



*Bringing Efficiency to Inefficient Markets*

## **The Strategic Alternatives Review**

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# Objectives

- Introduce *The Strategic Alternatives Review*
- Review examples of *The Strategic Alternatives Review*
- Review the benefits of *The Strategic Alternatives Review*

# Strategic Alternatives Review - Approach

*The Strategic Alternatives Review provides a framework for business owners to explore their available capital market alternatives, enabling them to meet their goals and objectives. We view the business owners' current inherent equity value as a portfolio asset that is invested or "rolled over" into the business. This rolled over equity has a clear return when viewed over a five year period. This return is evaluated in context of risk (business and market), wealth creation and other available alternatives that will meet stakeholder goals and objectives.*

## Strategic Alternatives

- Status Quo
- Recapitalization
- Acquisition(s)
- Divestiture
- Growth Capital

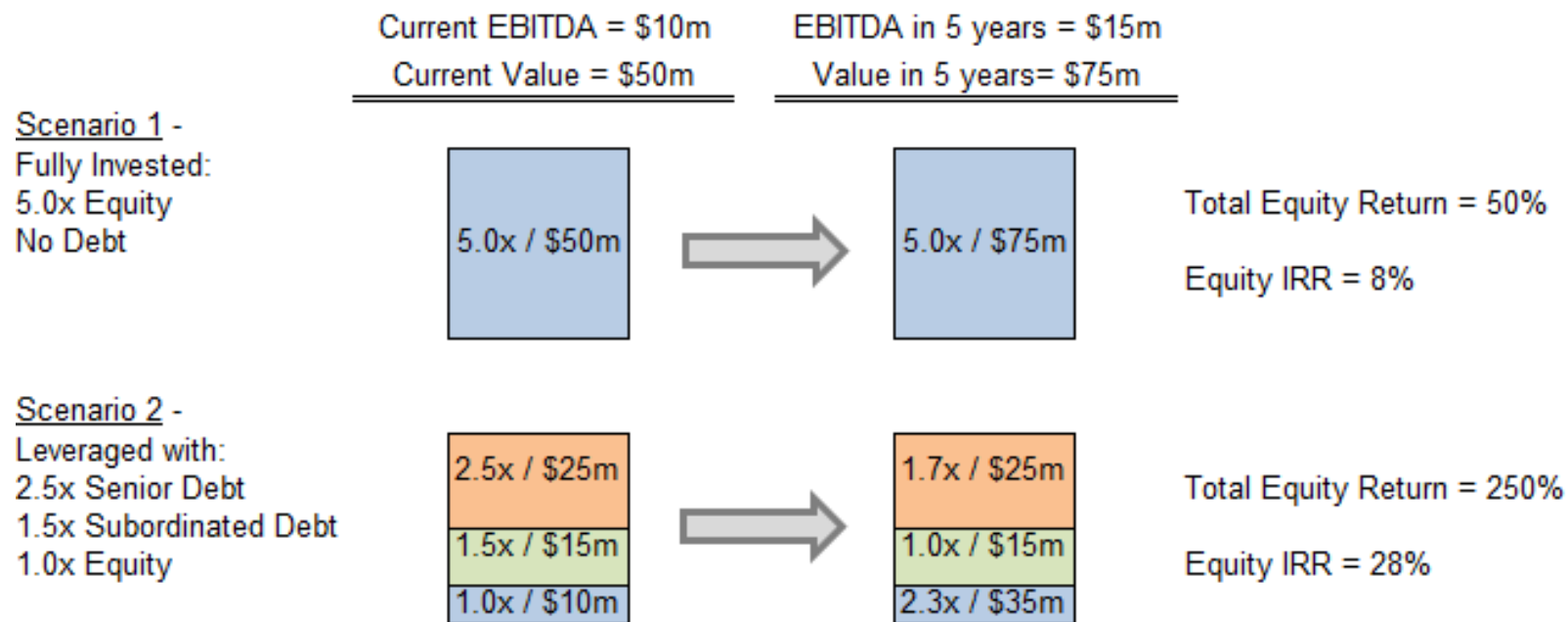
## Approach:

