

ESOP: Business Owners Cashing Out Today

The past decade has been “nirvana” for the transactional community. Eight to ten times multiples were somewhat commonplace. All cash or mostly cash deals were the standard. Bank financing was plentiful and terms were lenient. Most of all, buyers were plentiful, sellers were willing to consider any offer...and they both paid the fee when the deal was done.

Things have changed. Multiples are certainly down, and potentially back to a level that “makes sense.” All cash deals are the exception. Bank financing is considerably difficult to secure, and when achieved, the terms and rate can inhibit normal operations. The economy has punished bad or weak business models, and companies that cannot manage cash are out of business. One thing remains the same, however. Sellers are still willing to consider most any offer, and they will pay the fee when you can deliver.

As a result of the first wave of Baby Boomers now reaching retirement age, we are seeing an all-time-high of owners seeking exit strategies. The numbers tell us that over half of closely held companies will transition in the next five years. Unfortunately for those owners, today is a very difficult time to realize the value they have built in their companies via a third party sale. Fortunately, however, there is another option.

ESOPs have historically represented about 7% of transition strategies while third party sales have consistently represented about 60%. Today, owners surveyed by PricewaterhouseCoopers reveal that they are considering ESOPs nearly 20% of the time to transition their businesses. What’s driving this increase is macro economics 101...supply and demand. Today, there are simply more owners willing to sell than there are third parties willing to buy. This phenomenon has created a very tough environment for investment bankers and business brokers who have become accustomed to healthy deal flow due to an excellent transactional market and a lot of hard work.

Simply, an ESOP is a qualified retirement plan that differs in use from typical qualified plans in three ways: 1) ESOPs are required to “invest” in the stock of the sponsoring company 2) ESOPs can borrow money 3) ESOPs can engage in “transactions with parties in interest.” Put these three things together, and you have a retirement plan that acts as “willing buyer” for stock in a closely held company. In other words, in today’s environment where buyers are scarce, advisors are using ESOPs as the vehicle to perpetuate the desired transition of an owner. Not only does this strategy solve the problem of the current lack of third party buyers, it provides several key tax advantages for the seller (ability to get his proceeds tax free) and for the business (ability to pay for the transaction with pre-tax dollars).

If you are experiencing a lack of buyers for companies that you have under engagement or that you have had under engagement in the recent past, then you should consider introducing your client to an ESOP for the following reasons:

- An ESOP can help the owner sell today

- The ESOP can pay full market value for the Owner's stock (we're seeing 4-6x)
- The Owner can execute a partial deal today, and then 100% of the Company can be sold when the market returns
- The ESOP's tax advantages can enable the company's post-transaction value to return quicker than under a normal leveraged buyout/recap
- Executive Financial Services, Inc. can operate under your existing engagement (or pay referral fees).

If your client is operating a business that is performing well despite the economy and would "sell today" if the price were right, then an ESOP should be considered. We would welcome an opportunity to discuss how our firms might work together. Our expertise and focus is helping advisors achieve their client's goals of exiting the business in stages or in a single transaction using an ESOP.

To Learn more about please call Henry C. McNeese at (252) 321- 6500 or email hmcneese@horizonibes.com.

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