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- Great Elm Capital Group Inc Business Transaction with J.P. Morgan Broker-Dealer Holdings Inc.

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Joshua S. Horowitz *Palm Ventures LLC - Investment Manager*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Great Elm Group's Business Transaction Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to turn the conference over to your host today. Thank you. Please go ahead, sir.

Unidentified Company Representative

Thank you, and welcome, everyone. In addition to our comments for today's call, we will be utilizing an investor presentation as an accompaniment. While we will not be directly referring to the slides, our comments today will generally follow the form and structure of the presentation.

The slide presentation accompanying this morning's call and webcast can be found on our website. I'd like to call your attention to the customary safe harbor statement regarding forward-looking information. Also, please note that nothing in today's call constitutes an offer to sell or solicitation of offers to purchase our securities. Today's conference call includes forward-looking statements and projections, and we ask that you refer to Great Elm Group's filings with the SEC for important factors that could cause actual results to differ materially from these projections. Great Elm Group does not undertake to update its forward-looking statements unless required by law.

To obtain copies of the SEC filings please visit Great Elm Group's website under financial info and select SEC filing. With that, hosting our call this morning is Peter Reed, Great Elm Group, Chief Executive Officer. I'll now turn the call over to Peter.

Peter Andrew Reed - Great Elm Group, Inc. - CEO & Director

Please go ahead, sir. Good morning, and thank you for joining us today. I'm joined this morning by our President and COO, Adam Kleinman; and our CFO, Brent Pearson. I'll provide a brief overview of the changes at Great Elm, discuss the transaction in greater detail. Outline the strategic rationale for these changes. And then finally, we would be happy to take any questions you may have.

For greater detail into Great Elm, our DME business or operations in general, we would also invite you to review our quarterly investor presentation, which is available on Great Elm's website.

There's a lot to wrap here. So we will outline the reasons for the transaction and the impact for all shareholders. Ultimately, we believe that this outcome is favorable for our business and our shareholders.

At its core, this is a favorable recapitalization of our business. We lowered the cost of capital and increased the capital available to fund future growth at the DME business, and in our holding company. In our last quarterly conference call in November, we noted that given the low leverage we held at the DME business, our principal objective was to lower our cost of capital, while seeking additional debt capital to pursue add-on acquisitions. This accomplishes that goal.

Let me outline the specific details of the transaction and the rationale for each change. First, Great Elm completed an internal reorganization on December 29, 2020. As part of this reorganization, a new holding company, Great Elm Group, ticker GEG was created. Great Elm Capital Group Inc., GEC, became a subsidiary of GEG and was renamed Forest Investments, Inc.

Second, JP Morgan Broker-dealer Holdings, or JPM, provided financing in the form of a \$37.7 million investment to recapitalize Forest. We will use the proceeds to refinance the Durable Medical equipment, or DME business, thus lowering its cost of capital. Forest issued to JPM \$35 million of 9% preferred stock, with a maturity date of December 29, 2027.

Forest will use these proceeds to refinance DME's existing term loan debt of approximately \$24.8 million as well as put cash on DME's balance sheet to fund future growth. Forest will also distribute to GEG, its common ownership of the DME business, its ownership of the investment management business, its GECC shares and its cash. Forest will retain ownership of the real estate business and a preferred interest in the DME business.

Finally, JPM will purchase 20% of the common equity of Forest from GEG for \$2.7 million, which will also be held at our holding company. Ultimately, Forest will be owned 80% by GEG and 20% by JPM.

GEG's use of Forest's existing NOLs are also unaffected since it maintains an 80% ownership stake. Our new holding company name is Great Elm Group, or GEG. This transaction provided an opportunity to further distinguish GEG from our publicly-traded BDC, Great Elm Capital Corps, whose ticker is GECC.

As a result, as of this morning, our holding company name is Great Elm Group and we changed our ticker to GEG from GEC. This will help investors discern between the 2 businesses.

From a shareholder perspective, there will be no impact on holdings. Existing GEC stockholders will have their shares of GEC exchange in a 1:1 ratio for shares of GEG. GEC shares ceased trading on the NASDAQ as of the close of the stock market on December 28, 2020, and shares of GEG are expected to begin trading prior to the opening of the stock market today.

