

# DEEPER DIVE ON PRIVATE COMPANY TRANSITIONS TO WORKER CO-OPS AND FINANCING

May 18, 2023  
1:00 PM ET



In collaboration with  
project  
**{EQUITY}**

**COOPERATIVE LEARNING NETWORK**

NSAC Members: Free  
Non-Members: \$56



CPE



Speaker:  
**Stacey Smith**  
Vice President  
Program Operations &  
Client Experience  
Park House

nsacoop.org



# 2023 TFACC Collaboration Among Communities



JULY 23-26, 2023



PORTLAND, OR



HYBRID

# NEED HELP? ASK!

Use **CHAT** and send a **PRIVATE** message to a host or co-host



A screenshot of a chat interface. At the top, there is a blue header with the text "HELLO" in white and "my name is" in a smaller font below it. Below the header is a large white text input field with a blue border. The input field is currently empty.

Change your name to include your first and last name, and company to make connecting easier

*Example*

Stacey Smith | Project Equity



**DEEPER DIVE ON  
PRIVATE COMPANY  
TRANSITIONS TO  
WORKER CO-OPS AND  
FINANCING**

## NEED CPE?

- 1 Answer any polls
- 2 Send chat to host if you have technical issues
- 3 CPE Certificates arrive by email within 48 hours



Use the **CHAT BOX** to share your ideas and ask questions

TODAY'S SESSION MODERATED BY:



Wayne Sine  
NSAC Education Director



**BE ENGAGED**

ANSWER QUESTIONS  
and PROVIDE INPUT



# EMPLOYEE OWNERSHIP 101 for CPAs

NSAC May 2023

{ Project **Equity** }

# Presenter




**Stacey Smith**

Vice President , Project Equity  
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415-254-4898

# Agenda

- Why employee ownership is especially relevant now
- Making employee ownership relevant to your practice
- How employee ownership works
  - ESOP basics
  - Worker cooperative basics
  - Employee Ownership Trust basics
- Where to go from here



# Why employee ownership is especially relevant now

# What is employee ownership?

Broad - based employee ownership (EO) gives all employees the opportunity to become employee - owners.

In contrast, equity grants, stock options and key management buy - outs all involve getting an equity stake to employees, but they are usually only for select or key employees.



