DUE DILIGENCE

SENTINEL
RISK ADVISORS

due dil·i·gence

noun

Research and analysis of a company or organization done in preparation for a business transaction, particularly for mergers and acquisitions.

SENTINEL
RISK ADVISORS

RISK MANAGEMENT DUE DILIGENCE FOR MERGERS & ACQUISITIONS

Sentinel Solutions Close Deals

Successful mergers and acquisitions strike a balance between risk and reward. Optimizing profitability is the job of due diligence. As the Carolinas' premier risk management firm, Sentinel Risk Advisors is uniquely positioned to leverage the information and intelligence necessary to move even the most complex deals from negotiation to closing.

Sentinel's role in due diligence, whether retained on the buy-side or sell-side, is to identify and assess a company's known risks, uncover undisclosed and unexpected liabilities and exposures, and advise solutions that inspire the trust necessary to move the deal to a successful resolution.

Sentinel deploys a risk assessment strategy capable of navigating today's increasingly complicated insurance landscape. Our systematic process draws upon the latest trends in insurance litigation, claims, carrier behavior, and legal precedent to produce a final recommendation that has weight and value for all parties.

The ultimate goal of every due diligence Sentinel performs is to position the companies we represent for greater capacity and prosperity.

> "Sentinel's transaction support was nothing short of excellent. Your examination of our risk management was comprehensive and provided deep insight into the company's people, systems and processes."

Selling on Trust

When engaged by the seller in a transaction, Sentinel works to build the buyer's trust and proactively address challenges to the sale before a buyer is in place. Your team may not have the time, experience or expertise to identify and address potential challenges. Left unchecked, those challenges become full-fledged complications that erode a buyer's confidence in the seller's brand and business.

Further, an investment in pre-sale due diligence can assist in preparing for the buy-side due diligence.

Benefits of sell-side risk and insurance due diligence include:

- Thorough identification of risks and exposures
- Detailed review, audit and analysis of existing risk and insurance programs, claims and losses
- Proper review and audit of safety and loss control measures
- Added depth and expertise to the management team in preparation for the sale
- Strategic, proactive solutions to issues discovered in the buy-side due diligence process

Sentinel's Sell-Side Advantage: Years of corporate, risk management and insurance experience to help maximize value. We compliment your team's capabilities.

Buying on Confidence

Sentinel takes the uncertainty out of acquisitions by building confidence in the assets of a sale while mitigating its risks. Our due diligence experts ensure that you are making a beneficial acquisition at the right time and for the best possible price. Our mission is to make sure there are no post-sale surprises in store for you.

The acquisition has many dimensions, including financial, legal, operational, and strategic. Sentinel's focus is risk management and insurance, which are often either overlooked or engaged very late in the process, thereby diminishing value and benefit.

Benefits of buy-side risk and insurance due diligence include:

- Thorough identification of risks and exposures
- Detailed review, audit and analysis of risk and insurance programs, claims and losses
- Proper review and audit of safety and loss control measures
- Added depth and expertise to existing management team resources
- Planning and preparation around risk management and insurance best practices

Sentinel's due diligence reports are tailored and customized to your needs, owing to the size and scope of the engagement. A typical due diligence will receive:

1. Executive Summary
2. Overview/Scope of Project
3. Industry Assessment
4. Insurance Review and Analysis
5. Risk Management Program Review & Analysis
6. Loss Control and Claims Analysis
7. Risk Mapping and Total Cost Of Risk
8. Financial Considerations

Sentinel's sell-side services include:

- Provide objective and impartial analysis of the effectiveness of the existing risk management and insurance program
- Risk analysis
- Investigate and assess the scope of risks typically related to property and casualty exposures
- Assist with the validation of financial assumptions
- Provide options and alternatives to treat risks and exposures
- Qualitative and quantitative assessment of a targeted acquisition insurance program
- Analyze claims and losses
- Reserve analysis
- Review and analysis of the NCCI Experience Modifier
- Review safety and loss control programs, including recommendations
- Documentation of the company's "total cost of risk" assessment
- Contract review
- Disclosure of previously unidentified or uninsured exposures
- Evaluate risk management, loss control and claims management
- Review risk register
- Enterprise risk management
- Development of schedules of insurance
- Development of insurance of summaries
- Identification of open issues
- Identification of alternative risk financing options
- Review and assessment of director and officers liability
- Review and assessment of representation and warranties protection

Sentinel's Buy-Side Advantage: Unparalleled experience and acumen with acquisition due diligence involving deals valued at $5-to-$500 million, for public companies and privately held enterprise alike.

