



# Interaction between the Trustee and the Valuation Firm

## Presented by:

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# Agenda

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- Obligations of the Trustee
- Responsibilities of the Trustee
- Process of Selecting a Valuation Firm
- Interaction during the annual valuation process
- Approval of the Value
- After the Approval

# Obligations of the Trustee

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- Legal
  - ERISA – Section 404 – A trustee is judged by the “Prudent Man Standard” which is: a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of:
    - Providing benefits to the beneficiaries;
    - Defraying reasonable expenses of Plan.
  - With the skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims.
  - This is the highest legal standard applied to any fiduciary.

# Obligations of the Trustee

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- Legal
  - A trustee also has a duty to:
    - Diversify the investments of a Plan so as to minimize the risk of large losses.
- Co – Fiduciary Obligations
  - Please note that if your plan has an internal trustee, and the trustee is a committee or multiple individuals, they all share in the fiduciary responsibility and liability related to decisions they make regarding the Plan.
  - ✓ Use of special fiduciary in transactions.

# Responsibilities of the Trustee

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- **Vote Stock**
  - Generally in a Stock Purchase Transaction the Trustee must vote the shares held by the ESOP in the best interest of the ESOP and its participants.
  - There are certain exceptions for asset sales where the vote is passed through to participants.
- **Conduct Valuation**
  - Annual Valuation
  - Transactions
- **Monitor Company / Board**
- **Administer Trust**
- **Vet and Engage Valuation Firm**
  - What is proper vetting?

# Selecting a Valuation Firm

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What is the trustee looking for:

- Qualifications
  - Accreditations
    - Accredited in Business Valuation (AICPA)
    - Accredited Senior Appraiser (American Society of Appraisers)
    - Certified Valuation Analyst (NACVA)
    - Chartered Financial Analyst (CFA)
- ESOP Community Involvement
- Publishing, Speaking

# Selecting a Valuation Firm

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What is the trustee looking for:

- Valuation Experience
  - Number of ESOP Valuations
  - Have valuations been challenged? What happened?
- Internal Processes
- Firm Structure
- Methodologies employed for the valuation
- Checklist of required documents from subject company
- References

# The Valuation Process

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- Request of annual documents from the client
- Due diligence discussion (call or on-site)
  - Review of financial results
  - Discussion/vetting of the budget/forecast
  - Analysis of performance to past results
  - Benchmark comparison to comparable companies/industry ratios
- Development of the value conclusion and report
- Review of the report by the trust committee
- Presentation of the report to the trust committee



# Trustee Review of the Report

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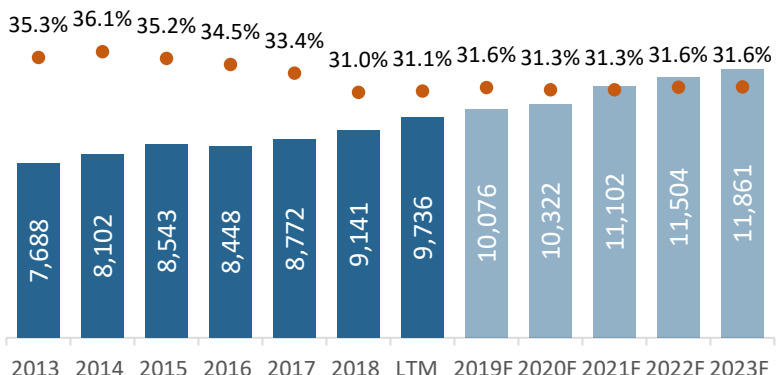
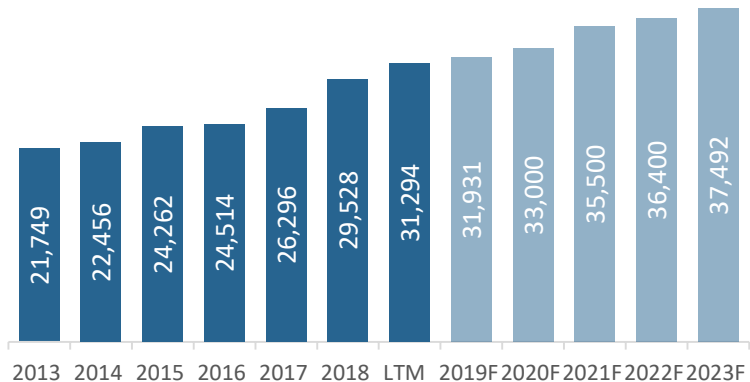
- Company narrative review
- Methodologies used (and not used)
- Industry and Economic Outlook
- Financial Review
- Value Conclusion and Reconciliation
- Financial Exhibits and Schedules
- Qualifications of the appraiser

