

Distressed ESOP Sales Presentation for Sellers

Created by John Hoffmire

1989

The attached slides were used with a variety of large multinational corporations which had divisions, plants and businesses that they wanted to divest. Often employees were considered to be potential buyers.

These slides are placed on CLEO for researchers to use to ascertain some of the perceived motivations behind the types of transactions that were being discussed and closed during this period of ESOP history when many of the big, union-oriented ESOPs were being formed.

These slides were used by Hoffmire & Associates.

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ESOP IMPLEMENTATION POSSIBLE MOTIVATIONS

TRADITIONAL

1. BENEFIT PLAN TO SUPPLEMENT REGULAR EMPLOYEE COMPENSATION/PENSION
2. ATTRACTIVE LOWER COST SOURCE OF FINANCING
 - LOWER COST (DUE TO PRINCIPAL DEDUCTABILITY AND LOWER INTEREST RATE).
 - AVAILABLE WHEN OTHER CIRCUMSTANCES PRECLUDE REGULAR SOURCES OF CAPITAL (SUCH AS WHEN LEVERAGED ESOPs ARE ESTABLISHED TO GENERATE FUNDS IN LIEU OF CONTINUING TO FUND A TRADITIONAL PENSION PLAN)
3. SUPPORT ACQUISITION/DIVESTITURE PLAN (CHANGE OWNERSHIP)
 - SOURCE OF INVESTMENT CAPITAL FOR LBOs
 - DIVESTITURE TOOL
 - PROVIDES A SELLER OF A PRIVATE COMPANY WITH TAX ADVANTAGED WAY OF "CASHING-OUT" OWNERSHIP WITHOUT LOSING OPERATIONAL CONTROL OF THE COMPANY
 - ALLOWS A COMPANY TO DIVEST OF UNATTRACTIVE BUSINESS SEGMENTS (I.E. DECLINING INDUSTRIES).
 - ATTRACTIVE ALTERNATIVE TO IPO FOR EXITING VENTURE CAPITALISTS
4. MISCELLANEOUS OTHER PURPOSES
 - FACILITATE MANAGEMENT TRANSITIONS/CASHING OUT
 - PLACE STOCK WITH A FRIENDLY PARTY (TRUSTEE OR EMPLOYEES) AS A TAKEOVER DEFENSE

ACHIEVE FULL POTENTIAL

5. FACILITATE INTRODUCTION OF OPERATIONAL EFFICIENCIES (COST REDUCTION).
 - ACHIEVE LABOR COST CONCESSIONS/WORK RULE CHANGES VIEWED UNATTAINABLE WITHOUT STOCK OWNERSHIP INCENTIVES
 - ENCOURAGE INCREASED WORKER PRODUCTIVITY IN GENERAL
6. ENABLE/ENHANCE A TOTAL STRATEGIC REORIENTATION OF THE COMPANY TOWARDS ACHIEVING ITS FULL POTENTIAL
 - UTILIZE EMPLOYEE/MANAGEMENT COLLABORATION STIMULATED BY ESOP TO IDENTIFY/ASSESS UNPRECEDENTED STRATEGIES/OPERATING APPROACHES

ESOP TRANSACTIONS

TAX ADVANTAGES

KEY ADVANTAGES (BY PARTICIPANT)

