PART III: SEARCH FUND ECONOMICS

OVERVIEW

This section addresses the basic economics for the entrepreneurs and investors in search fund investments.

The two key components impacting the split of proceeds in a search fund are the structure of the investor capital and the search fund entrepreneur's earned equity (referred to as "Manager Equity" in this *Primer*; also often called "Carried Interest").

Search fund investors typically structure their investments to gain preference over the equity received by the searcher. By doing this, the investors maintain protection in downside scenarios by having preference on the return of their capital (and often a guaranteed minimum return on the capital) while still keeping the potential for uncapped gains. Manager equity is usually issued as common equity; as such, only once some or all of the investor capital has been returned (often with a preferred return) does the search fund entrepreneur begin to realize value in his equity ownership in the company.

This section on economics is intended to emphasize that the primary drivers of economic return are the performance of the company and the absolute dollar gain on the investment. However, it also illustrates that the form and structure of the investors' capital can impact the split of proceeds between investors and search fund entrepreneurs.

INVESTOR CAPITAL

Search fund investor capital is provided in two stages: (1) to fund the search (the "search capital") and (2) to fund the company acquisition (the "acquisition capital"). Upon an acquisition, the search capital converts into the same securities issued for the acquisition capital investment; typically, this conversion is done at a stepped-up value, often 150 percent of the original investment, to compensate investors for running the risk on the search.

Once an acquisition is completed, the post-closing capital structure will include some or all of the following:

- Traditional debt (e.g., revolver, senior term debt, and potentially, mezzanine debt)
- Seller financing
- Investor equity (e.g., redeemable and nonredeemable preferred stock)
- Common equity

Investor capital can come in various forms. In today's financing environment, investors have structured acquisition capital to provide preference, in the form of capital structure seniority and preferred rate of return, over the Manager Equity. This can be accomplished using various securities, including, but not limited to, those addressed below.

Preferred equity – There are many variations, and therefore room for creativity, in structuring preferred equity. Preferred equity is junior to all debt securities but senior to common equity. In search funds, preferred equity is most often issued as participating preferred stock.

- *Preferred stock* offers the holder the right to BOTH (a) the initial value plus accumulated and unpaid preferred dividends (if any); PLUS (b) 100 percent of the common equity, less vested Manager Equity (described below) upon sale or liquidation. Preferred stock can be issued as redeemable preferred stock or non-redeemable participating preferred stock:

    - *Redeemable preferred stock* can be redeemed in whole or in part prior to a sale, recapitalization or liquidation. Once redeemed, the redeemable preferred stock has no further participation.

    - *Nonredeemable participating preferred stock* cannot be redeemed prior to a sale, recapitalization or other liquidity event as defined by the terms of the agreement.

For the sake of simplicity, the following analysis focuses on two potential structures of investor capital:

- Structure 1: For every $1 of Investor Capital, $1 buys Nonredeemable Participating Preferred Stock with Preferred Return (usually ~6 - 8%).

- Structure 2: For every $1 of Investor Capital, $0.50 buys redeemable preferred stock and $0.50 buys nonredeemable participating preferred stock.

    - Series A - Redeemable Preferred Stock (~15-17% coupon)
    - Series B - Nonredeemable Participating Preferred Stock with No Coupon (~0%).
        i. Manager Equity comes in the form of Common shares that participate with the Series B Nonredeemable Participating Preferred Stock

Structure 1 and Structure 2 can be substantially equivalent at certain interest rates and preferred returns.

So, why choose one structure or the other? Historically, as traditional private equity funds moved into the search fund space, they stated a preference for Structure 1. However, many high net worth individuals or search fund focused investment firms with extensive search fund investment or operating experience often propose Structure 2 as another viable alternative. In the recent past, approximately 75 percent of deals have been done with Structure 2, at the election of the search fund entrepreneur.

The advantages/disadvantages of each structure for the investor and the entrepreneur are depicted in the following chart.

