

ESOP repurchase obligation funding

Key assumptions

Your company

- Your corporate structure is a S corporation
- The ESOP owns 50% of the company
- 35% business tax bracket (Federal and State)
- 5% cost of money on cash (4% after-tax rate used for the NPV)

Corporate-owned investments

- 7% annual earnings
- 25% of annual mutual fund earnings are taxable due to capital gains distributions, interest and dividends

Corporate-owned life insurance

- 7% long-term net investment earnings rate
- Life expectancy for the insured(s) is age 85

Repurchase liability forecast

Based on management study dated 12/31/2019

Year	Year	Projected repurchase obligation	Percent of total
1	2023	\$0	0.00%
2	2024	\$0	0.00%
3	2025	\$0	0.00%
4	2026	\$23,058	0.23%
5	2027	\$67,067	0.67%
6	2028	\$195,200	1.95%
7	2029	\$170,983	1.71%
8	2030	\$279,267	2.79%
9	2031	\$304,883	3.05%
10	2032	\$361,475	3.61%
11	2033	\$589,920	5.90%
12	2034	\$595,333	5.95%
13	2035	\$601,383	6.01%
14	2036	\$662,283	6.62%
15	2037	\$626,992	6.27%
16	2038	\$624,167	6.24%
17	2039	\$809,508	8.10%
18	2040	\$1,431,625	14.32%
19	2041	\$1,053,192	10.53%
20	2042	\$1,603,664	16.04%

First 10 years
\$1,401,933
14.02%

Second 10 years
\$8,598,067
85.98%

Total	\$10,000,000	100%
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Unfunded

If you did nothing to save, you can think of this as a "pay-as-you-go" system. As payments come due, you use your company cash at that time to pay the obligation.

While you are not required to set aside assets, not doing so could lead to problems in the future. It leaves the liability down the road for future management to address.

Key features

Advantage: it's simple, you keep cash to help grow the company

Consideration: you should watch your future liquidity and cost of borrowing

Year	Year	Projected repurchase obligation	Net cost to company
1	2023	\$0	\$0
2	2024	\$0	\$0
3	2025	\$0	\$0
4	2026	\$23,058	\$23,058
5	2027	\$67,067	\$67,067
6	2028	\$195,200	\$195,200
7	2029	\$170,983	\$170,983
8	2030	\$279,267	\$279,267
9	2031	\$304,883	\$304,883
10	2032	\$361,475	\$361,475
11	2033	\$589,920	\$589,920
12	2034	\$595,333	\$595,333
13	2035	\$601,383	\$601,383
14	2036	\$662,283	\$662,283
15	2037	\$626,992	\$626,992
16	2038	\$624,167	\$624,167
17	2039	\$809,508	\$809,508
18	2040	\$1,431,625	\$1,431,625
19	2041	\$1,053,192	\$1,053,192
20	2042	\$1,603,664	\$1,603,664

Total cost to company	\$10,000,000
Net present value at 4% (NPV)	\$5,555,617

Corporate-owned life insurance (COLI)

Another option is to save with corporate-owned life insurance. The life insurance policy can potentially provide tax-deferred investment growth.

The company can use the policy cash values to fund its repurchase obligations. When a death occurs, the company can use the policy's proceeds to repurchase a deceased participant's interest. The policy proceeds can also be used for cost recovery or for the company's general purposes.

Key features

Advantage: you can potentially get tax-favorable growth and future death benefits

