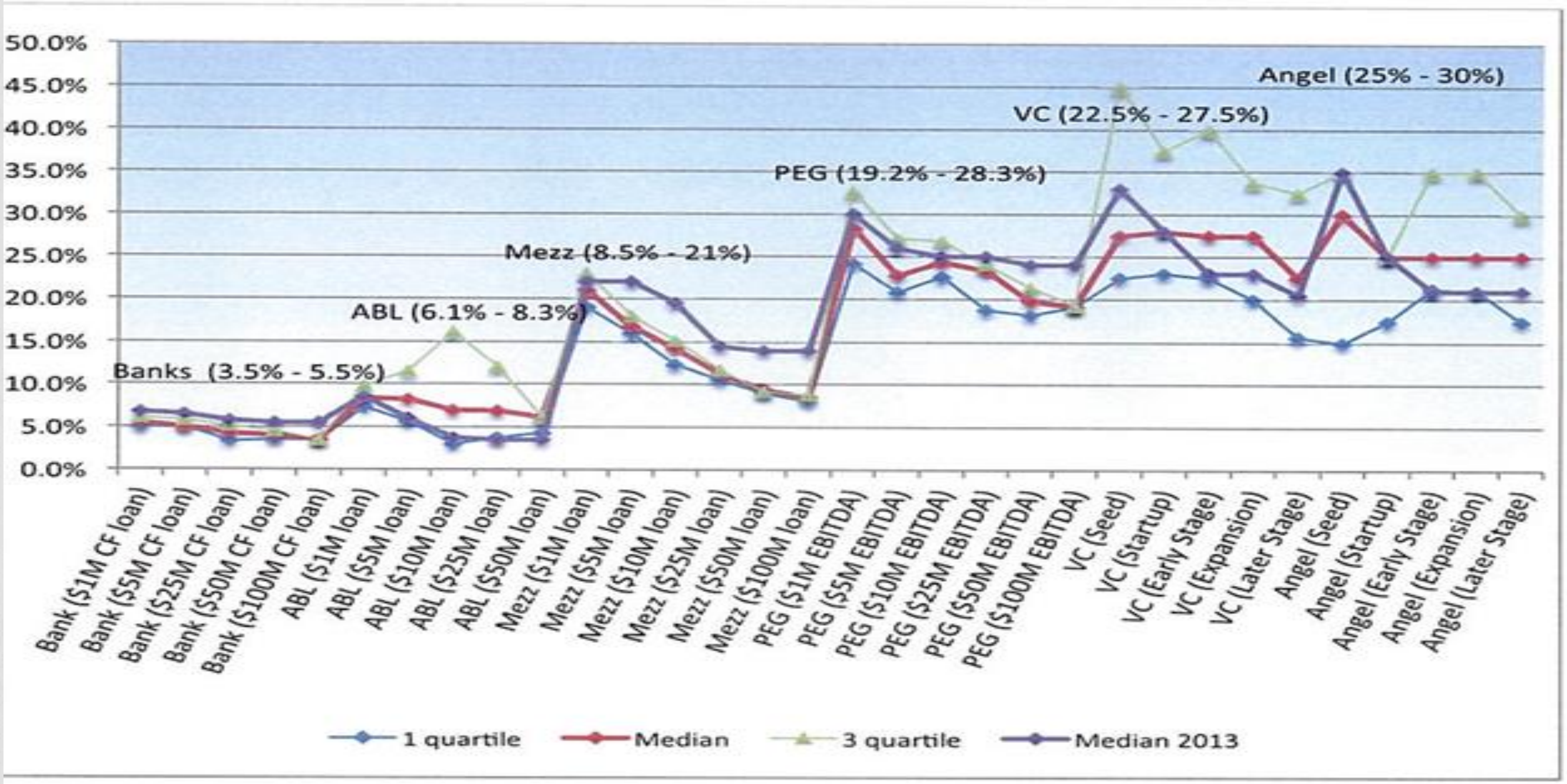
PRIVATE COMPANY ANALYSIS

2014 GENERAL OVERVIEW ECONOMIC & LITIGATION CLIMATE

PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
CAPITAL MARKETS REPORT – 2014
REQUIRED RETURN SURVEY



PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
CAPITAL MARKETS REPORT – 2014
QUALITATIVE RESPONSES

The majority of the 141 respondents to the investment banker survey indicated increasing margin pressure on companies over the last 12 months. They also reported slight increases in deal flow, increased presence of strategic buyers, leverage and deal multiples, and improved business conditions. Domestic economic uncertainty and taxes was identified as the most important current and emerging issue facing privately-held businesses.

