CASE STUDY

Assume your client, Jim, owns a manufacturing company with a wide range of expertise in precision machining, large part machining, machinery retrofitting, and engineering. Jim is 63 years old and in the second generation. Jim has approached you because he would like to be out of the business by 67 years old and preparation is top of mind for him.

Jim's retired father gifted his shares to his children and currently sits on Jim's board. Jim has two sisters and one brother who do not work in the business. They own 10% equity each. Jim owns the remaining 70% and has worked within the company since he was child. An Operating Agreement exists but the buy-sell terms are weakly defined, and the Agreement has not been re-visited in nearly 10 years. With a strong sense of family values and what Jim considers to be a strong company, he would prefer to keep the company in the family and transition to the third generation. He is at this point unwilling to finance a deal with his family members.

Jim also stated to you that one of his goals is to maximize the selling price of his company at the time of sale as he has some ambitious goals for life outside of his company. Jim currently owns two other small hobby-style businesses. Today, Jim works three days a week primarily focused on strategy, engineering, and customer relationships and is reluctant to give up control to what he considers to be the three most critical things for his company. Outside of his company, he is very charitable and enjoys mentoring. He sits on multiple boards, donates frequently to community activities and organizations, and speaks frequently at industry conferences.

He is a known thought leader in the space and the visionary for his company. Jim has expressed interest in starting his own consulting firm, explored a Vistage Chair type role, and would like to buy a small company he can run one day with his grandson who is in high school today and is very entrepreneurial.

Jim does not see eye-to-eye with his brother, a 10% equity shareholder and a corporate attorney, who sits on his advisory board. They tend to argue about the direction of the company. His only brother feels Jim's style and thought process is outdated. His two sisters remain outside of the business and tend not to participate. However, his niece, Joy, has been named the General Manager, but has no equity. She is the daughter of his oldest sibling, Ann. Joy has worked in the business in an engineering capacity since graduating college nearly 25 years ago and is close with her Uncle Jim. Jim holds the President and CEO titles, though relies on a non-family member, Brian, to operate the company. Brian has held the Vice President role for nearly 12 years and is familiar with the M&A process within the industry.

Brian and Joy get along and are innovative. They have expressed interest in equity, though the family is concerned with having non-family equity shareholders. Brian and Joy share a vision for the company. They believe the future is one that is technology and talent driven.
They envision the company as the next generation precision manufacturer that operates as much as a technology enterprise as a precision manufacturing company; building what they have pitched as a hybrid organization of traditional and technological. Jim's wife, Sarah, is listed on the payroll as an office administrator, but never comes into the office. She collects a $50,000 annual salary. Outside of Jim, Brian, and Joy there are no star executives, though the company does have talented first-line managers who are all dedicated to the company, its core values, and their customers. The company also has an outsourced fractional CFO.

CASE STUDY

The company has revenues of $18 million and pre-adjusted EBITDA of $1.45 million. The company has little debt and all its assets have been fully depreciated. The company has 86 employees. The engineers and quality assurance teams are veterans to the industry and the company. Some of the core technicians are approaching retirement age but have expressed no interest in owning it. Through conversation you learn that the company's largest client makes up 22% of revenue, another 10% is from a long-term government contract with NASA as they are DFARS Compliant through the United States Department of Defense. Outside of those major contracts, 30% of the business is reoccurring through customers in the aerospace, fuel cell technology, gas power and generation industries.

The remaining 38% is one off specialized projects coming from the Department of Defense, Department of Energy, Gear and Housing Industrial Equipment, Renewable Energy, and customers who need precision machining or rebuilding services that require high end engineers.

Jim pays himself a salary of $1 million annually. Jim and Sarah expense approximately $85,000 in personal items through the business each year. Jim believes he can live his current lifestyle with a $600,000 per year annual income and estimates with other investments and opportunities he has he needs about $28,000,000, which he states is his current wealth goal. He has not gotten a formal valuation done on his company but believes it is one of the strongest in its industry given his knowledge, products, engineering capabilities, and the people who work there. Jim has roughly $6,000,000 in assets outside of his business today.

Jim's most trusted advisor is his attorney while he considers his friend and CPA to the company also a close advisor. These two advisors, his board, and Brian and Joy round out his advisory team. Jim and Sarah have done only some basic formal estate planning. Although Jim is active outside of his company, there are no formal personal plans in place. Jim has three children. One starting college, which Jim and Sarah are funding, and two out of college and working outside of the company. However, his son is a Plant Manager at a similar style company and lives nearly 2,000 miles away where he has made home since college.

IN SUMMARY THE COMPANY HIGHLIGHTS THEIR FOUR INTANGIBLE CAPITALS:

Human Capital

Rating 3

- Have long-term employees in a family type atmosphere.
- Have experienced, talented, committed first-line managers.
- Have talented GM and VP with a vision.
- No clear job descriptions for VP and GM.
- Have talented engineers, but many at retirement age.
- No management succession program.
- No real defined leadership team.

Customer Capital

Rating 3

- Jim holds most of the key relationships near and dear to his heart.
- Most of the specialized project revenue is brought to the company by the VP, Brian.
- Government clearance and licensures are needed for major government contracts.
- One customer makes up 22% of revenue but there is a 5-year contract with 3 years remaining.
- Customers are loyal, long term, and happy.
- The top two customers are crossed sold into one-time specialized projects by Jim.

Social Capital

Rating 4

- Employee satisfaction surveys show the employees enjoy culture and benefits.
- Core values and purpose are well defined.
- Internal communication is there with a regular rhythm and structure.
- Family atmosphere. Many employees have friendships outside of work with fellow employees.
- Mix of old school and new school thought process, strategy, and vision.
- Though employees indicate the long-term vision is not clear and goals go undefined.
- Provides many employee perks including luncheons, midyear picnic, and professional development opportunities.

Structural Capital

Rating 3

- The company runs clean, well-maintained, but old equipment.
- Systems are updated with support technology implemented.
- Intellectual property is loosely protected.
- Facility is old and updates are needed to structure including more space.
- Long-term strategy undocumented.
- Lack of information flow across the company.

Other Financial and Valuation Considerations

- $785,000 of total addbacks to EBITDA including a $650,000 adjustment to normalize officer compensation.
- $1.45MM in pre-adjusted EBITDA
- Best in class industry EBITDA to sales performance is 15%; Jim's company with adjustments is 12.4%
- Attractiveness Score: 58%.
  Readiness Score: 49%.
  Blended Score: 54%
- Valuation: $2,235,000MM ($6,700,000 Recasted EBITDA x 3.0 multiple)

RANGE OF MULTIPLES		
IF YOUR AVERAGE SCORE IS:	**RISK LEVEL:**	**USE THIS MULTIPLE**
49% or lower	Very High Risk	1.0 x Recasted EBITDA
50% – 57%	Above Average Risk	3.0 x Recasted EBITDA
58% – 66%	Below Average Risk	6.0 x Recasted EBITDA
67% – 71%	Low Risk	7.0 x Recasted EBITDA
72% or above	Very Low Risk	8.0 x Recasted EBITDA