

# CALVERT STREET

CAPITAL PARTNERS

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## **The Emerging Role of Private Equity in the NDT Business**

*February 18, 2015*

CONFIDENTIAL

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## Introduction to Private Equity

# Introduction to Private Equity

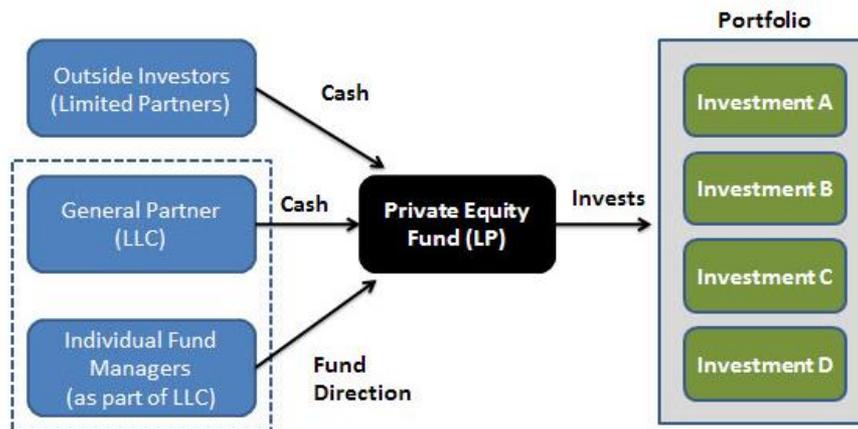
## Overview

- Private Equity refers to investment vehicles, in which private capital is pooled together to invest in businesses
- The Limited Partners (“LP’s) are passive investors that provide most of the capital
  - Public and private pensions
  - University endowments
  - Institutions – banks, insurance companies, investment companies
  - High net worth individuals and family offices
- The General Partner (“GP”), commonly referred to as the Private Equity firm, is a team of investment professionals that raise the pooled capital (including their own contribution to the fund) and make investment decisions in search of a return.

## Example LP’s



## Investment Structure



## Example GP’s



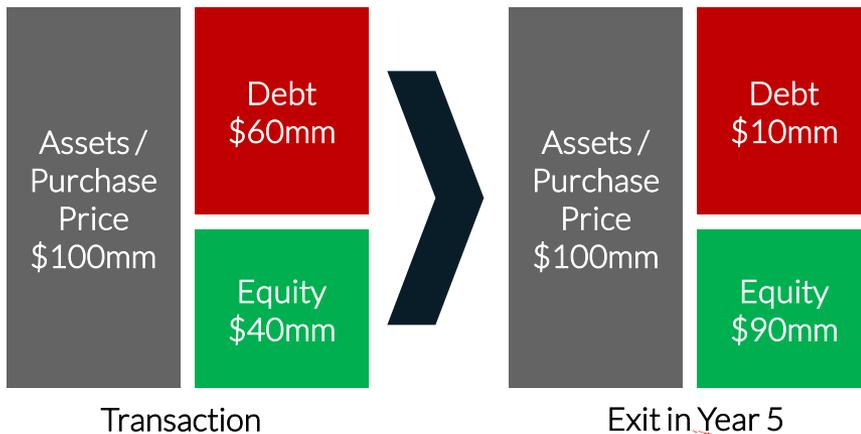
# Introduction to Private Equity

## Overview (cont'd)

- Acquired companies are referred to as “portfolio companies”
- After making an investment, the GP’s involvement in a portfolio company depends on the firm and the situation
- Private equity firms generate returns for their investors by selling the company to a buyer, taking the company public through an IPO or through dividends over time.
- General Investment guidelines
  - Acquire a company at a fair value using financial leverage, execute on growth plan, mitigate risk factors, and sell within 4 to 7 years
  - Target returns are 20% to 30%+ depending on the size and risk profile of an investment

