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The latest in small and mid-market sales, mergers, acquisitions, investments and advisory

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January Industry Scan

Merger & Acquisitions | Business Sales | Corporate Advisory | Funding

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The team at Scancorp wish all of our clients and colleagues the best for 2013.

Singapore: the undisputed regional hub for private equity

With the uncertainty faced within the Eurozone and the slowdown in the United States, Asia Pacific is rapidly becoming a major focus for private equity firms.

As the gateway to the region, we believe Singapore will establish itself as the hub of private equity activity. Singapore will continue to attract substantial financial resources due to:

1. the transparency offered by its regulatory environment
2. the efficiency and ease of doing business
3. the favourable taxation environment
4. its stable political system
5. its central position within the fast growing region of South east Asia

As noted in mergermarket's *Asia-Pacific private equity outlook 2013* "Singapore-based hubs are quickly becoming the norm as competition from other private equity firms and cash-rich corporates for assets and acquisitions heats up, forcing general partners and their firms to act with haste and allocate greater resources to Southeast Asia.

What does this mean for Australian based firms? This could be good news for Australian mid-market companies that are able to service the Asian market. 85% of respondents to mergermarket's survey expect growth in merger and acquisition activity in 2013. If this was to be the case, we would expect valuations to begin to rise as financial and strategic buyers compete for a limited number of quality assets.

The growth of the Southeast Asian economies; the increasing affluence of its middle class; the reducing levels of corruption; coupled with this expected increase in demand from buyers – sees Southeast Asia as a primary growth market for Australian companies.

Scancorp is represented in Singapore by its partners Incuvest Asia. For more information, contact: marcus.salouk@scancorp.com.au.

Scancorp's "5 Pillars" Underpin Acquisitions: Pillar 1 - Financial

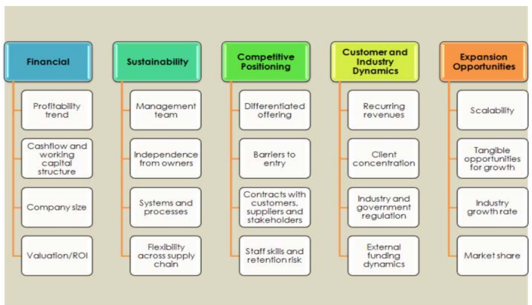
In our last newsletter, we provided an overview of the "5 Pillars" framework that we use to assess the attractiveness of an unlisted business for acquisition by trade or financial buyers.

The first pillar considers some of the key *financial characteristics* that acquirers will consider. These include:

1. **Profitability trend:** profitable unlisted companies with most commonly valued using a multiple of their future maintainable earnings (FME). The FME for an established company is typically represented by an average of their prior earnings before interest and tax (EBIT). As an estimate of future maintainable earnings is so key to valuation, it is important to consider potential profitability trends rather than merely taking averages of prior years, for example:
- For a company that has a sustained upward EBIT trend – the owner's may be able to justify continued growth and as such the FME estimate may heavily weight the most recent year(s) and/or include a reasonable projection for a future year in the calculation.
- For a company that has a steady or mildly fluctuating EBIT, without a significant trend – FME consider a longer period of historic earnings in the calculation (such as an average of 5 years of EBIT history)
- For a company that has a consistent downward EBIT trend – Acquirers are likely to assume that performance will continue to trend down, so FME may heavily weight the most recent year(s) and/or include a reasonable projection for a future year in the calculation.
2. **Cashflow and working capital structure:** in many cases the structure of a company's revenues may be as important as the size of historic revenues. A key consideration is the perceived repeatability or "stickiness" of a company's revenues in the future. A few examples of revenue sources in decreasing levels of stickiness include:
- *Long-term contracts:* buyers of companies in some industries seek long-term committed contracts, such as may be the case in project management, construction companies, IT maintenance and other service industries.
- *Subscriptions:* while subscriptions are typically shorter term, they are a measure of committed revenues and in some cases may be automatically renewed. This is often a consideration for acquirers of the media channels and companies providing web-based services.
- *Specialist products and services:* may relate to a primary or secondary sales, such as unique engineering components, specialist professional services or proprietary consumables that relate to specific machinery.
- *Generalised products and services:* companies that deliver generalised products and services usually operate in a highly price competitive environment, in some cases they are able to create loyalty programs to enhance the stickiness of their products/services – examples include food and product retailers.
3. **Company Size:** as a general rule, larger companies (as measured by EBIT or revenue) are valued at a higher multiple than smaller companies within the same industry. This is due to the reduced risk their scale offers as well as the availability of additional exit options.

