

The Special Committee of the Board  
of Directors of ESTec Systems Corp.  
17510-102 Avenue  
Edmonton, AB T5S 1K2

November 4, 2016

To the Special Committee:

Quantum Advisory Inc. (“Quantum”) understands that ESTec Systems Corp. (“ESTec” or the “Company”) has entered into a letter of intent (the “LOI”) concerning a proposed transaction (the “Proposed Transaction”) that is summarized as follows:

- an acquisition company indirectly controlled by Anthony Nelson (a director, officer and shareholder of the Company) proposes, through a series of transactions, to acquire all of the issued and outstanding common shares in the capital of ESTec. Pursuant to the Proposed Transaction, shareholders of the Company who are not also shareholders of the acquisition company (or an affiliated entity) at the time of closing of the Proposed Transaction would receive \$0.12 in cash for each common share held.
- an intention of subsequently de-listing the common shares of ESTec from the TSX Venture Exchange thereby taking the Company private.

### **Engagement of Quantum**

ESTec’s Board of Directors has constituted a Special Committee. Pursuant to an executed engagement letter dated October 18, 2016 (the “Engagement Letter”), ESTec at the direction of the Special Committee retained the services of Quantum. Quantum’s services under its engagement include the preparation and delivery to the Special Committee of an opinion as to the fairness, from a financial point of view, from the perspective of the ESTec shareholders receiving the offer pursuant to the Proposed Transaction (the “Fairness Opinion”).

Quantum understands that the Fairness Opinion and/or a summary thereof will be included in an Information Circular (the “Circular”) to ESTec’s shareholders and, subject to the approval and other terms of the Engagement Letter, Quantum consents to such disclosure.



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Quantum is entitled to a fee for the preparation of the Fairness Opinion to the Special Committee. The fees to be received by Quantum in respect of the Fairness Opinion are not contingent on either the conclusion of the Fairness Opinion or the completion of the Proposed Transaction or any alternative transaction. ESTec has also agreed to reimburse Quantum for its reasonable out-of-pocket expenses and to indemnify Quantum in respect of certain liabilities that may arise from the engagement.

Quantum has not been asked to prepare a formal valuation of ESTec and the Fairness Opinion should not be construed as such. Quantum has, however, conducted such valuation and other analyses as it considered relevant and appropriate in the circumstances to support the Fairness Opinion.

### **Credentials of Quantum**

Quantum is an independent firm that provides valuation, transaction and financing advisory services. The firm provides advisory services for acquisitions, divestitures, mergers, management buyouts, transactions between shareholders, employee share ownership plans, shareholder agreements, succession plans and fairness opinions as well as for accounting, income tax, estate and litigation purposes.

Quantum and its team members that have been involved in preparing this Fairness Opinion have previously completed:

- over 25 engagements in the engineering industry sector; and,
- over 50 engagements in the manufacturing industry sector.

Quantum's engagement lead for the Fairness Opinion is a Chartered Business Valuator ("CBV"). Accordingly, Quantum has prepared the Fairness Opinion in conformity with the practice standards of The Canadian Institute of Chartered Business Valuators ("CICBV").

### **Independence of Quantum**

Quantum believes that it is independent of ESTec, as determined in accordance with Section 6.1 of Multilateral Instrument 61-101 (Protection of Minority Security Holders in Special Transactions) of the Securities Act (Ontario). Quantum is not an insider, associate or affiliate (as such terms are defined in the *Securities Act* (Ontario)) of ESTec, and Quantum has not acted as a financial advisor to the Company in respect to the Proposed Transaction. ESTec has not retained Quantum for any of its services in the past. Quantum, to the best of its knowledge, does not have any existing relationships with any of the shareholders of the Company.

### **Overview of ESTec**

ESTec is an Alberta based company headquartered in Edmonton, Alberta. ESTec was incorporated on April 13, 1989. ESTec has been a public company since June 1998 and its common shares are currently traded on the TSX Venture Exchange. ESTec has 10,461,629 common shares issued of which 7,726,758 (73.9%) are held by interested parties with the balance of 2,734,871 (26.1%) held by the remaining shareholders which effectively represent the recipients to the offer pursuant to the Proposed Transaction.



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We understand that the Proposed Transaction would result in the delisting of the common shares of ESTec from the TSX Venture Exchange thereby taking the Company private.

