

# **Getting More and Keeping More**

## **How to Use ESOPs**

### **(Employee Stock Ownership Plans)**

### **to Generate Tax-Efficient Liquidity**

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**LONG POINT CAPITAL**

[www.longpointcapital.com](http://www.longpointcapital.com)

# ESOP BASICS – WHY ARE WE HERE ?

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- What is an ESOP ?
  - An ESOP is simply a tax-qualified employee benefit plan that is designed to invest primarily in stock of the sponsoring employer
- Why is it worth learning about ESOPs?
  - Tax Benefits - Congress has created many major tax incentives designed to encourage owners/employers to create ESOPs
  - Employee Productivity - ESOPs may be used to increase employee productivity because employees benefit directly from profit increases at the Company
- How can an ESOP be utilized?
  - **To Provide Tax Efficient Liquidity for Owners**
  - To Provide a Tax Efficient Corporate Structure for the Company

# WHAT ARE THE BENEFITS OF AN ESOP ?

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- For the Owners – Exit Planning and Legacy
  - **Risk reduction** – provides diversification of the wealth concentrated in Company ownership
  - **Tax-efficient liquidity** – provides a deferral or elimination of the capital gains tax on sale proceeds
  - Legacy – preserves the legacy of the founders through a sale of the Company to the employees
- For the Company – Cash Flow and Motivation
  - Cash flow – reduces or eliminates corporate taxes, thereby significantly increasing the free cash flows of the Company
  - Incentives – an ESOP can motivate the employees because they will benefit from profit improvements through their ownership in the Company
- For the Employees – Benefit Plan
  - A new retirement benefit plan at no cost to the employees









# REASONS TO EXPLORE LIQUIDITY OPTIONS

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- Partner Buyout
  - You need to generate the cash to repurchase the stock of a significant shareholder
- Exit Strategy Planning
  - You want to diversify your assets and reduce the risk of having “all your eggs in one basket”
  - You want to preserve an ongoing role and maintain equity ownership in the Company
- Retirement
  - You are looking to sell the entire Company and retire
- Family Succession
  - You need to provide for liquidity for an older generation as part of an appropriate succession plan

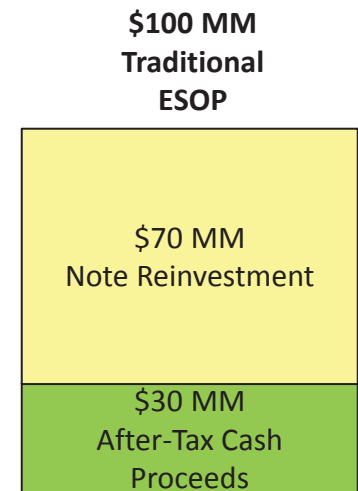
# YOUR LIQUIDITY STRATEGY MUST FIT YOUR GOALS

- Only certain types of acquirers can provide a selling owner the desired balance of liquidity and remaining control
- PE-Backed ESOPs offer the best liquidity option and enable a selling owner to remain a significant investment partner

LIQUIDITY STRATEGY	OWNER GOALS	
	WEALTH DIVERSIFICATION/ LIQUIDITY	CONTROL
TRADITIONAL ESOP		
PE GROUP		
STRATEGIC BUYER		
PE-BACKED ESOP		

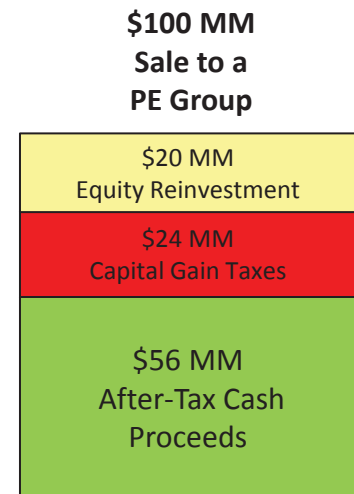
# SELL TO A TRADITIONAL ESOP

- What is it?
  - Cash is generated using only a senior loan from a bank
  - Owners receive proceeds consisting of cash and a seller note
  - Typical transaction split of value – 30% to 40% cash / 60% to 70% seller note
- Benefits
  - **The taxable gain can be reduced or eliminated if structured correctly, thereby eliminating a tax liability that could approach 35% of proceeds in CA**
  - Corporate taxes can be reduced or eliminated if structured correctly
  - Control is maintained by the owner, if desired
- Issues
  - Significant wealth diversification is not achieved because of limited cash liquidity
  - The ESOP is your partner, and growth in equity value is the priority