	Structure 1 (Preferred Equity) Usually 6-8% coupon	Structure 2 (split of Redeemable Preferred Equity and Nonredeemable Participating Preferred Stock) 15-17% Series A, 0% Series B
Investor	<u>Pros</u> • Maintains uncapped returns on entire investment <u>Cons</u> • In a middling outcome, the preferred return can become onerous and lead to misalignment of incentives between the entrepreneur and investors • May promote excessive risk-taking by searcher to create outsized growth in equity	<u>Pros</u> • Focuses managers on cash flow generation and early return of capital • Early return of capital allows for reinvestment in other opportunities • Investor still maintains 100% of the upside • Provides opportunity to take “chips off the table,” and therefore opportunity to reinvest redeemed capital in other growth investments while still preserving upside potential [reword] <u>Cons</u> • The searcher has a better chance at redeeming the high coupon debt quickly, therefore driving down returns
Searcher	<u>Pros</u> • More commonly known structure outside the search fund community <u>Cons</u> • 100% of the investor equity investment has a coupon attached, therefore significantly more cash generation and return to investors is required in initial years to stop coupon accretion • In mid-growth scenarios, significant accretion of the preferred equity can lead to misalignment of incentives and be demotivating to entrepreneur	<u>Pros</u> • Allows pay down of expensive component of capital structure more quickly because only half of the total investor equity investment is accreting • Early redemption of Series A Preferred creates economic value to entrepreneur, similar to paying down third-party leverage • Early return of capital can boost IRR and allow for early vesting of performance-based carry <u>Cons</u> • In middling outcome of greater than 5 years, significant accretion of Series A can become onerous

Some investors warned that Structure A could be “massively de-motivating to managers” and could have “a devastating effect on the entrepreneur.” These negative consequences are more acute in low growth outcomes without significant free cash flow generation. In these cases, the original investor capital plus the preferred coupon may prohibit the entrepreneur from participating in any meaningful equity gain. Ultimately, investors all noted that the equity capital should be structured to align the interests of investors and entrepreneurs.

MANAGER EQUITY

A typical search fund entrepreneur(s) will vest into 20-30 percent of the common equity ("Manager Equity") of the acquired company in three equal tranches:

- Tranche 1: Upon acquisition of a company;
- Tranche 2: Over time, as long as searcher remains an employee of the acquired company (commonly, a 4-5 year vesting schedule); and
- Tranche 3: By achieving performance benchmarks (e.g., IRR hurdles).

Partnerships typically earn 30 percent of the common equity while solo searchers earn 20-25 percent.

Performance benchmarks generally start at 20 percent IRR net to investors and max out at 30-40 percent IRR, net of Manager Equity. Performance vesting can be on a sliding scale or in increments upon achieving minimum thresholds (e.g. 20 percent, 25 percent and 30 percent IRR hurdles). Currently, there is a movement towards a reducing IRR scale based on years held (i.e., an investor might rather have a 20 percent IRR on a 10-year investment as opposed to a 35 percent IRR on a 2-year investment). Benchmarks based on Return on Invested Capital (i.e., cash-on-cash return) rather than IRR may be used, but it is uncommon.

In rare instances, the entrepreneur can request a third-party valuation of the company if a liquidity event has not occurred after five years. The IRR calculated at that point can be used for purposes of vesting the performance equity.

VALUE CREATION

There are three primary levers used to create equity value in any company:

<u>Operations</u>

- Revenue growth through sales and marketing efforts or strategic initiatives (e.g., new products/services, geographic expansion, pricing)
- Margin expansion through cost reduction or operating leverage
- Add-on acquisitions to enhance scale, product/service offerings, or capabilities

<u>Finance</u>

- Capital structure decisions
- Cost of capital
- Capital intensity reduction – fixed assets, working capital, and/or capital expenditures

<u>Valuation Multiple</u>

- Buy at lower multiples, sell at higher multiples

Of these three levers, managers can influence operations and finance most effectively. It is useful for a search fund entrepreneur to analyze potential acquisition opportunities by considering what "calculated bets" s/he is making to drive equity value creation. For instance, an acquisition opportunity may have incredibly high growth potential but also a high valuation multiple. Does the entrepreneur believe it is possible to hit the growth targets necessary to justify a high entry valuation multiple? Alternatively, another investment opportunity may have slower growth but high fixed asset intensity. Does the entrepreneur believe capital requirements can be reduced enough to generate a cash-on-cash return to be attractive to all involved?