- Understand the goals and objectives of the shareholders and managers
- Establish a "Status Quo" alternative of the business based upon a five year projection
- Determine Value (DCF, Market Comparables and Leverage Test)
- Develop other strategic alternatives that meet shareholder objectives
- Summarize alternatives and review business and financial impacts of implementing each alternative
- Compare alternatives on the basis of risk, wealth creation and meeting owners' objectives
- Make recommendations and assist in selecting the most appropriate alternative

# Strategic Alternatives Review

## ➤ The Risk / Return Profile of Invested Capital – The Effects of Leverage

- ❑ Illustration displays effect of returns on equity under two leverage scenarios
- ❑ Illustration assumes Enterprise Value equals 5.0x EBITDA
- ❑ IRRs are based on Current Market Equity Value



# Strategic Alternatives Review

## ▣ The Strategic Alternatives Developed

### ▣ *Status Quo:*

- Determines return on equity based on a 5 year projection
  - Projection provided by management or based on industry estimates - organic growth only

### ▣ *Recapitalization:*

- Determines debt capacity and analyzes various leverage scenarios
  - On underleveraged entities, recap could be an alternative to selling
  - On leveraged entities, recap could create liquidity and/or reduce overall cost of capital
- Determines ability to pay dividend to diversify “portfolio holdings”
  - Example: Potential ability to liquify up to 80% of equity while giving up little or no ownership
- Provides potential to increase return on equity on reinvested capital

### ▣ *Acquisition(s):*

- Establishes maximum acquisition size based on:
  - Current equity value that can be used to fund an acquisition
  - Current capital market constraints (leverage multiples)
  - Shareholders’ risk tolerance
- Allows for a diversification of “portfolio holdings” on a tax deferred basis
- Enhances return on equity on invested capital through increased leverage
- Enhances wealth creation potential

### ▣ *Divestiture:*

- Explores sale to financial buyers, strategic buyers & manage
- Buyers targeted are determined by goals & objectives of owners

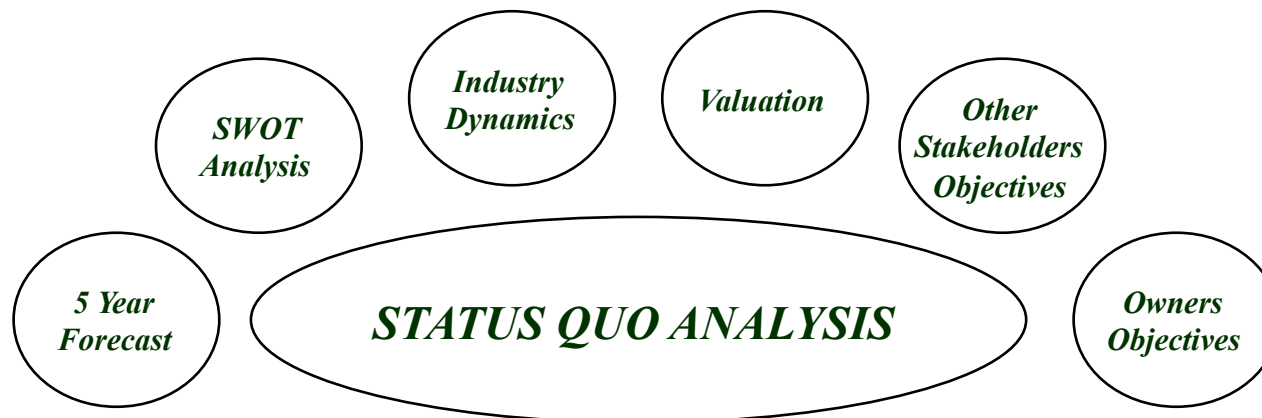
# Strategic Alternatives Review

## Developing the Status Quo Analysis – Six Step Approach

1. Identify specific shareholder goals and objectives
2. Establish a 5 year “normalized” projection
3. Formulate a SWOT analysis (Strengths, Weaknesses, Opportunities & Threats)
4. Develop an industry & competitive profile
5. Determine Value (DCF, Market Comps & Leverage Test)
6. Assess other stakeholder objectives

