Feasibility and preparation for doing an ESOP

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Managing Director, Investment Banking, Menke & Associates, Inc.

- Last 17 years – senior East Coast partner of Menke & Associates, focusing on ownership transitions through ESOPs. Assisted over 250 companies in designing, adopting and selling shares to new ESOPs.
- Previously 14 years as director of mergers & acquisitions investment banking for Morgan Stanley and Salomon Smith Barney.
- Previously two year as a research process engineer focusing on chemical plant scale ups at the Rohm & Haas.
- Chemical Engineering from the University of Delaware.
- MBA in Finance from UCLA.
- Board member - Boy Scouts of America, Del-Mar-Va Council.
- Board member - Delaware American Heart Association.
- Board member - Delaware Safety Council
- Board member - Global Algae Innovations, Inc.
- Board member - NY/NJ Employee Ownership Center.
- Board member - St Hubert High School for Girls, Philadelphia.
- ESOP speaker - ESOP Association, NCEO & CPA Academy.

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Menke & Associates, Inc.

| Oldest & largest ESOP Advisor | • 47 years in the business,  
|                              | • 50 dedicated ESOP specialists; including  
|                              | • 7 lawyers, 7 investment bankers; 20 recordkeepers |
| Most ESOPs Created           | • Over 3,500 |
| Largest Current Number of ESOP Clients | • 1,000+ clients |
| Most Sophisticated Online ESOP Administration | • $4 mm investment |
| ESOP Owned                   | • Menke is 70% ESOP owned |
Agenda

1. Feasibility of an ESOP
2. Preparation for an ESOP process & closing due diligence process
1 Feasibility of an ESOP
Who should consider an ESOP?

Private company shareholder(s) who are:

- looking to sell the company.
- looking to only sell some shares now and maybe more later on.
- buying one shareholder’s shares while others do not sell.
- looking to diversify net worth but want to keep working.
- looking for ways to enhance employee productivity.
Therefore, typical ESOP structures include:

1. ESOP + one owner/operator in control
2. ESOP + “partnership”
3. ESOP + numerous outside private S/H’s
4. ESOP + family owned business
5. ESOP + special/minority status business
6. 100% ESOP
7. ESOP followed by 100% sale to 3rd party
How to pay for the ESOP

• Are you already funding something similar?
  – 401(k) match
  – 401(k) profit sharing plan
  – 401(k) Safe Harbor contributions
  – Broad-based cash bonus plan

• Other funding sources for an ESOP
  – C corporation dividends
  – S corporation distributions
Typical Retirement Benefits with ESOP

**401(k)**
- 401(k) program typically continues.
- Employee can defer personal taxes by making payroll deductions to your 401(k).
- Matching usually stops.
  Safe Harbor contributions flow to ESOP

**ESOP**
- Employee contributes nothing.
- Contributions are funded by the Company.
- Employee ESOP shares receive allocations of company earnings.
- Appreciation in company value shared by eligible employees.
## Combination of programs

### You can start your ESOP this year!

<table>
<thead>
<tr>
<th>Program</th>
<th>Compatible with ESOP?</th>
<th>Typical Recommendation</th>
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<tbody>
<tr>
<td>PSP or SEP</td>
<td>Yes</td>
<td>But, typically replaced by ESOP</td>
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<tr>
<td>401k Match</td>
<td>Yes</td>
<td>Company match stops or lessened</td>
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<tr>
<td>401k Safe Harbor</td>
<td>Yes</td>
<td>But, ESOPs qualify for safe harbors too!</td>
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<td>But, safe harbor $ to ESOP starts next year (30 day notice)</td>
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Good ESOP candidates

- Owners need an exit or desire some liquidity
- Succession management team is or will be in place
- Profitable – strong cash flow
- ESOP valuation acceptable to owners
- Company is large enough to warrant installation and maintenance expense (approximately 15 employees & $200,000 of pretax income)
- Owners seek to increase employee productivity
Scenarios where ESOPs may not work well

