MASON WELLS

M&A Financing

Presentation to:
FEI – NE WI Chapter

April 19, 2016

Agenda

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- Characteristics of Attractive M&A Targets
- Key Financial and Tax Considerations
- Typical M&A Financing Participants
- Typical Buyout Capital Structure
- Key Legal Terms and Considerations
- Process Timing and Overview of a Buyout Transaction

Legal Disclaimer

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A Successful Tradition:

- Headquartered in Milwaukee, WI
- Formed in 1998
- Closed more than 35 transactions including follow-on investments
- Cohesive Buyout team with an average tenure of 20 years with Mason Wells
- Currently seeking investments by a $615 million fund(1) raised in 2015 - 16

Poised for Continued Growth:

- Our philosophy: “Invest in people” (vs. buy companies)
- Seek to achieve returns through sustainable value creation (revenue, earnings) vs. financial engineering
- A network of specialized executive partners with experience and expertise in a variety of industries

(1) Includes executive side-by-side fund.

Focused Investment Strategy

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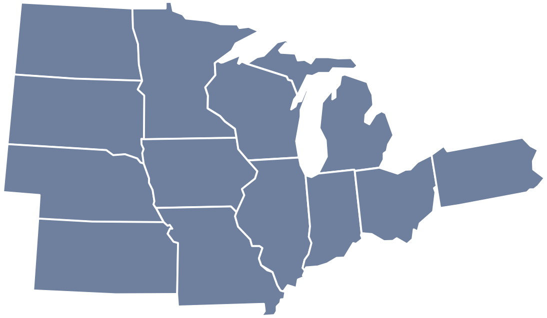
Lower Middle Market

- Company revenue $25 - $300M
- Transaction value $25 - $200M
- EBITDA $5 - $30M

HQ in Midwest Region



Targeted Industries

Value Creation System

- Invest for operational efficiency
- Focused strategies for growth
  - Internal via cap ex investment
  - External via tuck-in acquisitions
- Prudent financial structuring

Consistent Track Record of Fox Valley Region Investments

Pacon CREATIVE PRODUCTS
Let Your Imagination Shine®

cei
Converting Ideas Into Innovation

NEX
Performance Films

Converting, Inc.

sturmfoods

CREATIVE FORMING, INC.

DURALAM INC.

Characteristics of Attractive M&A Targets

Overview of Private Equity

- Equity capital for the acquisition or recapitalization (partial sale) of private companies

- Positive cash flow companies with growth opportunities

- Majority equity position held by PE fund
  - Typically held by just one private equity fund (compare to VC model)
  - Remaining equity held by management and possibly prior owners

- Returns generated through growth and improvement of the business
  - Investment in growth (IT system, geographic or product/service expansion, etc.)
  - Operational improvements
  - Strategic positioning

Typical Private Equity (Buyout) Transactions

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- Founders/owners seeking liquidity for estate planning or diversification purposes
  - Partial or full sale of equity position
  - Desire that company remain independent
  - Transaction pursued in confidence without competitive risk
  - Help in resolving any "delicate" family ownership or management transition issues
- Change in business environment drives need for additional equity
  - Significant capital expenditures needed to grow
  - Industry consolidation requires company to get larger to compete
  - New risks/opportunities
- Divestiture of a "non-strategic" subsidiary or division by a larger company
- "Going private" transaction of a publicly-traded company

Common Target Company Characteristics

- Financial Profile Meeting Investment Criteria
  - Sales, EBITDA and Annual Capex → Sustainable Free Cash Flow
  - Supports minimum investment size
- Management team in place
- Well defined growth opportunities
  - Strong position in a niche market
  - Benefitting from a large and growing market
- Limited customer concentration
- Opportunities for improvement
  - Margin improvement and capital management
  - Benefit from strategic focus and additional capital

Key Financial and Tax Considerations

Key Financial & Tax Considerations

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- Quality of Earnings
  - Audits vs. Reviewed Financials
  - History
  - Consistent sales growth and margins
  - EBITDA Addbacks
    - “Aggressiveness”
    - Total # proposed

