



**This Exit Strategies Newsletter  
Brought to you by:  
Riverbend Capital Group**

**Should an ESOP be Part of Your Internal Exit Plan?**

Dear Client,

Most business owners today are wondering how and when this economy is going to turn around so life will go back to 'normal'? Beyond those short-term concerns, many of these same owners are going to bed at night thinking, 'how will I exit this business when I get the next chance'? More and more owners are taking a second look at their management teams to assess whether or not these folks who helped create the value within the firm can, in fact, actually run the firm in the owner's absence. Normally, an owner would consider finding an outsider buyer as part of their exit, but today's economy has owners faced with lower values, less capital available, and fewer buyers to be found.

If you are an owner who is turning to your managers as an exit option, you are not alone. What many other owners are learning about is how an Employee Stock Ownership Plan (ESOP) can also be used to assist with the exit. The ESOP is a vehicle that is very much misunderstood in the marketplace today, but may be the perfect addition to an exit plan that is focusing on a management buyout. An ESOP can actually purchase shares from

an owner, as can managers. However, by installing an ESOP in a forecasted management buyout, owners can increase their exit alternatives and sell shares to more than one buyer – let's explain this a bit further.

When a company is sold to its managers, there is a great deal of risk that stays with you, the exiting owner. Assuming that the managers do not have the cash to finance the purchase – which is a very safe assumption – then your payout is going to occur over many years. And, if the company does not have enough cash flow to support future payments, you may not be able to meet your post-exit goals. Can this risk be reduced?

Well, what if you were to sell a portion of your stock to an ESOP years in advance of selling the balance of the company to your managers? This would take a substantial amount of risk 'off the table' and it would assist you in building a culture of ownership over a number of years that would create a stronger environment for a management buyout. Let's take a further look at this interesting option.

Without going into too many details regarding ESOPs, you should know that you can create a buyer for the shares of stock in your company – that buyer is an Employee Stock Ownership Trust. When the ESOT purchases your shares, the

employees, including the managers, become beneficial owners of that stock. And you, as the owner, receive cash or a note for your shares. If you take cash for your shares, the company most likely will be responsible for repayment of a loan that is taken to fund the ESOP and provide you with the cash. Now, the question is – is this strategy any different than the company repaying you through the management buyout? Not really. The primary difference is that you remain in control of the company for the original sale to the ESOP, instead of losing control after the sale to your managers. This strategy allows you to diversify your holdings in the company years before you complete a transaction with your managers. By diversifying your assets away from the company, you lower the risk associated with the MBO transaction.

Now, this strategy gets even more intriguing when you consider the tax advantages of an ESOP. And, there is also the potential for operational advantages within your company that result from making employees into shareholders. In effect you are setting the stage for your own departure years in advance of a sale to your managers by selling your first round of ownership to the ESOP and receiving cash in return. This transaction structure also lessens the burden on the managers to purchase the full amount of ownership from you in the future. And, it will discipline your organization to handle the leverage that is associated with the loan required for your original sale of stock to the ESOP.

You see, in today's environment, you need to get creative in order to get the equity out of your business. You do not have the option of following only one exit

plan – i.e. the envisioned sale of your business in the future. In order to address today's marketplace, you need several alternatives for an exit as well as a bit of creativity. By adding an ESOP to your envisioned management buyout, you are in a position to achieve liquidity today, while beginning the process of transferring ownership to your future buyers.

**If you have any follow-up questions or wish to provide feedback, please contact me.**

**And feel free to share this newsletter.**



David E. Prouhet  
Exit Strategist  
314-258-2000  
DProuhet@RiverbendCapitalGroup.com

Riverbend Capital Group  
2464 Taylor Road Suite 307  
Wildwood, MO 63040