



2020 Advisory Conference

October 27–29

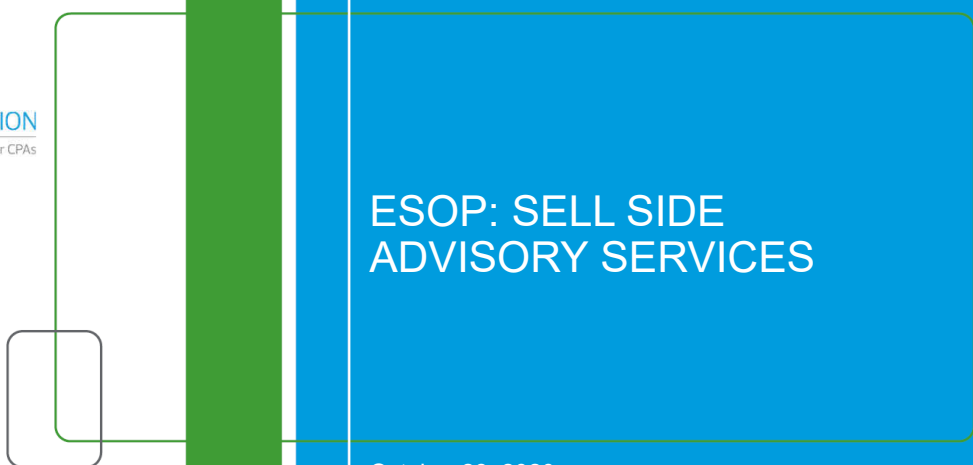
Converging knowledge and behaviors to deepen client relationships

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ESOP: SELL SIDE ADVISORY SERVICES

October 28, 2020

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Speakers List



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Agenda

Topic	Minutes
Middle Market Trends	5 minutes
Who is Best Suited for an ESOP?	10 minutes
ESOP Benefits	10 minutes
ESOP Drawbacks	10 minutes
ESOP Transaction Process	10 minutes
Questions and Answers	15 minutes



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Objectives

By the end of this course, you will be able to:

- Position yourself as a sell-side advisor in an ESOP transaction



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ESOP

Middle Market Trends

- Sell-side due diligence has been active since June/July, deals are closing by year-end
- Bank leverage is still strong
- Trustees utilizing claw backs and earn outs



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Possible Solution for Business Owners Who...

- Are looking for complete ownership transition, but
 - Have not been able to locate a buyer;
 - Are concerned about the impact on employees and/or community; or
 - Just don't want to sell to an outsider
- Are not ready for a complete ownership transition, but want some diversification of their personal net worth
- Are looking for a tax-favored opportunity to sell all or a portion of the business at the federal capital gains tax rate
- Would like to sell all or portion of the business to employees who lack the funds to purchase the business
- Want to share ownership as a motivation and retention tool



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Who is Best Suited for an ESOP?

- Companies best suited for an ESOP:
 - Have a good management team succession plan in place
 - Have a work force with over 20 employees
 - Have a valuation over \$3MM
 - Are not already highly leveraged



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How It Works

- ESOP Trust is formed, and the current shareholders sell their stock to the ESOP Trust.
- Shareholders are paid over time with seller notes and/or immediately with bank financing (outside note)
- Shares are allocated to participants over time as a percentage of eligible compensation (inside note)
- Most terminated participants are paid after the external notes are repaid (exceptions: death, disability, retirement)
- The Company contributes funds into the ESOP plan to pay exiting participants over time (i.e. repurchase obligation)



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The Valuation

- Must be independent
- Must consider all factors
- Values what ESOP is buying/getting
- Costs real money
- Takes real time
- Frequently is lower than seller expects
- Must be done annually thereafter
- Both the IRS and the DOL are highly skeptical in this area, so good documentation is the key!



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ESOP Benefits

- Provides a way to get liquidity to shareholders immediately and over time
- Is a qualified retirement plan for your employees
- Allows the Company to buy out shareholders with pre-tax dollars
- Offers a proven motivation for employee owners to share in the Company's growth
- Financing an ESOP provides an alternative to shareholders
- Certainty to close/minimizing confidentiality issues



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ESOP Drawbacks

- Leveraged ESOP can increase administration and implementation costs
- More complex than other qualified retirement plans
- Annual valuation by outside appraiser of stock required
- ESOP companies may be more difficult to sell
 - Trustee control over shares affects negotiation
 - Participants may be required to vote on decision to sell or merge
- Balancing the dilemma of contributions to trust with required pro-rata S Corp distributions (ESOP vs. non-ESOP owners)



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S-Corp Factors

- No corporate taxation. All taxation passes through to owners
 - 100% ESOP pays no federal tax and most states recognize ESOP as tax exempt
- All ESOP debt payments on internal note are fully deductible
- BIG tax would still apply for period of time after conversion to S-Corp from C-Corp (if applicable)
- Gain to shareholders is taxed at capital gain rates; installment option is available
- Tax benefit remains intact even after all shares are allocated



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Impact on Employees

- Culture of “ownership” and increased employee productivity
- Rollout can be key
- Ongoing communication and education

WHAT DOES
**EMPLOYEE
OWNERSHIP
MEAN?**



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ESOP Transaction Process – Phase 1

1. Harding, Shymanski & Company, P.S.C. (HSC) is engaged as seller's advisor to:
 - Provide ESOP range of values; perform in-depth due diligence work and ESOP feasibility review; discuss potential bank financing options; and make contacts
2. The company engages ESOP transactional trustee for representation of ESOP trust and future participants
 - ESOP transactional trustee hires a separate valuation firm to represent the ESOP trust
 - Trustee sponsored valuation firm performs ESOP range of value, and if it's acceptable, moves forward with ESOP feasibility



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ESOP Transaction Process – Phase 2

1. HSC and the company's management determine if a deal can be reached and move on to phase 2
2. Trustee sponsored valuation firm performs a full valuation
3. Negotiations between the company's management and ESOP trustee on transaction price and structure commence, and a deal is reached. During this time, HSC acting in advisor capacity ensuring best structure and price for the company
4. Trustee sponsored valuation firm performs a fairness opinion
5. HSC and the company discuss corporate attorney and third-party administrator (TPA) options and approve



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ESOP Transaction Process – Phase 2 (Continued)

6. Transactional trustee will hire ESOP attorney (with input from HSC and the company) to prepare closing documents, draft the trust agreement, plan document, etc.
7. Deal closing and financing arrangements are in place
8. In subsequent years, an annual valuation and participant accounting will be done



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