There is no right or wrong answer to these questions. Rather, the entrepreneur should match his/her personal risk/reward profile and operating strengths with the characteristics of the investment.

HYPOTHETICAL EXAMPLE OF SEARCH FUND ECONOMICS

To illustrate the potential economics of a search fund investment, we will take a representative search fund transaction and manager equity package and apply two different options of investor capital. To see the impact on returns to investors and searchers, we'll run three different operating scenarios:

Summary of Operating Scenarios

	Optimistic	Base Case	Pessimistic
Revenue Growth	20.0%	12.5%	--
Annual EBITDA Margin Expansion	0.50%	0.25%	--
Exit Multiple	7.0x	5.5x	4.0x
Increase in Net Working Capital	20% of Revenue Growth		
Cash Tax Payments	40% of Earnings Before Taxes		
Depreciation & Amortization	$500K in Year 0; fixed margin throughout		
Capital Expenditures	$250K per Year		

The representative transaction, with the capital structure at closing, follows.

<u>Transaction assumptions:</u>

- $15 million in sales and $3.0 million EBITDA
- 5.0x EBITDA purchase multiple ($15.0 million purchase price)
- 1.0x traditional Senior Debt
- 1.5x Seller Debt

Acquisition Capitalization

	$000s	EBITDA Mult.	% of Total
Senior Debt	$3,000	1.0x	19.4%
Seller Financing	$4,500	1.5x	29.1%
Investor Capital (a)	$7,950	2.7x	51.5%
Total (b)	**$15,450**	**5.2x**	**100.0%**

(a) Includes search capital of $300K at 50% step-up.
(b) Ignores transaction costs.

We will analyze the differences in returns to both investors and searchers under two different structures for the investor capital:

- Structure 1: 7% Nonredeemable Participating Preferred Stock
- Structure 2: 50/50 split of:
    - 16% Redeemable Preferred Stock
    - 0% Nonredeemable Participating Preferred Stock

Regardless of the structure of investor capital, the search fund principal will receive the following Manager Equity package:

- Potential of 30% of Common Equity
    - 1/3 (10%) vests at acquisition
    - 1/3 (10%) vests over 4 years (also commonly vests over 5 years)
    - Up to 1/3 (10%) vests according to net investor IRR performance hurdles
        - Straight line vesting is most common between 20% IRR and 35% IRR – i.e., 0% vesting at 20% IRR, 50% vesting at 27.5% IRR and 100% vesting at 35% IRR

Following is a summary of the results in each of the three operating scenarios described above depending on whether Structure A or Structure B is used for Investor Capital:

Summary of Returns ($000s)

	Investors		Seacher	
	Structure 1	Structure 2	Structure 1	Structure 2
Optimistic Case	$ 46,877	$ 49,077	$ 11,909	$ 12,813
Base Case	$ 26,481	$ 27,108	$ 5,110	$ 5,400
Pessimistic Case	$ 11,150	$ 11,235	$ -	$ -

As illustrated, the greatest driver of economic returns to investors and searchers is the company's operating performance and total gain on the investment.

Note that the economics to the searcher would be split in a partnership scenario.

The following two tables provide more detail on the results of the three operating and two financing cases described. Financial models with more detail on each scenario can be found in **Exhibit 12**.

