

---

---

# MEZZANINE INVESTMENTS :

Everything You Wanted to Know But Were Afraid to Ask

TEXPERS

Presented By:

*Venita E. Fields*

Partner

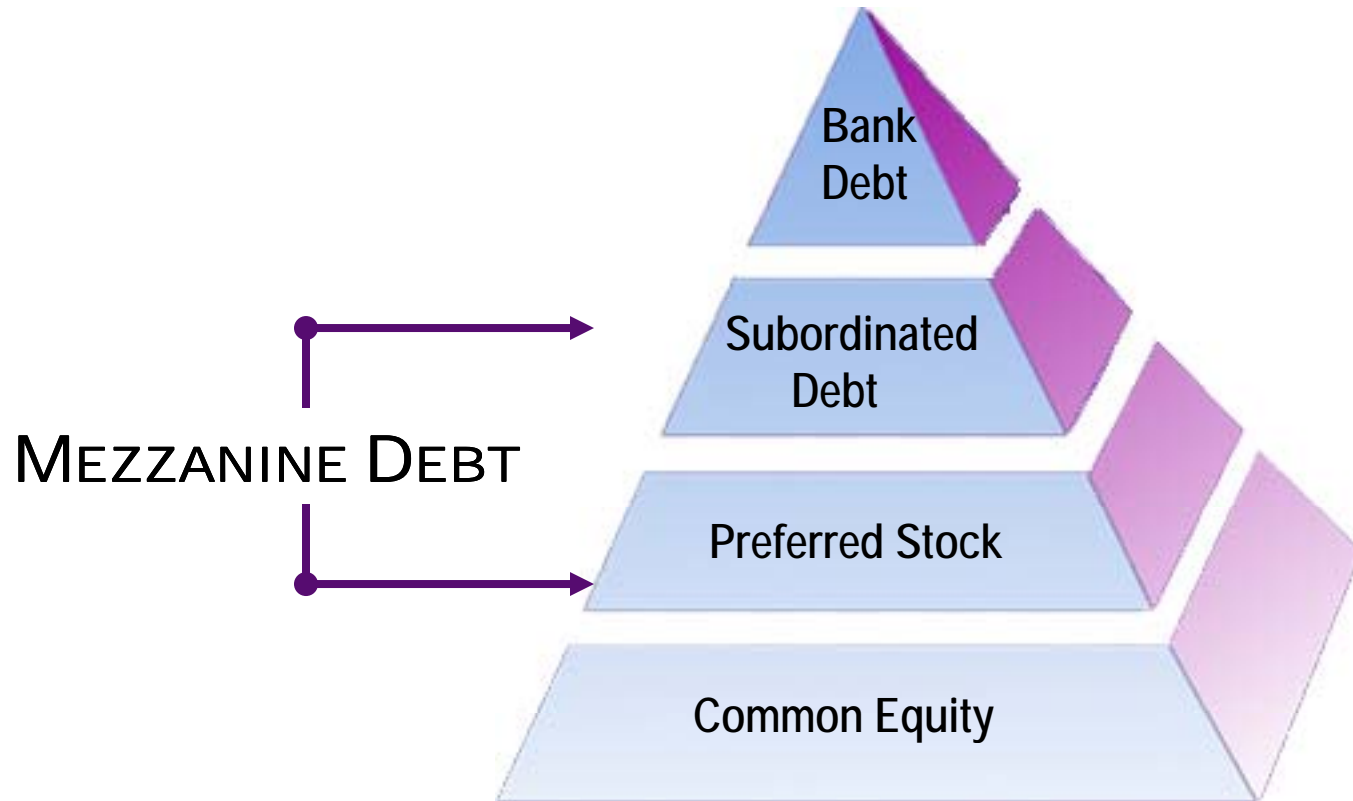
SMITH WHILEY & COMPANY



# CAPITAL PYRAMID

---

---



# CHARACTERISTICS OF MEZZANINE

---

---

- Mezzanine: subordinated debt with equity participation or preferred stock
- Equity participation (“kickers”) include:
  - Options (such as call or put rights)
  - Rights to participate in cash flow or earnings
- Conversion features (allow debt to become common or preferred stock)
- Mezzanine is typically less expensive than new equity financing with current return expectations of 16 – 18%



# CHARACTERISTICS OF MEZZANINE

(Continued)

