Successful Planning and Exit Strategies for Government Contractors in 2014 and Beyond

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Building Shareholder Value in Today's Government Services Market

March 25, 2014

ARONSON
CAPITAL PARTNERS

Aronson Capital Partners
INVESTMENT BANKING

Agenda

1. **I. Federal Market Overview and M&A Trends**
2. II. Value Creation Strategies
3. III. Introduction to Aronson Capital Partners

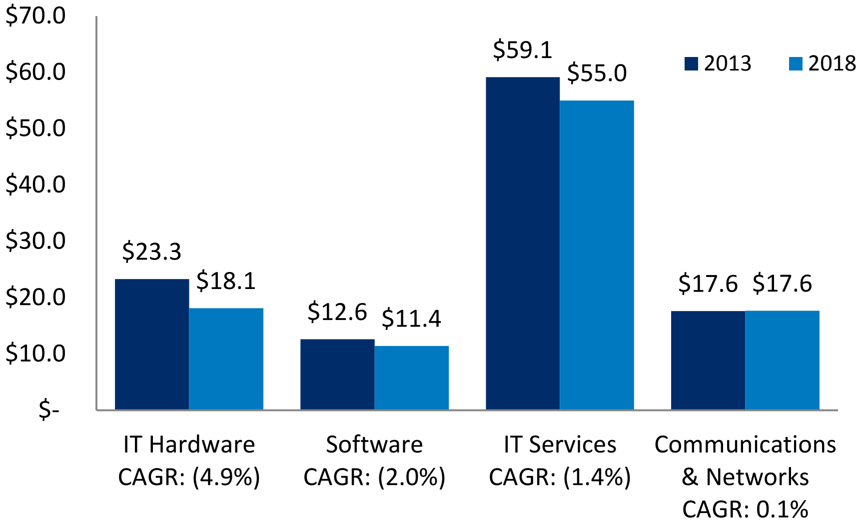
Government Services Market Headwinds

Trends

- ❑ Federal IT spending is forecasted to decline at a 1.9% CAGR from FY 2013 – 2018 (i.e. $112B to $102B)
- ❑ Contract award activity is weak due to budget/federal acquisition issues and an increase in the amount of protests; new procurements are being delayed which is leading to depressed backlogs and stagnant revenue
  - The shutdown exacerbated these issues and led to loss of revenue for many contractors
- ❑ Fewer awards, continued award delays, and further pressure on growth and margins will likely result in underperformance of contractors relative to the market over the next year
  - Full impact of sequestration will not be felt until *at least* 2016
- ❑ Feasibility and cost effectiveness reviews of major IT programs have already led to IT program cuts
- ❑ Intensified competition, tighter pricing and narrower margins as low price technically acceptable (“LPTA”) procurements reign

Federal IT Market:

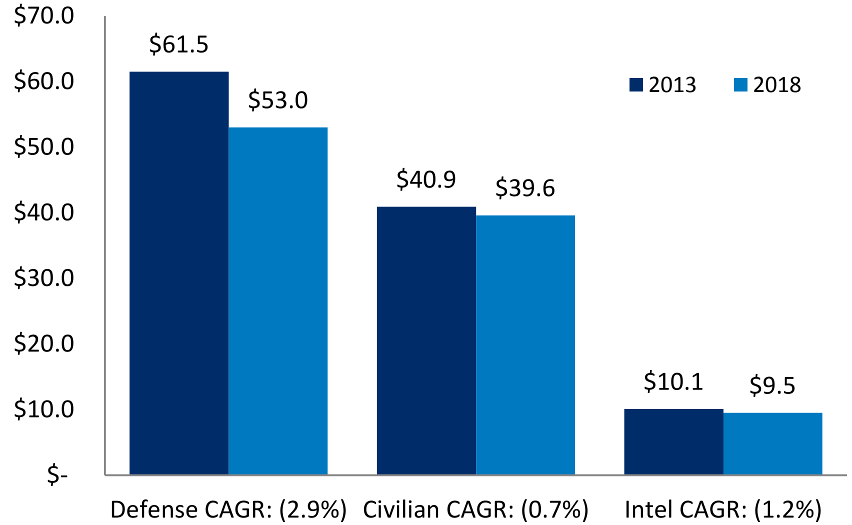
Component Market Size & Growth Rates ($ in billions)



Source: INPUT

Federal IT Market:

Customer Market Size & Growth Rates ($ in billions)

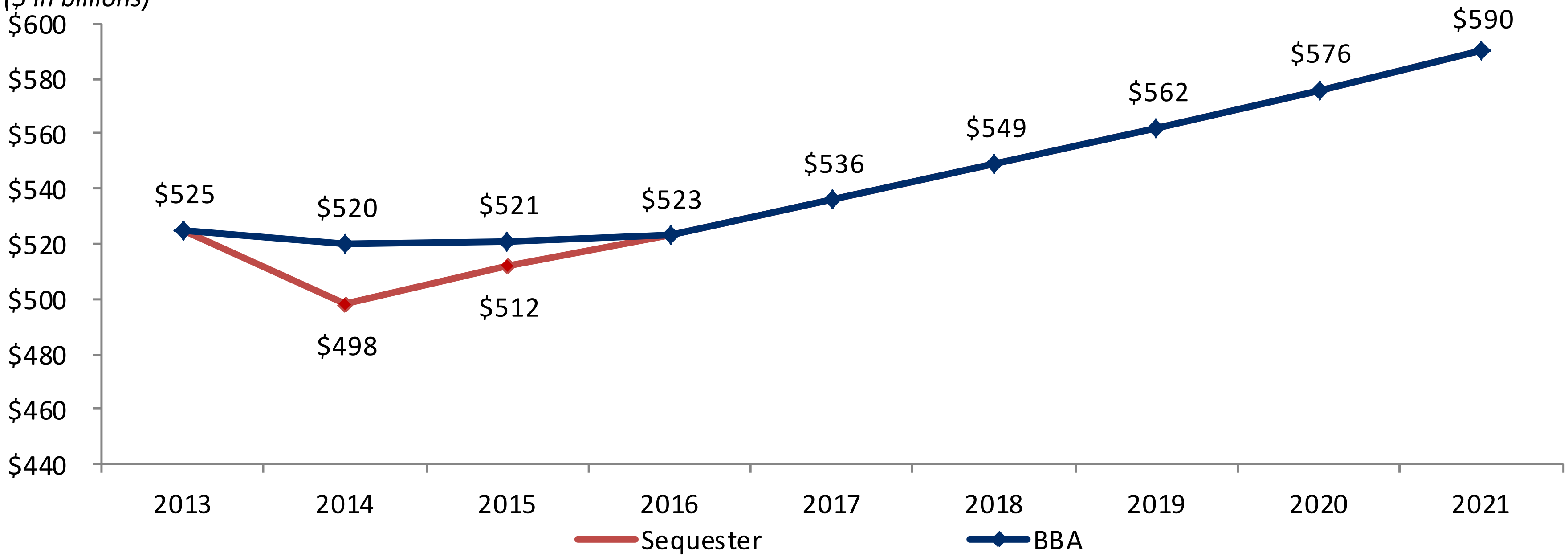


Defense Spending Environment

- The Bipartisan Budget Act ("BBA") of 2013 has provided needed visibility into GFY 2014 and 2015 and has allowed the DoD to significantly reduce the amount of anticipated cuts in technology, operations and maintenance and other areas of discretionary spending
  - $63B of total sequester relief for 2014 & 2015, split evenly between defense and non-defense programs
- The across-the-board spending cuts of sequestration have been replaced with the BBA's method of less drastic reduced spending levels and greater agency authority over resource allocation
- Defense contractors will continue to seek acquisitions in order to reposition their portfolios into higher growth market segments as global defense spending continues to decline due to the close out of efforts in Iraq and Afghanistan

Defense Spending: BBA vs Sequestration

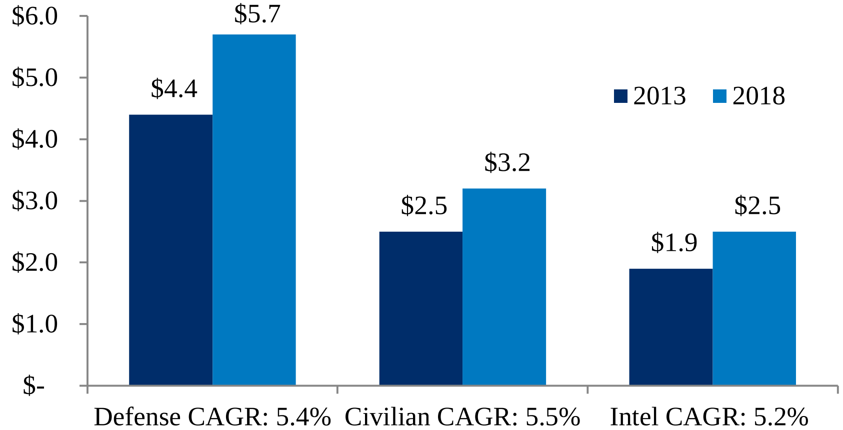
($ in billions)



Priority Markets: Sizing and Forecast

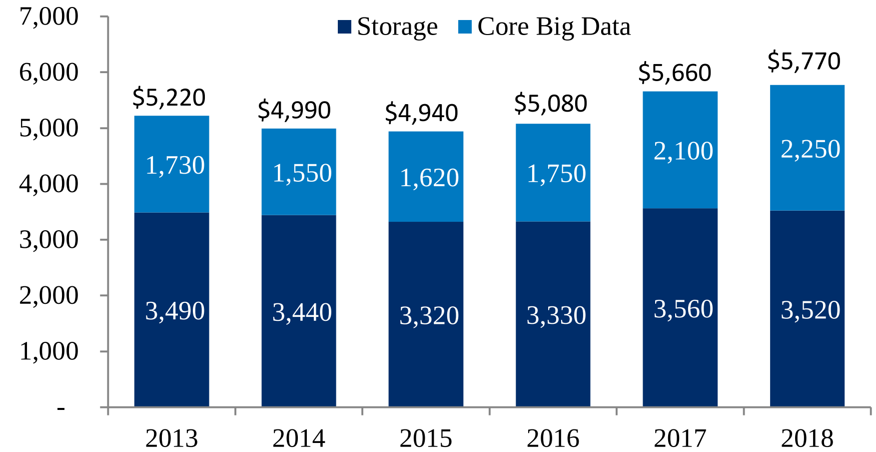
Cyber Security

Customer Segments
(S in billions)



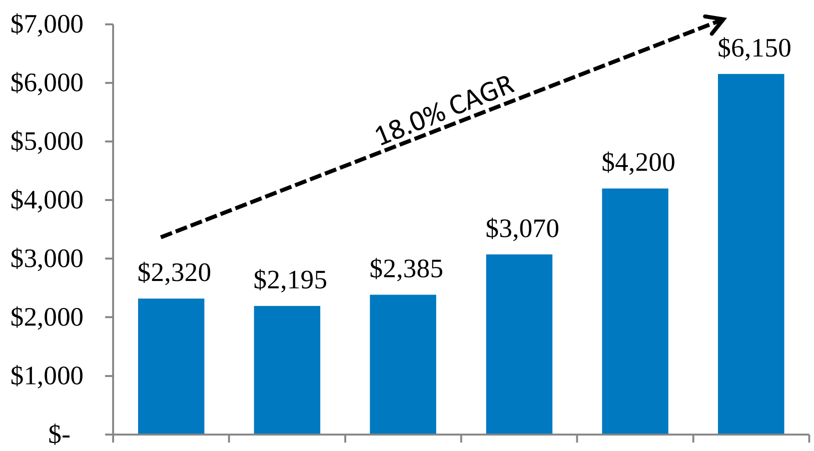
Big Data

Customer Segments
($ in billions)



Cloud Computing

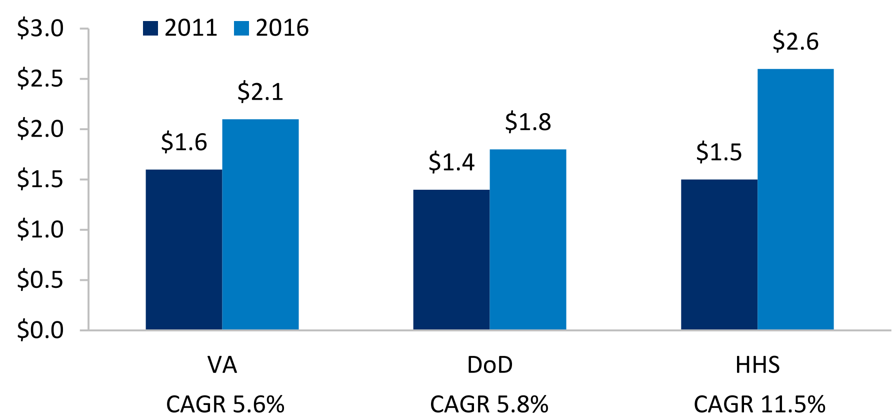
Service Types
($ in millions)



Source: INPUT

Health IT

Customer Segments
($ in billions)

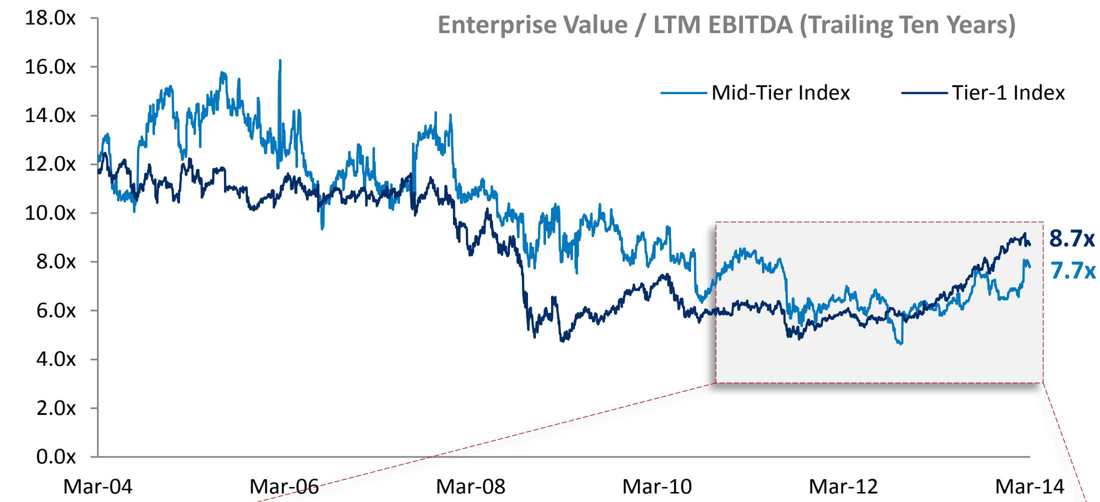


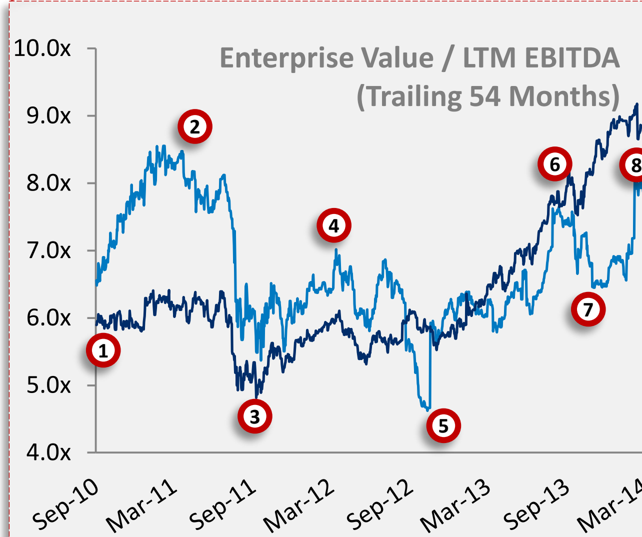
Government Services Index Performance and Valuations

Aronson Capital Partners

- The government services market has performed well over the last year
  - Unobligated funds from prior years lessened the impact of disastrous sweeping cuts due to sequestration
  - Re-compete pricing cuts have not been fully realized as contracts have been extended under current rates
  - Primes have cut SG&A expenses to maintain profitability
  - Aggressive share buyback programs and increasing dividends have bolstered performance
- As sequestration mitigation plans and shareholder distributions taper off, the index is expected to decline
- Private contractors have fared far worse than the index indicates
  - Stronger reliance on subcontracts where primes are cutting sub labor before their own
  - Less SG&A expenses to put on the chopping block
  - Less revenue diversification and more program-specific risk

Mid-Tier Index: Active Tickers - BAH, CACI, CUB, DRCO, EGL, ICFI, KEYW, LDOS, MANT, NCIT; *Inactive Tickers – GTEC, SRX, SXE*
Tier-1 Index: BA, GD, HRS, LLL, LMT, NOC, RTN