Sentinel performs due diligence under non-disclosure agreements. Fees vary by engagement and scope.

"Sentinel exceeded our expectations on every front, from planning to execution and support. Your team scoped the engagement correctly up front and laid out a clear timeline for the work. Furthermore, the Sentinel team communicated the right amount and at the right times, beat every deadline and delivered high quality work.

Sentinel's transaction support was nothing short of excellent. The team worked seamlessly and efficiently with lenders and attorneys on all insurance-related matters. Your examination of our risk management was comprehensive and provided deep insight into the company's people, systems and processes."

— Nate Edgerly
Executive Vice President and Treasurer
Investors Management Corporation

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The following executive summary is taken from a recent due diligence engagement performed by Sentinel, used for illustrative purposes in redacted form.

EXECUTIVE SUMMARY

On xxxx, 2015, "X" entered an agreement with Sentinel Risk Advisors to perform a Risk & Insurance Program Review and Audit. This Review and Audit was completed under a mutual Non-Disclosure Agreement. We reviewed:

- Public information (website, various SEC Filings, etc.)
- Various discussions with xxxx, CFO
- Toured xxxx facilities – xxxx and xxxx
- Reviewed insurance company loss history
- Reviewed Insurance Policies (see attached)
- Reviewed contracts – xxxx and related Certificate of Insurance
- We engaged in limited and controlled verbal conversations (with your authorization of xxxx) with several insurance companies for each key coverage.

Our summary comments include:

- "X" invested in a restructuring process starting in 2012 and activities have continued.
- Q1 and Q2 2015 have yielded record revenues and profit.
- Focus continues on G&A for all 4 segments.
- "X" has continued to improve its control of G&A with 2015 being xx% of Revenue, versus xx% for the same period 2014 and xx% in 2013.
- "X" insures many risks with deductibles ranging from $1,000, $10,000, $25,000, $100,000, $150,000 and $250,000. Several of the policies have 'basic' coverage with some noticeable 'gaps' (Property, Inland Marine, Crime & Fidelity, etal.)
- "X" purchases Liability Limits (typically, the limit is self-selected) ranging from $1,500,000, $2,000,000, $5,000,000, $20,000,000, $25,000,000 and $60,000,000.
- "X" self-insures a substantial amount of risk, some because of gaps or narrow coverage in insured programs, in excess of existing insurance policies and some entirely (Cyber, Liquidated Damages, etal.)
- "X" enters into written contracts for most new and recurring revenue. It is unknown how much risk is being retained or assumed by these contracts whether insured or self-insured.
- We estimate that "X" pays over $X in insurance premiums, annually;
- We estimate that "X" retains over $X in insured losses annually;
- Combined Insurance Premium and Insured Retained Losses are about $XM however uninsured retained losses could increase this by multiples.

Our Review & Analysis will be summarized in the following sections:

1. Operations
2. Risk Analysis
3. Policy Analysis
4. Loss Analysis
5. Insurance Market Analysis
6. Recommendations

Each of these sections is a summary of findings. Greater detail for each section was submitted and reviewed separately.

We have several Recommendations which are summarized in the final section.

1. OPERATIONS

"X" operates under 4 Segments:

- XXXX (approximately 1/3 of the Revenue)
  - Engineer, Procurement and Construction (EPC) of "X"

- Turnkey xxxx
- State-of-the-art systems packaging of xxxx controls with xxxx solutions and proprietary xxxx
- Customers include: xxxx, industrial, manufacturing, hospitals, data centers, military, municipal, and waste xxxx.
- Approximately 15% of systems are owned by "X" (though on customers property)

