

What's Driving Recent Hybrid Consolidation?

There has been a recent spike in consolidation activity within the hybrid market. Not the cars, but electronic circuitry that is built on ceramic substrate vs. fiberglass. "I have been getting a lot of attraction in this area recently," said Loren Lancaster, head of Core Capital Group's Electronics and Semiconductor Group. "Even though this technology has been around for many years, it is renewable. New product lines such as photonics, among others rely on the same substrate and heat management technology the hybrid market uses." Ceramic circuit technology is still key in products with high power dissipation and specialized needs such as photonics, sensors and MEMS (Micro-Electro Mechanical Systems).

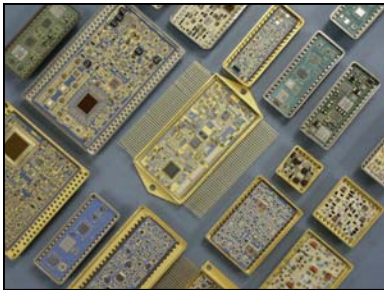


Photo Courtesy of Natel Engineering

The recent activity has been driven by several factors. Companies desire to outsource non-core competencies, company founders are reaching retirement age, and the shift in defense spending away from aircraft and spacecraft due to the IRAQ war's need for boots and bullets.

"As I see it, one of the trends is for companies with captive hybrid circuit operations to seek to outsource "non-core competence" activities," according to Ted Myers, president of Micro Hybrid Dimensions, a manufacturer and seller of a broad line of thick film hybrid substrates. "In many cases a company's hybrid circuit operations fit this model. Simply put, the operations are either consuming an excessive amount of management (and other) resources and/or they are not pulling their economic weight and the firm wishes to re-deploy these resources in more profitable activities."

Myers says such companies are looking for suppliers who can take over the production from their internal operations. Criteria for such outsourcing include technical competence to deal with sometimes less than properly documented products and processes, open capacity in both production and engineering, a sound reputation, financial stability, strong management and a compatible corporate culture. Generally these companies went into the hybrid business for reasons such as reliability of supply, flexibility and specialized requirements. They are looking to maintain these benefits while divesting themselves of the investment, headaches and overhead

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Weak Dollar Means Cheap US Companies, a Good Deal or Not?



The Wall Street Journal reported that the Euro reached a lifetime high against the dollar on November 6, 2007, and surging prices for crude oil and gold lifted the Canadian dollar and pushed the U.S. dollar

down to its lowest level since Ulysses S. Grant was president. The dollar is trading down significantly against most global currencies. So what does this all mean for international investors interested in buying US companies? "With the right strategy, it can mean an unprecedented opportunity to buy well performing solid U.S. companies at a discount," said Loren Lancaster, head of Core Capital Group's Electronics and Semiconductor Group.

Non-traditional investors are cited as one factor that may help shore up the weakening M&A activity. As Western companies get cheaper, (See page 2, col. 1)

Loren Lancaster recently traveled to Europe where he heard comment on the credit issues in the U.S. "There is still a high degree of sensitivity to the U.S. credit situation among people I spoke with," Lancaster commented.



Lancaster in the Czech Republic



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Hybrids *(From page 1, col. 1)*

associated with running a less-than-fully-utilized operation. This can lead them to seek out existing contract manufacturers who meet the criteria listed above. When such a transition occurs, it is generally beneath the radar of the M&A market, but it is certainly a facet of consolidation in this industry.

“Many hybrid manufacturers got their start in the late 1960s and early 1970s when the space and military spending really got going,” according to Dr. Prakash Bhartia, executive vice president of Natel Engineering, a leading manufacturer of LTCC/AIN substrates and modules, hybrids, MCM and higher assemblies. “The founding companies consisted mostly of smaller manufacturers whose owners and senior management have now reached retirement age and want out.” The transitioning leadership is helping to increase the number of companies that are for sale.

