KLH CAPITAL

The Resources You Need. The Partner You Want.

THE MINORITY RECAPITALIZATION

Sometimes selling a majority of your company doesn't make sense. A minority recapitalization can accomplish many of the same goals – asset diversification, succession planning, and growth financing – all while giving you greater participation in your company's future potential.

In a minority recapitalization, the goal is to offer liquidity to shareholders, particularly inactive or transitioning owners, allow active shareholders to maintain or increase their equity ownership, and provide funding and an enhanced capital structure to facilitate the company's growth plans, all in a tax efficient manner. At KLH we also provide operational support to management teams to help the company reach its full potential and value.

Specifically, a minority recapitalization:

- Provides capital for shareholder liquidity, business expansion, or both
- Adds experienced investors that can craft a growth oriented balance sheet and help you execute on a strategic growth plan
- Gives you majority of the equity to realize maximum value down the road
- Offers an alternative to borrowing from a lender with recourse or prematurely selling a majority of your equity
- Solves divergent shareholder views and objectives
- Puts a tax advantageous capital structure in place

WHAT IS A MINORITY RECAPITALIZATION?

KLH provides capital that can be used for shareholder liquidity, growth initiatives (organic or acquisitions), or a combination of both, in exchange for 10-49% ownership in a company. A number of factors, including the company's size, current balance sheet, and capital needs, together with shareholders' liquidity and ownership goals, determine the ownership percentages after the transaction.

The transaction uses a mix of senior and subordinated debt and preferred equity to minimize dilution to current shareholders and improve the company's ability to access capital going forward. In some instances current shareholders have the ability to increase their ownership in the transaction. The use of debt also creates a tax shield as interest payments reduce taxable income.

WHY CHOOSE A MINORITY RECAPITALIZATION?

A minority recapitalization can address a number of situations and is particularly compelling to entrepreneurs who are growing their businesses and want the advantages of a private equity partnver without giving up a majority of their ownership. The transaction is also useful when multiple owners

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have differing personal and professional goals. For instance, a retiring or inactive owner may desire liquidity while other business partners or family members are still working to build the company. It can also be a solution when an untimely death necessitates liquidity for estate taxes. In any recapitalization, the transaction offers an opportunity to optimize the company's balance sheet for future growth as well as reward key managers or family members with equity ownership. With KLH, you continue setting the company's direction and receive support in executing your growth plans. The combination of management's talents, KLH's experience, and greater access to capital allows the company to flourish and grow in value.

Benefits of a Minority Recapitalization

- Retain operational control and majority of common equity ownership
- Greater economic participation in future growth via large equity position
- Potential to regain 100% equity ownership through a recapitalization down the road
- Fully benefit from leverage and tax advantages associated with debt
- Lower debt/leverage ratios relative to a majority or full sale
- Eliminates personal guarantee requirements
- Strategic help from experienced financial partner
- Flexible balance sheet optimized for growth
- Ability to provide greater incentives to key management and family members
- Solves shareholder disagreements including differing valuation expectations and long term personal wealth objectives

INVESTMENT STRUCTURE OVERVIEW

In a KLH minority recapitalization a conservative combination of less dilutive capital sources is used to craft a balance sheet that is poised for growth while providing some level of liquidity to shareholders. Typically, KLH looks to use a combination of senior asset-based debt facilities, cash-flow based subordinated debt, and preferred equity to capitalize a company's balance sheet. Due to both KLH's equity contribution and experience working with lenders, the debt will not have the customary constraints imposed by senior lenders such as heavy amortization schedules, growth restrictive covenants, and personal guarantee requirements.

Common characteristics and advantages to using multiple types of capital:

- Senior asset-based facilities – The amount borrowed is based off of the company's asset base including accounts receivable and inventory. It is considered the lowest cost of capital, but the total amount borrowed is subject to a percentage of the asset base. The interest is tax deductible. KLH's philosophy is to put a large facility in place, using it as a low cost, readily available capital source to finance future growth.

- Cash flow-based subordinated debt – The amount borrowed is based on some multiple of cash flow, typically 2-3x in a minority recapitalization. This tranche is subordinate to senior debt but senior to equity tranches. The cost of this debt is typically higher, but it is generally more flexible with little or no amortization, less restrictive covenants, and interest rates comprised of both cash pay and Paid-In-Kind ("PIK") that preserve current cash flow. The interest is tax deductible. KLH seeks to partner with subordinated debt groups that are growth oriented and can provide additional capital for both add-ons and organic growth initiatives.
- Preferred Stock – KLH's investment is generally structured as preferred stock. This tranche of capital is junior to the subordinated debt, typically has a dividend associated with it, and is viewed as equity by the more senior sources of capital on the balance sheet.

EXPERIENCED FINANICAL PARTNER - ALL CAPITAL PROVIDERS ARE NOT CREATED EQUAL

In many situations a business may struggle to raise enough debt from senior and mezzanine lenders to create shareholder liquidity and still finance growth. The process is time consuming, and the loans will have some recourse in the form of personal guarantees as well as warrants which dilute current shareholders. Unlike KLH, these issuers and investors tend to focus solely on financial performance and do not offer operational support going forward.

