

ACQUISITION CRITERIA MEMO
Project Name: Hammer

Executive:

Date: 26 January 2011

<p>Industry Description</p>	<ul style="list-style-type: none"> • Pump & compressor manufacturing industry is defined as OEM and aftermarket manufacturing, distribution, and retailing of general purpose air and gas compressors, nonagricultural spraying and dusting equipment, general purpose pumps and pumping equipment (except fluid power pumps and motors), and measuring and dispensing pumps products and services (NAICS 33391) • The Pump and Pumping Equipment Manufacturing sub-segment is area of focus (NAICS 333911). This sub-segment includes general purpose pumps and pumping equipment such as reciprocating pumps, turbine pumps, centrifugal pumps, rotary pumps, diaphragm pumps, domestic water system pumps, oil well and oil field pumps and sump pumps • Primary industries served include chemical, petrochemical, food/sanitary, pharmaceuticals, mining, ceramics, construction, automotive, aerospace, pulp and paper, steel making, electric power generation, water and wastewater, oil and gas, and energy (including alternative energy such as windmills, etc.) • Other segments include (a) fluid power pumps and motors (NAICS 333996), (b) measuring and dispensing pumps (NAICS 333913), and (c) vacuum pumps (NAICS 333912) • Other markets and applications served by the fluid metering, transfer and control technologies range from chlorine injection in home water conditioning systems or swimming pools to heavy water transfer and processing in nuclear generators. Others include, but not limited to, car washes, ware wash, food processing, water conditioning, mining, pulp & paper, paints & dyes and utilities
<p>Size, Growth, Margins and Fragmentation</p>	<p>Pumps and Pumping Equipment Mfg Sub-segment (US market)</p> <ul style="list-style-type: none"> • \$13.2 bil, 4% growth, 10-17% margins • Estimated 35% of revenue from replacement parts and accessories • Estimated 407 companies; top 10=55% of industry revenues (rough estimate) • Estimated 95 companies with revenues between \$20M and \$500M • Estimated 256 companies with revenues between \$5M and \$20M
<p>Key Industry Trends/ Opportunities</p>	<ul style="list-style-type: none"> • Highly engineered products: most pumps are made to the end user's specific requirements for use in complex applications where the failure of the pump could be disastrous. Consequently, flexibility and reliability are stressed • Demands for higher-efficiency: mature industry with low rate of vitality. A good opportunity for innovative companies to grow organically and acquisitively • Ongoing research concerns include noise and leakage reduction, increased efficiency, corrosion-resistance and development of oil-free and self-lubricating models • Emerging markets: BRIC (Brazil, Russia, India and China) regions growth is forecasted at 20%+ in the next decade • The nuclear energy industry is expanding in the double digits over the next decade with over 20 nuclear power plants already planned worldwide (and more to come). China is the fastest growing demand market for nuclear power applications • Global wind and other alternative energy markets are on a growth upswing forecasted to continue over the foreseeable future <p>• Target markets indicator overview (Nov 2010):</p> <ul style="list-style-type: none"> - Macro: US PMI 56.9 (upward trend), Global PMI 53.7 (upward trend)