- Standalone Company vs. Corporate Carve-out
  - Determine go forward cost structure
  - Corporate carve-out – determine short-term & long-term incremental expenses
    - TSA – IT, HR, financial reporting
    - Add’l personnel – leadership & sales
  - Tax → ability to attain asset step-up
    - In stock deals – 338(h)10 elections for:
      - S-Corps
      - Corporate divestitures

Key Financial & Tax Considerations

<u>Example of Value to a Buyer w/338(h)10 Election</u>

Legal Structure: S-Corp (Privately Held)

Enterprise Value: $60MM

Marginal Tax Rate: 40%

Excess Purchase Price: $35MM (For Tax Purposes)

Tax Goodwill Amortization Period: 15 years

Annual Gross Tax Shield: $2.3MM

Annual Cash Tax Shield: $0.9MM (@ 40%)

- Discounted (@ 20%) value to Buyer over 5 years: $2.7MM
- 338(h)10 “Tax Make Whole” payment to Sellers: $100k
- Win-Win for Both Seller & Buyer

Typical M&A Financing Participants

Typical M&A Financing Participants

Senior Debt

Cash Flow (More popular approach)

- Open to “air ball” of no collateral coverage
- Relies on free cash flow & enterprise value to cover loan (e.g. can always be sold to payoff loan)
- EBITDA is critical → lend in multiples of EBITDA
- Higher Interest Rates – Libor plus 4 – 5%
- Higher amortization

ABL

- More traditional
- Requires appraisals of borrowing base and equipment
  - More expensive and time consuming
- Interest Rates – Libor plus 2 – 3% before any “air ball”
- Lower amortization on term loan

Typical M&A Financing Participants

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Mezzanine

- Source of subordinated debt (e.g. below senior debt)
- Key Terms include:
  - Rates – 11-13% with 1-2% PIK
  - Prepayment Penalties
    - Typically year one non-call
    - Then typically 1-3% in years 2 and 3
  - Often want some equity co-investment
    - Often 10% of mezzanine loan amount
  - May require warrants – 2-5% of fully diluted equity
    - Usually only in a “challenging” financing environment
  - Intercreditor Agreement
    - Agreement between senior and mezzanine lenders to lay out the rules in a downside scenario

Typical M&A Financing Participants

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Buyout Equity

- Require majority and board control → can control strategic plan, personnel decisions and exit timing
- Option pool (often 7 - 10% of FDE) to incentivize senior management
- Will utilize a leveraged capital structure
- Often involved over 4 - 7 year period

Growth Equity

- Option to finance an acquisition or major plant expansion if don't want to sell control
- Typically at least one board seat, but no control
- Typically sell 5 - 30% of the FDE
- Negotiation around enterprise value and "buy-in" price
- Equity investor is typically "along for the ride" but sometimes can negotiate a put option to get repaid at certain financial hurdles and/or time periods

Typical Buyout Capital Structure

Typical Transaction Structure

Representative Financial Structure:	Multiple of EBITDA
Senior Debt (Club Deals)	
• *Revolver* • *Term Loans*	2.0x – 3.0x
Mezzanine	0.5x – 1.5x
Total Leverage	2.5x – 4.5x
Equity	
• *Preferred Stock (8%PIK)* • *Common Stock*	2.5x – 3.5x
Total Purchase Multiple	5.0x – 8.0x

Typical Capital Structure

($ in 000's)

PURCHASE PRICE		SOURCES OF CASH		USES OF CASH	
Enterprise Value	$47,967	Revolving Credit	$4,211	Cash to Sellers	$42,990
+ Cash Balance	456	Term Debt - A	8,000	Cash on Hand	0
- Funded Debt Repaid	5,433	Term Debt - B	6,500	Retire Debt	5,433
- Supp Retirement Benefits	0	Subordinated Debt	7,500	Closing Costs	2,244
Equity Value	$42,990	Preferred - MW	20,520	**Total Uses**	**$50,667**
		Preferred - Co-Investor	900		
		Preferred - Mgmt	180		
Enterprise Valuation Multiples:		Common - MW	2,280		
Prior Year EBITDA	7.0 X	Common Stock - Co-Investor	100		
LTM EBITDA	6.4 X	Common - Mgmt	20		
Forward Year EBITDA	6.4 X	Cash & Equivalents	456		
		Total Sources	**$50,667**		