**FUN FACT:**there are upwards of 15 million employee - owners in the U.S.



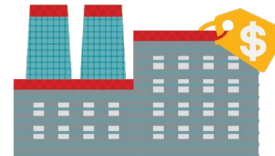
# Selling a business isn't easy



Over **half** of business owners in the U.S. are 55 or older

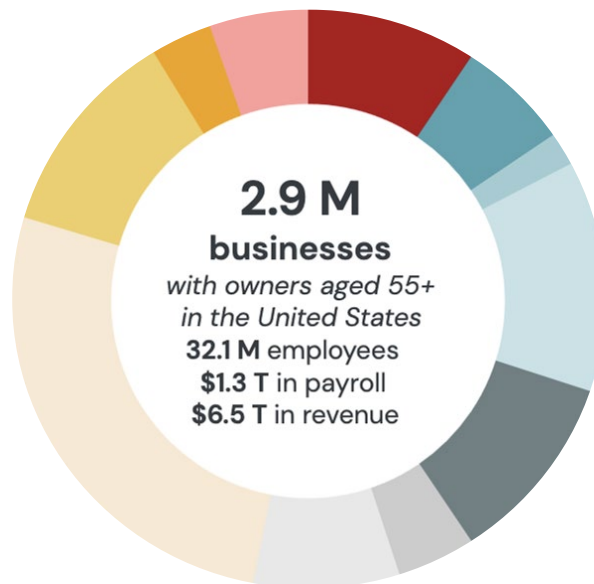
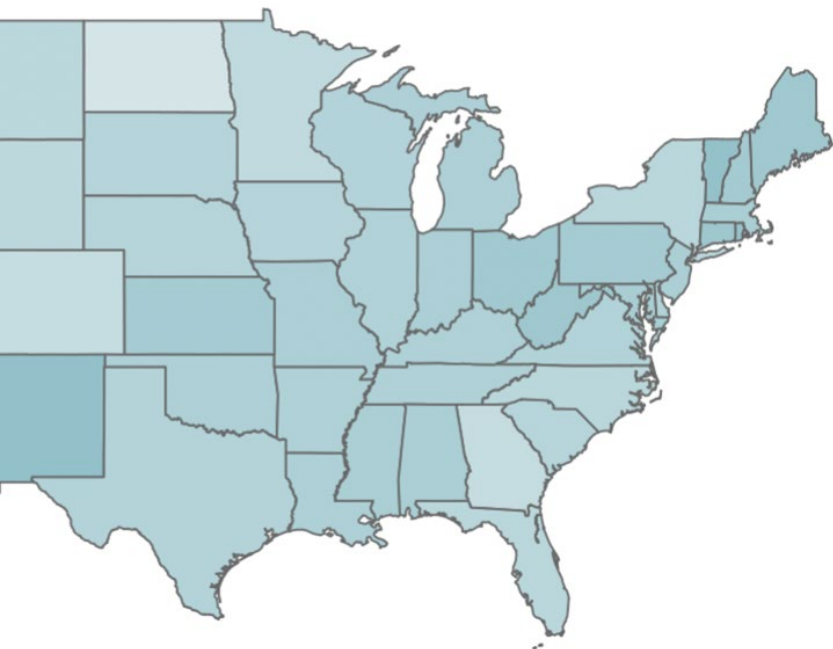


Less than **30%** transition within families

















Only **20%** of businesses sell

# Over half of all business owners in the US are over 55



[View our interactive study to learn about your state >](#)

# Employee ownership checks all the boxes

	 Preserve legacy	 Market value	 Tax benefits	 Retain employees
OPTIONS				
Sell to family members		?	?	?
Acquisition	?	?		?
Employee ownership				
Close down operations				

# Employee ownership

creates quality jobs & economically secure workers



**33%**  
higher wages



**53%**  
longer job tenure



**92%**  
higher household  
net worth

*Source: National Center for Employee Ownership*

# Employee ownership

creates stronger businesses and stronger communities



Profit margins are **8.5%** higher than peers

Sales and employment grow **2%** faster per year

*Sources: National Center for Employee Ownership and the Democracy at Work Institute*

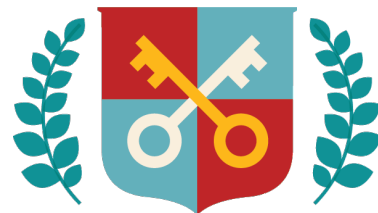
# EO benefits to selling owners



Owners can achieve a fair sales price



Owners retain influence on pacing and exit timeline



They can also preserve the company's legacy, culture, people and other assets

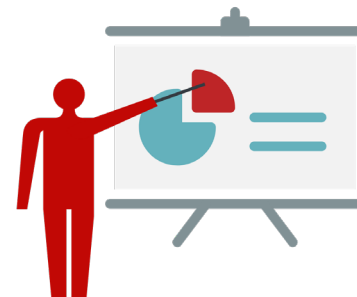
## EO benefits to business advisors



More clients, retained clients after transition to employees



Assets under management (AUM) grow as the business grows



You'll carve out a new niche for your practice

# Poll question #1



# Forms of broad - based employee ownership



## Employee Stock Ownership Plans (ESOPs)

ESOPs are retirement plans that own all or part of a company on behalf of its employees



## Worker cooperatives

Owned by the employee - owners, who share in profits and elect / serve on Board of Directors



## Employee Ownership Trusts (EOTs)

A more customizable form of EO that can be adapted to incorporate democratic principles and profit sharing

# Delta Pipeline

**2nd generation family - owned construction business**

**Transitioned to 100% ESOP in 2017**

**68 employees**

“The most important thing to do —and it’s not without its challenges —is to turn an employee mindset into an owner mindset. Our ESOP is not just a retirement program, it’s truly a benefit. We all have an investment to make together. It’s about putting your name on the list with the people who actually created it, made it and grew it.”