	<ul style="list-style-type: none"> - Chemicals: 94.2 (upward trend YOY, low risk) - Paint/Coatings: 72.8 (upward trend YOY, medium risk) - Adhesives: 74.1 (upward trend YOY, medium risk) - Petroleum/Coal Products: 96.7 (upward trend YOY, high risk) - Petroleum Refining: 99.3 (upward trend YOY, high risk) - Ethyl Alcohol: 128.3 (upward trend YOY, low risk) - Clay products: 77.1 (upward trend YOY, medium risk) - Machinery: 85.8 (upward trend YOY, medium risk) - Heavy Duty Truck: 67.4 (upward trend YOY, medium risk) - Food: 105.6 (upward trend YOY, low risk) - Sugar/Confectionary: 127.0 (upward trend YOY, low risk) - Dairy: 104.3 (upward trend YOY, low risk) - Housing Starts: 519 (downward trend YOY, high risk) - Total US Industrial Production: +5.4% YOY growth - US Industrial Products Mfg: +6.2% YOY growth - US Mfg Capacity utilization: +6.5% YOY growth - Basic Chemical Mfg (NAICS 3251): +6.7% YOY - Chemical Mfg (NAICS 325): Paint/Coatings/Adhesives +3.7% YOY - Paint/Coating/Adhesive Mfg (NAICS 3255): Paint & Coating +7.2% YOY - Paint/Coating/Adhesive Mfg (NAICS 3255): Adhesive +9.6% YOY - Clay Product/Refractory Mfg (NAICS 3271): Total Clay Production +12.9% YOY - Clay Product/Refractory Mfg (NAICS 3271): Pottery/Ceramic/Plumbing -8.8% YOY - Petroleum/Coal Products Mfg (NAICS 324): Petroleum Products +1.9% YOY - Petroleum/Coal Products Mfg (NAICS 324): Asphalt Paving/Roofing +2.8 YOY - Petroleum Refineries (NAICS 324110): +2.1% YOY - Ethyl Alcohol (NAICS 325193): +15.9% YOY - Crude Oil Production: +4.2% YOY - Machinery Mfg (NAICS 333): Machinery +15.2% YOY - Machinery Mfg (NAICS 333): Engine/Turbine +0.7% YOY - Transportation Equipment Mfg (NAICS 336): Heavy Duty Truck +9.0% YOY - Transportation Equipment Mfg (NAICS 336): Railroad +7.5% YOY - Water/Wastewater Quotation Activity: -54.7% YOY - Housing Starts (units): -1.9% YOY - Food & Beverage Mfg (NAICS 31): Food +6.2% YOY - Food & Beverage Mfg (NAICS 31): Beverage +6.7% YOY - Food Mfg (NAICS 311): Sugar & Confectionary +1.6% YOY - Food Mfg (NAICS 311): Other Food +15.0% YOY - Soap/Cleaning Compound/Toilet Prep (NAICS 3256): +2.5% YOY - Semiconductor Mach. Mfg: +158% YOY - Semiconductor Related Devices Mfg: +11.6% YOY • Opportunities in such a mature market lie in serviced growth segments some of which are listed above where the major fluid management players are expanding their market share primarily through acquisitive growth over the next 5 years. Our strategy entails: <ul style="list-style-type: none"> - acquiring technologically progressive companies (\$10M to \$75M) in this space, as well as in adjacent/complementary markets. Note that many of these target companies are operationally inefficient - bundling up the products & technologies and provide integrated value-add systems with premium pricing and margins - addressing operational inefficiencies labor, material, fixed costs, etc. in a quick and methodical manner. I, along with my team, provide a core competency and a
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	<p>proven toolset in this area including, but not limited, a standard and effective margin enhancement process that addresses commercial (pricing, discounts, etc.), operational, financial, engineering/material sourcing/value engineering opportunities with the deployment of actionable countermeasures</p> <ul style="list-style-type: none"> - in addition to acquisitive growth, driving above average core growth in this segment through accretive top line (improved demand drivers) and margins (operational improvements) - potentially localizing the operational footprint in emerging markets to leverage the US brand, the ability to service locally and the lower operating and logistics costs (incl. labor, material, duty/tax, freight) - positioning the company for improved prospects and acquisition by a major industry/segment player. Coming out of a low/trough over the next 3 to 5 years provides attractive timing <ul style="list-style-type: none"> • LCR competition is less preferred because of lower quality, lower technological aptitude and capabilities, lower service level • Option for vertical integration to take cost out and provide turnkey solutions/products. Risky in a down economy
<p>Key Threats/ Challenges</p>	<ul style="list-style-type: none"> • Mature industry in the US with the bulk of organic growth is expected to be tied to replacement purchases. Additional growth will come from vitality (technology improvements/new product development) requiring substantial engineering and capital investment • Economic volatility: The health of the pump manufacturing and fluid management product manufacturing industry depends to a great extent on the general health of industrial America. Future focus will have to be on producing technologically advanced, highly customized pumps and equipment • Material price and energy cost volatility: Product construction materials used include cast iron, steel, stainless steel, plastics (PP), aluminum and rubber – most are highly commoditized items. Present rising commodity prices are a red flag and may signal inflation that may be in the works which will lead to interest rate hikes by the Federal Reserve. Key to combat these inflationary effects is to pass the cost on to the customer or distribution channel through price increases (common but undesirable practice in this industry) • Require low-cost region material sourcing to remain competitive. Material content as % MP is around 35% to 50%. Labor content as % MP is only 7% to 10% • Top 10 market players have dominance over the US market. 60%+ of sales are through distribution channels that are brand focused • BRIC growth requires market localization. Brazil market concern with tax/duty costs. Russia market concern is corruption and political stability. India and China concerns are increasingly rising labor and material costs • Housing and municipal spending in the US will remain slumped at least for the next 2 years • Substantial operating and engineering capital investment may be required • Environmental & health risk exposure from historical operations require due diligence and valuation prior to acquisition
<p>Key Product Descriptions (prioritized and margins)</p>	<ul style="list-style-type: none"> • Air-operated diaphragm (AOD) standard duty pumps (40% margins) • Air-operated diaphragm (AOD) heavy duty pumps (50% margins) • Standard duty or general-purpose internal & external gear pumps (40% margins) • Heavy duty internal & external gear pumps (50% margins) • Hydraulically actuated diaphragm precision metering pumps (40% margins) • Mechanically actuated diaphragm precision metering pumps (40% margins)

