

# Case Study for

## Stybel Peabody/Board Options, Inc. Seat at the Table

## ABC Engineering Company, Inc.

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It was 7:30 in the evening on a Monday night and Rob was left in his office trying to make sense of what had just been presented to him by his longtime partner, Bill. Rob and Bill had begun their careers in Rob’s basement almost 30 years ago, building solutions for computer numerical controlled machines (CNC). Today they’re a worldwide leader in technology that allows a CNC machine to be more productive and run unattended. Their clients include high level defense contractors and major worldwide manufacturing companies. Their market has been growing rapidly every year and with it, profits and dividends to its owners have grown substantially, as well.

Bill has been by Rob’s side through good times and bad times. They formally began their engineering company 25 years ago and in 1999 their accountant suggested they convert from a C corporation to an S corporation. When they originally incorporated, in need of cash to begin their operations, Bill’s mom, Eva, had invested a substantial sum of money so they decided to make her a partner. Today the three of them were each 1/3 partners in equal shares. Eva, who is now nearing 80, still works at the company as a part-time receptionist and relies on both her small salary as well as the dividends from the company’s profits each year.

However, on this evening, Bill just informed Rob that he’s been diagnosed with stage 4 prostate cancer and must undergo major treatment. The survival rate for men with stage 4 prostate cancer is about 29% over the next 5 years as the cancer has most likely spread to other parts of his body.

As Bill sat in Rob’s office revealing the news, Eva who had just heard the news herself, sat and wept. All she could think about is how the children were going to take the news and how Bill would be able to continue to raise them? Having married later in life and having lost his wife to breast cancer shortly after their youngest was born, Bill had been raising the children on his own for the last 7 years with Eva’s help. Now, the children would need Eva’s full attention, as would Bill. The 3 children ranged in age between 9 and 16 years. The oldest had just begun looking at colleges and given her grades, she was definitely of IVY League caliber, whose cost certainly carries IVY League tuition bills.

Before Eva left Rob’s office, she informed Rob that given the news, she would have to consider stopping work. In fact, she stated, she had been considering asking Rob and Bill to buy her out as she wanted to provide for the kids’ education and be able to either fund an educational trust or other education plan for their behalf. Given the news, if she’s to take a more active role in helping Bill and the children, she would have to consider stopping work and focusing on the family.

On his way out, Bill also voiced to Rob that maybe it’s time “he calls it quits” as well. They would need to look at buyout options for him, as well. Although he was the company’s Chief Financial Officer, he felt that he could easily be replaced and given time between treatments, he could definitely try to train someone with at least some CFO experience. But given the fact that the company had never initiated any pension or savings plan beyond a basic 401(k) plan, he just didn’t feel he had enough in the way of retirement assets. He had never really given the idea of retirement any thought. Should he pass, there was limited life insurance in place given his pre-existing conditions. And at this stage of the game, purchasing new life insurance was out of the question.

Bill assured Rob that he would do everything in his power to make sure that any transition to a new CFO would be smooth. Rob knew Bill would give it his all. However, Rob also knew that he would have to take care of Bill, and now Eva and this could strain the company’s cash flow. Cashing them out was not in the budget at this time. And cashing both of them out at the same time was an even greater feat.

After both Bill and Rob left, Rob reached into his drawer and pulled out an old buy/sell agreement that they had put together. As he read through it, he remembered that they had never funded the agreement and that someone on his board of directors had once asked him to review the document, but that had never been followed up on.

There were other pressing issues that the company had to deal with. As a recent example, both Bill and Rob had recently come back from a conference and noticed more and more of their customers, and indeed suppliers, were becoming ISO certified. They figured at this stage of their development, it was time to take the company to the next level and consider becoming ISO certified. In their industry, the certification that would be most appropriate for them is known as ISO 9001:2015.

ISO is an independent, non-governmental international organization of members from every professional field who share knowledge and develop voluntary, consensus-based, market relevant international standards that support innovation and give world-class specifications for products, services and systems. The goal is to ensure quality, safety and efficiency and facilitate trade. ISO has published standards that cover almost every industry. For a company like Rob’s and Bill’s, although not required, it can ensure to customers that the products they engineer for CNC machines follow production standards that are world renowned and accepted.

Unlike manufacturing standards of the past, ISO 9001:2015 emphasizes the organizational context, interested parties, and leadership engagement. It also aligns QMS policy, procedures and objectives with the overall strategy of the organization. In short, to become ISO 9001:2015 certified, Bill and Rob’s company would have to evaluate and justify processes and procedures in each of the following categories:

▪ Planning ▪ Leadership ▪ People ▪ Operations

▪ Sales ▪ Marketing ▪ Finance ▪ Legal

The process of certification could take several months to implement, verify, document, and be evaluated on. But Rob understands that the certification could very well mean more customers and better acceptance of their organization in the marketplace.

For financial background, the following were rough financial numbers of the company for years 2015, ’14, and ‘13”:

**2015** **2014**  **2013**

**Gross sales/receipts** $15.9m $15.3m $14.3m

**Cost of goods sold** 3.8m 3.9m 3.5m

**Gross profit** $12.1m $11.4m $10.8m

**Total deductions** $ 9.8m $ 9.2m $ 8.7m

**Ordinary income/loss** $ 2.3m $ 2.2n $ 2.1m

**EBIDTA** $ 2.7m $ 2.4m $ 2.4m

The company has no debt and Rob and Bill own the building the company in which the company is together.

And at this time of crisis, Rob was at a crossroad. Even he felt a bit burned out and the current news was overwhelming him. Upon the suggestion of a friend of his about a year ago, he had put together a Board of Directors to help him make decisions, but he had never relied on the Board for direction or advice. Some of his Board members had been urging him to formalize the Board meetings and to produce more detailed financial reports. But up until now, Rob did not have the time and considered the Board more of an “old boy’s network”.

In the past, Rob had considered selling the company outright. He had established a good core of employees and there were certainly enough PE engineers on staff to carry the company. But without him and Bill around, would the company be able to continue and be profitable? The same friend who suggested the creation of a Board had also suggested that his company’s value was around 6x or 7x EBITDA since he was able to sell his own company for 6x EBITDA to his main competitor. If that were the case, he figured his value was in the neighborhood of $15m. Would that be enough for him to retire on (given 1/3 share)? It was probably enough for Bill and Eva to cash out, but Rob was not ready to let go of the baby. But between Bill and Eva together, they had the controlling interest in the company.

Today, Rob’s heard some pretty difficult news he has to deal with and he plans to bring these facts to you, a Board of Director at his company. What will you recommend he do?

* What are some of the first steps Rob, Bill and Eva must take?
* Should the ISO certification be pursued at this time?
* How do they go about selling the company?
* Should they sell the company? To whom? How? Are they ready?
* What options do they have for Rob to buy out Bill and Eva?
* Is there a tax efficient way to buy out Bill and Eva?
* What could the tax impacts of any of the decisions to either sell the company or to buy out Bill and Eva be to each party involved?