How Executives Successfully Partner With Private Equity

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Introductions--Who am I?

Jeff Gonyo

- Nearly 25 years of private equity experience
  - Co-Founder & Managing Director – Geneva Glen Capital
  - Managing Director – Wind Point Partners
  - Vice President – Heller Investments
  - Investment Professional – GTCR
- Previously Senior Strategy Consultant with E&Y; CPA with Price Waterhouse
- Have completed over 100 acquisitions (incl. add-ons)
- Industry generalist with expertise (representative prior investments) in:
  - Business Services (office equipment dealers, coin-operated vending)
  - Consumer Products (outdoor nursery products)
  - Healthcare (air medical transportation, outpatient physical therapy)
  - Industrial manufacturing (ceramic coated steel, chemicals, playground equipment)
- MBA Northwestern; BS with Honors from Indiana University

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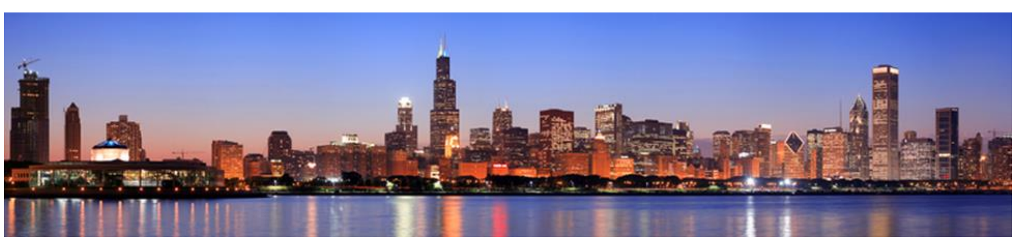
Who Is Geneva Glen Capital?

- Geneva Glen Capital ("GGC") is a Chicago-based private equity firm that invests in lower middle-market companies (generally below $100M in value)
  - EBITDA $3 - $20 million
  - Invest up to $40 million in proven private companies with leading market positions, significant growth potential, and stable cash flows
- Unique Fund Structure
  - Able to be long-term investors, as appropriate ,due to having <u>no funding horizon</u>
  - Use of conservative leverage – not focused on IRR but more on cash-on-cash returns
  - Able to "recycle" proceeds, aren't distracted with fundraising activities
- Strategic relationship with lead investor provides global capabilities when beneficial
  - Wanxiang is a privately-owned company with approximately $22 billion in worldwide revenues across many industries and geographies; 2nd largest privately-held business in China.
- Draw from our stable of seasoned operating executives with domain expertise
  - CEO
  - Active Chairman
  - Board member/Diligence Resource



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Why Are We Here?

- Private Equity has become very efficient over the past 25 years
  - Over 2,000 PE firms today, creating ample competition
  - Intermediaries are more plentiful, sellers more sophisticated in understanding their liquidity options. Truly proprietary deals harder to find ➔
  - In 1990 target PE returns were 35%+; now 20-25% is the norm
    - Financial engineering was the primary driver of returns during the "gold rush" years
    - Today more "heavy lifting" is required to enhance the growth plan to achieve returns
    - A strong executive "angle" with unique deal insight and value creation ability is paramount for successful returns
- Seasoned executives becoming more aware of Private Equity
  - Tremendous career opportunities for entrepreneurial-minded executives
  - Goal is for us mutually to "have fun and make money"
- Tonight, hope to shed some light on the PE-Executive partnership

Why Partner with a Private Equity Firm?

- Big Money $$$ (Potentially very lucrative)
  - Usually management earns an incentive stake of 5-15% of the company. May be tied to performance or simply time vested.
  - Financial leverage (debt pay-down) partly drives returns, but 5-20% annual growth of EBITDA needed to get the required results (of course depending on purchase price)
  - Upside often comes from arbitrage by acquiring smaller companies and selling at higher exit multiple.

