Objectives of Presentation

- Introduce *The Strategic Alternatives Review*
- Review examples of *The Strategic Alternatives Review*
- Review the benefits of *The Strategic Alternatives Review*
- Overview of Strategic Advisors, Inc.
The Strategic Alternatives Review - Approach

Objective:

- Provide a framework for middle market business owners ($20 to $200MM in sales) to explore the capital market alternatives available to meet their goals & objectives
- Establishes the owners’ current equity value as a “portfolio asset” on a “mark to market” basis

Strategic Alternatives:

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

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 Comps and Leverage Test)
- Develop other Strategic alternatives that meet shareholder objectives
- Summarize alternatives and review financial and business impacts of implementing each alternative
- Compare alternatives on the basis of wealth creation, risk, and meeting owners’ objectives
- Recommend and assist in selecting the most appropriate alternative
The Strategic Alternatives Review

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

- Illustration displays effect of returns on equity under various leverage scenarios
- Illustration assumes Enterprise Value equals 5x EBITDA- Typical WACC is 14- 16%
- IRRs are based on Current Market Equity Value & cash flows over 5 years including 5th year termination value
- Fully leveraged model used by most buyout funds

<table>
<thead>
<tr>
<th>Company WACC</th>
<th>Fully Invested</th>
<th>Leveraged 50%</th>
<th>Fully leveraged</th>
</tr>
</thead>
<tbody>
<tr>
<td>16%</td>
<td>16%</td>
<td>16%</td>
<td>16%</td>
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</table>

**Senior Multiple and Rate**
- No Leverage: 2.5x @ 6%
- Subdebt Multiple and Rate: 1.5x @ 18%
- Equity Multiple and Return: 1.0x @ 38%

**Subdebt Multiple and Rate**
- No Leverage: 2.5x @ 26%

**Equity Multiple and Return**
- 5.0x @ 16%
The 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 under leveraged entities, recap could be an alternative to sale
  - 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 liquefy up to 80% of equity while giving up little or no ownership
- 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 & management
- Buyers targeted determined by goals & objectives of owners
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) Assesses other stakeholder objectives
The Strategic Alternatives Review

Current Status

STATUS QUO ANALYSIS

SWOT Analysis
Industry Dynamics
Valuation
Other Stakeholders Objectives
Owners Objectives

5 Year Forecast

Status Quo

• No major changes
• Normal growth
• Base case
• 5 year forecast
• Current equity value
• Future equity value
• Determines 5 yr IRR
• Used as “hurdle rate”

Recap

• Tests debt capacity
• Max leverage figured
• Could use sub debt
• Diversifies holdings
• Min. equity dilution
• Max. current cash
• Retains control
• Reinvestment IRR

Acquisition Growth

• Models acquisitions
• Leverages equity
• Tests debt capacity
• Establishes criteria
• Max deal size
• 5 year forecast
• Determines 5 yr IRR
• Proj. wealth created

Divestiture

• Market comps
• Val: financial buyer
• Val: strategic buyer
• Max. current $$
• Diversifies all risk
### Example – Pinnacle Electronics – EMS contract manufacturer

<table>
<thead>
<tr>
<th>Scenario</th>
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</thead>
</table>
| Purchased by Main Street Capital (MSC) in 2001 for $7MM  
In 2003 Sales equaled $38MM & 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 |

<table>
<thead>
<tr>
<th>Alternatives</th>
</tr>
</thead>
</table>
| **Status Quo:** Estimated a 5 year IRR on equity at 14.8%  
**Recap:** 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% |

**Acquisition:** 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%  
5th year equity value increases to $136MM vs $77MM on Status Quo |

**Divestiture:** Sale to financial buyer estimated @ $37MM; sale to strategic buyer @ $41MM  
MBO not considered as manager desired exit |

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<tr>
<th>Conclusion</th>
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</table>
| SA hired in August to sell company  
Goal was to maximize proceeds while keeping entity intact in Pittsburgh  
Sale was complete to strategic buyer @ $43MM in February 2004 |
**Example - Project Tool**

**Scenario**  
Family owned 2nd generation controlled business  
2003 Sales equaled $60MM & EBITDA was $6.6MM; SA valuation was at $35MM to $39MM  
Company had $4.3MM of debt therefore equity value to owners equaled $31MM to $35MM  
Company forecasts 3.7% growth over next 5 years; faces cyclicality risks  
SA completed *Strategic Alternatives Review*  
Company concluded acquisition strategy was optimal to meet objectives

