

# Ownership Succession and the ESOP Value Proposition

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VALUE**

# John N. Vitucci, CPA

**John N. Vitucci** is a Principal & ESOP Practice Leader at PKF O'Connor Davies, LLP. John has more than 30 years of experience working with Fortune 500 corporations, private business and investment banks in all areas of employee benefits, executive compensation and ERISA. John is currently an Adjunct Professor at Columbia University where he teaches Pensions & ERISA and Oral Communications for Actuaries in the Actuarial Masters Program. He is also an Adjunct Professor at Baruch College where he teaches Deferred Compensation in the Master of Science in Taxation Program.

John was a senior partner at a Deloitte Tax LLP where he worked for 24 years. He was the National Employee Benefits Leader, Northeast Employee Benefits Leader and member of the Northeast Tax Management Committee where his primary focus was on ESOPs, serving clients and the development of new employee benefit products. He was previously a pension specialist with the Employee Plans Division of the Internal Revenue Service.

John has spoken at numerous seminars on employee benefits, has published many articles, and has been quoted in numerous publications, including *The Wall Street Journal*, *Forbes* & *the Financier*. He previously chaired the Employee Benefits Committee for the New York State Society of Certified Public Accountants. He was the chairperson of Foundation for Accounting Education's 1994 and 1995 Employee Benefits Conference. He was a contributing editor of the employee benefits column for *The CPA Journal* for 4 years.

## Professional Affiliations

Member of the American Institute of Certified Public Accountants & New York State Society of Certified Public Accountants  
Member of the ESOP Association and National Center for Employee Ownership  
Advisory Board Member for Rutgers NJ/NY Center for Employee Ownership  
Advisory Board Member for Rutgers Design Thinking Certificate Program

## Accreditation

New York State Certified Public Accountant

## Education

Pace University, Bachelor of Business Administration degree in Accounting



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Service

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# Harvey M. Katz

## *Harvey M. Katz*

Harvey serves as co-chair of Fox Rothschild's Employee Benefits & Compensation Department. He represents clients in all aspects of pension, executive compensation and employee benefits law. Harvey handles a broad array of sophisticated employee benefits issues for public and private companies, including those in connection with Internal Revenue Service, Pension Benefit Guaranty Corporation and Department of Labor audits, and the benefit problems facing employers in financial distress and those with overfunded plans. He frequently represents employers, trustees and lenders in connection with employee stock ownership plans (ESOPs) on compliance, fiduciary and transactional matters as well as the use of ESOPs in connection with business acquisitions.

In addition, Harvey has experience in post-retirement medical benefits for governmental and private employers. He also brings a wealth of experience regarding fiduciary responsibilities imposed upon employers, trustees and administrators under federal pension law. In addition, Harvey is knowledgeable about issues related to multiemployer plans, including withdrawal liability and funding issues. A frequent lecturer, Harvey has authored numerous articles on a variety of employee benefits topics. He is past president of ASPPA Benefits Counsel of New York, a professional association of actuaries and other pension professionals.

## **Education**

Harvey received his LL.M. from Temple University Law School (1982), his J.D. from New York Law School (1977) and a B.A. from Temple University (1973). He is admitted to practice in New York and Pennsylvania.



