



2017-2018 Case Study

To: **XPX Members and Guests**

From: Programming Committee

Re: Case Study for 2017-2018 XPX program year

Welcome to the 2017-2018 Exit Planning Exchange – TriState Case Study!

As you know by now, XPX is a multi-disciplinary community of professional advisors who work collaboratively to help owners build valuable businesses and assist them in preparing and executing a successful transition.

As an association of seasoned advisory professionals for business owners and their companies, we are all focused on delivering the highest level of subject matter expertise to our clients. However, none of us can work in a vacuum; each of us are part of a collective team effort that has to encompass a holistic approach to our clients and their needs. Each client is unique, as are the facts and circumstances surrounding each of our engagements. As a result, there are no standardized answers or ‘cookie-cutter’ solutions.

With this in mind, XPX has attempted to create a ‘*typical*’ case of a business owner and some (but certainly not all) of the issues that the owner is facing. We will be using this as our ‘client’ for this program year and will be building upon this case for each XPX-CT event this year so that there is consistency and continuity throughout the year. Below is our tentative schedule of events that outlines the journey of this client as it explores options to build value, prepare for a transition and manage owners’ expectations:

| | |
|-----------|--|
| September | Case Introduction / Identifying the Core Issues |
| October | Managing Family Dynamics – The Good, The Bad and The Ugly |
| November | Strategic Options Review – What makes the most sense? |
| December | Valuation – What could the business be worth...and why? |
| January | Operational Efficiencies – How can I maximize value in the short term? |
| February | <i>Joint Event with ACG – Successful Exit Stories – TO BE CONFIRMED</i> |
| March | Management Review – Hire Family Members or Professional Managers |
| April | Trust and Estate Planning – How Can Owners Keep What They Have Earned |
| May | Transaction Process – Tricks of the Trade from Investment Bankers |
| June | How Will The Company Be Valued – Perspectives from a Private Equity Investor |
| July | Closing Cocktail Party – A celebration of a great year at XPX |

While we hope you will attend the entire series of our meetings, you are welcome to come to any of these events without missing a beat. We hope that you will learn something new at each meeting, whether or not you have participated in prior sessions. We look forward to seeing you soon!



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To: Advisory Team

From: Jim Murphy, CEO
Murphy's Metal Manufacturing, LLC

RE: Planning for the Future

Thank you again for your time this morning. I am glad that our mutual friend put us together!

Based on our conversation, we are prepared to move forward and start the next phase in our business and prepare the next generation (the fourth!) to take over the business. We are glad to have you on the team to help us through this important transition! As promised, below is some background information that will give you a bit more color so that you can understand our situation and objectives.

Business Overview:

History:

Our grandfather had been working in the metal manufacturing industry for years as a sales rep, but found that large companies overlooked the medium sized and smaller sized businesses that needed more attention and slightly differentiated products. The Big Guys only wanted to do long run manufacturing, so nothing could be customized (actually, it was the Henry Ford motto, "Any customer can have a car painted any color that he wants so long as it is black."). Gramps thought he could solve this by focusing on smaller runs, adding in customized products and add more value to his clients (for more profit) if he did some light assembly too, so he started the business in his garage. He did a decent job of building the business but only focused on the industrial components markets (which he knew best).

When my dad returned from his tour of duty in the military, he joined the family business on the shop floor at age 23. He slowly worked his way up and took over the business in the late 1970s and really put us on the map. He was the one that was smart enough to expand into all of the new industries (aerospace, building products, transportation, etc) and so we have added a ton of 'value added' manufacturing to address these markets which has led to more business. By "value added" I mean that we make some commoditized products, but by adding in "bells and whistles" and taking a step out of the process of making a finished good, and not just the intermediate products, we can command a higher price than we could if we supplied the components only.

