Who Should Own Your Business AFTER YOU?

WHY THOUSANDS OF BUSINESS OWNERS SELL TO THEIR EMPLOYEES

This booklet helps business owners evaluate employee ownership. It shows how selling to your employees can mean flexibility and fair market value for you, security for your workforce and community, and the deep satisfaction of knowing the people who will be responsible for your company's success after you have left.

NCEO
NATIONAL CENTER FOR EMPLOYEE OWNERSHIP

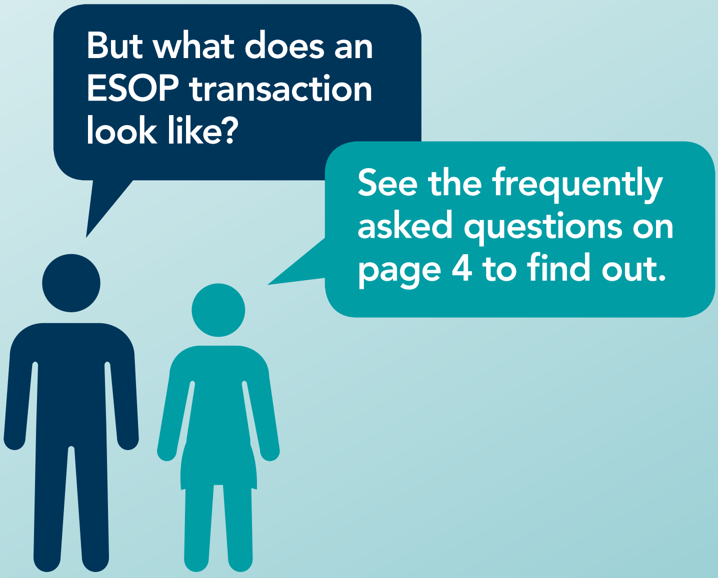
Why do some business owners sell their companies to their employees?

AS A BUSINESS OWNER, YOU WILL SOMEDAY HAVE TO DECIDE WHO SHOULD OWN YOUR BUSINESS AFTER YOU.

Some people sell to family members, to investors or to other businesses. But over the past four decades, thousands of owners have decided to make their employees the next owners of their companies.

The most common path to employee ownership in the United States is an employee stock ownership plan, or ESOP. In an ESOP transaction, you sell your shares at fair market value to a trust, and the trust holds the shares for the benefit of your company's employees. Across every state and nearly every economic sector, over 6,000 privately held companies have ESOPs. Though the motivation varies, over 90% of respondents to our ESOP transaction survey reported being satisfied with their ESOP.

The decision you make affects you, your family, your community, the people your company does business with, and your workforce. Striking the right balance is hard, and no one can understand that challenge better than people who were in your situation.



Joe Motz

Founder and CEO, *The Motz Group*

I founded Motz Environmental Maintenance in 1977, becoming an established landscape maintenance and commercial grounds care presence in our Cincinnati community and beyond. I soon found myself in the position to sell our lawn care division to a large group in our industry who promised that they would look after our employees and our valued customers.

The promises weren't kept. Sure, I received value in the end, but seeing a part of the company I built change only to the detriment of those who helped build it caused me a lot of pain, turning what should have been a joyous occasion into something altogether less gratifying. I wanted it done a better way.

I felt I found that better way in 2015, when I made the internal decision to sell the company "in" verses selling "out." In the spring of 2018 I sold 20% of the company to the ESOP in a self-financed transaction without warrants. I'm thankful that we had been practicing financial literacy and transparency before the ESOP. This puts us in the best possible position for the employees to understand the significance of the ESOP and to make sure that it keeps the Motz Group going well into the future, for the benefit of those who helped build it and who we serve.

Holly Saltzman

Founder and President, *Imagine Early Learning Centers*

Imagine Early Learning Centers' reputation for building and operating top quality, multi-site, boutique early learning centers has always made us attractive to bigger companies. Perhaps the primary reason we have been so sought after is the strength of our staff. So when it became time for me to assess my options for transitioning out of the business, I looked at strategic buyers. However, for me to go through with selling the company, I wanted a guarantee that all Imagine employees would be given contracts — not just the executive team, but the assistant teachers, the bookkeepers — everybody. After getting very close to finalizing a deal, it became apparent that the buyer would not make this guarantee. I then realized that selling to a strategic buyer was not the right move for Imagine.

Since my hang-up with any potential buyer was protecting my employees, I decided to Google "employee-owned" and started reading. After reading about stock options and alternative business structures, I finally came to ESOPs. The information seemed daunting at first and there were times I thought my head might explode. But with repetition the process eventually began to make sense. It doesn't seem that complicated anymore.

I'm proud to say that Imagine's employees now own nearly 33% of the company. The plan is to sell the remainder to them in the next few years. Imagine has always been a team, and the employees are crucial to that team. In my view, they deserve to be rewarded both for their excellent work and for sticking with the company over the years. I'm not quite ready to be home full time, but change is good. It's time for a new group of leaders to take Imagine into the future as an employee-owned company.

