

FAMILY SUCCESSION TRANSACTION - KEEPING IT IN THE FAMILY

A successful transition of ownership to future generations ranks high among concerns of family owned companies, yet few families understand how they can accomplish this goal, especially when the business is the “nest egg” for the older generation. Buying a business is a complex process that requires significant capital, and it’s rare that the younger generation has the financial resources and wherewithal to complete the purchase in a way that offers immediate liquidity or access to funds to the older generation. Layer in issues like active and inactive family members or properly preparing the next generation to lead before the transition occurs, and the complexity grows.

The older generation faces an ostensible tradeoff: either “seller finance” a sale to the next generation and receive the proceeds over time subject to company performance, economic climates, and general business risks, or sell to an outside buyer for immediate liquidity and asset diversification, but lose the opportunity to pass ownership to the next generation and keep the business in the family. In reality, the dilemma can be solved with the help of professionals whose line of work is focused entirely on investing in and growing small businesses.

KLH Capital “sponsors” or partners with the next generation to fully fund the purchase of their family business and navigate the process required to successfully complete the transaction. As an equity partner in the company, KLH has a vested interest in seeing a smooth transition of ownership to the next generation of leaders and provides ongoing support to help them create value for future generations to come.

Specifically, a private equity sponsored family succession:

- Provides capital for the next generation to fund the purchase of their family business
- Allows the older generations to fully monetize the value of their ownership at the time of the sale
- Offers an alternative to a seller financed transaction
- Keeps the company culture and reputation intact
- Gives the next generation an opportunity to create significant wealth via their new or continued ownership position
- Gives the next generation an experienced partner to support their transition and vision for the company

WHAT IS A PRIVATE EQUITY SPONSORED FAMILY SUCCESSION?

A private equity sponsored family succession is a transaction where a private equity partner like KLH Capital “sponsors” or partners with the next generation to buy their family business from retiring and inactive owners. KLH Capital arranges the entire capital package needed to fund the purchase, including the equity capital which comes from a dedicated fund managed by KLH Capital.

The purchase is structured to allocate ownership primarily to the company’s new leaders, including family and non-family managers, who will be responsible for the company’s future success. At KLH Capital, it is important that substantial ownership is in the hands of our partners, the next generation of company leaders, to ensure all interests are aligned.

WHAT ARE THE BENEFITS?

Older Generation Harvests Value and Diversifies Wealth Immediately

Buying a business is not as simple as buying a home by taking out a mortgage. It takes significant capital – an amount that is often more than a family member has in savings or can risk in one investment. Likewise, finding a bank that will provide adequate financing is challenging. While the older generation may be willing to take a note as a form of payment to complete the transaction, the combination of personal savings, bank loans and seller financing may fall short of the company’s full value. Furthermore, the capital structure may inhibit growth during the payoff period if the business is using its cash flow to buyout the older generation instead of investing in growth initiatives.

KLH Capital invests significant equity and arranges a capital structure that will not burden the company’s growth going forward. Our dedicated fund and investment experience allow us to quickly arrange capital on favorable terms. With our partnership, the older generation monetizes their “nest egg,” removes all exposure to the company’s future performance so their proceeds are definitive and final, and sets up the next generation up for success with

What is the Process?

Once the purchase price and terms are agreed upon, the sale takes roughly 60-90 days to close. Key tasks fall into three key activities: due diligence, financing, and transaction documentation. The process begins with due diligence, which involves engaging third party advisors to assess the financial condition, market dynamics, competitive landscape, and legal condition of the company. Once that process is complete and we “know everything” about the business, KLH approaches its trusted lending sources to arrange any new debt financing needed to facilitate the transaction. Finally, when the lending partner(s) has been selected, the lawyers get to work and the purchase agreement and associated financing are papered and finalized.

an experienced partner and capital structure that is supportive of future performance and growth.

