

Phonex Corporation: Financing the Future, Case A

Introduction

In May of 1990, Nick Smith, Chief Operating Officer of Phonex Corporation, was faced with the daunting task of securing funds to finance company operation, development and expansion. It was determined by management and the board of directors that any significant delays in funding would require company liquidation and potential bankruptcy. Having investigated and pursued a variety of potential financing options for the past two years, Mr. Smith wondered which package would provide the greatest overall benefits and flexibility.

Background

From the early 1980s, inventors Rod and Randall Mansfield had been working on the development of 'products enabling telephones to communicate reliably using standard electrical wiring.' Based on their belief that a need existed for such a product, the Mansfields visited trade shows, consumer electronics conventions and surveyed buyers and manufacturing representatives to confirm potential market opportunities. With the help of John Simonson, a former department head of engineering at Brigham Young University, the Phonex Corporation was incorporated in July of 1988. Once formally organized, it was decided Rod would serve as CEO and President while Randall would serve as an officer. John Simonson served as a board member and provided direction and industry expertise to Phonex.

Concerning the original vision of the company, Mr. Smith recounted,

"The original vision was to get involved with the phone companies in their installation issues and operations...With deregulation [of AT&T in 1986], [it] made it easy for occupants to hook up their own phonejack, and [we believed] the phone companies would embrace this technology. By law, they had to provide service when called upon and they possessed multi-billion dollar installation services which they didn't want... because it was a loss to them."

In essence, it was believed the portable phonejack would allow phone companies the ability to substantially cut the installation costs they were incurring to provide government-mandated support and service. In order to meet this need, the product would need to be further developed, manufactured and brought to market.

The embodiment of Phonex's original vision to create a 'wireless telephone connection' was initially one product: the Intelejak (see Exhibit 1). Eventually, other products associated with Intelejack would be developed (see Exhibit 2).

With no closed sales contracts or agreements through September of 1988, Phonex had been operating on funding it had received from approximately 30 investors consisting primarily of family and friends. Although helpful in developing a product prototype, Phonex's financial needs far exceeded their resources.

Nick Smith

It was at this point (the end of 1988) that owners approached Nick Smith to contract his services as a consultant. In particular, he was charged with the specific task of securing a financial package that would meet the capital needs of Phonex. Mr. Smith's past business experience and industry connections allowed him to make significant contributions to Phonex. Immediately prior to his work at Phonex, Mr. Smith served as one of the founding partners of Mountain Financial, a National Association of Securities Dealers (NASD) member company specializing in securities and investment banking. Mr. Smith had also served as the founder and managing partner at Alta Management Group, a firm consisting of Certified Financial Planners, accountants and insurance experts. The company was dedicated to financial advising and investment. This work included financial programs and investment products, some of which were organized through Merrill Lynch. Mr. Smith had managed or founded each of these entities.

After substantial effort, an initial \$200,000 of 'seed capital' was achieved almost immediately and supplemented four months later by an additional \$600,000. Primarily targeted by Mr. Smith were 'angel' investors, a group identified as "investors who supply seed or start-up moneys typically smaller than amounts offered through venture capital funds or bank financing, but far greater than self-funded ventures." (Business Journal, "Looking for an Angel," p.4-4a) The funding had been secured through a series of private placements to 'friendly' or flexible individuals. While the initial \$800,000 provided for development of prototypes in greater quantities as well as the securing of an initial manufacturer, company projections indicated the need for substantially greater amounts of financing.

Smith's commitment and exposure to Phonex had convinced him that 'the product would work.' It was this belief in the company coupled with the immediate financial needs of Phonex that prompted Smith to join the firm full time in June of 1989. However, he was sure a formal investigation of potential financing entities and subsequent sales and marketing effort would be required. Amar Bhide, writing in the Harvard Business review, confirms, "Raising big money requires careful market research, well thought-out business plans, top-notch founding teams,

sagacious boards, quarterly performance reviews, and devilishly complex financial structures.”
(Harvard Business Review, Nov.-Dec. 1992, p.109-17)

Even after the securing of \$800,000, Smith knew Phonex needed additional financial assistance to survive. This became more evident as the original contracted manufacturer produced many faulty prototypes. Even though Phonex’s investment yielded some functional prototypes, a new manufacturer would be required to produce higher-quality prototypes. Most essential to the continued progress of Phonex was purchase orders. Retail contracts in the form of purchase orders would drive growth and substantially effect their ability to secure future capitalization. Additional funding was also required to pay ongoing expenses and finance short-term capital needs.

In order for the aggressive pursuit of diverse financial packages to be effective, assembly of a capable and qualified management team was essential (see Exhibit 3). John Knab, a successful IBM and GTE executive, was hired to lead the development of the fledgling firm. Brought on to serve as CEO, Knab provided industry savvy, experience, credibility and essential personal connections. Likewise, Steve Metcalf, a former Senior Manager at Pete Marwick, was acquired to serve as CFO and provided similar benefits and advantages.

With a qualified management team in place and substantial market opportunity, Phonex believed they possessed the essential qualities of a viable candidate for potential investors. Well into 1990, management and staff worked diligently to develop a business and investment plan while pursuing a variety of potential sources for funding. One of the more promising options under consideration was that of venture capital funding.

