

A RECAPITALIZATION - UNLOCKING VALUE AND ENABLING GROWTH

HEY ROLLING STONES, "YOU CAN GET WHAT YOU WANT"

Many business owners think of only two options as it relates to their involvement with their company: they can run it or they can sell it. In reality, there is a middle ground – one that allows them to retain significant ownership in their business and continue setting its direction, all while diversifying their assets to provide greater financial security for their family. It is called a recapitalization transaction and, once educated on its benefits, many owners see it as a pathway for growing their business, preparing for their ultimate retirement, and reducing their risk along the way.

Specifically, a recapitalization:

- Provides capital for shareholder liquidity, business expansion, or both
- Adds experienced investors that can help you execute on strategic growth initiatives
- Solves divergent shareholder views and objectives
- Gives you resources to realize maximum value down the road
- Reduces dependency on any single owner so that day-to-day operations can continue should that person be unable to lead

WHAT IS A RECAPITALIZATION?

A recapitalization is a transaction where one or multiple shareholders sell a portion of their ownership to a private equity firm like KLH Capital to "cash out" some of their chips if you will and diversify their assets. After the transaction, KLH works closely with the company's leadership team to bring its long-term growth strategy to fruition.

WHAT ARE THE BENEFITS?

Wealth Diversification

All good investors know to "spread your chips" – or diversify investments across multiple asset classes to minimize exposure to the performance of any single asset type. Yet, many company owners have as much as 90% of their wealth tied to a single asset – their business. This concentration of wealth presents significant financial risk to owners and their families. A recapitalization allows owners to diversify their wealth outside of the business so "all their eggs are not in one basket." In addition, moving a portion of their wealth into more liquid assets ensures those funds are available if and when they need them.

Gain more Expertise in the Room

In a recapitalization, the company gains a new partner to help tackle growth initiatives and business challenges. KLH Capital works side-by-side with management teams 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 shoulder the load. In fact, some owners view a recapitalization as a tool for breaking through barriers and accomplishing goals with 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.

Grow the Value of Your Company

Value is created by growing sales and profitability through tactical decision making, operational efficiencies, synergistic acquisitions, and investments in people, technology, and equipment. In addition to business acumen, a private equity firm like KLH provides access to capital on more favorable terms. Lenders have greater confidence in a company backed by an experienced private equity group, especially when they have a successful historical relationship with that group, and, therefore, are more likely to provide capital without personal guarantees or risk to personal assets. When the owner does not have to use their personal balance sheet to fund the company's capital investments, they are more apt to make the big decisions that will grow the business the most. Equally important, availability to capital ensures the business is nimble and can respond quickly to growth opportunities when they arise.

Address Varying Shareholder Needs

Current shareholders may desire liquidity over the course of their investment, particularly if they are inactive or retiring. A recapitalization allows you to buy out shareholders with divergent goals and place that equity into the hands of stakeholders who are directly aligned with the goal of creating equity value.

Develop a Succession Plan

Small businesses tend to depend heavily on their owners. Developing a succession plan is essential to a company's future because it allows the company and its employees to continue beyond the founder's tenure. It also protects against undesirable outcomes in the event of an unforeseen accident or death. It is common to use a recapitalization as an opportunity to identify key managers who can take the business forward and reward them with equity ownership. Doing so aligns their goals with shareholders' interests and provides them an opportunity to create generational wealth for themselves. In addition, a recapitalization frees up the owner from "playing the bank" (i.e. being its primary source of capital). As discussed earlier, a private equity partner allows the company to fulfill its capital needs independent of the owner so that it can operate successfully regardless of the owner's affiliation.

Some founders are nervous about how their employees will respond to a recapitalization and new partner. In our experience, the company's employees are usually relieved to learn that the founder is addressing his or her succession plans because it gives the employees visibility into the company's future and confidence about their livelihoods.

Increase the Total Value You Receive – “Two Bites of the Apple”

Given the benefits described thus far, some business owners view a recapitalization as a means for maximizing their company’s value as they head towards retirement. Others use the partnership to accomplish those last couple ideas before “hanging up their cleats.” Either way, an owner can increase the total proceeds they receive by taking a two-step sale approach: sell a portion today and sell the remaining ownership after the company has increased in value – commonly referred to as “the second bite of the apple.”

At KLH, it is important that active owners and/or management teams retain significant equity in our partnerships and participate in the appreciation we create together. We also work closely with owners in the subsequent sale process to ensure we achieve their goals and honor their legacy – whether that be a sale to their management team, family members, or another company.

When should you consider a recapitalization?

