

Feasibility and preparation for doing an ESOP November 4, 2021

NJ/NY | Center for
Employee Ownership

BAMCO INC.
ARCHITECTURAL METAL WALL SYSTEMS



MENKE & ASSOCIATES, INC.
ESOP ADVISORS AND INVESTMENT BANKERS

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Presenter - Phillip DeDominicis

Managing Director, Investment Banking, Menke & Associates, Inc.



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- Last 17 years – senior East Coast partner of Menke & Associates, focusing on ownership transitions through ESOPs. Assisted over 250 companies in designing, adopting and selling shares to new ESOPs.
- Previously 14 years as director of mergers & acquisitions investment banking for Morgan Stanley and Salomon Smith Barney.
- Previously two year as a research process engineer focusing on chemical plant scale ups at the Rohm & Haas.
- Chemical Engineering from the University of Delaware.
- MBA in Finance from UCLA.
- Board member - Boy Scouts of America, Del-Mar-Va Council.
- Board member - Delaware American Heart Association.
- Board member - Delaware Safety Council
- Board member - Global Algae Innovations, Inc.
- Board member - NY/NJ Employee Ownership Center.
- Board member - St Hubert High School for Girls, Philadelphia.
- ESOP speaker - ESOP Association, NCEO & CPA Academy.

Menke & Associates, Inc.

Oldest & largest ESOP Advisor

- 47 years in the business,
- 50 dedicated ESOP specialists; including
- 7 lawyers, 7 investment bankers; 20 recordkeepers

Most ESOPs Created

- Over **3,500**

Largest Current Number of ESOP Clients

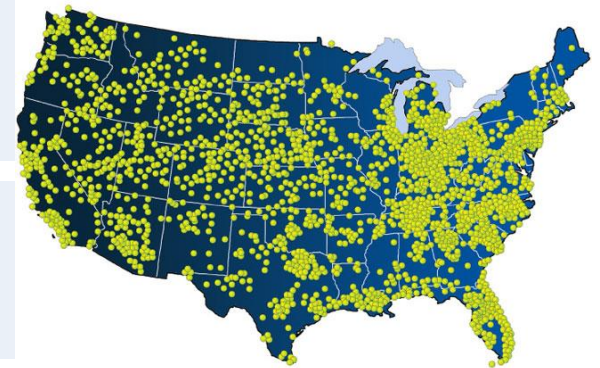
- **1,000+** clients

Most Sophisticated Online ESOP Administration

- **\$4 mm** investment

ESOP Owned

- Menke is **70%** ESOP owned



Agenda

- 1 Feasibility of an ESOP
- 2 Preparation for an ESOP process & closing due diligence process

1 Feasibility of an ESOP





Who should consider an ESOP?

Private company shareholder(s) who are:

- looking to sell the company.
- looking to only sell some shares now and maybe more later on.
- buying one shareholder's shares while others do not sell.
- looking to diversify net worth but want to keep working.
- looking for ways to enhance employee productivity.

Therefore, typical ESOP structures include:



- 1 ESOP + one owner/operator in control
- 2 ESOP + “partnership”
- 3 ESOP + numerous outside private S/H’s
- 4 ESOP + family owned business
- 5 ESOP + special/minority status business
- 6 100% ESOP
- 7 ESOP followed by 100% sale to 3rd party



How to pay for the ESOP

- Are you already funding something similar?
 - 401(k) match
 - 401(k) profit sharing plan
 - 401(k) Safe Harbor contributions
 - Broad-based cash bonus plan
- Other funding sources for an ESOP
 - C corporation dividends
 - S corporation distributions





Typical Retirement Benefits with ESOP

401(k)

- 401(k) program typically continues.
- Employee can defer personal taxes by making payroll deductions to your 401(k).
- Matching usually stops. Safe Harbor contributions flow to ESOP

ESOP

- Employee contributes nothing.
- Contributions are funded by the Company.
- Employee ESOP shares receive allocations of company earnings.
- Appreciation in company value shared by eligible employees.



Combination of programs

You can start your ESOP this year!

Program	Compatible with ESOP?	Typical Recommendation
PSP or SEP	Yes	But, typically replaced by ESOP
401k Match	Yes	Company match stops or lessened
401k Safe Harbor	Yes	But, ESOPs qualify for safe harbors too! But, safe harbor \$ to ESOP starts next year (30 day notice)





Good ESOP candidates

- Owners need an exit or desire some liquidity
- Succession management team is or will be in place
- Profitable – strong cash flow
- ESOP valuation acceptable to owners
- Company is large enough to warrant installation and maintenance expense (approximately 15 employees & \$200,000 of pretax income)
- Owners seek to increase employee productivity