Impact (Peak / Trough)	Tier-1	Mid-Tier
1. Insourcing (Q3'10)	5.5x	6.3x
2. Recovery (Q1'11)	6.4x	8.4x
3. Cont. Rsltn. (Q3'11)	4.8x	5.6x
4. Recovery (Q1'12)	6.1x	7.0x
5. Sequestration (Q4'12)	5.5x	4.6x
6. Recovery (Q3'13)	8.2x	7.4x
7. Shutdown (Q4'13)	7.5x	6.1x
8. BBA (Q1'14)	8.7x	7.7x

Source: CapIQ

Public Company Valuation

Aronson Capital Partners

(USD in Millions, excluding share prices)

Company	Price 3/15/2014	Equity Market Value	Enterprise Value	LTM Revenue	LTM EBITDA	EV as a Multiple of LTM Revenue	EV as a Multiple of LTM EBITDA	EV as a Multiple of NTM Revenue	EV as a Multiple of NTM EBITDA	EBITDA Margin CY13A	EBITDA Margin CY14P	Revenue Growth CY13A	Revenue Growth CY14P
Mid-Tier Government Services Index													
Leidos Holdings, Inc.	$42.23	$3,616	$4,283	$10,760	$755	0.4x	5.7x	0.8x	10.3x	7.0%	8.2%	(3.7%)	(50.6%)
Booz Allen Hamilton Holding Corporation	21.67	3,131	4,402	5,624	562	0.8x	7.8x	0.8x	8.7x	10.0%	9.5%	(2.2%)	(5.2%)
CACI International Inc.	76.09	1,785	3,142	3,578	332	0.9x	9.5x	0.8x	8.6x	9.2%	9.6%	(4.3%)	7.7%
Cubic Corporation	51.80	1,387	1,283	1,361	119	0.9x	10.7x	0.9x	9.9x	8.8%	9.2%	(1.3%)	6.9%
ManTech International Corporation	29.15	1,080	1,011	2,310	170	0.4x	5.9x	0.5x	7.3x	7.2%	7.0%	(5.5%)	(19.0%)
Engility Holdings, Inc.	43.86	761	942	1,407	128	0.7x	7.3x	0.6x	7.5x	11.0%	8.7%	(11.0%)	1.2%
ICF International Inc.	39.90	789	820	949	85	0.9x	9.6x	0.8x	8.1x	9.3%	9.7%	1.5%	9.7%
NCI, Inc.	11.48	148	149	332	20	0.4x	7.6x	0.5x	9.1x	5.8%	5.8%	(7.1%)	(12.1%)
					Mean	**0.7x**	**8.0x**	**0.7x**	**8.7x**	**8.5%**	**8.5%**	**(4.2%)**	**(7.7%)**
					Median	**0.7x**	**7.7x**	**0.8x**	**8.6x**	**9.0%**	**9.0%**	**(4.0%)**	**(2.0%)**
Tier-1 Aerospace and Defense Index													
The Boeing Company	$123.11	$91,521	$86,066	$86,623	$8,172	1.0x	10.5x	1.0x	9.3x	10.1%	10.3%	4.5%	6.0%
General Dynamics Corp.	107.63	36,836	35,443	31,218	4,241	1.1x	8.4x	1.2x	8.4x	13.7%	14.0%	(1.3%)	(3.2%)
Harris Corporation	72.56	7,749	9,090	4,978	1,085	1.8x	8.4x	1.8x	8.3x	20.3%	21.7%	(7.0%)	0.5%
L-3 Communications Holdings Inc.	115.30	9,898	13,118	12,629	1,501	1.0x	8.7x	1.1x	8.9x	11.6%	12.2%	(4.7%)	(3.5%)
Lockheed Martin Corporation	162.42	51,856	55,391	45,358	5,663	1.2x	9.8x	1.2x	8.8x	12.5%	14.1%	(4.3%)	(0.8%)
Northrop Grumman Corporation	121.44	26,321	27,101	24,661	3,618	1.1x	7.5x	1.1x	7.5x	14.6%	15.2%	(2.8%)	(3.1%)
Raytheon Co.	100.09	31,479	32,078	23,706	3,334	1.4x	9.6x	1.4x	8.7x	14.1%	16.1%	(2.6%)	(3.9%)
					Mean	**1.2x**	**9.0x**	**1.3x**	**8.5x**	**13.8%**	**14.8%**	**(2.6%)**	**(1.1%)**
					Median	**1.1x**	**8.7x**	**1.2x**	**8.7x**	**13.7%**	**14.1%**	**(2.8%)**	**(3.1%)**

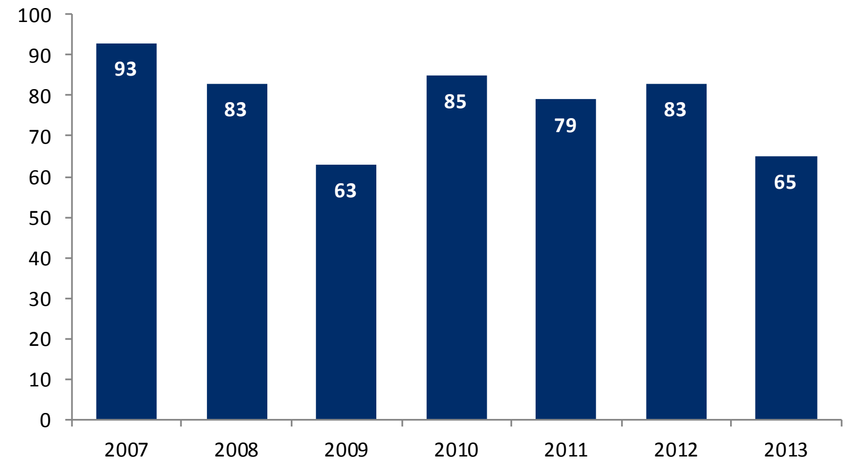
Source: CapIQ

Mid Tier Government Services firms trade at a median valuation 7.7x TTM EBITDA, while the Tier 1 A&D Firms trade at a median valuation of 8.7x TTM EBITDA

Current Deal Environment Observations

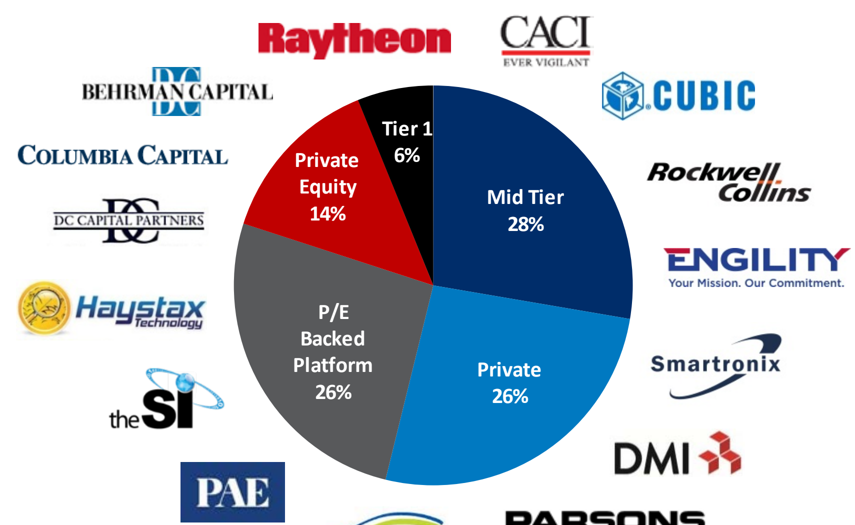
- 2013 was a down year for M&A
  - Transaction activity down 20% from 2012 with buyers focusing more on return on capital through dividends and share repurchases rather than deployment of capital through M&A
  - Buyer and seller valuation gaps due to uncertainty (delayed awards, fear of spending cuts to programs, lack of visibility into program budgets)
  - Tier 1, Mid Tier and Private contractors more hesitant in closing transactions in the current environment
- Buyers are active but highly focused
  - Buyers are actively seeking acquisition opportunities to reposition their capabilities to complement organic growth and amass scale to deal with the LPTA environment
  - Acquisition criteria has become more precise – smaller number of available targets that "check all of the boxes"
  - Contractors without differentiated services need to have scale
- Credit markets are attractive
  - There is a need to deploy a sizeable amount of both private equity and traditional bank capital
  - Lower middle market leverage multiples in the 3.5x-4.0x range, with low rates
- Valuations are deal specific
  - Value depends on a company's capabilities, customers, and contracts
  - Continued perception of downward pressure on valuation
  - Structured transactions (i.e. contingent payment) are prevalent

Historical M&A Deal Counts



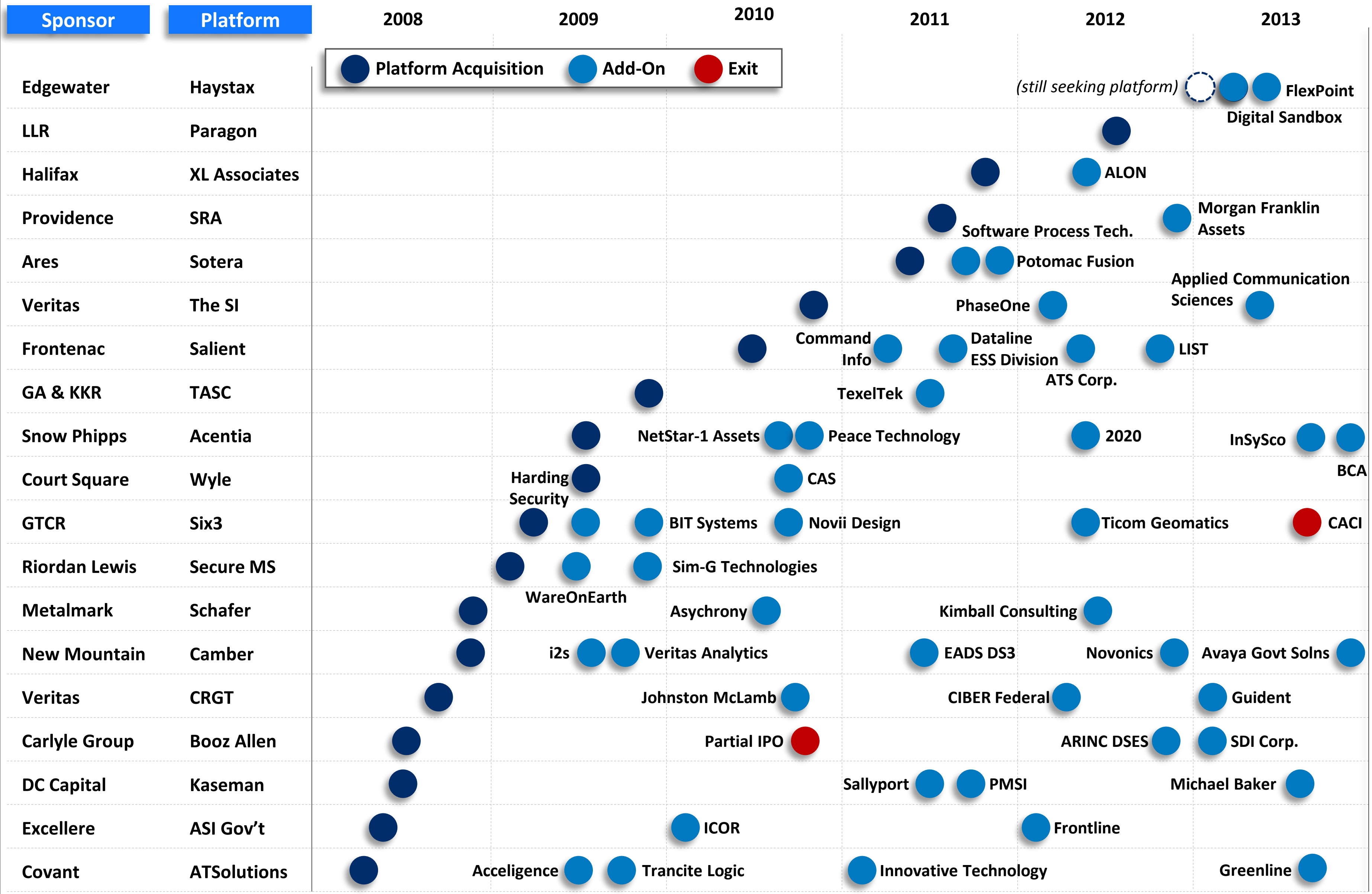
Source: InfoBase; Aronson research

Buyer Universe (2013 Deals)



Source: InfoBase; Aronson research

Continued Private Equity Interest in Gov't Services



The 80/20 Phenomenon

Due to a challenging budgetary environment and precise acquisition criteria, 80% of the prospective buyer universe is pursuing the same 20% of the acquisition targets

Prospective Buyer Universe

serco, CUBIC, Raytheon, CACI EVER VIGILANT, SAIC From Science to Solutions, HARRIS, Ultra Electronics, SRA, SOTERA DEFENSE SOLUTIONS, Scitor Corporation, Ball, KFORCE, DynCorp International, NCI Information Systems, Inc., KEYW, QinetiQ, Camber, BAE SYSTEMS, BOEING, ManTech International Corporation, KRATOS DEFENSE & SECURITY SOLUTIONS, Six3 Systems, ICF INTERNATIONAL, PARSONS, L3 communications, GENERAL DYNAMICS, TASC, NORTHROP GRUMMAN, CSC, DRC, IBM, Ernst & Young Quality In Everything We Do, Honeywell, MERCURY COMPUTER SYSTEMS, LOCKHEED MARTIN, MAXIMUS

All Private Equity

80% of buyers are pursuing 20% of acquisition targets

Targets' Focus:

◯ :Primary Target Markets

◯ :Secondary Target Markets

Primary Target Markets:

- *Data Visualization*
- *Big Data Analytics*
- *Cyber Services & Technologies*
- *Cloud Computing*
- *Healthcare IT*
- *Software Engineering & Development*
- *C4ISR*

Secondary Target Markets:

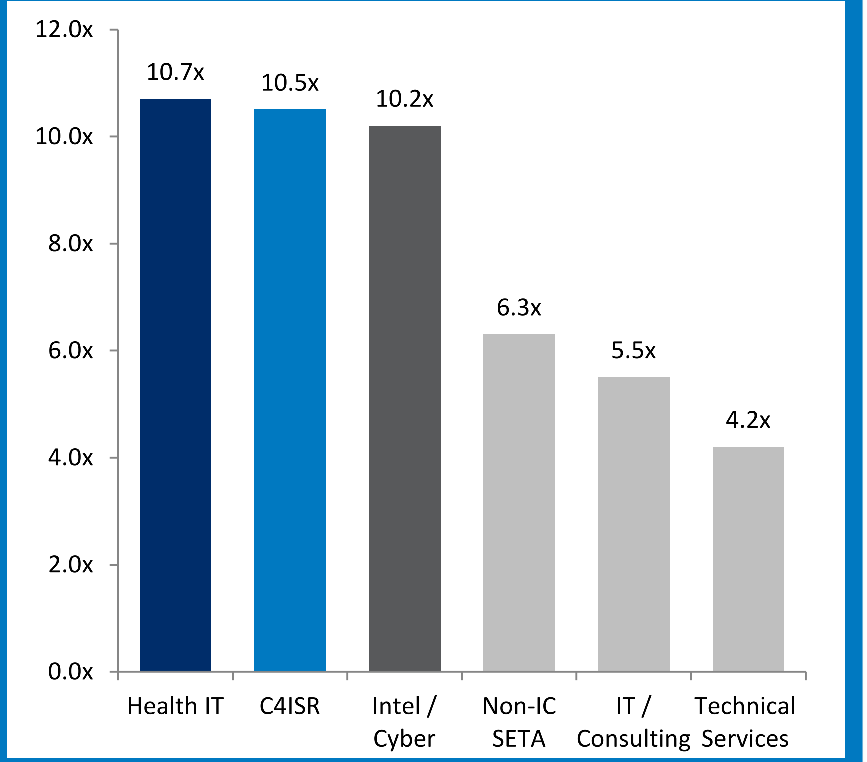
- *Grants Management*
- *International Assistance*
- *Program Management*
- *Program Portfolio Management*
- *Facilities Management*
- *OCONUS Language Translation*
- *Knowledge Management*
- *Financial Management*
- *Acquisition Support*
- *Engineering Services*
- *Advisory & Assistance Services*
- *Cost Estimating*
- *Technical Assistance*
- *IT Infrastructure*
- *Business Process Engineering*
- *Value Added Resellers*
- *IT Integration*
- *IT Compliance*

Acquisition Considerations

There are various motivations that are driving M&A activity in today's market:

- Buyers looking to reposition their business into the priority markets via acquisition
  - Premium valuations
  - Differentiated services perceived to be insulated from cuts
  - Solutions vs. services focus
- Buyers acquiring targets to gain critical mass and realize cost synergies to drive down rates
  - Lower valuations
  - Less differentiated services
  - Non-priority markets
- Targets that need to sell due to weak balance sheets, OCIs, or poor financial performance
  - Divestiture opportunities associated with OCIs or portfolio reshaping
  - Distressed sales driven by weak balance sheets
  - Valuations vary depending on the target and exact rationale for sale