VC Market and Process*

Historical Background:

Although present through the 60s and 70s, not until the 1980s did the Venture Capital industry realize significant contributions to both investor and client. A variety of factors were principally responsible for this development. First, funds organized in the 1970s yielded excellent returns which, in turn, provided financing for venture capital firms through the 1980s. Second, the Department of Labor clarified ERISA's Prudent Man Rule which allowed pension fund investment in venture capital partnerships. And third, capital gains tax was reduced, encouraging greater investment. As a result, the venture capital industry was poised for growth in the early 1980s.

In particular, 1982 and 1983 witnessed significant gains in new contributions and investment. \$1.4 billion followed by \$4.5 billion were the respective investment figures for these years. In 1984, \$4 billion in new capital was realized. However, during the latter part of 1984 and 1985, the venture capital industry experienced a reversal of fortune as investors believed previous gains of past years had resulted from overenthusiastic valuations and investment deals. Coupled with this concern was the Reagan administration's restructuring of capital gains tax rates to parallel more closely ordinary income tax rates. In addition, many VC funds yielded poor returns through the late 1980s. As a result of these changes, the industry experienced restructuring and 'shake out'.

Although the year 1990 saw a decrease in the number of Venture Capital firms, the survivors were more experienced, possessed refined strategies and were structurally leaner. Even still, the industry experienced in 1991 the fourth year of decline in total investment to \$1.3 billion. However, this figure rebounded in 1992 to almost reach \$2.5 billion, sparked in part by improved fund returns in 1991. Mild industry increases continued through 1993 as \$2.9 billion was invested and signs were encouraging for a record 1994 year (approximately \$4.0 billion of total capital projected to be raised by funds). Experts believed continued improvement of returns would result as companies backed by venture capital dollars realized strong stock market showings. In addition to investing by geographic region (See Exhibit 4), it was estimated that 1994 investment resources would be more evenly divided among large established VC funds and smaller VC funds due largely to investor's belief in the potential of smaller companies in industries such as health care and high technology.

Venture Capital Investment:

Originally, venture capital financing was thought of as primarily 'early-stage' financing for small growth companies. However, industry investment today includes a large variety of financing which includes all phases of business development. Nevertheless, the venture capital industry typically refers to general types of investment in the private equity market as seen below. These include 'early-stage', 'expansion' and 'acquisition/ buyout' financing. Below is an outline of the organizational structure of the industry.

1. Early-Stage Financing
 - a. Seed financing
 - b. Research and Development financing
 - c. Startup financing
 - d. First-stage financing
2. Expansion Financing
 - a. Second-stage financing
 - b. Third-stage or Mezzanine financing
 - c. Bridge financing
3. Acquisition/Buyout Financing
 - a. Acquisition financing
 - b. Management/Leveraged Buyout financing

(See Exhibit 5 for further explanation)

The Venture Capital Process:

The process of securing Venture Capital financing is anything but precise. In fact, Mr. Stanley C. Golder of Pratt's Guide to Venture Capital Sources claims each structure is unique. He elaborates, "The structure of venture capital investments follows no set formula nor does it fit into a perfect structure: the objective is to reconcile the differing needs and concerns of the venture capitalist and the entrepreneur in a way that is satisfactory to both parties. Since each situation is different, structures vary widely." In its most simplified version, the structure of the process includes presentation of a business plan, review by the funding entity, agreement or disagreement by representative parties, and finally, engagement in negotiation.

Evidence indicates venture capitalists are highly selective and that each development stage may result in termination of further dealings. Carol Steinberg of Success Selling explains, "When

selling yourself to investors, you've got a small window of opportunity in which to prove your worth. Each year, a venture capitalist fields 400 to 500 deals, seriously reviews 40 or 50, and funds only 4 or 5." It is no secret that securing venture capital financing is most difficult.

Nevertheless, there are a variety of specific considerations adopted by most venture capital firms. Fundamentally, most venture capital firms invest in projects that promise high returns, likely 15 to 20 times their money invested. Because high return is commensurate with high risk, many investments are unsuccessful and returns from successful projects must exceed losses. Another criteria for investment in a project typically calls for a cash-out opportunity within 3 to 8 years. Other equally significant product requirements include a large market, proprietary position, management quality and expertise.

** Sources included Pratt's Guide to Venture Capital Sources, Wall Street Journal, Harvard Business School's Note on Venture Capital Industry, Venture Capital, and Crain's Cleveland Business.*

Financing Alternatives

Company financial projections estimated the need for \$5 million in initial funding (see Exhibit 6). Given the difficulty of arranging a deal acceptable to both investor and company leadership, Mr. Smith and the management team knew they would need to develop a number of potential financing options. (See Exhibit 7 for partial listing) In general terms, Phonex was interested in a private placement, an initial public offering (IPO), or a venture capital/investment source.