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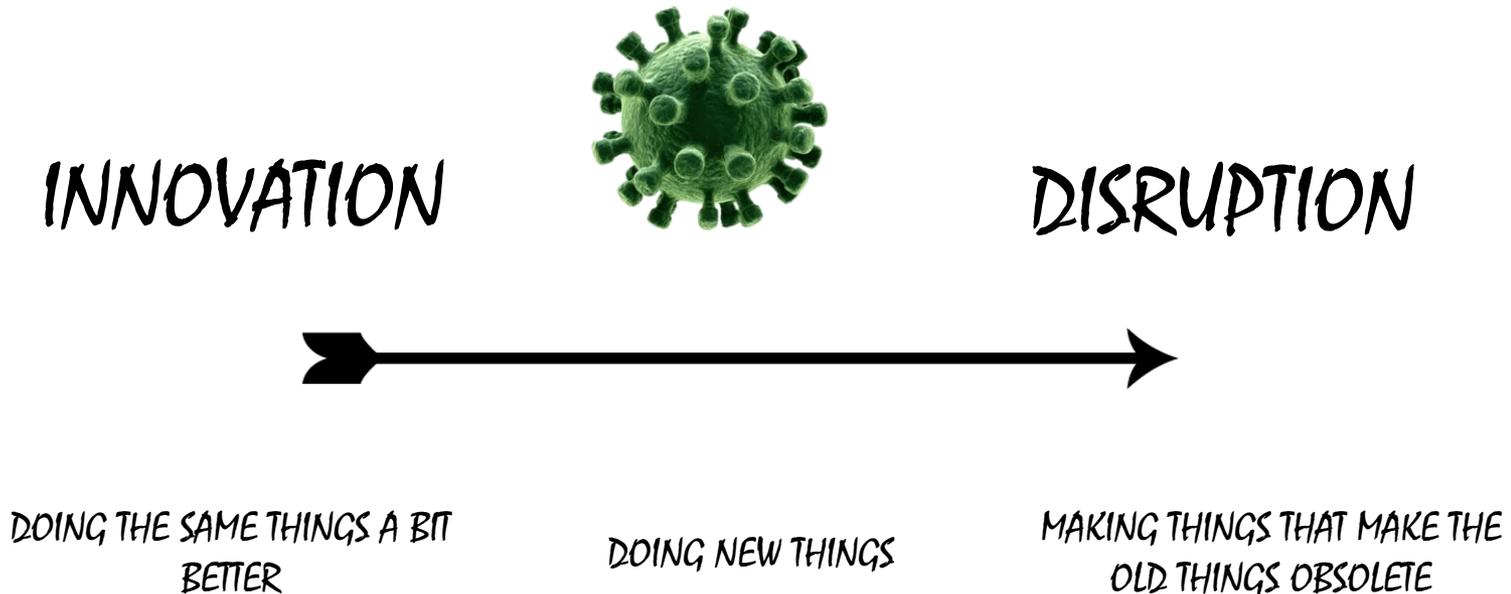
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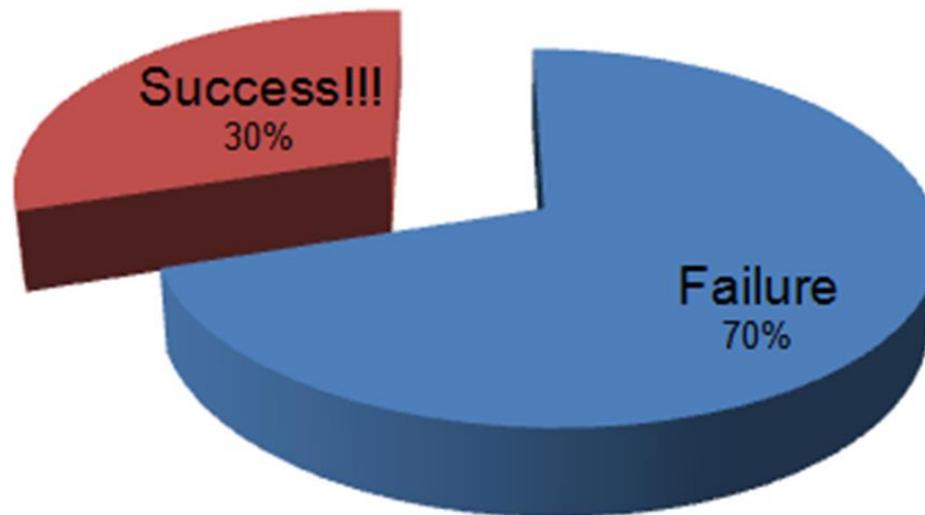
# Are you a Disrupter or a Victim?



