
CONTRACTING PROFITS

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Ready To Take Your Company To The Next Level & Plan Your "Exit" Strategy At The Same Time?

Are you looking for an opportunity to take your company to the next level, but not sure you have enough resources or risk tolerance to do so? Why not consider a financial strategy that can provide personal cash liquidity, capital for growth, favorable tax treatment, and continued involvement in the management of your company?

The strategy to which we are referring is called a recapitalization (or "recap"), which is simply the partial sale of your company to a financial partner/investor.

In addition to receiving a significant portion of the company's value in cash at closing, you may retain substantial equity ownership together with continued responsibility for running the company. With the selected financial partner providing assistance on financial and strategic issues, you continue to grow the business without bearing all the risk.

Then, when you have reached certain objectives (personally or professionally), the company could go public, could be sold in a private sale, or could undertake another recapitalization to give the owner a "second bite at the apple," which could be even bigger than the first.

Now you may wonder, where do you find such a financial partner. Most recapitalizations involve institutions, which are in the business of investing in successful, privately held businesses. Your company provides the platform for growth, and

they have the money and additional expertise you need to get to that next level.

As you think about the concept of recapitalization a bit more, consider this summary of benefits:

- **Liquidity.** A recapitalization (recap) allows an entrepreneur to "Take chips off of the table" without harming the company or overloading it with debt. Additionally, it is common that the financial partner eliminates all personal guarantees tied to the company.
- **Control.** While ownership control may be transferred to a financial partner, day-to-day operating control remains with the existing management team.
- **Power For Growth.** Financial partners are most interested when the target company not only has internal growth opportunities, but also is poised to identify and lead the process of acquisitions and consolidation. Successful add-on acquisitions can rapidly and dramatically increase the value of an enterprise. So while you may own a smaller "piece of the pie", the pie can grow much bigger and faster.
- **Substantial Equity for Sellers and Management.** Recapitalizations can be ideal for sellers who desire personal liquidity, yet wish to participate in future growth of the business. The financial partner typically ensures that the management team is rewarded with incentives for the value they create.



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- **Flexible Structures.** Investments are tailored to meet the needs of both the selling shareholders and operating managers. Additionally, the financial partner is sensitive to the employees and the surrounding community.
- **Confidentiality.** Most financial partners are private with no public registration requirements or mandates for public disclosure, even after a transaction is completed. Your employees may or may not have to know there are other investors, depending upon your situation.

After the closing, the financial partner works closely with management and the Board of Directors to provide advice and assistance in areas such as financial options, strategic acquisitions, and other long-term issues. Post acquisition activities include: “sounding board” advice (from parties with a vested interest and intimate knowledge of the company), a partner for growth, and future financing alternatives.

Some companies, which have chosen the recapitalization alternative, subsequently described the transaction as having the opportunity to “have their cake and eat it too.” Specifically, the structure allowed the selling shareholders to meet their personal liquidity objectives while keeping a significant piece of company ownership going forward. Management still runs all operations, but they also have a well-capitalized financial partner to fuel future growth.

AN EXAMPLE...

Let’s assume your building services company has sales of \$20 million and is making a pre-tax profit (Earnings Before Interest and Taxes or “EBIT”) of 10% (\$2 million). Assuming a multiple of 5 times EBIT, your company is worth \$10 million (historically valuations of building services companies have ranged between 3 and 7 times EBIT).

Let’s assume that you decide to sell 80% of the company for \$8 million and retain a minority ownership going forward of \$2 million. Let’s further assume that the financial partner invests \$4 million of equity and arranges \$4 million of debt financing through an institutional lender. Using the benefit of leverage, you would receive \$8 million in cash while retaining a 33% ownership position.

In the case of multiple owners, the \$8 million could be shared proportionally among all current shareholders. Alternatively, some owners could cash out entirely, while others could receive a mix of cash and continuing ownership.

SOURCES OF FUNDS

Equity from Financial Partner \$4MM
 Debt \$4MM
 Shareholders Retained Equity Value \$2MM
 TOTAL: \$10MM

Uses of Funds
 Cash Paid to Shareholders \$8MM
 Shareholders Retained Equity Value \$2MM
 TOTAL: \$10MM

Continuing Equity Ownership
 Financial Partner—66.7% (\$4MM)
 You/Shareholders—33.3% (\$2MM)
 TOTAL: 100%

In contrast to the above example, an outright sale might result in you, the owner, receiving the full \$10MM, but no continuing ownership.

ARE YOU A RECAP CANDIDATE?

Sound appealing? Now ask yourself if you meet the profile of a successful recap candidate. Recapitalizations only work for successful and profitable companies, which have proven histories of consistent cash flows. Qualified candidates must have strong market positions and proven management teams. In addition to a track record, cash flows, and management, a qualified candidate must have the ability and desire to grow.

And, from an ownership perspective, ask yourself if you are an owner who wishes to sell a portion of your company for liquidity or estate planning purposes, while retaining significant equity ownership to participate in the company's upside. If so, it could be a very exciting way to “cap off” your business career.

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