1. Regulation "D", Private Placement Offering. Similar to what had been done before, the 'Reg. D' private placement offering involved approaching individual investors and/or groups. This option allowed Phonex to approach a limited number of specified investors. Although the private placement did not require registration with the S.C.C., it was overseen by the state securities system. Under state regulation, 'Reg D' allowed participation of only 35 non-accredited investors while there existed no limit to accredited investors. Qualification as an accredited investor included at least a \$200,000 income for the previous 2 years and a \$1 million net worth (excluding home and property). Typically, contributions were made in relatively smaller amounts (not to be less than \$25,000). Presently, Nick had in his possession the names of several interested investors, several of which had already sent personal checks to Nick's attention. Nick and John were particularly interested in the retention of private ownership provided by this financing option.

2. Initial Public Offering (IPO). From the beginning, the underwriters were very interested in the project. They believed the stock would place easily and initial inquiries yielded substantial interest. At the time, Phonex had \$450,000 in commitments from numerous investors. Nick and John had completed many of the requirements of the IPO process. The underwriter's package included 'milestone' clauses promising certain benefits if reached and initial stock valuations were encouraging. Still, a public offering would be very expensive, require relinquishing control, demand full public disclosure, and take a lot of management's time and energy.

3. Venture Capital/Investment Funds. Not surprisingly, securing investment from these sources would be difficult. Indeed, many seemingly promising leads ultimately yielded little more than wasted effort and rejection. Nevertheless, numerous groups and funds had shown initial interest and had promised substantial contributions and incentives packages. One group in particular included representatives from numerous financial institutions including Solomon Brothers and Bank of America. Similar to other offers, the investment group proposed a debt-equity investment package which included over 50% ownership in addition to a majority board representation and a cash-out plan following growth.

Initial Attempts

In the beginning, Phonex management believed the pursuit of all three financing alternatives would lead them to one promising opportunity. But, the process proved more challenging than originally anticipated. After spending some time with the would-be underwriters, no agreement could be reached and some doubt had arisen concerning the ability of the underwriters to raise the capital. And, although management had received a surprisingly high number of checks from potential 'Reg. D' private-placement investors, total dollar amount was far short of the necessary \$2 to \$3 million needed.

In pursuit of venture-capital opportunities, Nick Smith aggressively sought all financial contacts. Previous experience had taught them that potential return for time invested in these activities could yield tremendous benefits. Nevertheless, securing venture capital financing is most challenging. In addition to absorbing significant management time and substantial resources, the process is discouraging and full of rejection. Mr. Smith describes one of these many experiences.

“The company needed, we figured, between \$2 and \$3 million. As I approached the bigger hitters to include venture capitalists and investment bankers, ...some of my fears became apparent-- that these more sophisticated-in-the-marketplace people were concerned about the management package [we offered] which was the inventor... We really didn't have a strong enough management package... to carry the interest in the technology and products... After a few months, he [John Knab] came on board and the company didn't have a lot of money. We had been approached by Larry Ruff who is Howard Ruff's son... I was interested in him because I had previous experience with him... Larry Ruff and his father had brought in investors [on another previous public investment opportunity]. They [Howard and Larry] said they would be in a position of raising \$3 to \$5 million. We did some due diligence... Well, about a month after he [John Knab] came on board, Howard Ruff called one day and said, 'I've lost a significant lawsuit, and I won't be in a position to pursue this.' We had spent a lot of time with the attorneys and spent a lot of money... to bring about this deal. So, the floor fell out from under us... and we started scrambling.”

The frustration continued as Phonex management continued to approach numerous investors and investor groups. Mr. Smith reviews another disappointing experience.

“I remember we were very committed. We were making a lot of presentations [to potential investors] and we had sent out a lot of packages... [In addition], we [the management team] had gone about 4 or 5 months without any salary... We made this trip out to see Jim Blanchard [potential investor group in New Orleans, LA]. We did as much due diligence as we could and there were big promises that he was going to get involved in a big way. We went out to dinner... building all these high expectations and the next morning we went into his office and he said, 'well, really, in my situation right now, I would be ill-advised to come up with the millions you need at this time..' So, we had experiences like that all the time... It was so painful to spend a thousand to two thousand bucks on a trip and... [then] the guy wasn't interested.”

After months of almost closing on a number of deals (only to have them fall apart at the last minute), One of Mr. Smith's leads developed into what appeared to be a substantial opportunity.

“I had done work with an individual in Chicago... I sent a couple of [investment / business plan] packages to him and he set up a couple of meetings for us while we were back in Chicago (in 1990 at the end of May) for the consumer electronics show. I don't even know how we got to that show because the company didn't have any money at all. We did the show and it was during that time that we met D.P. Kelly & Associates. They invited us to their offices and we seemed to perfectly fit... They had received the business plan, they liked our resumes and they liked the concept of the product. We had sent them a sample and the managing partner had taken it home... and it worked great. We sat down with them and they basically wanted to meet us and eye-ball us and see what we were like... They had recently raised an investment fund... We met with them briefly and went back to the show. That afternoon, I received a call to the booth at the show and they said, 'we want to do a deal with you. Here's what we'll do and here's how we'll structure it.' We went back in ...”

They discussed various deal structures and began the due diligence process. Approximately six months later, John and Nick were celebrating over dinner at the Sizzler when they received a call informing them that D.P. Kelly & Associates, after further financial analysis, were not interested in providing the solicited funding. Besides spoiling their appetites, the unwelcome news left them wondering if they should attempt further negotiation or bag the deal altogether and pursue other financing options.