4. **Valuation/ROI:** the return offered to the acquirer is a key measure of value and depends on a variety of considerations such as:

- *Industry* – certain industries operate within a typical range of ROI based on an established perception of risk and ability to gain bank finance (such as medical and child care centres)
- *Stickiness of revenues* – greater certainty of future revenues lowers the risk profile of a company which should increase its valuation
- *EBIT quantum* – larger EBIT typically attracts a larger EBIT multiple as discussed above.
- *Extent of tangible asset backing* including property, plant and equipment reduces the overall risk of the acquisition and may enable the acquirer to access greater levels of debt funding – higher levels of tangible asset backing supports a higher valuation.



We also leverage the "5 pillars" when we assist a Company to prepare for exit (Scancorp's Business Exit Services Overview).

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.

We can then work with the Company's owners and management to address the key issues and prepare the Company to optimise sale within 12-18 months.

Click here for more information regarding Scancorp's Business Exit Service Offerings.

Market Insights

IBISWorld predicts the best and worst performing industries for 2013

Industries expected to fly:

1. Oil and gas production – expected revenue growth of 15.9%. Liquefied natural gas production is expected to grow significantly this year. Several export-orientated plants are due to come on-line soon in an attempt to take advantage of surging prices. IBISWorld expects revenue from the oil and gas sector to grow by 15.9% to $44.4 billion in 2013.
2. Organic farming – expected revenue growth of 12.5%. Organic farming has achieved a compounded 10% annual growth rate year on year over the past 5 years. In 2013, IBISWorld anticipates growth of 12.5% to revenues of $617 million. According to the general manager of IBISWorld Karen Dobie "As Australian incomes rise, we are seeing consumers move away from conveniently farmed produce towards natural, chemical- and hormone-free counterparts."
3. Online education – expected revenue growth of 10.5%. "We are seeing an increase in demand for convenient education, particularly among working adults who wish to gain new skills and qualifications," Dobie says. IBISWorld expects revenue from online education to grow to $5.6 billion in 2013. BRW believes that young entrepreneurs have been much better at taking advantage of technology-based industries than the old guard. Ryan Trainor ($27 million) is a member of BRW's Young Rich. Trainor sold his education and training company Franklyn Scholar to major US-

based education provider Kaplan Professional last year.

4. Online shopping – expected revenue growth of 9.1%. The online shopping sector has also been fertile ground for young entrepreneurs. Online shopping is expected to grow by 9.1% to $11.7 billion in 2013.

5. Multi unit apartment and townhouse construction – expected revenue growth of 9.0%. “IBISWorld is seeing an urban shift towards medium to high density residential developments as occupants opt to remain close to the CBD, transport and commercial hubs,” Dobie says.

Industries expected to fall:

1. Gaming and vending machines manufacturing – expected revenue decline of 6.4%. In 2013, IBISWorld is expecting the poker machine manufacturing sector to contract. A rise in the replacement cycle and new legislative limits on poker machines will hurt the sector next year, according to Dobie.

2. Wired telecommunications carriers – expected revenue decline of 5.5%. “Competition in the mobile sphere is driving prices down to the extent that it is now cheaper for some consumers to disconnect their landlines and rely solely on mobile services,” Dobie says. “Increased wireless broadband penetration and strong growth in the number of naked DSL internet subscribers are also eating into industry revenue.”

3. Mineral exploration – expected revenue decline of 5.1%. IBISWorld expects revenue from minerals exploration to fall to $4.7 billion in 2013. “The combination of generally lower commodity prices, weak global growth, slowing demand from China and economic uncertainty is expected to result in reduced spending on mineral exploration over 2013,” Dobie says.

4. Newspaper printing or publishing – expected revenue decline of 4.0%. As advertisers and consumers opt for other types of media, the newspaper printing or publishing industry continues to lose advertising market share. Printed newspapers' share of advertising – which accounts for 75% of newspaper revenue – is expected to fall to under 30% of total advertising revenue in 2013, down from a 41.8% share in 2000.