- More flexible than traditional bank financing
- Allows companies to lower their overall cost of capital with less dilution
- Mezzanine financing is attractive for companies who need capital for:
  - Growth
  - Acquisitions
  - Management buyouts
  - Product development
  - Consolidation
  - Recapitalization
  - Other uses where bank debt or equity is not appropriate or desired by the company



# MARKET RETURNS AND SPREADS

	1995	2000	2007	2008
Five-Year Treasuries	7.8%	5.0%	4.5%	2.5%
Average Mezzanine Targeted IRR	22.7%	19.1%	18.0%	18.9%
Spread Over Treasuries	14.9%	14.1%	13.5%	16.4%
Average Buyout Equity Targeted IRR <sup>(1)</sup>	30.0%	27.5%	22.5%	21.0%
Spread Over Treasuries	22.2%	22.5%	18.0%	18.5%
Buyout Equity Targeted IRR Less Mezzanine Targeted IRR	7.3%	8.4%	4.5%	2.1%

Source:



*(1) Approximations based on market data (for illustration purposes).*

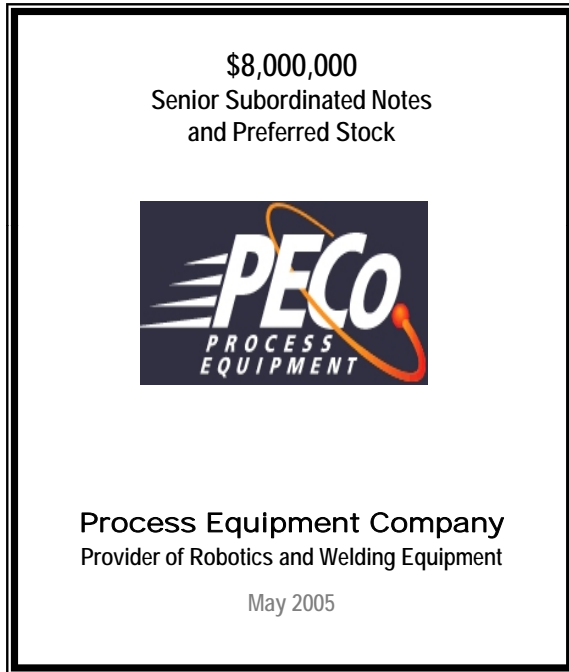


# CASE STUDY # 1

---

---

## PROCESS EQUIPMENT COMPANY ("PECO")



- Sponsor:**
- Buckingham Capital Partners
- Purpose:**
- Acquisition Finance
- Mezzanine Structure:**
- \$5.0 million subordinated debt
  - \$3.0 million preferred stock
- Mezz Features:**
- Current Coupon (12%) plus PIK (6%) Feature
  - Redeemable and Convertible Features
  - 23% Equity Ownership
- Sponsor Contribution:**
- Common Stock plus junior sub debt for working capital support



# CASE STUDY # 1

*(Continued)*

---

---

## WHY PROCESS EQUIPMENT (PECO) - VALUE PROPOSITION

- 60+ year old provider of highly engineered ( robotic) products for the automotive industry
- Sole source provider with immunity to foreign (Asian) competition
- Seasoned stable management team with strong operating controls



# CASE STUDY # 1

*(Continued)*

---

---

## WHY PROCESS EQUIPMENT (PECO) - VALUE PROPOSITION

- Company has solid order backlog through 2008
- Demonstrated strong consistent historic cash flow
- Partnership has collected over \$3.2 million in cash from principal and interest payments with the potential to realize an additional \$10.8 million through the sale of the company (\$8 million investment/\$14.0 million return potential in 5 years)

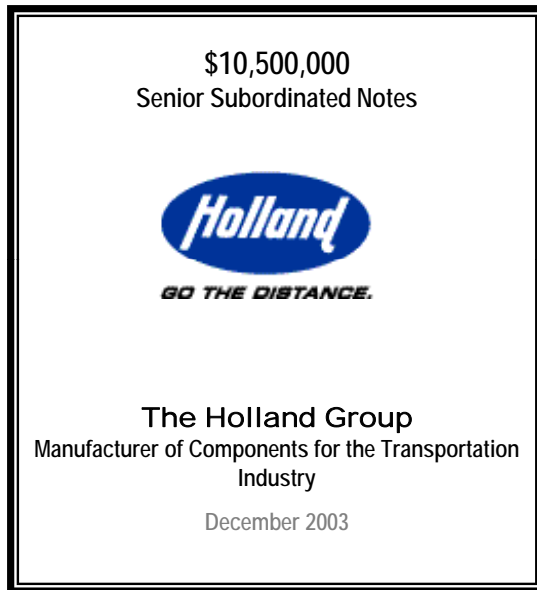


# CASE STUDY # 2

---

---

## THE HOLLAND GROUP



### Sponsor:

- NONE – Direct Deal

### Purpose:

- Balance sheet recapitalization

### Mezzanine Structure:

- \$10.5 million subordinated debt

### Mezz Features:

- Current Coupon (13%) plus PIK (7%) Feature
- Bonus Payment structured for increasing cash on cash returns in years 1-5
- No warrants

