

A black and white photograph of two hands shaking in a firm grip, symbolizing agreement or partnership. The hands are wearing white dress shirts with visible cuffs.

Business Succession Planning: Turning Goals into Reality

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Presenters



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Table of Contents



- About GBQ
- Succession Planning
 - Where to start
 - What are the options?
- ESOPs: A Savvy Business Succession Planning Alternative
 - What is an ESOP and how does it work?
 - Advantages of an ESOP
 - How to get started exploring an ESOP

Succession Planning

What is Succession Planning?

Comprehensive

- Business, personal, financial, legal and tax questions involved in transitioning a privately owned business

Contingencies

- Death
- Divorce
- Disability
- Disagreement

All-Encompassing

- Purpose: Maximize Value & Minimize Risk

Where do I start?

Define Your Goals

- Maximize Value
- Family Legacy
- Lifestyle Needs
- Reduce Risk
- Philanthropy
- Life After Business



Where do I start?

Build Your Team

Attorney

- Corporate
- Estate
- M&A

CPA

- Tax
- Financial
- M&A
- Consulting

Financial Advisor

- Financial Planning
- Lifestyle Planning
- Investment Advisory

Banker

- Covenants
- Guarantees
- Proper Capitalization



What are my options?

“Outside” Transition

- Sale to Third Party
 - Strategic Buyer
 - Private Equity
- Recapitalization
- Liquidation

“Inside” Transition

- Family Transfer
- Management Buyout
- Partner Buyout
- ESOP

Sale to Third Party/Strategic Buyer/PE

Pros:

Financial

- Higher price (generally highest of all options)
- More cash up front
- Walk away faster
- Stability of deal terms

Cons:

- Long process
- Distraction or loss of focus
- Privacy concerns
- Emotional for owner
- Complex

Family Transfer

Pros:

- Business legacy preservation
- Planned
- Lower cost
- More control
- Less disruption

Cons:

- Family dynamics
- Illiquid buyers / lack of funding
- Lower sale price
- Key employee flight risk
- Tradition may outstrip good strategy
- Path of least resistance – but not always the path to growth or success

Management/Partner Buyout

Pros:

- Business continuity
- Highly motivated buyers (pent-up desire)
- Preserves key human capital
- Planned
- Can be combined with private equity to access additional capital and resources for growth

