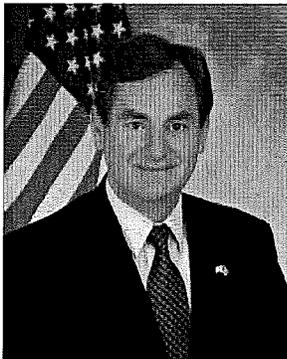


ESOP report

The Voice of The ESOP Association
Serving the Entire ESOP Community

State Treasurer Mourdock Working to Make ESOPs a Priority in Indiana



Indiana State Treasurer Richard Mourdock began an innovative program called Indiana's ESOP Initiative (IEI). The program was created to promote and encourage the formation of new ESOPs in Indiana. One of Treasurer Mourdock's goals after being sworn into office as the 53rd State Treasurer in November 2006 was to make Indiana the leading state with the number of ESOP companies within its borders. He saw it as an opportunity to keep more companies, future ESOP companies, and Hoosier jobs within the State of Indiana. His favorite line goes, "An employee-owned company has never, never, never, never, ever packed-up and moved to Mexico or China!"

The program is important to Indiana

What do Indiana and ESOPs have in common? More than you think.

In May 2008, Indiana State Treasurer

for one very basic reason — jobs. Expanding job opportunities and keeping businesses in the state are main concerns. The IEI program encourages Indiana businesses to become ESOP companies and remain in the state, saving jobs and hopefully creating new ones in the process. "The goal is to make Indiana the leading state in the country for employee ownership. Right now there are not nearly enough ESOP companies in Indiana. There are more ESOPs in Illinois, Ohio, and Minnesota and we need more in Indiana," stated Treasurer Mourdock.

The ESOP Association has been watching the program closely. "No other state has taken this bold step to help create ESOPs," said J. Michael Keeling, president of The ESOP Association. "Several of our professional members have and are working with the Treasurer's office on this innovative program, and we hope that other states will pick up Treasurer Mourdock's lead and begin programs such as his IEI program to help create ESOPs."

Treasurer Mourdock has given presentations about the IEI program at the national Association of State Treasures meetings and has noted interest in the

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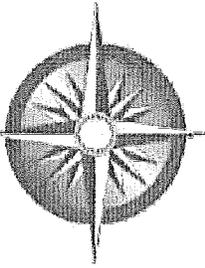
program but so far no similar programs have been created. However, he said he would like to see programs in other states created.

How did a State Treasurer become involved with ESOPs? In 1988, Treasurer Mourdock's employer began the process of becoming 100% employee-owned. It was not a journey without challenges as the company experienced changes in the economy and changes in its market. The ESOP, however, allowed for the expansion of the company, helped develop a sense of employee ownership throughout its workforce, and increased the stock value of the company. At the age of fifty, Treasurer Mourdock left the company confident that his retirement savings were sufficient for him to begin his own business and to pursue his goal of public service. An ESOP allowed Treasurer Mourdock to enjoy that kind of freedom, and it is an experience he wants thousands of Hoosiers to share in as well. As Treasurer Mourdock has

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Blog Corner

Employee Ownership and Job Growth

There are numerous proposals, ideas, and commentary floating around about how we can improve the jobs outlook in this country. Let's face it, it's not good right now. With unemployment around 10% (9.7% to be exact), and companies not hiring, where does that leave the discussion of job growth in this country?

Since we can, let's talk about employee ownership in the context of job growth. Does being employee owned make a difference? Research has shown that companies that are employee owned do outperform their non-ESOP counterparts. There are several studies out there touting the benefits. If you want to read more, click here. (http://www.esopassociation.org/media/media_corporate.asp)

Having The ESOP Association and Employee Ownership Foundation say that being employee owned makes a difference may not mean much, especially to the people that need to hear about employee ownership through an ESOP. So, you may want to read this article that was written by an ESOP Association member and appeared on American Solutions website, an organization founded by Former Speaker of the U.S. House of Representatives and rumored presidential candidate in 2012, Newt Gingrich, to address what he believes are America's most pressing problems. The article — Why Employee Ownership is Necessary for Economic Growth by Andrew J. Kulesza. (<http://www.americansolutions.com/economy/2010/02/why-employee-ownership-is-necessary-for-economic-growth.php>) Go ahead and read it now, we'll wait.

Andrew Kulesza is the Treasurer of R.E. Kramig & Co., Inc. in Cincinnati, Ohio and a member of The ESOP Association's Board of Governors. He is currently working with his member of Congress to have her co-sponsor pro-ESOP legislation. He's vocal in his support of employee ownership through an ESOP and is doing his best to let the public and his members of Congress know what makes his company work. We wanted to take a minute here to highlight his work and encourage other ESOP Association members to talk about employee ownership too. In this discussion, persistence is important and we want to give credit where credit is due.

So, now it's your turn. Are you out there talking to your members of Congress? Yes, we know we ask a lot, but it's important. We can't change the discussion if we aren't involved in it which means speaking up.

Posted to the Employee Ownership Blog March 4, 2010 <http://www.esopassociation.org/blog/default.asp>

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stated, "I would not have the opportunity to serve as Indiana's State Treasurer if I had not been involved with an ESOP early in my career."

The IEI Linked-Deposit program works like this: As with all ESOP companies, a company borrows money for the ESOP trust to purchase stock from the original shareholder(s). The Linked-Deposit program will allow the Treasurer's office to link its routine purchase of CDs from Indiana's financial institutions to the Indiana company needing capital for the ESOP transaction. A \$50 million investment has been designated for the Linked-Deposit program. Companies considering an ESOP that would like to participate in the IEI Linked-Deposit program must adhere to program guidelines and meet specific requirements. More information about the IEI program as well as guidelines and requirements are available on the State Treasurer's website at <http://www.in.gov/tos/2343.htm>.

