

Medical Device Outsourcing

Coverage Report

Market Intelligence for Business Owners

Q1 2013



Capstone Partners
Investment Banking Advisors

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MARKET FACTORS SUPPORT M&A ACTIVITY

The medical device outsourcing market, because of its fragmented nature and renewed industry focus on efficiency, is ripe for mergers and acquisitions. In fact, we expect that some of the very issues negatively affecting medical device OEMs could be a contributing factor to more mergers and acquisitions in this space.

Healthcare reform, increased regulatory costs, and reduced hospital budgets are all squeezing medical device OEMs. At the center of today's issues is the 2.3% excise tax on the sale of medical devices which took effect on January 1, 2013 and will require medical device manufacturers to offset their added tax payments through additional cost-saving initiatives. Many in the industry expect the tax could result in an increased use of contract manufacturers in an effort to reduce costs and accelerate time-to-market.

At the same time, hospital revenues and spending have declined over the past several years as some patients deferred elective surgeries due to the sluggish economy, and as hospitals administered higher levels of uninsured care due to high unemployment levels. As a result, and facing further changes in reimbursement levels, providers are seeking better value from medical device manufacturers.

These pressures are requiring medical device OEMs to enhance their business models to address internal structural costs and design, develop and manufacture devices in a more efficient manner to sustain profit levels. In many cases, their processes can be improved by outsourcing some or all of their production. As OEMs rely more and more on contract manufacturers, they are demanding enhanced performance from them as well. Such efficiencies often take the form of expanded design and manufacturing capabilities, or additional ancillary services such as assembly, packaging and sterilization. OEMs are increasingly turning to their outsourcing partners for assistance in engineering, product development, QA/RA, product distribution and supply chain management, and field management services. These new requirements by OEMs are leading to consolidation among contract manufacturers who are looking to quickly expand their offerings in an effort to offer OEMs the more complete "one-stop" solution they are demanding.

Going forward, we expect contract manufacturers will try to position themselves in such a way that they can offer a diverse level of manufacturing capabilities and a breadth of service that provides meaningful efficiencies through economies of scale. And, we expect them to look at acquisitions to obtain these new capabilities. Such large, multi-disciplined outsourcing companies will be the preferred partners of OEMs, and will be asked to either deliver all elements of the supply chain in-house, or manage it on behalf of the OEMs. As smaller contract manufacturers feel the effects of these trends, they will look to combine with the larger firms or face an increasingly difficult market to navigate.

At the same time, we expect M&A activity will get an additional boost once buyers have greater visibility regarding the effects of the new excise tax. In all, we expect buyers and investors to continue to be attracted to the "absolute demand" nature of the medical space and the consolidation and scale opportunities inherent in the medical device outsourcing industry.

A review of recent transactions in the medical device outsourcing industry shows the targets include a diverse group of outsourcing companies such as those providing grinding, machining, stamping, casting and plastic injection molding or extrusions.

MERGER & ACQUISITION TRENDS

Since the recessionary low of 2008, there has been an increase in mergers & acquisitions in the medical device industry. The uptick in transactions is in-part a result of economic trends, namely an improved credit environment that has made financing for transactions more accessible, as well as continued low interest rates and a gradually improving economy. Deal volume has improved year over year, yet total transaction value has fluctuated from year to year as smaller and middle market transactions dominate the activity. Furthermore, M&A activity has been tempered somewhat by uncertainties surrounding healthcare reform.

For 2013, it remains to be seen how the aforementioned excise tax will impact sales of medical device outsourcing companies, though many think it could boost industry performance, resulting in more M&A activity. Another tax change that could affect M&A is the increase in the capital gains tax rate, which reverted back to 20% (from 15%) when the Bush-era tax cuts expired on January 1st. Although rates are now 5% higher than in 2012, they are low by historical standards. In the past 50 years, capital gains rates were higher in 35 of those years as compared to the current rate of 20%. Furthermore, there is good news regarding the 3.8% capital gains surtax that healthcare reform legislation imposed on the investment income of high-income earners starting this year. Tax experts have so far deemed that this surtax applies only to passive investments, and is not applicable to business sales.

A review of recent transactions in the medical device outsourcing industry shows the targets include a diverse group of outsourcing companies such as those providing grinding, machining, stamping, casting and plastic injection molding or extrusions. The targets also cover a wide range of devices, therapeutic applications and technology, and many offer additional services and solutions including product development, design and engineering, tooling, prototyping, assembly, sterilizing and/or packaging.

The acquirers include both strategic and financial buyers. Strategic buyers tend to be cash rich and are looking to acquire companies that can add capabilities, diversify their customer base and obtain operational synergies. Additionally, the private equity community continues to be attracted to this space. They understand the value-add that outsourcers provide OEMs and they feel that contract manufacturers will be an increasingly important element of medical device manufacturing. Furthermore, they see the potential for scale through consolidation of this highly fragmented space.

