

Introduction to Private Equity Overview

CEO Forum – May 2016



KLH CAPITAL

Introduction and Contact Information

- Career Background
 - KLH Capital, *Partner*
 - Recovery Holdings, *CFO*
 - Founders IB, *Associate*
- Mobile, AL native
- BS, University of Alabama
- Covenant Life Church
- Married with three daughters (6, 4, and 2 yrs)

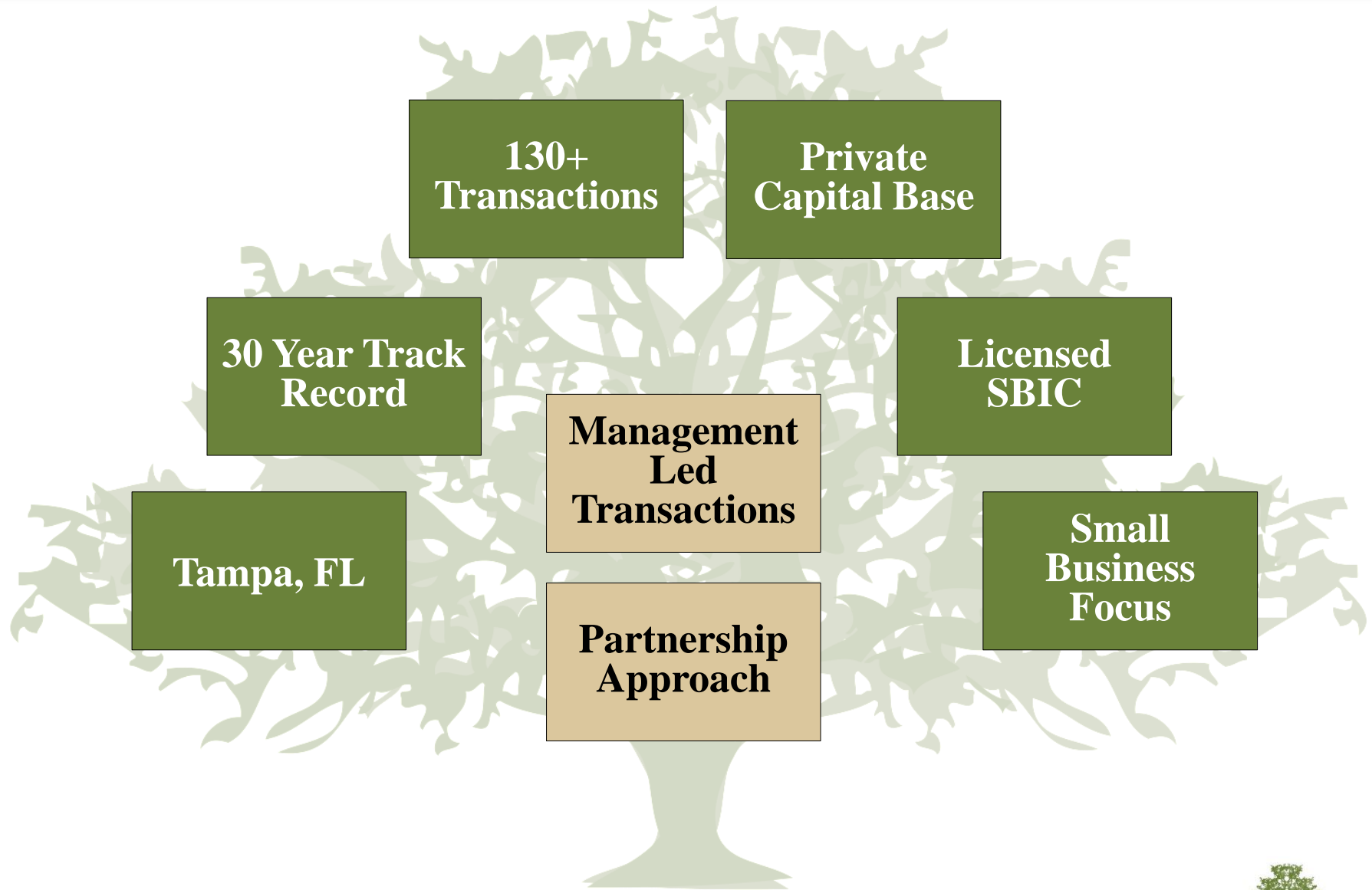


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Established Firm Focused On Small Businesses



The Goal for Today Is To Understand...

- 1. Introduction to Private Equity**
- 2. When to Consider Private Equity**
- 3. How Private Equity Values Businesses**
- 4. Top 5 Mistakes that Affect an Owner's Exit**

The Goal for Today Is To Understand...

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2. When to Consider Private Equity