M&A Valuations by Sub-Market (last 2 years)



Valuation Drivers

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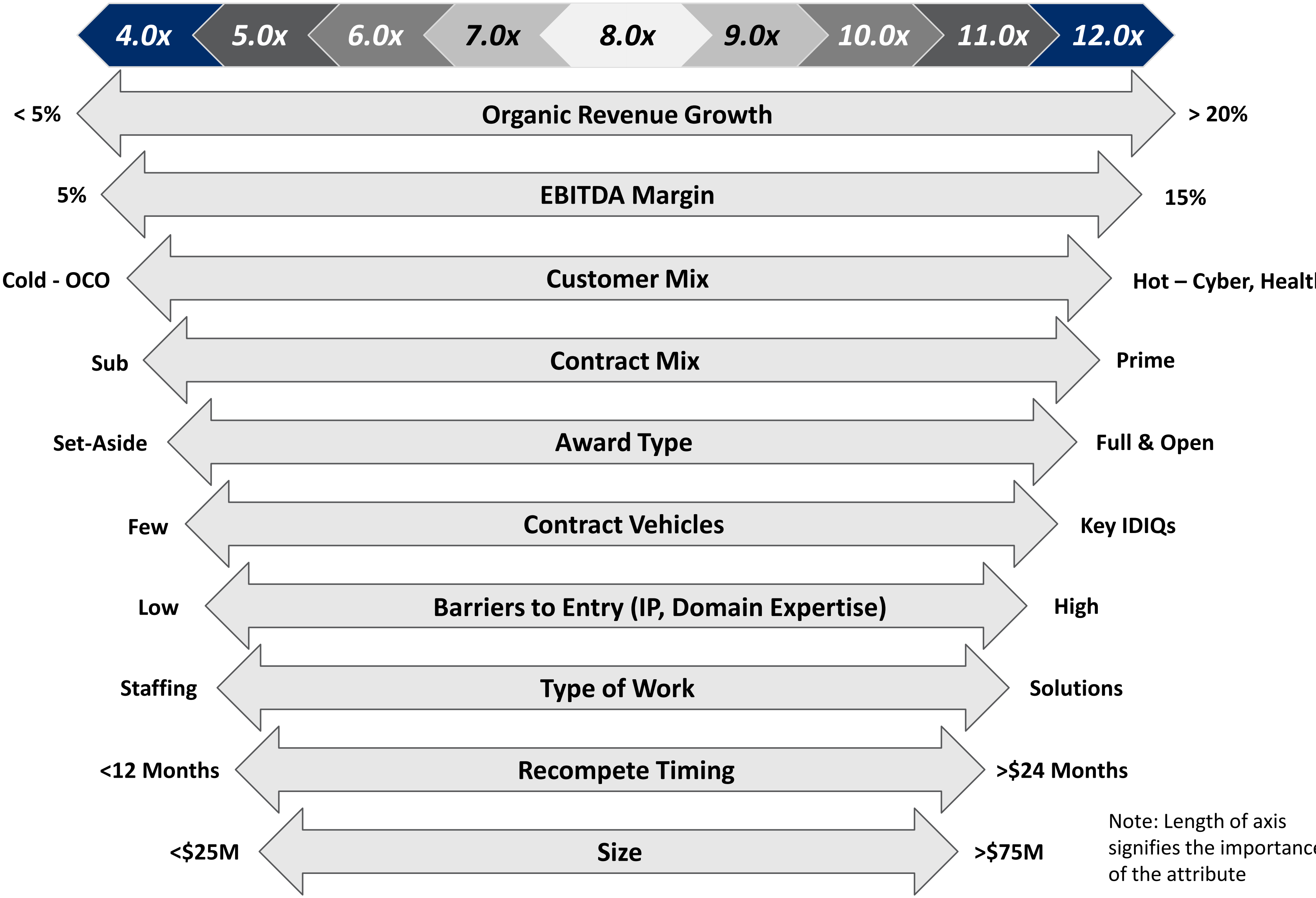


Note: Length of axis signifies the importance of the attribute

Agenda

Target Focus: Contract Mix

Key contracts are a primary driver of acquisition valuation

- Develop a suite of contract vehicles in both a prime and subcontractor role (Schedules, GWACS, BPAs, etc.)
  - Minimize reliance on a single contract
  - Establish a variety of customer relationships that can help to win prime awards
- Strategically utilize set aside awards to help position the business for F&O competitions
  - Establish the customer relationships that will become critical in the conversion to a F&O contract
  - Generate relevant past performance in a prime role; acquire key talent and qualifications
  - Use the cash flow from set aside awards to generate investment dollars and build the infrastructure and business development capabilities necessary to pursue F&O awards
- Deliver technology-driven solutions to the customer
  - Solve difficult problems; align with the mission
  - Commodity-type staffing services are harder to transition to F&O contracts once set aside status is lost, and are also more susceptible to downsizing /budget cuts
  - Develop a transition plan for set aside contracts
  - Customer intimacy is key

Target Focus: Revenue Visibility

Revenue visibility is a primary buyer focus during diligence

- The future cash flow potential of a business is the basis for valuation; well developed reporting capabilities can enhance shareholder value during the sale process
- Up-to-date backlog reporting provides management with a useful forecasting tool and provides insight into near-term revenue and profitability
  - Tracking backlog over time can be beneficial to sellers, as historically strong backlogs support higher valuations
  - Contract backlog is the foundation of reliable forecasting
- Current business development pipeline reports that capture the company's sales pipeline are necessary to support projections
  - A robust yet realistic pipeline heightens the upside potential of an investment for buyers, driving higher valuations
- Sellers and their advisors need to consider upcoming recompetes when determining the optimal time to start a sale process
- Maintain a "contract waterfall" as part of the annual planning process

Other Key Value Drivers

Strategic Positioning

- Companies that focus on specialized or niche service offerings command a valuation premium
- One mile deep is generally better than one mile wide

Intellectual Property

- Patents and other forms of IP drive higher valuations
- Create barriers to entry

Corporate Infrastructure Sufficient to Support Growth

- Budgeting and planning processes
- DCAA approved accounting systems
- Government contracting compliance
- Business development
- Strategic pricing capability

Management Team

- Most buyers want management to stay with the business for a period of 1-3 years after sale

Balance Sheet Efficiency

- Working capital / collection cycle / billing

Agenda

Full-Service Investment Banking Capabilities

Mergers & Acquisitions	❑ Sell-Side M&A ❑ Buy-Side M&A ❑ Management & Leveraged Buyouts ❑ Divestitures ❑ Asset Sales
Corporate Finance	❑ Recapitalizations and Restructurings ❑ Common and Preferred Equity Raises ❑ Mezzanine Capital Raises ❑ Debt Capital Raises ❑ Majority and Minority Private Equity Investments
Financial Advisory	❑ Internal Capital Transaction Advisory ❑ Independent Corporate Valuations ❑ Fairness Opinions ❑ ESOP Valuations ❑ Strategic Alternatives Assessments

ACP is a full service investment bank with the domain expertise, industry relationships, and corporate finance experience to complete a tailored transaction to fit shareholders' objectives

Leadership Team

Larry Davis
Partner & Founder
(301) 231-6225
ldavis@aronsoncapitalpartners.com

- Over 25 years of transactional experience in middle-market M&A, divestitures, and financings; having completed more than 40 transactions involving defense and government services companies
- 15 years operational experience as VP of Finance at DynCorp, acquiring 15 federal IT companies
- Selected notable transactions include: sale of TexelTek to TASC, Atlantic Coast Telesys to SAIC, AEPCO to VT Group plc, and Capital City Technologies to Ernst & Young
- Highly recognized industry expert and a frequent speaker/panelist at industry events
- Holds a B.S. in Accounting from University of Maryland and is a founding member of the MCCC Government Contracting Network and Board Member of Hearts and Homes for Youth

Phil McMann
Partner
(301) 231-6202
pmcmann@aronsoncapitalpartners.com

- 14 years of middle-market investment banking experience
- 10 years corporate finance with Goldman Sachs & Co. private equity affiliate and NYSE-traded company
- Has advised on more than 30 transactions in federal IT, government services and defense sector; subject matter expert in the IC with a focus in Cyber Security, SIGINT and C4ISR
- Notable transactions include: sale of Kimmich Software Systems to Vistronix, sales of SOTECH and Zu to Ultra Electronics, sale of Paradigm to ECS, sale of Zytel to SOTERA, i2S to Camber, DDK to ManTech and Applied Signal's acquisition of SEISMIC
- Holds a B.S. in Management and Economics from Tulane University and an MBA in Finance from Cornell University's S.C. Johnson Graduate School of Management

Tim Schmitt
Vice President
(301) 222-8285
tschmitt@aronsoncapitalpartners.com

- Over 5 years of middle-market investment banking experience at Aronson Capital Partners
- 2 years of "Big 4" advisory experience while working in the Aerospace and Defense group of Deloitte
- Notable transactions include: sale of Kimmich Software Systems to Vistronix, the sale of Hawthorne Services to the Berger Group, sale of Novonics Corp to Camber, sale of PMSI to KS International, sale of TexelTek to TASC, and i2S to Camber
- Graduated magna cum laude from the University of Richmond with a B.S. in Business Administration and is a licensed CPA

Recent Government Services Qualifications

Advised BIOQUAL, INC. *on its acquisition of the Preclinical Services Business of* ABL inc. Advanced Bioscience Laboratories

Advised KSSi Kiamichi Software Systems Inc. *on its sale to* Vistronix, Inc.

Advised General Dynamics *on its divestiture of IC SETA assets to* Scitor Corporation *portfolio company of* IG&P

Advised Haystax Technology *portfolio company of* **the edgewater funds** *on its acquisition of* FlexPoint Technology

Advised Hawthorne Services *on its sale to* The Berger Group

Advised Novonics *on its sale to* Camber *portfolio company of* NMC New Mountain Capital

Advised Paradigm Technologies, Inc. *on its sale to* ECS

Advised Sotech, ZU Industries *on their sale to* Ultra Electronics

Advised TexelTek, Inc. Global Intelligence Solutions *on its sale to* TASC *portfolio company of* General Atlantic, KKR

Advised Zytel *on its sale to* Sotera Defense Solutions

Advised Applied Signal Technology, Inc. *on its acquisition of* Seismic

Advised capital city Technologies *on its sale to* Ernst & Young Quality In Everything We Do

Advised Veritas Analytics Incorporated *on its sale to* Camber *portfolio company of* NMC New Mountain Capital

Advised GCI, Incorporated a wholly owned subsidiary of at&t *on its sale to* General Dynamics

Advised PMSI® *on its sale to* KS International *portfolio company of* DC Capital Partners

Advised i2s *on its sale to* Camber *portfolio company of* NMC New Mountain Capital

Advised 24/7 Solutions "We never close" *on its sale to* Sentel A Wholly Owned Subsidiary of WC Holding, Inc.

Advised accelligence *on its sale to* A-T Solutions, Inc. *portfolio company of* Covant

Advised DDK Technology Group, Inc. *on its sale to* ManTech International Corporation

Advised MAI McMunn Associates, Inc *on its sale to* Parsons

Advised Kaseman *on its sale to* Elite Training and Security *portfolio company of* DC Capital Partners

Advised RavenWing *on its sale to* Boeing

Advised AEPCO *on its sale to* VT Group

Advised TMS Technology & Management Services, Inc. *on its sale to* NISC National Interest Security Company *portfolio company of* DC Capital Partners

Advised IQM Institute for Quality Management, Inc. *on its sale to* CACI Ever Vigilant

Advised alphainsight *on its sale to* CACI Ever Vigilant

Advised McNeil Technologies *on its majority recapitalization by* Veritas Capital

Advised Atlantic Coast Telesys *on its sale to* SAIC From Science to Solutions

PILIERO MAZZA PLLC
ATTORNEYS AT LAW

888 17th Street, NW, 11th Floor
Washington, DC 20006
Tel: (202) 857-1000
Fax: (202) 857-0200

Successful Planning and Exit Strategies

For Government Contractors in 2014 and Beyond

Legal Update

Dean Nordlinger
Partner, heads the Business & Corporate Law Group

HOW TO POSITION YOUR BUSINESS TO REAP THE BENEFITS OF A LIQUIDITY EVENT

- Big Picture Perspective
  - Develop the "master strategic plan" for starting up, building, growing and selling the company
  - Chart a strategic path from the beginning, BUT, adjust it as needed going forward
  - For government contractors, portfolio of contracts and backlog = a big factor dictating potential buyer pool and driving terms of offer
- Minimize sale of the company as owners' retirement nest egg
  - When possible, over time, take some chips off the table (money out of the company) for retirement planning/investing
  - Buyer's valuation of company and offer is formulaic – it's all about the numbers versus owners "lifestyle" valuation

HOW TO POSITION YOUR BUSINESS TO REAP THE BENEFITS OF A LIQUIDITY EVENT

- Manage expectations
  - Owners drill down on "what's my company worth"
    - Recast financial statements – e.g., remove/adjust non-recurring or excessive items
    - Project revenue and earnings over next five years
  - Engage in a honest self-evaluation (know company's strengths and weaknesses)
- Plan Ahead
  - Use a comprehensive due diligence checklist for an internal review and check-up
  - Importance of good business owners agreement (including buy-sell)
  - Develop a strong management team and key employee base

HOW TO POSITION YOUR BUSINESS (INTERNAL REVIEW AND CHECK-UP)

- Company can use a comprehensive due diligence checklist to give itself an internal review and check-up across the board (in advance of a buyer doing the same)
  - Governing documents, corporate records and ownership records
  - Management
  - Assets
  - Financial (financial statements, debt, liens, security interests)
  - Contracts
  - IP
  - Labor/employment (employee benefit plans)
  - Taxes (federal and state tax returns, disputes)
  - Insurance
  - Litigation
  - Regulatory (licenses, permits)

HOW TO POSITION YOUR BUSINESS (INTERNAL REVIEW AND CHECK-UP)

- Are the company's governing documents, corporate/financial and ownership records in order and up to date?
  - Company complying with its articles and bylaws?
    - Shares issued in excess of authorized capital stock?
    - Company operating agreement says member-managed but company manager-managed?
    - S-corporation but non-pro rata distributions to owners (tax issue)?
  - Ownership records showing clear chain of title?
    - Documentation on all prior stock issuances and transfers?
  - Financial statements reviewed or audited by independent auditors?
    - Makes lenders and buyers more confident in company's position and company's information
- What's the consequence of such deficiencies?
  - Could impair a company's ability to borrow money at a critical time
  - Could have a chilling effect on a buyer's interest in a transaction

STRATEGIC AND STRUCTURING CONSIDERATIONS (BUSINESS OWNERS AGREEMENT)

- A good business owners agreement = good business planning
  - Prepare upfront for possible pitfalls and perils among business owners
  - A prenuptial agreement to plan for and overcome disruptive events in the company's business life cycle
    - Governance
      - Majority rule
        - Control over BoD; manager-managed vs. member-managed
        - Drag-along rights, tag-along rights
      - Deadlock provisions if no majority rule
    - Ownership
      - Specify ground rules for ownership
        - For example, ownership tied to active participation in company's day-to-day business and operations
      - Buy-out rights
        - Based on "triggering events" – death, disability, cessation of employment, disassociation

STRATEGIC AND STRUCTURING CONSIDERATIONS (BUSINESS OWNERS AGREEMENT)

❖ Hypothetical Scenario: Business Relationship among Owners Has Soured

- 3 individuals form an LLC to perform government contracting work
- One majority owner, two minority owners
- Implement a basic operating agreement – no dissociation and/or buy-out rights
- For several years owners are in harmony, after that they differ on business development and corporate strategy matters
- Relations deteriorate, company profitability and employee morale suffer
- What possible remedies? Partial but not full remedies
  - Majority owner can terminate minority owner's day to day role BUT cannot force sale of ownership interest
  - Petition court for expulsion of member (if allowed under state law, for example, Virginia), BUT if successful, expelled owner retains all economic rights
  - A negotiated buy-out (likely with a premium above FMV)

STRATEGIC AND STRUCTURING CONSIDERATIONS (EMPLOYEE INCENTIVE COMPENSATION)

- Key Question: have the owners positioned the company to access, recruit, retain and motivate the talent necessary to compete and succeed in this challenging environment?
- Use of employee incentive compensation to develop a strong management team and key employee base
  - Demonstrate the company's ability to succeed not dependent on owners
  - Buyers offer better exit/sale terms when line between owners' existence and company's is less blurred

STRATEGIC AND STRUCTURING CONSIDERATIONS (EMPLOYEE INCENTIVE COMPENSATION)

❖ All forms of incentive plans are helpful in recruiting employees

- Not a one size fits all
- Relevant and useful no matter stage of company life cycle

❖ Some incentive plans are more retention-oriented (e.g., RSUs or phantom stock)

- "full elevator ride" in value

❖ Other incentive plans are more motivation-oriented (e.g., SARs plan or cash bonus plan)

- Solely increase above floor value

DETERMINE THE APPROPRIATE "STARTING POINT"

- Income taxes
- Ownership and rights
- Entity structure
- Payroll taxes
- Securities laws and registration
- Federal acquisition regulation impacts
- Financial statements
- Who are you going reward?
- Valuation
- Administrative burden and cost
- Vesting, forfeitures
- And much more

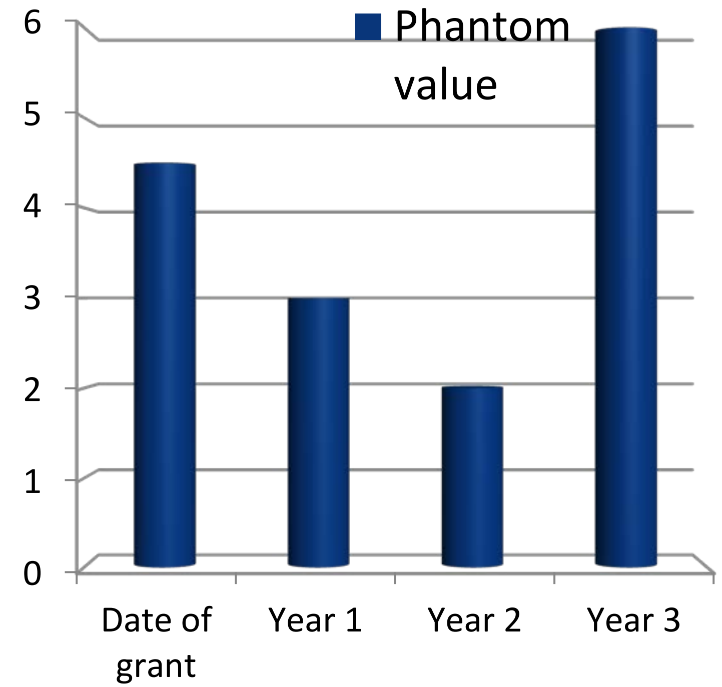
STRATEGIC AND STRUCTURING CONSIDERATIONS (EMPLOYEE INCENTIVE COMPENSATION)

- Does the company want to share real equity?
- How much of the company's equity or equity value is to be shared?
- Will awards be paid in stock or cash?
- Which employees will be eligible to participate (executive officers) versus "rank and file")
- Will employees have to make a monetary contribution to get the equity value?
- How and when will liquidity events occur?
- How is the award earned and can the company take it away?