Pass Down the Opportunity for Significant Wealth Creation

There are two ways to create wealth from a business – a paycheck and ownership. A paycheck, even with bonuses and commissions, is finite and often capped. Ownership is not. Ownership is the source of life changing wealth and is only capped by the value of the company's equity. As the company grows, the equity value increases exponentially. A private equity family succession gives the next generation and key leaders the chance to create wealth in a meaningful way.

The Company Stays Intact

When one company sells to another, cultures and processes merge and jobs are often affected. In contrast, a private equity sponsored family succession keeps the business intact, and more specifically "in the family" so that it can continue serving its customers, employing its people, and growing in value for future generations to come.

A Partner to Support Your Goals

In a private equity sponsored family succession, the company gains a new partner to help tackle initiatives and challenges. KLH Capital works side-by-side with management evaluating and prioritizing growth strategies, giving managers confidence in their decisions and investments. Whether it be implementing software systems, recruiting executives, making acquisitions, or responding to challenges, the company now has a vested, experienced partner to help share the load. In fact, once educated on the benefits, the next generation often views our partnership as a way of breaking through barriers and accomplishing goals at a greater speed than what they could achieve on their own.

As partners, our interests are directly aligned, our successes and failures are shared, and we all participate in the equity appreciation we achieve together. Such support may be particularly attractive if the next generation is still growing in their leadership role and could use a set of advisors as a sounding board as they assume full control of the business.

Access to Growth Capital

KLH Capital has a dedicated fund to support growth equity investments, and our experience gives lenders greater confidence in the company, so many of the customary constraints such as heavy amortization schedules, growth restrictive covenants, and personal guarantees are removed. In other words, the older generations can "cash in their chips" without the next generation risking their personal assets to do so. Not only can KLH help avoid the next generation from immediately putting their personal net worth at risk on day one, but a partner like KLH can also arrange future growth financing on more favorable terms. With the right capital structure in place, the company can respond to growth opportunities more quickly.

Address Estate Planning Goals

A private equity backed family succession transaction is highly customizable and can be tailored to address estate planning goals that minimize the tax implications of a business sale.

The transaction is an opportune time to set up trusts and other vehicles for future generations to build wealth in a tax efficient manner. Having completed over 50 company purchases, KLH Capital has the experience to recommend and establish a structure to achieve your specific goals.

CASE STUDY

FRS was founded by a husband and wife in the late 1980s to distribute maritime parts and products to the U.S. Navy. In 2005, under the direction of the founders' son-in-law, the company expanded into a new product category focused on chemical, biological, radiological, nuclear, and explosive ("CBRNE") detection which generated significant growth for the business.

By late 2011, the CBRNE division was generating \$65 million in annual revenue with healthy EBITDA margins and needed to increase its credit line from \$7 million to \$15 million for its growing inventory. Until then, the founders had provided personal guarantees to secure the company's capital resources; however, as they approached retirement and became less active in the day-to-day operations, they were no longer comfortable assuming the contingent liability. The family consulted its advisors about alternatives and was introduced to KLH Capital.

