

ESOPs' Upside for Founders in GovCon, Beyond



TechFlow's Rob Baum discusses the structure's quantitative and qualitative benefits.



By Chris Nolter

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When TechFlow Inc. founder, chairman and CEO Rob Baum first considered an employee stock ownership program, or ESOP, he wasn't immediately sold.

"Initially, I was not that excited about doing an ESOP," Baum said. "I looked at it as kind of a socialistic system."

However, the structure allowed some partners to tap liquidity, provided employees a stake in their workplace and carried other benefits. In particular, ESOPs can help government contractors gain and retain mandates. TechFlow converted to an ESOP in 2015.

For founders, M&A or PE investments may seem more obvious options for tapping liquidity. However, **CSG Partners LLC** managing director David Blauzvern said an ESOP is essentially a tax advantaged leveraged buyout with quantitative and qualitative advantages.

"Why do people like ESOPs?" Blauzvern said. "They care about their legacy. They care about the loyalty of their employees and the community they built their business up around. And they care about the tax impact of a transaction."

ESOP Appeal

TechFlow is a San Diego government and commercial tech and services company with clients such as the Transportation Security Administration, U.S. **General Services Administration**, U.S. Army Reserve, U.S. Navy and others.

"We do a tremendous amount of work on the logistics side, in terms of efficiency and optimization of operations and maintenance, for TSA," said Baum, 60. "It's one of our big contracts."

The company also offers digital solutions, base operations support, energy, electrical vehicle infrastructure and other services.

Since converting to an ESOP, TechFlow has grown from about \$40 million to \$50 million in revenue to about \$320 million.

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dictate what the ownership of their entity needs to be. You can sell to an ESOP and in most cases, maintain whatever status you have today."

CSG PARTNERS LLC MANAGING DIRECTOR DAVID BLAUZVERN

In addition to allowing partners to take some money off the table, Baum said, the ESOP gave employees ownership and formed a bond between workers.

"It's created kind of a culture of helpfulness," he said.

The company benefited from the success of local government contractor **Science Applications International Corp.** (SAIC). While the company is now publicly traded, it began as an ESOP in San Diego.

"Many of the employees of SAIC lived in San Diego, and when we became an ESOP we were able to attract a lot of those employees to our company," Baum said

ESOP conversion has costs that might not work for a smaller organization, however, Baum said.

"I don't think you'd want to do this at a \$2 million company, but at \$8 million, \$10 million or \$20 million you start to get into the numbers that really makes sense," he

said.

Government Benefits

ESOPs debuted in 1956 when San Francisco lawyer Louis Kelso created a structure to transfer ownership of a newspaper group from its founders to its employees.

Today, ESOP boutique CSG reports, the U.S. has about 6,300 ESOPs. Prominent examples include **Publix Super Markets Inc.**, Gore-Tex maker WL Gore & Associates and **D.A. Davidson Cos.**

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for monetizing that asset.”*

TECHFLOW INC. CHAIRMAN AND CEO ROB BAUM

The structure can pay off for government contractors.

For instance, government agencies often seek contractors owned by minorities, women or veterans.

"Many times those business owners are not able to sell their company because the contracts dictate what the ownership of their entity needs to be," CSG's Blauzvern

said.

"You can sell to an ESOP and in most cases, maintain whatever status you have today, because you don't have that PE firm, that strategic buyer taking over the contract vehicle," he said.

ESOPs with what are termed "sole-source follow-on contracts" may have another benefit.

"Usually you have to go up for re-compete against other players in the marketplace, when those contracts come to an expiration date," Blauzvern said. The government has incentivized employee ownership, he added, and may allow ESOPs to extend their contracts if they have met all of the requirements.

From ESOP to Exit

A sale to an ESOP can fetch the same price that a PE firm might pay, Blauzvern said. In govtech, for instance, multiples range from 6 to 14 times Ebitda, depending on contracts, the customer base, performance and other factors.

Tax benefits come into play, though.

"If I sell my company to a PE firm for \$100 million, I'm going to net \$65 million, \$70 million dollars after taxes," Blauzvern said.

"With an ESOP, I can sell for the same \$100 million dollars and net \$100 million after taxes," he said, noting that owners of privately held businesses that sell equity to an ESOP have the ability to defer and eliminate the capital gains tax. "So that's the biggest tax benefit for the selling shareholder," he said.

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CSG'S BLAUZVERN

ESOPs can also become 100% tax free at the corporate level, he said.

A business generating \$40 million of Ebitda might net \$25 million of cash flow after taxes, he said, while an ESOP with the same \$40 million of Ebitda could net \$40 million of cash flow.

The excess cash can pay down debt and fund growth.

"We have clients that use it to become acquisitive in their industry," he said.

For the for the shares to mean something to employees, TechFlow's Baum said, the company ultimately needs a transaction that provides liquidity.

While Baum isn't looking to exit in the era of DOGE cutbacks, he said he'll eventually consider transactions.

"If it always stayed in ESOP, cashing people out becomes a problem," he said. "There is a time in in the evolution of an ESOP for monetizing that asset."

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