- Your company has become your most valuable asset and you’re uncomfortable having “all of your eggs in one basket”
- You need capital and advice; unlike other capital sources, such as senior or mezzanine lenders, our investment comes with our full, active, and strategic support to help you achieve your growth plans and vision for the company. In every partnership with KLH, management has control of day-to-day operations, meaningful equity in the business, and unfettered access to us and our vast network of relationships.
- You want a vested partner to help break through barriers to growth
- Your partner is ready to retire, but you still have plans to grow the company
- An inactive shareholder desires liquidity
- An untimely death or other estate planning issues necessitate liquidity
- It’s never too early to take a proactive approach. A recapitalization can be a first step towards the ultimate harvest of your investment and retirement. A multi-step monetization approach with an experienced private equity partner increases the company’s value and reduces the risk of unfavorable market conditions in a single-event sale approach

CASE STUDY

Founded in 1975, Mid-State Machine & Fabricating Corporation (“Mid-State”) is a custom machining and fabricating company servicing the mining, chemical, power, and heavy industrial markets. The company grew rapidly throughout the 2000s because of consolidation in the phosphate industry. As the business grew, the owner was the company’s chief source of financing, providing the capital it required through personal loans and guarantees. He oversaw almost every aspect of the company with many direct reports.

In 2012, the owner was involved in a serious car wreck that caused him to reflect upon the far-reaching consequences had he not survived. Without a succession plan or fully developed management team to take over, the owner's family would be left to figure out the future of Mid-State and how best to pay significant estate taxes. The company's financial systems were outdated, making it difficult for anyone, internal or external, to quickly analyze the business and advise the family on the best course of action. In addition, Mid-State has some very large customers that depend on its services every day and is responsible for over 500 employees. The owner needed to address the issue of succession planning head-on for the sake of his family, employees, and clients.

In 2013, KLH Capital invested in Mid-State through a recapitalization, achieving the owner's objectives of asset diversification and succession planning. Since partnering with KLH, Mid-State developed a long-term organizational chart that placed the owner as chairman, promoted his "right hand man" to COO, and hired an experienced CEO and CFO. We also implemented new financial reporting systems and completed one acquisition. Bringing KLH on board ensured the company's future for its employees and clients while addressing the owner's personal financial well-being.

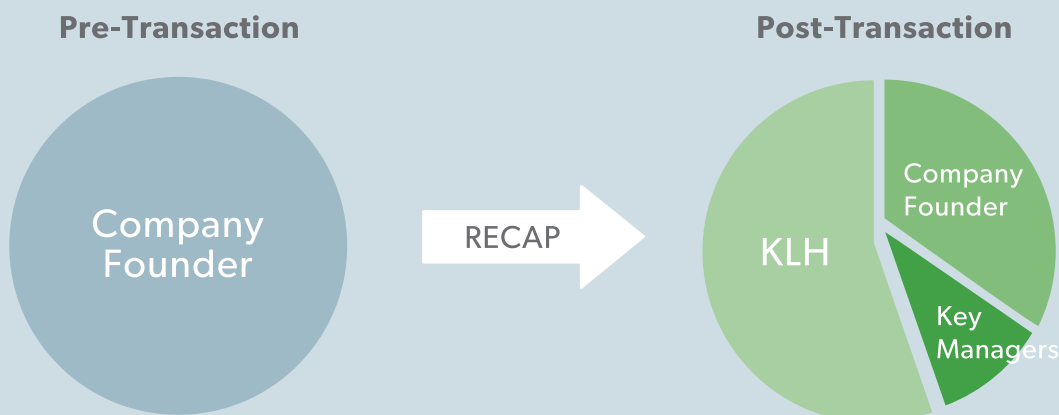
Case Study: Mid-State Machine & Fabricating Corporation

Summary:

- Family business highly dependent on single owner/leader
- Lack of a succession plan jeopardized the company's future and the family's financial well-being
- Significant customer/industry concentration
- Owner desired to accomplish several company initiatives prior to retirement

Investment Structure:

- The owner sold a slight majority interest in his company to KLH Capital
- KLH provided the equity and arranged debt financing, avoiding the use of personal assets as collateral
- Equity ownership was given for the first time to key managers
- Additional growth capital was made available to execute growth plans



Key Takeaways:

- The owner diversified his assets and continued setting the company's direction as its leader
- KLH helped shape an organizational chart and gave equity ownership to key managers for the first time
- Mid-State's debt was refinanced and personal guarantees were eliminated, giving the company access to growth capital independent of the owner
- KLH helped recruit a CFO and implement new financial reporting systems
- With new controls, capital, and an experienced partner, Mid-State made its first acquisition

SUMMARY

KLH Capital has the flexibility to make majority and minority investments in your business, allowing you to leverage our expertise and maximize your equity upside. Whether you need capital for growth initiatives, shareholder liquidity, or a combination of both, we work with you to structure an investment that matches your capital needs and ownership goals. An investment by us provides the company with increased financial strength and agility to respond to growth opportunities, especially when it comes to making acquisitions, and is often used as part of a long-term strategy to harvest the company's value over time.

In summary, a recapitalization with KLH Capital allows entrepreneurs and business owners to unlock value and enable growth in their companies giving them "what they want" – greater financial certainty and ownership in a company positioned to achieve greater success. So, it looks like Sir Mick Jagger was wrong after all – you CAN get what you want.

OVERVIEW OF KLH

Founded in 2005, KLH Capital is a private equity firm serving family- and founder-owned, lower middle-market companies in the specialty services and value-added distribution industries. The firm makes majority and minority equity investments in U.S.-based businesses to allow owners to harvest the value in their companies, to provide ownership opportunities for key managers, and to support the future growth of the business.

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. 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 \$520 million in committed capital.