



Selling Your Company To An EOT - How It Differs From An MBO

Webinar

Thursday 15 October 2020





A Word From The Chairman



Simon Mills

Associate

Z/Yen Group Limited

Agenda



- 11:00 – 11:05 Chairman's Introduction
- 11:05 – 11:30 Keynote address
- 11:30 – 11:45 Questions & Answers



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Selling Your Company To An EOT - How It Differs From An MBO



William Franklin

Partner

PettFranklin LLP

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ESOP Centre - EOTs

An alternative exit route for Owner-Managed Business owners

William Franklin, Partner PettFranklin LLP

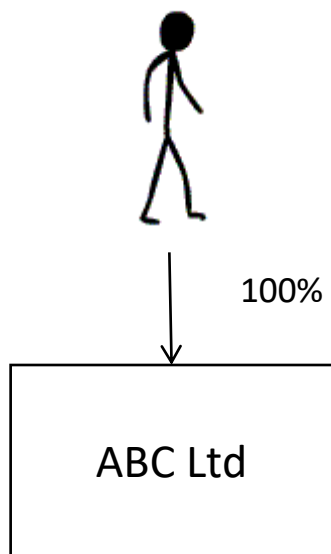
EOTs - The new style Buyout



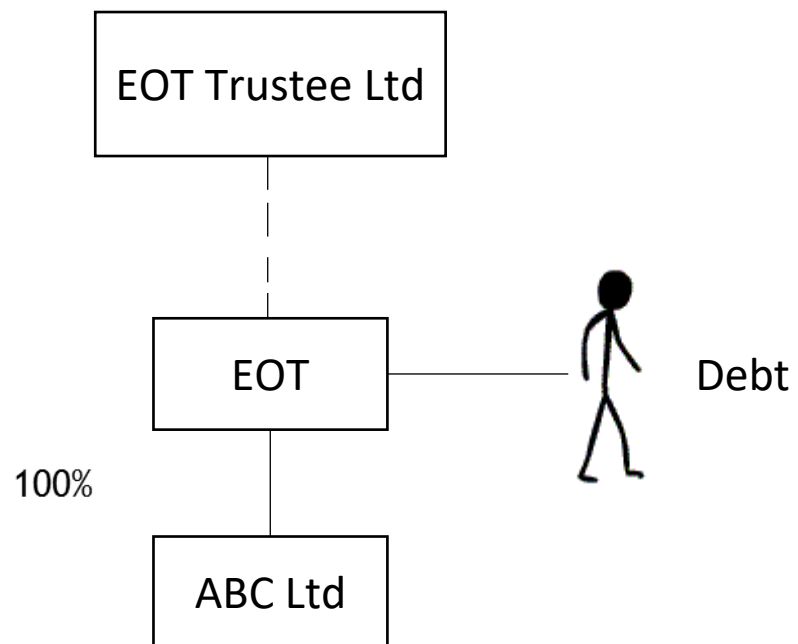
- Employee Ownership Trust EOT FA 2014
- EOT Trust but not an EBT---equality not selective principles
- Think of John Lewis and dozens of other companies
- Indirect collective employee ownership with trust having control for the long term benefit of employees as a whole
- Employee Buyout rather than narrow management buyout

The EOT Basic Model

Current State



Future State



Retiring Entrepreneur's dilemma

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- Trade Sale
- Sale to Private Equity
- Sale to management
- Wind down and closure
- Do nothing and leave mess for employees and family

External Sale trade or PE



- Maximise Sale Proceeds - Third party sale to trade buyer or private equity - with earnout
- Intrusive and pressurised at end of career
- New owners not interested in culture, employees, locality
- Pressure on business to deliver short term returns to purchaser

