



Subordinate Financing

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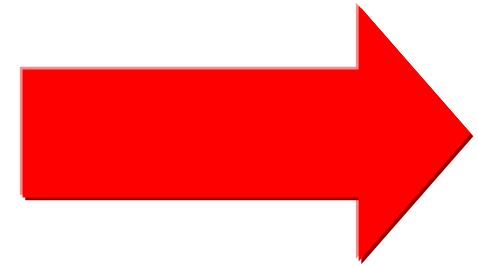


Sub-Debt

Traditional
Term Loans

Sub Debt
Mezzanine Financing
Quasi-Equity

Private Equity
Venture Capital



Land & Buildings
Equipment

Goodwill
Intangibles
Cash Flow

No Cash Flow
IPO

Sub-Debt for Acquisitions or MBO's

Company's typically sell for more than just the value of the assets.

- Multiples of EBITDA, Cash Flow, Revenue

This amount, above the market value of the assets, is *GOODWILL*. How do you finance it?

- purchaser's investment
- vendor take-back
- other sources of equity
- subordinate financing

Subordinate Financing = Quasi-Equity

	Senior Debt	Quasi-Equity	Equity
Repayments	Fixed	Flexible	Non-existent
Guarantees	1 st ranking	Subordinated	Non-existent
Compensation	Fixed <i>(Interest)</i>	Fixed & Variable <i>(interest and upside, 14-18%)</i>	Variable <i>(upside over 20% return)</i>
Risk	Low	High	Highest
Involvement in management	No involvement	No Involvement	Shareholder's Agreement & Mgmt Rights

Subordinate Financing

- The BDC sub debt group provides investments from \$300,000 - \$10 million
- Industries targeted: Manufacturing, Wholesale, Retail, Food, Transportation, Services, IT
- Excluded: Start-ups, workouts, real estate

Recent Transaction: ABC

- History:
 - Established in 1979 as an environmental consulting firm
 - 170 employees
 - Revenue Fcst FY06 is \$22M vs. FY05 of \$21M
- The deal: MBO 100% for \$6.5MM

- Valuation:

Normalized EBITDA most recent year \$2.5MM

Average EBITDA over last 3 years \$1.8MM

Purchase price \$6.5MM for 100% (2.6x to inside mgt)

BDC valuation for a FMV used 4x multiple due to the sales growth and increase in EBITDA over the past 3 years:

\$10.0MM for 100% of the company on most recent year or
\$7.2MM based on average 3 years.

Recent Transaction: ABC

- The Structure:
 - BDC Sub Debt \$2MM
 - BDC Equity \$1MM
 - Management Investment \$1.5M
 - Senior lender \$1.5M
 - Vendor Take-back \$0.5M
- Terms and Conditions:
 - Sub-Debt: ½ balloon, 11% coupon + % of EBITDA, 16% IRR
 - Equity: call option 15% IRR, if not 28.9% IRR in 5 years.
- Why they chose BDC:
 - Creativity: allowing our equity to be purchased when company becomes employee-owned (6 months after closing)
 - Quick to structure deal and provide “letter of intent”

Recent Transaction: XYZ

- History:

- Established in 1987, in the oil and gas service industry sold in 2002
- 30 employees
- Revenue Fcst FY06 is \$2.7MM vs. FY05 of \$2.5MM

- The Deal

- To refinance the vendor take-back \$260k and accrued profit sharing to the vendor \$350k and working capital \$90k

- BDC Valuation:

Normalized EBITDA \$560k

Applied a 4x multiple

Equity Value (no debt) \$2.2MM

Recent Transaction: XYZ

- Terms and Conditions:
 - \$700k investment with a Balloon of \$324k, 13.0% coupon, Royalties on Sales
 - IRR of 19%
- Why they chose BDC:
 - Other lenders had difficulty with the proforma debt to equity ratio 4.4:1. We worked with a bank that could understand sub-debt and with our subordination agreement could use our funds as equity in their clients covenants 0.4:1.
 - Profit Sharing to the vendor was onerous (50% of profits) and potential for growth was substantial.

Process

- Analysis of Financial Statements (Review Engagement, Audits)
- Due Diligence - discussions with management, customers, suppliers, on-site visit, lots and lots of questions...
- Due diligence and writing of the investment can take 2 weeks
- Legal documents must be completed (2-4 weeks)
- CLOSING!!

Definitions

- Bullet payments/Balloon payment
- EBITDA
- Free Cash Flow/Cash Sweeps
- Internal Rates of Return (IRR)
- Subordination Agreements
- Valuations
- Chartered Business Valuators