My brother and I each had our own careers for a few years after college, but it was always expected that we would come back to the business. After a few years in the 'real world', we both left our jobs and joined the company (I joined in 1990 and my brother in 1993). When my father passed, we got the business and hold it 50% / 50% today. We never spent time on the shop floor, but we know the inner workings of the business well and think we are decent operators. I run the 'front office' with finance,



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HR and sales reporting to me, whereas my brother runs the 'back office' with purchasing, operations, and shipping & receiving reporting to him. While it is not ideal, we make it work.

Different Objectives:

Both my brother and I make a comfortable living but frankly have different views on the future. I think there is still some real upside if we can make some investments in manufacturing (which would lower our costs) and in sales. Sales growth has slowed so now we are only about 5% growth per year, but without some new bells and whistles, we will continue to stagnate. Because of increased competition, we have not been able to implement a price increase in the last few years, and growth each year is becoming more of a challenge. I do believe we have the best products on the market, but in order to maintain our position, we need to develop new products which will enable us to pass through a price increase. I think it will take about \$5 million to buy the right equipment, restructure the manufacturing floor and get the right sales team in place. One of our smaller competitors has a high quality product that would fit in nicely in our portfolio, and an acquisition could be an alternative to building it ourselves. In either case, I don't have the cash to pull it off, so we are stuck.

I also want to grow this so that I can pass it down to my kids someday, as we have done for three generations. I have one son that works here now in sales, and a daughter that is graduating college this spring. I think she is going to go out on her own for a few years, but I hope she comes back once she realizes how great it is to be a business owner. I have another 10+ years in me to drive this company so would love to find the right partner to help me – perhaps a family office or angel investor?

Since our father has passed away a couple of years ago, my brother has become less engaged in the business. He got remarried last year to a woman that has plenty of money and is not afraid to show it. He is still here just about every day, but seems to be taking more vacation time with her and has been letting things slip a bit. His three kids from the first marriage are not involved with the business, but they are shareholders, thanks to some aggressive estate planning on his part (my kids are not shareholders, at least not yet). He has mentioned to me, informally, that he would be just as happy to sell the business and move on. While we haven't discussed in detail, I get the sense that he has much higher valuation expectations than I do, and as time goes on, I'm afraid that disparity will increase.

Financial Picture

The Company today is nearly \$50m in revenue with about 10% EBITDA margins. You wanted to have some overview financials, so I have attached a couple of high-level reports.

We have discussed raising some additional debt to fund the investments, but we are already pretty levered and really reluctant to sign Personal Guarantees on the debt. We do have some debt now, but it is fully secured by Accounts Receivable and Inventory, and all other assets of the business, but has no recourse to us.

We have been approached by private equity investors, but they will want to chop up the company and fire everyone, and we don't want that. I also don't want to sell out to strategic buyers as they will just shut down the plant and all of my people will be out of work. My legacy means more than that.



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We look forward to getting together with you and your team on helping us think through strategic options.

Thanks for your time and your advice.



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Murphy's Metal Manufacturing, LLC

Income Statement

(US\$ 000's)

| | | 2013 | 2014 | 2015 | 2016 | 2017 |
|------------------------------------|-----------------------|---------------|---------------|---------------|---------------|------------------|
| | | <i>Actual</i> | <i>Actual</i> | <i>Actual</i> | <i>Actual</i> | <i>Projected</i> |
| Net Sales | | \$38,456 | \$41,302 | \$44,152 | \$46,536 | \$49,142 |
| | <i>Growth</i> | | 7.4% | 6.9% | 5.4% | 5.6% |
| Cost of Goods | | \$24,766 | \$27,177 | \$29,361 | \$31,132 | \$32,434 |
| Gross Profit | | \$13,690 | \$14,125 | \$14,791 | \$15,403 | \$16,708 |
| | <i>Gross Margin</i> | 35.6% | 34.2% | 33.5% | 33.1% | 34.0% |
| Selling Expenses | | 5,722 | 6,195 | 6,649 | 7,232 | 7,401 |
| Operating Expenses | | 3,815 | 4,130 | 4,433 | 4,821 | 4,934 |
| Income from Operations | | 4,153 | 3,800 | 3,709 | 3,351 | 4,374 |
| | | 10.8% | 9.2% | 8.4% | 7.2% | 8.9% |
| Taxes | | 1,578 | 1,444 | 1,409 | 1,273 | 1,662 |
| Interest Expense | | | | | | |
| Net Income | | \$2,575 | \$2,356 | \$2,299 | \$2,077 | \$2,712 |
| Adjusted EBITDA | | | | | | |
| Income from Operations | | 4,153 | 3,800 | 3,709 | 3,351 | 4,374 |
| Depreciation & Amortization | | 636 | 647 | 657 | 667 | 675 |
| Excess Owner Comp > \$250,000 Each | | 150 | 150 | 150 | 150 | 150 |
| Related Payroll Expenses (10%) | | 15 | 15 | 15 | 15 | 15 |
| Adjusted EBITDA | | 4,954 | 4,612 | 4,531 | 4,182 | 5,214 |
| | <i>EBITDA Margins</i> | 12.9% | 11.2% | 10.3% | 9.0% | 10.6% |