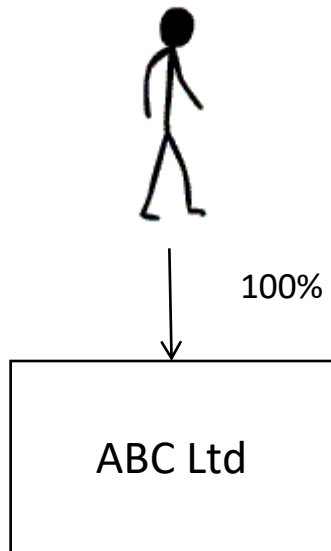
MBO



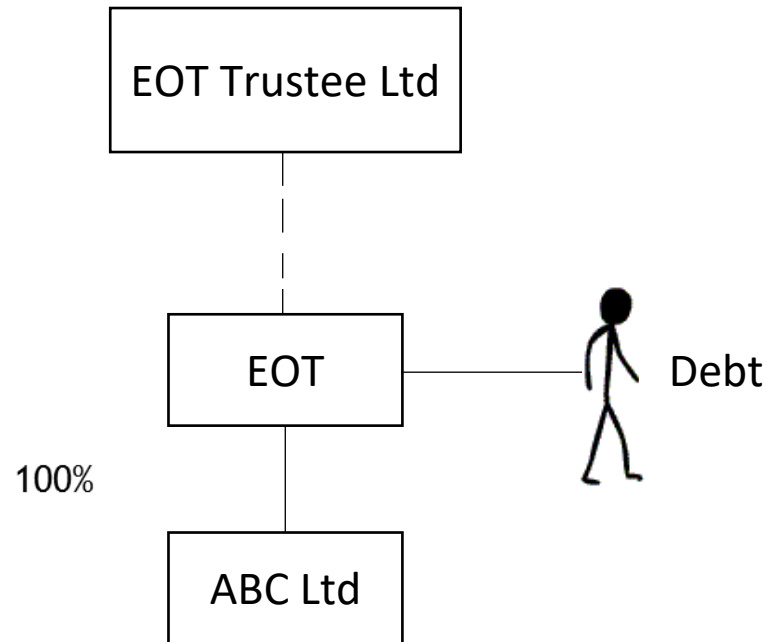
- How do they afford it without personal debt or selling at an undervalue?
- Do the management want the responsibility
- How do I retire?

The EOT Basic Model

Current State



Future State



The EOT Solution



- Vendor Funding/Patient Capital
- Deferred uncertain consideration; dependent on company making future profits and having cash to fund the EOT for the EOT to pay its debts to the vendors
- Upfront payment from available cash
- Future payments dependent on double lock: Distributable Reserves AND Surplus Cash
- Money gifted to EOT by company to a plan but only as it has spare cash

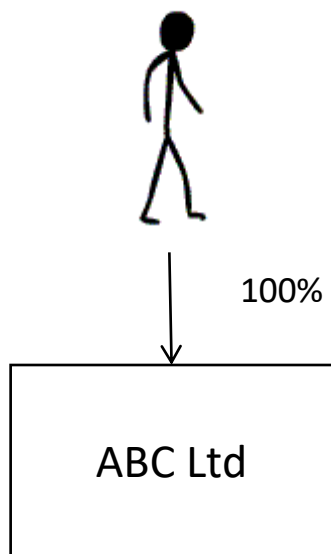
The Tax Incentives



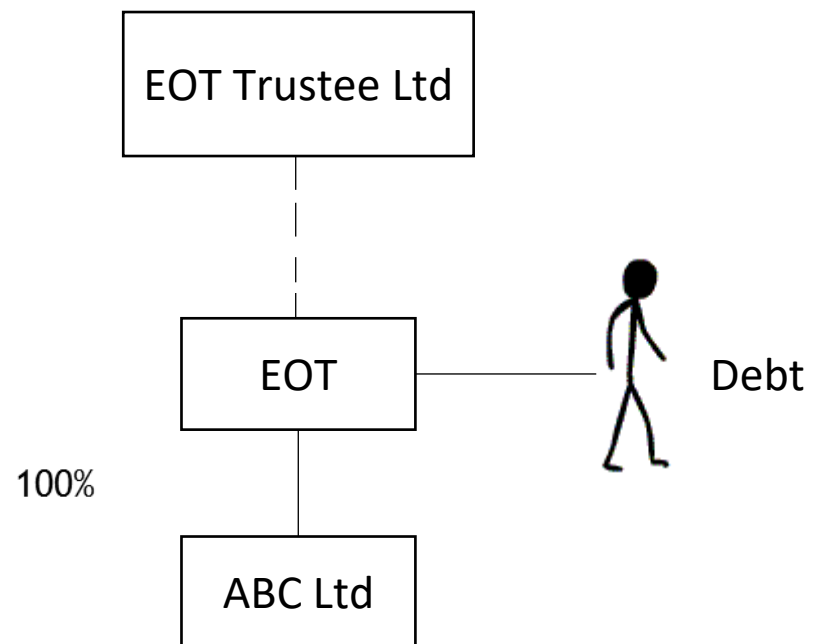
- Dividends not taxable
- Sale of majority control to an EOT exempt from CGT
- Stamp duty still payable
- Tax free bonuses for employees
- Payments to EOT by company not taxable dividends (ESOP Centre Letter)

The EOT Basic Model

Current State



Future State



EOT Income Tax Relief



- Part of the underlying concept of collective employee ownership. Employees should benefit from enhanced remuneration - profit sharing
- £3600 max tax free per person per annum
- Bonus is paid by the company so potential legal rigmarole of company paying dividends to the trust and then the trust paying out to the employees is cut out

Why the reliefs?



