The ESOP Feasibility Study

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An ESOP feasibility study is an important first step in the process of establishing an employee stock ownership plan (ESOP) in a qualifying employer corporation. Such a study provides useful information to shareholders who are considering selling shares to an ESOP and to employer corporation managers. This information allows these parties of interest to decide whether or not an ESOP employer stock purchase transaction is an effective strategy for achieving their various objectives. ESOP feasibility studies can be very different depending on the situation. However, most ESOP feasibility studies contain basic elements that should be addressed in order (1) to provide meaningful information to all parties and (2) to avoid costly mistakes that could impair the long-term success of the ESOP.

Introduction

The purpose of an ESOP feasibility analysis is to give the selling shareholder(s) and employer corporation management the information needed to determine whether to move forward with an ESOP installation transaction.

Further, the results of the feasibility study enable the employer corporation, the ESOP trustee, the legal advisers, and the selling shareholder(s) to structure a transaction that is beneficial to the parties to the transaction. Such a transaction should also be fair to the ESOP from a financial point of view.

In general an ESOP feasibility study should address the following questions:

- Who will be selling the employer shares to the ESOP?
- How will the employer stock purchase transaction be financed and how will this affect the cash flow of the sponsor company?
- What is the best plan design for the sponsor company? Should the sponsor company merge the ESOP with an existing 401(k)?
- What are the rules and technical aspects of an ESOP that the employer corporation management and the selling shareholder(s) should know?
- What if the sponsor company's actual future performance varies positively or negatively from the future performance anticipated at the time of the employer stock purchase transaction?
- How does the selling shareholder's desired sale price for the employer corporation stock compare to the range of values determined by the valuation analyst working for the to-be-formed ESOP?

The First Steps

The initial steps of the ESOP feasibility study can actually be completed by the selling shareholder(s) with the help of the sponsor company management. That is, the initial ESOP feasibility procedures can be performed without the need to engage outside financial advisers or legal counsel.

In general, employer corporations that are in the best position to successfully complete the ESOP formation process and to be a sustainable ESOP have the following fact pattern:

- closely held U.S. company
- more than 25 employees
- established track record of consistent profitability and earnings growth
- a number years of operating history
- owner who is interested in liquidity and a diversification of wealth
- owner who is interested in succession planning and transitioning ownership of the company to employees
- at least $1 million in revenue
- owner who is open to accepting a conservative deal value
- senior management team that supports the ESOP formation

The controlling shareholder(s) can compare the employer corporation relative to these benchmark criteria in order to determine if the subject corporation is an ideal ESOP candidate. This initial analysis can be done without having to spend large amounts of time and money.

The next step is to become more familiar with the ESOP installation process, as well as the financial and administrative aspects of an ESOP. The ESOP Association and the National Center for Employee Ownership (NCEO) are excellent sources for this type of information. This will allow the parties in interest to be able to address questions such as the following:

- Can the differing goals and objectives of various shareholders and others parties in the transaction (management team, employees, non-selling shareholders, etc.) be achieved through the installation of an ESOP?
- Would a merger or sale to a strategic buyer or other type of liquidity event be better suited to these objectives?
- What percentage of the employer corporation will the ESOP own post-transaction and which shareholders will sell or redeem their shares as part of the employer stock purchase transaction?
- How will management and current controlling shareholders react to voting/control rights and issues and corporate governance changes?
- How will management succession planning be addressed in relation to the transaction? How long will the selling shareholders (who are also managers or executives) remain in their current roles? How will successors be identified and transitioned in order to maintain continuity gong forward?
- Is it desirable to merge the ESOP with an existing 401(k)?
- What happens to existing management incentive plans? Would a new plan be introduced as part of an ESOP employer stock purchase transaction?
- Which employees will be eligible to participate in the plan?

Consideration of the aforementioned questions will help to clarify the goals and objectives of interested parties. In this way, the means of achieving these goals can later be evaluated as part of the ESOP feasibility analysis.

If these initial steps indicate that installing an ESOP is a favorable method of achieving the objectives of the interested parties, then it is probably time to engage qualified, experienced ESOP professionals to address some of the more technical (or complex) ESOP feasibility issues.

The Common Elements of a Full Comprehensive ESOP Feasibility Study

A comprehensive ESOP feasibility study is typically comprised of several analyses that focus on various areas of concern. These analyses may include the following:

- a preliminary valuation of the employer corporation to determine the approximate price that an ESOP could or may pay
- a stockholders' equity analysis to determine how an ESOP would affect existing shareholders and the employer corporation financial performance
- a plan design study to determine the ideal transaction structure and plan features to incorporate in the to-be-formed ESOP
- a liquidity study to assess the demands that the employer corporation repurchase obligations would eventually make on the sponsor company

The Preliminary Valuation

The preliminary valuation is an important part of the ESOP feasibility analysis. However, it is one of the early steps in the process. Therefore, the preliminary valuation is generally performed by the valuation firm without the benefit of due diligence adequate for developing a formal opinion of value.