<table>
<thead>
<tr>
<th><strong>Alternatives</strong></th>
<th><strong>Status Quo:</strong> Estimated a 5 year IRR on $31MM equity value estimated at 14%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Recap:</strong></td>
<td>Estimated a dividend of $20MM (75% of value) while giving up 15% warrant</td>
</tr>
<tr>
<td></td>
<td>Total debt to EBITDA of 3.75x; IRR on reinvested capital increased from 14% to 25%</td>
</tr>
<tr>
<td><strong>Acquisition:</strong></td>
<td>Model one acquisition maximizing senior debt. Purchase price $31MM</td>
</tr>
<tr>
<td></td>
<td>5th year equity value increased to $75MM</td>
</tr>
<tr>
<td></td>
<td>IRR on $31MM equity increases from 14% to 19%</td>
</tr>
<tr>
<td><strong>Divestiture:</strong></td>
<td>Sale to financial buyer estimated @ $35MM; sale to strategic buyer @ $39MM</td>
</tr>
<tr>
<td><strong>MBO:</strong></td>
<td>Modeled Management Buyout at $31MM.</td>
</tr>
</tbody>
</table>

**Conclusion**  
SA hired to conduct acquisition search
## Example Summary of *The Strategic Alternatives Review*

<table>
<thead>
<tr>
<th>Statistics</th>
<th>Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$60.0</td>
</tr>
<tr>
<td>EBITDA</td>
<td>$6.5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Value</th>
<th>Financial</th>
<th>Strategic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise Value</td>
<td>$35.6</td>
<td>$39.2</td>
</tr>
<tr>
<td>Less Debt</td>
<td>$(4.3)</td>
<td>$(4.3)</td>
</tr>
<tr>
<td>Equity Value</td>
<td>$31.3</td>
<td>$34.9</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Alternative</th>
<th>Reinvested Equity</th>
<th>5th Year Equity Value</th>
<th>Return on Reinvested Equity</th>
<th>Equity PV at Hurdle Rate</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Status Quo</td>
<td>$31.3</td>
<td>$60.6</td>
<td>14.1% (Hurdle Rate)</td>
<td>$31.3</td>
<td>• Concentration of wealth remains</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Must continue to grow at 3.7%</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Does not diversify strategy</td>
</tr>
<tr>
<td>Recapitalization</td>
<td>$31.3</td>
<td>$36.4</td>
<td>24.8%</td>
<td>$17.1</td>
<td>• Increases equity return via leverage</td>
</tr>
<tr>
<td></td>
<td>$(19.5)</td>
<td></td>
<td></td>
<td>$19.5</td>
<td>• Addresses concentration of wealth</td>
</tr>
<tr>
<td></td>
<td>$(0.9)</td>
<td></td>
<td></td>
<td>$36.6</td>
<td>• Conservatively utilizes mezzanine debt</td>
</tr>
<tr>
<td></td>
<td>$10.9</td>
<td></td>
<td></td>
<td></td>
<td>• Retention of 85% economic equity</td>
</tr>
<tr>
<td>Acquisition</td>
<td>$31.3</td>
<td>$74.8</td>
<td>19.0%</td>
<td>$38.7</td>
<td>• Increases IRR through leverage</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Potential for diversification of earnings</td>
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<td></td>
<td>• Could address Asian issue</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>• Concentration of wealth remains</td>
</tr>
<tr>
<td>Management Buyout</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>$31.3</td>
<td>• Addresses concentration of wealth</td>
</tr>
<tr>
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<td></td>
<td></td>
<td></td>
<td>• Allows for Management succession</td>
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<td></td>
<td></td>
<td></td>
<td>• Keep company intact</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• $1.0MM required investment by Mgmt.</td>
</tr>
<tr>
<td>Divestiture</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>$34.9</td>
<td>• Goal is to keep the company intact</td>
</tr>
<tr>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>• Maximizes shareholder's current wealth</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Owners have reinvestment risks</td>
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</table>
The Strategic Alternatives Review

Benefits to Clients

- Establishes a five year baseline projection
- Determines market value of enterprise and ownership equity
- Brings management & owners together on an agreed upon 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
The Strategic Alternatives Review

Timetable for completing the Strategic Alternatives Review

Execution of engagement letter
On-site 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 Board of Directors 1 day
Estimated time to complete One month

Strategic Advisors’ Pricing

A) Stand Alone Project: $25,000 with 10% retainer

B) In context of an transaction engagement we are flexible