AN EXIT PLANNING CASE STUDY:
WHAT HAPPENS WHEN THE MUSIC STOPS?

The following case study is based on a true story. For owners of closely held businesses, this case study highlights the importance of engaging an experienced and professional exit planning team. Even when an exit appears to be years in the future, circumstances might force a change to the exiting owners' timing. Therefore, we recommend that all business owners seek help from professional exit planners, like our NAVIX Consultants.

Key Lessons*:*

One of the four possible exit strategies is to sell the company to an outside buyer. These buyers can fall into one of two main categories: strategic buyers or financial buyers. At NAVIX, we call selling to an outside buyer an "Outie" exit strategy. Key risks for this type of transaction are timing, readiness for the actual execution of the transaction, and securing a satisfactory price and acceptable terms.

- **Timing changes** – An owner's age, shift in priorities, evolving co-owner relationships, and health declines are all reasons why owner exit timing can change.
- **Industries evolve** – As technology progresses and industries change, a business may not generate significant interest from buyers if it is not positioned for industry changes.
- **Golden handcuffs** – If key employees are not properly rewarded and retained, they may leave at inopportune times.
- **Ownership documents** – Legal agreements between co-owners must be systematically reviewed and updated. They should address the rights of majority and minority owners.
- **Professional help** - Most business owners do not have the expertise and experience to know all the potential risks and opportunities associated with exiting their business. They should seek help from a professional exit planning team.

Case Study: What Happens When The Music Stops?

Wes Branyan and his older cousin, John Germany, founded Bank Branch Design and Reimaging (BBD&R), a design build firm serving the banking industry, in 1996. They spent over eighteen months working at night on two drafting tables in Wes's garage designing the "branch of the future" for local community banks. Wes and John launched their firm at the opportune time and in the perfect location. BBD&R was created in Atlanta, Georgia, which at the time was the most prolific area in the country for banks.

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The first decade was great. They grew to $10mm in revenue and more than 65 employees. Wes and John worked hard and groomed a young and eager leadership team, consisting of Mary Beth in project management, Mandy leading operations, and Rob overseeing business development. As the firm grew, profits followed. Wes and John enjoyed the substantial annual dividends from BBD&R.

In 2008 the music stopped. Finding themselves in the midst of the great recession, banks were no longer focused on building new branches. They simply wanted to keep their doors open. Given BBD&R's industry concentration, John quit and went to work for the firm he left in 1996. John was 10 years older than Wes and could not tolerate the uncertainty. However, he maintained his ownership in BBD&R. Wes, ever the optimist, was unflappable. He saw the "branch of the future" as more viable than ever. Banks needed capital, they accessed capital through deposits at branches, and the "branch of the future" required a smaller footprint and less staff. In the face of the storm, Wes worked closer with Rob, head of business development, and re-doubled their sales efforts. In return, Wes granted shares representing 2% ownership to each of his leadership team, Rob, Mary Beth, and Mandy, in an attempt to keep them engaged.

While it wasn't easy or fun, BBD&R weathered the storm. They managed to eke out growth and a small profit during 2009 and 2010 due to their backlog and sales efforts. To this day, Wes continues to take pride in BBD&R's performance during the financial crisis, pointing out that he even continued paying John dividends.

That's why when Wes reached out to us, the NAVIX Consultants team, in 2013 for help in designing and implementing his exit plan, he thought he was right on track. He planned to exit in 2017 but wasn't certain about his strategy. He was torn between selling additional ownership of the business to his leadership team or selling to a third party, largely preferring to sell to the former if he could make it work.

When we first met, Wes expressed great pride in his company, its team, and culture. He pointed out their generous pay relative to peers, their great benefits offerings and as a result, their low employee turnover. He also mentioned BBD&R's eight years of consecutive growth and improved profits even during the financial crisis. He jokingly referred to his business as an ATM that dispensed dividends. Finally, he talked about his family. He shared with us that his wife, Mary, suffered from multiple sclerosis, and that he wanted to spend more time with her.

As we were preparing the plans to execute a sale to inside employees and shareholders (we call that an "Innie" exit strategy) we quickly learned that there were foundational flaws in Wes's planning.

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We outlined the following critical risk factors to the success of the transaction:

1. No one could find the shareholder agreement Wes and John originally signed, nor any subsequent transactions between them. Also, they didn't have an up-to-date stock ledger to reflect the leadership team's grants of shares.
2. There weren't any retention programs nor employee agreements in place.
3. BBD&R had not properly protected the "branch of the future" concept, any of their proprietary design/build software, nor the tools they used to model and illustrate the financial benefit of their designs.
4. Finally, although they were slowly trying to diversify into other opportunities, BBD&R derived more than 90% of their business from banks. They had to diversify into other markets quickly.