	Pro Forma	FYE 12/31				
	At Close	Year 1	Year 2	Year 3	Year 4	Year 5
Revenues	$74,419	$79,267	$86,618	$92,400	$100,205	$108,221
EBITDA	7,528	7,480	8,782	10,743	12,210	13,698
EBITDA Margin	10.1%	9.4%	10.1%	11.6%	12.2%	12.7%
Interest Expense	375	1,778	3,024	2,984	2,762	2,431
Capital Expenditures	3,270	3,263	2,750	3,000	3,000	3,000
Balance Sheet						
Total Assets	$58,417	$61,929	$62,904	$64,154	$65,743	$67,334
Senior Debt	18,711	22,363	20,808	18,668	15,554	11,150
Total Funded Debt	26,211	29,976	28,652	26,750	23,881	19,730
Shareholder's Equity	24,000	23,608	25,002	27,567	31,204	35,988
Ratios						
Fixed Charge Coverage Ratio		1.5 X	1.4 X	1.5 X	1.7 X	2.3 X
Total Debt Leverage Ratio	3.8 X	4.0 X	3.3 X	2.5 X	2.0 X	1.4 X
Senior Debt Leverage Ratio	2.7 X	3.0 X	2.4 X	1.7 X	1.3 X	0.8 X

Typical Capital Structure

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CAPITAL STRUCTURE				
($ in 000's)				
Debt	At Close	At Close % of Capital	Mult. Of EBITDA	Coupon
Revolving Credit	$4,211	8.4%	0.6 X	5.5%
Term Debt - A	8,000	15.9%	1.2 X	5.5%
Term Debt - B	6,500	12.9%	0.9 X	6.0%
Capex Note	0	0.0%	0.0 X	0.0%
Subordinated Debt	7,500	14.9%	1.1 X	12.0%
Total	26,211	52.2%	3.8 X	
Equity				
Preferred - MW	20,520	40.9%	3.0 X	
Preferred - Co-Investor	900	1.8%	0.1 X	
Preferred - Mgmt	180	0.4%	0.0 X	
Common - MW	2,280	4.5%	0.3 X	
Common Stock - Co-Investo	100	0.2%	0.0 X	
Common - Mgmt	20	0.0%	0.0 X	
Total	$50,211	100.0%	7.3 X	

EQUITY SPLIT & TARGET RETURNS	Equity Split	Target Returns
Revolving Credit		5.5%
Term Debt - A		5.5%
Term Debt - B		6.0%
Subordinated Debt		12.0%
Mason Wells	84.07%	20%+
Mason Wells Co-Investor	3.69%	20%+
Mgmt & Other Employees	10.74%	50%+
(Includes 10% Option Pool)		
Director Options	1.50%	50%+
Sub Debt	0.00%	
Total	100.00%	

Key Legal Terms and Considerations

Key Financing Legal Terms & Considerations

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Senior Credit Agreement from a Borrower's Perspective

- Club deals are preferred over syndicated deals
  - Prefer to know lenders around the table
  - Retain control over lender group
- No pledge of the Fund's securities at the Holdco level
  - Opco vs. Holdco stock pledge
- Avoid covenants that cannot be rendered without an infusion of capital
  - Ex: Minimum EBITDA covenant
- Key covenants typically include:
  - Fixed Charge
  - Senior Debt/LTM EBITDA
  - Total Debt/LTM EBITDA
  - Annual Capital Expenditures Cap

Key Financing Legal Terms & Considerations

<u>Note Purchase Agreement (Mezzanine) from a Borrower's Perspective</u>

- Mezzanine lender should piggyback its agreement off of the senior Credit Agreement
  - Always second to be negotiated
  - Very similar (in many cases identical) definitions
- Typically see 15-20% cushion to the senior Credit Agreement covenants and default levels
- If a warrant is issued under NPA, many of the covenants should terminate when the mezzanine debt is paid off
- Prepayment penalty is a key term and obviously seeks as short a period as possible
  - <2 years is currently market
  - Seek no penalty if want to do a large tuck-in acquisition and need to refinance

