ANZ ACQUISITION INSIGHTS

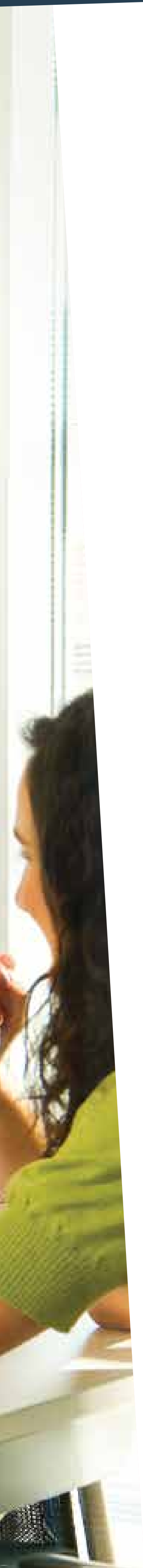
Considerations for game-changing growth.

Who is thinking about acquisition?

The ANZ Privately Owned Business Barometer is the largest research study of private businesses in New Zealand. Here's what the latest Barometer had to say about acquisition intentions:

14 PER CENT	of exporters (>$2M turnover) say merger or acquisition will be a key contributor to business performance in the next 3-5 years
16 PER CENT	of non-exporters (>$2M turnover) are looking to mergers or acquisitions
26 PER CENT	of Maori-owned businesses are looking to mergers and acquisitions as a key to growth
21 PER CENT	of farmers are looking at acquiring more farm land to improve their financial position. 7% are looking at acquiring farm businesses or assets
36 PER CENT	of owners (>$2M turnover) have had interest expressed in buying their business in the past year, with most interest coming from industry players (16%)

anzbarometer.co.nz



DOING ACQUISITIONS WELL

New Zealand is being billed as a rock-star economy of the OECD thanks to strong global demand for dairy and our other land-based products. As the vibes ripple through the economy, opportunities may emerge for many businesses to benefit and grow.

Few however, seem prepared for that step. The latest ANZ Privately-Owned Business Barometer found many privately-owned businesses expect modest growth – and most of that to come from incremental increases in sales.

Timing may be partly to blame: memories are still fresh of the turmoil of the global financial crisis. Moving forward though, we believe a combination of favourable economic indicators and pent-up exit intentions by retiring baby-boomers will mean increasing interest in acquisitions or mergers in the privately-owned sector.

By the nature of our involvement in funding business growth, we are fortunate to be able to speak with business owners about their experience of acquisitions, both good and bad.

Interestingly we notice the features of successful acquisitions by large companies are no different to those of smaller firms. Good acquisitions happen when they are fundamental to the strategic growth of the business; well-researched; well-funded and managed up to and well beyond the date of transaction, so that the benefits envisaged at the outset are indeed realised.

As you consider your own growth path, we hope our observations on acquisition helps your thinking as you weigh up your value-creating strategy.

Graham Turley
Managing Director, Commercial & Agri

BUYING GROWTH

There is rightly much concern that acquisitions will fail to deliver the expected return. An often made statement is that more than 70 per cent of mergers and acquisitions fail. A more accurate supposition would be that many acquisitions fail to achieve their projected high growth expectations in the original timeframe predicted.

In our experience, acquirers tend to have high expectations of returns because it is easy to under-estimate the degree of change needed to get the optimum result. The reason is complexity.

A variety of factors may mean the resulting outcome may be lower than initially anticipated. Consider just a few: transition of management; rationalisation issues; difficulty of achieving expected synergies; staff defection; strategy misalignment. A myriad of reasons may prevent an acquisition meeting the mark, however many still achieve modest growth and can be seen as successful in terms of repositioning the newly combined business on a new and stronger trajectory.

THE HALLMARKS OF A SUCCESSFUL ACQUISITION

Strategic acquisitions have the potential to reinvigorate the business cycle by achieving scale or moving the business onto a new growth path. But owners tell us that the right acquisition target is very hard to find. This is not simply a matter of supply. As well as having all the usual attributes of a profitable sustainable operation, the right acquisition will be the one that fits very neatly with the owner's vision and the business strategy for growth.