EQUITY LINKED INCENTIVES: PHANTOM STOCK

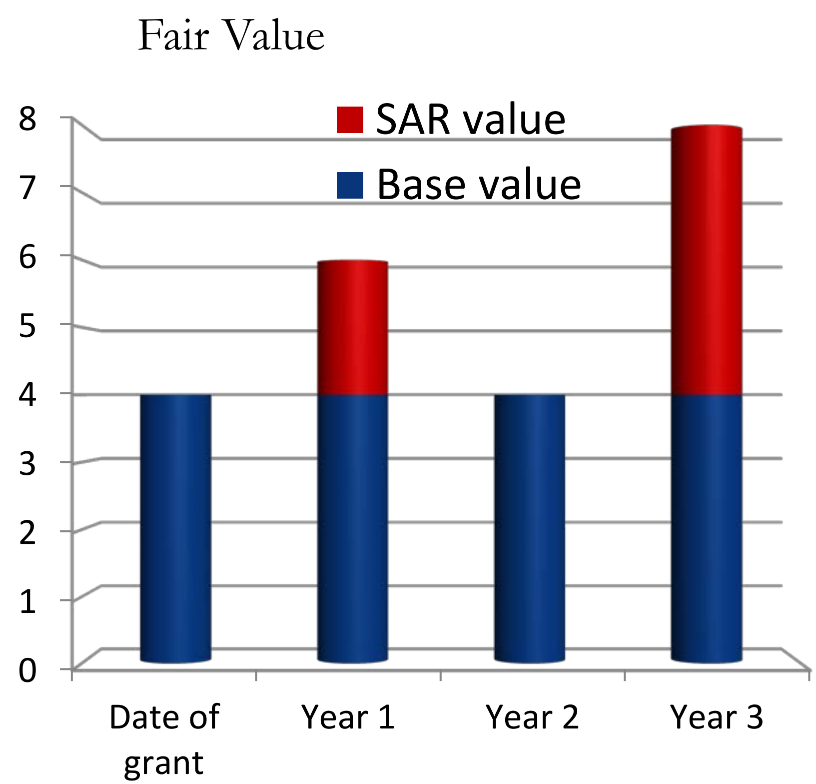
- Not real equity/ownership
- Typically no capital investment required
- Typically structured for immediate value
- Typically established to balance motivation versus retention
- Separate account to track increases and decreases
- Benefit = full elevator ride in value
- No appreciation = should STILL PROVIDE BENEFIT

Fair Value



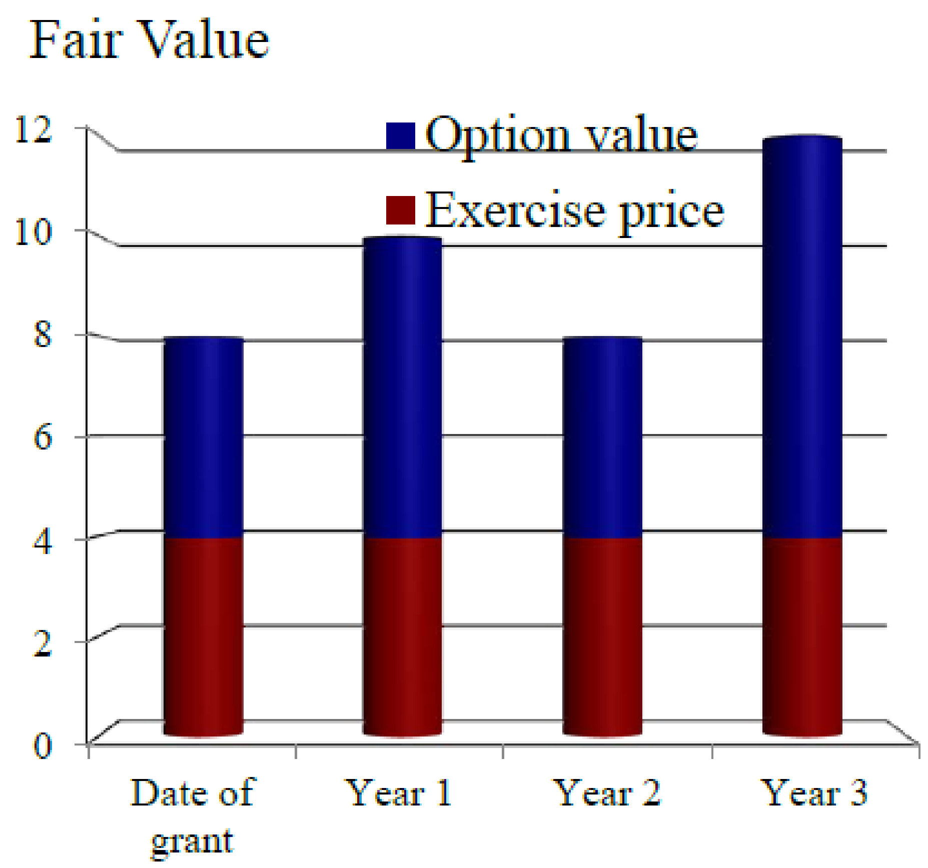
EQUITY LINKED INCENTIVES: STOCK APPRECIATION RIGHTS (SAR/UAR)

- Not real equity/ownership
- Base value fixed/set at date of grant
- No investment required
- Typically established to motivate increasing equity value (versus retention)
- Separate account to track increases and decreases
- Benefit = appreciation above floor value
- No appreciation = NO BENEFIT



EQUITY (OWNERSHIP) INCENTIVES: STOCK OPTION PLAN

- Real equity/ownership occurs open exercise
- Typically some capital investment required (exercise); Recipient has financial investment at risk
- Can be structured for immediate and/or future value
- Benefit = full elevator ride in value, share in ownership rights
- No appreciation = may still provide benefit (non-statutory option)



TO PUT IT IN PERSPECTIVE…
A HYPOTHETICAL CLIENT SCENARIO

Company Background:

- Single owner, S corporation
- Owner inclined to not issue equity
- 7 year anniversary of company's existence
- Revenue $10 million
- FMV of stock is $5 per share value
- Culture: cash oriented

Goals:

- Planning for exit strategy ("sale of the company") within 5 to 7 years
  - **Reward** 2 key employees who have been with the company since the beginning, and Retain them through the closing of a "sale of the company" transaction
  - **Recruit** someone in the healthcare IT space
  - **Motivate** company's employee base

HYPOTHETICAL CLIENT SCENARIO (CONT'D)

Possible Solution:

- Retain/Reward: Long term incentive agreement
  - Cash or phantom stock
- Motivate/Recruit: SARs plan
  - Management group or key employees
- Cash Bonus Plan
  - Select employee pool – business development and sales people

MAXIMIZING THE VALUE OF "SMALL BUSINESS" STATUS

- "Former Affiliate" Rule
- Joint Ventures
- Mentor Protégé

WHY SIZE MATTERS

- Small business status is the #1 eligibility requirement for all of the set-aside programs
  - Therefore, if a company participates in set-aside programs, its small business status is one of its most important assets
- Being small also exempts a company from certain requirements, such as reporting executive compensation, contractor code of ethics, and cost-accounting standards
- SBA's new "Presumed Loss Rule" increases importance of protecting and verifying a company's small business status
  - Creates a presumption of loss to the government from a size or status misrepresentation equal to the total amount expended on a contract obtained by misrepresentation

USE THE FORMER AFFILIATE RULE IN CORPORATE PLANNING AND RESTRUCTURING

- ❖ Does the company have operating divisions that are naturally separable or are otherwise operated on a segregated, stand-alone basis?
- ❖ SBA's rules do not say once affiliated, always affiliated
  - Affiliations can change/lessen over time
- ❖ Former affiliate rule allows a company to back out the revenues/employees of a former affiliate from the company's revenues/employees – for the entire time period used to measure its size
  - Retroactive
  - Can be used effectively in corporate restructuring to sell a subsidiary or sister entity and reestablish the former parent and/or subsidiary as a small business

ABOUT JOINT VENTURES

- Main Characteristics:
  - Co-management
  - Sharing profits and losses
  - Limited duration
- Competing as a Joint Venture:
  - Joint Ventures should be formed before submitting offer
  - Agreement should provide for contract performance
  - FAR requires disclosure in the proposal
- Forms of Joint Venture
  - Partnership
  - Limited Liability Company
  - Corporation

JOINT VENTURES

- JV revenue is attributed to the JV partners in proportion to their ownership interests in the JV
- JV partners are generally affiliated for a contract, so a JV will be considered a small business if the combined size of the JV partners meets the size standard for the contract
- JV partners can also be deemed affiliated for all purposes if the JV is awarded more than 3 contracts in a 2-year period
- Exceptions to joint venture affiliation:
  - When each JV partner is small under the applicable size standard and either: (1) the procurement is bundled or consolidated; or (2) the procurement exceeds one-half the size standard or $10 million (depending on the nature of the size standard)
  - Joint Ventures between 8(a) protégé and SBA-approved mentor

Business & Corporate Law Group

- We represent clients on business and corporate matters in all phases of their business life cycle, from start-up to sale of the company. We advise clients on entity formation and structure, draft documents that serve as the backbone for clients' companies as they grow, and assist with all aspects of an exit strategy.

Headed by Dean S. Nordlinger, Partner

dnordlinger@pilieromazza.com
202.857.1000

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- Corporate Restructuring
- Exon-Florio Filings (CFIUS)
- Management Buy-Outs
- Earn-outs
- Due Diligence

Government Contracts
- Small Business Issues
- Novations
- SBA Change of Ownership Approvals

Commercial
- Bank Financing
- Commercial Contracts

Limited Liability Companies

Joint Ventures

Real Property
- Commercial Leases

Employee Incentive Plans
- Stock Option Plans
- Equity Linked (Stock Appreciation Rights, Phantom Equity)

SUCCESSFUL STRATEGIES START WITH PLANNING

John P. Keenan, CFP®, C(k)P®, AIF®

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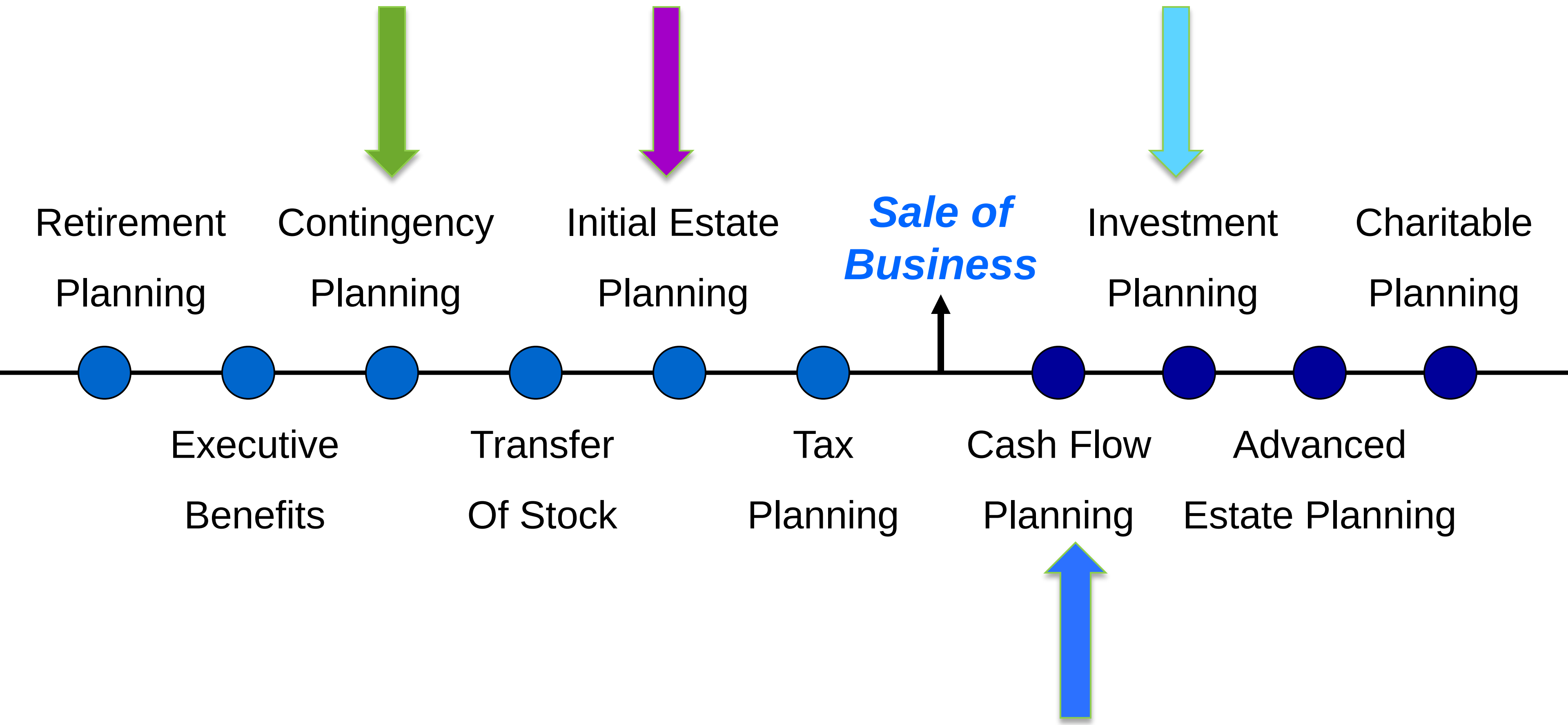
Exit Strategies Timeline



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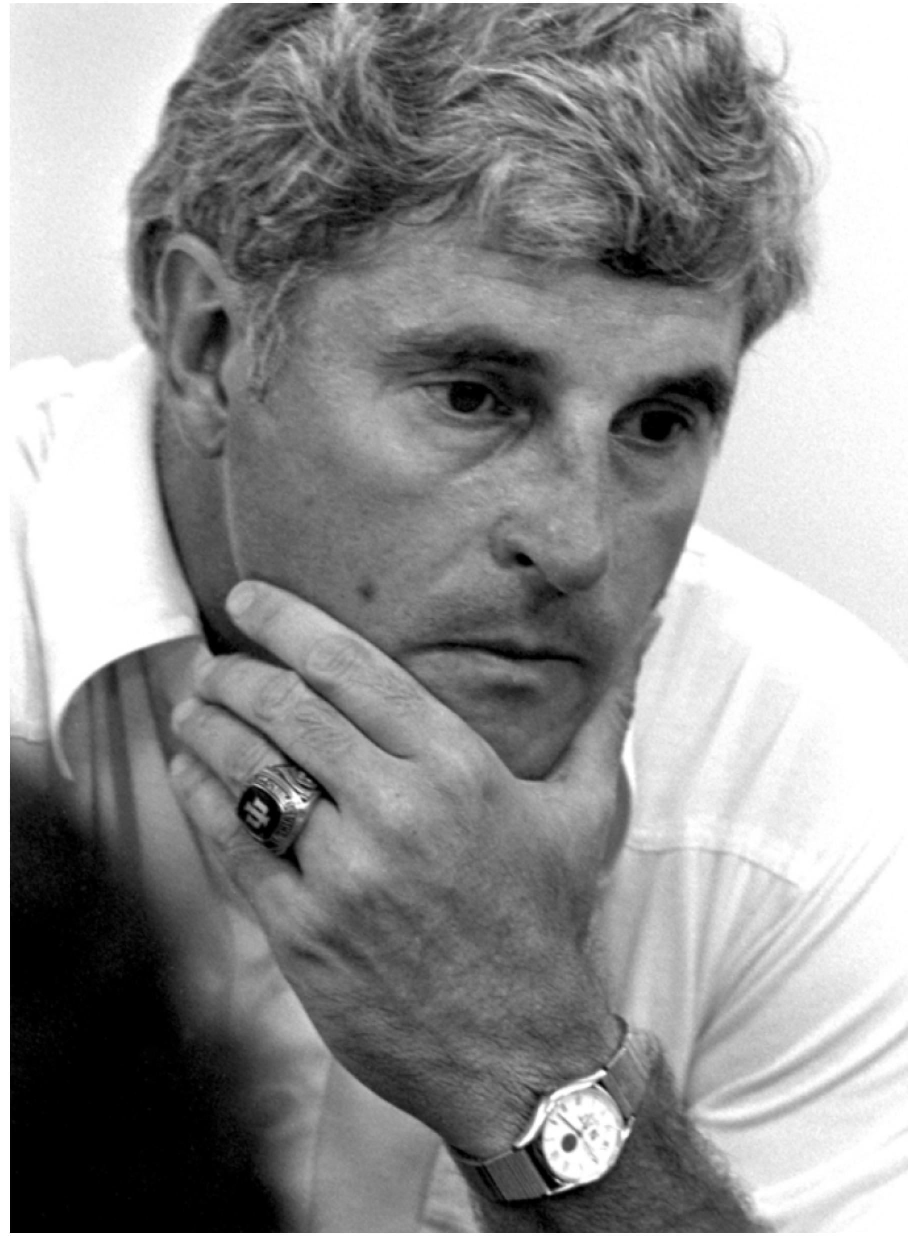
“The key is not the will to win… everybody has that. It is the will to prepare to win that is important.”

