

Proposed Leveraged Buyout of

**Rimage Corporation (RIMG)**

for the Offer Price of:

**One Hundred Twenty-Three Million U.S. Dollars**

**(\$123,000,000.00)**

Material Prepared by Sung Nam,

on behalf of **SN Capital**

November 4, 2011

## Company Overview

Rimage Corporation (Rimage) (herein referred to as the “company”, “target”) is a provider of digital publishing systems that are used by businesses to produce recordable compact disc (CD), digital versatile disc (DVD) and Blu-ray Discs with customized digital content on an on-demand basis. Rimage products provide solutions for distribution and archiving of information on recordable CD, DVD and Blu-ray media for just-in-time, on-demand and mass customization of discs with content and labels. Rimages digital publishing systems have been divided into two primary product lines: the Producer line of equipment for higher volume requirements for production of recordable CD, DVD or Blu-ray media, and the Desktop line of lower-cost products for office and other desktop applications. On October 10, 2011, it acquired Qumu, Inc.

Source: Google Finance

## Considerations

For the Leveraged Buyout, we will consider the following factors:

- 1) Intrinsic value of the share and annualized return
  - A. Is the Terminal Value, or the Exit Sales Price, supported by the figures in Year 5?
  - B. Is the growth in increased value supported by the figures leading up to Year 5?
  - C. Would a rational buyer purchase the company from us in Year 5?
- 2) Liquidity and free cash flow to support the additional leverage and interest payments

## Intrinsic Value of the Share and Annualized Return

### Current Valuation

The company is undervalued, considering the negative enterprise value. The company has net cash of \$116.8 MM, when the market capitalization is \$107.0MM. Thus, we see a negative enterprise value of \$9.8 MM. However, the company has been steadily generating roughly \$8 MM in net income from 2009-2011, even when revenues dipped 16% and 9% in 2008, 2009, respectively, during the global economic crisis. With zero cash burn, we find the current market price to be a discounted entry price for a LBO deal.

### Intrinsic Valuation

#### Discounted Cash Flow

WACC Terminal Value:	-
EV/EBITDA Terminal Value:	\$33.81
Net Tangible Asset Terminal Value:	\$19.42
EVA:	\$17.65
Net Tangible Asset/Market Price:	\$17.39
Average:	\$22.07

### Offer Price

We are proposing a **\$13.00** per share Leveraged Buyout, or an 15.04% premium over November 3, 2011's market price of \$11.30. At \$13.00 per share, the market capitalization is at \$123.1 MM and the implied Enterprise Value is a positive \$6.3 MM.

### Annual Return During Holding Period

Based off the average intrinsic value derived from the valuation methods listed above, we are forecasting an **11.16%** annualized return, excluding extraordinary dividends. With an exit market price of \$22.07 at Year 5, the investors will see an EV/EBITDA multiple of 22.35 and EV/EBIT multiple of 15.19.

Although the market price based off the valuation models would increase 11.16% annually, for levered equity partners, the return after paying back \$50 MM in debt borrowed for the deal with the company's cash balance will be **29.6%**, assuming a 5.0 times EV/EBIT in Year 5 terminal value, which is lower than the current comp multiple. Crucial point is the change in EV/EBIT multiple during the holding.

**Liquidity and Free Cash Flow to Support the Additional Leverage and Interest Payments****Borrowed Debt Interest and Repayment**

80.0% of the offer price, or \$98.5 MM will be provided by our debt partners. The remaining 20.0%, or \$24.6 MM will be contributed by equity partners and SN Capital.

The special purpose entity (SPE), SN Capital Fund I, LLC, will be the sole owner of the company. As a subsidiary of the SPE, the company will bear the debt borrowed for the transaction.

Currently, the company has zero debt outstanding. By borrowing \$98.5 MM to purchase all of the outstanding shares and repaying \$50 MM after the deal closes from the company's cash balance, ultimately \$48.5 MM of debt will be placed on the company's books.

We based our debt interest expense at the forward LIBOR curve plus the corporate debt spread. NYU's Professor Damadoran provides an annually updated spread table. We have based our forecast of the company's debt rating based off the table.

