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Insights

FOR MANUFACTURERS

Manager's Insights

You are the last to know.

On the front page of my local paper the other morning was the story of a woman who said she did not know how she had stolen money from her company or for how long. By the time she was caught, she had stolen \$143,000 over a two week period back in November 2007.

Her general manager finally realized something was wrong when her cash deposits from collecting cash-on-delivery monies did not match her deposit slips. She used the money to help her children and pay bills.

According to the Association of Certified Fraud Examiners, the average organization loses 6% of its total annual revenue to fraud and abuse by employees. Nationally, employee theft is estimated to cost between \$20 and \$90 billion annually. The typical perpetrator looks like you and me; the older and more trusted the employee, the larger the fraud.

Averages suggest that companies with 100 employees or fewer are more at risk than larger businesses. Smaller companies suffer the most costly abuses and are 100 times more likely to be victimized than larger companies. One study showed that between 30 and 50% of all business failures are caused by employee theft.

Employees steal because they can. Forensic accountants talk about the three causal factors of fraud, the most important and most easily controlled of which is *opportunity*. It is very common that a single individual is responsible for virtually all paying and receiving functions. Often this is the bookkeeper who grew up with the company and has the owner's complete trust. What goes unrecognized is that he holds the company's life in his hands. If that person decides to steal, there are few or no checks and balances to alert management.

This brings up the next critical factor: desperation can undermine the highest principles. The pressure of domestic problems, substance abuse, and other serious personal issues can provide

rationalizations for borrowing from the company "...after all, I helped build this place." Of course the intention is to repay the money, but somehow it never happens.

Resentment from an overwhelming workload, difficult working conditions, or even someone else's compensation can be enough to turn a trusted bookkeeper into an embezzler. In the current economic environment, these pressures seem to have increased for many.

What can you do? *Reduce Opportunity.*

- Segregate financial duties. If necessary, pay your accountant a little extra to verify your cash, receivables and payables.
- Personally review your accounts receivable and payable aging periodically.
- Make sure bank statements are reconciled on a timely basis by someone other than the person approving the checks.
- Since most frauds are discovered by accident, require your employees to take at least one full week's vacation every year.

We've all been sensitized to the threat of outsiders stealing checks or attempting to trap us with phony wire transfer schemes; we need to work as hard at addressing the more common risk of an inside theft.

Ric Sarfert
Senior Vice President,
Manufacturing Group Head



You're in the business
of making things.
We're in the business of
making things happen.®

What's Inside

CLIENT INSIGHTS Penn Foam Corporation	2
EDUCATION INSIGHTS <i>Your Business and Fraud</i> Lee Roberts, National Penn	4
ECONOMIC INSIGHTS <i>Curing the Addiction</i> Dean P. McDermott, Ph.D	5
TEAM INSIGHTS	6
MANUFACTURING GROUP IN THE NEWS	6
MANUFACTURING BUSINESSES FOR SALE	7
SOLUTION NETWORK® CORNER	8

SOLUTION NETWORK®
CORNER

To increase profitability and sales growth, STRATEGIC RESOURCES, INC. gets real personal.

When a company's sales are flat or increased profitability eludes them, help is a phone call to Strategic Resources away. Strategic Resources is a management and financial consulting firm with an uncommon personal touch. Since 1991, they've been supporting closely held and family-owned businesses, helping them diagnose the issues stifling their success and determine the right course of action to take. Unlike large consulting firms, you work with the "first team" – the principals – to achieve optimum results.

"REAL." An acronym with meat and meaning.

These days, acronyms are a dime a dozen. But Strategic Resources offers one based in sound strategic thinking and results. In fact, many companies have found Strategic Resources' proprietary REAL Profit StrategySM the most valuable acronym they ever bought into. REAL, which stands for "Research, Evaluate, Act, Leverage," is a proven approach, which offers insights derived directly from the facts. It's a hands-on method of helping clients "get real" with their issues and achieve real value for their business.

RESEARCH – a fact-based beginning.