- Opportunity to run your own show
  - Yes, you will still have a boss but most of us are “deal guys” and want to move on the next deal and interests are closely aligned
  - Of course, if things don’t go well we (and the lenders) will get much more involved
  - We like CEOs who can build a team with prior lieutenants

- Yes, PE firms can add value
  - Draw upon deep experience from numerous prior investments
  - Insert accomplished board members or advisors with relevant industry or operating experience
  - Handle much of the lender relationships (with the CFO too)
  - Know-how to get deals done including add-ons
  - Extensive contacts with service providers and advisors

Before you get too excited though, consider…

- There is some luck involved in finding a deal—need perseverance
  - It’s a “numbers game”
  - PE firm may review a +1,000 opportunities, yet only invest in a few deals a year
  - Could take years to find a deal; “hot” target could “die” after 6-9 months of “free” work

- Are you open to relocation?
  - Shows commitment and increases odds of finding a matching deal
  - Commuting is suboptimal at best; hard on you and your family, sends a mixed signal to employees; commuting time zaps CEO productivity—careful consideration for all

- PE firms will want some “skin in the game”
  - The absolute dollar amount isn’t important; but meaningful amount of liquid net worth
  - You should expect to make 3-4x this co-invested capital if things go to plan but could lose it all if company unsuccessful

- Be prepared for detailed requests for information
  - “Proctology exam” during due diligence for PE firm and lenders to gain comfort with the deal
  - Post-closing, usually quarterly board meetings and monthly operating calls

- While more autonomy, not necessarily more job security
  - Company may need a different skill set if company performance suffers for prolonged period—PE firm/lenders may push for turnaround artist to stem the bleeding
  - PE firm will seek liquidity at some point (5 years avg) and the next buyer may not need you.

What do PE firms look for in CEOs?

- Consider the 11/19/07 WSJ article ”Tough CEOs Often Most Successful”
  - Traits that matter….
    - Persistence
    - Attention to detail
    - Efficiency
    - Analytical Skills
    - Setting high standards
  - Traits less so of importance
    - Strong oral communication
    - Teamwork
    - Flexibility/adaptability
    - Enthusiasm
    - Listening Skills

- Generally would agree but for PE would also emphasize the following critical abilities/qualities:
  - Thinks strategically, like an investor, to identify value drivers to increase EBITDA, reduce working capital invested in the business, and deploy capital in high ROI projects
  - Hands-on, multi-tasking operator, without need for a big staff
  - Recruits high performers in key lieutenant positions
  - Nimble and able to make quick, yet thoughtful decisions
  - Recognizes the power of financial leverage, understands the financial model and importance of financial covenants (critical for the CFO)
  - Selling skills—key customers, lenders, and ultimately a buyer for the business
  - Acquisition and deal making skills important if big driver of growth but PE firm can augment

How do I get one of these PE CEO gigs?

- Ways to participate
  - CEO of new investment
    - Ideal way to get involved but “stars need to align”
    - Retainer and exclusive or non-exclusive and independent?
  - Hired gun to fix a troubled portfolio business or fill a vacancy
    - Riskier but often lucrative and short term stint
  - Chairman/Active Board member
    - Useful when strong incumbent CEO in place
  - Operating Partner of the PE firm itself
    - Need clear definition of role vs. incumbent portfolio company management

- How to break in?
  - Warm introduction from someone who knows the firm is best
  - Direct mailing/LinkedIn to PE firm with resume emphasizing industry/ special skills
    - Try to identify the partner who has the most relevant industry experience
  - Search firms
  - Having an actionable deal to present gets immediate attention

- Be prepared to:
  - Develop your own criteria of deals targeting your sweet spot
  - Spend months getting to know the firm and going through their extensive diligence process of multiple interviews, reference checks and sometimes an industrial psychologist review
  - Work for “free” or at least contingent if related to a new deal
  - Invest a significant amount of personal capital (“skin in the game”)

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What should you look for in a PE firm?

