megabuyte scorecard

The Megabuyte Scorecard

What does a 'good' mid-market technology company look like?

Whilst the need to build a position in a new market or technology may require a technology company to lose money during its formative years, we feel strongly that, once this stage is passed, high growth, high margin, cash generative businesses will always provide better long term returns for investors.

But how does one go about assessing which companies are performing better than others?

The Megabuyte Scorecard provides technology companies, their investors and advisers a standardised methodology to help them benchmark their performance against similar companies.

How does it work?

The Megabuyte Scorecard is a proprietary benchmarking methodology developed by the research team at Megabuyte, pooling over 60 years of combined experience assessing the performance of Software and ICT Services companies. The Scorecard assesses companies using a combination of seven key measures, covering: growth, margins, cash flow and overall size. These measures are then weighted to provide what we feel is the optimum balance for mid-market companies.

- Growth:
  In assessing a company's revenue growth we have struck a balance between our view that organic (or underlying) growth is preferable, whilst acknowledging that acquisitions are also an important additional way to grow. Growth in EBITDA is also a key measure in the Scorecard.
- Profitability:
  When evaluating profitability, we look at adjusted EBITDA margins as the optimal measure of P&L profitability.
- Cash conversion:
  A central tenet of our view of optimal financial performance is that as much as possible of reported EBITDA profit is converted to operating cash flow (OCF) over time.
- FCF conversion:
  We look at the conversion of EBITDA to FCF over time, using (OCF-capex)/EBITDA. This is the truest measure of a company's ability to generate free cash flow, taking into account actual operating cash flows rather than EBITDA.
- Size:
  While size does not, in itself, mean that a company is good or bad, the law of large numbers does mean that it is harder to generate organic growth, in percentage terms, as a company gets larger. As a result, we feel that it is right to give some credit to larger companies.

Inclusion Criteria

Eligibility

We only score companies under full Megabuyte coverage, including public and private companies. Within that universe, companies must meet the following criteria:

- UK Companies:
  - More than £10m of revenues but no more than £100m of EBITDA in the most recent financial year, and with at least £1m of EBITDA in one of the last four years.
  - Detailed and meaningful accounts available for at least three years for revenues and profitability and at least two years for cash flow.
  - Are not a subsidiary of a much larger organisation.
  - Have not been through very significant M&A recently or other such transformational events.

The Scoring Process

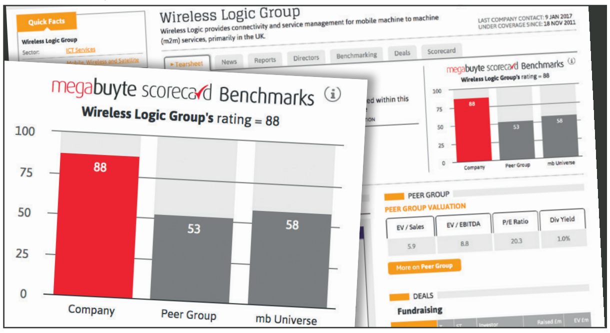
A four stage process

Stage 1: Data Cleansing
In order to calculate the scorecard KPIs, we need to ensure that company data is comparable across our selected company universe. For this reason we require clean and consistent company accounts for the periods described above. We reserve the right to adjust financials in cases where this provides a more accurate reflection of the true underlying performance of a business. We also reserve the right to exclude companies where we feel that published accounts are inconsistent over time. For example, if a company has sold an asset but hasn't clearly restated previous accounts relating to discontinued activities.

Stage 2: Data Analysis
Once we have calculated the KPIs for our selected universe, we calculate the quartile performance for each KPI. Companies are then positioned with quartiles, with each company being assigned a score of one (bottom quartile) to four (top quartile).

Stage 3: Weighting of Quartiles
We then apply a proprietary weighting to the seven KPIs. While we do not disclose exact weightings, priority is given to organic growth over reported growth and the extent to which profits are cash-backed.

Stage 4: Relative Positioning
Finally, a company's performance within each quartile is taken into account. Therefore, if a company is in the top quartile it will be given a score of between three and four. If it is in the bottom quartile, it will receive a score of between zero and one.



Where can I find Scorecard ratings?

Snapshot Scorecard ratings are available in our Company and Peer Group reports, while live Scorecard ratings – which are updated daily – are available in the Company and Peer Group sections of the Megabuyte database.

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