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

SCANCORP
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Industry Scan

Merger & Acquisitions | Business Sales | Corporate Advisory | Funding

May 2013

In this edition:

Announcement: Scancorp/nem Alliance

After 9 months of planning, Scancorp and nem have formalised a partnership to leverage the capabilities of the two firms. As a result, Scancorp and nem have partnered to form one of Australia's largest privately-held Management Consulting, Business Advisory and M&A practices helping Australian business owners generate cash today and wealth tomorrow.

Expanded Capabilities and Reach

With more than 40 partners around Australia, **nem** is Australia's largest privately held referral based management consulting firm. The average nem partner has over 25 years corporate experience gained typically at "C level". Importantly, nem utilizes an unleveraged model whereby a partner assists clients with strategy, planning through to implementation – without the reliance of junior analysts.

Rationale

While Scancorp and nem offer complimentary services, it was clear the two firms operate with aligned values – focused on optimising the client's outcome. Both firms derive virtually all of their business through referral and therefore understand the importance of enhancing the relationship between the referrer (such as the accountant, lawyer, financier etc) and their client (the business owner).

Scancorp estimate that more than 50% of the clients it meets are not ideally prepared for sale and will now be able to refer those clients to nem in order to enhance the eventual sale value of their business. This is expected to significantly reduce the time to sale with a shorter due-diligence period when the business is subsequently taken to market. It may also reduce the amount of time the former owner/management team are required to work in the business post-sale.

Similarly, in some cases, nem's clients decide that after working with a nem partner their business is then optimally positioned for sale. In these cases nem's clients will be able to leverage Scancorp's M&A expertise to optimize their sale.

Benefit to Clients

The partnership combines nem's consulting expertise, scale and reach with Scancorp's 26 year history in private company sales and acquisitions - resulting in a broad service offering including:

- Advisory and transactional support - such as funding support, product commercialisation, market expansion and commercial negotiations
- Strategy and business planning – leveraging nem's proprietary Value Encounter methodologies and industry expertise
- Business Improvement – including the implementation of identified projects
- Acquisition – of new businesses, divisions of companies, strategic assets or IP
- Succession & Exit – via sale or merger

The objective is to provide clients with a trusted partnership to assist their business with consolidation and growth *(money today)* through to successful exit *(wealth tomorrow)*.

Additionally, the parties are working together to construct a wholesale Expansion Capital Fund that will enable qualified high growth nem clients to obtain funding to facilitate their expansion. The parties have now successfully received conditional registration of the Fund as a tax advantaged Early Stage Venture Capital Limited Partnership (ESVCLP).

More Information

For more information or to enquire on behalf of a client, please contact:

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Scancorp in the news

Please see the May issue of My Business Magazine which includes: "BUSINESS SALES – HOW TO SELL/BUY A BUSINESS FOR ITS TRUE WORTH: Marcus Salouk explains his 'Five Pillars' process for determining the true value of a business you may be looking to sell or acquire."

Investment Spotlight: Data Centre Services

Data centres provide services for the storage and retrieval of electronic information. This industry has significant growth potential due to the ongoing adoption of cloud computing by corporations and government entities. Clients outsource their electronic information storage requirements to data centres in order to:

- avoid significant initial capital expenditure,
- access a service "on tap" with the ability to scale as required and
- benefit from economies of scale.

Industry Performance

IBISWorld forecasts that the industry will continue to grow. In the five years to 2017-18, IBISWorld forecasts substantial growth of 6.9% p.a to reach $620M in 2017-18. IBISWorld is also forecasting profit growth for the industry as providers become more efficient in their service offering.

Some of the major external drivers of industry performance include:

- *Outsourcing of IT Services:* IT outsourcing is now well accepted and is expected to continue to grow as companies and government departments seek to outsource expensive computer storage requirements in order to reduce their power, real-estate and staff costs.
- *Management of privacy issues:* the industry will need to effectively address issues related to data privacy as well as the use of client's data. Given data may be stored on servers in any geographic location, different jurisdictions may have regulations that do not meet the client's expectations. To maintain growth, data centre providers will need to implement policies that enhance the trust of their clients.
- *Capital expenditure on computer software:* this largely correlates with the overall level of business confidence which is expected to gradually improve over the next 5 years.
- *Technological advances:* ongoing advances in technology infrastructure will further enhance the industry value proposition. Advances include the rollout of the National Broadband Network (NBN) and Telstra's 4G mobile network. New revenue streams should also become available through e-health and e-education programs.

Barriers to Entry

The barriers to entry within this industry are relatively high due to:

1. high capital costs related to real-estate, computing/storage, networks and climate control technology,
2. existence of contracts with current providers (in many cases multi-year contracts), and
3. significant ongoing advances in technology that providers must respond to in order to remain competitive.