- Track record of success
  - Ask how their returns have been on an absolute basis and relative to their peers
  - Great reputation as a firm and/or as individuals
    - Ask for references from current and former execs, former employees

- PE domain knowledge in your industry of expertise very helpful but not critical
  - Ask what deals they have done in your space?
  - Outside advisors and consultants often employed in due diligence to understand issues

- Willingness to find a deal for you
  - What is the understanding of who will find the deal—you, them, both?
  - Are you getting senior level attention?
  - What resources will they dedicate in research and finding a deal?
    - Advisors
    - Internal staff
    - Outside intermediaries
  - Develop your own specific investment criteria, leveraging your operating strengths and knowledge of particular markets to create a road map

- Good working chemistry
  - Will be spending lot of time together
  - Feel like a partner vs. an employee?
  - Is the hard work all about creating value or more bureaucracy?

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GGC Executive Partners Strategy

- We work alongside accomplished operating executives to identify opportunities where you can become either:
  (1) a part-time advisor, co-investor and/or board member, or
  (2) a full time executive with a company as CEO, CFO or other ongoing senior role.

- We help you develop your own specific investment criteria, leveraging your operating strengths and knowledge of particular markets to create a specific value-creation plan.

- We work closely with you throughout the entire investment process, including:
  - Identifying and evaluating potential investment targets
  - Development and execution of strategic growth plan
  - Investment realization

- We search for the following characteristics in our prospective Executive Partners:
  - Successful track record in growing EBITDA and creating shareholder value
  - Able to spend time searching for deals; often "in transition"
  - Willing to roll up sleeves in smaller company situations
  - Strong domain knowledge, i.e. ability to understand dynamics with markets, customers, and vendors
  - Full P&L experience of at least $150M in revenues with knowledge across all functions including sales and marketing, operations and finance

- The benefits that we offer to our Executive Partners:
  - Tap into the GGC deal sourcing network
  - Opportunity to own a significant stake in a business and generate substantial personal wealth
  - Leverage skill set and domain expertise in a well capitalized, industry leading company with the support of a seasoned investment group and a patient and flexible capital source