ESOP ADVANTAGES

DEBT
RELATED GENERAL

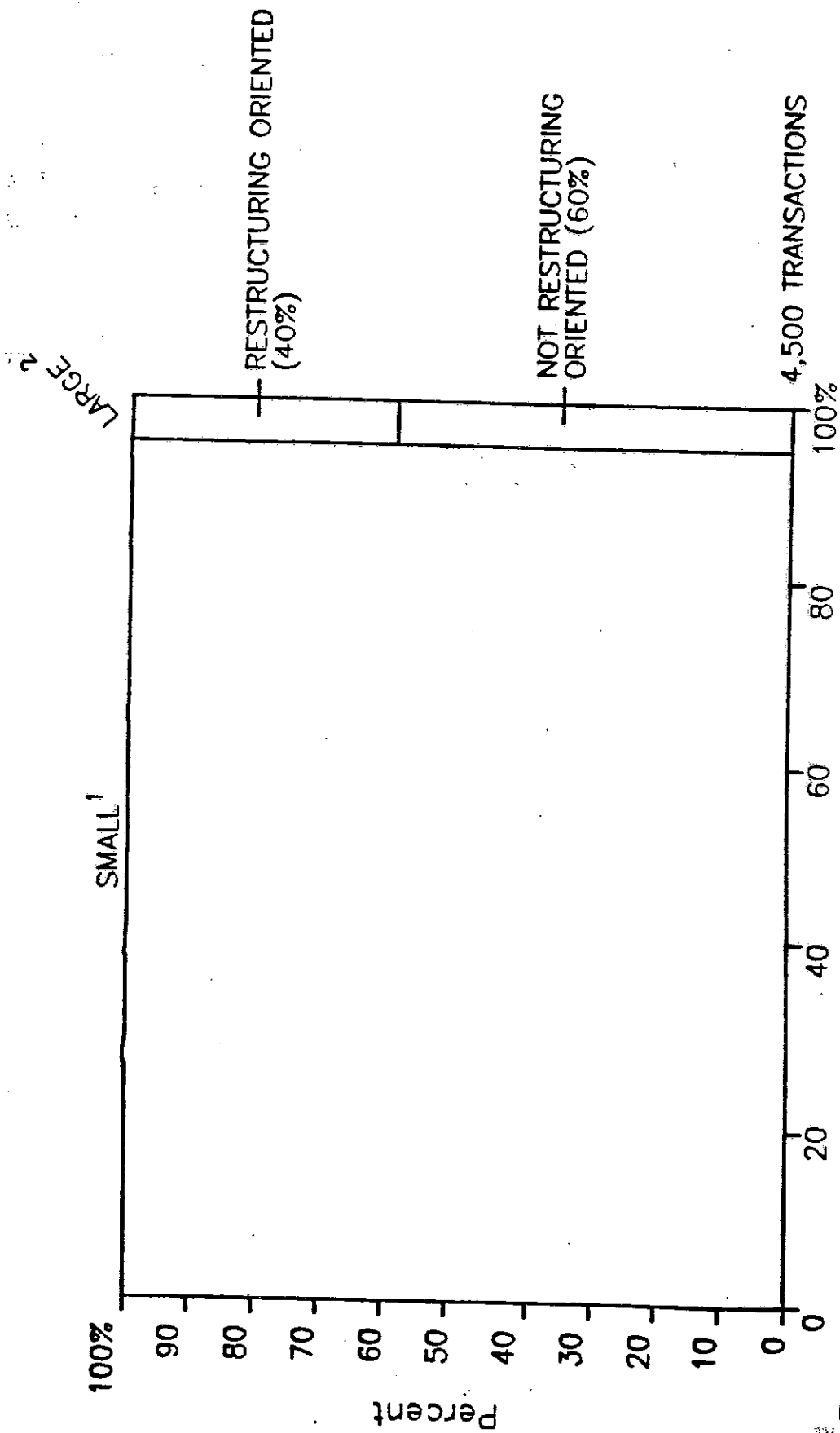
- INSTITUTIONAL LENDERS
 - DEDUCT 50% OF INTEREST INCOME X

- COMPANIES
 - DEDUCT PRINCIPAL PAYMENTS (UP TO 25% OF PAYROLL) X
 - DEDUCT INTEREST PAYMENT X
 - DEDUCT DIVIDENDS TO ESOP IF USED TO REPAY LOAN OR PAID IN CASH X
 - PAY NO TAXES ON OVERFUNDED PENSION TRANSFER OF SURPLUS TO ESOP (ONLY IN 1988) X
 - USE NOLs IF ESOP OWNS AT LEAST 50% OF COMPANY X

- SELLERS
 - IF SOLD AT LEAST 30% OF CLOSELY HELD COMPANY -- OWNERS MAY REINVEST DEFERRING TAXES X
 - ESTATE SELLING STOCK TO ESOP PAYS TAXES ON 50% OF PROCEEDS (UP TO \$750K) IF CLOSELY HELD CORPORATION, ESOP MAY ASSUME TAX LIABILITY CARRYING 4% INTEREST X

- EMPLOYEES
 - ACCUMULATE DIVIDENDS ON A TAX-DEFERRED BASIS WHEN SHARES ARE KEPT WITHIN ESOP
 - TAX TREATMENT OF SHARES ON:
 - . VESTING?
 - . RETIREMENT?
 - . CASHING?