Strategic Resources examines a business to gain a clear understanding of its operations, uncovering its profitable and unprofitable aspects. They work closely with and involve managers and other key people in this systematic process. Reviewing financial and operating trends, comparing with industry benchmarks, organizing data into understandable information, uncovering initial key opportunities – getting to know a business from an objective and different perspective to benefit the owner.

EVALUATE – discovering a business' true competitive advantage.

Assessing segment, customer, and product profitability, analyzing costs and identifying key elements for success, all helps clients understand their optimal business model, identify activities that don't fit and gain consensus on major opportunities and issues.

ACT – hands-on implementation of success strategies.

They share the good, the bad and the ugly – and then implement strategies to eliminate the latter two. They're a group of talented, passionate experts who understand the business of business and work directly with owners and their teams to analyze, strategize, organize and implement. They make it happen!

LEVERAGE – sustaining the momentum.

This is where improved profitability and growth take hold and long-term value is created. Businesses see more effective data analysis and problem solving, out-of-the-box thinking, motivated employees, improved accountability, broader participation and buy-in to changes in processes and organization – and, most importantly, sustainable results through a more focused and enhanced business model.

Some REAL success stories.

After analyzing their customer segments, products and supply chain, Strategic Resources worked with a manufacturer to determine their impact on profitability and implemented targeted sales plans and pricing strategies. Profits grew by four times their best prior year. Another manufacturer with high-labor, low-profit work realigned their customer base to significantly boost profits. A contractor significantly increased sales and profitability through an enhanced understanding of the company's cost structure and the buy-in of employees. A distributor that was experiencing rapid growth was able to get a firm grip on how to best manage and sustain their growth.

If you would like more information about how Strategic Resources, Inc. can help you identify your real issues, provide you with real solutions, and make your company a success story, contact your Manufacturing Group Relationship Manager or call 888.248.3654.



Manufacturing Group

COMPANY: **Penn Foam Corporation**

LOCATION: **Allentown, Pa.**

EMPLOYEES: **85**

2007 SALES: **\$18 million**

www.pennfoam.com

While attending your favorite sporting event and waving a foam #1 finger, you're likely using a novelty product made with Penn Foam's foam. Or maybe while reveling in Times Square on New Year's Eve, you have a foam



Left to right: Sandra Fromknecht, David Quinn, Robert Fromknecht, Christy Ernst, Leo Quinn, III, Timothy Quinn, James Quinn, Ric Sarfert and Steve Zeigler.

Statue of Liberty crown on your head. That's also a Penn Foam product. Have you recently splurged and bought yourself a memory foam pillow or mattress? You might be sleeping on another one of Penn Foam's superior products. The packaging that encased your new computer purchase and kept it bump-free during delivery was possibly manufactured by Penn Foam.

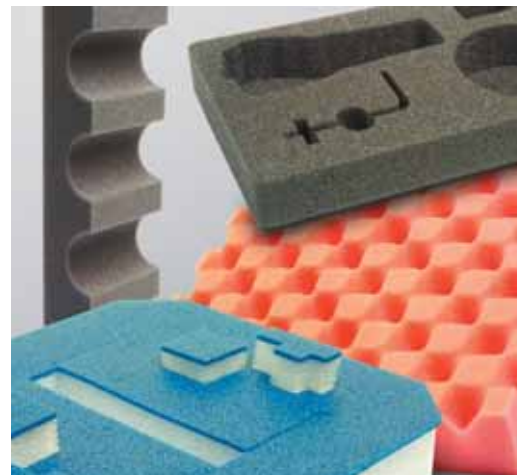
Penn Foam Corporation is a premier custom manufacturer and fabricator of innovative flexible foam cushioning products. Some of their well-known clients include Ashley Furniture, Graco Children's Products and Bemis Manufacturing. You'll find Penn Foam's products in novelty items, home and office furniture, gymnastics equipment, padded toilet seats, sponges and packaging.

