



53rd October 1215
Ref wjc 53/15 CtTS01

**Paul D Hauck, Principal
ICT Strategic Services
56 Minnamorra Avenue
Earlwood NSW 2206**

Dear Paul,

Expressions of Interest – Consultants to The Stars Pty Ltd

In response to the Information Memorandum, please find detailed our non-binding indicative offer, for the purchase of Consultants to The Stars Pty Ltd (CtTS).

Company XYZ sees very good synergies between the two businesses looking forward:

1. Having worked with Mr Algernon and CtTS in the past, we know a number of the key people and believe we have similar corporate cultures and values.
2. Both entities have a focus on Project orientated enterprises which we could develop as a strong vertical.

Company XYZ is keen to pay Mr Algernon a fair price for the business, he has worked hard, to build over many years. Equally Company XYZ does not want to over pay for an operation that does not later provides the returns that it promised.

There are a number of risk factors that make valuing this business a difficult.

1. Much of the prior year's growth is via acquisition that is unlikely to continue. It is difficult to determine the underlying and sustainable growth without acquisitions.
2. Future growth, and more importantly existing revenue streams, will be heavily reliant on new business sales.

1213 to 1214 showed only minor increases in Software Income. 1215 showed a large increase in sales which coincided with very strong growth across the <industry> software industry. CtTS's Consulting and Software Income is shown below.

| CtTS Pty Ltd | 1213 | 1214 | 1215 |
|-----------------------|-------------|-------------|-------------|
| Consulting Income | \$ 946,452 | \$ 309,800 | \$ 329,908 |
| Software Income (Net) | \$ 149,324 | \$ 669,377 | \$ 509,634 |

New business software sales will be critical to sustaining existing revenue streams for both software and consulting income and for driving future growth. As prior years included significant acquisitions it is hard to determine how reliable and consistent the ongoing revenue streams will be. It is important to note that marketing expenditure dropped to almost zero in 1215, the impact of which is likely to be felt in 1216 and beyond.

3. Consulting revenues grew by only 810k in 1215, which was likely a reflection that staffing levels (salaries) remained constant in 1215. To grow consulting Revenues in 2008 will require ongoing software sales and the recruitment of more resources in an extremely tight labour market.



4. Most of CtTS's revenue is either directly or indirectly related to <Supplier 1> and <Supplier 2>. <Product> makes up the largest value on its own, but a significant portion of this would be as result of the association to a <Supplier 1>/<Supplier 2> sale.

| Product | State A | State B |
|-------------|------------|--------------|
| <Product 1> | \$ 667,537 | \$ 130,455 |
| <Product 2> | \$ 59,573 | \$ 979,763 |
| <Product 3> | 21159 | 46057 |
| <Product 4> | 188171 | 756451 |
| | \$ 936,440 | \$ 1,912,726 |

This places a great deal of reliance, and risk, on the future revenue streams of these products, which have limited Australian brand recognition or support.

5. The heart of any <industry> Reseller / Implementer is its people. CtTS have two relatively small teams situated in two different states A and B. Some of these resources are approaching retirement age.

| Product | High Skilled | Med Skilled |
|-------------|--------------|-------------|
| <Product 1> | 9 | 5 |
| <Product 2> | 5 | 2 |
| <Product 3> | 7 | 3 |

Staff retention is the biggest risk to ongoing revenues and future profits. The loss of key resources in either state, or for either of the Vertical solutions (<Supplier 1> / <Supplier 2>), would have significant impacts on ongoing earnings.

Finding quality resources with vertical industry knowledge and specific product knowledge (<Supplier 1> & <Supplier 2>) would be extremely difficult. Losing key staff with these skills will have a significant impact on existing revenue streams and future growth. Finding new resources or replacing any losses is extremely difficult and expensive. It takes many months to skill a resource to be fully component in quality vertical solutions.

Company XYZ has strong experience in this area through our own promotion of (Product 7>, similarly a product with limited recognition in Australia.