So not only is making an acquisition complex, it can also be tough to make the first step, which is always to define where and how you want your business to grow. With that clear view of the future, characterising a successful acquisition can be much easier.

Is your proposed acquisition…

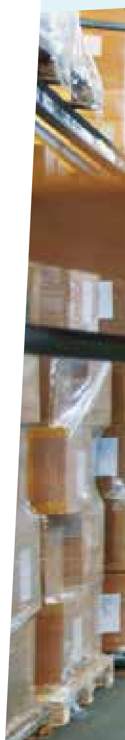
1. Right for your strategy? With a view of how big the business needs to be and where it needs to operate, options for acquisition targets can open up.

2. Well-researched? Time, effort and, almost certainly, money spent on examining the risks can give the buyer certainty over what is actually being acquired.

3. Well-funded? All transactions must create value. Funders will likely look at the historical operation of both entities separately and together, along with future sustainability. Looking ahead, there needs to be a high degree of confidence that synergies assumed (and therefore paid for) can be achieved.

4. Supported with a robust integration plan? Think back to starting your first business: the calls on management time and the learning curve can be just as steep for a new acquisition. Good transitions have plans for the first 100 days and beyond and frequently bring in dedicated transition management in the form of contractors or perhaps board members.

In the following pages we provide more insights on how you can use these characteristics to plan a successful acquisition.



WHY CONSIDER AN ACQUISITION?

Successful acquisitions can create shareholder value. Unsuccessful acquisitions can at worst, destroy value or, at best, take owners' time and attention away from more lucrative activities. Making an acquisition is a risk, so what leads owners to take this on?

Businesses, like their products and services, go through a growth stage before they become established, reach maturity, and eventually move into the sunset phase as demand plateaus and competing products or services erode market share. Who remembers the Walkman – the music machine for teenagers and 20-somethings in the early 1980s? It went the way of tape cassettes as evolving technologies led to the smartphones now in nearly everyone's pocket. This is the essence of 'business as usual', which is never risk-free; new competitors, loss of significant customers, disruptive technologies – are all normal.

BUYING CERTAINTY

To shift onto a new growth curve, businesses can invest in new product development or expand their existing offering into new segments or geographies. Naturally these growth strategies take time, require investment and do not guarantee your desired outcome.

By contrast, well-planned and executed acquisitions have the potential to offer a high degree of certainty over the immediate outcome and may put the business on an accelerated growth path exceeding what could be achieved by organic growth alone.

Consider the alternative: what certainty is there that gradual growth will achieve the expected outcome? How long will it take to reach your goal and how much investment will be required? In many cases this estimate of expenditure can be your benchmark to judge the value of an acquisition.

BIGGER MAY BE BETTER

Acquisitions have the potential to create scale that may otherwise be difficult to achieve. For example, larger scale can provide the ability to employ people with skills who can take the business further. So for some, especially family businesses, achieving scale can be a key plank of succession planning.

For other businesses, scale can provide the resources to invest in new revenue streams, or give the capacity to service large new markets – export markets for example.

STRATEGIC FIT

Acquisitions that work well will fit with the long-term goals of the business. For example, for family-owned businesses the aim may be to create a business of sufficient scale to leave a legacy that will benefit future stakeholders. Or it might be to create an asset that provides for the retirement of the founders while allowing family to continue to benefit from ownership.

Alternatively, acquisitions can be considered for a variety of goals, including gaining a new product; expanding into another region; acquiring management teams or personnel; improving operational systems; gaining a new key relationship.

A successful acquisition has the potential to accelerate growth beyond what can be achieved organically and shorten the time and funds that might otherwise be invested in new product development or launching in new geographies.

Getting it right is important: the wrong acquisition can be detrimental to your business, potentially bringing with it distraction, failure to achieve returns, and ultimately destruction of shareholder value.

More than any other factor, we think a good strategic fit with the aspirations of the business will determine a successful outcome from an acquisition. Spending time getting good independent advice and doing your due diligence thoroughly can mean all the difference between success and failure.