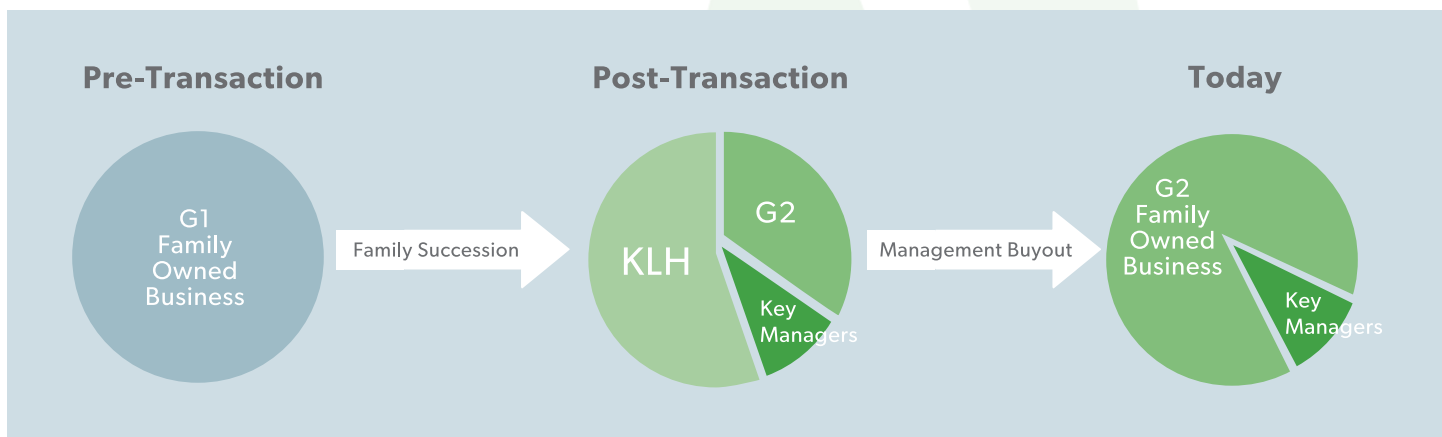
Case Study: Federal Resource Supply

Summary:

- Family owned business experiencing rapid growth
- Value-added distribution business with increasing capital needs
- First generation nearing retirement

Investment Structure:

- KLH provided 100% of the equity and arranged debt financing
- Post-deal, KLH owned 60% and the second generation plus key managers owned 40%, with the ability to earn significantly more as the business grew
- After four years of growth, the management team purchased KLH's shares in the business



The founders decided to sell 100% of their ownership to KLH and retire. KLH became partners with the son-in-law who also monetized a portion of his ownership and gave first time equity ownership to his key leaders. As soon as the transaction closed, KLH lined up a \$12 million credit line that grew to \$32 million within six months with no personal guarantees. KLH also recruited a CFO as well as additional sales professionals and advised FRS through the implementation of new ERP and CRM systems. Finally, KLH spearheaded the company's first acquisition, HazMat IQ, a leading provider of specialty hazardous material training to federal, state and local first responders, which expanded the company's services and diversified its revenue.

After four years building the company together, the management team, led by the family's son-in-law, approached KLH about buying KLH's stake. KLH guided the team through a successful management buyout and the company remains in the family to this day.

Key Takeaways:

- KLH provided the capital required to purchase the business, avoiding the use of seller financing
- The older generation received payment upfront versus over time and diversified their risk immediately
- As part of the transaction, KLH arranged an expanded credit facility with no personal guarantees to support the company's growing capital needs
- KLH Capital's professional and personal values resonated with the family's values giving them confidence in their new partnership
- KLH brought on board in-depth experience and relationships, improving the growth and value profile of the business
- KLH funded an internal sale, preserving the company legacy, customer relationships and valued employees

SUMMARY

A private equity family succession is an ideal option for business owners who are retiring, but would like to see their company's legacy remain in the family. It allows the owner to immediately and fully diversify their wealth outside of the company and it sets the next generation up for a successful transition and future growth – an incredible opportunity to hand down.

KLH Capital helps families continue their legacy by facilitating internal sales to future generations. In addition to capital, we commit our strategic support to the next generation as they take over. We are particularly sensitive to estate planning issues, family business dynamics, and the need for discretion and trust to make these transactions seamless and successful.

ABOUT KLH CAPITAL

Founded in 2005, KLH Capital is a private equity firm serving management teams of lower middle-market companies in the specialty services, value-added distribution, and niche manufacturing industries. The firm makes majority and minority equity investments in U.S.-based businesses to support the company's growth plans, provide ownership opportunities for key managers, and allow owners to harvest the value in their businesses.

Our commitment goes beyond financial support as we believe in establishing a collaborative team of peers, all of whom have a hand in the company's progress. We believe that when we combine management's industry and operational expertise with our own, the company's full potential is unlocked and value is created.

Since its founding, KLH Capital has raised more than \$935 million of committed capital across five funds. For more on our investment approach, please visit our website:

www.klhcapital.com.