

October 23, 2012

# What is Phantom Stock? *and why do I keep hearing about it?*



THE VISIONLINK  
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Today's Presenter:

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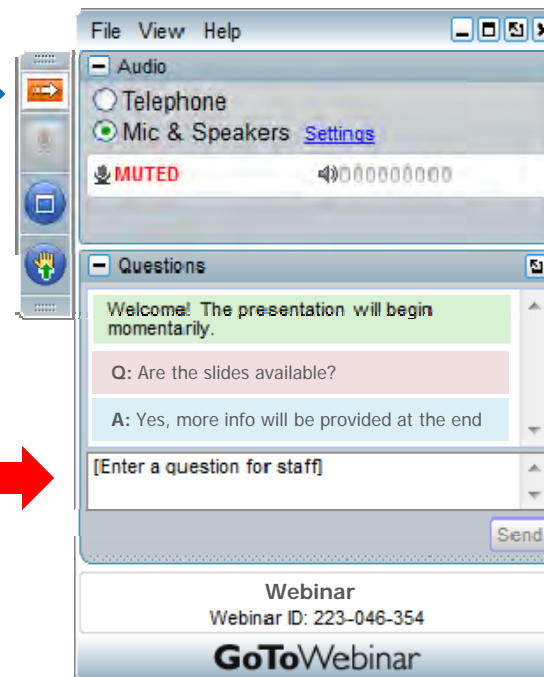
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# What problem are we trying to address?

How do we create a compensation plan that both shareholders and employees can agree on?



# What shareholders want

- Align with shareholder interests
- Tie pay results to value creation
- Large incentives are fine if shareholders receive a fair return first
- Encourage top talent to join and stay



# What top producers want

- Align with shareholder interests
- Share in value creation
- Large variable upside once shareholders receive a fair return first
- A place to make a long-term difference



# Well, look at that...

- Align with shareholder interests
- Tie pay results to value creation
- Large incentives are fine if shareholders receive a fair return first
- Encourage top talent to join and stay

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- Align with shareholder interests
- Share in value creation
- Large variable upside once shareholders receive a fair return first
- A place to make a long-term difference



# So, you're hiring John...

- New president
- What do you offer him?
  - Significant salary
  - Meaningful target bonus





# John's comp package

	<b>2012</b>
Annual Salary	\$ 325,000
Bonus	\$ 85,000

# John's expected contribution

1. Deliver on annual budget achievement
2. Deliver on 6-year growth plan
  - a) Revenue from \$17mm to \$39mm
  - b) Net Income from \$5.0mm to \$13.5mm
  - c) Book value from \$19mm to \$51mm
  - d) Market value (conservative) from \$25mm to \$67mm



# John's alternative comp package

## Employee Value Statement

*John Ferry @ Target*

### Cash Needs

	2012	2013	2014	2015	2016	2017	2018
Annual Salary	\$ 325,000	\$ 334,750	\$ 344,793	\$ 355,136	\$ 365,790	\$ 376,764	\$ 388,067
Bonus	\$ 85,000	\$ 87,550	\$ 90,177	\$ 92,882	\$ 95,668	\$ 98,538	\$ 101,494
<b>Total Cash Received</b>	<b>\$ 410,000</b>	<b>\$ 422,300</b>	<b>\$ 434,969</b>	<b>\$ 448,018</b>	<b>\$ 461,459</b>	<b>\$ 475,302</b>	<b>\$ 489,561</b>

### Security Needs

Core Benefits	\$ 21,000	\$ 22,260	\$ 23,596	\$ 25,011	\$ 26,512	\$ 28,103	\$ 29,789
Executive Benefits	\$ 18,000	\$ 18,540	\$ 19,096	\$ 19,669	\$ 20,259	\$ 20,867	\$ 21,493
<b>Total Value</b>	<b>\$ 39,000</b>	<b>\$ 40,800</b>	<b>\$ 42,692</b>	<b>\$ 44,680</b>	<b>\$ 46,771</b>	<b>\$ 48,970</b>	<b>\$ 51,282</b>

### Wealth Accumulation

#### Retirement Plans

401(k) Company Match	\$ 16,500	\$ 16,995	\$ 17,505	\$ 18,030	\$ 18,571	\$ 19,128	\$ 19,702
Deferred Comp Match	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000

### Total Value Projection

<b>Total Cash Received</b>	<b>\$ 410,000</b>	<b>\$ 422,300</b>	<b>\$ 434,969</b>	<b>\$ 448,018</b>	<b>\$ 461,459</b>	<b>\$ 475,302</b>	<b>\$ 489,561</b>
<b>Total Benefits Annual Value</b>	<b>\$ 39,000</b>	<b>\$ 40,800</b>	<b>\$ 42,692</b>	<b>\$ 44,680</b>	<b>\$ 46,771</b>	<b>\$ 48,970</b>	<b>\$ 51,282</b>
<b>Annual Value of LTIP</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 287,767</b>	<b>\$ 574,926</b>	<b>\$ 579,137</b>	<b>\$ 564,580</b>	<b>\$ 527,541</b>
<b>Annual Value of Ret Plan Contr's</b>	<b>\$ 26,500</b>	<b>\$ 26,995</b>	<b>\$ 27,505</b>	<b>\$ 28,030</b>	<b>\$ 28,571</b>	<b>\$ 29,128</b>	<b>\$ 29,702</b>
<b>Total Annual Value</b>	<b>\$ 475,500</b>	<b>\$ 490,095</b>	<b>\$ 792,933</b>	<b>\$ 1,095,655</b>	<b>\$ 1,115,938</b>	<b>\$ 1,117,980</b>	<b>\$ 1,098,087</b>

