

There Are Options Other Than Selling Your Company – Recapitalizations

When business owners feel the need to reduce their risk of having so much of their personal wealth tied up in a privately held company, but are reluctant to sell the entire company, a recapitalization or partial sale (“recap”) might be the solution. In simple terms, a recap is a transaction that allows business owners to sell a portion of their company to a financial partner who infuses capital into the company, allowing the owner to partially cash out of the company and still retain some ownership. The retained ownership allows the owner to participate in the future of the company, teaming with an experienced financial partner capable of investing growth capital for expansion.

Recaps are a way to infuse the company with cash, without the seller giving up all their ownership, which could be worth substantially more as the environment improves and/or the company grows. Recaps create liquidity; i.e. cash for the owner/seller, but allow for upside potential, thus permitting the seller “two bites at the apple” when the company is subsequently sold.

A recapitalized company can also allow entrepreneurs to be more aggressive, since their personal wealth is no longer solely tied to the company. As a result, the aggressively grown company often becomes ripe for a future acquirer that will pay a proportionally higher price.

Advantages of Recapitalization

A properly structured recap with the appropriate financial partner can provide a business owner with additional flexibility and a broad range of advantages, both personal and financial, including the following:

1. **Immediate Cash** – A portion of the market value of the company will be paid at closing. This enables the owner to diversify his or her net worth, realize other business or personal goals, or pursue a lifestyle of change.
2. **Ownership Retention** – Retained equity in the company ensures a financial stake for the owner in the future of the company.
3. **Experienced Financial Partner** – The company will gain a financial partner and investor. These investors are often experienced in assisting entrepreneurs in realizing their ultimate and long-term goals for the company.
4. **Operating Control** – As the focus of the financial partner is on the future of the business and potential return on investment, their primary interest is supporting management in achieving significant growth and profitability. The owner, on the other hand, often retains control of managing day-to-

day operations and plays a key role in the implementation of growth strategies.

5. **New Equity Capital** – After years of taking risks to grow the company, entrepreneurs tend to become more conservative in their decision-making and reluctant in their actions — understandably so. Despite this, they know the potential of their company and understand what is necessary to reach that potential. The infusion of capital allows the owner to concentrate on growing the company backed by more financial resources.
6. **Two-Step Strategy** – Often referred to as “two bites of the apple”, a recap presents a business owner with the opportunity to get paid twice, but potentially even more than in a conventional M&A transaction. The second payout will occur after the company has achieved a desired level of growth and increased value that will often proportionally exceed the “first bite”.
7. **Corporate Culture** – A recapitalization can allow the image and corporate culture of the company to improve.

Financial partners and private equity groups (PEGs) vary substantially in their expectations, motives, strategy and culture. The partner selected by the owner will have a significant influence on the future of the company. Therefore, the owner should carefully choose the financial partner that will be the right fit.

The key is to have the ability to choose the financial partner that not only offers the best deal for the owner with the “first bite at the apple” but also shares a similar culture and vision as an operating partner, such that the “second bite at the apple” is proportionally better than the first.

About Flatirons: Flatirons Capital Advisors, LLC (www.flatironscap.com) is an investment banking firm that helps privately held companies sell their businesses, acquire other businesses, and raise capital. Our services include accomplishing mergers and acquisitions, obtaining financing, sourcing loans for distressed or bridge finance situations, and financial restructuring. Our unique business model affords sell-side advisory clients the ability to improve their company’s performance, earnings and effectiveness in the short-term, while simultaneously increasing their market value for a future sale. Flatirons has offices in Colorado and Texas.

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