

DPRCG 2024 CONVOCATION

Ownership Transition: What path is right for your journey?

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THE VALUE OF
TRUST

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- Joe has provided valuation, corporate finance, and consulting services to privately held companies since 2004. Much of his professional career has been dedicated to providing independent financial advisory services to boards of directors and ESOP trustees. Joe has worked on many M&A transactions, representing both buyers and sellers. He also has experience advising clients on ownership transition alternatives as well as helping mature ESOPs operate sustainably.
- Joe leads Chartwell's architecture and engineering practice, which has grown to serve more than 150 clients over the years. Decision makers seek out Joe for his expertise and experience advising AE firms owned by their employees in financial matters. Joe is passionate about advancing the business of engineering and educating people about the value of employee ownership.
 - **Professional Involvement & Certification**
 - Joe is a member of The ESOP Association, the National Center for Employee Ownership (NCEO), and the American Council of Engineering Companies (ACEC). He has presented a variety of valuation related topics at conferences across the country. Joe is a Chartered Financial Analyst (CFA) and a member of the CFA Institute and the CFA Society of Minnesota. He is a registered representative with Chartwell affiliate, CCS Transactions, LLC and holds FINRA Series 63 and 79 licenses.
 - **Education**
 - Joe holds a Bachelor of Science degree, with honors, in finance and international business from the University of Minnesota Carlson School of Management.



Chartwell Overview

Chartwell is a national leader in financial advisory, serving the unique needs of middle-market companies.

SERVICES & EXPERTISE



CONSULTING

- ESOP Ownership
- Individual Ownership
- Executive Compensation
- Capital Structure



CORPORATE FINANCE

- Mergers & Acquisitions
- Capital Markets
- ESOP Transaction Advisory
- Strategic Alternatives



TRANSACTION OPINIONS

- Fairness Opinions
- Solvency Opinions



VALUATION

- ESOP & ERISA
- Financial Reporting
- Tax, Compliance & Planning
- Alternative Investments & Assets