- Before FA 2014 and EOTs vendors who tried to convert to this structure had to be very determined, altruistic and patient
- Dry CGT tax charge on sale to Trust
- Had to do it in stages to make tax payments manageable
- Making the sale to an EOT CGT free removed this huge obstacle - providing EOT conditions satisfied of which the key one is giving control to the EOT “ handing over the keys of the castle”
- Income tax relief of tax free (but not NIC free) bonuses to the employees gives the employee a financial benefit from collective EOT ownership and control
- Lib Dem idea and condition of the Coalition Agreement which like the pupil premium and increased personal tax allowances has been adopted and embraced by the Conservatives

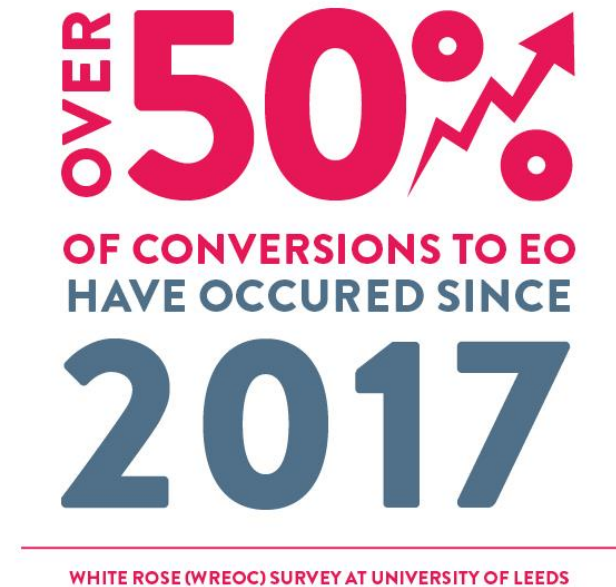
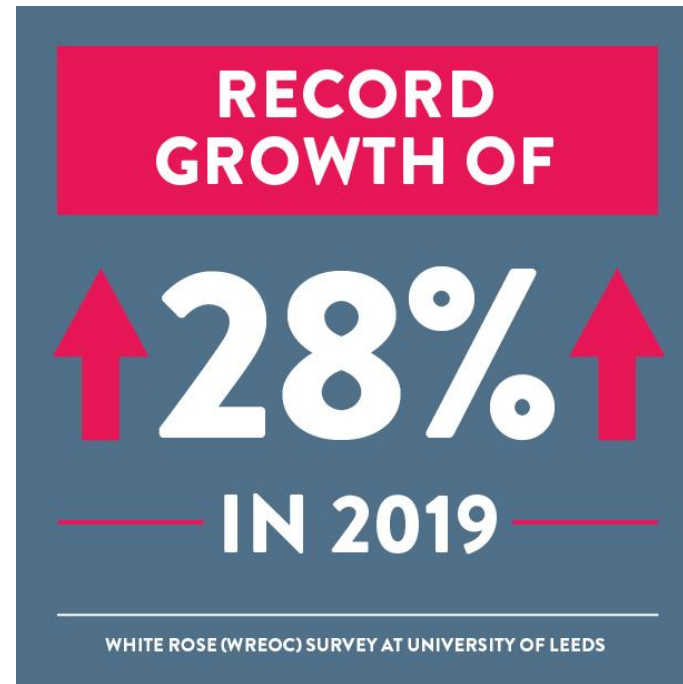
Vision

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- Long termism
- Employee engagement through ownership
- Employee Responsibility
- Reforming / Redeeming capitalism
- Spreading income and wealth more widely
- Localism
- Better securer jobs
- Stronger performance EO evidence