While Australian data centre providers must generally compete with global participants, some government departments prefer to keep critical information onshore which benefits local providers.

Valuation Considerations

IBISWorld estimates that the average profit margin across data centre providers is around 12% of revenues. This is expected to improve as providers begin to realise an improved return on recent infrastructure investment.

Data centre operators provide a range of services ranging from:

- rental of rack space that a client uses to store their computing, storage and telecommunications equipment (ie a real-estate service)
- outsourced end-to-end provision of data storage and retrieval services for a client defined by a Service Level Agreement (ie a business service)

As such a variety of valuation techniques are utilised within this industry including:

- *Space comparables:* based on a dollar per square metre comparison, similar to commercial property valuation – this is seen to be flawed by some analysts as this technique does not consider density or utilisation of the data centre
- *Energy comparables:* based on a per critical energy capacity comparison – this is seen by some analysts to be

more reliable and less volatile than space comparables

- *Discounted cashflow (DCF):* to determine the net present value of future revenues generated by the centre

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Scancorp's "5 Pillars" Underpin Acquisitions: Pillar 5 - Expansion Opportunities

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

The fifth pillar considers the *expansion opportunities* presented by a business that will be considered by acquirers. Some of the considerations regarding opportunities for growth include:

1. The business is **scalable** and can increase revenues 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 licensing of its Intellectual Property.

Internet based businesses generally offer high scalability and may therefore valued based on their potential for growth. This is in contrast with property based businesses that are already operating at very high occupancy, which are valued based on current yield.

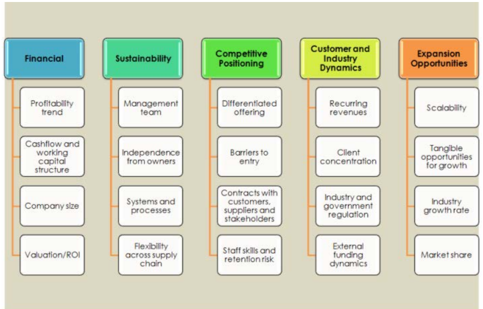
2. The extent to which the business has **tangible opportunities for growth.** Acquirers are attracted to businesses which have well identified expansion strategies. Acquirers will then confirm that the business has sufficient capacity (staff, machinery, licenses etc) to pursue the expanded business 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.

3. The **industry growth rate** within which the business operates. While acquirers will generally seek a businesses that operates within their preferred industry, the industry growth rate sets the baseline for a business' potential expansion. As described above, the data centre industry is anticipated to expand at 6.9% p.a over the next 5 years while newspaper publishing in Australia is expected to contract by 4.5% p.a over the same period (IBISWorld). The benchmark industry growth is considered by many acquirers when they assess the probability the target business will maintain or expand on its historic earnings.

4. The current **market share** enjoyed by the business. A business with minimal market share may suffer high revenue volatility, while a business with abnormally high market share may offer only limited growth potential. As such, while the ideal level of market share will vary significantly by industry, in general, acquirers will prefer a business that enjoys a material share of market as compared with its competitors but where there still remains a tangible potential to further

expand market share.



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**.

Other News

- The SME Association of Australia’s Federal Budget response
- Planning the acquisition process
- Australian industry looks forward to direct trading between AUD and renminbi

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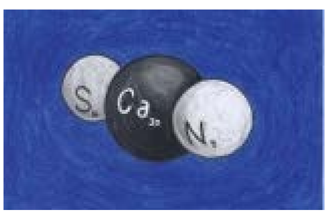

Featured Investment

Plastic Products - EOI Launch June

* Highly profitable product range with GP circa 50%
* Entirely contract manufactured – suitable for investor or manufacturer
* Forward 12 month revenues circa $4.5M with an EBIT of $2M
* Distribution in place through all major wholesale and retail distribution channels (eg Bunnings, Tradelink, BCF etc)

Featured Investment

3 x Pizza Capers Franchises SEQ

* 3 stores fully run under competent management
* All key personnel in place
* Ideal for an investor or owner manager
* Locations include prestige inner city and outer suburb – exceptional demographics
* All equipment and fit-out of highest standard with no further investment required

SCAN
Scan Business Brokers

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

* Robust IP protection in place
* Minimal moving parts and minimal warranty issues
* **Significant pre-EOI interest: register for EOI by contacting Scancorp**

Contact: ned.petrovic@scancorp.com.au

* One store ranks in Franchise's top 15 stores
* EBIT $330,000 per annum (owner's forecast FY2013)
* Combined average weekly revenues: circa $40k
* **Total investment:** $990k @ 33% ROI

Contact: paul.tiller@scancorp.com.au

Scancorp's Business Exit Service

Offerings

Scancorp Capabilities

Last Newsletter

April Newsletter

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