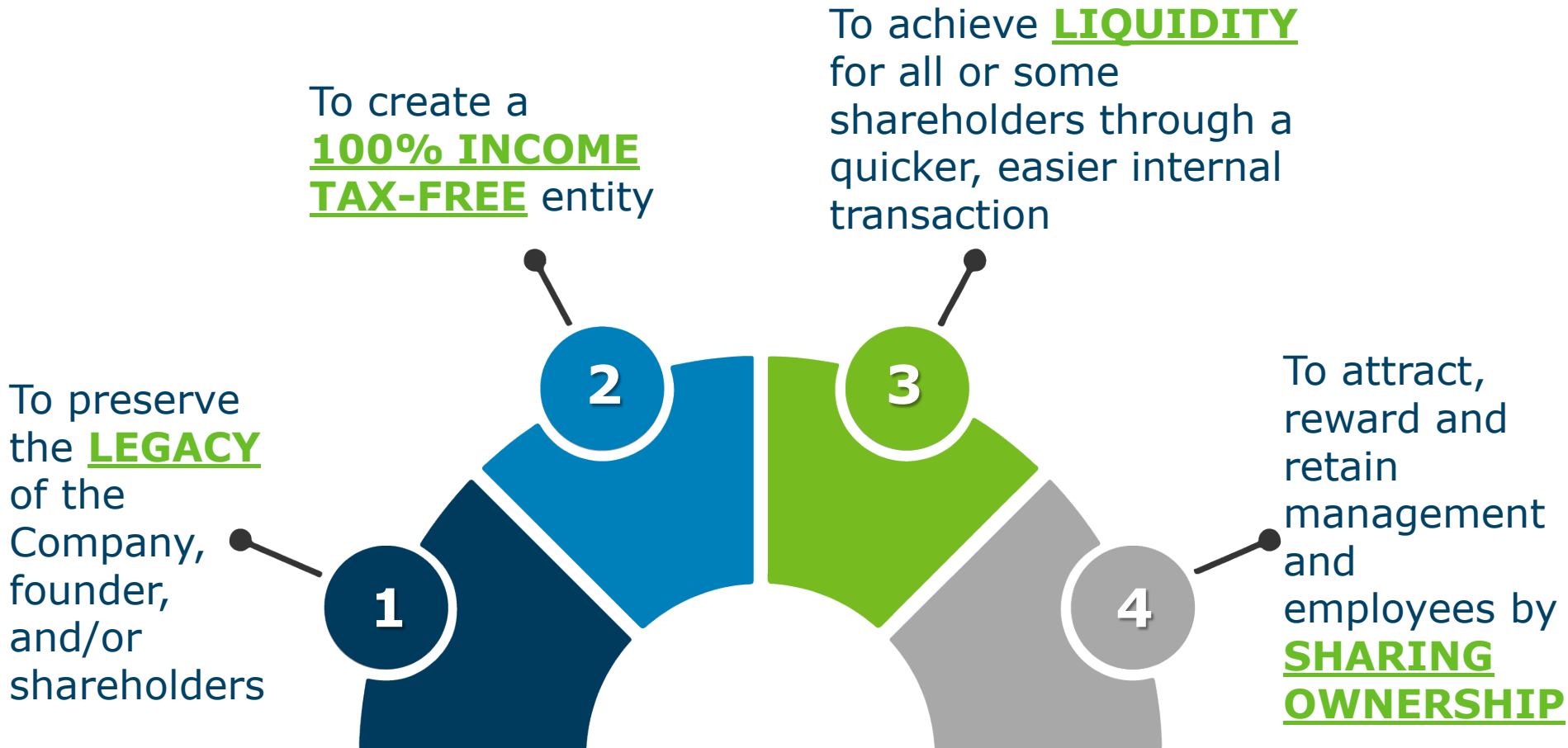
Cons:

- Distraction
- Threat of flight
- Illiquid buyers
- Lower price and generally heavy seller financing (increases risk)

ESOPs:

A Savvy Business
Succession Planning
Alternative

Top Reasons Sellers Choose an ESOP



What is an ESOP?



Ownership Liquidity Tool

Owners can gain liquidity for all or a portion of their ownership, up front or over time.



Tax-Advantaged Employee Ownership

All employees who satisfy certain criteria become beneficial owners, while the company can enjoy tremendous tax advantages not available to other forms of employee ownership.

Qualified Retirement Plan

An Employee Stock Ownership Plan ("ESOP") is a qualified retirement plan (governed under ERISA, similar to a 401k plan) that allows business owners to sell ownership to their employees.