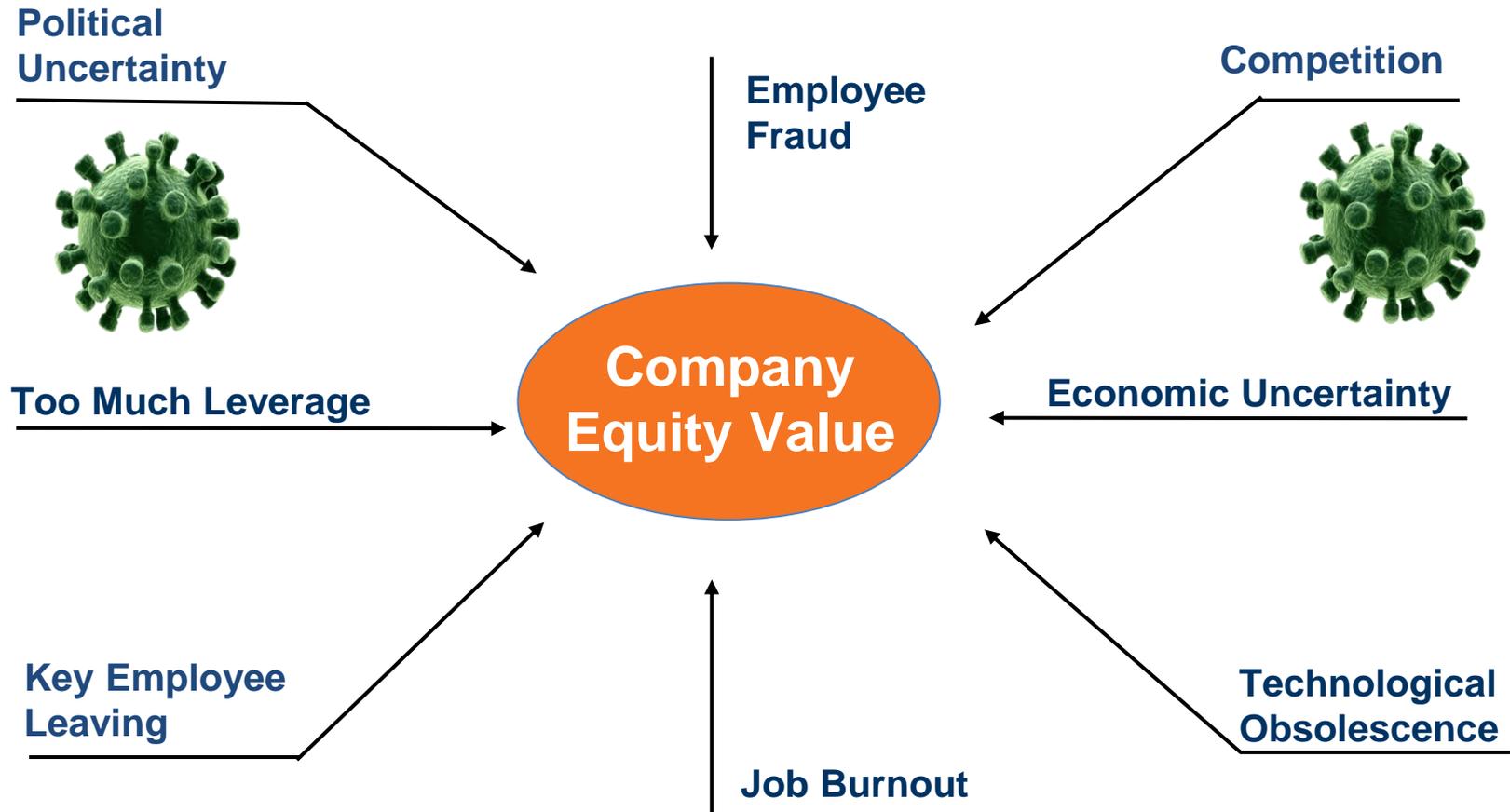
***In business sometimes, insanity can be defined as doing the same thing and expecting a different result!***

# Family Business Succession

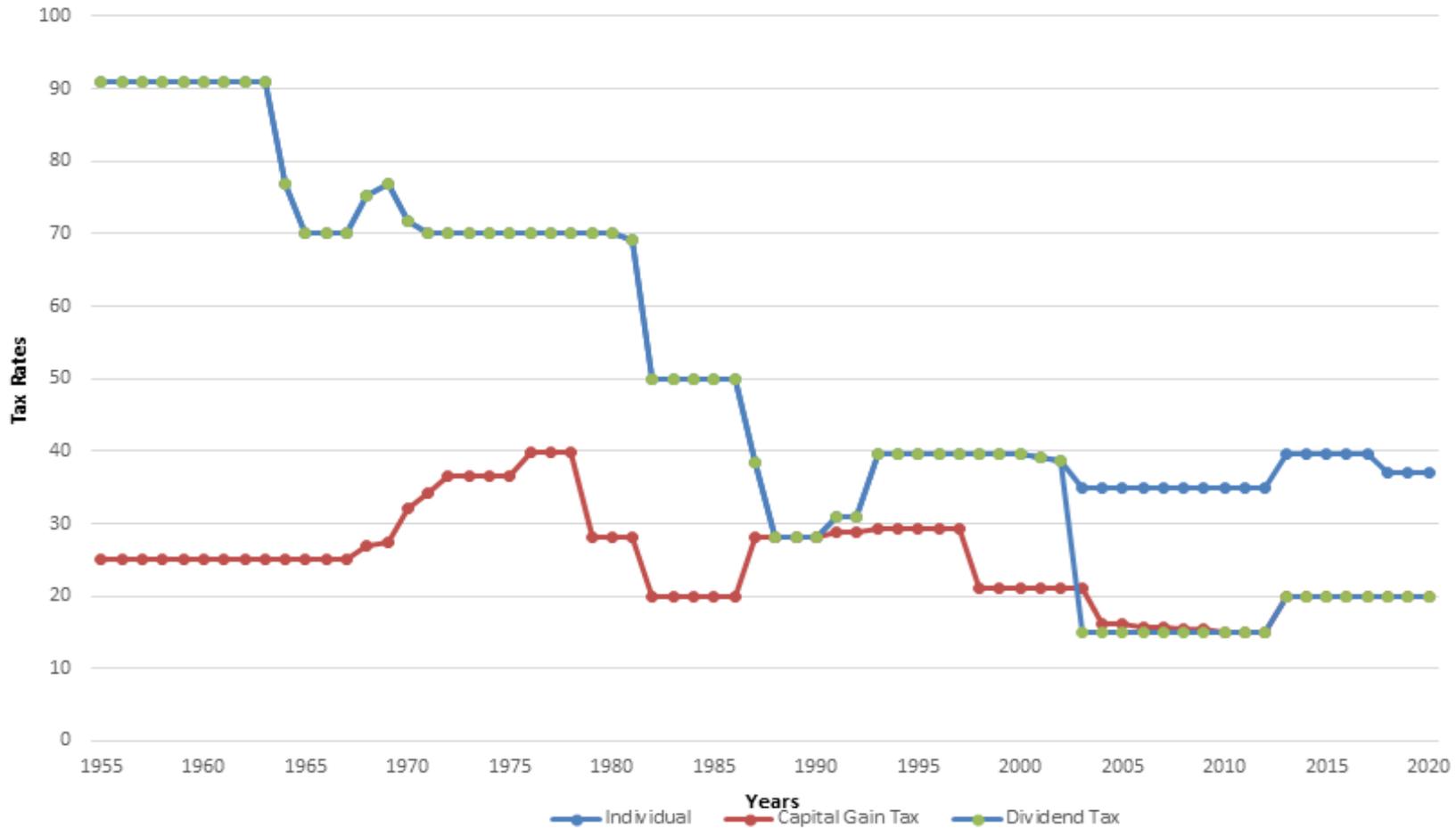
## Family Businesses Going Into the 2nd Generation



