CIP Capital Advisors, LLC

Merger and Acquisition Advisors and Investment Banking

Structuring Business Liquidity Events
and
Ownership Transitions

Monetization of the Privately-Owned Business
The Exit/Liquidity Event Decision

Senior ownership of privately-held companies usually reach a decision point on whether to sell their business into the market place, transfer ownership to next generation family members or transition ownership into the hands of operating management.

This inflection point might be driven by competitive market conditions, family pressures, health issues, estate diversification objectives or simply the desire to slow down and realize the business's value created over years of hard work.

If the owner's decision is to exit and monetize the value in a business, they then face the perplexing and complicated question of how to accomplish the objective. Ownership exit formats include a range of alternatives and many variations exist; each unique circumstance must be carefully evaluated in deciding upon the best approach and optimum structural solution.

The following slides present an overview of the common avenues used to monetize or exit a business interest. Depending on which alternative is considered, different enterprise value ranges may apply.

Business Liquidity Events and Ownership Transactions-
A Range of Alternatives

- **Dividend Recapitalization-Maintaining Ownership**

- **Change of Control Transactions**
  - **Strategic buyer**
  - **Financial buyer**

- **The Internal Transaction—Management Led Buy-Out (MBO)**

The Dividend Recapitalization-
Leveraging the Balance Sheet/Maintaining Ownership

- **Dividend Recapitalization-Maintaining an Ownership Position:**
  - Allows for a measured degree of value/liquidity realization while permitting the principals a second opportunity for value realization (the so-called “second bite of the apple”) upon a later transaction event.
  - Involves a significant dividend distribution to the owners, usually funded by new external debt borrowings, resulting in a new capital structure for the business.
  - The transaction may also may involve infusion of third party patient capital (mezzanine debt or equity) to provide for balance sheet strength or to fund growth, which usually involves some degree of equity dilution.

The External Transaction-
Strategic Buyer or Financial Investor

- **Change of Control Transactions**
  - **Strategic buyers-** Sale of all or a controlling interest in the business, usually to a larger organization within the company's industry vertical (or horizontal), often retaining existing, incentivized management team, with senior ownership transitioning out over a defined period
  - **Financial buyers-** Sale of all or a portion of the business to a private equity firm or family office fund with operating management remaining with up-side incentives. Often involves continuing seller economic participation of some form (subordinated debt, preferred instrument, and/or common equity hold)—all subject to negotiation between the parties.

- **Deal structure variations:**
  - asset vs. stock transactions,
  - seller equity-roll,
  - seller subordinated debt,
  - earn-outs

External Transactions-
The Process Underlying Success

- **Define Target Buyers-**
  - Specific, limited targets or broad groups, strategic--vertical/horizontal, financial buyers
  - Buyer-candidate list assembled and agreed

- **Market-based transaction pricing**—Determine the range of market-based enterprise value expectations--usually denominated as a multiple of adjusted operating earnings before interest expense, income taxes and depreciation/amortization (EBITDA). The applicable multiple falls within a range and is influenced by both company-specific attributes and broader industry factors.

- **Initial "teaser**"—A summary of the subject company (but not identified), is circulated on an unidentified "opportunity" basis to targeted buyer-candidates.

- **Confidential Information Memorandum ("CIM"):** A more comprehensive deck or "book" that identifies the specific company and highlights its unique attributes is prepared for presentation to qualified potential buyers under non-disclosure agreements (NDAs).

- **Expressions of interest/Letters of Intent–** The process continues by qualifying interested parties, managing conference calls and on-site visits and evaluating and selecting finalist(s) and then moving to a non-binding letter of intent phase with one party under limited exclusivity.

- **Closing Process**- Qualification of buyer financing, manage buyer due diligence, transaction structure (legal and tax), documentation, funding and closing.

The Management Buy-Out (MBO) Transaction- an Internal Transition Alternative

- **The Management Buy-Out (MBO) Transaction-** is an ownership shift transaction structured together by ownership and the operating team (which might include family members interested in continuing in the business) that results in either an **immediate or phased change of control** to management and may involve these variations:

  - Partial MBO with alignment/support of a strategic partner
  - On-going leadership by exiting owner(s) for agreed period to achieve successful internal and external (customer/supplier) transition,
  - Partial MBO coupled with incoming seasoned CEO participating in the buy-in transaction
  - Employee Stock Ownership Plans (ESOPs)- involve more much more rigid participation and on-going compliance requirements but possess attractive tax and financing attributes.

