



Kline Electric, Inc. Employee Stock Ownership Plan



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What is an ESOP?

ESOP stands for Employee Stock Ownership Plan

An ESOP is a **qualified retirement plan** that can be used as a **business transition tool** and as an **employee ownership vehicle**:

1. An ESOP is a business transition tool that establishes an ESOP trust to be an ongoing perpetual owner of the company.
2. An ESOP is an optimal employee ownership vehicle for a company to provide employees with an ownership stake in the company.
3. An ESOP is an IRS qualified retirement plan, similar to a 401(k) Plan, that buys, holds, and sells company stock, providing employees with a retirement plan benefit and additional form of compensation.

Fun Facts about ESOPs

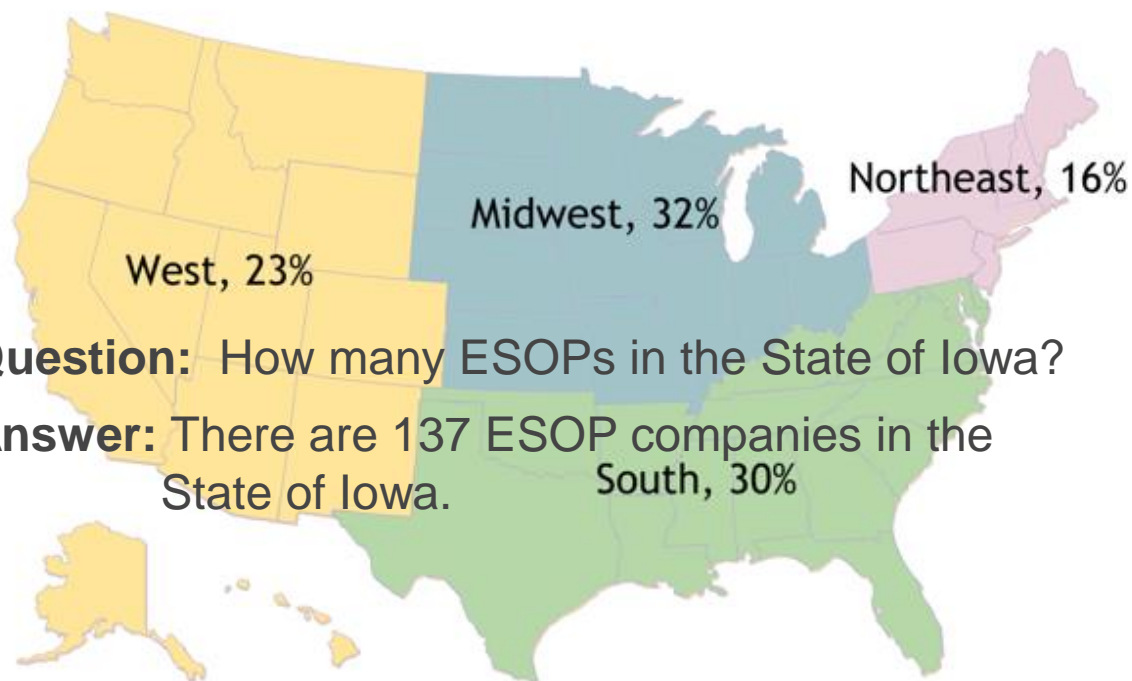
- There are approximately 6,243 ESOPs in the United States.
- There are approximately 2,500 ESOPs that are 100% employee-owned.
- These plans cover over 14 million employee owners of whom 10.6 million are active participants or currently employed.
- The ESOP trusts associated with these ESOPs hold total assets of more than \$1.38 trillion.
 - This breaks down to an average of \$129,521 per employee-owner.
- 97% of Employee-Owned Companies also sponsored an additional retirement plan like a 401(k).

Fun Facts about ESOPs

- Here is a breakdown of ESOPs by industry:
 - Manufacturing – 22%
 - Professional/Science/ Tech. Services – 19%
 - Finance/Insurance/Real Estate – 16%
 - Construction – 11%
 - Wholesale Trade – 9%
 - Retail Trade – 6%
 - Management – 3%

Communicating an ESOP

- Where are ESOPs located?



Question: How many ESOPs in the State of Iowa?

