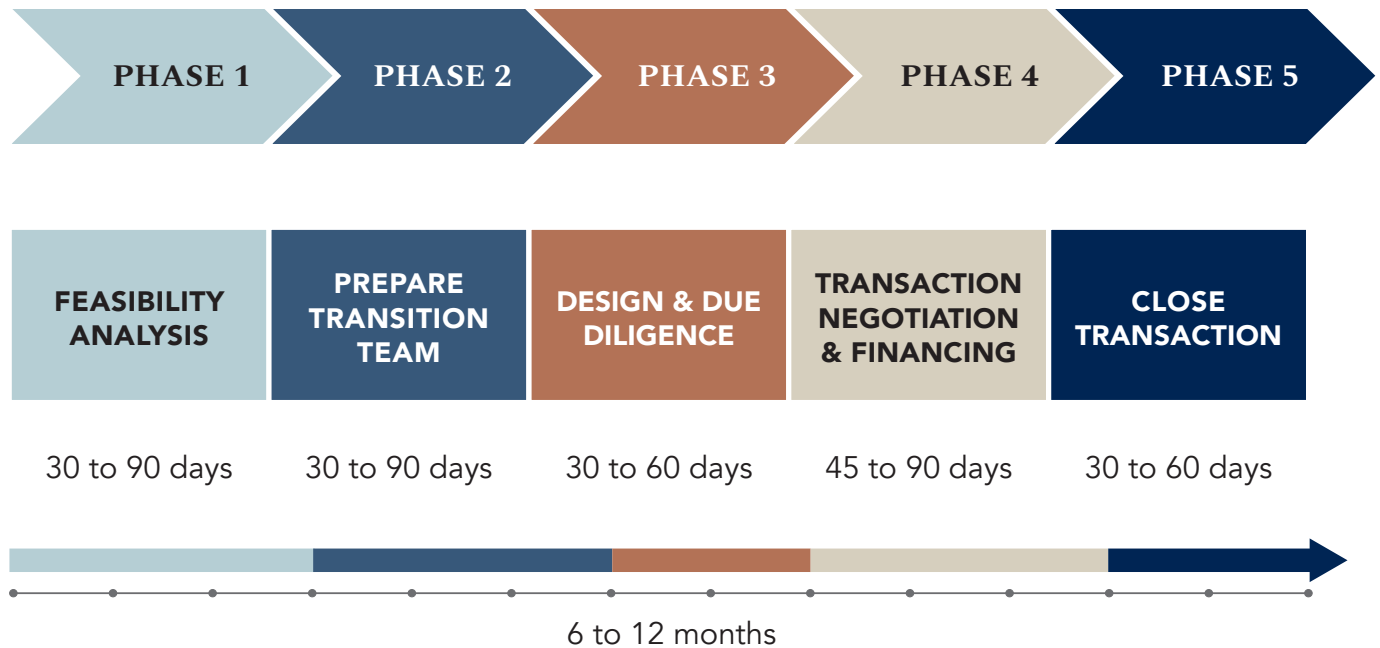




ESOP Roadmap: from Feasibility to Transaction



Typical Timeline of ESOPs Transaction



Introduction

OVERVIEW OF EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs)

An Employee Stock Ownership Plan (ESOP) is a qualified retirement plan designed to invest primarily in the employer's securities, giving employees an ownership stake in the company. ESOPs are unique among retirement plans because they are both a tool for retirement savings and a corporate finance strategy. They are defined contribution plans, similar to profit-sharing plans, and must comply with the regulatory requirements set forth by the Internal Revenue Code (IRC) and the Employee Retirement Income Security Act of 1974 (ERISA). Compliance with ERISA involves adhering to specific standards for participation, vesting, fiduciary responsibilities, and funding, ensuring that the interests of the employees are protected.

ESOPs are widely adopted in the United States, with approximately 7,000 ESOPs in place covering 13.5 million employees¹. These plans are prevalent across various industries, although the majority are found in privately held companies. A significant portion of ESOPs are leveraged, meaning they use borrowed funds to acquire employer securities. According to the National Center for Employee Ownership (NCEO), companies with ESOPs often experience higher growth rates, with employee ownership firms practicing participative management growing 8% to 11% faster than they would without such plans². Additionally, many ESOP companies appear on Fortune Magazine's "100 Best Companies to Work for in America" list, reflecting the positive impact of employee ownership on workplace culture and performance³.

"...with approximately 7,000 ESOPs in place covering 13.5 million employees."



Source:¹<https://www.esoppartners.com/news/ses-environmental-completes-sale-to-employee-stock-ownership-plan-esop#:~:text=According%20to%20the%20National%20Center%20for%20Employee%20Ownership,place%20in%20the%20U.S.%2C%20covering%2013.5%20million%20employees.>²<https://www.esop.org/#:~:text=Companies%20that%20combine%20employee%20ownership%20with%20employee%20workplace,ownership%20plans%20than%20they%20would%20have%20without%20them.>³<https://www.nceo.org/employee-ownership-blog/fifty-nine-percent-2020-100-best-companies-work-have-employee-ownership>

Key Features of ESOPs

TAX ADVANTAGES: ESOPs can serve as significant tax-saving tools, allowing for the deferral or elimination of taxes on the sale proceeds. Through IRS Section 1042, business owners can defer capital gains taxes if they reinvest the sale proceeds into **Qualified Replacement Property (QRP)** within a specific timeframe. This deferral can potentially avoid taxes entirely if the QRP is held until death, benefiting from a step-up in basis. This step-up in basis means that the heirs will inherit the property at its current market value, potentially avoiding capital gains taxes altogether.