GGC Executive Partners Process

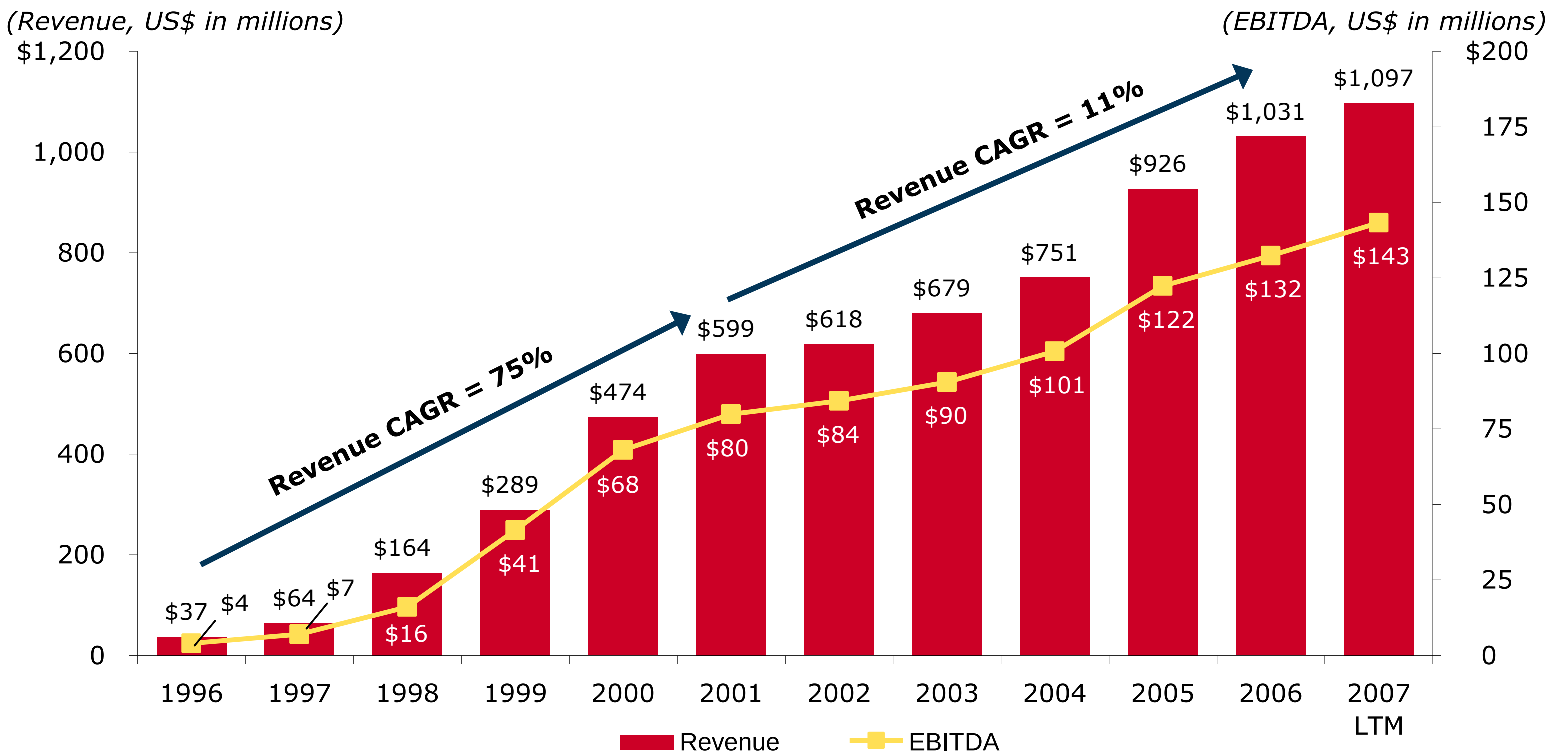
- Phase I: Determine if there's mutual interest
  - Understand the goals and objectives of the potential Executive Partner
  - Appreciate the executive's accomplishments and special skill sets; such as organic growth, cost cutting, acquisitions, start-ups, etc.
  - Walk through economics, time and financial commitments
    - It is important for both GGC and Executive Partner to personally invest in each deal
    - Tentatively agree upon key employment terms

- Phase II: Source the initial acquisition
  - Mutually establish a very specific criteria of both (a) type of business and (b) situation
  - Reach out to our extensive network of investment bankers, intermediaries, lenders and sources for potential targets
  - Employ "Rifle Shot" approach by directly calling specifically identified "high potential" candidates
  - Attend trade shows and either industry networking events/conferences together

- Phase III: Negotiate and complete the initial acquisition
  - Agree on a reasonable valuation for the acquisition and sign a Letter of Initial Interest to ensure exclusivity on the Seller's behalf
  - Using our third party resources, we will work side-by-side to complete due diligence
  - Arrange financing

Executive Case Study: Global Imaging Systems

- In 1994, identified the office equipment dealership industry as ripe for consolidation.
- Cold called Tom Johnson, the former #2 executive at two large industry players, with an eye to build a sizable company through acquisition and jointly co-founded Global Imaging Systems in 1994
- After six months of searching, acquired our first company with $6M of revenue.
- Acquired over 100 other companies over the next 13 years and completed an IPO in 1998 before selling to Xerox for $1.5B in 2007. Original equity grew 20x in value.
- Revenue of the company exceeded $1 billion dollars in 2006.