-Bobby Knight



Which line is longer?

Things aren't always what they seem to be

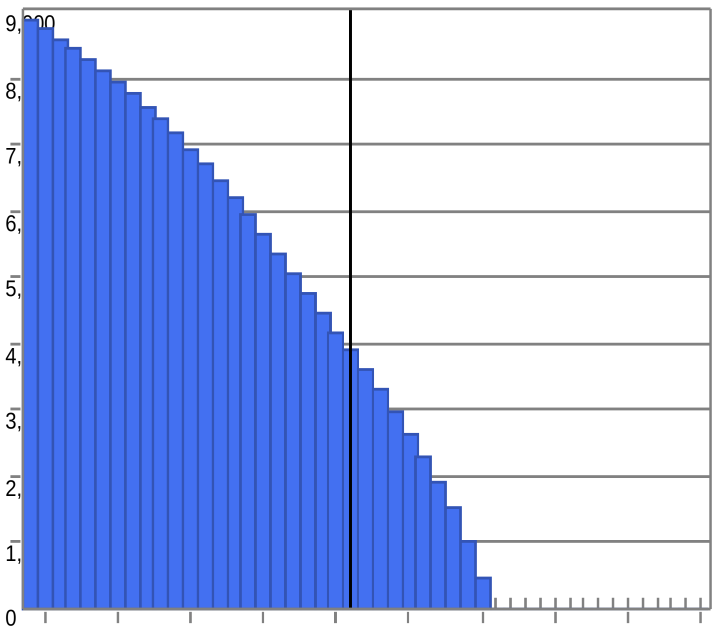
Which owner is more likely to retire comfortably? A or B?

Owner A	Owner B
• 45 yrs old	• 65 yrs old
• Annual Income Need: $300k gross	• Annual Income Need: $300k gross
• Business Proceeds: $10M	• Business Proceeds: $2M
• Retires at 45 when business is sold	• Retires at 65 when business is sold
• Takes SSI at 67	• Takes SSI at 67
	• Has pension income

Straight line outcomes: 45 vs 65 yr old

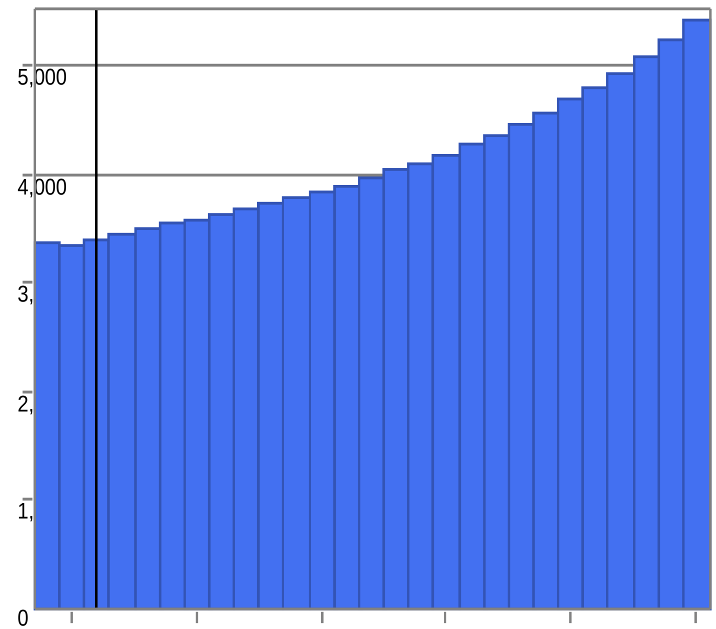
Owner A

Portfolio Assets



Owner B

Portfolio Assets

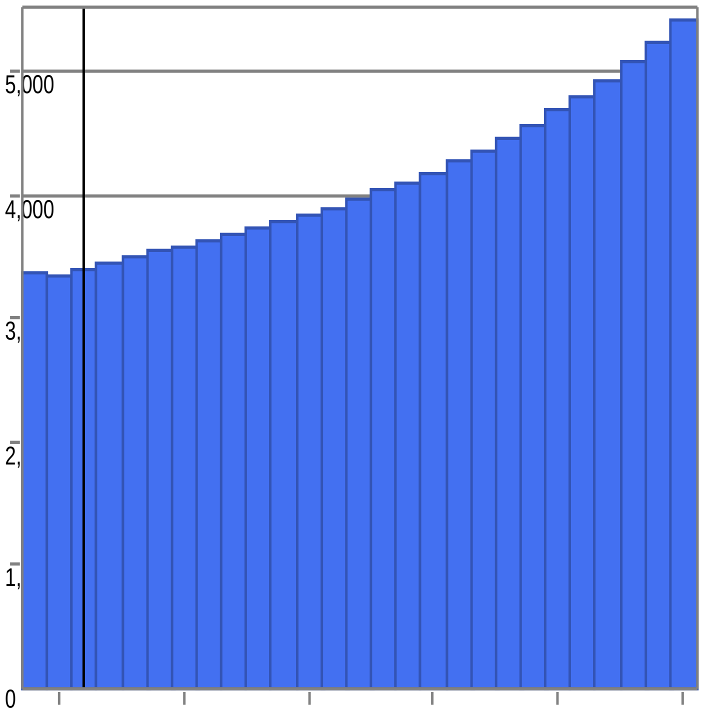


Monte Carlo simulation is 5% successful

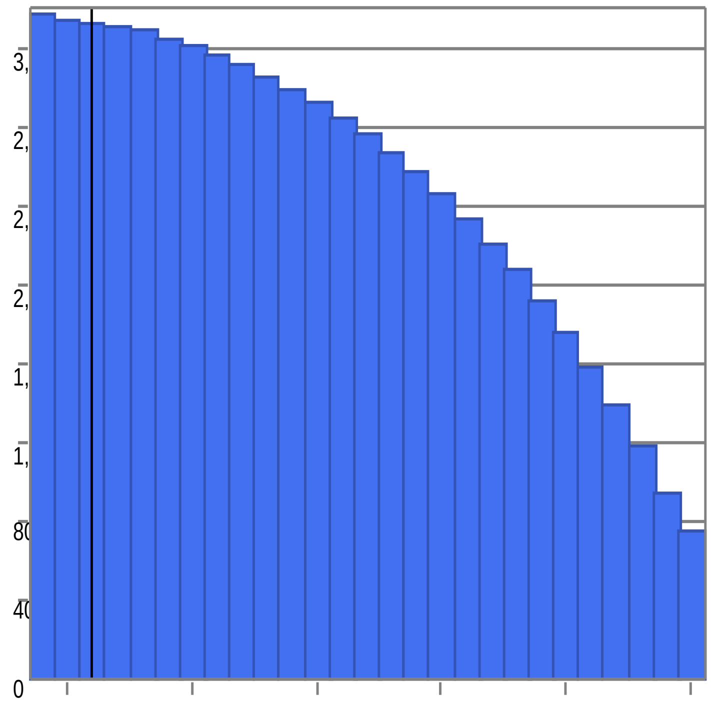
Monte Carlo simulation is 98% successful

Owner B (65) with / without pension

Owner B w/Pension



Owner B w/o Pension

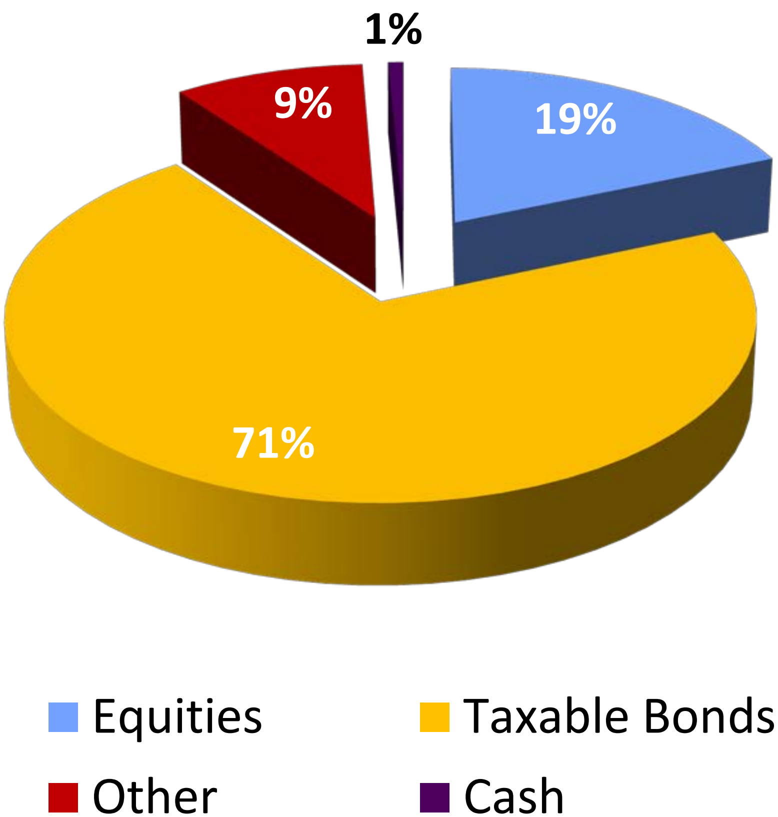


Monte Carlo simulation is 98% successful

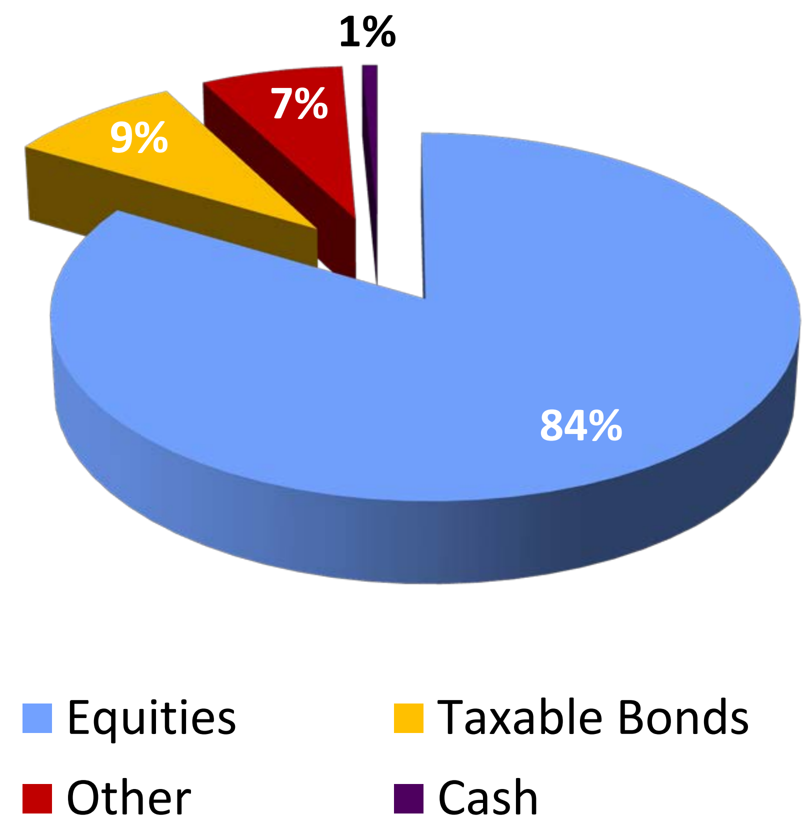
Monte Carlo simulation is 42% successful