<b>Total Wealth Projection</b>	<b>475,500</b>	<b>\$ 965,595</b>	<b>\$ 1,758,528</b>	<b>\$ 2,854,182</b>	<b>\$ 3,970,120</b>	<b>\$ 5,088,100</b>	<b>\$ 6,186,187</b>
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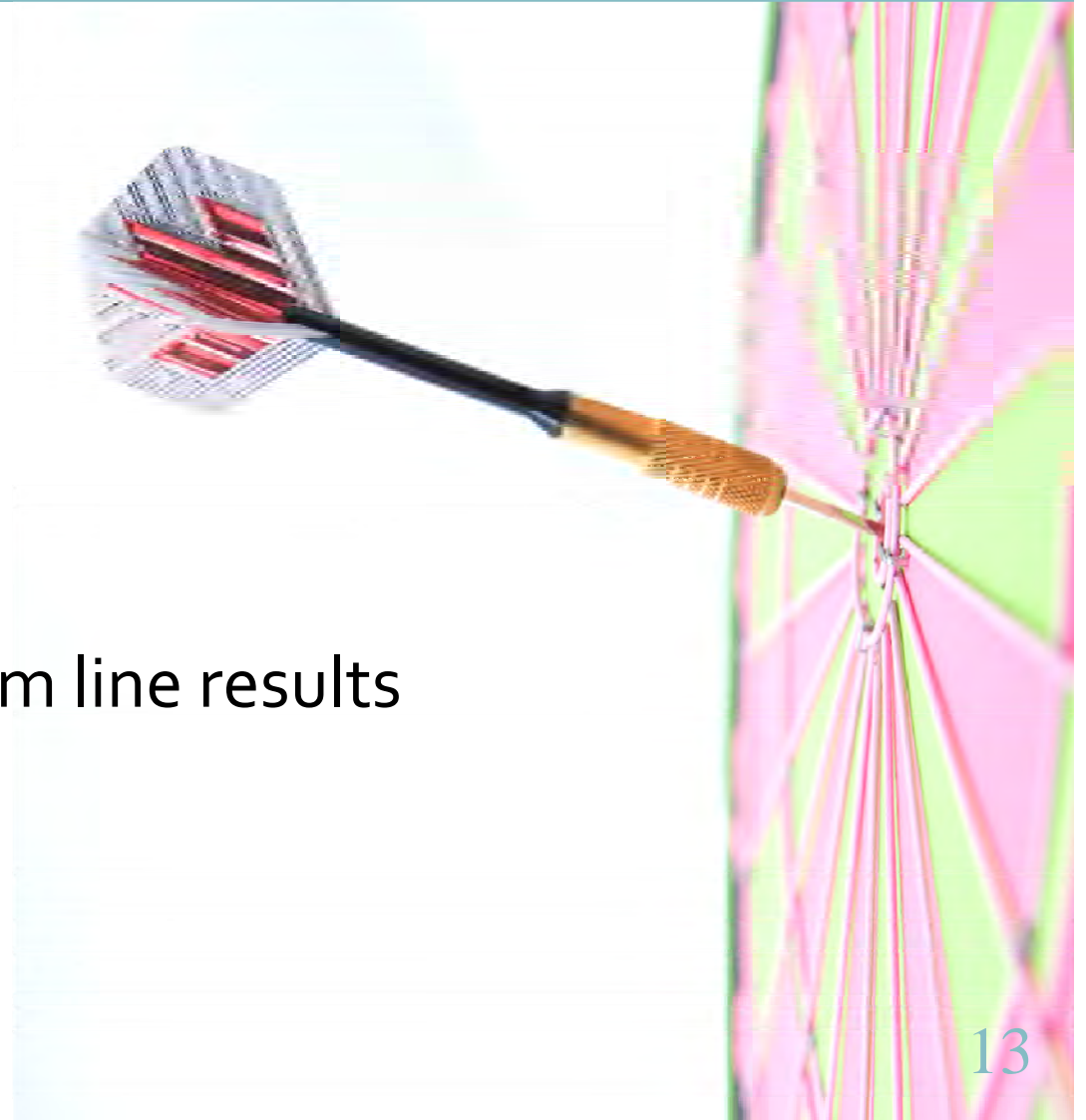
# Two differences

- Long-term perspective
- Long-term incentive plan



# Phantom Stock

- What is it?
- What's the goal?
- Does it work?
  - Do it wrong
  - Do it right
- How to impact bottom line results
- Final observations



# What is Phantom Stock?

- A deferred bonus
- Awards made in “units” (like stock)
- Unit price is tied to a formula (or appraisal) that reflects company value
- Settled in cash (almost always)





# What's the goal?

"Can I reward employees like owners without giving away stock?"

"How do I compensate employees for contributing to the creation of my future company?"

"What compensation techniques do I use to attract and retain top talent?"







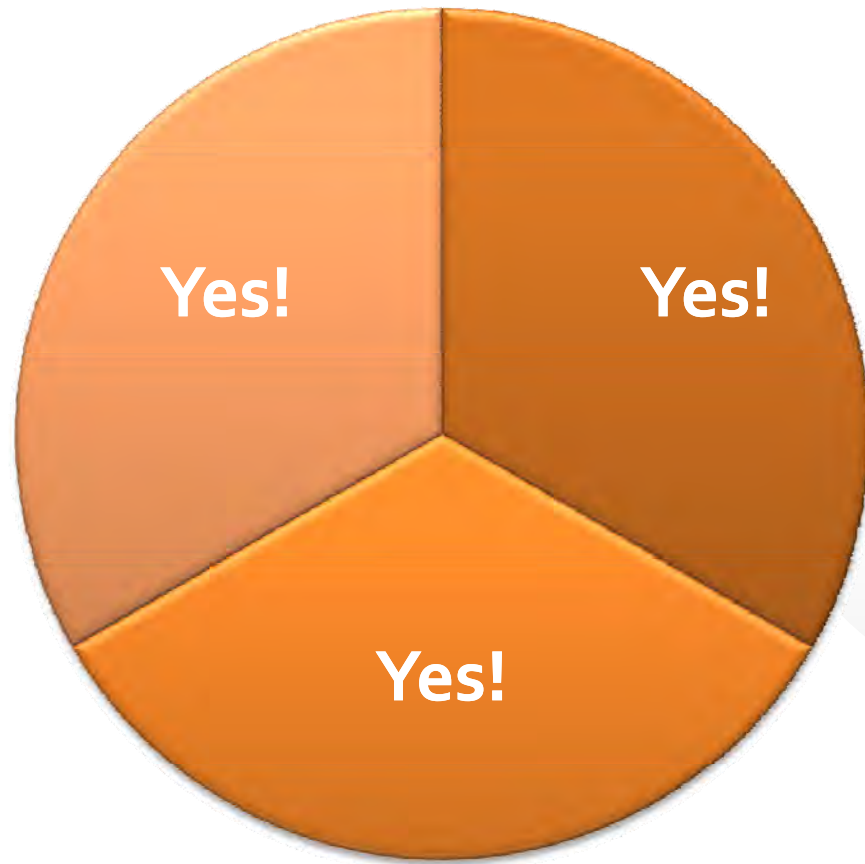
# Does phantom stock work?

- Does it help you create an ownership mentality?
- Does it properly reward for value creation?
- Does it help you win the talent wars?