Answer: There are 137 ESOP companies in the State of Iowa.

Iowa's ESOP Community

- 137 privately held ESOP companies.
- Headquartered across 50+ communities.
- Covering over 40,000 participants, with 30,000 current employee-owners in ESOPs.
- Holding more than \$6.1 billion in total plan assets.
- The average Plan Participant in the state of Iowa has an ESOP account balance of \$152,500.
- ESOPs are mostly in smaller businesses with more than half of the ESOPs having 100 participants or less.
- Iowa ESOP companies paid out over \$385 million in benefits in the most recent year.
- Roughly three (3) Iowa companies set up an ESOP each year.

Iowa's ESOP Community

- Here is a breakdown of ESOPs by industry in Iowa:
 - Finance/Insurance/Real Estate – 26%
 - Manufacturing – 24%
 - Management/Holding – 9%
 - Construction – 9%
 - Wholesale Trade – 8%
 - Professional Services – 8%
 - Accommodations/Food – 5%
 - Retail Trade – 4%
 - Other – 8%

Communicating an ESOP

A recently completed three-year study from **Rutgers University** published on April 30, 2019, showcases the following benefits of Employee Ownership for low to middle class employee-owners versus non-employee owners.

- The low to middle income workers* with an ESOP account had values ranging from \$15,000 to \$4 million, with a **median value of \$165,000**.
- By contrast, the typical American household has just \$17,000 in savings.
- Of the low to middle income workers surveyed, those closest to retirement (ages 60 – 64) have **10 times more wealth** than the typical American in that age group.

* Defined as earning less than \$61,372

Communicating an ESOP

Other results from this three-year study from **Rutgers University** published on April 30, 2019, showcases that assets enable people to:

- Remain stable through financial emergencies
- Have housing security
- Pursue a path to prosperity and upward mobility

Communicating an ESOP

Continued...

- Advance through higher education for themselves or their children
- Take risks that result in a better job or starting a business
- Retire securely
- Pass on opportunity through inter-generational wealth building

These are all reasons why we need to communicate through an employee-owners entire career lifecycle.

History of the Kline Electric, Inc. Employee Stock Ownership Plan (ESOP)

- The ESOP was formed and had an effective date of January 1st, 2016.
- The ESOP trust purchased 100% of the company and is the legal owner once the transaction was completed.

ESOP Plan Basics

- The first employee-owned company was Peninsula Newspapers.
- The Kline Electric, Inc. Employee Stock Ownership Plan is a qualified retirement plan, similar to your 401(k) Plan, and must satisfy the requirements of the Internal Revenue Code and the Employee Retirement Income Security Act (“ERISA”) of 1974.
- ERISA was introduced by senator Russell Long.
- The Plan is a retirement plan that is designed to purchase company stock and provides employee owners with an ownership stake in the company effected by your work performance.
- The Plan is 100% funded by the company with the maximum contribution level at 25% of eligible compensation. This benefit is at no cost to you and is part of the benefits for eligible participants.

Benefits of Employee Ownership

- The legal owner of Kline Electric, Inc. will be the ESOP Trust.
- Employees are the beneficial owners of the stock in the Trust.
- This provides you with the upside benefits of ownership without the downside risk:
 - Participation is free and 100% funded by the company.
 - Employees share in 100% of the value as beneficial owners.
 - The legal shareholder of the trust is the Plan trustee.
 - As legal shareholder, the Plan trustee:
 - takes on all of the tax obligation (as a retirement plan the Plan is tax exempt),
 - takes on all legal risk,
 - takes on the company's liabilities and all obligation to creditors.

Leadership and Daily Operations

- The Plan does not change the leadership of the company.
- As legal shareholder, the ESOP Plan trustee votes for the Kline Electric, Inc. board of directors each plan year and the board chooses management.
- The Plan does not affect the operations of the company. Company management continues to run the daily operations of the company.
- Each employee-owner plays an important role in the success of the company and is responsible for performing their daily job responsibilities and now has a greater financial incentive for the company to succeed.

ESOP Participant Rights

- You have the following rights as an Employee Owner and beneficial shareholder of the company through the ESOP Plan:
 - To Receive Information About the Plan
 - Summary Annual Report (SAR)
 - To Have Access to Plan Documents
 - Summary Plan Description (SPD)
 - Beneficiary Designation Form
 - To Receive Annual Account Statements
 - Participant Statement

Annual Plan Contributions



Kline Electric, Inc.