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Murphy's Metal Manufacturing, LLC

Balance Sheet

(US\$ 000's)

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---------------|---------------|---------------|---------------|------------------|
| | <i>Actual</i> | <i>Actual</i> | <i>Actual</i> | <i>Actual</i> | <i>Projected</i> |
| Assets | | | | | |
| Current assets | | | | | |
| Cash | \$320 | \$344 | \$368 | \$388 | \$410 |
| Accounts receivable | 4,487 | 4,704 | 5,274 | 5,171 | 5,733 |
| Inventory | 13,460 | 15,029 | 17,906 | 17,839 | 20,476 |
| Prepaid expense | 180 | 184 | 185 | 208 | 206 |
| Total current assets | 18,447 | 20,261 | 23,732 | 23,605 | 26,824 |
| PP&E, Net | 6,357 | 6,471 | 6,574 | 6,667 | 6,750 |
| Total assets | \$24,804 | \$26,732 | \$30,306 | \$30,271 | \$33,574 |
| Liabilities and Stockholder's Equity | | | | | |
| Current Liabilities | | | | | |
| Accounts payable | \$1,169 | \$1,434 | \$1,713 | \$1,730 | \$1,712 |
| Accrued expenses | 64 | 63 | 74 | 87 | 82 |
| Due to Officer | 50 | 50 | 50 | 50 | 50 |
| Total current liabilities | 1,283 | 1,547 | 1,837 | 1,867 | 1,844 |
| Noncurrent liabilities | | | | | |
| Revolving Line of Credit | 8,475 | 8,525 | 6,575 | 3,989 | 6,776 |
| Senior Term Loan | 4,750 | 3,250 | 1,750 | 9,750 | 7,750 |
| Total liabilities | 14,508 | 13,322 | 10,162 | 15,606 | 16,370 |
| Stockholders's equity | | | | | |
| Common stock | 21 | 21 | 21 | 21 | 21 |
| Paid-in capital | 49 | 49 | 49 | 49 | 49 |
| Retained earnings | 10,226 | 13,340 | 20,075 | 14,596 | 17,134 |
| Total stockholder's equity | 10,296 | 13,410 | 20,145 | 14,666 | 17,204 |
| Total liabilities and stockholder's equity | \$24,804 | \$26,732 | \$30,306 | \$30,271 | \$33,574 |

| | | | | | |
|----------------------|------|------|------|------|------|
| AR Days | 42 | 41 | 43 | 40 | 42 |
| Inventory Days | 126 | 131 | 146 | 138 | 150 |
| Inventory Turns | 2.9 | 2.7 | 2.5 | 2.6 | 2.4 |
| Prepaid Expenses | 17 | 16 | 15 | 16 | 15 |
| AP Days | 17 | 19 | 21 | 20 | 19 |
| Accrued Expense Days | 6 | 5 | 6 | 7 | 6 |
| Sr. Debt to EBTIDA | 2.67 | 2.55 | 1.84 | 3.29 | 2.79 |