**Craig Danley**

President and CEO



# Atthowe Fine Arts Services



**3rd generation family - owned logistics company**  
**Transitioned to a worker - owned cooperative in 2021**  
**40 employees**

“Our main competitor was just swallowed by private equity. It is a different business model and they are eating all the little guys. Now people in our industry tell us how cool what we did is.”

**Bryan Cain**  
CEO, Atthowe Fine Arts Services

# Hummingbird Wholesale

**Charlie and Julie purchased Hummingbird Wholesale, an organic wholesale food distribution company in 2003**

**It transitioned to a partial EOT in 2023**

**48 employees**

After 19 years of ownership, Charlie and Julie looked for a way to preserve the unique culture of the company and empower their team with the opportunity to experience ownership.

They sought guidance from Project Equity to support the transition to an employee owned structure.



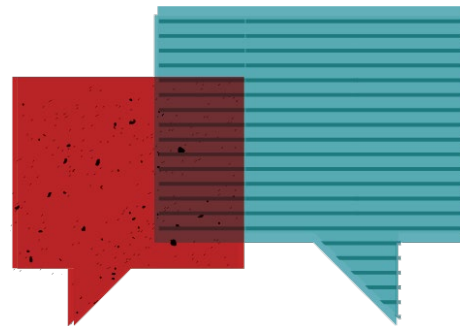


# Making employee ownership relevant to your practice

# How CPAs can support business owners

to consider employee ownership through advising

- Spot clients who can benefit from employee ownership transition
- Invite conversations about business exit and succession
- Introduce employee ownership and provide general education
- Refer clients to other service providers, and stay connected, as appropriate



# How CPAs can support business owners

to consider employee ownership through providing services

- Educate clients, their stakeholders and advisors
- Conduct feasibility assessments, including estimate of value and employee education
- Conduct EO transition services, including assembling and leading the deal team
- Help identify financing





# How does employee ownership work?



# Employee ownership transition process

## STEP 1 EXPLORATION

Early conversation and education to assess options and fit



## STEP 2 FEASIBILITY

Deep dive into valuation, management capacity, and timeline



## STEP 3 TRANSITION

Structure of the future business including governance, management, and seller's role



## { CLOSING THE SALE }

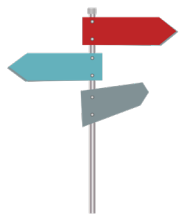
Finalizing deal, closing financing



## STEP 4 THRIVE

Capacity building for ownership culture and governance

# Employee ownership sale of the business



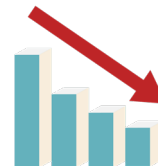
EO form is chosen and designed



Sale price and deal terms are finalized



Business obtains a loan



Loan is paid off over time through future revenue

# Typical sources of financing

## Senior debt

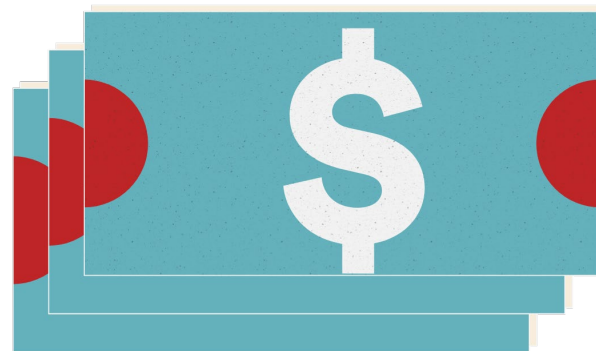
- Multiple of EBITDA or debt capacity
- 4- 7 Years (short duration)
- 40 - 70% sale price
- Banks, CDFIs, credit unions

## Junior and subordinate debt

- Seller note, seller earnout, warrants
- 5- 10 years
- 30 - 60% sale price

## Other possible sources

- Non-voting preferred equity
- Mezzanine debt
- Employee equity



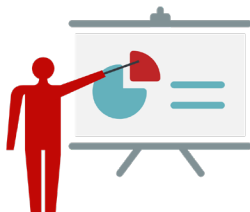
# What changes when becoming employee owned?



