



MOSAIC CAPITAL  
PARTNERS

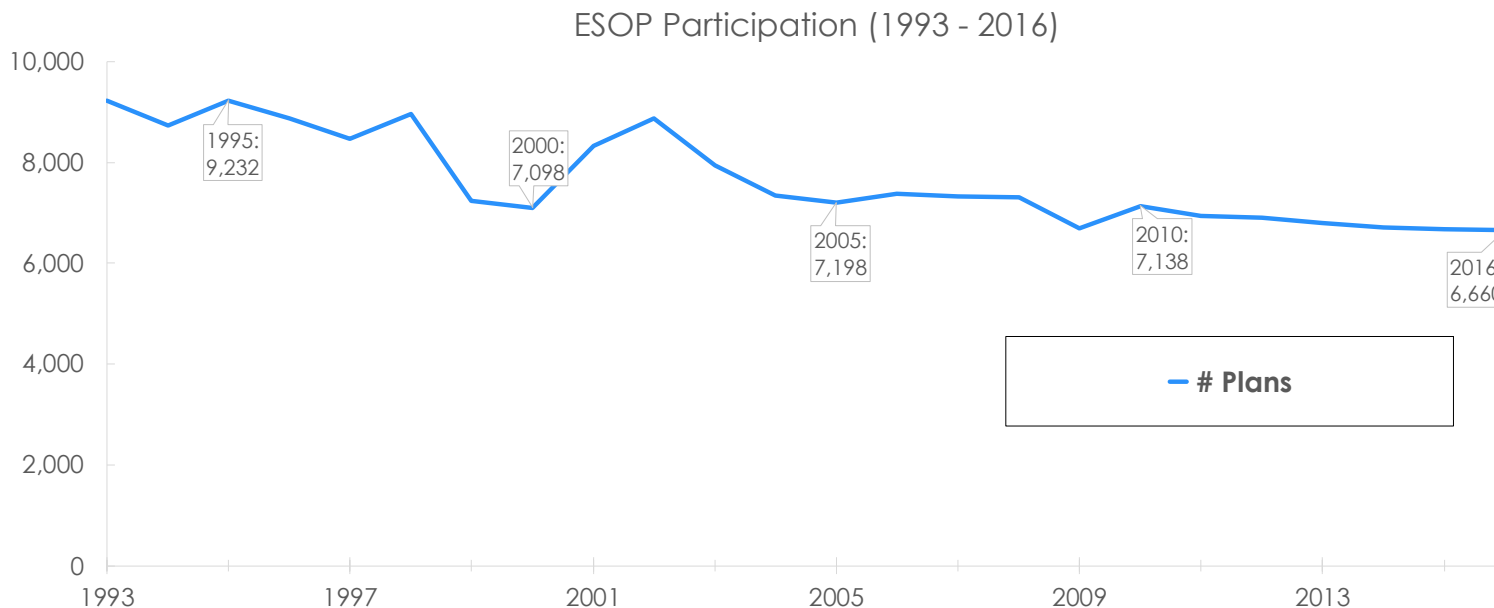
# Mosaic Capital

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## Employee Ownership (EO) Buyout Primer

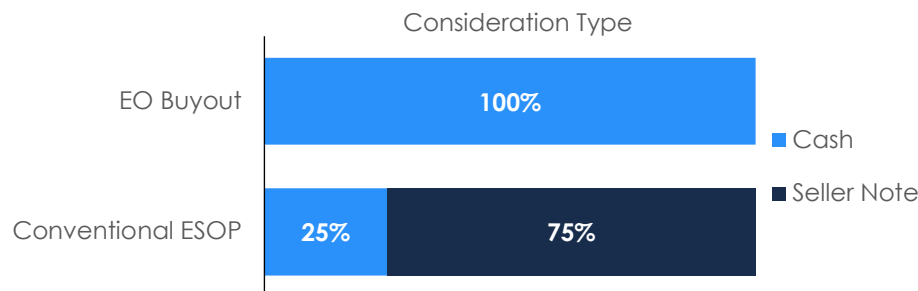
2019

- Employee Stock Ownership Plans (ESOPs) date back to 1956, when economist Louis O. Kelso effected the first ESOP transaction in transitioning ownership of Peninsula Newspapers, Inc. from its two founders (each in their 80s) to their chosen successors, the employees
- ESOP adoption accelerated when Senator Russell Long inserted provisions regarding ESOPs into the Employee Retirement and Income Security Act (ERISA) in 1974 making ESOP-owned companies income tax exempt
  - ESOPs further accelerated by the Tax Reform Act of 1984 (indefinite deferral of capital gains tax on proceeds if >30% of shares sold to ESOP) and Small Business Job Protection Act of 1996 (permitted ESOPs as eligible shareholders of S Corporations)
- Despite their many benefits, ESOP conversion has stalled over the past 25 years and comprise a tiny fraction of the 30+ million small business in the U.S.



