DEALREADER | Private Company Group

The merger-and-acquisition newsletter for owners of private companies and their advisors

Summer 2014

Inside this Issue

Welcome to the Summer 2014 issue of the Private Company Group DealReader, a newsletter focused on merger-and-acquisition trends, transactions and events of interest to owners of private companies and their advisors.

In this issue, we pose five questions to Natalie Marjancik of the Debt Advisory Group at Lincoln International. She discusses dividend recapitalizations, a viable alternative for private company owners who desire liquidity without giving up control of their business.

Other topics covered in this issue include:

- Key M&A market and purchase agreement statistics
- Profiles of recent Lincoln International transactions, including the sales of KZ, Inc. to Thor Industries and Cobham Integrated Systems to Genesys Aerosystems Group.

We hope you find this newsletter a useful tool and we welcome your comments or questions.

Lincoln International

Five Questions For: Natalie Marjancik, Lincoln International - Dividend Recaps

Natalie Marjancik, Director at Lincoln International

Lincoln International's Debt Advisory Group acts as an "outsourced capital markets desk" for financial sponsors, corporations and private company owners. The Group has advised on over $3.0 billion of financings in 2013.

Natalie Marjancik is a Director with Lincoln's Debt Advisory Group. Natalie's primary area of expertise is advising clients on the structuring and arranging of financing for acquisitions, leveraged buyouts, dividend recapitalizations, refinancings, and restructurings. Additionally, Natalie participates in the firm's financial advisory activities, including assessing and rendering opinions on companies' debt capacity.

We asked Natalie five questions regarding dividend recapitalizations ("dividend recaps"), which are a commonly pursued strategic alternative utilized by private company owners.

Q: What is a dividend recap?

A: A dividend recap is a transaction that involves a company borrowing money that is then distributed to shareholders to fund a one-time, special dividend. Over time (typically a span of three to five years), the company must repay the funds borrowed, meet certain financial thresholds and satisfy other obligations, or covenants, while the loan remains outstanding. Generally speaking, these covenants will limit the company's ability to take on additional leverage, make future dividends (other than tax-related distributions to members) and acquire other companies without the lenders' consent and will also require that the company regularly report its financial results to its lenders.

"For companies potentially considering a dividend recap, now is a very good time to explore that option. "

Q: Do I have to give up equity in my company to finance the recap?

A: Typically no – while the structure and terms of debt available to a company are dependent on the borrower's overall credit profile and market conditions, dividend recaps can be financed in such a way that there's no change in the company's ownership structure. Importantly, this means that a company's shareholders are not diluted, and they continue to reap the full benefit of any upside in the company's performance going forward.

Q: How much debt can my company handle, and how big of a dividend can my company make?

A: The amount of debt a company can bear (and the resulting size of the dividend that gets funded) is dependent on the company's specific credit profile. Lenders will consider a number of factors when evaluating how much debt to loan to a company, including, among others, how well the company has performed historically, the sustainability of its current financial performance, its free cash flows available to service debt obligations, the nature of its collateral base, the quality of its management team, the outlook/ fundamental drivers of its end-markets and the company's enterprise valuation. Under most debt structures, a borrower must repay a portion of the funds back (usually quarterly), along with cash interest payments. So it is important for a company to also consider how much "free cash flow"

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Dividend Recaps: Pros and Cons	
Pros	**Cons**
• No change in ownership levels or dilution of existing shareholders	• Introduction of leverage to the balance sheet may shift operational focus of management and requires new financial reporting obligations
• Provides partial liquidity to shareholders, without giving up control of the business and retaining full upside	• Increased leverage and covenants may limit ability to execute other strategic initiatives (e.g., acquisitions)
• Relatively rapid process requiring less management involvement than a full sale transaction (60 days from launch to funding compared to 6 months or more for a sale transaction)	• Reduced flexibility to weather deteriorating market conditions (e.g., cash flow used to service debt rather than reinvesting in the business)

(Continued from page 1)

it typically has available to service its debt after considering its after-tax cash earnings and capital expenditure requirements. A good rule of thumb is that a company's after-tax cash earnings (net of its capital expenditures) in a given year should equal at least 1.15x the required principal and interest payments on the company's debt obligations in that same year.