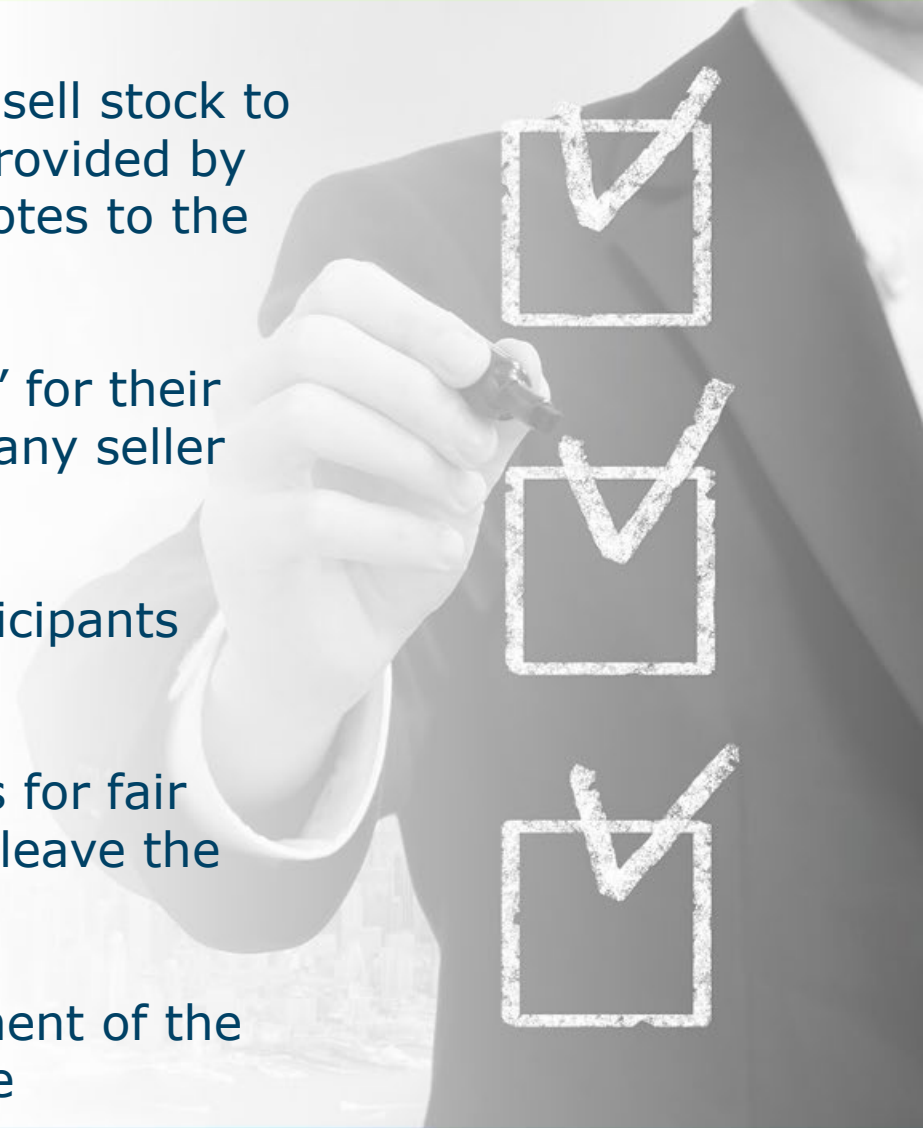
Long-term Business Succession Strategy

Company can be set up for continuous and sustainable leadership and ownership succession.



How does an ESOP Work?

- The selling shareholders typically sell stock to the ESOP in exchange for cash (provided by the company or a bank) and/or notes to the seller
- Sellers receive “fair market value” for their stock, plus a fair interest rate on any seller financing
- ESOP shares are allocated to participants (employees) over time
- Participants cash out ESOP shares for fair market value when they retire or leave the company
- Operational control and management of the company does not need to change

