ESI Enterprise Services, Inc.

Beyond the Numbers$

www.esi-enterprise.com

2009, Issue 2

Evaluating the ESOP valuation.

Adapted from Employee Ownership Report.

The single most important duty of an ESOP fiduciary is to make sure the ESOP is paying the appropriate value for the shares. When buying shares from an outside seller, that means paying not more than fair market value. When buying shares from former employees, it generally means paying fair market value, but not less than that. When the ESOP is buying or selling shares along with other buyers or sellers, it also means making sure that the ESOP is getting a fair deal compared to the deal that the other players are getting.

In reviewing the valuation report, fiduciaries should be sure that:

1. All material information is provided to the appraiser and has been represented objectively. Excessively optimistic projections or assumptions are especially dangerous.

2. The appraiser has the required skills and experience specifically with ESOPs to provide a competent analysis.

3. The appraiser uses appropriate methods (income approach, comparable companies, and asset value) and makes a convincing case for how to weight each one.

4. Repurchase obligation projections were provided to the appraiser and considered in the final report.

5. Discounts for lack of control and lack of marketability were appropriately applied.

6. Earnings projections were appropriately normalized to reflect compensation or other spending practices that a willing buyer would not sustain. This might include, for instance, very high employee benefits not needed to attract and retain the same quality of people, excessive perks for some or all employees, nonproductive assets held by the company for non-business reasons (an RV for the president, for instance), etc.

7. Any comparison companies used to conduct the analysis truly were comparable, or adjustments were made for size, product mix, and other factors. ■

Free-thinking boosters.

Adapted from Insight magazine.

Creating a culture where people feel comfortable enough to express their opinions and stimulated enough to think outside the box can be difficult. The days when innovation meant offices with open floor plans and ping pong tables are long gone. But that doesn't mean your company environment can't be creative.

Value quantity as much as quality. Some of the best innovations come from massaging ideas that may have seemed impossible, undesirable, or unlikely to succeed.

Phrase concerns as opportunities. Don't state concerns as fact ("We don't have enough money"). Instead, phrase them as creative challenges ("How can we get the necessary money, or do it for less?").

Reward new thinking. Employees sometimes become so focused on meeting their next deadline or sales target that they forget to take the time to exercise their imaginations. Let them know, by discussing ideas and implementing some of them, that original thinking is important.

Fail frequently, fail fast and fail forward. Overanalyzing ideas can squash something with great potential. Many companies measure failure rates - to ensure there are enough. If you aren't failing, you aren't trying new things.

Say "Yes, and..." not "Yes, but..." Force people to build on the ideas of others - even the craziest ideas.

Strive for alignment, not consensus. Consensus takes too long and results in watered-down solutions. Instead, encourage alignment where people say, "Although the solution is not exactly the way I want it, I will fully support it as though it were my own idea." ■

There is no shortcut to achievement - only gates that are opened by persistence.

Talk about your ESOP or someone else will.

In today's economy, stories about companies in crisis are everywhere. If it's an ESOP company that is having problems, many times the story gives a poor impression of ESOPs to those reading it. If you don't make the time to communicate about your own company's ESOP plan, someone else will. **You** can be proactive and build understanding of, and enthusiasm for, the valuable benefits of employee ownership.

Most people are unfamiliar with employee ownership – whether it's in an ESOP, company stock in a 401(k) plan or stock options. Ignorance is not bliss; often it creates susceptibility to the latest rumor, especially from those that are perceived to be a credible source. Fill that void of ignorance with basic facts: why your plan was created, where the company is headed and what it means to own company stock.

Sometimes employees are suspicious because ownership plans may be provided at no cost. Grumblings of "no one gets something for nothing" arise and the rumor mill's negative spin falls into place. Attack these misconceptions by explaining your plan's benefits.

In the spirit of telling the story of ESOPs, three ESI team members, along with a contingent of Wisconsin ESOP company representatives, visited Capitol Hill to meet with Senators Kohl and Feingold during the Annual ESOP Association Conference in Washington D.C. The purpose of the meetings was to talk about ESOPs, to lobby for federal legislation that encourages ESOPs, and to prevent changes in tax law that may negatively impact ESOPs.

Although there is no current legislation pending, it is anticipated that tax legislation will be drafted within the year. By being an advocate for ESOPs, and creating a relationship and rapport with congressional leaders now, they will become familiar with ESOP concepts and companies and will hopefully remember the positive aspects of ESOP ownership when it comes time for a vote. ■

If you're contemplating a stock transaction, it is important that you contact ESI before transacting. As your valuation advisor, we can provide insights into the process that you may not have considered.

ESI's Sandy Paavola receives award.

The ESOP Association presented Sandy Paavola with the 2009 Membership Recruitment Award for a Professional Member at the 32nd Annual Conference in Washington, D.C. "Sandra has done a tremendous job furthering the community's cause and encouraging ESOP companies to join the Association," said J. Michael Keeling, ESOP Association President. "I am pleased to present her with this award." ■

Employee-owned companies abound on *Fortune* magazine's top 100 list for 2009.

Adapted from The ESOP Association.

The list of top 100 companies by *Fortune* magazine shows that employee-owned companies in the U.S. are becoming more prominent. Approximately 14% of the companies on the 2009 list are employee owned.

According to *Fortune*, a company has to be at least seven years old and have more than 1,000 U.S. employees to be eligible. *Fortune* conducts an extensive survey of employees to name the top 100 companies. Two-thirds of the score is based on survey responses and the rest on a Culture Audit which includes information about pay, benefits, demographics, and communications practices, among other criteria. The Great Places to Work Institute created the survey used by *Fortune*. A list of the top 100 companies can be found at http://money.cnn.com/magazines/fortune/bestcompanies/2009/.

"Employee owned companies are out there doing exactly as intended, creating great places to work," said J. Michael Keeling, president of The ESOP Association. "In 2008, an economic performance survey conducted among ESOP Association members showed that 92% of companies believed that employee ownership was good for business. With this in mind, our nation's leaders should be looking to these companies and examining business practices and culture to help make our economy stronger." ■