Illustrative Dividend Recapitalization Example	
Financing	
Company EBITDA	$7.5 million
Amount of Debt Available	4.0x
Funded Debt	$30 million
Estimated Transaction Fees	$1 million
Total Pretax Proceeds	**$29 million**

Terms	Asset-Based	Senior Cash Flow	Unitranche	Subordinated Debt
Rate	L + 1.75% - 2.25%	L + 4.25% - 5.25%	L + 7.50% - 8.50%	11.00% - 13.00%
Floor	n/a	1.00%	1.00%	n/a
Amortization	2.5% - 7.5% in year 1, depending on type of senior debt			
Lender Closing Fees	0.5% - 2.0%, depending on type of debt			
Prepayment Fees	0.0% - 3.0%, depending on deal structure and timing of payment			

Note: The values presented above are based on prevailing metrics observed by Lincoln in recent months; however, the amount and type of debt available to fund a dividend recap is highly dependent on a specific borrower's credit profile and may differ than those shown above.

Q: How are current market conditions affecting companies' ability to refinance?

Even if a company has a strong credit profile, overall conditions in the financing market will have a significant impact on the type of debt and key economic terms that will be available to a borrower. Currently in the middle market, there is a capital supply and demand imbalance, meaning that lenders have significant capital to deploy but there are not enough financing opportunities for them to put all of that capital to work. As a result, lenders are increasingly agreeing to very "borrower-friendly" terms (such as increased leverage levels, lower interest rates and less stringent financial covenants) to win mandates from potential borrowers. Historically, though, lenders have preferred to fund strategic transactions that enhance the value of the borrower's enterprise, such as acquisitions, as opposed to dividends, where the proceeds of the financing do not remain in the company and are not used to grow the company. So, if M&A activity continues picking up, it may be more challenging to complete dividend recaps since lenders will have opportunities to deploy capital in other ways. For companies potentially considering a dividend recap, now is a very good time to explore that option.

Q: How long does it take to complete the recap process?

A: To ensure optimal financing terms, Lincoln recommends that a company run a robust financing process, which involves approaching and obtaining financing proposals from multiple lenders at the same time. This process typically takes about 60 days from when lenders are first contacted to when the dividend is funded. While a company's historical "relationship" lenders are a good starting point, often times, especially for private companies, other lending sources may be able to provide additional capital beyond what a local or regional bank can provide or fund the entire credit facility on terms that are much more advantageous to the company than those being offered by its relationship lenders. Lincoln's Debt Advisory Group has raised debt capital to fund a number of dividend recap transactions, and in many of those cases, commercial finance companies, business development companies and credit opportunity funds were able to fund larger dividends on much more attractive terms to the borrower than the terms proposed by the borrower's existing lenders. Approaching these types of groups can be especially beneficial for private companies because non-bank institutions tend to be more open to and have more flexible mandates when investing in companies that are not backed by a private equity group. ■

For more information on dividend recapitalizations, please contact Natalie at (312) 506-2729 or nmarjancik@lincolninternational.com

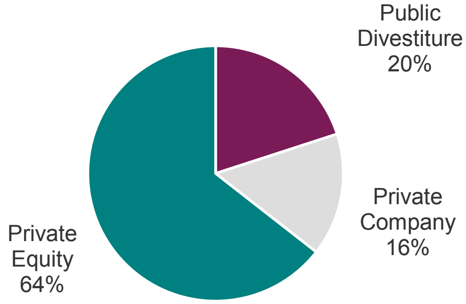
About Lincoln International's Debt Advisory Group

With professionals worldwide, Lincoln International's Global Debt Advisory Group has a proven track record of designing innovative financing solutions to help its clients achieve their capital raising objectives. Lincoln's Global Debt Advisory Group's service offering includes acquisition financing, post-acquisition financing, dividend recaps, sell-side ('stapled") financings, and refinancing / expansion capital.

