

ESOPs & Surety: Talk Before the Transition



Rely on Surety Bonding? Considering an ESOP? Consider this first...

The construction industry is facing a significant demographic shift as many company owners approach retirement, prompting increased discussion around succession planning. Employee Stock Ownership Plans (ESOPs) have emerged as one of the more popular exit strategies for owners of construction companies and have received growing attention in recent years.

ESOPs provide owners with a way to access liquidity while rewarding employees, preserving the company's culture and legacy, and potentially benefiting from meaningful tax advantages. They also tend to align well with the structure of many construction businesses. Construction companies are often privately held, family-owned, and relationship-driven, and an ESOP allows owners to transition the business without selling to competitors or private equity firms.

While ESOPs can be an effective ownership transition strategy, contractors that rely on surety bonding must carefully consider the potential implications for their bonding programs.

An ESOP transaction introduces changes to a company's ownership and financial structure that sureties will need to understand and evaluate. For this reason, it is a best practice to involve your surety partners early in the process, before a transaction is finalized, to ensure alignment and avoid potential disruptions. The longer a contractor waits to inform their surety, the greater the risk that the bonding program could be impacted.

Your surety is a critical partner to your business and expects to have a seat at the table when significant ownership transitions are being considered. In addition to understanding the immediate financial impact of the transaction, sureties will want clarity on the company's long-term leadership and continuity plan. Your surety broker plays an important role in this process, helping to facilitate early discussions with the surety, communicate the structure of the transaction, and ensure underwriting concerns are addressed throughout the planning stages.

While underwriters will review the full transaction structure and supporting documentation, contractors should be prepared to address several key questions during the evaluation process:

- What is the total transaction value, and will the ESOP represent a partial or 100% ownership transition?
- How is the ESOP being financed, and what is the composition of seller financing versus bank debt?
- How will the transaction affect the balance sheet, particularly with respect to working capital and equity? Sureties will typically request pro forma financial statements that reflect the company's post-closing financial position.
- Will the company be able to service ESOP-related debt through industry cycles or potential downturns?
- Will there be any changes to the indemnity structure supporting the surety program?
- Who will lead the company following the transition, and what does the long-term leadership plan look like?

Fortunately, surety underwriters have become increasingly knowledgeable about ESOP transactions, which is a positive development for the industry. As ESOP discussions become more common, underwriters are gaining more firsthand experience evaluating these transactions and engaging in conversations with contractors and their advisors, often providing valuable insights based on similar transactions.

At the same time, the industry has benefited from a growing number of educational resources focused on ESOPs including webinars, conferences, and industry associations. At American Global, we also seek to grow our collective knowledge. While our team includes business advisors and construction CPAs with strong ESOP experience, we have brought in third party ESOP experts to present internally, to foster greater understanding of how these transactions affect our clients, so our broader team can engage clients in more thoughtful and detailed dialogue on this topic.

When thoughtfully structured, ESOP transitions are often well received by sureties. By proactively addressing key underwriting considerations, particularly those related to leverage, leadership continuity, and indemnity, contractors can position their transition in a way that supports both their long-term ownership objectives and the stability of their bonding program.



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