"Imagine has always been a team, and the employees are crucial to that team. In my view, they deserve to be rewarded both for their excellent work and for sticking with the company over the years." — Holly Saltzman

Frequently Asked Questions

To be sure you have fully explored your options, you should plan on six to twelve months from the date you decide to sell your business until the documents are signed. During that time, you'll hire a team of advisors, determine the size and financing of the transaction, design the employee benefit package, and manage communications with the workforce.

Q. How much will an ESOP pay?

A. The ESOP buys the stock at fair market value, as determined by an independent appraiser. ESOPs can also provide you tax benefits in the form of a deferral of capital gains. Third-party strategic buyers may pay fair market value up front, but owners who sold to an ESOP often find that their after-tax take-home is higher in an ESOP sale.

Q. Do employees pay for their shares?

A. It's possible but rare. Generally, company contributions to the ESOP support the buyout of the selling owner's shares while also providing a benefit to employees.

Q. What will my role be in the company?

A. It's flexible. Some sellers stop working the day the sale is completed, or even before. Others provide for a long-term, orderly transition, and some remain as CEO or board member.

Q. Does employee ownership make a difference?

A. Typical ESOP companies outperform competitors and provide above-average compensation, benefits, and employment security.

Q. Do I have to sell 100% of my shares?

A. You can sell all or some of your shares. Unlike most other buyers, an ESOP can buy a portion of your shares or can buy in stages.

Q. Are ESOPs complicated?

A. No matter what anyone tells you, there is no simple, hassle-free way to sell your business. ESOP transactions require the support of experienced advisors because an ESOP is an employee retirement plan subject to substantial federal regulation. They also give sellers more control over the inherent risks of a business sale, and they may cost less and close more quickly than a sale to a third party.

Q. Can I choose who gets shares?

A. ESOP rules generally require that at least all full-time employees with a year or more of service be in the plan and get allocations of stock based on relative pay or a more level formula.

Q. What about taxes?

A. ESOPs can be used in C or S corporations, and they have different tax incentives.

See page 6 for information on the structure, price, and process of the sales transaction.

Shawn Burcham

Founder and President, *PFSbrands*

When I started researching my options for selling my company, I knew I wanted two things: I wanted the flexibility to stay involved in the business, and I knew I wanted PFSbrands to remain a thriving and vital part of central Missouri. This essentially ruled out third-party and private equity sales, because there are too many horror stories of those resulting in a business moving, massive layoffs, or closing.

I was familiar with the ESOP model from various supermarkets we distribute to, so we started exploring that around 2008, getting more serious about it in 2012. After assembling an awesome senior leadership team and examining our options, we decided that selling 100% of our S corporation was the best for all involved—doing so gave the company all the tax benefits possible while also demonstrating to the employees that I'm serious about giving them a stake in the outcome and seeing them make PFSbrands as successful as they possibly can.

So in 2017 we set up a long-term leveraged transaction that involved senior debt, seller financing, and seller warrants. Now the community and our employee-owners know these jobs aren't going anywhere. And the proof is in the pudding—in the first year since the sale, our stock price is up 488%.

"Now the community and our employee-owners know these jobs aren't going anywhere. And the proof is in the pudding—in the first year since the sale, our stock price is up 488%." — Shawn Burcham

ESOP Companies OUTPERFORM

- ESOP companies have been found to generate 2.5% more new jobs per year than these same companies would have generated if they did not have an ESOP.
- Employee-owners are one-third to one-quarter as likely to lose their jobs compared to non-employee-owners, according to an NCEO analysis of data from the General Social Survey.
- NCEO analysis found ESOP companies default on their loans at a rate of 0.2% per year.
- A 2017 study found companies with ESOPs were 50% less likely to go out of business looking at the last two recessions.

ESOPs Create GOOD JOBS

Among workers aged 30 to 36, employee-owners do better than non-employee owners:

- 90% higher or nearly two times the median household wealth at age 30
- 22% higher median income from wages
- 46% longer median job tenure

The relationships between employee ownership and improved economic outcomes for workers largely persist over time and when controlling for demographic factors.

THE SALE
Structure, Price, and Process

ESOP sales range from small and simple to complex M&A transactions. In all cases, the company makes tax-deductible contributions to the ESOP trust to buy shares from one or more sellers.

In the simplest kind of transaction, a company sets up an ESOP trust and contributes cash annually on a discretionary basis as profits allow. The trust uses these contributions to gradually buy the shares for sale. Employees gradually build up an ownership interest as the owner sells more and more shares.

The most common structure involves a loan from the seller, from an outside lender on standard commercial terms, or a combination of the two. The borrowed money allows the ESOP to buy shares. The original owners can sell some or all of their shares. The company makes annual contributions to cover the repayment of the loan.

ESOP Transaction Main Steps

1. Spend some time getting educated about ESOPS
2. Complete a feasibility study and determine an initial valuation range
3. Hire a team of advisors
4. Develop the transaction structure and conduct due diligence
5. Establish the trust and appoint the trustee
6. The trustee hires an independent appraiser and determines the shares' fair market value
7. Negotiate the transaction terms and conditions; the trustee ensures the terms are in the interest of participants
8. Close the transaction and communicate to employee-owners

Valuation

ESOPs are financial buyers and cannot pay a strategic price. An independent appraisal firm values the shares being purchased by the ESOP at fair market value. If the ESOP is buying a minority interest, the price will likely include a minority interest discount. Most ESOP valuations also include a small discount for lack of marketability.