## Operations

Day-to-day operational functions of the business

Does not change



## Management

Senior leadership, departmental control, etc.

Does not change (some people may shift roles if/when an owner exits the business)



## Governance

Fiduciary oversight and decisions for deep / broad impact

A board of directors will be established, or expanded



## Ownership

Control and benefit associated with ownership

This moves from the previous owner(s) to the employees



# ESOP basics

# What is an ESOP?

## Employee Stock Ownership Plan



- A qualified retirement plan like a 401K, but invested primarily in the stock of the company
- Trust ownership of the business equity on behalf of the employees
- Employees do not pay for their ownership stake
- Board of Directors elected by the shareholder(s) including, the trustee
- Significant tax benefits and compliance
- Higher cost of transition and maintenance ongoing

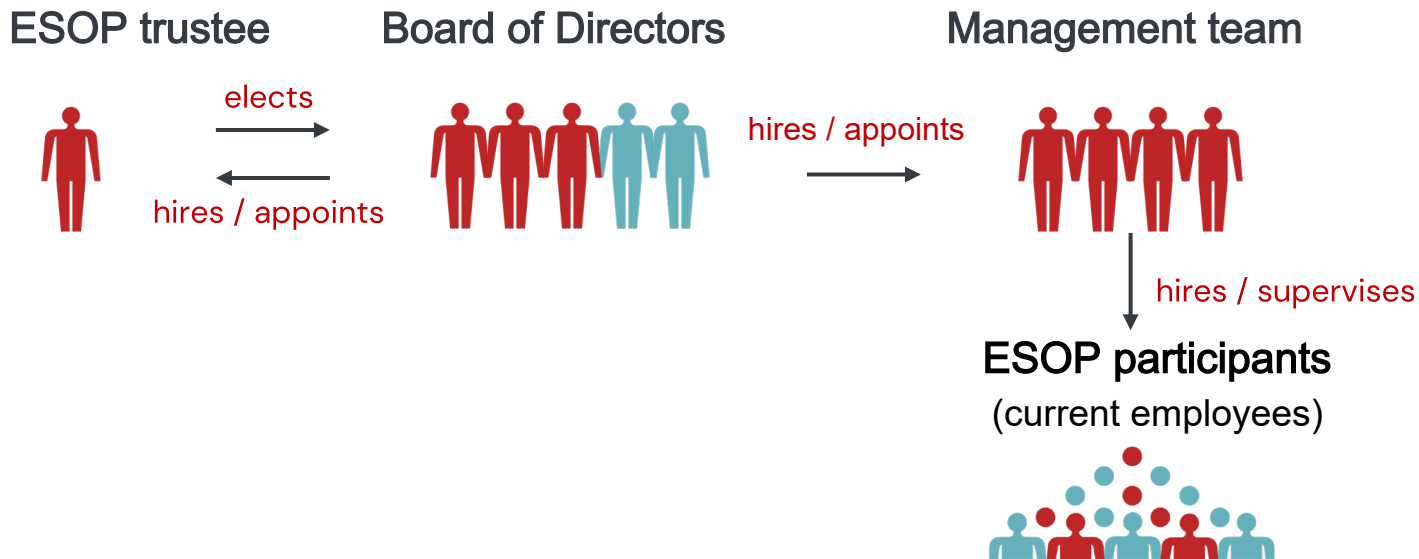
# Significant tax benefits

The tax savings from a leveraged ESOP equals 100% of the transaction value, over time and occur at three levels:

- Corporate savings generated by the ability to deduct principal payments to the lender
- Selling shareholder savings generated by ability to defer capital gains tax
- Employees savings generated by ability to defer income taxation on value of the stock they receive

