

# MARKET INSIGHTS:

## Flying Under the Radar: The Dividend Recapitalization

Q4 - 2018



You're an entrepreneur, and like many business owners, much of your wealth is tied up in your company. You still enjoy running the business, and don't want to give that up for another 5 years (or maybe more). In addition, there are still growth opportunities to pursue, and in your view, selling today would mean giving up value you'll be able to realize in the future.

But you'd like to take some cash out of the business now. Perhaps there's a beachfront property in the Caribbean with your name on it, or you'd like to help your adult kid out with a down payment on her house. Or maybe you just want to diversify your assets.

### A below-the-radar liquidity option

The above scenario is not uncommon. For Canadian lower mid-market business owners, there are few paths to (even partial) liquidity that preclude a sale of a majority stake in the company. The sale of a *minority* stake is one of those paths, but, in our experience, private equity (PE) investors are unlikely to make a minority investment in a small, mid-market company, and if they do, the valuation will generally reflect a heavy discount for their non-control position.

Another option is a dividend recapitalization (recap), which provides liquidity to the business owner using corporate debt, while leaving 100% ownership in his or her hands. PE investors have been using these for years, as a tool to create liquidity early on in a given investment without selling it. While the dividend recap flies under the radar amongst lower mid-market business owners, for some, it's a viable alternative to selling equity in order to take money out of the company.

### Pros and cons: liquidity options for business owners

Liquidity Considerations	Majority Stake Sale	Dividend Recapitalization	Minority Stake Sale
<b>Timeframe to closing</b>	12-36 months	2-3 months	12-36 months
<b>Limitations on capital raised</b>	Market value of company	Company's capacity to take on debt; Lender's willingness to lend	Reaching agreement on key shareholder decisions; Investors' willingness to invest
<b>Impact on management control</b>	Control transfers to buyer	Owners retain control	Owners share some control with new minority shareholders
<b>Opportunity to participate in further growth</b>	Limited to rollover equity or earnouts (if any)	100% retained by owners	Limited to remaining stake
<b>Timing of liquidity</b>	Majority usually received on closing	Received on closing	Received on closing
<b>Impact on succession planning</b>	Negates need to find a successor	Must still be planned for	Significantly improved as new management team members usually join
<b>Impact on company's future performance</b>	Depends on buyer's plans for company	Debt payments reduce cashflow available for CAPEX, etc.	Depends on plans and whether growth capital is injected

### How does a dividend recap work?

The mechanics of a dividend recap are relatively simple:

1. The company takes on a new loan, which is added to the company's balance sheet as a new liability;
2. The proceeds of that loan are paid to the owner(s) of the business in the form of a special dividend;
3. The result: the owner(s) receive cash out of the business but retain 100% of the equity.

### Who are the right candidates?

Given the addition of debt to the balance sheet, only companies that have limited debt on their balance sheets, along with stable cash flow, low capex requirements, relatively predictable growth and a strong management team will be good candidates.

### Not unlike a partial shareholder buy-out...

A dividend recap can also be useful in a situation where some shareholders want to retain ownership of the company, while others want to exit. In this case, the same kind of term debt used in a dividend recap may also be used to buy out the departing shareholders' positions. This scenario often arises in a family owned business, where some family members want to stay in and others want to pursue different paths or projects.

### So what do you do?

Let's return to our opening scenario: how will you move forward? Being aware of the dividend recap option is a great start. And further due diligence may lead you to conclude that this is the right liquidity solution for you and your business.

## RECENT TRANSACTIONS

NOVEMBER 2018	NOVEMBER 2018	OCTOBER 2018	OCTOBER 2018
<p>Gap Debt</p> <p>For</p>  <p>The undersigned is a lender to the company</p> 	<p>Equity Capital Advisory</p> <p>For</p>  <p>The undersigned acted as the exclusive advisor to the borrower</p> 	<p>Gap Debt</p> <p>For</p>  <p>The undersigned is a lender to the company</p> 	 <p>Acquired a Stake in</p>  <p>The undersigned acted as the exclusive advisor to the seller</p> 

## ABOUT FIREPOWER CAPITAL

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