

Sustaining ESOP Value and Values

Andy Manchir, *Katz Sapper & Miller*, Indianapolis, IN

www.ksmcpa.com

KATZ, SAPPER & MILLER

Mary Josephs, *Verit Advisors*, Chicago, IL

www.veritadvisors.com

Verit Advisors

Christopher Mackin, *Ownership Associates*, Cambridge, MA

www.ownershipassociates.com

OA *Ownership Associates, Inc.*
Advising new and established employee-owned companies since 1987

ESOP Association, Las Vegas, NV

November 3, 2011

Outline

I. Keys to sustaining corporate value:

- Valuation
- Access to Capital
- Culture

II. Select Case Studies:

- Project Turtle
- Project Abby
- Project Ike
- Project Cowboy
- Project Sunshine

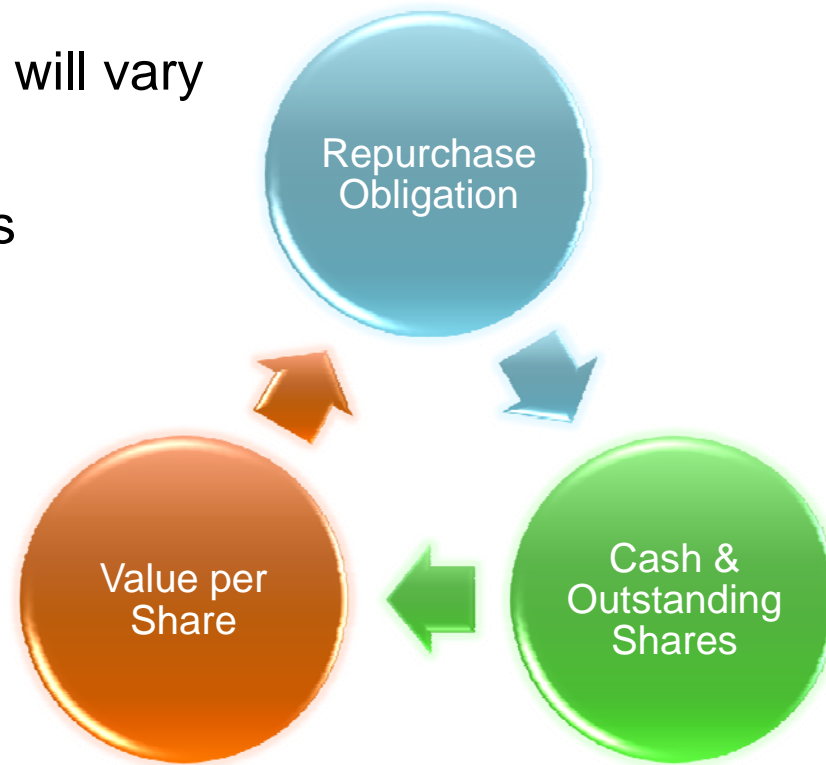
III. Question & Answer

Valuation Considerations

- ESOPs have matured with many companies having over 25 years of employee ownership
- With the S-Corp ESOP, ESOPs own a greater percentage of the company
- Success of ESOP companies overall
- Increased 55/10 – diversification
- Aging U.S. Workforce and employee base
- Repurchase Obligation ‘bubbles’
- Changing business dynamics:
 - Industry
 - Global
 - Access to workforce