ESOP TRANSACTIONS BY SIZE/MOTIVATION



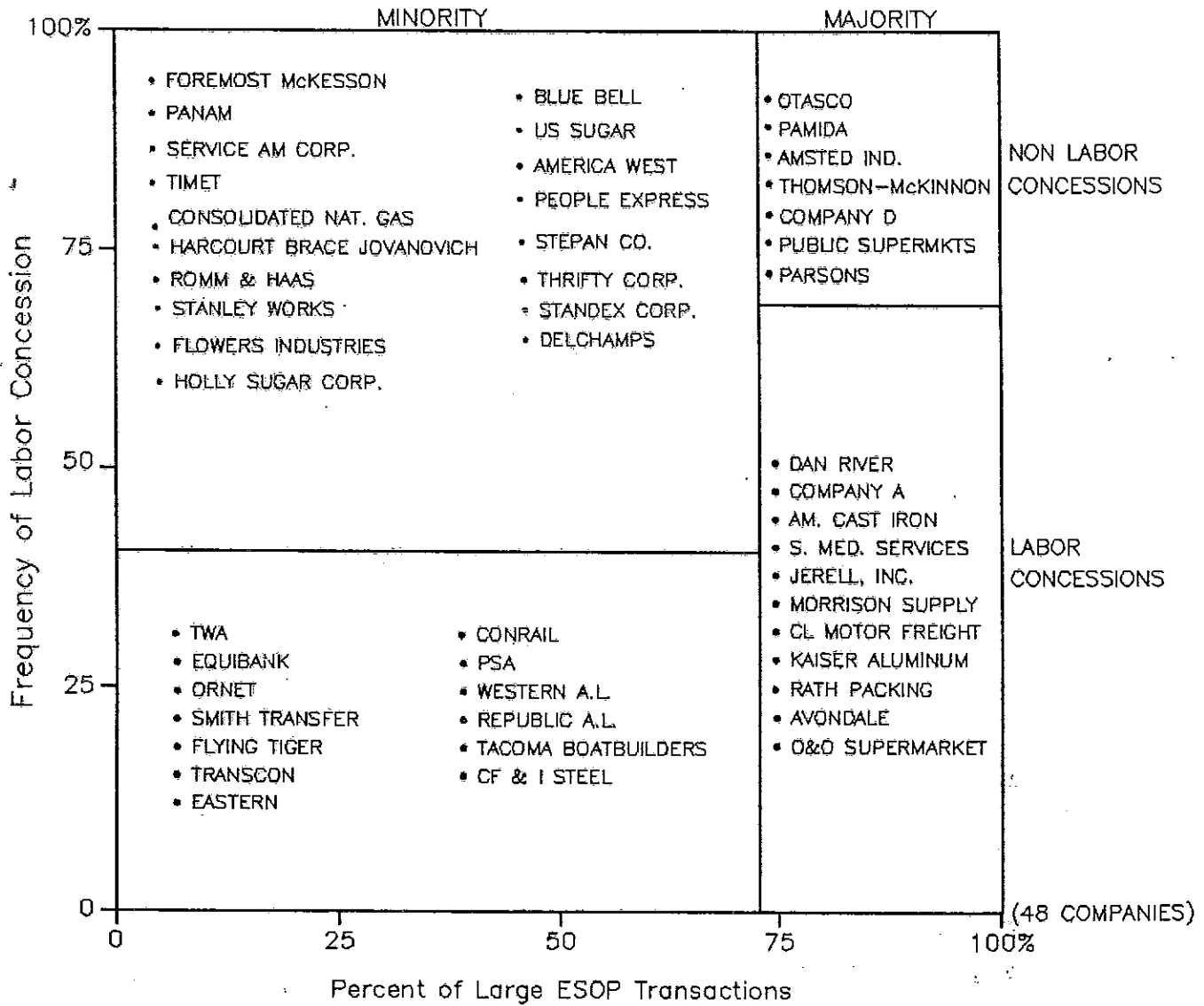
Source: NCEO Database

- 1) Less Than \$200MM Revenue or 2,000 Employees
- 2) More Than \$200MM Revenue or 2,000 Employees