### Sponsor Contribution:

- N/A



# CASE STUDY # 2

*(Continued)*

---

---

## WHY HOLLAND? - VALUE PROPOSITION

- 90 + year old family owned business in the cyclical transportation products industry
- Highly motivated management team with significant equity stake in the company
- Tight cohesive management team together in 2 recessions
- Company has significant market share in all product lines



# CASE STUDY # 2

*(Continued)*

---

---

## WHY HOLLAND? - VALUE PROPOSITION

- Company has strong cash flow capability in good times
- Brand name and market share provided some protection from foreign competition
- The Partnership made a \$10.5 million investment, which returned \$19.5 million in 16 months for a cash-on-cash return of 1.85 times

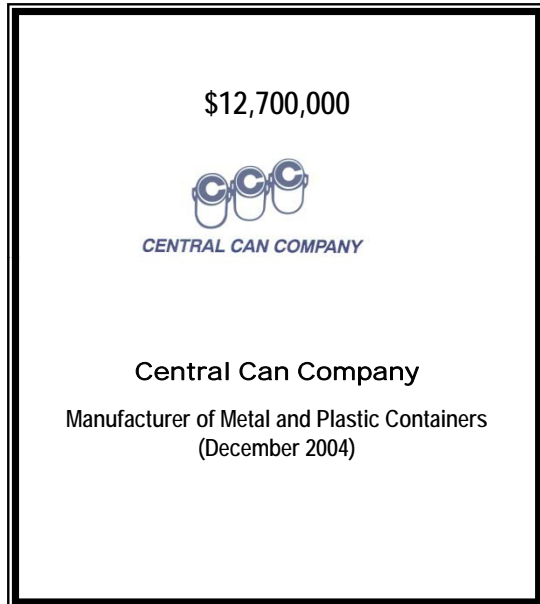


# CASE STUDY # 3

---

---

## CENTRAL CAN COMPANY



Sponsor: ■ DN Partners

Purpose: ■ Product Expansion

Mezzanine ■ \$12.7 million subordinated debt with warrants

Structure:

Mezz Features: ■ Current Coupon (12%)  
■ Detachable Warrants (4%)



# CASE STUDY # 3

*(Continued)*

---

---

## WHY CENTRAL CAN COMPANY? - VALUE PROPOSITION

- Opportunity to invest in a profitable business with history of strong cash flow, strong customer relationships and significant growth potential
- Company seeks to grow in hybrid plastic arena utilizing long-term contracts with valued customers in order to enhance value
- Company is the nation's only manufacturer of a particular size of pail which is sold to a captive customer base
- One of the nation's leading producers of high quality metal and plastic containers used in variety of specialized applications



# CASE STUDY # 3

*(Continued)*

---

---

## WHY CENTRAL CAN COMPANY? - VALUE PROPOSITION

- Manufacturers and supplies cans and pails as a subcontractor to the US Government under the US vegetable program
- Generates strong revenue and EBITDA on a consistent basis, not overly leveraged
- Proceeds to support construction of hybrid plastic line – currently generating significant revenues and contribution from long term contracts
- Partnership realized over \$9.4 million in 3 years on \$12.7 million investment with the potential to realize an additional \$8.7 million in next two years



# MEZZANINE: ATTRACTIVE RISK ADJUSTED RETURNS

---

---

## JUNIOR CAPITAL (Subordinated Debt\*)

- Liquidation preference
- Greater cash flow predictability due to seniority and ongoing payments of principal and interest
- Shorter duration
- 16%-18% average return potential

## PRIVATE EQUITY

- Last out capital
- Valuation uncertainty
- Limited liquidity prior to full exit
- 19% to low 20s% return potential

Conclusion: When return expectations narrow (current scenario)  
**MEZZANINE IS A BETTER RISK ADJUSTED VALUE**

