Forbes.com: Strange And Wonderful Bedfellows: Private Equity And Employee Ownership

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The rise of private equity as a corporate ownership format has over the last 40 years or so roughly paralleled that of employee ownership, two very separate approaches to business and, in the minds of most people, approaches that are mutually exclusive.

In oversimplified sound bites, private equity often represents big money and the primacy of capital; employee ownership is caricatured as the triumph of the working class via Employee Stock Ownership Plans, or ESOPs. Put in such dramatic terms, outright war seems the next logical step, right?

But guess what: some of the smartest people in private equity are now partnering with ESOPs to buy companies. ESOPs are being formed to buy companies already owned by private equity funds. And private equity funds are buying companies already owned by ESOPs. And everyone seems to be getting along just fine.

It turns out that private equity and employee ownership have a lot in common, and going forward that may matter more than what separates them. A wonderful case study resides in Woburn, Mass.: Atlantic Plywood, a \$120 million-a-year supplier of high-quality wood products, hardware and other components to the custom furniture and interiors industry along the East Coast.

Founded in 1974 by two entrepreneurs. Profitably sold to private equity buyers in 1999. Profitably sold once again to its employees in 2008. And since the ESOP, Atlantic Plywood has rapidly paid down debt taken on to finance the buyout and now its strong profits are building up in employee accounts: shares valued at 25 cents each in 2008 are now appraised at \$9.95.

A worker making \$35,000 a year at Atlantic Plywood can expect to see his or her ESOP account grow by \$7,700 this year. And the CEO since the initial 1999 sale, Paul Vella, credits the former private equity owners with helping instill the financial and operating discipline at Atlantic Plywood that is now providing employees with a shot at a comfortable retirement.

Ira Starr, one of the <u>managing</u> directors of the private equity fund, Long Point Capital, remains on the Atlantic Plywood board of directors, and he is an unabashed ESOP enthusiast. The tax benefits and potential productivity gains from an ESOP, Starr tells me, "are exceptionally

compelling." Employee ownership has become a standard consideration when Long Point is buying or selling a company.

As it should with all middle market M&A, in my opinion.

I don't want to overstate the interplay between the private equity and ESOP communities. People who embrace them both – Paul Vella, Ira Starr, myself – remain in the distinct minority. But word is getting around. And with private equity funds holding some 7,500 portfolio companies – too many to take public, too many to simply re-leverage to another private equity fund – ESOPs will become a growing factor in enabling funds to exit these investments. And a big wave of employee ownership, it's safe to say, would demonstrate in the best way possible how we might begin solving this country's retirement savings crisis.

Paul Vella, now 62, joined Atlantic Plywood in 1981 and moved up to run operations and sales by 1993. When its original founders decided to sell, Vella was the obvious choice to become CEO. "I was excited," he recalls. "Like anybody, you always want to be in charge."

The new owners from Long Point had lots of big company experience, and rather than find them intrusive, Vella soaked up their advice. "From that point on, we were a much better-run company," he says. Financial and budgeting discipline was a particular strength of the Long Point people. Vella and his management team learned to operate with a significant amount of debt, and that would help Atlantic Plywood through downturns that followed its 1999 and 2008 buyouts.

When Long Point decided to sell in 2007, Vella says, the offers that came in weren't great. Long Point had previously sold a company to an ESOP and Ira Starr asked Vella to look into employee ownership. Once Vella came to understand the tax benefits and potential operating advantages, he was sold. A bank experienced in ESOP lending was enagaged. And Long Point took back some paper (later paid off) to get the deal done.

Vella has a handful of key metrics that help him manage. Inventory needs to turn about 6.5 times a year. Sales people need to get the right price, rather than giving up too much, 70% of the time or more. Deliveries need to be on time and goods undamaged, a service imperative that differentiates Atlantic Plywood from mere price cutters. Atlantic Plywood has moved its product mix into higher margin goods, reducing reliance on plywood and other "panels" to 60% of revenue from 72% in 2001.

Managing through the 2001 downturn soon after the private equity buyout gave Vella and his team confidence. So, when the economy likewise tanked almost immediately after the 2008 sale of the company to the ESOP, he didn't cut sales staff and didn't cut inventory. "My sales went down 18%. My competition's sales dropped 40%. We took market share."

Adds Greg Pray, a vice president at Columbia Forest Products, one of Atlantic Plywood's biggest suppliers: "They didn't bury their heads in the sand. Atlantic went out to sell into new channels."

Atlantic employs about 190 and has nine distribution facilities in the Northeast. Andrea Hallett, 32, is an outside sale rep and has worked at Atlantic Plywood since college. She works with about 200 customers in central Connecticut. "Once we became an ESOP, it definitely changed the morale of the company," she says. "We're working toward a common goal." The amount of damaged good shipped to customers – always an unpleasant surprise, and one requiring extra shipping to fix the problem – is way down. Teamwork between sales and the warehouses is up.

Jeff Engelbrecht, director of business operations at Atlantic Plywood, oversees the warehouses and information technology workers, 16 direct reports in all. As an owner, he views all of that as helping himself. "You do what you need to do. That's part of the ESOP culture."

"Everybody's now looking at the little things," Vella says. "All the people who work here – this is their retirement."

If you're a founder/owner/CEO/management team, or a private equity fund, considering <u>selling your business</u> in part or in whole, and you haven't included an ESOP in your analysis, it's probably because you haven't been made aware of the <u>significant tax benefits</u> to sellers and to the ongoing company, or the productivity boost an ESOP often delivers.