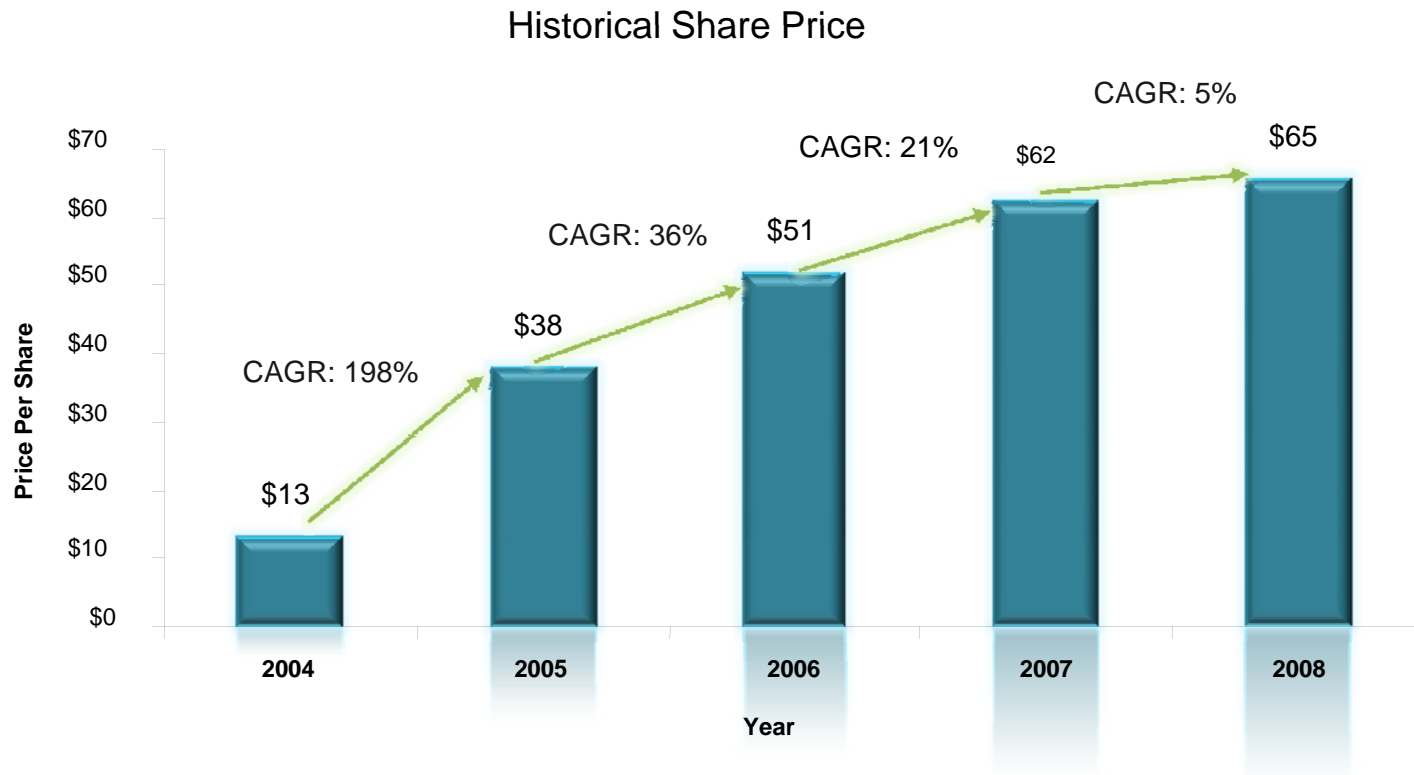
Valuation and Repurchase Obligation

- Treatment of RO in valuation will vary
- Unlikely to change
- Focus on areas of consensus



Value drivers: Repay Debt & Grow Enterprise Value

Sustaining Compounded Annual Growth



Capital Considerations

- Adequacy of Capital:
 - Working Capital
 - Organic Growth
 - Acquisition
 - Debt Service (repay seller and individual shareholder obligations)
 - Repurchase Obligations
 - Cushion
 - “Dry Powder”

What and when are company's long term capital needs?

Capital Considerations

- Types of Capital:
 - Senior Credit
 - Non-Bank Financial Institutions
 - Uni-tranche
 - Subordinated or Mezzanine
 - Seller financing
 - Private placements
 - Private Equity
 - Growth Capital
 - Recap
 - Patient

What type of capital optimizes long term capital needs?

Capital Considerations

- Strategic thoughts around Capital:
 - Tenure
 - Assets
 - Cost
 - Dry Powder
 - “bench”
 - Does one move force the next move?
 - Long-Term Flexibility
 - Control
 - Opportunity