- Doctor & dental practices, CPA firms – depending on state licensing requirements, non-licensed professionals may not be able to own shares
- Certain franchised businesses
- Real estate or insurance agencies – if agents are “independent” and not W-2 employees
- Minority-status businesses – ESOP is counted as a non-minority shareholder; limits ESOP to 49%
- Unprofitable businesses
ESOPs span all non-governmental industries
Employee count within private ESOP companies

Source: ESOP Association 2015 Survey

Number of employees in privately held businesses with an ESOP

- Over 1,000: 16.9%
- 500-999: 10.2%
- 240-499: 14.3%
- 100-249: 29.2%
- 50-99: 22.4%
- 10-49: 6.9%
- 25-249: 14.3%
- 500-999: 10.2%
- Over 1,000: 16.9%
Liquidity for shareholders
(While Still Running Their Business!)

- Many times significant portion of owner’s wealth tied up in company stock
- Owners can sell all or part of their shares
- Can spread sale of shares over years
- Can keep some shares, even after retirement
- Many times selling the entire company to a third party is not possible, but this option does not come off the table after the ESOP is started
ESOP stock ownership of private companies - No requirement to sell a certain percent

<table>
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<tr>
<th>Percent of each private company owned by its ESOP</th>
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<tbody>
<tr>
<td>0-10%</td>
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<table>
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<th>Percent of 11,000 private ESOP companies</th>
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<tr>
<td>20%</td>
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Over 2,500 U.S. businesses are owned 100% by their ESOP!
Sale of business not an option

- No third party buyer at this time or offers not acceptable (2018 SBA estimated that 80% of private companies brought to market were NOT sold).
- Owner may lose his/her job
- Additional employees may lose their jobs
- Loss of control
- Loss of stock price upside
- Loss of legacy
- Sale process is expensive, complicated, exhaustive due diligence process, long process, low probability of success
Agenda

1. Feasibility of doing an ESOP
2. Preparation for an ESOP process & closing due diligence process
Presenter – Robert Friedman
CFO and Director, Bamco, Inc. 100% S Corp owned ESOP

- Last 19 years – CFO, board member and former shareholder at Bamco, Inc. a leading provider of architectural facades and metal wall panel systems (Middlesex NJ). Robert led the Company through the process to become a 100% employee owned S Corp ESOP in 2018.
- Robert is both a CPA and CFP. Previous 18 years experience in public accounting firms serving primarily privately held family and closely held SMB clients in a diverse mix of industries.
- Expertise in finance, reporting, audits, taxes and use of various sophisticated strategies capitalizing on opportunities
- Focus on strategies to grow and rebuild organizations, align resources and increase shareholder value
- BBA Accounting – University of Miami
- Certificate in Financial Planning – New York University
- Nominated 2x for CFO of the Year in prior NJBIZ competitions
- Member of AICPA, ESOP Association, NCEO and CFMA

RF@GoBamco.com
Bamco, Inc.

A 100% Employee Owned Company

BAMCO Inc., a construction and manufacturing Company located in Middlesex, NJ is a regional leader in the design, fabrication and installation of architectural facades and metal wall panel systems. We design, fabricate and install state-of-the-art architectural facades for commercial, institutional, educational, manufacturing and residential projects. With over 35 years of experience in exterior facades, our expansive resources and knowledge make your project a success. The Company has 150 Full Time employees and became 100% employee owned in 2018.

Rutgers Chemistry Building
Overview of Bamco’s ESOP Process

- **Part 1: Preliminary Appraisal/Feasibility Study**
- **Part 2: Moving Forward/Due Diligence & Closing**
  - **Step 1:** BOD approval to move forward – hire banker
  - **Step 2:** BOD selects ESOP trustee and team (appraiser and counsel)
  - **Step 3:** Trustee due diligence
  - **Step 4:** Negotiate and sign a term sheet
  - **Step 5:** Legal due diligence & contracts
  - **Step 6:** Final Documents & closing the deal
1 Preliminary Appraisal/Feasibility Study
Step 1

