

FOCUS

Enterprises, Inc.

Investment Banking

12 VALUE DRIVERS: Self Assessment Scorecard

Develop Your Own Firm’s Profile Using This Self-Assessment

Use this scorecard to rate your firm (not yourself) on a 1 (low) to 10 (high) scale for each driver. Some sections won’t apply as much as others. Ratings generally should fall into the 3 to 8 range.

There is no overall score. But developing your own firm’s profile should help you gain insight into your firm’s areas of strength and of additional needs. Circle the appropriate number on each of the twelve VALUE DRIVERS and then connect the circles to create a visual profile of your firm.

	12 VALUE DRIVERS	1	2	3	4	5	6	7	8	9	10
1	Your Customer Base										
2	Recurring Revenue										
3	Product Integration										
4	Gross Margin Trends										
5	Intellectual Property										
6	Human Capital										
7	Management Tenure & Experience										
8	G & A Leverage										
9	Distribution Leverage										
10	History/Reputation										
11	Sales & Marketing Effectiveness										
12	Barriers to Competitive Entry										

Using Your Profile to Anticipate, Address, and Strengthen Areas of Concern Will Drive Your Firm’s Value Upward

This scorecard should be used in conjunction with the FOCUS article, “Twelve Value Drivers Help Ensure Success in Today’s Tough M&A Environment.” Detailed definitions and examples for each of the twelve areas listed here are included. Remember that potential partners--including customers, suppliers, distributors, licensees, lenders, equity investors, and potential acquirers--will be creating their own profile in order to evaluate their alternatives.

Twelve Value Drivers Help Ensure Success in Today's Tough M&A Environment

By Marshall Graham

The M&A process has changed. Today, buyers and sellers are more cautious than ever before. Pre-LOI due diligence is lasting much longer prior to firm deal terms being agreed upon. There is much more focus on forecasted revenues and stable and growing customer bases. Integration planning on paper is taking longer prior to the execution of a Letter of Intent. Finally, management teams, while extremely important in all M&A activity, are becoming much more central to success in today's M&A transactions.

For buyers and sellers alike, the key to achieving successful M&A transactions, with the assistance of intermediaries, is to identify the value components or "value drivers" of the transaction and then to make certain a plan is in place to integrate these components at the least cost. At FOCUS Enterprises, we assist our clients in carefully evaluating twelve specific Value Drivers when considering a buy-side transaction.

Value Driver #1: The Customer Base

The customer base of the company being acquired is extraordinarily important. What is the buying trend from these customers over the past five years? What is the extent of customer churn? How many new customers have been acquired annually over the past few years? What is forecasted revenue from these customers over a specific forecast period? How stable is the customer base? What is the profile of the customer base? Are the customers large, medium or small? How vulnerable are these customers to economic fluctuations? What is the revenue distribution of these customers over the entire revenue base of the company to be acquired?

Value Driver #2: Recurring Revenue

One of the top value drivers to consider is the recurring revenue coming from the customer base of the company to be acquired. Of total revenue, what percentage is recurring? This portion of total revenue is valued more highly than so-called "one-time revenue." Will the combination of revenues from the acquiring company and the acquired company create an opportunity for a higher recurring revenue percentage of the total when the deal is completed? Finally, is there an opportunity to change the business model of the acquired company to result in stronger recurring revenue?

Value Driver #3: Product Integration

A major reason for making an acquisition is to acquire a new and complementary product line(s) so that the acquiring company can leverage its current distribution system and therefore increase gross margins. Great attention must be paid to technical platforms of different products. Even more attention and analysis needs to be completed on whether products are complementary or competitive. Product/market segment research often must be completed before a product integration advantage can be substantiated.

Value Driver #4: Gross Margin

At Focus Enterprises, we believe this is most important line item on the P&L. In-depth analysis on paper needs to be completed to determine whether acquiring the target company will ultimately improve or degrade gross margins. Manufacturing processes need to be analyzed to accommodate more--and presumably complementary--product sets as well as items such as customer installation/training and service/warranty commitments.