Step 1: Contribution



Trust/
Allocated Shares

Step 2: Loan
Repayments

Unallocated Shares

Step 3: Shares
Allocated to Participants



Step 1: Kline Electric, Inc. pays the annual Plan contribution to Trust.

Step 2: Trust uses contribution to make annual loan repayment.

Step 3: Shares are released from the suspense account and proportionately allocated to eligible participants as the loan is paid.

POP Quiz???

- **Question:** How much does it cost to participate in the ESOP?
- **Answer:** Nothing
- **Question:** How many Employee-Owned companies are in the State of Iowa?
- **Answer:** 137 Employee-Owned companies are located in Iowa.
- **Question:** When was the Kline Electric ESOP effective?
- **Answer:** January 1, 2016.

How do I participate in the Plan?

- Participating in the Plan is a benefit of working for Kline Electric, Inc.
- Eligible employees enter the plan on January 1st or July 1st after meeting the following requirements:
 - Completion of 12 Months of Service
 - Or attainment of age 18, whichever is later
- If you are an employee owner, you will receive the Summary Plan Description (SPD) and the beneficiary form at your new employee orientation.

Eligibility Examples

- When would employee #1 enter into the ESOP?
 - Hire date January 3rd, 2021 and age 23.
- When would employee #2 enter into the ESOP?
 - Hire date October 23rd, 2022 and age 17 with birth date of November 1st.
- When would employee #3 enter into the ESOP?
 - Hire date July 7, 2021 and age 32.
- When would employee #4 enter into the ESOP?
 - Hire date September 15, 2021 and age 27.

How do I get an allocation of shares?

- Contributions and forfeitures will be allocated based on an individual's eligible compensation for each Plan Year.
- **Eligible compensation** is defined as wages (salary and/or hourly), bonuses, commissions, overtime, holiday pay, vacation pay and all reimbursements.
- An eligible participant must meet the following two (2) provisions to receive an annual allocation:
 - Actively employed on the last day of the Plan Year (December 31st)
 - Work 1,000 hours

How do I get an allocation of shares?

- Participants that terminate employment due to **death, disability, or retirement** (age 65) are eligible to receive an allocation of contributions in the year they terminate regardless of employment on the last day of the Plan Year.

Share Allocation Example

- Here is an example:
 - 2021 Eligible Employee Compensation - \$40,000
 - Total Eligible Compensation for all Employees - \$2,000,000
 - Company's contribution releases 20,000 shares

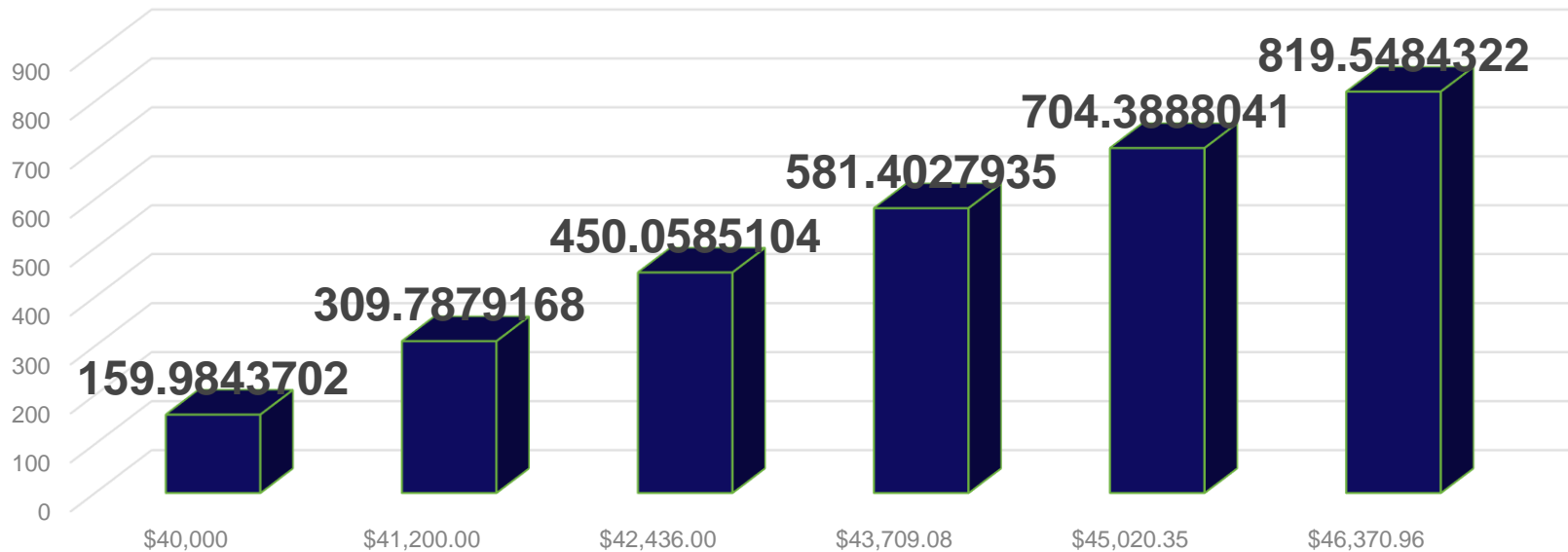
$$\$40,000/\$2,000,000 = .02 \text{ or } 2.0\%$$