# How governance works

## Employee Stock Ownership Plan





# An ESOP builds employee wealth

- 100% funded by company and gifted to employees
- Assets include company stock and maybe a little cash
- Account value grows over time
- Employee account is cashed out when the employee leaves the company
- If the employee is not yet retirement age, the value is rolled over into another qualified retirement account
- When the employee reaches retirement age, the value of the account is fully accessible
- Employees don't pay taxes on this wealth until retirement

# Poll question #2



# Worker cooperative basics

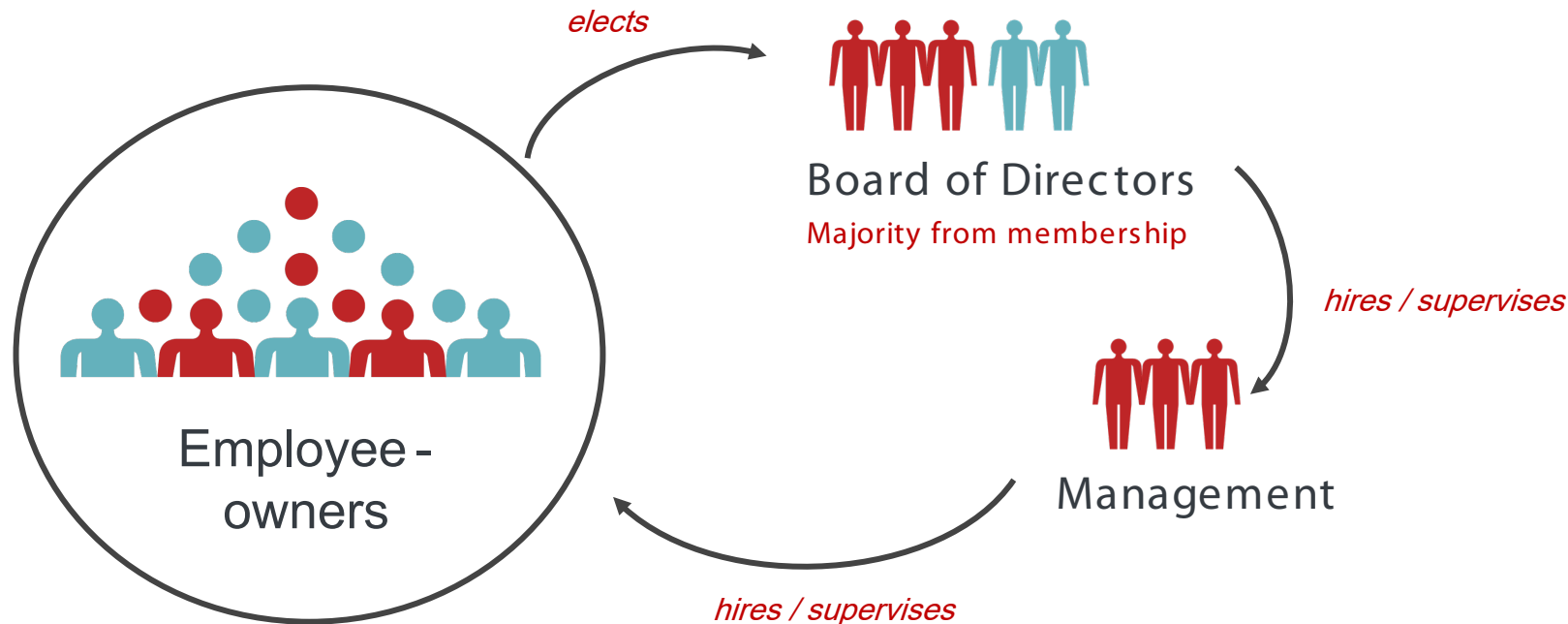
# What is a worker cooperative



- Business owned and governed by its employees
  - One share, one vote
  - Board of Directors made up of majority employee - owners
  - Profit sharing via patronage, based on hours worked
- Employees choose to become owners and buy in to receive their right to vote and profit sharing
- Flexible business form (Cooperative Corp, LLC most common)
- Federal tax benefits
- Lower cost set up and ongoing