Outcomes using different investment profiles for the same client

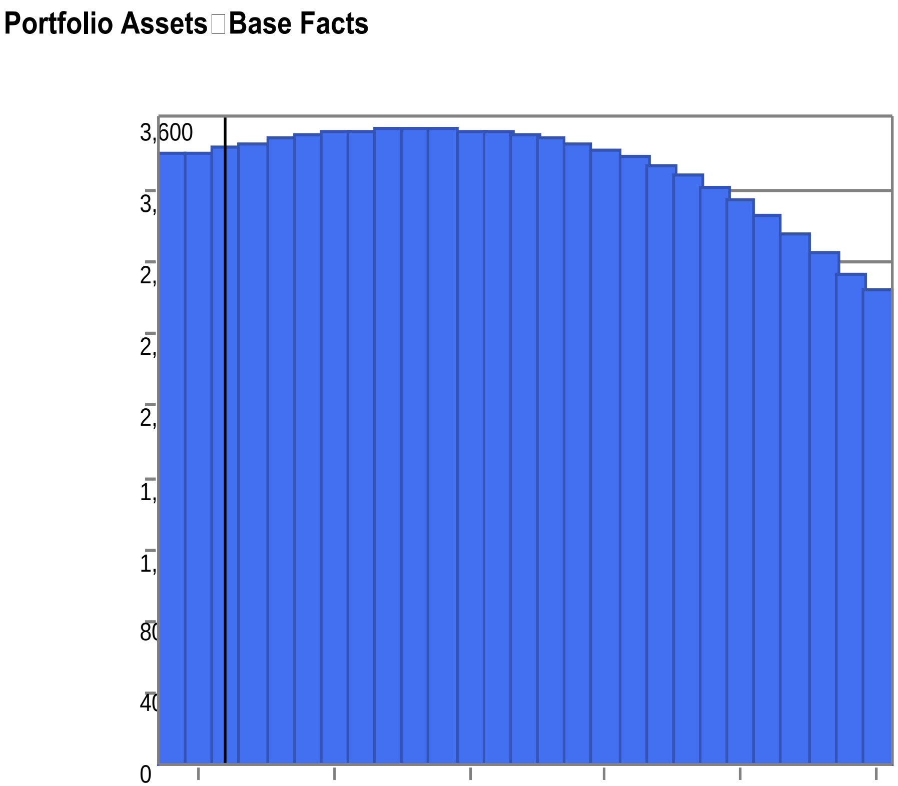
Conservative

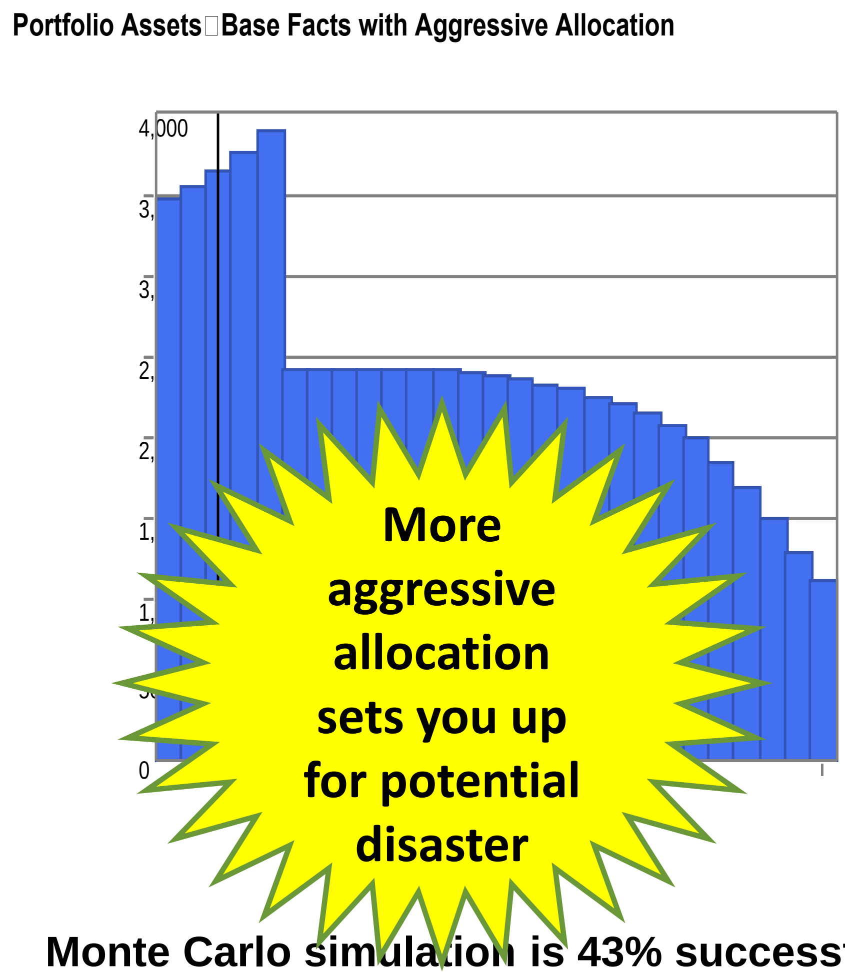


Aggressive



Outcomes based on different allocations



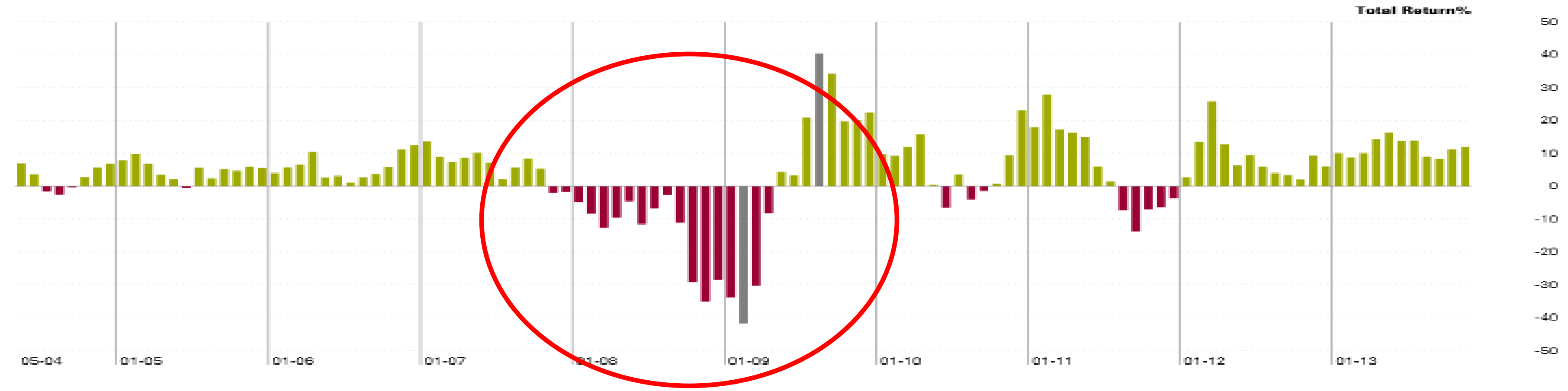


Monte Carlo simulation is 79% successful

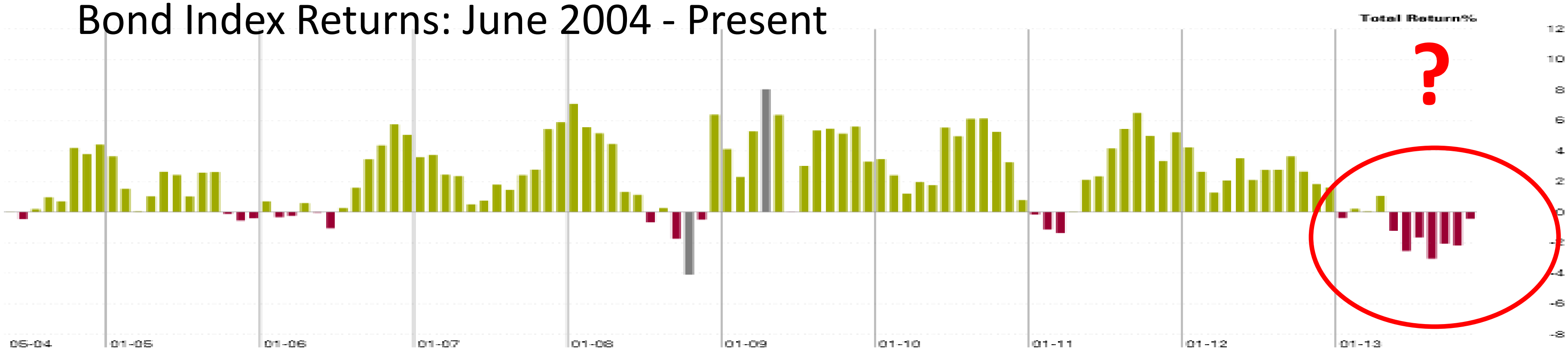
Monte Carlo simulation is 43% successful

Avoiding sharp or prolonged periods

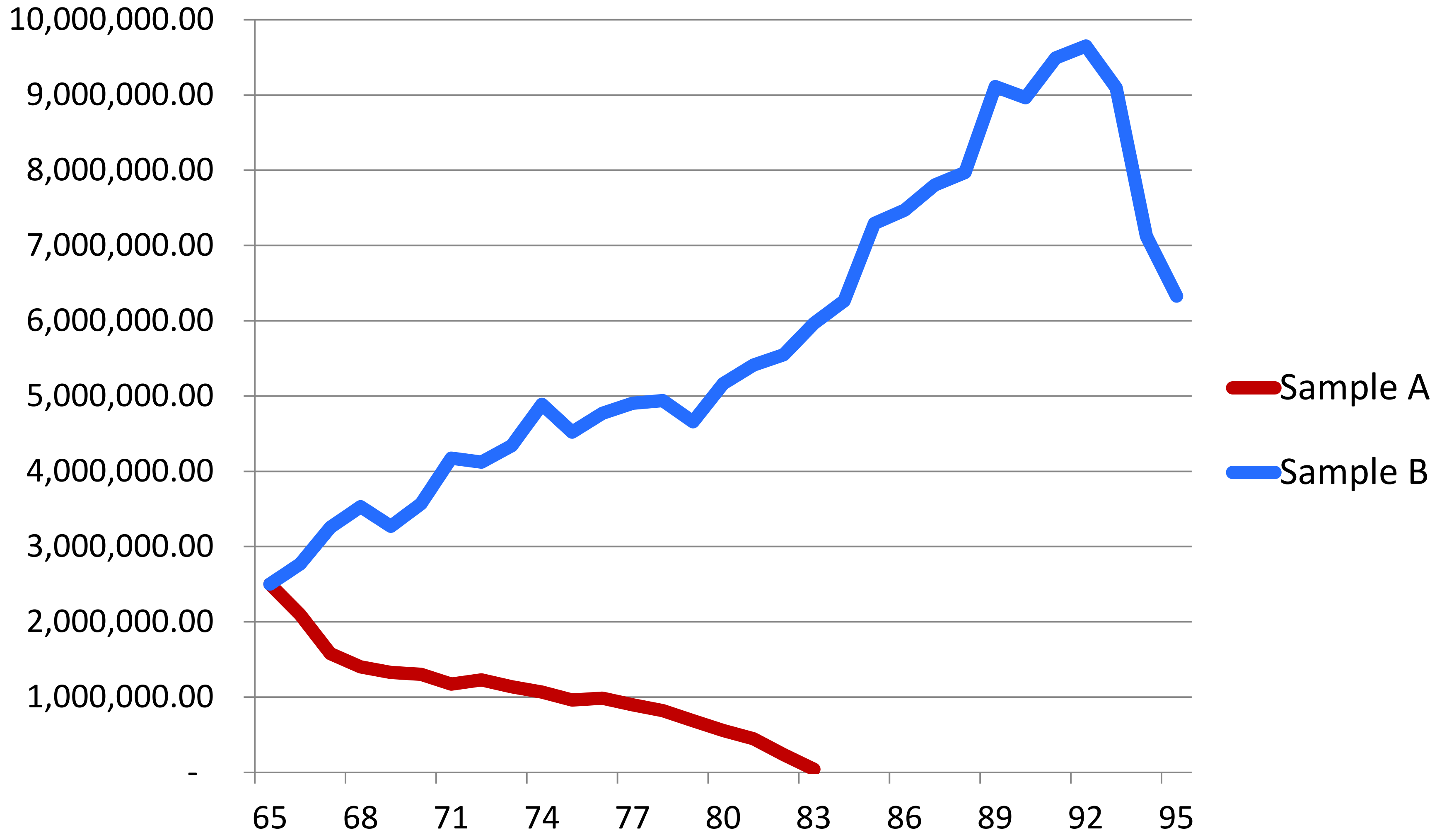
Stock Index Returns: June 2004 - Present



Bond Index Returns: June 2004 - Present



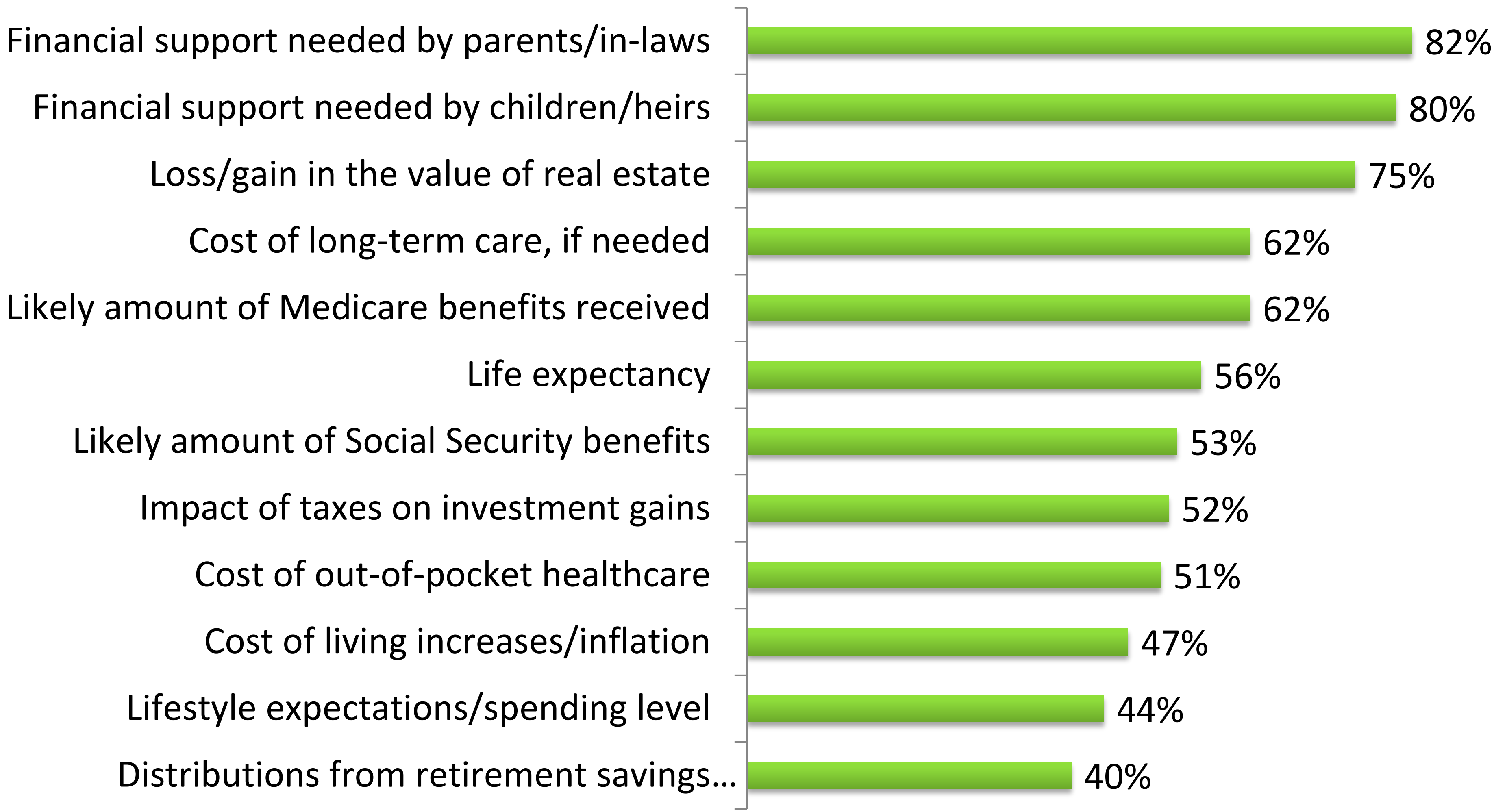
Sequence of returns impacting retirement



Other Variables to Consider

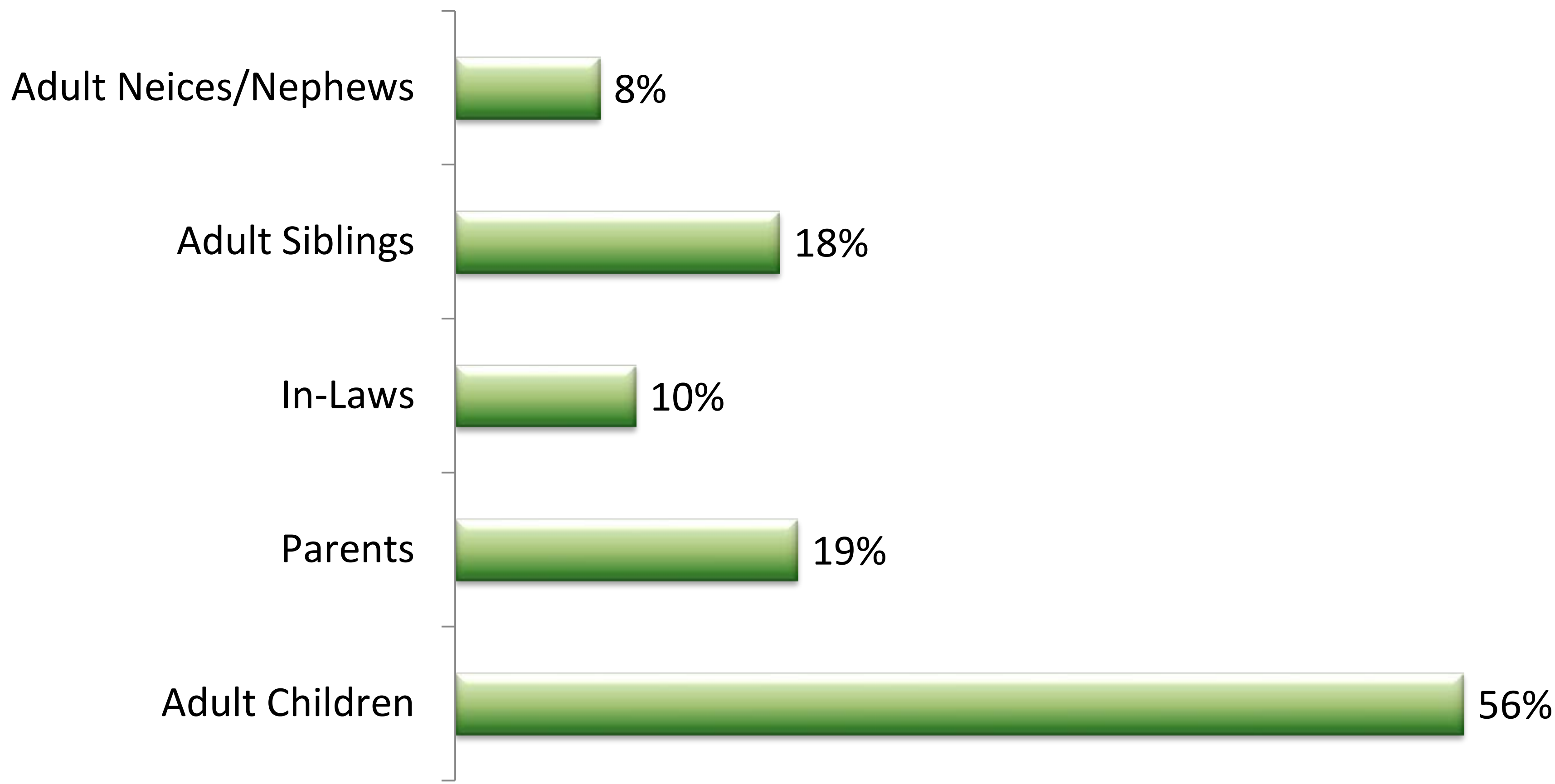
Sold right before or after the net market correction
Sold right before the worst bond market in a decade
Either the owner or spouse has to pay for health care for each other or one of their parents
Gets Divorced
Has or wants to pay for college tuitions (kids or grandkids)
Wants to gift a substantial amount of assets to kids or charity