# Equity Value of a Private Business at Risk



## U.S. Individual Tax Rate Trend



## Exit or Succession Plan

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- A monetization event or a sale of a private business can be accomplished in a number of ways:
  - **Leveraged recapitalization** – limited by level of bank financing but business is not sold
  - **Taxable sale to a third party such as private equity** – however, not every business is easy to sell or can be sold without ongoing participation by business owner
  - **Sell to employees using a book value approach** – lower sale value and is usually utilized by professional service firms such as accounting firms or engineering firms
  - **Tax Free Sale to an ESOP** – use of leverage, must buy replacement property and business owner can get warrants in company
  - **Taxable Sale to ESOP** – business owner participates in ESOP

## Hypothetical Company – Project ESOP

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- One business Owner owns 100% of S-Corporation
- Business has \$3 Million of EBITDA and is valued at \$15 Million
- The owner takes a \$250,000 salary and pays \$1.5 million a year in Federal & State Taxes
- The Business has 100 employees excluding the owner
- Taxable Sale to ESOP – business owner participates in ESOP
- The business owner takes a 10 year seller note paying 7% interest in exchange for the sale
- What is the value proposition?

## Project ESOP – Illustrative Example 5% Growth

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- Project ESOP is owned by one individual
- Company undertakes a 100% ESOP owned, S-Corporation transaction
- 5.0x Illustrative EBITDA Multiple, \$3.0 million of estimated 2019 EBITDA and \$18.0 million of revenue
- Equity value of \$15.0 million, net of estimated net, debt of \$0
- EBITDA growth of **5%** per year from 2019 and thereafter
- 99.0% equity redemption for seller debt of \$14.850 million
  - Seller debt interest rate of 7.0% assumed; principle paid off in Years 1-10
    - \$0.8 million in Year 1
    - \$1.0 million in Year 2-5
    - \$2.0 million in Year 5-10
- 1.0% equity sale to the ESOP for cash of \$0.150 million
- Owner to receive 49.0% of post-transaction equity ownership through the ESOP
  - \$19.6 million illustrative 49.0% ESOP equity value at end of Year 10

# Hypothetical Company – Project ESOP

EBITDA of Business	3,000,000	<b>5.0% EBITDA Growth Rate</b>
Transaction Multiple	5.0x	
Consideration Received	\$ 15,000,000	
Less: Current Assumed Debt	\$ -	
Equity Value All Owners	\$ 15,000,000	
<b>Net, Cash Received at Close</b>	<b>\$ 150,000</b>	
Seller Debt Investment	\$ 14,850,000	7.0% Interest Rate
Totals	\$ 15,000,000	
Owner ESOP Ownership Percentage	49.0%	
Other Employees ESOP Ownership Percentage	51.0%	