# Answer

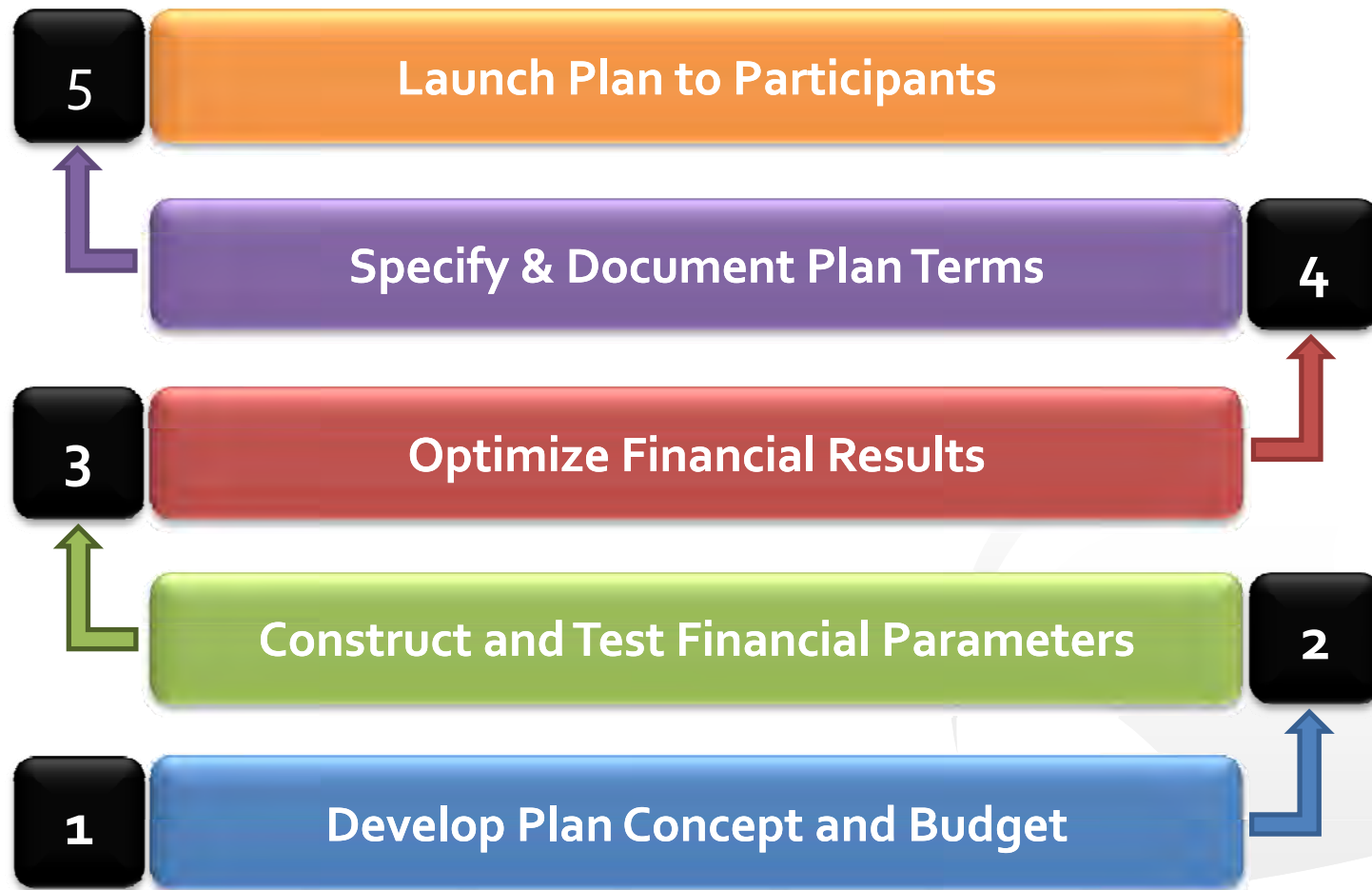
If you do it right...