LARGE RESTRUCTURING ORIENTED ESOPS

TYPE OF RESTRUCTURING

EMPLOYEE OWNERSHIP



*BASED ON SAMPLE OF 48 COMPANIES WITH MORE THAN 2,000 EMPLOYEES OR \$200MM OF REVENUE

ESOP RESTRUCTURING

EMPLOYEE CONCESSIONS POTENTIAL

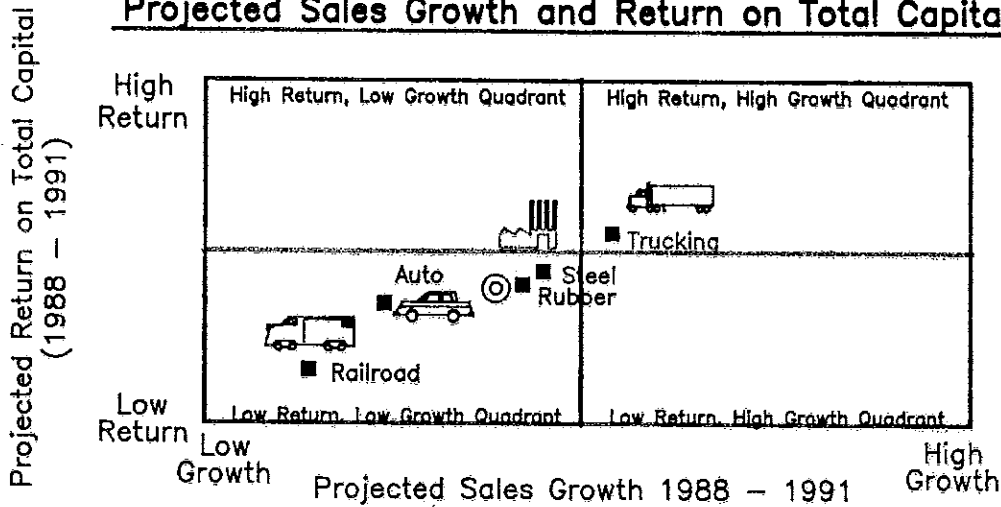
Yes
 Maybe
 No

PRE-ESOP KEY CHARACTERISTICS	COMPANY			
	A	B	C	D
● CREDIBLE ANTI-LABOR SHAREHOLDER OPTIONS	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>
● HIGH LABOR COSTS (AS PORTION OF TOTAL COSTS)	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>
● HIGHLY UNIONIZED WORKFORCE	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>
● FEW UNIONS	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>
● HIGH WAGES (ABOVE COMMUNITY AVERAGE)	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>
● ANTIQUATED WORKRULES	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>
● DOWNWARD PRESSURE ON HEADCOUNT	<input checked="" type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>
● EMPLOYEE WILLING TO TAKE EQUITY	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>
● CLEAR UNION LEADERSHIP	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	N/A
● PERCEIVED VALUE OF ESOP EQUITY	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>
● REALISTIC EMPLOYEE FORECASTS				
- WAGES	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	N/A
- HEADCOUNT	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	N/A
● CONCESSIONS OBTAINED	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
- HEADCOUNT REDUCTION	<input type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>
- WAGE REDUCTION	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>

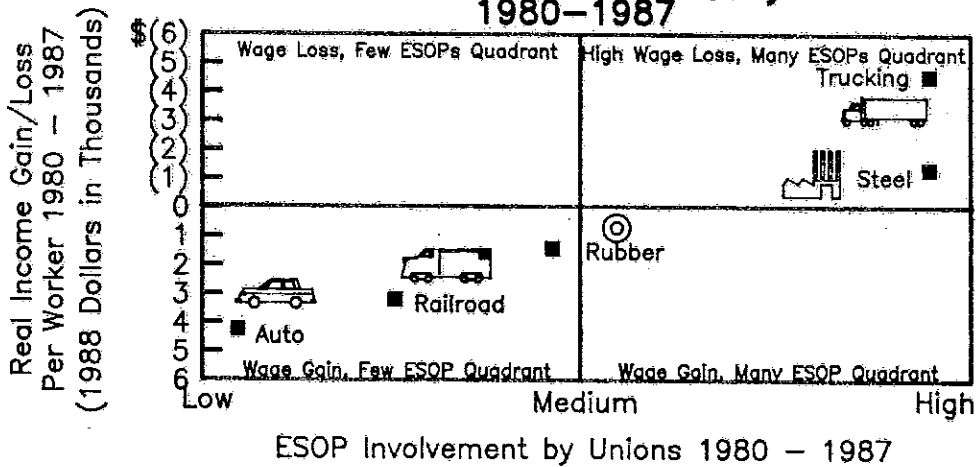
ECONOMIC PERFORMANCE, WAGE LEVELS AND ESOP EXPERIENCE