Because the determination of value is such a complex undertaking, an experienced valuation firm is required. In most cases, the preliminary valuation is expressed as a range of values as of a specific date.

An experienced ESOP valuation analyst can establish this range of value without rendering a detailed valuation report. Consequently, the cost will be much less than that of a final valuation report.

The determination of the range of values is on the critical path of the ESOP formation process. If (1) it is below the price desired by the seller(s) and (2) structuring alternatives, such as earn-outs or warrants, can't be used to encourage seller(s) to proceed, then other strategies may be employed to increase value (waiting until the employer corporation performance improves, reducing employer corporation expenses, etc.).

If the major shareholders are not willing to sell stock, or to permit the issuance of new stock at a price within the range of values determined by the valuation analyst, then the ESOP formation process should be abandoned.

The preliminary value should be completed as early in the process as possible so that owners can change direction and evaluate other liquidity alternatives while minimizing costs incurred pursuing a strategy that would ultimately be unsuccessful.

Equity Analysis/Cash Flow Analysis

The stockholders' equity analysis, a liquidity study, and a design study can be started concurrently, while the preliminary valuation is being performed.

The stockholders' equity study will address several of the important questions usually asked by major shareholders who are considering an ESOP.

Typically, such shareholders want to be shown the following, for the period that the ESOP loan will be outstanding:

- how the ESOP will affect the value of their stock
- how the ESOP will affect the sponsor company's cash flow and its profitability
- what employer stock value dilutive effects the ESOP will have

When the employer corporation employer corporation has an existing pension and/or profit sharing plan, the analysis may also show the effects of the ESOP compared to those of the existing plans.

"If the major shareholders are not willing to sell stock, or to permit the issuance of new stock at a price within the range of values determined by the valuation analyst, then the ESOP formation process should be abandoned."

The stockholders' equity analysis uses the employer corporation's internally produced projections, projections with alternative growth and profitability assumptions, and other ESOP transaction variables to create several scenarios in order to illustrate the resulting impact on cash flow and value.

It is important to note that the cash flow analysis can be used as a structuring tool to evaluate a mixture of financing options such as varying levels of bank debt versus seller debt, as well as the assorted terms and conditions of the proposed financing.

Some of the important variables that can be adjusted in order to construct various scenarios include, but are not limited to, the following:

- revenue growth
- profit margin
- amount of bank financing
- bank financing terms (interest rates, covenants, maturity, required prepayments, guarantees, etc.)
- amount of seller financing
- seller subordinated debt terms (interest rates, maturity, required prepayments, warrants, etc.)
- refinancing
- capital expenditures
- working capital

Many times, the valuation analyst will use employer corporation provided projections as a base case scenario. The valuation analyst will then adjust revenues or profitability to create other scenarios such as optimistic, pessimistic, and zero growth scenarios.

These scenarios hold changes in other variables consistent across the scenarios. The goal of these alternative scenarios is to demonstrate how the

Exhibit 1
Employer Corporation
Projected Income Statements
As of January 1, 2010
(Management Expectations "Base Case" Scenario)

	Projected 12/31/10 $000s	Projected 12/31/11 $000s	Projected 12/30/12 $000s	Projected 12/30/13 $000s	Projected 12/31/14 $000s	Projected 12/31/10 %	Projected 12/31/11 %	Projected 12/30/12 %	Projected 12/30/13 %	Projected 12/31/14 %	Avg. %
Revenue	9,000	9,900	10,692	11,227	11,788	100.0	100.0	100.0	100.0	100.0	100.0
Revenue Growth Rate		10%	8%	5%	5%						
Cost of Goods Sold	6,120	6,732	7,305	7,706	8,128	68.0	68.0	68.3	68.6	69.0	68.4
Gross Profit	2,880	3,168	3,387	3,521	3,660	32.0	32.0	31.7	31.4	31.0	31.6
Operating Expenses	(2,121)	(2,086)	(2,027)	(1,915)	(1,810)	(23.6)	(21.1)	(19.0)	(17.1)	(15.4)	(19.2)
Operating Income [EBIT]	759	1,082	1,360	1,606	1,851	8.4	10.9	12.7	14.3	15.7	12.4
Interest Expense	(90)	(60)	-	(1)	(2)	(1.0)	(0.6)	-	(0.0)	(0.0)	(0.3)
Other Income (Expense)	518	-	-	-	-	5.8	-	-	-	-	1.2
Pretax Income	1,187	1,022	1,360	1,605	1,849	13.2	10.3	12.7	14.3	15.7	13.2
Cash Flow Calculation											
EBIT	759	1,082	1,360	1,606	1,851	8.4	10.9	12.7	14.3	15.7	12.4
+ EBITDA Add Backs	2,974	3,004	3,064	3,063	3,061	33.0	30.3	28.7	27.3	26.0	29.1
- Lease Add Back	-	-	-	-	-	-	-	-	-	-	-
= EBITDA	3,733	4,086	4,424	4,669	4,912	41.5	41.3	41.4	41.6	41.7	41.5

employer corporation may fare under multiple sets of operating circumstances.