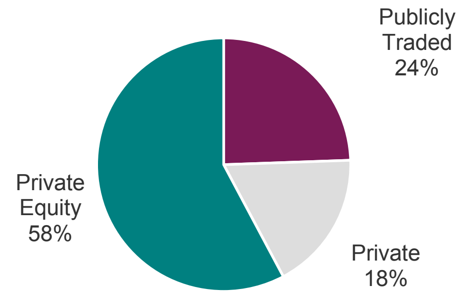
The Market Pulse: DATA THAT AFFECTS THE MID-MARKET M&A LANDSCAPE

Lincoln Completed Transaction Data (N. America) — Last 12 Months Ended March 31, 2014

Seller Type



Buyer Profile



Valuation Statistics: Average Enterprise Value Multiples
Last 12 Months Ended March 31, 2014

	EV / LTM EBITDA				EV / LTM Revenue			
	Mean		Median		Mean		Median	
Less than $75 million	7.27x	▲	7.11x	▲	1.01x	▲	0.90x	▲
Greater than $75 million	8.36x	►	8.17x	►	1.82x	►	1.71x	►

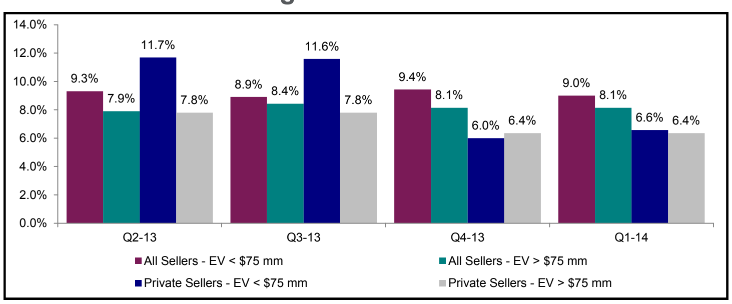
Note: Arrows denote comparison with M&A transactions completed during the 12 months ended December 31, 2013; adjusted mean excludes high and low values prior to mean average calculation

Observations

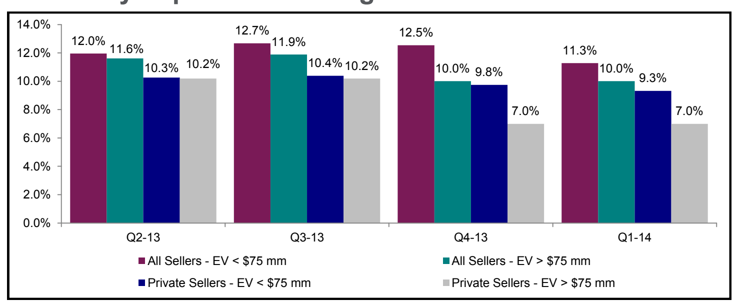
- Valuation multiples have increased or remained steady
- Larger companies' premiums over smaller businesses, as measured by EBITDA and Revenue multiples, declined slightly

Key Purchase Agreement Terms — Lincoln's North American transactions

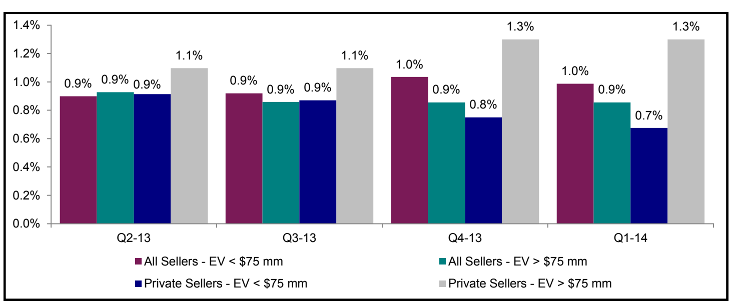
Escrow as a Percentage of Purchase Price



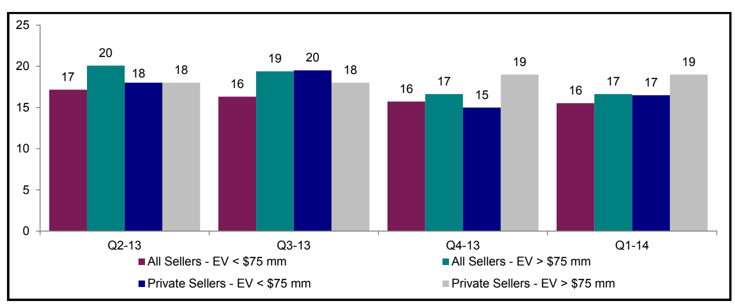
Indemnity Cap as a Percentage of Purchase Price



Basket as a Percentage of Purchase Price



General Indemnity Term (in months)



