Strategic Exit & Liquidity Options:

Employee Stock Ownership Plans

CCG Advisors can help business owners to explore this strategic option and manage the implementation of an ESOP to ensure that the seller gets the highest possible price, the most competitive financing and the most flexible structure available in the marketplace.

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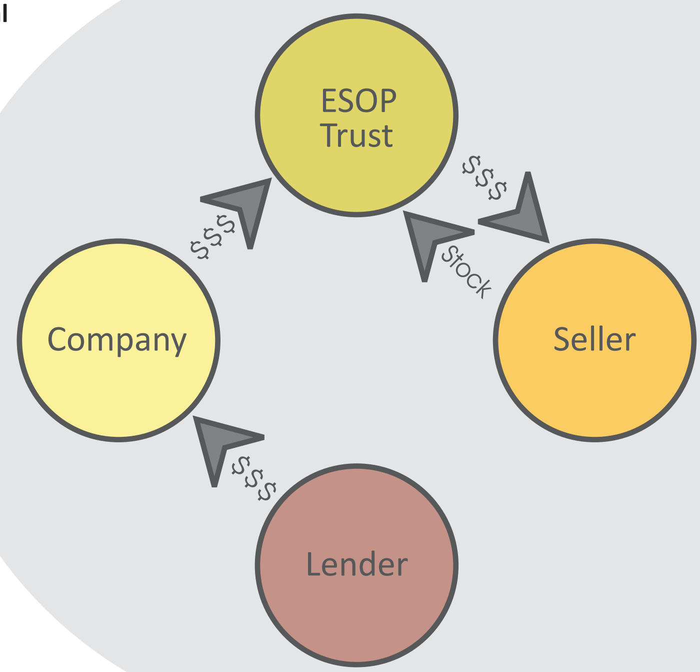
In a 2011 study, a very high percentage of companies, 92.21%, declared that creating employee ownership through an ESOP was "a good decision that has helped the company."

Employee Stock Ownership Plans (ESOPs) are just one of several options available to owners of privately held companies to create a liquidity event or exit strategy. The implementation of an ESOP enables business owners to achieve liquidity and diversification from their company in a tax-advantaged manner through the creation of a retirement plan benefitting company employees. An ESOP allows the selling shareholder to get full, fair market value for any ownership interests in the business which are sold, yet maintain control of the company if they desire. The ESOP can provide a vehicle to both reward and incent employees with real ownership in the company. There are also great tax benefits to the selling shareholders, the company and the employee participants depending upon how the plan is designed.



Frequently Asked Questions

What is an Employee Stock Ownership Plan?

An ESOP is a qualified retirement plan that acquires shares from the owners of the sponsor company. This retirement plan creates a pool of ownership for qualified employees of the company and a vehicle for selling shareholders to receive liquidity for their ownership. Many times, an ESOP is an ideal way for business owners to achieve diversification of their net worth. As the business gets larger and they get nearer to retirement age, an ESOP may allow them to reduce their personal reliance on the business in terms of retirement and estate planning. Congress has granted unique tax incentives to ESOPs in order to encourage employee ownership.

How is an ESOP created?

The process is straightforward. First, an ESOP trust is created and a trustee is appointed. Valuation must be negotiated and established to ensure an arm's length transaction for the employees and fair market value for the sellers. Once the price per share and the number of shares to be sold has been established, the company typically seeks financing for some or all of the purchase price from a lender and in turn lends those funds to the ESOP trust. The ESOP uses these funds to acquire shares from the selling shareholders. The selling shareholder can sell all or any portion of his or her interests on a personally tailored timetable with certain thresholds required for tax benefits.

How does an ESOP work once it is in place?

Each year the company will make an annual contribution to the ESOP trust. The contributions are allocated to individual employee accounts within the trust. The business owner can design the formula for allocation when the ESOP is created with contributions being allocated in proportion to compensation, years of service, or some combination of the two. Employees become entitled to an increasing percentage of their accounts over time - a process called "vesting". Employees will receive the vested portion of their accounts at termination, disability, death, or retirement. Any shares that are not vested will be reallocated to the remaining plan participants.

What are the tax benefits of an ESOP?

In order to encourage employee ownership and create a unique corporate finance tool, Congress has put in place tax incentives to encourage creation of ESOPs. The tax advantages available differ based on whether the company is a C Corporation or S Corporation, although both types are eligible to implement an ESOP. First, the company's annual contributions to the ESOP trust are tax deductible. Second, in a C Corporation, the selling shareholder can defer taxes on the gain from the sale of his or her stock to the ESOP trust and, if designed properly, never recognize the gain via a 1042 rollover. Third, in a C Corporation, the Company can take a tax deduction for cash dividends paid to employees from ESOP stock.

Alternatively, S Corporations are entitled to other, unique tax benefits - primarily that any shares owned by the ESOP are no longer subject to taxation. The company will derive enormous tax savings that assist in the repayment of both bank financing and seller financing since S corporation shares owned by the ESOP are tax exempt.

What does "leveraged ESOP" mean?

In a leveraged ESOP, the company borrows funds from a lender which the company then lends to the ESOP, taking back a note from the ESOP. The ESOP uses the cash to buy the shares being sold by the owner(s). At least 70 percent of ESOP companies are leveraged, meaning they used borrowed funds to invest in ownership interests. It is this leverage that provides cash at closing to the selling shareholders, allowing them to achieve the liquidity and diversification they desire. Any amounts that cannot be borrowed from a third party lender can be financed by the selling shareholder at attractive returns subject to being subordinated to the lender.

What's in it for me as the owner of the company?

