

HOW ADOPTING AN ESOP CAN BE A WIN, WIN, WIN

OVERVIEW

The shareholders of Vision Engineering and Development Services, Inc., is a closely held private corporation in Tennessee. Vision had not adopted an employee stock ownership plan (ESOP), but learned that similarly situated companies had — so they came to SHDR to find out more.

CHALLENGE

First, Vision wanted to be educated on the pros and cons of adopting an ESOP. Particularly, they wanted to understand why similarly situated companies adopt ESOPs to determine if it was in their best interest to do the same.

Second, Vision asked that we analyze the estimated value of their company, the demographics of their employee population, their financial situation and the projected redemption of company stock upon the retirement of shareholder-employees to illustrate specific application of an ESOP to their needs.

SOLUTION

To reach this objective, SHDR provided rather broad-based written educational material followed up with several conference calls to further explain what benefits might be applicable to Vision's particular needs. SHDR focused this discussion on the creation of a market for the stock of their shareholders, the tax savings associated with pretax rather than after-taxed debt service, and the comparison of leveraged acquisitions to unleveraged acquisitions of their closely held stock.

VISION provided an employee census, financial statements for several years, a current shareholder listing and a completed ESOP feasibility questionnaire.

The employee census provided sufficient information to make a preliminary determination as to the ability of an ESOP to acquire stock (analyzing contribution deduction limitations and allocation limitations). The financial statements provided the ability to analyze cash flow available for contributions to fund the ESOP.

SHDR mapped a schedule of leveraged and unleveraged acquisitions resulting in purchase by the ESOP of the stock of all existing shareholders over the course of the next 15 years. At the end of this schedule, the ESOP would own 100% of Vision.

In addition, SHDR reviewed Vision's long-term debt. Even with the scheduled stock purchase, sufficient room still remained within deduction limitations to convert all existing long-term debt from after-tax to a pretax basis. The savings attributed to this tax savings can be illustrated, as follow:

Assuming a 40% tax bracket, the company must earn \$1.67 for each dollar of principal repayment on existing debt. If the debt can be converted to pretax payments, each dollar of principal payment is subsidized to the tune of 40% by the state and federal governments. The net cost is \$.60. This transaction improves cash flow by \$1.07!

RESULTS

A win, win, win. The shareholders win with the creation of an exit strategy and an established succession plan. The company wins with improved cash flow, reduction of tax liability, and employees who have an incentive to perform. And the employees win with a new retirement benefit and capital accumulation plan.