

**Presented at the Stybel/Peabody – Board Options Workshop**

**L & M Specialty Fabrics  
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Case Study**

L&M Specialty Fabrics is a market leader in the premium fabrics for bed, bath and personal care. Their products include bed sheets and liners, towels and other bathing supplies, and selected personal care fabrics for the discriminating buyer. Most major retail outlets carry their brands, and they have significantly grown their on-line presence. They are known for the quality of their products and customer service effectiveness. This is an exciting company with a strong future despite what is happening in the retail marketplace.

Robert Johnson is the CEO and was brought into the company in 2013. The company is private and remains in the hands of the original founder family and trusts. The company grew rapidly under the leadership of the founder until around 2010, when he suddenly died. The company was managed temporarily by the CFO and other family members. The business started to suffer from the loss of strong customer relationships and missing the market shift in terms of on-line consumer practices dominated by Amazon and others. Rob was brought into the company in order to turn the company around and get it back into a strong growth and profitable condition. The expectation established at the time of Rob's hiring was that the family would sell the business and Rob and his executive team would receive 10% of the value of the company net proceeds.

Rob brought in a strong team of leaders including Phillip Nivison, his CFO, John Whittier, the Head of Operations, and Sam Newport as Head of Marketing and Sales. He left several other executives in place, to manage HR, Product Management, and Supply Chain Relationships. They were very successful in making the turn around, although they made some big investments (via debt) for updating the operations (using more robotic technology) and digital development and marketing. This debt was critical to the turnaround but has had a significant impact on the firm's value. The expectation, however, is that by 2018, the owners would find a buyer for the company and the executive team would receive a significant payout. Though there was no formal long-term incentive plan or phantom or actual shares, there was a written commitment in the offer letters to the executive team (and reinforced by Rob in his offer letters to them) to share 10% of the company's value with core executive leaders.

Well, because of the significant improvement in the firm's profitability and growth but significant debt, the owners have decided to take the company off the market. There were no time parameters in the proceeds sharing agreement, and the offer of 10% still stands. However, it may be a number of years before this will be a reality. Further, the owners have several children working in the firm and they are growing in their experience and leadership abilities. They are not yet ready to take over the firm, but may be at some time in the future.

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Needless to say, Rob and the executive team are not happy. They feel that they all took big pay cuts to come to work for L&M with the promise that they would make up the difference when the company was sold. They did a market study of their pay levels (by the well-known Wilson Group), and have presented this information to the Board. They have requested an immediate increase in their base salaries by 2x and a doubling of their bonus targets. They realize that this will put them well above the market, but this is necessary to make up for the difference they were promised in income. They have little confidence that another LTI deal could be arranged. If they do not receive these pay adjustments, they have all agreed to leave the firm. There are no non-compete agreements for this executive team, because at the time the owners were desperate for leadership talent. Now things have changed.

### Your Assignment:

You are members of the Board of Directors. Your assignment is to examine the facts of this case and determine what actions to take. The information on the company's financial and market study of executive compensation are below. Good luck, and may you come to the right solution.

### Historical Financial Summary:

	2014	2015	2016	2017
Gross sales	\$ 69,448,869	\$ 71,683,061	\$ 84,922,182	\$ 96,201,498
Discounts and Allowances	\$ (5,793,411)	\$ (5,017,814)	\$ (6,793,775)	\$ (8,177,127)
<b>Net Sales</b>	<b>\$ 63,655,458</b>	<b>\$ 66,665,247</b>	<b>\$ 78,128,407</b>	<b>\$ 88,024,371</b>
COGS	\$ 37,546,404	\$ 37,345,163	\$ 43,241,184	\$ 49,665,153
<b>Gross Profit</b>	<b>\$ 26,109,054</b>	<b>\$ 29,320,083</b>	<b>\$ 34,887,223</b>	<b>\$ 38,359,218</b>
Operating Expenses	\$ 24,656,007	\$ 28,040,652	\$ 31,927,437	\$ 36,255,249
<b>Income from Operations</b>	<b>\$ 1,453,047</b>	<b>\$ 1,279,431</b>	<b>\$ 2,959,786</b>	<b>\$ 2,103,969</b>
Current long-term Debt	\$ 3,752,250	\$ 6,106,097	\$ 6,780,206	\$ 8,557,935
Shareholders Equity	\$ 14,359,071	\$ 15,390,690	\$ 16,656,832	\$ 20,985,085

### Percentage Relationships:

	2014	2015	2016	2017	Average:
<b>Revenue Growth %</b>		<b>3%</b>	<b>18%</b>	<b>13%</b>	<b>12%</b>
Gross Profit Margin	41%	44%	45%	44%	<b>43%</b>
Oper Exp as % of Net Rev	39%	42%	41%	41%	<b>41%</b>
<b>Income from Ops as % of Rev</b>	<b>2.3%</b>	<b>1.9%</b>	<b>3.8%</b>	<b>2.4%</b>	<b>3%</b>
<b>Debt to equity ratio</b>	<b>26%</b>	<b>40%</b>	<b>41%</b>	<b>41%</b>	<b>37%</b>

	L&M Fabrics			External Market Composite (Median)					Comparison to Market			
	Base Salary	Total Cash Comp	Bonus Target	Base Salary	Total Cash Comp	Bonus % of Salary	Value of LTI Awards	Total Direct Comp.	Base	Total Cash Comp	Value of LTI Awards	Total Direct Comp
Chief Executive Officer	\$ 250.0	\$ 350.0	40%	\$ 315.8	\$ 521.1	65%	\$ 250.0	\$ 771.1	79%	67%	0%	45%
EVP, Chief Financial Officer	\$ 180.0	\$ 234.0	30%	\$ 210.0	\$ 294.0	40%	\$ 100.0	\$ 394.0	86%	80%	0%	59%
SVP Operations	\$ 150.0	\$ 195.0	30%	\$ 195.2	\$ 265.5	36%	\$ 75.0	\$ 340.5	77%	73%	0%	57%
SVP Sales & Marketing	\$ 155.0	\$ 210.0	35%	\$ 190.5	\$ 285.8	50%	\$ 75.0	\$ 360.8	81%	73%	0%	58%
VP Product Management	\$ 140.0	\$ 182.0	30%	\$ 163.9	\$ 195.6	19%	\$ 25.0	\$ 220.6	85%	93%	0%	83%