ESTec is a holding company with two wholly owned subsidiaries summarized as follows:

- Allan R. Nelson Engineering (1997) Inc. (“ARN”) – ARN was incorporated in 1997. An amalgamation of ARN and Estec Oilfield Inc. was completed effective June 30, 2007. ARN is based in Edmonton, Alberta. ARN is a group of professional engineers and technologists. ARN provides forensic engineering (largest part of its business) and design engineering services to the oil and gas, mining, manufacturing, transportation and forestry industries. ARN and ESTec’s head office has 11 employees. ARN and ESTec comprise the Company’s Engineering Business Segment for financial reporting purposes.
- Encore Electronics Inc. (“Encore”) – ESTec acquired Encore effective May 1, 2011. Encore is based in Saratoga Springs, New York, USA. Encore is an electronics design and manufacturing business whose product lines include signal conditioners, strain gage amplifiers, vibration monitoring equipment and computer controlled signal conditioning instrumentation. Encore is an Original Equipment Manufacturer (“OEM”) supplier to some of the largest multi-national aerospace, power generation and technology based industrial companies in the United States. Encore’s products and services are used in a wide variety of engineering, industrial and technology applications including aircraft engine design, automotive and turbine testing, and research and development in aerospace electronics. Encore has 17 employees. Encore represents the Company’s Electronics Business Segment for financial reporting purposes.

### **Scope of Review**

In preparing the Fairness Opinion, Quantum has reviewed and/or relied upon, amongst other things:

1. The terms of the Proposed Transaction as provided in ESTec’s press release and LOI dated October 24, 2016.
2. ESTec’s corporate structure as at October 31, 2016, as confirmed by ESTec management;
3. ESTec’s Management Information Circular dated October 6, 2015;
4. The consolidated audited financial statements of ESTec for the fiscal years ended June 30, 2007 to June 30, 2016, inclusive;
5. The unaudited non-consolidated financial statements of ESTec for the fiscal years ended June 30, 2011 to June 30, 2016, inclusive;
6. The unaudited financial statements of ARN for the fiscal years ended June 30, 2011 to June 30, 2016, inclusive;



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7. The unaudited financial statements of Encore for the fiscal years ended June 30, 2011 to June 30, 2016, inclusive;
8. The income tax return of ESTec for the fiscal year ended June 30, 2016;
9. The income tax return of ARN for the fiscal year ended June 30, 2016;
10. The income tax return of Encore for the fiscal year ended June 30, 2015;
11. The audited financial statements of Encore for the fiscal year ended December 31, 2010 with comparatives for the fiscal year ended December 31, 2009;
12. Certain unaudited financial information of Encore relating to the fiscal years ended December 31, 2005 to December 31, 2008, inclusive;
13. A consolidation spreadsheet of ESTec for its balance sheet as at June 30, 2016 and its income statement for the fiscal year ended June 30, 2016;
14. The Cdn:US dollar exchange rate assumed in the preparation of ESTec's consolidated financial statements for its fiscal year ended June 30, 2011 to June 30, 2016, inclusive;
15. The revenues attributable to a key customer of Encore for the fiscal years ended June 30, 2011 to June 30, 2016, inclusive;
16. A breakdown of the investment, intercompany accounts and amounts due to/from related parties for ESTec, ARN and Encore for the fiscal years ended June 30, 2011 to June 30, 2016, inclusive;
17. A confirmation from ESTec management that there has been no material changes to the consolidated financial position of the Company from June 30, 2016 to October 31, 2016;
18. A breakdown of the headcount of ESTec's head office, ARN and Encore as at October 31, 2016;
19. Trading information relating to the common shares of ESTec from May 1, 2011 to October 21, 2016, inclusive, provided by Yahoo Finance;
20. The banking and debt agreements of ESTec, ARN and Encore that were in effect as at October 31, 2016;
21. Other financial information obtained from ESTec management relating to the businesses of the Company, ARN and Encore;
22. Discussions with management of the Company and the Special Committee with respect to the information referred to above, amongst other things; and,
23. Such other financial, market, and industry information and such other analyses as Quantum considered relevant and appropriate in the circumstances.

Quantum was granted access to ESTec's management and was not, to its knowledge, denied any requested information.

Based on the scope of review and the related timing of the drafting and delivery of the Fairness Opinion, the effective date of the Fairness Opinion is October 31, 2016.



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### **Assumptions and Limitations**

Quantum's Fairness Opinion is subject to the assumptions, qualifications and limitations set forth below. Quantum's role is limited to the preparation and delivery of the Fairness Opinion. We have not been requested to prepare, nor have we prepared, a formal valuation or appraisal of any of the assets or securities of ESTec and our Fairness Opinion should not be construed as such, nor have we been requested to identify, solicit, consider or develop any potential alternatives to the Proposed Transaction.