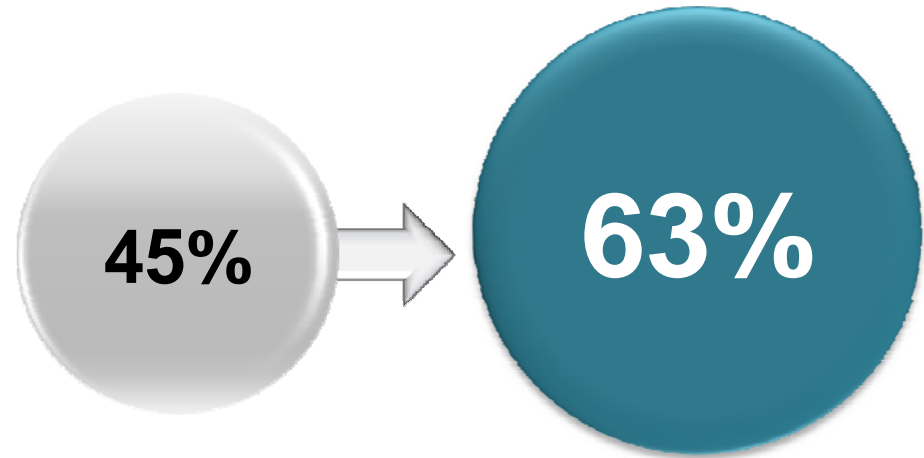
Strategic Capital Analysis is Key to Sustainability

Sustainability & Culture

The Ownership Difference

- ▶ *A more productive and engaged employee base.*

Employee satisfaction at companies with a culture of ownership is almost 20% higher than the national average.*



The national average is based on a 2010 survey of 5,000 U.S. households conducted for The Conference Board.

The ownership culture data is from employee surveys conducted by the National Center for Employee Ownership and Ownership Associates of over 5,800 employees at over 30 companies.

ESOP Culture

According to numerous studies, companies that combine a financially significant ownership stake with an ownership culture have a distinct advantage in the marketplace.

Employee-owned companies with a strong ownership culture perform between

8% to 11%



better than they would be expected to otherwise.

A More Engaged Employee-Base

At companies with a strong ownership culture,

90%

of employees
“care about
meeting the
customer’s
needs.”

89%

“actively
contribute to
group problem-
solving efforts.”

96%

are “willing to do
extra work to get
the job done”
when the
company needs it.

This data is from employee surveys conducted by the National Center for Employee Ownership and Ownership Associates of over 6,000 employees at over 40 companies.

Understanding Ownership

At companies with a strong ownership culture,

83%

of employees responded that “ownership is important” to them.

84%

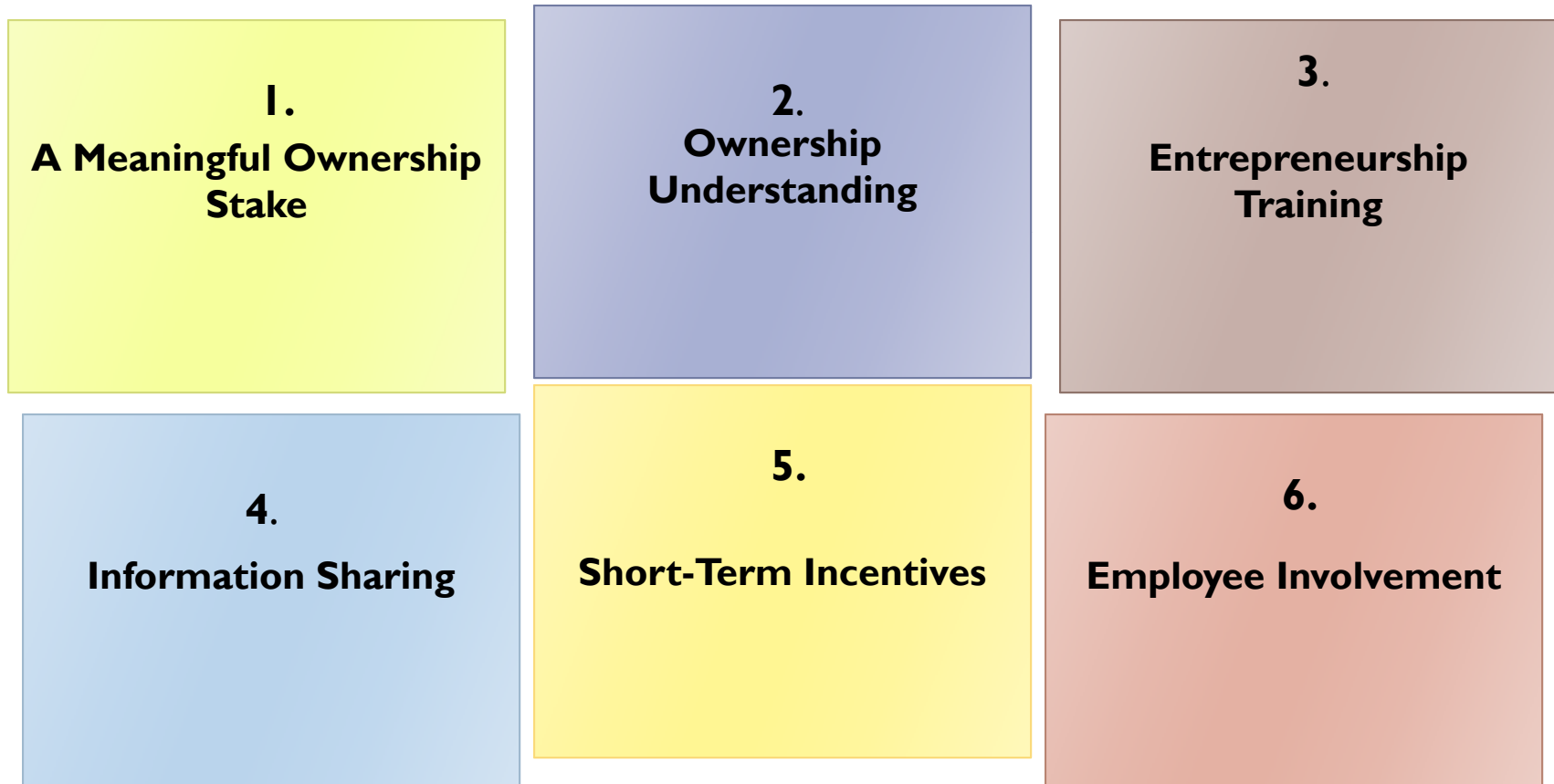
recognize that the company’s future performance will affect their financial security.