Factors NOT accounted for in calculating retirement income



Source: US Trust 2013 Key Findings on Insights on Wealth and Worth

Percent who have provided substantial financial support to family members

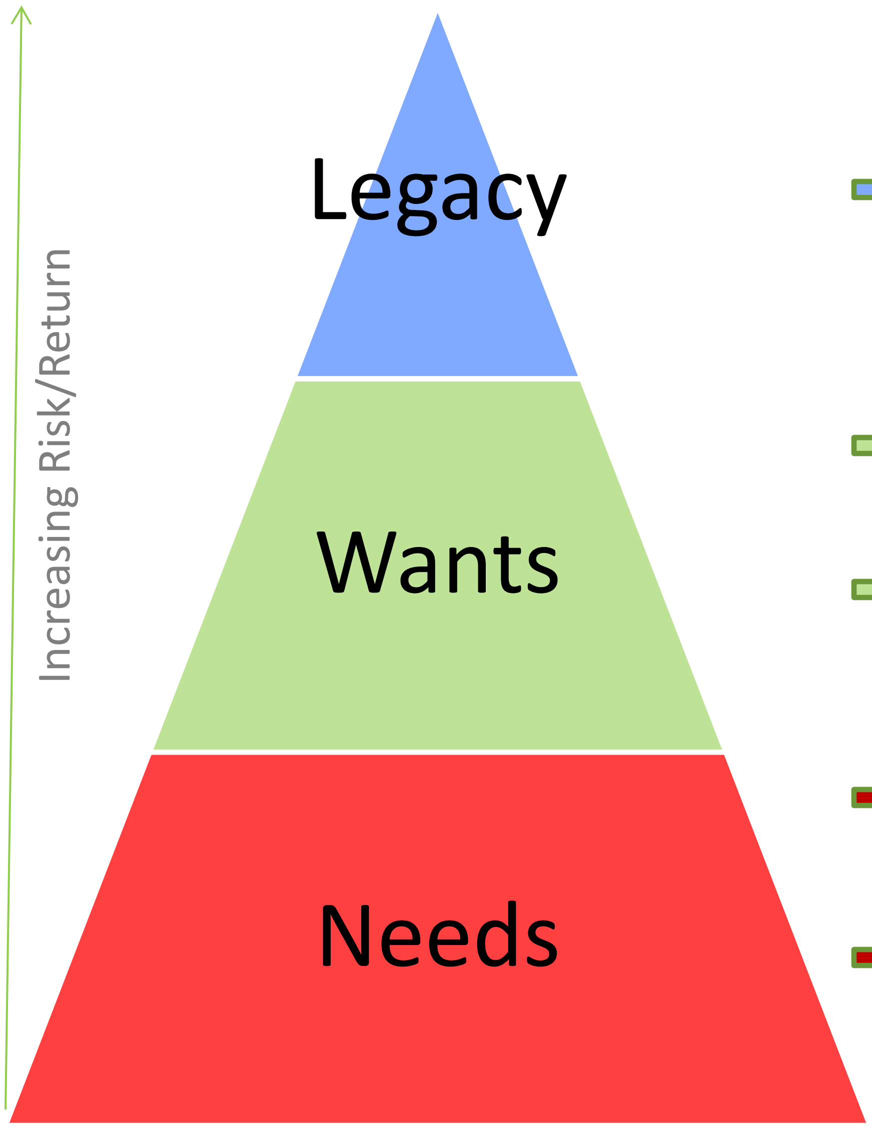


Source: 2013 U.S. Trust Insights on Wealth and Worth

Now the planning is done

How do you construct the portfolio?

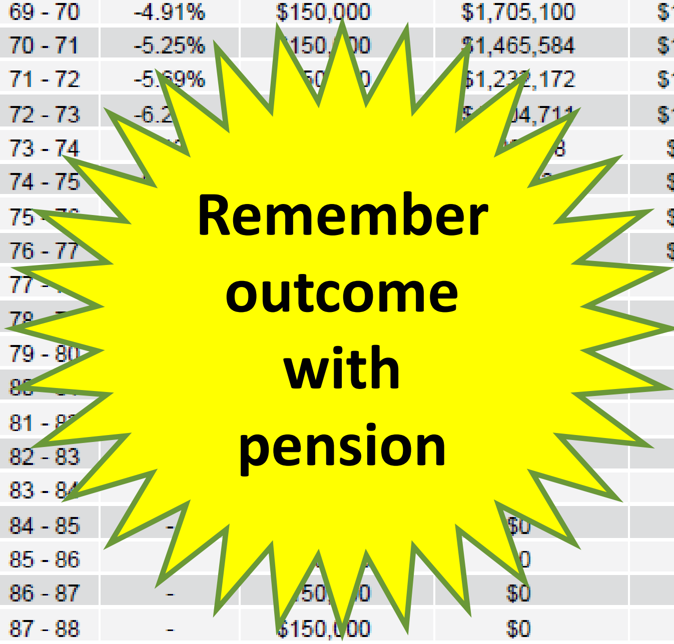
Hierarchy of Financial Priorities



Considerations	Potential Solutions
What is the time horizon not only of yourself, but also of your heirs or endowment?	Equities Alternatives
What are your wants/desires? How much risk are you willing to take?	Equities Bonds
What are your basic needs? What income sources do you have or will you need to create?	Social Security Pension Annuities Bonds Cash / Cash Alternatives

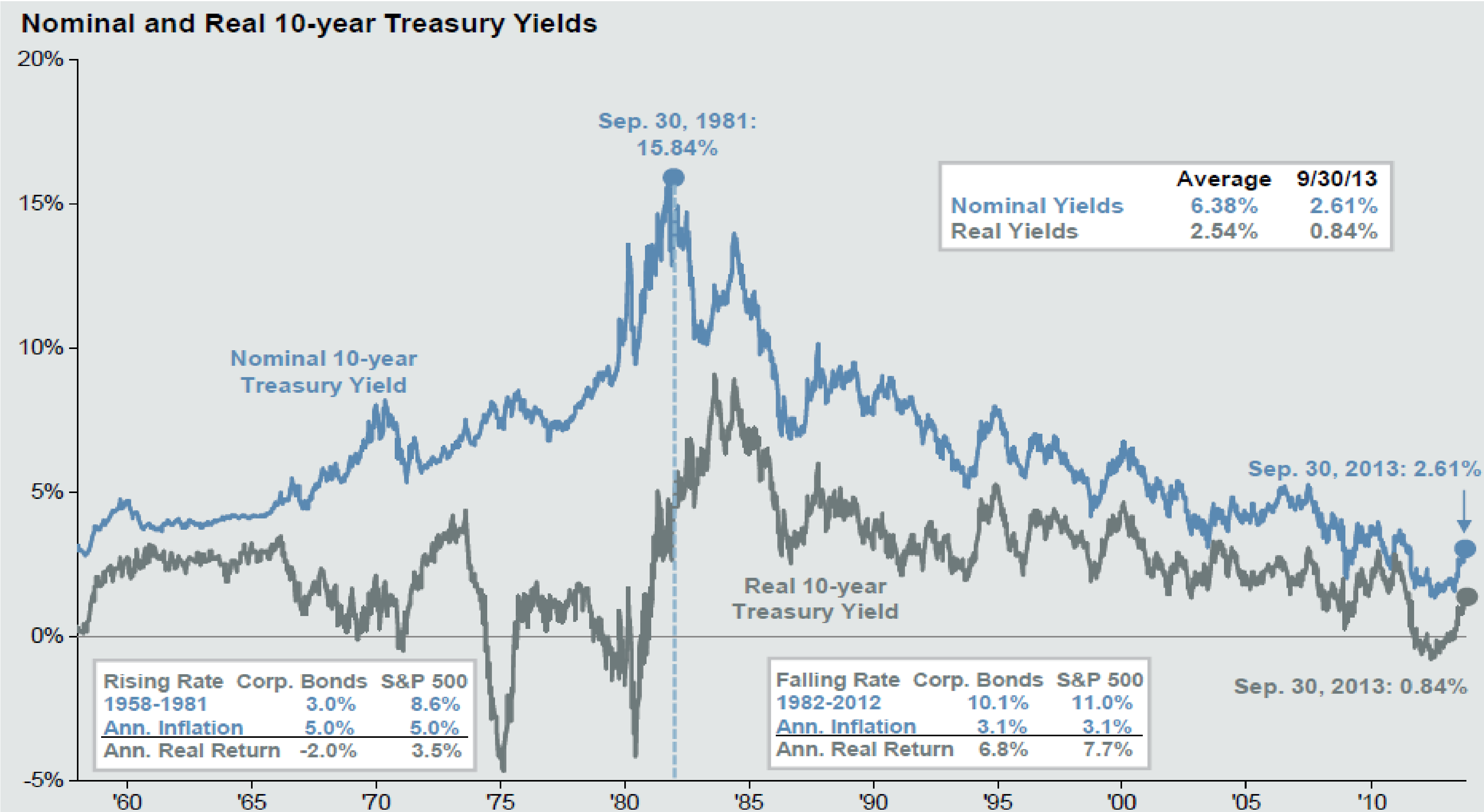
Private Pension with Variable Annuity

Policy Year	Age	Net Annual Return	Annual Withdrawal Amount	Policy Value	Cash Value	[1]Highest Rider Monthiversary Value	Withdrawal Base	Rider Withdrawal Percentage	Available Rider Withdrawal Amount Next Year	Total Withdrawals Received
At Issue	65	-	$0	$3,000,000	$2,784,000	-	$3,000,000	5.00 %	$150,000	$0
1	65 - 66	-4.08%	$150,000	$2,727,476	$2,523,476	-	$3,000,000	5.00 %	$150,000	$150,000
2	66 - 67	-4.24%	$150,000	$2,461,899	$2,293,899	-	$3,000,000	5.00 %	$150,000	$300,000
3	67 - 68	-4.42%	$150,000	$2,203,092	$2,068,092	-	$3,000,000	5.00 %	$150,000	$450,000
4	68 - 69	-4.64%	$150,000	$1,950,882	$1,845,882	-	$3,000,000	5.00 %	$150,000	$600,000
5	69 - 70	-4.91%	$150,000	$1,705,100	$1,627,100	-	$3,000,000	5.00 %	$150,000	$750,000
6	70 - 71	-5.25%	[illegible]	$1,465,584	$1,411,584	-	$3,000,000	5.00 %	$150,000	$900,000
7	71 - 72	[illegible]	[illegible]	[illegible]	$1,232,172	-	$3,000,000	5.00 %	$150,000	$1,050,000
8	72 - 73	[illegible]	[illegible]	[illegible]	$1,004,711	-	$3,000,000	5.00 %	$150,000	$1,200,000
9	73 - 74	[illegible]	[illegible]	[illegible]	$783,048	-	$3,000,000	5.00 %	$150,000	$1,350,000
10	74 - 75	[illegible]	[illegible]	[illegible]	$567,034	-	$3,000,000	5.00 %	$150,000	$1,500,000
11	[illegible]	[illegible]	[illegible]	[illegible]	$356,527	-	$3,000,000	5.00 %	$150,000	$1,650,000
12	76 - 77	[illegible]	[illegible]	[illegible]	$151,386	-	$3,000,000	5.00 %	$150,000	$1,800,000
13	[illegible]	[illegible]	[illegible]	[illegible]	$0	-	$3,000,000	5.00 %	$150,000	$1,950,000
14	[illegible]	[illegible]	[illegible]	[illegible]	$0	-	$3,000,000	5.00 %	$150,000	$2,100,000
15	79 - 80	[illegible]	[illegible]	[illegible]	$0	-	$3,000,000	5.00 %	$150,000	$2,250,000
16	[illegible]	[illegible]	[illegible]	[illegible]	$0	-	$3,000,000	5.00 %	$150,000	$2,400,000
17	[illegible]	[illegible]	[illegible]	[illegible]	$0	-	$3,000,000	5.00 %	$150,000	$2,550,000
18	82 - 83	[illegible]	[illegible]	[illegible]	$0	-	$3,000,000	5.00 %	$150,000	$2,700,000
19	[illegible]	[illegible]	[illegible]	[illegible]	$0	-	$3,000,000	5.00 %	$150,000	$2,850,000
20	84 - 85	-	[illegible]	$0	$0	-	$3,000,000	5.00 %	$150,000	$3,000,000
21	85 - 86	[illegible]	[illegible]	[illegible]	$0	-	$3,000,000	5.00 %	$150,000	$3,150,000
22	86 - 87	-	[illegible]	$0	$0	-	$3,000,000	5.00 %	$150,000	$3,300,000
23	87 - 88	-	$150,000	$0	$0	-	$3,000,000	5.00 %	$150,000	$3,450,000
24	88 - 89	-	$150,000	$0	$0	-	$3,000,000	5.00 %	$150,000	$3,600,000
25	89 - 90	-	$150,000	$0	$0	-	$3,000,000	5.00 %	$150,000	$3,750,000



This is a sample illustration. Actual illustrations will vary depending upon a number of factors, including but not limited to : issuing carrier, age at issue, initial deposit amount, and any additional riders purchased.

Historical View: Bond Interest Rates



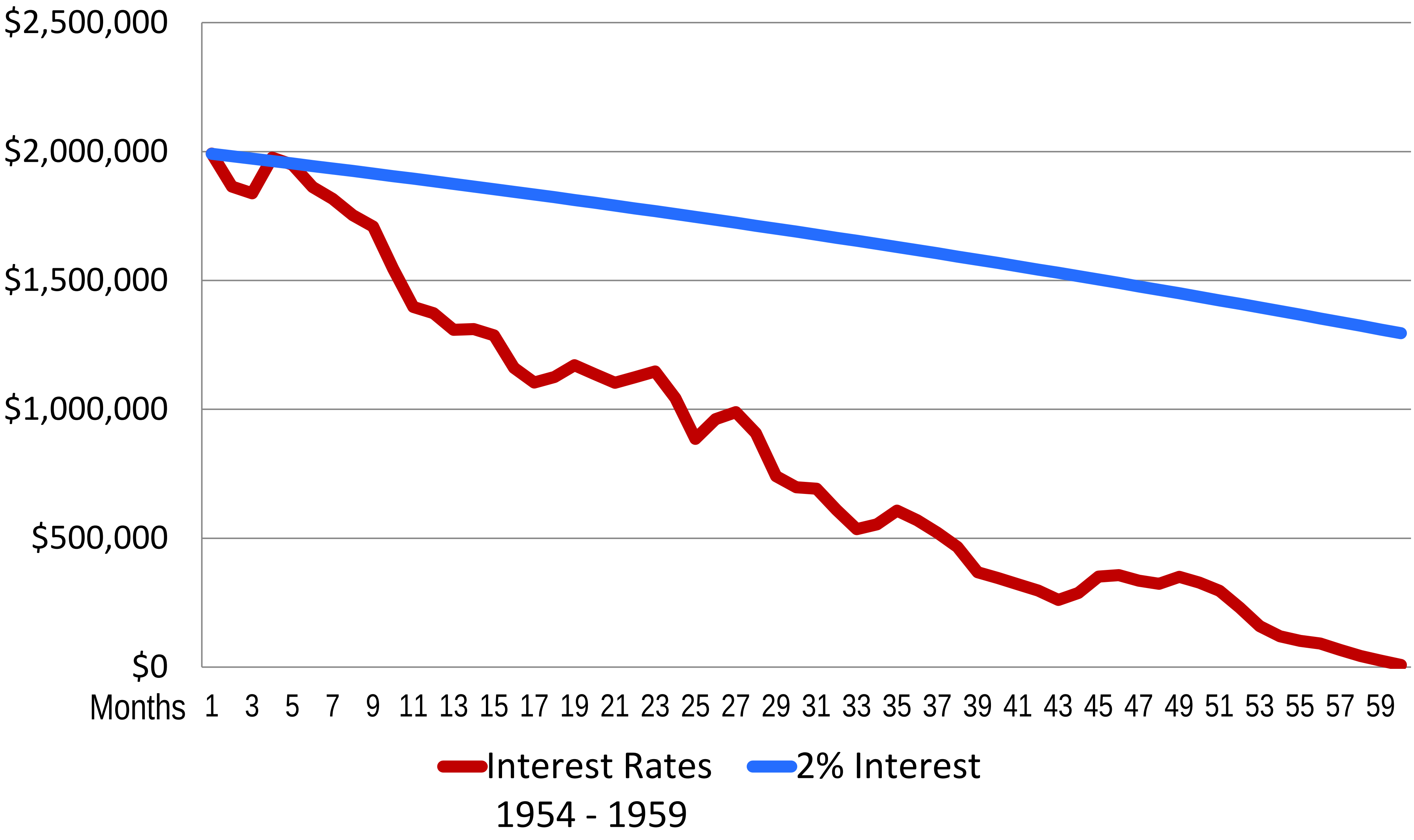
Source: Federal Reserve, BLS, J.P. Morgan Asset Management.
Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core inflation for that month except for September 2013, where real yields are calculated by subtracting out August 2013 year-over-year core inflation. All returns above reflect annualized total returns, which include reinvestment of dividends. Corporate bond returns are based on a composite index of investment grade bond performance. "Guide to the Markets – U.S."
Data are as of 9/30/13.