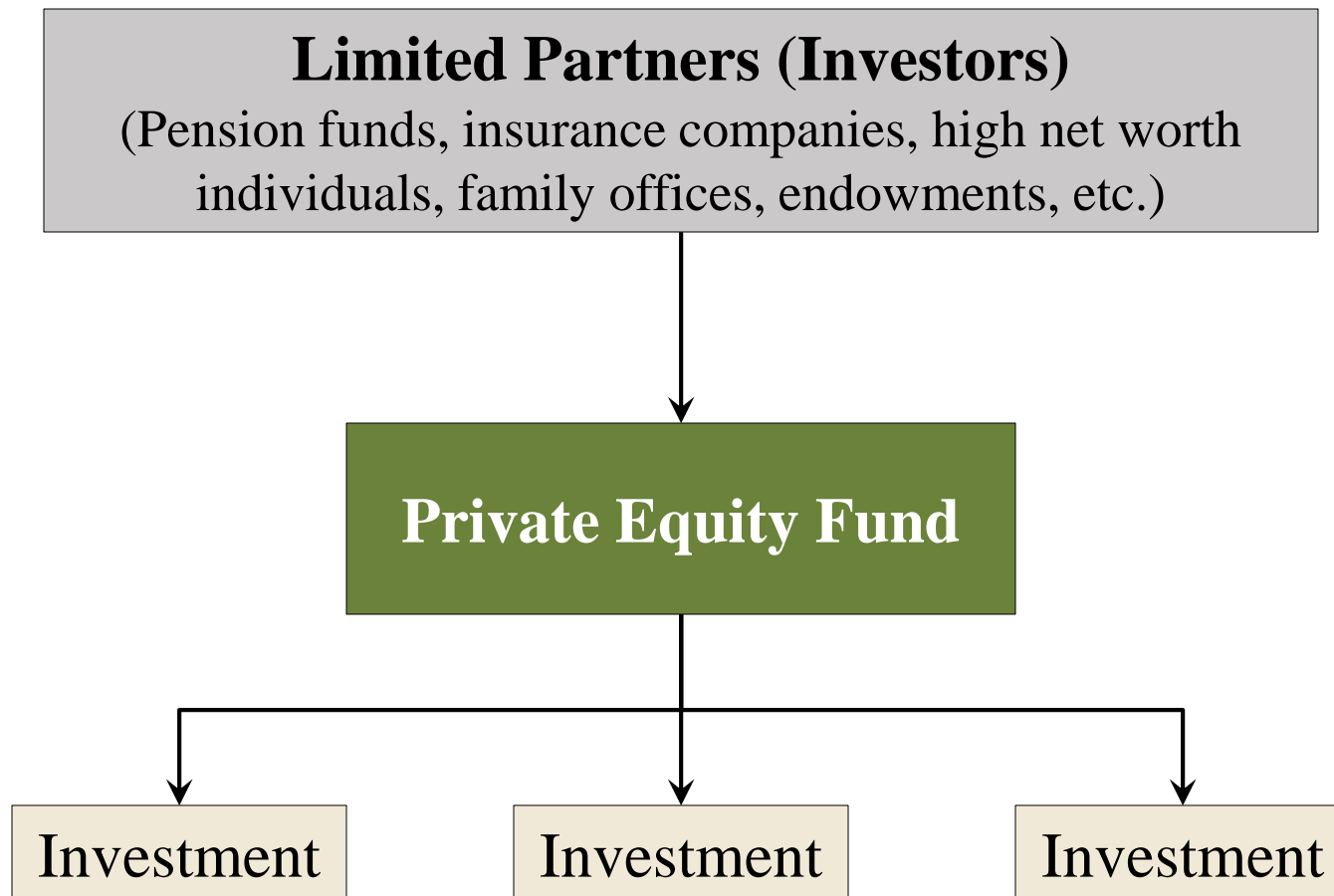
3. How Private Equity Values Businesses

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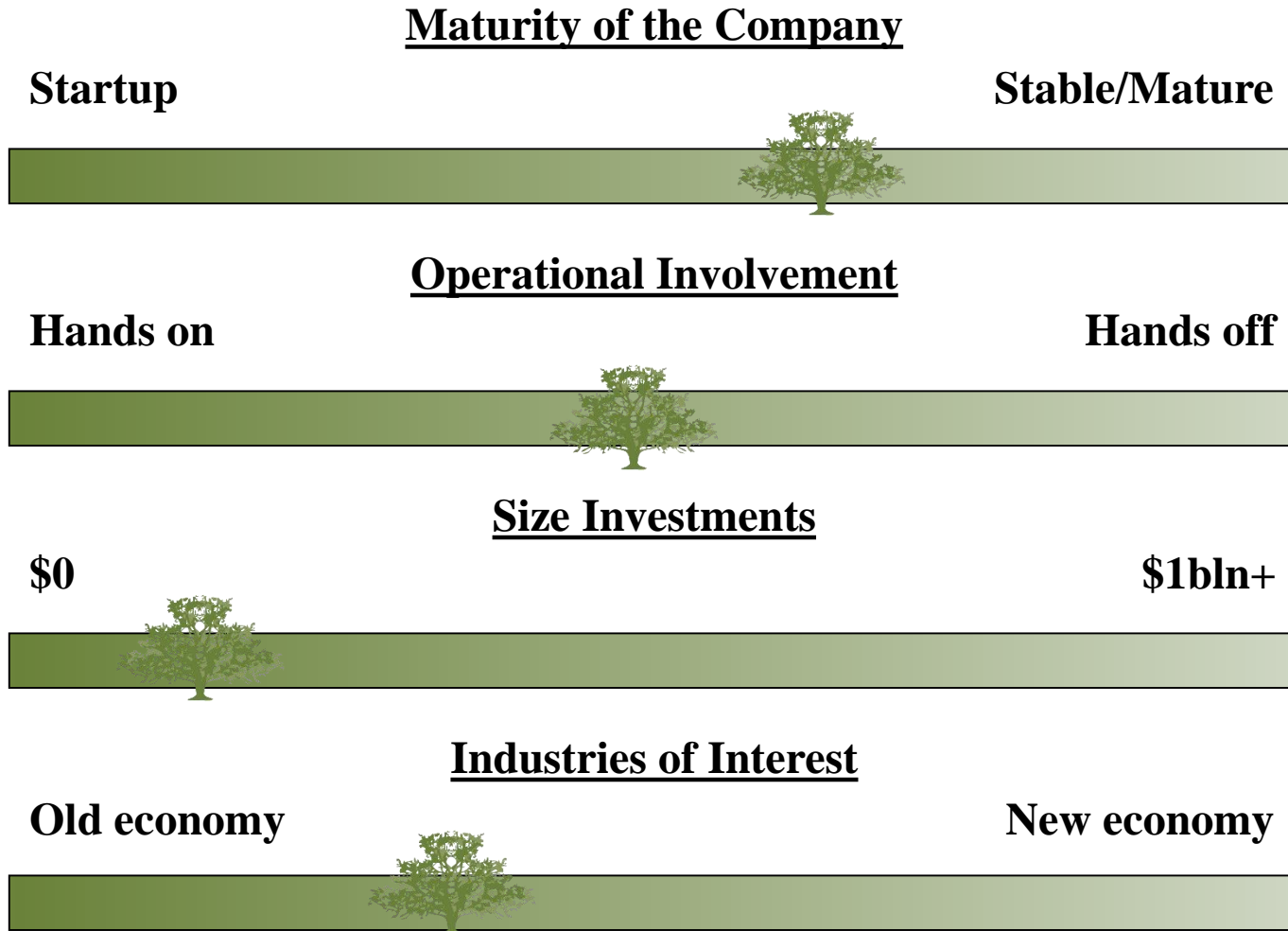
What is Private Equity?

- **Investors and funds that make investments into private companies (not publicly traded)**
- **Capital for private equity is raised from high net worth and institutional investors**
- **Money can be used to accomplish a myriad of goals and objectives in the context of a deal**

Fund Structure Is Typically Consistent...