SUMMARY CASH FLOW MODEL & RETURNS - INVESTOR CAPITAL STRUCTURE 1

(US$ in 000s, except where noted)

	Optimistic Case	Base Case	Pessimistic Case
Operating Assumptions:			
Annual Revenue Growth	20.0%	12.5%	0.0%
Annual EBITDA Margin Expansion	0.50%	0.25%	0.00%
Exit Valuation Multiple	7.0x	5.5x	4.0x
Year 5 Sales	$ 37,325	$ 27,030	$ 15,000
Year 5 EBITDA	$ 8,398	$ 5,744	$ 3,000
Exit TEV	$ 58,787	$ 31,592	$ 12,000
Less: Net Debt	-	-	972
Total Equity	$ 58,787	$ 31,592	$ 11,028
Redeemable Preferred Equity	$ -	$ -	$ -
Non-Redeemable Preferred Equity	11,150	11,150	11,150
Value of Common Equity	$ 47,636	$ 20,442	$ -
Returns:			
Investor Redeemable Preferred Equity	$ -	$ -	$ -
Investor Non-Redeemable Preferred Equity	11,150	11,150	11,150
Investor Common Equity	35,727	15,331	-
Total Return to Investors	$ 46,877	$ 26,481	$ 11,150
Original Investment	$ 7,950	$ 7,950	$ 7,950
Return on Invested Capital	5.9x	2.4x	1.4x
Investor IRR	44.8%	28.8%	7.0%
Manager Common Equity Ownership %	25.0%	25.0%	20.0%
Manager Payout	**$ 11,909**	**$ 5,110**	**$ -**

SUMMARY CASH FLOW MODEL & RETURNS - INVESTOR CAPITAL STRUCTURE 2

(US$ in 000s, except where noted)

	Optimistic Case		Base Case		Pessimistic Case	
Operating Assumptions:						
Annual Revenue Growth		20.0%		12.5%		0.0%
Annual EBITDA Margin Expansion		0.50%		0.25%		0.00%
Exit Valuation Multiple		7.0x		5.5x		4.0x
Year 5 Sales	$	37,325	$	27,030	$	15,000
Year 5 EBITDA	$	8,398	$	5,744	$	3,000
Exit TEV	$	58,787	$	31,592	$	12,000
Less: Net Debt		3,558		6,017		7,247
Total Equity	$	55,229	$	25,575	$	4,753
Redeemable Preferred Equity	$	-	$	-	$	1,647
Non-Redeemable Preferred Equity		3,975		3,975		3,975
Value of Common Equity	$	51,254	$	21,600	$	-
Returns:						
Investor Redeemable Preferred Equity (a) (b)	$	6,661	$	6,933	$	7,260
Investor Non-Redeemable Preferred Equity		3,975		3,975		3,975
Investor Common Equity		38,440		16,200		-
Total Return to Investors	$	49,077	$	27,108	$	11,235
Original Investment	$	7,950	$	7,950	$	7,950
Return on Invested Capital		6.2x		3.4x		1.4x
Investor IRR		47.4%		30.7%		6.5%
Manager Common Equity Ownership %		25.0%		25.0%		20.0%
Manager Payout	**$**	**12,813**	**$**	**5,400**	**$**	**-**

(a) Includes Investor Capital dividends during duration of investment.

(b) Cash from operations pays down Redeemable Preferred Equity over 5 year hold period.

