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

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Industry Scan

Merger & Acquisitions | Business Sales | Corporate Advisory | Funding

March 2013

In this edition:

Investment Spotlight: Child Care Services

The high profile demise of ABC Learning created significant turbulence within the Child Care industry. ABC's collapse was not related to systemic issues within the child care sector – its collapse was a consequence of its reliance on high levels of debt to fund its US expansion, just as the impacts of the GFC were felt.

As such, the impact to the industry was enormous (ABC operated 1,200 centres or 8% of the centres in Australia), but short lived. While Scancorp noted little appetite for divestment or acquisition of child care centres in 2010-2012, we have seen significant increase in interest over recent months from both buyers and sellers. We believe this is due to several factors:

1. Owners of high quality centres have now adapted to recent government regulations
2. Industry reputation has recovered from the ABC fall-out
3. The industry is generally robust and is experiencing further growth

Industry Performance

At almost 25% of all enrolments, Queensland represents a significant proportion of the national child care industry.

IBISWorld forecasts that child care services will continue its strong growth with 4.1% compound growth anticipated between 2013 and 2018. This will be driven by the following factors:

- Total employees in the workforce, particularly females in the workforce – which is anticipated to increase year on year through to 2018

- Population under 14 years of age – which is forecast to grow almost linearly through to 2018
- Increased household disposable income

In 2008-09, there was an increase in the Child Care Rebate paid by the Government from 30% to 50%. This resulted in significant increase in demand for child care centres. Since 1 January 2012, the National Quality Standard has been gradually phased in – this required centres to increase the staff to child ratio. Additionally, childcare staff must be appropriately qualified and by 1 January 2014, at least half of the long day care centre staff will have to be working towards a Certificate III in early childhood education and care qualification.

On 19th March, the government announced a new $300 million pool that will provide grants to child care centres. The new "early years quality fund" is intended to support the implementation of the National Quality Framework.

Critical Success Factors

IBISWorld identifies several critical success factors for the child care sector, the key of which include:

- Ensuring an optimum number of places and age mix of children
- Maintaining an optimum capacity (> 70% is typically required to ensure sustained profitability)
- Compliance with government regulations including the National Childcare Accreditation Council
- Location and easy access for clients
- Adequate public relations within the local community

Valuation Considerations

While every centre is different, indicative valuation parameters include:

- High quality child care businesses are currently valued at 3.3 to 4.5 times EBIT (net of commercial lease), therefore representing yields of 22% - 30%.
- Child care freehold are currently valued based on 7.5 – 9.5% net yield and are generally maintained to high standards by the child care operator.
- Freehold going concerns (combined business and property) are attracting yields of 12.5% – 15.0%.

As such, the returns are perceived to be attractive for the relatively low volatility associated with the sector.

Current Investment Demand

Since January 2013, the enquiry for good quality childcare centres has been exceptionally strong. Enquiry has been across all of: going concerns (business and property); leasehold centres (business only) and the property only of well leased childcare premises.

Interest has been particularly strong for centres with 75 places or more (twin centres). In our view, the current market has returned to balance with sellers now able to demand fair value for their assets.

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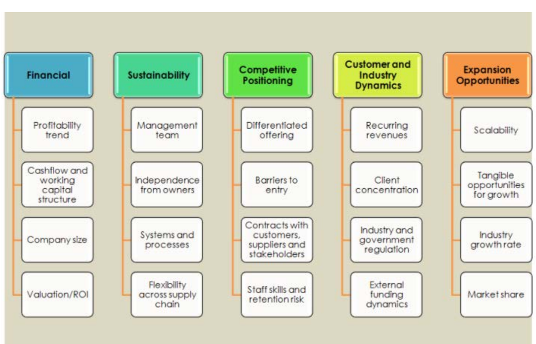
Scancorp's "5 Pillars" Underpin Acquisitions: Pillar 3 - Competitive Positioning

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

The third pillar considers some of the key *competitive considerations* that concern acquirers. These include:

