



May 27, 2008

Mr. Peter Cutler  
President  
California Metal Solutions  
123 Main Street  
Anywhere, CA 90210

**Re: California Metal Solutions Business Plan Review**

Dear Peter:

I have had an opportunity to review your business proposal and have a number of concerns. I will attempt to enumerate these below in no particular order:

1. **Valuation**--Most of the valuation examples you sent me used valuation multiples of 10x-15x EBITDA, which seems to be a more reliable indicator than multiple of revenue. To establish your current valuation at 2x of projected future revenue seems very high.
2. **Dilution**--The offering affords investors no dilution protection. Unless the company is planning to finance its future growth 100% with debt (highly unlikely), there is a high probability that investors are going to be diluted—probably significantly. Our rule of thumb is that an early stage investment like this one will likely be diluted by a factor of 2 or 3. Assuming a pre-money valuation of \$20 million and sale price of \$50 million in three years, a \$100,000 investment, after dilution, will return about \$150,000 (including interest) for a 15% IRR, or a 1.5x return. To be in the ballpark, your pre-money valuation would have to be more like \$8-\$10 million.
3. **Intellectual Property**--Your patent costs are going to be higher, given the number of countries, etc., you will need patent protection in. You should also include a cost for defense of your patent—you are almost guaranteed to have knock-offs.
4. **Distributions of Profits**--If distributions of profits are made to investors prior to an IPO or liquidity event, it will more likely be in the 8% - 12% area. All investor returns should be calculated with the liquidity event included.

5. **Litigation**--Our concern is that a significant portion of the investment may be siphoned off for legal fees rather than be used to finance the company's expansion.
6. **Financial Information**--There is too little information in the way of historical or projected financial information.
7. **Scalability**--It is not clear whether your revenue model will scale in the same manner outside of California.
8. **Sales**--The first month of sales (August) show 25K units and consistent thereafter. Based on our discussion, there is going to be a thirty-day test phase. During the test month, sales should be lower. Also, the initial wholesale price per unit should be higher. The first customer(s) should expect to pay more per unit (as with the sales of HDTV's, for example). Over time, as you reach economies of scale, you can pass these savings on to the customer. It is important to remember, however, that the point of the cost breaks is to pass your savings, i.e., bulk purchase of resin, etc., on to the customer.
9. **Cost of Goods Sold**--Is COGS a number that has been contractually agreed to by XYZ? It is their costs, i.e., COGS that are going to be decrease over time. Do you have some type of sliding scale in effect? If not, XYZ's actual COGS may start at .035 and decrease to .002 over time. The two of you should participate in these savings jointly. If not, the .015 difference between the original COGS and new COGS is excess profit to XYZ. We will need to see a copy of your agreement with XYZ. It might be good to have a timeframe in your agreement, i.e., a two- or three-year agreement with the option to extend.
10. **Financial Statements**--Although these financials are fine for now, you are probably going to need real income statements, balance sheets and cash flow pro formas for three to five years. Most investors want to see them month-by-month for 2 or 3 years and quarterly thereafter. This will also allow you to incorporate the liquidity event into the analysis and demonstrate how it will impact the investors' return.
11. **Manufacturing Agreement**--The agreement with XYZ is very uncomfortable. In essence, they own all of the equipment and the entire manufacturing process. If something goes wrong, even events beyond their control such as a worker's strike, you are stuck. This reminds me of the situation that occurred several years ago with UPS when their workers went on strike. It was the strike that led to the creation of FedEx Ground—customers never again wanted to be locked into a single supplier. It gives them too much control of your business.
12. **Customer Billing**--Hopefully, all customer billing is going to be controlled by CMS, not XYZ. You want to maintain control of your cash flow at all times. However, this will necessitate billing and tracking systems that integrate with XYZ's.

13. **Cost Audit**--You are going to want to be able to audit XYZ's costs—in particular as their costs decrease over time.
14. **Sales Covenants**--There must be something in the agreement that restricts XYZ from selling product from the equipment for which CMS does not receive a split.
15. **Sales Commissions**--Some percentage of the sales commission will probably be allocated to the sales representative within either organization responsible for the sale.
16. **Financial Assumptions**--Financial assumptions need to be spelled out in the business plan.
17. **Competitive Analysis**--The competitive analysis is wholly inadequate. In particular, we should include a section I typically call, "Anticipated Competitive Response".

If you are able to address/correct these issues, I think your business might have significant investor appeal. Thank you for the opportunity to review your business plan and I wish you the best of luck in all your endeavors.

Regards,

A handwritten signature in black ink, appearing to read "James Robinson". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

James Robinson  
President  
The Gideon Group, Inc.