The ABCs of selling your business


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Commentary

Business owners considering the sale of their privately held companies might want to bone up on their ABCs in advance of the potential economic downturn. While the M&A market is still active, execs should also get acquainted with these four letters: E-S-O-P.

The acronym ESOP stands for employee stock ownership plan. The concept is relatively simple: A company can set up an ESOP and allow shareholders to sell stock to a trust in which the employees are participants. But the execution of ESOP transactions is relatively complex when compared to standard M&A deals. Regardless, if history is any guide, ESOPs are about to enjoy a moment.

ESOP activity traditionally heats up when the M&A marketplace cools down as it allows for sellers to "create" an internal buyer of their stock. And colder times are beginning to appear in the forecast. In recent days, for example, Maryland legislators were told to expect a recession by the middle of next year.

So here's some of what business owners and their employees need to know about ESOPs.

Lots of company

Maryland business owners and their employees who select the ESOP route will find lots of company across the country and in our state.

There were more than 6,600 ESOPs in the United States as of 2015, the last year for which data is available, according to the National Center for Employee Ownership. The nationwide list includes high-profile businesses such as Clif Bar and Publix Super Markets.

Locally, we have some 130 ESOPs headquartered in Maryland, such as EA Engineering and our firm, SC&H Group, and many more that are based elsewhere but have significant operations here, including Jasper Engines & Transmissions, Torch Technologies, and the Wawa convenience store chain.

For buyers (employees) and sellers (owners) alike, there are many good reasons to explain the popularity of ESOPS.

Employees tend to love the idea of owning a part of the company they work for. They know that they are not just punching a clock.

A 2017 study by the National Center for Employee Ownership reports that employees, especially millennials, who work for ESOP companies have 92 percent higher median household wealth, 33 percent higher income from wages and 53 percent longer median job tenure than peers at non-ESOP companies.

An ESOP, like a 401(k), is an employee benefit program regulated by the federal government. But unlike many, if not most, 401(k) programs, an ESOP does not require contributions from employees.

Sellers, on the other hand, get to "create" a buyer and generate liquidity in an ESOP transaction, as the companies often borrow money from a lender to finance a portion of the sale of stock to the ESOP. Additionally, some sellers want more than just money; they also desire to pass their beloved company on to the employees they care about to protect and promote them as well as the legacy they have created through their years of toil and leadership.

And don't overlook the possible positive tax implications. Some sellers can defer, or potentially even eliminate, the payment of capital gains taxes on the sale of stock to an ESOP, provided they meet eligibility requirements.

There are also substantial post-transaction tax benefits for ESOP-owned companies. While strategic third-party M&A buyers may be able to offer a higher headline valuation in certain circumstances, sellers often fare better on an after-tax basis in a properly structured ESOP transaction.

Not for everybody

After we explain ESOPs to business owners contemplating a sale, we often get the following question from them: Why doesn't everybody do this?

We have a number of answers for them.

One: An ESOP transaction is a gradual transition strategy that generally is better suited for owners who are looking to transition out of the business over a period of time.

Two: An ESOP is a nuanced transaction that requires coordination with multiple service providers and is not as intellectually straight forward as selling to a third-party buyer, collecting a check, and heading to the beach to live out retirement.

And three: An ESOP doesn't make sense for every company. ESOPs work for companies with steady earnings and cash flow, not fledgling firms still working to achieve stable financial footing or organizations in highly volatile industries like oil and gas.

Before owners sell off their babies, they owe it to themselves to understand ESOPs, both the benefits and limitations, to make a truly informed once-in-a-lifetime decision.

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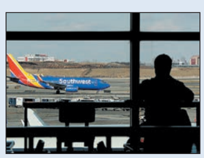
NEWS BRIEFS

Federal shutdown costs Southwest $60M

(AP) — Southwest Airlines is lashing out at the union representing its mechanics, suggesting that they are purposely grounding planes in order to gain leverage in new contract negotiations. Separately, Southwest said Wednesday that the partial shutdown of the federal government will cost it $60 million in lost revenue during the first quarter — far more than the airline's previous estimate of a $10 million to $15 million. Southwest said it has continued to see softer bookings that it blames on the shutdown, which ended officially on Jan. 25. The earlier estimate covered the period through Jan. 23. On the labor front, Southwest is fighting the Aircraft Mechanics Fraternal Association, which represents nearly 2,400 Southwest mechanics.



CVS Health sets lower earnings expectations

(AP) – CVS Health is setting 2019 earnings expectations well below Wall Street forecasts, as the company struggles to fix part of its business while blending in a major acquisition and attempting to change how customers use its stores. The drugstore chain and pharmacy benefit manager also is dealing with industry-wide pressure to reduce what customers pay for prescriptions. CVS Health shares sank while broader indexes stayed largely flat Wednesday after the company unveiled its 2019 forecast and detailed fourth-quarter results. CVS Health booked a $2.2 billion charge in the final quarter of 2018 from a business that provides services to long-term care facilities.

Digital advertising to pass print, TV for first time

(The Washington Post) – This year, the money spent on digital advertising in the United States will surpass that on traditional ads for the first time, according to forecasts by eMarketer, representing a landmark inversion of how advertisers budget their resources and highlighting the rise of digital media as platforms to seek consumers' attention. By the end of the year, eMarketer expects companies to spend nearly $130 billion on digital ads, compared with about $110 billion on traditional advertisements, or about 54.2 percent of the ad market vs. 46.8 percent, respectively.

$130B
Amount expected to be spent on digital advertising in 2019

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