In 1976, Leo F. Quinn started Penn Foam to create molded foam for the padded toilet seat industry. His five children worked for the business during summer vacations and while attending college. In 1995, the siblings became the second generation to run the business and have successfully divided job responsibilities based on their strengths:

- **Sandra Fromknecht**, President – team leader, oversees finances, legal matters, and accounting
- **Leo Quinn, III**, Vice President – oversees the foam manufacturing, foam formulations, and plant operations
- **James Quinn**, Vice President – sales; strategic planning and investigating new equipment needs
- **Timothy Quinn**, Vice President – sales and product development including the engineering of foam products, designs, and concepts
- **David Quinn**, Vice President – leads the foam chemical formulations and standards testing of the foam products
- **Robert Fromknecht** – sales manager and engineers many of the foam packaging products
- **Christy Ernst** – production manager overseeing all fabrication areas

How do all of these brothers, sisters and spouses make it work? "We support and encourage each other, but don't interfere with each other's job responsibilities. We hold weekly meetings to discuss our particular areas, products, customers, new innovations, finances and challenges. Most importantly, we try not to talk about business at family functions," replied Sandy.

Penn Foam Corporation has many competitive advantages including the ability to be flexible for customers and provide a higher level of personal service. "We are small enough to be able to make quick decisions which help our customers when they have an urgent need.



We value close business relationships with our customers and suppliers," Sandy said.

Penn Foam has always been concerned with being environmentally responsible and the impact of manufacturing on the environment. Therefore they don't use CFCs in the foam manufacturing processes. Also, Penn Foam recycles 100% of all manufactured foam and fiber, so there is no fall off or scraps thrown away to be land filled. Recently they began applying new "green" technologies to the product line. From recycled bottles, they manufacture polyester fiber batting which is used primarily in seat cushions.

Like many manufacturers, one of Penn Foam's greatest business challenges is controlling the cost of raw materials. According to James, "Many of our accounts are long-term, loyal business relationships. Due to our close customer relationships and strong competition, we don't always pass along price increases. Instead, whenever possible, we work on innovations to cut costs and search for vendors that help us increase our efficiency—just like we do with our customers."

After her father's passing, Sandy took over the business reins in 1996, continuing best practices and close relationships that her father had started, including the banking relationship with National Penn Bank.

In 1999, the relationship proved to be a "blessing," according to Sandy, when National Penn formed its niche Manufacturing Group that had relationship managers, relationship developers and support teams specially trained in lean manufacturing and other skilled industry disciplines.

"The Manufacturing Group is a wealth of information and advice. When Steve Zeigler [relationship manager] visits, I always expect to learn something new and useful. Scott Gruber [former head of the Group] helped us find our new accounting firm," said Sandy.



"The entire team understands the manufacturing cycle, the challenges we face, and in turn, how that affects the financial-side of manufacturing. Their expertise – both in financial and non-financial matters – brings a level of specialized knowledge we wouldn't easily find at another bank."

"We really benefit from the convenience and time savings of National Penn's cash management products – especially the new remote deposit capture. We're so satisfied with National Penn's Manufacturing Group that we always recommended them to our business associates," added James.

Penn Foam is located in a territory that recently expanded National Penn's footprint. With our acquisition of KNBT Bancorp, Inc., we increased our community office locations by 56 throughout Lehigh, Northampton, Carbon, Luzerne, Schuylkill and Monroe counties. On April 21, 2008, the conversion of the two banks was completed and our clients can enjoy banking at KNBT and National Penn's other divisional banks: FirstService Bank (Bucks County), HomeTowne Heritage Bank (Lancaster County) and Nittany Bank (State College).

Interestingly, Sandy's personal accounts were with Keystone Savings (KNBT) since 1984. She loves the personal service she receives there and the branch locations are convenient to the business and her home. Now she feels she has the best of both worlds – a great business and personal bank. "I'm happy that my employees have more choices and convenient locations to visit – especially on payday."

Now that's something to wave your #1 foam finger at.

Penn Foam manufacturers packaging and novelty products at their Allentown plant.



Foam cushioning is an integral part of the Penn Foam product group.

Your business and fraud – what are you doing about it?