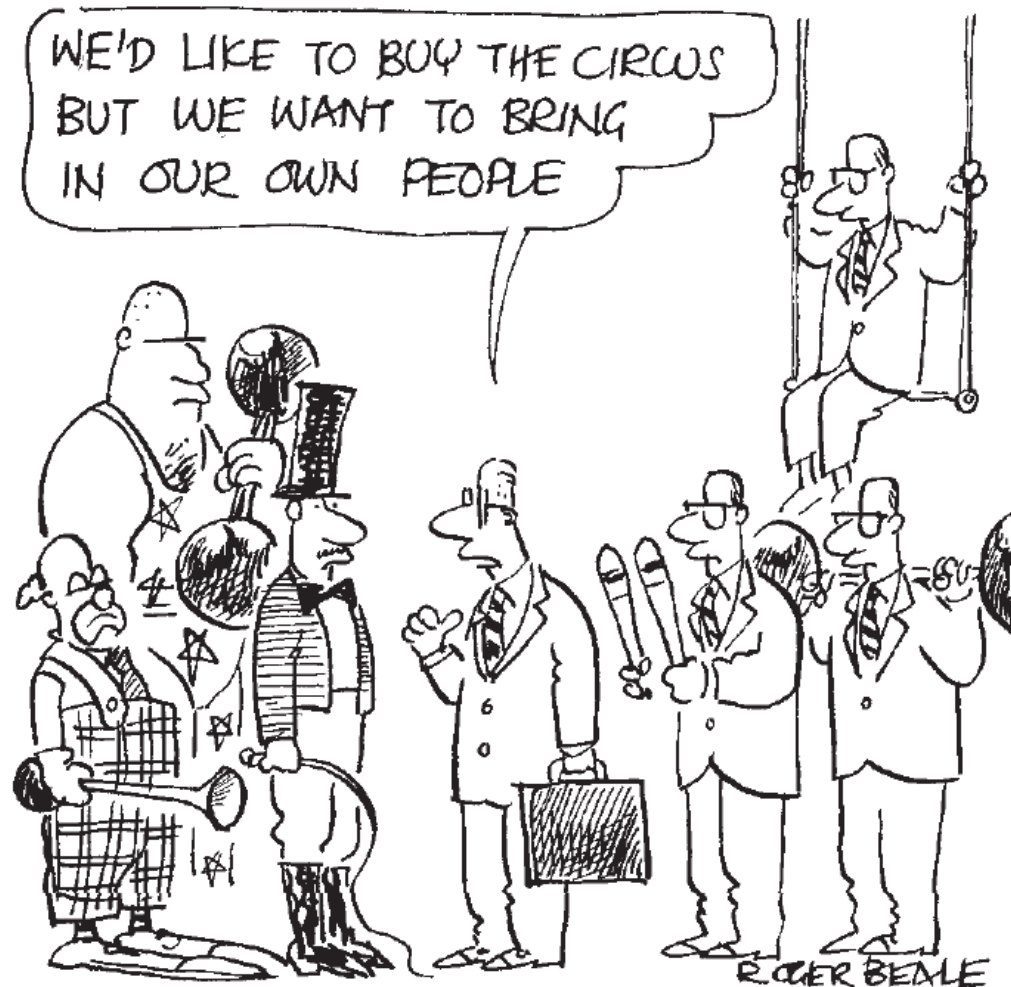
...But Each Firm Has Targeted Criteria...



