ESOPS IN ACTION: HABERFELD ASSOCIATES CASE STUDY

BUTCHER JOSEPH & CO.
INVESTMENT BANKERS

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INTRODUCTION

ButcherJoseph advised Haberfeld Associates on three transformative transactions which structurally featured:

1. Change of ownership control

2. Formation of an employee stock ownership plan (ESOP)

3. Establishment of equity incentive plans for management

In addition, the company tapped the capital markets to support both a recapitalization and, most recently, a refinancing to position Haberfeld for future growth. These transactions highlight the flexible and tax-efficient nature of ESOPs and the advantages of working with an advisor that has expertise across all buyer types (strategic, financial, and employees), as well as full access to the debt and equity capital markets.

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ABOUT HABERFELD ASSOCIATES

Haberfeld Associates is a leading provider of omni-channel marketing and consulting services focused on increasing customer traffic and improving the profitability of retail financial institutions. Named after its founder, Ralph Haberfeld, the company was launched in 1989 and is headquartered in Lincoln, Nebraska. It is a pioneer in customer acquisition through checking account marketing. Over the past three decades, Haberfeld has partnered with more than 600 community banks and credit unions to grow their customer bases, leading to significantly more low-cost core deposits, enhanced cross-selling, and increased fee and interchange income.

PIVOTAL MOMENTS: HABERFELD'S THREE TRANSFORMATIVE TRANSACTIONS

Transaction 1: ESOP

Goals: Sell the company and provide liquidity to founders; establish management incentive equity plan to motivate new management team; minimize tax consequences

Structure: ESOP is formed for benefit of employees and holds 100% of the common stock post-transaction; founders receive seller note plus warrants (similar to long-term stock options); management team receives meaningful upside participation through synthetic equity

Transaction 2: Recapitalization

Goals: Recapitalize company to provide institutional capital and flexibility; update management incentive equity plan

Structure: Raise senior bank debt to purchase founders' warrants; convert synthetic equity to common equity to provide flexibility; expand equity ownership to include new management team

Transaction 3: Refinancing

Goals: Refinance the balance sheet and raise new institutional capital to position company for future growth

Structure: Refinance existing senior bank debt; raise junior debt from private credit fund with industry expertise and alignment with growth strategy

TRANSACTION 1: ESOP ACHIEVES TAX-EFFICIENT SUCCESSION PLANNING AND INCENTIVIZES TEAM

Several years after Haberfeld's founding, the founder-owners were considering their exit options. They retained ButcherJoseph to advise on a potential sale transaction and more generally on the path forward. In addition, the founders had identified a new CEO and needed a way to properly compensate and incentivize the next generation of leadership. They also strongly believed in the company and wanted to continue to participate in its growth. While Haberfeld was receiving interest from strategic buyers, the founders did not want to sell to a competitor. They were motivated to preserve their legacy, maintain their upside in the company, and benefit the loyal employees who had helped to build Haberfeld's success.

ButcherJoseph guided Haberfeld through the process of exploring its options for generating liquidity and positioning the company for the next phase of its growth. Drawing on ButcherJoseph's extensive experience working with all types of M&A buyers and completing several transactions in the debt and equity capital markets, the founders opted to sell the company to an ESOP. Along with rewarding employees, a sale to an ESOP can be structured to be very capital gains tax efficient for the seller and the company going forward.

In establishing the ESOP, 100% of the company's common stock was purchased by a trust established for the benefit of the company's employees. The founders financed the transaction in the form of a seller note—reflecting how strongly they believed in the future growth of the company—and received equity upside in the form of warrants (similar to long term stock options). ButcherJoseph also helped Haberfeld establish a synthetic equity program for the new leadership team to provide new managers with additional upside participation (incremental to the ESOP participation) and further incentivize them to grow the business.

TRANSACTION 2: RECAPITALIZATION STRENGTHENS CAPITAL STRUCTURE, PROVIDES GREATER FLEXIBILITY, AND FURTHER INCENTIVIZES TEAM

Following the initial sale to the ESOP, Haberfeld continued to grow rapidly, expanding its services and widening its client base as digital marketing took on increasing importance in the retail banking industry. Haberfeld's ESOP structure had benefited the company by aligning and incentivizing its workforce and strengthening the corporate culture. In addition to receiving attractive interest payments on the seller notes, the founders also continued to participate in the company's growth through the warrants. Also, because of its growth and strong financial performance, the company was able to pay down much of the ESOP transaction debt, providing an opportunity to raise more capital.

Again, Haberfeld turned to ButcherJoseph for advice. ButcherJoseph conducted a deep analysis of Haberfeld's liquidity and financing options, focusing on crafting a plan that would allow the firm to pursue new growth opportunities. To address the current legacy liabilities and align the next generation of management and leaders for future value creation, ButcherJoseph examined a range of liquidity and capital choices, including bank capital, private credit, and private equity financing.

The solution was to raise institutional debt in the form of senior debt. In addition to providing capital for general corporate purposes, Haberfeld could buy out the founder warrants, achieving the coveted "second bite of the apple" in the form of additional proceeds to the original founders. The company also created flexibility in its corporate structure and updated the management equity incentive pool to further incentivize new additions to the management team.