76%

understand employee ownership and how it works at their company.

This data is from employee surveys conducted by the National Center for Employee Ownership and Ownership Associates of over 10,000 employees at over 60 companies.

Six Building Blocks of an Ownership Culture



“Return on Ownership”

	Investment	Return
Incentive Only	Low to Medium	Low (-1 to 2%)
Culture + Incentive	High	High (5 to 13%)

What Makes Ownership “Real”?

Experience shows:

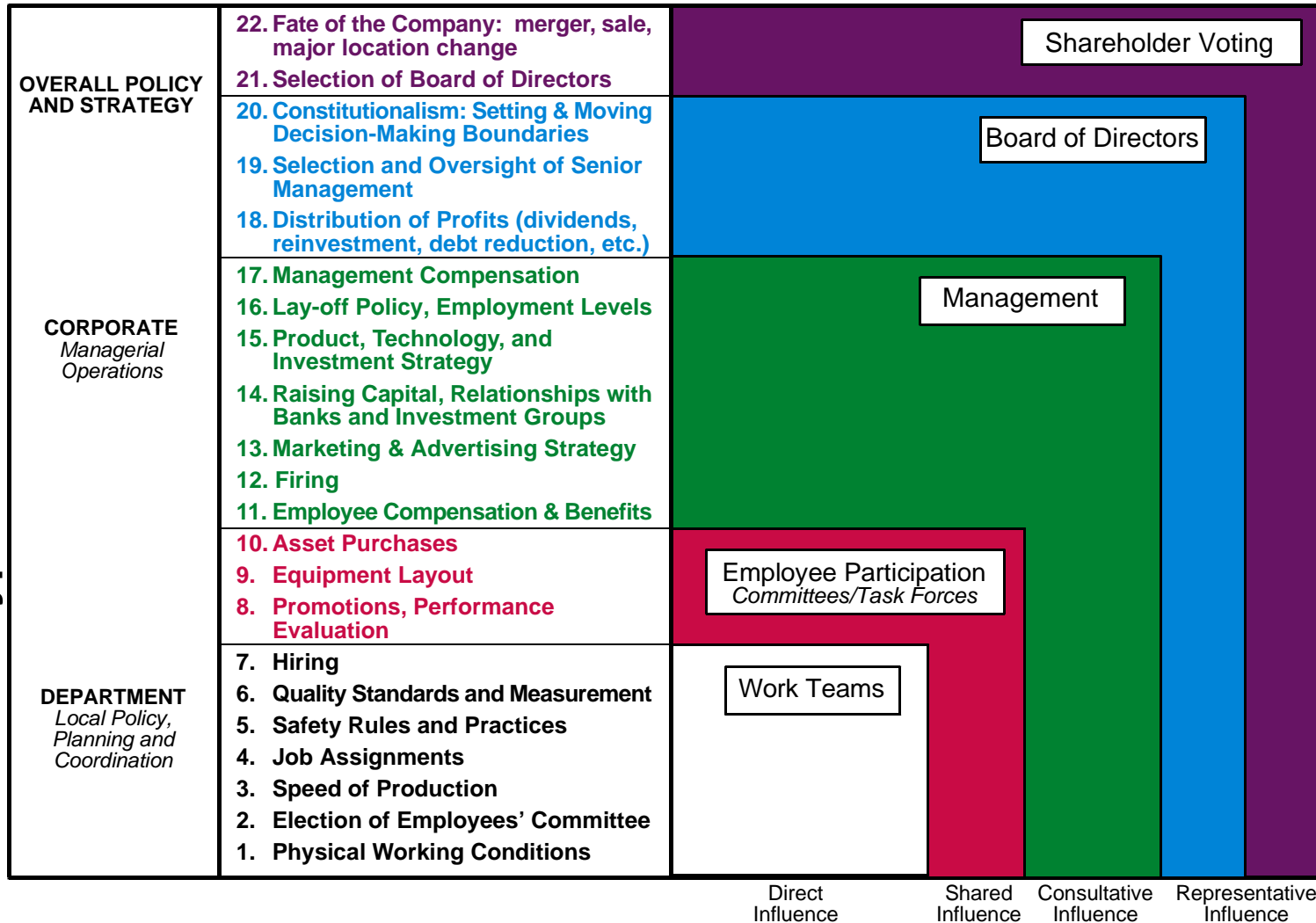
“Employee involvement happens not because you allow it but because you structure it.”