1. A **Differentiated offering:** a company that has an offering that is clearly differentiated from its competitors will generally be more attractive to acquirers. For many companies the extent of differentiation includes only quality of service and/or price. However some companies have a differentiated offering based on characteristics such as:
    - Protected IP - such as a manufacturer that owns a range of proprietary products,
    - Exclusive qualifications - such as professional practices that possess specialist qualifications that are not readily obtained,
    - Unique capabilities - such as a mining services company that possesses a specialised piece of equipment, or
    - Access to an exclusive market - as may be the case for a franchises of an attractive franchise territory.
2. Meaningful **Barriers to entry:** substantial barriers to new market entrants offer some protection to the future revenues of a company. Barriers to entry may include the requirement for a high degree of specialist skills, the acquisition of specific qualifications or licenses or specialist equipment. In many industries, a key barrier to entry is the capital cost associated with the establishment of a new business, as may be the case for some mining services companies.
3. Material **Contracts with customers, suppliers and stakeholders:** companies that have robust contracts with customers, such as an exclusive right to provide a product or service for a period of time have greater certainty of future revenues and therefore are attractive to acquirers. For example, a data-centre that provides outsourced hosting services to several clients will be assessed on the strength of the contracts with its customers.
4. Mitigation of **Staff skills and retention risk:** the requirement for specialist skills is often a “double edged sword” as the need for the specialist skills provides a barrier to new entrants but similarly presents a risk that must be mitigated should staff exit the company. Any company that has specialist staff would have a sourcing strategy to replace staff. This may include proactive relationships with industry groups, educational providers or international staffing channels. As an example, a large regional medical centre will require an ongoing source of medical practitioners but may have contingencies in place to source international doctors to fill places or support expansion.



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

CBA's Business Sales Indicator reveals sixth consecutive month of increases

Business sales rose again in February according to the Commonwealth Bank Business Sales Indicator. The BSI indicates economy-wide spending grew by 0.4% in trend terms in February, which is the sixth consecutive monthly gain. Analysts claim this may represent a sustained improvement in retail confidence. Annual growth is now at 4.8% in trend terms.

CBA's executive general manager for local business banking, Adam Bennett, believes the results are promising. "Although there was a slight decrease in the rate of growth in February, these results remain a positive sign for businesses. In trend terms we've now seen six straight months of gains, which indicates consumers are willing to spend even if they are still treading with caution."

The strongest sector increases were:

- amusement and entertainment - up 2.1%
- service providers - up 1.3%
- transportation - up 1.0%

The weakest sectors were:

- mail orders and telephone orders - down 3.8%
- business services - down 0.4%
- contracted services - down 0.1%

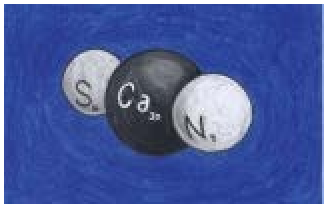
In annual terms no state or territory recorded sales lower than a year ago. CommSec economist Craig James said the results indicate the economy is in a better position than this time last year: "we have seen consumer spending respond in line with positive economic indicators, and this is contributing to the formation of back-to-back spending gains."

However, he qualified his comments stating that consumers are still acting with caution: "with the Reserve Bank holding the cash rate steady in February, we have seen consumers maintain cautious optimism when it comes to spending."

The news comes after recent figures from Westpac indicate that consumer confidence has continued to rise.

Other News

- State of the Nation Report 14: Spotlight on Small Business
- Small Business Out-manages Top End of Town
- The top 10 pieces of business software for Windows and Mac
- How to network like a professional

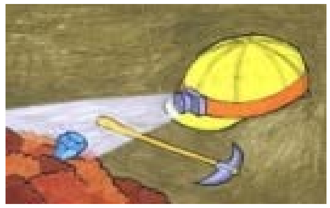


Featured Investment

New Media Company

* Innovative new media company with exclusive contracts in place
* Provides exclusive new media channels to facilitate sale of personalised products
* Robust business model with exceptionally low overheads and high margins
* Products include mobile apps, gaming apps, social network apps and personalised printed products
* Round 3 funds will be used for marketing to drive revenues
* Seeking Round 3 interim funding in advance of VC funding (VCs in Singapore and Australia expected to close balance of funds) 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



Featured Investment

Precision Engineering Business

* Delivers mission critical services to tier 1 clients
* Exceptional reputation
* One of the largest CNC based manufacturing facilities within Central Queensland
* Specialises in general and precision milling, CNC machining and CNC milling
* Established 11 years
* Broad client sector exposure including mining, manufacturing, transport, construction, engineering and agriculture industries
* Highly profitable with GP > 75%
* Consistent EBITDA margins in excess of 30%
* Tangible growth potential
* Ability to operate under management
* 2 year normalised EBITDA of $880k
* 33% return on invested capital
* **Total investment:** $2.7M

Click here for an opportunity summary

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

February Newsletter