Important Considerations

Not surprisingly, Nick and John experienced a great deal of stress and anxiety over this time period. They had invested 2 years in identifying and developing each financing option. As expressed by Nick, "After all of the analysis and dreaming and scheming, it becomes an emotional issue."

To make matters worse, management had gone nine months without salary in order to keep the business afloat. Also, some difficult restructuring had taken place within the company. With the addition of John Knab as CEO, the company founder, Rod Mansfield, decided to leave Phonex. Randall stayed on as Marketing Manager.

As Nick and John considered their options, many questions still needed answering. Among these questions were, if Nick and John were valuing the company at \$2 million, were they asking too much or not enough? which financing group would provide the type of working relationship best suited to their organization? Also, should Phonex go public or remain private? How would loss of majority ownership affect their business? How would the timing of funds from the three different options affect Phonex's performance? Which financing group could deliver on their promises?

Note on Valuation: If the company is valued at \$2 million before new financing and they raise \$5 million, what % of ownership did company forfeit? Suppose Vbf (Value before financing) = \$2 million with 100,000 shares. ($\$2 \text{ mil.} / 100,000 = \$20 / \text{share}$) Raise \$5 million at \$20 share = 250,000 new shares. Conclusion: company forfeited 5/7, or 71% ownership for \$5 million in post financing.

Phonex Corporation: Financing the Future, Case B

After presenting what seemed like 50 to 60 presentations, Nick Smith and John Knab were close to finalizing a financial package. Among other entities, these groups principally included investment bankers, venture capitalists and individual investors. Almost all were contacts Mr. Smith had developed prior to joining Phonex.

According to Mr. Smith, one of the more promising opportunities was with a venture capital group from Chicago, IL he originally had met through prior professional dealings. D.P. Kelly & Associates was dedicated to investing over \$20 million in funds of a diverse group of investors which included entities from Solomon Brothers, Continental Bank, Bank America, and Credit Agricole of France. The company had been involved in many Leverage Buyouts (LBOs) during the 80's, the largest of which was Beatrice Inc.. They were looking for 5 to 6 companies in which they could invest \$2 to \$6 million each.

Before reaching any kind of offer, a number of presentations and information sessions were required. Most of the discussion centered on product and size of market. Phonex had compiled a number of pro forma financial statements as well as research detailing the potential customer base and marketing plans. This work included an exit strategy (i.e. merger, acquisition and/or IPO) stressing future liquidity and investor return on investment. Of great concern to D.P. Kelly was the Phonex management team, their experience and potential to successfully create and bring products to market.

After a series of offers and counteroffers, D.P. Kelly presented a final financial package. Because valuation was so difficult and speculative, they required majority ownership (65%) and control of the board (4 of 7 members). In return, Phonex would receive an initial \$3 million and a pledge for more if necessary. Phonex also had the option to receive additional capital as long-term debt. In this way, they could receive more funding without giving up additional ownership. Phonex was promised consulting services, particularly the use of connections within the financial community. Support, professional involvement and potential additional funding would be contingent on company performance measurements and progress towards goals.

Concerning the offer, Mr. Smith commented, "It was pretty much a take it or leave it kind of thing. We looked at them, their backgrounds, their muscle, their ability to help us go forward in the long run and then weighed that against the fact that we had made many presentations and not really had a credible and firm offer." Still, Mr. Smith wondered about the implications of giving up so much ownership.

Phonex Corporation: Financing the Future, Case C

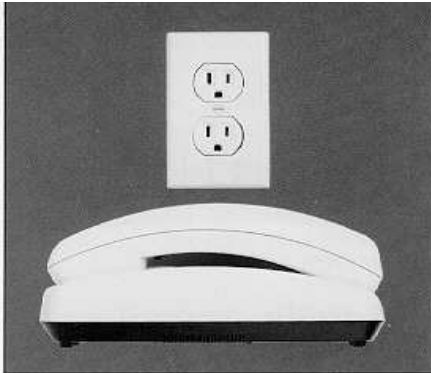
Although convinced of their product's potential, Phonex was unsure exactly how to bring the product to market. One potential marketing option was to sell the product under a reputable brand name. As a result, Phonex had approached a variety of electronics suppliers/manufacturers to present their idea. Initially, their efforts produced no tangible results.

However, about 6 months later, Phonex was approached by a product manager from Thomson Consumer Electronics, the largest consumer electronics manufacturer which included RCA and General Electric brand names. He had seen an advertisement for the Intelejak and was interested in discussing a potential sales and marketing contract. In particular, they believed the Intelejak would provide a valuable accessory to Thomson's D.S.S. Satellite System. In return, Phonex would benefit from access to a much more substantial customer base.

Thomson proposed a marketing deal that required 'exclusivity' of access to Phonex products and a substantial portion of gross margin on every item sale. Specifically, Thomson would reap 2/3 of the gross margin of each product sold. In return, Phonex would receive an up-front marketing fee of between \$4 and \$6 million in addition to an enhanced client base. In essence, Thomson had agreed to become Phonex's distributor.

Mr. Smith believed this was a tremendous opportunity to reach many new customers and align themselves with a credible marketing institution. But, he wasn't sure if the conditions were such that they would provide needed returns. Smith also wondered if better opportunities might present themselves later.