By A. Lee Roberts, EVP, National Penn
Operating Risk Management & Compliance

One of the greatest, common fears among business owners is learning that their business has been a victim of fraud. On average, I see a new case every day, and want to help your business prevent the disruptions and costly effects.

Typically, there's an 84% chance of not getting your money back even when the criminal confesses or is convicted—not to mention the accountant and lawyer fees you'll accumulate.

While there are many faces of fraud, the most common are occupational fraud, electronic fraud and check fraud.

Occupational Fraud is using one's occupation for personal enrichment through the deliberate misuse/misapplication of the company's resources or assets. At least once a month, we are informed of a long-time, trusted employee – often the bookkeeper – who has been stealing from a customers' company.

Typically, 10% of employees will not ever steal from you while another 10% will steal regardless of the controls you employ. The remaining 80% may steal if there is opportunity and if they think they won't be caught.

Establishing effective controls will increase the likelihood of being caught and therefore reduce the temptation to steal. Since a (criminal) employee returns to the scene of the crime every day, implement a simple deterrent such as having a second person look at the checkbook to discourage them.

The Association of Certified Fraud Examiners' survey reported that small businesses (less than 100 employees) suffer the greatest number of frauds and financial losses – likely because they have fewer controls.

What can you do?

- Perform background checks on all new employees. There are inexpensive services that run electronic background checks in seconds.
- Develop good internal controls to increase the "perception of detection."
- Establish a confidential hotline or someone employees can talk to anonymously.
- Ask your accountant to specifically audit for fraud.
- Require mandatory vacations; fraud is often detected when the criminal is away.
- Conduct surprise audits where possible.

Electronic Fraud is on the rise in financial institutions across the world. The most common electronic fraud is counterfeit debit cards. And in the past two years, sophisticated crime rings have attempted to create fraudulent wires and ACH debits from business accounts. At National Penn, we have a team dedicated solely to monitor, detect and prevent fraud. We continually strengthen our controls, protecting our customers' assets and confidential information.

What can you do?

- If you fax a wire request to National Penn, expect a call back from us to authenticate your request.
- Keep your system's virus protection updated, to prevent keylogging viruses, allowing thieves to mimic your key strokes and obtain your user ID and passwords. This is especially important if you use e-cash manager or electronic methods to send wires or ACH transactions.

Check Fraud occurs when counterfeiters get your account, routing and check numbers (within the range you're using) to produce counterfeit checks on your account – supplies for which are easily accessible at office supply stores that sell check stock, software and hardware to print quality checks. For \$100 - \$200 per check, counterfeiters pay 10 - 20 young adults to open new accounts and cash checks drawn on your account. They reap the balance, usually about \$1,000 - \$3,000.

Another check fraud ploy is establishing a relationship with a business via the Internet and asking them to serve as a "payment clearing house." The business is instructed to deposit the customer's checks and immediately wire the funds to a foreign bank. The checks are identified and returned as counterfeit, and the business loses the wired funds.

What can you do?

- Stop writing checks. Enroll in electronic banking to pay bills through National Penn's cash management system.
- Monitor your account often and closely.
- Balance your accounts immediately upon receiving your statement; verify every check.

Taking these precautions will help you reduce fraud risk, protect your business, and avoid costly frustrations.

Curing the Addiction

By Dean P. McDermott, Ph.D.

The American populace has had an addiction. An addiction to loose credit, easily obtainable money and the ability to live over their heads. The United States government has fed their addiction by turning a blind eye to the abuses which were going on in the financial industries.

As with any addiction, to be cured the addict must realize they have a problem. Over the past year this has occurred as we have seen an increased amount of individuals losing their possessions to foreclosure and repossession.

Concurrently, the government is finally coming to the realization that there are significant problems in the housing and credit markets, both of which must be tended to at the same time. They are facing and finally admitting that a recession is "a distinct possibility."

With these admissions, we are finally seeing the addict and the enabler realize that there is a problem.

Political doublespeak aside, although we are not in a "textbook" recession, we are in a sector recession. A sector recession is one where we see a particular section of the economy in a steep decline, in this case the housing and consumer durable areas.

