Employee Ownership Strategies:
Building High Performance, Inclusive Companies
for the 21st Century

Rutgers School of Management and Labor Relations
NJ/NY Center for Employee Ownership

Event Partner
Santa Clara University
Certified Equity Professional Institute

ESOPS AS A TOOL FOR SUCCESSION AND GROWTH

Presented by

James Steiker

Chairman & CEO
SES Advisors, Inc./Steiker, Greenapple & Fusco, P.C.
555 City Avenue, Suite 910
Bala Cynwyd, PA 19004
Tel: (215) 508 – 5643
Email: jsteiker@sesadvisors.com

SG&F Steiker, Greenapple & Fusco, P.C. SES | ADVISORS

Agenda

- Liquidity & Succession Planning & Alternatives
- The ESOP Approach

Why Care About ESOPs?
The Problem of Liquidity and Succession

- All businesses must be sold or transferred– privately held companies have no ready market
- Current economic conditions have not eliminated need/desire for liquidity and succession
- Approach should be based on shareholder goals in the context of achievable alternatives

Common Liquidity and Succession Goals

- Maximize after-tax proceeds
- Control timing of succession and transfer
- Shareholder/officer ongoing role as executive
- Diversify personal wealth
- Legacy

Common Liquidity and Succession Concerns

- Determine/secure role or opportunities for family members in business
- Continuity of business identity and operations
- Getting free--ongoing responsibilities as executive officer
- Reward key management/employees
- Sale of enterprise without continued financial liability/responsibility

Liquidity & Succession: Alternatives

- External buyers
  - Strategic
  - Financial
  - IPO
- Internal Buyers
  - Family
  - Management
  - Partner (Redemptions & Buy-Sells)
  - ESOP
- Liquidation

Good ESOP Candidates

- Non-cyclical slow to medium growth
- Stable cash flow
- Ownership group interested in remaining involved/participating in the business
- Patient long-time horizon—not seeking immediate cash payment in full
- Ownership group concerned about employees and/or long term future of company/motivated by "legacy" or mission goals in addition to cash
- Lack of cash strategic buyers willing to pay significant premium for the company

Some Core ESOP Advantages and Disadvantages

Advantages

- Tax efficient
- Shareholder directed process
- Control over timing
- Legacy

Disadvantages

- Complex
- Regulated
- Often involve Seller notes

THE ESOP APPROACH

What is an ESOP?

- ESOP = “Employee Stock Ownership Plan”
- Qualified deferred compensation plan under ERISA and Internal Revenue Code
- Similar to Profit Sharing and 401(k) Plans
- Must invest primarily in company stock
- Can be leveraged

Typical Goals of ESOP Transactions

- Shareholder Liquidity
- Long-term succession plan
- Corporate and personal tax planning
- Ownership/Partnership incentive for key employees

Significant ESOP Tax Preferences

- Effective deduction of principal on ESOP loan repayment
- Section 1042 Capital Gains Deferral
- Deduction of dividends paid on ESOP shares
- S Corporation ESOP non-recognition of corporate income

Section 1042 Capital Gains Deferral

- Permits shareholders selling to an ESOP to defer indefinitely capital gains tax on sale of shares
- ESOP must own 30% of value of all company stock after sale
- Selling shareholders must purchase qualified replacement property (“QRP”)—stocks or bonds of any domestic operating corporation

