



Triumvirate Industries Case Study

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Triumvirate Industries, Inc., an international small aircraft engine manufacturing firm, is in its third generation of Barkley ownership. Currently, there are forty shareholders in the Company, some of which are trusts set up for the benefit of members of the youngest generation.

Currently, there are ten members of the Barkley family that are involved with the executive management or Board of Directors of the Company. The positions held by the members of the family are as follows:

- R.M. Barkley II, Chairman of the Board
- R.M. Barkley III, CEO
- Peter Barkley, CFO
- William Barkley, Board Member
- Jacqueline Barkley Smith, Board Member
- Claudia Barkley Anderson, Board Member
- Michael Barkley, Board Member
- Jerry Barkley, Board Member
- Alison Barkley Williams, Board Member
- Christian Barkley Johanssen, Executive Vice President International Operations

Though the Company has run smoothly during the last decade, the executive management and the Board of Directors have run the Company with little transparency and as little disclosure as possible to the other shareholders. In the last two years, the executive management at the leisure of the Board has embarked on a largely unsuccessful expansion into international commercial aircraft financing. As a result of the losses in the financing arm stemming from the downturn in the global aviation industry, Triumvirate Industries' earnings remained flat, showing no growth in net income or cash flow, forcing the Board to suspend any increases in the Company's dividend—the first such suspension of dividend increases in over fifty years. Several

members of the third and fourth generation of the Barkley family have requested additional information be disclosed regarding the Company's expansion into aircraft financing and the Company's overall financial position. The executive management and the Board of Directors have refused to disclose any information other than that included with the annual audited financial statements. The Company's annual report that was once considered comprehensive and comparable to those published by publicly traded companies has been suspended by the executive management. These actions by the executive management and the Board of Directors come despite the recent revelations of corporate malfeasance at companies such as Adelphia, Enron, WorldCom, Tyco, etc.

As a result of the brewing dissention between the executive management and the Board of Directors and certain shareholders, the group of dissenting shareholders have filed suit against the Company demanding more information and have waged a proxy war to remove the Board and the executive management. At the most recent shareholders' meeting, the dissenting shareholders withheld their still minority vote of roughly 30% of the shares for the re-election of several Board members. In response, the CEO replaced several additional executive management personnel with insiders friendly to the executive management and the Board of Directors and willing to support their agenda.

From a valuation perspective, this dissention between the shareholders and the executive management will likely decrease the value of the firm by increasing the Company's cost of equity capital. With favorable goodwill between the executive management and the shareholders, the Company's "patient capital"¹ is likely lower than when relations between the management and the shareholders are acrimonious. In these situations, the shareholders demand a higher return on their invested capital in the firm. To appease the shareholders, the executive management is faced with the dilemma of protracted conflict, and quite possibly litigation, or acquiescing to the demands of the shareholders for a higher return. This may prompt management to take extraordinarily high risks that are needed to generate the returns sufficient to satisfy the shareholders' demands for increased return on capital, especially in the short term.

In the case of Triumvirate Industries, assume that the cost of equity capital using a build-up method was previously estimated at 26%. The Family Business Risk Premium factor analysis, developed by Highland Global, LLC, was originally estimated at 0.0%. As a result of the dissention between the shareholders and the executive management, the financial analyst reassesses the Family Business Risk Premium factor analysis. The ratings have changed significantly based on the recent developments at the Company, resulting in the following factor analysis.

¹ Patient capital is focused on long-term growth of the enterprise, rather than short-term dividend payouts.

TABLE 1		
Family Business Attributes Risk Analysis		
Factor		Rating
1 Vision		0.0
0	Clear, developed vision	
1	Ambiguous or no vision	
2 Professionalization of Management Team		1.0
0	Includes outside professionals & advisors	
1	Primarily owners/insiders	
3 Professionalization of Ownership		1.0
0	Regular family meetings	
1	Irregular meetings, no long-term ownership plans	
4 Effective Communication		1.0
0	Clear communication including annual reports	
1	No effective communication between board & owners	
5 Corporate Governance		1.0
0	Transparent governance	
1	Opaque governance	
6 Succession Plan		1.0
0	Buy-sell agreements in place	
1	No effective succession plan in place	
7 Strategic Plan		0.0
0	Strong strategic plan in place & accountability	
1	Weak strategic plan and little accountability	
INDICATED FAMILY BUSINESS RISK PREMIUM		5.0

Based on the above the factor analysis, the cost of equity capital (now demand capital) was estimated at 31% by the financial analyst. The increase from the original patient capital stems from the higher Family Business Risk Premium calculation, as illustrated in the following table.

TABLE 2		
Triumvirate Industries		
Cost of Equity Capital		
Calculation	Patient Capital	Demand Capital
Premia		
Risk Free Rate	5.0%	5.0%
Equity Risk Premium	7.2%	7.2%
Size Premium	9.2%	9.2%
Specific Company Risk Premium	4.6%	4.6%
Family Business Risk Premium	0.0%	5.0%
Cost of Equity Capital	26.0%	31.0%

Based on an assumed net cash flow to invested capital of \$3,000,000, the Company's weighted average cost of capital is estimated at 23.2%. With the increased cost of equity capital and the same net cash flow to invested capital of \$3,000,000 (assumed interest rate on debt of 8% and tax rate of 35%), the Company's weighted average cost of capital increases to 26.9%. With a long-term sustainable growth rate of 3%, the capitalization rate with patient capital was 20.2% (multiple of 4.95) whereas the capitalization rate resulting from the increased demand capital is 23.9% (multiple of 4.18). As a result of the increased demand capital, the value of the firm and the value of its equity decrease as illustrated in the following table.

TABLE 3		
Triumvirate Industries		
Fair Market Value of Firm	Patient Capital	Demand Capital
Net Cash Flow to Invested Capital	\$3,000,000	\$3,000,000
Capitalization Rate	20.2%	23.9%
Value of Invested Capital	\$14,851,485	\$12,552,301
Less Long-term Debt	\$2,000,000	\$2,000,000
Value of Equity	\$12,851,485	\$10,552,301
Less Marketability Discount of 25%	(\$3,212,871)	(\$2,638,075)
Fair Market Value of Equity (rounded)	\$9,639,000	\$7,914,000
Shares Outstanding	2,000,000	2,000,000
Fair Market Value per Share	\$4.82	\$3.96

Based on the preceding example, the per share value of the stock in Triumvirate Industries decreased by roughly 18% as a result of the increased demand capital stemming from the deterioration in relations between the management of the Company and some of its shareholders. This should illustrate why it is crucial for closely held or family controlled businesses to excel in the seven attributes of businesses that have

been successful in creating transgenerational wealth, as discussed in Highland Global's book *The Seven Deadly Sins of Business Valuation: Closely Held and Family Controlled Companies*, in order to maximize wealth creation for shareholders.