Who Should Own Your Business After You?

Who Pays?
Funding the Transition to Employee Ownership

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Investment Bankers

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Summary

- This presentation will focus on the financing of initial ESOP transactions (leveraged ESOP buyouts)
- As can be expected, financings for initial ESOP transactions vary in terms and conditions, depending on the nature of the lender
- The major players within ESOP finance have traditionally been commercial banks with dedicated ESOP lending groups
- The universe of potential lenders has expanded to non-bank credit institutions, providing greater variety in the types of credit facilities available, and their respective terms and conditions

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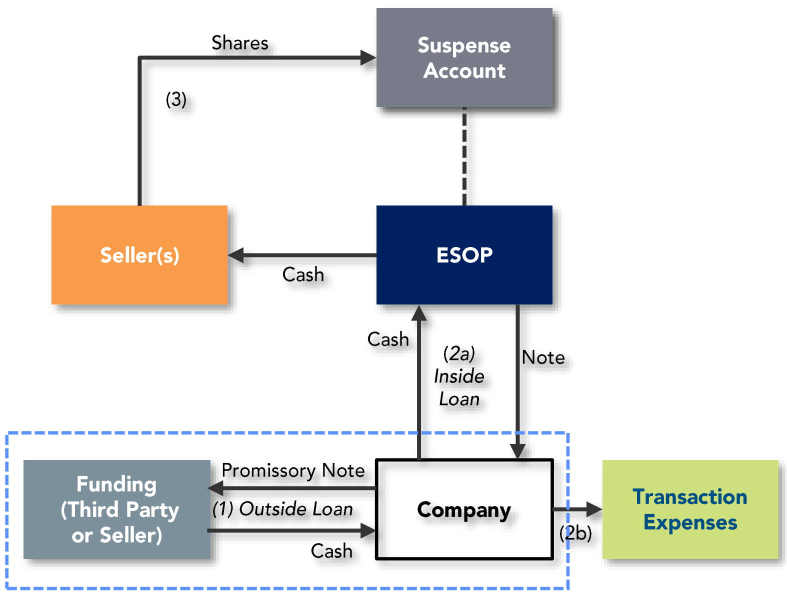
Leveraged ESOP Transaction Illustration

INITIAL ESOP SALE TRANSACTION



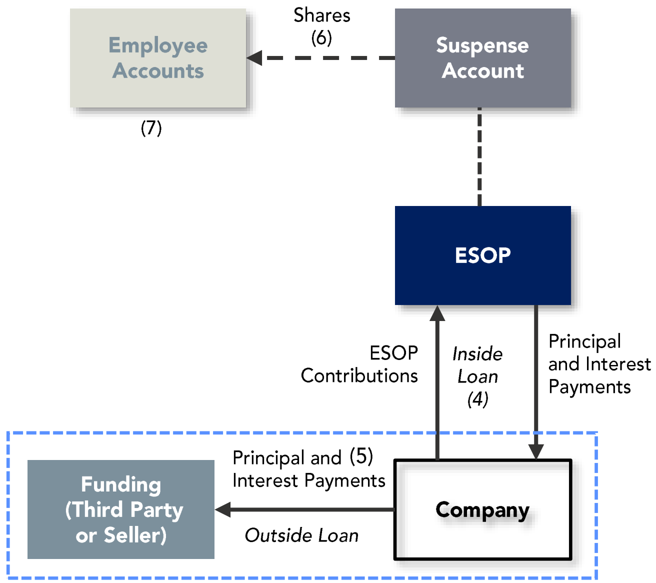
1. The company borrows money from a lender (Outside Loan)

2a. The company lends the borrowed funds to the ESOP (Inside Loan)

2b. Company pays transaction expenses

3. The ESOP uses the borrowed funds to purchase the Company's stock

ONGOING ANNUAL MAINTENANCE



4. The company makes tax-deductible contributions to the ESOP, which in turn pays back the Inside Loan
5. The company then uses the funds to pay the Outside Loan
6. As the Inside Loan is repaid, stock is released from the suspense account and is credited to individual employee accounts
7. Once credited with shares, a participant in the ESOP (employee) has a beneficial interest in the present and future equity value in the Company subject to such vesting and eligibility rules as defined in the ESOP Plan document