This means the ESOP participant would receive 400 of the 20,000 shares allocated to all the eligible ESOP participants in 2021.

$$20,000 \text{ shares} \times 2.0\% = 400 \text{ shares}$$

Share Allocation Example

- Here is a chart showcasing how many shares of company stock this employee-owner would receive in the next six (6) years based on the following assumptions:
 - 3.0% increase in pay
 - 10% increase in total eligible compensation



When Do I Become Vested?

- You earn a year of vested service for each Plan Year you work 1,000 hours.
- A Plan Year is defined as January 1st till December 31st.
- Your vested percentage is determined based on your years of vested service and the vesting schedule:
 - 1 year of service - 0% vested
 - 2 years of service - 20% vested
 - 3 years of service - 40% vested
 - 4 years of service - 60% vested
 - 5 years of service - 80% vested
 - 6 years of service - 100% vested
- Participants are automatically 100% vested if they terminate due to **death, disability, or retirement** (age 65).

Vesting Example

- How many years of vested service would an employee have at Plan Year End of 12/31/2021 if...
 - An employee #1 was hired on February 17th, 2018 at age 23 and worked full time (2,080 hours annually).
 - An employee #2 was hired on November 1st, 2019 at age 42 and worked full time (2,080 hours annually).
 - An employee #3 was hired on March 23, 2020 at age 32 and worked full time (2,080 hours annually).
 - An employee #4 was hired on September 17, 2020 at age 44 and worked full time (2,080 hours annually).

Distribution Rules

What are the five distribution events that trigger a distribution:

1. Retirement (age 65)
2. Death
3. Disability
4. Termination (voluntary or involuntary)
5. Diversification (minimum age 55 and 10 years of participation in the Plan)

When Do I Get Paid?

Is there a distribution event while still employed?

- Diversification – What is Diversification?
 - The opportunity, as one approaches retirement age, to diversify closely held stock to other investments (ideally those valued daily or more frequently than once a year.)
- Diversification – After attaining **BOTH** age 55 and 10 years of participation in the plan, participants are eligible to request a distribution of up to 25% of the shares accumulatively. This includes all the shares that have ever been allocated in your account.
 - The optional diversification window is for 6-years and the distribution can occur during any of those six years.
 - In the final year of the diversification window, the cumulative eligible percentage increases from up to 25% to up to 50%.

Distribution Rules (Termination of Employment)

When do payments commence after termination of employment?

- In the case of **death, disability, and retirement** (age 65), distributions begin in the calendar year following the year in which the event occurred.
- In the case of **termination (voluntary or involuntary)**, distributions can be delayed until the end of the 6th Plan Year after the Plan Year in which you terminated employment.
- A participant who is no longer employed with the company will receive information concerning the particulars, including amounts, payout options available, and tax information, in an ESOP packet.

When do I get paid?

How and when do payments commence after termination of employment?