Scenarios where ESOPs may not work well

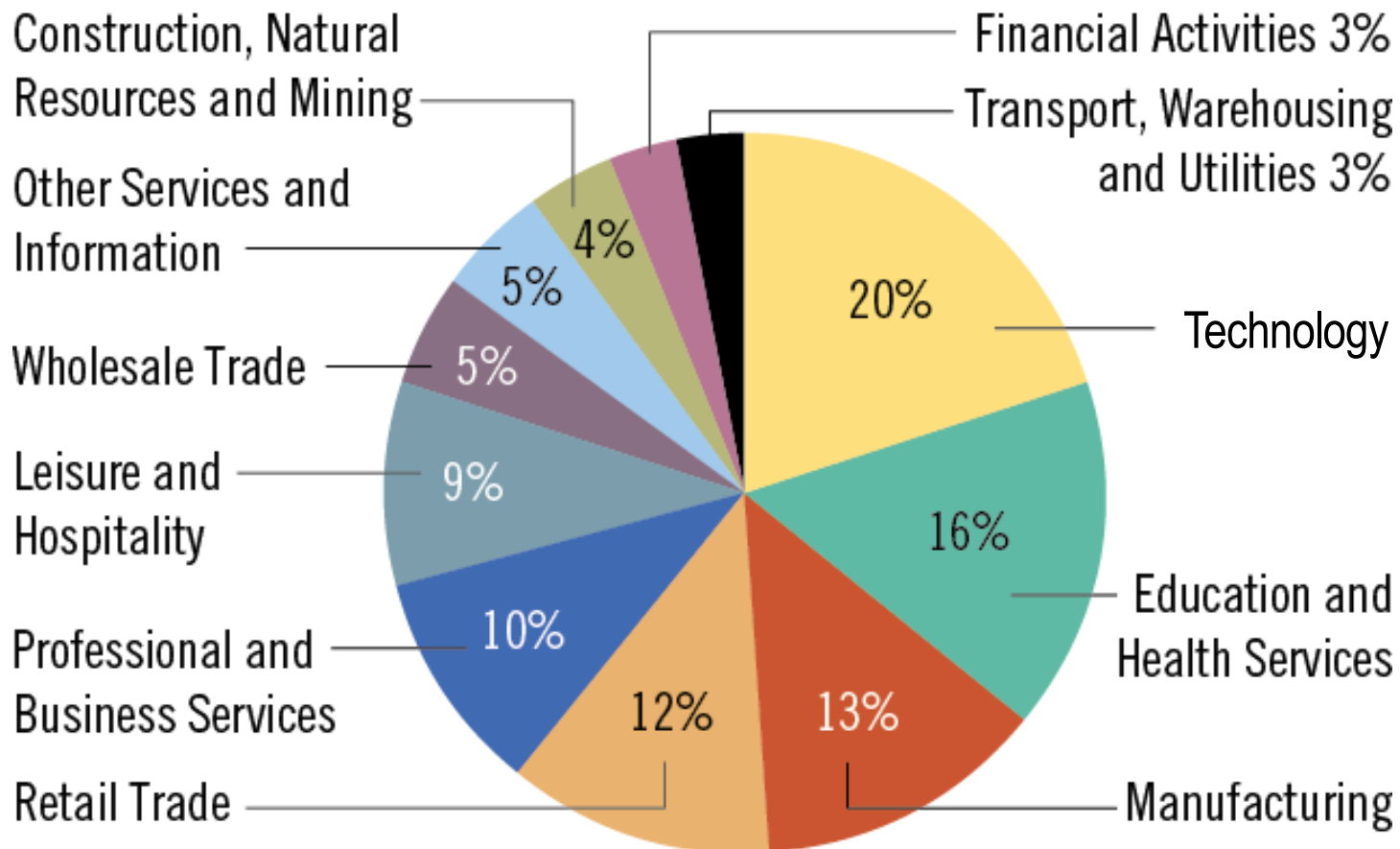


- Doctor & dental practices, CPA firms – depending on state licensing requirements, non-licensed professionals may not be able to own shares
- Certain franchised businesses
- Real estate or insurance agencies – if agents are “independent” and not W-2 employees
- Minority-status businesses – ESOP is counted as a non-minority shareholder; limits ESOP to 49%
- Unprofitable businesses