To maintain a "B" debt rating, or SN Capital's standard, we believe the company should have at minimum, a 2.0x times EBITDA/interest coverage ratio. With projected interest rates at an average 6.00%, the company still maintains reliable coverage during the period.

With roughly \$2 MM in cash after capital expenditures, operating and financing cash flow, we will pay back \$1 MM in principal annually.

## Risks

The company's revenues decreased YoY during 2008 and 2009. Granted, the global economy was volatile, but on top of the macro concerns, analysts have voiced concerns related to the computer peripheral, CD/DVD space. With files being transferred via USB, internet and smartphones, CD/DVD usage is on a decline. Unless the company finds an alternative product to market, the lingering concern, even after the purchase, will remain. Also, at the time of disposition, potential bidders may see the declining sector as a reason to dock the exit multiple.

## Ownership Structure

SN Capital invests 1% of overall deal amount, gets equity partners to invest 19% of overall deal. Thus, equity is 20% of deal. The remaining 80% are debt partners. No prepay penalty needs to be included in loan covenant.

When disposition occurs, the 5% of equity we currently owned (1% of 20% equity), will be changed to 20% of equity. The 95% of equity owned by equity partners will change to 80% of equity.

## Conclusion

The only factor that changed the valuation was the EV/EBIT multiple. The multiple went from zero in Year 0 to 5.0 times in Year 5. Thus, the growth is really from a switch in multiple.

Therefore, RIMG is not a good LBO candidate, since it doesn't generate enough cash to cut down on debt. Ceteris paribus, all other things the same, our investment in RIMG would be generating 11.0%, if EV/EBIT multiple is 0% in Year 5, or if EV/EBIT multiple is 5 in Year 0.

Real value is driven by cash flows that cut down on debt. RIMG LBO is just a change in capital structure.

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**Discounted Cash Flow**

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**Intrinsic Price in 5 Years:**

Market Price:	11.30
LBO Price:	<b>13.00</b>
Premium to Market Price:	15.04%
LBO Price Annualized Return:	11.16%

Annualized Price Targets based off LBO Price:

0	1	2	3	4	5
13.00	14.45	16.06	17.86	19.85	22.07

LBO Price:	13.00
Outstanding Shares:	9,470,000
<b>Market Capitalization:</b>	<b>123,110,000</b>
Available Cash:	116,770,000
Debt:	0
Net Cash:	116,770,000
Enterprise Value:	6,340,000
EV/EBIT:	0.55
EV/EBITDA:	2.66
Original EV/EBIT:	(0.84)
Original EV/EBITDA:	(0.77)
Competitor Average EV/EBIT:	14.00
Competitor Average EV/EBITDA:	7.00

Exit Price:	22.07
Outstanding Shares:	9,470,000
<b>Market Capitalization:</b>	<b>208,965,940</b>
Available Cash:	75,070,648
Debt:	43,488,000
Net Cash:	31,582,648
Enterprise Value:	177,383,293
EV/EBIT at 5 Years:	15.19
EV/EBITDA at 5 Years:	22.35
Original EV/EBIT:	(0.84)
Original EV/EBITDA:	(0.77)

Exit Price:	9.50
Outstanding Shares:	9,470,000
<b>Market Capitalization:</b>	<b>89,976,822</b>
Available Cash:	75,070,648
Debt:	43,488,000
Net Cash:	31,582,648
Enterprise Value:	58,394,174
EV/EBIT at 5 Years:	<b>5.00</b>
EV/EBITDA at 5 Years:	4.31

Equity Partners:	24,622,000	20%
Debt Partners:	98,488,000	80%
Interest Rate:	10.00%	