# Democratic governance

in a worker cooperative



# Owner buy in

- The amount of money an employee pays to become an owner
- Rights and responsibilities of ownership
  - One vote in governance
  - Right to receive profit sharing
- Customized to the business (feels significant, but accessible for all employees)
- Returned when an owner leaves the business
- Not meant to contribute to the purchase price of the business

# Profit sharing

- Net profit to worker - owners gets paid out based on a predetermined formula
  - A formula that is based on hours worked, salary or production
  - Can take into account things like longevity with the company and founder status
  - The coop can decide to keep some of this in the business as working capital (Retained Patronage)
- Retained “Patronage”
  - Is owned by the worker - owner, and reflected in their Individual Capital Account
  - When a worker - owner leaves the company, the buy - in and the balance in their Individual Capital Account from retained patronage is paid out, usually over a period of years

# A cooperative builds employee wealth

## Owners are paid profit sharing annually (known as Patronage)

- Based on the net profit at year end
- Board determines the pool of profit available for distribution (taking into account business needs)
- Allocated based on a formula typically including hours worked during the year
- Taxable as regular income for the owner (deductible by the business)

## Retained profit sharing (Patronage)

- Annual allocation paid in two parts - cash and retained owner earnings (in an Individual Capital Account)
- When a owner leaves the company, the balance in their Individual Capital Account is paid out, usually over a period of years



# Poll question #3



# Employee Ownership Trust basics

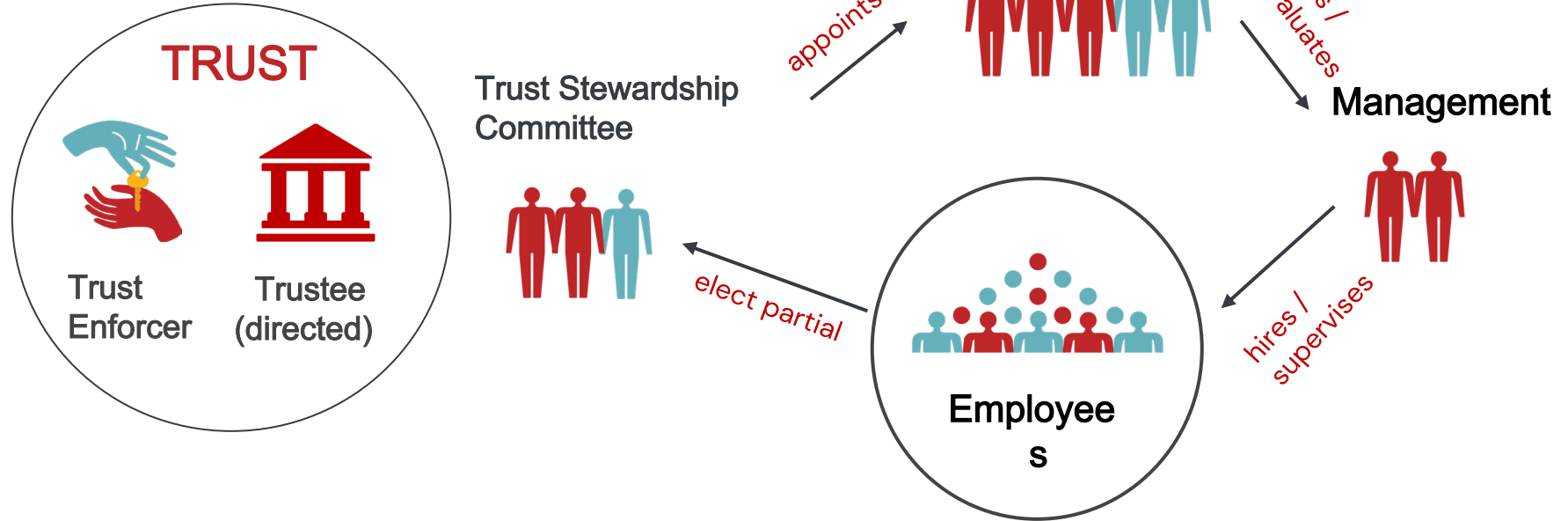
# What is an Employee Ownership Trust?