ESOPs by Industry

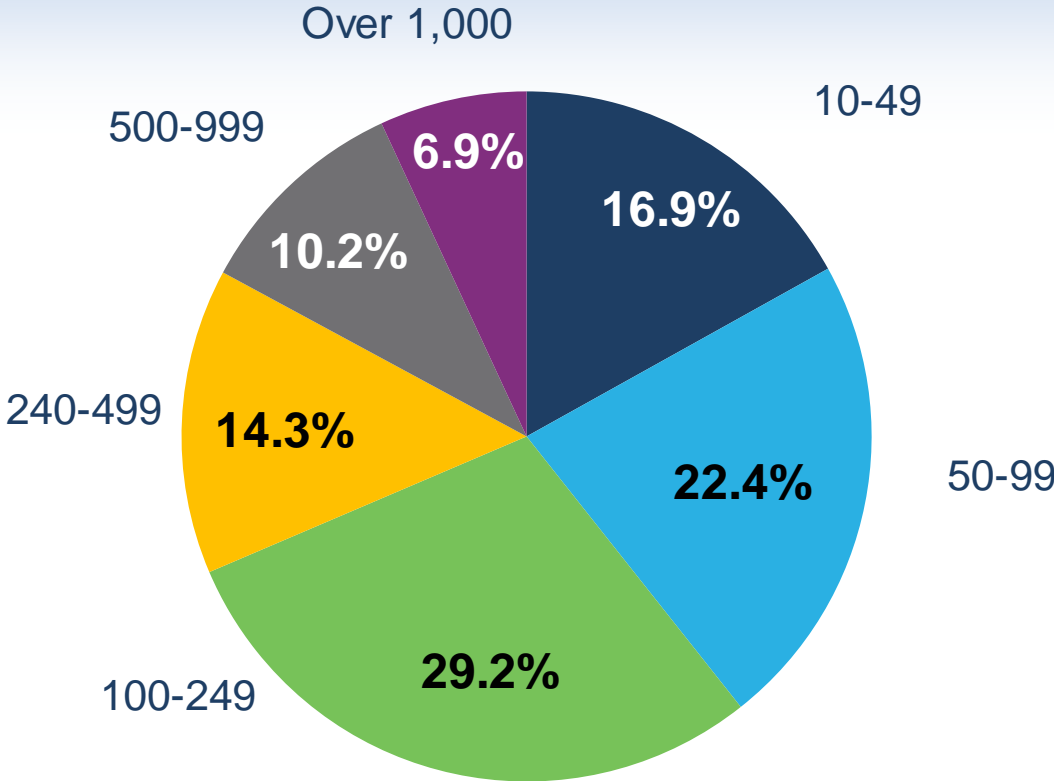
ESOPs span all non-governmental industries



Employee count within private ESOP companies



Source: ESOP Association 2015 Survey



Number of employees in privately held businesses with an ESOP



1 Liquidity for shareholders

(While Still Running Their Business!)

- Many times significant portion of owner's wealth tied up in company stock
- Owners can sell all or part of their shares
- Can spread sale of shares over years
- Can keep some shares, even after retirement
- Many times selling the entire company to a third party is not possible, but this option does not come off the table after the ESOP is started



ESOP stock ownership of private companies - No requirement to sell a certain percent



Percent of each private company owned by its ESOP

	0-10%	11-30%	31-50%	51-100%
Percent of 11,000 private ESOP companies	20%	20%	25%	35%

**Over 2,500 U.S. businesses
are owned 100% by their ESOP!**





Sale of business not an option

- No third party buyer at this time or offers not acceptable (2018 SBA estimated that 80% of private companies brought to market were NOT sold).
- Owner may lose his/her job
- Additional employees may lose their jobs
- Loss of control
- Loss of stock price upside
- Loss of legacy
- Sale process is expensive, complicated, exhaustive due diligence process, long process, low probability of success



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- 2 Preparation for an ESOP process & closing due diligence process





Presenter – Robert Friedman

CFO and Director, Bamco, Inc. 100% S Corp owned ESOP



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- Last 19 years – CFO, board member and former shareholder at Bamco, Inc. a leading provider of architectural facades and metal wall panel systems (Middlesex NJ). Robert led the Company through the process to become a 100% employee owned S Corp ESOP in 2018.
- Robert is both a CPA and CFP. Previous 18 years experience in public accounting firms serving primarily privately held family and closely held SMB clients in a diverse mix of industries.
- Expertise in finance, reporting, audits, taxes and use of various sophisticated strategies capitalizing on opportunities
- Focus on strategies to grow and rebuild organizations, align resources and increase shareholder value
- BBA Accounting – University of Miami
- Certificate in Financial Planning – New York University
- Nominated 2x for CFO of the Year in prior NJBIZ competitions
- Member of AICPA, ESOP Association, NCEO and CFMA



Bamco, Inc.



A 100% Employee Owned Company

BAMCO Inc., a construction and manufacturing Company located in Middlesex, NJ is a regional leader in the design, fabrication and installation of architectural facades and metal wall panel systems. We design, fabricate and install state-of-the-art architectural facades for commercial, institutional, educational, manufacturing and residential projects. With over 35 years of experience in exterior facades, our expansive resources and knowledge make your project a success. The Company has 150 Full Time employees and became 100% employee owned in 2018.