## Internal Rate of Return Analysis - Entire Holding

	Owner Total Pre-Tax Cash Flows	Seller-Debt Pre-Tax Interest Income	Seller-Debt Pre-Tax Principal	Owner Pre-Tax Combined Principal + Interest	Owner Year-End ESOP Ownership Value	Other Employees Year-End ESOP Value	100% Company Year End Equity Value ESOP Owned
2019	\$ (14,850,000)		\$ -	\$ -			
2020	\$ 1,859,750	\$ 1,009,750	\$ 850,000	\$ 1,859,750	\$ 1,359,000	\$ 1,414,000	\$ 2,773,000
2021	\$ 1,945,000	\$ 945,000	\$ 1,000,000	\$ 1,945,000	\$ 2,755,000	\$ 2,868,000	\$ 5,623,000
2022	\$ 1,875,000	\$ 875,000	\$ 1,000,000	\$ 1,875,000	\$ 4,285,000	\$ 4,459,000	\$ 8,744,000
2023	\$ 1,805,000	\$ 805,000	\$ 1,000,000	\$ 1,805,000	\$ 5,952,000	\$ 6,194,000	\$ 12,146,000
2024	\$ 1,735,000	\$ 735,000	\$ 1,000,000	\$ 1,735,000	\$ 7,763,000	\$ 8,080,000	\$ 15,843,000
2025	\$ 2,630,000	\$ 630,000	\$ 2,000,000	\$ 2,630,000	\$ 9,740,000	\$ 10,137,000	\$ 19,877,000
2026	\$ 2,490,000	\$ 490,000	\$ 2,000,000	\$ 2,490,000	\$ 11,903,000	\$ 12,389,000	\$ 24,292,000
2027	\$ 2,350,000	\$ 350,000	\$ 2,000,000	\$ 2,350,000	\$ 14,261,000	\$ 14,843,000	\$ 29,104,000
2028	\$ 2,210,000	\$ 210,000	\$ 2,000,000	\$ 2,210,000	\$ 16,820,000	\$ 17,507,000	\$ 34,327,000
2029	\$ 21,659,000	\$ 70,000	\$ 2,000,000	\$ 2,070,000	<b>\$ 19,589,000</b>	\$ 20,389,000	\$ 39,978,000
Totals	<b>\$ 40,558,750</b>	\$ 6,119,750	\$ 14,850,000	\$ 20,969,750			

