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Technology Investment Banking — OEM Capital

EDITOR'S COMMENT: *The technology sector is so ubiquitous, pervasive and complex that it is almost unthinkable for a generalist in the investment banking world to achieve the same type of success for a high-tech company as an industry specialist. It was with this premise that M&A Today was enlightened to interview OEM Capital in Westport, Connecticut, a firm that specializes in merger and acquisition advisory and investment banking services for hardware and software companies in the electronics, communications and computer industry.*

BACKGROUND
OEM Capital was founded in 1985 by Ron Klammer who perceived a need for a high-tech investment banking firm serving the middle market. His vision was to build an organization of professional dealmakers with a variety of high tech industry expertise but all of whom had extensive prior experience as operating executives. For example, Ron has over 35 years of experience in all aspects of the electronics industry and

was a corporate vice president of Gulton Industries, Inc., a diversified NYSE electronics company, where he was responsible for initiating and closing the acquisition and divestiture of six businesses and returning four divi-

sions to profitable growth. In 2000, Stuart Litt rejoined OEM after a leave of absence in which he was executive vice president of American Technical Ceramics Corp., a manufacturer of high performance capacitors and thin film networks. Earlier, he was president of the Tech Systems division of Datron, Inc. and led business development activities for Vega Precision Laboratories and Hazeltine Corporation.

OEM has a total of six principals who are all deal-



Ron Klammer

makers and there are four support staff. OEM also has an affiliate in London, Henk van-Holst, who has a firm that specializes in identifying, qualifying and evaluating potential business partners for technology transactions in Europe.

Since OEM Capital's inception, the firm has initiated and completed a large number of transactions for New York and American Stock Exchange and NASDAQ listed companies, and a variety of

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Technology Investment Banking — OEM CAPITAL

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over-the-counter and privately held companies located throughout the United States. The average transaction size of companies OEM sold has ranged from \$5 to \$50 million, and in some cases, these companies were divisions or subsidiaries of larger entities with revenues over \$2 billion.

OEM'S OPERATING MODEL

Focusing strictly on US companies in the electronics, communications and computer industry, OEM's space includes approximately 12,500 companies of which 2,500 are public and about 10,000 are privately held. Of this total, there are approximately 4000 software companies of which most of the smaller software companies face huge distribution problems, thus need help consolidating in the near future. With OEM's universe of potential clients defined and identified, the firm can approach them indirectly with mailings showing their industry expertise or directly from professional or corporate referrals. Once in front of the potential client, then "getting the business" is a matter of exploiting OEM's competitive advantages which boils down to five critical items as follows:

- sharing similar operating experiences
- rapidly appreciating the potential client's business model

- talking the potential client's language
- comparing mutual industry contacts
- demonstrating OEM's success with their tombstones.

About 65% of OEM's business is geographically from California, the Middle Atlantic States and New England, covering most of the high-tech hot spots in the country; however, last year two of OEM's transactions were located in the

Denver area. Further, about 5-10% of OEM's annual deals are cross border, but this figure is expected to grow with their relationship with von-Holst Associates in the U.K. and OEM's alliance with International Association of Merger & Acquisition Professionals (IMAP) to be discussed later.

According to Ron Klammer: "85% of our M&A assignments are representing sellers in which we run a sophisticated variant of an auction process. If these sellers are not under operational or financial distress, we have an incredibly high closure rate as almost all the acquirers

are strategic and we are able to position our client to them in an optimal fashion. The OEM client mix is approximately 40% public companies, 40% private companies, and 20% com-



Stuart Litt

ination of Venture Capital and Private Equity Groups. 15% of OEM's transactions involve recapitalizations or involve buyers if our client has predetermined the target companies, and/or we are also engaged in the acquisition financing."

Few other investment banks successfully undertake the sale of the operationally and/or financial distressed high-tech companies owned by venture capital firms.... commonly known as the "living dead" and frequently comprising one-third of venture capitalist portfolios.

From Stuart Litt's perspective: "OEM's success is knowing which companies

are not in that particular space, but want to be in that particular business... then network like crazy to get in front of these potential buyers. Aside from our extensive relationships, OEM has a computer database of 12,500 industry players plus 4,000 investors of venture capitalist and private equity groups."

An important part of OEM's sales and marketing efforts is attending industry trade shows which includes the following six: CTIA (wireless), SEMICON (semiconductor tools), MTT (microwave), NAB (broadcasting), Comdex (computers and software), and CeBIT, the Hanover Germany electronics show. OEM receives the exhibitors list well in advance, schedules appointments with company principals and then follows-up with a telephone call after the show. This type of networking is essential for OEM in initiating new relationships and reconfirming old relationships.

