

2023

ESOP VIRTUAL CONFERENCE

JUNE 20



ESOP Transactions: Sell Side

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Agenda

- Describe the Process
- Pre-Feasibility Discussion
- Business owner education - ongoing
- Valuation – range of “fair market value”
- Feasibility Analysis Basics
- Implementation Steps
- Post-Closing

The Process

- Pre-Feasibility (“light”) discussion
- Business owner education
- Valuation range of value
- Feasibility Analysis
- Transaction Structuring
- Financing (senior, subordinate, sourcing or assisting)
- Term Sheet Prepared
- Selection of Trustee Team
- Diligence Meeting with Trustee Team
- Negotiation
- Closing

PRE-FEASIBILITY (“LIGHT”)

1. Transaction Goals & Objectives
 2. Business Owner Education
 3. Consideration of other transition options – e.g. 3rd party sale
 4. Good ESOP Candidate?
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WHAT MAKES A GOOD ESOP CANDIDATE?

- Is the Company profitable with stable cash flows?
 - Does the Company intend to *benefit* a broad base of employees?
 - Does the Company have a management team willing and able to run the business?
 - Company has EBITDA of at least ~\$500,000
 - Does the Company have at least 20+ eligible employees?
 - Reasonable valuation expectation of Seller(s)
 - Good diversified customer base, no material concentrations
 - Favorable future industry prospects
 - Low existing debt with good debt capacity
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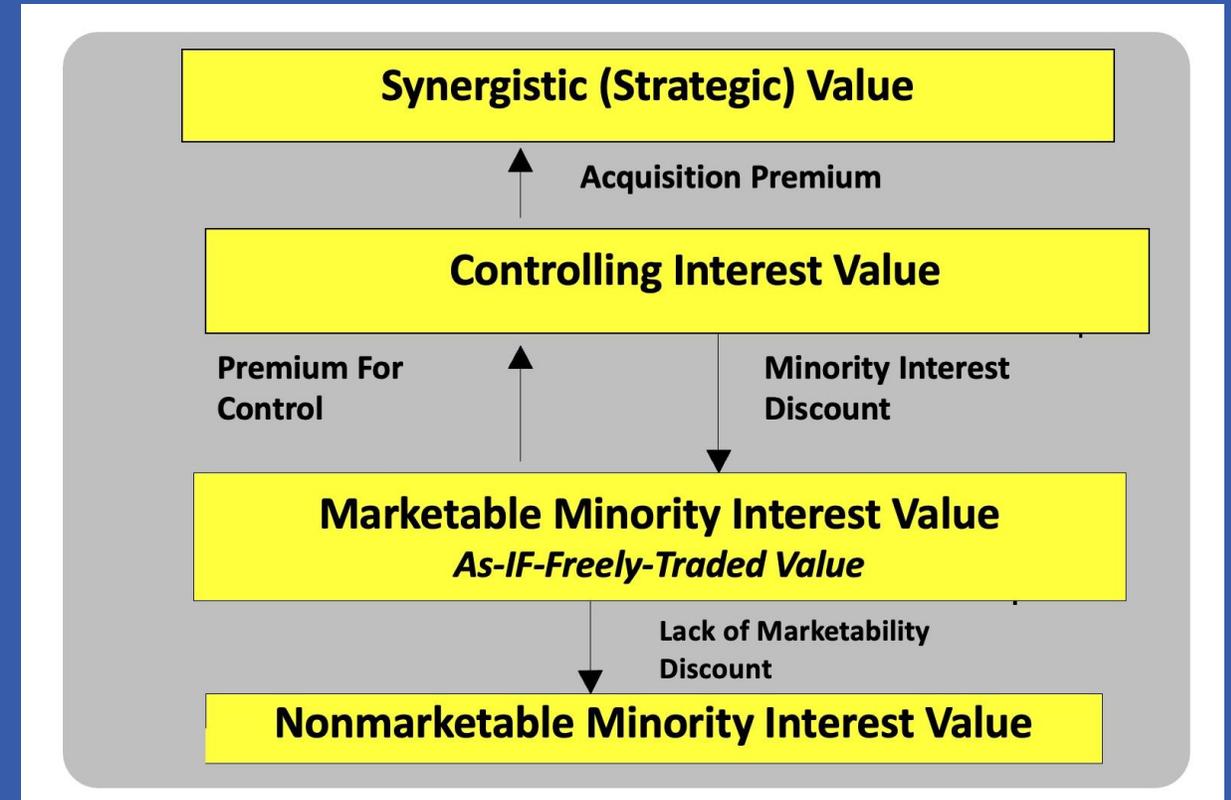


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Valuation

VALUATION

- ❑ Range of estimated Fair Market Value (aka purchase price)
- ❑ Impact of discounts for lack of marketability and/or minority interest discounts
- ❑ Other significant items that impact the value/purchase price





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Feasibility

ESOP FEASIBILITY ANALYSIS – KEY INFORMATION?