SELECTED INDUSTRY EXAMPLES

Projected Sales Growth and Return on Total Capital



Historical Union Wages Gain or Loss by Industry 1980-1987

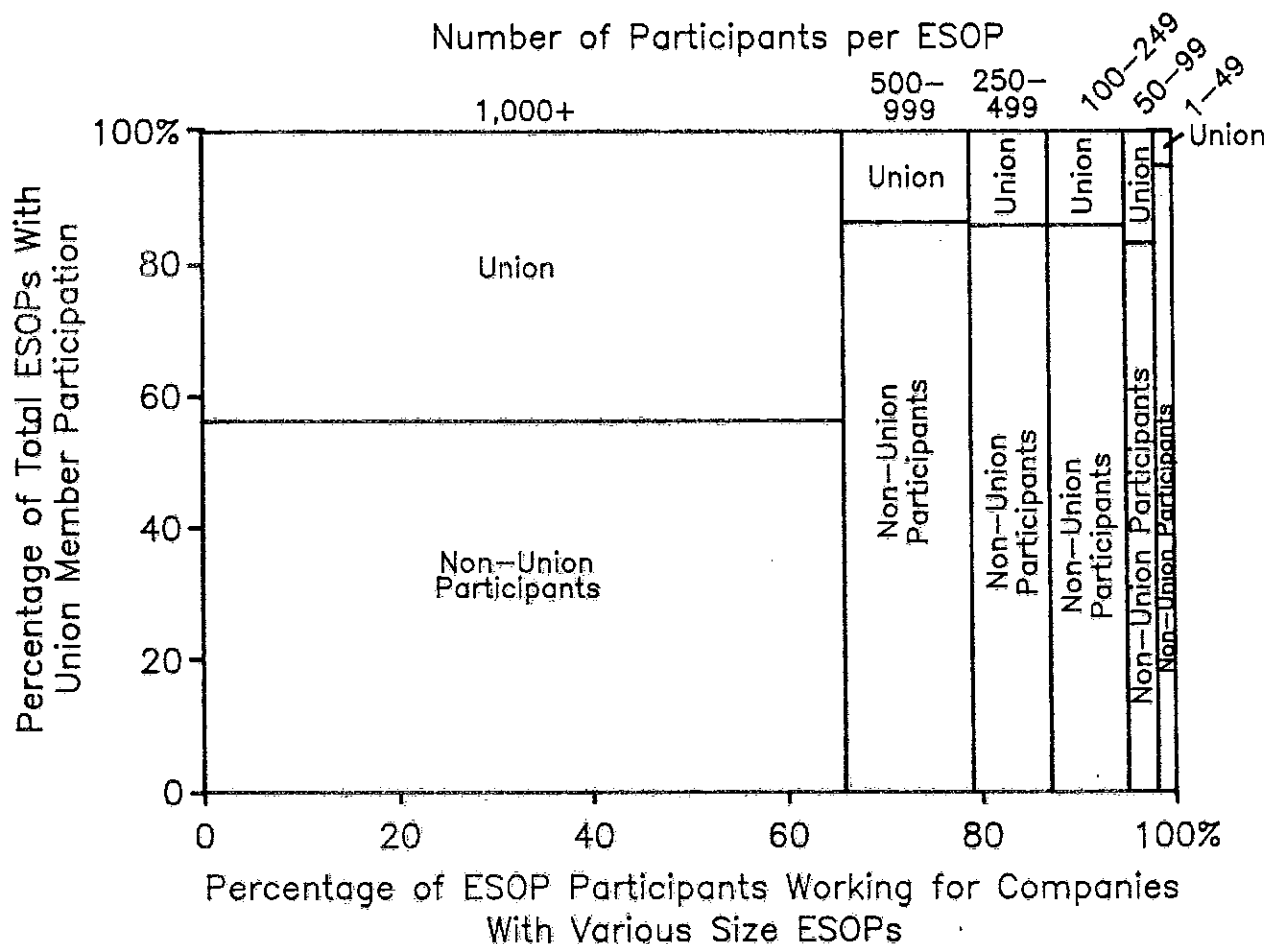


- LOW PROFITABILITY AND SALES GROWTH PROJECTIONS CORRESPOND TO HISTORICAL WAGE GAINS
- HISTORICAL WAGE LOSSES CORRESPOND TO PROJECTED MODERATE SALES GROWTH AND PROFITABILITY
- HIGH ESOP INVOLVEMENT BY UNIONS HAS EXISTED IN INDUSTRIES WITH SIGNIFICANT HISTORICAL WAGE LOSSES

Sources: Value Line, Labor Department Publication "Employment and Earnings"

UNION PARTICIPATION IN ESOPs

PERCENTAGE OF ESOP PARTICIPANTS 1988



● EXPLANATION OF PRESENTATION FORMAT

- THE SIZE OF EACH RECTANGLE REPRESENTS BOTH THE NUMBER OF PARTICIPANTS IN VARIOUS SIZE ESOPs AND THE PERCENTAGE OF ESOP COMPANIES WHICH INCLUDE UNION OR JUST NON-UNION EMPLOYEES IN THEIR ESOPs. ESOPs ARE BROKEN DOWN INTO SIZES FROM 1 TO OVER 1,000 PARTICIPANTS