Ron Klammer believes that OEM's basic competition comes from regional brokerage firms and lower tier national investment banks, which in some cases have inexperienced investment banking associates who are put in charge of the smaller deals. Ron cited one case in which another IMAP firm, Mertz Associates, and OEM combined together in presenting their services to a selling company. As part of

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their presentation, Ron said that they estimated the enterprise value of the selling company was \$30 million. The competing nationally recognized firm estimated the enterprise value to be \$43 million, and not surprisingly won the assignment. Guess what? The company was never sold!

THE GROOMING PROCESS

Once the assignment commences, OEM wants to be sure that they do not rush the company to market before their client is fully groomed. Realizing the value of first dressing up the company, Chuck Gamer, who is a principal of OEM and former senior sales executive at Digital

and Compaq explained as follows: "We encourage our selling client to take the necessary time and energy to properly prepare the company for sale. It might include obtaining audited financials and credible multi-year projections if not already available. It might be selling off unprofitable product lines and reducing receivables and inventory in order to increase cash. It might be reviewing the company's business model in order to spot fundamental weaknesses or solidify next year's contract with the company's major customer or improve the plant's house-keeping. Maybe it is strategizing differently by selling the company as a product line valued at a multiple of

contribution to fixed costs, especially if the company does not show a profit at the EBITDA level. These are the types of programs we help the client implement to earn our stripes."

OEM'S AFFILIATES

OEM is a member of IMAP which is comprised of over 57 member firms in the U.S. and abroad, i.e., United States (40), Europe (12), Canada (2), South America (2), and Asia (1). This network which communicates regularly and meets twice a year is a select group of dedicated merger and acquisition professionals and gives the firm representation in many of the important cities throughout the world. In 2001 total transactions by

the member firms amounted to 199 worth \$2.1 billion in the aggregate.

The other group of OEM's affiliates include over twenty industry consultants who may introduce the firm to potential buyers or sellers, who are called upon to provide industry expertise or who may write the marketing and competition sections of certain Offering Memorandums for OEM. In all cases, these consultants are compensated by OEM.

OUTLOOK FOR TECH COMPANIES

The outlook for OEM is positive given the need for further consolidation in the technology sector, and the

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Historical OEM Client Distribution by Major Product Category



Electronic Components	5%
Packaged Products	15%
Communications Equip.	20%
Production Equipment	10%
Measurement/Control	20%
Computers/Periph.	20%
Software	10%

Components include discrete electronic parts and semiconductors

Products include antennas, power supplies, embedded computers and other items not classified as capital equipment

Equipment includes capital items without a large software content

Systems include capital items that are approximately equal in hardware and software value

Software does not include any hardware items

TECHNOLOGY INVESTMENT BANKING — OEM CAPITAL

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likelihood that many small companies will not survive on their own. As Stuart Litt states: "Another round of industry consolidation is imminent, just waiting for things to stabilize enough to give a little confidence to business valuations. This will be fueled by:

- * Reduction in the number of customers at the top of the 'food chain' as they merge, outsource and consolidate vendor bases, leaving less competitive space for lower-tier vendors.

- * Decimation of 'second-lowest-price' companies by foreign competition

- * Increased integration of products, requiring broader technical and manufacturing capabilities

- * Increasing use of acquisitions as a growth strategy by the stronger companies

- * Public companies' desire to show top line stability, helped by new accounting rules for goodwill.

Unlike recent times, mergers and acquisitions will not be supported by irrationally cheap public equity money, so tomorrow's successful M&A deals will have to be crafted carefully to provide fair

value and reasonable opportunity for return on investment."

CONCLUSION

In the recent past, shareholders of high-tech companies have held inflated values of their business. With the recent dramatic correction in NASDAQ stock prices, high-tech val-

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uations are now closer to historical norms. This industry is not necessarily cyclical but it is volatile; and it is also maturing and consolidating. There is a real need for OEM's technology investment banking expertise for middle market companies. Their industry specialization is essential for not only understanding technology but in knowing the right buyers and sellers, often on a first name basis. OEM's dealmakers are former CEOs who have "been

there and done that" and not young MBAs "learning how to do deals as they go." OEM's professionals have the insight to customize parts of the Offering Memorandum or a customized presentation to appeal to the needs of specific acquirers and then show the acquirer why they can not afford to lose this acquisition opportunity to a competitor.

As Ron Klammer states: "Because our senior executives have a combination of investment banking and electronics industry operating expertise, we have been usually successful in securing exceptional results for our clients. Our past performance illustrates that, whether a business is

healthy or impaired, maximum shareholder value can be realized by investment banking professionals who are knowledgeable about the electronics industry and the state of the financial markets."

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