- Distributions of your vested account balance will be in the form of cash.
- Vested ESOP account balances may be paid in a lump sum or five annual installments determined by the Board of Directors.
- For vested account balances under \$1,000 your account balance will be issued directly to you.
- For vested account balances under \$5,000, but above \$1,000 your account balance will be transferred to an IRA (individual retirement account) in your name.

When Do I Get Paid?

Example: Participant retires (age 67) from the company on May 15th, 2025.

- Participant will be eligible for a distribution after the 2025 plan year has been completed on December 31st, 2025.
- The 2025 valuation and administration first must be completed to compute the account value as of December 31st, 2025. This will likely occur by June 2026.
- Distributions will be determined shortly thereafter and will likely be paid in early September 2026.

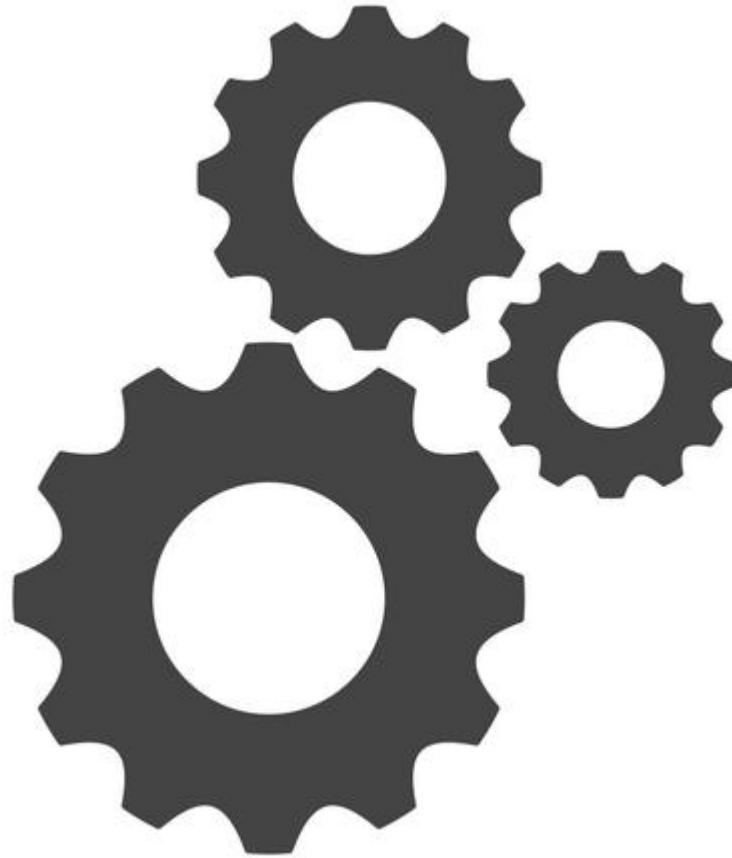
How is my Plan Account Taxed?

- Employee owners don't pay taxes on their Plan balance until it is paid out of the plan (much like a 401(k) plan or IRA). It's your very own tax shelter!
- When you get a Plan distribution, you can*:
 - roll the amount into an Individual Retirement Account (IRA) and pay no taxes until later, or
 - have it paid to you and pay income taxes on the amount of the distribution. **If you are not yet 59½, you'll also owe a 10% penalty tax.** (These are the same rules that apply to other qualified retirement plans.)
- ** Best practice: Speak with a financial advisor whenever electing a distribution from your account.*

POP Quiz???

- **Question:** What two (2) milestones need to be achieved in order to become eligible to enter the company's ESOP?
- **Answer:** 1). Completion of 12 months of service; 2). Attainment of age 18, which ever is later.
- **Question:** What MUST eligible employee-owners do in order to receive an allocation?
- **Answer:** To receive an allocation you MUST work at least 1,000 hours and be actively employed on 12/31 of the Plan Year.
- **Question:** What MUST you do in order to receive a year of vested service?
- **Answer:** You MUST work at least 1,000 hours in a Plan Year in order to receive a year of vested service.