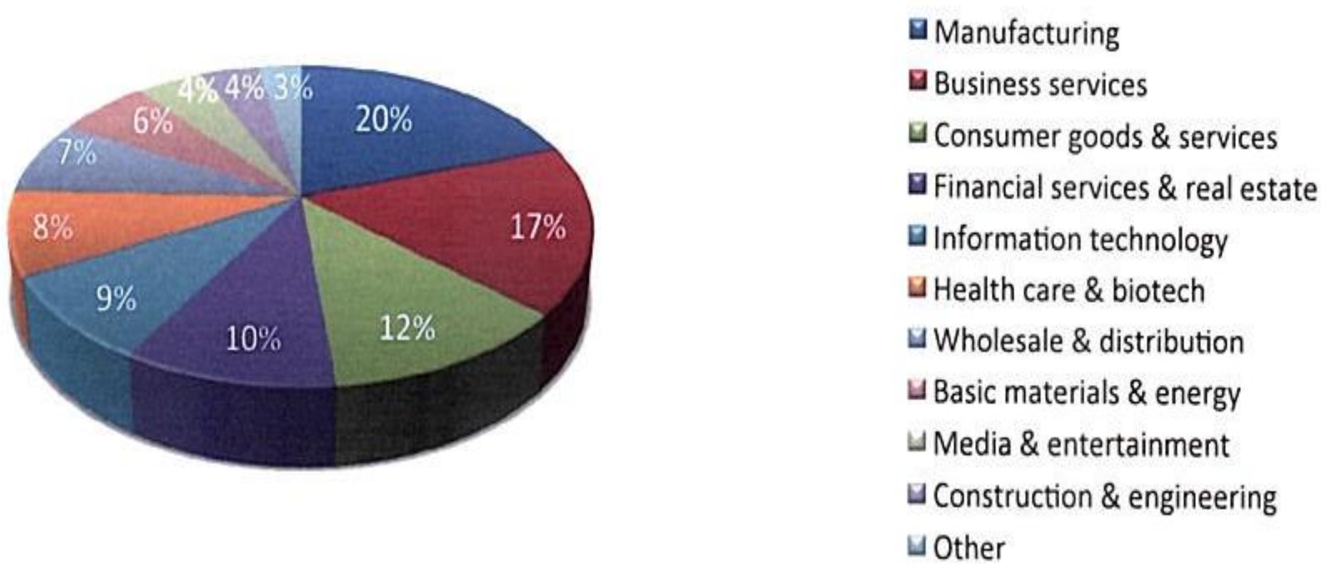
Other key findings include:

- Approximately 31 percent of respondents expect to close six or more deals in the next 12 months.
- The top three reasons for deals not closing were valuation gap (26 percent), unreasonable seller or buyer demand (21 percent), economic uncertainty (12 percent), and insufficient cash flow (12 percent).
- Respondents indicated a general imbalance between companies worthy of financing and capital available for the same. There is a reported shortage of capital for those companies with less than $10 million in EBITDA, but a general surplus for companies with $10 million in EBITDA or more.
- The most popular valuation methods used by respondents when valuing privately-held businesses were discounted future earnings and guideline company transactions approaches.
- When using multiples to determine the value of a business, the most popular methods used by respondents when valuing privately-held businesses were recast (adjusted) EBITDA multiple (58 percent), revenue multiple (13 percent) and EBITDA (unadjusted) multiple approaches.

PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
PRIVATE COMPANY TRANSACTIONS
MARKET SECTORS

Approximately 20 percent of all transactions closed in the last 12 months involved manufacturing, followed by 17 percent that involved business services, and 12 percent that involved consumer goods and services.

Figure 3. Business Types That Were Involved in the Transactions Closed in the Last 12 Months

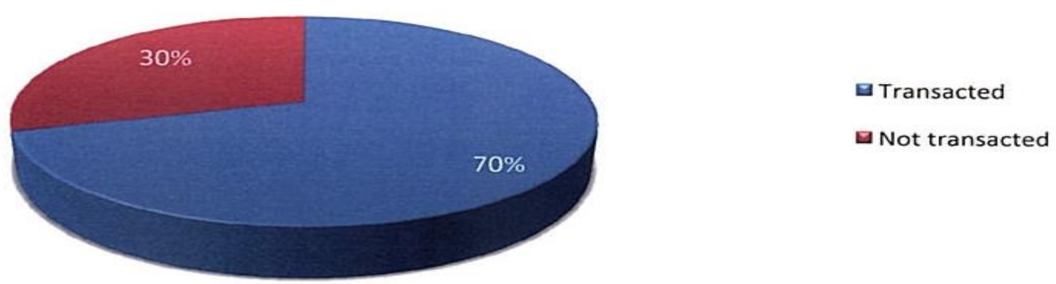


The majority of deals (68 percent) took 6 to 12 months to close. 10 percent of closed deals take more than one year to close.

PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
PRIVATE COMPANY TRANSACTIONS
DATA REGARDING TRANSACTIONS CLOSING

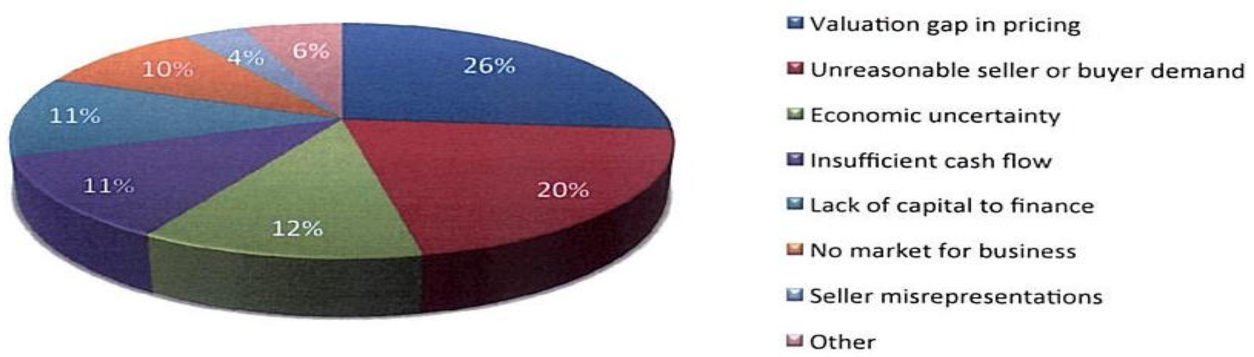
Approximately 30 percent of deals terminated without transacting over the past year.