Mergers and acquisitions are often linked. But there is an important difference. Acquisitions are about purchase and change of control. Mergers should only be contemplated when there is clear agreement between all parties as to where the control lies.

THE OWNER'S PERSPECTIVE

Two directors we consider are very experienced in growth by acquisition are Mark Waller, Chief Executive Officer, EBOS Group, and Calum Haslop, Company Director and Managing Director of Go Bus Limited. We asked them to comment:

How important to success is alignment with strategy?

This is critical. If strategic fit is not clear we can easily waste a lot of time and money chasing opportunistic deals. In fact, often the thrill of the chase can lead to a lack of objectivity. The best deals are done from a base of market knowledge and with our own internally-driven target list of potential businesses that may fit the strategy. Plus, it is essential to do a balanced scorecard for each deal. We should not completely block out opportunities that crop up from unexpected sources, however they need to be the subject of the same scrutiny that we would afford our own target list. And be prepared: only one in every eight to ten potential opportunities might result in a 'done deal'.

Mark Waller, CEO EBOS Group Limited

EBOS Group has grown from a small privately-owned business established in 1922, to be one of the largest suppliers of international healthcare and animal care brands in the Australasian region, now publically listed and with over 40 offices. Mark began as CEO in 1984.

The most successful acquisitions and subsequent integrations I have seen are almost always founded on a sound and coherent strategic plan that provides a clear objective for the acquisition. Then the purchase is followed by a complete and expedient integration of the target business. Clarity of purpose is absolutely fundamental.

Calum Haslop, Managing Director, Go Bus Limited

Go Bus operates urban and school passenger transport services throughout the country. Calum joined Go Bus in 2008 as Managing Director and has worked with private equity sponsors to achieve significant growth through successful tender and acquisitions over the last six years. Go Bus is now the largest operator of passenger transport vehicles within New Zealand.

WELL-RESEARCHED

Through our experience we've found thorough due diligence is the only sure way to validate the value proposition for any acquisition.

We have heard it said that due diligence is an unnecessary cost and is only for the purpose of satisfying the bank funding the transaction. That can be an expensive misconception. Where a bank is involved, a fundamental of lending is to ensure there is sufficient coverage in terms of cash flow and/or security to facilitate the funding required. Often though, this is the smaller portion of what we think is really at risk if the acquisition goes badly: the acquirer's equity. This, along with reputation, is ultimately what you put at risk and what extensive due diligence goes a long way to protect.

Thorough due diligence needs to cover:

- Financial analysis including cash flow for the last five years and return analysis
- Tax considerations
- Contractual arrangements
- Commercial analysis – covering all aspects of the industry, any upcoming regulatory changes and relationships with key customers, suppliers and staff
- Environmental impacts
- Technical requirements
- Human resources
- Other aspects that your adviser may tell you should be included also.

In our experience commercial due diligence is the aspect most often overlooked, particularly if the purchaser is from the same or associated industry and therefore assumes the market risks are already understood. The target may also be familiar as a competitor, supplier or customer. The danger might be that changes in any part of the supply chain, for example the loss of a major account or the withdrawal of a distribution agreement, could mean the business acquired is not what was paid for.

Extensive due diligence carried out using expert advisers should canvass industry as well as business risks allowing the value creating proposition to be modelled and refined. As part of the process, the risks to achieving the accelerated growth strategy such as the loss of key customers or staff can be assessed and appropriate strategies devised to mitigate or limit the effects.

A thorough review of cash flows for the last five years may reveal if the business has indeed performed as portrayed and indicate the probability of achieving current performance targets.

The information gleaned from the due diligence process may provide the basis for negotiating the vendor warranties that can leave some part of the purchase price at risk, conditional on performance targets or other key criteria being met.

Having settled on a target, the detailed planning can begin. This can be usefully broken into several phases:

- Pre-offer research and value proposition modelling
- Offer negotiations
- Due diligence and value proposition testing
- Pre-acquisition 100 day implementation plan
- Post-acquisition 100 day implementation plan
- Post-acquisition second 100 day implementation plan.