- Potential transaction structure
 - ✓ What percentage of stock will the ESOP acquire?
Minority (<50%), Control (>50%)
 - ✓ What financing terms are being considered?
 - ✓ What other key terms need to be considered?
 - ✓ Is the Sect. 1042 Tax Deferral desired? Is it feasible?

- ***Cash Flow Analysis***

- Are projected cash flows adequate to finance the proposed ESOP transaction structure while meeting the working capital and capital expenditures needs of the Company?
- Will the Company's projected cash flows support the proposed financing structure?

Important variables:

- Revenue growth
- Profit margin
- Amount of bank financing and terms (interest, covenants, maturity date)
- Amount of seller financing and terms
- Capital expenditures
- Working capital

- *Employee Benefit Level Analysis*

- Analyze qualified payroll amounts, ESOP allocations, and other ESOP Plan compliance testing considerations.
- It should estimate the Company's future employee benefit levels. Are these employee benefit levels reasonable and sustainable?
- What's the Impact on any proposed key management incentive plans (i.e. SARs or Phantom Stock) Are the value of the incentive plans reasonable?

ESOP RETIREMENT PLAN LIMITS FOR 2023

- IRC Section 415
 - \$66,000 per participant

- IRC Section 404
 - Annual deduction for ESOP contributions limited to 25% of eligible payroll (caps all HCE compensation at \$330k).
 - S corporation – includes interest & principal
 - C corporation – only applied to principal
interest is deductible

 - Will payroll permit full deductibility of the ESOP Loan payments for taxes or will the deal structure need to be modified?

[BANK] FINANCING ASSESSMENT

- Are Lenders making loans to finance ESOP transactions in the current market?
- Assumptions regarding amount/terms of senior/bank/seller financing
- Will there be **Sufficient** cash flow coverage?
- Are the terms **Acceptable**?
 - ✓ Interest
 - ✓ Collateral, guaranty
 - ✓ Term



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Implementing the ESOP

IMPLEMENTING - BANK FINANCING

- Run a competitive bank financing process? Or assist the Company with its existing bank?
- Prepare a Book with company cash flows and debt coverage ratios, etc...
- Assist company in negotiating the most favorable financing terms available

IMPLEMENTING THE ESOP --- ENGAGING THE ESOP TRANSACTION TEAM

- Company ESOP Legal Advisor
 - ESOP Trustee (aka “Buyer”)
 - ESOP Trustee Financial Advisor - Valuation
 - ESOP Trustee Legal Advisor
 - Third Party Administrator
 - Seller’s 1042 Specialized Investment Advisor (if any)
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IMPLEMENTING THE ESOP --- NEGOTIATING THE TRANSACTION

- Due Diligence / Kick Off Meeting
- Negotiation of Deal Terms through Term Sheet
- Preparation of Flow of Funds



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Post-Closing



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POST-CLOSING:

- Working Capital Adjustment Calculation

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- ❑ Chuck is the Leader of Empire’s ESOP Advisory Practice. He specializes in transactional consulting services, including fairness opinions, business succession planning, mergers and acquisitions, ESOP feasibility and transaction structuring, ESOP transaction quarterbacking, assistance in sourcing financing, and other financial advisory consulting services. Chuck has assisted hundreds of companies ranging in size from 10 million to over half a billion in sales revenues.
- ❑ For over 30 years, Chuck has provided business valuations of privately held companies in various industries. He is a frequent speaker at ESOP conferences nationwide. He regularly presents ESOP valuation and feasibility topics and how an ESOP can be an effective exit planning tool for owners of closely held businesses.
- ❑ Chuck is the Past Chairman of the Valuation Advisory Committee (“VAC”) of The ESOP Association (“TEA”) and is a member of the National Center for Employee Ownership (“NCEO”).
- ❑ Chuck has spearheaded industry best practice initiatives, including a recent survey on the valuation community’s approach to repurchase obligations.

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- Tabitha is an attorney, shareholder and directors at **Devine, Millimet & Branch, P.A.**, with a national practice focused on Employee Stock Ownership Plans (ESOPs) as succession and employee compensation strategies. In addition to counseling clients regarding transactional, compliance and fiduciary issues with respect to their ESOPs, she has represented companies, sellers and internal and external trustees in ESOP transactions ranging from under a million dollars to over four hundred million dollars. She is a frequent speaker at ESOP conferences nationwide and presents regularly on how ESOPs can be an effective exit or transition planning tool for owners of closely held businesses.
- Tabitha serves as a director of the Vermont Employee Ownership Center (VEOC), is an active member of The ESOP Association and the National Center for Employee Ownership (NCEO) and serves on the Board of Trustees for the Employee Ownership Foundation.

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