# Poll



# Developing and Implementing a Phantom Stock Plan



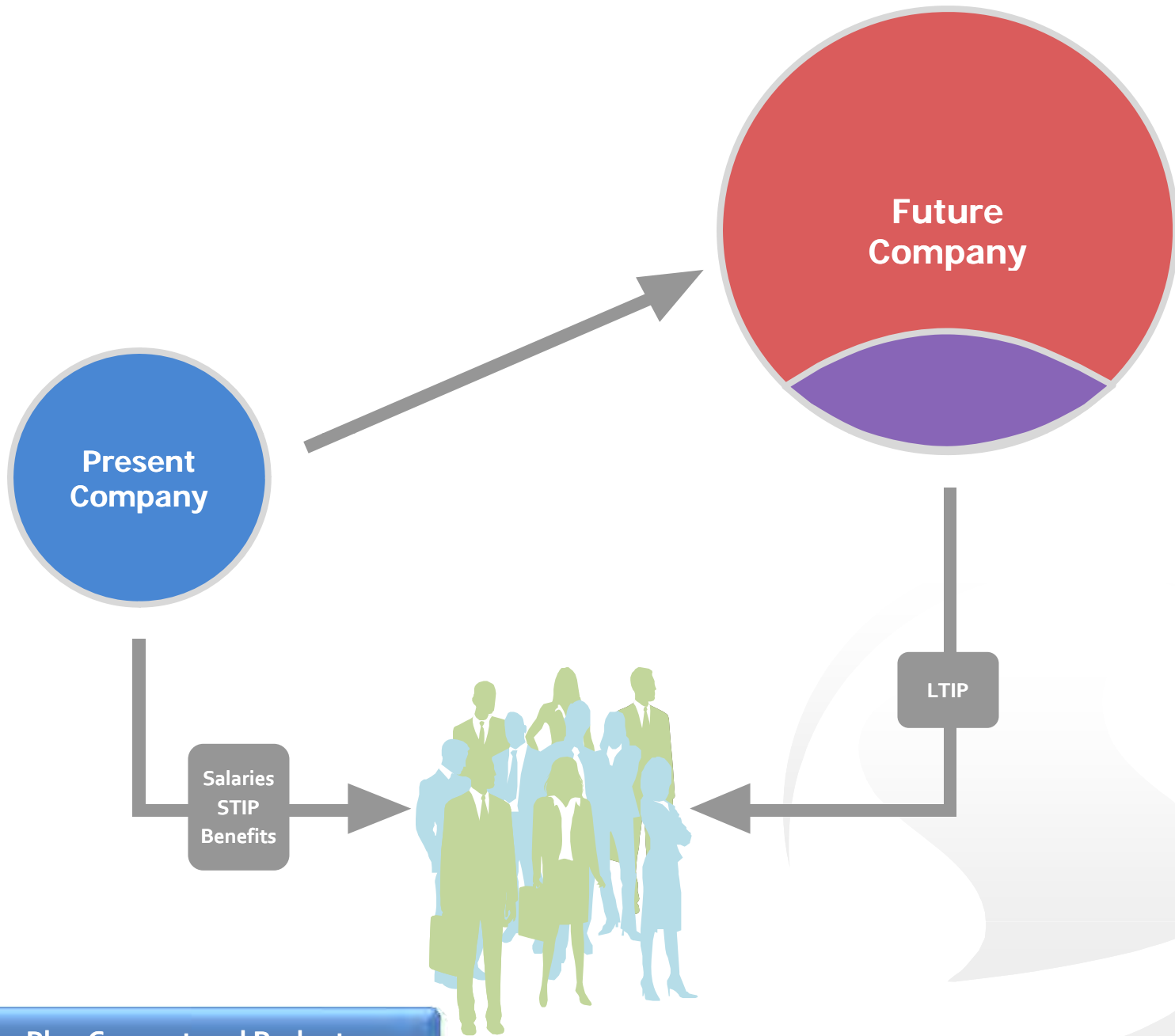
# 1

## Develop Plan Concept and Budget

- A. Identify the plan purpose
- B. Forecast your future company
- C. Identify potential participants
- D. Carve out the plan "budget"
- E. Select the right plan type