Source: National Center for Employee Ownership (NCEO)

- The impact organization Democracy Collaborative launched an initiative in 2016 to create 50 million employee owners by 2050 (“50 by 50”)
- There are an estimated 40,000 M&A Transactions<sup>1</sup> completed each year versus ~150 ESOP transactions<sup>2</sup>
- The conventional ESOP transaction requires the selling shareholders to take the majority of their proceeds in a deeply subordinated seller note
  - Typical payback is 5 – 10 years if the company generates sufficient cash flow to pay back
    - Eliminates private equity sellers who need to return capital to their investors immediately
    - Eliminates carve-out transactions
    - Eliminates founder / owners seeking a full liquidity event
- An EO Buyout addresses a much larger universe of sellers by having a private equity firm provide the traditional seller debt portion of sources in an ESOP conversion, creating a full liquidity event for the sellers
  - The introduction of a sponsor allows for more attractive financing terms
  - Senior / Mezzanine lenders more willing to invest when there is sponsor money beneath them
- Sponsor (Mosaic) provides capital & vision for growth which is absent in a conventional ESOP

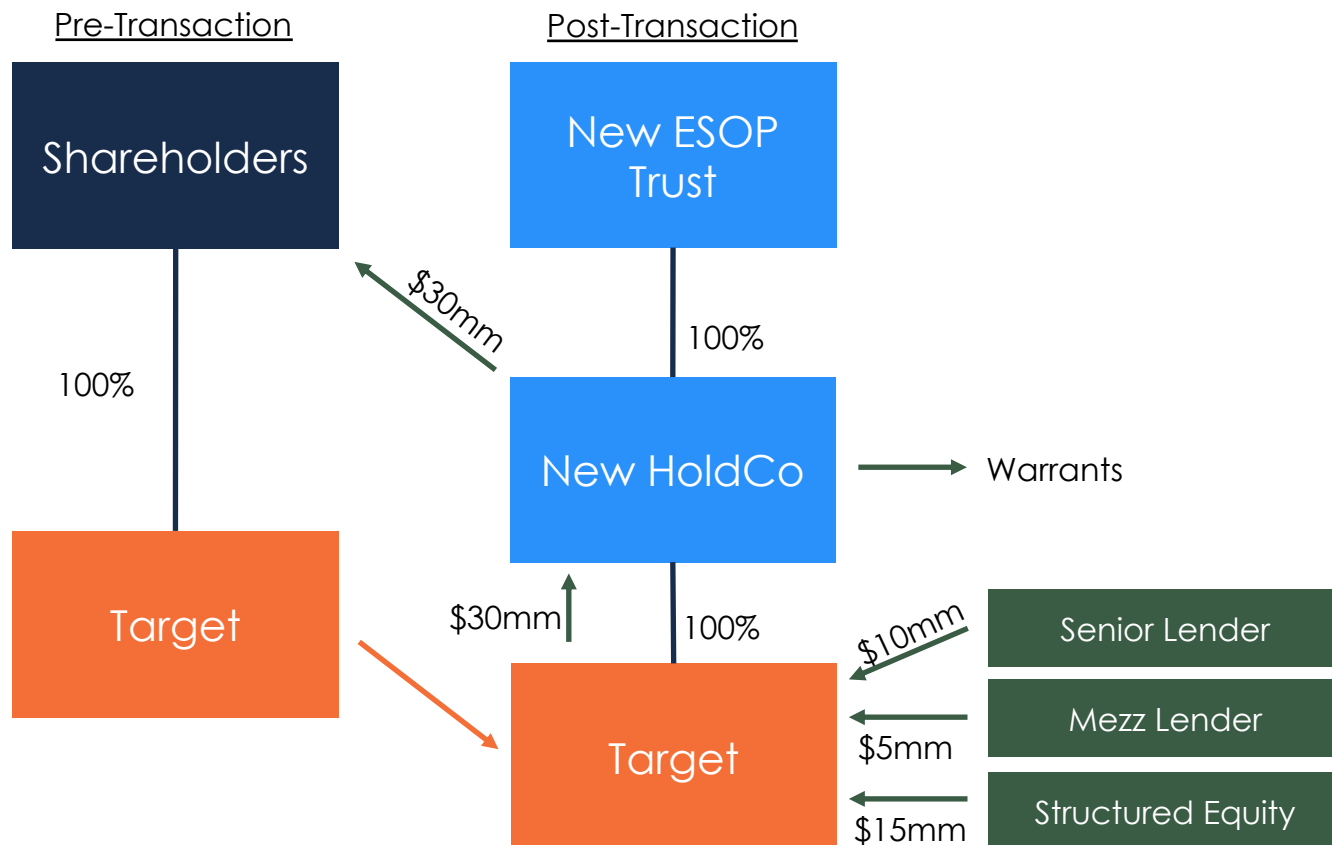


<sup>1</sup> Bain & Company, Inc. Global Private Equity Report 2018

<sup>2</sup> NCEO

- In an EO Buyout, the “Buyer” is a new HoldCo set up by Mosaic
- Concurrent with the acquisition of the operating entity (“Target”) by Buyer, a newly formed ESOP Trust subscribes for 100% of the shares of the HoldCo

Sources (\$000s):		Uses (\$000s):
Senior Debt:	\$10,000	Proceeds to Shareholders: \$30,000
Mezzanine Debt:	\$5,000	
MCP Structured Equity	\$15,000	
<b>Total:</b>	<b>\$30,000</b>	<b>\$30,000</b>



- Post-transaction, 100% of the outstanding shares are owned by the ESOP Trust
  - Shares are typically allocated on an annual basis to employees over a 15 – 30 year period
  - Shelters 100% of income tax exposure freeing up significant cash flow
- Structured Equity is an unsecured debt security with a flexible interest rate and equity participation via warrants