EO Evidence

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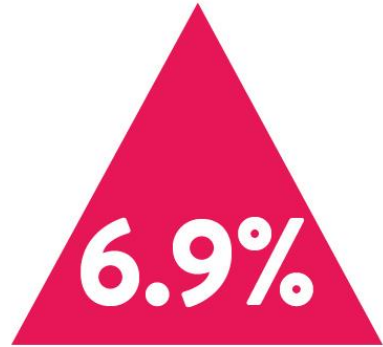
As published by the Employee Ownership Association

EO Evidence

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PRODUCTIVITY IN EMPLOYEE OWNERSHIP TOP 50 HAS RISEN



TOP 50 EMPLOYEE OWNED BUSINESSES 2020

Productivity is defined as value added per employee. Value added is operating profit plus wages

THE COMBINED SALES OF THE
EMPLOYEE OWNERSHIP TOP 50

£20.1bn
UP 4.3%

LIKE-FOR-LIKE

THE COMBINED
EMPLOYEES OF
THE EMPLOYEE
OWNERSHIP TOP 50

178,000
UP 1%

LIKE-FOR-LIKE

TOP 50 EMPLOYEE OWNED BUSINESSES 2020

THE EMPLOYEE OWNERSHIP TOP 50

	2014	2015	2016	2017	2018	2019	2020
Combined Sales (£bn)	20.5	21.5	22.5	22.7	19.8	19.2	20.1
Total Employees (000s)	151	164	175	176	171	166	178
Minimum Employee Numbers to Qualify	143	251	340	357	389	403	378

TOP 50 EMPLOYEE OWNED BUSINESSES 2020

As published by the Employee Ownership Association

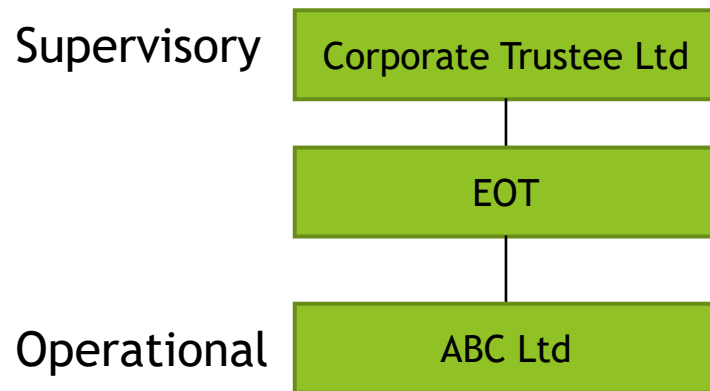
Cash and Culture



- Future cash flows are key
- Set price at one the company can sustain over the long term
- Unstrained Price and Terms
- Culture of employee responsibility as well as rights
- Grow management internally who accept the ethos

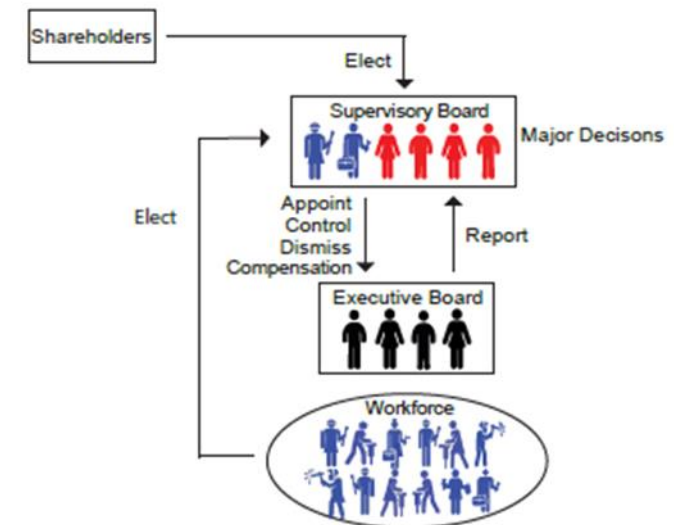
New Governance Structures

- Employee Engagement Employee council? Not Prescriptive
- Supervisory board structure



German two-tier board structure

- Employee representation on the Supervisory Board:
 - 500+ employees: one third employee representatives (*One-third Participation Act, Drittelbeteiligungsgesetz*)
 - 2,000+ employees: half employee representatives (*Co-determination Act, Mitbestimmungsgesetz*)
- Employee representatives elected by the workforce in secret, equal & direct elections organised by Works Councils



Role of Trustee board

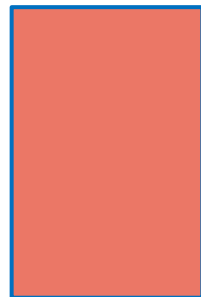


- Fiduciary and legal responsibilities
- Dual responsibilities director/trustee
- ‘Moral compass’ for company - tax mitigation strategy ?
- Hold the executive to account against the strategy / Challenge the executive against strategy management
- Appointing MD/Board
- Ultimate arbitrator for appeals against directors
- Offer from third party
- What are the boundaries of responsibilities between the 2 boards
- How are trustee directors appointed
- Where do employees get involved - Employee counsel ?

