XPX NEW YORK
EXIT PLANNING EXCHANGE

2016-2017 Case Study

To: Advisory Team

From: Fred Coyne, Partner
HiTech Service Co.

RE: Planning for the Future

Thank you again for your time this morning. I am glad that our mutual friend put us together!

Based on our conversation, I think we are prepared to move forward and start to plan the next phase in our business and prepare us for a transaction in a couple of years. We are glad to have you on the team!

As promised, below is some background information that will give you a bit more color so that you can understand our situation and objectives.

<u>Business Overview:</u>
HiTech Service Co ("HiTech") provides specialized business technology solutions for the high-tech industry. Essentially, we rebuild and supplement medium sized data rooms for our clients with a mix of server equipment helping them utilize the most cost effective solution customized for their needs. While we don't install the equipment, we are the 'go-to' source for either new, but recently discontinued products (2-5 years old) that are no longer supported by the authorized channel or gently used equipment. There is still a huge need in the market place because of the large installed base of similar products, but these products are not generally available through traditional channels. Think about a large corporate client that has multiple data rooms around the globe that wants to expand their capacity. They can either rip out all the existing infrastructure, spending millions to upgrade to the newest technology or they can buy recently discontinued products from us for pennies on the dollar to simply add the required new capacity while still utilizing their existing technology platform.

We have offices in both the US (headquarters and most of the operations) and UK (warehouse and distribution only servicing the rest of the world), and source products from all over the world (sell and source in 26 countries). We are well known in the industry, but we certainly have a bunch of competition. People choose us because of our lower prices (because we mix in some gently used equipment), our availability of hard to find products (because of our global sourcing) and our ability to deliver on time.

The business was formed nearly 20 years ago by three of us – all of whom are best friends from college – when we worked together for another company for about 10 years. We ended up buying the business from the retiring owner about 10 years ago at an 'insider' price after we made him a ton of money for years. Now we work for ourselves and are having a blast.

A few years ago, we added two new partners. So now we own the business as follows:
- Fred Coyne - 25%
- John Coyne- 25% (my younger brother)

- Bill Cashin – 25%
- Francis Moulah – 15% (promoted from sales)
- Art Dougherty – 10% (whom we promoted from the warehouse)

We run the business as a true partnership. We all sit in the bull-pen with the rest of the team, we collaborate on every decision and all have an open policy. This way we can collaborate on every sales or purchasing decision and make them quickly. There are no secrets here. We each are committed to staying with the business – with the right partner – as we think we all have about 10 good years left before we all want to retire (we are all in our early to mid-50s). There are no kids in the business as most are still in college or younger and none of them have shown any real interest in the business – at least not yet.

You wanted to have some overview financials, so I have attached a couple of high-level reports.

As you know, we recently ran a process trying to sell the business. Unfortunately, we were less than successful. We hired a good investment bank, referred to us by both our auditors and legal counsel. After an extensive search (our investment bank approached 30+ strategic buyers and 100+ private equity funds) we received a number of offers – all from private equity investors. We heard that the M&A market was very strong, but either it didn't apply to our Company or we caught the wave after it already got to shore. While the valuations we saw were 'fair', none of them were really attractive. We ended up passing on all of them.

The strategic buyers were worried about our concentration in one brand name (about 70% of our business is based on Hewlett Packard technology) and our flat management structure. Our concentration is really just the result of a great relationship with HP and it was the easiest way to grow. We have tried to diversify, but it has not been a core focus for any of us. We know HP like the back of our hands, so it has been pretty easy.

Also, we went down the road with one strategic buyer, and while they loved our global sourcing, we procure much of our products from their competitors, and sell to them too, so there was a fear that we would lose both revenue and our core source of products if we were acquired as the competitors would not sell / buy from the 'other big guy' in the industry.

As for the private equity investors, either they didn't share our vision or they were undervaluing our potential. We have been growing fairly consistently at 10-15% per year for more than 10 years. Yes, we had an abnormally good year in 2014 because of a new high-profile client (who is now about 20% of our revenue), so last year's growth looks like it was flat, but if you look at the long run, we have a really steady business. We have no debt, a strong balance sheet and plenty of room for growth. There was too much focus on TTM EBITDA rather than long term performance and our brand name. Furthermore, some of the investors were convinced that the technology was changing quickly and that sales of these old servers (specifically HP) will be phased out. We know the industry well – it has been in a constant state of change for 30 years, and we profit because of it. How do we prove that the market will continue to be there for these products that the HiTech will continue to grow as it has for 30 years?

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One lingering challenge that you should be aware of: Bill is thinking about retiring shortly. His performance has certainly been lacking over the past few years, but he has been with us since the beginning so perhaps we have been a bit too lenient. The other owners were hoping to use the transaction to transition Bill out of the business. Today, because the deal did not close, we would like to buy him out. The market gave us valuation data point, and we were hoping to buy him out at a discount to that price for his minority stake. However, his valuation for his stake of the business is much higher than the amount that we just turned down from the market. We want to be fair to him, but we need to bridge the gap somehow. We are not sure what to do or where to get the cash to buy him out.