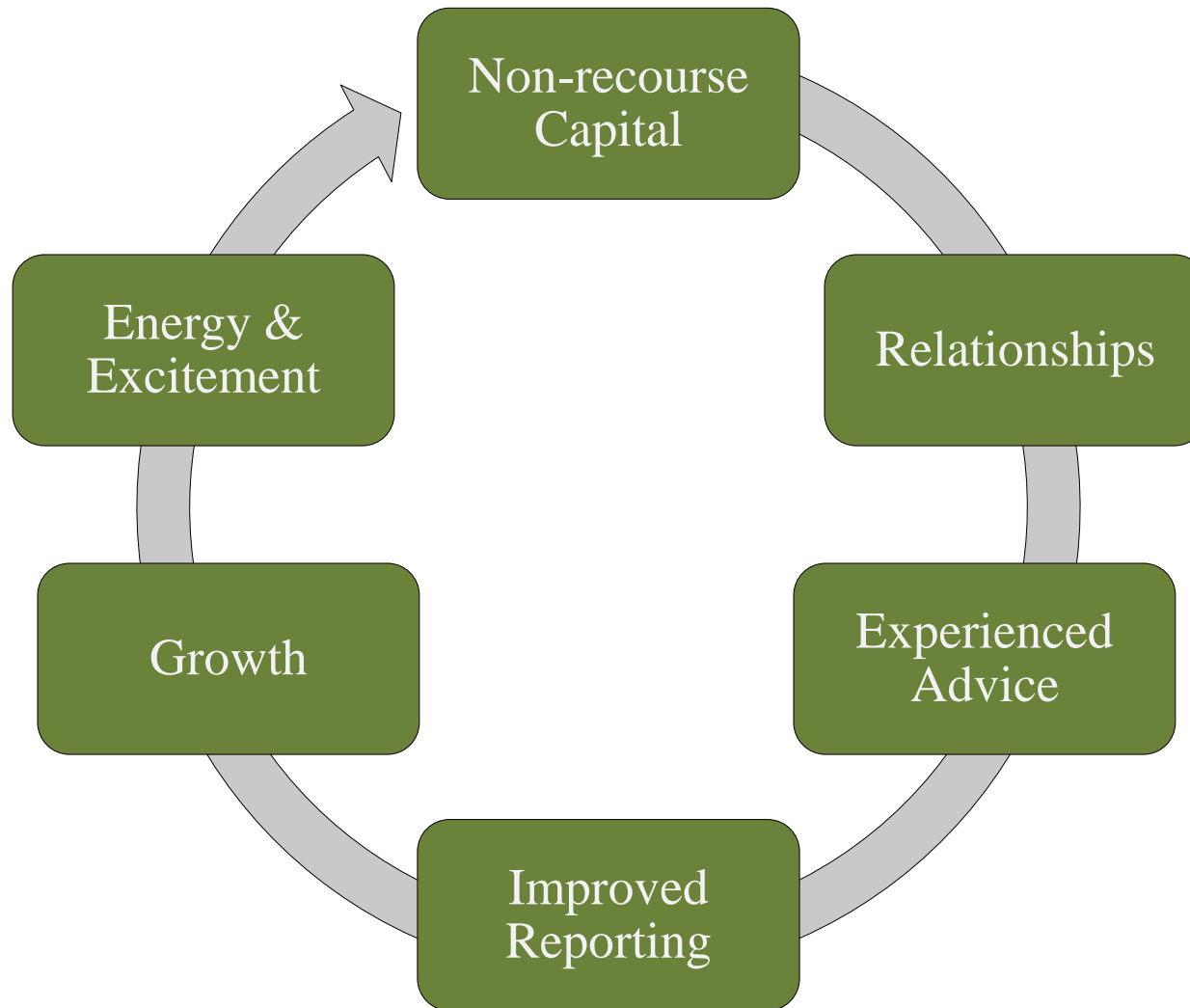
...For Example, At KLH We Invest In

Company Maturity	Mature, growing businesses with a history of profitability that need capital for growth, expansion, working capital, or buyouts
Company Size	Revenue of \$10.0 to \$100.0 million with EBITDA of \$2.0+ million
Management	Desire to assume meaningful ownership stakes
Targeted Sectors	<ul style="list-style-type: none">▪ Niche manufacturing▪ Value added distribution▪ Specialty services
Geography	Nationwide

Common Misconceptions of Life Afterwards



But Actual Reality Is Much Different

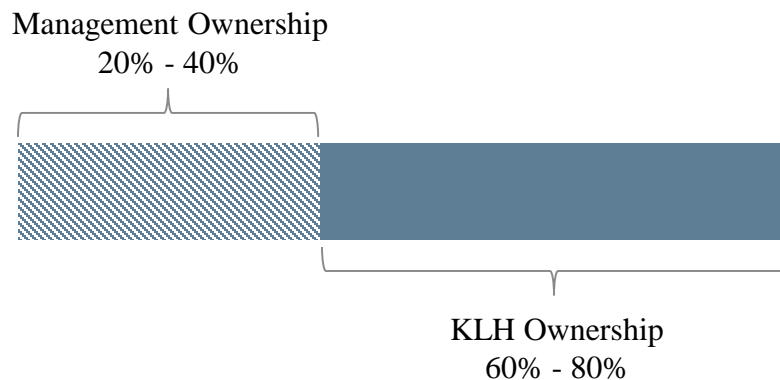


Big Idea of the PE Partnership

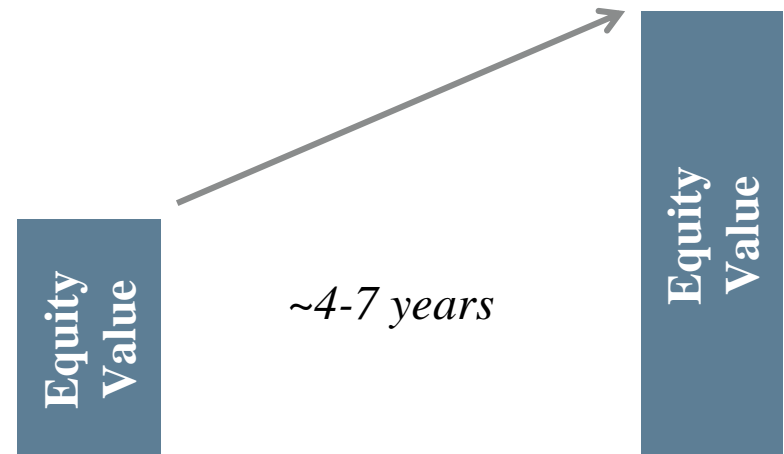
Core Tenets of a Partnership with KLH

- Management has control of day-to-day operations
- Management has meaningful equity in the business
- Management has an experienced financial partner to help grow the business
- Management has no personal guarantees or risk to personal assets

Post-Closing Ownership



Primary Goal = Equity Growth



A Partner to Focus on Achieving Success and Health

Strategic Planning

- Operating Plans
- Budgets
- Board Meetings
- Strategy Sessions

Leadership Development

- C Level Talent
- Middle Management
- Succession Planning
- Executive Coaching

Infrastructure Investment

- IT/ERP systems
- Audit and Taxes
- Insurance
- Real Estate

Add-On Acquisitions

- Analysis & Planning
- Sourcing
- Underwriting
- Closing
- Integration

While keeping your business moving forward

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Why Do I Own a Business?

Lifestyle



OR?

Investment



Understanding Your Goals & Objectives Is the First Step

Goals & Objectives

Key Questions To Answer

- Who owns the company?
- Who runs the company and is creating the most value?
- Where is the company heading?
- Where do I want to be in 5 years?
- What is my exit strategy?

Common Problems Solved by Private Equity

Growth & Diversification

Business owner wants to diversify personal assets and bring in capital to help him grow

Retirement

Business owner wants to retire in 5 – 10 years, wants to maximize the value of his business over that time frame

Shareholder Buyout

Business owner needs to buyout minority partner and bring in capital to help him grow

