

Catalyst | Hall

*Providing Value-Added
Capital*

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Catalyst/Hall - and its affiliated family of private investment funds - specialize in middle market equity and mezzanine investments from their offices in Houston, Oklahoma City, and Westchester (Chicago).

Catalyst/Hall currently manages \$150 million in total capital and seeks investments in companies with solid, defensible business franchises and a defined requirement for capital including:

- ♦ Capital for growth and expansion
- ♦ Recapitalizations of family owned or closely held companies
- ♦ Generational changes in ownership
- ♦ Management buyouts of private companies or divisions of larger companies

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Financing Trends

Every business owner at some time or another has wondered when and how to obtain liquidity for the value in his/her business. While owning a company can be very rewarding, an owner can grow weary of the CEO role and desire to involve a partner to provide an outside perspective on key decisions. It can also be comforting in turbulent economic times to diversify one's assets to avoid having all one's eggs in a private company basket.

The list of possibilities for exiting a business as a going concern includes:

- ♦ A sale or merger
- ♦ IPO (initial public offering)
- ♦ Recapitalization

Current capital markets have virtually eliminated the IPO as an exit strategy for all but a few companies. A sale or merger requires prior planning, and now may not be the optimal economic period to sell the entire business. Enter the recapitalization as a viable option.

A recapitalization of a profitable company is simple in concept, but relatively involved and highly tailored in final construction.

The concept is to monetize some portion of the business' future earnings, using either debt or equity. The owner remains involved in the business and depending on the investment partner, can elect to either convey or retain economic and/or voting control. For example, the business owner may choose to remain active in the day-to-day management of the business or take an advisory position as a board member or executive management.

The "win/win" financial model of a well conceived recapitalization derives from the following:

- ♦ The retained ownership continues to grow in value, while the business owner remains active in management, contributing to the ongoing growth.
- ♦ The investor's acquired ownership grows at a rate sufficient to enable it to achieve their desired return on investment. For example, given a 5-7 year timeframe a private equity firm would generally seek to double their investment when investing mezzanine debt, and as

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much as triple their investment when investing preferred equity. Often the optimum capital structure can take advantage of the lower tax effected cost of mezzanine debt as well as the more patient capital provided by equity and utilize a combination of both.

The benefits of a recapitalization for the business owner include:

- ♦ Money in hand today, and the expectation of additional money in hand in the future;
- ♦ Diversification of wealth (i.e., the business owner can diversify their investments or net worth independent of the business and retained business ownership);
- ♦ The ability to grow the business with capital other than personally guaranteed bank debt or placing additional personal wealth or capital at risk;
- ♦ The ability to work with outside investors that are experienced in the elements required to successfully grow and ultimately exit the businesses;
- ♦ The ability to remain involved in management; and
- ♦ Taking a step that partially addresses succession planning and estate considerations.

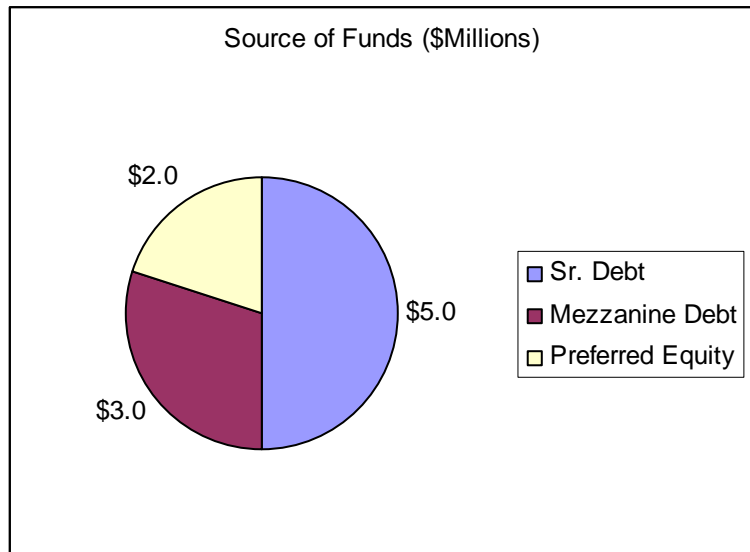
Sample Recapitalization

Assume a business with revenues of \$30 million, producing average annual free cash flow (i.e., EBITDA, less recurring capital expenditures) of 10%, or \$3 million. Further assume the business is free of third party funded debt, and has the ability to grow 8% per year.

Assumptions:

- ♦ Gross Enterprise Value ("GEV") is 5 times free cash flow, or \$15million;
- ♦ Net Enterprise Value ("NEV"; defined as GEV, less 3rd party funded debt, net of surplus cash) is \$15 million;
- ♦ The business possesses assets to support a non-recourse conventional revolving line of credit of \$5 million;
- ♦ GEV can conservatively grow at 8% per year, and all of the debt funded is retired. The result is a NEV of \$22 million in five years.

A private equity firm could structure a recapitalization (assuming the owner desired to receive \$10 million of cash or two-thirds of the existing NEV), as follows:



Using the pricing and structural techniques frequently employed by a private equity firm to achieve appropriate risk adjusted returns while preserving a mutually beneficial outcome, the owner could retain approximately 75%, while the private equity firm would receive, in addition to its loan and redemption value of the preferred stock, a 25% share of the future anticipated NEV of \$22 million.

When the final exit occurs, the owner would receive his/her second payday payment of \$16.5 million, while the private equity firm would receive a payment equal to \$5.5 million.

The private equity firm would assist in the exit, given their experience and contacts, and also seek to secure the desired outcome relative to the owner's ongoing desire for employment, and/or perspective consultation, etc. In total the owner received \$26.5 million over the life of the partnership, while diversifying his/her holdings at the recapitalization inception, based on the existing NEV of \$15 million.

A recapitalization can be structured to achieve the objectives, both economic and otherwise, for all parties involved. Remember, this is a long term relationship and it critical to invest the upfront time to select a compatible partner and then work closely together to achieve the desired outcome.

Catalyst/Hall (www.catalysthall.com) is a private equity firm with offices in Houston, Chicago and Oklahoma City that specializes in providing value-added mezzanine and equity capital to middle market companies. The firm manages \$150 million of committed capital from its investment partners and provides business and capital markets experience, analytical resources and outside perspective to support their portfolio companies with the goal to optimize operating results and value appreciation