

▶ Integrated Pension Strategy Benefits International Power Products Supplier

Company Profile:

- A leading international supplier of digital power electronic products
- Public company founded in the 1980s
- Focused on growing markets in the digital economy to create a global, technology-based firm

SEI Solution: Integrated pension solution including funding strategies and asset allocation recommendations

Key Benefits:

- Improve plan's funded status while reducing overall contribution amounts by up to 30%
- Implement a portfolio that provides similar or increased returns for the plan while reducing pension expense volatility in poor market scenarios
- Support company's growth strategy by controlling financial impact of pension plan

BACKGROUND

Fiscal year 2003 was a tough year for the power supply company. Faced with the deterioration of the company's primary markets and liquidity concerns, the company's shares had fallen more than 70% from its 52-week high. Further exacerbating the situation, the company lost nearly \$1.50 per share due to one-time factors such as asset impairment charges, a lawsuit settlement and various divestitures. However, over the past year the company experienced a turnaround. Boosted by improving economic and market conditions, the company reported a profit in early 2004.

In anticipation of a pickup in the business, the firm has been increasing its spending on research and development (R&D) aimed at expanding the breadth of existing product lines. Furthermore, the company has aggressively expanded its sales force to capture the upturn in technology spending. The company also recently completed negotiations on its bank line, receiving a \$19 million asset backed facility, which now brings total availability to \$40 million.

In order to maintain profit margins, controlling costs is critical. One of the company's main concerns is around pension expense. While pension income inflated earnings in the past, its previous pension income of \$1 million has turned into pension expense of \$3.5 million.

To manage the cost of running the pension plan, the company decided to freeze benefit accruals at the end of fiscal 2003. As a result, pension liabilities are projected to decline and pension expense will decrease due to the elimination of the plan's service cost. Additionally, while the company does not have to make contributions in the near future, the company is expected to make an \$18 million contribution in 2008.

SEI ADVICE SOLUTION

SEI developed a solution that addressed plan and company objectives through customized funding and investment strategies.

Funding Solution

SEI recommended a funding strategy that would require contributions of \$4 million to the plan for a span of three years (from 2006-2008). This strategy improves the funded status of the plan and builds up the credit balance over the course of the ten-year timeframe, thus removing the \$18 million contribution spike in 2008 that occurs when the credit balance runs out. Under expected scenarios, the strategy will result in a \$6 million reduction to contributions. To determine the feasibility of the funding strategy, SEI will monitor the status of the plan over the next three valuation periods prior to execution. If market

conditions improve, a rebound in asset values could alter or eliminate the need to pre-fund the contribution and provide the firm with greater cash flow flexibility. Figure 1 illustrates the contribution stream of the two scenarios.

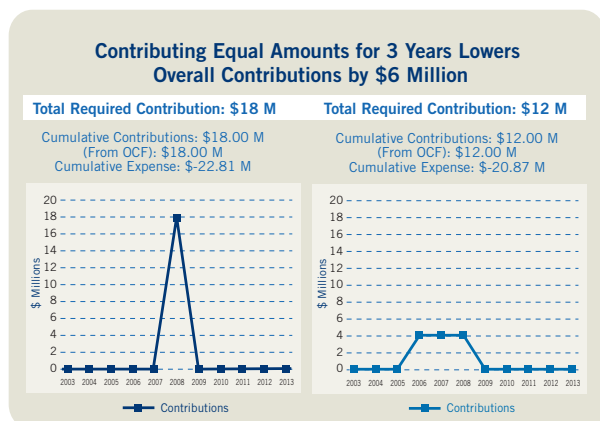


FIGURE 1

Investment Strategy

In conjunction with the funding strategy, SEI developed various custom investment strategy options with the focus of providing similar or better return expectations for the plan than its current allocation while managing the volatility of pension expense. SEI ensured that the existing allocation to company stock was included in all portfolios due to the company's desire to retain the security. The stock was originally contributed in lieu of cash to satisfy the ERISA minimum contribution requirement. Taking into consideration the company's risk tolerance, SEI developed four portfolios that provided similar levels of returns but varying levels of expected pension expense and pension expense volatility. Figure 2 breaks down the asset allocation of the four portfolios and compares them to the company's current investment allocation.

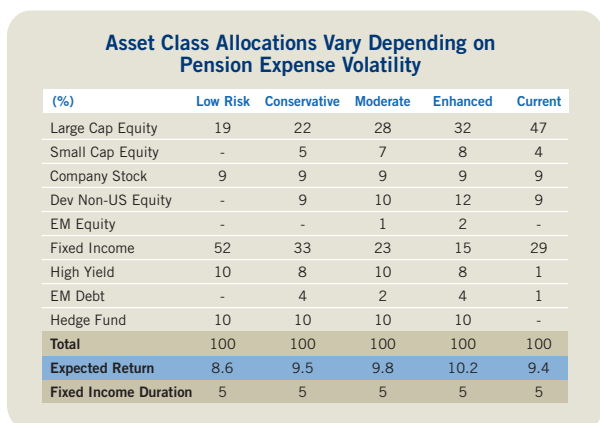


FIGURE 2

SEI recommended the Moderate Portfolio as an alternative to the company's current allocation of 70% Equity, 30% Fixed Income. The Moderate Portfolio performs comparably to the company's current portfolio under expected market conditions and performs significantly better under poor market conditions. Additionally, the Moderate Portfolio is expected to return above the needed return threshold of 7.6% (benefit payments required as a percentage of pension assets). In poor market scenarios, the Moderate Portfolio is expected to decrease pension expense volatility as well as reduce pension expense by up to \$1 million. The allocation of the Moderate Portfolio would require the company to lower its equity allocation to 55% and increase its allocation to fixed income and alternative investments. Figure 3 compares the performance of the two portfolios under poor market scenarios.

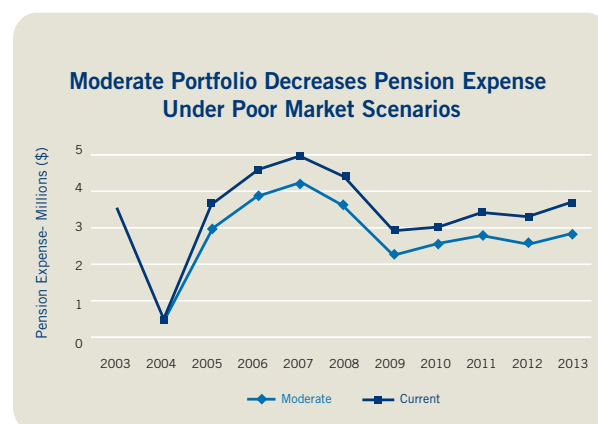


FIGURE 3

IMPLEMENTATION

SEI presented a solution designed to meet plan objectives while supporting the company's goal of expanding the sales force and increasing spending on research and development.

The company's Board of Directors agreed with the results of SEI's analysis and accepted the recommendation to implement the Moderate Portfolio. After implementation, SEI will continue to proactively monitor the allocation to ensure that it continues to meet the needs of the plan and the company's goal of managing pension expense. This will allow the firm to focus more time and resources on achieving its corporate objective of expanding the business.

Plan sponsors should make investment decisions solely in the interest of plan participants and for the main purpose of providing benefits. So long as interests of the plan are considered first, the interests of the plan sponsor can and should be considered. This case study focused on just such an "incidental" or "secondary" benefit to plan sponsors, and did not focus on any primary benefits to plans.