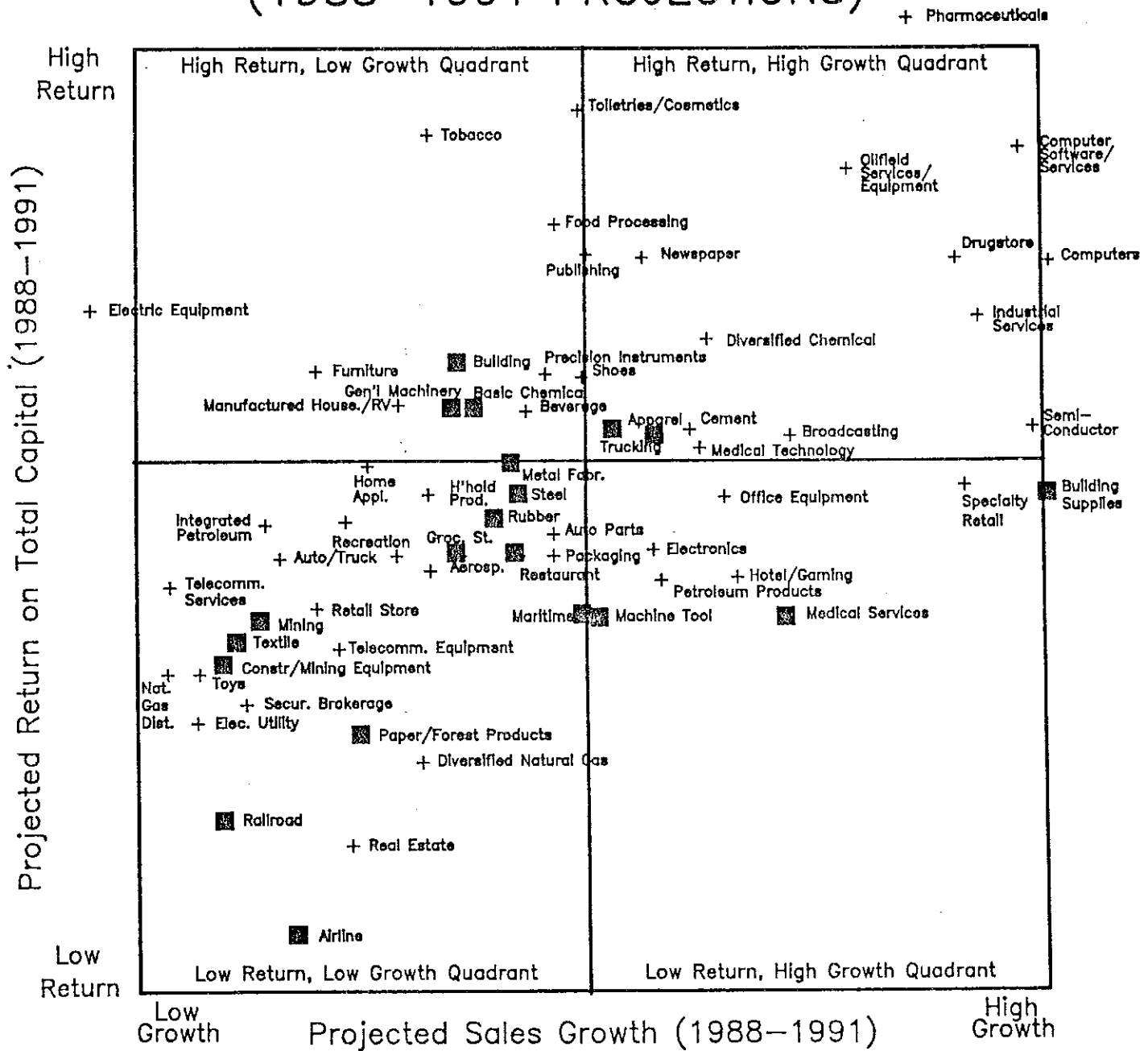
- PERCENTAGE OF ESOPs WHICH INCLUDE UNION MEMBERS IS COINCIDENTALLY SIMILAR TO PERCENTAGE OF EMPLOYEES ACROSS THE NATION WHO ARE MEMBERS OF UNIONS
- BOTH UNIONS AND MANAGERMENTS HAVE THE RIGHT TO EXEMPT UNION EMPLOYEES FROM PARTICIPATION IN ESOPs. THIS FACT LOWERS OVERALL PARTICIPATION OF UNION MEMBERS IN ESOPs

Source: ESOP Association Membership Survey

*Note: The ESOP Association Membership May Not Reflect a Perfect Sample to Extrapolate From Regarding Union Participation Issues and ESOPs

ESOP INDUSTRY SCREEN

SALES GROWTH AND RETURN ON TOTAL CAPITAL (1988-1991 PROJECTIONS)



- THE GRAPH PLOTS INDUSTRIES BY PROJECTED GROWTH AND PROFITABILITY
- INDUSTRIES IN THE BOTTOM LEFT QUADRANT ARE GROWING SLOWLY AND HAVE LOWER PROJECTED PROFITABILITY
- THE PUBLICLY RECOGNIZED ESOPs ARE IN INDUSTRIES WITH LOWER PROJECTED GROWTH AND PROFITABILITY
- DIVESTITURES IN GENERAL TAKE PLACE IN LOW GROWTH AND PROFITABILITY INDUSTRIES