  - Cash interest can be toggled as low as 0% depending on the cash flow needs of the business
    - The delta between cash interest and the total coupon accrues as PIK interest
      - i.e. if cash interest is 4.0%, PIK interest would be 10.0% (MCP targets FCCR >1.50x)
  - Selling shareholders and management are encouraged to roll-over proceeds into structured equity pari passu with Mosaic
- Base case assumes the company de-levers sufficiently over 5 years to payback structured equity and redeem warrants through a recapitalization event versus a second sale of the Company

Security	Amount (\$000s)	xEBITDA	Typical Terms
Senior Debt	\$10,000	2.00x	LIBOR + [3.50% - 4.00%]
Mezz Debt	\$5,000	3.50x	[10.00% - 12.00%]
Structured Equity	\$15,000	7.00x	[12.00% - 14.00%] + 40.00% Warrants



~20% IRR & 2.2x MOIC



## Governance

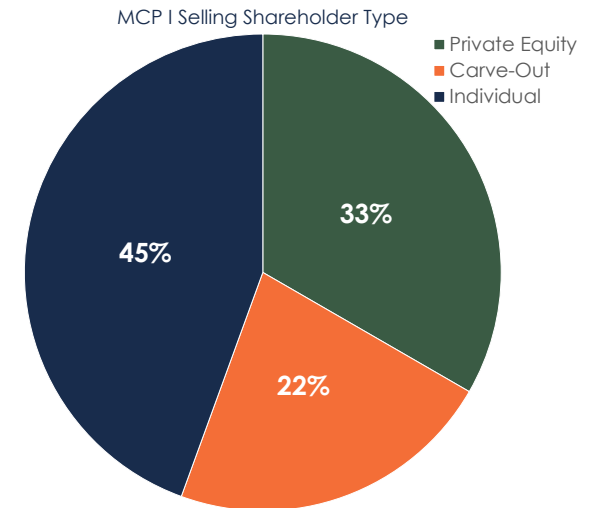
- The employees are represented by a Trustee, a fiduciary who looks after the employees' interests
  - In a Mosaic EO Buyout, Trustees are always third-party institutional firms
- The Company is governed by the Board of Directors, which is outside controlled in an EO Buyout
  - Like private equity, a management incentive pool (MIP) of 10 – 15% is created for key members of management
- Unlike private equity, an EO Buyout creates a true partnership model

EO Buyout Board Composition



## Why it Matters

- 1) All cash EO Buyout expands potential ESOP candidates to the full M&A market
- 2) 100% alignment of interest top-to-bottom
- 3) Empower employee-owned companies with the financial and strategic resources of private equity
- 4) Avoids private equity cycle of needing to be re-sold every 3 - 5 years
- 5) Retain quality jobs in communities
- 6) Deliver attractive risk adjusted returns to investors



## MCP I Highlights

- 3,500+ employee owners created and/or emboldened by the fund
- 1 / 10 EO Buyout portfolio companies considered an ESOP transaction before being introduced to Mosaic
  - 8 / 10 sourced from competitive processes run by a sell-side advisor
- Portfolio companies span a broad range of industries, sectors, and geographies