AT A GLANCE



25+

Years in Business

100+

Dedicated Professionals

60+

Annual Transaction Engagements

150+

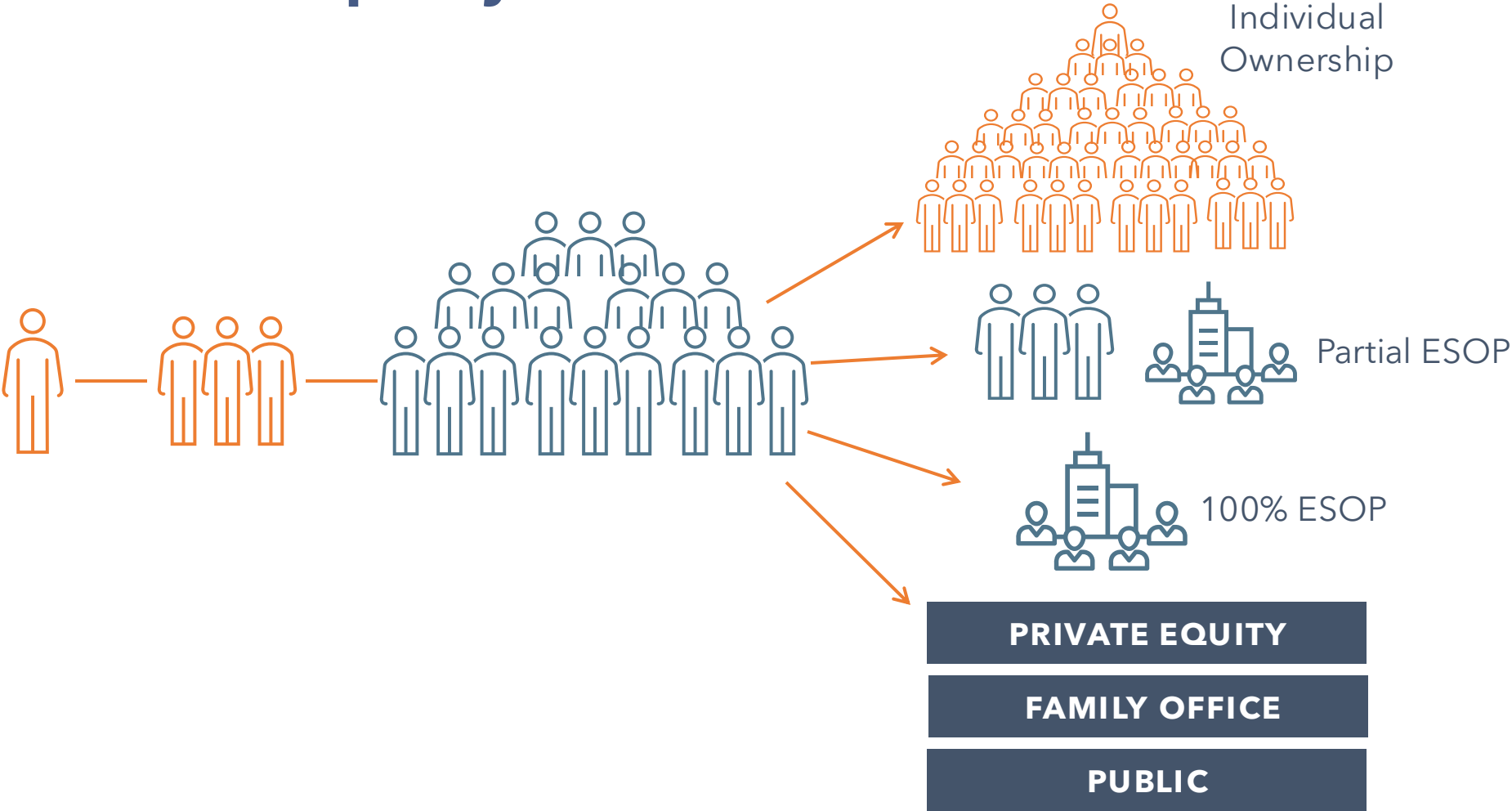
Annual Consulting Engagements

500+

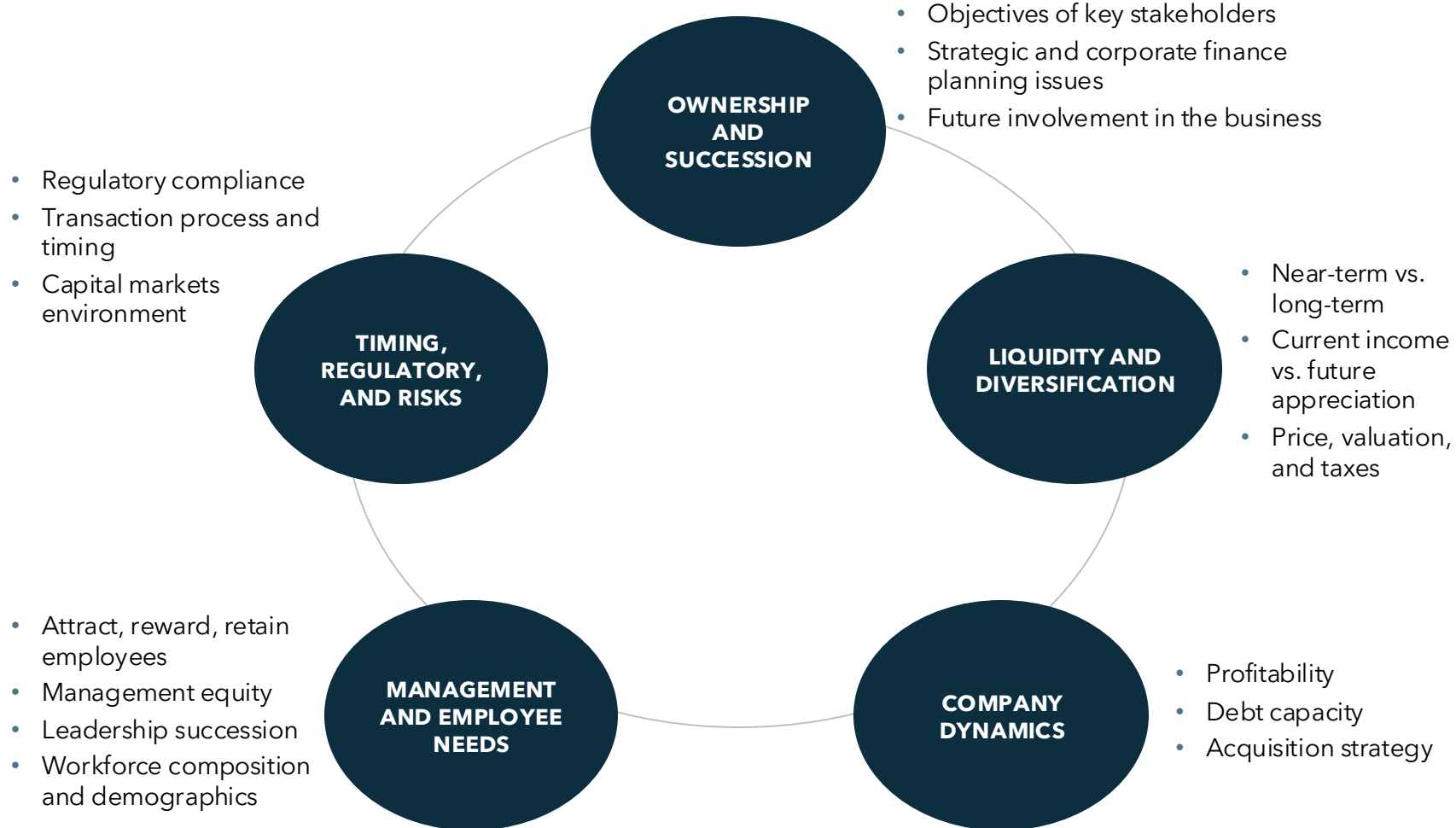
Annual Valuation Engagements



Private AE Company Structures



Stakeholder Considerations in Ownership Transition



The decision to transition ownership is grounded in thoroughly understanding key