With the Special Committee's approval and as provided for in the engagement agreement, Quantum has relied upon the completeness, accuracy and fair presentation of all of the financial and other information, data, advice, opinions or representations obtained by it from public sources and management of ESTec (collectively, the "Information"). The Fairness Opinion is conditional upon the completeness, accuracy and fair presentation of such Information. Subject to the exercise of professional judgment, Quantum has not attempted to verify independently the completeness, accuracy or fair presentation of any of the Information. Quantum has further assumed that financial budgets, if any, provided by management of ESTec and used in Quantum's analyses were prepared in good faith.

Management of ESTec have represented to Quantum in certificates delivered as of the date hereof, amongst other things, that (i) the Information (as defined above) provided orally by, or in the presence of, officers of ESTec or in writing by ESTec or any of their subsidiaries to Quantum relating to the Company or any of its subsidiaries or to the Proposed Transaction, for the purpose of preparing the Fairness Opinion was, at the date the Information was provided to Quantum, and is complete, true and correct in all material respects, and did not, and does not, contain any untrue statement of a material fact in respect of the Company, its subsidiaries or the Proposed Transaction, and did not, and does not, omit to state a material fact in respect of the Company, its subsidiaries or the Proposed Transaction necessary to make the Information not misleading in the light of circumstances under which the Information was made or provided; and that (ii) since the dates on which the Information was provided to Quantum, except as disclosed in writing to Quantum, or as publicly disclosed by the Company, there has been no material change, financial or otherwise, in the financial condition, assets, liabilities (contingent or otherwise), business, operations or prospects of the Company or any of its subsidiaries and no material change has occurred in the Information or any part thereof that would have, or that would reasonably be expected to have, a material effect on the Fairness Opinion.

In preparing the Fairness Opinion, Quantum has assumed that all conditions precedent to the completion of the Proposed Transaction can be satisfied in due course, and that all consents, permissions, exemptions or orders of relevant regulatory authorities will be obtained, without adverse condition or qualification.

The Fairness Opinion is rendered on the basis of securities markets, economic, financial and general business conditions prevailing as at the date hereof and the condition and prospects, financial and otherwise, of the Company and its subsidiaries, joint ventures and affiliates, as they were reflected in the Information and as they have been represented to Quantum in discussions with management of ESTec. In its analyses and in preparing the Fairness Opinion, Quantum made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond the control of Quantum or any party involved in the Proposed Transaction.



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The Fairness Opinion has been provided for the use of the Special Committee and ESTec's Board of Directors (the "Board") and may not be used by any person or relied upon by any person, other than the Special Committee or the Board, without the express prior written consent of Quantum. The Fairness Opinion is given as of the date hereof and Quantum disclaims any undertaking or obligation to advise any person of any change in any fact or matter affecting the Fairness Opinion that may come or be brought to Quantum's attention after the date hereof. Without limiting the foregoing, in the event that there is any material change in any fact or matter affecting the Fairness Opinion after the date hereof, Quantum reserves the right to change, modify or withdraw the Fairness Opinion.

This Fairness Opinion should not be construed as a recommendation to any ESTec shareholder to accept or reject the Proposed Transaction.

Quantum believes that its analyses must be considered as a whole and that selecting portions of the analyses or the factors considered by it, without considering all factors and analyses together, could create a misleading view of the process underlying the Fairness Opinion. The preparation of a fairness opinion is a complex process and is not necessarily susceptible to partial analyses or summary description. Any attempt to do so could lead to undue emphasis on any particular factor or analyses.

### **Fairness Considerations**

#### **(A) Shareholder Alternatives to Realize Liquidity (Cash) on Common Shares of ESTec**

ESTec had not paid any dividends on the Company's common shares in the 124 months (10+ years) ended October 31, 2016.

ESTec had not undertaken any share repurchases of the Company's common shares in the 124 months (10+ years) ended October 31, 2016.

ESTec shareholders seeking liquidity (cash) on an investment in the common shares of the Company would generally have the following two alternatives:

- a sale of ESTec's common shares on a publicly traded exchange; and/or,
- a sale of ESTec's common shares pursuant to an offer from a prospective purchaser.