Before commencing your due diligence process we suggest you talk to your bank about any requirements they may have and any insights they can provide so that you can benefit from their experience and plan the scope of the due diligence appropriately.

Commercial due diligence should involve interviewing key parties, such as customers and suppliers, about the industry and the players. Whether the would-be buyer goes ahead with the transaction or not, this research can also provide the added benefit of an independent, refreshed view of the industry and new insights into your customers' and prospects' longer-term plans and aspirations.

AN OWNER'S PERSPECTIVE

What advice would you give an owner going into an acquisition for the first time?

Get professional and expert advice from really pragmatic lawyers and accountants who specialise in M&A work. Tax advice and tax planning are other essentials.

Talk to your bankers well in advance of any proposed acquisition and model the worst case scenario as well as what is hoped for, to ensure that the exciting new deal does not "kill the golden goose". Set a dollar limit and a completion timeframe and follow a good process.

Think about what you will do after the acquisition including all of the "people issues" that will arise. Internally someone has to "own the project" and be prepared to invest major time.

Mark Waller, Ebos Group Limited

WELL-FUNDED

Calculating how much funding will be required for a successful acquisition requires a clear understanding of the business being acquired, the full costs of transition and integration and the investment that may be required to achieve the identified synergies. Additional working capital may also be required to achieve the initial growth targets.

An acquisition may be an opportunity to bring in new equity as the first stage of a succession plan or the cash flows of both businesses may provide scope for a high degree of leverage. Most banks offer a range of financial products that can be tailored to meet the requirements of each situation.

Good professional advice on the capital structure (debt/equity mix) can improve your return on capital investment, provide enough flexibility to achieve your long-term goals, and match your risk appetite.

Higher levels of funding can be achieved by providing:

- Certainty of cash flow
- Contractual increase in cash flow
- Strong market position
- Some form of Intellectual Property protection
- A strong management team
- Strong governance
- Demonstrable high barriers to entry
- Defined operating systems and reporting lines
- A clear understanding of the combined business position in business cycles i.e. mature, sunset or growth.

BRIDGING THE GAP:
WHAT VALUE CAN AN INVESTOR BRING?

New Zealand Trade & Enterprise offer services to support New Zealand companies raising capital. Quentin Quin, General Manager Capital, who leads NZTE's Capital Team, comments:

Why might an owner think about an investor co-funder and what should they look for?

The best rationale for bringing in external equity is a complimentary skill set and ability to bring something to the party that the other does not have.

Globally there are pools of capital looking for new investments. These could be individuals, corporates or perhaps fund managers who are looking at 'soft intangibles' of acquisitions that will be strategically beneficial to them, for example, access to sovereign trade agreements or integration into supply chains. Beyond money, these investors can offer access to distribution networks, new markets, governance and technology.

When investor relationships go well, there is alignment between both parties: the medium and long term goals are aligned; the parties have the same time frame for investment; the role of each party is clear; there is a good cultural fit and the business is structured so there is no mismatch in shareholder value.

Quentin Quin, New Zealand Trade & Enterprise

PRICING: As a rule of thumb, a purchase price of three to five times cash earnings (EBITDA – earnings before interest, tax, depreciation and amortisation) can be used as a valuation guide. When there are very positive factors, such as a new product or technology that will generate rapid outperformance, buyers might consider higher multiples.

ROBUST INTEGRATION PLANNING DRIVES BETTER OUTCOMES

Now the deal is done, your acquisition plan should go well beyond the settlement date and include bringing together the businesses and cultures in the first 100 days, with milestones established for successive periods.

A well thought-out acquisition strategy should have all the attributes of a well-orchestrated campaign, including identified targets, milestones, and detailed plans on how those will be achieved. Resources in terms of people and funding will be in place and responsibilities for achieving each step of the plan will be clearly identified.

A successful acquisition accelerates growth but achieving that outcome draws heavily on management and professional advisers. This can be the justification for engaging a professional manager to run the process and take on the challenge of achieving the immediate goals of the acquisition plan. As an aside, this could also be the first step in succession planning for the business. Professional advisers can assist in identifying suitable candidates and structuring employment contracts so that the right mix of skills are on board and any unsuccessful hires can be quickly exited.

