NA0030

Private Equity Case: Merger Consolidation*

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In early 2006, Aaron Brown, recently promoted to partner, was meeting with John Fields, the founder of ACE Equity Partners, a mid-size private equity fund in Chicago, Illinois. Aaron was recently put in charge of the newest investment opportunity for ACE, the possible acquisition of two physical therapy ("PT") companies in Ohio and Maryland. ACE's primary investment strategy for the space was to consolidate smaller private PT businesses that focused on patient outcomes into a much larger enterprise. ACE anticipated selling the consolidated enterprise to a larger private equity fund or taking the company public in three to five years.

John: Congratulations on your recent promotion to partner. Now you get the chance to prove yourself on this potential PT investment.

Aaron: Thanks. I'm excited to be in charge of this investment opportunity. I now have all the major documents for these two PT companies including (1) the CPA firm's accounting reports on both PT Companies, (2) the investment banker's prospectus on both PT Companies, and (3) financial analysts' reports on the PT industry.

John: Excellent. I look forward to your analysis and recommendations on this PT investment opportunity for our partners investment committee meeting next Monday.

Aaron: I will be ready.

PT Industry

In reviewing the financial analysts' reports on the PT industry, Aaron noted that one analyst had just initiated coverage of two public PT companies, U.S. Physical Therapy and RehabCare Group. He thought such interest was a good sign for the PT industry although he noted that his recommendations for these two companies were "hold/high risk." Aaron summarized key PT industry points from the reports of the financial analysts and the prospectus of the investment banker as follows:

- The United States spent a larger share of its gross domestic product (GDP) on healthcare than any other major industrialized country. Expenditures for healthcare represented nearly one-seventh of the nation's GDP and continued to be one of the fastest growing components of the Federal budget. For example, in 1960 healthcare

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expenditures were five percent of GDP. By 2005, healthcare expenditures had grown to more than fifteen percent of GDP.

- Economic factors in the healthcare industry were driving growth in PT. Healthcare payers, such as governments, insurance companies and employers, had become increasingly focused on eliminating unnecessary healthcare costs from the system. Because of the trend toward minimizing healthcare cost, many payers were focused on the quality of the care provided to patients. It was less expensive for payers to have a patient treated correctly the first time than to have the patient return to therapy after a recurring injury. Thus, PT companies that focused upon outcome based results were receiving increased referrals from payers and employers.
- The PT industry was estimated to be a $12 billion market and had been growing 12 percent annually over the last five years. The industry was highly fragmented with 16,000 companies, the majority of which were small "Mom and Pop" entrepreneurs. No competitor had more than a 5 percent market share and the top five operators, HealthSouth, Select Medical, Stryker, Benchmark, and U.S. Physical Therapy, together had only a 17 percent market share. Smaller private companies comprised the remaining market share.
- The PT industry had low barriers to entry because the cost (facilities and exercise equipment) of starting a practice was minimal. Additionally, Congressional legislation in 1998 allowed physicians to open PT clinics, thereby increasing competition for patients.
- There were more than 120,000 licensed physical therapists in the U.S. They practiced in many settings, including outpatient clinics, inpatient rehabilitation facilities, skilled nursing facilities, extended care facilities, homes, research centers, schools, hospices, workplaces and fitness centers. The Department of Labor predicted above average employment growth for therapists through 2012 as (1) the growing number of individuals with disabilities or limited function, including aging baby boomers, spurred demand for therapy services and (2) therapists' compensation was among the industry's highest levels. The growth, however, had created a shortage of therapists in many markets as new job demands exceeded the number of licensed PTs.
- The most important driver of any PT company was its relationships with referral sources and payers. Although patients received the treatment, physicians generally controlled the flow of patients to PT companies through referrals. Additionally, large commercial health insurance carriers and Health Maintenance Organizations (HMOs) often determined the reimbursement rates that PT companies received. PT companies typically negotiated directly with these commercial payers for reimbursement both contractually and for each individual claim.
- Price was always an issue in the PT industry as payers viewed low prices as the easiest way to cut down on expenses. Pricing pressure in the industry, intensified by legislation that allowed physician office-based clinics, had created a difficult environment for providers to offer the right quality of care at the right price.

The Ohio PT Chain

The Ohio PT company was founded in 1997 by physical therapists and exercise physiologists. By the end of 2005, it had grown to eight clinics located in major cities across Ohio. Patients typically ranged from 16 to 55 years of age. The Ohio firm focused upon combining and applying best practices from the disciplines of physical therapy, exercise physiology, and athletic training.