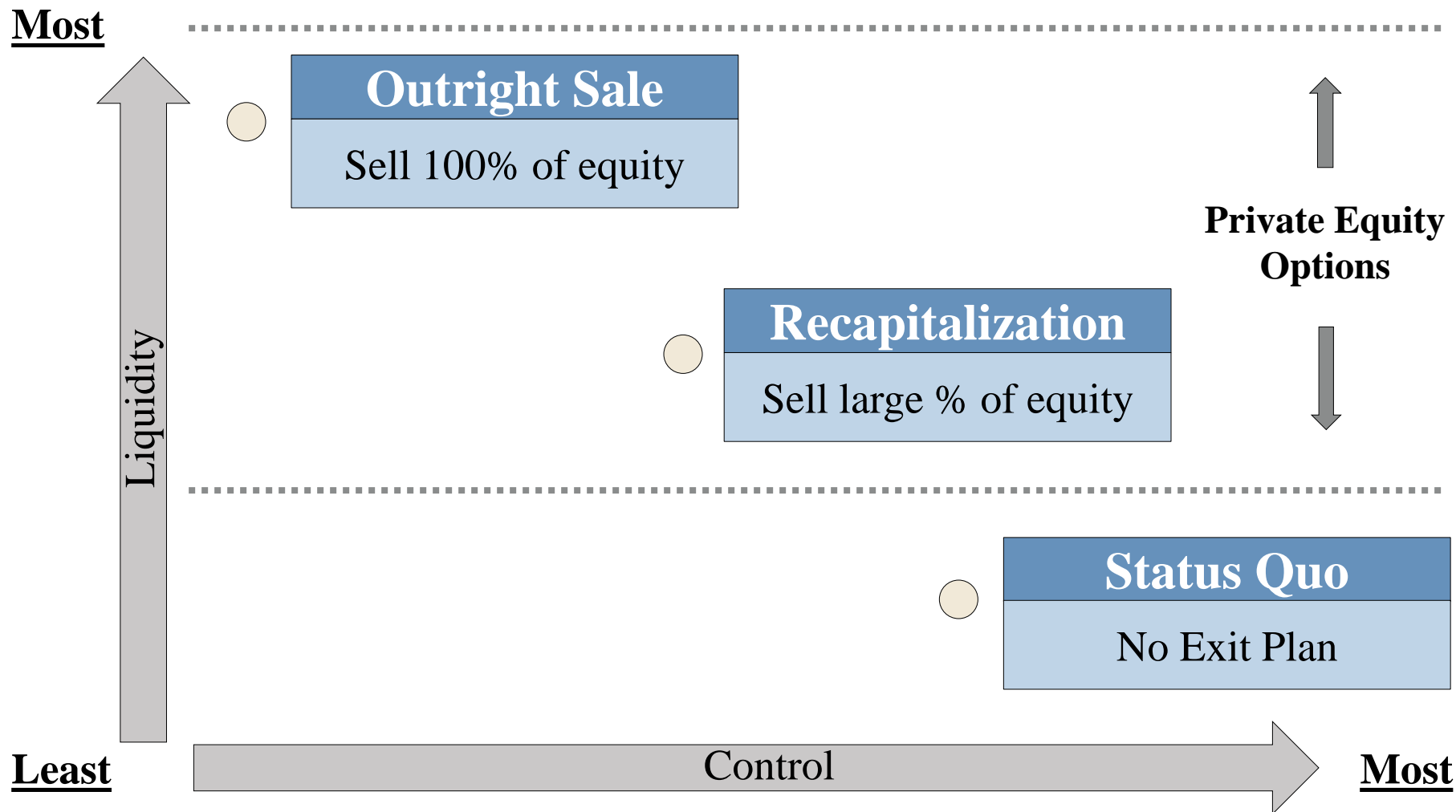
Family Transfer

Patriarch of the family company wants to retire, but doesn't trust 2nd generation to run the company with all his net worth on the line

Management Buyout

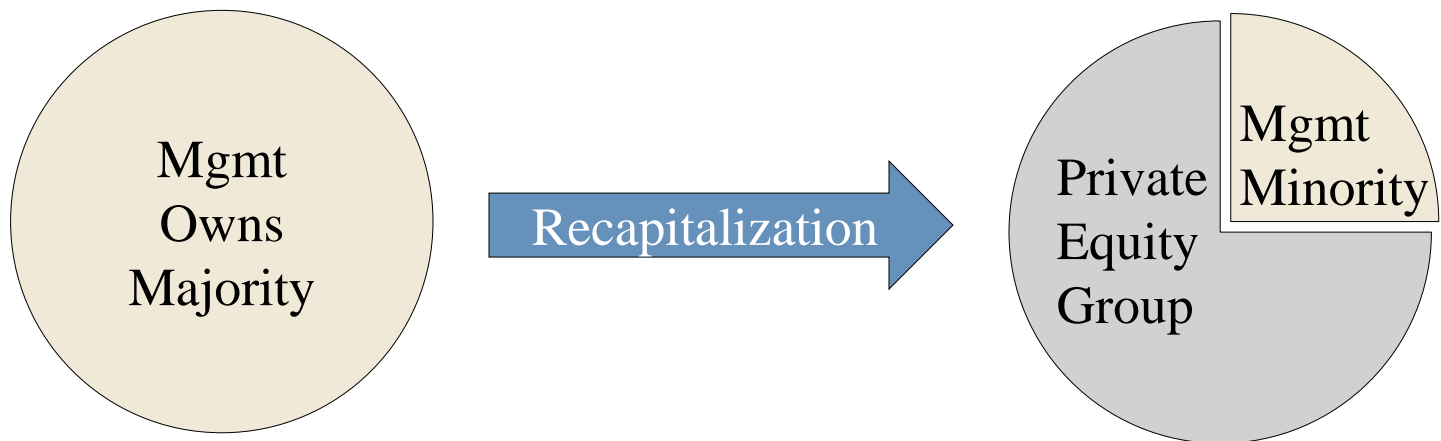
Inactive business owner wants to sell the company to his management team

Fundamental M&A Transaction Options



Recapitalization As a Phased Exit Plan

Big Idea: Client sells a portion of his or her ownership now at FMV, brings on partner to help grow the business and setup for 2nd “bite at the apple” in 4 – 7 years



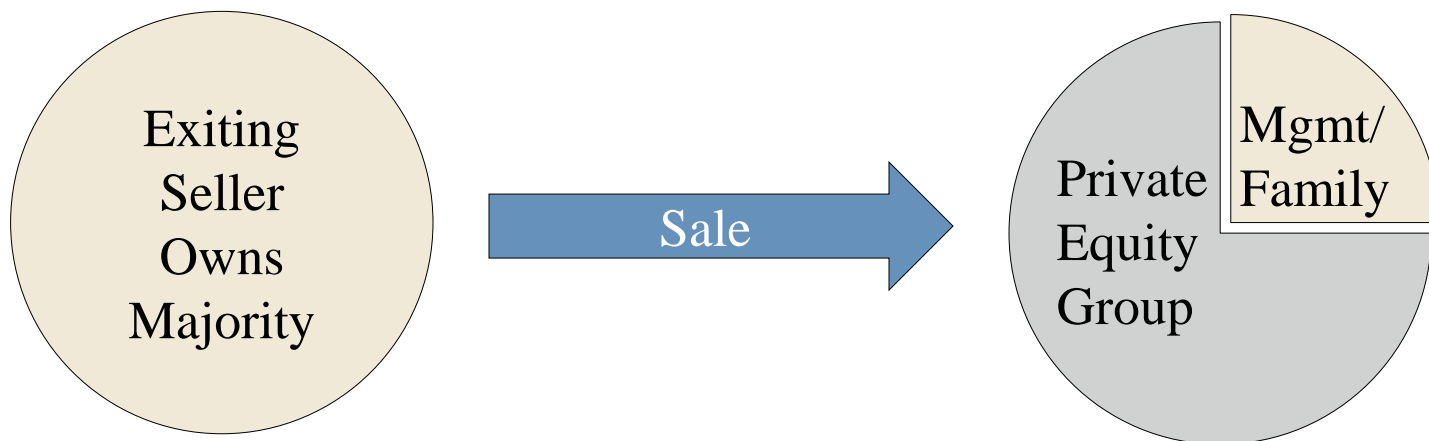
Case Study: Mid-State Machine & Fabricating