Hypothetical Bond Income on $3M

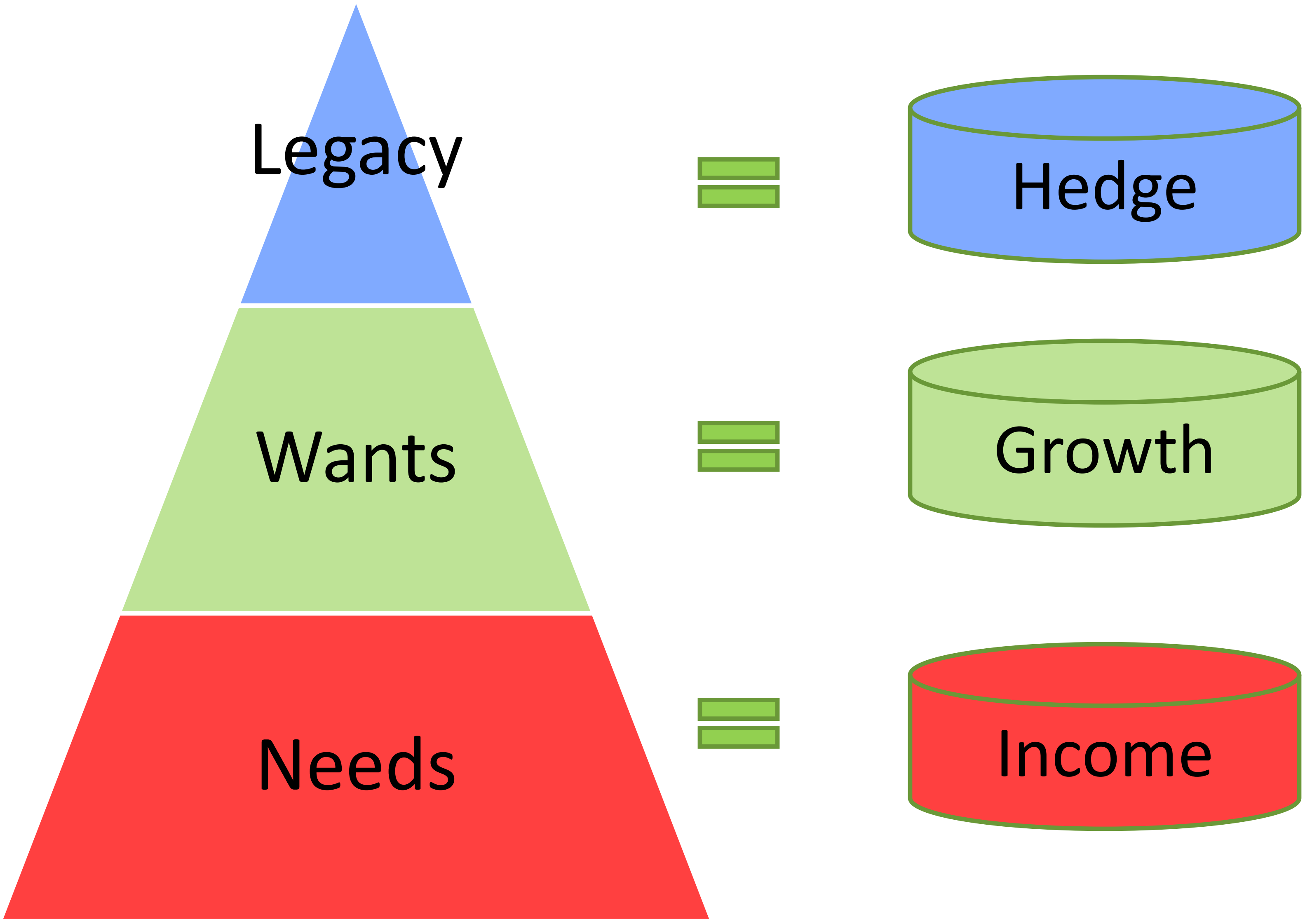
Name	Coupon	Amount	Income
10 Year US Treasury	2.75%	$3,000,000	$82,500
10 Year US Muni Bonds	2.82%	$3,000,000	$84,600
10 Year Corporate Bond	3.32%	$3,000,000	$99,600

Source: Bloomberg Markets 12/12/2013

Interest Rate Effect w/6% Drawdown



Bucket Strategy



Restructuring Portfolio

Income

- Social Security
- Pension
- Annuities
- Bonds
- Cash/Cash Alts
- Real Estate

Growth

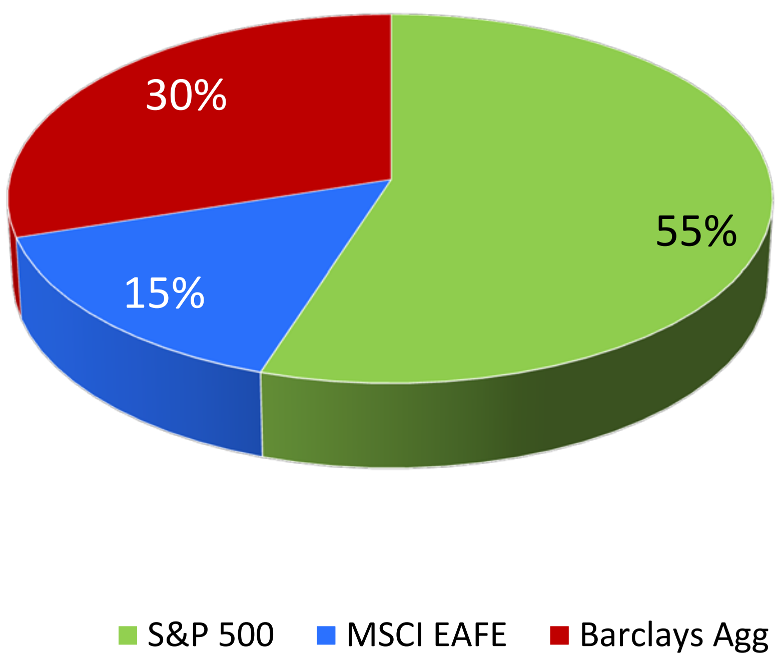
- Equities
- Conv Bonds
- HY Bonds

Hedge

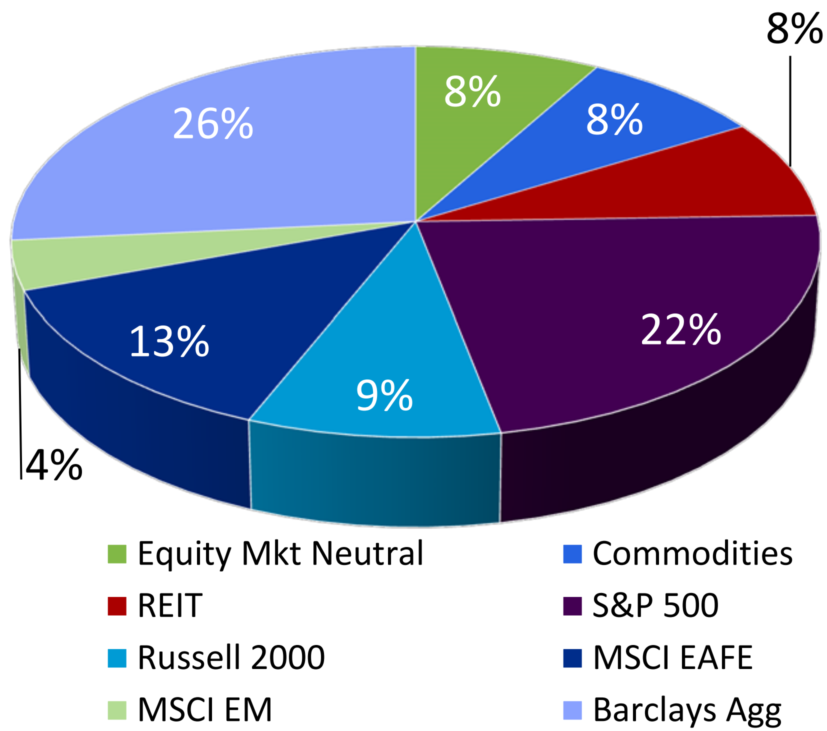
- Equities
- Alternatives
  - Real Return Bond
  - Global Real Estate
  - Multi Sector Bond
  - Currency Strategy
  - Global Absolute Return Strategy

Adding Alternative Assets to a Traditional Portfolio

Traditional Portfolio



More Diversified Portfolio



Risk/ Return Summary (Nov 2003- Nov 2013)	Annual Return	Standard Deviation
60% Stocks/ 30% Bonds/ 10% Cash	6.45%	8.91%
50% Stocks/ 30% Bonds/ 5% Cash/ 15% Alternatives	6.89%	9.07%
45% Stocks/ 30% Bonds/ 5% Cash/ 20% Alternatives	6.93%	8.90%
40% Stocks/ 30% Bonds/ 5% Cash/ 25% Alternatives	6.97%	8.76%

Using Alternatives: Case Study

Endowment Funds for Harvard and Yale Universities

Results of the Endowment Approach to Investing[1]		
	1985-2008	Volatility
Yale and Harvard Endowments Combined	15.95%	9.75%
S&P 500® Index	11.98%	15.6%

	10 Year Average Annual Return	Returns 2009-2012
Yale and Harvard Endowments Combined	10.00%	10.07%
S&P 500® Index	8.22%	15.99%
Typical 60% stocks/ 40% bonds	5.86%	12.82%

1) Source: The Ivy Portfolio by Mebane T. Faber & Eric W. Richardson. © 2009 John Wiley & Sons Inc. 2) Source: Harvard Gazette, January 2010, www.hmc.harvard.edu, S&P Annual Return from Bloomberg.

Typical Balance Sheet

Non Qualified Assets

Cash Equivalents

Checking:	$250,000
Savings:	$250,000

Taxable Investments

Trust A	$714,407
Stock Account:	$1,227,376
Muni Bond Acct:	$892,000
Trust B:	$2,598,290
Sub-Total	***$5,882,073***

Retirement Assets

Qualified Retirement

IRA:	$2,201,532
Roth:	$916,191
Sub-Total	***$3,117,796***

Life Insurance

Whole Life:	$400,000

Real Estate Assets

Primary Residence:	$875,000
Total Assets:	**$10,274,796**

Reorganized

Cash Equivalents:	Income	Growth	Hedge	Total
Checking	$250,000	-	-	$250,000
Savings	$200,000	-	-	$200,000
Taxable Investments:				
Trust A (*xxxx)	$714,407	-	-	$714,407
Stock Account	-	$1,227,376	-	$1,227,376
Muni Bond Acct	$892,000	-	-	$892,000
Trust B (*xxxx)	-	-	$2,598,290	$2,598,290
Insurance Policies:				
Whole Life		-	$400,000	$400,000
Total: Non-Qualified Assets	**$2,056,407**	**$1,227,376**	**$2,998,290**	**$6,282,073**
Qualified Retirement:				
IRA (*xxxx)	$2,201,532	-	-	$2,201,532
Roth (*xxxx)	-	$916,191	-	$916,191
Total: Retirement Assets	**$2,201,532**	**$916,191**	**-**	**$3,117,723**
TOTAL LIQUID ASSETS	**$4,257,939**	**$2,143,567**	**$2,998,290**	**$9,399,796**
Total: Real Estate Assets	-	-	$875,000	$875,000
TOTAL ASSETS	**$4,257,939**	**$2,143,567**	**$3,873,290**	**$10,274,796**
Target Bucket Allocation	41%	21%	38%	

TARGET

Income	**Growth**	**Hedge**
62%	**28%**	**10%**

“In preparing for battle I have always found that plans are useless, but planning is indispensable.”

-President Eisenhower

What happens

if a third-party sale is not a current solution?

Alternatives to Third Party Sale

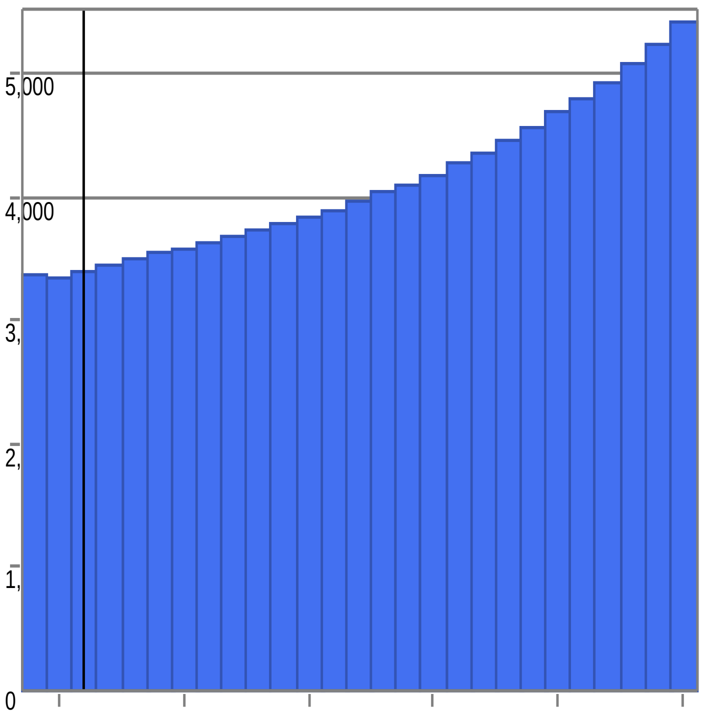
- ESOP
- Sale to Management (Seller Financed)
- Ride out contracts and save as much as possible on a pre-tax basis = **Defined Benefit**
- NQ Executive Retirement
  - Retain, reward, recruit
  - Fund your buy out

Example of DB Plan

	Contribution for Owners	Cost for Employees	Tax Savings @40%	Net Current Benefit (Cost)
Current Safe Harbor and 401(k)	$59,500	$26,580	$34,432	$7,852
Safe Harbor, 401(k) and top off with X-Tested Profit Sharing Plan	$105,500	$57,094	$65,038	$7,944
Combination Cash Balance/401(k) Profit Sharing Plan	$310,000	$100,358	$164,143	$63,785

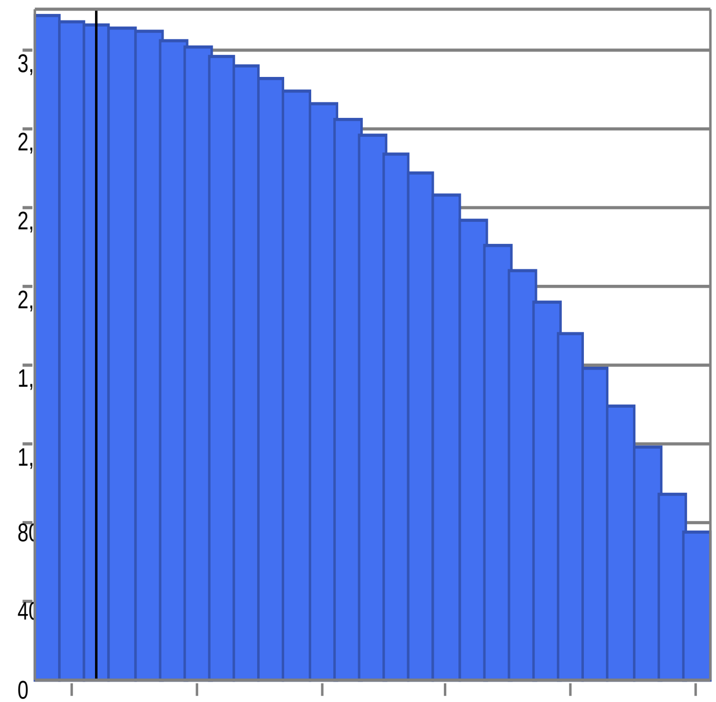
Owner B (65) with / without pension

Owner B w/Pension



Monte Carlo simulation is 98% successful

Owner B w/o Pension



Monte Carlo simulation is 42% successful

Key Points

- Proper Planning = Superior Results
- Consider Multiple Variables
- Timing is Everything
- Contingency Planning

Thank you!

John P. Keenan, CFP®, AIF®, C(k)P®
Partner, SEIA
8607 Westwood Center Drive, 3rd Floor
Vienna, VA 22182
703.287.7151
JKeenan@SEIA.com

SEIA

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www.SEIA.com