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ESOP VALUATION

September 9, 2008

Gardner, Willis, Sweat & Handelman, LLP hopes you find the information in this newsletter helpful. This information is intended to be general in nature and is not a substitute for competent legal advice. Because every issue is unique, we do not recommend that you apply the information in this newsletter without first seeking appropriate legal advice.

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Valuation of Employee Stock Option Plans

ESOP transactions in closely held companies must be based on a current appraisal by an independent, outside valuation expert. The valuation process assesses how much a willing buyer would pay a willing seller for the business. Various factors are considered in valuing ESOPs such as:

- price-to-earnings
- discounted future cash flows
- asset value
- comparable companies

A true valuation of an ESOP will reduce the value of the company for a lack of control, a lack of marketability, and repurchase liability. The reduction for a lack of control is taken due to the fact that owning a controlling interest in the business is worth more than owning a minority interest, even on a per share basis. The value is reduced from marketability because shares of publicly held companies are worth more than closely held firms because they are easier to buy and sell. Although ESOP company shares have better marketability than non-ESOP firms, they are still not as active or marketable as stock trades on a stock exchange.

ESOP valuations are generally more complex than regular valuations of businesses. ESOP valuations include adjustments relating to fair market value, liquidity discounts, tax pass-through status, and other factors. ERISA regulations for ESOPs add the “adequate

consideration” standard to the fair market value standard of IRS valuation review. Employee Retirement & Income Security Act of 1974 (ERISA) established a regulatory requirement that an ESOP pay no more than “adequate consideration” in the purchase of employer securities, ESOP valuations must support the decisions of the trustees and must also withstand review by Department of Labor and the IRS. Valuations that are subject to being reviewed by third parties must include in-depth descriptions on the methods and factors used during the valuation as well as descriptive information on the sponsoring company’s financial and operating history and the industry in which it competes. In addition, ESOP regulations place various obligations on the sponsoring employer and allow for limitation of the voting rights of ESOP shares. These, and other features specific to the ESOP, require special consideration in the determination of the fair market value of ESOP owned securities of privately held companies.

Fair market value is the price for which the ESOP would sell under the existing market conditions for such property as established in arms-length negotiations between knowledgeable and independent parties. The “market” implied in definitions of fair market value encompasses all potential buyers and sellers of the property involved.

ESOP valuations consist of qualitative and quantitative analysis of businesses, reviewing detailed information on the business, the industry, management, competition, financial performance, operating conditions and future projections. Valuations are required at the formation of the ESOP and the ongoing operation of the ESOP to determine the organization’s value. Feasibility assessments are conducted to determine the best path for each individual ESOP.

GWSH can assist with the valuation of your company’s ESOP shares. Please give us a call if you have any questions or requests in this area. We will be happy to give you a quote for a valuation of your ESOP by our qualified expert.

Glenn Booker’s practice centers around estate planning for property transfers and estate/trust administration. He also specializes in appraising closely-held business interests. Glenn advises clients on complex accounting and finance issues, yet his conversational approach enables him to explain such issues in simple and understandable terms. Glenn and his wife, Debbie, enjoy jazz music, Cajun food, and camping with their children.



GMB/32-249.811