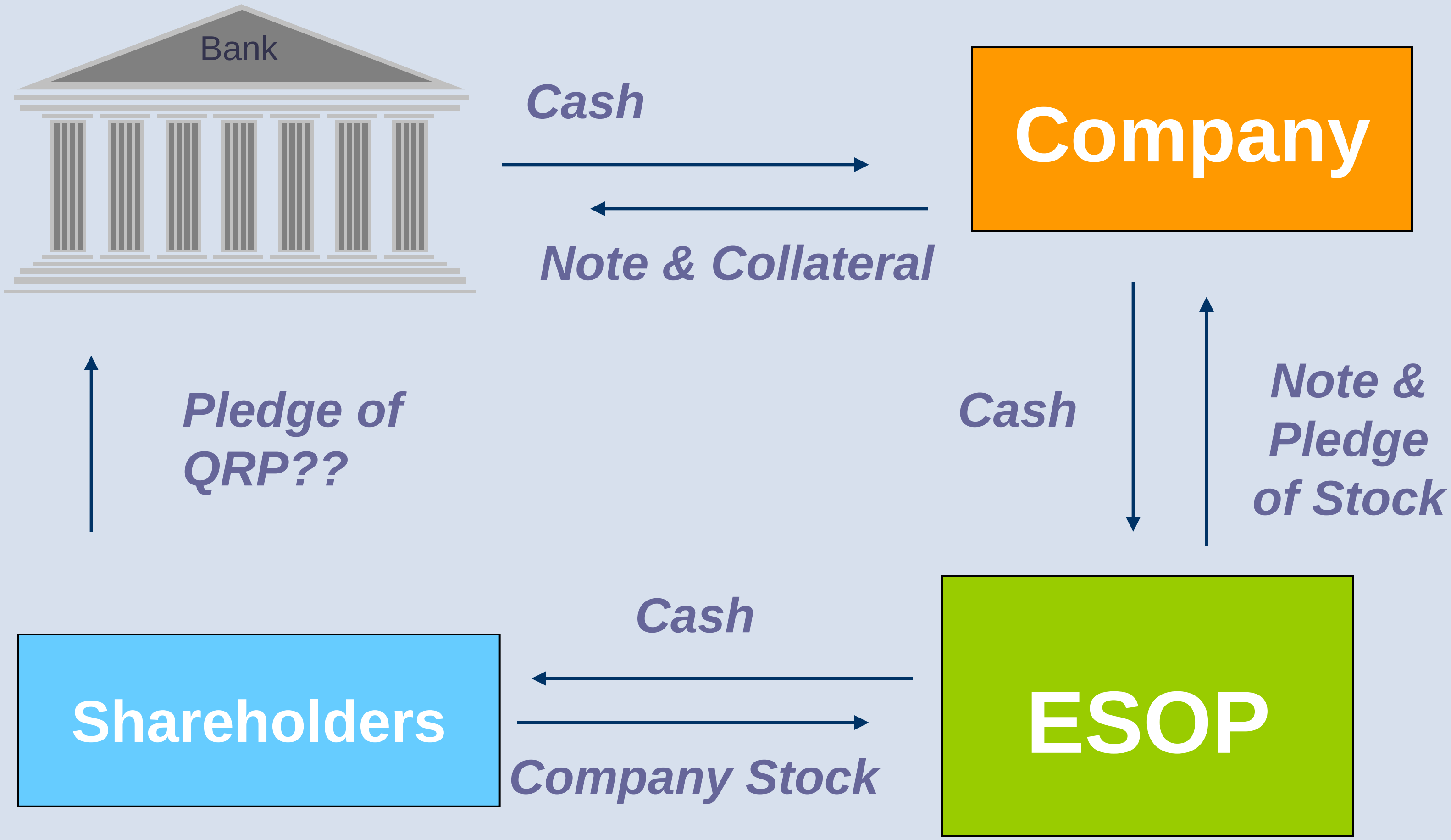
“S” Corporation ESOPs

- “S” Corporation income attributed to shareholders
- ESOP as S Corp shareholder pays no taxes on its share of corporate income
- No section 1042 Capital Gains Deferral

How Does an ESOP Work?

- Company establishes an ESOP Trust
- ESOP Trust purchases company stock from shareholders or company
- Bank or seller provides financing to Company
- Company pays contributions or dividends to ESOP that ESOP uses to repay debt
- Company or ESOP repurchases shares from employees after termination

Initial "C" Corporation ESOP Transaction



ESOP Loan Repayment

Company

Contributions or Dividends ($$$)

