

Liquidity, Growth and Control for Family Businesses During Times of Change

Ownership Transition

Minority Shareholders

Asset Concentration

Estate Taxes

Growth Needs

Acquisitions

More Time For Golf

A Unique Perspective From:

T. Patrick Hurley, Jr.

MANAGING DIRECTOR
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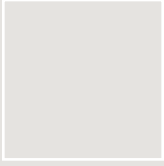
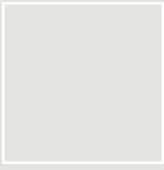
AND

Peter C. Jeton

PARTNER
HERITAGE PARTNERS, INC.



MidMarket
Capital Advisors, LLC



Liquidity, Growth and Control During Times of Change

The Right Combination for Middle Market Companies

Life is good and your business is performing well. The economy is solidly on track and the outlook is healthy. In addition, capital market conditions for private equity and debt are even stronger than you may realize. For these reasons, there may be no better time than *now* to seriously consider the most advantageous ways to deal with ownership issues and concerns you may be facing.

For many founder-controlled businesses that may be contemplating an ownership transition, achieving the right balance of liquidity for shareholders and capital for growth—while retaining management control—is their dream.

The Private IPO® from Heritage Partners, Inc., a leading private investment firm, is viewed by MidMarket as a viable, proven option that offers distinct advantages to founder-controlled firms facing particular circumstances as they consider a business transaction.

In this interview, Patrick Hurley, Managing Director, MidMarket Capital Advisors, and Peter Jeton, Partner, Heritage Partners, discuss The Private IPO® as an example of how middle market companies can take advantage of currently favorable conditions.

The Private IPO®
is an innovative solution
that can balance competing
demands for liquidity,
growth and control
during times of change.



T. Patrick Hurley, Jr.
Managing Director
MIDMARKET CAPITAL ADVISORS, LLC



Peter C. Jeton
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What are the concerns facing founder-owned or family-run businesses that may be on the threshold of transition?

Hurley: CEOs face competing demands and competing constituencies. They want to assure top value and fair treatment for all shareholders without restricting continued growth or requiring painful changes.

Jeton: I broadly agree with Patrick, though Heritage has found, after nearly 20 years of working with family and founder-run businesses that, while the maximization of equity dollars is of primary importance, it is closely followed by other issues unique to family companies. These include minimizing the use of debt, keeping control in the family/founder’s hands and ample funding for continued growth. Also important are the myriad issues associated with employees’ wellbeing, the company’s place in the community, and the often divergent needs of the rest of the family. They express a sincere need for thoughtful input from trusted partners and associates to drive the right solution.

What are some of these tangible and intangible issues and why are they so critical to firms that may be considering a transition of wealth or control?

Jeton: It is important to factor in what we call the human dimension and its impact on the family CEO. Usually, it comes down to the competing yet interwoven demands between the business and the family. From the business perspective, the owner, who usually has 20 to 40 years invested in the business, likely has a reduced appetite for risk associated with continued growth. Access to capital may be needed to fuel this growth, yet the source of this capital is unknown. Capital expansions may be postponed or even cancelled. So all of these things are swirling around in the owner’s head.

Plus, the owner is concerned with the influence and desires of his or her children and non-family managers actively involved in the business, as well the financial wellbeing of inactive family members.

Finally, he or she simply may desire more personal and family time. The owner is probably looking at his or her own legacy and wants to guarantee the best possible financial outcome for continued growth and expansion. What is the next step for the business? Usually the answer is some kind of transaction.

What kinds of transaction solutions are available?

Hurley: There are several common and traditional approaches that can be explored or pursued. These typically include an IPO (initial public offering), a leveraged ESOP (Employee Stock Ownership Plan), a leveraged buy-out, merger, or outright sale. However, these types of transactions often do not take into account the intangible, emotional and often complex issues that owners of family businesses face. The rigidity and terminal nature of these traditional approaches often make them unsuitable for the founder- or family-controlled company.

Challenges and Opportunities

- Monetize Value for Diversification
- Keep Growing for Long Term Potential
- Minimize Debt
- Maintain Control

▶ Example: Business Valued at \$100 Million

The family receives \$85 million after reinvesting \$15 million in the new entity

The family retains voting control through ownership of 51% of common stock
Heritage holds preferred/common stock

Heritage invests \$15 million in preferred stock plus \$15 million for 49% of common stock, and the new entity borrows \$55 million

The family can earn up to 50% economic value based on achieving their projections

How has Heritage Partners learned about and responded to the needs of these family and founder-controlled firms?

Jeton: Heritage Partners built its business exclusively on understanding the needs of family firms. Early on we conducted extensive research that revealed and confirmed the importance of the human dimension. As a result, we've worked only with family owners and their close advisors to provide solutions to the seemingly contradictory issues they face...the issues we are talking about here. The challenge—and the opportunity—resides in addressing the human dimension without weakening the company's growth potential or violating the owner's deep sense of responsibility to the employers, customers, suppliers and the local community.

