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Financing an Employee Ownership Transition: What Owners and Advisors Need to Know

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Who this is for: Business owners considering an internal sale or EOT transaction, and advisors supporting clients through ownership transitions.

Why it matters: Understanding how these transactions are financed, and when to engage your professional team, is one of the most important factors in a successful outcome.

Internal vs. External: Two Very Different Paths

Most owners are familiar with the external sale process: engage a broker, market the company, respond to term sheets, complete due diligence, sign a share purchase agreement, and walk away. It's a process largely driven by external forces, aimed at selling 100% of the company to an unknown buyer, and it can take six months or longer just to find traction.

An internal transition, to employees, family, or through an EOT, works differently. You know your buyers. You control the structure. You can sell anywhere from 1% to 100% of the company. The process is more collaborative, due diligence is lighter (employees already know the business), and a well-organized transaction can close in 3 to 6 months.
The tradeoff is that internal transactions require more intentional preparation. You're the one setting the tone, engaging the professional team, and keeping employees informed along the way.

One principle rises above everything else in an internal transaction: communicate early and often. Employees are not passive bystanders, they are your buyers, future co-owners, or future beneficiaries. Keeping them informed about the valuation process, the timeline, and what to expect reduces anxiety on all sides and sets up the transition for long-term success.

Getting Your Business Valued

Before any transition can happen, you need to know what your company is worth. This requires engaging a Chartered Business Valuator (CBV), an independent expert who assesses your company's value based on professional standards. You can find several Valuators with experience in employee ownership transactions on Employee Ownership Canada's Service Provider Directory.

The valuation process typically takes 3 to 6 weeks, depending on the complexity of the business and the availability of financial information. Expect to receive an extensive information request from your valuator upfront. Involving your own accountant or financial advisor to help you navigate this list will reduce stress and speed up the process.

Types of valuation reports: Like financial statements, valuation reports come in different levels of depth and rigour. The minimum you should ever accept for an Employee Ownership transaction is an estimate valuation report (equivalent to a review engagement). A more comprehensive report carries greater credibility with employees, with lenders, and with any other parties to the transaction.

Don't cut corners here. A well-credentialed valuation report:

- Gives employees and their advisors confidence in the fairness of the price
- Satisfies lender requirements for financing
- Demonstrates that an independent, arm's-length process was followed (which is also a legal requirement for accessing the $10 million EOT capital gains tax exemption)

An important distinction:

The valuation sets the value of your company. The price you actually receive will depend on the deal structure; how much is paid upfront, whether there's an earn-out, how long repayment is stretched. A company that is valued at $5M may result in a higher or lower effective price depending on those terms.

The Three Key Value Drivers

If you have 12 to 24 months before you want to transition, these are the areas worth focusing on to maximize your valuation:

1. Cash flow:

At its core, a business valuation is an assessment of the present value of your future cash flows. Strong, stable, and growing cash flow directly increases value. Inconsistent or declining cash flow will reduce it.

2. Balance sheet health:

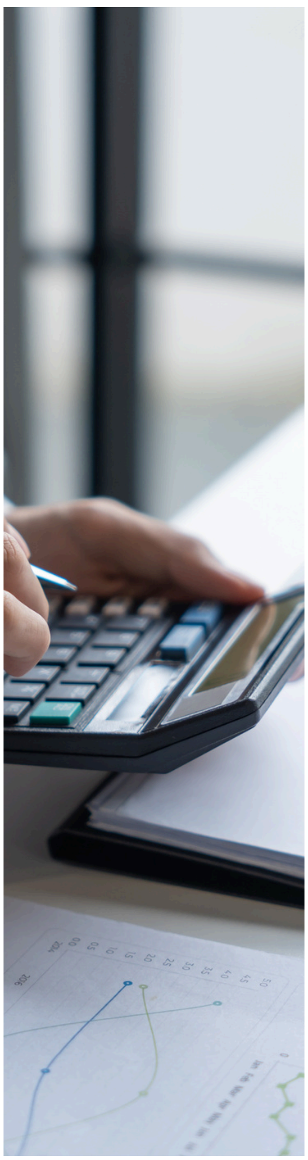
Low debt and clean financials signal lower risk. Excess debt or complicated non-operating assets drag value down and can create tax problems (see below).

3. Customer base stability:

A business that relies on one or two customers for 80% of revenue carries significant concentration risk. A diversified, long-tenured customer base with stable gross margins tells a more compelling story to both valuators and lenders.

Avoiding Costly Mistakes: The Capital Gains Tax Asset Test

The permanent $10 million capital gains tax exemption for EOT transactions comes with asset eligibility requirements. If your company holds non-operating assets such as excess cash, a vacation property, investment accounts, anything not actively used in the business, you may be at risk of failing the qualifying test and losing access to the exemption.



The rules require:

- For the 24 months before the sale: At least 50% of your company's assets (by fair market value) must be active business assets
- On the day of sale: At least 90% of your assets must be active business assets

This means you may need to "purify" your company well in advance, removing or restructuring non-operating assets before the clock starts. Discovering this issue six months before a planned close can derail the entire timeline.