Exhibit 1 illustrates an example base case operating scenario, using projections provided by employer corporation management.

Exhibit 2 shows the proposed deal financing structure, interest rates, debt maturities, and the resulting sponsor company cash flows and covenant compliance.

Exhibit 3 illustrates the impact of declining revenue on profitability.

Exhibit 4 demonstrates how the decline in profitability affects cash flow and covenant compliance.

From this analysis, interested parties to the transaction can observe the impact that a decline in revenue/profitability would have on the cash flow of the sponsor company. The interested parties can then develop a plan of action or alter the deal structure to ensure that the sponsor company has adequate capital in the event that base case projections are not achieved.

A similar analysis is presented in Exhibits 5 and 6. However, this analysis calculates the value of the employer corporation in future years using sponsor company projections forecasted out at least to the year that all seller debt matures.

The market value of invested capital (MVIC) in future periods is estimated by applying market-derived pricing multiples of revenue and EBITDA (earnings before interest, taxes, depreciation, and amortization) for each period. The two indications of value are then averaged in order to arrive at a single indication of value.

Next, the operating debt and ESOP debt are subtracted from the MVIC, and a discount for lack of marketability is applied to arrive at the estimated fair market value of sponsor company equity for each year.

In the example presented in Exhibit 5, warrants are attached to the seller debt. These warrants give the selling shareholder the right to purchase 700,000 shares of stock at 90 percent of the December 31, 2009, fair market value of equity per share in tranches that are exercisable upon the sponsor company achieving certain EBIT targets.

Exhibit 6 presents the cash flow implications of the additional debt from the exercise of the warrants. This analysis can help to facilitate discussions between the selling shareholder(s), legal advisers, and the ESOP financial advisers regarding (1) the total return on the debt and warrants to be received by the selling shareholder(s), (2) the resulting dilutive impact on value and (3) the cash

Exhibit 2
Employer Corporation
Debt Service Projections
As of January 1, 2010
(Management Expectations "Base Case" Scenario)

		2011 *$000s*	2012 *$000s*	2013 *$000s*	2014 *$000s*	2015 *$000s*	2016 *$000s*	2017 *$000s*	2018 *$000s*
Term Loan									
Principal	10,000								
Interest Rate	4.65%								
Amortization	7								
Term	3								
Beginning Principal Balance		10,000	7,356	5,955	4,080	2,916	1,655	289	-
Principal Payments		2,644	1,401	1,874	1,165	1,261	1,366	289	-
Interest Payments		380	312	379	284	188	83	3	-
Total Loan Payment		3,025	1,713	2,253	1,449	1,449	1,449	292	-
Ending Principal Balance		7,356	5,955	4,080	2,916	1,655	289	-	-
Total Principal Payments		2,644	1,401	1,874	1,165	1,261	-	-	-
Total Interest Payments		380	312	379	284	188	-	-	-
Total Transaction Debt Service		3,025	1,713	2,253	1,449	1,449	-	-	-
Cash Flow for Debt Service [b]		3,452	3,757	3,998	4,207	4,418	4,638	4,870	5,114
Senior Debt Service Coverage (Deficit)		427	2,044	1,745	2,758	2,969	4,638	4,870	5,114
Subordinated Note 1									
Principal	3,000								
Interest Rate	10.00%								
Term	3								
Beginning Principal Balance		3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Principal Payments		-	-	-	-	-	-	-	-
		-	-	-	-	-	-	-	-
Interest Payments		300	300	300	300	300	300	300	300
Total Loan Payment		300	300	300	300	300	300	300	300
Ending Principal Balance		3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Cash Flow for Debt Service		427	2,044	1,745	2,758	2,969	4,638	4,870	5,114
Subordinated Note Payment		300	300	300	300	300	300	300	300
Debt Service Coverage (Deficit)		127	1,744	1,445	2,458	2,669	4,338	4,570	4,814
Excess Cash Flow									
EBITDA		4,086	4,424	4,669	4,912	5,157	5,415	5,686	5,970
LESS: cash interest expense		680	612	679	584	488	300	300	300
cash taxes (if any)		-	-	-	-	-	-	-	-
required and voluntary debt payments (principal)		2,644	1,401	1,874	1,165	1,261	-	-	-
unfinanced capital expenditures		495	545	588	617	648	648	648	648
dividend distributions		194	258	305	351	369	387	407	427
treasury stock purchases		-	-	-	-	-	-	-	-
		72	1,609	1,223	2,194	2,391	4,079	4,331	4,595
Mandatory Prepayment		(36)	(804)	-	-	-	-	-	-
Adjusted Cash Flow		36	804	1,223	2,194	2,391	4,079	4,331	4,595
Beginning Cash		1,348	1,384	2,189	3,412	5,606	7,997	12,076	16,407
Ending Cash		1,384	2,189	3,412	5,606	7,997	12,076	16,407	21,002
Personal Guarantee		2,500	2,500	2,500	2,500	-	-	-	-
Covenant Compliance									
Letter of Credit		-	-	-	-	-	-	-	-
CapEx Loan		-	-	-	-	-	-	-	-
Term Loan		7,356	5,955	4,080	2,916	1,655	289	-	-
Sub Note 1		3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Sub Note 2		-	-	-	-	-	-	-	-
Guarantee		2,500	2,500	2,500	2,500	-	-	-	-
Total Funded Debt		12,856	11,455	9,580	8,416	4,655	3,289	3,000	3,000
EBITDA		4,086	4,424	4,669	4,912	5,157	5,415	5,686	5,970
ESOP Contribution Expenses		-	-	-	-	-	-	-	-
EBITDAE		4,086	4,424	4,669	4,912	5,157	5,415	5,686	5,970
Total Leverage		3.15x	2.59x	2.05x	1.71x	0.90x	0.61x	0.53x	0.50x
Maximum Allowed		3.25x	3.25x	3.25x	3.25x	3.25x	3.25x	3.25x	3.25x
In Compliance?		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Exhibit 3
Employer Corporation
Projected Income Statements
As of January 1, 2010
(Declining Revenue Scenario)