- Employee Ownership Trust (EOT) is a trust that holds some or all of the shares of a company on behalf of the employees
- An EOT provides permanent or long - term ownership of a business
- An EOT is a highly customizable structure that can mimic most / all of the features of a cooperative
- All employees are members of the ownership group
- Employees are represented in the governing bodies of the business
- An EOT distributes annual (or quarterly) profit sharing

# How governance works

## Employee Ownership Trust



# An EOT builds employee wealth

Owners are paid profit sharing annually (or quarterly)

- Based on the net profit at year end
- Board determines the pool of profit available for distribution (taking into account business needs)
- Allocated based on a formula (flexible)
- Taxable as regular income for the owner (deductible by the business)
- EOT has the flexibility to also determine other “ownership” benefits



# Where to go from here

# There is an EO form for all situations

## Employee Stock Ownership Plans (ESOPs)

- Larger businesses (50+ employees; \$1M+ EBITDA)
- Professional management in place (succession CEO, Finance Dir, HR, etc.)
- Employee base motivated by retirement benefits
- Owner can take §1042
- Automatic employee enrollment
- Business is oriented towards growth

## Worker cooperatives

- All sizes of business
- Line of sight to succession management
- Employee base motivated by cash in hand
- Owner can take §1042
- Strong sense of culture, strong employee governance role
- Lowest set - up costs

## Employee Ownership Trusts (EOTs)

- All sizes of businesses
- Line of sight to succession management
- Employee base motivated by cash in hand
- Flexible employee governance role
- Automatic employee enrollment
- Low set - up and maintenance costs

# A CPA's role in an EO transition

## STEP 1

### EXPLORATION

Owner needs / desires

Educate on EO

Discuss EO vehicles and fit

Determine who to support

## STEP 2

### FEASIBILITY

Conduct debt capacity analysis

Advise selling owner (e.g. sale type, capital gain treatment, tax considerations)

Educate on EO process

Educate key employees

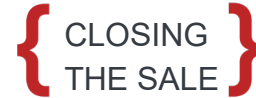
## STEP 3

### TRANSITION

Advise on impact to the business (e.g. leveraged balance sheet, tax considerations, etc.)

Assemble deal team

Model pro forma financial statements



## STEP 4

### THRIVE

Support selling owner in managing new assets

Support EO business with tax and accounting services





# How Project Equity can support you and your clients

## Education

- We can educate advisors about employee ownership
- Help advisors be "candidate spotters"

## Support

- As contracted or referral consultants, we can directly support your clients to explore and assess feasibility of EO transitions

# What to look for in an employee ownership service referral / deal team

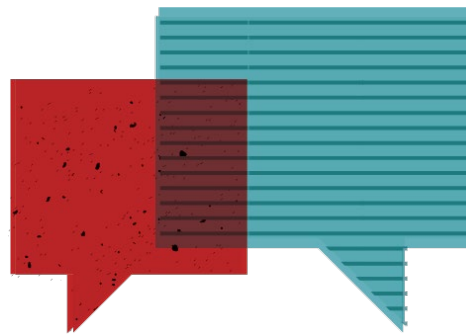
- Comprehensive feasibility assessment
- EO type expertise and experience
- Hands on transition support including quarterbacking various experts and assessing / supporting management transition needs
- Connections to transaction financing and other business capital needs by lenders versed in employee ownership
- Post-transaction support to ensure the business and its employee - owners thrive (training, ownership culture, coaching)

# Is employee ownership right for your client?



Visit our business  
advisor page

[project - equity.org/advisors](https://project-equity.org/advisors)



Book a free consultation  
and let's talk

[project - equity.org/free - consultation](https://project-equity.org/free-consultation)

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# Questions and discussion

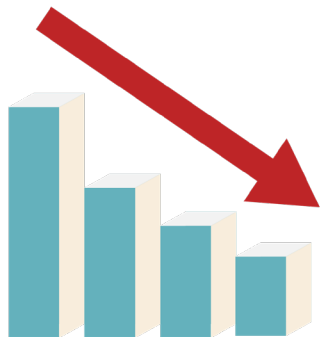
Thank you for joining us today!