“I needed to protect the asset I had spent 35 years building to ensure continuity for my employees and give financial certainty to my family.” – Hal Kersey, CEO

Outright Sale to Family or Management

Big Idea: Client sells the company to the Management team or someone else in his or her family to facilitate a liquidity event at a fair market value



Case Study: Atchafalaya Measurement



“We didn’t have family members to loan us the money and the local bank would cover just a portion of what the company was actually worth” – Nick Trahan, President

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Finance Theory Says That Value Is...

$$\text{NPV} = -\text{Principal} + \sum_{i=1}^n \frac{\text{payment}_i}{(1 + \text{rate})^i}$$

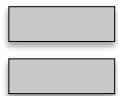
...But The Real World Values EBITDA

EBITDA

Earnings before
interest, taxes,
depreciation &
amortization

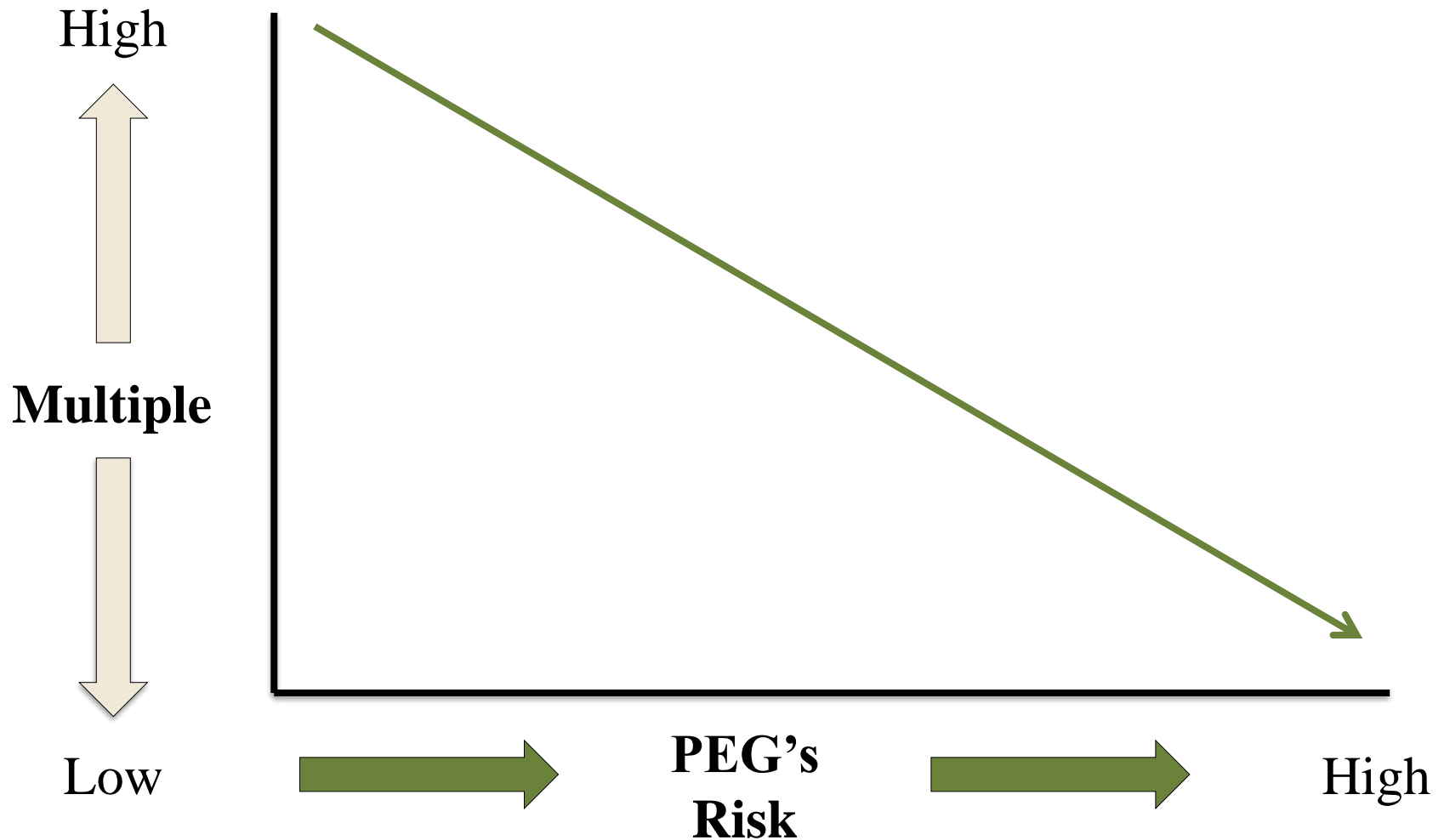


Multiple

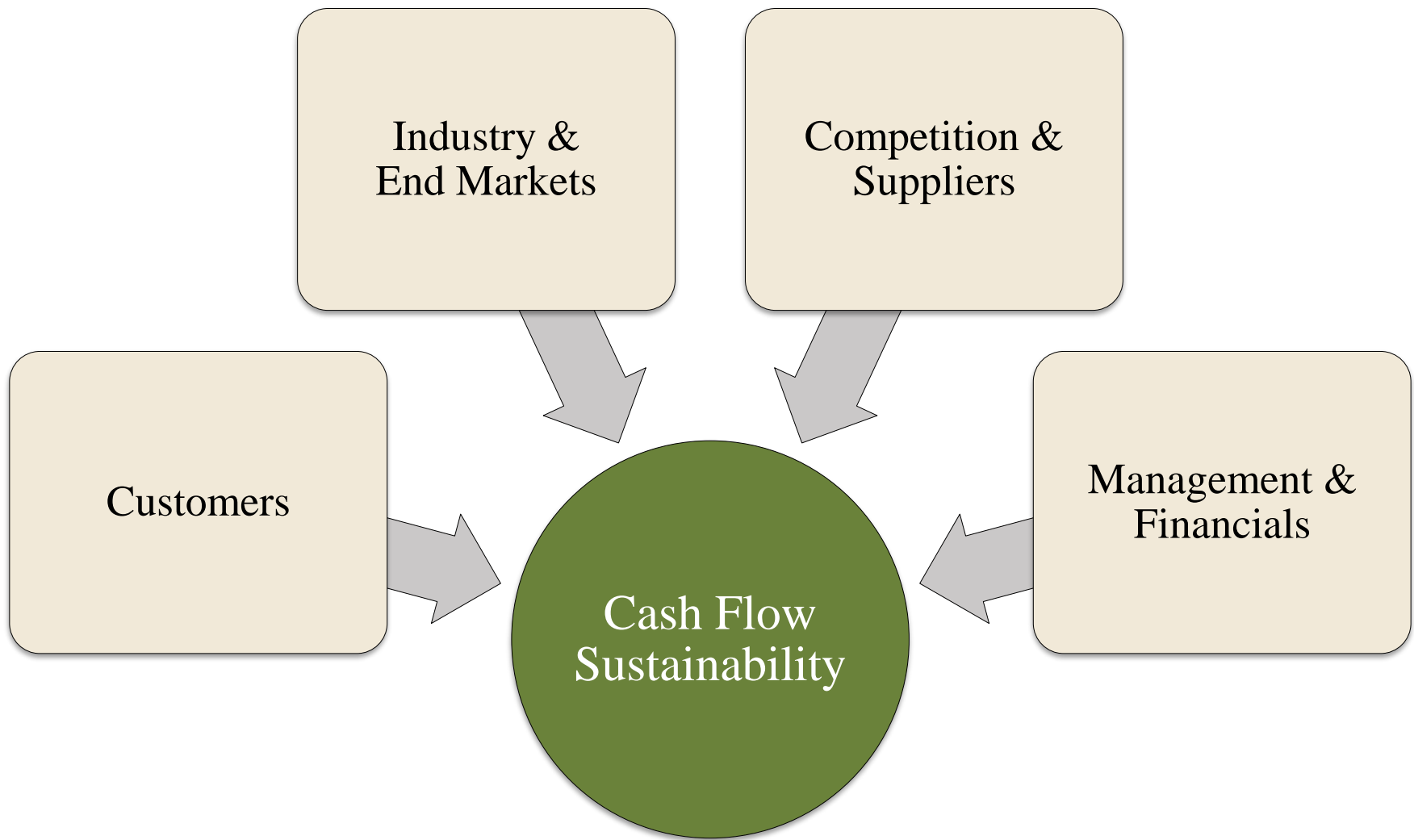


Valuation

Multiple Determined As Function of Risk

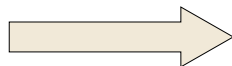


How Do We Evaluate Risk?

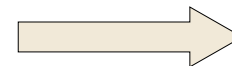


Calibrating Risk

$\leq 4.0x$



$4.0x - 6.0x$



$6.0x+$

Customers

- | <u>$\leq 4.0x$</u> | <u>$4.0x - 6.0x$</u> | <u>$6.0x+$</u> |
|---|--|---|
| <ul style="list-style-type: none">▪ Top 3 customers > 90% of revenue▪ Lumpy / project revenue | <ul style="list-style-type: none">▪ Top 10 customers < 50% of revenue▪ Mix of one-time and recurring revenue | <ul style="list-style-type: none">▪ No customer more than 5% of revenue▪ Small, recurring purchases |
| <ul style="list-style-type: none">▪ Small market size that is shrinking▪ Boom or bust | <ul style="list-style-type: none">▪ Low market growth▪ Cyclical business; correlated to GDP | <ul style="list-style-type: none">▪ Large market; growing rapidly▪ Steady business; grew through the recession |

Industry & End Markets

Calibrating Risk

	<u>< 4.0x</u>	<u>4.0x – 6.0x</u>	<u>6.0x+</u>
