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Recapitalization—The Ideal Liquidity and Value-Enhancing Solution for Entrepreneurs

By Excellere Partners

The Successful Business Owner Challenge – Managing Conflicting Motivations

Building a business is an emotional and personal journey for most entrepreneurs. Typically, entrepreneurs are as proud of the culture they created as they are of their company's financial performance. Their businesses consume their day-to-day lives—whether they're working long, intense hours at their desk or staring at their bedroom ceilings late at night. To build their businesses, entrepreneurs sacrifice family relationships, friendships, health, and other personal needs. In essence, their companies become their babies, and are reflections of the entrepreneurs. It is not surprising, then, that entrepreneurs experience tremendous angst when their personal goals and strategic vision for their companies conflict.

An entrepreneur often experiences the anxiety when contemplating comprehensive estate planning while also exploring strategic planning and ways to grow the business. Growing the business, for example, may require reinvesting hard-earned gains and further postponing already-delayed dividends, and cause the entrepreneur to reflect on other personal interests that may have been forsaken in the business' early life. Reallocating more energy, time, or capital to further grow the business may create seemingly irreconcilable conflicts of interest.

Recapitalization puts cash in the business owners' pockets, enables the owners to retain their roles, and implements strategic resources. At the same time, the management team and culture that built the business' success remains.

Complicating the choice between the entrepreneur's personal needs and needs for the business are the employees who loyally contributed to the business' success and culture. After all, no company of significance and value is built solely by the entrepreneur. Any transformational decision may put at risk the unique culture that helped drive the company's success.

These are some of the challenges faced by the entrepreneur who realizes that the business can survive or even grow without the entrepreneur. That same entrepreneur will also soon realize that an exit plan—operationally and financially—is necessary. The questions are, "When?" and "How?" And the path the entrepreneur chooses may be similar to or unlike paths chosen by other entrepreneurs.

Javelin Technical Training Center – A Real Life Example

Robyn Taylor, CEO and founder of Javelin Technical Training Center, faced similar choices during the fall of 2008. In just seven years, Robyn, and Josh Taves, her business partner, built Javelin from a single campus, IT-focused, non-accredited (and therefore no Title IV) school with 30 students, to a multi-campus, allied health-focused, COE-accredited institution with enrollment of more than 800 students. While Robyn and Josh received attractive annual distributions from the business, most of their wealth was in Javelin, a relatively illiquid asset. A confluence of circumstances, including an evolving regulatory environment, growing families, inquiries from potential acquirers, and realizing that it was time to diversify, put Robyn and Josh at a crossroads experienced like so many entrepreneurs before them, wondering what path was their best choice.

Further complicating their options, Robyn and Josh weren't really ready to relinquish their leadership roles. They were passionate about their business and knew it could grow substantially more. But they also knew that their growth strategy might be dictated by their desire to preserve wealth rather than create wealth. For example, the exciting program and campus expansions they planned required putting their accumulated wealth at risk.

Alternatively, Robyn and Josh considered selling the company. Selling would enable them to diversify their holdings, but they would also relinquish control of the company they built, and they wouldn't benefit from any possible growth. Robyn and Josh were also concerned about the effect of a sale on their employees. Lastly, both partners truly loved what they did and wanted to lead the company to its next stage of growth. They wanted a solution that resolved the conflict between their personal, financial, and strategic objectives.

Thankfully, Robyn and Josh were introduced to Excellere Partners, a Denver-based private equity firm that specializes in creating partnerships with entrepreneurs. Excellere's preferred partnership transaction is a recapitalization. In an Excellere-sponsored recapitalization, the business owners exchange some of their equity for cash, but they continue as owners in the recapitalized business. Recapitalization puts cash in the business owners' pockets, enables the owners to retain their roles, and implements strategic resources. At the same time, the management team and culture that built the business' success remains.

The major benefits of a recapitalization include five key aspects:

(1) Cash – In a typical leveraged recapitalization the cash represents 80 to 90 percent of the total enterprise, depending on how much ownership the sellers want to retain. This cash provides the entrepreneur with financial comfort and removes the growth constraints caused by the concentration of wealth before the sale.

