CASE STUDY:

INTRODUCTION

Specialty Manufacturing Solutions (SMS) is a family held S Corp that was founded in 2002 by Mark and Ellen Resnick. Mark was unhappy working as a General Manager for a small manufacturing company, so at age 45, he decided to start SMS with wife Ellen age 42. SMS was located midway in Pennsylvania, midway between Philadelphia and Pittsburgh.

In 2019, Mark and Ellen began to explore the possibility of selling their company. Their goal was to spend more time in Idaho, at their second home. They also hoped to help their adult children in other business ventures that were already operational.

BACKGROUND

In 2019, SMS was producing $40M in revenue and $3.7M in profits. As a tier 1 and tier 2 supplier producing precision parts for a variety for industries including aerospace, military, medical, and outdoor recreation and sporting goods, and automotive. SMS is ISO 9001 certified. Their gross margins ranged from 28.9% to 32.3% historically.

SMS enjoyed longstanding relationships with their clients. In 2016, 2017, 2018, and 2019 revenue from 9 of their top 10 customers grew by between 2% to 10%. Seventy Percent 70% of this repeat business was repeat orders of the same part. In 2019, their top 10 customers represented 30% of their business.

Mark and Ellen had a strong management team that ran the day-to-day operations. As a result, they were only working 15 hours per week each in SMS. Mark was overseeing manufacturing and sales. Ellen was overseeing Finance, HR and IT.

To prepare for a potential sale, they had their accountant prepare a valuation and equipment appraisal. The date of the valuation was June 2019 and it was based on 2018 results. After receiving the valuation, Mark and Ellen began the process of assembling a team of advisors to help them with the process of selling their business.

Mark and Ellen engaged an M&A advisor to sell their business in February of 2020.

PEELING THE ONION

Financials: In addition to SMS, Mark and Ellen have been helping their kids grow 2 separate but related businesses. One of the businesses, Specialty Ammunition Solutions (SAS) has developed their own proprietary products. SAS was a top 20 customer of SMS and shared the same facility and some key employees. In addition, some expenses for the related businesses are paid for by SMS. The products produced by SMS for the related businesses are manufactured at low margins or breakeven.

QuickBooks is used for Internal financials. QuickBooks is partially integrated into Shoptec E2 Manufacturing System. The internal financials do not reflect the true Cost of Goods sold since all employees are reported as G&A expense. Their accountant prepared reviewed financials statements at year end.

People: Other than the owners, there are four key employees in the company. Three would remain in the business. The VP of Manufacturing, Joe, the controller, Jane, and the Head of Sales, Jerry are all running the current operation and are expected to continue with the business after a sale. The fourth key employee is the V.P of Quality, Mark. He is Mark and Ellen's son-in-law. He works 50% of the time in SMS and 50% of the time on SAS. He would need to be replaced by a buyer within three to six months of the sale.

Good employees for the manufacturing plant are tough to find. SMS has had success hiring younger employees who have some mechanical and technical competencies and train them on their specialty equipment.

Operations: The company runs three shifts and needs additional machines and building expansion to fulfill the customer demand. The manufacturing floor is compact, organized, and clean. Everyone on the manufacturing floor is cross trained with a focus on quality. Currently there are 135 employees.

The owners take pride in their ability to keep old machines running efficiently while being able to upgrade and replace equipment to expand or when a machine is out of service too often due to repairs. Their Capital Expense were inconsistent year to year. In 2018, 2019 and 2020, investments in machinery saw their Capex at $950K, $1.2M and $1.35M respectively.

Sales and Marketing: Their head of Sales has been very successful in bringing on new clients. His team of 5 salespeople average about 20 new clients a year. Outside sales success, along with the inside sales associates who service current clients has helped the company grow on average at 11% a year. The head of sales feels he could have brought in more business, but Mark has been very cautious about pursuing projects that would result in problems with high customer concentration.

Many of their leads are generated through participation in trade shows and direct sales. There is minimal marketing effort beyond that.

Customers: SMS's clients are diversified. Aerospace, and Outdoor Recreation are their largest segments. SMS is known for their quality machining on small low volume precision parts which have high margins. They are having success, with manufacturing high volume parts with "lights out" manufacturing methods. Although the margin on these parts is lower the ease of manufacturing and the volume added to growth and profits.

THE CURRENT SITUATION

SMS was an "Essential business" and continued to operate throughout the early months of Covid. By June of 2020, the business was 25% behind 2019, due to what Mark and Ellen described as malaise among their work force. However, by the end of 2020 the company showed a 9.7% growth over 2019. The backlog remained strong and 2020 was 5% ahead of 2019.