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Buyout Equity Economics 101

Direct Investment and Incentive Equity Plan

- Executive's direct investment is made side-by-side with GGC in the same securities and on the same economic terms
  - Direct investment is made into preferred units ("Preferred Base Amount")
  - Preferred units bear a 10% dividend rate, which compounds quarterly and accrues until the sale of the company (the "Preferred Return")
  - Preferred units also benefit significantly from value creation of the enterprise akin to common stock ("Preferred Distribution")

- Incentive equity pool participates in the residual value of the company after Preferred Base Amount and Preferred Return are paid off
  - Wealth creation vehicle for existing members of the management team to share in the future success of the company

- Incentive units generally receive capital gains tax treatment upon exit (under current tax law)

- Incentive units vest over 5 years
  - All units automatically fully vest if exit occurs prior to 5th anniversary

Direct Investment and Incentive Equity Plan

- Example capital structure assuming a $70 million purchase price, capitalized with 60% debt and 40% equity
  - Example 7.0x purchase price on a company with $10 million EBITDA
- Debt (60%)
  - 3.5x senior leverage, 4.35x total leverage
  - Senior debt 6% interest rate
  - Mezzanine 13% (11% cash, 2% PIK)
- Equity (40%)
  - Preferred – GGC, management, co-investors

SOURCES OF FUNDS

Sources	$000s	Multiple of EBITDA	% of Capital
Term loan	35,000	3.50 x	48.3%
Mezzanine	8,500	0.85 x	11.7%
Equity	29,000	2.90 x	40.0%
Total Sources	**$72,500**	**7.25 x**	**100.0%**

USES OF FUNDS

Uses	$000s
Purchase Price	70,000
Fees & Expenses	2,500
Total Uses	**$72,500**

Components of Equity Value Creation

- As EBITDA grows, the value of the enterprise increases
  - Example growth drivers:
    - Increase sales with current customers
    - Introduce new products
    - New customer penetration
    - International expansion
    - Improve margins through cost reductions
    - High ROI capital investments

- At the same time, debt is repaid from company cash flow
  - Maximizing cash results in accelerated debt pay down and enhanced equity value
  - Revolving credit facility and free cash flow provide funds for organic growth

- Complementary add-on acquisitions

- Multiple expansion due to larger scale, more diversified business at exit

Value Creation – Organic Case

Example Projections

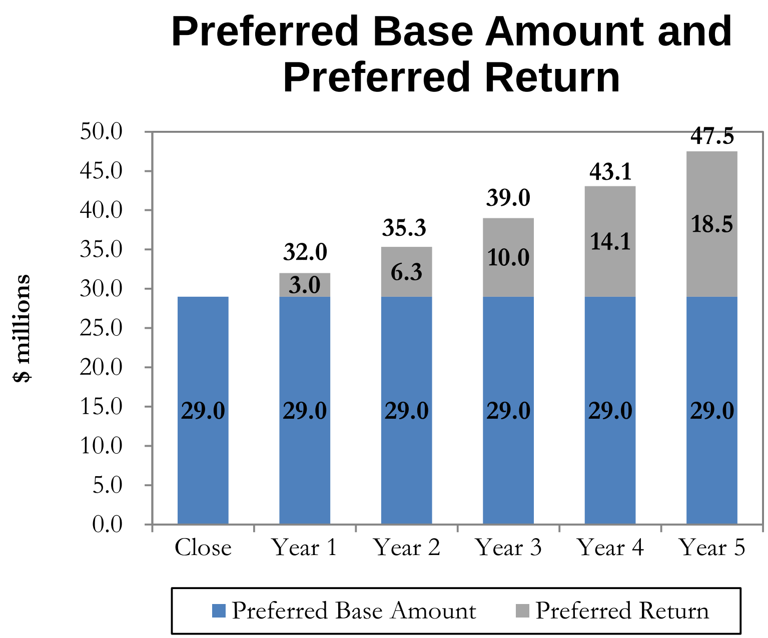
- Example organic projections are summarized below
  - 10% revenue growth, modest margin enhancement = 12% EBITDA CAGR over 5 years
  - Acquisitions are not included in this example

