Jefferson Electric

My name is Thomas Klink. I am the president and owner of Jefferson Electric, Inc. I have held the position of president since January of 2008. From August of 1996 until January of 2008, I was a minority owner of Jefferson and served as the vice president of the company. My duties as both vice president and president have included lender relations. My understanding of the purpose of my testimony is to shed some light on the credit markets from my perspective as a small business owner in my community.

The Company History

Jefferson Electric has manufactured dry type transformers for almost 95 years, beginning operations in Illinois in 1915. From 1915 until the mid 1960's, Jefferson was privately held by the founder's family. During the mid 1960s, Jefferson was purchased by Litton Industries in a move that was part of a diversification strategy for Litton. Litton held the company until 1984, when it was purchased by MagneTek, Inc. MagneTek Inc held the company until 1996, when it was purchased taken private by me and another individual. That ownership structure remained in place until January of 2008, when Jefferson redeemed the majority investor's interest leaving me as the sole owner of Jefferson.

I have been involved with Jefferson since 1994, beginning my employment while it was still owned by MagneTek. During my tenure with Jefferson, sales volume has increased steadily with an over 300% increase since 2001. During calendar year 2008, we achieved the largest sales volume and the second largest earnings since I began working for Jefferson. In 2008, the Company received an award from the MMAC, Metropolitan Milwaukee Association of Commerce, as one of the "Future 50" companies of south eastern Wisconsin.

Jefferson's Business.

Jefferson designs and manufactures dry type transformers. A dry type transformer is a piece of electrical equipment that. increases or decreases a supplied voltage. An example of this would be the conversion from 120 volts the utility supplies to 24 volts for under cabinet lighting in your home. Transformers are manufactured for a wide range of sizes and voltages, from as small as a product that would fit in the palm of your hand to as large as a small refrigerator. Jefferson's product line encompasses small product used in industrial control panels to very large units used to distribute power throughout an entire facility.

Jefferson uses three methods to sell the products it manufactures:

1. Wholesale Distribution. Jefferson has a network of 31 independent sales representatives, covering the entire continental United States. Distributors generally purchase and stock our inventory for sale as well as make just in time purchases of our catalog items. The distributors then resell the product to electrical contractors, industrial plants and equipment manufacturers.

2. Direct OEM sales. We design, manufacture and sell product directly to equipment manufacturers, in accordance with specifications unique to the manufacturer's application. This

manufacturer sells his product to end users.

3 Brand or Private Label. We manufacture and brand label a portion of our product line for companies who have chosen to buy and resell transformers rather than manufacturer them.

Jefferson currently leases facilities and uses them as follows:

1 – Franklin Wisconsin is a 5,000 square foot office space, with most of the customer service, accounting, sales, marketing and design engineering activities occurring from this location.

2 – Brownsville, Texas is a 33,000 square foot production facility that currently manufactures all products greater than 150kVA and all specialty products greater than 15 kVA.

3 – Pharr, Texas is a 22,000 square foot distribution facility that acts as the central hub to our logistics solution; and

4 – Reynosa, Mexico is a 50,000 square foot production facility that manufactures all standard products below 225kVA.

Jefferson's Banking Relations.

Starting in 1996, Jefferson used a large regional bank which was servicing the Milwaukee market. They provided a term loan and a revolving line of credit to support the operations of the Company. Through acquisition, that bank eventually went on to become one of the larger banks in the United States. As they began to expand, the bank seemed to lose interest in or lacked the desire to focus on smaller companies. Based on this lack of interest, Jefferson began to look for other alternatives.

In 2003, Jefferson changed lenders. This change was made because the new lender appeared to desire to work with smaller companies and offered to refinance Jefferson's higher interest bearing subordinated debt with a conventional term loan.

This relationship remained in place until January, 2008, when Jefferson was looking to redeem the ownership shares of the majority shareholder. The existing lender declined to finance the redemption. However, another smaller regional based lender stepped up with funding that allowed this redemption to occur using only bank indebtedness. This type of deal structure was important because the majority shareholder was unwilling to receive any subordinated debt as part of this transaction.