	Projected 12/31/10 *$000s*	Projected 12/31/11 *$000s*	Projected 12/30/12 *$000s*	Projected 12/30/13 *$000s*	Projected 12/31/14 *$000s*	Projected 12/31/10 *%*	Projected 12/31/11 *%*	Projected 12/30/12 *%*	Projected 12/30/13 *%*	Projected 12/31/14 *%*	Avg. *%*
Revenue	9,000	7,650	6,503	5,527	4,698	100.0	100.0	100.0	100.0	100.0	100.0
Revenue Growth Rate		-15%	-15%	-15%	-15%						
Cost of Goods Sold	6,120	5,202	4,443	3,794	3,239	68.0	68.0	68.3	68.6	69.0	68.4
Gross Profit	2,880	2,448	2,060	1,733	1,459	32.0	32.0	31.7	31.4	31.0	31.6
Operating Expenses	(2,121)	(1,612)	(1,233)	(943)	(721)	(23.6)	(21.1)	(19.0)	(17.1)	(15.4)	(19.2)
Operating Income (EBIT)	759	836	827	791	738	8.4	10.9	12.7	14.3	15.7	12.4
Interest Expense	(90)	(60)	-	(1)	(2)	(1.0)	(0.8)	-	(0.0)	(0.0)	(0.4)
Other Income (Expense)	518	-	-	-	-	5.8	-	-	-	-	1.2
Pretax Income	1,187	776	827	790	736	13.2	10.1	12.7	14.3	15.7	13.2
Cash Flow Calculation											
EBIT	759	836	827	791	738	8.4	10.9	12.7	14.3	15.7	12.4
+ EBITDA Add Backs	2,974	3,004	3,064	3,063	3,061	33.0	39.3	47.1	55.4	65.2	48.0
- Lease Add Back	-	-	-	-	-	-	-	-	-	-	-
= EBITDA	3,733	3,840	3,891	3,854	3,799	41.5	50.2	59.8	69.7	80.9	60.4

flow implications of the timing and magnitude of the warrant cash out payments.

Liquidity Analysis

The liquidity analysis is intended to estimate the amount of the repurchase obligation that the sponsor company will incur over the next, say, 10 to 15 years. This repurchase obligations results from employees' termination of service due to death, disability, retirement, and so forth.

"While a liquidity analysis does not typically address the source of funding for repurchase obligations, it is a valuable analysis tool that can help the sponsor company management to estimate the timing and amounts of funding needed for repurchasing shares."

The liquidity analysis typically does not address the source of funding for the repurchase obligation. However, it is a valuable analysis tool that can help the sponsor company management to estimate the timing and amount of the funding that will be needed for repurchasing the employer shares. This information allows the sponsor company management to make the appropriate plans.

Plan Design Study Analysis

The greater the flexibility integrated into the design of the ESOP, the more effectively it will be able to accomplish the objectives (1) of the employer corporation and (2) of the selling shareholders.

The plan design study will typically address the following issues:

- participant eligibility
- vesting schedules
- timing of benefit distributions
- forfeitures
- contribution levels
- allocation formulas
- past service credit
- early retirement policies
- a charter or bylaw provision restricting stock ownership to the employee group

The use of one or more special classes of stock (e.g., nonvoting stock, preferred or convertible preferred stock, etc.) can also be addressed in this plan design study.