# SELL TO A PRIVATE EQUITY GROUP

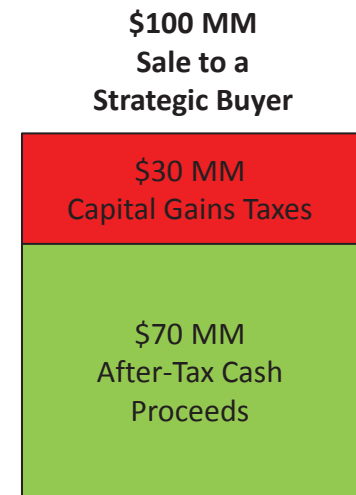
- What is it?
  - Cash is generated through a junior capital investment by the PE group and bank loans arranged by the PE group
  - Owners receive proceeds consisting of cash and an equity interest in the ongoing company
  - Typical transaction split of value – 80% plus in cash, 20% in equity reinvestment
- Benefits
  - **More cash at closing** because of PE investment and additional bank financing generated by PE group
  - PE Group can provide significant value through additional expertise, relationships and capital
- Issues
  - Tax Inefficient – Owners pay capital gains taxes / Company pays corporate taxes
  - PE group will typically control the Company



# SELL TO A STRATEGIC BUYER

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- What is it?
  - Strategic buyer, often competitor, pays cash or stock, if public
- Positives
  - **Potential for most pre-tax liquidity** if buyer attributes value to and pays for synergies
  - No further risk in company investment
- Issues
  - Tax Inefficient – Owners will pay capital gains taxes on cash, potentially mitigating value of higher price
  - Elimination of owner upside in Company
  - Complete lack of control over future of business
  - Most potential for culture shock to management team and employees





# SELL TO A PE-BACKED ESOP

- What is it?

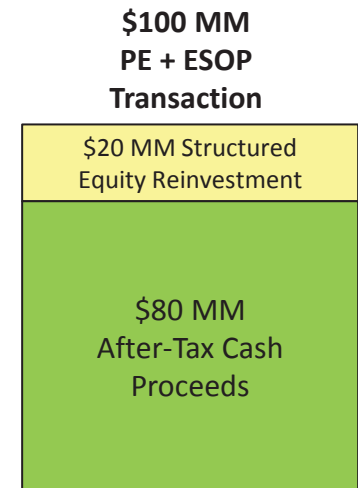
- Structured as a Traditional ESOP, but cash is generated through a junior capital investment by the PE group and bank loans arranged by the PE group
- Owners receive proceeds consisting of cash and an equity interest
- Typical transaction split of value – 80% plus in cash, 20% in equity reinvestment

- Positives

- **The taxable gain can be reduced or eliminated if structured correctly, thereby eliminating a tax liability that could approach 35% of proceeds in CA**
- Corporate taxes can be reduced or eliminated if structured correctly
- **MOST AFTER-TAX LIQUIDITY** – more cash, less taxes
- PE Group can provide significant value through additional expertise, relationships and capital
- PE group, owner and ESOP are aligned in desire for fair price and future equity value creation