The company focused on large clinics with extensive equipment, located in major population centers, marketing itself as providing one-source or one-stop rehabilitation solutions. Each Ohio facility had a minimum of 5,000 square feet, as opposed to the typical "store-front" PT facilities of about 1,000 square feet. With state-of-the-art equipment and one-on-one sessions with physical therapists and trainers, the Ohio facilities appeared to be gyms where people were enjoying rehabilitation. Such practices led to a 10 percent appointment cancellation rate, as opposed to the normal 50 percent cancellation rate in the PT industry. Such practices also helped retain and attract physical therapists. Additionally, the Ohio firm was well known throughout the industry as providing the best rehabilitation services in the industry and had recently been honored as the best private practice in the U.S. by a rehabilitation magazine.

The Maryland PT Chain

The Maryland (MD) PT company, founded in 1999 by physical therapists, was somewhat younger than the Ohio company. It had grown to fourteen clinics located in major cities across Maryland and Delaware and treated patients ranging from 16 to 55 years of age. MD focused primarily upon the discipline of physical therapy.

MD also tried to concentrate on large clinics in populated areas, but it did not have state-of-the-art equipment and was known as a "churn and burn" provider, focusing on putting as many patients through the system as possible. MD's focus was similar to the typical PT approach, relying on many "store-front" clinics to increase the number of patients. Therefore, it did not have an established, favorable reputation to facilitate the growth rate that the Ohio PT company had. However, MD did provide a number of services that the Ohio firm did not, including aquatic therapy, hand therapy and spine therapy. Also, MD had a very efficient collection system that focused on ongoing communications with its payers, especially for accounts past 30 days old.

Estimating EBITDA for Business Valuation

Working with the information from the CPA firm, Aaron planned to recast the financial statements in order to derive earnings before interest, taxes, depreciation, and amortization (EBITDA) for the last two years. He knew that an accurate EBITDA calculation was needed to help determine the final valuation for each PT company. In order to accurately calculate this figure, Aaron had to adjust or recast whatever revenues and expenses had been reported in the income statements by the PT firms' unsophisticated bookkeepers. Such initial numbers were mainly cash accounting with attempts to do accrual accounting for accounts receivable, prepaid expenses, and accrued expenses. These adjustments focused on recasting this unsophisticated combination of cash and preliminary accrual accounting to complete accrual accounting for revenues and expenses under generally accepted accounting principles (GAAP). Neither company had ever had an

audit of its financial statements but ACE's potential lenders would require the use of GAAP and an audit by a CPA firm. Aaron summarized the last two years of unadjusted financial statements for both companies (the only reliable historical information available due to the limitations of both companies' bookkeeping practices) in **Exhibit 1**.

The most complex calculations involved converting the reported revenues to actual accrual revenues. This process focused on converting gross revenues to net revenues once reimbursement rates were determined for different types of PT services. Such rates depended upon individual states and insurance company procedures. Various payers, such as Blue Cross or Kaiser, negotiated with various service providers (HealthSouth or Humana Hospitals or the PT companies in this case), to agree upon various reimbursement rates. These service providers would bill at full rates (gross revenues) but the payers would pay just the negotiated rates (net revenues) to the service providers. The patients (subscribers) were only responsible for their co-pay amounts, if any, to their insurance companies and did not have to pay any differences between gross and net revenues to the PT companies. Thus, the amount billed by the service providers often represented a total cost computed with full overhead allocation that the payor would negotiate down to a lesser amount (with less than a full overhead charge),

Exhibit 1 ACE Private Equity Fund—Ohio and Maryland Physical Therapy Firms: 2005 and 2004 Unadjusted Financial Statements (000)

INCOME STATEMENT

	Ohio		Maryland	
	2005	**2004**	**2005**	**2004**
Net Revenue	$ 20,041	$ 15,049	$17,726	$ 17,352
Cost of Services	7,547	5,806	7,093	6,464
Gross Profit	12,494	9,243	10,633	10,888
Operating Expenses	3,137	1,598	5,883	5,463
Operating Income	$ 9,357	$ 7,645	$ 4,750	$ 5,425