ESOP Mechanics



ESOP Mechanics

We have four participants:

- Employee #1 - Newly hired employee with a DOH (date of hire) of April 15th, 2022
 - Employee #2 - Tenured employee with a DOH of October 23rd, 2009, with no breaks in service
 - Employee #3 - Tenured employee with a DOH of August 22nd, 2011, with no breaks in service
 - Employee #4 - Tenured employee with a DOH of January 20th, 2017, with no breaks in service
 - Each employee is over the age of 21 and earns the same eligible compensation.
- Complete an allocation of stock for 2021 (12/31/21).

ESOP Mechanics

- Complete an allocation of stock for 2022 (12/31/22).
- Complete an allocation of stock for 2023 (12/31/23).
- In 2024 the following happened:
 - Employee #1 was terminated on February 15th, 2024.
 - What happens to the employee's account balance?
 - Does the employee receive their entire ESOP balance?
- Complete an allocation of stock for 2024 (12/31/24).

ESOP Mechanics



- Complete an allocation of stock for 2025 (12/31/2025)
- In 2026, the following happened:
 - Employee #2 retires at age 65 on April 2nd, 2026.
 - What happens to their account balance?
- Complete an allocation of stock for 2026 (12/31/2026).
- Complete an allocation of stock for 2027 (12/31/2027).

Valuation Process

- The Plan Trustee determines Fair Market Value.
- Value is based on financial analysis and report prepared by BCC Advisors.
- Current Valuation Date is December 31, 2021.
- Due Diligence was conducted.
 - Financial Statement analysis.
 - Interviews with management regarding trends in products, services, and customers.

What Drives the Value?

- BCC Advisors uses a capitalized earnings method.
- This is driven by historical earnings as adjusted (debt free basis and non-recurring expenses) over 2021 results and 2022 budget/forecast.
- This earnings base is capitalized at an interest rate that reflects both market risk and perceived company risk.
- The result is adjusted for debt & marketability.

What Can Affect Future Value?

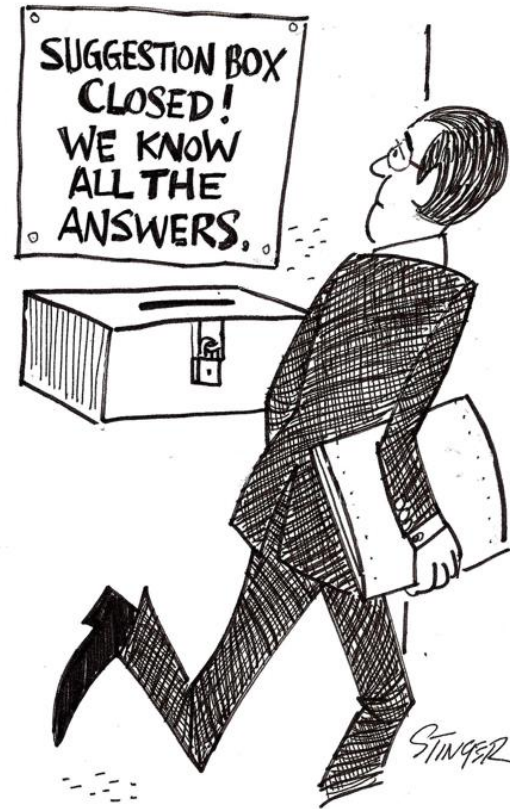
- Exceed the budget for profits and cash.
- Increase sales and services.
- Increase the profit margins on sales.
- Pay down debt.

Ways to Increase Your ESOP Share Value

- Increase your Stock Value through your daily performance.
- You have the ability to influence the stock price through your daily efforts!
 - More profits mean a higher stock price.
 - Reduce expenses.
 - Improve productivity.
- Expenses can be reduced by:
 - increasing accuracy and/or efficiency,
 - finding and suggesting ways to do your job better, and
 - reducing inventory and supplies.