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### (B) Trading of ESTec Common Shares on a Publicly Traded Exchange

The following summarizes ESTec's volumes and price per common share traded on the TSX Venture Exchange from May 1, 2011 (ESTec acquisition date of Encore) to October 24, 2016 (last day of trading prior to the announcement of the Proposed Transaction):

Cdn \$  <u>Period</u>	Common Shares <u>Traded</u>	Price Per ESTec Common Share		
		<u>Low</u>	<u>High</u>	<u>Weighted Average</u>
2 months ended June 30, 2011	2,000	\$0.10	\$0.10	\$0.10
12 months ended June 30, 2012	114,800	\$0.02	\$0.04	\$0.03
12 months ended June 30, 2013	228,500	\$0.02	\$0.10	\$0.06
12 months ended June 30, 2014	225,300	\$0.01	\$0.10	\$0.04
12 months ended June 30, 2015	211,500	\$0.04	\$0.10	\$0.09
12 months ended June 30, 2016	1,453,400	\$0.07	\$0.15	\$0.09
July 1, 2016 to October 24, 2016	<u>171,500</u>	\$0.08	\$0.13	\$0.10
66 months ended October 24, 2016	<u>2,407,000</u>	\$0.01	\$0.15	\$0.08
Closing price October 24, 2016				\$0.10
Proposed Transaction Offer Price - October 24, 2016				\$0.12

The following summarizes our noteworthy comments and observations:

- The offer price of \$.12 based on the Proposed Transaction represents a 20% premium to the closing price on October 24, 2016.
- The offer price of \$.12 based on Proposed Transaction represents a premium to the trading price on 99.5% of the common shares traded over the 66 months ended October 24, 2016.
- The common shares of ESTec lack liquidity as evidenced by the following:
  - ESTec's common shares traded on 7.53% of trading days over the 66 months ended October 24, 2016.
  - 2,407,000 ESTec common shares traded over the 66 months ended October 24, 2016 representing 88% (less than 1x turnover) of the common shares of the Company owned by the public (i.e. not owned by reporting insiders of ESTec).
- The Proposed Transaction offers liquidity to recipients of the offer without incurring selling costs (i.e. commissions).



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**(C) Alternative Offers for the Common Shares or Material Assets of ESTec and/or its Subsidiaries**

Quantum understands from ESTec management that in the 24 months prior to the date of this Fairness Opinion that there have not been any:

- en bloc offers for the common shares of ESTec, ARN or Encore; and/or.
- material assets of ESTec, ARN or Encore.

**(D) Valuation of ESTec and its Engineering and Electronics Business Segments**

The following summarizes the revenues and EBITDA (Earnings Before Interest Taxes Depreciation & Amortization) attributable to ESTec (on a consolidated basis) and the Company's two business segments (Engineering & Electronics) for the five fiscal years ended June 30, 2012 to June 30, 2016, inclusive:

Cdn \$000's	Fiscal Years Ended				
	June 30, 2012	June 30, 2013	June 30, 2014	June 30, 2015	June 30, 2016
<b>By Business Segment &amp; Consolidated:</b>					
Engineering = ARN + ESTec:					
Revenue	\$2,725	\$2,398	\$2,017	\$2,160	\$1,158
EBITDA	\$260	\$(155)	\$(437)	\$(201)	\$(802)
Electronics = Encore:					
Revenue	\$2,391	\$3,179	\$3,232	\$3,674	\$4,364
EBITDA	\$163	\$644	\$276	\$756	\$759
ESTec Consolidated = ARN + ESTec + Encore:					
Revenue	\$5,116	\$5,576	\$5,249	\$5,834	\$5,522
EBITDA	\$423	\$489	\$(161)	\$555	\$(43)

EBITDA - Earnings Before Interest Taxes Depreciation & Amortization

The following summarizes our noteworthy comments and observations:

- Engineering Business Segment – This business segment has generally been contracting in terms of revenues and experiencing losses in its most recent four fiscal years which was anticipated to continue in the near term as of the effective date of this Fairness Opinion. Accordingly, we concluded that there was no goodwill attributable to this business segment. We therefore selected a Net Book Value Approach (an asset based approach) to determine the value of the Engineering Business Segment.





- Electronics Business Segment – ESTec acquired this business segment through the acquisition of Encore effective May 1, 2011. The Electronics Business Segment has experienced growth in revenues and profits which was anticipated to continue in the near term as of the effective date of this Fairness Opinion. We selected and considered two alternative valuation approaches (Capitalized Earnings and Market Approach) to determine the value of the Electronics Business Segments:
  - Capitalized Earnings Approach – The following summarizes our Calculation of Value and related key considerations in applying the Capitalized Earnings Approach for ESTec’s Electronics Business Segment:

US \$000's	Fair Market Value		
	Low	High	Mid-Point
Maintainable EBITDA	\$475	\$600	\$538
Less: Sustaining capital expenditures	(25)	(25)	(25)
Less: Interest on debt \$300 x 5% =	(15)	(15)	(15)
Maintainable earnings before income taxes	435	560	498
Less: Income taxes @ 34% =	(148)	(190)	(169)
Maintainable net earnings (A)	287	370	328
Capitalization rate (B)	18.5%	21.5%	20.1%
Capitalized value of operations (C=A/B)	\$1,552	\$1,719	\$1,635