This lender provided a term loan to refinance Jefferson's existing term loan and cost associated with the share redemption. This lender also provided a revolving line of credit for the daily operations of the company. The lending relationship would be characterized as highly leveraged from its inception as Jefferson was poised for stable and increasing growth that would have made the debt less significant in a short period of time.

Jefferson's Manufacturing Growth.

Most of the competition Jefferson faces comes from companies that are much larger and have an existing manufacturing presence in lower cost environments. To remain competitive, in April of 2008, Jefferson added a manufacturing facility in Mexico to take advantage of the favorable NAFTA regulations and reduce costs. This facility provides the lower cost structure that

Jefferson requires to remain competitive, specifically in the distribution and brand label markets. . To fund this necessary expansion we approached our lender and were provided with an adequate increase in our lending limits to complete this transaction.

With this new production capacity and cost structure Jefferson received the opportunity to increase its business with a brand label customer. The contract Jefferson was supplying under was up for renewal and the Brand Label customer, executed a very thorough reverse auction process to qualify prospective supplies and obtain the most competitive bids. Part of the prequalification process was a representation that Jefferson maintained the manufacturing and financial capacity to support the increase in business if it was chosen as a supplier. The Mexican plant acquisition allowed Jefferson to qualify for this auction. At this time, I contacted Jefferson's lender and asked them for a preliminary determination regarding their willingness to support business opportunity. Without the lender's willingness to increase working capital lines, Jefferson would not have the working capital required to support this business increase. The lender's positive response to pursue the business came before the bid process was completed in August 2008.

Jefferson's Banking Dilemma.

Armed with this preliminary approval and its increase production capacity, Jefferson pursued the bid opportunity and ultimately was the winning bidder on the majority of the business. This represented an increase of more than 300% in their current business with Jefferson. This 1 customer is a Fortune 100 account.

Following our winning bid our lender made several data requests with which the Company complied. This was done during September, 2008. I asked the lender if the banking issues affecting the nation might have an impact on Jefferson and was assured that they should not.

On September 18, the bank's lending committee met and rejected the loan request. In support of the committee's decision to reject the credit line increase, the lender highlighted several issues:

1. Collateral concerns. Jefferson would be moving more of the collateral of the company outside of the United States and was relocating it to Mexico. This was jeopardizing their loan to value ratios and they were concerned about this. It seemed odd to us that they would bring this up now as we had identified in April that with the purchase of Mexico production facility this was going to occur and the bank did not raise this concern or otherwise comment on this point at that time.
2. Growth. Jefferson was growing too fast and the lender had concern about Jefferson's ability to maintain this growth. Furthermore, in light of the bank's outlook for the economic environment, it did not want to increase its exposure at this time.
3. Leverage Concerns. The existing debt on the balance sheet from the redemption of shares transaction did not allow the bank to increase the line of credit. The lender advised us that to allow them to continue their relationship with Jefferson, we needed to find a third party to provide Jefferson with an equity

infusion or provide debt financing subordinated to the bank.

The net effect of these actions was: Jefferson now had a large amount of new business; and, no working capital available to address the costs associated with inventory build-up and accounts receivable carrying costs.

Because of the value of the contract, the decision was made to pursue financing alternatives to fund the project including: mezzanine financing; selling a portion of the Company; and, possibly refinancing the existing debt structure with an alternate lender. During the third quarter, each option was vigorously pursued. None bore any fruit.

In meetings with mezzanine financiers, they indicated the amount of capital we needed was not sufficiently large enough to warrant their interest in pursuing a transaction.

Meetings with investors for the company yielded no reasonable offers. . At the time our financial statements reflected reduced earnings, due to projects underway. Jefferson was forced to expend funds to cover increases in inventory and the lag between sale and collection of receivables. With reduced earnings, the formulas that prospective investors used suggested they needed to become majority owners of the company to provide the funding we sought. One investor even indicated that he needed to become a 100% owner of Jefferson. This was not acceptable to me for several reasons. I had always intended to sell a portion of Jefferson but wanted to wait until an appropriate time to complete a transaction so that this sale would not force me to lose the “lion’s share” of the company. I had not redeemed my partner’s shares to immediately bring in another majority partner. Also, there were several on going projects that needed completion, including the addition of the Mexican facility, that included significant initial expenses which reduced earnings in the current period. Over time, the expenses would be recovered and the earnings would increase, and that would be the time to sell part of the company. Selling Jefferson during 2008 and 2009, would have lead me to liquidate more of the Company to a third party for the same dollar investment.