Exhibit 12 – Sample Search Fund Financial Models

STRUCTURE 1 - Operating Case: Optimistic Case

		Closing	Year 1	Year 2	Year 3	Year 4	Year 5
Revenues		$15,000	$18,000	$21,600	$25,920	$31,104	$37,325
Revenue Growth			20.0%	20.0%	20.0%	20.0%	20.0%
EBITDA Margin		20.0%	20.5%	21.0%	21.5%	22.0%	22.5%
EBITDA		**$3,000**	**$3,690**	**$4,536**	**$5,573**	**$6,843**	**$8,398**
Less: Depreciation & Amortization		($500)	($600)	($720)	($864)	($1,037)	($1,244)
Less: Interest Expense			($180)	($60)	$ --	$ --	$ --
Earnings Before Taxes			$2,910	$3,756	$4,709	$5,806	$7,154
Taxes @ 40%	40.0%		($1,164)	($1,502)	($1,884)	($2,322)	($2,862)
Net Income			$1,746	$2,254	$2,825	$3,484	$4,292
Free Cash Flow							
EBITDA			$3,690	$4,536	$5,573	$6,843	$8,398
Less: Cash Interst Expense			($180)	($60)	$ --	$ --	$ --
Less: Cash Taxes			($1,164)	($1,502)	($1,884)	($2,322)	($2,862)
Less: Changes in NWC @ 20% of Rev Growth			($600)	($720)	($864)	($1,037)	($1,244)
Less: CapEx			($250)	($250)	($250)	($250)	($250)
Less: Mandatory Debt Paydown			($300)	($300)	$ --	$ --	$ --
Free Cash Flow for Voluntary Debt Paydown			**$1,196**	**$1,704**	**$2,575**	**$3,234**	**$4,042**
Cumulative FCF			***$1,196***	***$2,899***	***$5,475***	***$8,708***	***$12,751***
Capital Structure							
Cash		$ --	$ --	$ --	$ --	$82	$4,125
Senior Debt		3,000	1,504	-	-	-	-
Seller Financing		4,500	4,950	4,946	2,865	-	-
Total Debt		$7,500	$6,454	$4,946	$2,865	$ --	$ --
Investor Capital - Redeemable Preferred Stock		-	-	-	-	-	-
Investor Capital - Non-Redeemable Preferred Stock		7,950	8,507	9,102	9,739	10,421	11,150
Total Capitalization (excl. Common Stock)		**$15,450**	**$14,961**	**$14,048**	**$12,604**	**$10,421**	**$11,150**
Seller Financing + Investor Capital Accretion			*$1,007*	*$1,090*	*$1,132*	*$968*	*$729*
Exit Valuation							
EBITDA							$8,398
Valuation Multiple							7.0x
TEV							$58,787
Less: Net Total Debt							($4,125)
Total Equity Value							**$62,911**
Less: Value to Redeemable Pfd Stock							$ --
Less: Value to Non-Redeemable Pfd Stock							$11,150
Value to Common Equity							**$51,761**

STRUCTURE A - Operating Case: Base Case

	Closing	Year 1	Year 2	Year 3	Year 4	Year 5
Revenues	$15,000	$16,875	$18,984	$21,357	$24,027	$27,030
Revenue Growth		12.5%	12.5%	12.5%	12.5%	12.5%
EBITDA Margin	20.0%	20.3%	20.5%	20.8%	21.0%	21.3%
EBITDA	**$3,000**	**$3,417**	**$3,892**	**$4,432**	**$5,046**	**$5,744**
Less: Depreciation & Amortization	($500)	($563)	($633)	($712)	($801)	($901)
Less: Interest Expense		($178)	($58)	$ --	$ --	$ --
Earnings Before Taxes		$2,676	$3,201	$3,720	$4,245	$4,843
Taxes @ 40% (40.0%)		($1,071)	($1,280)	($1,488)	($1,698)	($1,937)
Net Income		$1,606	$1,920	$2,232	$2,547	$2,906
Free Cash Flow						
EBITDA		$3,417	$3,892	$4,432	$5,046	$5,744
Less: Cash Interst Expense		($178)	($58)	$ --	$ --	$ --
Less: Cash Taxes		($1,071)	($1,280)	($1,488)	($1,698)	($1,937)
Less: Changes in NWC @ 20% of Rev Growth		($375)	($422)	($475)	($534)	($601)
Less: CapEx		($250)	($250)	($250)	($250)	($250)
Less: Mandatory Debt Paydown		($300)	($300)	$ --	$ --	$ --
Free Cash Flow for Voluntary Debt Paydown		**$1,243**	**$1,581**	**$2,219**	**$2,564**	**$2,956**
Cumulative FCF		***$1,243***	***$2,825***	***$5,044***	***$7,608***	***$10,564***
Capital Structure						
Cash	$ --	$ --	$ --	$ --	$ --	$1,780
Senior Debt	3,000	1,457	-	-	-	-
Seller Financing	4,500	4,950	5,020	3,303	1,070	-
Total Debt	$7,500	$6,407	$5,020	$3,303	$1,070	$ --
Investor Capital - Redeemable Preferred Stock	-	-	-	-	-	-
Investor Capital - Non-Redeemable Preferred Stock	7,950	8,507	9,102	9,739	10,421	11,150
Total Capitalization (excl. Common Stock)	**$15,450**	**$14,913**	**$14,122**	**$13,042**	**$11,490**	**$11,150**
Seller Financing + Investor Capital Accretion		*$1,007*	*$1,090*	*$1,139*	*$1,012*	*$836*