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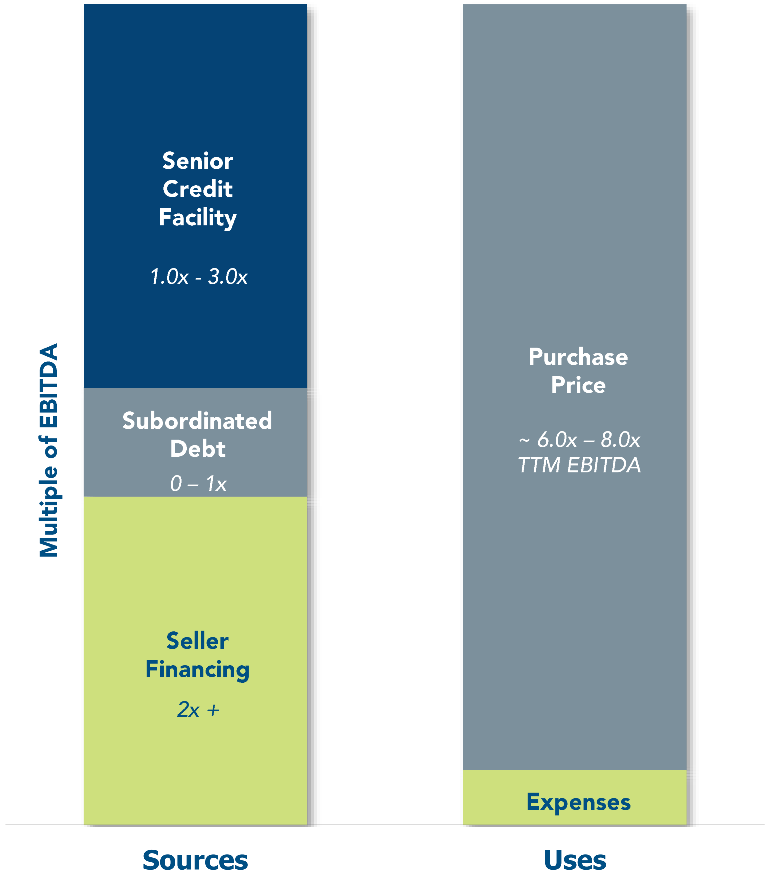
How Are Initial ESOPs Financed?

In sourcing debt capital for a leveraged ESOP transaction, options range from traditional commercial bank lending to innovative solutions such as credit fund financing, subordinated financing, or hybrid structures



- Most ESOP transactions are leveraged
- Senior bank credit is the least expensive source of debt
- Unitranche debt is likely an option
  - The interest rate required for uni-tranche and subordinated financing is higher than senior financing and is a trade off for more flexibility
- Seller financing can have unique structural elements (warrants, payment-in-kind)
- Seller financing returns may be difficult to replicate in public markets

SELECTED CAPITAL SOURCES

BMO Harris Bank, Fifth Third Bank, Comerica, J.P.Morgan, Regions, Academy Bank, BB&T, First, PNC, Wells Fargo, Wintrust, Associated Bank, Bank of America, usbank

Capitala, THL Credit, Monroe Capital, Crestline, Graycliff Partners, Saratoga Partners, PennantPark, H.I.G. Capital, Prospect Street Capital, Comvest Partners, CVC Capital Partners

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Senior Financing: Commercial Bank

FINANCING MULTIPLE	▪ ~2-3x LTM EBITDA for Companies with EBITDA <$5MM; ~3-4x LTM EBITDA for EBITDA >$10MM
INTEREST RATE	▪ Floating rate interest; typically tied to LIBOR with spread in basis points (L + 500bps); NYFED SOFR increasingly used as an alternative; Likely subject to a reference rate floor; Can swap to fixed rate
FACILITIES	▪ Revolving credit facility for ongoing working capital needs ▪ Term credit facility to finance the transaction
MATURITY / AMORTIZATION	▪ Maturity typically 3-5 years ▪ Amortization typically 5-7 years; Possibly variable amortization (10%, 10%, 20%, 30%, 30%)
FEES	▪ Commitment fee typically of 50 bps; undrawn revolver fee
PREPAYMENT	▪ Borrower may prepay the Senior Credit Facilities in whole or in part at any time without premium or penalty
EXCESS CASH FLOW SWEEP	▪ Typically tiered to leverage with step-downs
REPORTING REQUIREMENTS	▪ Reviewed financials, quarterly covenant testing ▪ Repurchase studies, 409(p) analysis
COVENANTS	▪ Minimum Consolidated Fixed Charge Coverage Ratio ▪ Maximum Consolidated Senior Leverage