Figure 6. Percentage of Business Sales Engagements Terminated Without Transacting



Top three reasons for deals not closing: valuation gap in pricing (26 percent), unreasonable seller/buyer demand (20 percent), and economic uncertainty (12 percent).

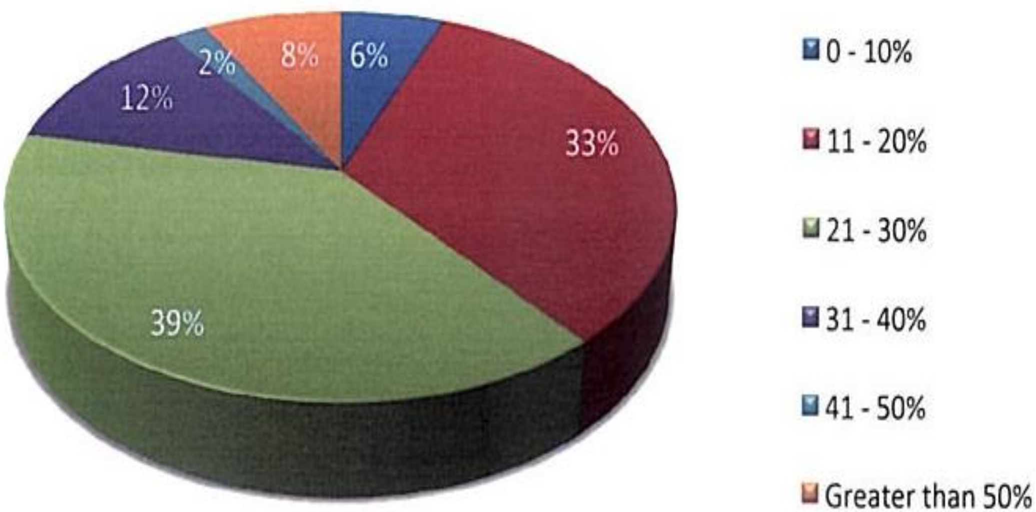
Figure 7. Reasons for Business Sales Engagements Not Transacting



PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
VALUATION GAP REGARDING
TRANSACTIONS THAT FAILED TO CLOSE

Of those transactions that did not close due to a valuation gap in pricing, approximately 39 percent had a valuation gap in pricing between 21 percent and 30 percent.

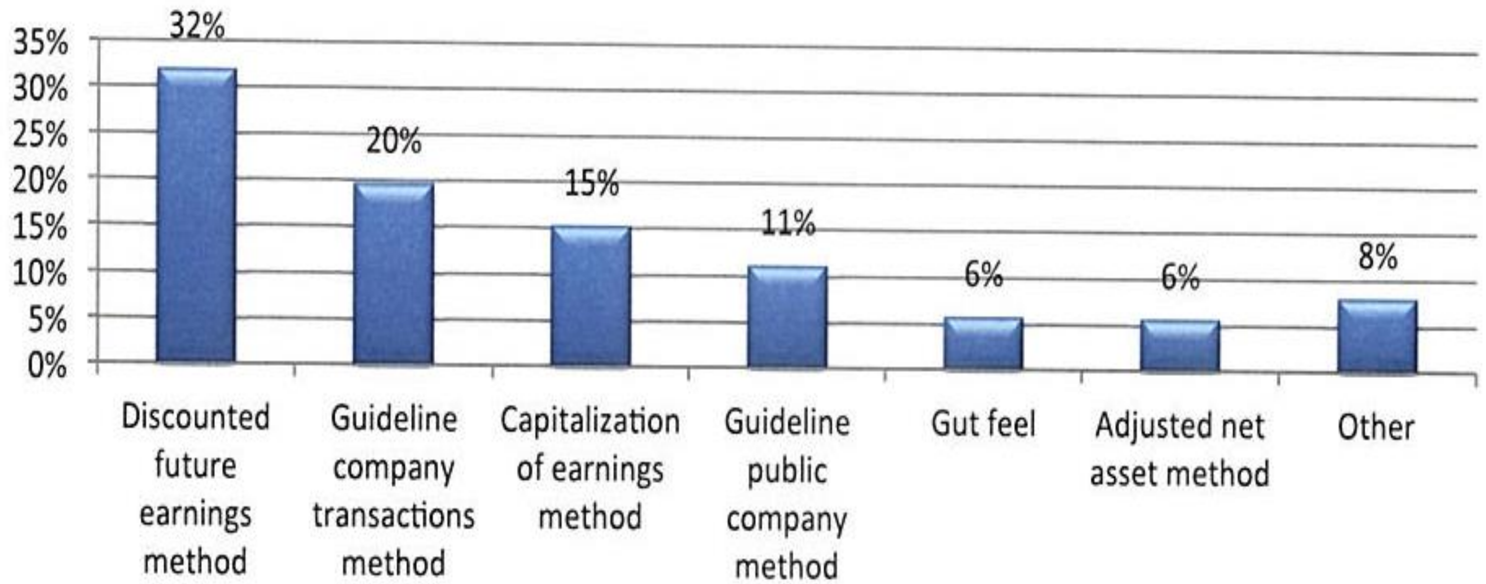
Figure 8. Valuation Gap in Pricing for Transactions That Didn't Close



PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
PRIVATE TRANSACTIONS
VALUATION METHODS EMPLOYED

The weights of the various valuation methods used by respondents when valuing privately-held businesses included 32 percent for discounted future earnings method.