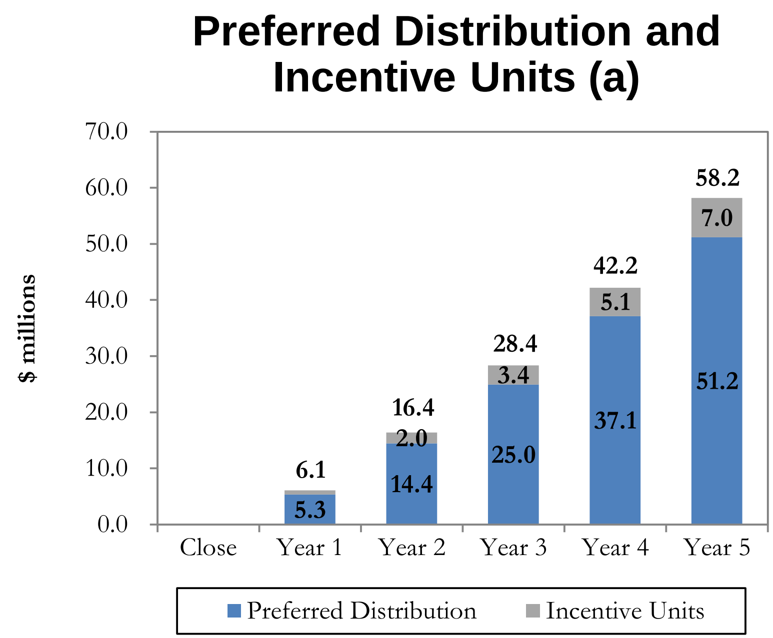
	Projections						CAGR
	@ Close	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	***5 Years***
Revenue	$50.0	$55.0	$60.5	$66.6	$73.2	$80.5	***10.0%***
growth		*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	
EBITDA	$10.0	$11.2	$12.5	$14.0	$15.7	$17.6	***12.0%***
margin	*20.0%*	*20.4%*	*20.7%*	*21.1%*	*21.5%*	*21.9%*	
Net debt (a)	$43.5	$40.1	$35.9	$31.0	$25.0	$17.9	

(a) Debt balance is shown net of excess cash

Significant Value is Created

- Debt paid down
- Preferred Base Amount and Preferred Return get paid off
- Residual value falls to Preferred Distribution and Incentive Units





(a) Values shown here assume no multiple arbitrage at exit

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Liquidity Analysis

- Equity waterfall
  - Preferred Base Amount
  - Preferred Return
  - Remaining cash is distributed pro rata to preferred units (88%) and incentive units (12%)

Valuation Summary at Exit ($ millions)

Exit multiple	7.00x	8.00x	9.00x	10.00x	
EBITDA	17.6	17.6	17.6	17.6	
Enterprise value	123.4	141.0	158.6	176.2	
Cash	0.1	0.1	0.1	0.1	
Debt	(17.8)	(17.8)	(17.8)	(17.8)	
Equity value	105.7	123.3	140.9	158.6	
Equity waterfall:					Notes
Preferred Base Amount	29.0	29.0	29.0	29.0	Equal to capital contribution at close
Preferred Return	18.5	18.5	18.5	18.5	10% return, compounded quarterly
Remaining Available Cash	58.2	75.8	93.4	111.1	
Preferred Distribution	51.2	66.7	82.2	97.7	Equal to 88% of "Remaining Available Cash"
Incentive Units Distribution	7.0	9.1	11.2	13.3	Equal to 12% of "Remaining Available Cash"

Note: Exit assumed to occur at the end of year 5

Direct Investment and Incentive Value at Exit

Direct Investment: $100K example ($ thousands)					
Exit multiple		7.00x	8.00x	9.00x	10.00x
Value at close					
Preferred Base Amount	$100				
Value at exit					
Preferred Base Amount		$100	$100	$100	$100
Preferred Return		$64	$64	$64	$64
Preferred Distribution		$177	$230	$284	$337
Total		**$340**	**$394**	**$447**	**$501**
Returns					
IRR		27.8%	31.5%	34.9%	38.0%
Cash-on-cash		3.40x	3.94x	4.47x	5.01x