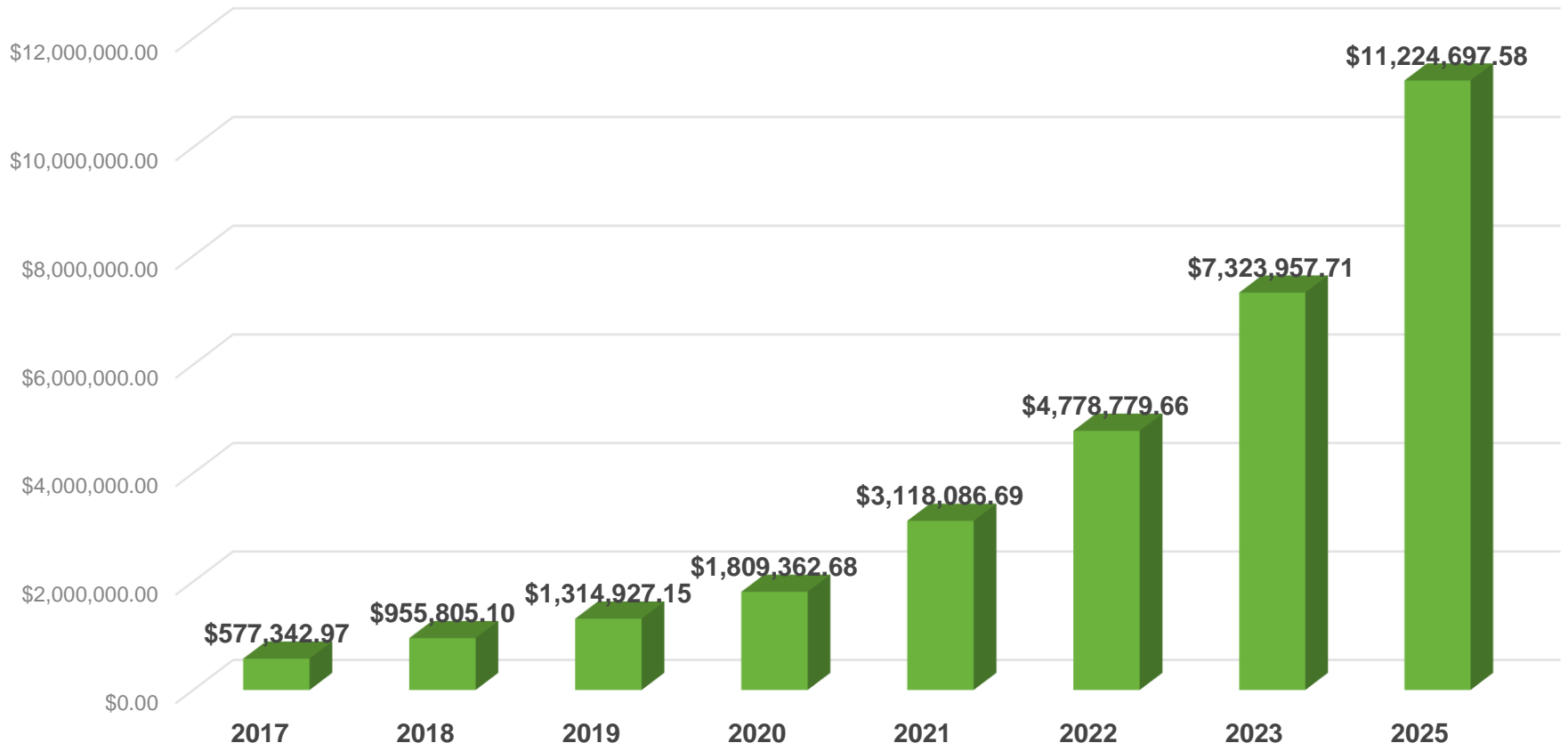
Ways to Increase your Account Value

- Earn another year of vested service by working 1,000 hours this year.
- Stay actively employed each year (12/31), so you can earn another allocation of shares.
- Share Ideas and Suggestions
- Be an Ideal Team Player:
 - ✓ Build Trust
 - ✓ Collaborate with Each Other
 - ✓ Accountability
 - ✓ Humility



This is Employee Ownership

Total ESOP Trust Value Current & Projected



Summary of Your Plan

- Participation is of no cost and 100% funded by the company.
- Company stock accumulates in your account as contributions are made to the plan.
- Once your account is vested, it belongs to you.
- You get paid from the Plan when you leave or are eligible to diversify.
- You pay no tax until you receive a taxable distribution.
- The stock price is impacted by your efforts and performance.
- Stock value is impacted by the financial results of the company.
- The Plan is a retirement plan, so please maintain a long-term focus.

Questions/Comments