# Trustee Review of the Report

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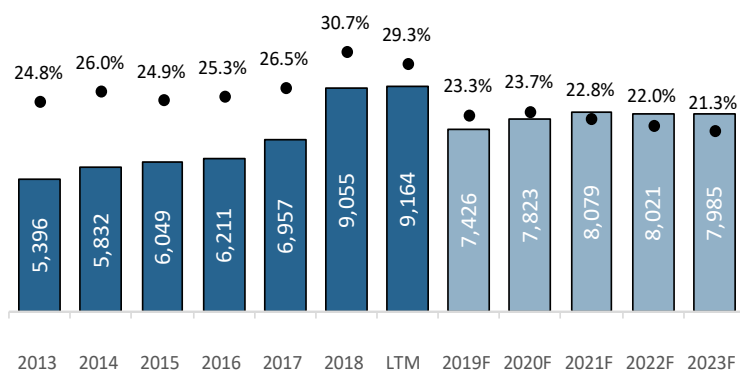
- Application and weighting to specific methods
- Discounts applied
  - Lack of control
  - Minority discount
  - Control premium
  - Lack of marketability
  - Lack of liquidity
- Enterprise value and per share conclusion

# Vetting the Forecast



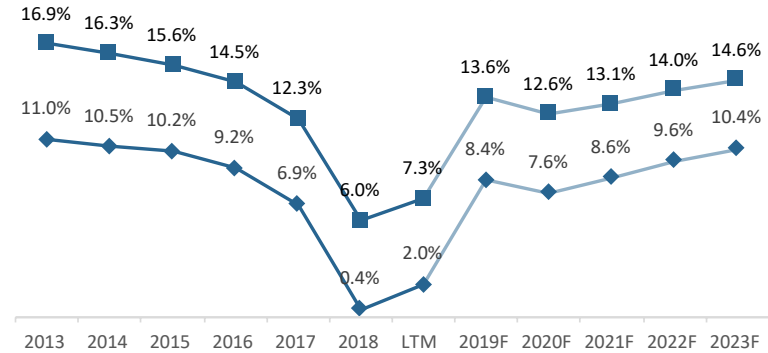
6.3% CAGR (Historical) 4.9% CAGR (Forecast)

■ Gross Profit ● Gross Profit Margin



■ Operating Expenses ● Operating Margin

## EBIT/EBITDA Margin



◆ EBIT Margin ■ EBITDA Margin

# Reconciliation Review

- What changed?
- Why?
- Does it make sense?
- Is the reasoning justified and defended in the report?

<b>Income Approach</b>	<b>12/31/17</b>	<b>12/31/18</b>	
Selected Risk Free Rate	2.7%	3.0%	
Specific Company Risk	4.0%	4.5%	
Cost of Equity	18.6%	19.2%	
Cost of Debt (after-tax)	4.0%	4.0%	
Capital Structure (Equity / Debt)	90 / 10	90 / 10	
Discount Rate	17.1%	17.7%	
Growth Rate	3.5%	3.5%	
Capitalization Rate	13.6%	14.2%	
Sum of Present Value of Cash Flows	15,238	16,802	
Present Value of Stabilized Cash Flow	<u>21,247</u>	<u>22,132</u>	
Total Invested Capital	36,485	38,934	6.7%
Less: Debt	<u>(23,238)</u>	<u>(20,162)</u>	(3,076)
Equity Value	13,247	18,772	41.7%
<i>Weighting</i>	90%	90%	
<b>Market Approach</b>	<b>12/31/17</b>	<b>12/31/18</b>	
Selected EBITDA	5,130	5,300	
Selected Multiple	7.4	7.7	
MVIC Value	37,962	40,810	7.5%
Less: Debt	<u>(23,238)</u>	<u>(20,162)</u>	(3,076)
Equity Value	19,598	20,648	5.4%
<i>Weighting</i>	10%	10%	
<b>Valuation Adjustments</b>			
Add: Non-operating Assets (excess)	1,050	1,550	500
<b>Value Conclusion</b>			
Concluded Value, Before Discounts	14,932,000	20,847,000	39.6%
Total Shares	1,000,000	1,000,000	
ESOP Shares	1,000,000	1,000,000	
<i>Ownership</i>	100%	100%	
Preliminary Price Per Share	\$ 14.93	\$ 20.85	
DLOM/Liquidity	10%	5%	
ESOP Price Per Share	<u>\$ 13.44</u>	<u>\$ 19.81</u>	47.4%

# The Valuation Process

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- Presentation of the report to the trustee committee
  - Valuation firm walks through the report
  - Discusses company narrative and any changes
  - Reviews financial performance
    - Most importantly...comparison of actual to budget
  - Valuation methodologies
  - Drivers of change in value
  - Do the assumptions and overall conclusion make sense?
- The Trustee is responsible for setting value
- What if the Trustee disagrees with the valuation firm?

# After the Approval

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- Trustee determines stock value
  - Company forwards per share value to accounting firm and TPA
- Accounting firm releases final financial statements
- Final ESOP administration reports and compliance testing reports
- Conduct employee meetings
  - Participant statements delivered
- Diversification and distribution elections are processed
- Accounting firm completes ESOP plan audit
  - File IRS Form 5500, IRS Form 8955-SSA
- Deliver updated SPD or SMM to participants within 210 days after the close of the plan

# Don't Forget!

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Please fill out your evaluation for this session

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# Questions ?

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