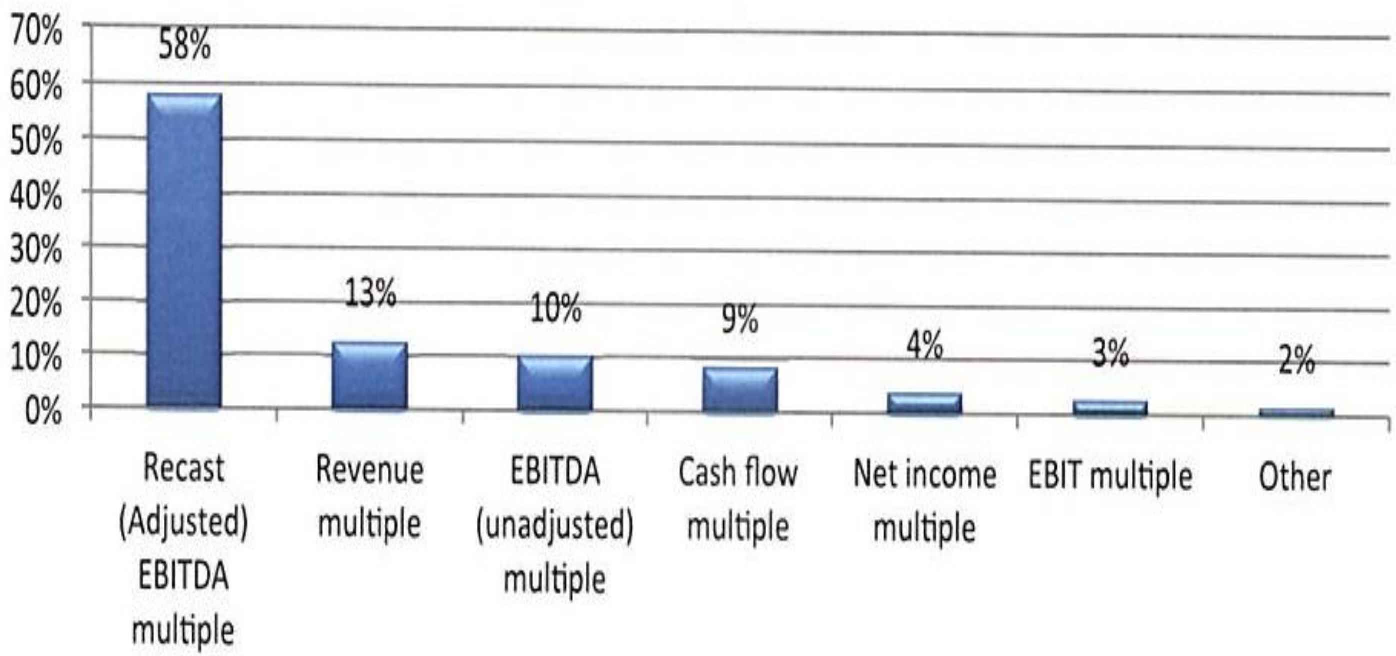
Figure 9. Usage of Valuation Methods



PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
PRIVATE TRANSACTIONS
VALUATION METHODS EMPLOYED
WEIGHTED BY USE

The weights of the various multiple methods used by respondents when valuing privately-held businesses included 58 percent for recast (adjusted) EBITDA multiple.

Figure 10. Usage of Multiple Methods



PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
INVESTMENT BANKERS PRIVATE TRANSACTIONS
EBITDA VALUATION MULTIPLES BY
ACQUIRER SIZE AND MARKET SECTOR

Average deal multiples on transactions from the prior 12 months as observed by respondents varied from 4.2 to 7.7.

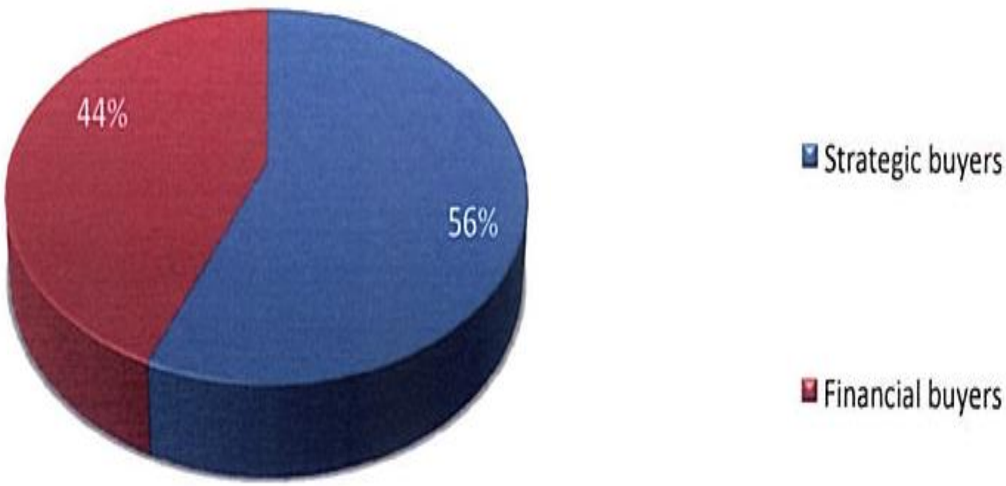
Table 2. Median Deal Multiples by EBITDA Size of Company