stakeholders' goals, objectives, and unique circumstances. These same issues are involved in determining the appropriate ownership structure.

Ownership & Compensation Philosophy



What is Different About Today's Market?

NOTABLE DYNAMICS

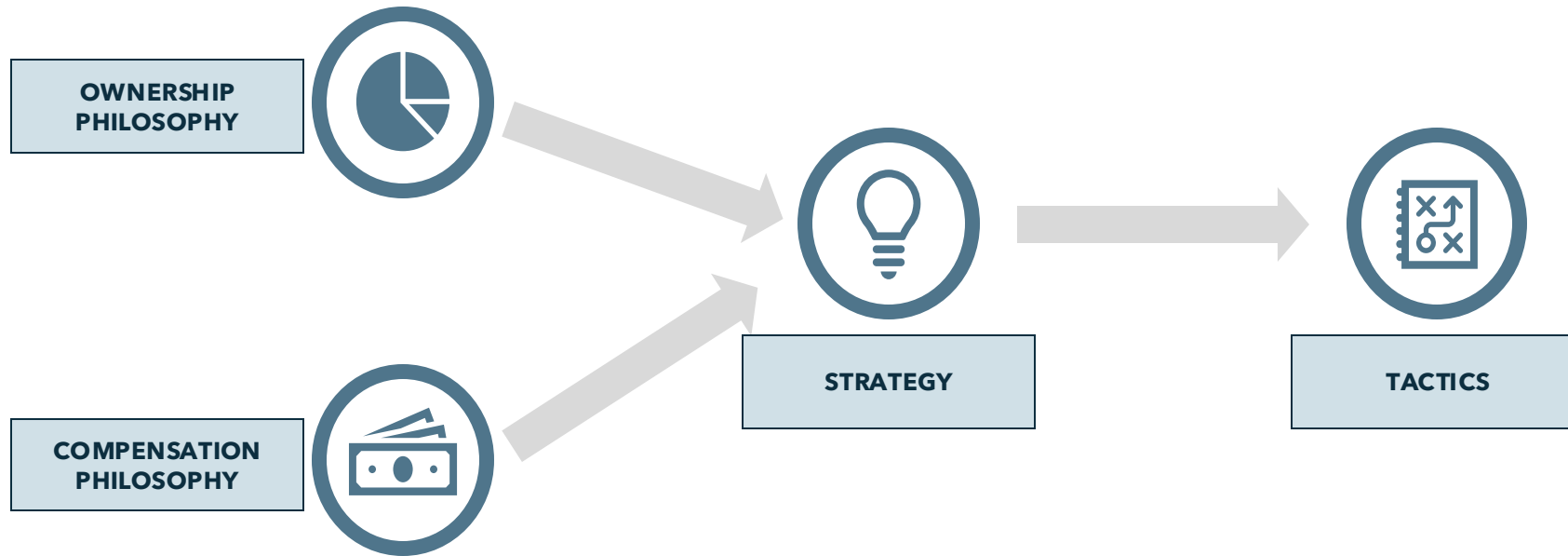


Employee-ownership remains the most prevalent, well accepted/understood ownership transition model, but it is currently being challenged by external forces.