EXHIBIT 1



Intelejak[®]
Wireless Phonejak System

Your house is
already wired
for another
telephone

The Intelajak
allows you to
use your elec-
trical outlets for
phone jacks

No wiring,
drilling or tools
*Saves time and money.
Simply plug the
Intelejak into any 110
electrical outlet, and
have phones wherever
you want them*

EXHIBIT 1 (con't)

TELEPHONE



No Wiring!
No Drilling!
No Tools!

WIRELESS PHONE JACK SYSTEM

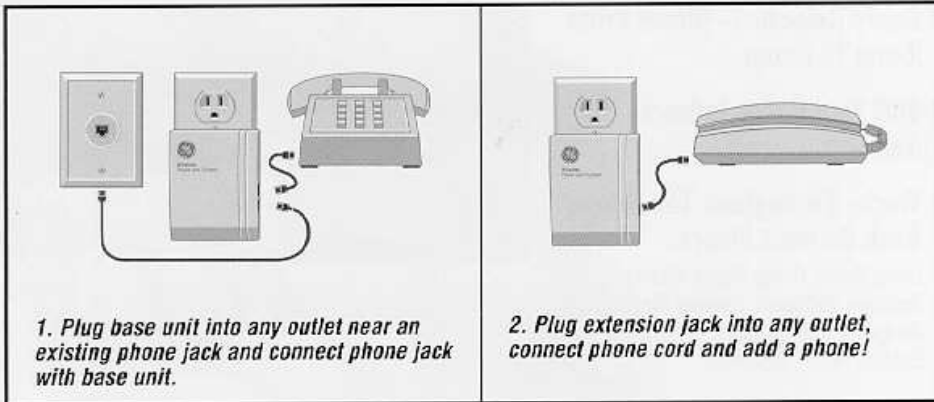
Instant Phone Jack in Any Electric Outlet

■ Works With

- Corded Phones
- Cordless Phones
- Answering Machines
- Fax Machines
- Computer Modems

■ Compatible With

- Call Forwarding
- Call Waiting
- Three Way Calling
- Conference Calling
- Speed Calling



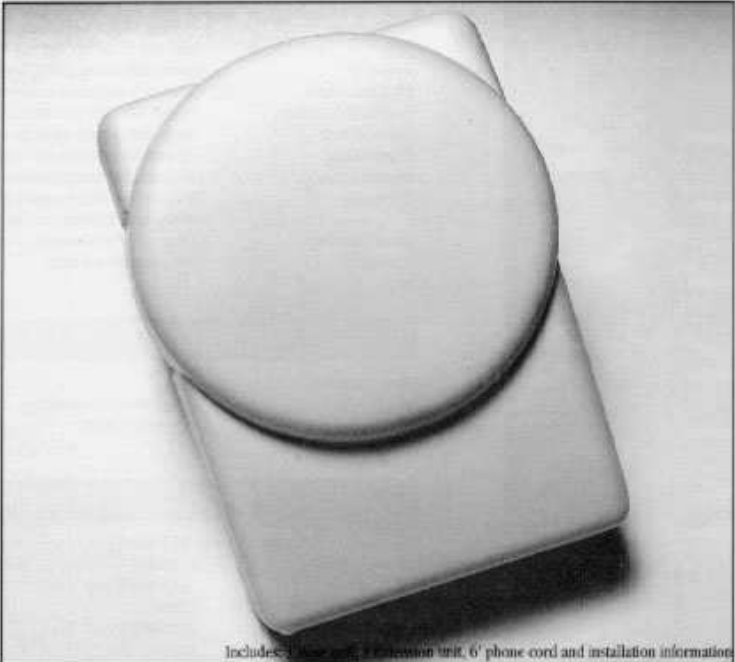
EXCLUSIVE TECHNOLOGY							
Product	Model Number	Description	UPC	Master Pack	Cube	Weight GS	Opt Retail
	GE916	Base Unit Extension Unit 6 Ft. Cord	0-79000-30312-1	6	1.33	18.3	134.95
	GE910	Extension Only	0-79000-30308-4	6	.66	9.0	49.95

Warranty: 1 Year, Parts & Labor

EXHIBIT 2

WIRELESS
MODEM JACK
phonex[™]

WIRELESS MODEM JACK



Includes: base unit, extension unit, 6' phone cord and installation information

Installation is simple, plug the base unit into an electrical outlet and an existing phone jack, then plug the extension unit where the modem equipped product is located.

The **Wireless Modem Jack** is an FM carrier current phone extension system designed to work with computer modems and modems for Pay-Per-View phone connections on satellite systems.

The system is designed to be as transparent to the telephone circuits as possible. All of the control tones, and pulses except the ring signal are transmitted both directions along with the duplex audio signals. This is accomplished by converting the audio and control signals at each end to frequency modulated radio carrier signals which are injected into the power lines at each end of the carrier current transmission line.

The power lines are isolated from the phone lines at each end by the use of high voltage, U.L. approved capacitors and inductors, while providing a conductive path to the Radio Frequency Carrier.