# Strategic Alternatives Review

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<b>STATUS QUO</b>	<b>RECAP</b>	<b>ACQUISITION GROWTH</b>	<b>DIVESTITURE</b>
<ul style="list-style-type: none"> <li>• No major changes</li> <li>• Normal growth</li> <li>• Base case</li> <li>• 5 year forecast</li> <li>• Current equity value</li> <li>• Future equity value</li> <li>• Determines 5 yr IRR</li> <li>• Used as "hurdle rate"</li> </ul>	<ul style="list-style-type: none"> <li>• Tests debt capacity</li> <li>• Max leverage found</li> <li>• Could use sub debt</li> <li>• Diversifies holdings</li> <li>• Min. equity dilution</li> <li>• Max. current cash</li> <li>• Retains control</li> <li>• Reinvestment IRR</li> </ul>	<ul style="list-style-type: none"> <li>• Models acquisitions</li> <li>• Leverages equity</li> <li>• Tests debt capacity</li> <li>• Establishes criteria</li> <li>• Max deal size</li> <li>• 5 year forecast</li> <li>• Determines 5 yr IRR</li> <li>• Proj. wealth created</li> </ul>	<ul style="list-style-type: none"> <li>• Market comps</li> <li>• Val: financial buyer</li> <li>• Val: strategic buyer</li> <li>• Max. current \$\$</li> <li>• Diversifies all risk</li> </ul>

## Example – Pinnacle Electronics – EMS contract manufacturer

<p><b>Scenario</b></p>	<p>Purchased by Main Street Capital (MSC) in 2001 for \$7MM                  2003 Sales equaled \$38MM &amp; EBITDA was \$7MM; SA valuation was at \$37 to \$41MM                  Company had no debt therefore value to owners equaled \$37 to \$41MM (\$39MM)                  Company faced potential “Asia threat” in future; manager (25% owner) wanted to explore exit                  MSC hired SA in June 2003 to explore strategic alternatives</p>
<p><b>Alternatives</b></p>	<p><b>Status Quo:</b> Estimated a 5 year IRR on equity at 14.8%</p> <p><b>Recap:</b> Estimated a dividend of \$21MM (58% of value) while giving up 9% warrant                  Total debt to EBITDA of 3.75x                  IRR on reinvested capital increased from 14.8% to 23.1%</p> <p><b>Acquisition:</b> Acquire two smaller EMS firms over next two years @ \$6MM each                  Leverage with senior debt                  Diversify customer base                  IRR on reinvested \$39MM equity increased to 28.3%                  5<sup>th</sup> year equity value increases to \$136MM vs \$77MM on Status Quo</p> <p><b>Divestiture:</b> Sale to financial buyer estimated @ \$37MM; sale to strategic buyer @ \$41MM                  MBO not considered as manager desired exit</p>
<p><b>Conclusion</b></p>	<p>SA hired in August to sell company                  Goal was to maximize proceeds while keeping entity intact in Pittsburgh                  Sale was completed to strategic buyer @ \$43MM in February 2004</p>