Other questions that may need to be addressed in the plan design study include the following:

- Who will participate in the ESOP?
- Must the sponsor company distribute stock to employees at retirement or other required distribution dates if they demand it, or can the sponsor company limit the distributions to cash?
- What divisions or subsidiaries can be excluded from the plan?
- Who will vote the ESOP stock and under what circumstances?
- Should you combine other plans, such as a 401(k) plan, with the ESOP?
- What will happen to an existing pension or profit sharing plan?
- Is the existing pension plan overfunded, underfunded, or currently funded?
- What about the selection of ESOP fiduciaries-trustee(s), and possible administrative and/or advisory committee(s)?

An analysis of income tax issues should also be part of the plan design aspect of an ESOP feasibility study. The relevant income-tax-related issues include the tax implications of ESOP-related legislation, regulations and rulings, and judicial precedent.

In addition, interested parties should consider the implications of the following:

1. "tax-deferred reinvestment" or "tax-free rollover" of funds from the sale of the employer corporation stock to an ESOP
2. tax-deductible dividends if paid to participants or used to repay the ESOP debt
3. S corporation ESOP considerations
4. any new or proposed regulations or legislation

If a deferred profit sharing or money purchase pension plan exists at the sponsor company, it is normally "frozen." And, the assets of the existing plan will typically remain invested in a diversified portfolio. However, the employees can be given the option to invest a portion or all of their assets from a profit sharing, money purchase, or 401(k) plan either (1) into the sponsor company stock or (2) into part of the ESOP employer stock transaction.

All federal and state securities laws should be complied with, and "full disclosure" should be given to the sponsor company employees. Full disclosure can be a very expensive proposition. Almost all ESOP sponsor companies either maintain or establish a diversified 401(k) plan that is not invested in the sponsor company stock. However, in some cases a sponsor company may decide to merge its existing 401(k) plan with the ESOP.

In these situations, employees that are invested in the sponsor company's 401(k) plan are given the opportunity to invest their money into the ESOP. These funds are considered part of the employer stock purchase transaction financing, and these funds are used to purchase sponsor company shares from the selling shareholder(s).

As mentioned above, there are certain costs and risks associated with an ESOP. For example, the sponsor company will be required to create a disclosure memorandum. The disclosure memorandum describes:

1. the nature of sponsor company operations,
2. historical operating performance,
3. expectations for future performance,
4. risks associated with investing in the sponsor company, and
5. other information that an investor would require in order to make an informed investment decision.

The disclosure memorandum is then distributed to the employees. The sponsor company employees are typically given 20-30 days to make their decision about investing in the sponsor company stock. The distribution of this disclosure memorandum may be considered a risk to the ESOP formation process. This is because, many times, the employees don't have the financial sophistication or desire to evaluate the information contained in the disclosure memorandum.

Therefore, many employees elect not to invest. As a result, the sponsor company may not receive the level of employee participation that was expected from this method of financing.

In some cases, the sponsor company may make financial advisers available to the employees at no cost. These financial advisers are provided in an effort to give the sponsor company employees the resources needed to make informed decisions.

Exhibit 4
Employer Corporation
Debt Service Projections
As of January 1, 2010
(Defining Revenue Scenario)