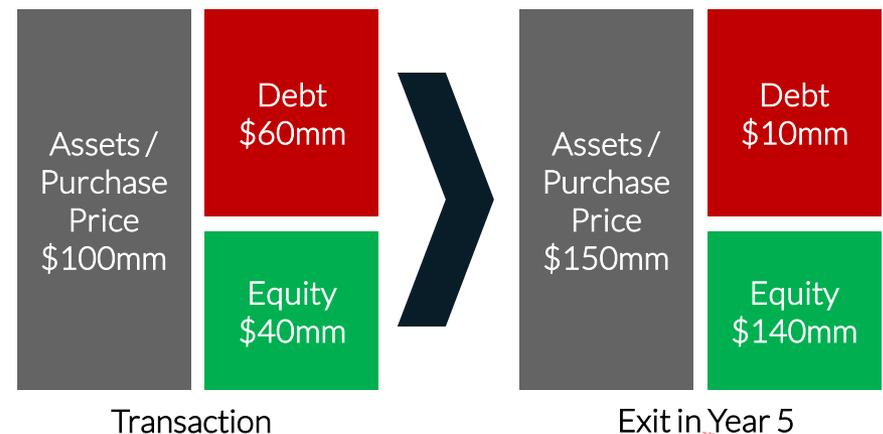
### Example

#### Efficient Capital Structure with No Growth<sup>1</sup>



18% IRR

#### Efficient Capital Structure + Growth<sup>1</sup>



28% IRR

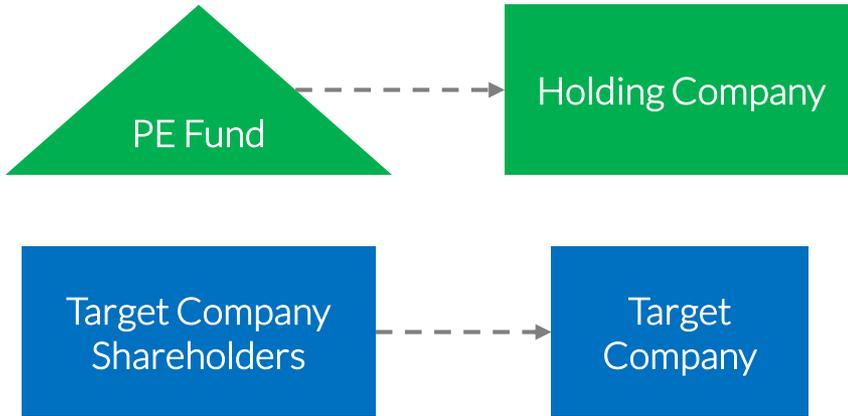
<sup>1</sup> Assumes \$10mm of levered free cash flow per year.