STATEMENT OF FINANCIAL POSITION

Assets				
Current Assets				
Cash	$ 1,342	$ 606	$ 653	$ 620
Accounts Receivable, Net	5,033	3,241	3,698	3,650
Prepaid Expenses	129	39	104	93
Total Current Assets	6,504	3,886	4,455	4,363
Fixed Assets, Net	1,677	910	1,538	1,477
Other Assets: Deposits	456	66	108	88
Total Assets	$ 8,637	$ 4,862	$ 6,101	$ 5,928
Liabilities and Owners' Equity				
Current Liabilities				
Accounts Payable	$ 200	$ 222	$ 264	$ 241
Accrued Expenses	77	90	749	671
Current Portion of LT Debt	226	62	0	0
Total Current Liabilities	503	374	1013	912
Long-Term Debt	597	96	1,047	1,107
Owners' Equity	7,537	4,392	4,041	3,909
Total Liabilities & Owners' Equity	$ 8,637	$ 4,862	$ 6,101	$ 5,928

similar to a quantity discount, since the payor represented a large number of patients or subscribers. Aaron had determined the appropriate reimbursement percentages for the four types of PT services (workmen's compensation, medical insurance payers, medicare, and other) in converting from gross revenues to net accrual revenues which had to be compared to the reported revenues of the two PT firms.

Aaron was also considering another revenue or "run-rate" adjustment for newly opened clinics. This EBITDA adjustment gave a full years' worth of revenue (and EBITDA) to new clinics opened by Ohio and MD in the current year. For valuation purposes, Aaron thought it would be unfair to calculate partial EBITDA for a clinic that would achieve full EBITDA and revenue capacity in the near future. Thus, such adjusted financial statements no longer represented actual or historical numbers but the most likely or normalized accrual revenues (and expenses) for business valuation purposes. The last revenue (and EBITDA) adjustment was to reduce the 2005 workmen's compensation fees (revenues) in Ohio for a new legislative change that capped or limited such revenue reimbursement per patient.

Expense adjustments involved the under-accrual of payroll expenses since the PT firms' bookkeepers kept the payroll on just a cash or payday basis. Another recasting goal was to normalize the income statement to focus on sustainable or core earnings. Thus, one-time, unusual, or non-recurring expenses, such as consulting fees and excessive owners' compensation and perks, had to be eliminated. These potential adjustments for recasting the financial statements are summarized in Panel A of **Exhibit 2**. The depreciation adjustments shown were already included in the financial statements but were just add-backs to get to EBITDA numbers used by ACE for business valuation purposes.

Forecasting for Business Valuation

Aaron worked with ACE's investment bankers to determine reasonable forecasting assumptions for the two PT firms. He needed to project EBITDA for ACE's typical four-year holding period for its investments. The plan was to have the Ohio and MD PT firms open nine and six new clinics, respectively, per year. The annual sales growth rates (25 percent for Ohio and 15 percent for Maryland in the base case) included both new and same store growth for both firms and the new Ohio legislative cap for workmen's compensation. Aaron thought that such sales growth rates were reasonable based on ACE's strategy of finding and growing a niche market in an industry—here primarily using the Ohio PT firm's best practices as an acknowledged leader in the PT industry. However, in order not to overpay for such investments, ACE typically used probabilities of occurrence for base (60 percent), best (20 percent), and worst (20 percent) cases and a low 3 percent growth rate for any terminal value calculations. Aaron thought he would rely on these ACE guidelines because this business valuation was his first major project as an ACE equity partner.

Related capital expenditures and working capital requirements were also estimated by the investment bankers and seemed reasonable to Aaron. The constant capital expenditures for new clinics and maintenance were based upon Ohio's experiences in starting slowly with smaller initial capital expenditures ($200,000) and then rapidly expanding with maintenance capital expenditures (primarily for more equipment—$300,000 per year) as Ohio established and expanded its customer base. Aaron planned to use this Ohio strategy as a benchmark of best practices for the future projections of both companies. Also, the Maryland strategy of aggressively collecting its receivables through

Exhibit 2 ACE Private Equity Fund—Due Dilligence Information for Possible M&A Transactions

PANEL A: POTENTIAL RECASTING ADJUSTMENTS (000)

