

Electronic Manufacturing Services

# Strategic Alternatives for Balancing Growth and Liquidity

For additional information or inquiries, please contact one of our team members:

Matthew Jamison  
Managing Director  
(248) 223-3368  
[matt.jamison@pmcf.com](mailto:matt.jamison@pmcf.com)

Gene Bitonti  
Vice President  
(248) 603-5088  
[gene.bitonti@pmcf.com](mailto:gene.bitonti@pmcf.com)

## Electronic Manufacturing Services Sector Overview

### General Trends

Companies in the electronics and electronic manufacturing services (“EMS”) industry are seeking to optimize positioning to capitalize on the growth dynamics currently in play. Increased demand for consumer electronics, automobiles and communication devices is expected to be driven by the rebound of the global economy, worldwide population growth and the emergence of large and growing middle classes in developing nations. In addition, the industry shift towards outsourcing and the evolution of technology will contribute to rising production volume. Increased automation in the aerospace and medical industries will also provide EMS companies with revenue opportunities. Finally, the industry is undergoing a consolidation phase, which will allow EMS firms to leverage economies of scale to increase profit margins, product offerings and capabilities. As a result, business owners looking for exit opportunities will find the coming months and years attractive for potential transactions.

The following table describes end market demand, outsourcing trends and margin profiles for the most common industries served in the EMS sector:

End Market	End Market Demand Forecast	Outsourcing Trend	Margin Profile
<b>Aerospace &amp; Defense</b>	<ul style="list-style-type: none"> <li>Driven by Increased Component Automation</li> </ul>	<ul style="list-style-type: none"> <li>Increasing</li> </ul>	<ul style="list-style-type: none"> <li>Lower Volume, Higher Mix</li> <li>Higher Margin</li> </ul>
<b>Automotive</b>	<ul style="list-style-type: none"> <li>Continued Recovery of Production Volume</li> </ul>	<ul style="list-style-type: none"> <li>Steady</li> </ul>	<ul style="list-style-type: none"> <li>Downward Pressure on Margins</li> </ul>
<b>Communication Equipment</b>	<ul style="list-style-type: none"> <li>Mobile Device Growth with Smartphones</li> </ul>	<ul style="list-style-type: none"> <li>High and Steady</li> </ul>	<ul style="list-style-type: none"> <li>Average Margin</li> <li>High Competition</li> </ul>
<b>Data and Computers</b>	<ul style="list-style-type: none"> <li>Healthy Growth Projected</li> </ul>	<ul style="list-style-type: none"> <li>High and Steady</li> </ul>	<ul style="list-style-type: none"> <li>Increasing Competition</li> <li>Decreasing Margin</li> </ul>
<b>Medical</b>	<ul style="list-style-type: none"> <li>Steady Revenue Projected</li> </ul>	<ul style="list-style-type: none"> <li>Increasing</li> </ul>	<ul style="list-style-type: none"> <li>Lower Volume, Higher Mix</li> <li>Higher Margin</li> </ul>

### Factors Supporting Growth in Electronic Manufacturing Services

In addition to growth in end markets, the following outlines select trends increasing the prevalence of electronic component outsourcing:

- Higher Technological Capabilities - Companies operating in the EMS industry have exhibited increasing technological sophistication. This increase in capabilities allows EMS companies to provide products and components meeting tighter tolerance requirements and more complete assemblies.
- Comprehensive Service Offerings - EMS companies currently provide a full suite of services to complement their manufacturing services. Comprehensive service offerings include design and engineering services on the front end of the manufacturing process, and enhanced diagnosis and repair of damaged or malfunctioning parts on the back end. These service offerings increase OEM reliance on EMS providers and strengthen and lengthen customer relationships.
- Desire to Shift Production / Commodity Pricing Risk - OEMs, faced with high volatility in end markets, are looking to shift the risk of production volume and commodity prices to a third party. As a result, there will be tremendous growth in the outsourcing of product inputs. Production volatility is exacerbated by shorter product cycles in many end markets.

### M&A Trends in Electronic Manufacturing Services

The EMS sector is undergoing a consolidation phase as industry participants evaluate strategic alternatives associated with customer and end market exposure, manufacturing and service capabilities and economics of scale. There are several factors contributing to the consolidation trend, including the shifting of end market preferences and the desire of EMS companies to enhance their service offerings. Characteristics important to prospective acquirers of EMS companies include the volume, strength and durability of client contracts, desirability of the end markets served, health and creditworthiness of the client base, degree to which service offerings are complementary to the buyer’s current suite of services, management talent and breadth and depth of the workforce skill sets. Small and medium sized EMS firms with these features will be poised to enjoy attractive transaction multiples.