# Introduction to Private Equity

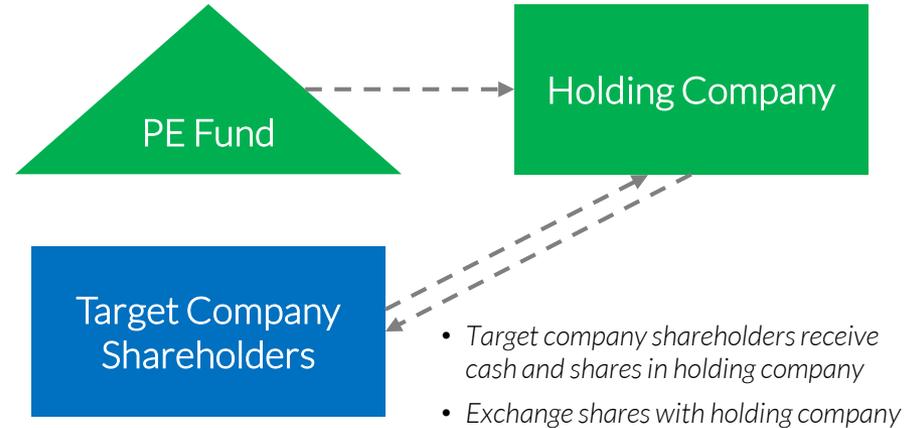
## Equity Rollover

### Example

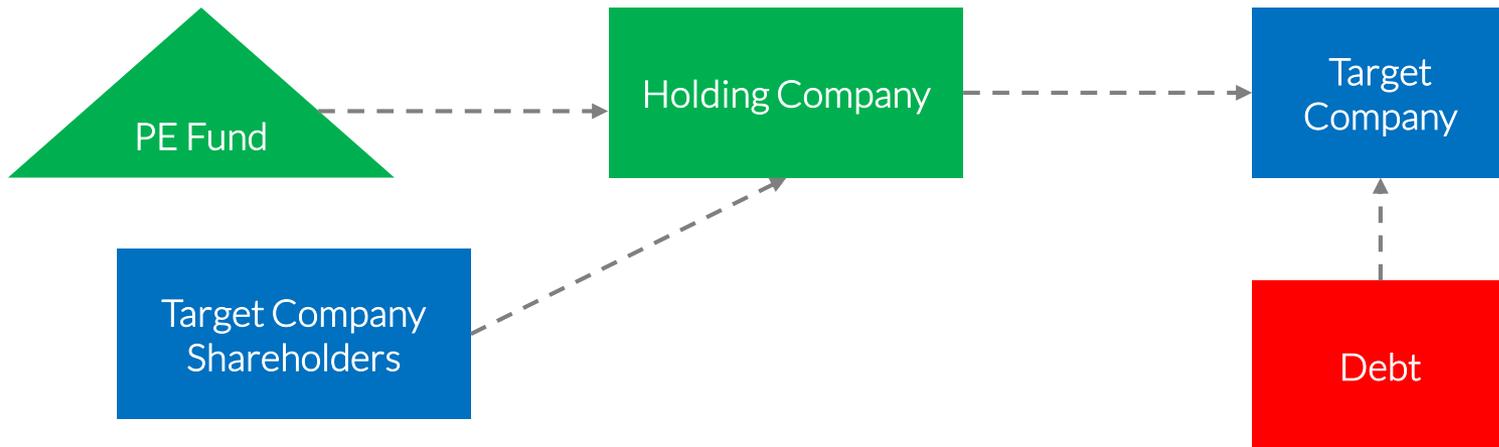
#### Step 1 – Pre-Transaction



#### Step 2 – Exchange of Shares



#### Step 1 – New Capital Structure



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## Why is Private Equity Interested in NDT?

# Why is Private Equity Interested in NDT?

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What makes a good investment candidate for a private equity firm?

- Stable and recurring cash flow
- Relatively low capital needs (capital expenditures and working capital)
- Favorable industry trends
- Multiple avenues of growth
- Strong management team
- Opportunity to add value

# Why is Private Equity Interested in NDT?

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## Non-Destructive Testing Industry – Services Primarily

- Stable and recurring cash flow
  - Regulatory drivers (e.g., OSHO 1910.1910)
- Relatively low capital needs (capital expenditures and working capital)
  - Cost of equipment and vehicles low % of revenue
  - No inventory to hold and manage
- Favorable industry trends
  - Increasing demands for customer
  - Aging infrastructure and assets
- Multiple avenues of growth
  - Large and fragmented market
  - Add-on acquisitions

# Why is Private Equity Interested in NDT?

## Valuation Considerations

### Positives

- ✓ Diversity
  - Customers and end markets
  - Products / service lines
  
- ✓ Recurring revenue
  - Part of operating budget
  - Contracted business, highly visible
  
- ✓ Strong back office functions
  - Fast and accurate accounting
  - Good safety, quality, and training records
  
- ✓ Strong management team
  - Strong mid-level managers
  - Manage by metrics

### Negatives

- ✗ Concentration
  - 1 or 2 major customers or end markets
  - Few major projects
  
- ✗ Inconsistent / cyclical revenues
  - Large capital projects
  - New construction projects
  
- ✗ Poor QHSE and Administration
  - Lack of functional departments
  - Poor record keeping
  
- ✗ Founder/ Entrepreneur Dependent
  - No middle managers or succession plan
  - No transfer of knowledge and experience

# Why is Private Equity Interested in NDT?

Valuation Considerations (cont'd)

Select End-Markets	Outlook	Commentary
<p>Upstream O&amp;G</p> 		<ul style="list-style-type: none"> <li>✗ Collapse in energy prices has resulted in most sites losing money</li> <li>✗ Wave of corporate bankruptcies beginning</li> <li>✗ Structural supply / demand dynamics likely to worsen with lifting of Iranian sanctions, increased production in Iraq, and a slower growing Chinese economy</li> </ul>
<p>Midstream O&amp;G</p> 		<ul style="list-style-type: none"> <li>✓ Constrained capacity &amp; increased production driving long-term investment</li> <li>✓ Aging infrastructure</li> <li>✓ Increasing regulatory pressures</li> <li>✗ Pull back in new projects</li> <li>✗ Increased pricing pressure from customers and increased competition</li> <li>✗ Discretionary integrity programs mothballed</li> </ul>
<p>Downstream O&amp;G</p> 		<ul style="list-style-type: none"> <li>✓ Cheap feedstocks has lead to record profits</li> <li>✓ Inspection and testing demand largely driven by regulation</li> <li>✓ Economic cycles have had limited impact of maintenance and testing / inspection budgets historically</li> </ul>
<p>Aerospace</p> 		<ul style="list-style-type: none"> <li>✓ Demand growth driven by increasing global traffic, economic recovery, and fleet replacement</li> <li>✓ Advanced materials / technologies</li> <li>✓ Increasing regulations</li> </ul>
<p>General Industrial</p> 		<ul style="list-style-type: none"> <li>✓ Increased demand for operational excellence by end-users</li> <li>✓ Regulatory compliance</li> <li>? Late in economic cycle with recession looming</li> <li>? Large companies pulling back capex spending</li> </ul>

