp has grouped the key characteristics into "5 Pillars":

1. **Financial:** such as the trend of profitability and the proposed valuation,
2. **Sustainability:** including the strength of the management team and independence of the business from the current owners,
3. **Competitive Positioning:** which considers the extent to which the company's offerings are differentiated and the barriers that deter new entrants to the market,
4. **Customer and Industry Dynamics:** such as the extent to which revenues are recurring and the level of industry regulation (which may present as a positive barrier to new entry or a negative barrier to further growth), and
5. **Expansion Opportunities:** including for example, tangible opportunities for growth and the ability of the company to scale to enjoy such growth.



Scancorp utilises the "5 Pillars" as a guide to assess:

1. the relative ease with which a business can be sold – such as by identifying the breadth of target acquirers, and
2. the likely return the shareholders will achieve if the business is sold – by identifying where in a multiple range a specific business is likely to be valued.

The "5 Pillars" are useful when we work with business owners to prepare for or facilitate the sale of their business, as well as work for companies to identify an acquisition that is a strong strategic fit.

Using the "5 Pillars" to Facilitate a Sale

The following are examples of some of the desirable attributes we seek when assessing a business:

Pillar 1: Financial

Example of Desirable Attributes	➢ A general upward trend in profitability as measured by EBIT (earnings before interest and tax) with a growth rate ideally in excess of established industry trends. ➢ Revenues secured by long-term contracts or at least via a substantial level of repeat clients.
Example of Practical Application	➢ Businesses that do not exhibit a clear trend in profitability are often valued using an average of 3-5 years EBIT history. Scancorp has managed the sale of businesses with consistent EBIT growth based only on their final year profitability. This maximised the value achieved for the owners.

Pillar 2: Sustainability

Example of Desirable Attributes	➢ A governance structure that oversees an effective risk management framework ➢ Presence of an experienced and qualified management team that are motivated to remain with the business post sale. ➢ A highly systemised business that operates largely independently of its current owners. ➢ Quality control systems that are at or above industry standard and comply with regulated standards. ➢ Flexibility across the supply chain including limited dependence on key suppliers
Example of Practical Application	➢ Scancorp has worked with clients to identify their core business processes and relationships. We were then able to work with the owners to ensure their key responsibilities were effectively delegated to the management team prior to sale. This made the company more attractive for sale and eliminated the requirement for a prolonged earn-out.

Pillar 3: Competitive Positioning

Example of Desirable Attributes	The business' revenues are broadly protected by a clearly differentiated offering which may include: ➢ Protected IP - such as a manufacturer that owns a range of its proprietary products, ➢ Exclusive qualifications - such as professional practices that possess specialist qualifications not readily obtained, ➢ Unique capabilities - such as a mining services company that possesses a specialised piece of equipment, ➢ Access to an exclusive market - as may be the case for a franchise of an attractive territory or ➢ Mission critical products or services – such as a company that develops a critical subcomponent to a large manufacturer.
Example of Practical Application	➢ Many contract manufacturers rely on long-term contracts or specialised machinery to create a competitive barrier. Otherwise they are required to compete entirely on price which results in low margins. Alternatively, manufacturers could acquire proprietary products to differentiate themselves from their competitors. Scancorp has assisted manufacturers to identify and acquire patented products to improve their margins and diversify their business. Ultimately, well selected acquisitions will enhance the buyer's valuation faster than they would have achieved via organic growth.

Pillar 4: Customer and Industry Dynamics

Example of Desirable Attributes	➢ A low level of customer concentration (which for most industries would equate to no single customer representing more than 10% of the business' revenues). ➢ Established mitigation strategies in the event that government or industry regulation changes – this may include strategies for revenue mitigation (such as a company that has a substantial proportion of it revenues dependent on government funding) as well as cost mitigations (such as a regulated company that is exposed to cost increases related to the implementation of new national standards).
Example of Practical Application	➢ Scancorp facilitated the sale of a manufacturing company. The manufacturer had strong EBIT growth but with 2 key clients generating > 75% of the company's revenues, it suffered from extreme client concentration. With a high EBIT generated from these clients, the owner was reluctant to increase business development efforts – an issue that was raised by several potential acquirers. Over the following 12 months, one of the key clients postponed its major projects and the manufacturer's EBIT plummeted. As a result a sale was achieved, however at a price well below initial offers.

Pillar 5: Expansion Opportunities

Example of Desirable Attributes	➢ The business can be scaled to achieve significant revenue growth with only incremental increase in costs – this may be the result of geographic expansion, expansion of the products and services offered by the business or new methods of monetising the business' assets such as via the licensing of its Intellectual Property. ➢ The business has a material share of market as compared with its competitors but there still remains a tangible potential to further expand the business' market share.
Example of Practical Application	➢ Acquirers are attracted to businesses that have a well identified expansion strategy. Acquirers will then confirm that the business has sufficient capacity (staff, machinery, licenses etc) to pursue the expanded business opportunities. Assuming the business exhibits these favourable characteristics, potential acquirers will want to understand why the current owners haven't already pursued the growth opportunities. Acquirers will greatly discount expansion opportunities that haven't been pursued because they are high risk or difficult to attain. They may however favourably consider opportunities that the current owners did not pursue because they lacked the skill and/or motivation.

Using the "5 Pillars" to Guide Acquisitions

Scancorp has found the key characteristics identified within the "5 Pillars" are used by acquirers in various forms of business acquisitions. As such, when Scancorp is engaged under an acquisition mandate, we leverage the "5 Pillars" to guide the selection of targets and due-diligence of the acquisition. This can be applicable to a variety of acquisition transactions including:

- trade sale to an industry buyer – which may include a corporate or individual
- sale to a private equity firm – typically as a financial investment or as to generate synergies with one or more of its existing portfolio companies
- sale to an investment syndicate or other financial buyers – which may be pre-existing or assembled by Scancorp or other professional advisers
- management buy-out
- roll-up of a smaller business into a larger acquirer

The key difference in priorities of strategic and financial buyers are that:

- Strategic buyers will have their own management and so will be less reliant on the target company's ability to be operated independently of its current owners, however they will be focused on the synergies the target company generates with their current business and strategy.
- Financial buyers will be highly focused on the ability of the target company to operate independently of its current owners and on the risk associated with its projected financial performance

Using the "5 Pillars" to Prepare for Divestment

Scancorp also leverage the "5 Pillars" when we assist a company to prepare for exit (through our Divestment Readiness offering). We use the "5 Pillars" to:

1. Identify the attributes that are most relevant to the business and the industry within which the business operates, and then
2. Work with the current owners to optimise these attributes as far as practical.

While very few Companies excel in all 20 characteristics, we find the "5 Pillars" enables us to readily identify the strengths and weaknesses of a business. This enables us to most effectively work with the Company's owners and management to address the key issues and prepare the Company to optimise sale within 12-18 months.

Contact

For more information regarding facilitating the sale of a business, preparing for the sale of a business or acquiring a business, please contact:

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About Scancorp

Scancorp comprises Scan Capital (AFSL 400964) and Scan Business Brokers. Scancorp has a 28 year history in mergers, acquisitions and divestments of Australian private businesses. Scancorp specialises in servicing companies with revenues typically within the $5M - $50M range across all industry sectors.

Scancorp assists companies across Australia and has representation in Singapore, Queensland, New South Wales and Western Australia.

Scancorp's services include:

- Company divestments – partial and complete,
- Mergers and acquisitions – for corporate acquirers,
- Business sales – including share sales and asset sales,
- Corporate advisory – including preparation for sale, transactional support and profit optimisation, and
- Funding – debt, equity and mezzanine