One of the most popular uses for an ESOP is to create a liquid market for some or all of the shares held by the company owners. With an ESOP in place, shareholders have a surefire exit plan - to sell their shares to the ESOP for full, fair market value when the time is right for them. The tax benefits to the seller can make this transaction very appealing in terms of the increased net proceeds versus selling to a strategic or private equity buyer and paying full tax rates at the time of sale with no offsetting personal or company deductions. Additionally, the selling shareholder is not required to sell a controlling or majority interest in the company, which enables absolute flexibility for the selling shareholder to sell all or part of his or her ownership interest on a tailor-made schedule that suits the owner's personal, business and professional goals. Finally, through an ESOP, the selling shareholder can maintain as much or as little control over the management of the company as he or she desires.

At A Glance: ESOP Benefits

- Selling shareholders receive full, fair market value
- Can sell only minority interest, if desired
- Receive cash at closing
- Friendly buyer
- Maintain management control
- Reward and incentivize employees
- Permanently defer capital gain taxes on sale
- Typically quicker than a third party sale or recapitalization
- Due diligence less disruptive
- Maintain complete confidentiality of business practices and trade secrets
- Purchase price remains stable through negotiation
- Holdbacks, earnouts and indemnity claims are less common

How do I know if my company is a good candidate for an ESOP?

An ESOP is a suitable strategic plan for a broad range of companies across many lines of industry. Stable revenue streams, strong cash flows, unlevered balance sheets and a capable management team are all factors that point toward the success of an ESOP. Often an ESOP is an excellent solution for an owner ready to retire in an industry without ready buyers, or for the owner who wants to see their legacy continue and the corporate culture they've built to remain intact. Finally, owners who are particularly interested in rewarding and incentivizing long-term, loyal employees often appreciate the ability to do so through an ESOP.

How will an ESOP benefit my employees?

An ESOP works as a retirement plan for employees. Allocations to employees' accounts are not taxable until the employee takes distributions from the account, creating a tremendous tax savings for employee participants during their working careers. Distributions can be made in the form of cash or stock and employees have the option to take a lump sum or receive distributions in installments, typically over a five year period. Studies show that the retirement assets of ESOP participants exceed those of comparable employees at non-ESOP companies by three times.

Can an S Corporation Adopt an ESOP?

One of the most common misconceptions about ESOPs is that they are only available for C Corporations. In fact, since 1998, **S Corporations are also permitted to be shareholders of an ESOP**, although with some additional restrictions and limitations. Further, any shares of the ESOP which are owned by an S Corporation will no longer be subject to federal income taxes.

Do all my employees have to participate?

Not necessarily. There are eligibility requirements in all qualified retirement plans. However, the IRS requires that the ESOP must cover a substantial percentage of non-highly compensated employees for non-discrimination purposes. Upon formation, the retiring owner can specify eligibility and allocation rules, based often on tenure of service or compensation level. ESOPs, like all qualified retirement plans, are subject to the non-discrimination rules of ERISA (Employee Retirement Income Security Act of 1974).

Do I have to share sensitive corporate information with my employees?

No. Employees are simply participants in the ESOP, which is a retirement plan that owns shares in the company rather than publicly traded stocks, bonds and mutual funds. The only party that has a right to corporate information in an ESOP is technically the trustee of the ESOP, a professional ESOP administrator or other party selected by the business owner to oversee the ESOP on behalf of the employees. The trustee is required to act for the exclusive benefit of all participants. Employee participants are entitled to an annual statement detailing the number of and fair market value of the shares allocated to their employee account. However, employee participants are neither required nor entitled to be involved in management decisions by virtue of their participation nor are they entitled to review the books and records of the company.

Will it be good for business?

Upon the creation of an ESOP, the sponsoring company receives tax incentives as well. The ESOP trust is permitted to repay acquisition loans with pre-tax dollars. Also, in C Corporations, dividends on ESOP stock are tax deductible when used to repay the ESOP loan. The tax savings from utilization of an ESOP can increase cash flow which in turn can be reinvested in the business once the any leverage has been repaid. Numerous studies have shown that companies adopting ESOPs realized increased levels of sales, profitability and increased morale as well as lower levels of layoffs in economic downturns than their non-ESOP counterparts.

Tax Advantages of an ESOP

For the selling shareholder:

- All state and federal capital gains taxes from the sale of shares to the ESOP trust can be deferred

For the ESOP trust:

- Loans for the acquisition of shares may be repaid with pre-tax dollars

For the company:

- Annual contributions to the ESOP trust are tax deductible
- Cash dividends paid to employees from ESOP stock are tax deductible
- Dividends on ESOP stock are tax deductible when used to repay the ESOP loan
- Shares owned by S Corporation ESOPs are exempt from income tax going forward

For the employee participants:

- Allocations to employee accounts are not taxable until the employee takes distributions
- Real ownership and retirement benefit which does not require any contribution by the employee

What is CCG's experience with ESOPs?

ESOPs are one of several exit strategy options that CCG Advisors can help you explore and execute. At CCG, we feel it is vital to offer all of the potential shareholder liquidity or exit strategy alternatives so that our clients can knowingly choose the strategy that accomplishes their goals most effectively. We have advised numerous companies on evaluating ESOP options and have direct experience with the implementation of ESOPs. We also maintain a network of specialist ESOP advisors, including attorneys, accountants, valuation firms, specialized ESOP lenders and wealth advisors, to help you assemble a best in class team for your transaction.

CCG Advisors' experienced professionals help privately held companies to implement an ESOP, in cooperation with the company's trusted advisors. We quarterback the process, focusing on garnering the highest valuation and the most favorable financing.

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