# Leveraged recaps put debt to work for you

**If you're thinking about selling your company but are frustrated with the current market, you may want to consider a leveraged recapitalization. These transactions can be risky, and in an uncertain economy you may not want to add debt to your balance sheet. However, for some companies looking to raise capital, a leveraged recap can be an excellent stopgap tool.**

## Debt for cash

In a leveraged recap transaction, a company accesses liquidity by assuming new debt — generally a significant amount for a specific purpose. The cash might be used, for example, to pay shareholders an extraordinary dividend, fund a major share repurchase program or finance a business acquisition.

Recaps usually take one of two forms:

1. The company borrows from a private equity group (which typically will want a 51% equity share) that then becomes a co-owner of the business, or

2. The company receives additional financing via new bank loans or new debt issuance. The size and terms of the recap depend on a variety of factors, including its purpose and the company's current revenues and debt load. An already debt-heavy balance sheet generally harms a company's leveraged recap prospects.

## Reasons for a recap

Companies undertake leveraged recaps for a variety of reasons — primary among them, of course, is to raise cash. Recaps can offer enough liquidity to make an outright sale unnecessary. They also can improve your company's chances of selling for a fair price in the future by:

**Beefing up defenses.** By assuming additional debt and reducing cash reserves, a company becomes less attractive to hostile bidders and, therefore, buys time until more appealing buyers emerge.

**Lending more control**. A recap can provide members of management with a larger number of shares and, thus, reduce the ability of dissident shareholders to force a sale.

**Improving financials.** It may seem like a paradox, but high debt levels can incentivize a company to improve its financial profile by reducing expenses and divesting itself of underperforming or nonessential units. The result can be a stronger company and more appealing acquisition target.

## Some may be vulnerable

Leveraged recaps can be risky. A University of North Carolina survey of leveraged recaps in the 1990s found that companies had an average 17% debt-to-total-capital ratio before the transaction and a 50% ratio afterward. Such high debt loads typically make companies more vulnerable to general economic distress and market volatility. But if your company's fundamentals are strong and you're looking for an alternative to selling, a recap may be the solution for you.


"Doc, what will it take to get my blood pressure down until I can get my company profitable again?"