# A. Our Plan Purpose Statement



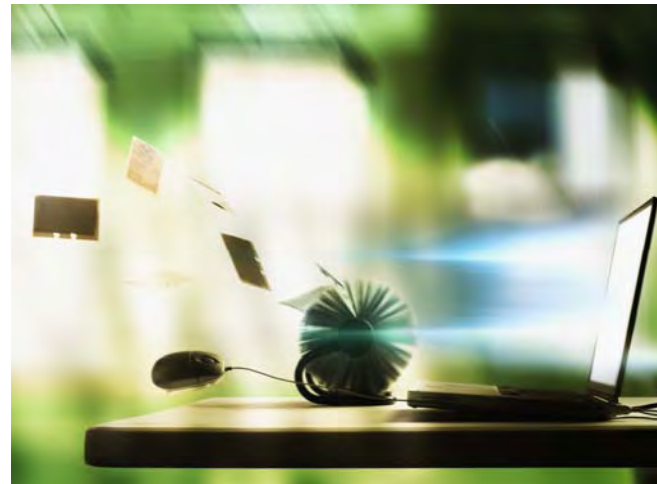


Develop Plan Concept and Budget



## B. Forecast the Future Company

*(from here on you're going to see a lot of numbers)*



Develop Plan Concept and Budget

# C. Identify Potential Participants

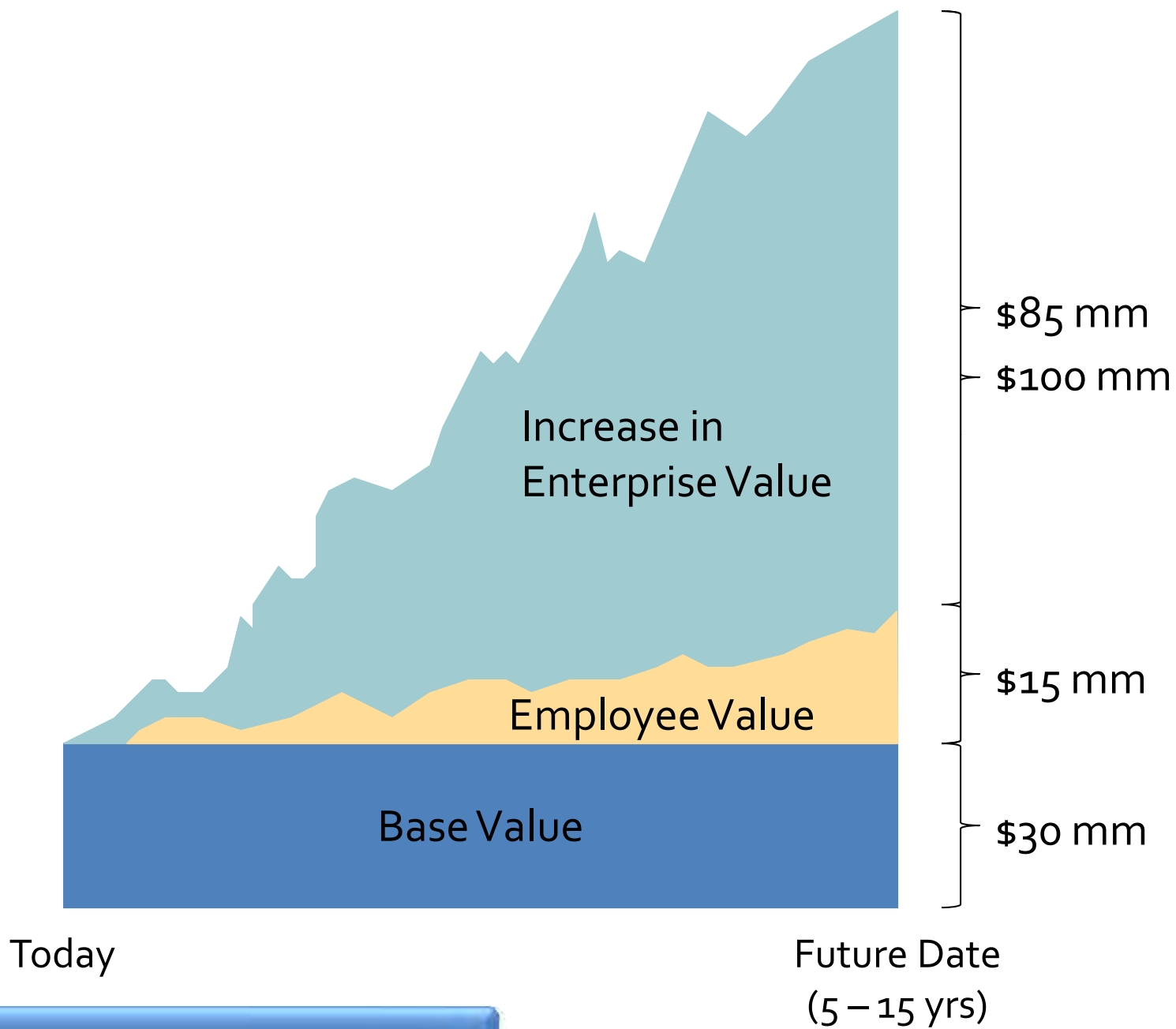


Develop Plan Concept and Budget

# D. Carve Out the Plan Budget



Develop Plan Concept and Budget



Develop Plan Concept and Budget

# E. Select the Right Plan Type

Phantom Stock Option

Restricted Stock

Performance Shares

Profit Pool

Phantom Stock

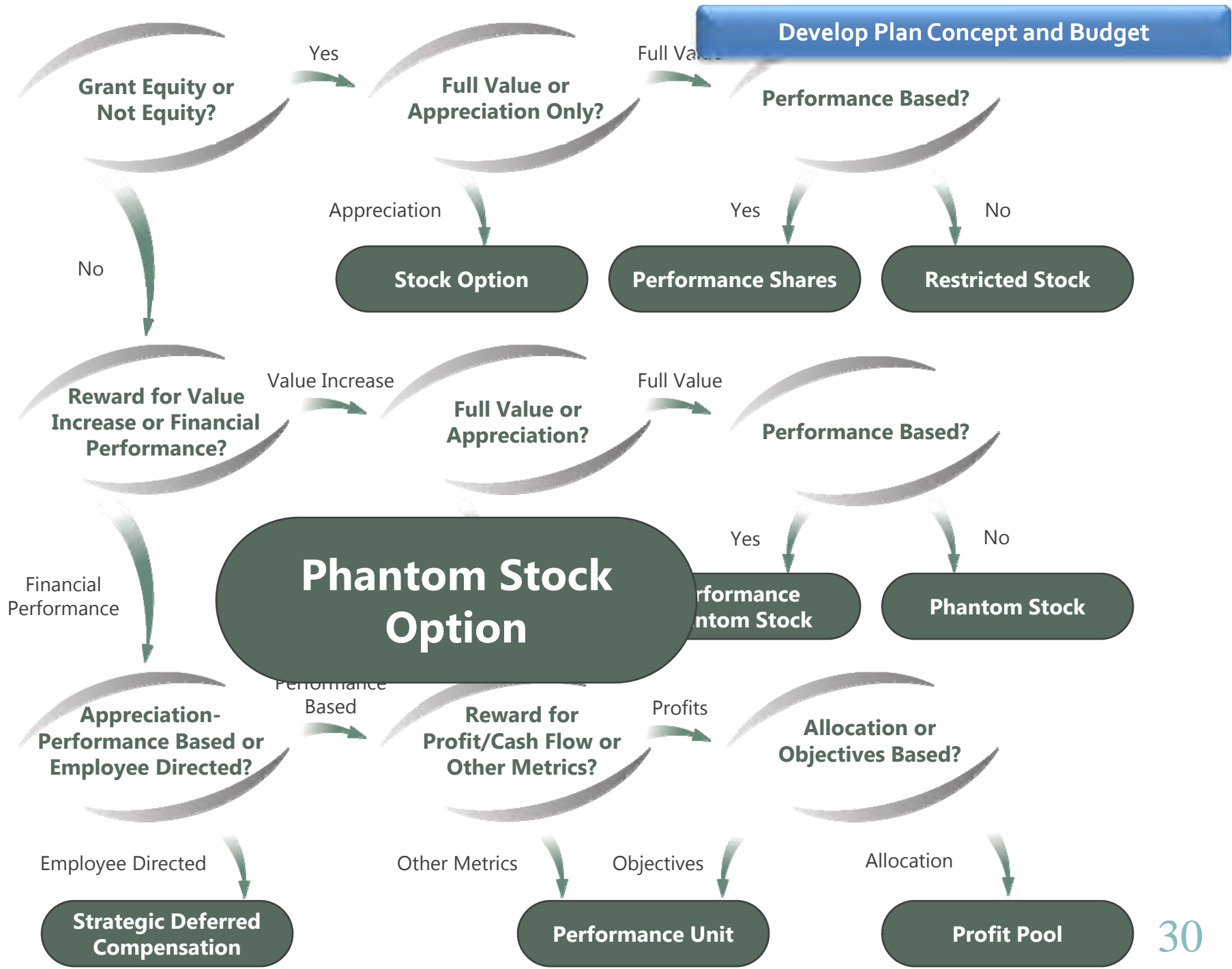
Strategic Deferred Compensation

Performance Phantom Stock

Stock Option

Performance Unit

Develop Plan Concept and Budget



# Stage 1 Completed

## Develop Plan Concept and Budget

- ✓ Identify the plan purpose
- ✓ Forecast your future company
- ✓ Identify potential participants
- ✓ Carve out the plan "budget"
- ✓ Select the right plan type

## 2

### Construct and Test Financial Parameters

- A. Assign relative values for participants
- B. Consider “Level 1” decisions (awards, vesting, etc.)
- C. Test and validate
- D. Determine preliminary award levels
- E. Finalize “Level 1” terms and conditions



# A. Assign relative value for participants



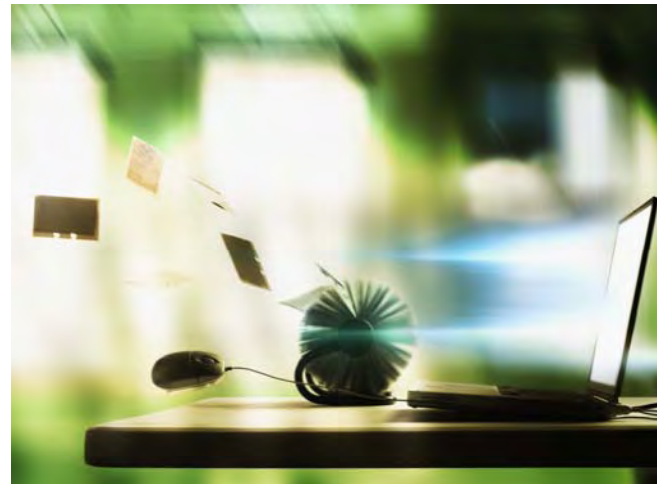
Construct and Test Financial Parameters

## B. Consider “Level 1” Decisions



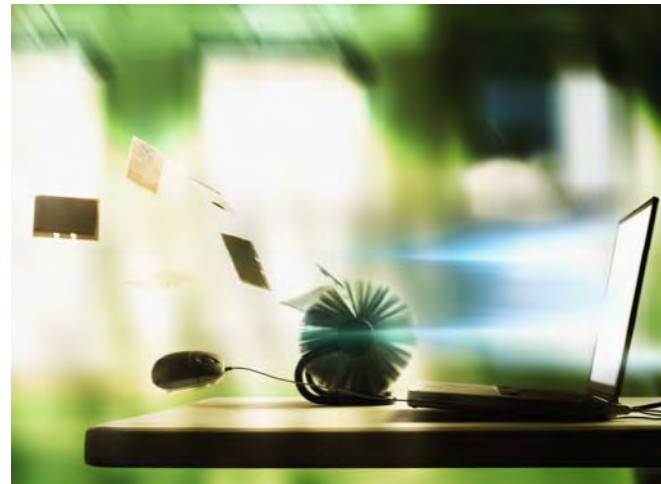
Construct and Test Financial Parameters

# C. Test and Validate



Construct and Test Financial Parameters

# D. Determine Preliminary Award Levels



Construct and Test Financial Parameters

# E. Finalize Level 1 Terms and Conditions



Construct and Test Financial Parameters

# Stage 2 Completed

## Construct and Test Financial Parameters

- ✓ Assign relative values for participants
- ✓ Consider “Level 1” decisions (awards, vesting, etc.)
- ✓ Test and validate
- ✓ Determine preliminary award levels
- ✓ Finalize “Level 1” terms and conditions