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## Life Under Private Equity Ownership

# Life Under Private Equity Ownership

## Overview

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- Private equity firm and management should be “in partnership”:
  - PE firms do not manage the operations day-to-day operations, Management does
  - Serve as advisors through board membership to help support the development of strategic plans
  - Identify, evaluate add-on acquisition candidates, source resources and capital to execute
  - Locate and recruit talent through wide network of industry and business contacts
- Private equity firms will seek to enhance the organization and create a “sustainable” enterprise:
  - Robust financial reporting and corporate governance
  - Developing corporate policies and procedures
  - Board oversight via quarterly meetings and independent directors
  - Management team transitions, additions, and succession planning
- Private Equity ownership is always looking for alignment and shared vision towards value creation with management teams, example incentives include:
  - Stock option plans
  - Stock Appreciation Rights
  - Performance and transaction bonuses

**Private equity firms vary significantly by  
level of experience, operational involvement, and culture**

# Life Under Private Equity Ownership

## Strategic / Corporate Buyer Overview

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Strategic or Corporate Buyers' approach is usually different than Private Equity:

- Buy companies to increase market share, add a complementary service, technology, or enter a new market
- Typically pays in all cash or cash/equity and buys 100% of the target
- May pay a higher price based on:
  - Synergies / cost savings (benefits and risks of headcount reductions, org structure changes, brand perception)
  - Multiple arbitrage
- Already know industry well and have an established infrastructure and brand name:
  - Shorter diligence period
  - More risk around confidentiality, proprietary technology, customer and employee relationships
- Long investment horizon, often indefinitely



# Life Under Private Equity Ownership

## Comparison of Private Equity vs. Corporate Buyer

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- While not true 100% of the time, the below observations are good guidelines.

### Private Equity Buyer

#### Pro's

- Opportunity to reinvest and materially benefit from value creation in the next sale
- Flexibility in role (remain in charge or having significant influence in Ops or on the Board)
- Transaction flexibility - acquiring minority stakes, structured transactions, succession planning
- Maintain legacy – brand, culture and employees

#### Con's

- Operating with more debt introduces ROI discipline and risk to strategic decision-making
- High pressure situation with focus on growing EBITDA quickly and ROI
- Lower valuation

### Corporate Buyer

#### Pro's

- Theoretical ability to pay a higher price due to potential synergies
- Advantages of scale and access to more resources
- Shorter diligence period
- Long investment horizon

#### Con's

- Higher likelihood of headcount reductions
- Inability to rollover ownership into new company
- Interference in operations from corporate
- Potential loss of brand identity, legacy and culture

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Whom you pick as your buyer is a decision that requires deep reflection of personal goals

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## Appendix

## Appendix

### Recent Transactions

Transactions		
Date	Target	Buyer
November 23, 2015*	Professional Service Industries	Intertek Group
November 2, 2015	Furmanite Corporation Team	Team
July 7, 2015*	Qualspec Group	Team
June 9, 2015	Inspecta Group	ACTA Holding
May 13, 2015	BM TRADA Group	Exova Group
December 22, 2014	Pike Corporation	Court Square Capital Partners
July 8, 2014*	Desert NDT	ShawCor
April 10, 2014	Focus Corporation	WSP Global
November 22, 2013	National Technical Systems	Aurora Capital Group
October 3, 2013*	Global X-Ray & Testing	Intertek Group
July 19, 2013	Global Ascent	Team

\* Denotes private equity owned businesses that were sold to strategics.

# Appendix

## Calvert Street Overview

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- Founded in 1995 as the private equity business of Legg Mason, Calvert Street Capital Partners is a lower middle market private equity firm
- Our strategy has remained consistent for 20 years:
  - Partner with owner-operators and family-owned businesses to drive growth and organizational transformation
  - Focus on companies with \$5 to \$15 million of EBITDA
  - Invest \$20 to \$40 million of equity capital in each platform strategy
- Over time, we have focused our investing activity on the following industries where we have accumulated deep institutional knowledge and experience:
  - Industrial Services
  - Healthcare Information Technology
  - Specialty Manufacturing
  - Business Services
- Demonstrated track record with control investments in 60+ companies
- Based in Baltimore, Maryland