Designing an Ownership Plan that Keeps Shareholder Risk Under Control

Managing Repurchase Obligations



Core Challenge

1. In A/E firms, owners also run the business, win the work, and protect the reputation
2. Retirements often cluster when several principals are close in age
3. A profitable firm can still struggle to fund share buybacks
4. Unplanned repurchases can drain working capital, delay investment, or force unfavorable borrowing

Map Your Exposure

1. List every shareholder, ownership percentage, expected exit window, and current share value
2. Total repurchase obligations by year to reveal clusters
3. Compare the forecast to realistic annual free cash flow
4. The gap is the liquidity risk to close

Year	Repurchase Obligation	Free Cash Flow	Gap
2027	$1.2M	$0.8M	($0.4M)
2028	$2.1M	$0.9M	($1.2M)
2029	$0.6M	$1.0M	$0.4M

Map Your Exposure

Line Item	Amount (000s)	Cash Effect
Net Income	$750	Starting point
Add: D&A	450	Non-cash, added back
Less: Increase in NWC	(100)	Cash tied up in operations
Less: CapEx	(300)	Cash reinvested in assets
Free Cash Flow	$800	Available for obligations

Broaden the Ownership Base

1. Define clear criteria for becoming an owner
2. Offer share opportunities at regular intervals
3. Cap the number of shares any individual can hold
4. Use smaller blocks so more people can participate

Agree on Pricing Before It Matters

1. Choose a valuation method in advance: formula, independent appraisal, or a combination
2. Update valuations annually so prices stay current
3. Optional floors or ceilings can be added
4. Consistency matters more than the specific method

Balancing Valuation Levels

Valuation Level	Likely Effect
Too low, with strong profit distributions	High demand for shares and reluctance to sell
Too high	Employees struggle to buy in, and repurchase obligations become hard to meet
Fair market value	Widely preferred balance of fairness and affordability

Structure the Payout

1. Staged payments over several years, often documented with a promissory note at market rates
2. A modest down payment with the balance paid over time
3. Different terms by trigger: faster payment for death or disability (often insurance-funded), longer schedules for voluntary exits
4. Flexibility to accelerate payments in strong years and defer within agreed limits in weak ones
5. Cap shareholder payments as a percentage of profits to protect incentive pay for staff

Assign Ownership of the Plan

1. Name one person accountable for the plan
2. Update the forecast, valuations, reserve balance, and insurance each year
3. Revisit documents after mergers, new owners, or major profitability shifts

What's the cost of redeeming shares?

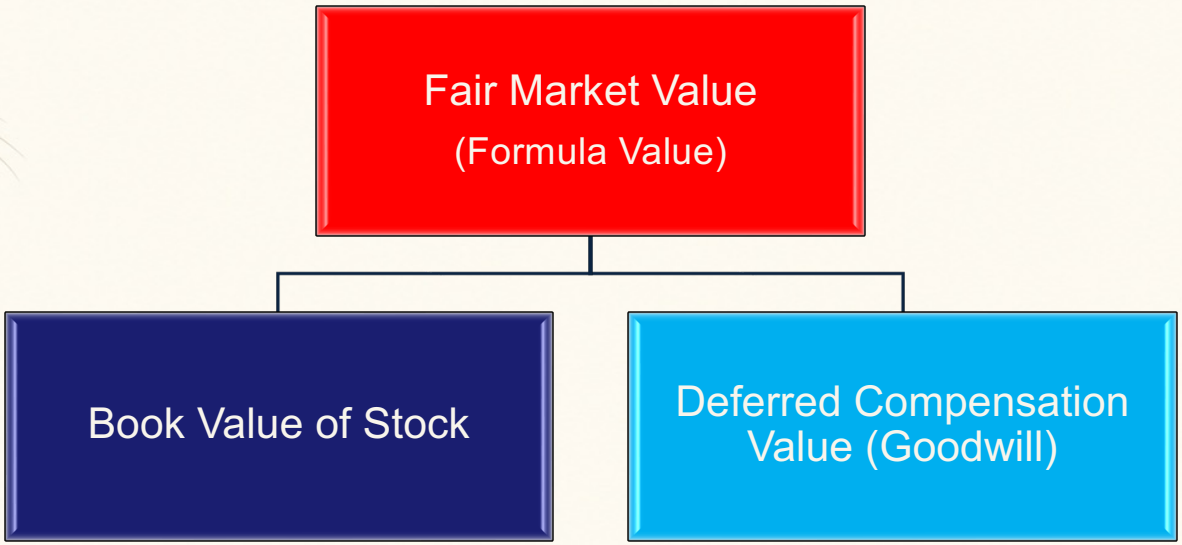
- The hidden cost of redeeming shares are TAXES. The location of your company will impact how much more cash flow (over the cost of the shares) you need to generate to satisfy your repurchase obligation.