  <u>Observations</u>:

  - Transaction pricing in a non-MBO, external sale process might be more competitive and may yield higher results (but not always) albeit, with the complications and hazards associated with such an approach.
  - Selling principals in an MBO transaction often retain a period-specific purchase price "claw-back" should the company later be sold by the MBO team at a higher price.

Management Buy-Outs-
Essentials for Success in an MBO Transaction

- **Management's capacity and commitment-** Central to accomplishing a successful MBO transition are:
  - **individual dedication** to the transaction and a clear understanding of what it means, and
  - **financial commitment** at a reasonable, meaningful level supports management's commitment to transaction success,
- **Forward leadership team cohesion** –Spheres of responsibility, day to day interaction, and harmony of leadership, absent the historical CEO/owner, must be agreed, understood and accepted,
- **Efficient, non-disruptive transaction execution and integration-** (internal and external),
- **Strong capital structure**-A meaningful level of equity in the post transaction balance sheet provides strength and cushion in the event of business downturns or other adversity,
- **Balanced leverage and tangible equity**- Third party debt levels shouldn't exceed customary ratios measured against historical results and conservative forward earnings assumptions. Balance sheet "tangible" net worth (usually, equity less goodwill and other intangibles) is necessary to assist in meeting loan covenants and provide underlying strength to the capital structure's equity component,
- **Revolving credit availability-dry powder-**Maintain an optimum revolving line of credit facility that provides advance ratios and adequate limits and availability at competitive borrowing rates to meet requirements of future business volumes and conditions.

Management Buy-Outs-
The Process: Structure, Financing and Closing

- **<u>Acquisition structure</u>-** Develop a specific, unique acquisition structure to fit the particular MBO-transaction objectives, including balanced business economics and tax results for both parties,
- **<u>Valuation</u>**-Prepare financial analyses to support the transaction valuation,
- **<u>Financing Structure and Process</u>**-Develop transaction financing structures which fit the market for third party financing, and develop and prepare financing information packages for presentation to capital providers (senior lenders and junior capital providers), including integrated forward projections demonstrating post acquisition debt capacity,
- **<u>Financing Process</u>**-Selection of senior lenders (junior capital providers as/where necessary) to source financing term sheets (term debt, working capital revolver, junior capital) that accommodate the intended transaction. This aspects includes meetings and communications with capital providers, evaluation and the selection process, negotiations and execution of financing agreements,
- **<u>Documentation and Closing</u>**-Negotiate and structure the Definitive Purchase Agreement and all related documentation, as necessary, and manage the external financing process, all orchestrated to culminate in a successful closing.