Observations

- In general, terms continue to be highly favorable for both smaller and larger companies, as lenders remain highly competitive on both terms and pricing
- Public strategic acquirers have increased activity

Note: Agreement terms on last twelve month basis ended in noted quarter
Source: Lincoln International

Selected Recent Lincoln International Transactions

MSOUTH EQUITY PARTNERS has sold GaiaTech to RPS

- Sell-side transaction (May 2014)
- GaiaTech is a leading provider of environmental consulting and engineering services. The company is headquartered in Chicago, Illinois.
- Acquired by RPS Group, a leading multinational energy resources and environmental consultancy company. The company is headquartered in Abingdon, United Kingdom.

Kinematics Manufacturing, Inc. has received a growth equity investment by ANGELENO GROUP

- Sell-side transaction (May 2014)
- Kinematics Manufacturing Inc. is a leading supplier of highly-engineered, precision motion control solutions, servicing the solar, oil & gas, mining, construction and other industrial markets. The company is headquartered in Phoenix, Arizona.
- Acquired by Angeleno Group, a leading private equity firm focused on partnering with next generation clean energy and natural resource companies. The company is headquartered in Los Angeles, California.

K-Z has been sold to THOR INDUSTRIES

- Sell-side transaction (May 2014)
- K-Z, Inc. is a leading manufacturer and assembler of innovative, high-quality travel trailers, fifth wheels and toy haulers. The company is headquartered in Shipshewana, Indiana.
- Acquired by Thor Industries, Inc., the world's largest manufacturer of recreational vehicles. The company is headquartered in Elkhart, Indiana.

COBHAM has sold CHELTON FLIGHT SYSTEMS and S-TEC to GENESYS AEROSYSTEMS

- Sell-side transaction (April 2014)
- Cobham Integrated Systems, comprised of S-Tec Corporation and Chelton Flight Systems, is a leading developer and manufacturer of autopilots and advanced electronic flight, navigation and integrated safety systems. The company is headquartered in Mineral Wells, Texas.
- Acquired by Genesys Aerosystems Group, an entity formed by Cobham Integrated Systems' management team. The company is headquartered in Mineral Wells, Texas.

Undisclosed security equipment company

Dividend Recapitalization

- Dividend recapitalization of a privately held business (March 2014)
- Lincoln represented a leading provider of security products.
- Private placement financing was successfully completed for the full amount sought by the company, providing a special one-time dividend to shareholders, while also maintaining flexibility to continue to grow the business.

Health Solutions has been sold to Interactive Health a portfolio company of CI Capital Partners

- Sell-side transaction (March 2014)
- Health Solutions is a leading provider of evidence-based wellness screenings, health improvement programs, and wellness program management services to employers, hospitals, government agencies and commercial health plans. The company is headquartered in Owings Mills, Maryland.
- Acquired by Interactive Health, a portfolio company of CI Capital Partners, is the leading provider of outcomes-based health management solutions. The company is headquartered in Schaumburg, Illinois.

Lincoln International's Global Footprint

170+ professionals throughout the Americas

110+ professionals plus a 24-person advisory board in Europe

Offices throughout the "BRIC" economies of Brazil, Russia India and China

Indicates Lincoln International office

About Lincoln International

Lincoln International specializes in merger and acquisition advisory services, debt advisory services, private capital raising and restructuring advice on mid-market transactions. Lincoln International also provides fairness opinions, valuations and pension advisory services on a wide range of transaction sizes. With sixteen offices in the Americas, Asia and Europe, Lincoln International has strong local knowledge and contacts in key global economies. The firm provides clients with senior-level attention, in-depth industry expertise and integrated resources. By being focused and independent, Lincoln International serves its clients without conflicts of interest. More information about Lincoln International can be obtained at **www.lincolninternational.com.**

Save the Date

New York Athletic Club, New York, NY

Industry Groups

Lincoln International's dedicated industry verticals are organized on a global basis and led by senior professionals with significant advisory and sector expertise:

- Aerospace and Defense
- Automotive and Truck
- Building and Infrastructure
- Business Services
- Chemicals
- Consumer
- Electronics
- Healthcare
- Industrials
- Packaging
- Renewable Energy
- Technology
- Transportation and Logistics

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