Evolution of Trustee Board



The mixture of skills on the Trustee board needs to evolve over time to reflect the needs of the company



Conversion



Transitional period



Maturity

EOT Conditions



- The Trading requirement s236I, TCGA 1992
- The all-employee benefit requirement s236J, TCGA 1992
- The equality requirement s236K(1)-(4), TCGA 1992
- The Controlling Interest Requirement s236M TCGA 1992
- The Limited Participation Requirement ss 236N (1) - (3) TCGA 1992

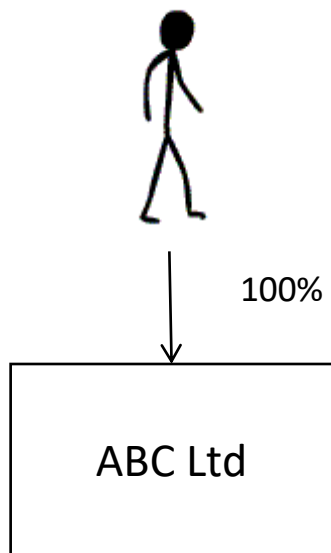
Limited Participation Requirement



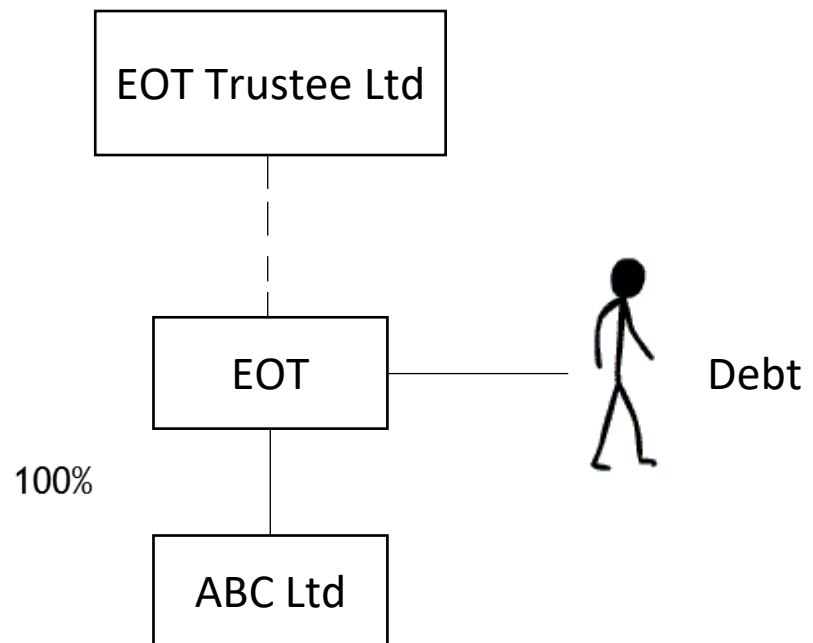
- Condition for CGT exemption
- Block conversions of small family companies converting and carrying on regardless
- 40% NP/ NE test
- At date of conversion and before and after