Physical Therapy Services	Reimburse Percentage	Gross Revenues Ohio	Gross Revenues Maryland
Workmen's Compensation	80%	$ 14,248	$ 5,857
Medical Insurance Payers	46%	17,820	24,418
Medicare	57%	2,043	3,407
Other	40%	410	1,019
Total Gross Revenues		$ 34,521	$ 34,701
Run rates (revenues) for newly opened clinics		674	87
Legislative change: reduction of workmen's compensation fees (revenues)		274	0
Under-accrual of payroll expenses:			
Cost of services		$ 400	$ 158
Operating expenses		50	12
Adjustments for core or sustainable earnings:			
Non-recurring consulting expenses		148	265
Excessive owners' compensation		0	330
Excessive owners' perks		0	139
Depreciation expenses—last year for old clinics		378	308

PANEL B: FORECASTING ASSUMPTIONS

Probabilities and Sales Growth Rates: (Including new clinics to be opened)		
Base Case (60%)	25%	15%
Best Case (20%)	35%	25%
Worst Case (20%)	15%	5%
New clinics to be opened per year	9	6
Capital expenditures per new clinic	$200,000	$200,000
Annual capital expenditures for maintenance	$300,000	$300,000
St. Line Depreciation for new clinics	5 year life	5 year life
Working capital requirement: % of sales increase	30%	15%
Cost of service expenses as a % of sales:		
First Year	40%	40%
Therapist salary increase per year	2%	2%
Operating expenses as a % of sales	15%	20%
Income tax rate	35%	35%
Normal investment holding period	4 years	4 years
M&A Financing		
Debt (8% interest)	50%	50%
Equity	50%	50%
	100%	100%

Source: Investment bankers, CPA firms, and financial analysts' reports.

increased communication with any accounts over 30 days was reflected in its working capital requirements (as a percentage of sales increase) of only 15 percent versus 30 percent for Ohio. Aaron planned to use this Maryland strategy as a best practices benchmark.

Aaron also agreed that both cost of services and operating expenses were variable expenses. From consultations with both PT firms' management, he concurred that the cost of services expense should be increased by 2 percent per year to try to retain and

attract physical therapists in order to have a key competitive advantage in this industry. Also, for forecasting purposes, operating expenses as a percentage of sales had been reduced to 15 percent for Ohio and 20 percent for Maryland, due to ACE's well-established practice of consolidating the support services of accounting, finance, human resources, and information technology at a centralized location. The only decentralized or local support services that remained were sales and marketing.

From previous ACE acquisitions, he knew that the company initially financed its deals with 50 percent debt (now at 8 percent interest). Regarding the cost of capital, ACE typically used a beta of 2 to 3 since these merger and acquisition (M&A) deals were volatile and risky. The current risk-free rate of interest was 4 percent and the current market risk premium was 8 percent. In addition, ACE typically added another 7 percent investment risk factor to its cost of equity capital in order to further increase the weighted average cost of capital (WACC) as a higher hurdle rate in assessing high risk M&A investments. This 7 percent guideline was derived from past M&A experiences in using the cost of equity build-up method. Aaron summarized the forecasting assumptions in Panel B of Exhibit 2.

Benchmarking Performance

From the investment bankers' and financial analysts' reports, Aaron had compiled benchmarking information that compared public company performance to both the Ohio and MD PT firms for the last two years. In his research of this industry, he found the following performance metrics were cited repeatedly: revenue per PT visit, total expenses per PT visit, visits per day-per clinic, and EBITDA per visit. Such statistical comparisons had helped ACE in its decision to turn down HealthSouth's offer to sell ACE all of its 1,000, mainly "store-front," PT clinics. Such 1,000 HealthSouth clinics generated only $35 million in EBITDA versus just the Ohio firm's eight clinics which generated $9.4 million in EBITDA. This benchmarking information is summarized in **Exhibit 3**.

ACE's normal strategy was to adopt the best practices of each company acquired to the other acquired companies in the same industry. The key aspect of this acquisition strategy was to first acquire the industry leader in best practices or the second-best company if the leader was not available. In this case, the Ohio PT company was targeted to be the major benchmark of best practices (revenues, product mix, cost behavior, and size of outlets) to apply to all subsequent PT firm acquisitions, starting with the MD PT company. Such best practices have been considered in the forecasting assumptions for both the Ohio and MD companies.

To help determine acquisition prices for these two PT companies, Aaron had obtained a list of the most recent private PT company sales (SIC Code 8049) from the Pratt's Stats database that ACE subscribed to. Business valuation ratios for these twelve PT companies are listed in Panel A of **Exhibit 4.** For additional benchmarking analysis, financial ratios of these twelve companies are listed in Panel B of Exhibit 4.