Credit Fund: Unitranche/Subordinated

FINANCING MULTIPLE	▪ ~3-4x LTM EBITDA; or ▪ Additional 1-2x subordinate to bank financing
INTEREST RATE	▪ Can be fixed or floating rate interest, and higher than bank terms
FACILITY	▪ Term credit facility to finance the transaction
MATURITY / AMORTIZATION	▪ Longer maturity than bank financing ▪ Low amortization of 1-10% per year
PREPAYMENT	▪ Customary prepayment premium of 3%, 2%, 1%, if prepaid during year 1, 2, 3, respectively
EXCESS CASH FLOW SWEEP	▪ Typically tiered to leverage with step-downs
FEES	▪ Commitment fee typically of 2%
REPORTING REQUIREMENTS	▪ Reviewed financials, quarterly covenant testing
COVENANTS	▪ Looser covenants than bank: Lower minimums and higher maximums ▪ Minimum Consolidated Fixed Charge Coverage Ratio ▪ Maximum Consolidated Senior Leverage

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Comparison of Funding Characteristics

BANK	CHARACTERISTIC	CREDIT FUND
	FINANCING MULTIPLE	✓
✓	INTEREST RATE	
✓	FACILITY	
	MATURITY / AMORTIZATION	✓
✓	PREPAYMENT	
✓	EXCESS CASH FLOW SWEEP	
✓	FEES	
	REPORTING REQUIREMENTS	✓
	COVENANTS	✓

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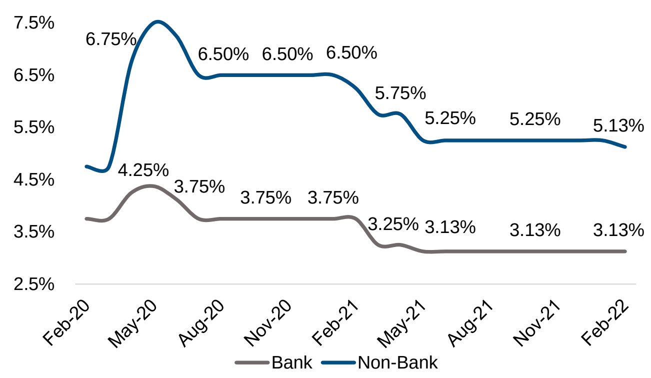
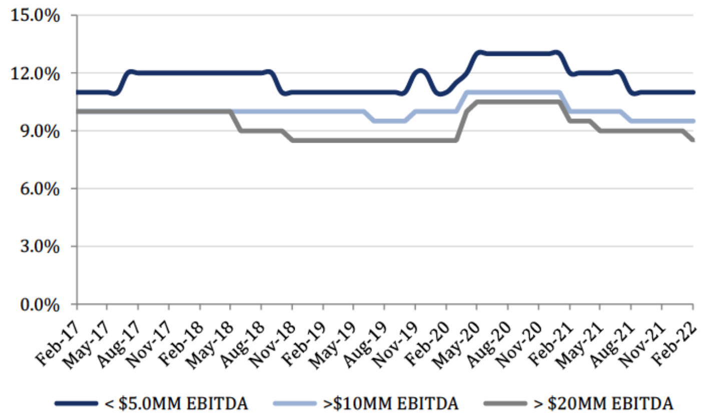
ESOP

