

“New & Notable ESOP Valuation Issues”



2019 National Conference | Washington, DC

#ESOPSROCK

Brundle Discussion Take Aways

- Consideration of prior valuations
- Application of control premium
- Due diligence on financial projections prepared
- Impartiality of preparer of projections
- Appropriate due diligence time line
- Correction of an overvaluation through subsequent sale



Control Premium Issues

- When if ever is paying a control premium appropriate
- What does control mean
 - Legally
 - Practically
- If valuation based upon cash flows is there economic difference between minority and control value

Event Protection

- Trustee should consider negotiating event protection, i.e. sale of the company within a short period following ESOP implementation or “short sale”
- Short sale – purchase of all stock held by ESOP and/or assets of ESOP owned company within 3 years of original ESOP transaction
 - Negotiation of “cap” on proceeds received by non-ESOP equity holders
 - Warrants
 - Stock Options/Stock Appreciation Rights
- Burden on Trustee team to prove short sale was not contemplated as part of the original ESOP transaction
- Impact of “caps” on ESOP valuation



Repurchase Obligation and Impact of Valuation

- Integration with valuation process and conclusions
- Iterative process between valuator, trustee, company and administrator
- Management of Benefit Levels
- Sustainability



Weighting of Valuation Approaches

- No set formula
 - What is central tendency of RANGE OF VALUES?
 - Do methods support each other?
 - What is the most appropriate method?
- Income approaches
 - Tend to receive greatest weight
 - Availability/reliability of forecast
- Market approach
 - Quality/comparability of market data
 - Consistency among multiples
- Asset approach
 - Often a floor value



Redemption Transactions

- Simultaneous
- Sequential
- Economic Difference



Projections

- Who prepares the forecast (if done by the company), how often is one prepared and what is management's success ratio of hitting the forecast?
- If there is customer concentration, then it is recommended the VA and trustee have discussions with that main customer and get their projections for the future.

Projections

Per the AICG Settlement Agreement, conduct reasonable inquiry into projections given by individual(s) responsible for providing any projections reflected in the valuation report and conduct reasonable inquiry whether those individuals have or reasonably may be determined to have any conflicts of interest in regard to the ESOP.



Criteria Evaluation of the Company

- Conduct a thorough due diligence of the company. For example, if notating the company has a “competitive advantage”, then it must be substantially demonstrated in the report and analysis; must be able to be articulated.
- Buzzwords lack substance without demonstration of term meaning.

Methodology

- Discounted Cash Flow Method: Per the Joyner SA, if the VA does not use a DCF analysis, explain why it was not used.
- Or with any methodology/approach.



Not “New”, But “Notable”

- Per the FBTS SA:
 - If the trustee believes the projections are unreasonable, the trustee shall ask the VA to account for the unreasonable projections in its valuation, request new and reasonable projections from management, or reject the transaction.

Not “New”, But “Notable”

- Per the FBTS SA:
 - Ensure that the information the VA obtains from the ESOP sponsor and purchasing or selling shareholder(s) includes the following, to the extent it exists:
 - Prior attempts of purchasing within preceding 2 years
 - Any prior lending defaults within past 5 yrs
 - Management letters from accountants within past 5 yrs
 - Any information related to a valuation of sponsor



Not “New”, But “Notable”

- Per the FBTS SA:
 - Explain any material differences between present valuation and the most recent prior valuation of ESOP sponsor performed within past 24 months for any purpose.
 - Describe the risks facing the plan sponsor that could cause the plan sponsor’s financial performance to fall materially below the projections relied upon by VA.



EBITDA Adjustments

- Should VA accept any and all adjustments provided by company management?
- How should the VA handle historical excess shareholder compensation?



Subordinated Debt with Warrants

- Nature of subordinated debt
- Warrants supplement coupon to drive total return on debt security
 - Impact on purchase price?
- ESOP fully diluted ownership position
 - Does it matter??
- What about equity based incentives



Chuck Coyne, ASA



Chuck Coyne

860-233-6552

CCoyne@empireval.com

www.empireval.com



Chuck is a Managing Director at Empire Valuation Consultants and is an Accredited Senior Appraiser (ASA) of the American Society of Appraisers.

He has over 30 years of professional experience providing financial consulting, business appraisals, ESOP feasibility and transaction consulting, due diligence and expert witness testimony on business valuation matters. Chuck has extensive experience in the valuation of business assets and interests for purposes of employee stock ownership plans (ESOPs), providing ESOP feasibility studies, plan design and implementation consulting services. He has assisted over 100 companies in exploring the feasibility of utilizing an ESOP and implementing an ESOP for business succession purposes.