Annualized Return Market Price: 11.16%

**Annualized Return for Equity Partners: 29.59%**

## LBO Pro Forma Income Statement

Name: Rimage Corp

Ticker: RIMG

	Historical				Forecasted				
	12 months ending 2007-12-31	12 months ending 2008-12-31	12 months ending 2009-12-31	12 months ending 2010-12-31	2011	2012	2013	2014	2015
Revenue	108.87	91.39	83.23	88.73	91.39	94.13	96.96	99.87	102.86
COGS	57.72	51.73	42.89	45.22	47.25	48.44	49.92	51.43	52.96
Gross margin	51.16	39.66	40.33	43.51	44.14	45.69	47.04	48.44	49.90
SG&A	24.37	22.66	21.94	25.43	25.21	26.15	26.97	27.74	28.59
R&D	5.90	5.25	7.14	6.51	6.90	7.14	7.32	7.55	7.78
Depreciation	1.52	1.37	1.25	2.11	1.55	1.66	1.78	1.92	1.86
Unusual expense	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other operating expense	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Operating Income	20.88	11.75	11.25	11.57	10.49	10.73	10.97	11.22	11.68
Interest income/(expense)	3.53	2.71	1.86	0.53	-1.08	-1.65	-1.83	-1.96	-2.12
Gain (loss) on sale of asset	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other	-0.02	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Income before tax	24.39	14.46	13.11	12.10	9.41	9.08	9.15	9.26	9.56
Tax	8.63	5.03	4.62	4.50	3.50	3.38	3.40	3.44	3.56
Income after tax	15.76	9.43	8.49	7.60	5.91	5.71	5.74	5.82	6.00
Minority Interest	0.00	0.00	0.00	0.10	0.06	0.07	0.07	0.07	0.08
Equity in affiliates	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net income	15.76	9.43	8.49	7.70	5.97	5.78	5.82	5.89	6.08
*Figures are in millions (\$)									
Revenue Growth	N/A	-16.06%	-8.93%	6.61%	3.00%	3.00%	3.00%	3.00%	3.00%
Tax Rate	35.38%	34.79%	35.24%	37.19%	37.19%	37.19%	37.19%	37.19%	37.19%
Debt Interest Rate					5.00%	6.00%	6.50%	7.00%	7.50%
Margins									
COGS	53.02%	56.60%	51.53%	50.96%	51.70%	51.46%	51.48%	51.50%	51.49%
Gross margin	46.99%	43.40%	48.46%	49.04%	48.30%	48.54%	48.52%	48.50%	48.51%
SG&A	22.38%	24.79%	26.36%	28.66%	27.58%	27.78%	27.81%	27.78%	27.79%
R&D	5.42%	5.74%	8.58%	7.34%	7.55%	7.59%	7.55%	7.56%	7.56%
Interest expense/(income)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Unusual expense	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Other operating expense	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Operating Income	19.18%	12.86%	13.52%	13.04%	11.47%	11.40%	11.32%	11.24%	11.35%
Interest income/(expense)	3.24%	3.86%	2.23%	0.60%	1.42%	1.25%	1.24%	1.26%	1.25%
Gain (loss) on sale of asset	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Other	-0.02%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Income before tax	22.40%	15.82%	15.75%	13.64%	10.29%	9.65%	9.43%	9.27%	9.29%
Tax	7.93%	5.50%	5.55%	5.07%	5.26%	5.23%	5.22%	5.23%	5.23%
Income after tax	14.48%	10.32%	10.20%	8.57%	6.46%	6.24%	6.29%	6.36%	6.57%
Minority Interest	0.00%	0.00%	0.00%	0.11%	0.07%	0.07%	0.08%	0.07%	0.08%
Equity in affiliates	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Net income	14.48%	10.32%	10.20%	8.68%	6.53%	6.14%	6.00%	5.90%	5.91%