- Profitability of firms has increased (also, growth) → increased valuations
 - Transition from “lifestyle” firms
 - Business acumen
 - Professionally run
- Demographics have changed
 - Baby Boomers retiring
 - Talent shortage
 - Willingness and ability to invest
- Increased capital investments in technology, innovation

Ownership & Compensation Overview

PHILOSOPHY DRIVES STRATEGY, WHICH DRIVES DECISION-MAKING



An effective ownership and compensation structure is a critical component of a business which, designed and operated properly, will help the Company achieve its overall business objectives.

Ownership Philosophy Overview

Chartwell believes it is best practice for companies to clearly articulate their Ownership Philosophy Statement which establishes the foundational ownership principles of the firm.



An ownership philosophy statement is a visionary document stating the Company's view of its optimal ownership structure.

Clearly articulated, this foundation sets the stage for developing and implementing strategies and tactics designed to achieve the objectives articulated in the ownership philosophy statement.

Ownership Philosophy Questions

Clearly articulating a vision of the stakeholder's view of the optimal ownership mix is ideally grounded in an Ownership Philosophy Statement which becomes a timeless document used to evaluate strategies and tactics.

Key Executives

- Should key executives be required to own equity? If so, how much?
- Should executive equity be purchased with hard dollars or offered as incentive compensation?
- Should executives hold equity post employment or be immediately divested at termination of employment?
- Should the Company make a market for executive equity during employment, or is it exclusively a retirement asset?

Ownership Philosophy Questions

- Broad Based Associate Ownership
 - Should all Associates have an opportunity to benefit from equity ownership?
 - If yes, should equity be purchased with hard dollars or offered as an employee benefit?
- Third Parties
 - Should any other parties than those above own equity? If so, why and under what circumstances?
- The Ownership Philosophy Statement may describe an outcome similar to the current ownership mix, or it may describe a significantly different state requiring many years to reach the eventual goal

"Value" of Owning Company Equity



Financial Implications

Capital Appreciation

Current Income



Why?