5. Recorded media manufacturing and publishing – expected revenue decline of 2.8%. Physical format music sales have dropped by an estimated compound annual rate of 15.9% since 2007, compared with a compound annual rise of 32.6% for digital music. “Consumers have turned away from purchasing physical media in favour of paid online subscription services, such as Spotify and Pandora, and limited free services such as YouTube and VEVO,” says Dobie. “The industry also has been dramatically exposed to high levels of music and video piracy.”

Client in focus : My Heroes - http://www.myheroes.co.in

My Heroes is an innovative new media company committed to connecting fans with their heroes to create, market and sell personalised interactive printed, digital, and electronic ‘Hero’ products of various kinds. These products include branded digital content accessible on various new media platforms across the internet, mobile and social media platforms such as Facebook, Twitter, YouTube, and Instagram.

My Heroes is pleased to announce the partnership with IPL and former Australian international cricketer Brett Lee. Brett is a strike pace bowler for the reigning champions of the Kolkata Knight Riders. My Heroes has been granted *exclusive rights* to assist Brett in personally *connecting with his fan base across India and throughout the world*.

“It’s great being associated with innovative Hero products that motivate and inspire kids to aim high and emulate their heroes. Furthermore, I’m delighted that every time there is a connection with one of my fans on a personal level and one of my Hero products is purchased, a percentage of the sale goes directly to my MEWSIC Foundation in India. In many ways both My Heroes and my MEWSIC Foundation have a similar vision in unlocking the potential that’s within all children,” concluded Lee.

Personalised printed products such as bespoke cards and posters will be available to the fans through the My Heroes link located on Brett Lee's website homepage and via his social networks. As part of Brett Lee's offering, printed Hero products can have a barcode added, enabling the transfer of the fans Hero image to their mobile phone to further enhance the interaction.

Augmenting the experience further, it can activate premium video clips specific to a recent achievement in the fans life or a milestone. Such as achieving their best bowling figures which when the code is scanned provides Brett's top 3 tips for budding opening bowlers. Alternatively, it could be a "Happy Birthday" or "Diwali" message - taking their personalised experience with Brett to another level, while extending the reach across India's 800 million mobile phone subscribers.

"My Heroes is thrilled to be working with Brett, still one of the fastest and most exciting pace bowlers in the world, to further expand his personal contact with his fans in India and throughout the world. We look forward to providing an exciting and continually evolving range of interactive experiences for Brett, and his fans" commented Peta Field, Communications Director at My Heroes.

[Click here to view Channel 7 News exclusive]

For further information regarding My Heroes, please contact: Jon Field, Executive Director of My Heroes at jon.field@myheroes.com.au

Scancorp is providing consulting services to My Heroes.

Other News

- Mining industry powers on with growth across Central Qld
- Strike it rich in 2013
- Business booms in the heat – the four business sectors making money off Australia's heat wave

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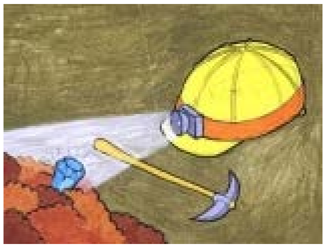
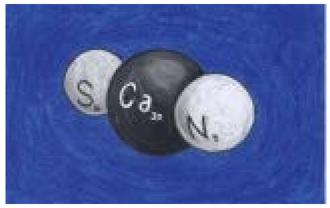


Featured Investment

Forklift rental and service sale

- Established 18 years
- Highly profitable with GP > 62% and EBITD margin > 30%
- FY12 EBITD $1.058M
- Exceptional asset backing - written down value of hire plant, equipment and inventory approx $2.5M
- Total investment: $4.3M

For more informations, contact Ross Tiller at 07 3902 2400 or tiller@scancorp.com.au



Featured Investment

Proprietary plastic product portfolio divestment

- Highly profitable product range with GP circa 50%
- Entirely contract manufactured – suitable for investor or manufacturer
- Forward 12 month revenues circa $5M with an EBIT of $2.1M
- Distribution in place through all major wholesale and retail distribution channels (eg Bunnings, Tradelink, BCF etc)
- Robust IP protection in place
- Minimal moving parts and minimal warranty issues

Our Mission

We provide the highest quality advisory services and solutions, previously inaccessible to the small to mid market.

Our Vision

To be the leading boutique provider of advisory services to fellow small and medium companies.

Our Services and Capabilities

Business Exit Service Overview

Scancorp Capabilities

Sellability Score

Last Newsletter

December Newsletter