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RECAPITALIZATION A CASE STUDY

How recapitalization helped one company achieve greater success

As business owners approach retirement, their businesses are sometimes prevented from reaching full potential due to the owners' growing aversion to risk.

Often, a business represents a significant portion of an owner's net worth. As retirement approaches, some owners reduce capital spending and new product or channel development, which stifles long-term growth.

In such instances, a recapitalization — selling a majority of the business to a growth-minded private equity firm for cash, while maintaining an ownership interest that fits the owner's risk appetite — can rejuvenate a company both financially and culturally.

A case in point is Happ Controls. The company, headquartered in Elk Grove Village, Ill., was founded in 1986 and has grown to become North America's largest manufacturer and distributor of parts for the amusement, vending and gaming industries. In 2004, Frank Happ, the founder and sole shareholder of Happ Controls, was approaching retirement and sought to take some of his chips off the table. Fortunately, the time was right, as revenue and profit were at an all-time high.

Because of the company's success and growth, Happ faced challenges typical of owner-operated companies, such as broadening the company's product line, increasing international sales, leveraging foreign sourcing opportunities and improving operating efficiencies, quality control and financial planning. In addition, Happ recognized the need for additional capital to support internal growth and opportunistic acquisitions.

In 2004, Frank Happ sold a majority of Happ Controls to a private equity firm and assumed the role of vice chairman.

According to Frank Happ, the recapitalization of Happ Controls opened the door to opportunities

that were previously unavailable to the company. Historically, it had focused on revenue growth as the key driver to increased profitability. Now, while revenue growth is still important, the company also emphasizes professional management practices and information systems that allow it to scrutinize margins. Subsequently, operating margins have doubled while quality, ontime delivery and customer satisfaction are at all-time highs.

In addition, the company completed a merger with its largest European counterpart and has made eight smaller acquisitions, including one in China. Happ Controls is now the dominant global player in its industry and offers tremendous synergies related to sourcing, product line, distribution channels and sharing best practices.

"Without the capital provided by our private equity investor," says Happ, "the transaction wouldn't have been possible. Not to mention that we had little experience in doing an acquisition or integrating companies post-closing. However, I think the most important change came at the employee level."

Previously, decision-making at Happ Controls was very centralized. Now, it has a company-wide, team-based, continuous-improvement program that encourages and rewards all employees for improving the value Happ Controls brings to its customers. Employees feel empowered and recognize their importance to the company's success.

"While they were initially and naturally worried about how the change in ownership would affect them," Happ says, they are now energized and have a refreshed attitude and commitment to their job. Most of our key managers have an equity interest in the company, and all employees have more career options."



SCOTT A. FINEGAN is a Managing Director at Pfingsten Partners, L.L.C., an operationally focused private equity firm located in Chicago, IL.

Positively affecting the day-to-day happiness of the company's dedicated workers turned out to be one of the biggest pluses to the merger, and the fact that it was an unforeseen bonus only makes it sweeter.

As this example illustrated, successful recapitalization transactions are often built upon a positive and dynamic relationship between the business owner and the private equity investor. Many middle-market companies have significant growth and profit potential but lack adequate capital, resources and experienced outside counsel.

A recapitalization can be a successful means of creating a more profitable and competitive business. ■