Consult your advisors early. Talk to your accountant now about the current asset mix in your company, whether you're offside, and what steps are needed to qualify. This is one of the most common and costly surprises in EO transactions. If you need assistance from a professional advisor, consult Employee Ownership Canada's Service Provider Directory.

Financing the Deal: What to Expect from Your Bank

For sales directly to employees (such as Employee Share Ownership Plans or Management Buyouts) employees generally don't have the personal capital to buy a meaningful ownership stake outright. External financing is what makes the transaction possible, it bridges the gap between what the seller needs and what the employees can pay on day one.

For Employee Ownership Trust (EOT) transactions, employees do not directly purchase shares, and the seller is paid through future cash flows of the company. However, in EOT transactions, external financing allows the seller to get more cash on day one.

Banks play three roles in an EO transaction:

- **Pressure-testing what can be financed** before deal terms are locked in
- S**tructuring capital around cash flow,** not just enterprise value
- S**upporting post-close stability** so the business can operate and grow while servicing the debt

The single most important piece of advice from the bank: engage early. Early conversations preserve optionality. They let you understand what's financially feasible before you've committed to a structure. Bringing the bank in late, after terms are set, limits your choices and increases the risk of surprises.

The Financing Toolkit

There is no single financing solution that fits every transaction. Most deals involve multiple layers of capital working together:

Senior debt (bank loan): The most common and lowest-cost form of financing. Banks lend based on what the business can reliably repay from cash flow, not just on asset value. Senior debt sits at the top of the repayment order and comes with regular principal and interest payments, plus financial covenants (reporting checkpoints that monitor business health).

Vendor financing (seller note): The selling owner defers a portion of their proceeds and is repaid after the bank. This is very common in EO transactions. It bridges valuation gaps, demonstrates the seller's confidence in the business, and is reassuring to lenders because it signals the seller believes the company will continue to perform.

Mezzanine financing: Sits between senior debt and equity in the capital structure. More flexible than senior debt, but more expensive. Used when senior debt alone isn't sufficient to fund the full transaction.

Personal loans / equity stakes: Sometimes used for management buyouts (MBOs). Effective, but introduces personal financial risk that requires careful consideration.

Other tools: Real estate refinancing, asset-based lending, and other structures can sometimes fund part of a transition. The key principle: match the right type of capital to the right asset.

What Banks Look For

Before approving financing, a bank will analyze three core areas:

Cash flow: The primary driver of everything. Banks look beyond headline EBITDA to free cash flow: How stable is operating performance over the last 3 to 5 years? How predictable are margins? What are working capital and capital expenditure requirements? Strong cash flow is what services the debt; it's non-negotiable.

Collateral: Receivables, inventory, equipment, real estate. Important, but a secondary source of repayment. Strong collateral cannot fix weak cash flow.

Leverage: The full picture of debt on the company, including existing loans, any new acquisition debt, and vendor notes. The goal is a structure the business can comfortably service while continuing to invest and grow.

Beyond the numbers, banks also assess non-financial factors: management depth beyond the founder, customer and supplier concentration, and the quality and timeliness of internal financial reporting. Strong reporting reduces uncertainty, and uncertainty is risk.

What Makes a Deal Financeable

From a banker's perspective, the deals that go smoothest share one thing in common: the ownership and leadership team came prepared. That means:

- A clear financial information package ready before conversations begin
- Historical financial statements (3 to 5 years minimum)
- Forward-looking forecasts for at least 12 months
- Working capital details (accounts receivable aging, inventory)
- Organizational structure and leadership information
- A third-party valuation report
- Proposed transaction terms and documentation

Deals stall when information is incomplete, arrives late, or creates unexpected questions mid-process. Preparation isn't just about speed; it signals credibility and seriousness to the lender's internal credit team, which ultimately approves the financing.

A Common Mistake: Too Much Leverage, Too Fast

Taking on maximum bank financing from day one is a mistake many businesses come to regret. High leverage:

- Limits cash available for distributions and operations
- Comes with intensive reporting and covenant obligations
- Reduces flexibility if the business hits a rough patch

The better approach is to borrow what you actually need on day one, leave room to breathe, and refinance or adjust terms over time as the business proves its performance. Bank deals can be renegotiated. Nothing agreed at close is permanent. Start with a structure you can manage, not the maximum you can theoretically access.

The Timeline

A well-organized EO financing process typically takes:

Pre-transaction preparation	Feasibility, valuation, information package: 2–3 months
Transaction process	Financing, legal, due diligence: 3–6 months
Total:	6 to 9 months from start to close

This resource is based on content from EOC's March 2026 webinar, "Financing Employee Ownership Transitions," presented by Andrew Dey (Chartered Accountant and Business Valuator) and Anthony Carbone (Managing Director, Commercial Banking, BMO). It is intended for general educational purposes and does not constitute legal, tax, or financial advice. Consult your own professional advisors before making decisions specific to your situation.