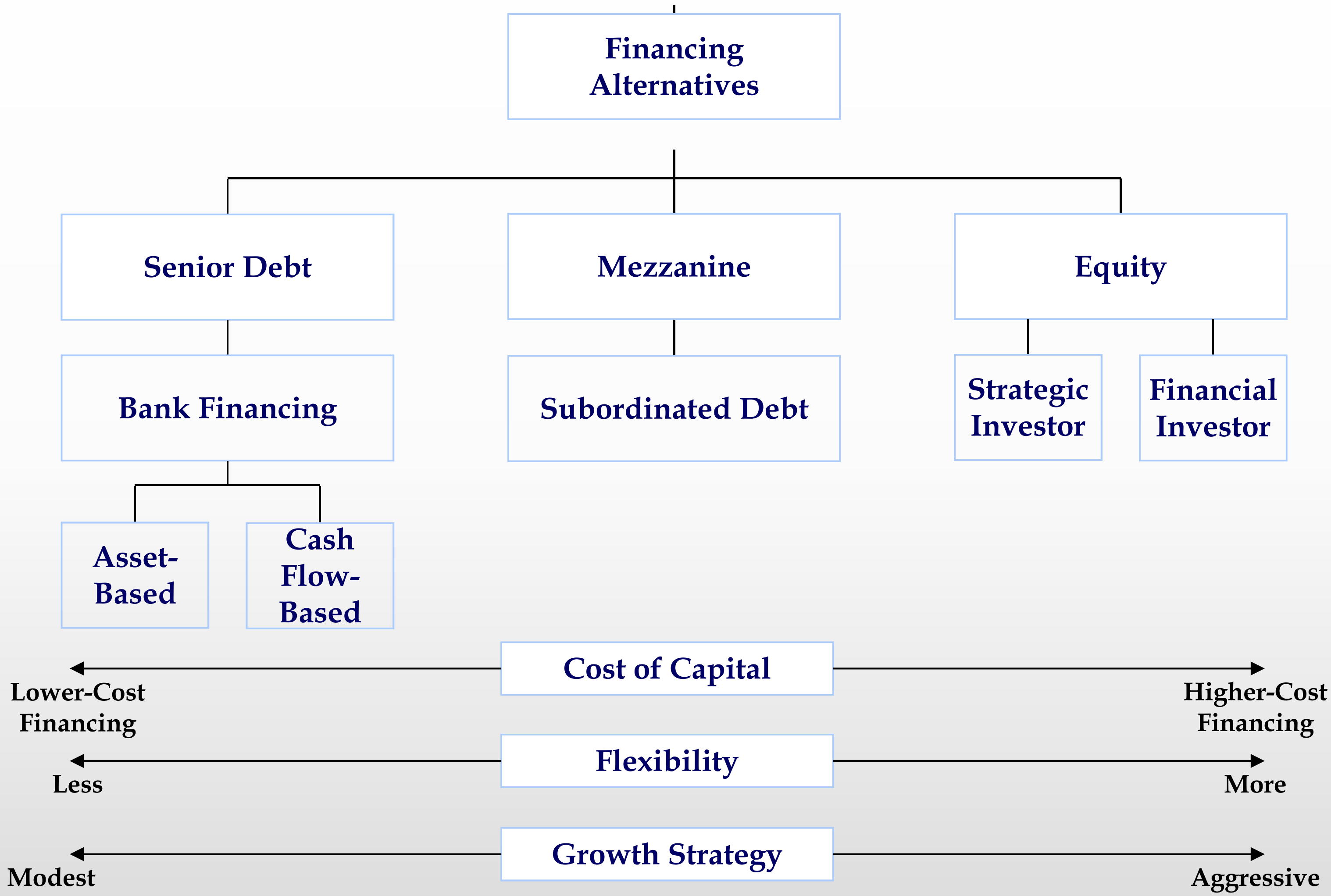
Transaction Structuring Considerations-
Form, Seller Continuing Economics and Tax Aspects

Whether an intended transaction is external or internal and regardless of form, the following are essential to address when structuring and negotiating a liquidity event transaction:

- **Seller Continuing Economic Positions: Equity, Debt or Hybrid Instruments**-The nature and structure of any forward non-cash transaction economics, whether debt, equity or a combination thereof , must be understood, carefully evaluated and negotiated where the owner is asked, or desires, to continue with an economic interest in the business.

- **Tax Ramifications and Benefits –Balancing the Economics between Buyer and Seller**-The diverse and complex income tax rules and special elections that may adversely impact or benefit the parties to a transaction must be carefully considered during the structuring process to both avoid unintended consequences and to achieve some very beneficial after-tax economics. Each circumstance carries its own unique attributes; accordingly the tax ramifications of an intended transaction must be thoroughly vetted and alternatives explored before agreeing to any proposed structure.

Overview of Financial Alternatives



Overview of Financial Alternatives

Financial Alternatives: Summary Comparison

The following chart describes the advantages and disadvantages of the three distinct classes of capital.