	<ul style="list-style-type: none"> • Solenoid diaphragm precision metering pumps (40% margins) • Centrifugal transfer pumps (35% - 40% margins) • Rotary lobe pumps (40% margins) • Vane pumps (40% margins) • Regenerative Turbine Pumps (40% margins) • Chemical feed systems (45% margins) • Controllers (40% - 50% margins) • Compressors (35% - 40% margins) • Truck pumps (35% margins) • By-pass valves (40% - 50% margins) • Custom engineering solutions (50% - 60% margins) • Spare parts & aftermarket solutions (55% to 65% margins) • Other misc. (45% to 65% margins): <ul style="list-style-type: none"> - Gear Reducers - Basket Strainers - Power load monitors - Mufflers • Complete Systems (50% to 65% margins)
Key Segments	<ul style="list-style-type: none"> • Typically, 65% to 90% sales through global distribution channels • Balance is strategic or OEM accounts (target for system platform sales) • See above for key segments and markets
Manufacturing tech/processes (prioritized)	<ul style="list-style-type: none"> • Strategic sourcing of material especially in low-cost regions (LCR). Managing the supplier quality and delivery, as well as the demand forecast and material logistics are key to success or failure • Primary manufacturing processes include machining, assembly and testing • Secondary processing include painting and system/platform integration • Packaging and shipping
Acquisition Thesis	<ul style="list-style-type: none"> • Build a \$50M - \$75M fluid metering and transfer technology/manufacturing company to \$150M - \$220M in 3 years; 70% acquisitive / 30% organic growth • • [xyz] segment is attractive because [a, b, c] • Acquire a platform with \$40-60 mil of revenues in [xx] segment • Make add-on acquisitions with \$15-100 mil in revenues in [x, y, z] segments to complement the product offering, improving the long term growth prospects • Scale economies and consolidation of plants will improve margins by 750 bps • → Result is platform positioned as #1 player in niche segment with above average margins and growth prospects
Top 5 Targets	<ul style="list-style-type: none"> • [x] = \$45 mil rev; personal relationship/actionable • [y] = \$35 mil rev; interested only when platform consummated • [z] = \$60 mil rev; no contact/cold • [a] = \$100 mil rev; no contact/cold • [b] = \$75 mil rev; no contact/cold • [there are 15 more potential platform targets in N.A.]
Geographic Preferences	<ul style="list-style-type: none"> • North America HQ with global reach • Geographic preferences include OH, NC, SC, GA, TX and the midwest

Preferences (Size, Segment, other)	<ul style="list-style-type: none"> • Platform: \$40-100 mil • Add-on: \$15-50 mil • Desire supplemental acquisitions to build scale
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DISCUSSION LOG

Conversation Log	<ul style="list-style-type: none"> • 12/17/10 – Delivered resume and first thesis cut and discussed with Blackmore • 01/27/11 – Delivered 2nd cut thesis and investment candidate descption • [e/f/g – sent to likely PEG interested and qualified; awaiting introductory call]
Next Steps and Follow-up	<ul style="list-style-type: none"> • [set up 30 minute intro with PEG xyz, discuss opportunity and next steps] • [date to occur by]

[note: if data is not available, note it as an estimate which is better than nothing]