All buyers are attracted to the fact that the industry is growing, driven by an aging population and continued advances in medical technology. In fact, over the past five years the medical device industry has consistently been a top performer, having grown 16.3% annually. This \$60 billion-plus industry is expected to expand more than 6% annually through 2016, to an estimated \$82.1 billion in revenues. As the medical device industry grows, and market factors support increased use of contract manufacturers, Capstone expects that M&A activity in the space will benefit in terms of both heightened buyer interest and more attractive business valuations.

SELECTED MEDICAL DEVICE OUTSOURCING TRANSACTIONS

Date	Target	Target Business Description	Acquirer	Enterprise Value (\$mm)	EV / LTM	
					Revenue	EBITDA
Jan-13	Source Scientific, LLC	A contract manufacturer for medical device and other OEMs.	BIT Analytical Instruments GmbH	-	-	-
Jan-13	Mountain Molding LLC	Provides contract manufacturing for medical device and other markets.	Arcady Capital, Inc.	-	-	-
Jan-13	Accu-Mold, LLC	Produces plastic parts for a variety of OEMs, including medical device manufacturers.	Mno-Bmadson	-	-	-
Dec-12	HK Plastics Engineering, Inc.	Through Truer Medical, provides medical product design and development, as well as device assembly.	Balda AG (XTRA:BAD)	-	-	-
Dec-12	Thomas Medical Products Inc. (Div. of GE Healthcare)	Designs and manufactures Class II and Class III medical devices for OEM customers.	Merit Medical Systems, Inc. (NasdaqGS:MMSI)	\$167.0	4.5x	10.1x
Dec-12	Tenere, Inc.	Provides rapid prototyping and high-precision manufacturing for medical device and other OEMs.	The Watermill Group	-	-	-
Dec-12	Venta Medical, LLC	Operates as a medical device contract manufacturer.	Laserage Technology Corporation	-	-	-
Dec-12	Spectralytics, Inc.	Provides contract manufacturing services to the medical device industry.	CreteX Companies, Inc.	-	-	-
Nov-12	Onyx EMS, LLC	Provides contract manufacturing services to a range of industries, including medical devices.	Sparton Corp. (NYSE:SPA)	\$43.3	-	-
Oct-12	MedVenture Technology Corporation	Designs and manufactures surgical tools for medical device companies.	Helix Medical, LLC	-	-	-
Oct-12	Coeur, Inc.	Operates as a contract manufacturer of disposable syringes and other medical devices.	Illinois Tool Works Inc. (NYSE:ITW)	-	-	-
Sep-12	MedTorque, Inc.	Provides contract manufacturing and assembly services for orthopedic medical devices.	Inland Midwest Corporation	-	-	-
Sep-12	Latshaw Enterprises, Inc.	Through MC Electronics, is a contract manufacturer for the medical and electronic industries.	Caledonia Investments plc; Nova Capital Management	\$48.6	0.5x	-
Jul-12	Hi-Tech Manufacturing, LLC	Manufactures precision machined components and assemblies for the medical device and other markets.	Yukon Partners; May River Capital	-	-	-
Jun-12	OakRiver Technology, Inc.	Provides manufacturing engineering technology and services to manufacturers of medical devices.	PaR Systems, Inc.	-	-	-
Jun-12	Advent Tool & Mold, Inc.	Manufactures medical device parts and assemblies for OEMs.	Röchling Engineering Plastics KG	-	-	-
May-12	Alliance Medical Products, Inc.	A contract manufacturer for the pharmaceutical, medical device and laboratory markets.	Siegfried Holding AG (SWX:SFZN)	\$58.0	2.9 x	-
May-12	Absolute Manufacturing, Inc.	Provides machining, assembly and program management services for medical & other markets.	Roanwell Corp.	-	-	-
Apr-12	QCC, LLC	Manufactures products and assemblies for medical and other applications.	First Capital Partners; Aldine Capital Partners; Promus Equity	-	-	-
Apr-12	Paramount Industries, Inc.	Manufactures prototypes for the medical device industry.	3D Systems Corp. (NYSE:DDD)	\$7.4	-	-
Mar-12	Polymer Technology Corporation	Provides custom injection molding services including for medical device manufacturers.	Capital For Business; First Capital Partners; Magna Capital	-	-	-
Feb-12	AccuSpec Electronics, LLC	Offers electronic contract manufacturing services for medical and other markets.	Armstrong Group of Companies	-	-	-
Feb-12	LAI International, Inc.	A contract manufacturer of precision parts & subassemblies for medical and other industries.	Monroe Capital LLC; RLJ Equity Partners, L.P.	-	-	-
Feb-12	McKey Perforating Company, Inc.	Provides contract manufacturing of perforated and fabricated products, including for medical devices.	Diamond Manufacturing Company, Inc.	-	-	-
Feb-12	Pro-Dex Astromec, Inc.	Manufactures powered surgical devices for the medical device and dental industries.	SI-Monteideo Technology, Inc.	-	-	-
Jan-12	AESCO Electronics, Inc.	A full service contract manufacturer serving diverse customers including medical instrumentation.	Airborn, Inc.	-	-	-
Jan-12	Catalyst Manufacturing Services, Inc.	Contract manufacturer of components for medical equipment manufacturers.	AsteelFlash Group SA	-	-	-
Jan-12	Remmele Engineering, Inc.	Contract manufacturing of components and subassemblies for medical devices.	RTI International Metals, Inc. (NYSE:RTI)	\$182.5	0.3x	8.3x
Jan-12	Omni Plastics, Inc.	Produces thermoplastic components and parts for medical device and other OEMs.	Florida Production Engineering, Inc.	-	-	-