It is clearly evident that the downturns in these particular sectors are now spilling into other areas of the economy through unemployment and loss of consumption power by the unemployed.

It is our feeling that we will be in a full-blown recession in the third and into the fourth quarter of 2008. The severity will depend on the governmental stimulus packages for bailouts currently being orchestrated and their ability to sustain the economy.

Inflation

In previous articles, I have discussed inflation creeping into the economy. That is no longer the scenario. Inflation now has been waving a red flag for the past two quarters and shouting I'm here. Get used to it!

We have seen significant increases in food and energy costs. The good news is, however, we are starting to see a flattening out in the futures markets of certain grains and energy commodities giving us an indication we may see some relief from inflation in these sectors by the end of the year.

Domestically, we are seeing demand soften in the oil sector as domestic supplies are rising. Gasoline supplies are currently at a several decade high. This can prove to be a good sign as a reduction in gasoline prices may be coming as refiners may wish to move excess inventory.

With a softening in demand in the gasoline sector and the corresponding seasonal shifts in the energy sector, we are anticipating a reduction in gasoline prices at the pump over the next few months. This should provide some relief to the beleaguered consumer.

A reduction in gasoline prices may also mean that the inflation in the food and grains sector may subside, due to a reduction in transportation costs.

Manufacturing

The March ISM manufacturing index came in above consensus at 48.6% versus a reading of 48.3% in February. A reading above 50 is considered a positive for the economy. Certain pockets of manufacturing have been holding their own, benefiting from the declining dollar against world currencies which have boosted U.S. exports.

By our estimates, we anticipate overall ISM numbers to remain in the 48 to 51 percentile for the balance of the year. It is our opinion that manufactured items for the domestic market should see a slight downturn in the second and third quarters of 2008 with a slight recovery starting in the end of the fourth quarter 2008.

Bottom line

Currently we are in a sector recession, which we anticipate to continue for the balance of the year in the housing and consumer durable sectors as well as their ancillary markets. We expect the consumer non-durable sector to maintain at current consumption levels.

We anticipate some relief in the energy sector in the latter half of the year. That combined with the economic stimulus package being doled out in Washington should lead us into a better economy in 2009.

The road to recovery usually starts with an admission of a problem.

In every issue, we spotlight a Manufacturing Group team member, giving you the opportunity to get to know us better. Our next profile is our new department head, Ric Sarfert.



Facts about Ric:

- Ric is a Senior Vice President and head of the Manufacturing Group. His office is located in Boyertown.
- Ric graduated from Penn State University with a B.S. in Business (Finance). He is currently working towards his MBA at St. Joseph's University.
- Ric has 23 years of banking experience. Previous to National Penn, Ric worked for Meridian.
- Ric was born in Berks County and currently resides in Limerick, Montgomery County. He is married to Amy and they have two children – Leisel and Zachery.
- Favorite movie: "Caddy Shack"
- Last book you read/author: Introduction to Business Ethics, DesJardins / Good to Great, Collins
- Favorite food: Steak, salad and fries
- Favorite type of music: Classic rock
- Favorite sport / sports team: Soccer / Penn State football
- Favorite vacation spot: Outer Banks or Germany
- Hobbies: Golf, reading, fishing and hiking
- A person you would most like to meet: Colin Powell

Manufacturing Group in the News

In the February 11, 2008 online edition of The Philadelphia Inquirer, Manufacturing Group head Ric Sarfert was quoted in staff writer Joseph DiStefano's article: "Greenback's slide has a silver lining. Phila. manufacturers find demand abroad is boosted by a favorable exchange rate."

Ric discussed with DiStefano how factories in Philadelphia and the suburbs are "getting squeezed on increases in raw-materials costs, delivery charges and fuel costs, but at the same time, quite a few factories have had requests for price quotes from foreign entities, primarily out of Europe. They aren't making a lot of shipments yet. But I think the weakening of the dollar will start to help."