Source: Value Line

■ = Industries With Well-Known ESOPs
 + = Industries With Fewer Well-Known ESOPs

ESOP PERFORMANCE STUDY RESULTS

	<u>STUDY</u>	<u>CONCLUSION</u>
• OVERALL PERFORMANCE	1986 NCEO	- MOST PARTICIPATIVE IMPROVED PERFORMANCE BY 8-11% VS. 3.5% FOR LEAST PARTICIPATIVE
• SALES GROWTH	1986 NCEO	- ESOPs GREW 5.4% FASTER THAN COMPETITORS VS. 1.89% BEFORE ESOP PLANS PUT IN PLACE
• EMPLOYMENT GROWTH	1986 NCEO	- ESOPs EMPLOYMENT GREW 5.05% FASTER THAN COMPETITORS VS. 1.21% BEFORE ESOP PLANS PUT IN PLACE (95% CONFIDENCE LEVEL)
	1984 ATLANTA FEDERAL RESERVE	- EMPLOYEE OWNERSHIP FOUND TO BE A COMMON THREAD OF PREMIER SOUTH COMPANIES
	1978 UNIVERSITY OF MICHIGAN	- SAMPLE OF 30 ESOP COMPANIES HAD PROFITS OF 1.5x AS HIGH AS COMPARABLE CONVENTIONAL FIRMS
	1984 NCEO	- NYSE SAMPLE OUTPERFORMED 62.75% OF COMPETITORS (DEPENDING ON MEASURE USED)
• POSITIVE EMPLOYEE ATTITUDES TOWARD ESOP	FOUR YEAR NCEO STUDY	- MOST IMPORTANT POSITIVE FACTOR: LARGE ANNUAL CONTRIBUTION TO ESOP PLAN - OTHER IMPORTANT FACTORS: . MANAGEMENT ATTITUDES TOWARD EMPLOYEE OWNERSHIP . JOB LEVEL PARTICIPATION OPPORTUNITIES
	1985 ESOP ASSOCIATION SURVEY	- 16% OF COMPANIES SAY "STRONG IMPROVEMENT" - 56% OF COMPANIES SAY "SOMEWHAT IMPROVED"
	1980 JOURNAL OF CORPORATION LAW	- ESOPs HAD TWICE THE ANNUAL PRODUCTIVITY GROWTH RATE OF CONVENTIONAL FIRMS DURING 1975-1979
• BUSINESS SURVIVABILITY	1984 UNIVERSITY OF MICHIGAN	- ESOP COMPANIES 10% MORE LIKELY TO STAY IN BUSINESS
• DESIRABILITY OF EMPLOYERS	1984 100 BEST COMPANIES TO WORK FOR	- SHARING OWNERSHIP ONE OF CHARACTERISTICS OF DESIREABLE EMPLOYERS



USE OF ESOPs SUGGEST:

- BETTER OVERALL PERFORMANCE
 - HIGHER PROFITABILITY
 - FASTER GROWTH
 - IMPROVED PRODUCTIVITY
- IMPROVED BUSINESS SURVIVABILITY
- ENHANCED DESIRABILITY OF EMPLOYERS
- DEGREE OF BENEFIT DEPENDS ON MANAGEMENT EFFECTIVENESS IN ACHIEVING POTENTIAL

