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By allowing business units to retain their individuality, company hopes to realize synergies under a bigger corporate umbrella

QE2 Acquisition is more than the sum of its parts

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Any entrepreneur will tell you that to get a company off the ground, you have to work hard.

He'll also tell you to aim for the highest possible level of operational efficiency, as well as to plow through your obstacles.

But the skills needed to set up — and, then, maintain — a profitable outfit often differ from those needed to generate growth.

One way of generating growth is through consolidation — that is, by forming a bigger company from many smaller parts.

That's where **QE2 Acquisition Corp**. (QE-TSX/VEN, $0.11) comes in. The Calgary-based company, which went public in early November, was formed specifically to combine smaller independent firms into a bigger, yet more flexible, corporate structure.

But rather than operate as subsidaries, the independent companies will carry on as separate business units.

Not only does this allow their individual strengths to be preserved, but it enables the companies to create synergies within the corporate framework.

QE2 came into existence after a reverse takeover which itself came on the heels of two acquisitions.

One acquisition, Pillar Contracting, provides streetlight, electrical and painting services, while the second acquisition, Candesto Enterprises, installs and maintains guardrails and road signs.

Each company is able to operate independently, serving highly profitable and stable markets — markets with diversified clienteles.

At the same time, both companies now function under a unified head office which results in streamlined bookkeeping, as well as financial reporting.

It's crucial to keep in mind that QE2 didn't make the acquisitions because the companies needed restructuring or because their business plans went off the rails.

Both Pillar and Candesto are established private businesses — and successful ones at that.

QE2's objective in buying them was to put the organic growth of each company under a larger corporate umbrella.

There are advantages to doing so. For one thing, there's less need for short-term injections of cash flow because billing cycles are smoothed out.

Moreover, because big companies have more clout, they have easier access to capital. Then, too, for a large corporation, interest rates are often lower.

Over time, QE2 expects to reap economies of scale by sharing labor and equipment, as well as by integrating customer bases.

As an example, consider Pillar's recent contract to replace traditional streetlight heads in Calgary with energy-saving ones based on light-emitting diodes.

To do its work, Pillar will use both yard space and logistics at Candesto, which is based near Calgary.

In the meantime, because both companies boast low ratios of cost to enterprise value, they should help create shareholder value.

Added to this are strong operating margins, the ability to generate free cash flow from operations, along with a pipeline of many more growth opportunities.

Of course, in any business, corporate culture always plays a big, if intangible, role.

Indeed, the willingness of senior execs of each business unit to commit to long-term contracts can ensure a seamless transition when operations are brought under a new umbrella.

Yet, who knows better how to squeeze out the maximum efficiency of these businesses than the people who built them?

Indeed, keeping strong management teams intact, while continuing to give them incentives, helps make any acquisition a success.

Meanwhile, QE2 can take heart in its appointment of Mike Belantis as both a director and CEO.

Track record is good

For starters, he has a good track record of successfully launching new ventures.

Second, he has experience as a consultant in identifying opportunities for investment.

And since QE2's growth will depend on the successful addition of new business units, Mr. Belantis's experience in this regard is obviously of key importance.

Then, too, because both management and company insiders own roughly 30 per cent of QE2, their interests necessarily jibe with those of the stockholders.

By focusing on established companies specializing in infrastructure development and support, QE2 is tying itself to a growing segment of the Alberta economy, but one that's less exposed to the wild gyrations of the oilpatch.

In fact, given the existing service relationships the two business units have with big companies, QE2 should enjoy the stability that comes with recurring revenue.

The company also stands to reap recurring revenue, given its infrastructure contracts with government.

For fiscal 2014, QE2 expects to generate $9.5 million in revenue and roughly $1.3 million in operating cash flow.

The company is now reporting gross margins above 30 per cent, thereby giving it a profitable niche to build around.

Although it plans to make no more acquisitions in the next six to 12 months, QE2 is committed to an aggressive growth strategy.

The company has identified other possible candidates that complement its core strength as a provider of infrastructure services.

The plan is to build relationships with target companies that would immediately fatten the bottom line, although they would still have the potential for faster growth following the acquisition.

Bottom line important

Initially, QE2 will stay focused on Alberta, where the economy remains relatively strong and where the company's management team knows the marketplace.

But as QE2 gains traction, it will likely explore acquisition opportunities in both Saskatchewan and Manitoba.

In the interim, as long as QE2 can convince established local companies to become part of a bigger corporate structure, its business plan should result in fast growth, but at relatively low risk.

As a new company just out of the starting gate, its shares are moving in sync with high-risk concept stocks in that corner of the market beloved by speculators.

But I believe QE2's strong procespects merit a higher share price. The company operates efficiently within a profitable subsector. And this alone tempers much of the risk associated with any new firm.

Yes, infrastructure development and servicing isn't sexy. But the prospect of stable revenue, as well as attractive opportunities for expansion, should allow investors to sleep easy through the early part of QE2's growth curve.

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