December 2009
Issue 83

The ESOP Quarterly

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As we embarked upon a new year, ESOPs are becoming a more effective exit planning strategy. Below is an article found on the online edition of the *Wall Street Journal* by Diana Ransom. Happy Holidays from Executive Financial Services, Inc.

Giving Employees a Share *by Diana Ransom*

Article published by Dow Jones & Company, Inc. This article can be found at http://online.wsj.com dated November 17, 2009

It is not the best of times for an IPO of any description, but it is especially hard for small firms.

In the first six months of this year, just 12 companies went public in the United States, down from 38 for all of 2008 -- and more than 215 in 2007, according to a recent report from accounting firm Grant Thornton. What's more, the size of the IPO has ballooned. The median IPO in the first half of 2009 was $135 million, according to the Thornton study; just 20 years ago it was common for Wall Street to accept a $10 million IPO. At a time when credit is tight and alternatives like selling to a private equity firm have dried up, owners of the smaller businesses who want to exit and move on are in a bind.

What are the options? One is putting off retirement in the hopes that a turnaround in the economy will bring buyers back. However, others who don't want to -- or can't wait -- are increasingly looking for alternative strategies. One approach that's coming back into vogue is the ESOP, or employee stock-ownership plan, a defined contribution benefit plan that allows employers to sell all or part of their companies' ownership shares to employees. First popularized in the 1970s, ESOPs were created as a way to reduce workplace tensions and increase corporate performance.

Yet, several ESOPs have imploded or come under intense scrutiny in recent years, making many companies wary of the strategy. This past spring, the Department of Labor opened an investigation of the Chicago-based media firm, The Tribune Co., in relation to the company's bankruptcy and its ESOP. When United Airlines filed for bankruptcy protection in 2002, employees said they took a double financial hit because they had paid for their stock out of their wages instead of receiving it as an additional benefit -- and they sued the airline.

Other problems include the fact that ESOPs are highly regulated under the Employee Retirement Income Security Act -- better known as ERISA -- making the corporation legally liable to buy back shares from employees when they quit or retire. To determine a company's worth for an ESOP, an independent valuation is required, and some owners balk at the notion of someone else issuing their company's appraisal, says Michael Keeling, the president of the ESOP Association, an association of ESOP-owned companies in Washington, D.C. "They believe they can win more via negotiating with a prospective buyer," he says.

Still, ESOPs do boast some hefty-tax benefits that any company looking into ESOPs should consider. Among others, shareholders can deduct both the principal and interest payments on loans used to finance ESOPs. Plus, shareholders may defer federal income taxes on gains from the sale of shares to an ESOP as long as they reinvest those funds into qualifying investments within 12 months from the date of transaction.

"Basically, the seller gets his money without paying any taxes," says Bob Massengill, the president of SES Advisors, a private company financial advisory firm in Philadelphia. "Employees benefit because it is company funded deferred compensation," he says. In other words, "they are getting a larger retirement benefit that is funded by the company."

Landing financing is necessary for most ESOPs. (ESOPs financed by sellers don't involve banks at all.) And while doing so may be rough for companies with spotty credit histories, these entities are often seen as lower risk bets for banks. "Some banks look favorably on ESOPs because their default record is extremely low," says Corey Rosen, the executive director of the National Center for Employee Ownership, a nonprofit research group in Oakland, Calif.

In fact, the default rate for ESOPs clocked in at less than half of a percent, according to a study conducted by the NCEO last year. By contrast, private equity-owned companies logged a 19.4% default rate between January 2008 and September 2009, according to a Moody's study of 186 private-equity owned companies. Companies not involved in private-equity transactions, defaulted at a rate of roughly 18.6% over the same period, said Moody's.

Another argument in the ESOP's favor: When it works well, everyone benefits. Bruce Ballengee is the co-founder of Pariveda Solutions, a six-year-old information-technology consulting firm in Dallas. Ballengee converted Pariveda to an ESOP in 2006 because he had little faith he could pull off a successful IPO. He also doubted whether or not a merger or acquisition would benefit his company. Already, the conversion is making a difference. For 2009, Ballengee expects the company to have $25 million in revenues, a 5% to 10% improvement over 2008. "If you have an employee ownership culture, your ability to grow your enterprise is stronger than a company that's not collectively owned," he says.

Executive Financial Services, Inc. is the preeminent Exit Planning and ESOP consulting firm in the MidSouth. We provide innovative solutions for closely held companies through a multi-disciplinary team of experienced, highly qualified professionals. Since 1981, EFS has established over 90 ESOPs throughout the U.S. ESOPs as exit strategies are quickly growing in popularity due to the significant tax advantages they offer for businesses and business owners who are seeking creative means to transition their companies. Over the next five years, approximately 50% of U.S. companies will transition. Therefore, if you have clients who are considering exiting their business or need to be considering exiting, we would appreciate the opportunity to work together. Don't lose a client by failing to introduce the concept of proactive Exit Planning. Many business owners sell out because they have not been exposed to strategies that can allow them to continue to run their business yet provide liquidity and diversification.

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