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NORTH CAROLINA

FORSYTH COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
02 CVS 1895

NORMAN T. BENNETT, Plaintiff, v. W. AVALON POTTS and MODERN MACHINE & METAL FABRICATORS, INC. Defendants.	)	ORDER

This matter came before the court for trial without a jury pursuant to a Consent Pretrial Order in which the parties consented to the Court's determination of both the value to be placed upon the 143 shares of stock in Modern Machine & Metal Fabricators, Inc. owned by Norman T. Bennett and the terms for the purchase of those shares. The parties further agreed that W. Avalon Potts and Modern Machine & Metal Fabricators, Inc. would then have the option to purchase Mr. Bennett's shares. The parties have requested that the Court indicate the factors that weighed in its decision, without rendering a formal opinion.

In reaching its decision, the Court has considered the following factors in addition to and in connection with the expert valuations presented to the Court and the testimony of the parties and their witnesses.

Mr. Bennett's desire to retire and Mr. Potts' desire to continue working even though both are at a normal retirement age are both understandable and balance each other. Neither desire is unreasonable, and the parties' inability to find common ground on the buyout is regrettable.

The stock purchase agreement entered into between the parties almost twenty years ago, which has since suffered from neglect, provided the Court with guidance on three subjects. First, the Court gleaned from the agreement that the valuation the parties agreed to place on each other's shares was a valuation as a going concern. Second, the court gleaned that they had agreed that a buyout of one partner should not prevent the business from continuing to operate as usual. Third, the parties did not amend the agreement to account for the subsequent decision to convert to subchapter S status for tax purposes or the retention of large non-operating assets in the business. The Court has considered all three subjects, especially the fact that substantial assets are within the business upon which Mr. Bennett has already paid taxes. The retention by the shareholders of large amounts of non-operating assets on which tax has already been paid renders the long-term payout provisions originally agreed to unrealistic with respect to those assets. The parties should have amended the agreement when the tax status was changed or when the accumulation of non-operating assets started.

This situation is similar to a deadlock between 50-50 shareholders. As in a deadlock situation, neither shareholder really desires or benefits from liquidation. Here only one shareholder wishes to sell.

The Court has not in the past and will not here apply a discount for lack of a controlling interest. Mr. Potts will ultimately have a 100 percent controlling interest and would benefit unfairly if he could buy Mr. Bennett's shares at a discount and immediately resell them for a profit. The fact that the parties retained earnings in excess of that required to operate the business and did so in a sub S corporation is not consistent with an intent to apply a minority discount to repurchased shares. Nor would application of a minority discount to non-operating assets be fair.

The cash projections needed for the business, as determined by both experts, were substantially similar and correct in the Court's view. The company is almost debt free and has the borrowing capacity for expansion and modernization.

The company's loyal customer base is mitigated by the fact that it is a job shop that must compete on price for much of its business. Management succession clearly would become a problem if the company were to lose Mr. Bennett and Mr. Potts at the same time. Modern has no viable sales force with which to preserve or expand its customer base in the absence of Mr. Potts or Mr. Bennett. Its business will cycle with the general manufacturing cycle.

The experts each attempted to address three unusual factors in their valuations. First, they attempted to deal with the obvious spike in the company's revenues during the years 1997, 1998 and 1999. At least part of that surge in revenues was attributable to business from customers who were in telecommunications-related businesses. Second, the compensation structure of this business was not similar to other comparable businesses. The salary structure needed some adjustments for valuation purposes. Modern will not replace Mr. Bennett, but current or new employees would assume some of his duties. Because of Mr. Potts' management style the post-dissolution company is unlikely to have a management structure and salary composition like that of similar companies.

The two shareholders also own two-thirds of the stock of the company that owns the primary real estate out of which the business operates. The company has paid far less than the market rental rate for the property for many years. The parties have agreed that if Mr. Potts purchases Mr. Bennett's shares in Modern Machine, they will each vote their shares in the real estate holding company to sell the property to Modern at a price below market value. However, a third shareholder in the real estate company to whom some duties are owed has not said whether he will agree to the sale. Each of these unusual factors affected the valuations prepared by the experts and this Court's views on how to structure the dissolution.

The Court has adjusted the expert valuations in several ways. First, in trying to account for the peaks in the revenue stream, it altered the weighting to .6 for 1996, .1 for 1998, .1 for 2000, and .2 for 2001.