Competition & Suppliers	<ul style="list-style-type: none"> ▪ Easy for new competitors to spring up and copy what you are doing ▪ Top 3 suppliers > 90% of purchases 	<ul style="list-style-type: none"> ▪ New entrants would require significant investment to compete ▪ Top 10 supplier < 50% of purchases 	<ul style="list-style-type: none"> ▪ Significant capabilities that would be hard to recreate ▪ No supplier more than 5% of purchases
Management & Financials	<ul style="list-style-type: none"> ▪ Little to no accounting systems ▪ No professional accounting staff 	<ul style="list-style-type: none"> ▪ Limited information systems ▪ Controller on staff 	<ul style="list-style-type: none"> ▪ Sophisticated information systems ▪ Full time CPA or CFO on staff

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Lack of Financial Veracity

ve·rac·i·ty [vuh-ras-i-tee]

conformity to truth or fact; accuracy;
correctness or accuracy

A very high percentage of small business owners neglect their financial accounting systems. At the very least, this creates a situation where the owner does not have the right tools to measure and run his business. At the worst, this lack of proper financial management can cost millions of dollars of lost valuation when the business is sold.

Lincoln, NE 68506
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Project Summary - First 7 sites we have Open

Budget	Cost	Profit
Sow 11 - 1,149,898	610,089	539,809
Sow 12 - 1,156,478	584,391	572,087
Sow 13 - 1,109,128	529,160	589,968
Sow 14 - 1,248,334	581,762	666,572
Sow 1 - 1,065,163	380,835	684,328
Sow 2 - 1,001,621	397,830	603,791
Sow 4 - 1,065,221	425,082	640,139
Totals 7,801,973	3,508,597	4,293,376
Avg per site 1,114,568	Avg per site 501,229	Avg per site 613,337

Not yet Started Projects under Verbal Contract

Sows - 5, 6, 7, 8, 9, 10, 16, 17, 18, 19, 20, 21, 22, 23, 24, 27, 28, 31, 113, 113, 114, 115, 116

Total of 24 Sow Farm yet to do as of Today

Projected Verbal Deal

24 sites x 1,114,568 Budget	Cost Budget 501,229	est Profit
26,749,632	12,229,496	14,520,136