Since the IEI program began, several Indiana companies have taken advantage of the program including: Radian Research, Lafayette, IN; McFarling Foods, Indianapolis, IN; AIT Laboratories, Indianapolis, IN; HIS Constructors, Inc., Indianapolis, IN; and Kocolene Development Corp., Seymour, IN. According to the Treasurer's office, two more ESOP conversions are in the works and will hopefully close by the end of the 1st quarter.

Andy Manchir, Business Valuation and ESOP Services, Katz, Sapper & Miller LLP in Indianapolis, IN and Immediate Past President of the Indiana Chapter of The ESOP Association, has had direct experience with the program and had this to say: "I have had more than one client work with the Treasurer's office as part of the IEI program. The most refreshing part of working with the Treasurer's office is the straightforward nature of the program. The IEI has requirement of each company that participates, but Treasurer Mourdock's office is accommodative with its process, and the program is not burdensome or bureaucratic in its nature. What makes that work is the direct involvement of Treasurer Mourdock. His passion for ESOP employee ownership has allowed for even more business owners in Indiana to complete their transactions, in a banking environment that has been difficult to say the least."

Mr. Manchir went on to say, "The IEI Linked-Deposit has been more important than ever since the credit crunch. Bankers not only care about the quality of the loan, but they care about increasing deposits on the other side of their balance sheet."

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When an IEI program company can create *both* a loan and a deposit, it makes the ESOP transaction more appealing to a bank.”

When asked if state officials were supportive of the program Treasurer Mourdock said the response to the program has been fully positive. “There were some questions initially about why the state would want to support one type of business plan but the idea of keeping businesses in the state, creating long-term businesses, and creating wealth for employee won people over,” said Treasurer Mourdock. “Working with the program on the state level brings a lot of satisfaction. You can really affect the businesses and do a lot of good. It’s a good feeling to be able to go out and do that for the companies and the state of Indiana.”

Advisory Committee on Valuation

The Impact of Public Stock Market Volatility on Private ESOP Company Valuations

By : Mark R. Fournier, CFA, Stout Risius Ross, Inc., McLean, VA and Andrew S. Ward, Stout Risius Ross, Inc., Chicago, IL

Throughout the second half of 2008 and early 2009, public stock markets experienced a loss of value not seen since the Great Depression. Fortunately, the public stock markets have begun to rebound since March of 2009 as some investors believe the economy is beginning to stabilize. As a result of these volatile market conditions, ESOP trustees and company management have recently inquired about what impact such public stock market volatility should have on the valuation of a private ESOP company.

Generally, the values of private ESOP companies have not been as volatile as public company share prices. However, this does not imply that private ESOP company valuations are unaffected by public stock market volatility. Rather, the degree of such volatility’s impact on value (both positive and negative) is somewhat mitigated due to: (1) the quality and breadth of data used to form the underlying assumptions employed in a typical private ESOP company valuation; and (2) the tendency for public stock markets to overreact to corporate news and constantly changing economic conditions. As a result, private ESOP company values have typically moved slower along the curve than public company values during both good and bad economic conditions.

Valuation Methodology

To understand the potential impact of public stock market volatility on private ESOP company valuations, it is important to understand how a private ESOP

company is valued. The two more common methods for estimating the value of a private ESOP company are the Guideline Public Company Method (“GPC Method”) and the Discounted Cash Flow Method (“DCF Method”). Under the GPC Method, pricing multiples (e.g., price/earnings) are applied to the private ESOP company’s historical and projected financial fundamentals to arrive at an indication of value. Under the DCF Method, management forecasts are relied upon to estimate the private ESOP company’s future cash flows. These future cash flows are then discounted to the present utilizing a discount rate commensurate with the risk in attaining such levels of cash flow.

Essentially, the key assumptions in the valuations of most private ESOP companies are: (1) the projected growth in sustainable cash flows; and (2) the risk in attaining those levels of cash flow. The GPC Method implicitly assesses a private ESOP company’s growth and risk in the selection of pricing multiples while the DCF Method explicitly recognizes growth through the projected cash flows and evaluates risk in the selection of a discount rate.

Guideline Public Company Method

Public company pricing multiples theoretically reflect the market’s perception of a company’s growth in earnings and the risk in attaining such growth. However, while the public stock markets are generally viewed to be efficient, numerous studies have suggested the public

investor tends to overreact to corporate news and constantly changing economic conditions which can result in overly optimistic or pessimistic growth and risk expectations. Such psyche of the public stock markets, along with other factors, could lead to a dislocation between the public stock markets and the true long-term fair market values of publicly traded companies. Regardless, most would agree such behavior exhibited by investors in publicly traded companies has partially attributed to historical volatility in public company share prices and pricing multiples.

When selecting pricing multiples under the GPC Method, several factors such as size, profitability, growth, and risk are compared and contrasted between the private ESOP company and the comparable public companies. Pricing multiples are then selected to apply to the historical and projected financial fundamentals of the private ESOP company based on such comparative analysis. The pricing multiples selected for a private ESOP company generally should be less volatile than the implied pricing multiples of publicly traded companies, partially due to the focus on a longer-term perspective when valuing a private ESOP company. As a result, the pricing multiples selected under the GPC Method may be at a significant discount to the medians of the comparable public companies when the markets’ growth and risk expectations are too optimistic, but close to or at a premium to the median multiples of the public comparable com-

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