- Maintainable EBITDA – A range of US\$475,000 to US \$600,000 (mid-point of \$537,500) was selected being in the upper end of the range of Encore’s experience over its most recent five fiscal years.
- Sustaining Capital Expenditures – US\$25,000 was selected to maintain the operations of Encore based on discussions with ESTec management.
- Debt and Interest Expense – US\$300,000 in debt was selected as being available at an interest rate of 5% with consideration to:
  - Encore’s limited assets/security to borrow against; and,
  - the banking covenants that Encore would be expected to meet on a stand-alone basis.
- Income Tax Rate – 34% was selected based on the effective income tax rate applicable to businesses of Encore’s size operating within the state of New York, USA.



- Capitalization Rate – An after-tax rate of return on equity in the range of 18.5% to 21.5% (mid-point of approximately 20%) was selected with consideration to the following factors attributable to ESTec’s Electronics Business Segment:
  - Lack of tangible net assets – There is limited working capital and/or equipment and there is no property/real estate underlying/supporting the valuation.
  - Customer reliance – There is significant reliance on a single customer comprising 57.2% of revenues from May 1, 2011 to June 30, 2016.
  - Limited Size – Given revenues approximate US\$3 million and there are 17 employees.
  - Foreign Exchange Exposure – Cash flows and net assets are 100% denominated in US dollars. Accordingly, ESTec has a material foreign exchange exposure associated with its investment in Encore.
- Market Approach – The implied fair market value of the goodwill & intangibles based on the Capitalized Earnings Approach was compared to the actual goodwill & intangibles paid by ESTec pursuant to its acquisition of Encore effective May 1, 2011 summarized as follows:

\$000's		Fair Market Value			ESTec Acquisition of Encore (note 1)
		Low	High	Mid-Point	
Capitalized value of operations (\$US)	(A)	\$1,552	\$1,719	\$1,635	
Less: Tangible net assets (\$US)	(B)	(272)	(272)	(272)	
Goodwill & intangibles (\$US)	(C=A+B)	<u>\$1,280</u>	<u>\$1,447</u>	<u>\$1,364</u>	\$737
Maintainable EBITDA (\$US)	(D)	\$475	\$600	\$538	\$300
Goodwill & intangibles multiple of EBITDA	(E=C/D)	2.69x	2.41x	2.54x	2.46x
Cdn:US exchange rate October 31, 2016	(F)	1.3411	1.3411	1.3411	
Goodwill & intangibles (\$Cdn)	(E=CxF)	\$1,717	\$1,941	\$1,829	

Note 1: Based on ESTec acquisition of Encore effective May 1, 2011.

Based on the above, the Market Approach supported the valuation based on the Capitalized Earnings Approach for ESTec’s Electronics Business Segment.



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The following summarizes the fair market value of ESTec's common shares based on the valuation approaches selected for the Engineering Business Segment (Net Book Value Approach) and the Electronics Business Segment (Capitalized Earnings Approach and Market Approach):

Cdn \$000's (except for per ESTec common share)	Fair Market Value			Proposed Transaction
	Low	High	Mid-Point	
ESTec common shares - net book value	\$387	\$387	\$387	\$387
Less: Encore goodwill & intangibles - net book value	(956)	(956)	(956)	(956)
Add: Encore goodwill & intangibles - fair market value	1,717	1,941	1,829	1,824
ESTec common shares - fair market value (A)	<u>\$1,148</u>	<u>\$1,372</u>	<u>\$1,260</u>	<u>\$1,255</u>
Issued & outstanding ESTec common shares (000's) (B)	10,462	10,462	10,462	10,462
Per ESTec common share (C=A/B)	\$0.11	\$0.13	\$0.12	\$0.12

Based on the above, the Proposed Transaction was considered fair to the common shareholders receiving a cash offer of \$0.12 per ESTec common share being in the range of the fair market value of \$0.11 to \$0.13 per common share of the Company.

### Conclusion

Based on the scope of our review and the assumptions and considerations noted herein, it is our opinion that as at the October 31, 2016 effective date of this Fairness Opinion, that the Proposed Transaction is fair from a financial point of view from the perspective of the ESTec shareholders receiving a cash offer of \$0.12 per ESTec common share.

Yours very truly,

*Quantum Advisory Inc.*

Quantum Advisory Inc.