		2011	2012	2013	2014	2015	2016	2017	2018
		$000s	*$000s*	*$000s*	*$000s*	*$000s*	*$000s*	*$000s*	*$000s*
Term Loan									
Principal	10,000								
Interest Rate	4.65%								
Amortization	7								
Term	3								
Beginning Principal Balance		10,000	7,356	6,059	4,279	3,104	1,833	455	-
Principal Payments		2,644	1,297	1,780	1,174	1,272	1,377	455	-
Interest Payments		380	316	394	300	202	97	7	-
Total Loan Payment		3,025	1,613	2,174	1,474	1,474	1,474	463	-
Ending Principal Balance		7,356	6,059	4,279	3,104	1,833	455	-	-
Total Principal Payments		2,644	1,297	1,780	1,174	1,272	-	-	-
Total Interest Payments		380	316	394	300	202	-	-	-
Total Transaction Debt Service		3,025	1,613	2,174	1,474	1,474	-	-	-
Cash Flow for Debt Service [b]		3,555	3,648	3,647	3,623	3,804	3,994	4,194	4,404
Senior Debt Service Coverage (Deficit)		530	2,035	1,473	2,149	2,330	3,994	4,194	4,404
Subordinated Note 1									
Principal	3,000								
Interest Rate	10.00%								
Term	3								
Beginning Principal Balance		3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Principal Payments		-	-	-	-	-	-	-	-
		-	-	-	-	-	-	-	-
Interest Payments		300	300	300	300	300	300	300	300
Total Loan Payment		300	300	300	300	300	300	300	300
Ending Principal Balance		3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Cash Flow for Debt Service		530	2,035	1,473	2,149	2,330	3,994	4,194	4,404
Subordinated Note Payment		300	300	300	300	300	300	300	300
Debt Service Coverage (Deficit)		230	1,735	1,173	1,849	2,030	3,694	3,894	4,104
Excess Cash Flow									
EBITDA		3,840	3,891	3,854	3,799	3,988	4,188	4,397	4,617
LESS: cash interest expense		680	616	694	600	502	300	300	300
cash taxes (if any)		-	-	-	-	-	-	-	-
required and voluntary debt payments (principal)		2,644	1,297	1,780	1,174	1,272	-	-	-
unfinanced capital expenditures		495	421	358	304	258	258	258	258
dividend distributions		147	157	150	140	147	154	162	170
treasury stock purchases		-	-	-	-	-	-	-	-
		(127)	1,400	872	1,581	1,809	3,475	3,677	3,889
Mandatory Prepayment		63	(700)	-	-	-	-	-	-
Adjusted Cash Flow		(63)	700	872	1,581	1,809	3,475	3,677	3,889
Beginning Cash		1,348	1,285	1,985	2,857	4,437	6,247	9,722	13,399
Ending Cash		1,285	1,985	2,857	4,437	6,247	9,722	13,399	17,288
Personal Guarantee		2,500	2,500	2,500	2,500	-	-	-	-
Covenant Compliance									
Letter of Credit		-	-	-	-	-	-	-	-
CapEx Loan		-	-	-	-	-	-	-	-
Term Loan		7,356	6,059	4,279	3,104	1,833	455	-	-
Sub Note 1		3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Sub Note 2		-	-	-	-	-	-	-	-
Guarantee		2,500	2,500	2,500	2,500	-	-	-	-
Total Funded Debt		12,856	11,559	9,779	8,604	4,833	3,455	3,000	3,000
EBITDA		3,840	3,891	3,854	3,799	3,988	4,188	4,397	4,617
ESOP Contribution Expenses		-	-	-	-	-	-	-	-
EBITDAE		3,840	3,891	3,854	3,799	3,988	4,188	4,397	4,617
Total Leverage		3.35x	2.97x	2.54x	2.27x	1.21x	0.83x	0.68x	0.65x
Maximum Allowed		3.25x	3.25x	3.25x	3.25x	3.25x	3.25x	3.25x	3.25x
In Compliance?		No	Yes	Yes	Yes	Yes	Yes	Yes	Yes

However, due to the costs associated with giving employees the option to invest their 401(k) or profit sharing assets in sponsor company stock, the employer corporation management should carefully weigh the risks versus the probability of success before pursuing this strategy.

If sponsor company management determines that this strategy will be pursued, a temporary "floor price" will usually be attached to the employer stock acquired with assets of other plans. This temporary floor price will often remain in effect until the ESOP debt is completely repaid.

This "floor price," in most cases, is calculated as the fair market value of the sponsor company stock without taking into account the impact of ESOP stock acquisition debt.

The plan design features should also allow for factors that will positively influence employee motivation. For example, an accelerated vesting schedule serves to motivate employees. However, as a means to prevent vested employees from terminating their employment prematurely in order to receive large account balances, the sponsor company may postpone distribution of accounts to terminated employees for a considerable time period.

Voting rights are a major concern for many shareholders of closely held corporations. However, this issue has not proven to be a concern with ESOP-owned sponsor companies. There is no requirement to "pass-through" voting rights to employees of closely held sponsor companies, except for issues such as mergers, consolidations, recapitalizations, sale of the business, liquidation, dissolutions, and similar types of transactions.

When a trusted, experienced management team has a track record of successfully operating a business to achieve growth and profitability, employees are generally content not to be involved in the management of the sponsor company.

Summary and Conclusion

Upon the completion of the ESOP feasibility study, the findings are typically presented to the employer corporation board of directors or the ESOP formation committee. The board or the special committee then makes the final decision regarding the formation of an ESOP.

It is important for the professionals involved in conducting the ESOP feasibility study (which may include a valuation firm, an ESOP consultant, investment bankers, lenders, the senior management team, legal advisers, and the shareholders):

1. to anticipate potential ESOP formation obstacles and
2. to have considered solutions to these obstacles. In this way, these issues can be evaluated as part of the board of directors' or ESOP formation committee's decision-making process.

Further, the evaluation of the ESOP feasibility is an ongoing part of the ESOP formation process. As decisions are made, circumstances change, and various opportunities are considered, the different aspects and analyses of the ESOP feasibility study should be updated. This update analysis should reflect the most current set of facts related to the sponsor company in order to confirm the continued feasibility of an ESOP formation.

"Plan design features should also allow for factors that will positively influence employee motivation. "

Sources:

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3. Smiley, Robert W. Jr., Ronald J. Gilbert, David Binns, Ronald L. Ludwig, and Corey M. Rosen, eds. *Employee Stock Ownership Plans: Business Planning, Implementation, and Law and Taxation.* San Diego: The Beyster Institute, 2006 and 2007.
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6. Bonn, Karen. "Feasibility Studies Help Avoid ESOP Foibles." *The Tax Adviser (*February 1, 1999).

"It is important for the professionals involved in conducting the feasibility study . . . to anticipate potential obstacles and to have considered solutions to these obstacles."

