

CONFIDENTIAL

ESOP FINANCIAL BENEFITS

ESOP FINANCIAL BENEFITS COMPARED TO A NON-ESOP TRANSACTION

Following is an overview of the potential benefits an ESOP transaction could provide to both the selling and buying sides. For purposes of this example, we have assumed a 100% ESOP buyout from a private seller with a transaction value of \$10 million (and a negligible or zero tax basis in the securities sale). The proportionate benefits of using the ESOP technique of corporate finance would inure to the parties to the transaction regardless of size.

Seller Benefits

Section 1042 of the Internal Revenue Code enables shareholders of privately held companies which have a three-year holding period to reinvest the proceeds of a sale of stock to employees into any U. S. domestic corporate securities (either public or private) on a tax-deferred basis.

1042 Rollover Benefit Comparison

	<u>Non-ESOP</u>	<u>ESOP</u>
Gain on Sale	\$10,000,000	\$10,000,000
Tax (Combined Federal and State) ¹ (20%)	2,000,000	-0-
Net Proceeds	<u>\$ 8,000,000</u>	<u>\$10,000,000</u>

¹Assumes state of residence sale where this benefit is recognized for both state and federal tax purposes (rounded).

Reinvestment Benefit

Additional After-Tax Proceeds	\$2,000,000
After-Tax Reinvestment Return	.05
Life Expectancy - Years	21
Total Future Value of Reinvestment Benefit	<u>\$5,572,000</u>

Buyer Benefits

Deductible Principal and Dividend Payments Over the Life of the ESOP Debt

Principal and interest payments on ESOP debt are tax deductible, thus reducing the pretax cash flow required to service ESOP debt.

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	<u>Non-ESOP</u>	<u>ESOP</u>
Pretax Earnings Required to Service Debt	\$16,666,667	\$10,000,000
Combined Federal and State Tax (@ 40%)	<u>6,666,667</u>	<u>-0-</u>
After-Tax Earnings Available for Debt Service For the Life of the Loan	<u><u>\$10,000,000</u></u>	<u><u>\$10,000,000</u></u>

Computation of Total Additional Financial Benefits

1042 Rollover Tax Benefit	\$ 2,000,000
Seller Reinvestment Benefit	3,572,000
Principal Repayment Tax Benefit	<u>6,666,667</u>
Total ESOP Financial Benefits	<u><u>\$12,238,667</u></u>

As evidenced above, the total *additional* benefits available to both buyer and seller in the ESOP transaction exceed 100% of the transaction value. It is the overall magnitude of the enhancements an ESOP can provide that appeals to both potential buyers and sellers and makes an ESOP worthy of further evaluation.

Additional Benefit: Convert to an S corporation after being a C corporation and income to the ESOP is tax-free.