• No State Income Taxes	133.0%
• Average State Corporate Taxes	137.5%

Tax efficient transfers without an ESOP

- Low cost to buy in
- The long-term investment focus
- Goodwill is earned over long-term
- Lowers cash flow required for repurchasing shares
- Mitigates value dilution risks
- Creates tax efficiencies for transferring ownership
  - Similar tax benefits to partial ESOP
  - No DOL oversight, may use formula for valuing
  - May select key employees to participate

Tax efficient transfers without an ESOP



The Deferred Compensation Plan

- Long-term vesting
  - Typical ten to fifteen years
  - Current shareholders will be immediately vested
- 409 (a) Limitations
  - Once payment begins, cannot be paid off early
  - Payments – 36 to 84 months
  - Trigger Events must be established
    - Retirement, Death, Disability, Termination, Age (68)
- Golden handcuffs
  - The value of the DC could be the biggest component of their overall value
    - Performance of company is biggest influence
    - Forfeiture for leaving to competing firms

The Deferred Compensation Plan

- Grant of Units
  - At the time of stock purchase
  - Equals the same number of shares purchased
  - New vesting schedule for each share(s) purchased

- Valuation
  - Difference between FMV and Book Value (or formula value and book value)
  - The higher the profit margins the greater the DC value

The Stock Plan

- Value is at book value
  - Lowers cash outlay for high dividend yield
  - Paid through compensation and bonuses
- Redemption
  - Down payment
  - 36 to 84 months note, may be paid off early
- Purchase
  - Down payment
  - 36 to 84 months note, may be paid off early

Assumption

Capital Gains Rate	33.0%
Income Tax Rate (Individual W2)	42.3%
Income Tax Rate (Corporate Distribution)	31.3%
Stock Value	15,000,000
Book Value	4,500,000

Cost of Share Redemption - Company

	Direct Stock	100% ESOP	30% ESOP	Deferred Comp
Value of Stock Sale	$15,000,000	$15,000,000	$15,000,000	$4,500,000
Income Taxes @	31.3%	0.0%	21.9%	31.3%
Cash Profits Required to Redeem (a)	**$21,830,000**	**$15,000,000**	**$19,210,000**	**$6,550,000**
Cash Profits Required for Deferred Comp (b)	**N/A**	**N/A**	**N/A**	**$10,500,000**
Cash flow required to Fund Transaction (a+b)	**$21,830,000**	**$15,000,000**	**$19,210,000**	**$17,050,000**
Cash Flow Reduction		**$6,830,000**	**$2,620,000**	**$4,780,000**

High Dividends without Breaking the Bank

Stock Value	15,000,000
Book Value	4,500,000
Desired Yield	15%
Dividend based on Stock Value	2,250,000
Dividend based on Book Value	675,000

Key Takeaways

1. Forecast the exposure before it arrives
2. Widen the pool of buyers
3. Set clear rules for order, price, and payout
4. Fund obligations ahead of time
5. Start early, because the earlier the work begins, the more options the firm has



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