In 1987, we leveraged our understanding of the needs of family businesses to launch The Private IPO® as an alternative to existing liquidity options. Companies that fit The Private IPO® profile are stable, mature, profitable, privately-held middle market companies with revenues between \$50 and \$300 million, with a minimum EBITDA of \$10 million.

How does the Private IPO® work?

Jeton: In a typical Private IPO® transaction, Heritage will take a significant minority equity position in a company through a substantial investment in common and preferred stock. This allows the owner to achieve several key objectives, including personal liquidity, continued family control of the company, the ability to address generational transition, and creation of a platform for continued growth. Through the transition, Heritage supports the family owner as a strong and committed financial partner.

What are some of the common applications in which The Private IPO® has been particularly effective?

Jeton: A successful Private IPO® depends on the unique circumstances of the particular company. It could be simple disharmony or a lack of family unity, problems with ownership transition, a desire to achieve better work/life balance, minority shareholders seeking liquidity for their illiquid investments, or a need for capital to take the business to the next level.

In general terms, how does The Private IPO® differ from a traditional leveraged buy-out?

Jeton: The big advantage to the family is retaining voting control. Also, the debt levels incurred with The Private IPO® are significantly less than with the LBO. Our research indicated that the high debt levels of the LBOs concern family business owners. Whereas an LBO will usually have total leverage, including both senior and subordinated debt of 4 to 1, The Private IPO® has only 1 to 1 leverage. The other big advantage is the way we structure the economics of the deal or, for the family, "the second bite of the apple." Taking a simple example of a business valued at \$100 million, in a Private IPO®, the family could take out as much as \$85 million while reinvesting \$15 million in the company. Heritage would invest \$30 million, with the balance (\$55 million) coming as a traditional bank loan. For the family's \$15 million, they would get 51% voting control of the company—even though Heritage would have twice the equity at risk that they would—and an opportunity to earn up to 50% of the economic value of the firm—compared with just one-third of the equity that they contributed—at exit. Heritage would exit through a sale to the management, an IPO or a sale to another private equity firm or strategically-aligned company with growth plans.

▶ **Example: Business Valued at \$196 million After Five Years**

Decision is made to recapitalize, IPO or sell Heritage preferred stock redeemed and debt repaid from operating cash flow	The family ownership value of “second bite” is \$98 million or 50% of economic value Initial amount plus \$98 million total \$183 million
Operating profits increased 12% annually Transaction occurs at same multiple as The Private IPO®	Heritage common stock worth \$98 million is 50% of total economic value after preferred and accrued dividends are paid

What are the typical results of companies that have utilized The Private IPO® approach?

Jeton: During the life of the investment, the family/management and Heritage will benefit from continued sales growth. So in addition to the \$85 million received at the original transaction, the owner and management will reap substantial gains in the additional value created when the next transaction takes place and Heritage exits.

How have MidMarket and Heritage combined their respective strengths and expertise to address the unique needs of family businesses?

Hurley: When I first met with Heritage Partners, it was clear we shared the same business philosophy. That was 15 years ago when a client, Klearfold, was introduced to Heritage at a symposium held by MidMarket’s predecessor firm, Howard, Lawson & Co. That transaction became an early example of how successful The Private IPO® can be. The broad concept of the “human” dimension and the importance of being client-focused rather than transaction-focused are embraced by both organizations. MidMarket and Heritage Partners take the time to get to know our clients, their goals and their desires, before there is any discussion about alternative approaches for increasing equity value. We also seek out meaningful partnerships and relationships that are focused on the long-term wellbeing and success of the client. Our mission is to do whatever is right to help our clients be successful. In the types of cases that Peter has outlined, The Private IPO® can be a meaningful tool to achieve this goal.

What can and should middle market companies do as next steps, even if they are just beginning to think about a transition?

Hurley: Owners should begin by outlining the issues that are most important to them and by asking questions about what they want for the business, for their families and for themselves. There must be a realization and acceptance that some flexibility will be required if any third party investors are to become involved and that change may be healthy for everyone. Determining the right kind of change is where MidMarket and Heritage Partners can help. We are ready to assist companies with the best solution, including The Private IPO®, for achieving the right balance of liquidity, growth and control—for the near and long term.

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About MidMarket Capital Advisors, LLC

MidMarket is an independent investment banking firm that provides unbiased, highly-qualified advice to international and domestic private and public middle market companies, boards of directors, owners and related fiduciaries and investor groups.

Our services and approach are built around doing what is best to meet the specific needs and interests of the client. MidMarket is equipped to provide advisory and transactional services in ownership transition, mergers and acquisitions, financing, fairness and valuation analysis, and international trade.

About Heritage Partners, Inc.

Heritage Partners, with \$1.4 billion in capital under management, is the leading private investment firm specializing in the acquisition and equity-based recapitalization of private, family-owned businesses. Since 1987, the Partners have assembled a diversified portfolio of nearly 70 investments with aggregate revenues exceeding \$2.0 billion.

Heritage's fundamental objective is to invest preferred and common stock, on a minority or majority basis, in mature, successful manufacturing, distribution and service companies with revenues of \$50 million to \$500 million.

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