We immediately began working with Wes to implement a new shareholder agreement, even though he was hesitant to discuss the subject. Luckily, there were no disputes within the group. Wes owned 51%, John owned 43%, and the three key employees each owned 2% each. Although Wes paid John regular dividends, he and John had grown apart due to family differences. We discussed the major provisions, and we introduced Wes to an attorney who created a fair and even-handed document. The document allowed the majority shareholder to exercise control, and it protected the rights of minority shareholders. The new document included drag along / tag along provisions which would allow Wes to compel minority shareholders to sell while also allowing minority shareholders to participate in a sale Wes negotiated. It also included a valuation methodology for shareholder transactions. Finally, it included a discount to stock repurchases if shareholders went to work for a competitor, caused the company material harm, or violated their moral norms.

Our next challenge was getting Wes to talk to John about the new agreement and to get him to sign it. We did that through conversations focused on the need for all shareholders to be protected and the lack of current protections for any shareholders. What helped most materially was suggesting that John's own attorney, review the document. Upon review John's attorney confirmed the document was even handed and actually put John in a better legal position. As a result, we were able to secure John's signature.

Next, we addressed BBD&R's lack of intellectual property protections. When we discussed the business implications with Wes, he confirmed that the most valuable components of his firm were their processes and that they were essentially a software company. We immediately worked with him and his operations manager, Mandy to understand their proprietary processes and software. We laid out the blueprint of a plan with another attorney to prioritize their needs and to develop a budget for this work. Finally, we succeeded to protect BBD&R's intellectual property through patents, trademarks, and copyrights.

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Following the success and the speed of resolving the outlined risk factors, we were eager to move on to the next challenges. We needed to formulate an alternative and credible growth plan. The goal was to allow BBD&R to diversify away from banks. We also planned to work with Wes on golden handcuff strategies for the leadership team. We scheduled an offsite meeting with Wes and the leadership team to begin the planning.

Wes never showed for that meeting. He had suffered a massive heart attack that morning on the treadmill in his basement. While he survived the heart attack, he required quadruple bypass surgery. The music had stopped once again.

When we saw Wes a couple of days later in the hospital, he confided to us that he changed his plans and that he wanted to sell his business as soon as possible to a third party. We let a week pass and visited him again. He confirmed that with his wife Mary's ailment and his own deteriorated health, he needed to sell quickly. He owed it to Mary.

A month after Wes's heart attack, he received more bad news. Rob, lead business developer, was leaving to join their largest competitor as CEO. Rob expressed regret to Wes, but said it had been in the works for months, and he simply couldn't pass on the opportunity.

With this sudden sequence of events, our exit plan had to change. Although BBD&R had an emerging leadership team and steady profits, Wes was unwilling to wait to be paid over time. He simply could not contend with the risk associated with an installment sale, and he did not have the drive to continue coaching and rebuilding the leadership team.

Once Wes regained his strength, we immediately helped him interview and hire an M&A advisor to assist with the transaction. They executed their process, and we received preliminary feedback from suitors. BBD&R had a solid team; their processes, systems, and software were second to none; and lastly, they had performed admirably during the financial crisis. However, sales and growth were not robust enough. Potential buyers' doubts increased when they learned of Rob's departure. Most of the financial buyers passed on the opportunity as they were dubious about the viability of bank branches in the future. Most banks were decreasing their number of branches. All of the strategic buyers passed except two. These final two were interested in BBD&R's intellectual property portfolio and its potential application to other financial services businesses. They also wanted to cross-sell other services to their clients.

With minimal leverage due to the limited interest of outside buyers, Wes accepted the higher of the two offers. While Wes took the deal, he did not leave feeling like he went out on top. He is still disappointed that he was unable to sell the business to his leadership team. His main regret is that he hadn't started preparing earlier for the exit he wanted.

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The table below shows the main issues, and actions we took to resolve them and the outcome.

Issue	Pre-NAVIX Situation	Post-NAVIX Situation	Benefit or Missed Opportunity
Ownership Agreements	Unable to find signed shareholder agreement nor updated ownership ledger	Updated both the shareholder agreement and stock ledger. Agreement included drag along/tag along terms	Allowed Wes, as majority owner, to drag other owners along in the sale
Golden Handcuffs	Wes granted ownership to key employees, but did not have any retention or non-compete/non-solicit agreements in place	Rewarded leadership team at a change of control and allowed acquirer to retain team for 24 months	New program was implemented too late to retain Rob, and his turnover adversely impacted sales price
Intellectual Property	No trademarks, patents, or copyrights on their processes or software	Secured protections on intellectual property portfolio	One of the primary "assets" buyers were interested in
Industry Concentration	More than 90% of revenue was derived from bank branches, a declining segment	Diversified into other parallel businesses in the financial services industry, credit unions and brokerage operations	New growth plan was implemented too late; this adversely impacted sales price

NAVIX® helps owners of closely held businesses plan for and execute successful exits: achieving financial freedom, creating a sustainable legacy, and exiting on their own terms. To review your exit goals and objectives with someone from the NAVIX team, or to learn about the NAVIX program, please visit http://www.navixconsultants.com

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