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Exhibit 5
Employer Corporation
Total Seller Rate of Return Calculation
As of January 1, 2010

		Current 12/31/09 $000s	12/31/10 $000s	12/31/11 $000s	12/30/12 $000s	12/30/13 $000s	12/31/14 $000s	12/31/15 $000s	12/30/16 $000s	12/30/17 $000s	12/31/18 $000s	12/31/19 $000s	12/30/20 $000s	12/30/21 $000s	12/31/22 $000s	12/31/23 $000s	12/30/24 $000s	12/30/25 $000s	12/31/26 $000s
Projected Revenue			40,000	37,000	42,000	46,000	49,000	51,450	54,023	56,724	59,560	62,538	65,665	68,948	72,395	76,015	79,816	83,807	87,997
Growth Rate				*-8%*	*14%*	*10%*	*7%*	*5%*	*5%*	*5%*	*5%*	*5%*	*5%*	*5%*	*5%*	*5%*	*5%*	*5%*	*5%*
Projected EBITDA			1,500	2,373	4,471	5,999	7,500	7,875	8,269	8,682	9,116	9,572	10,051	10,553	11,081	11,635	12,217	12,828	13,469
EBITDA Growth Rate				58%	88%	34%	25%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
EBITDA Margin				*6%*	*11%*	*13%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*
Projected EBIT			1200	2,273	4,371	5,899	7,999	8,398	8,818	9,259	9,722	10,208	10,719	11,255	11,817	12,408	13,029	13,680	14,364
EBIT Growth Rate				89%	92%	35%	36%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
EBIT Margin				6%	10%	13%	16%	16%	16%	16%	16%	16%	16%	16%	16%	16%	16%	16%	16%
Market Value of Invested Capital (MVIC)[before DLOM]																			
Future MVIC [Revenue Pricing Multiple]			28,000	25,900	25,200	27,600	29,400	30,870	32,414	34,034	35,736	37,523	39,399	41,369	43,437	45,609	47,890	50,284	52,798
Future MVIC [EBITDA Pricing Multiple]			22,500	35,593	33,532	44,989	56,250	59,063	62,016	65,116	68,372	71,791	75,380	79,149	83,107	87,262	91,625	96,207	101,017
Estimated Future MVIC		35,000	25,250	30,746	29,366	36,295	42,825	44,966	47,215	49,575	52,054	54,657	57,390	60,259	63,272	66,436	69,757	73,245	76,908
Equity Value																			
Estimated Future MVIC		35,000	25,250	30,746	29,366	36,295	42,825	44,966	47,215	49,575	52,054	54,657	57,390	60,259	63,272	66,436	69,757	73,245	76,908
- Operating Debt		11,943	3,030	3,690	2,000	1,500	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,201	1,202	1,203	1,204	1,205	1,205
Warrant Note 1		-	-	-	-	-	5,970	5,412	4,830	4,223	3,590	2,931	2,243	1,526	779	-	-	-	-
Warrant Note 2		-	-	-	-	-	-	3,339	3,027	2,701	2,362	2,008	1,639	1,254	854	436	-	-	-
Warrant Note 3		-	-	-	-	-	-	1,670	1,513	1,351	1,181	1,004	820	627	427	218	-	-	-
Warrant Note 4		-	-	-	-	-	-	-	1,034	938	837	732	622	508	389	264	135	-	-
Warrant Note 5		-	-	-	-	-	-	-	-	622	564	503	440	374	305	234	159	81	-
- ESOP Note		10,600	10,477	9,572	8,630	7,650	6,630	5,568	4,462	3,312	2,114	868	-	-	-	-	-	-	-
= Indicated Equity Value [Rounded]		12,457	11,743	17,484	18,736	27,145	29,025	27,778	31,148	35,230	40,207	45,412	50,426	54,768	59,317	64,081	68,259	71,959	75,703
- DLOM	-5%	(623)	(587)	(874)	(937)	(1,357)	(1,451)	(1,389)	(1,557)	(1,761)	(2,010)	(2,271)	(2,521)	(2,738)	(2,966)	(3,204)	(3,413)	(3,598)	(3,785)
= Concluded Total Fair Markte Value of Equity [Rounded]		11,800	11,200	16,600	17,800	25,800	27,600	26,400	29,600	33,500	38,200	43,100	47,900	52,000	56,400	60,900	64,800	68,400	71,900
Number of ESOP Shares		700	700	700	700	700	700	700	700	700	700	700	700	700	700	700	700	700	700
Warrant Shares Exercised		-	-	-	-	-	300	225	50	25	10	-	-	-	-	-	-	-	-
Price Per Share		16.86	16.00	23.71	25.43	36.86	39.43	37.71	42.29	47.86	54.57	61.57	68.43	74.29	80.57	87.00	92.57	97.71	102.71
Warrant Shares Exercised			-	-	-	-	300	225	50	25	10	-	-	-	-	-	-	-	-
Market Value Warrant Exercised			-	-	-	-	11,057	8,871	1,886	1,057	479	-	-	-	-	-	-	-	-
Warrant Exercise Price	15.17		15.17	15.17	15.17	15.17	15.17	15.17	15.17	15.17	15.17	15.17	15.17	15.17	15.17	15.17	15.17	15.17	15.17
Total Warrant Exercise Value			-	-	-	-	4,551	3,414	759	379	152	-	-	-	-	-	-	-	-
Warrant Cash Out Value			-	-	-	-	6,506	5,458	1,127	678	327	-	-	-	-	-	-	-	-
Cumulative Warrant Value			-	-	-	-	6,506	11,964	13,091	13,769	14,095	14,095	14,095	14,095	14,095	14,095	14,095	14,095	14,095
Return to Sellers																			
ESOP Note		(10,600)	544	1,306	1,306	1,306	1,306	1,306	1,306	1,306	1,306	1,306	885	-	-	-	-	-	-
Warrant Note 1		-	-	-	-	-	812	812	812	812	812	812	812	812	812	779	-	-	-
Warrant Note 2		-	-	-	-	-	-	454	454	454	454	454	454	454	454	454	436	-	-
Warrant Note 3		-	-	-	-	-	-	227	227	227	227	227	227	227	227	227	218	-	-
Warrant Note 4		-	-	-	-	-	-	-	141	141	141	141	141	141	141	141	141	135	-
Warrant Note 5		-	-	-	-	-	-	-	-	85	85	85	85	85	85	85	85	85	81
Total		(10,600)	544	1,306	1,306	1,306	2,118	2,799	2,940	3,025	3,025	3,025	2,604	1,719	1,719	1,686	879	220	81