- XXXX (approximately 1/3 of the Revenue)
  - Direct service to xxxx customers
  - xxxx & xxxx services
  - Build, Upgrade and Maintain "X"
  - Technical Design & Engineering
  - Regulatory Consulting
  - xxxx Security Consulting – North American xxxx (a regulatory agency) and xxxx (2nd regulatory agency) compliance
- XXXX (approximately 18% of Revenue)
  - xxxx Manufacturing
  - xxxx Solutions & Services ('an industry' focused)
  - Customers include: xxxx and xxxx
- XXXX (approximately 15% of Revenue – spun of xxxx in 2015)
  - xxxx Projects and Manufacturing
- Approximately xx full-time employees versus xx in 2012 (+30%)
- 2014 Revenues were $XM versus $XM in 2012 (+58%)
- Acquisitions, typically <$XM) – xxxx, xxxx, xxxx, etal.
- Divestitures of non-core business – xxxx, xxxx
- International activity – xxxx, xxxx, xxxx and increasing
- Investment in R&D
- Contracts are used extensively
- Each segment is dynamic – requires close engagement to ensure alignment of risk and insurance

2. RISK ANALYSIS

"X" lists several risks in the 10K. Some of the risks are summarized and relate to Insurance:

- OSHA and Accident & Safety Investigations
- SEC Class Actions
- Regulatory Compliance
- Key Person Risk
- Contractual Damages for xxxx
- Supply Chain
- Product Warranty
- Information Technology Systems
- Mergers & Acquisitions
- Real Property Ownership

Additionally, we believe there are additional risks to consider:

- Cyber
- Supply Chain Risk Analysis – upstream & downstream
- Tracking Contracts – Terms, Conditions & Covenants
- Tracking Supplier Contracts, Evidence of Insurance
- Time Element Risks
- Brand & Reputation
- Contractual Compliance
- Crisis Management
- Disaster Recovery
- M&A Due Diligence

We did not complete a detailed review and analysis of these risks as they were beyond our scope. However, in our experience these are high profile risks that many firms identify and work to transfer or finance.

3. POLICY ANALYSIS

We completed a review of the policies which were provided. We have scheduled these policies (see attached). The following are several of the concerns we identified:

- Several policies contain schedules of locations – these do NOT reconcile with each other nor with the 10K.
- Named Insureds vary in a couple policies – accordingly, gaps may exist.
- No Business Interruption Coverage at xxxx and limited at xxxx - through discussions with "X" team, this must be reviewed immediately.
- Property Policy contains a 'xxxx' Endorsement – this is a WARRANTY for coverage to apply.
- 10K notes that about 15% of xxxx systems are owned by "X" – we could not find any evidence of coverage for these assets.
- Inland Marine Policy references xxxx on schedule with the insurance company – we were unable to determine if there is adequate coverage (always require a dated and version if required).
- Global Property Policies xxxx.
- Global Property Insurers appear to have inconsistent focus on safety and loss prevention recommendations.

- Cargo Policy is extremely broad – broader in scope than Property Policies covering the same exposure within their jurisdiction.
- Crime & Fidelity coverage is very narrow.
- xxxx are currently covered by xxxx Policies which are more restrictive in coverage.
- Policies appear to be placed on a 'transactional' and/or a reactionary basis – limits and retentions vary dramatically and do not appear to align with direction of the business.

4. LOSS ANALYSIS

Losses can have a material negative impact on Cash Flow, Balance Sheet, employee morale and relations, Brand & Reputation and business/contractual relationships.

Our analysis of losses was limited to the xxxx Loss Report ('Detailed') and xxxx Report – both provided WC, Auto and GL loss history only. These reports provide vary basic information. We were unable to develop Loss Ratios as we were not provided historic premiums.

- WC Experience Modifier (NCCI) or xxxx is significantly better than peers.
- Over \$XM of Incurred Value losses retained in the last WC/Auto/GL policy year (66% were Auto, 28% WC and 6% GL).
- 3-Year average of incurred value losses, that would be retained, is over \$XM per year.
- Some claims appear to be categorized incorrectly – listed as Auto and appear to be GL – proper categorization can aid in more competitively priced premiums and targeted Loss Prevention and Safety.
- Claims are not allocated to the business segments – again this would aid in Loss Prevention and Safety and potentially improved allocation or alignment of expense.
- Some claims appear to have subrogation potential, yet there is no indication this is being pursued – this could reduce the incurred value.
- Largest Claim is >\$XM (xxxx and xxxx claims from single event).
- Second largest claim is >\$XM and very little information is contained in the reports.
- Slip and Fall is the largest Cause of Loss – over xx per year.
- Caught In/Between represents the greatest average incurred (paid and reserved) value at > \$XK per claim.
- WC claims average >xx per year – based on 3 years of history.
- Most recent WC year had xxxx WC Claims.
- Approximately 20% (xxxx) of WC Claims have incurred values > \$X
- Approximately 40% (xxxx) of Auto Claims have incurred values > \$X
- Approximately 50% of General Liability Claims have incurred values > \$X
- xx Claims (<xx%) have an incurred values > \$XK (current Deductible)
- xxxx has yielded the largest losses; XX are >\$XM

We did not receive a complete list of property losses, however, xxxx. Losses appear to be \$X per year. Accordingly, we recommend xxxx.