Reward for Past Service

Drive Business Future Performance



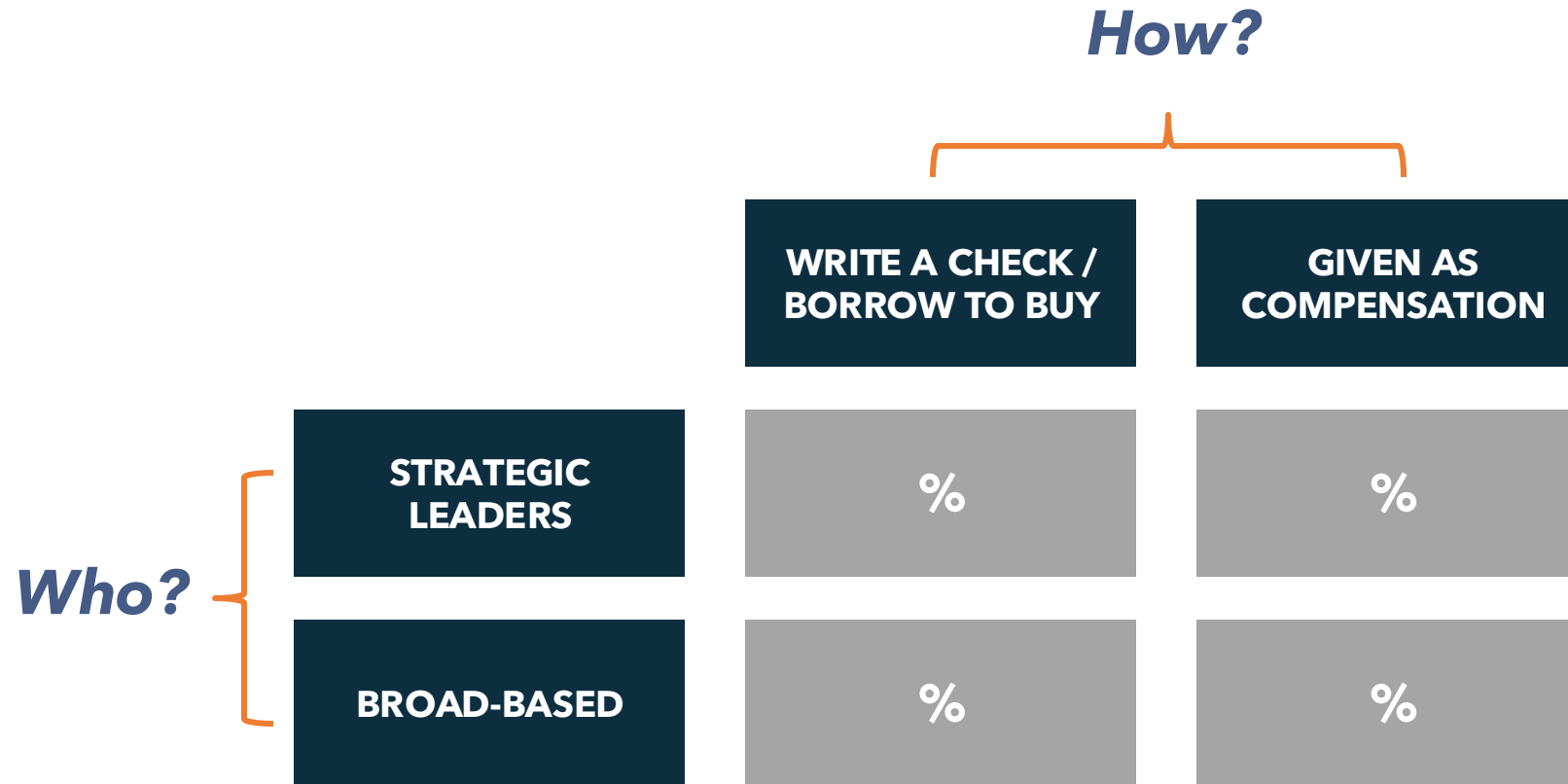
Cultural Implications

Perceived Status

Legacy

Defining why stakeholders desire to own company equity can help guide decision making around the long-term ownership model.

Ownership Philosophy Framework



Preliminary Ownership Considerations



QUALITATIVE OBJECTIVES

- Executive Ownership
- Employee Ownership
- Acquisition Strategy
- Remaining Privately Held
- Culture and Legacy
- "Skin in the Game"



QUANTITATIVE OBJECTIVES

- Creating Shareholder Value
- Preserving Shareholder Value
- Providing Current Income
- Shareholder Liquidity & Timing
- Shareholder Tax Efficiency
- Company Debt Level
- Company Tax Efficiency
- Capital Structure Flexibility

The company's ownership philosophy statement will guide its decision-making regarding the available alternatives to create employee wealth.

Ownership Philosophy Example

OWNERSHIP OBJECTIVES



- ✓ Remain privately held and independent
- ✓ Want strategic leaders to invest
- ✓ Ensure key employees have “skin in the game”
- ✓ Maintain affordability for those purchasing shares (today and tomorrow)
- ✓ Maintain attractiveness of equity ownership as an investment
- ✓ Create/grow shareholder value
- ✓ Limit ownership of a single individual
- ✓ Minimize risk of becoming a potential takeover candidate

Compensation Philosophy Overview



Philosophy drives strategy, which drives decision-making.

Chartwell believes it is best practice for companies to clearly articulate their Compensation Philosophy Statement which articulates key tenets of executive compensation for the firm.

Compensation Philosophy Overview

- A compensation philosophy establishes the desired positioning of pay elements versus market (base pay + target bonus = total cash compensation)
- Ties the philosophy to the company's strategic plan (e.g., discusses metrics that drive programs and why they are important)
- Ties the philosophy to the company's culture (e.g., compensation and culture are circular)
- Considers how compensation is impacted by other important aspects of the overall company experience (e.g., employer of choice, strength of benefits package, etc.)