# Example - Project Tools

<p><b>Scenario</b></p>	<p>Family owned, 2<sup>nd</sup> generation controlled business            2003 Sales equaled \$60MM &amp; EBITDA was \$8MM; SA valuation was at \$40 to \$44MM            Company had no debt therefore value to owners equaled \$40 to \$44MM (\$43MM)            Company forecasted 3.7% growth over next 5 years; faced cyclicity risks            SA completed <i>Strategic Alternatives Review</i>            Company concluded acquisition strategy was optimal to meet objectives</p>
<p><b>Alternatives</b></p>	<p><b>Status Quo:</b> Estimated a 5 year IRR on \$42MM equity estimated at 12.4%</p> <p><b>Recap:</b> Estimated a dividend of \$30MM (75% of value) while giving up 15% warrant            Total debt to EBITDA of 3.75x            IRR on reinvested capital increased from 12.4% to 22.5%</p> <p><b>Acquisition:</b> Model one acquisition maximizing senior debt for \$41MM            5<sup>th</sup> year equity value increased from \$72MM to \$97MM            IRR on \$40MM equity increases from 12.4% to 19.2%</p> <p>Modeled second acquisition maximizing all debt (senior &amp; sub) @ \$71MM            Larger acquisition strategy eliminated as return on equity only rose to 22.5%</p> <p><b>Divestiture:</b> Sale to financial buyer estimated @ \$40MM; sale to strategic buyer @ \$44MM</p>
<p><b>Conclusion</b></p>	<p>SA hired to conduct acquisition search</p>

# Summary

Statistics	Prior Year
Sales	\$60.0
EBITDA	\$6.5

Value	Financial	Strategic
Enterprise Value	\$35.6	\$39.2
Less Debt	(\$4.3)	(\$4.3)
Equity Value	\$31.3	\$34.9

Alternative	Reinvested Equity	5th Year Equity Value	Return on Reinvested Equity	Equity PV at Hurdle Rate	Comments
<b>Status Quo</b>	\$31.3	\$60.6	14.1% (Hurdle Rate)	\$31.3	<ul style="list-style-type: none"> <li>Concentration of wealth remains</li> <li>Must continue to grow at 3.7%</li> <li>Does not diversify strategy</li> </ul>
<b>Recapitalization</b> \$19.5MM pre-tax dividend \$0.9MM transaction costs	\$31.3 (19.5) (0.9) \$10.9	\$36.4	24.8%	\$17.1 <hr/> 19.5 \$36.6	<ul style="list-style-type: none"> <li>Increases equity return via leverage</li> <li>Addresses concentration of wealth</li> <li>Conservatively utilizes mezzanine debt</li> <li>Retention of 85% economic equity</li> </ul>
<b>Acquisition</b> Purchase Price of \$30.7MM No synergies	\$31.3	\$74.8	19.0%	\$38.7	<ul style="list-style-type: none"> <li>Increases IRR through leverage</li> <li>Potential for diversification of earnings</li> <li>Could address Asian issue</li> <li>Concentration of wealth remains</li> </ul>
<b>Management Buyout</b> Sale to Mgmt. for \$31.3MM Financial Buyer price	NA	NA	NA	\$31.3	<ul style="list-style-type: none"> <li>Addresses concentration of wealth</li> <li>Allows for Management succession</li> <li>Keep company intact</li> <li>\$1.0MM required investment by Mgmt.</li> </ul>
<b>Divestiture</b> Sale to Strategic Buyer @ \$34.9MM	NA	NA	NA	\$34.9	<ul style="list-style-type: none"> <li>Goal is to keep the company intact</li> <li>Maximizes shareholder's current wealth</li> <li>Owners have reinvestment risks</li> </ul>

# Strategic Alternatives Review

## Benefits to Clients

- Establishes a five year baseline projection
- Determines market value of enterprise and ownerships' equity
- Brings management & owners together on an agreed projection
- Helps owners view their equity in their business as an “IRR portfolio asset”
- Begins process of long term financial planning by establishing goals & objectives
- Provides framework to explore strategic capital market alternatives
- Concludes with selection of agreed upon strategy