5. INSURANCE MARKET ANALYSIS

As part of over Review and Analysis, we under took a 'limited and controlled' market analysis. We did not make any request nor submit or share any information in writing. We contacted several key insurers that have capabilities to insure "X". Preliminary conversations have been favorably received and we believe they would be viable alternatives to your existing insurers.

- XXXX – Currently participates on "X"'s Executive Protection Program. They insured xxxx May 5, 2012 – May 5, 2013. They were not given any details on why they lost the program and they have not had any other lines submitted for review. They are very interested increasing their participation.
- XXXX – Currently participates on "X"'s Executive Protection program which was submitted by an intermediary broker and not xxxx. xxxx has not seen a submission for other lines of coverage for several years. (Note: "xxxx")
- XXXX – Currently participates on "X"'s Executive Protection program. Have not seen other lines in several years.
- XXXX – have no record of a recent submission. (Note: xxxx).
- XXXX – have no record of a recent submission.
- XXXX – have no record of a submission for numerous years.
- XXXX – have no record of a recent submission.

In addition to the conventional or traditional commercial insurance market, there are other risk transfer and risk financing programs. Among these are Captive Insurance Companies. Captives can be a viable alternative for the right business.

6. RECOMMENDATIONS

Based on our Review & Analysis we offer the following recommendations:

- Insurance is prospective protection – coverage is forward protection – accordingly, clarity of understanding the risk profile for "X" going forward is critical

- Policies appear to be placed without an overall strategy – there are gaps, there are overlaps in coverage, inconsistency in limits and retentions
- It appears that several coverages have been secured in a 'reactive' manner – xxxx, xxxx, xxxx.
- "X" insures many risks with deductibles ranging from $1,000, $10,000, $25,000, $100,000, $150,000 and $250,000. The company should evaluate developing a more consistent approach to retentions and deductibles.
- "X" purchases Liability Limits (typically, the limit is self-selected) ranging from $1,500,000, $2,000,000, $5,000,000, $20,000,000, $25,000,000 and $60,000,000. The company should evaluate developing a more consistent approach in securing limits.
- Several of the policies have noticeable 'gaps' or for which there is no overage (Property, Inland Marine, Crime, Cyber, etal.) – these gaps are significant risks to "X" and the Board – the gaps are presented in detail in the main report.

• Two programs have high volatility – xxxx and xxxx – both require aggressive and robust strategies and discussions to ensure choice, options and alternatives and to control, rather than react to potential issues.

• Leadership must invest proactively to control and secure the risk and insurance program – this includes ongoing meetings, calls and discussions – agendas, action items, goals and expectations will maximize results and manage time.

• Given the large number, value and exposures in contracts, especially for risk and insurance, these should be reviewed, tracked and monitored for a minimum threshold of assuring Contractual Compliance.

• M&A activity xxxx however, risk & insurance factors should be incorporated prospectively – for example establish the criteria in advance so variances can be registered.

• Retained losses average over $XM each year – strengthening claim management and data gathering which develops enhanced safety and loss prevention strategies.

• Aggressive and controlled brokering/marketing of certain lines of coverage should be undertaken every xx years.

• A strategic approach must be undertaken to build relationships with targeted alternative or back-up insurers – this must be an ongoing investment.

• Enhanced engagement of key underwriters in understanding "X"'s business and operations – current insurers are typically very good, however, through discussions, it was evident that they do not believe they adequately understand the operations and risks.

• Significant gaps in coverage exist – these must be addressed immediately.

• Numerous questions on all policies exist – these must be reviewed and discussed, as soon as practicable.

• Many business risks that are uninsured should be further analyzed and evaluated.

• "X" has enhanced many of its business practices and improved operational efficiency. However, based upon our Review, Analysis and the facts identified and presented, we have identified several areas of concern within the risk and insurance program. We recommend that "X" xxxx, xxxx, and xxxx effective immediately.