Compensation Philosophy Framework

BASE	BONUS	STOCK BASED
AT OR BELOW MARKET	AT MARKET FOR ALL	MOST OR ALL OWNERS
ABOVE MARKET	EXTRA HIGH PERFORMERS	HIGH PERFORMERS - REGARDLESS OF LEVEL
	EXTRA FOR OWNERS	FIRST TIME OWNERS
		ALL EMPLOYEES OR ALL PROFESSIONALS

If the Ownership Philosophy is "we want employees to invest," the Compensation Philosophy must provide them the means to do so.

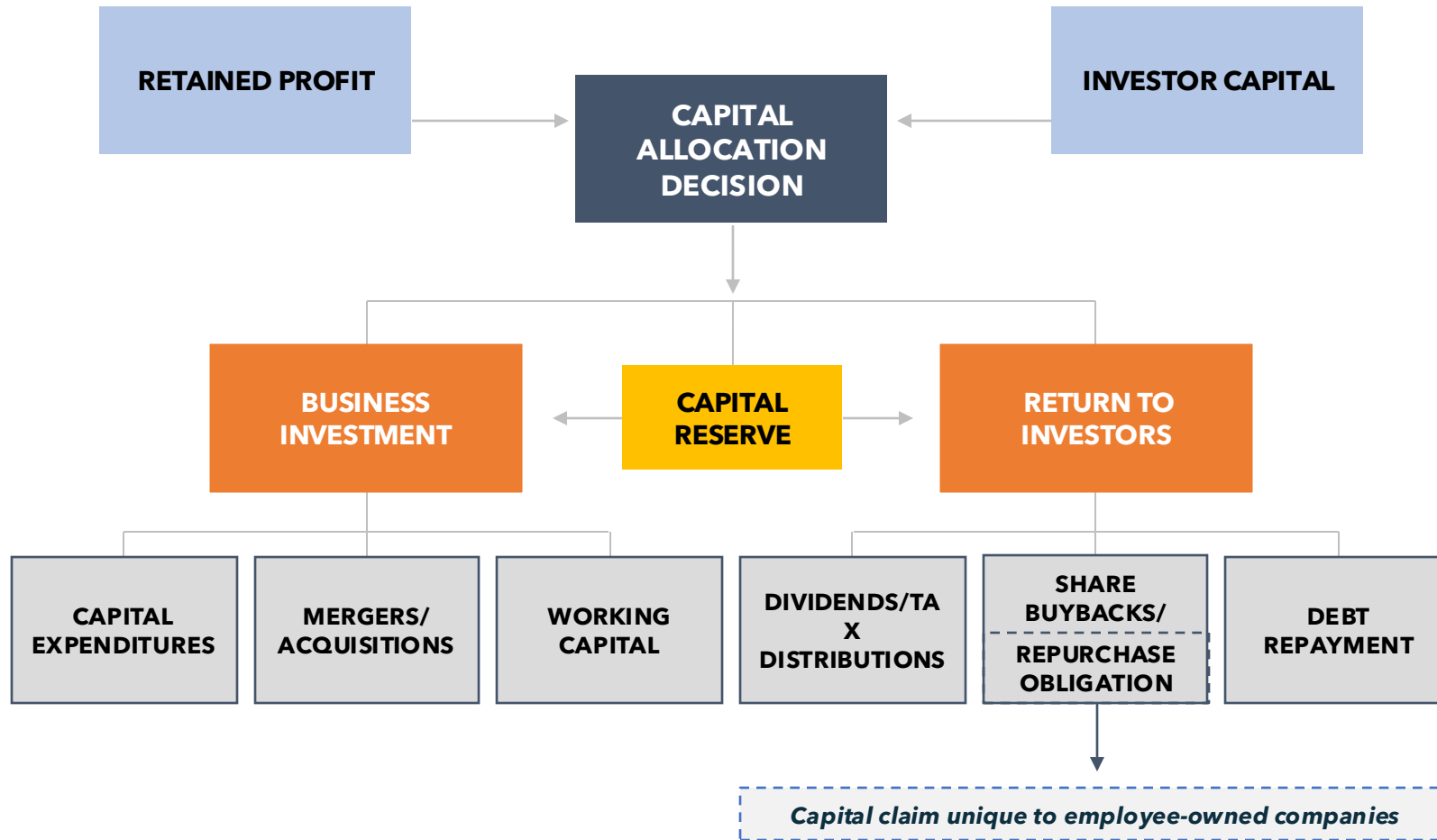
Compensation Philosophy Example

COMPENSATION OBJECTIVES



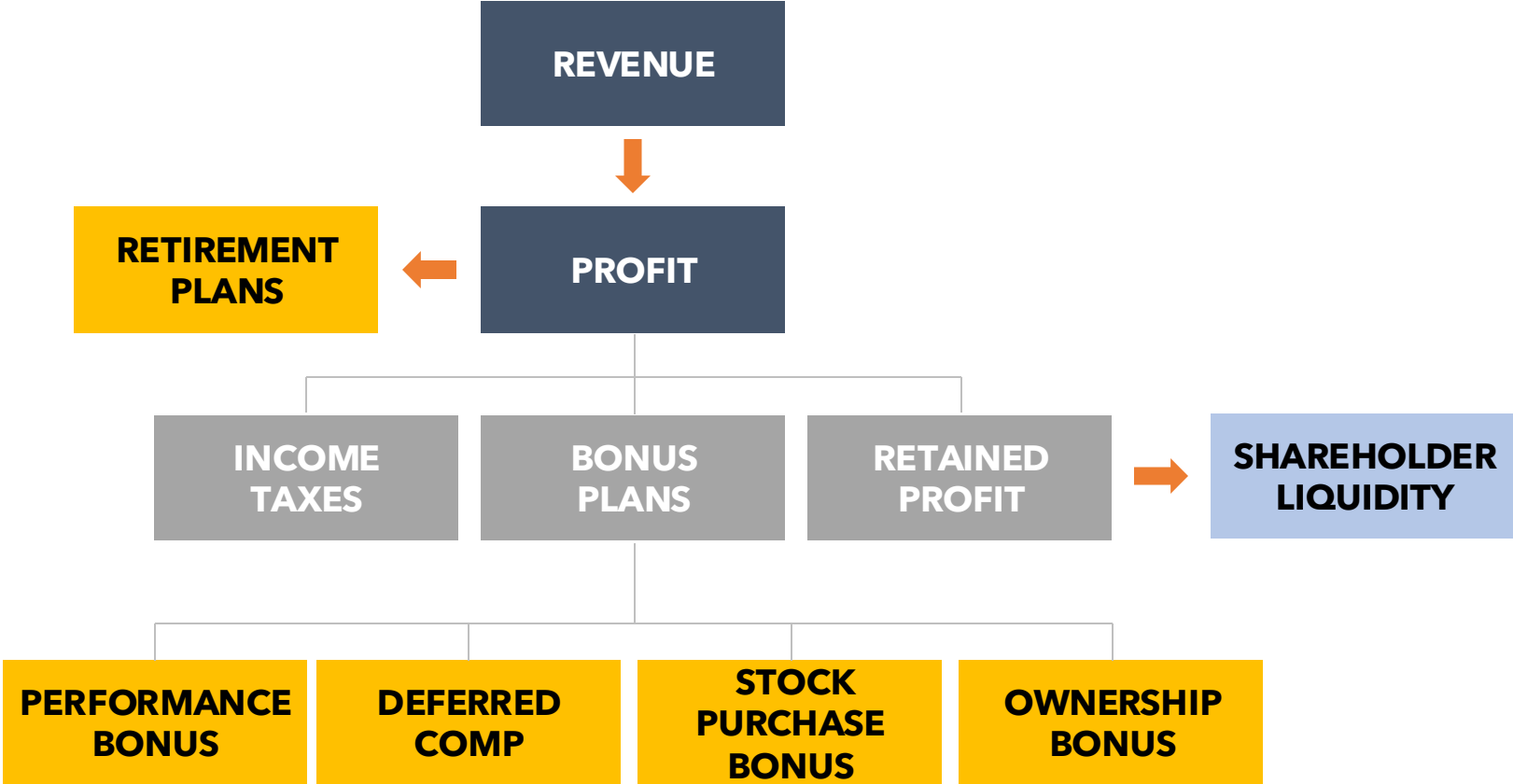
- ✓ Pay market-competitive salaries to all employees
- ✓ Provide robust bonus program for non-shareholders and rising stars
- ✓ Provide ability to grow total compensation and wealth of the individual shareholder across entire career
- ✓ Provide current income and deferred compensation program
- ✓ Operate as a single profit center to promote collaboration
- ✓ Provide rewards based on a meritocracy
- ✓ Achieve balance between near term compensation enhancement and long-term capital appreciation
- ✓ Provide stock-based bonuses to rising stars to get their investment started

Capital Allocation Decision



Many privately-held companies face complex decisions regarding how to strategically grow the enterprise, recognizing their ownership structure may compete for a finite supply of capital.