# 3

## Optimize Financial Results

- A. Assess earnings and cash flow impact
- B. Calculate funding targets
- C. Adjust Level 1 terms to calibrate
- D. Consider alternative funding methods
- E. Complete funding decision

# A. Assess earnings and cash flow impact



Optimize Financial Results

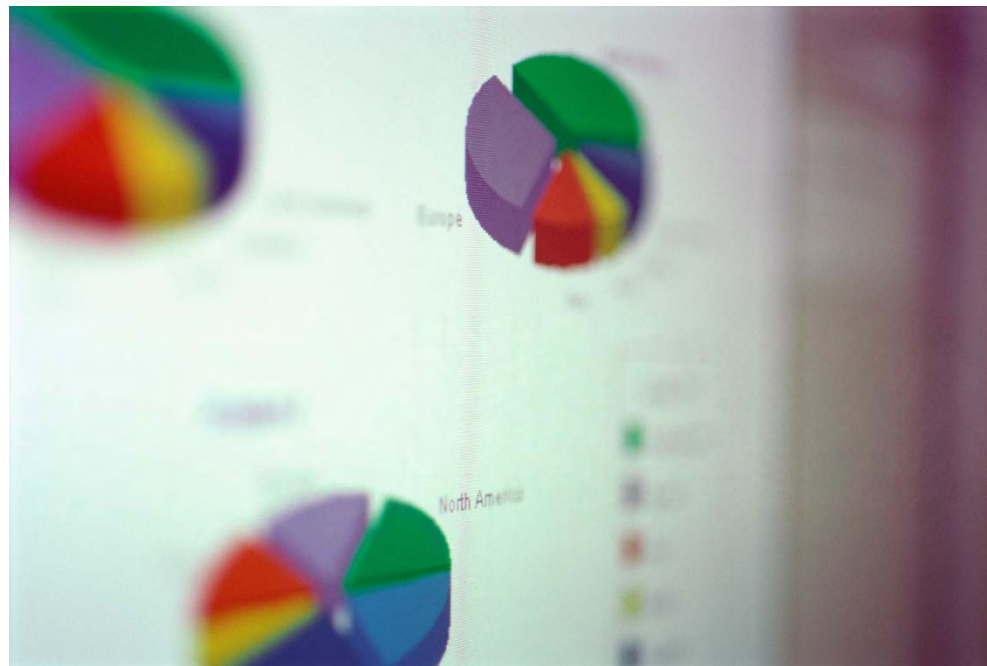


## B. Calculate Funding Targets



Optimize Financial Results

# C-E. Adjust, calibrate, finalize



Optimize Financial Results

# Stage 3 Completed

## Optimize Financial Results

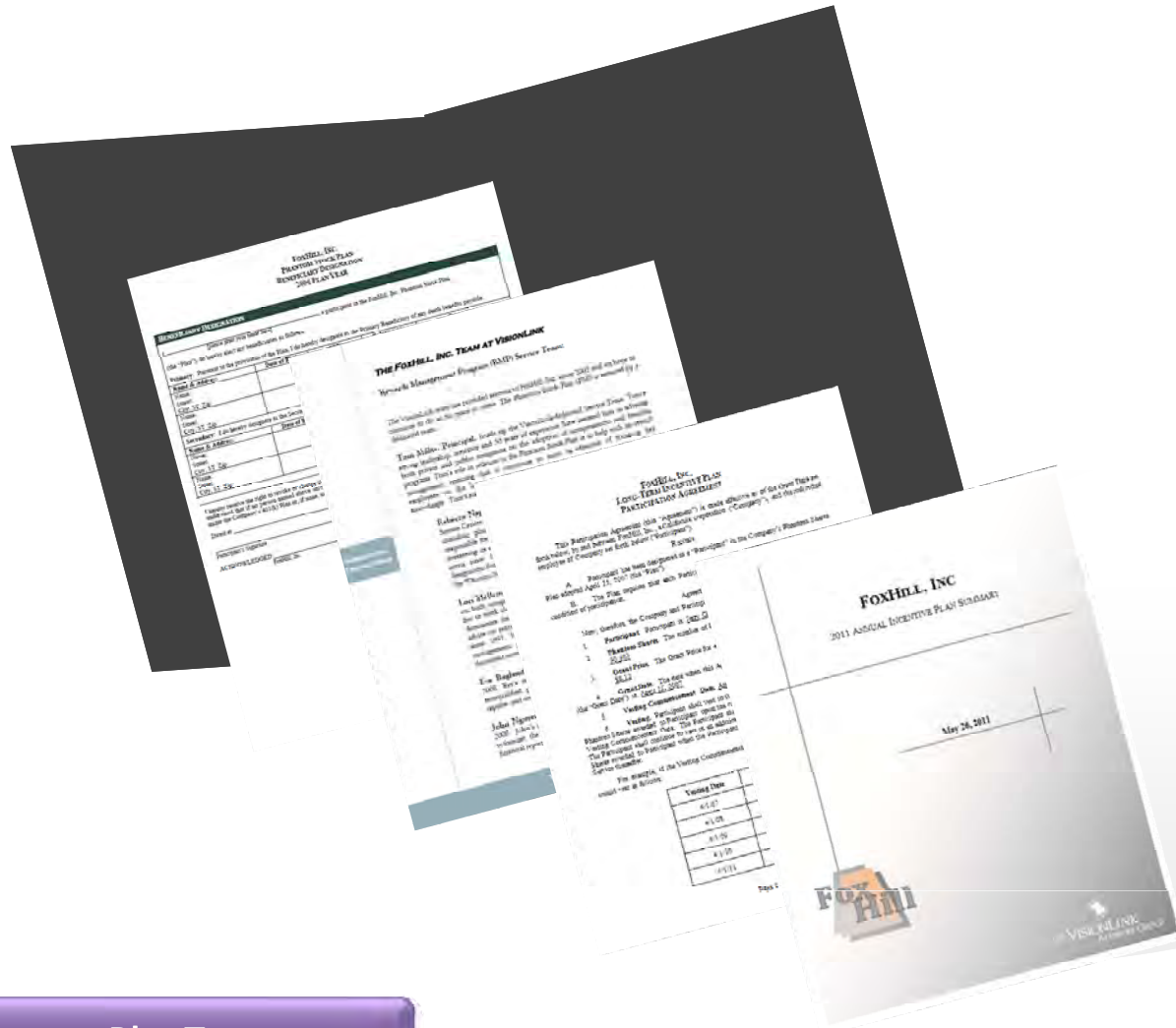
- ✓ Assess earnings and cash flow impact
- ✓ Calculate funding targets
- ✓ Adjust Level 1 terms to calibrate
- ✓ Consider alternative funding methods
- ✓ Complete funding decision