Exit Valuation	
EBITDA	$5,744
Valuation Multiple	5.5x
TEV	$31,592
Less: Net Total Debt	($1,780)
Total Equity Value	**$33,371**
Less: Value to Redeemable Pfd Stock	$ --
Less: Value to Non-Redeemable Pfd Stock	$11,150
Value to Common Equity	**$22,221**

STRUCTURE A - Operating Case: Pessimistic Case

	Closing	Year 1	Year 2	Year 3	Year 4	Year 5
Revenues	$15,000	$15,000	$15,000	$15,000	$15,000	$15,000
Revenue Growth		--	--	--	--	--
EBITDA Margin	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
EBITDA	**$3,000**	**$3,000**	**$3,000**	**$3,000**	**$3,000**	**$3,000**
Less: Depreciation & Amortization	($500)	($500)	($500)	($500)	($500)	($500)
Less: Interest Expense		($174)	($54)	$ --	$ --	$ --
Earnings Before Taxes		$2,326	$2,446	$2,500	$2,500	$2,500
Taxes @ 40% 40.0%		($930)	($978)	($1,000)	($1,000)	($1,000)
Net Income		$1,395	$1,467	$1,500	$1,500	$1,500
Free Cash Flow						
EBITDA		$3,000	$3,000	$3,000	$3,000	$3,000
Less: Cash Interst Expense		($174)	($54)	$ --	$ --	$ --
Less: Cash Taxes		($930)	($978)	($1,000)	($1,000)	($1,000)
Less: Changes in NWC @ 20% of Rev Growth		$ --	$ --	$ --	$ --	$ --
Less: CapEx		($250)	($250)	($250)	($250)	($250)
Less: Mandatory Debt Paydown		($300)	($300)	$ --	$ --	$ --
Free Cash Flow for Voluntary Debt Paydown		**$1,345**	**$1,417**	**$1,750**	**$1,750**	**$1,750**
Cumulative FCF		***$1,345***	***$2,763***	***$4,513***	***$6,263***	***$8,013***
Capital Structure						
Cash	$ --	$ --	$ --	$ --	$ --	$ --
Senior Debt	3,000	1,355	-	-	-	-
Seller Financing	4,500	4,950	5,082	3,840	2,474	972
Total Debt	$7,500	$6,305	$5,082	$3,840	$2,474	$972
Investor Capital - Redeemable Preferred Stock	-	-	-	-	-	-
Investor Capital - Non-Redeemable Preferred Stock	7,950	8,507	9,102	9,739	10,421	11,150
Total Capitalization (excl. Common Stock)	**$15,450**	**$14,811**	**$14,184**	**$13,579**	**$12,895**	**$12,122**
Seller Financing + Investor Capital Accretion		*$1,007*	*$1,090*	*$1,145*	*$1,066*	*$977*
Exit Valuation						
EBITDA						$3,000
Valuation Multiple						4.0x
TEV						$12,000
Less: Net Total Debt						$972
Total Equity Value						**$11,028**
Less: Value to Redeemable Pfd Stock						$ --
Less: Value to Non-Redeemable Pfd Stock						$11,028
Value to Common Equity						**$ --**