Value Driver #5: Intellectual Property

"Intellectual property" is a catchall term meaning one thing to one person and something entirely different to another. Generally, at Focus Enterprises, we use the term in its broadest sense when assisting a client with a transaction. Intellectual property certainly means trademarks, patents and

copyrights but it also can mean a "developed process" such as a unique way to generate sales leads and then close sales using only the Internet. Accordingly, proprietary processes should be closely examined when evaluating a company for acquisition.

Value Driver #6: Human Capital

Today, this area is being looked at and evaluated to a much greater extent than ever before. During the late 1990s, a common approach was to acquire a company, assume that management and other key employees would stay for a while and then, the acquiring company would expect to augment or replace management as employment agreements expired. Today, buyers look for situations where management wants to stay for the long term. Post-sale integration failures of the past are largely the result of management departing after the deal is closed.

Value Driver #7: Management Experience and Expertise

This Value Driver is closely aligned with Value Driver #6: Human Capital, with the following differences: Does the management team of a company being acquired have substantial knowledge of a specific product, process or market segment that is a necessary requirement of the acquiring company? Can the managers of the company to be acquired add value to the current management team? Will this new management team give the organization the capacity to grow to the next level?

Value Driver #8: General and Administrative Leverage

Almost as important as the Gross Margin Value Driver is the general and administrative leverage when combining the acquiring company and the company to be acquired. Once again, careful planning is necessary in this area prior to the LOI stage. Buyers tend to overestimate the cost savings of combining companies at the G&A line. Also, transition costs are often underestimated, if not overlooked altogether.

Value Driver #9: Distribution Leverage

Potential buyers frequently say, "I want to buy a company where I can drive the products from the acquired company through my existing distribution system." While this concept is sound, there are pitfalls. Buyers need to be sure that end user customer requirements are complementary to this strategic approach.

Demand should be measured through effective market research. Sales and dealer training costs need to be taken into account, and customer service expense of the new products needs to be analyzed. These are just a few of the items about this Value Driver that need to be studied. Distribution leverage is an exciting concept and a top Value Driver, but a hard look at implementation details is critical.

Value Driver #10: History/Reputation and Operating Tenure

In the heat of an M&A transaction, this Value Driver is often overlooked. It has to do with the stability and constancy of the business being acquired. The fact that the company to be acquired has been in business for some time does matter and does have value.

The fact that customers have been with this company for some period of time does matter and the fact that the company is operating with the same management team in place is a positive factor. While there are other factors with this Value Driver, company history, reputation and continuing operations are very important to the contemplated transaction.

Value Driver #11: Sales and Marketing Effectiveness

This Value Driver is right at the top of our list when we are advising clients. All too often buyers concentrate on exotic product sets, exciting technology (that someday could be turned into a product) or new markets and customer sets. One key and very important element of a successful buy-side transaction is to determine whether the company to be acquired has developed an effective and "least cost" sales and marketing model.

When was the model developed? How long has the model been in place? What are the statistical results of the sales and marketing model over time? Is the model scaleable through the forecasted period? If the answers to these and additional questions are positive, chances are you are on the right acquisition path.

Value Driver #12: Barriers to Competitive Entry/Competitive Differentiation

Barriers to competition are becoming more difficult to identify as time goes on, as many companies are reluctant to file for patents even if a technology or a process is evaluated to be "protectable." Buyers must look for effective barriers to competition when evaluating a potential acquisition through competitive differentiation.

Examples are: Does the company have a "first mover" advantage in a particular market or market segment? Does the company to be acquired have significant product features that would provide a real product advantage when compared to competition? Does the company to be acquired have a significant technological edge that affords a 12 to 18 month product roadmap advantage? These are but a few of the questions that should be asked and then thoroughly and objectively answered when looking for a competitive advantage Value Driver.

Conclusion

In today's tough merger and acquisition environment, it is more important than ever to concentrate on these twelve solid Value Drivers when advising clients on the transaction process. The late 1990s called for buying a company and then making it work. Today's environment dictates careful study and analysis of all of the potential Value Drivers prior to establishing value, setting a purchase price and executing a Letter of Intent to acquire.