Total Sow Projects Verbal contract Deal

Budget	Cost	Profit
34,551,605	15,538,935	19,012,670

Hesitance to Hire the Best Talent

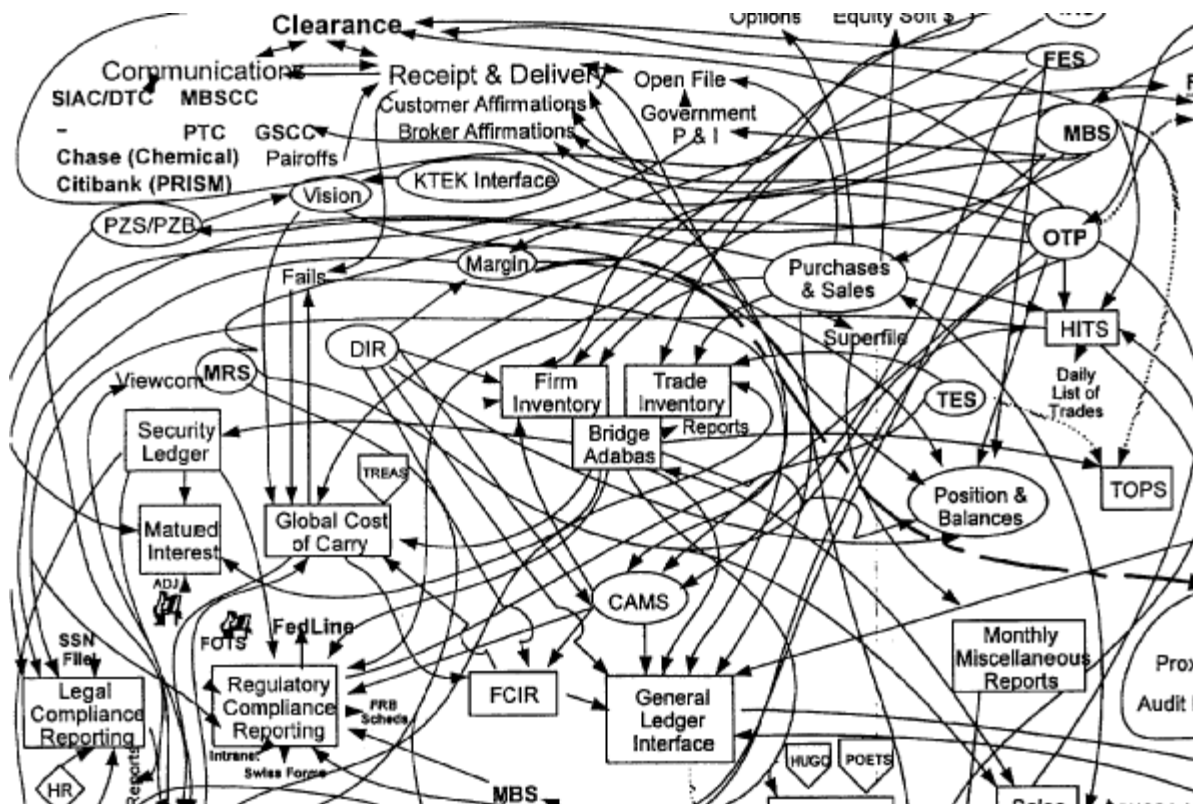
Many small businesses “settle” for whatever person happens to pick up a task, or whatever person is the best of the worst to answer a craigslist ad → Often desire to save money is what makes the hiring decision.

- Why is your sister-in-law the controller of the company when she has no understanding of GAAP accounting?
- I know your head of sales has been with you since day 1, but you know he is struggling to grow sales.
- “Boudreaux drinks a little, but he knows the operations side of this company better than anyone.” And we all know Boudreaux drinks a LOT.



Overcomplicating Your Legal Structure

“Our company is organized as an S corporation. Oh, and we have a leasing entity for the employees, a separate LLC for the real estate, an S corporation for the commissions paid to the sales team, and we license the patents from a partnership. Some of those entities are December 31 year end, and some are March 30.”

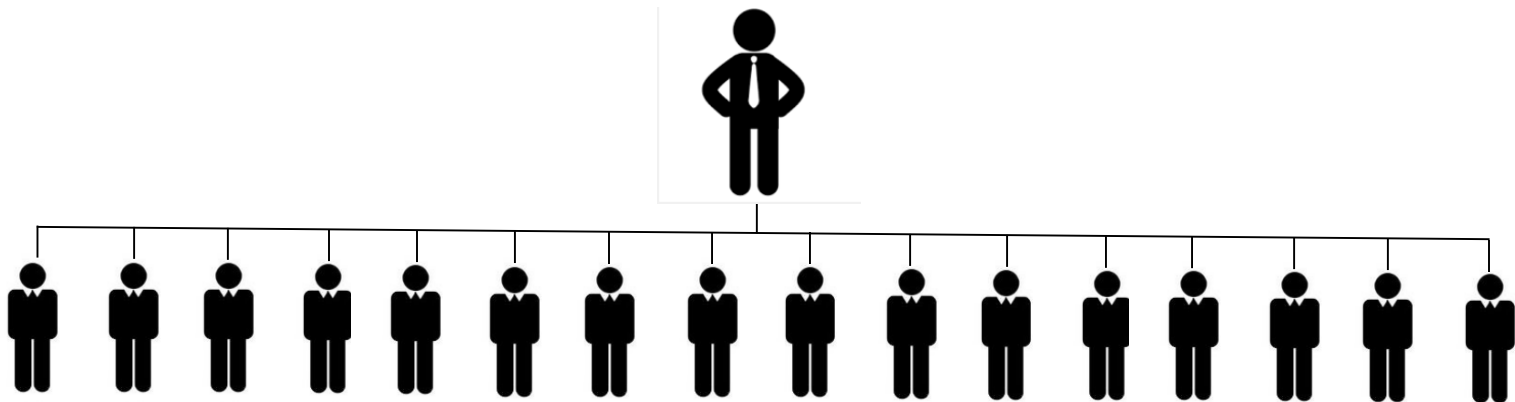


Lack of Delegation

For many small businesses, the business owner is the business.

- Can you go on vacation for a week and only call the office 30 minutes each day?
- Can you go to Asia for two weeks and manage the company only via email on your smart phone? 30 minutes in the morning and 30 minutes at night?

Not having the right talent to delegate to holds back growth and profitability. It leads to personal stress, health problems and unhappiness.



Failure to Understand the Real Value of Your Business

- Deals only get done when buyers and sellers **agree** on a valuation for the business
- Most business owners think the value of their business is what they need to “retire”
- The multiple Thibodeaux got for his business is not what Boudreaux should expect

KLH Capital

James Darnell, Partner

james@klhcapital.com

813-397-1284

Established Firm

- Tampa, FL based team
- 9 full time professionals, 4 active partners
- Manage \$300mm in assets
- Currently investing out of \$135mm SBIC fund
- Eight committed funds over 30+ years
- 130+ successfully closed transactions

Targeted Strategy

- Equity investors
- History of profitability
- Revenues between \$10 and \$100mm
- EBITDA of \$2mm+
- Management teams with large equity stakes
- Strong growth potential