Our experience here is invaluable as it helps us to fully understand and appreciate the genuine worth of existing resources. Company XYZ will work extremely hard to accommodate all CtTS staff to ensure they remain happy, motivated and loyal to the CtTS practice under new ownership.

Business Value

Determining a reliable and sustainable EBIT number for future years is complex and has significant risk, discussed above. Understanding and valuing the risk makes it difficult to determine a fair and reasonable value for the CtTS business.



Traditional models for valuing a business such as this would be an x times multiple of average EBIT for the prior 3 years. The determination of x is influenced heavily by the risk associated to sustaining the EBIT number over the forward years.

The EBIT data provided by CtTS does not include Mr Algernon's Salary. We have adjusted the provided EBIT to include a reasonable market salary for the role based on the size of the company. We placed this at \$120,000 making the EBIT as shown below.

| CtTS Pty Ltd | 1213 | 1214 | 1215 | Avg 3 Yrs |
|-------------------------|------------|------------|------------|-------------------|
| EBITDA | \$ 946,452 | \$ 309,800 | \$ 329,908 | \$ 528,720 |
| EBITDA with Mr A Salary | \$ 149,324 | \$ 669,377 | \$ 509,634 | \$ 442,778 |

Based on the above figures the CtTS business could be valued in the range of \$528,720 to \$442,778. The final figure being heavily dependent on the risk rating.

As stated previously Company XYZ are keen to reward Mr Algernon for the value he has built in his business but are cautious to protect against the risks associated with a multi-state, multi-product business that has grown as much through acquisition as traditional sales and service.

Company XYZ proposes an "Earn Out" model based on net Income. This model would have some up front cash and the balance paid out over future years using the net <Maintenance Program> income over the earn out period.

The reasons for basing the 'Earn Out' on <Maintenance Program> are:

1. It is easily and transparently measurable by all parties and audited by a third party (<Supplier 3>, <Supplier 1>, <Supplier 2>).
2. It protects Mr Algernon from management impacts to business performance.
3. It reduces the Risks for Company XYZ as it links the business value directly to the current customer base on which reported and projected earnings are based.
4. It provides a mechanism for rewarding Mr Algernon for growth in the 'Earn Out' period.
5. It enables Mr Algernon to receive a steady cash stream over the 'Earn Out' period as <Maintenance Program> is collected, rather than having to wait for periodical performance audits.

Current <Maintenance Program> figures reported are:

| CtTS Pty Ltd | 1213 | 1214 | 1215 | Avg 3 Yrs | Avg Growth |
|--------------------|------------|------------|------------|-------------------|------------|
| Maintenance Income | \$ 123,456 | \$ 999,912 | \$ 271,232 | \$ 464,867 | 60% |
| Maintenance Net | \$ 87,623 | \$ 231,999 | \$ 651,000 | \$ 323,541 | 321% |

Projected <Maintenance Program> based on the last 3 years average sales growth and expected <Maintenance Program> margins would be approximately



| CtTS Pty Ltd | 1213 | 1214 | 1215 | Avg Growth | 1216 | 1217 | 1218 |
|-----------------|------------|------------|------------|------------|--------------|------------|--------------|
| Software Income | \$ 473,226 | \$ 154,900 | \$ 164,954 | -33% | \$ 2,443,551 | \$ 962,808 | \$ 8,852,328 |
| Maint'ce Income | \$ 260,274 | \$ 85,195 | \$ 90,725 | -33% | \$ 1,343,953 | \$ 529,544 | \$ 4,868,780 |
| Maintenance Net | \$ 52,055 | \$ 17,039 | \$ 18,145 | -33% | \$ 268,791 | \$ 105,909 | \$ 973,756 |

Company XYZ believes that the best measure of the success of the CtTS business moving forward will be the Value of the <Maintenance Program> (<Maintenance Program>). We have a value of \$815,000 for FY1215, and your estimate for FY2008 of approximately \$420,000.