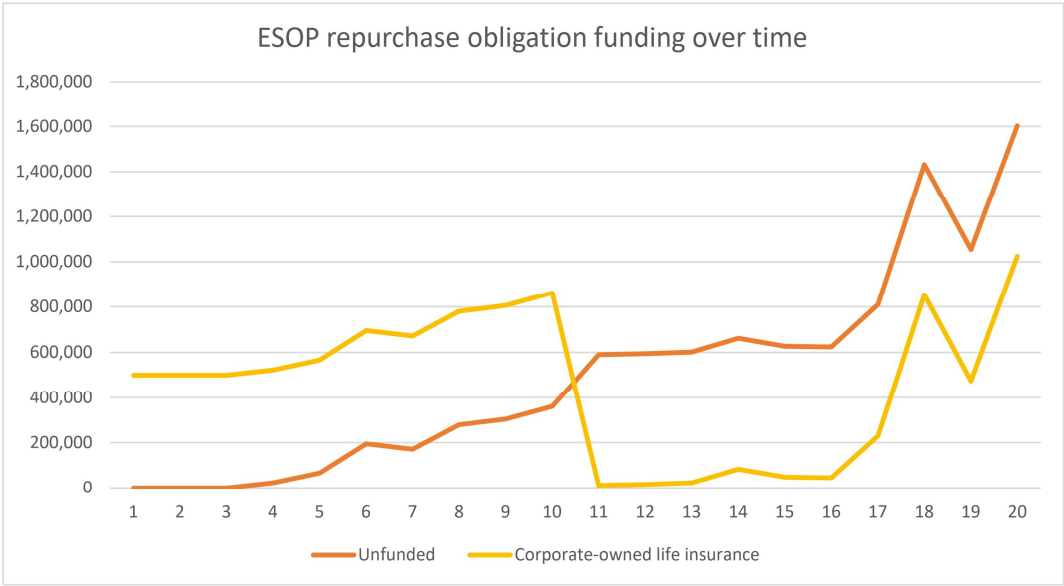
Consideration: you pay policy costs

Year	Projected repurchase obligation	Life insurance premiums paid	Life insurance withdrawals & loans	Out of pocket (cash or funds)	Net cost to company	Life insurance cash surrender values*	Life insurance death benefits*
2023	\$0	\$500,000	\$0	\$0	\$500,000	\$506,581	\$10,486,206
2024	\$0	\$500,000	\$0	\$0	\$500,000	\$1,023,228	\$10,975,728
2025	\$0	\$500,000	\$0	\$0	\$500,000	\$1,568,941	\$11,498,441
2026	\$23,058	\$500,000	\$0	\$23,058	\$523,058	\$2,146,417	\$12,056,417
2027	\$67,067	\$500,000	\$0	\$67,067	\$567,067	\$2,755,225	\$12,650,225
2028	\$195,200	\$500,000	\$0	\$195,200	\$695,200	\$3,395,063	\$13,282,563
2029	\$170,983	\$500,000	\$0	\$170,983	\$670,983	\$4,069,466	\$13,955,716
2030	\$279,267	\$500,000	\$0	\$279,267	\$779,267	\$4,802,167	\$14,692,167
2031	\$304,883	\$500,000	\$0	\$304,883	\$804,883	\$5,582,774	\$15,475,899
2032	\$361,475	\$500,000	\$0	\$361,475	\$861,475	\$6,399,148	\$16,299,148
2033	\$589,920	-	(\$578,905)	\$589,920	\$11,015	\$6,118,557	\$16,052,241
2034	\$595,333	-	(\$578,905)	\$595,333	\$16,428	\$5,826,353	\$15,787,931
2035	\$601,383	-	(\$578,905)	\$601,383	\$22,478	\$5,519,567	\$15,506,882
2036	\$662,283	-	(\$578,905)	\$662,283	\$83,378	\$5,201,606	\$15,201,606
2037	\$626,992	-	(\$578,905)	\$626,992	\$48,087	\$4,871,983	\$14,871,983
2038	\$624,167	-	(\$578,905)	\$624,167	\$45,262	\$4,555,598	\$8,555,598
2039	\$809,508	-	(\$578,905)	\$809,508	\$230,603	\$4,213,936	\$8,213,936
2040	\$1,431,625	-	(\$578,905)	\$1,431,625	\$852,720	\$3,845,255	\$7,845,255
2041	\$1,053,192	-	(\$578,905)	\$1,053,192	\$474,287	\$3,447,700	\$7,447,700
2042	\$1,603,664	-	(\$578,905)	\$1,603,664	\$1,024,759	\$3,019,324	\$7,019,324

Total Cost to Company	\$9,210,950
Less: Death Benefits at Age 85	(\$11,640,994)
Net Benefit to Company	\$2,430,044
Net Present Value of Cost at 4% (NPV)	\$3,875,492

Comparison of funding methods

Year	Annual cost to fund		Assets		
	Unfunded	Corporate-owned life insurance	Unfunded	Life insurance cash surrender values*	Life insurance death benefits*
2023	0	500,000	0	506,581	10,486,206
2024	0	500,000	0	1,023,228	10,975,728
2025	0	500,000	0	1,568,941	11,498,441
2026	23,058	523,058	0	2,146,417	12,056,417
2027	67,067	567,067	0	2,755,225	12,650,225
2028	195,200	695,200	0	3,395,063	13,282,563
2029	170,983	670,983	0	4,069,466	13,955,716
2030	279,267	779,267	0	4,802,167	14,692,167
2031	304,883	804,883	0	5,582,774	15,475,899
2032	361,475	861,475	0	6,399,148	16,299,148
2033	589,920	11,015	0	6,118,557	16,052,241
2034	595,333	16,428	0	5,826,353	15,787,931
2035	601,383	22,478	0	5,519,567	15,506,882
2036	662,283	83,378	0	5,201,606	15,201,606
2037	626,992	48,087	0	4,871,983	14,871,983
2038	624,167	45,262	0	4,555,598	8,555,598
2039	809,508	230,603	0	4,213,936	8,213,936
2040	1,431,625	852,720	0	3,845,255	7,845,255
2041	1,053,192	474,287	0	3,447,700	7,447,700
2042	1,603,664	1,024,759	0	3,019,324	7,019,324
Total cost	10,000,000	9,210,950			
Net present value at 4%	5,555,617	3,875,492			



Comparison of funding methods

Both taxable assets and life insurance can help you achieve the goal of asset accumulation for your ESOP funding strategy. This gives you and your participants greater confidence in the sustainability of the benefit program. Regardless of your funding choice, your participant's benefits are the same.

Below is a recap of the asset accumulation options, including the numbers from this demonstration.

	Unfunded	Corporate-owned life insurance
Key features	Pay as you go	Earnings accumulate tax-deferred Tax free distributions Tax free corporate owned life insurance death benefit (subject to rules) Cost recovery
Key numbers	\$10,000,000 20-year repurchase obligation \$0 No death benefits	\$10,000,000 20-year repurchase obligation \$10,000,000 Initial death benefits
Total funding	\$10,000,000 Total contributions	\$9,210,950 Total contributions
Less death benefits	\$0 No death benefits	\$11,640,994 Death benefits at mortality (Age 85)
Equals	\$10,000,000 Net cost to fund \$5,555,617 Net present value at 4%	\$2,430,044 Net benefit to company \$3,875,492 Net present value at 4%

*Life insurance cash surrender values and death benefits are based on a 7% net rate of return.

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