## Strategic Planning Considerations

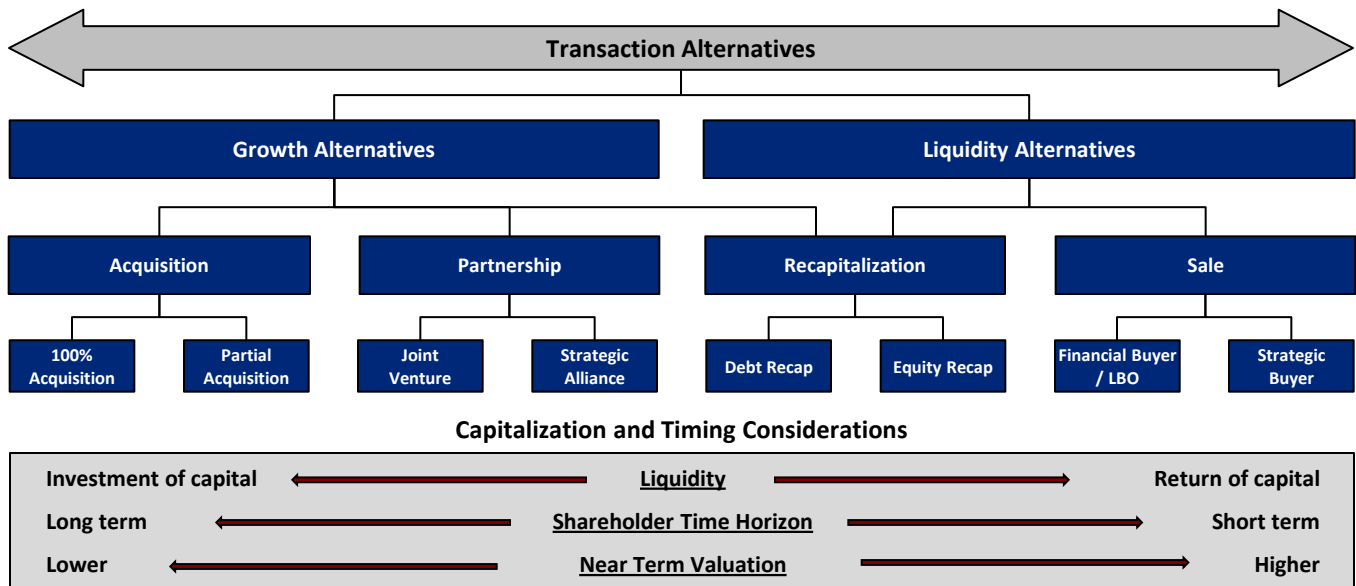
### Balancing Business Objectives and Shareholder Objectives

Maintaining and growing an electronic manufacturing services business in today’s climate can be a challenging task amid increasingly complex customer requirements combined with more stringent quality and turnaround expectations. The changing landscape has propelled many firms to re-evaluate their goals and objectives both from a business standpoint and an owner/shareholder standpoint. In some cases, the need for capital (to support growth or make new investments) can be at odds with its shareholders’ need for liquidity, diversification of their personal estate or other risk management objectives. Privately-held business owners are re-evaluating their personal investment horizons and exit timelines based on changes to their overall financial position and the relative percentage of their net worth their business represents, while corporations are reconsidering what functions/business lines/divisions are core, and which ones could be divested or outsourced to better utilize available capital. In these scenarios, determining the appropriate strategic direction for the firm necessitates the consideration of several company-specific and shareholder-specific factors.



### Continuum of Alternatives

Whether the goal of the company is to create liquidity for shareholders or raise capital for strategic initiatives, several alternatives exist to accomplish a given objective. Key criteria to consider when evaluating alternatives include the timeframe of the shareholders’ investment horizon, the ultimate exit strategy, impact on near term valuation of the business, availability of capital (internally or externally) and tax implications, among others. Additionally, external market factors weigh heavily on the feasibility of certain alternatives. Credit markets have normalized and alternatives that require significant leverage or debt capital are once again possible. Structured transactions involving strategic buyers, which were prominent during the credit lull, will also continue to be options.



## Evaluation of Strategic Alternatives

The following table summarizes the benefits and considerations of each strategic alternative, incorporating the impact of current market conditions for electronic manufacturing services firms.