The EOT Basic Model

Current State

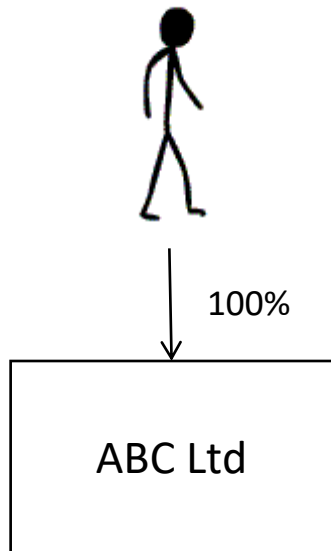


Future State

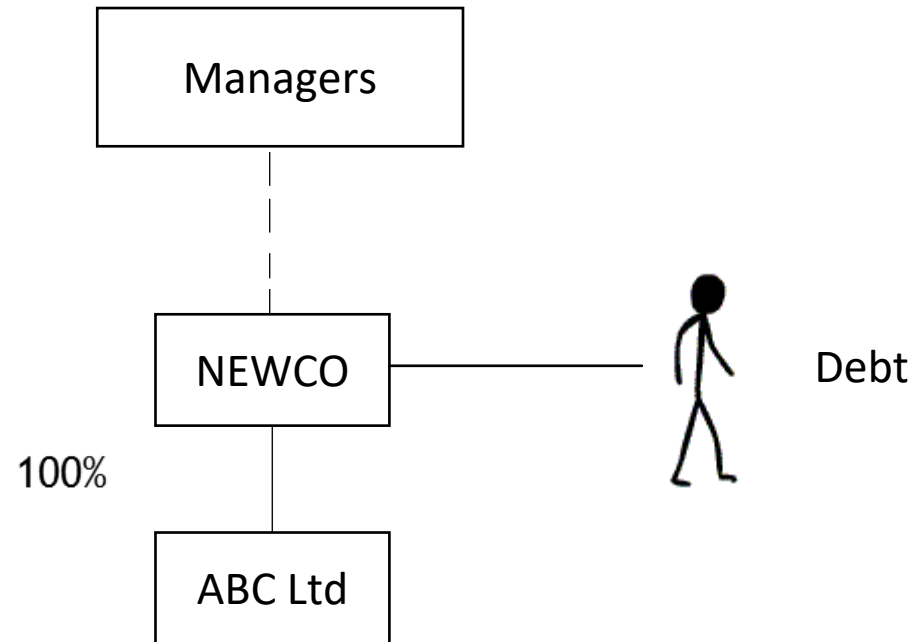


Vendor Financed MBO

Current State



Future State



MBO v EOT



- Newco owes vendor debt not EOT
- If Newco cannot fund debt, ownership can revert back to vendors
- EOTs if company cannot fund EOTs debt repayment cant be paid and may have to be written off by vendors
- Means the long payment periods of EOTs 5-10 years not commercially acceptable in an MBO
- Managers have direct individual ownership
- EOTS collective all employee ownership
- EOT sale tax free
- So write off of unpaid debt is more tolerable for vendors

The Hybrid EOT



- Founders retain minority interest
- Share Schemes for some or all of employees
- Control 51% remains with the EOT
- More Conflicts of Interest to manage
- Key employees managers can have shares
- Value of shareholdings? Status, dividends, internal market maker exits, possibility of sale of company

Moral Compass Dangers



- Very generous tax relief
- Narrow Tax Planners mindset
- Ignore the societal purpose, and the goals of the founder /vendor
- Offshore trusts
- Unregulated UK trust industry
- Inherent conflicts of interest
- Excessive cash extraction
- Ignoring the cultural employee engagement and governance issues

Abuse or Missed Opportunities



- Tax reliefs; Control by EOT; keys of the castle
- Double lock
- Best practice guidelines emerging slowly eg trustees
- Long term Success requires employee engagement
- Managing conflicts of interest inherent in the model
- Evolutionary journey



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Questions & Comments



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newspad

The Esop Centre's *newspad*, edited by Fred Hackworth, is a monthly publication providing in-depth coverage of the main international news in the employee share ownership field.

NB Reminder: The email address of Fred Hackworth, editor of *newspad*, has now changed to: fred_hackworth@zen.com (please note the under-score). Please send all press releases, company bulletins and news items for *newspad* to the above address. Thank you.

October 2020

In this month's edition:

- Educate public about share schemes, says HMRC study
- Employee-owned companies near 500 milestone
- Centre webinar reports: Could equity be used to replace a portion of an employee's salary?; Employee ownership and the future of capitalism; Employment-Related Securities
- Roadchef: widow urges tax-free compensation
- Float will create 200 millionaire staff shareholders, claim
- Free share awards value employees
- Loan Charge dubbed 'one of the worst laws ever'
- Centre weblave report
- Share plans symposium London March 24
- Companies section: Admiral, BA, Sir Patrick Vallance, Frasers Group, Gymshark, John Lewis, Pearsons, Rio Tinto, Royal Mail, Ryanair and FCA
- Chancellor seeks to reduce job cuts



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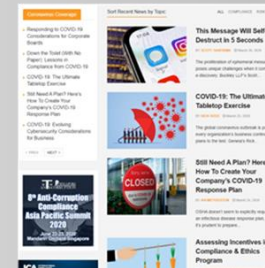
<https://esopcentre.com/news/newspad/>



FS Club Bulletins



From 43,000 curated sources, you get a machine summary of the key point(s) from forward-looking articles, not just article titles:



(LF.10) Reduced Inequalities

In September 2015, 193 world leaders agreed to 17 Global Goals for Sustainable Development. If these Goals are completed, it would mean an end to extreme poverty, inequality and climate change by 2030.

