ESOP Overview Presentation

- Introductions
- ESOP Overview Presentation
- Panelist Discussion
- Q&A

- If you would life CE and/or CFP credit for attending this webinar, please send an email to Caroline@wealthpoint.net with the following information
  - Name
  - Type of CE needed
  - License number

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)

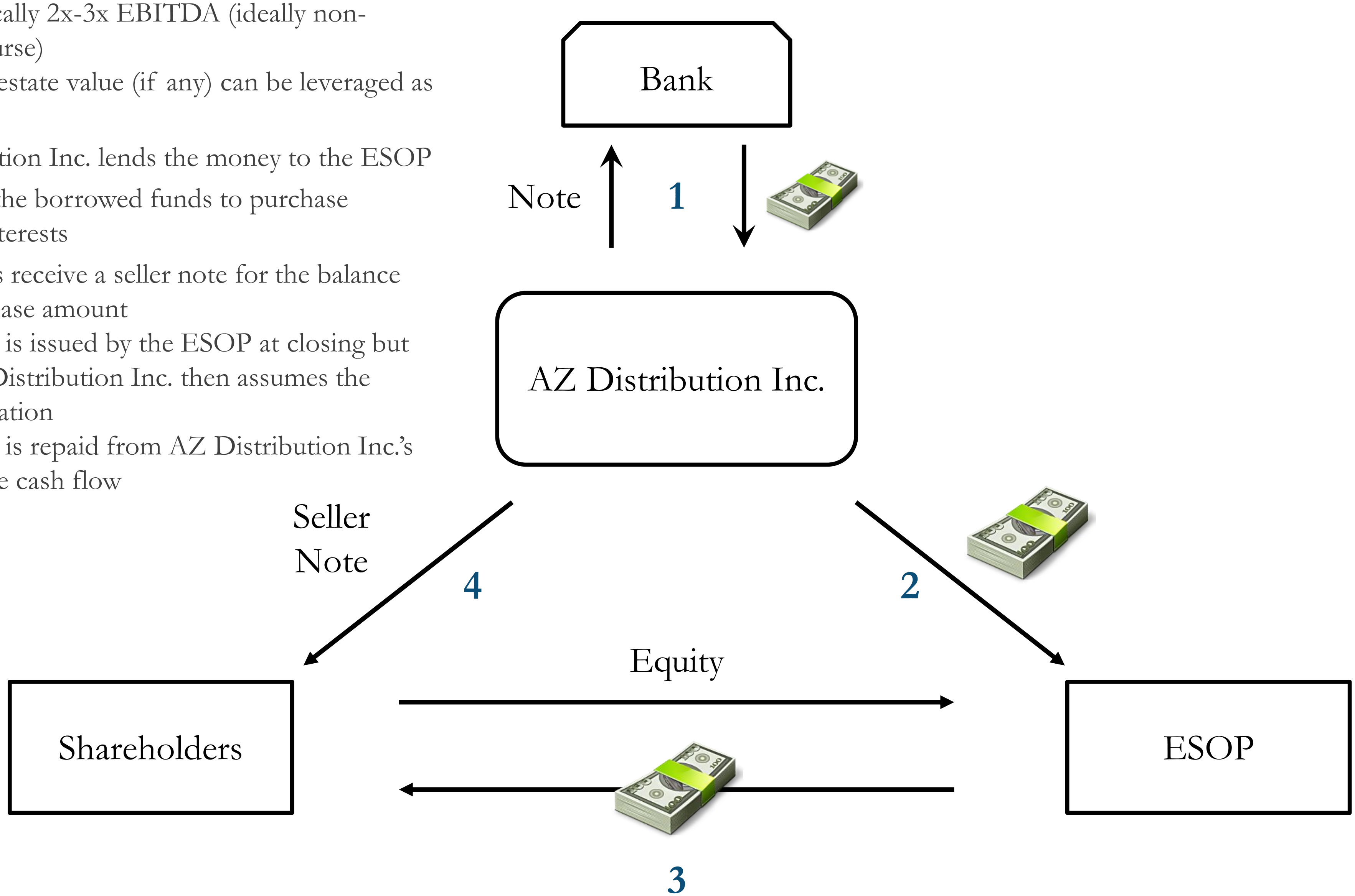
ESOP

- ESOP creates a method to monetize a company's owners' interests while maintaining control and provide a benefit to the employees
  - Stock in ESOP is allocated to employees over time (based on compensation – subject to certain limits)
    - Employees will monetize their interests upon retirement or other triggering events
      - Payments are typically paid over 5-years
  - All full-time employees must participate – ESOPs are non-discriminatory plans
    - However, you can provide key executives with additional ownership/value via stock appreciation rights plans (SAR)
  - ESOPs operate very similarly to a 401(k) or profit-sharing plan
    - Growth on value while in the ESOP is tax-deferred – employees pay ordinary income tax when they monetize their shares
    - Difference between 401(k) plan – the only asset is the company's shares

Who are the Players?