The end result is that through this restructuring and recapitalization, we accomplished the following goals: We lowered the cost of capital at our DME business. We added cash at both our DME business and at the holding company level to pursue opportunities for growth. GEG's use of the existing NOLs is unaffected. GEG retains ownership of its operating entities. We worked with JPM to create a successful transaction that benefits all shareholders. And finally, we have a new name and ticker.

Despite these changes, which we believe are all for the betterment of Great Elm and its shareholders, it's almost equally important to highlight that, directionally, nothing changes. Our management team is dedicated to leveraging our corporate structure to build value across several verticals and to utilize our tax assets to enhance that value creation. We have clear objectives in each of these verticals.

In operating companies we're focused on acquiring under-capitalized companies with significant growth potential, both organic and through M&A. In Investment Management, we seek to increase assets under management, both in our publicly-traded Great Elm BDC and in other investment vehicles managed by GECM.

In conclusion, we remain focused on maintaining long-term alignment with you, our shareholders. Our team collectively owns approximately 2 million shares, or 7% of GEG's outstanding shares, including our Board of Directors and their funds under management, insiders collectively own over 20% of the shares outstanding.

We believe this fosters a significant and long-term alignment of interest amongst employees, directors and other shareholders. With that, I'll open the floor for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Brian Alexitch with Greenwich Investment.

Brian Alexitch - *Greenwich Investment Management, Inc. - Director Transaction Unit*

With regards to the lowering of the cost of capital, I mean, I see that the DME business is going to be repaying the Corbel Capital term loan, which was an L plus 10. So you've certainly got 130 basis points of savings there. There's also a prepayment penalty that you guys are going to be paying, which arguably goes towards the cost of capital of the new financing. And I realize it's 1% to 5% if it's paid off in the first 5 years alone. Do you know -- do you have that handy what the prepayment is? The prepayment penalty, I should say?

Peter Andrew Reed - *Great Elm Group, Inc. - CEO & Director*

I don't have it off the top of my head, but it's -- I think on the -- it's roughly on the high end of what you just said. I also think, Brian, it's important to note that, in addition to saving on the cost of capital, putting -- we put \$6 million on the balance sheet to fund future growth. And then, finally, another key difference between this new financing and our previous financing is this allows, under certain conditions, DME to incur senior debt in front of this financing to fund future growth, where the prior financing did not permit that.

So not only we've lowered the cost of capital, but we've significantly increased the potential to fund growth opportunities, whether they be organic or through M&A.

Brian Alexitch - *Greenwich Investment Management, Inc. - Director Transaction Unit*

So you're saying with the Corbel loan, you really only had the opportunity to add junior debt, which argue you have been probably mid-teens or so?

Peter Andrew Reed - *Great Elm Group, Inc. - CEO & Director*

We certainly did not have the opportunity to add senior debt, and I can't recall if there was junior debt, but it would have been so expensive that it was functionally not an option that made any sense, whereas this would allow us to incur much cheaper senior secured debt to fund growth. So on a blended average basis, if we avail ourselves of that, there would be really significant savings.

Brian Alexitch - *Greenwich Investment Management, Inc. - Director Transaction Unit*

Got it. Then on the preferred stock, was there any OID? Or was that issued at a discount? So \$75 million proceeds?

Peter Andrew Reed - *Great Elm Group, Inc. - CEO & Director*

No.

Brian Alexitch - *Greenwich Investment Management, Inc. - Director Transaction Unit*

Okay. Then the 20% sales force, which appears to include just DME and the real estate, it looks awfully cheap, right? I mean, when I look at the 10-K, I come up, just using quick math, with pretax cash flow of about \$3.7 million annually and then selling 20% of the business for \$2.7 million puts an

equity value of, I guess, \$13.5 million on it. So that's like about 3 and 2/3x pretax cash flow, just -- it seems really cheap. Can you just comment on that or where I might be oversimplifying?

Peter Andrew Reed - Great Elm Group, Inc. - CEO & Director

Yes. So Forest doesn't own the common equity interest in DME. All of the 80.1% common equity interest is retained by GEG, our Hold Co. So what Forest has is a piece of preferred equity in DME. So I think from the valuation perspective that you're doing, you're really looking at the value of real estate, plus the value of that preferred equity interest plus a very nominal amount of cash, about \$1 million or so less the JPM preferred investment. But the 80.1% common equity interest in DME is held by GEG, our holding company.

