UBS

Employee Stock Ownership Plans

In brief

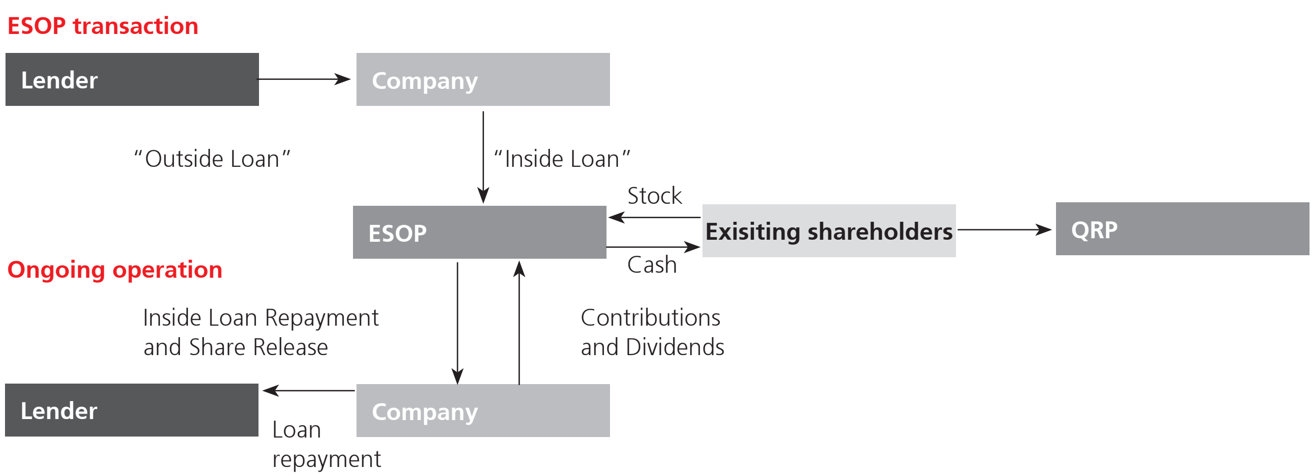
The ESOP Group

Business owners may benefit from a potential ESOP transaction as follows:
- Provides partial or complete liquidity to shareholders, often on a tax-advantaged basis
- Enhances free cash flow generation
- Increases certainty of closing in today's challenging markets as compared to transactions that are dependent on favorable market conditions
- Incentivizes employees to maximize value

UBS can support its clients in an ESOP transaction through a collaborative team.

What is an ESOP?
An ESOP is a formal arrangement in which employees gain ownership in the company. ESOPs can be viable liquidity alternatives to sell-side M&A, recap, or IPO transactions, and can be structured in different ways to meet a client's objectives:
- Liquidity
- Defer and/or minimize tax liability
- Retain operational control
- Transition management/succession planning
- Tax-efficient corporate structure

An ESOP is essentially a Leveraged Buyout (LBO) that may provide several tax benefits to the company and its owners



- Company creates ESOP
- Company borrows funds **from** Lender ("Outside Loan") and re-lends the proceeds to the ESOP ("Inside Loan")
- ESOP uses funds from Inside Loan to purchase shares **from** existing shareholders
- Company services the **new** debt by:
  - Making tax-deductible contributions and/or dividends/distributions to the ESOP
  - ESOP repays Inside Loan to Company
  - Company repays Outside Loan to Lender
  - As the Inside Loan is repaid, shares held as collateral for the Inside Loan are released and allocated to the employee accounts

When/Where are ESOPs Applicable

Situations that ESOPs can address

Situation	ESOP solution	Issues to consider
– **Closely Held Companies**	– Full or partial exit strategy to one or more selling shareholder(s)	– Maintaining control – Creating tax-efficient liquidity
– **Quasi-Public Companies**	– Effective in "going private" transactions	– Deductibility of debt – Potential utilization of qualified plan assets – Other possible tax advantages
– **PE Portfolio Companies**	– ESOP S-Corp structure combined with MBO	– Portfolio company borrows part of acquisition price – Employees and management can use partial qualified plan funds to purchase the remainder to create 100% S-Corp
– **Busted Auctions**	– Partial or full sale to ESOP can provide last resort option – 100% S-Corp sale with tax benefits	– Debt capacity – Potential utilization of qualified plan assets
– **Family-Owned Companies**	– Partial sale to ESOP facilitates business succession planning – Keeps business intact and rewards faithful employees	– Maintaining control – Opportunity to gift shares at significant discount to next generation – Creating tax-efficient liquidity
– **Companies with Existing ESOP**	– Creates efficient acquisition mechanism – 100% Sub S-Corp conversion for more tax-efficient structure	– Target sellers can sell on tax-free basis – Mature ESOPs have growing repurchase liability, often resulting in IPO, sale or recap – Debt capacity
– **Subsidiaries/Divisions for Divestiture/Spin-Off**	– Partnership with private equity firm	– Utilizing qualified plan assets – Tax efficiencies – Debt deductibility – No corporate income tax

Advantages/Disadvantages

Comparative Analysis

	Sale of Company	IPO	Dividend Recap	ESOP
– **Shareholder Liquidity**	– 100%	– Typically zero to partial	– Partial	– Between partial and 100%
– **Valuation**	– Premium over market value	– Stock is issued at discount to market value	– N/A	– No greater than Fair Market Value (FMV)
– **Certainty**	– Low	– Low	– Medium	– High
– **Financing Risk/Dependence on Favorable Market Conditions**	– High PE for buyers – Varies for strategic buyers	– High	– High	– Low
– **Ownership Dilution**	– Typically 100% transferred to buyer	– Typically 20%–40% dilution	– Typically zero dilution	– Typically 30%–100% transferred to employees through ESOP trust
– **Business Disruption**	– High	– High	– Moderate	– Low
– **Employee Retention**	– Significant flight risk	– Excellent retention incentive	– Leverage increases operational risk	– Superior retention incentive and increased productivity
– **Confidentiality**	– Sale process may be leaked – Competitors/strategic buyers may access confidential information	– Business strategy/key contracts publicly disclosed	– Confidential information limited to potential lenders	– Confidential information limited to potential lenders, trustees and valuation firm

The ESOP Group

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