- Issues

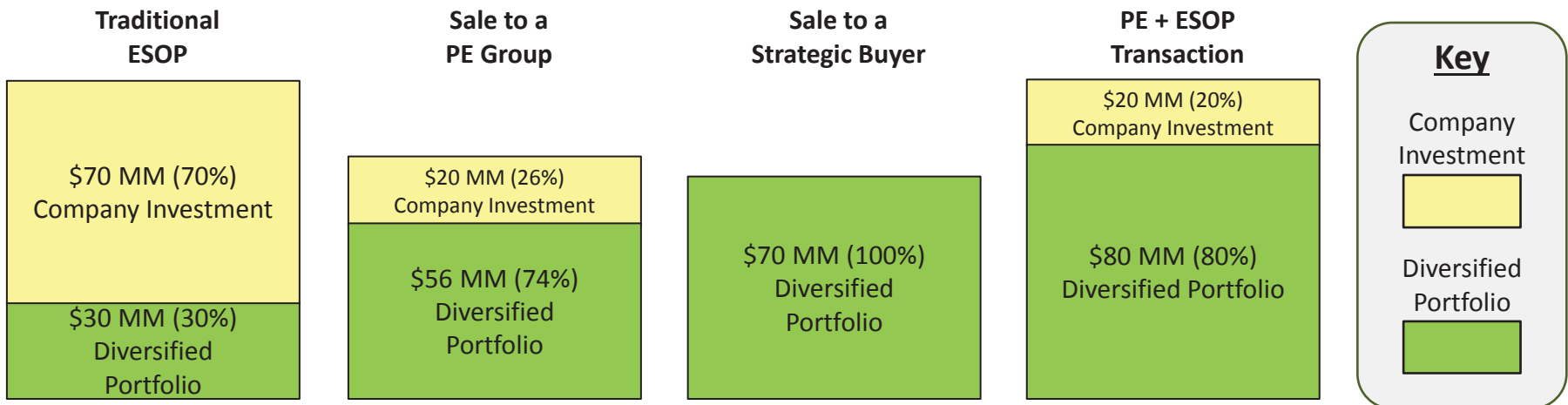
- PE group will typically control the Company



# PE-BACKED ESOP - MOST WEALTH DIVERSIFICATION

- Business owners often have 100% of their wealth tied to the success of one business
- Sale to a PE-Backed ESOP provides for greater total proceeds and broader asset allocation than other liquidity options
- Sale to a PE-Backed ESOP allows an owner to stake a meaningful investment in the future performance of the business

## \$100 million Transaction Value – Examples of Wealth Diversification for Seller



# LONG POINT CAPITAL

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## WHO ARE WE ?

We are a private equity firm, founded in 1998, that partners with and invests in successful founder and family-owned lower middle-market businesses with total enterprise values between \$25 million and \$250 million. Using a simple formula of common sense and integrity, we have developed a stellar reputation over the past 17 years as a partner to management teams.

## WHAT DO WE DO?

We provide liquidity and wealth diversification solutions to founder and family-owned companies. We partner with management teams to grow businesses by providing strategic guidance, creating goals and priorities, providing resources, and aiding in financings and acquisitions.

## WHAT MAKES US UNIQUE?

***WE ARE THE MOST EXPERIENCED PE GROUP INVESTING IN ESOP TRANSACTIONS.*** Through our expertise and experience in ESOPs, we can generate 40% or more after-tax proceeds for an owner than a typical private equity transaction.

## WHAT ARE OUR INVESTMENT CRITERIA?

We seek to invest \$10 million to \$50 million in a new transaction. We look for:

- EBITDA – At least \$5 million
- Revenues – At least \$25 million
- Geography – Based in the United States and Canada
- Industries – Open to most industries, but typically stay away from companies with high technology adoption risk or significant exposure to fluctuations in commodity prices.

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# LONG POINT CAPITAL – ESOP SUCCESS STORIES



LONG POINT CAPITAL

has exited its investment in



- Designer, manufacturer and marketer of middle to better-end Jacquard upholstery fabrics



LONG POINT CAPITAL

has exited its investment in



- Distributor of interior-grade hardwood plywood and other related specialty woodpanel products



LONG POINT CAPITAL

has made an investment in



ATTORNEY PLACEMENT CONSULTANTS



- Provider of legal placement and temporary attorney staffing and review management



LONG POINT CAPITAL

has made an investment in



- Largest McAlister's Deli franchisee with 53 locations in TX, OK, KS and MO



LONG POINT CAPITAL

has recapitalized its investment in



- Provider of stormwater drainage solutions in the Western US



LONG POINT CAPITAL

has recapitalized its investment in

 UMA Enterprises Inc.

- Full service importer and wholesaler of home décor products