

Majority Recapitalization

A majority recapitalization is a transaction whereby a business owner(s) sells a majority interest in the company to an investor to raise cash while maintaining a significant minority ownership stake and continuing to manage the recapitalized business.

Top reasons for and against a majority recapitalization:

FOR:

- Raise cash for shareholders
- Seller continues to manage the business
- Seller wants to benefit from a second sale at an even higher valuation
- Gain a strategic partner to help develop a long term growth and succession plan
- Access to additional growth capital

AGAINST:

- Don't want to give up majority ownership
- Don't want any ongoing management responsibilities in the business
- Don't want any ongoing ownership in the business

Example:

XYZ Company generates \$3 million in EBITDA and is valued at 5x resulting in an enterprise value of \$15 million. The sources and uses of funds are as follows:

SOURCES: (\$000)

Debt	7,500	
Equity (Rollover)	3,000	(36.4%)
Equity (New investor)	<u>5,250</u>	(63.6%)
Total Sources	15,750	

USES:

Cash to selling shareholders	12,000
Equity rollover	3,000
Transaction expenses	<u>750</u>
Total Uses	15,750

Note: This does not take into account the impact of taxes, escrow accounts, existing debt repayment or future management incentive plans.

Based on this example, the selling shareholder(s) would effectively sell 80% of their business for \$12 million in cash and rollover 20% of their proceeds back into the new capital structure consisting of \$8.25 million of total equity resulting in a 36.4% ongoing stake in the company.

Depending on the creditworthiness of the company, collateral, cash flow and other factors, the use of debt to finance this transaction could be higher or lower. The resulting debt could be provided by senior or subordinated lenders or selling shareholders or some combination of these groups.

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