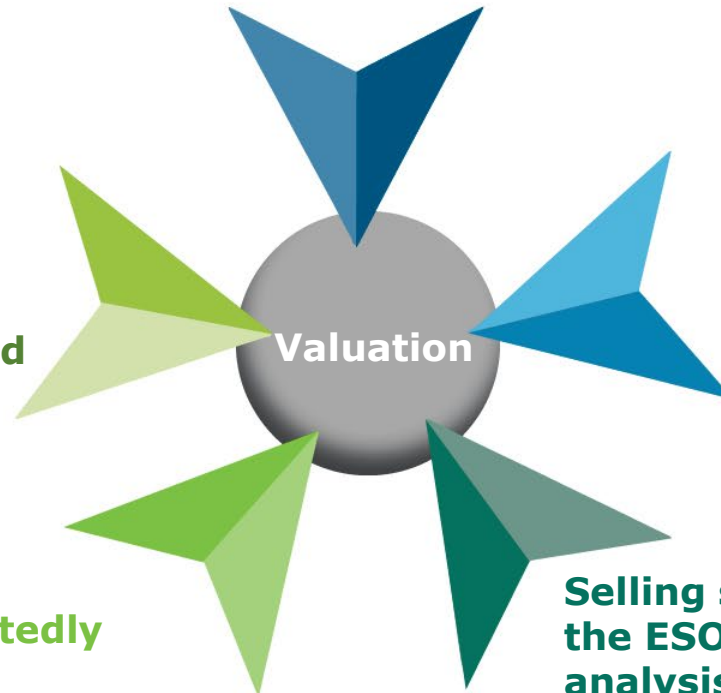


ESOP Valuation

ERISA prohibits ESOPs from paying more than (or receiving less than) adequate consideration (i.e., fair market value) for company stock

ESOP companies are valued every year. The annual ESOP valuations determine the value of participants' accounts and any payouts

The DOL has repeatedly and aggressively challenged prices paid (and other financial terms) in ESOP transactions



ESOP transactions are negotiated between the sellers(s) and the ESOP trustee. As the buyer, the trustee (with help from an ESOP valuation firm), ultimately determines how much an ESOP can pay (by establishing their opinion of fair market value)

Selling shareholders will not see the ESOP trustee's valuation analysis, nor will they know the maximum price the ESOP can pay. As such, it is helpful for selling shareholders to have an experienced ESOP financial advisor "on their side"

ESOP Administration

Participation

- ESOPs are inclusive; generally, everyone participates
- Typical ERISA rules apply (18 years of age, 1,000 hours of service)

Vesting

- Can have a maximum of 3-year cliff or 6-year graded vesting schedule
- Can give “credit” for service-to-date



Allocation

- Shares may be allocated based on compensation or combination of compensation & tenure
- Plan cannot be “top-heavy” or discriminatory

Repurchase

- Shares must be repurchased on a non-discriminatory basis
- Can defer payments until ESOP loan is repaid, and can pay out over a period of years

Many Benefits of ESOP Ownership



Financial

- Can create income tax free company (if 100% ESOP-owned)
- Tax-deductible financing (including principal)
- Tax savings finance large portion of transaction
- Stock sale (favorable tax treatment)
- Potential for tax-free rollover
- Sellers can participate in ESOP
- Opportunity for additional return through interest, warrants, SARs



Non-Financial

- Unique ownership transition alternative tool that preserves a company's legacy
- Sellers can retain operational control of the business
- Reward, attract, retain and motivate employees
- Flexible; can customize ESOP
- Low "transaction risk"; ESOP transactions almost always close
- Productivity gains are likely
- Tax/cash flow savings can facilitate growth

Advantages to Selling Shareholder(s)

<u>Owner Objective</u>	Third Party Sale	MBO	ESOP
Preserve Company Legacy	??	YES	YES
Assure Financial Security	YES	??	YES
Flexibility – Sell any %	NO	??	YES
Control Transaction Timing	NO	??	YES
Maintain Operational Control / Keep Current Job	NO	??	YES
Low Transaction Risk	??	??	YES
Retain/Reward Employees	??	??	YES
Minimize Taxes	??	??	YES

An ESOP can **Eliminate** Federal Income Taxes

- S-Corporations 100%-owned by an ESOP have a significant competitive advantage.
- This benefit **more than pays** for the cost of the ESOP transaction and administration.
- What would your company do with **50+% greater cash flow?**

	Non-ESOP Company	ESOP Company
Revenue	\$ 30,000,000	\$ 30,000,000
Expenses	25,000,000	25,000,000
Pre-Tax Income	5,000,000	5,000,000
Less: Effective Income Tax Burden	(1,650,000)	-
Net Income	3,350,000	5,000,000
Cash Flow Adjustments	(300,000)	(300,000)
Net Cash Flow	3,050,000	4,700,000
Improvement in Cash Flow	1,650,000	54.1%