ESOP

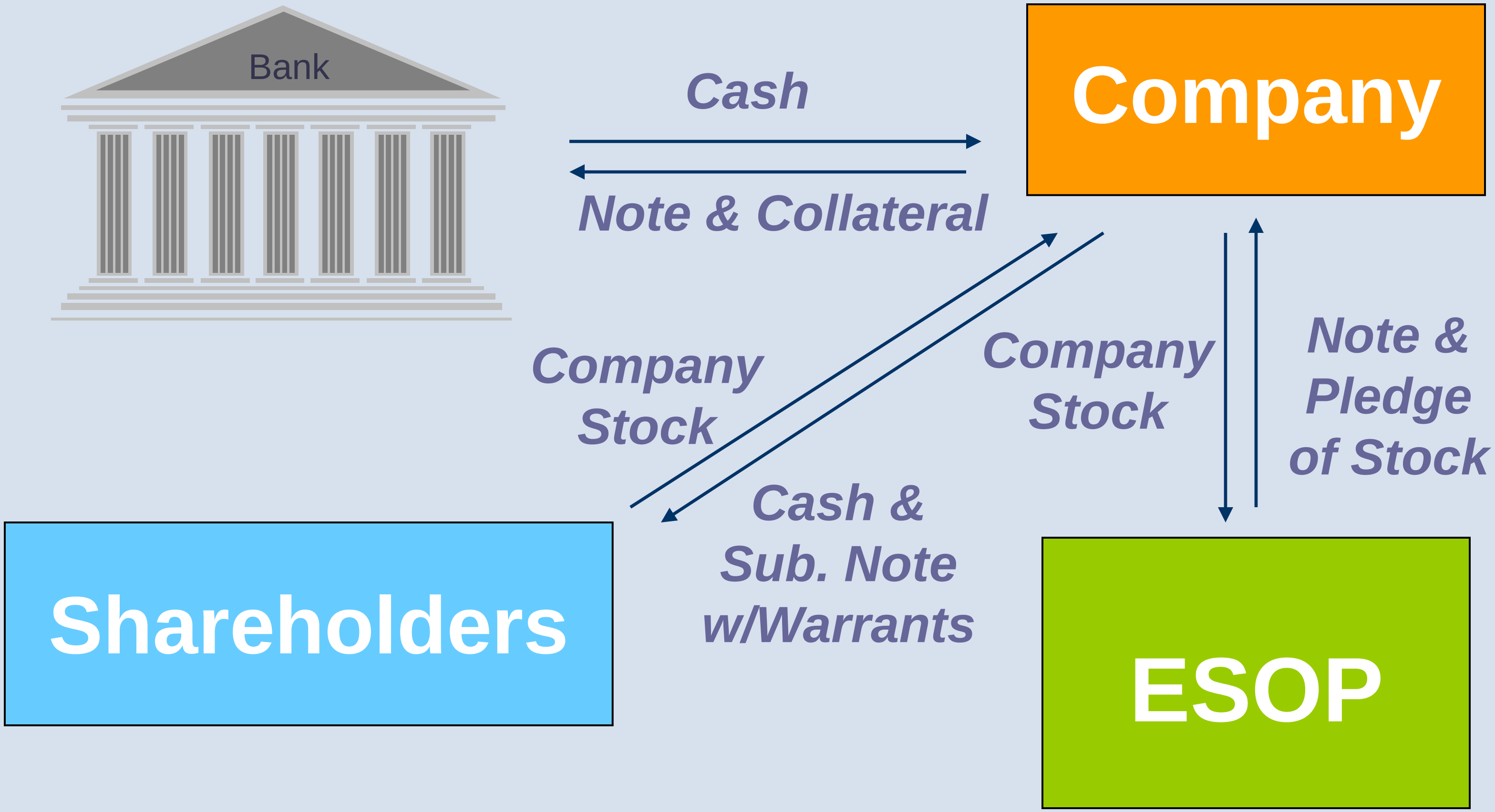
Loan Payments ($$$)

Loan Payments ($$$)

Bank and/or Shareholder

Release of Shares Pledged as Collateral and Share Allocations to Individual ESOP Accounts

Initial “S” Corporation ESOP Transaction



A Typical ESOP Transaction "Vision"

- One or more Section 1042 ESOP transactions to transfer most or all stock ownership to ESOP
- Synthetic equity (usually stock appreciation rights or phantom stock) granted to key management in second stage transaction to allow key executives to own eventually 10-20% of economic value of entity outside ESOP
- "S" Corporation ESOP election

Another Typical ESOP Transaction "Vision"