Profit Allocation Model



Case Studies



Situation 1: Redeem Retirees, Sell to Next Gen and Establish Contributory ESOP

Ownership Philosophy

- Remain private, independent
- Legacy
- Want all employees to share in company they helped create; however, still desire shareholder model
- Interested in ESOP due to success of mentors in industry

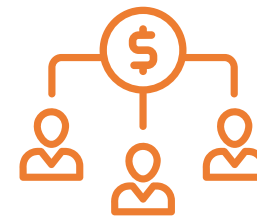
Compensation Philosophy

- Market base pay
- Bonus for everyone but based upon contribution so high performers get more
- Want to treat all employees fairly
 - Fairness is a fundamental value of existing owners

Situation 1: Redeem Retirees, Sell to Next Gen and Establish Contributory ESOP

OWNERSHIP TRANSITION OUTCOME

- Company redeemed stock of retiring shareholders
- Sold shares at to Next Gen Leaders at fair market value – wanted Next Gen Leaders to have a bigger share than other employees
- Established contributory ESOP to start making everyone an owner – leaders and employees felt strongly everyone should be an owner



Situation 2: Sale to New ESOP

Ownership Philosophy

- Remain private, independent
- Legacy
- Next Gen not stepping up to invest
- Want all employees to share in company they helped create
- Culture of early and broad opportunity to become a shareholder
- Tax aversion (with pending cash to accrual conversion)

Compensation Philosophy

- Market base pay
- Bonus for everyone but based upon contribution so high performers get more
- Business accelerating into growth mode - needed capital to invest (not return to shareholders)

Situation 2: Sale to New ESOP

OWNERSHIP TRANSITION OUTCOME

Shareholders sold 100% to ESOP

- Ownership philosophy was to have broad based ownership
- Limited willingness/ability from next gen to purchase shares
- Wanted to eliminate current taxes



Situation 3: Sale to Employee-Owned Firm

Ownership Considerations

- Next Gen not stepping up to invest (but love the concept of employee-ownership as part of their culture)
- But want principals of business to own more
- Liquidity needs for significant retiring shareholder(s), while others recently bought/brought into ownership

Compensation Philosophy

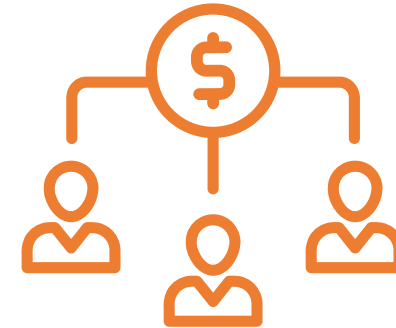
- Market base pay. Bonus for everyone but based upon contribution so high performers get more. Current income was important to the emerging shareholders.
- To transition ownership internally, 80% of next gen bonus for ten years was needed to buy-out shareholders. Was not feasible based on culture and talent/retention challenges in the market.

Situation 3: Sale to Employee-Owned Firm

OWNERSHIP TRANSITION OUTCOME

Shareholders sold to another privately-held, employee-owned firm

- Liquidity provided to transitioning shareholders
- Employee-ownership opportunity provided to remaining shareholders



Situation 4: Sale to Private Equity Firm as a Platform

Ownership Considerations

- Limited perceived value of minority ESOP
- Liquidity needs for significant retiring shareholder(s), while others recently bought/brought into ownership

Compensation Considerations

- Market base pay and bonus
- Desire to implement more at-risk compensation policy

Situation 4: Sale to Private Equity Firm as a Platform

OWNERSHIP TRANSITION OUTCOME

Shareholders sold to a private-equity firm as a platform company

- Liquidity provided to transitioning shareholders
- Employee-ownership opportunity provided to remaining shareholders (PE did not own 100%)
- Compensation model reset - conversation to more at-risk compensation to drive growth-oriented behaviors (PE provided framework)
- Ability to retain control of strategic direction and growth trajectory through organic and inorganic growth



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