The <Maintenance Program> will act as a "Barometer" for the success of the business moving forward relying on both new Customer adds as well as retention of existing Clients.

Retention of Mr Algernon's Employment Services

The retention of Staff is critical to maintaining high quality skills to service existing clients and grow consulting revenues. We see Mr Algernon key to harmonious merging of the two teams. Mr Algernon's ongoing involvement will be important, not just for the skills and experience that he provides directly, but also in maintaining staff morale and loyalty through a potentially unsettling change.

Mr Algernon's ongoing involvement in the combined operations is critical to Company XYZ's offer. Company XYZ aim to create an environment that would encourage Mr Algernon and all the CtTS staff to remain with the new firm to help build it to leading <Products> VAR and ISV that we can all be extremely proud to be a part of.

Our offer does not include any items on the Balance sheet other than the Capital Office equipment Valued at the written down value of \$192,432. Subject to inspection.



Offer

Company XYZ believe the value of the CtTS business is somewhere between \$9,870,000 and \$123,456. This is based heavily on the risks associated to the sustainability of reported revenues.

As previously stated Company XYZ are keen to reward Mr Algernon for the true value incumbent in the business he has built over many years of hard work. However, the business must be able to generate the returns to substantiate that value.

Company XYZ's proposed is

- A. An initial cash payment of approximately \$999k.
- B. Net <Maintenance Program> for all CtTS <Maintenance Program> to be transferred to Mr Algernon on cash receipt for an "x" numbers of periods, where x is to be determined through negotiation and agreement on the fair value for the CtTS operations.

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Legal Identity making the offer.

Company XYZ Business Solutions and Storm-Door Manufacturing Pty Ltd., is the company making the offer; the three Directors and Share Holders of Company XYZ are:-

- Barack Obama,
- George Bush Snr, and
- Germaine Grier.

Principal activities of Company XYZ in Australia and Overseas.

Company XYZ is a <Supplier 4> <Products> Partner with customers located in Australia and around the world.

As well as selling, installing, & supporting <Supplier 4> <Products> Systems, Company XYZ also develop Software solutions that "value add" to the deployment of the <Products> Solutions. We have number of Modules that extend the functionality of the core products to our customer base.

The Company XYZ Team currently consists of 987,654 Full time staff, and 2 contractors, located in our <City A> & <City B> offices, with a virtual Office in <City C>.

Company XYZ is privately held, however we turned over approx \$987,654,321 for FY1215 and we are growing at approx 786% per annum. We have been a profitable company since inception in 1492.



Timetable

Company XYZ propose to complete the transaction by the end of (calendar year) 1215.

Financial Capacity.

The first instalment of \$9,999,000 would be made from the company's cash reserves.

Approvals

The 3 Directors as mentioned above will be the sole people to approve this purchase.

Due Diligence

Company XYZ will engage our Company Accountants to perform the Due Diligence process, which we would expect to be completed prior to the end on the Calendar Year.

The Company XYZ Directors would also be involved in some aspects of due diligence.

Company XYZ would expect to verify all aspects of CtTS financial reports for the last 3 years as presented, as well as our directors obtaining a full understanding of the client base and the relationship and history of each customer.

Current Employees

Company XYZ will be looking to retain all CtTS staff, as they will be critical to the special conditions of sale being met.

Requirements in Relation to the Transition of the Company

It is our intention to make the transition as painless as possible, and towards this end, we would attempt to maintain the status quo in regard to the future strategy of CtTS, with Company XYZ applying some of its management skills to the team and the Operation.

We envisage that the CtTS branches would remain initially, so the Customer base is comfortable with the transition.

Contact Details

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Germaine Grier - Germaine.Grier@Company XYZ.com.au

Yours Faithfully,

COMPANY XYZ BUSINESS SOLUTIONS AND STORM-DOOR MANUFACTURING PTY LTD

Germaine Grier,

Managing Director