# Strategic Alternatives Review

## Timetable for completing the *Strategic Alternatives Review*

Execution of engagement letter

Due diligence

2 – 3 days

Industry research, Financial modeling & Valuation

2 weeks

Report preparation

1 week

Preliminary review with management

3 days

Final presentation to shareholders

1 day

Estimated time to complete

One month

# Professionals

## **Andrew R. Hays - Managing Director**

Prior to founding Strategic Advisors, Mr. Hays led Mellon's Strategic Advisors Group (MSA) which provided M & A and private placement advisory services. Under his leadership, MSA serviced the needs of Mellon's Middle Market client base. Prior experience includes three years as a Principal with Main Street Capital Holdings, Inc., a middle market private equity firm, and fifteen years at Westinghouse Financial Services as Vice President (Group Head) Asset Sales and Syndications, for the Corporate Capital Group where he was responsible for marketing its \$3.5 billion debt and equity portfolios. Other positions at Westinghouse Financial included Vice President, Corporate Finance and Vice President, Marketing, for the Asset Based Lending Group. Mr. Hays currently serves on the Board of Directors of St. Clair Hospital, Bridgeway Capital, Inc., AccuSpec Electronics, LLC, LTS Scale Company, LLC, and Sajar Plastics, LLC. He is a past president of the Pittsburgh Chapter of Association for Corporate Growth (ACG). and has also served on the Board of Directors for Mellon Financial Markets, LLC. FINRA Series 24, 7 and 63 licensed. B.A. Economics, Indiana University of Pennsylvania. M.B.A. University of Pittsburgh, Katz Graduate School of Business.

## **Andrew J. Bianco, CM&AA - Managing Director**

Prior to forming Strategic Advisors, Mr. Bianco was a Managing Director within the Mellon Strategic Advisors Group which provided merger & acquisition and private placement advisory services to its clients. At Mellon, he headed the Acquisition and Private Placement Group and grew fee income significantly. Mr. Bianco was responsible for originating and completing various acquisition, divestiture and corporate finance engagements. In addition to his technical expertise, Mr. Bianco has developed an extensive national network of lenders and investors. Other experience includes three years as a Principal with Main Street Capital Holdings, Inc., a middle market private equity firm, nine years at Westinghouse Financial Services and three years at Corporate Development Partners, Inc., a regional investment banking firm focused on merger & acquisition and private placement services to middle market companies. At Westinghouse Financial Services' Corporate Capital Group, he was intimately involved in establishing and providing private placement capabilities to the group and liquidity to its \$3.5 billion debt and equity portfolios and was directly involved in the sale of numerous investments including senior, mezzanine, equity and limited partnership interests. As a Managing Director and Principal at Corporate Development Partners, Mr. Bianco was responsible for originating and completing corporate finance engagements with middle market clients. Mr. Bianco currently serves on the Board of Directors for NABCO Incorporated LTS Scale Company LLC, and Sajar Plastics, LLC. M.S., Corporate Taxation, Robert Morris College. B.S., Accounting, Duquesne University. Certified in Mergers & Acquisitions by the AM&AA. FINRA Series 7 and 63 licensed.

# Professionals

## **Matthew M. Dalton, Associate**

Prior to joining Strategic Advisors, Mr. Dalton was a Corporate Development Analyst for Polyconcept, the global leader in the promotional products industry. While at Polyconcept, Mr. Dalton's chief responsibility was analyzing and evaluating potential acquisitions. In addition to this responsibility, he managed strategic projects geared towards enhancing the company's sales and profitability. Mr. Dalton has several years of experience in site development working as a civil engineer for Civil & Environmental Consultants, Inc. and STV Inc. Mr. Dalton was also a minor league pitcher in the Toronto Blue Jays Organization for two years. He has an M.B.A. from the University of Pittsburgh, Katz Graduate School of Business and a B.S. in Engineering from Virginia Tech. Series 7 and 63 licensed.

## **Matthew A. Steve, Associate**

Before joining Strategic Advisors, Inc., Matthew A. Steve worked as an Associate at Curtis Financial Group, a boutique investment bank in Philadelphia, PA. His major focus at Curtis Financial Group was M&A and capital raise advisory services for middle market firms. He also completed valuations for gift and estate planning, financial reporting and purchase price allocations. Prior to his position at Curtis Financial Group, Mr. Steve completed PNC Bank's Credit Training Program and worked as a Credit Officer for PNC's insurance and asset securitization credit group. Mr. Steve has an M.B.A. from the University of Pittsburgh, Katz Graduate School of Business and a B.S. in Financial Economics from Westminster College. Matt FINRA Series 7 and 66 licensed and is a CFA Level II candidate.

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