Governing the Transaction

The ESOP trustee, generally an outside institution or an individual with specific expertise in ESOPs, ensures that the ESOP transaction meets all the legal requirements and that the ESOP does not pay more than fair market value. The trustee is obligated to work solely in the interest of plan participants.

Roger Ryberg

Former Owner and CEO, *Windings*

I know I'm mortal. So I started exploring my exit options in 1990, only seven years after I bought the company from its founder, JW McKinney.

That's 28 years before I exited the company in full. I loved working at Windings, I love the company and its people and I'd love to still be working there to this day, but the reality of the situation is you can't live forever.

I was drawn to the ESOP idea because I knew that I wanted to see Windings continue to benefit its employees and its community in New Ulm, Minnesota. Employee ownership seemed like a win-win-win: a win for the owner, the employees, and for the community. Private equity or a third-party sale would take away our independence without the employees reaping potential reward.

So a little over 10 years after I started exploring my options, I began selling Windings to its employees through an ESOP. I sold the company piece by piece, with my wife and me financing all but the last transaction without warrants. I sold 13% at a time until the ESOP reached majority ownership, then sold two 15% tranches. At this point I wanted to sell the rest of the company in a transaction that was financed with a local bank.

When I acquired Windings in 1983, it was a $700,000 per year business. By the time I sold my last portion to the ESOP, it was a $25 million business and financially strong such that the local bank that financed the final transaction didn't even ask my wife and me to cosign the loan! And it's only grown stronger since then, doubling in share value in the time since I left in 2008.

Exiting over time allowed me to continue steering the ship through the transition. What's more, as the share value grew, so did the value of my retirement, as both an ESOP participant and as the majority owner. Most of all, I'm proud to say that our company is still a thriving and important part of the community, one that is owned by all the people who continue to make it great.

Kevin Mauger

President, *NCC Automated Systems*

I didn't strongly consider anything but the ESOP, which now owns 42% of the shares. I plan on selling off the remainder of my shares at some point, either all at once or in tranches along the way, but I'm not exiting NCC Automated Systems yet and I have no desire to work elsewhere.

At the core of this is me asking myself, "How do we take the next step as a company?" To have a thriving environment, you have to have really strong players whom you challenge and to whom you provide opportunity. In order to further that environment and to leave a lasting impact for all of these great people in my life, it starts with growth. One of the foundational ways of encouraging that growth is by providing a stake in the game through an ESOP.

Curt Curry

Manager of IT Support and employee-owner, *Cape Air*

It's life-changing to be a part of a company that's employee-owned. As an employee-owner, every decision I make is not only for myself but for everyone around me and every other department around me. There's a real connection. There's a real desire to take things to another level and to be a part in making the best possible decisions, not just around personnel but also equipment issues and issues of fiscal responsibility. So I think it truly transforms your relationship with your company.

"It's life-changing to be a part of a company that's employee-owned."

— Curt Curry

How You Can Learn More

As the leading source of information on ESOPs and employee ownership, the NCEO is committed to helping businesses make informed decisions. We're happy to help guide you through the process of figuring out whether an ESOP is right for you.

- **Speak with an employee-owned company in your state or industry:** We can connect you with an NCEO member in your area or industry to learn about their experience and better decide whether an ESOP will suit your succession needs. Contact Timothy Garbinsky at 510-208-1310 or TGarbinsky@nceo.org to get started.
- **Become an NCEO member:** With discounts on meetings and publications, free weekly webinars, an ESOP document library, and more, being an NCEO member is the best way to stay up to date on the ESOP world and learn the nuts and bolts of selling to your employees. Sign up at **nceo.org/join**.
- **Give us a call:** As an NCEO member, you can call us anytime with questions at 510-208-1300.
- **Not sure?** Do you want to sell to your employees but are not sure if an ESOP is the right fit? See **nceo.org/articles/choosing-employee-stock-plan**

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ABOUT THE NCEO:

The National Center for Employee Ownership (NCEO) is a nonprofit membership organization established in 1981 to provide practical resources and objective, reliable information about employee ownership to businesses, employees, and the public. We have more than 3,000 members, from companies and the professional advisors who assist them to academics, government officials, and others.

The NCEO holds meetings, such as our annual conference (with 1,800-plus attendees); conducts weekly webinars; is the main publisher in the field, with more than 60 publications; conducts employee surveys and compiles and distributes data on ESOP companies; and provides speaking and introductory consulting services. Our work also includes assistance to academics and extensive contacts with the media, both through interviews and through writing articles.

We do not lobby or provide ongoing consulting services. We are qualified as a 501(c)(3) charitable nonprofit.

For both members and nonmembers, our site at www.nceo.org plus our www.esopinfo.org companion site provide a wealth of information.

Opening Session of the NCEO's 2018 Employee Ownership Conference