# 4

## Specify & Document Plan Terms

- A. Consider “Level 2” terms (CIC, SOS, etc.)
- B. Prepare plan provisions outline
- C. Draft “legal ready” documents
- D. Receive client counsel input
- E. Finalize/execute plan documents and forms

# A-E: Documentation



Specify & Document Plan Terms

# Stage 4 Completed

## Specify & Document Plan Terms

- ✓ Consider “Level 2” terms (CIC, SOS, etc.)
- ✓ Prepare plan provisions outline
- ✓ Draft “legal ready” documents
- ✓ Receive client counsel input
- ✓ Finalize/execute plan documents and forms

# 5

## Launch Plan to Participants

- A. Prepare all presentation & enrollment material
- B. CEO & VisionLink present plan
- C. CEO meets with participants privately
- D. Copy administrator on all relevant forms
- E. Prepare plan for ongoing operation

# A-E: Enroll your plan



Launch Plan to Participants



# Stage 5 Completed

## Launch Plan to Participants

- ✓ Prepare all presentation & enrollment material
- ✓ CEO & VisionLink present plan
- ✓ CEO meets with participants privately
- ✓ Copy administrator on all relevant forms
- ✓ Prepare plan for ongoing operation

# Developing and Implementing a Long-Term Incentive Plan



# Doing it “right”

## Good plan

- Simple valuation method
- Annual awards
- In-service redemptions (payments)
- Budgeted grants
- Drafting precision

## Not so good plan

- Appraisal or over-engineered formula
- One time “block” awards
- No redemptions until major event
- Random grants
- Casual documentation

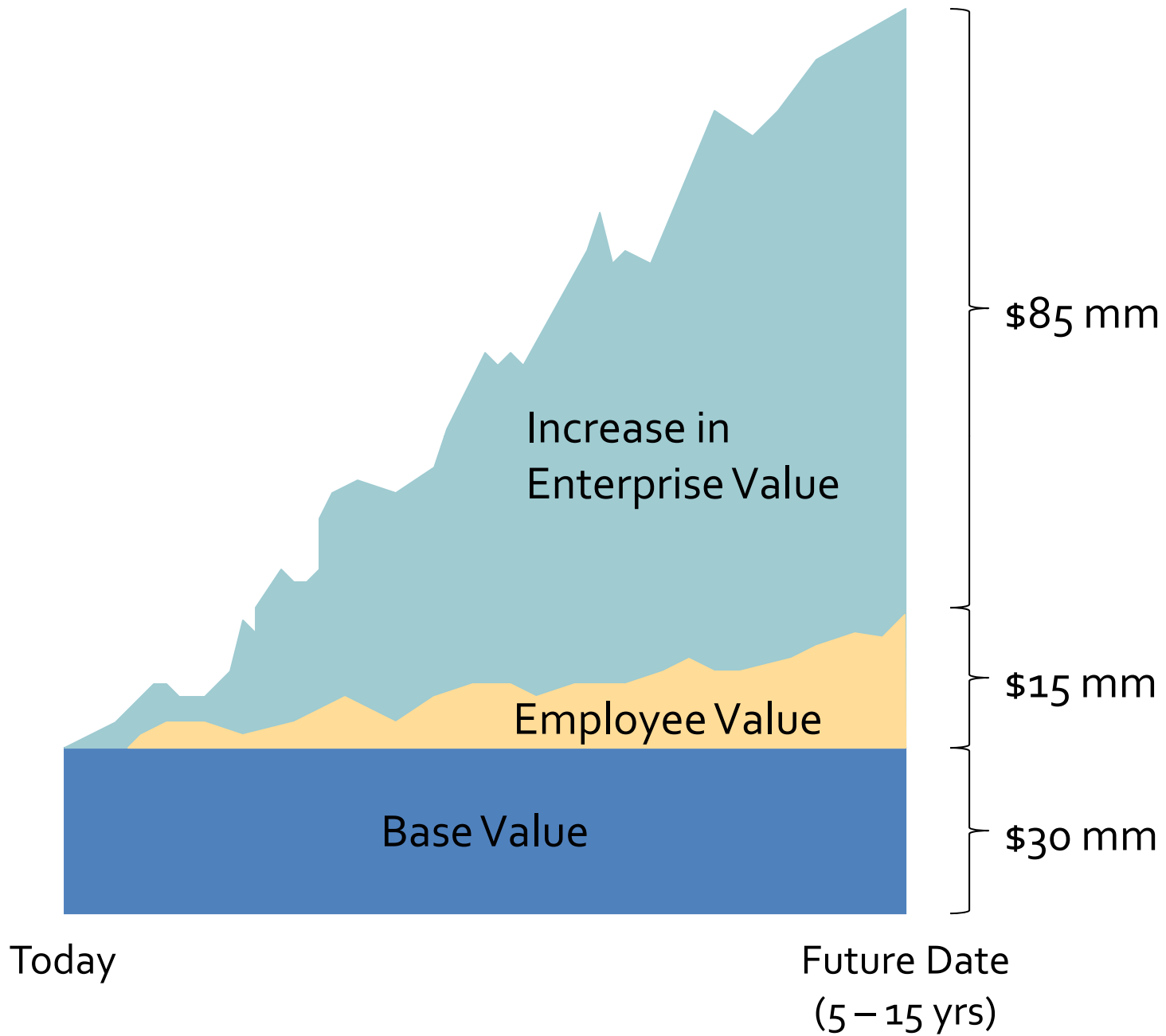
# Best practice tips

- PSO over Full Value
- Vesting schedules
- Payment schedules
- Grant schedules as a percent of salary