Dr. Bhartia says the hybrid market consolidation is also being driven by the downturn in defense spending on aircraft and spacecraft. “The conflicts in IRAQ and Afghanistan have shifted defense spending away from technology dependent on hybrid components to boots and bullets. In fact, the joint strike fighter is the only U.S. aircraft currently being developed for the military.”

The recent market activity has allowed buyers to make strategic acquisitions. “Some larger players have been buying hybrid manufacturing companies to establish a dominant position in the market,” Lancaster commented. “There has also been a great deal of interest from European buyers who are looking to establish a foothold in the U.S. which allows them to cross pollinate global customer demand.”

The desire for national geographic diversity is also attractive to buyers. “We are based in California so we have been buying companies that make financial sense and are located on the east coast to establish a national focus,” said Dr. Bhartia.

Buyers are looking for acquisitions that shore up their market position, complement their technology and provide geographic diversity. However, the bottom line is always opportunity costs. “If I invest \$1 million, am I going to get \$100,000 or better from that investment, or would the money be better spent elsewhere?” added Dr. Bhartia.

According to Lancaster, sellers are getting between 1-2 times sales and multiples of 5 – 6 times EBITDA. “While not as high as the more dynamic segments which command 7 times EBITDA, these are solid multiples and make for reasonable deals on both sides of the equation.”

As we see it at Core Capital Group, this is the second—and possibly last—wave of M&A opportunity for small to medium size companies serving the domestic hybrid market. The first wave was driven by off-shoring of high-volume, low margin markets to lower cost Asian suppliers. Now the second wave is among the small to medium size suppliers of low volume, high margin markets that focus on high engineering and high quality services. We are advising our clients to move forward now—to sell if they are planning an exit, or to buy if they wish to be one of the remaining leaders. The acquisition party won't last forever.

Dollar *(From page 1, col. 2)*

buyers from oil-rich Arab nations, China and India may see it as a good time to spend existing cash reserves.

It is important to understand the dynamic the lower dollar has on foreign investors. Traditionalists would say that foreign investors may get a better price due to the exchange rate, but that the newly acquired company will be earning money in dollars that when brought back to the parent company are diminished due to the exchange rate. However, the overall strength of the world economy and robust U.S. exports provide good incentive for investors to buy export-focused U.S. companies. “We are recommending that our overseas clients look for strategic acquisitions with U.S. companies with strong export-centric business models. This way you get the best of both worlds,” Lancaster said. “Companies can be acquired at a discount, given the exchange rate, and benefit from strong business growth driven by exporting products overseas.”

Recent Transactions

MIPS Technologies Inc.’s \$147 million acquisition, August 27, 2007 of **Chipidea Microelectronica S.A.**, a privately held supplier of analog and mixed-signal intellectual property, advances both companies ambitions for transforming system-on-chop design.

Analog Devices Inc.’s baseband chip lines as well as some of ADI’s cellular handset baseband support operations were bought by **MediaTek Inc.**, one of Taiwan’s top fables chip groups and consumer chip design houses. The deal announced September 10, 2007 was valued at \$350 million.

Configurable-processor specialist **ARC International** has acquired multimedia intellectual-property developer **Alarity Corp.** for roughly \$4 million in cash. Alarity focuses on codec software, firmware and advanced multimedia architectures. The deal was announced on September 24, 2007.

Gateway Inc. announced on October 1, 2007 it has sold its professional business division to **MPC Corp.** for approximately \$90 million, concluding one of two major outstanding transactions ahead of plans by **Taiwan’s Acer Inc.** to buy the troubled U.S. personal computer vendor.

On October 18, 2007, **Sony Corp** announced it is selling the fab that makes the Cell microprocessor to **Toshiba Corp.** for \$875 million. The Cell processor was co-developed by Sony, Toshiba and IBM Corp and is used in Sony’s Playstation 3 game console.

LSI continued to divest its product units, selling its mobility chip line to **Infineon Technologies AG** of Munich, Germany. The deal, announced October 24, 2007, was valued at \$450 million in cash.

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