RECAPS OFFER OWNERS SECOND BITE OF APPLE

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When it comes to the succession of a company, different objectives drive every business owner: Some want to transfer ownership to the next generation or to their employees through a management buyout. Others strive to sell outright and retire, and some want to keep growing the business but are reluctant to take on the additional risk and personal obligations growth entails.

If you are contemplating the succession of your business, a recapitalization or "recap" is an option worth considering. Quite simply, recaps involve the restructure of a company's balance sheet as a way of providing liquidity to the owner and a source of growth capital for the business.

In essence, a financial partner – typically a private equity group (PEG) – uses a combination of cash, senior debt and subordinated debt to finance a partial acquisition of the company.

Generally, the business owner retains 20 to 40 percent ownership in the company, allowing for a "second bite of the apple" when the financial partner exits. Though majority recaps are more typical, minority recaps are also prevalent.

Should You Recap?

Recaps are ideal in situations where the owner is enthusiastic about future growth opportunities but concerned about the personal financial obligations that growth typically demands.

As with most transactions, what PEGs look for in a company considering a recap is a strong, established business with a defensible market position, sustainable cash flows, a strong management team and a solid growth plan.

Recaps are a good option for companies and owners that want to accomplish the following goals:

- Limit financial risk and possibly eliminate personal borrowing guarantees
- Provide partial liquidity and a vehicle for complete liquidity
- Consolidate control when a large number of minority shareholders are present
- Buy out dissenting shareholders
- Grow the company with help from industry veterans

Recap Pros & Cons

Recaps offer a number of advantages to business owners to diversify their investment portfolio. Many times, business owners have a large portion of personal wealth tied up in the business.

Recaps also allow current management to continue operating the business. Other advantages include:

- Employees' jobs are typically protected
- Management may be allowed to buy into the new company
- Provides time to groom a successor
- Enhances the company's marketability
- Reduces financing strain when transferring ownership to the next generation

Recaps are not the best option in every situation, especially those where the business owner wants to exit quickly. The business must also have the ability to take on debt without overleveraging the balance sheet, which can be detrimental to the company's profitability.

Finally, potential investors won't be interested in a company with limited marketability. The financial partners

Our Best Credential: Satisfied Clients

"BKD Corporate Finance managed the recapitalization of my company, P-Chem, Inc., and I was delighted with the results. Having a highly qualified group of professionals manage a transaction as important as this was very valuable. BKD Corporate Finance was able to bring in several potential investors, handle the negotiations and ultimately exceed the value expectations we originally had. The sale, or recapitalization, of a company is a very time-consuming project, and since this is truly a once-in-a-lifetime occurrence, using BKD Corporate Finance was a very wise decision."

– J.B. Turn, President
P-Chem, Inc., Latexo, Texas

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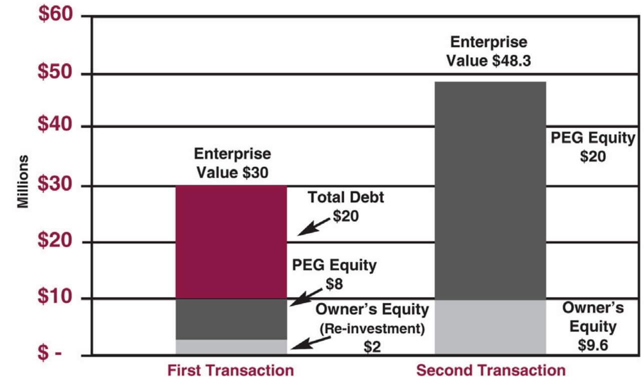
themselves must first see a viable exit strategy. The following is an example of how a recap works:

- ABC Company is sold in first transaction to a PEG for $30 million (MM) and recapitalized as NewCo
- ABC Company had $30MM in revenue for a multiple of revenue of 1x and $5MM in earnings before interest, taxes, depreciation and amortization (EBITDA) for a multiple of EBITDA of 6x
- NewCo is recapitalized with $20MM in debt (combination of senior and subordinated) and $10MM in equity
- PEG invests $8MM in equity for an 80% ownership stake
- Seller reinvests $2MM of proceeds for a 20% ownership stake
- For the next five years, revenues grow at 10% annually and EBITDA margins hold steady. Because of the company's profitability, the entire debt load from first transaction is paid down
- Revenues reach $48.3MM with EBITDA of $8.05MM
- NewCo is sold five years after the first transaction at the same multiples for a transaction value of $48.3MM
- Seller nets $28MM in the first transaction and $9.6MM in the second transaction for a pre-tax and pre-transaction fee total of $38.7MM for its $8MM original investment

Representative Example of a Recap



As the example illustrates, recaps can be attractive options for owners and financial partners because they provide owners with immediate asset diversification and the possibility of a sizeable "second bite of the apple."

Though not the best option for every company or owner, if the circumstances are right, they can be an excellent succession planning strategy.

Take Our Advice

BKD Corporate Finance, LLC, a subsidiary of **BKD, LLP**, can help you evaluate ways to achieve your business succession goals. Let our team of corporate finance professionals and financial and market analysts help you benefit from implementing strategies to preserve and protect your wealth. Call us today.

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Recapitalization Benefits Business, Owners & Investors

Three owners of a successful $25 million company with 250 employees were evaluating potential exit strategies even though none was near retirement age and all wanted to continue working in the industry.

BKD Corporate Finance recommended a recapitalization transaction because research showed the company's value was peaking. The timing was right. More than 50 potential investment companies showed an interest in the company. Twelve were selected to receive the transaction deal book, detailing the company's financial picture and industry outlook. Once an investor was identified, BKD Corporate Finance assisted with negotiations to help the owners achieve their business and personal financial goals.

The result: The owners took a significant amount of wealth out of the business and retained an ownership interest. They continue to operate the business with additional capital from the investment partner to help it grow. Employee morale never dipped because the owners continue to foster the company's success, providing an opportunity to reap additional dividends when they eventually sell their remaining interest in the business.

Representative Recapitalization Experience

P-Chem, Inc.
Latexo, Texas
Acquired by Syrgis Performance Products, an Edgewater Capital Partners Company

Dixon Midland
Chicago, Illinois
Financial investment made in Tech for Less
Colorado Springs, CO

Wellspring Hospice
Birmingham, Alabama
Merger with
Community Hospices of America