EBITDA	Manufacturing	Construction & engineering	Cons. goods & services	Wholesale & distribution	Business services	Basic materials & energy	Health care & biotech	IT	Financial services	Media & entertain.	**Avg.**
\$0M - \$1M	3.8	3	3.5	4	4	3.5	6	5	5	4	**4.2**
\$2M - \$5M	5.0	4.3	5.3	5	5	4.5	6	6	5.5	4.8	**5.1**
\$6M - \$10M	6.0	4.3	6.3	5.3	6	5	6	6	6.3	6.0	**5.7**
\$11M - \$25M	6	10	6.3	7	6.5	5.0	6.5	7.5	6.3	7.5	**6.9**
\$26M - \$50M	6.5	n/a	6.3	7.0	6.5	7	8.8	7.5	7	n/a	**7.1**
>\$50M	6.5	n/a	6.3	7	7.5	7	8.8	7.75	7.5	11	**7.7**

PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
TRANSACTIONS
STRATEGIC AND FINANCIAL

Approximately 56 percent of closed business sales transactions over the past 12 months involved strategic buyers.

Figure 12. Percent of Transactions Involved Strategic and Financial Buyers



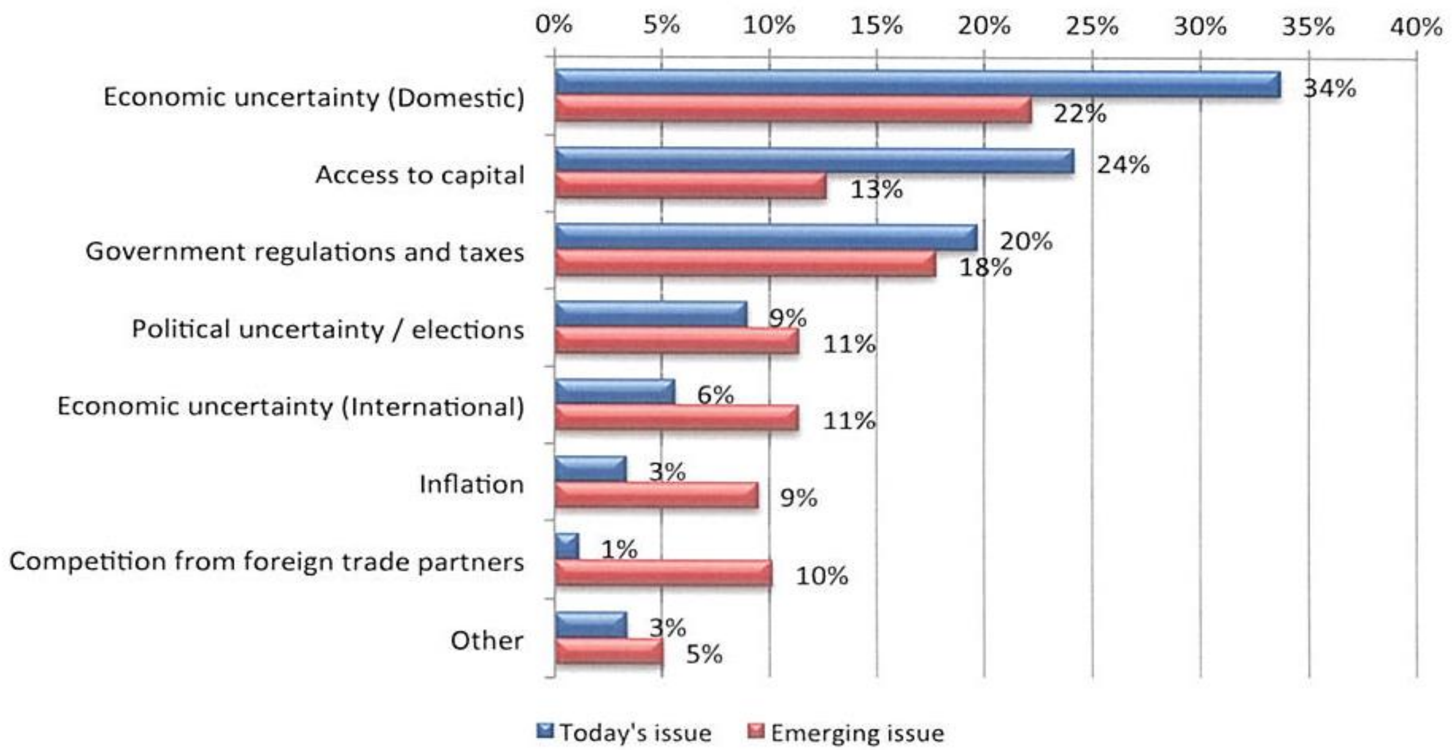
PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
TRANSACTIONS
2014 EXPECTATIONS