Incentive Units: 1.0% Example				
Exit multiple	7.00x	8.00x	9.00x	10.00x
Value at exit				
Incentive Distribution	$582	$758	$934	$1,111

Note: Exit assumed to occur at the end of year 5

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Value Creation – Acquisition Case

Example Projections

- Same projections used for organic growth
- Assumed to acquire $1 million of EBITDA each year
  - Add-on acquisitions completed at 5x purchase multiple
- Capital structure
  - Assume acquisitions are financed with 100% debt

	Projections						CAGR
	@ Close	Year 1	Year 2	Year 3	Year 4	Year 5	*5 Years*
Revenue - organic	$50.0	$55.0	$60.5	$66.6	$73.2	$80.5	***10.0%***
growth		*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	
Revenue - acquisitions	-	$5.0	$10.2	$15.6	$21.2	$27.1	
Total revenue	$50.0	$60.0	$70.7	$82.2	$94.4	$107.6	***16.6%***
EBITDA - organic	$10.0	$11.2	$12.5	$14.0	$15.7	$17.6	***12.0%***
margin	*20.0%*	*20.4%*	*20.7%*	*21.1%*	*21.5%*	*21.9%*	
EBITDA - acquisitions	-	$1.0	$2.1	$3.4	$4.5	$5.7	
Total EBITDA	$10.0	$12.2	$14.7	$17.4	$20.3	$23.3	***18.4%***
margin	*20.0%*	*20.3%*	*20.8%*	*21.2%*	*21.5%*	*21.6%*	
Net debt (a)	$43.5	$45.3	$46.1	$45.6	$43.9	$40.7	

(a) Debt balance is shown net of excess cash

Liquidity Analysis

- Equity waterfall
  - Preferred Base Amount
  - Preferred Return
  - Remaining cash is distributed pro rata to preferred units (88%) and incentive units (12%)

Valuation Summary at Exit ($ millions)

Exit multiple	7.00x	8.00x	9.00x	10.00x	
EBITDA	23.3	23.3	23.3	23.3	
Enterprise value	163.0	186.3	209.6	232.9	
Cash	0.1	0.1	0.1	0.1	
Debt	(40.8)	(40.8)	(40.8)	(40.8)	
Equity value	122.3	145.6	168.9	192.2	
Equity waterfall:					Notes
Preferred Base Amount	29.0	29.0	29.0	29.0	Equal to total capital contributions
Preferred Return	18.5	18.5	18.5	18.5	10% return, compounded quarterly
Remaining Available Cash	74.8	98.1	121.4	144.7	
Preferred Distribution	65.8	86.3	106.8	127.3	Equal to 88% of "Remaining Available Cash"
Incentive Units Distribution	9.0	11.8	14.6	17.4	Equal to 12% of "Remaining Available Cash"

Note: Exit assumed to occur at the end of year 5

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Direct Investment and Incentive Value at Exit

Direct Investment: $100K example ($ thousands)					
Exit multiple		7.00x	8.00x	9.00x	10.00x
Value at close					
Preferred Base Amount	$100				
Value at exit					
Preferred Base Amount		$100	$100	$100	$100
Preferred Return		$64	$64	$64	$64
Preferred Distribution		$227	$298	$368	$439
Total		**$391**	**$461**	**$532**	**$603**
Returns					
IRR		31.3%	35.8%	39.7%	43.2%
Cash-on-cash		3.91x	4.61x	5.32x	6.03x

Incentive Units: 1.0% Example				
Exit multiple	7.00x	8.00x	9.00x	10.00x
Value at exit				
Incentive Distribution	$748	$981	$1,214	$1,447

Note: Exit assumed to occur at the end of year 5

Any Questions?

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