EQUITY
INCENTIVES
LIMITED

ESOPs as a corporate finance tool

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ESOPs can play an important corporate finance role in transactions, especially in management and employee buyouts.

The need for a whitewash is removed if the buyout company raises loan finance indirectly through an ESOP trust and is able to claim the exemption from financial assistance that is available to "employee share schemes."

Leveraged Buyouts

If an ESOP subscribes for new shares using third party finance, and if company contributions to the ESOP are carefully structured to be tax deductible, then both the interest and the principal on the ESOP loan can effectively be serviced from pre-tax profits, reducing the company's overall cost of capital.

This technique has been used successfully in management buyouts (with the ESOP subscribing for new shares in the buyout company prior to the acquisition of the target company) and in established companies seeking development capital.

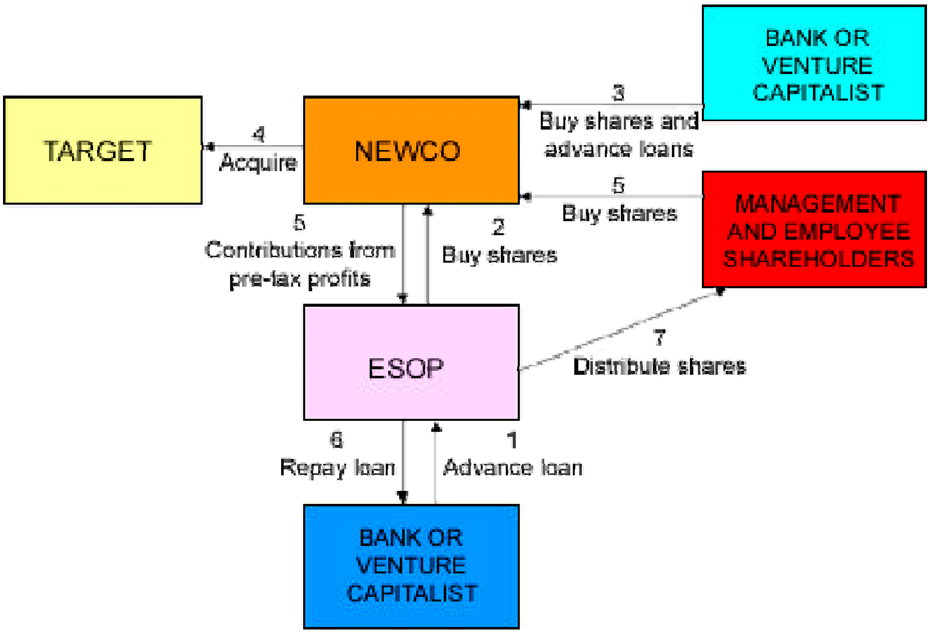
Financial Assistance

A company is generally prohibited from offering "financial assistance" to enable a third party to buy shares. Financial assistance is broadly defined and covers company guarantees of third party loans. This affects management buyout companies which need to secure bank loans to the buyout company using the assets of the target company. Financial assistance is permitted in limited circumstances if a creditor-protection procedure, called a "whitewash" procedure, is followed, but this can be onerous and expensive in some transactions.

Alternative to Public-to-Private Buyouts

In the last two years, there has been a marked increase in the number of smaller quoted companies being taken private by means of a venture capital backed buyout. This trend has been stimulated by the low valuations of many smaller Stock Market companies and by the plentiful supply of debt and private equity.

However alluring the prospect of a public-to-private to the management team, whose share of the equity in a quoted company may be modest, some companies may need to retain their Stock Market listing for the purposes of financing future acquisitions or for maintaining a degree of liquidity in their shares. For these companies, the half-way house of a leveraged co-investment plan may be attractive. This involves the company gearing up its balance sheet by taking on senior debt and tendering for its own shares in the market. If the debt is channelled through an ESOP trust, this creates the opportunity to capture a significant portion of the equity for employee share schemes. These might be granted to employees as options, which when exercised will result in an inflow of funds to the ESOP with which to repay its loan. The whole transaction is potentially self-financing.



Who are we?

Equity Incentives has substantial experience in all aspects of employee benefits, including equity incentives. The Managing Director, Graeme Nuttall, is a member of the HM Treasury advisory group which helps the Inland Revenue introduce new share schemes including EMI. Through membership of the **Global reward plan group** we implement international share schemes.

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