	Decrease significantly	Decrease slightly	Stay about the same	Increase slightly	Increase significantly	% increase	% decrease	Net increase/ decrease
Deal flow	2%	4%	33%	55%	6%	61%	6%	**55%**
Leverage multiples	0%	11%	50%	38%	0%	38%	11%	**27%**
Deal multiples	0%	8%	49%	42%	1%	42%	8%	**34%**
Amount of time to sell business	0%	13%	68%	17%	3%	19%	13%	**7%**
Difficulty financing/selling business	0%	22%	61%	14%	3%	17%	22%	**-5%**
General business conditions	3%	9%	43%	44%	2%	45%	12%	**33%**
Strategic buyers making deals	0%	3%	49%	44%	3%	48%	3%	**44%**
Margin pressure on companies	0%	10%	58%	29%	3%	32%	10%	**23%**
Buyer interest in minority transactions	6%	7%	70%	15%	2%	17%	13%	**4%**

PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
TRANSACTIONS
2014 ISSUES PRIVATE BUSINESSES

Respondents believe domestic economic uncertainty is the most important current and emerging issue facing privately-held businesses.

Figure 15. Issues Facing Privately-Held Businesses



PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
PRIVATE EQUITY
VALUATION MULTIPLES

Deal multiples vary from 2.8 to 7.5, the highest multiples are indicated in consumer goods and services.

Table 12. Deal Multiples Among Industries (medians)

	$1M EBITDA	$5M EBITDA	$10M EBITDA	$15M EBITDA	$25M EBITDA	**Average**
Manufacturing	5.5	5.5	5.5	6.8	n/a	**5.8**
Construction & engineering	4	4.3	n/a	n/a	n/a	**4.2**
Consumer goods & services	6.5	6.5	7.5	7.5	7.5	**7.1**
Wholesale & distribution	3.5	3.5	4.5	7	n/a	**4.6**
Business services	4.8	5	5	7.3	7.5	**5.9**
Basic materials & energy	2.8	4	n/a	4.5	n/a	**3.8**
Average	**4.5**	**4.8**	**5.6**	**6.6**	**7.5**	**5.8**

PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
PRIVATE EQUITY
FINANCING ISSUES

Most of the respondents believe the number of companies "worthy of financing" exceeds "capital available" for the companies with less than $10M in EBITDA;whereas, for the larger companies, "capital available" exceeds the number of companies "worthy of financing."

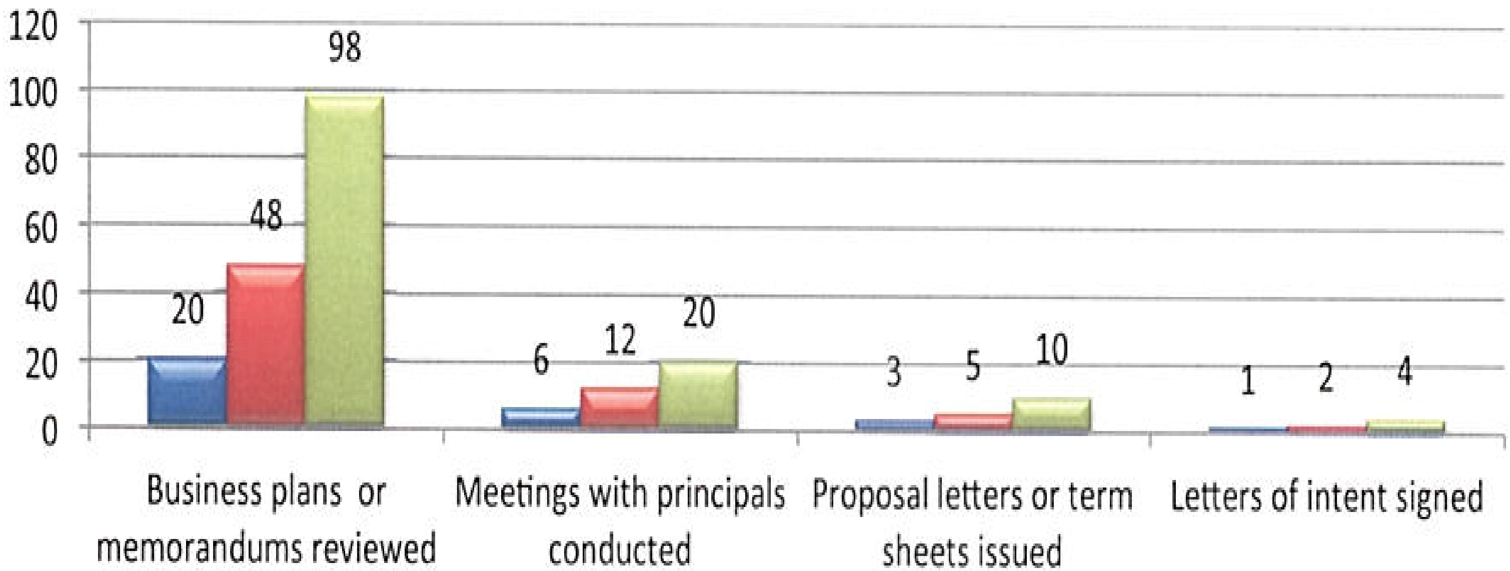
Table 13. The Balance of Available Capital with Quality Companies for the Following Size

	Companies worthy of financing GREATLY exceed capital available	Companies worthy of financing exceed capital available	General balance	Capital available exceeds companies worthy of financing	Capital available GREATLY exceeds companies worthy of financing	**Score (-2 to 2)**
$1M EBITDA	26%	36%	15%	15%	8%	**-0.6**
$5M EBITDA	10%	33%	21%	23%	13%	**-0.1**
$10M EBITDA	0%	22%	30%	30%	19%	**0.5**
$15M EBITDA	0%	11%	35%	27%	27%	**0.7**
$25M EBITDA	0%	14%	22%	38%	27%	**0.8**
$50M EBITDA	0%	11%	20%	40%	29%	**0.9**
$100M EBITDA	0%	15%	15%	35%	35%	**0.9**
> $100M EBITDA	3%	12%	21%	30%	33%	**1.1**

PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY
PRIVATE EQUITY
DEAL ISSUES AND ATTRIBUTES

Respondents reported on items required to close one deal.