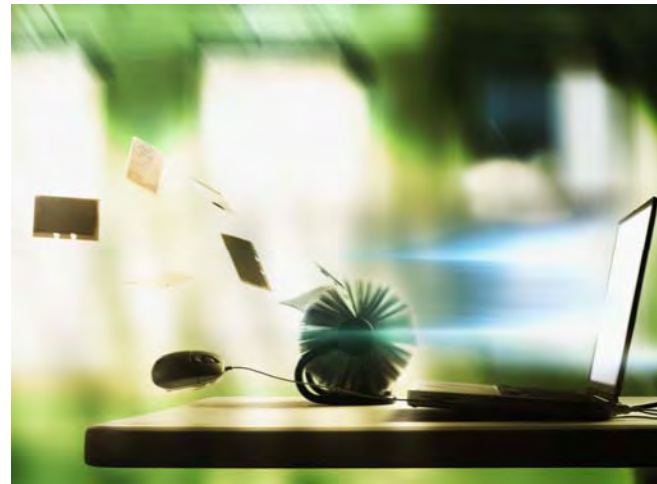


# IMPACTING THE BOTTOM LINE





# How do we know?







# Employees must...

- ...grasp the plan as a significant commitment with meaningful potential value
- ...understand and believe in the results implied by the commitment
- ...see their economic value tied to that of the owners



# Employer must...

- ...earnestly commit to meaningful grant levels
- ...paint a vibrant picture of potential value
- ...organize a dynamic communication and reinforcement effort



# Remember

- Companies with engaged employees achieve higher levels of productivity
- Engagement does not occur without a serious effort to communicate a compelling future and involve employees in that future
- A phantom stock (or similar long-term incentive) plan is the best way to financially unite shareholders and key employees



# Conclusions

- A good incentive program must include both short-term and long-term incentives
- Phantom stock, done right, may be the most important investment you ever make in business growth
- Experience has informed us of the things to do, and the things not to do
- Spend more time communicating how the organization shares value that employees help create



# First Step

- Are we ready for a plan?
- VisionLink's Tool:
  - 10 question questionnaire
  - Evaluation and VisionLink comments
- Complimentary to today's attendees





**Questions**

# Next Online Seminar:

## “The Future of Compensation: What’s Next & Why?”

To be held on:  
Tuesday, December 4th, 2012

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The screenshot shows the Phantom Stock website homepage. At the top left is the logo "PhantomStock The Equity Alternative" with a green arrow pointing up and to the right. To the right of the logo is a green navigation bar with white text: "KNOWLEDGE CENTER", "TOOLS", "BUILD A PLAN", "BLOG", "ABOUT US", and "CONTACT". In the top right corner, it says "POWERED BY VISIONLINK". Below the navigation bar is a main content area with a light green background. On the left, there are three green arrow-shaped buttons pointing right, labeled "WHAT IS IT?", "WHAT WILL IT CHANGE?", and "WHERE DO I BEGIN?". To the right of these buttons, the text "A way to share ~~equity~~ Value" is displayed, with "equity" crossed out and "Value" written in red. In the top right corner of this main area, there is a red play button icon and the text "Phantom Stock Watch overview". Below the main content area is a row of four white boxes, each with a green header and an icon: "KNOWLEDGE CENTER" with an information icon, "TOOLS" with a briefcase icon, "BUILD A PLAN" with a wrench and screwdriver icon, and "BLOG" with an RSS icon. Each box contains a short description of the respective section. At the bottom of the page is a dark green footer with white text: "Knowledge Center Tools Build a Plan Blog About Us Contact" and "© 2012 PhantomStockOnline.com".

You can also subscribe to our blog

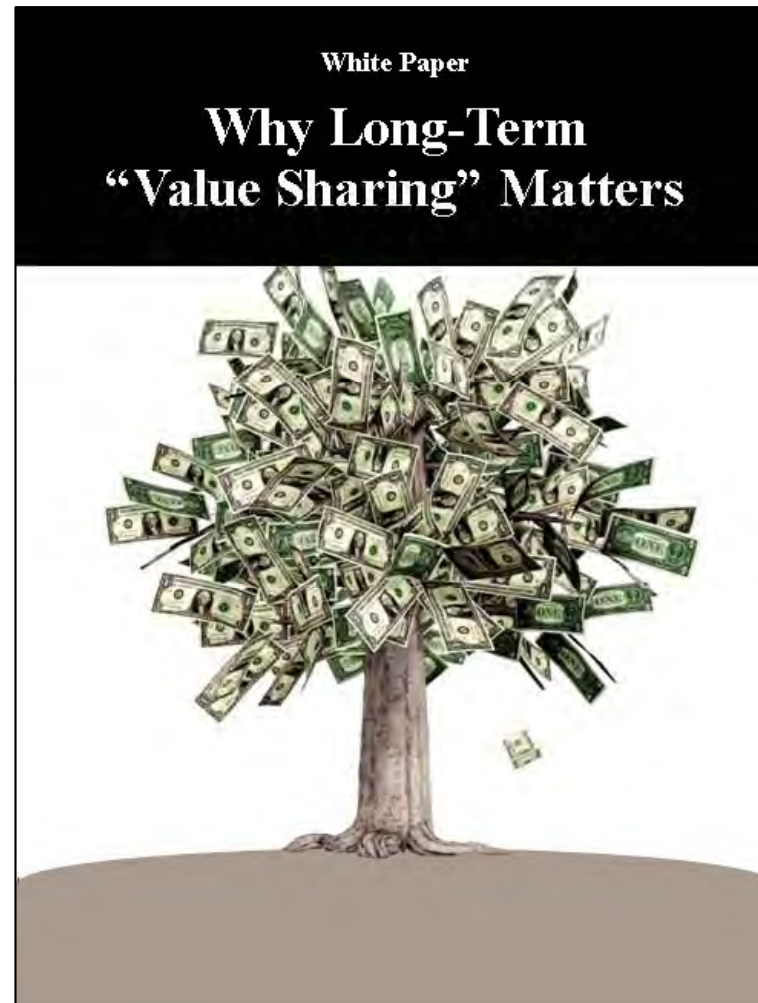


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The screenshot shows the homepage of The VisionLink Advisory Group. At the top left is the logo, and at the top right is a 'Client Login' button and a phone number: (888) 703 0080. A navigation bar contains links for Home, About Us, Client Profile, Knowledge Center, Speaking Engagements, Events, Blog, and Contact Us. The main content area features a large image of a mountain peak. Below the image are three article teasers: 'WHAT IS PHANTOM STOCK?', 'HOW SHOULD I SHARE VALUE?', and 'HOW DO I END ENTITLEMENTS?'. To the right of the mountain image is a featured article titled 'How should I Share Value?' with a 'Learn More' button. Below the main content is an 'Events' section with a list of dates and topics, and a 'Join our webinar invitation list' form with an 'Email Address' field and a 'Go' button. At the bottom, there are three columns with the headings 'ASK THE RIGHT QUESTIONS', 'FOLLOW THE RIGHT PROCESS', and 'CHOOSE THE RIGHT COACHES', each with a brief introductory sentence.

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*We value your input.*

*You may request a copy of our slides (sorry, the spreadsheet is not available), or more information about the “Are You Ready?” assessment.*

# Thank you!

## Tom Miller

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