- QUICK AND CONVENIENT PHONE JACK FOR THE HOME OFFICE.
- CONNECT TO THE INTERNET FROM ANY AC OUTLET.
- FAST AND EASY HOOK UP OF IMPULSE PAY-PER-VIEW.
- TURNS ANY ELECTRICAL OUTLET INTO A PHONE JACK.
- SIMPLY PLUG IT IN!
- AVOID COSTLY PERMANENT INSTALLATIONS.



EXHIBIT 3

FOUNDED	Phonex Corporation is the only company to develop, manufacture, and market products enabling telephones and telephone devices to communicate reliably using standard electrical wiring. Headquartered in Midvale, UT, Phonex Corporation was founded in 1988.
FINANCIAL	Phonex Corporation is a privately held company. The company is listed in Dun and Bradstreet under #18-978-7229. For more information contact Steve Metcalf, CFO.
OFFICERS	CEO/Director: John Knab, MBA Director: GTE Corporation Manager: IBM CFO: Steve Metcalf, CPA Senior Manager: Peat Marwick COO: Nick Smith, MBA Managing Partner: Alta Management Group
MANUFACTURING	Phonex Corporation contracts manufacturing at various locations including: Flextronics International: Malaysia
DISTRIBUTION	Phonex maintains a 12,000 square foot distribution center in Midvale, UT. Product distribution and fulfillment are handled from this location.
MARKETING	Phonex Corporation markets its product through independent manufacturer's representative firms in the domestic market and through distributors in sixty countries worldwide. Domestically, the product is available through catalogs, specialty stores, home centers, department stores, mass merchants, office supply stores and others. Phonex has sold the marketing rights to Thomson Consumer Electronics and is now in a support role for the Thomson Sales Department.
CONTACT	For more information contact Randy Mansfield at Phonex, (801) 566-0100.

EXHIBIT 3 (con't)

Management and Technical Team

President and Chief Executive Officer

John M. Knab

Mr. Knab, 38, has had experience in high technology industries for nearly 15 years. His background includes strategic planning work for both IBM and GTE.

As a 10-year IBM veteran, Mr. Knab has held various positions from marketing representative, regional staff, field marketing management and headquarters assignments in marketing programs, strategic planning and product requirements. While at IBM, Mr. Knab earned an MBA degree at Emory University in Atlanta, where he specialized in business planning. A software tool he jointly developed for business planning has been adopted by IBM, UNISYS, Wordperfect, GTE and thousands of small businesses.

Mr. Knab was executive director of a business unit in the GTE Telephone company that distributed telephone and computer products from over 700 major manufacturers to a national customer base. While at GTE, Mr. Knab has been listed in the Who's Who in Telecommunications and the Computer industry. He has been an invited guest speaker at several national industry events each year.

Besides holding an MBA, Mr. Knab has an undergraduate degree from Brigham Young University in Advertising and Promotion where he studied under Dr. G. Barrus and was listed as the outstanding senior of his college.

Chairman of the Board

John M. Simonsen

Mr. Simonsen, 64, recently retired Vice President of Engineering at Valtek, Inc., is a founding shareholder and serves on the Phonex Board of Directors and as secretary of the corporation. Dr. Purdue University and his B.S.M.E. from the University of Utah. Dr. Simonsen directed and established an accredited engineering program at Brigham Young University, where he also served as associate professor, professor and chairman of the Mechanical Engineering Department. In addition, he serves on the Governor's Advisory Council for the Center for Excellence Program.

V.P. Operations

Nicholas Smith

Mr. Smith, 43, Vice President of Operations, received his B.S. and MBA degrees from Brigham Young University. As an officer of several organizations, he has a proven track record in sales and marketing of financial products and services that will prove critical to when Phonex becomes a public company. He has served as senior vice president of marketing of the Paradigm companies, a national financial services firm; partner of Advisors West and Mountain Financial, Inc.; and as a founder and managing partner of Alta Management, a consulting firm. High technology and communications firms which have been his consulting clients include Eyring Research Institute, Larson-Davis Laboratories, Inc., Medirec, Inc., and Intermountain Telephone Corporation. Mr. Smith has been a lecturer for the Cox School of Business at Southern Methodist University and Northwestern University in Chicago.

EXHIBIT 4

Chart 1

Ten Leading States
(By capital and number of firms in 1991)

	Capital (\$billions)	No. of Firms
California	\$6.93	147
New York	8.18	165
Massachusetts	4.23	57
Illinois	2.21	34
Connecticut	1.55	27
New Jersey	1.46	24
Maryland	1.00	13
Texas	.91	37
Pennsylvania	.63	27
Minnesota	.49	17

Source: Venture Economics Publishing Co.

Chart 2

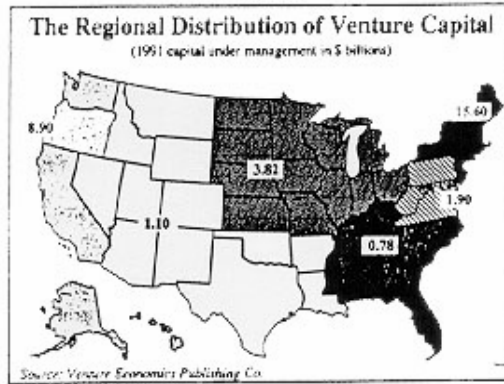


Chart 3

Top Ten State Recipients
(Ranked by capital disbursed in 1991)

Rank	State	Dollars Invested (\$ millions)
1	California	\$661
2	Massachusetts	155
3	Texas	91
4	Arizona	47
5	New Jersey	36
6	Minnesota	34
7	Maryland	34
8	Colorado	32
9	Pennsylvania	28
10	Oregon	26

Source: Venture Economics Publishing Co.