Corey Rosen

Executive Director, National Center for Employee Ownership

Chart

Types of Issues



Case Study: Project Turtle

- Mature ESOP
- 2 Business Lines
 - One, growing niche
 - One, increasingly commoditized
- Claims on Capital
 - Not used to sufficiently expand niche line
 - Focus on sustaining Share Price vs. entrepreneurial focus

*How do we retain the “spirit of the Entrepreneur”
after the Entrepreneur sells to the ESOP?*

Case Study: Project Abby

- Mature majority C-Corp ESOP
- Very successful growth in share value since inception
 - Over 150%
 - Benefit approaching 50% of pay as allocated
 - Concern over 'running out of shares' in a few years
 - Concern over covering international employees
- Strong Employee Ownership culture
- Need for Capital:
 - Repurchase Obligation
 - Individual shareholder liquidity
 - Growth

Can we stay private and keep our culture?

Case Study: Project Echo

- Mature ESOP
- 1,500 plan participants; 400 employees
- No more shares for newer employees, including leadership
- Founder desires an exit from this partial minority ESOP
- Management wants to grow the company through acquisition and organic growth
- Management and new board want equity participation
- Failed private equity sale
- Culture solid, but not leveraging ESOP

Can we be 100% ESOP and be a growth company?

Case Study: Project Cowboy

- Mature ESOP
- Minority interest C-Corporation
- Son, who led most of growth of the company evaluating alternatives after founder passes
- Outstanding performer in a competitive industrial sector
- Interest from Competitors to buy them
 - Theoretically higher price?
- Interest from Management
 - Can they afford to purchase company?
- Interest from private equity
 - Will this change the culture?
- Culture clearly drives differentiation

Will an ESOP provide a fair value for founders family?

Case Study: Project Sunshine

- Mature ESOP
- Minority interest S-Corp
- 90% of the Stock owned by 10% of the workforce
- Significant shifting Industry Dynamics
 - Globalization
 - Larger Companies
 - New Domestic competition
 - Acquire or be acquired?
- Long tenured management prioritizing 'holding' value for near in retirees
- New management prioritizing continued growth

When is an ESOP no longer sustainable?

Questions and Answers

Contact Information



Christopher Mackin

cm@ownershipassociates.com

617.868.4600

Ownership Associates

Cambridge, MA



Mary Josephs

mary@verit.com

312.572.6211

Verit Advisors

Chicago, IL

KATZ, SAPPER & MILLER

Andy Manchir, ASA, CMA

amanchir@ksmcpa.com

317.428.1134

Katz, Sapper & Miller

Indianapolis, IN