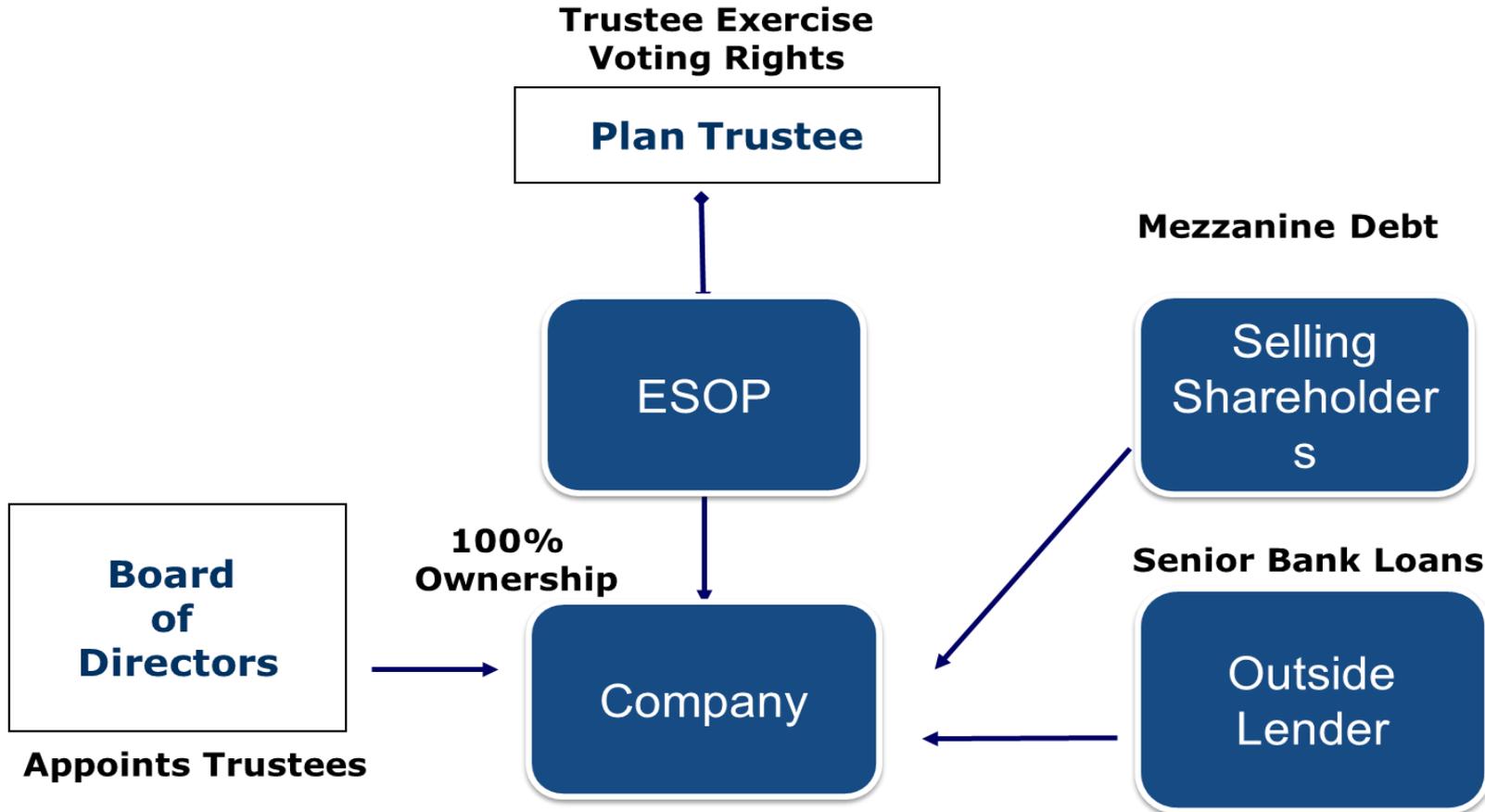
Internal Rate of Return **15.2%**

## ESOP Opportunity

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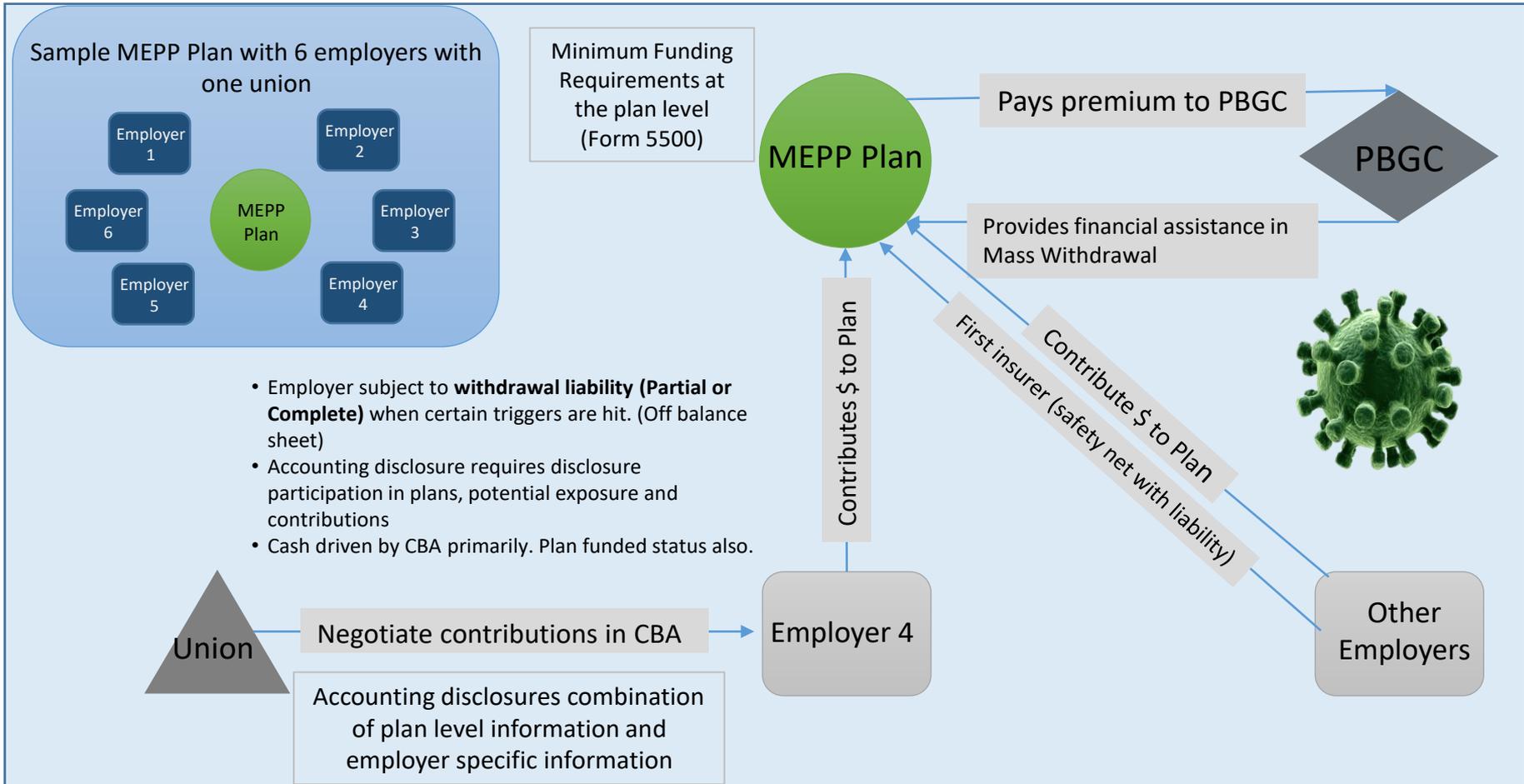
- Special tax rules applicable to ESOPs for S-Corporations
- Benefits of employee ownership to shareholders, management team and employees
- An ESOP can be utilized as an effective succession planning tool
- In situations with seller financing, selling shareholders can be repaid with improved cash flow of the business due to ESOP tax benefits
- In certain situations, selling shareholders that provide seller financing can participate in the ESOP (if they continue employment with the company)
- Distributions from the Firm to ESOP can offer diversification and bankruptcy protection
- An ESOP can be combined with a 401(k) plan