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COMPARING THE OPTIONS: KEY BENEFITS AND DRAWBACKS OF SELLING TO A THIRD PARTY VS. AN ESOP

	Sale to Third Party		Sale to ESOP
BUYER	STRATEGIC BUYER	PRIVATE EQUITY	EMPLOYEE TRUST
Key Benefits	• Highest value consideration due to synergies that may be recognized through the purchase	• Well capitalized partner • More predictable future for existing management and employees vs. selling to a strategic buyer • Opportunity for reinvestment (or “rollover”) into the acquiring entity, allowing participation in future growth	• Attract and retain employees; boost employee morale • More control over legacy • Limited disruption to business operations and management • Potential corporate tax advantages • Potential capital gains tax deferral for seller • Transaction can be structured in phases • Shorter execution timeline (four to six months)
Key Drawbacks	• Loss of strategic and operational control • Future of existing management and employees unknown due to possible redundancies • May be required to share intellectual property and best practices with competitors during sale process • Longer execution time (six to nine months)	• May receive lower purchase price vs. selling to a strategic buyer • Potential disruption and turnover risk to existing employees • Longer execution time (six to nine months)	• May receive lower purchase price vs. selling to a strategic buyer, but still at fair market value • Potential for lower cash at close depending on how transaction is financed

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TRANSACTION 3: REFINANCING BRINGS ON STRATEGIC INSTITUTIONAL CAPITAL AND PROVIDES FLEXIBILITY FOR FUTURE GROWTH

After another multi-year period of strong growth, Haberfeld once again reached a point where a fresh look at its capital structure—and overall growth strategy—was in order. The company was interested in not only bringing on capital to refinance the existing bank debt, but also seeking to partner with an institutional capital provider with the capabilities and expertise to provide strategic guidance outside of their target industry.

With those objectives in mind, ButcherJoseph advised Haberfeld on a senior and junior debt refinancing transaction. The transaction provided the company with new senior debt from its incumbent bank provider as well as junior debt financing from a private credit fund with relevant industry expertise. This allowed Haberfeld's employees and managers to realize equity value appreciation while also bringing in a third party with relationships and expertise to support further growth.

"We recognized that there was an opportunity to refresh our balance sheet and renew our ownership structure to better match Haberfeld's strategic plans moving forward, while maintaining an employee ownership structure and culture. This refinancing provided us with capital to retire obligations to the company's founders and with financial partners that will continue with us on our growth journey."

– David Furnace, Haberfeld's CEO, June 2021

DOES AN ESOP ALIGN WITH YOUR GROWTH AND TRANSITION GOALS?

Selling your company is an incredibly momentous and nuanced process with ramifications that extend far beyond your own wealth and estate planning. No matter what path may be best for your company—whether that is an ESOP, recapitalization, sale to a strategic buyer, or sale to private equity—ButcherJoseph can help you explore all your options.

One of the services we provide to business owners is our Feasibility Study Analysis. This free service helps sellers learn more about the structure and the results for shareholders as well as the potential outcome for management and employees if you were to sell your business to private equity, a strategic buyer, or into an ESOP structure. We use the analysis to help you and your team see the benefits and considerations of each transaction type.

As a firm specializing in the middle market, ButcherJoseph's team of professionals has executed more than 200 transactions exceeding $15 billion in total value.

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GLOSSARY OF TERMS

Junior debt – Borrowing that has a lower payment priority, and thus greater risk to the lender, than more senior debt on the balance sheet. In the event of a bankruptcy, junior debt may not be fully repaid; therefore, it typically offers investors a higher interest rate. Also referred to as subordinated debt.

Private credit fund – Pooled capital from qualified investors seeking to lend to companies that may not have access to traditional sources of debt financing in exchange for an attractive rate of return. Private credit typically pays a floating rate of interest to shield investors from interest rate risk.

Private equity fund – Pooled capital from qualified investors seeking to acquire or take substantial equity positions in companies that are generally too small to go public. These funds often specialize in certain industries and may identify synergies across their portfolio companies, which they typically seek to sell or take public in 5-7 years.

Seller note – A loan provided by the seller/owner of a company to the buyer to help the buyer finance an acquisition. Seller notes, which are typically fully amortizing, are often used when the buyer is unable to obtain external financing sufficient to fund the entire purchase price.

Senior bank debt – Bank loans that have the highest priority for timely payment of interest and principal repayments. Senior bank debt typically requires borrowers to adhere to financial covenants over the life of the loan; in a bankruptcy, senior bank debt is repaid before other non-securitized loans.

Strategic buyer – A buyer that pursues an acquisition because it perceives a strategic fit between the target company and the buyer's current operations. Strategic buyers are often willing to offer a higher price to a seller because they expect to realize synergies that will create value for the combined entity.

Synthetic equity – A broad term describing ways to replicate the returns from owning equity shares in a company without conveying ownership rights. Often used as a form of employee compensation, two of the most common forms are phantom stock, which is redeemed in cash at a fixed future date, and stock appreciation rights (SARs) which, like stock options, give the recipient the right to a stock's appreciation over time, beyond a specified "strike" price.

Warrants – Similar to an option, warrants give holders the right, but not the obligation, to purchase new shares of stock, at a set price, that are issued when the warrant is exercised. Unlike options, when exercising warrants, the strike price is paid to the company and dilutes existing shareholders.