Total Rate of Return [IRR]	15.0%
IRR with Mid-Period Discounting	**16.3%**

Exhibit 6
Employer Corporation
Sponsor Company Cash Flow Analysis
As of January 1, 2010

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
	12/31/10	12/31/11	12/30/12	12/30/13	12/31/14	12/31/15	12/30/16	12/30/17	12/31/18	12/31/19	12/30/20	12/30/21	12/31/22	12/31/23	12/30/24	12/30/25	12/31/26
	000's	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*	*000's*
Projected Revenues	$ 40,000	$ 37,000	$ 42,000	$ 46,000	$ 49,000	$ 51,450	$ 54,023	$ 56,724	$ 59,560	$ 62,538	$ 65,665	$ 68,948	$ 72,395	$ 76,015	$ 79,816	$ 83,807	$ 87,997
Projected EBITDA	$ 1,500	$ 2,373	$ 4,471	$ 5,999	$ 7,500	$ 7,875	$ 8,269	$ 8,682	$ 9,116	$ 9,572	$ 10,051	$ 10,553	$ 11,081	$ 11,635	$ 12,217	$ 12,828	$ 13,469
Senior Bank Debt - Revolver	(120)	(111)	(126)	(138)	(147)	(154)	(162)	(170)	(179)	(188)	(197)	(207)	(217)	(228)	(239)	(251)	(264)
Cash Flow after Bank Payments	1,380	2,262	4,345	5,861	7,353	7,721	8,107	8,512	8,938	9,384	9,854	10,346	10,864	11,407	11,977	12,576	13,205
Seller Sub Notes	(544)	(1,306)	(1,306)	(1,306)	(1,306)	(1,306)	(1,306)	(1,306)	(1,306)	(1,306)	(885)	-	-	-	-	-	-
Warrant Note 1	-	-	-	-	(812)	(812)	(812)	(812)	(812)	(812)	(812)	(812)	(812)	(779)	-	-	-
Warrant Note 2	-	-	-	-	-	(454)	(454)	(454)	(454)	(454)	(454)	(454)	(454)	(454)	(436)	-	-
Warrant Note 3	-	-	-	-	-	(227)	(227)	(227)	(227)	(227)	(227)	(227)	(227)	(227)	(218)	-	-
Warrant Note 4	-	-	-	-	-	-	(141)	(141)	(141)	(141)	(141)	(141)	(141)	(141)	(141)	(135)	-
Warrant Note 5	-	-	-	-	-	-	-	(85)	(85)	(85)	(85)	(85)	(85)	(85)	(85)	(85)	(81)
Total Sub Debt Service	(544)	(1,306)	(1,306)	(1,306)	(2,118)	(2,799)	(2,940)	(3,025)	(3,025)	(3,025)	(2,604)	(1,719)	(1,719)	(1,686)	(879)	(220)	(81)
Capital Expenditures	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)
Working Capital Additions	4,983	270	(450)	(360)	(270)	(221)	(232)	(243)	(255)	(268)	(281)	(295)	(310)	(326)	(342)	(359)	(377)
Excess Cash Flow (Deficit)	5,619	1,026	2,389	3,995	4,765	4,501	4,735	5,044	5,458	5,892	6,768	8,132	8,635	9,196	10,556	11,797	12,547