LTM = last twelve months; EV = enterprise value

Sources: Capstone Partners LLC research; Capital IQ; public filings and press releases

CAPSTONE PARTNERS: COMPLETED HEALTH & MEDICAL TRANSACTIONS

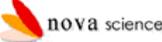


has been acquired by



Capstone Partners recently completed a transaction in which it successfully advised Surgical Monitoring Associates®, Inc. (SMA®) on its acquisition by SpecialtyCare. Surgical Monitoring Associates® is a leading provider of outsourced Intraoperative Neurophysiological Monitoring (IONM) services to leading hospitals and surgical groups throughout the Northeast.

Capstone Partners has successfully advised on a number of transactions related to the sale of medical device contract manufacturers and OEMs. These and other health & medical transactions are shown below.

<p>CONFIDENTIAL</p> <p><i>corporate sale (UNDER LOI)</i></p> <p>OUTSOURCED SERVICES PROVIDER TO THE GLOBAL PHARMACEUTICAL INDUSTRY</p>	<p>CONFIDENTIAL</p> <p><i>corporate sale (IN PROCESS)</i></p> <p>MEDICAL DEVICE MANUFACTURER</p>	 <p><i>has been acquired by</i></p> 	 <p><i>has divested assets to</i></p> 	<p>AGGU*MET LASER, Inc.</p> <p><i>has been acquired by</i></p> 
 <p><i>has acquired</i></p> <p>CERTIFIED IT & TRICITY FREEDOM DATA</p>	 <p><i>has divested assets to</i></p> 	 <p><i>has secured financing from</i></p> 	 <p><i>has been acquired by</i></p> 	 <p><i>has been acquired by</i></p> 
 <p><i>has been acquired by</i></p> 	 <p><i>acquisition advisory</i></p> 	 <p><i>has been acquired by</i></p> 	 <p><i>has been acquired by</i></p>  <p>a portfolio company of MVC CAPITAL</p>	<p><i>has been acquired by</i></p>  
 <p><i>has been acquired by</i></p> 	 <p><i>has been acquired by</i></p> 	 <p><i>has been acquired by</i></p> 	 <p><i>has divested assets to</i></p> 	 <p><i>has been acquired by</i></p> 

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Eric serves as Managing Director and Head of the Eastern Region for Capstone, based out of Philadelphia. Prior to Capstone, Eric was responsible for managing the Eastern region for Morgan Stanley Smith Barney's Capital Strategies Group and its predecessor, Citi Capital Strategies. Eric has 20 years of experience managing strategic sale assignments and leveraged recapitalizations for owners of privately held companies. He has successfully completed over 100 transactions in a wide range of industries including medical technology outsourcing, health care services, pharmaceutical services, and education and training. He has also executed complex cross-border transactions with foreign buyers based in London, Germany, Sweden, and Switzerland and has structured deals with leading private equity groups and strategic corporate buyers. He graduated cum laude from the University of California and is a Series 7 and 63 Registered Securities Representative as well as a Series 24 Registered Securities Principal.

Mark Surowiak, Director

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Mark is a Director in the Philadelphia office, supporting the management of the Eastern Region. Previously, Mark served over 10 years as a senior investment banking professional in Morgan Stanley Smith Barney's Capital Strategies Group. Over his career, Mark has focused on developing deep credentials and expertise in the sale and recapitalization of privately held businesses. Mr. Surowiak's experience spans a broad range of industries, including the post-secondary education, government and defense contracting, manufacturing, and outsourced business services sectors. Prior to investment banking, Mark enjoyed a career in the social services field. Mark is a graduate of Illinois State University with a BS in Business Administration. He is a Series 7 and 63 Registered Securities Representative.

ABOUT CAPSTONE PARTNERS

Capstone Partners LLC is a leading national investment banking firm dedicated to serving the corporate finance needs of middle market business owners, investors and creditors. The firm provides merger & acquisition, private placement, corporate restructuring, valuation and financial advisory services. Capstone maintains various industry specialties including one in the Health & Medical Products & Services sector. The firm also possesses merchant banking capabilities to actively co-invest in transactions.

Additional information about Capstone Partners can be found at www.capstonellc.com.

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