(2) Stock – The remaining portion of the transaction includes stock that provides continued ownership in the recapitalized company. This equity stake aligns the

interests of those selling and the new majority owner.

(3) Growth Resources – A private equity partner provides capital to facilitate the recapitalization and support business growth by investing in organic- and acquisition-related initiatives. With the right partner, an entrepreneur gains the resources and capitalization to achieve the boldest goals.

(4) Employee Ownership – The private equity sponsor and rollover investors provide key managers and employees with equity ownership opportunities as a reward for past efforts and to incent future efforts. Stock programs also encourage managers to think like owners of the business.

(5) Operating Control – The key difference between a buyout and recapitalization is that with recapitalization the private equity sponsor invests capital and strategic resources and the existing management team is obligated and responsible to continue operating the business.

Why a Recapitalization Made Sense for Javelin – Robyn Taylor's Point of View

Prior to my introduction to Excellere, Josh and I didn't know we could meet all of our personal and professional goals through a transaction. I am proud of Javelin. I love coming to work every day, and enjoy the benefits of owning a successful business. However, I knew it was financially responsible to diversify

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About Excellere Partners

Excellere Partners is a Denver-based private equity investment firm, specializing in partnering with middle-market entrepreneurs and management teams to build best-in-class industry leading companies. The source of Excellere's $265 million fund includes the principals of Excellere and a prestigious group of institutional investors that include major pension funds, leading insurance companies and financial institutions.

Employing a proven and highly disciplined middle-market investing strategy, Excellere works in concert with management to build a strong foundation from which to pursue aggressive organic growth as well as selective add-on acquisitions. The focus of this strategy revolves around providing more products, services and/or capabilities to the company's customers while positioning the company for profitable long-term growth (for more information, please visit our website at: www.ExcellerePartners.com).

The founders of Excellere have a proven and successful track record, including more than 50 years of combined experience investing and partnering with entrepreneurs of emerging companies. Additionally, the partners have been involved in 60 acquisitions, while investing approximately $700 million of equity within six core industry areas of focus.

my holdings. Josh and I were very excited about Javelin's direction, and we had several ideas to grow the company significantly. But we were concerned about risking what we already created. There was a strong chance that the anxiety caused by the risk from any major growth initiatives would inhibit us from choosing to grow Javelin. We also knew that we didn't want the business to stagnate. We were far too passionate about growth to become passive owners. We would not be happy holding the business as it is today and just collecting checks. We needed additional capital and strategic resources to realize our vision. In short, we needed a partner with the capital and value-add capabilities to ensure that Javelin would grow successfully.

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– Robyn Taylor, CEO
Javelin Technical Training Center

I had to overcome several preconceived notions about working with a private equity partner. We built our company without using debt and were very concerned about the "leverage" portion of the "leveraged recapitalization" that Excellere proposed. However, I was pleased to know that Excellere's proposal included conservative debt levels that would not stress business operations, but would benefit Excellere's investment and our reinvestment while also providing us the money to support growth initiatives. A significant cash infusion and retaining considerable equity ownership also appealed to me because I was confident we could create tremendous value through this next growth phase. We still have much to accomplish with Javelin, and I don't know if I am the retiring type, so I am happy to continue leading the company. This recapitalization allowed Josh and me to have our cake and eat it too, something we didn't know was available when we began exploring options months ago.

Given that we had one chance to get this right, we set a few "must haves" for a capital partner. Some things were obvious, such as the ability to close a transaction and provide ample capital to continue growing the business. There were other less tangible considerations, such as integrity, ethics, energy, passion for education, added value beyond capital, commitment to fulfill promises and obligations, and personal chemistry with the individuals that we'd work with. Having been through this process and the early stages of a partnership with Excellere, we believe the basics of a transaction, the challenges of transitioning to an investor-owned company, and reporting to a board of directors are simpler with the right partner.