ACE Equity Partners

ACE Equity Partners, founded in 1990 in Chicago, Illinois, by three former investment bankers, had grown to twenty partners and twenty other employees with $1.5 billion of assets under management. ACE's primary investment strategy was to consolidate companies. It typically bought several private companies in the same industry, developed

Exhibit 3 ACE Private Equity Fund—Ohio and Maryland Benchmarking

	OHIO		MARYLAND		Public Company
	2005	2004	2005	2004	Comparables
Total revenues	$ 20,041,100	$ 15,049,000	$17,726,000	$17,352,000	$ 264,336,888
Total visits	94,275	72,846	180,179	177,529	2,812,693
Revenue per visit	$ 212.58	$ 206.59	$ 98.38	$ 97.74	$ 93.98
Number of clinics	8	6	14	14	529
Visits per clinic	11,784	12,141	12,870	12,681	5,317
Revenue per clinic	$ 2,505,125	$ 2,508,167	$ 1,266,143	$ 1,239,429	$ 499,692
Visits per day	374	289	715	704	11,161
Visits per day per clinic	47	48	51	50	21
Total expenses	$ 10,684,000	$ 7,404,000	$12,976,000	$11,927,000	$ 210,236,888
Expenses per visit	$ 113.33	$ 101.64	$ 72.02	$ 67.18	$ 74.75
Expenses/sales	53%	49%	73%	69%	80%
EBITDA	$ 9,357,000	$ 7,645,000	$ 4,750,000	$ 5,425,000	$ 54,100,000
EBITDA per visit	$ 99.25	$ 104.95	$ 26.36	$ 30.56	$ 19.23
EBITDA/sales	47%	51%	27%	31%	20%

Source: Investment Bankers Reports

them for three to five years with revenue and cost synergies, and then sold this larger consolidated company to a larger private equity fund, like Blackstone or KKR, which would subsequently take the company public. ACE's investment strategy focused on three major tactics: (1) build more valuable companies through growth and consolidation, (2) use arbitrage to buy smaller companies at lower EBITDA multiples and then sell them together as a much larger combined enterprise that could justify the higher public company EBITDA multiples, and (3) leverage acquisitions with debt to spread risk and enhance returns.

For investment acquisitions, ACE used leverage buyouts (LBOs) in restructuring the capitalization and ownership of a company, typically a more conservative 50 percent LBO strategy, as opposed to the more aggressive 80 percent LBO strategy of larger private equity companies such as Blackstone and KKR. This restructuring often involved paying off existing debt of the acquired companies in consolidating all debt under the LBO financing strategy. Such an LBO strategy enabled a private equity fund to acquire a target company by using the existing assets and cash flows of the target company as loan collateral. This strategy provided the debt needed to finalize the acquisition and enhance the returns of a private equity fund.

Aaron Brown graduated from a local private university in June 2004 after working sixty hours a week as an unpaid intern at JPMorgan during his senior year. This internship led to a full-time job with JPMorgan. To achieve a competitive advantage over other new hires, he worked more than full time (approximately 100 hours a week) for JPMorgan as an Investment Banking Analyst. One year later he met two ACE partners while working on a deal together. They subsequently hired him away for a substantial pay increase to work as an analyst for ACE. Given Aaron's exceptional work ethic and performance, ACE's founder, John Fields, offered Aaron a Partner position to retain him. Aaron accepted the ACE offer and was now a partner of a private equity company only three years after graduating with an undergraduate major in finance and a minor in accounting.

Exhibit 4 Valuation and Financial Ratios for the Firms in SIC Code 8049

PANEL A: VALUATION RATIOS FOR 12 COMPANIES; SALES DATES FROM NOVEMBER 1994–MARCH 2007

	Range	Mean	Median
Equity/sales	0.21–6.62	1.22	0.66
Equity/gross CF	1.88–11.52	4.42	3.16
Equity/EBT	0.99–111.40	16.64	3.45
Equity/net income	0.99–151.42	22.69	3.62
Equity/equity book value	1.30–22.52	7.98	4.06
MVIC/sales	0.21–6.52	1.06	0.63
MVIC/gross profit	0.21–3.80	1.10	0.65
MVIC/EBIT	0.30–103.53	12.80	2.38
MVIC/EBITDA	0.30–5.68	2.67	2.38
MVIC/book value invested capital	1.05–21.78	5.88	2.80

Note: MVIC = Market Value of Invested Capital (Debt + Equity)