	Alternative	Benefits	Considerations
<b>GROWTH</b>	<b>Acquisition (Full / Partial)</b>	<ul style="list-style-type: none"> <li>• Provides control of target firm</li> <li>• Ability to capture:                             <ul style="list-style-type: none"> <li>○ Geographic footprint</li> <li>○ Market share</li> <li>○ Service offering</li> <li>○ Management talent</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Increasing credit availability provides broader range of transaction alternatives</li> <li>• Post-merger integration can be difficult</li> <li>• Preservation of seller’s customer relationships/personalized service can be a challenge if change of control</li> </ul>
	<b>Joint Venture / Strategic Alliance</b>	<ul style="list-style-type: none"> <li>• Affords benefits of an alliance with lower resource commitment and high option value</li> <li>• Can provide economies of scale</li> <li>• Beneficial when external financing is limited/unavailable</li> </ul>	<ul style="list-style-type: none"> <li>• Does not provide the same level of control vs. acquisition alternative</li> <li>• Can be more complex to structure than an acquisition</li> <li>• Confidentiality concerns</li> <li>• Governance/control issues</li> </ul>
<b>BOTH</b>	<b>Debt Recapitalization</b>	<ul style="list-style-type: none"> <li>• Provides immediate capital to firm</li> <li>• Can be used for shareholder distributions, capital projects and/or working capital</li> <li>• Cheaper form of financing vs. equity recapitalization</li> </ul>	<ul style="list-style-type: none"> <li>• Increasing availability of debt capital</li> <li>• Available capital has become cheaper and less restrictive</li> <li>• Leveraged balance sheet can limit operational flexibility</li> </ul>
	<b>Equity Recapitalization</b>	<ul style="list-style-type: none"> <li>• Provides immediate capital to firm</li> <li>• Can be used for shareholder distributions, capital projects and/or working capital</li> <li>• Provides access to investor resources and network</li> </ul>	<ul style="list-style-type: none"> <li>• Ownership dilution</li> <li>• Potential loss of control in business</li> <li>• Most expensive form of financing</li> </ul>
<b>LIQUIDITY</b>	<b>Financial Buyer Sale / LBO</b>	<ul style="list-style-type: none"> <li>• High level of shareholder liquidity</li> <li>• Provides access to buyer (equity fund) resources and network</li> <li>• Can be less disruptive to customers than strategic sale</li> </ul>	<ul style="list-style-type: none"> <li>• Loss of control in business</li> <li>• Availability of capital leads to higher valuations</li> <li>• Confidentiality concerns (if buyer owns a competitor)</li> </ul>
	<b>Strategic Buyer Sale</b>	<ul style="list-style-type: none"> <li>• High level of shareholder liquidity</li> <li>• Often higher valuation premium versus a sale to a financial buyer</li> <li>• Strategic buyers are very active in current market</li> </ul>	<ul style="list-style-type: none"> <li>• Business ceases to exist on a standalone basis</li> <li>• Preservation of seller’s customer relationships/personalized service can be a challenge if change of control</li> <li>• Confidentiality concerns</li> </ul>

### Summary

The ultimate choice of strategic alternatives depends on the consideration of several factors, including the company’s industry positioning, strength of balance sheet, access to capital, time horizon, liquidity requirements and overall strategic plan. Firms with strong cash reserves or access to capital can potentially capitalize on acquisition opportunities, while others may see more benefit in pursuing a strategic partnership, utilizing a debt or equity recapitalization or maintaining the status quo. Regardless of the path taken, the continual evaluation of business and shareholder objectives is critical to ensuring the company is pursuing the most prudent strategic path to optimize the value of the firm.

PMCF specializes in assisting shareholders and management teams in the evaluation, selection and execution of the strategic alternatives best-suited to their particular circumstances. We welcome the opportunity to discuss your business and shareholder objectives and determine if there is an opportunity for PMCF to serve as a resource for your success.

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For more information, please contact:

**Matthew Jamison**  
Managing Director  
(248) 223-3368  
[matt.jamison@pmcf.com](mailto:matt.jamison@pmcf.com)

**Gene Bitonti**  
Vice President  
(248) 603-5088  
[gene.bitonti@pmcf.com](mailto:gene.bitonti@pmcf.com)

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### Chicago

225 W. Washington Street, Suite 2700  
Chicago, IL 60606  
312.602.3600

### Detroit

26300 Northwestern Highway, Suite 120  
Southfield, MI 48076  
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