Manufacturing Businesses For Sale

Packaging Equipment Manufacturer - 1530E

Located in the mid-Atlantic region, this company has been in business for over 30 years and offers a complete comprehensive line of automated packaging systems to meet the demands of manufacturers throughout various industries. Employees are non-union. Annual revenue approximately \$6.5 million.

Corrugated Box Manufacturer - 1566E

The company manufactures custom corrugated containers and related products. It has one of the most versatile and efficient collections of container-making equipment in the industry. Presently approximately \$18 million in annual revenue with approximately \$2.9 million in normalized EBITDA.

Printing and Fulfillment/Distribution Company - 06032P

A 50 year old full-service company specializing in handling high-end, nonprofit clients. Facilities consist of a 27,000 sq. ft. manufacturing and office complex situated on roughly 2.7 acres and two nearby leased warehouses totaling roughly 22,000 sq. ft. The business is located in the mid-Atlantic region and is a niche leader in the Eastern/mid-Atlantic market with a heavy concentration of major customers in New York City. Year ending June 30, 2006: \$10.5 million (estimated).

Commercial Printing and Fulfillment Company - 06103P

The company specializes in very high quality, multi-color for major advertising/design firms and manufacturing, retail, education, and financial services companies. Located in the mid-Atlantic region with a heavy concentration of customers in eastern Pennsylvania, Maryland and New York City. The year ending December 2006 estimated sales is \$6.5 million.

Contract Machine Shop - 07082P

A high-end, contract machine shop specializing in quality precision milled and turned parts with critical tolerances. The facilities consist of a 16,000 sq. ft. M/L manufacturing and office complex. Located in the mid-Atlantic region. Sales revenues are approximately \$3.5 million. There is room for expansion.

Swiss Turning Manufacturing 9918T

This company is located in the southeastern section of the U.S. specializing in Swiss Turning Manufacturing. Has varied customers, including the automotive industry. Sales have been increasing over the last four years. Limited competition makes this a niche business with tremendous potential for the future. This company has its (TS16949) certification. Cash flow is \$650,000, sales \$1,650,000 and sales price \$2,590,000.

Custom Dump Truck Body and Trailer Manufacturer - 0104V

Founded in 1966, the company is now one of the most recognized names in dump truck body/frames and trailers in the mid-Atlantic region. As a result of their quality and service record, almost 75 percent of sales are from repeat customers. Sales growth has been exceptional in the last few years. In 2005, the company generated revenues of \$6.4 million.

Custom Conveyor Manufacturer & Integrator – Food Industry - 0105V

A conveyor design and fabrication company for customized material handling applications in process manufacturing. The company value proposition is to maximize efficiency throughout and eliminate waste thereby reducing production cost. Net sales in 2006 were approximately \$1.1 million.

Consumer Product Manufacturer with Home & Office Delivery Service - 0106V

The manufacturer has built a strong regional brand in the home and office delivery (HOD) business. The company's products are also sold to large retailers and to other delivery service under private label agreements. These three channels of distribution give the company a unique ability to achieve consistent internal sales growth. In addition, the company has grown with selective acquisitions utilizing its strong cash flow.

Sales for 2006 were approximately \$9 million.

High-Tech Engineering & Precision Machining Company - 0107V

The company is a full-service engineering and machining company located in Pennsylvania. The company works with a wide variety of materials and a diverse market base that includes defense contractors, fiber optics, electronic components, powdered metal parts, custom injection molds, and foundry industries. 2006 sales were approximately \$1.4 million.

Specialty Manufacturer - 0108V

This manufacturer is known for its innovation and creativity both in product development and in manufacturing processes. They serve major distributors throughout the U.S. and are an authorized supplier to the U.S. General Service Administration. The 2006 sales were approximately \$2.6 million.

Niche Manufacturer 4047189VC

This company has been in existence for three generations and has specialized in their current niche for over 20 years. They serve both the residential and commercial needs of a specific segment of the construction industry. Their manufacturing process includes steel fabrication, woodworking, and assembly. Production is centralized in a custom built 30,000 sq. ft. facility in the mid-Atlantic region. 2006 revenue was \$5 million and EBITDA of \$1.6 million.