- Goal 10: Reduce inequality within and among countries.
- If the distributions of income, means tested transfers, and federal taxes follow CBO's projections, income inequality will be greater in 2025 than it was in 2015.
- High growth over the past decade has been based on unsustainable resource exploitation; addressing the resulting growth in inequality and environmental cost will be critical to ensure social stability and to ensure strong sustainable growth in the coming decade.
- The increase in inequality observed in the last 20 years is a serious threat to France's social contract.
- America's plutocrat president is pushing a tax plan that will further increase economic inequality at a time when income and wealth gaps are already widening.
- A failure to give the world's poorest women control over their bodies could widen inequality in developing countries and thwart progress towards global goals aimed at ending poverty by 2030.
- Under French leadership the G7 group of the 7 largest advanced economies plus the European Union will focus in 2019 on fighting inequality, including poverty induced by climate change.
- Leadership might require companies to take positions and advocate for change on global inequality - including in-work poverty, reduced inequality and more - would open a market opportunity of \$12 trillion by 2030.
- The next decade offers an opportunity to address Africa's urban poverty and inequality and shape development priorities to ensure that urbanisation helps foster well-functioning, livable and sustainable cities.
- In Africa and in the LDCs, eradicating poverty by 2030 will require both double-digit GDP growth and dramatic declines in inequality, illustrating the scale of the current challenges faced.
- The economic catch-up of Asia with the West will continue in the coming decades - thereby reducing global inequality among countries and among world citizens.



(FS.3.05) Employee Share Ownership

Considering 75 percent of the 2022 global workforce will be Millennials and Generation Z, it's critical that organizations keep a pulse on employee engagement and in a way that's consistent with how the emerging generations communicate.

- 2019 will see a continued evolution in designers' understanding of workplace optimisation with designs that boosts office morale and employee wellness while facilitating a creative work environment.
- By 2016, Gartner Predicts Twice as Many Employee-Owned Devices Used for Work than Enterprise-Owned Devices. With proposed revisions to the UK Corporate Governance Code, from 2020, companies will be required to report on employee engagement, as announced earlier this year by Financial Reporting Council.
- For HR leaders looking to better determine the attitudes that drive employee turnover and increase retention, using AI to provide insights into employee engagements will be crucial.
- By 2021, Artificial Intelligence (AI) will allow the rate of innovation in New Zealand to double. Employee productivity gains are expected to increase 1.5 times.
- Artificial Intelligence will double the rate of innovation improvements and improve productivity gains by 1.5 times in New Zealand by 2021.
- US health benefit costs per employee will increase 4.1% next year - slightly higher than inflation and less than the double-digit increases seen in years past.
- With a tight labour pool, small businesses will find 2019 to be the year to focus on employee engagement and happiness.
- Nearly 50 percent of companies also expect that automation will lead to some reduction in their full-time workforce by 2022, based on the job profiles of their employee base today.
- Employee wellness has been on trend for years, but expect to see some high-tech changes in 2019.
- By 2020, automation and artificial intelligence will reduce employee requirements in business shared-service centers by 65 percent, which adds the RPA market will top \$1 billion by 2020.
- This year, many organizations will look to employee scheduling software to solve problems around creating, publishing and managing employee schedules that include rotating its open shifts to reflect course and increase. Act on sales to help identify customer specific content to enhance worker value.



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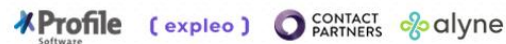
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| 16 October 2020 (12:00) | What Should You 'Outsource' To Your Chamber(s) Of Commerce Of Choice? |
| 20 October 2020 (16:00) | Uncovering Opportunities: How Finance Executives Can Use Machine Learning To Gain A Leading Edge |
| 21 October 2020 (12:00) | Employee Share Schemes: Innovative Communication Strategies Guaranteed To Increase Employee Take-Up |
| 22 October 2020 (11:00) | Nature Smart Cities: Innovative Financial Mechanisms To Support Local Authorities With Urban Greening |

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