	Senior Debt/Bank Debt	Mezzanine / Subordinated Debt	Equity
Advantages	• No dilution • Lowest short-term cost of debt • Relatively flexible • Availability of capital	• Lock in rate (predictable financing costs) • Mitigates dilution • Less restrictive covenants	• No cash payment requirements • Improves capital structure and reduces risk • Improves financial flexibility by improving future debt capacity
Disadvantages	• Interest rate exposure if not swapped to fixed • Financial covenants • Reporting requirements/ administrative burden	• High fixed interest costs • High prepayment costs • Somewhat restrictive covenants • Would likely require equity kicker • Increases overall leverage	• Potentially significant dilution to current shareholders • Potential governance role for investor

Choosing the Right Pathway–
Reaching an Informed Decision

CIP Capital Advisors– Transaction Process Leadership
Planning>Structuring>Financing>Closing

Deciding upon the best transaction alternative and accomplishing the intended result requires leadership and support of experienced professionals to evaluate, design and implement the proper structure to meet owner objectives according to the uniqueness of each situation. CIP Capital employs a two-phase approach in leading and supporting the process through to a successful transaction conclusion.

<u>Phase I : The Decision Process—</u>

- CIP begins by meeting with a company's ownership to fully understand their objectives and evaluates of all aspects of each circumstance and, based upon that input and analysis, develops and recommends a directional approach for ownership's consideration. This process includes consideration of the company's position within its competitive environment, its forward visibility on earnings growth or decline, on-going management depth and strength, among other factors.

- Following that assessment, transaction pricing parameters are defined and deal structure profile, mechanics, financing formats and tax planning are formulated to best achieve objectives. Upon ownership's agreement and decision to proceed, Phase II of the transaction process is pursued as follows, according to the nature of the transaction decided upon (recapitalization, external sale, MBO).

Choosing the Right Pathway–
Accomplishing the Objective

CIP Capital Advisors– Transaction Process Leadership
Planning>Structuring>Financing>Closing-------continued

<u>Phase II—Executing the Process and Reaching the Objective</u>

- **Dividend Recapitalizations:** CIP provides guidance in determining an appropriate level of balance sheet debt load to accommodate a leveraged cash distribution to the owners. CIP prepares all necessary proforma forward projections, prepares the financing "book" and sources proposals from appropriate capital providers, managing the entire process through to a successful closing.

- **External transactions**: CIP leads the external transaction process by: identifying the strategic buyer (or institutional buyer) universe, preparing and circulating the information memorandum, managing meetings, communications and expressions of intent, selecting finalists, evaluating letters of intent and supports final negotiations, documentation and closing.

- **Management Buy-Out Transactions:** Most importantly in an MBO transaction, CIP works at the outset with the principals and the MBO team to reach a mutual understanding and agreement on the terms for a successful transaction. Following the "buy-in" by all parties, CIP develops an optimum acquisition and financing structure and the market-based valuation parameters for the transaction and leads the capital raising process with appropriate capital providers. From there CIP supports counsel in the documentation drafting process where appropriate, works to resolve issues between the parties and supports the closing process

CIP Capital Advisors, LLC
Merger and Acquisition Advisory Services

Transaction Process Leadership
Planning>Structuring>Financing>Closing

CIP Capital Advisors, LLC is a Midwest-based M&A and capital advisory firm specializing in acquisitions, strategic alignments, buyouts and related financings for middle market companies.

Centered in the industrial Midwest, CIP Capital brings together diverse senior management experience earned across manufacturing and related productive sectors to meet the challenges private enterprises face when seeking to expand through acquisition. This platform drives the Firm's success in assisting middle market companies to achieve sustainable growth through strategic expansion and realignment initiatives. Equally, this expertise is employed to manage enterprise ownership transition and liquidity recapitalization transactions to achieve orderly and maximized value-realization events.

CIP Capital delivers a combination of managerial and transactional expertise, providing the power for our clients to accomplish value-creating business transactions. At the foundation of every engagement is the firm's adherence to the hallmarks of quality, integrity and confidentiality.

CIP Capital Advisors, LLC

Merger and Acquisition Advisors and Investment Banking

Managing Member:
Robert K. Bublitz, CM&AA, CPA

Please visit our website at: www.cipcapitaladvisors.com

CIP Capital Advisors, LLC
21624 Melrose Avenue
Southfield, Michigan 48075
Office: 248-663-5774
Cell: 248-515-5721
Email: RBublitz@corpimprove.com