Figure 24. Items Required to Close One Deal



LITIGATION
VALUATION ISSUES IN CASES

- **Unrealistic Growth Projections**
- **Unreliable Financials**
- **Inconsistent Internal Assumptions**
- **Failure to Identify, Examine, and Test Robustness of Assumptions**
- **Failure to Appropriately Identify and Discount Company-Specific Risks**
- **Lack of Comparability or Similarity Between or Among Comparable Companies**
- **Inappropriate Adjustments to Reported Financial Statements**
- **Qualitative Analysis and Narrative at Variance with Valuation Conclusions**
- **Lack of Adequate Consideration to Previous Offers or Comparable Transactions**
- **Issues Related to Control Premiums**
- **Lack of Consideration Regarding Size and Application of Marketability Discount**
- **Lack of Consideration Regarding Size and Application of Minority Discount**
- **Illogical and Confusion Regarding Valuation Methodologies**

LITIGATION
GENERAL ISSUES REGARDING SELECTED CASES

- **Reasonableness of Management Assumptions:** ***BCC Capital, Maran Corp, Sierra Aluminum***
- **Employment Related Agreements with Sellers:** ***McKay Corp, Parrot Cellular***
- **FMV of ESOP Note Used to Pay for Stock:** ***Hans, Inc.***
- **Control Premiums:** ***Rembar Corp and Sierra Aluminum***
- **Plan and Stock Restrictions Impact on Fair Market Value:** ***Hollister Inc*.**
- **Transaction Complexities:** ***Tribune Group***
- **ESOP Company Indemnification of ESOP Fiduciaries:** ***Sierra Aluminum***
- **Failure to Investigate Credibility of Financial Forecast:** ***GreatBanc Trust and Sierra Aluminum***
- **Valuation Price Excessive:** ***People Care Holdings***

LITIGATION: REMBAR INC.
CASE FILED JULY 17, 2012

BACKGROUND: ESOP Purchased 100% of Construction Firm in 2007 for $16 Million. Valuation Firm Used a Control Premium of 25%

ISSUE: Who Actually Exercised Control of Control in Fact vs. Majority Ownership

DEPARTMENT OF LABOR ARGUMENTS:

- Cash Flows Were Valued Using Controlling Basis so Control Premium Was Duplicative
- Legal Documents Left Control with Seller Until ESOP Notes were Satisfied, so ESOP was Left Without Unilateral Control
- Trustee Failed to Ensure that Valuation Firm had Accurate and Complete Financial Data and Inaccurate or Erroneous Information was Included in Financial Forecast

Litigation: Miller Health Systems, Inc.
Case Filed January 2, 2014

BACKGROUND: ESOP Purchased 100% of Assisted Living Care Facility in 2007 for $40 Million.

ISSUE: Discounts and Other Contingent Issues

DEPARTMENT OF LABOR ARGUMENTS:

- Earn-Out Agreement and Related Factors
- Incentive Stock Options and Impact on Value
- Seller Note Interest Rate
- Governance Agreement
- Flaws in Valuation Including 1)No Discount for Lack of Marketability, 2) No Discount for ESOP Lack of Control, 3) Failure to Adequately Account for Earn-Out, and Failure to Adequately Account for Incentive Stock Options

LITIGATION: MARAN CORP.
CASE FILED NOVEMBER 28, 2012

BACKGROUND: ESOP Purchased 49% of Apparel Company in 2006 for $71 Million.

ISSUE: Valuation

DEPARTMENT OF LABOR ARGUMENTS:

- Aggressive and Optimistic 5-Year Financial Forecast
- Forecast Served as Basis for Valuation
- Forecast Not Supported by Historical Performance
- Inappropriate Reliance on Comparable and Guideline Company Valuations

LITIGATION: SJP GROUP
CASE FILED JULY 17, 2012

BACKGROUND: ESOP Purchased 38% of a Paving Company in 2007 for $16 Million.

ISSUE: Valuation

DEPARTMENT OF LABOR ARGUMENTS:

- Arguments Center on Accuracy and Veracity of Financial Information Used by Valuation Firm

LITIGATION: OMNI GROUP
CASE FILED NOVEMBER 18, 2013

BACKGROUND: ESOP Purchased 38% of a Information Technology Co. for $13.7 Million.