ESOP Companies Outperform Non-ESOPs

Sources: Various Studies and Surveys on Employee Ownership & ESOPs

Company Performance Before and After ESOP

Measure	Before ESOP	After ESOP	ESOP Advantage
Employment Growth	1.21%	5.05%	4.2x
Sales Growth	1.89%	5.40%	2.9x

Avg. Retirement Savings: ESOP vs. Non-ESOP Employees

Employee Age	ESOP Employee	Non-ESOP Employee	ESOP Advantage
Under 25	\$ 5,617	\$ 2,740	105%
25-34	\$ 50,722	\$ 12,405	309%
35-44	\$ 179,716	\$ 37,039	385%
45-54	\$ 373,940	\$ 91,054	311%
55-64	\$ 426,098	\$ 142,124	200%
65 and Older	\$ 325,641	\$ 108,363	201%

72% of workers want to work for employee owned companies

78% of ESOPs report increased revenue last year

Workers with employee ownership had layoffs **6X less often** than those without employee ownership

70% of ESOP company employees are heavily involved or somewhat involved in expense reduction initiatives

Employee turnover can be **3X lower** in ESOP companies

70% of ESOPs report increased net profit last year

38% of customers say they are more likely to buy from employee-owned companies

Attributes of a Good ESOP Candidate

Owner Considerations

- Desire to preserve legacy as independent company
- Interest in company's future success
- Desire to reward employees with ownership, opportunity, and security
- Family business where some children are not involved with business
- Willingness to participate in leadership transition

Company Characteristics

- Enterprise Value of \$2 - \$200 million
- Strong management team
- Strong cash flows and debt capacity
- Participative management style; healthy corporate culture
- Stable and motivated employee base

Parties Involved in an ESOP Transaction

“Sell-Side”

Selling Shareholder(s)

Accounting Firm

Company ESOP Counsel

TPA / Record-keeper

Wealth Advisor



Capital Advisors

- Financial & valuation advisor to the Company
- Structure transaction to optimize for all parties
- Facilitate / quarterback ESOP transaction process
- Negotiate deal terms with ESOP trustee/valuator
- Assemble ESOP advisors; manage deal team
- Close transaction on time and on budget

“Buy-Side”

ESOP Trustee

Trustee’s Valuation Firm*

Trustee’s Counsel

Other Parties

Management/Employees

Bank

Bank Counsel

* **GBQ often serves in this role, when not serving as Company financial advisor**

GBQ's ESOP Transaction Process and Philosophy

Consultation/ Education

1
Learn whether
an ESOP could
work for your
company

Feasibility Study

2
Low cost,
comprehensive,
customized
analysis to
determine whether
an ESOP is an
optimal solution

Deal Execution

3
Full service
advisory to plan
and successfully
execute an ESOP
transaction

- As proud supporters of the ESOP ownership model (having seen it work for 100+ clients), we are happy to provide complimentary educational consultations.
- Our philosophy is that ESOP transactions are complicated and need a steady hand, but not one that charges excessive “success” fees that burden the ESOP company or create pressure to close a transaction.

ESOP Feasibility Study – Transaction “Blueprint”

- The ESOP Feasibility Study serves as the “blueprint” for the eventual ESOP Transaction.
- It can be customized and revised, until all parties are comfortable with the “house” before the “construction phase” begins, saving time and money.

ESOP Feasibility Study



ESOP Transaction



Questions Answered by GBQ* Feasibility Study

What price will I get?

When will I receive my money?

How will the company benefit with an ESOP?

How much tax will I save with an ESOP?

Can the company afford an ESOP?



How will key management benefit with an ESOP?

How will my employees benefit with an ESOP?