In meeting with other lenders, we found that none of them wanted to participate. Among the reasons given were:

1. An unwillingness to lend on Mexican operations as part of the revolving line of credit, even though we are in full compliance with all regulatory requirements and NAFTA laws;
2. In early 2008, lenders seemed comfortable with senior debt levels at 8 to 10 times the earnings of the company. Our lender had accepted our transaction in this range. By the end of 2008, the threshold had shrunk to 3 to 4 times the earnings of the company. With the expenditure of costs associated with start-up of the private label contracts and the costs associated with the acquisition of cost effective manufacturing facilities outside of the United States reducing Jefferson’s earnings new lenders were unwilling or unable to enter into a transaction at the same levels the current lender was at, much less provide additional working capital to support the growth of the company. We spoke to more than a dozen lenders with the same response.

Outside influences on Cash Flow and the Current Status of TARP

During November of 2008, the company met with its lender. Since September of 2008, the company was able to prepare for the increase in business with the existing line of credit available to Jefferson by significantly tightening its operations and extending trade credit from vendors. By the end of November, we needed to increase the line in order to satisfy those vendor obligations. During the second half of 2008, vendor trade credit started to significantly tighten up and vendors that had offered extended terms to Jefferson were now reducing these terms. Discussions with the vendors indicated that they were also having trouble with their lenders and needed to reduce our terms in order to have cash flow to support their businesses and meet their lender demands. This seemed to start a circle of everyone waiting to get paid before they paid someone else. With this reduction in trade credit terms, the Company needed and received the support of the lender with an increase in the line of credit, as long as it was supported by the borrowing formula. This increase was about 1/3 of the increase the company was looking for in September but did allow Jefferson to continue to operate while it sought another financial partner. This change extended the line of credit into the middle of 2009.

Jefferson has continued to meet with other lenders and investors. To date, nothing has come from these conversations, for the same reasons as indicated above. It appears from Jefferson's viewpoint that little or no relief has been afforded as a result of the TARP funding, whether lenders have accepted funds or not.

Currently, Jefferson is discussing a renewal of its credit facilities with its current lender. Business has fallen during the first quarter. As a result of this reduction in business, Jefferson has decided to close its Brownsville Texas facility and relocate all of its production to the Reynosa Mexico facility. It is the larger of the two facilities and will accommodate all of the production. The Brownsville Texas facility is not able to handle the entire production demands of the Company and the cost to produce our products in Texas would make our company unprofitable. While this action will substantially trim production expenses, it also exacerbates collateral issues with Jefferson's lender since all raw materials and equipment will now be located in Mexico. This relocation clearly allows the company to generate substantial profits at the reduced sales levels. The lender is presently evaluating this request. Jefferson also continues to look for private investors that are willing to participate in a long term vision for the company, under terms that are not so onerous as to eliminate any incentive for the Company to achieve this vision.

Implications to Jefferson's Business

Since September Jefferson has been hampered in the pursuit of our strategic plan to profitably grow the company with new customers and new products manufactured the most cost effective way possible. All my available time since September had been spent working on funding the company rather than addressing opportunities to grow. Work that should be done now to afford growth at later date is also on hold as we pursue external funding. . Upon a successful long term resolution to the funding issues, Jefferson will return to executing our strategic plan. A plan that includes investment in the development of our products and people.

In meetings with investors and lenders, there is a lot of excitement regarding what Jefferson has been able to do in the past, and its plans for the future are even more exciting. Jefferson needs a food long term stable relationship with its lender and some investors that will allow it to pursue the long term objectives of the Company.

Although Jefferson will succeed and is presently doing an excellent job of keeping a valuable product in the stream of commerce in the United States, the anticipated relief from government intervention has not been noticed in our banking relationships, vendor relationships and customer relationships. It is my sincere desire that this information will help the Panel to evaluate and produce a better result for small businesses in the United State.

Thank you for your time and the chance to speak with you today.

Thomas Klink
President, Jefferson Electric