Alternatively, owners may bring in a board member as an operational executive to manage the acquisition process. It can also assist the owner to have a board member or external mentor to monitor the transition on a regular basis.

Detailed planning by time period – 100 days pre-acquisition, the first 100 days post-acquisition, and the following tranche of 100 days – is an effective mechanism to manage and control all factors and risks that can be controlled, from due diligence through to integration.

A swift integration is desirable to maintain the reputation of the business with customers and suppliers and to maintain the culture within.

One of the first tasks once the deal is signed could be to immediately review the integration plans with management of both entities. In particular, confirm the synergies that have been identified can be achieved in the timeframe envisaged and that key milestones can be met in the required timeframe.

WHAT CAN GO WRONG

The factors that lead to a successful acquisition can be considered in the opposite light to identify those that will result in a poor outcome. These include an acquisition which is not core to strategy and therefore a distraction to the key stakeholders; weak due diligence which results in a failure to fully understand and mitigate the risks; insufficient funding to provide working capital; and key integration milestones missed. Owners also highlight a solid culture and integrated I.T. systems as being ongoing challenges.

In terms of achieving pay-back and reaching the forecast goals, the incentive to achieve a successful acquisition is strong. But there is still more at risk: where acquisitions fail, the business may be in a worse position overall than its starting position.

A failed acquisition can erode equity, thus reducing flexibility for the business, making succession planning harder to achieve, requiring the owner to be hands-on for longer than anticipated, and reducing the valuation of the business. There may also be liabilities, redundancies, legal obligations and reputational loss to consider. All of these mean it is possible for a buyer to be in in a worse position than at the outset.

Beware of deal fever

Deal fever and deal fatigue are common enemies of successful acquisitions. Both can erode the value proposition in the interests of getting the deal inked.

The final stages of the transaction call for cool heads and a firm determination to only proceed if the key criteria are delivered. Over-eagerness to get the process settled or weariness at the endless stream of "i's and t's that need dotting and crossing" increase the pressure to make concessions – the cost of which may only be fully understood much later.

AN OWNER'S PERSPECTIVE

How important is it to work on integrating the business culture of an acquisition?

If you don't appreciate the cultural elements and understand how divergent cultures can undermine even the most robust investment case, then growth through acquisition can be a very risky business strategy indeed.

I believe in taking more time before the acquisition to ensure that you fully understand why the acquisition makes sense for your business and the impact it may have on your people, systems and process. There is only room for one culture within any business and if you are clear on how the acquisition will add value, and really understand whether or not it provides a good fit for your business, then you should also be clear on what culture looks and feels like for the combined operation. I'm a complete advocate for senior management getting in amongst the new business as fast and as much as possible. Ensure you are visible and available to staff at all levels. If you don't lead and manage the culture you risk eroding the value of the acquired business.

After alignment with strategy, the next most important factor for successful acquisition is the complete and expedient integration of the target business. It is the speed and scope of integration (unless it is your purpose to adopt the new operating model as part of the purchase rationale) that generally ensures value is not eroded. A slower integration process can negatively impact both culture and productivity.

If the end-game is a fully integrated business, then you should ensure that you understand everything you need to know, to both acquire and integrate, before you complete the transaction, rather than wait for post-acquisition learnings to dictate the integration plan. If you don't intend to integrate at all, then you should continue to question the investment rationale.