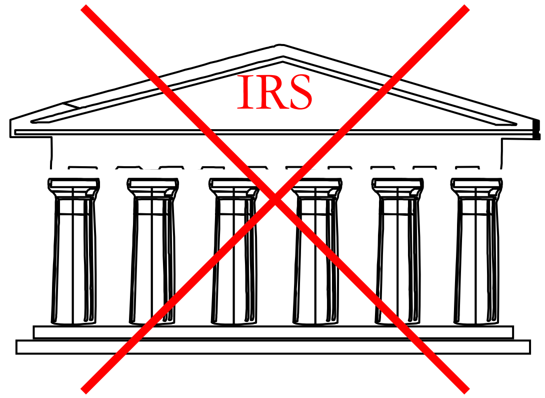
- Company and its Shareholders
  - Note that not all Shareholders have to participate in the sale to an ESOP
- Trustee
  - Hired by the ESOP plan sponsor to represent the best interest of the employees
  - Highly encourages to have an independent Trustee (at a minimum for the transaction)
- Legal counsel x2
  - Both the Trustee and Company will have legal counsel to represent the arms-length transaction
- Valuation firm
  - Hired by the Trustee to perform an independent valuation of the business
    - Used by the Trustee to support the negotiations with the Seller
- TPA
  - Outsourced firm to help manage the compliance aspects of an ESOP
    - Participant statements, compliance testing, etc.
- Facilitator
  - Helps to structure the transaction, stress-test financial models and push the process forward
- Commercial Banker
  - Provides bank financing (if applicable)

1. AZ Distribution Inc. borrows money from a bank to finance part of the purchase amount
   a. Typically 2x-3x EBITDA (ideally non-recourse)
   b. Real estate value (if any) can be leveraged as well
2. AZ Distribution Inc. lends the money to the ESOP
3. ESOP uses the borrowed funds to purchase members' interests
4. Shareholders receive a seller note for the balance of the purchase amount
   a. Note is issued by the ESOP at closing but AZ Distribution Inc. then assumes the obligation
   b. Note is repaid from AZ Distribution Inc.'s future cash flow



TRUE OR FALSE – COMMON ESOP INACCURACIES

Statement	True or False	Comments
When you sell to an ESOP, you must sell for less than fair market value	FALSE	An independent 3rd party valuation is performed to substantiate the purchase price
The Trustee takes over control of the business	FALSE	The Trustee's only role is to represent the employees in their best interest. Most quality Trustee's want nothing to do with running the business.
All employees must weigh in on every decision	FALSE	The employees now have beneficial ownership in the business – that doesn't mean they now have control
I must sell 100% of my ownership to the ESOP	FALSE	An owner can sell any amount of shares to the ESOP
Employees will never have enough cash to buy me out	FALSE	Most ESOPs are funded out of the company's future cash flows
The annual compliance fees make an ESOP unaffordable	FALSE	Compared to the tax savings and employee impact, the compliance fees are a small price to pay
ESOPs are a viable succession planning strategy for the right business	TRUE	Depending on the company and shareholders' objectives, ESOPs can be a viable strategy for an exiting businessowner



- Beat the IRS out of their money with their own rules
  - An ESOP is a tax-exempt entity
    - Income flows through from the company to the ESOP and zero taxes are paid (if an S Corp.)
  - Use the government's money to be reinvested into future growth or accelerated repayments of company's debt
  - ESOP Contributions are tax deductible (up to 25% of eligible payroll)
    - Funds are repaid to the company to pay off the internal note between the ESOP and the company
- §1042 Rollover for shareholders
  - Selling shareholders can defer and eliminate capital gains due upon sale
  - Shareholders have 12 months to reinvest proceeds into "qualified replacement property" (QRP)
    - Example: stocks and bonds of US operating companies
  - No capital gains due on reinvestment
    - QRP investments receive carryover cost basis of stock sold to ESOP
  - Constraints: Company must be a C Corp at the time of sale