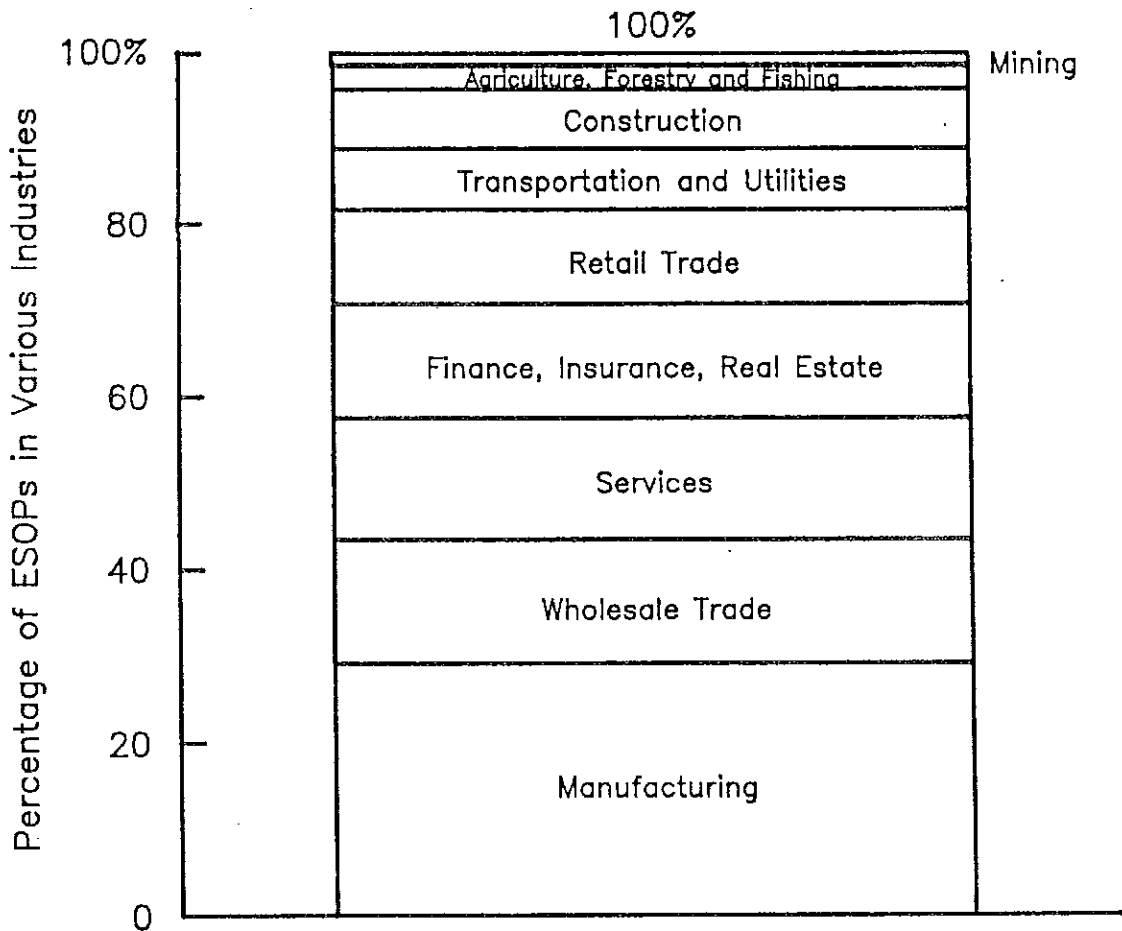
DISTRESSED COMPANIES' OPTIONS PARTICIPANTS' PREFERENCES IN POTENTIAL DIVESTITURE SITUATIONS

CURRENT SHAREHOLDER AND MANAGEMENT PREFERENCE

LABOR PREFERENCE		SHAREHOLDERS AND MANAGEMENT PREFER OPTIONS IN THIS COLUMN	SHAREHOLDERS AND MANAGEMENT DO NOT PREFER OPTIONS IN THIS COLUMN
LABOR PREFERS OPTIONS IN THIS ROW	<ul style="list-style-type: none"> ● ESOP ● GAINSHARING ● COOPERATIVE TURNAROUND 	WIN WIN	<ul style="list-style-type: none"> ● MAINTAIN OR INCREASE NUMBER OF JOBS ● INCREASE PAY AND BENEFITS ● GUARANTEE EMPLOYMENT
LABOR DOES NOT PREFER OPTIONS IN THIS ROW	<ul style="list-style-type: none"> ● DIVEST THE COMPANY ● BREAK UP THE COMPANY ● AUTOMATE ● DEUNIONIZE ● CUT WORK RULES ● MOVE JOBS OFF-SHORE ● CUT WAGES AND BENEFITS 	LOSE WIN	<ul style="list-style-type: none"> ● SHUT DOWN ● BANKRUPTCY

- THE OPTION WHERE LABOR, MANAGEMENT, AND SHAREHOLDERS ALL BENEFIT IS THE ESOP OPTION
- DISTRESS ESOPS ARE MOST VIABLE WHEN THE SALE TO THE ESOP IS MADE BEFORE BUSINESS SITUATIONS REACH DESPERATION STAGES

DISTRIBUTION OF ESOPs BY INDUSTRY



- ESOPs ARE FAIRLY EVENLY DISTRIBUTED ACROSS DIVERSE INDUSTRIES, WHEN BROAD INDUSTRY DEFINITIONS ARE USED AS CATEGORIES
- BUT THE DEVELOPMENT OF ESOPs IN PARTICULAR TYPES OF COMPANIES HAS BEEN PROFOUND
- KEY VARIABLES IN INDUSTRIES WITH SIGNIFICANT ESOP DEVELOPMENT INCLUDE: HIGH PERCENTAGE OF UNIONIZED WORKERS, WAGES HIGHER THAN THE NATIONAL AVERAGE, LOW PROJECTED PROFITABILITY, LOW PROJECTED SALES GROWTH, AND HIGH LABOR COSTS AS A PERCENTAGE OF TOTAL COSTS

Source: GAO, 1986