Chart 4

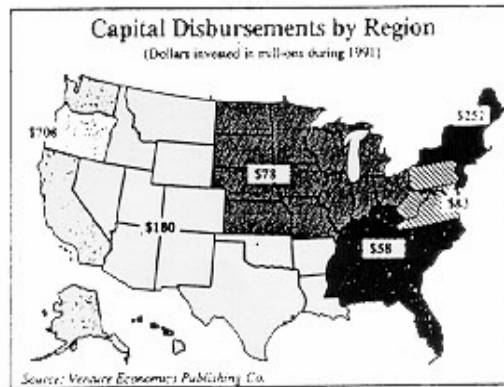


EXHIBIT 5

Early-Stage Financing

Seed Financing is a relatively small amount of capital provided to an inventor or entrepreneur to prove a concept and to qualify for startup capital. This may involve product development and market research as well as building a management team and developing a business plan, if the initial steps are successful.

Research and Development Financing is a tax advantaged partnership set up to finance product development for startups as well as more mature companies. Investors secure tax write-offs for the investments as well as a later share of the profits if the product development is successful.

Startup Financing is provided to companies completing product development and initial marketing. Companies may be in the process of organizing or they may already be in business for one year or less, but have not sold their product commercially. Usually such firms will have made market studies, assembled the key management, developed a business plan and are ready to do business.

First-Stage Development is provided to companies that have expended their initial capital (often in developing and market testing a prototype), and require funds to initiate full-scale manufacturing and sales.

Expansion Financing

Second-Stage Financing is working capital for the initial expansion of a company that is producing and shipping, and has growing accounts receivable and inventories. Although the company has made progress, it may not yet be showing profit.

Third-Stage or Mezzanine Financing is provided for major expansion of a company whose sales volume is increasing and that is breaking even or profitable. These funds are used for further plant expansion, marketing,

working capital, or development of an improved product.

Bridge Financing is needed at times when a company plans to go public within six months to a year. Often bridge financing is structured so that it can be repaid from the proceeds of a public underwriting. It can also involve restructuring of major stockholder positions through secondary transactions. Restructuring is undertaken if there are early investors who want to reduce or liquidate their positions, or if management has changed and the stockholdings of the former management, their relatives and associates are being brought out to relieve a potential over-supply of stock when public.

Acquisition/Buyout Financing

Acquisition Financing provides funds to finance an acquisition of another company.

Management /Leverage Buyout funds enable an operating management group to acquire a product line or business (which may be at any stage of development) from either a public or private company; often these companies are closely held or family owned. Management/leveraged buyouts usually involve revitalizing an operation, with entrepreneurial management acquiring a significant equity interest.

The type of venture capital firm best suited for a specific situation must be determined by the company seeking financing and by its advisors. Each venture capital firm has particular preferences, methods of investing and selecting investments and its own type of legal investment agreements. Since no two venture firms operate in exactly the same way, it is essential that entrepreneurs and business managers analyze their needs and attempt to match these requirements with the skills and interests of an appropriate venture capital firm.

EXHIBIT 6

Financial Extract for Investment Analysis

	1990	1991	1992	1993	1994
Sales	\$ 6,807,650.00	\$ 21,815,375.00	\$ 36,930,000.00	\$ 61,629,000.00	\$ 107,874,000.00
Unit Volume	\$ 85,450.00	\$ 291,875.00	\$ 870,000.00	\$ 1,540,725.00	\$ 2,696,850.00
Gross Margin	49.3%	49.5%	43.9%	45.5%	45.6%
Net Income (after tax)	\$ 695,035.00	\$ 2,903,331.00	\$ 8,461,622.00	\$ 14,545,488.00	\$ 26,380,568.00
Earnings per Share (EF \$	0.03	0.13	0.38	0.66	1.20
Cumulative	\$ 0.03	\$ 0.16	\$ 0.54	\$ 1.20	\$ 2.40
Investment Return on E	5.0%	21.0%	61.0%	106.0%	192.0%
Multiple (15x) per share \$	0.47	1.98	5.77	9.92	17.99
Rtn. on Investment		217%	823%	1487%	2770%
Bus. value	\$ 10,425,525.00	\$ 43,529,965.00	\$ 126,924,330.00	\$ 218,182,320.00	\$ 395,708,520.00

Capitalization Assumptions: In January of 1990, approximately 14,500,000 shares were outstanding. During the year, 3,750,000 shares will be issued at \$.50 per share.

An additional 3,750,000 warrants will be exercised at \$.75 for a capital infusion of \$4,675,000, resulting in approximately 22,000,000 issued shares.

Note: The above analysis makes assumptions relative to profitability of the Company and potential multiples on those earnings, the accuracy of which cannot be reliably predicted.