# Post Closing – 100% ESOP Ownership



# Union Pension Exposure

## Multiemployer Pension Plan Landscape



# Players Involved in ESOP Transactions

## The Company

- Accountant and/or Consultant
  - ESOP Micro Feasibility Analysis
  - ESOP Transaction Design
  - Manage ESOP Implementation Process
- Company Financial Advisor
  - Valuation
  - ESOP Macro Feasibility Analysis
  - Debt Placement
- Legal Counsel
  - Assist in ESOP Transaction Design
  - Draft ESOP Documents

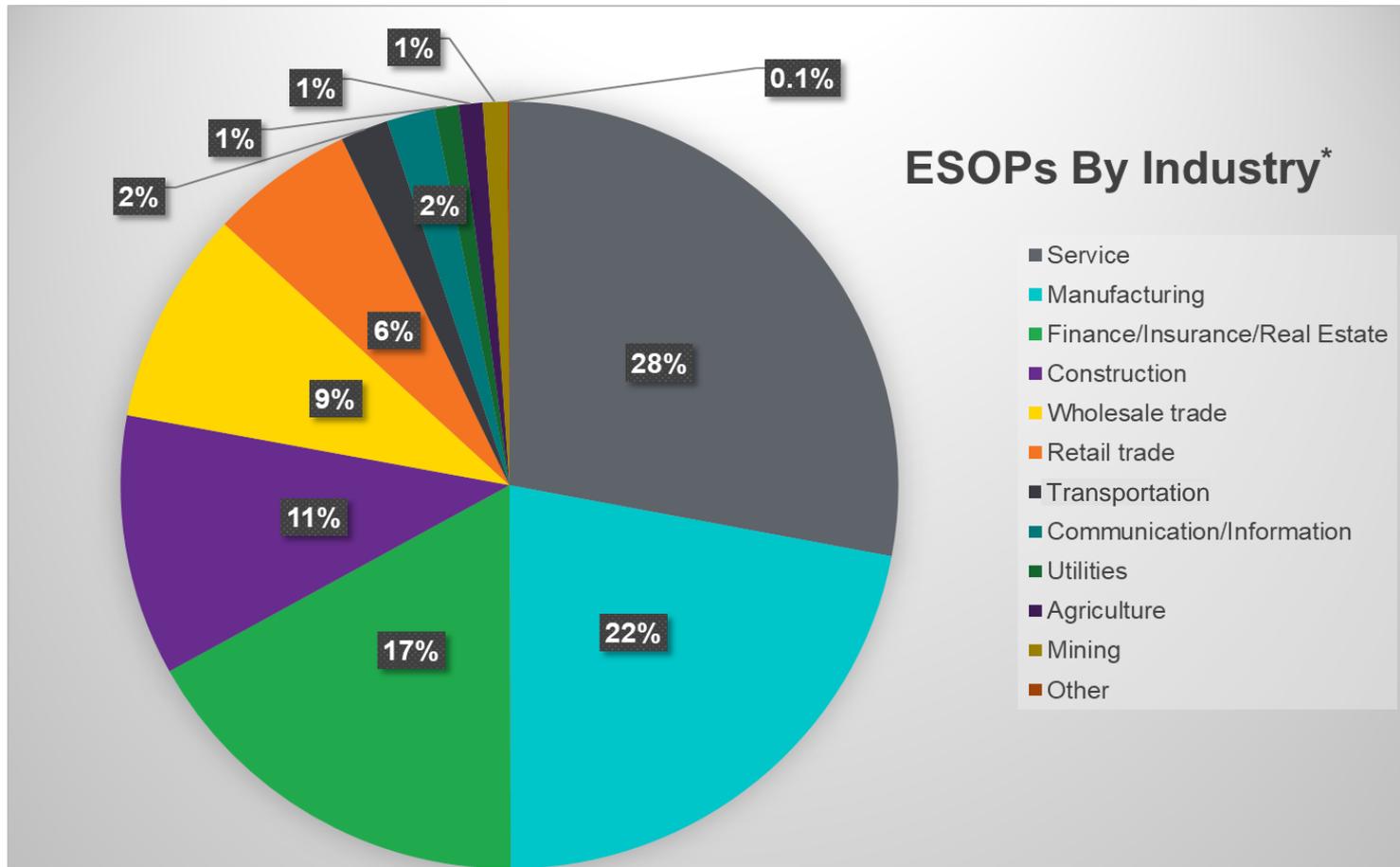
## The ESOP

- ESOP Trustee
- ESOP Trustee's Financial Advisor
  - Valuation & Fairness Opinion to Trustee
- ESOP Trustee's Legal Advisor