Overview of Bamco's ESOP Process



- **Part 1: Preliminary Appraisal/Feasibility Study**
- **Part 2: Moving Forward/Due Diligence & Closing**
 - **Step 1:** BOD approval to move forward – hire banker
 - **Step 2:** BOD selects ESOP trustee and team (appraiser and counsel)
 - **Step 3:** Trustee due diligence
 - **Step 4:** Negotiate and sign a term sheet
 - **Step 5:** Legal due diligence & contracts
 - **Step 6:** Final Documents & closing the deal



1 Preliminary Appraisal/Feasibility Study



Step 1

- **Feasibility study/preliminary appraisal for the seller/company's use**
 - Engage an ESOP Advisor/Investment Banker (i.e.; Menke)
 - Questions & Answers
 - Offer price – preliminary appraisal – range of business value
 - Talked about transaction structure
 - How will it effect our Culture today and in the future?
 - Management – who will run the business going forward?
 - Use financial models to help understand and fund/manage cash flow (not only paying for stock, but also funding participant distributions)
 - ESOP design and other employee benefits



Preparation and Due Diligence

Several Layers of Due Diligence in Sequence – some overlapping

- Prepared by Company and coordinated with
 - ESOP Advisor/Banker – feasibility/appraisal of business value all the way through closing the deal (month 1)
 - Trustee – (starts month 2)
 - Appraiser – (starts month 3)
 - Legal Team – (starts month 4)
- Interact with all and address inquiries



Step 1

Feasibility Study and More

- ESOP Advisor/Investment Banker Due Diligence:
- Business information including:
 - Overview of the Business
 - Review of Challenges, Goals and Objectives
 - History of the Company & Organizational Structure
 - Reliable Financial Information – 5 years historical, budgeted and forecasted – start with CPA audited/reviewed financial statements
- Banker's financial model helps you plan/better understand ESOP finances, cash flows using what ifs to see possibilities for the future!





2 Preparation for an ESOP process
& closing due diligence process



Step 2

- **Moving Forward – Hire Investment Banker (ESOP advisor) and Get the Company Ready**
 - Review financials – dig in and clean up the numbers!
 - Adjust to get to normalized cash flows (EBITDA) – adding back items like interest, taxes, depreciation & unusual non-recurring
 - Review relationships – customers, vendors, banking, professional – are there any dependencies?
 - Employees/Org Chart – bench strength and talent?
 - Customers - A/R and any bad debts
 - Vendors/Suppliers – Purchasing and Inventories
 - Legal & Compliance – review
 - More





Step 3

Board Hires the ESOP Trustee

- ESOP Trustee (Fiduciary) represents the shareholders – will negotiate the deal on their behalf
- ESOP Trustee hires a team
 - Attorney/Counsel
 - Independent Valuation Consultant – Appraise the business
- Company hires its own team (if desired)
 - ESOP Counsel
 - Independent Valuation Consultant
 - Others – as needed (CPAs, more)





Step 4

Start the Due Diligence Process

- Abbreviated – Detailed Checklist Provided by the Trustee
- More Company History & Information
- Review of markets, competitors, pricing, strategies
- Provide Copies of Documents
 - Corporate – articles of incorp, minutes, Bylaws, stock records, agreements and other instruments
 - Tax & Financial Matters
 - Note: this is *not as deep a dive when compared to a sale to Private Equity or a Strategic Buyer*





Step 5

Negotiate and Sign a Term Sheet

- Between the Trustee, Company and Sellers
- Layout Key Terms and Deal Structure
 - Transaction Description
 - Financing
 - Proposed Closing Date
 - Conditions Precedent, Reps & Warranties
 - Due Diligence Review
- All parties sign – then begin next step towards closing



Step 6

Line up Bank Financing (if any)

- To provide cash up front / with a term loan
- At Bamco, 100% Seller Notes funded the sale
- Start the process early (usually in Step 2 or 5)



Step 7

- **Closing due diligence and documentation**
 - Largely legal – work with counsel to read & finalize documents – (too much detail to show here) – I spent over 100 hours doing this
 - Coordinated with all parties assisted by Investment Banker, Trustee and Attorney
 - Guided by a detailed Legal Checklist
 - Provide full disclosure (reps and warranties)!!!
 - ESOP Trust Documents
 - Loan documents
 - Much more

Summary and Key Takeaways



- Key Takeaways

- Complex process – takes from 4 to 6 months with lots of questions, data gathering, analysis & coordination between the parties
- Be ready to invest 200–400 hours in the process through closing
- Closing process is easier than a sale to a strategic or financial buyer
- Hire an experienced team – ESOP Banker, Trustee and others
- Keep the deal private/confidential until you are ready to close
- Tidy up your financial house and determine any adjustments to get to EBITDA (adjust and normalized cash flows)
- Get ready for an exciting future as an Employee Owned Company!!!