ISSUE: Valuation

DEPARTMENT OF LABOR ARGUMENTS:

- Valuation Was Completed in August of the Year of the Transaction However, the Transaction Closing Date was December
- Valuation Methods

LITIGATION: ANTIOCH CORP.
CASE FILED MAY 14, 2014

BACKGROUND: ESOP Purchased 100% of Company, But Sellers Maintained Control. Also Put Option Held by Sellers Created Liquidity Crisis When Valuation Was Higher Than Transaction Price

ISSUE: Put Option Was Not Adequately Accounted For in the Valuation

DEPARTMENT OF LABOR ARGUMENTS:

- Control Remained With Sellers
- Put Option Was Not Adequately Considered in Valuation
- Put Option was Global with Significant Financial Attributes Not Considered

LITIGATION: ARMSTEAD CORP.
2006 CASE REMANDED

BACKGROUND: ESOP Had a Put Option That Forced Company to Purchase Stock

ISSUE: Put Option Was Not Adequately Accounted For in the Valuation as Stock was Put to Company and Created a Liquidity Crisis and Threatened Ongoing Operations

DEPARTMENT OF LABOR ARGUMENTS:

- Put Option Was Not Adequately Considered in Valuation Regarding Impact on Liquidity and Ongoing Operations Given the Scope and Magnitude of Terms of Put Option
- Discount for Lack of Marketability was Not Afforded Sufficient Consideration Given Potential Magnitude of Put Option

LITIGATION: TRACHTE BUILDING SYSTEMS CASE REMANDED

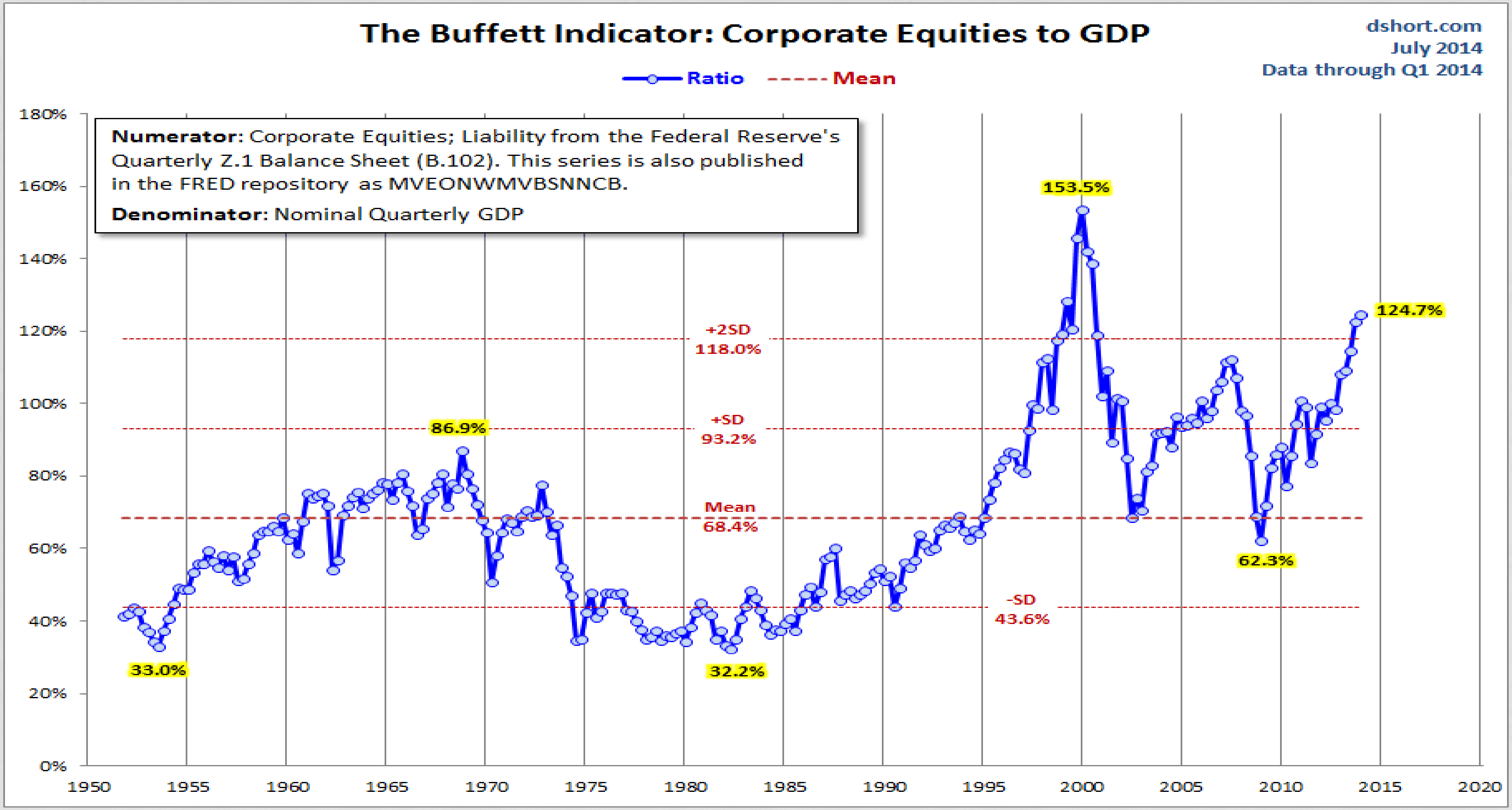
BACKGROUND: Impact of Phantom Stock Plan and Valuation Impact

ISSUE: Company Had a Phantom Stock Plan and Impact was Not Adequately Considered in Valuation

DEPARTMENT OF LABOR ARGUMENTS:

- Phantom Stock Plan was Not Adequately Considered in Valuation
- Marketability Impact on the Stock Related to Phantom Stock Plan

STOCK MARKET VALUATION
AND
GROSS DOMESTIC PRODUCT (GDP)



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QUESTIONS?

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