EXHIBIT 6 (con't)

Sources and Uses			
1990			
Sources	Mar-Sept	Sept-Dec	Totals
Equity contributions	\$1,875,000	\$2,812,500	
Sales revenue	\$2,022,800	\$4,784,850	
Credit lines	\$300,000	\$950,000	
Total sources	\$4,197,800	\$8,547,350	\$12,745,150
Uses			
Product development	\$121,500	\$51,000	
Inventories	\$1,015,800	\$2,434,100	
Selling expenses	\$500,646	\$943,846	
Administrative	\$690,717	\$288,615	
Patent royalty	\$0	\$75,000	
License fees	\$10,114	\$23,924	
Debt payoff	\$187,500	\$187,500	
Consulting fees	\$187,500	\$140,625	
Taxes	\$64,578	\$275,104	
Total uses	\$2,778,355	\$4,419,714	\$7,198,069
Balance	\$1,419,445	\$4,127,636	\$5,547,081

The above sources and uses of capital are estimates only for planning purposes. Any or all of the numbers could change for a variety of reasons, such as changing management, market, and product conditions and inadvertent omissions and inaccuracies in the data.

Funds Required: Use of Proceeds

Phonex requires \$5,000,000 in order to continue the development, production and marketing efforts to launch a full frontal attack on this unique market niche. The funds received would be placed in the working capital of the Company and used to meet current obligations and operating cash flow needs and for all corporate purposes as shown in the financial forecasts.

Phonex conservatively forecasts break even and positive cash flow by year-end 1990, and sales of approximately \$107 million dollars by 1994. Based on the assumption that the projections contained in this business plan are met, it is projected that the \$5.0 million being requested hereby would be sufficient to carry the Company into a positive cash flow position. If the forecasts contained herein are substantially exceeded, causing a considerable cash drain for working capital, or if the market for the Company's products does not develop as fast as anticipated or other factors cause the forecasts to be missed substantially, there could arise a need for additional outside financing.

Proposed Capital Structure and Suggested Terms

Phonex proposes that the new investment be made in the form of additional equity at the rate to be determined per share. The Company has about 14 million common shares outstanding at the present time on a fully diluted basis.

Cashout

The Company expects to provide liquidity to the investor by going public or merging with a public company in three (3) to six (6) years.

EXHIBIT 6 (con't)

FINANCIAL PLAN*

Basis of the Projections

Based upon Phonex's knowledge of the consumer electronics industry, upon preliminary contacts with prospective customers, and upon sales made to date, management has made estimates of the market for Phonex's products in several markets.

The Company has investigated the requirements of typical customers and estimated the prices at which sales might be made. It is assumed that each of the customers contacted represents a stratum of potential users, and therefore a separate vertical market to target.

In those areas of sales, forecasts were made on the basis of estimated market size, knowledge about the market, and the percentage of the market population that might be captured by the methods described. In each of these categories, the volume estimates are considered conservative and attainable by the Company.

Large transactions, such as arrangements with the Regional Bell Operating Companies, are considered windfalls and are not included in the enclosed forecasts.

Range of Projected Revenue

An analysis of the requirements mentioned in the previous section yielded a range of expected gross revenues of \$6.8 million for fiscal year ended December 31, 1990. Beyond 1990, forecasts are based on the assumption of a reasonable rate of growth, which in turn is based on the assumption that the market develops in a reasonably strong growth pattern.

Assumptions Underlying Expense Forecasts

The expense forecasts are based on the current burn rate plus reasonably predictable increases in expenses as a more aggressive marketing program is launched, and then moving toward the Company's operating model presented above as sales move into a more mature mode. It is anticipated that Administration will be a higher percentage of sales than indicated in the model for the first several quarters until the sales volume can catch up with the expense levels incurred.

Development expenses will remain at a higher percentage of sales as development is completed and the product brought to marketable condition. As the company matures, development expenses will be held close to the 2% called for in the model.

*Information represents original estimates as documented in the original business plan.

EXHIBIT 7

Phonex Potential Financing Sources and Leads* (a partial listing)

Seed Capital

Friends, neighbors, relatives, etc.**

'Angel' Investors

The Fairway Group (three individuals)
Two individuals (local group)
Ruff Group (multiple contacts)
Ladd Christensen

Investment Bankers

Wm. Blair, Chicago
DH Blair, New York***
Dain Bosworth, Denver
Hannifen Imhof, Denver

Venture Capitalists/ Investment Funds

Utah Ventures
25 California/Silicon Valley (venture capitalists)
Ventana
New Tech Adventures

D.P. Kelly & Associates, Chicago (ltd. partnership)
DPK & Associates
Solomon Brothers
Continental Bank Ventures
Credit Agricole, France

* List compiled and contacts organized by Nick Smith

**Financing secured from this source requires issuance of 'subscription' document to inform investor(s) of risk, etc.

***Offered to underwrite IPO for market cap. of \$4 to \$16 million

Financial Extract for Investment Analysis

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Cumulative	\$0.03	\$0.16	\$0.54	\$1.20	\$2.40
Investment Return on EPS	5.0%	21.0%	61.0%	106.0%	192.0%
Multiple (15x) per share	\$0.47	\$1.98	\$5.77	\$9.92	\$17.99
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Sources and Uses

1990

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Uses

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