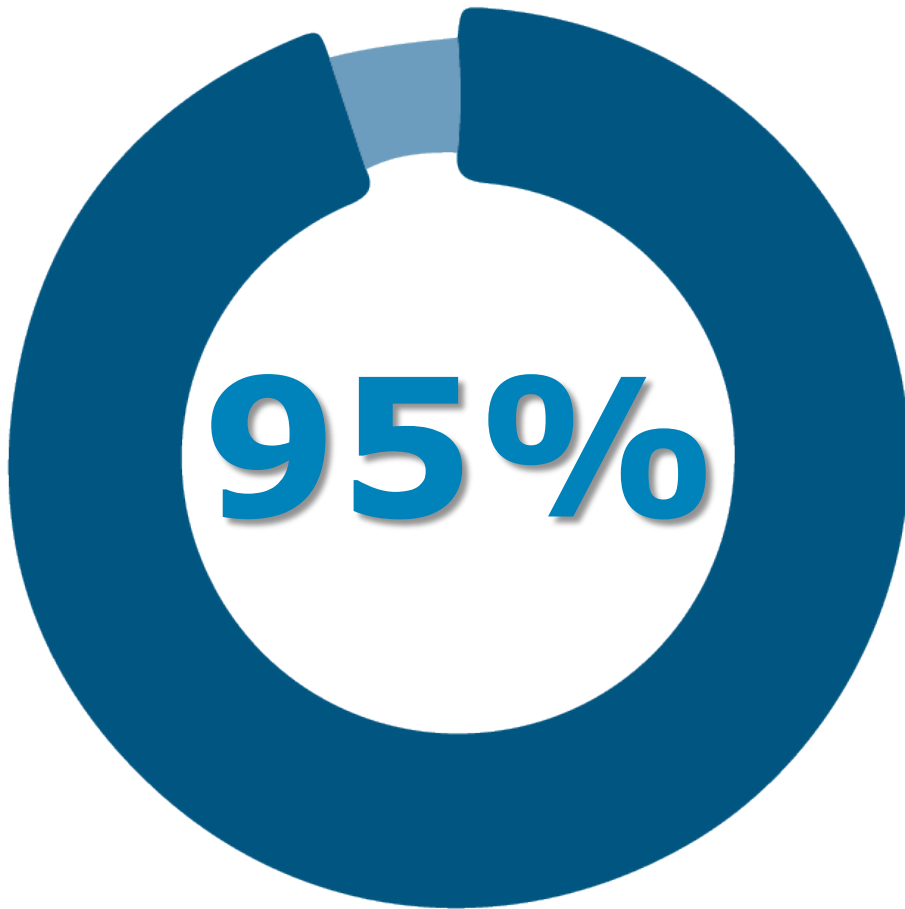
What is the best transaction structure for me?

What is the cost and timeline to put in an ESOP?

*Note: There is no universally accepted definition of an ESOP feasibility study. Others may offer an inadequate version that does not answer key questions

Bottom Line: ESOPs Unleash Legacy of Success

Source: Employee Ownership Foundation Annual Performance Survey



95% of ESOP companies report that creating employee ownership through an ESOP “was a good business decision that has helped the company”

Why? ESOP = 3x Win:

1. Selling Shareholders
2. Company
3. Employees/Management

About GBQ

GBQ's ESOP Advisory Services

Pre-ESOP Planning and Evaluation

- ESOP Education
- ESOP Feasibility Studies
- Preliminary Valuation
- ESOP Transaction Illustrations
- ESOP Consulting

ESOP Formation

- Initial Valuation
- Trustee Representation
- Company Representation
- Transaction Structuring & Financing
- Fairness & Solvency Opinions



ERISA Compliance

- Annual ESOP Valuations
- Trustee Advisory
- ESOP Transactions
- Valuation Report Review

Mature ESOP Planning

- ESOP Sustainability Assessments
- Transaction Advisory
- ESOP Terminations
- Fairness Opinions

GBQ's Tax Advisory Services

Our team has provided tax services to clients in many high profile and complex matters including:



www.gbq.com
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Questions



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