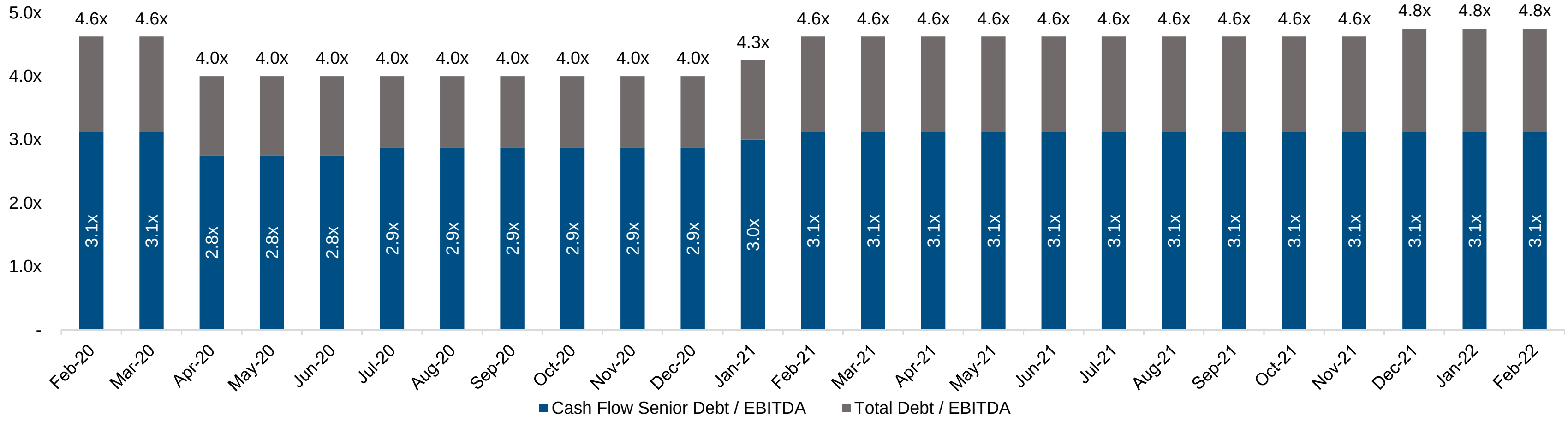
Capital Markets Conditions

Senior Cash Flow Pricing (Spread To Libor)



Historical Subordinated Debt Pricing





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Source: SPP Capital "Middle Market Leverage Cash Flow Market at a Glance." Leveraged Commentary & Data (LCD)

Source: SPP Capital Partners: "Market At A Glance"; S&P Global Leveraged Commentary & Data Loan Stats ; PWC Capital Market Insights ; Alpha Week (Jan. 2021): "Agecroft Partners Predicts 2021 Will Be One Of The Best Capital Raising Environments For Hedge Funds In Years"

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Illustrative Leverage Ratios

In the illustrated transaction, [Company] demonstrates significant deleveraging through the projection period

($ in thousands)	**2020B**	**2021**	**2022**	**2023**	**2024**	**2025**
Adjusted EBITDAE	$ 31,903	$ 36,616	$ 40,113	$ 42,119	$ 44,225	$ 46,436
(+) Depreciation & Amortization	304	330	330	346	363	382
(-) Capital Expenditures	-	-	-	-	-	-
(-) Incremental Working Capital	-	-	-	-	-	-
Adjusted Free Cash Flow	**$ 32,207**	**$ 36,945**	**$ 40,443**	**$ 42,465**	**$ 44,588**	**$ 46,818**
Cash Interest Expense	20.1	19.7	18.9	18.1	17.1	16.1
Scheduled Principal Payments	5.6	5.6	5.6	5.6	5.6	5.6
Total Fixed Charges	**25.7**	**25.3**	**24.5**	**23.6**	**22.7**	**21.7**
Total Debt (Total Funded and Seller)	223.3	214.9	205.4	195.2	184.3	172.5
Total Debt / EBITDAE	**7.0x**	**5.9x**	**5.1x**	**4.6x**	**4.2x**	**3.7x**
Funded Debt	111.7	103.3	93.8	83.6	72.6	60.8
Funded Debt / EBITDAE	**3.5x**	**2.8x**	**2.3x**	**2.0x**	**1.6x**	**1.3x**
Total Debt (Total Funded and Seller) Fixed Charges	25.7	25.3	24.5	23.6	22.7	21.7
Cash Flow to Total Debt Fixed Charges	**1.3x**	**1.5x**	**1.6x**	**1.8x**	**2.0x**	**2.2x**
Funded Debt Fixed Charges	15.6	15.3	14.5	13.6	12.6	11.6
Cash Flow to Funded Debt Fixed Charges	**2.1x**	**2.4x**	**2.8x**	**3.1x**	**3.5x**	**4.0x**

Leverage ratios Coverage ratios

Note: EBITDAE represents EBITDA before deduction of ESOP expenses; Credit metrics include 25% excess cash flow sweep on funded debt; Assumes no capital expenditures and no material changes in working capital through the projection period, per management's guidance

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Factors Impacting Available Leverage