ENHANCED CASH FLOW: For S-Corporations, the income attributable to the ESOP is not subject to federal income taxes (and most state taxes), improving cash flow and providing the company with a competitive advantage.

EMPLOYEE INCENTIVES: ESOPs align the interests of employees and shareholders, often leading to increased productivity and growth.

LEGACY AND COMMUNITY IMPACT: Selling to an ESOP helps maintain local jobs and preserves the company's legacy, offering stability and benefits to the community.



Five Transition Phases

Phase 1: Feasibility Analysis

OBJECTIVE: Assess the viability of transitioning to an ESOP.

KEY STEPS:

1. Document Collection

- Designated contacts will have access to a secure online portal

2. Develop Financial Forecast

- Foundation of the study, including a 10-year pro forma

3. Initial Feasibility Modeling

- Overlay ESOP and analyze impact on stakeholders

4. Review Additional Scenarios

- Stress testing and scenario analysis until a decision point is reached

5. Comprehensive Feasibility Report

- Pro Forma Management Forecast with ESOP expansion (10 years)
- ESOP Transaction Price Computations
- Total ESOP After-tax Payments
- Projected Enterprise & ESOP Equity Value
- Projected Loan Payments, Release of Shares and Participant Allocations

6. Additional Factors

- ESOP contribution limits
- Relationship with other qualified retirement plans (e.g., 401(k))
- Current company status (LLC, C, or S-Corp.)

7. Educational Support

- Single point of contact for stakeholders
- Clear explanations of complex ESOP issues

RESULT: Comprehensive feasibility report with a clear go/no-go decision point.

PHASE 1

PHASE 2

PHASE 3

PHASE 4

PHASE 5



Phase 2: Prepare Transition Team

OBJECTIVE:

Organize and prepare the internal team for the ESOP transition.

KEY STEPS:

1. **Identify and hire necessary professionals**
(ERISA attorney, ESOP advisors, etc.)
2. **Educate management and key stakeholders**
3. **Plan internal and external communications**

RESULT:

A well-prepared team ready to execute the ESOP transition.



Phase 3: Design & Due Diligence

OBJECTIVE:

Create a detailed ESOP design and conduct thorough due diligence.

KEY STEPS:

1. **Plan design, including vesting, distributions, and accounting considerations**
2. **Conduct due diligence, including buy-side and sell-side evaluations**
3. **Regular regroup meetings with all professionals involved**

RESULT:

Detailed ESOP plan design and completion of due diligence.



Phase 4: Transaction Negotiation & Financing

OBJECTIVE:

Negotiate transaction terms and secure necessary financing.

KEY STEPS:

1. Represent the seller in negotiations until terms are agreed upon
2. Educate and present findings to banks for financing
3. Finalize sale-ready management forecast and banking documents

RESULT:

Agreed-upon transaction terms and secured financing.

Phase 5: Close Transaction

OBJECTIVE:

Finalize and execute the ESOP transaction.

KEY STEPS:

1. Execute sale documents and transition to ESOP
2. Ensure timely execution of the plan
3. Post-transaction administrative orientation and setup

RESULT:

Successful transition to an ESOP and ongoing support.



Archford Can Help You To AND Through Your ESOP Transaction



MAXIMIZING PROCEEDS & ENSURING LONG-TERM SUCCESS

Archford focuses on maximizing proceeds for the seller while ensuring the long-term success of the ESOP post-transaction. This dual focus helps balance immediate financial benefit potential with sustainable growth and stability.



COMPREHENSIVE WEALTH & TAX PLANNING

Unlike a purely transactional approach, Archford offers comprehensive wealth and tax planning for the seller, including long-term generational planning. This holistic strategy aims to ensure the seller's financial future is secure and optimized.



STRONG BANKING RELATIONSHIPS

Archford has deep relationships with numerous banking partners, allowing them the opportunity to secure the best financing available at the time for both the seller and the ESOP. This includes pursuing the best terms across multiple banking relationships and minimizing seller financing requirements.



EXPERT ESOP PARTNERSHIPS

Archford maintains strong partnerships with ESOP advisors, Trustees, legal advisors, and other professionals throughout the entire ESOP cycle. These relationships ensure that every aspect of the ESOP transaction is handled with experience and precision.



LONG-TERM CLIENT RELATIONSHIP MANAGEMENT

Archford works closely with sellers to develop personalized plans addressing charitable giving, education funding, retirement planning, and generational wealth transfer. By maintaining close relationships, we provide continuous guidance, helping sellers achieve peace of mind and ensure financial success post-transaction.

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