Chuck has prepared and managed estate and gift tax valuations, fairness opinions, purchase price allocation among acquired intangible assets and goodwill impairment testing, shareholder and partnership disputes, marital dissolution, acquisitions, divestitures and mergers.

He has testified as an expert witness on valuation matters in various State Supreme Courts, U.S. Bankruptcy Court, and has had his valuations accepted by the IRS and U.S. Tax Court. He has also testified as an expert witness before the American Arbitration Association.

Chuck has published articles and lectured on business valuation, mergers and acquisitions, succession planning and ESOPs before various professional and industry groups throughout the United States.

EDUCATION

M.B.A. - University of Hartford – Barney Graduate School of Business and Public Administration
B.S. in Business Management - University of LaVerne

AFFILIATIONS

American Society of Appraisers: New England - Regional Governor, Ethics Committee – Member, Connecticut Chapter - Past President; National Center for Employee Ownership (NCEO) - Consultant Member; The ESOP Association/Valuation Advisory Committee - Professional Member; Employee Ownership Foundation (EOF) –Trustee;



Erin Turley, Esq., Partner



Erin Turley

Partner

214.295.8020

eturley@mwe.com

www.mwe.com



Erin Turley is a partner in the ESOP and Employee Benefits Practice Group of McDermott Will & Emery LLP. Erin serves as Legal Liaison for the Valuation Committee of the ESOP Association. Ms. Turley's ESOP practice focuses on the design, implementation, maintenance, and termination of ESOPs. She has represented companies, inside ESOP trustees, and outside ESOP trustees in buy-side and sell-side transactions, as well as in ongoing ESOP compliance matters. Ms. Turley has been involved in hundreds of transactions, including leveraged buyouts, mergers, acquisitions, and the structuring and financing of ESOPs using private equity. She has extensive experience representing lenders in designing and negotiating credit facilities specifically tailored to the needs of ESOP-owned companies. Ms. Turley regularly writes and speaks on topics she encounters in her practice, including issues raised in connection with corporate mergers, acquisitions, divestitures, ESOP compliance, ERISA's regulatory framework, and health and welfare benefit plan arrangements. She is the co-author of Bloomberg Bureau of National Affairs (BNA) Tax Management Portfolio 354 – ESOPs and BNA Corporate Practice Portfolio 62 – ESOPs in Corporate Transactions.



ERIN D. HOLLIS, ASA, CDBV



125 S. Wacker Drive
Suite 850
Chicago, IL 60606
ehollis@marshall-stevens.com

marshall

stevens

Erin D. Hollis, ASA, CDBV, is a Director at Marshall & Stevens Incorporated. She works within the Chicago financial practice group conducting opinions and analyses for closely-held and publicly-traded entities for litigation, taxation and transactional purposes, and with ESOP clients on financial analysis and consulting services needs.

Experience – Since 2000, Ms. Hollis has worked with advisors and closely-held business owners for ESOP valuation needs, and has experience providing valuation advisory and economic analysis services in the areas of litigation, taxation, transactional, and planning purposes. Erin has provided valuation services in industries, such as manufacturing, construction, transportation, agricultural, distribution, retail, wholesale, and a wide range of service industries, including architecture and engineering.

She is a qualified expert witness, and has testified for various marital and corporate litigation matters. She is a prolific author on the subject of business valuation, and has written for several industry trade publications and as a contributing author for professional organizations. Erin sits on the Business Valuation Committee of the American Society of Appraisers (ASA) and the Valuation Advisory Committee (VAC) of the ESOP Association, and is a member of the NCEO.

Education – Erin received a B.A. and B.S. from Michigan State University. She is an Accredited Senior Appraiser (ASA) with the American Society of Appraisers, and Certified in Distressed Business Valuation (CDBV) with the Association of Insolvency & Restructuring Advisors (AIRA).



Admin

- Please fill out a session evaluation form and drop it off at the table outside of this room
- Your feedback on topics and presenters is important and will be used to develop subsequent TEA programs
- Remember to get your CPE sheet stamped before and after each session for CPE credit





The ESOP Association

National Conference
Washington, DC
May 2019



Follow us on Twitter for live conference updates:
[@ESOPAssociation](https://twitter.com/ESOPAssociation)