LOWER LEVERAGE → HIGHER LEVERAGE

LOWER LEVERAGE — COMPANY CHARACTERISTICS

- ▼ Heavy customer concentration
- ▼ Heavy industry concentration
- ▼ Heavy supplier concentration
- ▼ Low growth / high risk industry outlook
- ▼ Significant key man risk
- ▼ No stickiness with customers
- ▼ Low quality customers in undesirable markets
- ▼ Nonrecurring project-based revenue
- ▼ No contracts / short-term relationships
- ▼ No growth / inconsistent growth
- ▼ Limited geographic reach
- ▼ No brand recognition
- ▼ EBITDA < $3M
- ▼ High fixed costs / cash flow inefficient

HIGHER LEVERAGE — COMPANY CHARACTERISTICS

- ▲ Significant customer diversification
- ▲ Significant industry diversification
- ▲ Significant supplier diversification
- ▲ High growth / low risk industry
- ▲ No key man risk
- ▲ Stickiness with customers (essential)
- ▲ Blue chip clients in desired end markets
- ▲ Recurring revenue
- ▲ Long-term relationships / contracts
- ▲ Multi-year consistent / growing performance
- ▲ National and global reach
- ▲ Established brand name
- ▲ EBITDA > $10M
- ▲ Low fixed costs / cash flow efficient

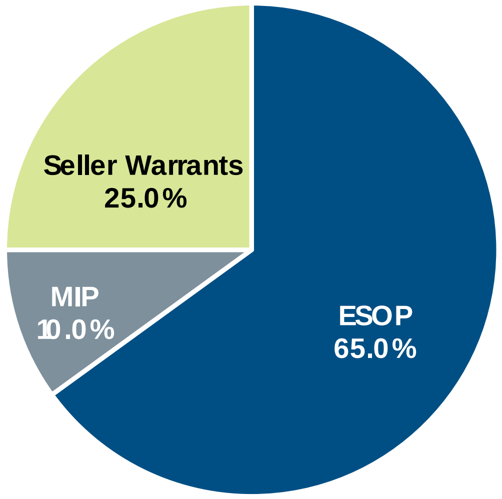
Seller Subordinated Notes

OVERVIEW

- **Market-based** interest rate commensurate with the risk of the facility
- Ideally used in tandem with 3rd party financing, not solely used to finance transaction
- Likely contains warrants
  - Similar to stock options with favorable tax treatment and longer-term return horizon
- May be cash and/or PIK interest
  - Provides flexibility for company to make funded debt fixed charge payments
- Can be refinanced out in future with senior debt

POST-TRANSACTION ECONOMICS

Fully-diluted



Often a Management Incentive Plan (MIP) is established to provide equity participation in the form of options to participating key executives

ESOP Who Should Own Your Business After You?

Illustrative Transaction Process

MODELING AND PRE-MARKETING *(3-4 WEEKS)*	MARKETING *(4 WEEKS)*	Q&A AND DILIGENCE *(2-3 WEEKS)*	FINAL TERMS AND NEGOTIATIONS *(1-2 WEEKS)*	CLOSING *(6-8 WEEKS)*
Up-front organization is key to an efficient process and optimal outcome: deal team roles are assigned, and pro-forma models are finalized before going to market	ButcherJoseph produces concise, impactful marketing materials that best showcase the opportunity and ensure lender / investor 'mindshare'	Delivery of sensitive information is strictly managed and provided only to qualified lenders / investors that advance through the process	Driving principle: Maintain momentum and flexibility. A tight timeline is provided to keep parties 'on track' and principally focused on the opportunity	"Last-mile" discipline is absolutely necessary: Drive through to closing with the closing checklist, scheduled calls, and full working group commitment

TRANSACTION MANAGEMENT SERVICES

- Identify and explain the key considerations and potential implications of the transaction to Board of Directors, management, and employees
- Draft the transaction calendar and coordinate weekly status calls to ensure milestone dates are met
- Conduct advanced feasibility analysis, which will include customary transaction due diligence
- Create financial models to analyze aspects of the Company in light of the transaction
- Organize and manage the financing process, raising debt or equity capital as applicable from interested parties within our proprietary network of capital providers
- Prepare trustee memorandum, valuation analysis and offer documentation
- Populate data room and coordinate due diligence on the part of interested financing sources, and the ESOP trustee and its independent financial advisor and legal counsel
- Manage the negotiation process with the trustee
- Coordinate the documentation process with respect to both the transaction and financing on behalf of the Company
- Manage, negotiate, structure and execute the transaction

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Questions?

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