• Feasibility study/preliminary appraisal for the seller/company’s use
  – Engage an ESOP Advisor/Investment Banker (i.e.; Menke)
  – Questions & Answers
  – Offer price – preliminary appraisal – range of business value
  – Talked about transaction structure
  – How will it effect our Culture today and in the future?
  – Management – who will run the business going forward?
  – Use financial models to help understand and fund/manage cash flow (not only paying for stock, but also funding participant distributions)
  – ESOP design and other employee benefits
Preparation and Due Diligence

Several Layers of Due Diligence in Sequence – some overlapping

• Prepared by Company and coordinated with
  – ESOP Advisor/Banker – feasibility/appraisal of business value all the way through closing the deal (month 1)
  – Trustee – (starts month 2)
  – Appraiser – (starts month 3)
  – Legal Team – (starts month 4)

• Interact with all and address inquiries
Step 1

Feasibility Study and More

• ESOP Advisor/Investment Banker Due Diligence:

• Business information including:
  – Overview of the Business
  – Review of Challenges, Goals and Objectives
  – History of the Company & Organizational Structure
  – Reliable Financial Information – 5 years historical, budgeted and forecasted – start with CPA audited/reviewed financial statements

• Banker’s financial model helps you plan/better understand ESOP finances, cash flows using what ifs to see possibilities for the future!
Preparation for an ESOP process & closing due diligence process
Step 2

- Moving Forward – Hire Investment Banker (ESOP advisor) and Get the Company Ready
  - Review financials – dig in and clean up the numbers!
    - Adjust to get to normalized cash flows (EBITDA) – adding back items like interest, taxes, depreciation & unusual non-recurring
  - Review relationships – customers, vendors, banking, professional – are there any dependencies?
  - Employees/Org Chart – bench strength and talent?
  - Customers - A/R and any bad debts
  - Vendors/Suppliers – Purchasing and Inventories
  - Legal & Compliance – review
  - More
Step 3

Board Hires the ESOP Trustee

- ESOP Trustee (Fiduciary) represents the shareholders – will negotiate the deal on their behalf

- ESOP Trustee hires a team
  - Attorney/Counsel
  - Independent Valuation Consultant – Appraise the business

- Company hires its own team (if desired)
  - ESOP Counsel
  - Independent Valuation Consultant
  - Others – as needed (CPAs, more)
Step 4

Start the Due Diligence Process

- Abbreviated – Detailed Checklist Provided by the Trustee
- More Company History & Information
- Review of markets, competitors, pricing, strategies
- Provide Copies of Documents
  - Corporate – articles of incorp, minutes, Bylaws, stock records, agreements and other instruments
  - Tax & Financial Matters
  - Note: this is *not as deep a dive when compared to a sale to Private Equity or a Strategic Buyer*
Step 5
Negotiate and Sign a Term Sheet

- Between the Trustee, Company and Sellers
- Layout Key Terms and Deal Structure
  - Transaction Description
  - Financing
  - Proposed Closing Date
  - Conditions Precedent, Reps & Warranties
  - Due Diligence Review
- All parties sign – then begin next step towards closing
Step 6

Line up Bank Financing (if any)

- To provide cash up front / with a term loan
- At Bamco, 100% Seller Notes funded the sale
- Start the process early (usually in Step 2 or 5)
• Closing due diligence and documentation
  – Largely legal – work with counsel to read & finalize documents – (too much detail to show here) – I spent over 100 hours doing this
  – Coordinated with all parties assisted by Investment Banker, Trustee and Attorney
  – Guided by a detailed Legal Checklist
  – Provide full disclosure (reps and warranties)!!!
  – ESOP Trust Documents
  – Loan documents
  – Much more
Summary and Key Takeaways

• Key Takeaways
  – Complex process – takes from 4 to 6 months with lots of questions, data gathering, analysis & coordination between the parties
  – Be ready to invest 200–400 hours in the process through closing
  – Closing process is easier than a sale to a strategic or financial buyer
  – Hire an experienced team – ESOP Banker, Trustee and others
  – Keep the deal private/confidential until you are ready to close
  – Tidy up your financial house and determine any adjustments to get to EBITDA (adjust and normalized cash flows)
  – Get ready for an exciting future as an Employee Owned Company!!!