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**MBBI Illinois Event
2017 M&A Market Trends**
April 11, 2017 | 5:00 PM to 7:00 PM
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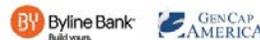
MBBI Newsletter April 2017
**Recapitalization
Is It Right for Me?**

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Increasingly business owners are taking advantage of a financial tool known as a recapitalization or recap for short. This begs the question – what is a recapitalization and would it work for me?

A recapitalization is a partial sale of a company. Whether it is a minority or majority stake, usually to a private equity firm. There are many private equity funds looking for companies to invest in; so much so, that there are now funds that specialize by industry, by minority (non-control) or majority (control) stakes, as well as numerous other investment subsets.

The advantages to a recapitalization:

It allows the owner to take a sizeable chunk of money off the table (diversify your net worth) and still take advantage of the continued growth of the company into the future. This is especially true of owners that view today as too soon to sell. Owners also realize that having 98% of your net worth in one business does not always make good investment sense, as retirement is on the short-term horizon (5 to 10 years out). As my client, Jay once said to me after we did a recap of his company, "the reason I wanted to do a recap was I did not want to continue to risk the lives of my family, 110 employees, and their respective families on the chance that something would happen to me or I would make one big mistake with the company."

A recap positions the owner to take advantage of estate planning techniques. At the time of the recap, while the value of the company remains the same, the equity value is reduced by the debt in a recap. The lower equity value opens up the opportunity to time gifts and set up trusts with the now lower valued shares. Those shares transferred to the trusts, are now out of the owner's estate, and can grow and appreciate value and reduce estate taxes down the road.

A recap allows the owner to continue to run their business, receive a salary and benefits, and capture the additional equity growth the company can obtain. Sometimes referred to as the second kick at the cat or second bite at the apple. That second bite can be and as I have seen most of the time, larger than the first bite.

The debt used to recap a company is nonrecourse, thus removing the owner from any personnel guarantees.

Outside investors bring a depth of experience, connections, resources, and work with the owner to better position the company for its eventual sale sometime in the future.

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A recap presents the opportunity to reward management and key employees. Management and key employees are often allowed and usually greatly encouraged to co-invest and in most cases, are set-up in an incentive program to receive a portion of the appreciation in the value of the company, commonly referred to as stock appreciation rights. This also helps maintain and preserve the management team post transaction and the company culture. For example: Two shareholders, one owns 2/3 and the other owns 1/3. The 2/3 owner is 65 and the other is 55 years old. The younger shareholder wants to continue and the older shareholder wishes to retire. A recap with private equity allows the younger shareholder to buy out the older shareholder without over leveraging the company. Added advantages are the younger shareholder is now the majority shareholder and the debt used with private equity is not personally guaranteed by the remaining shareholder.

Private equity firms offer a readily available source of capital that can be tapped in the future for growth opportunities and potential add-on acquisitions.

A Board of Directors, which may be a first for the company, offering the company outside perspective on business, economic, and personnel issues.

The disadvantages of a recapitalization:

One day you are the person in charge and report to no one and the next you have a business partner and a Board of Directors. This can be a rude awakening for someone who for 30 years did it all by themselves. It can take some getting used to.

A recap can be a time-consuming process (5 to 8 months) and an expensive one, since it normally involves retaining investment bankers, lawyers, and accountants.

Size can be a determining factor. If your company has less than \$2 million dollars in EBITDA, your potential suitors are limited. Once you are north of \$2 million in EBITDA, your audience of suitors grows immensely. Private equity firms are most interested in capitalizing on their investments, meaning they look for companies that have the potential for future growth, whether organically or through acquisitions.

Despite these disadvantages, recapitalizations have become quite prevalent in today's market and are an attractive alternative for a business owner wishing to convert some of the value in his business to cash without actually selling the whole company.

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