Capital Notes

Midyear Update for Friends and Clients of Corporate Capital Resources

Corporate Capital Resources Newsletter 2nd Quarter 2013

A Key Issue Keeps Coming Up This Year

Business success is often driven by a few key players. Business success(ion) plans are best designed to coordinate the rewarding and retaining of this group with the overall strategy. Where an ESOP is a part (whether large or small) of the program, the typical notion of rewarding rising management with equity compensation must be considered together with the ESOP valuation and the stock repurchase obligations.

The direct coupling of equity benefits outside the ESOP to the ESOP stock value means that the incentive for a management group to aggressively grow share price is effectively saying 'grow the ESOP stock repurchase obligations' aggressively.

There are equity-equivalent forms of discriminatory compensation which can be 'decoupled' from the ESOP stock value to allow performance-based rewards either lower or higher than ESOP results. These rewards can be both prudent from a fiduciary perspective and meaningful in that they use real-world metrics. Our presentation to the NCEO national conference in Seattle summarizes some of the issues. Our point is simply to avoid a cookie cutter "get-them-some-stock" response when building selective compensation plans outside an ESOP.

They're Forever Blowing Bubbles...

Much of the liquidity supporting the economy derives from what is euphemistically called 'Quantitative Easing' This

Quick Links

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Meet Our Professionals:

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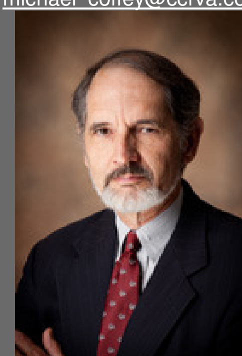

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liquidity for our debt (bonds) in particular is decried by A. Haldane, Bank of England Director of Financial Stability reporting to Parliament on June 12:

"Let's be clear. We've intentionally blown the biggest government bond bubble in history... If I were to single out what for me would be biggest risk to global financial stability right now it would be a disorderly reversion in the yields of government bonds globally," adding there have been "shades of that" in recent weeks.

The implication for folks considering liquidity events is potentially greater risk in the markets for reinvesting their sales proceeds. If QE is reduced, the markets could retreat significantly, or if not, there is possible high inflation. While we are not investment advisors, these considerations color our view of transaction designs - we remain committed to conservative strategies. For example, avoid over-leverage in financed deals, even seller financing, with returns to sellers in this case indexed for potential inflation - among other things. Please do call our shop, if you are contemplating a leveraged transaction.

Summer 2013: Federal Support of ESOPs?

Many old hands in the ESOP community (ourselves included) have observed that Washington's 'nanny state' mentality does not comport very well with ESOPs. Employee ownership is designed to reward participants with capital in their company. If you happened to be a member of the federal apparatus believing that such capital is "too risky" for employees or that employees "can't really understand an ESOP," you could disapprove of this exercise in capitalism. Sadly, that is not an uncommon view in some provinces of the Department of Labor.

We have seen an increasing number of DOL audits with the auditors expressing views similar to the above, and going so far as to audit the auditors (even requesting the work papers from the firms which do plan audits for those with over 100 participants).

As you also may have seen in the press, President Obama's FY2014 Budget contains some misinformed ESOP proposals. His "Blue Book" goes so far as to say that workers in an ESOP Company with revenues less than $5 M do not understand how their work impacts the success of the employer. We should give these employees far more credit than that. When visiting our clients and conducting employee meetings, we

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have seen a depth of individual understanding, productive work efforts, and the overall success of hundreds of closely held businesses that have adopted ESOPs because the employees "get it". If only the regulatory and executive arms of our government would!

Corporate Capital believes that ESOP companies, regardless of their size are for the most part more productive, more profitable, keep local jobs and provide a much needed retirement benefit for loyal long term employees. How can this be bad you ask? We ask that too! We believe in the ingenuity and spirit of American entrepreneurs and workers. We want to see closely held businesses continue beyond the retirement of the founders and remain locally owned and operated as going concerns employing those in the community.

What to Do?
Plug into the many national and regional associations that serve as the voice of the ESOP community with coordinated letter writing efforts and meetings with lawmakers. The ESOP Association has a good list of the contact information for all of our the senators and representatives. We all must do our part to make sure Washington perpetuate orderly succession of closely held businesses everywhere.

Publications and Conference Presentation Outlines

Chapter Six in the book, "Selling to an ESOP," co-authored by Michael discusses the IRC Section 1042 tax-free ESOP rollover and deals with strategies to counter increasingly volatile capital markets. The book is available from the National Center for Employee Ownership and can be ordered here: http://www.nceo.org/Selling-Your-Business-ESOP/pub.php/id/31/.

The CCR team also co-authored "The ESOP Handbook for Banks." It is both a strategic overview of how ESOPs function in the banking space and a more technical treatment of their effect on capital, leverage ratios and employee benefits. It is designed to help any director or officer of a closely-held bank or bank holding company evaluate ESOP alternatives to outside capital in the era of stress-testing and TARP. The book is available at: http://www.amazon.com/ESOP-Handbook-Banks-William-Gust/dp/0982536445.

Please visit our website for links to our latest presentations at national conferences discussing ESOPs.

ESOP Strategy Notes from Our Technical Corner: Repayment of ESOP Loans - Another Hot Topic

Discussions concerning the repayment of ESOP loans and the sources of funds come up quite a bit in the CCR shop. Mistakes are unfortunately not uncommon. An ESOP may repay an exempt loan from the following sources:

C-Corporations

- Deductible cash contributions.
- Reasonable dividends paid on just the shares, (allocated and unallocated), acquired by the ESOP with the exempt loan. These are not counted in the overall 25 percent of covered payroll limit.

S-Corporations

- Deductible cash contributions.
- Distributions of earnings attributable to the shares acquired (allocated and unallocated) by the ESOP with the exempt loan. The interest payments are counted towards the overall 25 percent of covered payroll limit.

Remember:

1. Very careful planning and recordkeeping is necessary to coordinate the C-dividend or S-distribution deposit and allocation on any shares that were not acquired with the loan being paid down. For example, dividends on shares that were bought with cash already in the ESOP, or shares purchased with a prior loan that has been paid off cannot be used to pay the current ESOP loan.
2. If there are multiple loans then each "bucket" of shares attached to each loan need to be tracked separately and only dividends or distributions attributable to those shares can pay on the respective ESOP exempt loan.
3. The C-dividend or S-distribution should be designated clearly as to its use (being applied to principal payments, interest payments, or both) and communicated to all interested parties such as the CPA, TPA and the ESOP consultant. Please remember internal financial GAAP expense accruals may be affected by using C-dividends or S-distributions to pay ESOP debt.
4. The law requires that the number of shares being

released from suspense as a result of the loan payment needs to have a fair market value of at least the dividend or S-distribution paid. This test needs to be done by your third party administrator each year and a remedy made if the fair market value of the shares has fallen.

Always allocate C-dividends and S-distributions as outlined in your ESOP plan document. If in doubt about any aspect of using C-dividends or S-distributions to pay ESOP loans, ask your ERISA counsel for directive.

Please call anytime, even if the National Security Agency is eavesdropping. They know, as do we, that real knowledge is power. And when dealing with our current complex regulatory environment and escalating taxation, our ideas and strategies can give you the power to retain more dollars and less headaches.

The above summary is an educational discussion and must not be construed as tax, accounting, fiduciary, investment or legal counsel.