STRUCTURE B - Operating Case: Optimistic Case

	Closing	Year 1	Year 2	Year 3	Year 4	Year 5
Revenues	$15,000	$18,000	$21,600	$25,920	$31,104	$37,325
Revenue Growth		20.0%	20.0%	20.0%	20.0%	20.0%
EBITDA Margin	20.0%	20.5%	21.0%	21.5%	22.0%	22.5%
EBITDA	**$3,000**	**$3,690**	**$4,536**	**$5,573**	**$6,843**	**$8,398**
Less: Depreciation & Amortization	($500)	($600)	($720)	($864)	($1,037)	($1,244)
Less: Interest Expense		($180)	($60)	$ --	$ --	$ --
Earnings Before Taxes		$2,910	$3,756	$4,709	$5,806	$7,154
Taxes @ 40% 40.0%		($1,164)	($1,502)	($1,884)	($2,322)	($2,862)
Net Income		$1,746	$2,254	$2,825	$3,484	$4,292
Free Cash Flow						
EBITDA		$3,690	$4,536	$5,573	$6,843	$8,398
Less: Cash Interst Expense		($180)	($60)	$ --	$ --	$ --
Less: Cash Taxes		($1,164)	($1,502)	($1,884)	($2,322)	($2,862)
Less: Changes in NWC @ 20% of Rev Growth		($600)	($720)	($864)	($1,037)	($1,244)
Less: CapEx		($250)	($250)	($250)	($250)	($250)
Less: Mandatory Debt Paydown		($300)	($300)	$ --	$ --	$ --
Free Cash Flow for Voluntary Debt Paydown		**$1,196**	**$1,704**	**$2,575**	**$3,234**	**$4,042**
Cumulative FCF		***$1,196***	***$2,899***	***$5,475***	***$8,708***	***$12,751***
Capital Structure						
Cash	$ --	$ --	$ --	$ --	$ --	$ --
Senior Debt	3,000	1,504	-	-	-	-
Seller Financing	4,500	4,950	5,445	5,990	6,588	3,558
Total Debt	$7,500	$6,454	$5,445	$5,990	$6,588	$3,558
Investor Capital - Redeemable Preferred Stock	3,975	4,611	4,849	3,050	304	-
Investor Capital - Non-Redeemable Preferred Stock	3,975	3,975	3,975	3,975	3,975	3,975
Total Capitalization (excl. Common Stock)	**$15,450**	**$15,040**	**$14,269**	**$13,014**	**$10,868**	**$7,533**
Seller Financing + Investor Capital Accretion		*$1,086*	*$1,233*	*$1,320*	*$1,087*	*$708*
Exit Valuation						
EBITDA						$8,398
Valuation Multiple						7.0x
TEV						$58,787
Less: Net Total Debt						$3,558
Total Equity Value						**$55,229**
Less: Value to Redeemable Pfd Stock						$ --
Less: Value to Non-Redeemable Pfd Stock						$3,975
Value to Common Equity						**$51,254**

STRUCTURE B - Operating Case: Base Case

	Closing	Year 1	Year 2	Year 3	Year 4	Year 5
Revenues	$15,000	$16,875	$18,984	$21,357	$24,027	$27,030
Revenue Growth		12.5%	12.5%	12.5%	12.5%	12.5%
EBITDA Margin	20.0%	20.3%	20.5%	20.8%	21.0%	21.3%
EBITDA	**$3,000**	**$3,417**	**$3,892**	**$4,432**	**$5,046**	**$5,744**
Less: Depreciation & Amortization	($500)	($563)	($633)	($712)	($801)	($901)
Less: Interest Expense		($178)	($58)	$ --	$ --	$ --
Earnings Before Taxes		$2,676	$3,201	$3,720	$4,245	$4,843
Taxes @ 40% 40.0%		($1,071)	($1,280)	($1,488)	($1,698)	($1,937)
Net Income		$1,606	$1,920	$2,232	$2,547	$2,906
Free Cash Flow						
EBITDA		$3,417	$3,892	$4,432	$5,046	$5,744
Less: Cash Interst Expense		($178)	($58)	$ --	$ --	$ --
Less: Cash Taxes		($1,071)	($1,280)	($1,488)	($1,698)	($1,937)
Less: Changes in NWC @ 20% of Rev Growth		($375)	($422)	($475)	($534)	($601)
Less: CapEx		($250)	($250)	($250)	($250)	($250)
Less: Mandatory Debt Paydown		($300)	($300)	$ --	$ --	$ --
Free Cash Flow for Voluntary Debt Paydown		**$1,243**	**$1,581**	**$2,219**	**$2,564**	**$2,956**
Cumulative FCF		***$1,243***	***$2,825***	***$5,044***	***$7,608***	***$10,564***
Capital Structure						
Cash	$ --	$ --	$ --	$ --	$ --	$ --
Senior Debt	3,000	1,457	-	-	-	-
Seller Financing	4,500	4,950	5,445	5,990	6,588	6,017
Total Debt	$7,500	$6,407	$5,445	$5,990	$6,588	$6,017
Investor Capital - Redeemable Preferred Stock	3,975	4,611	4,924	3,493	1,488	-
Investor Capital - Non-Redeemable Preferred Stock	3,975	3,975	3,975	3,975	3,975	3,975
Total Capitalization (excl. Common Stock)	**$15,450**	**$14,993**	**$14,344**	**$13,457**	**$12,051**	**$9,992**
Seller Financing + Investor Capital Accretion		*$1,086*	*$1,233*	*$1,332*	*$1,158*	*$897*
Exit Valuation						
EBITDA						$5,744
Valuation Multiple						5.5x
TEV						$31,592
Less: Net Total Debt						$6,017
Total Equity Value						**$25,575**
Less: Value to Redeemable Pfd Stock						$ --
Less: Value to Non-Redeemable Pfd Stock						$3,975
Value to Common Equity						**$21,600**

