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Parksite Group

Parksite Case Debunks ESOP Myth: Actually a Great M&A Vehicle

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One of my jobs, I've learned during 30 years of advising on employee ownership transactions, is to dispel myths about ESOPs, or Employee Stock Ownership Plans.

Too complicated (not true). Takes forever to close a deal (not true). Inmates-running-the-asylum governance issues (not true). And then there's this misperception: ESOPs, while fine for mature and slow-growing companies, are ill suited to a fast-growing serial acquirer looking to consolidate an industry (not only not true, but dead wrong).

As we'll see in the case study of Parksite Group, a Batavia, Illinois-based distributor and marketer of building products, an ESOP actually possesses fabulous advantages in the middle market M&A world:

- 100% ESOP-owned S-Corporations, like Parksite, don't pay federal or most state income taxes; as with IRAs and 401(k)s, the owner-workers pay taxes when they retire and withdraw funds. So, while normal operating companies may be taxed at 35% or so, an ESOP retains that income and has meatier cash flow. That builds a bigger war chest for acquisitions, pays down debt from deals more rapidly, and provides more capital to invest in modernizing acquired operations.

- ESOP-owned companies, a wide survey of research shows, receive a productivity bump from their worker-owners. They also suffer less management-worker friction and enjoy the benefits of self-policing workforce - such as reduced waste. All of this can make acquired operations more valuable when brought under the ownership and culture of an ESOP. That value, of course, accrues to the worker-owners.

"The retirement account will be great," says Elizabeth Wheeler, a corporate administrator with 15 years at Parksite. "But it's more a sense of belonging, and the way we work together - the bond we have."

George Pattee, Parksite's CEO, says, "We share the information, share the wealth, share the fun." Pattee started at the company at age 17, 42 years ago, loading and unloading cans of stain stored in a cramped one-time chicken coop.

In 1989, Parksite's original owners - Ray Biggins and John Morrisroe - sold 75% of the company to an ESOP, later selling the remaining 25%. In such a transaction, the company borrows money to fund the buyout, using profits over time to pay down the debt. And as the debt is repaid, shares are released to the ESOP and credited to employee retirement accounts.

Parksite, having paid off its ESOP debt, in the year 1999 was a roughly $50 million-a-year company looking to use its pristine balance sheet to finance growth. Would its ESOP status stand in its way? Hardly.

The owners of a far-larger building supplies distributor, Plunkett-Webster, with annual sales of roughly $150 million, were looking for an exit. Parksite, with 11 years of rapid organic growth and solid results as an ESOP, enjoyed the confidence of its bankers, and it purchased Plunkett-Webster for more than $50 million, borrowing the entire amount.

The timing was brilliant, as the U.S. was just beginning one of the biggest housing booms in history. Sales at the combined companies almost tripled by 2006. Profits were strong. And the acquisition debt was entirely eliminated, thanks also to a highly productive group of worker-owners and to the ESOP's favorable tax status.

Then, of course, came the financial crisis of 2008-2009. Plenty of competitors in the building supply industry went bankrupt, but Parksite's employee-owners pulled together to cut costs and operate more efficiently. There were layoffs and it was painful. But in mid-2009, as management was considering another round of staff reductions to keep up with declining sales, rank-and-file employees stepped forward with a better idea: days off without pay (a DOWOP) for everyone to keep the remaining staff employed. Pattee, Parksite's CEO, happily agreed, and the adjustment roughly equaled a 5% pay cut across the board. Shared sacrifice.

Meanwhile, employees scoured the company for ways to save small amounts, dubbing the effort the "power of $100." Victoria Paesch, an office manager in Parksite's Baltimore facility, recalls damaged goods being returned - say a 12-foot wooden post - and being tossed out in earlier years. To save, during the slump Parksite workers began trimming such returned posts down to 8 feet, say, cutting off the damaged portion and then selling the shorter size. Every contract was rebid aggressively - office cleaning, coffee service, snow removal, dumpsters, "even the Orkin guy," Paesch says.