Brian Alexitch - Greenwich Investment Management, Inc. - Director Transaction Unit

Okay. I see. So help me out there, then that means that JP Morgan financed the preferred stock and then essentially bought back a chunk of that preferred stock. Is that -- or not really buyback, but made their own investment in it through the 20% purchase of Forest?

Peter Andrew Reed - Great Elm Group, Inc. - CEO & Director

No. JP Morgan through they own 20% of Forest or common equity, which they purchased for \$2.7 million. They purchased \$35 million of preferred stock issued by Forest. The sum of those 2 are their entire investment. Forest, in turn, provided financing to DME and retained ownership in the real estate business and has a small amount of cash.

Brian Alexitch - Greenwich Investment Management, Inc. - Director Transaction Unit

Okay, I see. So it's essentially just the real estate business that the \$2.7 million acquired part of?

Peter Andrew Reed - Great Elm Group, Inc. - CEO & Director

That and the debt financing to DME, whereas the common equity is retained by the holding company.

Brian Alexitch - Greenwich Investment Management, Inc. - Director Transaction Unit

Okay. Okay. Got it. Okay. All right. So it's not such a cheap thing then. Sorry, it was just -- was a little apiece together.

Peter Andrew Reed - Great Elm Group, Inc. - CEO & Director

Understood. There's a lot of moving parts. But no, we did not think that we sold equity very cheaply. We were pretty pleased with the price. Great.

Brian Alexitch - Greenwich Investment Management, Inc. - Director Transaction Unit

Okay. I'll be looking forward to what you guys -- how you put the cash to work then.

Operator

(Operator Instructions) Our next question comes from Joshua Horowitz with Palm Global.

Joshua S. Horowitz - *Palm Ventures LLC - Investment Manager*

How does this arrangement advance the opportunity for you to take advantage of the NOLS?

Peter Andrew Reed - *Great Elm Group, Inc. - CEO & Director*

Sure. So what I would say is that this opportunity doesn't change any of our ability to utilize our NOLS because our holding company maintains an 80% common equity ownership of Forest, which is the entity that has the vast majority of our NOLS. We filed one consolidated tax return. So any opportunity that was available to us prior to the transaction remains available to us post the transaction. I do think that it's possible that there are some incremental steps that we can take to reset the basis in some of our assets, which might use some of our NOLS. We went in -- to the extent that we're able to complete that, we will update the market in due course. But this transaction and all of the internal shifting that we did may offer us an opportunity to reset the basis in some of our assets to the fair market value from where they are presently. And that difference -- were that to happen, that difference would utilize some of our NOLS. Again, we have a little bit more work to do on that front. And to the extent that we're successful in doing so we'll update the market.

Joshua S. Horowitz - *Palm Ventures LLC - Investment Manager*

Got it. And let's say, JPM wanted to take a stake greater than the 20% that it now owns. Is there a mechanism to do that?

Peter Andrew Reed - *Great Elm Group, Inc. - CEO & Director*

There's not that would have to be if they wanted to increase their equity position or if they wanted to provide more preferred equity to Forest or anything else, that would be a new transaction and a new negotiation. There's no existing mechanism to make either of those things happen.

Joshua S. Horowitz - *Palm Ventures LLC - Investment Manager*

Got it. And on the DME side, is there anything with respect to reimbursements or other regulatory or legislative matters that we should be looking at on the horizons that are either beneficial or concerning?

Peter Andrew Reed - *Great Elm Group, Inc. - CEO & Director*

Excellent question. So the competitive bid process, which some industry participants were concerned about the potential for that to impact reimbursement rates in a negative way, that process has been canceled. So the potential -- the near-term potential for a negative impact on reimbursement rates has gone away, which, I think, most industry participants have welcomed.

Joshua S. Horowitz - *Palm Ventures LLC - Investment Manager*

Great. Seems like a positive transaction.

Peter Andrew Reed - *Great Elm Group, Inc. - CEO & Director*

We're very excited about it.

Operator

(Operator Instructions) And I'm showing no further questions at this time. I'd like to hand the call back over to management for any closing remarks.

Peter Andrew Reed - *Great Elm Group, Inc. - CEO & Director*

Thank you all for joining us today. We're very excited about this transaction. And if you have any questions and follow-up, please don't hesitate to reach out.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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