STRUCTURE B - Operating Case: Pessimistic Case

	Closing	Year 1	Year 2	Year 3	Year 4	Year 5
Revenues	$15,000	$15,000	$15,000	$15,000	$15,000	$15,000
Revenue Growth		--	--	--	--	--
EBITDA Margin	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
EBITDA	**$3,000**	**$3,000**	**$3,000**	**$3,000**	**$3,000**	**$3,000**
Less: Depreciation & Amortization	($500)	($500)	($500)	($500)	($500)	($500)
Less: Interest Expense		($174)	($54)	$ --	$ --	$ --
Earnings Before Taxes		$2,326	$2,446	$2,500	$2,500	$2,500
Taxes @ 40% 40.0%		($930)	($978)	($1,000)	($1,000)	($1,000)
Net Income		$1,395	$1,467	$1,500	$1,500	$1,500
Free Cash Flow						
EBITDA		$3,000	$3,000	$3,000	$3,000	$3,000
Less: Cash Interst Expense		($174)	($54)	$ --	$ --	$ --
Less: Cash Taxes		($930)	($978)	($1,000)	($1,000)	($1,000)
Less: Changes in NWC @ 20% of Rev Growth		$ --	$ --	$ --	$ --	$ --
Less: CapEx		($250)	($250)	($250)	($250)	($250)
Less: Mandatory Debt Paydown		($300)	($300)	$ --	$ --	$ --
Free Cash Flow for Voluntary Debt Paydown		**$1,345**	**$1,417**	**$1,750**	**$1,750**	**$1,750**
Cumulative FCF		***$1,345***	***$2,763***	***$4,513***	***$6,263***	***$8,013***
Capital Structure						
Cash	$ --	$ --	$ --	$ --	$ --	$ --
Senior Debt	3,000	1,355	-	-	-	-
Seller Financing	4,500	4,950	5,445	5,990	6,588	7,247
Total Debt	$7,500	$6,305	$5,445	$5,990	$6,588	$7,247
Investor Capital - Redeemable Preferred Stock	3,975	4,611	4,986	4,034	2,929	1,647
Investor Capital - Non-Redeemable Preferred Stock	3,975	3,975	3,975	3,975	3,975	3,975
Total Capitalization (excl. Common Stock)	**$15,450**	**$14,891**	**$14,406**	**$13,998**	**$13,492**	**$12,870**
Seller Financing + Investor Capital Accretion		*$1,086*	*$1,233*	*$1,342*	*$1,244*	*$1,127*
Exit Valuation						
EBITDA						$3,000
Valuation Multiple						4.0x
TEV						$12,000
Less: Net Total Debt						$7,247
Total Equity Value						**$4,753**
Less: Value to Redeemable Pfd Stock						$1,647
Less: Value to Non-Redeemable Pfd Stock						$3,105
Value to Common Equity						**$ --**