- "S" Corporation redemption of all of the stock held by current shareholders for cash and subordinated notes with warrants
- Synthetic equity (usually stock appreciation rights or phantom stock) granted to key management to allow key executives to own eventually 10-20% of economic value of entity outside ESOP
- Company uses "S" corp. tax-free operation to accelerate debt reduction

ESOP Transaction Concerns

- Valuation
- Financing
- Effect of ESOP on overall benefits structure
- Legal/fiduciary risk
- Cost and complexity

Steps in an ESOP Transaction

- Feasibility study
- Financing
- Appraisal
- Plan Design
- Legal Documents
- Closing
- IRS Determination Letter

Ongoing ESOP Items

- Annual appraisal update
- Annual recordkeeping and administration
- Repurchase obligations
- Communications training and education
- Legal compliance

SES Advisors and
Steiker, Greenapple & Croscut, P.C.

ESOP Consultants

Doug Cannon
Tina Fisher
Michael Golden
John Kintzer
Mychelle Holloway
Jane Rogers
Chuck White

SES | ADVISORS

ESOP Consulting and
Plan Record Keeping

Attorneys

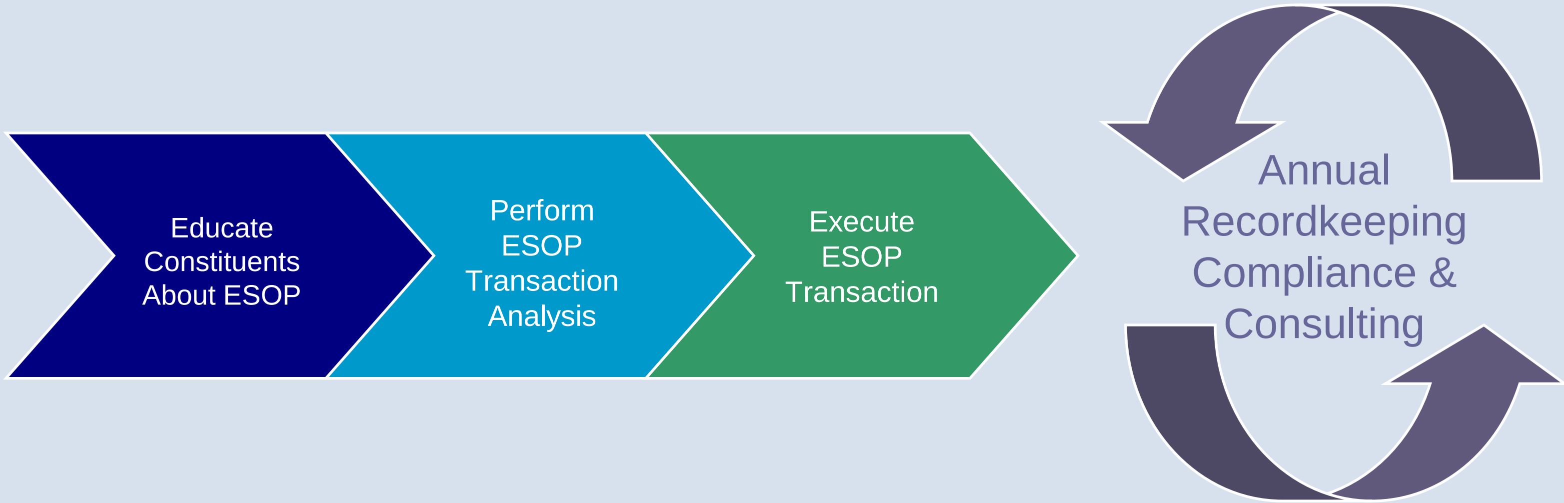
Jim. Steiker
Steve Greenapple
Paul Fusco
Terrie Borzelli
Avery Chenin

SG&C
Steiker, Greenapple, & Croscut, P.C.

ESOP Law Firm

Shareholders of SES are both SES ESOP consultants and attorneys at SG&C

SES Advisors, Inc. &
Steiker, Greenapple, & Croscut, P.C.
ESOP Service Delivery



Questions ?

James Steiker
Chairman & CEO
SES Advisors, Inc.
555 City Avenue, Suite 910
Bala Cynwyd, PA 19004
Tel: (215) 508 – 5643
Email: jsteiker@sesadvisors.com