## SN VALUATION

## LBO Adjusted Proforma Cash Flow

	12 months ending 2010-12-31	2011	2012	2013	2014	2015
Net Income	7.60	5.97	5.78	5.82	5.89	6.08
Depreciation	2.11	1.55	1.66	1.78	1.92	1.86
Amortization	0.00	0.00	0.00	0.00	0.00	0.00
Deferred Taxes	-0.12	0.00	0.00	0.00	0.00	0.00
Non Cash Items	1.89	0.00	0.00	0.00	0.00	0.00
Change in Working capital	0.17	0.00	0.00	0.00	0.00	0.00
Accounts Receivable	-0.03	0.00	0.00	0.00	0.00	0.00
Other Receivables	0.00	0.00	0.00	0.00	0.00	0.00
Inventory	-0.38	0.00	0.00	0.00	0.00	0.00
Prepaid Expenses	0.20	0.00	0.00	0.00	0.00	0.00
Accounts Payable	-0.86	0.00	0.00	0.00	0.00	0.00
<b>Cash from Operating Activities</b>	<b>11.65</b>	<b>7.52</b>	<b>7.44</b>	<b>7.60</b>	<b>7.81</b>	<b>7.94</b>
Capital Expenditures	-4.18	(5.00)	(5.00)	(5.00)	(5.00)	(5.00)
Long term investment	0.00	0.00	0.00	0.00	0.00	0.00
Intangibles	28.27	0.00	0.00	0.00	0.00	0.00
<b>Cash from Investing Activities</b>	<b>24.09</b>	<b>(5.00)</b>	<b>(5.00)</b>	<b>(5.00)</b>	<b>(5.00)</b>	<b>(5.00)</b>
Financing Cash flow items	0.65	0.00	0.00	0.00	0.00	0.00
Total Cash Dividends Paid	0.00	0.00	0.00	0.00	0.00	0.00
Issuance (Retirement) of Stock	-0.88	0.00	0.00	0.00	0.00	0.00
Issuance (Retirement) of Debt	-0.02	(1.00)	(1.00)	(1.00)	(1.00)	(1.00)
<b>Cash from Financing Activities</b>	<b>-0.25</b>	<b>(1.00)</b>	<b>(1.00)</b>	<b>(1.00)</b>	<b>(1.00)</b>	<b>(1.00)</b>
Foreign Exchange effect	0.00	0.00	0.00	0.00	0.00	0.00
Beginning Cash Balance	72.51	57.98	59.50	60.94	62.54	64.34
<b>Net Change in Cash</b>	<b>35.48</b>	<b>1.52</b>	<b>1.44</b>	<b>1.60</b>	<b>1.81</b>	<b>1.94</b>
Ending Cash Balance	107.99	59.50	60.94	62.54	64.34	66.28

Depreciation to Sales	2.38%	1.69%	1.77%	1.84%	1.92%	1.80%
Amortization to Sales	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
A/R to Sales	15.51%	15.06%	14.62%	14.19%	13.78%	13.38%

# SN VALUATION

## LBO Debt Schedule

	<b>Proforma</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
Net Change in Cash	35.48	1.52	1.44	1.60	1.81	1.94
Debt Repayment		1.00	1.00	1.00	1.00	1.00
Outstanding Debt	48.488	48.49	47.49	46.49	45.49	44.49
<b>Ending Debt</b>	<b>48.49</b>	<b>47.49</b>	<b>46.49</b>	<b>45.49</b>	<b>44.49</b>	<b>43.49</b>
Forward Libor Curve		4.00%	4.50%	5.00%	5.50%	6.00%
Spread		1.00%	1.50%	1.50%	1.50%	1.50%
<b>Interest Rate</b>		<b>5.00%</b>	<b>6.00%</b>	<b>6.50%</b>	<b>7.00%</b>	<b>7.50%</b>
<b>Interest Expense</b>		<b>2.37</b>	<b>2.79</b>	<b>2.96</b>	<b>3.11</b>	<b>3.26</b>
EBITDA		10.49	10.73	10.97	11.22	11.68
<b>EBITDA/Interest Expense Coverage</b>		<b>4.42</b>	<b>3.85</b>	<b>3.71</b>	<b>3.60</b>	<b>3.58</b>

**Interest Rate Coverage Table**

Debt Rating					
AAA					
AA					
A+					
A					
A-	A-				
BBB		BBB	BBB	BBB	BBB
BB+					
BB					
B+					
B					
B-					
CCC					
CC					
C					
D					

\*Source: NYU; Professor Damodaran