At the beginning of 2021, Mark and Ellen had several competitive offers that they were considering for the business but they were questioning whether they should wait until the end of 2021 to sell.

See the following pages for the Financials.

INCOME STATEMENT

	2018	2019	2020	2021e	Comments
Revenue	$32,563	$36,568	$40,115	$47,095	
% Growth		*12.3%*	*9.7%*	*17.4%*	
Cost of Goods	$22,045	$26,000	$27,359	$30,141	
Gross Profit	$10,518	$10,568	$12,757	$16,954	
% Margin	*32.3%*	*28.9%*	*31.8%*	*36.0%*	
Operating Expenses	$8,108	$8,082	$9,026	$10,361	
Operating Profit	$2,410	$2,487	$3,731	$6,593	
% Margin	*7.4%*	*6.8%*	*9.3%*	*14.0%*	
Depreciation	$549	$720	$913	$1,020	
Interest	$497	$502	$448	$394	
EBITDA	$3,456	$3,709	$5,092	$8,008	
Owners Salary	$850	$850	$850	$850	
Private Company Expenses	$150	$150	$150	$150	
Adjusted EBTIDA	$4,456	$4,709	$6,092	$9,008	
% Margin	*13.7%*	*12.9%*	*15.2%*	*19.1%*	

BALANCE SHEET

	2018	2019	2020	2021e	Comments
Assets					
Cash	$578	$2,467	$2,758	$11,796	
Accounts receivable	$3,889	$3,657	$5,237	$3,925	
Inventory	$8,683	$8,837	$9,472	$9,812	
Prepaid & Other Assets	$52	$52	$52	$52	Rent Deposit and Loan to employee
Total Current Assets	$13,203	$15,013	$17,519	$25,584	
PP&E (net)	$8,235	$8,715	$9,151	$8,881	Per CapEx schedule below
Other Assets	$117	$117	$117	$117	Includes 1967 Shelby Cobra
Total Assets	$21,555	$23,845	$26,787	$34,582	
Liabilities & Sharholder Equity					
Accounts Payable	$1,715	$2,167	$2,204	$2,512	
Accrued Expenses	$225	$269	$276	$288	
Deferred Revenue	$4,251	$5,181	$6,129	$7,849	
Bank Line of Credit	$1,750	$950	$0	$0	
Total Current Liablities	$7,941	$8,567	$8,608	$10,649	
Term Loan	$2,975	$2,275	$1,575	$875	$3.5m CapEx loan - Per schedule
Mortgage	$5,177	$5,055	$4,925	$4,786	$6m Mortgage 12 years into 30 ry loan - Proceeds used to buy out brother
Long Term Debt	$8,152	$7,330	$6,500	$5,661	
Common Equity	$1	$1	$1	$1	
Retained Earnings	$5,460	$7,947	$11,678	$18,271	
Shareholder Equity	$5,461	$7,948	$11,679	$18,272	
Total Liablities and Equity	$21,555	$23,845	$26,787	$34,582	

Assumptions				
AR Days	43	36	47	30
Inventory Days	96	87	85	75
AP Days	28	30	29	30
Accrued Expenses	10	12	11	10
Deferred Revenue	47	51	55	60
CapEx per Year	$950	$1,200	$1,350	$750

CASH FLOW STATEMENT

	2018	2019	2020	2021e
Cash Flow from Operations				
Net Income		2,487	3,731	6,593
Non Cash Items		720	913	1,020
Changes in Working Capital				
Accounts receivable		233	(1,580)	1,313
Inventory		(154)	(634)	(340)
Prepaid & Other Assets		0	0	0
Accounts Payable		452	37	308
Accrued Expenses		44	6	12
Deferred Revenue		929	948	1,721
Change in Working Capital		1,504	(1,223)	3,013
Total Operating Cash Flow		$4,711	$3,421	$10,627
Cash Flow from Investing				
Capital Investment		(1,200)	(1,350)	(750)
Cash Flow from Investing		(1,200)	(1,350)	(750)
Cash Flow from Financing				
Other Assets		0	0	0
Bank Line of Credit		(800)	(950)	0
Term Loan		(700)	(700)	(700)
Mortgage		(122)	(130)	(139)
Cash Flow from Financing		(1,622)	(1,780)	(839)
Beginning Cash Balance		578	2,467	2,758
Net Free Cash Flow		1,889	291	9,038
Ending Cash Balance	578	2,467	2,758	11,796

Comments