Putting the **right** capital structure in place for growth is not easy. A partner like KLH can help craft an appropriate capital structure and arrange the financing with the "right" capital providers. Since we are putting capital into the transaction behind these capital structures, you can have the utmost confidence that **our interests are aligned with yours** when negotiating with lenders. We have worked with a wide variety of lenders giving us the wherewithal to know how they will act in good times and in bad. Finally, with an investment from an institutional partner like KLH, it is unlikely lenders will require personal assets as collateral.

OPERATIONAL EXPERTISE AND THE "WAR CHEST"

KLH has a long history of working with lower middle-market companies – from implementing ERP systems to augmenting management teams to completing multiple add-on acquisitions – and our investment comes with our full support to help you reach your vision and create value. With KLH as a partner, you also have access to a deep rolodex of industry contacts. In our experience, these contributions are more valuable than just capital, and they can be the difference between plodding along and realizing the full potential of the company.

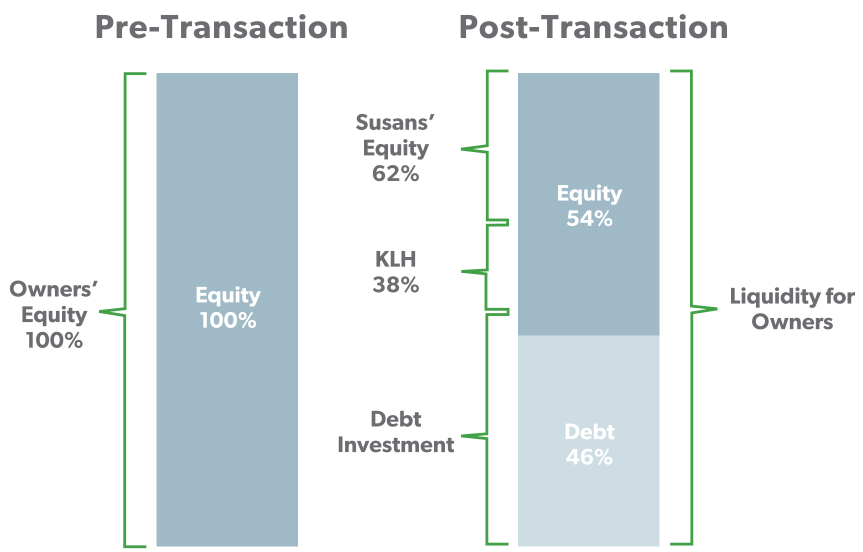
A company's capital sources, or what we call its "war chest," are critical to executing a company's growth strategy. Partnering with flexible, long term debt providers with a willingness to support the company's future growth is essential. So is having a committed equity sponsor that can contribute more capital along the way. It is much better to have access to growth capital **before** the growth opportunity presents itself so the company can act quickly and avoid squandering precious time trying to secure capital after the fact. KLH has a fund with committed capital ready to deploy when opportunity strikes.

CASE STUDY

A minority recapitalization addresses a number of situations. For illustrative purposes, let's review how it resolves varying short and long term goals of multiple shareholders. In our example, we assume a company is owned by two partners, John and Susan, who are equal owners. John is ready to retire while Susan wishes to grow the company further. The business is valued at $30 million based on EBITDA of $5 million and John desires full liquidity for his 50% share. Susan would like to buy out her partner and create some personal liquidity to diversify her assets.

1. Susan would like to buy out John and is willing to borrow debt to finance the purchase, however her lenders will only provide a portion of the $15 million needed and have requested a personal guarantee
2. Susan would like to take some "chips off the table" to diversify her wealth as well
3. KLH is introduced as a new partner who, together with Susan, buys John's stake using both equity and debt financing
4. The transaction allows for Susan to increase her ownership and create partial liquidity for her family
5. A conservative amount of debt (2.75x EBITDA), gives the company room to borrow additional capital for growth initiatives

Assuming an initial debt-free balance sheet, the graphic below illustrates the basic capital structure of the transaction:



If we assume Susan takes out $5 million to diversify her assets, the total amount of capital needed is $20 million. To demonstrate the sources and uses of capital, let's also assume the proceeds to shareholders of $20 million is financed using $13.75 million of debt and $6.25 million of equity from KLH Capital. Post transaction, Susan owns 62% of the company and KLH owns 38%. Using debt and equity, Susan is able to create liquidity **and increase her ownership from 50% to 62%.** With KLH, she also receives a new partner with more than 120 years of combined experience growing lower middle-market companies.

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Transaction Overview

$20.0mm
Cash Distribution to Owners

Investor Debt	**Investor Debt**	**Investor Debt**
$13.75mm	$13.75mm	$13.75mm

Operating Company
Enterprise Value of $30.0mm

Additonal Growth Capital Availability Throughout the Investment
$10mm+[1]

[1]Growth Capital is defined as debt and equity. Additonal capital could be raised in an acquisition scenario.

Did the business owners achieve their original goals with a minority recapitalization transaction?

- Retirement transition accomplished for John
- Susan retained control and increased her ownership
- Diversification of assets for Susan
- Identified an institutional partner to:
    - Provide sounding board for strategic growth and operational expertise
    - Arrange a balance sheet tailored for growth without risking personal assets

SUMMARY

A minority recapitalization allows you to diversify your wealth and sets the company up for even greater success while allowing you to maintain as much equity ownership and operational control as possible. In some cases, you can even increase your ownership stake. With an experienced, supportive partner on board and a capital structure poised for growth, you will be able to grow the value of your ownership faster and more effectively than before.

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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.

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