Second, the Court adjusted for the uncertainty in the real estate situation by using a rental expense in between the two figures employed by the experts. In doing so, the Court attempted to neutralize the unusual real estate arrangement as a factor in the valuation. The ultimate resolution of the real estate situation is simply an unknown at this point.

Third, the debt expenses used by both experts were on different ends of the spectrum of what is likely to happen to this business. The Court adjusted the debt expense to a level between the two expert valuations in an effort to reflect a scenario that the Court believed was more likely for this company without Mr. Bennett and under Mr. Potts' management.

Fourth, the Court deducted the expense for a Chief Operating Officer ("COO") from Mr. Hawkins' approach. It then added back a fraction of the COO compensation to allow for additional or current lower level employees to fulfill necessary functions.

The Court relied primarily on a cash flow approach, as the market did not provide clear comparables from the Court's perspective. The market sales figures that were available were only a check on the Court's valuation.

The Court does not believe that the subcontracting of work by either shareholder to companies in which they had an interest affects the valuation significantly. Thus, the Court did not adjust the valuation to reflect any shareholder involvement in other business entities.

The Court did conclude that the modification of its original report by Dixon Odom was more than a mathematical adjustment in response to a change in the compensation composition. The Court used the basic approach taken by Banister Financial, including use of the RMA data, but adjusted that approach where necessary to accommodate for the uncertainties and ambiguities existing with respect to this particular business. The above adjustments caused adjustments in the weighted average cost of capital, which were included in the Court's valuation.

Based upon the foregoing adjustments, the Court concludes that the value of the operating company is $4,000,000. The value of the non-operating assets is $9,320,864.

Assuming that the same salaries and bonuses are paid for 2003 as have been paid in the past and that a distribution occurs to each shareholder to cover his 2003 taxes, if any, resulting from the subchapter S status, and that an acceptable noncompetition agreement is reached, then a sale should be structured along the following lines:

1. The purchase of Mr. Bennett's shares would be effective January 1, 2004, with a closing date no later than January 20, 2004.
2. At the closing, Mr. Bennett would receive a distribution equal to one-half the value of the non-operating assets and one-half the value of the operating business. The price attributable to the operating company shall be paid in 5 equal installments, 20 percent in cash at the closing, and a note providing for payment of the balance in installments of 20 percent on January 1 of 2005, 2006, 2007 and 2008. The note will bear annual

interest from January 1 of each year at the prime rate that BB&T charged its commercial customers on December 31 of the previous year. The Court examined the cash flow of Modern as well as the non-operating assets and finds that the company should encounter little trouble in servicing the payments.

3. The installment note will be secured by a pledge of all common stock in Modern Machine. The note will provide for prepayment at the election of the company. James Kelley will act as escrow agent for the shares and shall not release the shares unless directed to do so by the Court or with the consent of Mr. Bennett. Mr. Potts will retain all voting rights for the shares during the escrow period.
4. The price attributable to the non-operating assets will be determined by using one-half of the value of the non-operating assets on December 31, 2002. The amount due from the company will be offset by the repurchase at cash value of the life insurance policy on Mr. Bennett's life held by the company and distributed to him at the closing. In addition, any debt owed to the company by Mr. Bennett shall be cancelled. The value of the debt cancelled shall be counted against the payout of non-operating assets.
5. The price for the non-operating assets will be paid in real estate and cash and/or marketable securities. The use of marketable securities will require that they be valued on the date of closing and that the percentage of marketable securities constituting the payment be no greater than one-half the value of the marketable securities held by the company on December 31, 2002. The Court directs that Mr. Bennett receive the real estate set forth on Schedule A as partial payment for his shares. Those properties having some relation to the business of Modern Machine have been left in the company for obvious reasons. Please see Schedule A for an illustration of the distribution.
6. The parties are free to negotiate any consent amendments to this order to alleviate any hardships unforeseen by the Court.

7. If Mr. Potts and/or Modern Machinery elect not to purchase Mr. Bennett's share, counsel will notify the Court and opposing counsel, and a hearing on liquidation will be held in January 2004.

SO ORDERED, this the 10th day of December 2003.

Ben F. Tennille
Special Superior Court Judge
For Complex Business Cases