PANEL B: FINANCIAL RATIOS FOR SAME 12 COMPANIES

	Range	Mean	Median
Net income/sales	(38%)–83%	21.0%	21.0%
EBIT/sales	(38%)–83%	23.0%	22.0%
Sales/total assets	1.3–5.7	3.1	2.7
LTD/total assets	2%–85%	35.5%	28.0%
ROA	(152%)–220%	29.6%	24.0%
ROE	15%–250%	84.3%	32.0%

PANEL C: INDIVIDUAL COMPANY TRANSACTIONS

Number	Business Description	MVIC	Sale Date	Net Sales	MVIC/Sales	MVIC/EBITDA
1	Physiotherapists	$ 15,000	9/10/2003	$ 60,000	0.25	0.30
2	Physical therapy	$ 200,000	3/27/2007	$ 640,167	0.31	0.92
3	Physical therapy	$ 630,000	10/31/2006	$ 788,841	0.80	2.86
4	Weight reduction	$ 1,125,225	11/01/2005	$ 1,808,018	0.62	N/A
5	Paramedical testing	$ 80,313,000	11/01/1999	$ 83,029,936	0.97	N/A
6	Physical therapy	$ 600,000	09/06/2005	$ 902,588	0.66	N/A
7	Physical therapy	$ 708,000	06/01/2004	$ 1,331,000	0.53	1.89
8	Hypnotist	$ 72,000	04/02/2004	$ 347,788	0.21	4.76
9	Geropsychiatry	$ 25,000,000	12/01/1996	$ 3,832,188	6.52	N/A
10	Physical therapy	$ 5,300,000	07/02/1996	$ 10,643,247	0.50	5.68
11	Chiropractic therapy	$ 105,000	11/08/1994	$ 162,848	0.64	3.07
12	Physiotherapy	$ 2,614,000	06/30/1996	$ 3,602,000	0.73	1.88

Source: Pratts' Stats Database

Final Thoughts

Aaron knew he had a lot to do before the upcoming investment committee meeting. He had to summarize his investigation of the physical therapy industry for a potential investment opportunity. He needed to recast the most recent income statements and balance sheets of the two PT companies from the potential income statement and balance sheet adjustments. He also had to determine acquisition prices for these two firms. ACE

Partners normally used a "buy-side" EBITDA multiple range of 3 to 5, depending on the size and sales growth rate of the acquired company (low, average, or high, respectively). He was thinking about using the smaller EBITDA multiple of 3 for both companies since both had small sales and assets. Although Ohio appeared to have a high sales growth rate, MD had almost no sales growth. Further complicating this issue was the fact that neithr firm had audited financial statements. ACE Partners liked to have three years of historical financial statements for their acquisitions but often had to settle for current and prior year financials as in this case, due to the "Mom and Pop" nature of the companies it acquired. Such companies typically had only unsophisticated bookkeeping personnel who only compiled brief summaries of historical financial statements.

To assess the future prospects of this potential deal, Aaron wanted to use benchmark comparisons to develop strategies and synergies for growing these two PT firms efficiently. Using such strategies, he wanted to construct pro-forma income statements for the next four years (ACE's typical holding period) in order to help determine a business valuation for the consolidated PT company. ACE normally used a "sell-side" EBITDA multiple range of 6 to 8, depending upon the size of the combined company and upon the interest of potential buyers. Aaron observed that both sides of M&A deals were commanding higher multiples since there was now over $1 trillion of worldwide private equity capital seeking investments. He was thinking about using the larger EBITDA multiple of 8 as recently verified in the HealthSouth spin-off of its entire PT business. ACE's investment strategy was to combine and grow its acquisitions to a sufficient size to justify the larger public company comparables. As a key tactic for this investment strategy, ACE Partners often retained an investment banker for a possible initial public offering (IPO) in order to justify a higher EBITDA multiple while at the same time seeking a large private equity fund buyer.

Personally, Aaron was intrigued by his potential share of his first investment deal as a General Partner. ACE's distribution of the net sale proceeds was 80 percent to its investors (Limited Partners) and the remaining 20 percent to its twenty General Partners. Due to intense lobbying efforts by private equity fund General Partners, the U.S. Congress had failed in its efforts to increase the income tax rate on such sale proceeds from the capital gains rate of 15 percent to the highest ordinary income tax rate of 35 percent for General Partners. Aaron was a bit nervous at having to make his first investment recommendation to all the General Partners at their upcoming investment committee meeting.