Ron Barthel, Chief Financial Officer, says the $100 ideas easily saved $100,000 in annual costs. But more than that, they brought employees together. "We have a great culture," Barthel says. "Everyone is encouraged to identify ways to do things better."

Self-sacrifice at the economy's nadir also freed up about $400,000 to invest in radio frequency warehouse inventory systems, boosting productivity, while many competitors were at best hunkering down. Now, freed-up capital is funding a voice-activated warehouse system that is expected to further boost productivity between 12% and 25%.

By 2011, a slow turnaround gaining momentum, Pattee declared a DOWIP - day off with pay. Shared gain.

Profitable since the mid-2009 point, and with housing growing again, Parksite is on the prowl for acquisitions once more; it made smaller acquisitions in 2001, 2005, and 2010, building out its geographic reach in selling Corian countertops and Tyvek insulation fabric, both DuPont products, and Azek Building Products.

Why did Parksite's original owners choose to become an ESOP? I met them in 1989 when one of them, Ray Biggins, had decided to retire and was looking to exit. His stake was a bit too much for his partner, John Morrisroe, to buy, and neither wanted to sell to a third party. They figured that would result in the dismantling of what they'd built. Their management approach already was aligned with employee ownership, says Steve Schmidt, vice president of logistics and a 40-year employee. "Open door, sharing information, emphasizing the value of associates." ESOP became the logical choice.

Some background: Parksite started in the early 1970s, when Biggins and Morrisroe, two building products veterans, struck out their own and initially represented a wood stain manufacturer. To stimulate demand, they put on staining clinics at independent hardware stores and lumber yards and trained contractors. They added more products. And, early on demonstrating their mettle, when relations soured with the stain manufacturer, they dropped the product line, despite the fact that it represented 75% of sales. Their entire sales staff quite. Biggins and Morrisroe got busy selling the other products themselves, rebuilt the business, and saved the company.

Over time, DuPont came calling and Parksite began selling Corian countertops. And then DuPont showed up with an odd fabric, permeable to vapor yet waterproof, and wondered whether it might have a construction application. Manufacturer and distributor, over time, brainstormed and saw Tyvek's use as an insulation, and the two DuPont products became the foundation of Parksite's growth. From 1986 to 1990, sales nearly tripled to $16 million. Brief pause for early-'90s recession. Then over the five years ended in 1997, sales more than doubled to $35 million.

During that latter period, too, the value of ESOP shares was rising and employees saw their hard work transformed into actual retirement savings. Jimmy Keifer was working for a logistics company that ran a Parksite warehouse in Tampa. "Once I learned about the ESOP, I was like, 'man alive, I want to be a part of that,'" Keifer recalls. He took the first job at Parksite he could snap, in sales, and then later switched back to an in-house logistics role.

"The culture of an ESOP company is way different," Keifer says. "Before, I worked at a family-owned company and the family was reaping all the benefits. At Parksite, I'm part of the family." Keifer is married, with three young children, and expects the ESOP will allow him to retire comfortably.

Lighting the way for all the Parksite employees, as they think about life after work, is Minaxi "Meena" Patel. She joined Parksite in 1989, the year its initial ESOP was formed. Performing accounting jobs for 18 years, she says her annual pay never rose much above $50,000. Her husband died in 1999. There were three children to raise and send to college.

In 2007, newly a grandmother, Patel decided to look into retiring. Her ESOP shares, near the peak due to the construction boom, were valued at seven figures. (Before your eyes pop out, consider that in today's low-interest-rate environment, a $1 million annuity, for instance, wouldn't produce much more than $4,000 in monthly income). Patel retired then, helped her kids through college and has been using some of her remaining savings to fund construction of a library in India, near where her husband's family lives.

"The ESOP did so much," Patel says. "I put my kids through college. I never had to raise my hand for help." She's putting aside small funds for her grandchildren's education now.