## The Selling Shareholder

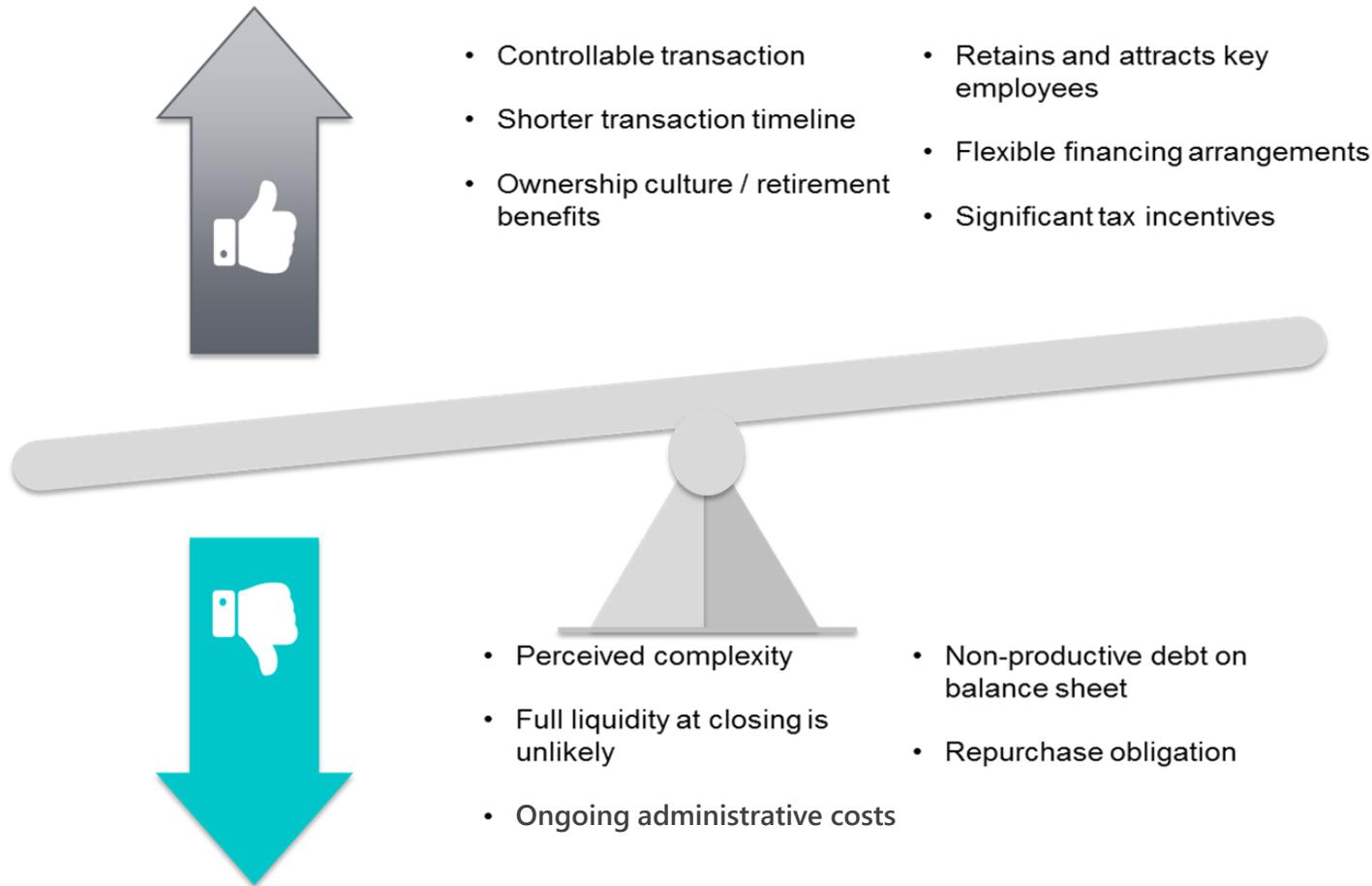
- Financial Advisor
- Accountant
- Legal Counsel
  - Review Transaction Documents

# ESOPs by Industry Group



\*Data received from NCEO website: [www.nceo.org/articles/esops-by-the-numbers](http://www.nceo.org/articles/esops-by-the-numbers)

# ESOP Pros & Cons



# Questions

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