Contact us at  
[learning@project - equity.org](mailto:learning@project-equity.org)

{ **Project Equity** }

[project - equity.org](https://project-equity.org)

## True or false?



Selling to employees requires accepting a lower selling price.

## False!



A fair sale price is established by debt capacity, just like in a bank-financed sale to an individual.

## True or false?



Employees will have to “pay out of pocket” to buy the business.

## False!



Employees are not obligated to finance the transaction. Usually it is completed through a leveraged buyout.

## True or false?



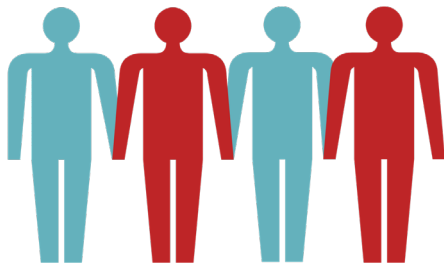
Selling owners can remain strategically involved after the transition.

## True!



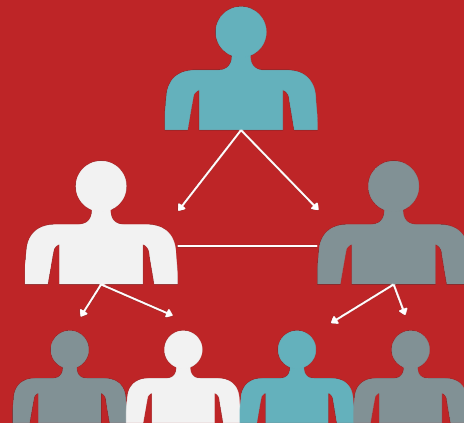
Selling owners have many options to stay involved in the business.

## True or false?



All employees will be managing the business equally.

## False!



Management can stay in place or strategically shift to ensure a robust operational structure.



# The CPA's role in employee ownership transitions

CPAs can play an important role in the entire employee ownership transition lifecycle including:

- Due diligence / valuation on behalf of the employees
- Advise selling owner (e.g., asset sales, 1042 rollovers of capital gains, etc.)
- Impact on the business to both selling owner and employees (e.g., leveraged balance sheet, tax implications, etc.)

# EO expertise benefits

Wins for you, the CPA

- Differentiate yourself from the competition
- Grow your practice revenues
- Retain a business client



# EO transition benefits

Wins that expand your network

- Leverage your client's built-in buyer group
- Gain better access to Silver Tsunami business owners
- Become more engaged with your client business owner's advisory team
- Grow your own referral network of professional advisors and partners



# Sample transaction - ABC Company

Revenue: \$16.6 million | EBITDA:\$1,330,000 | Valuation: \$4 million | Transaction price : \$4 million

	Initial liquidity <i>60% of sale price</i>	Seller note <i>40% of sale price</i>	Earnout income *	Seller's interest income **	Tax savings ***	Total financial benefit
Best case	\$2,400,000	\$1,600,000	\$520,000	\$363,389	\$360,000	\$5,243,389
Base case	\$2,400,000	\$1,600,000	- 0 -	\$363,389	\$360,000	\$4,723,389

*\*Earnout calculated over 3 years at best case revenue growth scenario (3.3% per year)*

*\*\*Assumes 6% interest rate and 7 - year term on seller's note*

*\*\*\*Assumes all \$600K reinvested in a QRP and 15% capital gains rate*

*Seek legal and tax advice to assess this option*

# Key ESOP tax savings



1. Company has the ability to deduct principal and interest payments from income, leaving more “after - tax” for reinvestment
2. Employees have the ability to defer income taxation on value of the stock they receive