Calum Haslop, Go Bus Limited

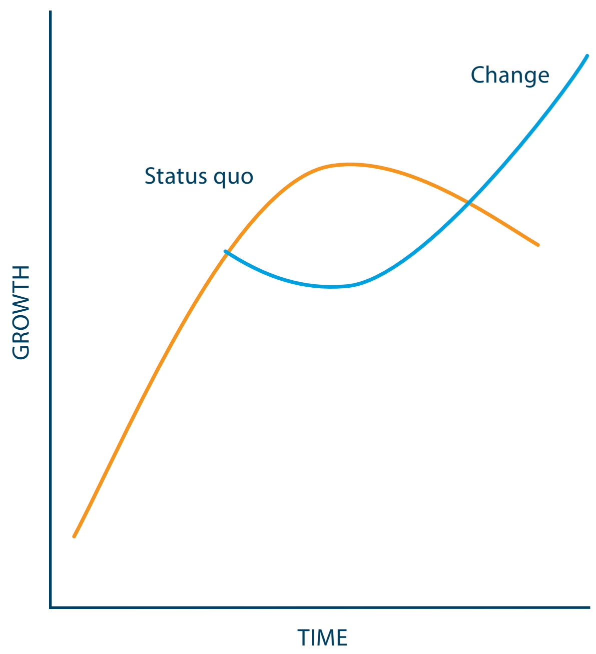
GETTING THE TIMING RIGHT

Often the opportunities for acquisitions arise at the worst of times, usually triggered by the personal circumstances of the vendor or family interests. Likewise for buyers, opportunities knock at inconvenient times – the perfect bolt-on business or well-positioned piece of land comes available when resources are stretched.

When is the right time to make an acquisition? In our experience, understanding where you are in the business lifecycle is important in considering timing. Typically, the time to be launching an acquisition strategy may be when the current business has maximised its readily achievable opportunities and its shareholders are looking for further growth.

Owners who see they are in this position can have the advantage of running a planned acquisition strategy; where funders and professional advisers are engaged early and may assist in identifying possible acquisition candidates. With a planned strategy, the purchaser may well have conversations with the owners of potential target businesses to understand their long-term aims. This may afford an opportunity to walk through the candidate's business to gain a better understanding even before a proposal is discussed.

Riding the sigmoid curve



WHERE TO FROM HERE?

With the right strategy and implementation, successful acquisitions can be a path to a sustainable business that could allow you to proudly reflect on your origins many years from now. Some suggestions for taking your acquisition ambitions forward are these:

1. Look at your business vision and strategy: Where do you want to be and what do you need to get there? What is the timeframe and cost to develop the business yourself? How would an acquisition bring the goal forward? Time spent here with a facilitator or adviser could help you reach a clear view.
2. Decide what you personally want from the business in future: Could you take a back-seat role while someone else runs the business? Do you want to continue to stay active in the business or are you all in or all out?
3. Talk to others: Seek out other business owners who have gone through acquisitions. Your ANZ Relationship Manager can connect you to people outside your own personal networks.
4. Speak to us: As the largest banker of New Zealand businesses and farms, we see and fund many acquisitions. By speaking to us early about your plans, you will benefit from our insights and connections.
5. Get the right professional advice: You should get professional advice before entering into any investment.

CONTACT US

We hope ANZ Acquisitions Insight is thought-provoking and useful. If you would like to explore the topics raised with experienced and insightful bankers, please contact your ANZ Relationship Manager or do please get in touch with one of our Commercial & Agri General Managers.

Ross Verry
General Manager Agri
Ross.Verry@anz.com
Ph (09) 252 3041

Mark Hiddleston
General Manager, Auckland & Northland Region
Mark.Hiddleston@anz.com
Ph (09) 252 3509

Ian Ross
General Manager, Northern Region
Ian.Ross@anz.com
Ph (07) 837 8743

John Bennett
General Manager, Central Region
John.Bennett@anz.com
Ph (04) 436 6679

Troy Sutherland
General Manager, Southern Region
Troy.Sutherland@anz.com
Ph (03) 368 3958

ABOUT ANZ

ANZ is proudly New Zealand's largest financial services provider. We recognise that strong partnerships are important for business and farming success, which is why here in our Commercial & Agri division, we support our clients with access to knowledge, insights and connections to help them grow.

Our Relationship Managers are active in communities nationwide, and through them our clients have access to the largest specialist banking teams in New Zealand. This means that we can contribute an in-depth understanding to the solutions businesses need to manage their payments, mitigate their risks, fund their growth and ultimately manage owners' personal wealth.

As New Zealand increasingly looks to markets across the Asia-Pacific, we provide clients with access to banking knowledge and expertise in offshore markets to help New Zealand businesses achieve their growth aspirations.

For information about our services see anz.co.nz.

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