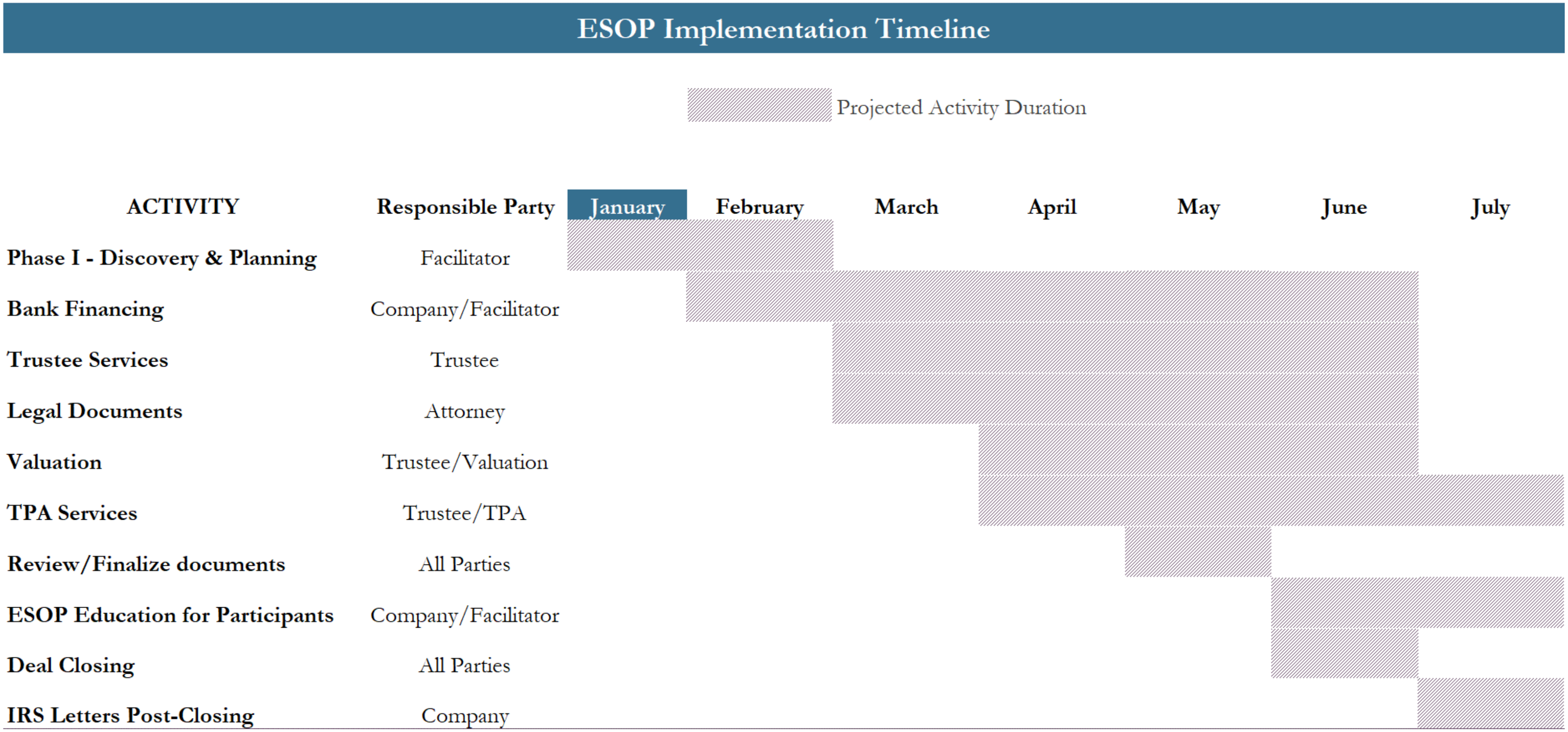
BOARD CONTROL/GOVERNANCE

- The business operations and governance will remain the same pre- and post-ESOP
  - Company will continue to be run by a Board of Directors
    - ESOP Trustee is a shareholder and not involved in day-to-day management
- Board of Directors is determined prior to sale to ESOP
  - Current owners determine who will comprise the Board prior to closing
  - ESOP Trustee typically requests that within a certain period of time post-closing, the Board must include 1 independent board member
    - Not appointed by the Trustee but approved by the Trustee
  - State law will dictate how the Board remain in place
    - Until resignation; specific period of time; etc.
  - The Board will have the ability to replace the ESOP Trustee (if deemed prudent)

- Transaction could include an Equity Plan for key employees and management
  - Could represent X% of Company's equity value (for example)
  - Typical structure includes synthetic equity (i.e. Stock Appreciation Rights, etc.)

- Employee will share in economic value of the business without receiving actual equity
  - Vesting and exercise rights can be customized based on the company's objectives
  - When exercised, the key employee is paid the increase in value of a specific percentage of the company's fair market value
  - SARs package must be negotiated with ESOP Trustee and valuation firm prior to ESOP transaction
    - Dilutes ESOP ownership/value

- Alternatively, employees could receive real equity via a buy-in or equity grant



- There is a defined sales process with an ESOP transaction
  - Most ESOPs can close in approximately 6-7 months
    - Depends on the complexity of the transaction

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