BCC ADVISERS

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ESOP Company Growth Through Acquisitions

As we talk with business owners, we are often asked about the benefits and risks of creating an Employee Stock Ownership Plan (ESOP). This topic could fill our entire newsletter and then some, but **for this article we'll focus on one advantage of ESOP companies, growth through acquisitions.**

An ESOP in its simplest form is a tax-qualified retirement plan that invests in the stock of the sponsoring employer. It can hold all or any percentage of the company's stock, providing a beneficial ownership stake to all employees.

Generally when a company incurs debt to finance an acquisition, only the interest payments on that debt are tax-deductible. However, when an ESOP-owned company (particularly a 100% S-Corp ESOP company) makes the same acquisition, both the interest amount and the principal payments may be deductible. The result is that an ESOP-owned company generally has a much lower cost of capital making an acquisition than does a non-ESOP company. Theoretically this would enable an ESOP-owned company to pay a higher purchase price at the same cost, as shown in the example chart "Advantage: ESOP."

Considering all else being equal, which buyer can justify paying more in a competitive bidding process? The ability to use leverage and repay debt with non-taxed dollars is a substantial advantage.

If an ESOP-owned company decides to acquire another company's stock directly, an independent appraisal and/or fairness opinion may be required or advisable. The degree of fiduciary involvement in the acquisition process is highly dependent on whether or not the ESOP is the majority shareholder of the purchasing company.

The opportunity to accelerate returns to the buyer, the potential for favorable tax treatment on sales proceeds, and the benefit to the employees of a target company who will become beneficiaries of the ESOP post-transaction, all make the ESOP-owned company an attractive acquirer.

Acquisitions are complex. When you factor in the added complexities involved in an ESOP transaction, an experienced team of advisors is necessary to complete the acquisition. BCC has successfully advised ESOP companies in retained acquisition searches, as well as annually opining on dozens of business valuations for companies with Employee Stock Ownership Plans.

ADVANTAGE: ESOP

	ESOP Buyer	Non-ESOP Buyer
Purchase Price	**20,000,000**	**20,000,000**
Senior Debt	10,000,000	10,000,000
Tax Rate	35%	35%
Tax Savings from Principal Payments	**(3,500,000)**	**-**
Transaction Cost	**16,500,000**	**20,000,000**

in this issue

business lines

By Steve Jacobs

BCC Advisers is in its 26th year of business. All practice disciplines have been busy, but merger and acquisition activity has been particularly strong. It seems since about 12 months ago, owners of companies have decided that it is time to either reinvest in their operations or else sell. Valuations have improved significantly for most businesses over the last four years. With substantial amounts of capital available and interested buyers, now is a good time to consider options.

According to most economists it appears the U.S. and world economies are headed for continued moderate to steady growth through 2014 and beyond. That will chip away at the unemployment rate, and more capital spending will fuel the expansion. One of the key factors driving higher valuations for businesses is relatively cheap and readily available cash. Buyers are still cautious and are completing fairly exhaustive due diligence, especially in evaluating the quality of both historic and projected earnings. But, they are willing to offer higher valuations (prices) to companies that have a solid business plan that is scalable and that have a defendable niche.

Successful M&A advisors must be equal parts management consultant, financial planner, business partner and sales advocate. Gone are the days where "rule of thumb" valuation methods are easy sells to qualified buyers. Companies need an advisor that understands the key value drivers of their particular business and truly comprehends the strategic positioning and unique aspects of the operation. Getting maximum value for a business requires more than having the best possible business to sell. It also requires using methods well suited to obtain the most favorable transaction benefiting all stakeholders.

Most likely you'll only get one chance to sell your business. Choosing the right advisor to guide you through the process is a critical initial step towards ensuring you get maximum value for all your years of hard work and sacrifice.

BCC Shares Expertise

BCC's Director, **Lindy Ireland**, co-presented **"Valuation of Stock for Sale to an ESOP"** during a panel discussion which she moderated at the **2014 Employee Ownership Conference** hosted by the National Center for Employee Ownership (NCEO) in Atlanta, Georgia in April. The discussion provided technical information and addressed the concerns of companies considering selling part or all their stock to an ESOP. Lindy also facilitated a roundtable luncheon topic titled **"Helping Your Employees Understand Value - and How They Influence It."**

BCC principals **Steve Jacobs** and **Jim Nalley** shared their expertise co-presenting at the **2014 Iowa Association of Business and Industry's Annual Conference** held in Cedar Rapids in June. **"What is Your Exit Strategy?"** a topic addressing transitioning your business in a variety of ways, included discussions on the when, why and how of creating an exit strategy to a forum for business leaders from across the state.

Transaction Adviser **Tom Cavanagh** had the opportunity to once again share his expertise with international colleagues. During the **Alliance of International Corporate Advisors' 2014 Global Meeting** in Munich, Germany, Tom served on a panel discussing the value of having a diversified investment banking practice with expertise in deal making, valuation and financing.

Our Newest Acquisitions

Kyle Larson, CFA

Kyle Larson, CFA has joined BCC Advisers as a financial analyst in the M&A practice of the firm. Previously a senior equity analyst and portfolio manager with Miles Capital, Kyle brings valued experience in financial research and analysis. He earned his bachelor's degree in accounting and finance from Iowa State University, and holds the Chartered Financial Analyst® designation.

Chartered Financial Analyst® is a registered trademark owned by CFA Institute.

Austin Estlund

Austin Estlund joined BCC's real estate division, Iowa Appraisal and Research Corporation, as a real estate appraiser after earning bachelor's degrees in accounting and finance from Iowa State University. Prior to joining the firm, Austin completed successful internships with Roth & Company and Nelson Development, gaining experience in property market research and understanding a wide range of financial and tax related issues.