While I could evaluate potential partners through the conversations, dinners, and other interactions throughout the due diligence process, we also chose to speak with management teams that Excellere already partnered with. Those entrepreneurs gave honest answers to my questions and constructive feedback to my concerns about taking on a partner, in particular, Excellere. It was comforting to hear that Excellere had a record of delivering what they promised. We encourage entrepreneurs considering a private equity partner to take the time to speak to fellow business leaders who have partnered with the firm being considered for a transaction.

Excellere's Perspective – Why Javelin was a Great Opportunity

Partnering with Javelin and its founders was attractive to Excellere because Javelin had a proven track record of growing enrollment, providing value to students through strong outcomes, achieving outstanding financial results, and maintaining compliance with its accrediting body and the Department of Education.

Additionally, Robyn and Josh's vision for the business inspired us, and imbued in us significant confidence in their ability to grow the business. And while not all entrepreneurs are prepared for a partner, Robyn and

Recapitalization Mechanics

A recapitalization begins with an agreement between the business' owners and the potential partner about the enterprise value ascribed to the business and the desired ownership structure. Typically, private equity firms value companies based on a multiple of EBITDA (Earnings Before Interest Taxes Depreciation and Amortization), which serves as a proxy for the business' cash flow. After evaluating the business' growth prospects and its track record, leadership, market position, value proposition to students, regulatory compliance, partnership, business foundation, and infrastructure, a multiple is applied to the company's EBITDA to arrive at the enterprise value for the business.

A recapitalization is funded through a combination of cash from a private equity firm, a rollover of a portion of the business owners' existing equity into the recapitalized company, and debt. The component's sum equals the enterprise value that the owners and private equity firm agree to.

Debt in the capital structure allows shareholders to rollover (reinvest) a smaller portion of their cash proceeds into a substantial ownership position in the newly funded company. The structure and proportion depends on the private equity firm. Most private equity firms finance a transaction with as much debt as the market allows, enabling the firms' and the rollover investors to invest a smaller portion of equity for the same level of ownership. Doing so also places additional burden on the management team to manage a highly levered balance sheet, focusing significant attention on paying the debt's interest and principal instead of implementing a growth initiative.

As part of Excellere's dedication to partnering with the management teams Excellere invests in, Excellere employs modest leverage to ensure that management focuses on growing the business and executing the strategic plan—not making burdensome debt payments each month.

Below is an illustrative example of a typical leveraged recapitalization and a recapitalization using Excellere's preferred structure:

EBITDA:	**$5 mm**
Enterprise Value:	**$30 mm**
Continued Seller Ownership:	**40%**

$ millions	Pre Close	Typical Leveraged Recap	Excellere Structure
Enterprise Value	$30	$30	$30
Senior Debt	$0	$15	$15
Subordinate Debt	0	5	0
Sponsor Cash Equity	0	6	9
Cash Proceeds to Seller	0	$26	$24
Seller Equity / Rollover Stock	$30	$4	$6
Total Consideration to Seller at Close	$30	$30	$30

NOTE: This is an example and does not reference any specific company or transaction.

Josh embraced us and the capabilities we offered. Plus, they built a strong team in key areas such as operations and financial aid that can readily support a larger organization.

Javelin also provided an excellent platform on which to build a best-in-class institution providing leading health and wellness programs. Its three Atlanta campuses have an excellent reputation for serving students, and have made Javelin a market leader.

Excellere was excited to help Javelin pursue organic and acquisition initiatives that fit with the strategy to build a best-in-class organization offering health and wellness certificate and degree programs and leading outcomes to students. Moreover, we were delighted to help Robyn and Josh achieve their personal, financial, and strategic objectives and are honored to become partners.

Conclusion – Solution and Success

Selling all or a part of the business is a difficult decision for any entrepreneur. The decision typically has personal and financial implications, making it difficult to choose the best path. Personal and financial motivations are not always aligned with each other and often are in opposition. Many business owners see this decision as binary—sell and walk away or hold and operate the business. Recapitalization that implicitly addresses many of the entrepreneur's professional and personal goals may be an ideal solution. Choosing the right recapitalization partner ensures that the entrepreneur's concerns and goals are addressed and creates a successful future for the entrepreneur and the business.

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