So, given this background, we are committed to focusing back on our business, learning from this experience, and fix our business to make it salable in a few years. We heard from the buyers about a couple of priorities:

- Streamline our management structure to be a bit more professional – We tend to work in our business and not on our business. We have not talked about it as a team, but I am willing to step up and take the lead. This is more because everyone here is focused on the day-to-day operations of buying and selling products but I would welcome the change.
- Improve our front end operations to be more scalable – We still do a lot of our costing and bidding with spreadsheets and manual processes that I think can be automated. The one limitation to our growth is that there are simply not enough hours in the day to process the orders. One of the interested investors thought that we might be able to use technology to simplify our processes, but we have no experience in this area. We recently put in a new accounting and ERP system which was hard enough, so I think we feel that what we have works well enough.
- Make our back office more scalable - We do just about everything out of this one office, but we should explore expanding into the West Coast, more distribution in the EU and expand into Latin America. We don't need a ton of CapEx, but rather more people, particularly skilled technicians.
- Add in more sales and sourcing professionals to diversify our brand concentration. We especially need international sales people and those that specialize in Dell, IBM and other high tech names. Having done this for 20 years, we know everyone in the industry so it should not be all that hard. We already hired a new guy a couple of months ago, and hope that he starts to produce pretty soon.
- We have several companies that we compete against that are much smaller than us, but often win deals in their particular niches. We know of a couple that would be willing to sell to us at the right price. We have never done an acquisition and are unsure of the risks and the rewards. We have faith in the industry and would be willing to make an acquisition to grow, but would that pay off in the end?

I think we have enough capital and cash flow to get through all of these investments as we have plenty of cash on our books, but want to make sure we have enough money to purchase inventory, which is the lifeblood of our company. How can we look at how much we might need? How much can we borrow? Should we think about approaching the debt and minority equity markets? What do you think it will cost? What will we need to give up to get the right investor?

The real question is: How do we get started? What should be our priorities?

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We look forward to getting together with you and your team on helping us prepare for a successful exit in a few years.

Thanks for your time and your advice.

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HiTech

(US$ Thousands)	2012	2013	2014	2015	2016	2017	2018	2019
	Actual	*Actual*	*Actual*	*Actual*	*Projection*	*Projection*	*Projection*	*Projection*
Net Sales	$26,751	$29,560	$28,318	$31,632	$34,795	$38,274	$42,102	$46,312
Growth	*16.4%*	*10.5%*	*-4.2%*	*11.7%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*
Cost of Sales	20,089	22,437	19,640	22,734	25,226	27,749	30,524	33,576
Gross Profit	6,662	7,123	8,678	8,898	9,569	10,525	11,578	12,736
Gross Margin	*24.9%*	*24.1%*	*30.6%*	*28.1%*	*27.5%*	*27.5%*	*27.5%*	*27.5%*
Salary	1,637	1,808	1,732	1,935	2,129	2,342	2,576	2,833
Guarenteed Payments	850	850	850	850	850	850	850	850
Travel	155	162	171	172	181	190	199	209
Rent & Related	402	347	360	365	383	402	423	444
Insuracne	205	142	118	119	125	131	138	145
Other	410	524	528	538	565	593	622	654
Operating Expenses	3,657	3,834	3,759	3,979	4,232	4,508	4,808	5,135
Income From Operations	3,004	3,289	4,919	4,919	5,336	6,018	6,770	7,601
Operating Margin	*12.6%*	*11.9%*	*19.3%*	*17.7%*	*15.5%*	*15.6%*	*15.8%*	*15.9%*
Interest Income	0	0	0	0	0	0	0	0
Interest Expense	(32)	(22)	(1)	0	0	0	0	0
Other Income (Expense)	(32)	(22)	(1)	0	0	0	0	0
Net Income	$2,972	$3,267	$4,918	$4,919	$5,336	$6,018	$6,770	$7,601

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(US$ Thousands)	2012	2013	2014	2015	2016	2017	2018	2019
	Actual	*Actual*	*Actual*	*Actual*	*Projection*	*Projection*	*Projection*	*Projection*
Assets								
Cash	$1,464	$1,372	$2,413	$2,783	$7,051	$11,744	$16,847	$22,394
Accounts Receivable (net)	2,660	2,935	2,032	2,236	2,413	2,603	2,809	3,031
Inventories, net	2,198	2,823	2,567	2,916	3,226	3,481	3,756	4,053
Prepaid Expenses	166	105	133	139	152	163	175	187
Current Assets	6,488	7,234	7,145	8,074	12,842	17,992	23,587	29,666
Computers & Equipment	282	282	282	282	282	282	282	282
Furniture & Fixtures	174	174	174	174	174	174	174	174
Leasehold Improvements	183	183	183	183	183	183	183	183
Total PP&E	639	639	639	639	639	639	639	639
Less: Accumulated Depreciation	(610)	(631)	(639)	(639)	(639)	(639)	(639)	(639)
Property, Plant & Equipment	30	8	-	-	-	-	-	-
Total Assets	6,518	7,242	7,145	8,074	12,842	17,992	23,587	29,666
Liabilities and Equity								
Accounts Payable	$1,261	$1,210	$674	$766	$852	$919	$992	$1,070
Accrued Expenses	181	221	226	236	259	277	297	318
Current Portion of LT Debt	333	363	-	-	-	-	-	-
Current Liabilities	1,775	1,794	900	1,002	1,110	1,196	1,288	1,388
Term Note	363	163	-	-	-	-	-	-
Long Term Liabilities	363	163	-	-	-	-	-	-
Total Member Equity	4,380	5,285	6,245	7,072	11,731	16,796	22,299	28,278
Total Liabilities and Equity	$6,518	$7,242	$7,145	$8,074	$12,842	$17,992	$23,587	$29,666