Is it a Good Time to Sell Your Business?

BCC Advisers considers the current business environment as extremely attractive to sell your business. Here are just a few reasons as to why this is a good time to consider selling.

- ***Aging population:***

  It is estimated that over 10,000 baby boomers reach retirement age daily (per Pew Research Center). This number will only increase as more of the current U.S. workforce nears retirement age. Of those retiring, it can be assumed that there will be a rising number of business owners wanting to sell their business. In an environment with a high influx of companies for sale, buyers tend to be selective in acquiring the most attractive business, which may result in lower business valuations (supply/demand implications). It would be advantageous to sell before this occurs.

- ***Excess liquidity across all levels of capital:***

  Record levels of capital used to buy/invest in a business or loan to a business is driving the demand and increased valuation for attractive acquisition opportunities. Combined capital from strategic and financial buyers and banks are in excess of $2.0 trillion dollars - dollars which need to be spent or loaned. A lack of attractive and well-performing companies available for sale is driving the competition and demand for quality acquisition candidates. This results in lower cost of capital and higher business valuations. As is the case in the stock market, "sell high and buy low." Now, more than ever, is a great time to sell.

- ***Prospect for higher capital gains taxes:***

  Long term capital gains have increased from 15% in 2012 to 20% in 2013 (for highest marginal income tax brackets). The most recent change in rates was instituted to help fund the federal deficit. With all the concern and attention on Washington's raising the debt ceiling, annual deficit spending, higher income taxes, health care and continued business regulation, the general business sentiment is that capital gain taxes are headed higher, not lower. Likely changes in the tax rate can create a rush to sell businesses, which tends to impact valuations negatively.

The confluence of the above variables continues to impact near-term merger and acquisition activity. Given today's favorable merger and acquisition market dynamics and the personal liquidity needs of a business owner, now is an attractive time to sell a company. This is an important consideration for owners nearing retirement age or those seeking cash from their business. This window of opportunity will not stay open forever. Why wait and lose the chance to sell your company near the top of a seller's market?

If you are thinking about selling this year, now is the time to consult with your investment banking advisor. Selling a business may take up to twelve months to complete. BCC Advisers can help you with all phases of this consideration: the decision-making process to determine the most advantageous exit option and whether the timing of a sale is right for you, determining the range of value of your business, and confidentially selling your company at maximum value for all stakeholders.

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Demonstrating Success

Rarely do we have as intimate of a relationship with a business prior to being engaged to sell it as we did with **Demonstratives, Inc.** ("DI"). In 2005, BCC met the owners of DI following the passing of one of their key partners, and at the beginning of a transition period at DI. BCC was then engaged to provide management consulting services and had the opportunity to acquire a small ownership stake in the company. After a few years of receiving BCC's professional assistance, DI was in a position to buy back BCC's shares. We've maintained a close relationship since.

The four owners proceeded to build the business into a leading provider of litigation animation services. Continuously looking forward, they contemplated opportunities to grow and enhance service offerings for their clients. It was decided that the best route was to sell to a larger organization that provided complementary services, where each company would be able to cross-sell services while cross-utilizing resources.

DI was looking for a buyer that brought growth opportunities for both the owners and employees, complementary services, financial resources, and an overall cultural fit. Three of DI's owners were interested in staying on as employees and continuing their careers, while the fourth desired to transition out completely. The depth of BCC's relationship with the owners along with our previous involvement with the company were key components enabling BCC to identify prospective buyers that were strong fits.

"BCC's thorough understanding of our firm, the services we provide and the objectives of the owners was key to the success of the sale process and ultimately in negotiating the agreement to sell to Engineering Systems, Inc." – Dan Kruger, Owner

Engineering Systems, Inc. (ESI) is a full-service engineering, scientific and technical consulting firm headquartered in Aurora, IL, with 14 offices across the United States. They met all of DI's criteria and were clearly the best fit out of all options DI owners were evaluating. From the start, ESI's focus was not only on acquiring the business DI had built, but also on opportunities for taking the business to "the next level." The fit was so strong that the two firms began working together on projects well before the ink on the transaction was dry, which closed in early June of this year. The transaction terms were structured so that DI owners received a component of cash at closing, an earnout allowing for upside in the growth of the business, and stock consideration in ESI which allowed some ownership retention in the larger business.

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Some Recent BCC Advisers Transactions:

Advised an Iowa wholesale distributor of lumber products on a sale to an Oklahoma wholesale building materials distribution company.

Advised a leading provider of science-based, 3-D computer animation company on the sale to an engineering and scientific investigation and analysis firm.

Prepared a fair market valuation of an Iowa manufacturing company for purposes of ownership transfer.

Prepared a fairness opinion regarding the purchase of shares of a Midwest manufacturing company by an ESOP.

Prepared a fair market valuation of a Midwest ethanol company for shareholder investment assessment.

Prepared a fair market valuation of a national transportation company acquired by an ESOP.

"When we sat down with BCC at the beginning of this process and evaluated prospective buyers, ESI was our number one choice, even at that point. We could not be more excited about the future of the company. We are already seeing significant opportunities to generate more business together." – Chuck Fox, Owner

The Market Front

Some opportunities available through BCC Advisers:

U.S. leading provider of business-to-business services to the automotive industry - *is seeking buyer*

U.S. structural steel fabrication and supply company - *is seeking a buyer*

Midwest farrow-to-finish pork production company - *is seeking a buyer*