Process Timing and Overview of a Buyout Transaction

Overview of Timing: Process of a Buyout

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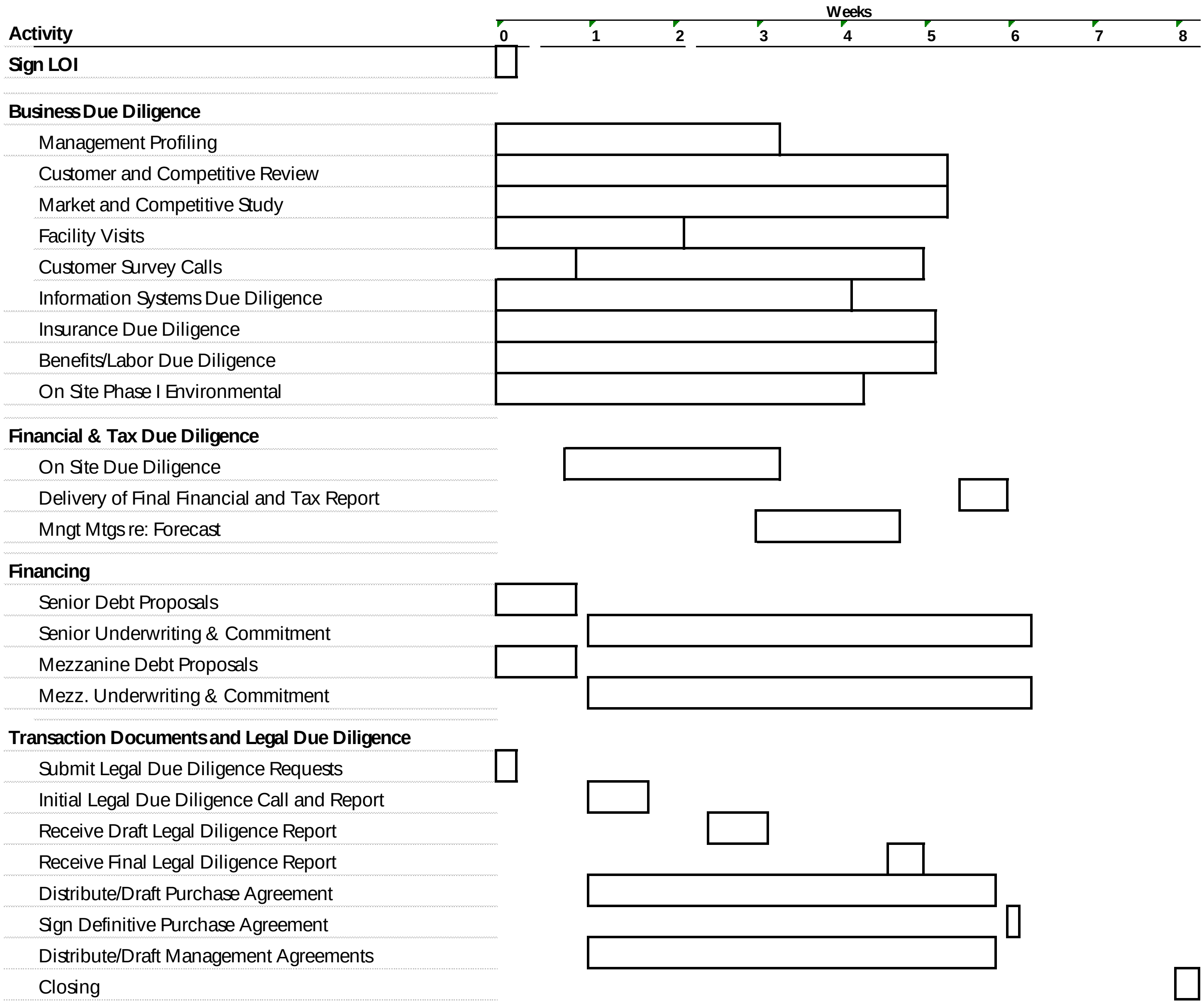

QUESTIONS?