

January 22, 2013

# “What Problem is Your Compensation Strategy Solving?”



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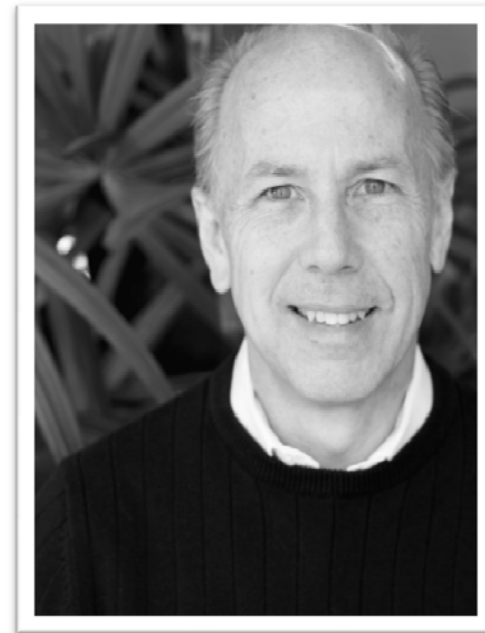
Today's Presenter:

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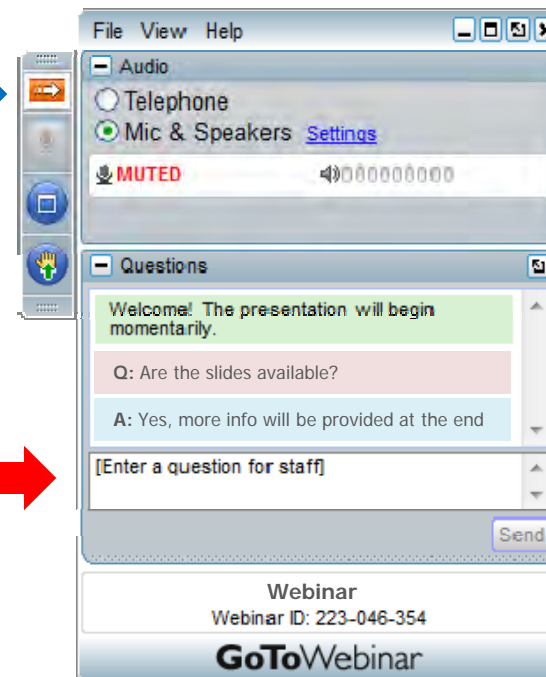
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We're happy to provide a copy of today's slides.  
Information will be provided at the close  
of the presentation.

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the control panel:** →  
Click the red arrow

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today's presentation:** →  
Use the question area  
on your control panel



# Key Questions



- Have I clearly identified the key growth indicators in my business?
- Have I clearly identified the barriers to achieving those indicators?
- Is compensation helping overcome barriers or creating new ones?

# Defining the Issue

## SonoSite

- Founded 10+ years ago
- Based in Seattle
- Created to make hand-held ultrasound equipment
- Prior—solely cart-based ultrasound, CT scan or MRI machines



# SonoSite—Two Products



## Titan

- Principal product
- About the size of a laptop computer



## iLook

- Less than half the size of the Titan
- One-third the price of the Titan

# Growth Issues

- iLook not as sophisticated as Titan
- iLook not as profitable as Titan

However...

- iLook was more portable than the Titan
- iLook had more promising market
  - Generated 1,000 leads in the first six weeks after its introduction

PROBLEM: If SonoSite didn't sell the iLook, someone else was likely to develop same compact technology and disrupt the sales of the more expensive machines

# The Sales Call



CEO, Kevin Goodwin

+

Top Salesman

“Tell them about the iLook.”



# The Core Issue

## CEO Perspective

The handheld innovation had enormous long-term potential for the company—probably more than the highly successful laptop-size model



## Salesman Perspective

Paid on commission. Success defined by the total value of their sales and gross margin dollars. Easier to sell one of the Titans than it was to sell five of the iLooks.



# What's the Problem Here?

Goodwin thought he was pouring clear instructions into the salesman's ear. However, the compensation system was shouting louder in his other ear.

# Problem Solving and Compensation



Every strategy should be assessed, in part, in terms of the problem it will help resolve.

Too often, compensation solutions that are put in place create behaviors or outcomes that miss the target in solving key barriers a company is facing or, worse yet, create a new problem that didn't exist before a given pay strategy was implemented.

# Example #1

## Initial Problem

A lack of stewardship for key initiatives

## Solution

The company institutes an annual bonus plan based largely on individual performance metrics

## New Problem

The company discovers it has created an entitlement mindset and placed the company in the position of paying out incentives even during periods of distressed economic performance



## Example # 2



### **Initial Problem**

A private company needs to overcome attrition of key people and the inability to compete for premier talent

### **Solution**

The company begins giving stock to key producers

### **New Problem**

The equity position of previous shareholders is diluted and new shareholders have few options for capitalizing on value increases in the business other than a major transition event such as the sale of the business.

# Example #3

## Initial Problem

The owner of an enterprise wants to overcome a short-term focus and grow her business value in anticipation of a sale.

## Solution

She institutes a phantom stock plan that distributes value only upon the sale of the businesses—which she anticipates being in approximately 5-7 years.

## New Problem

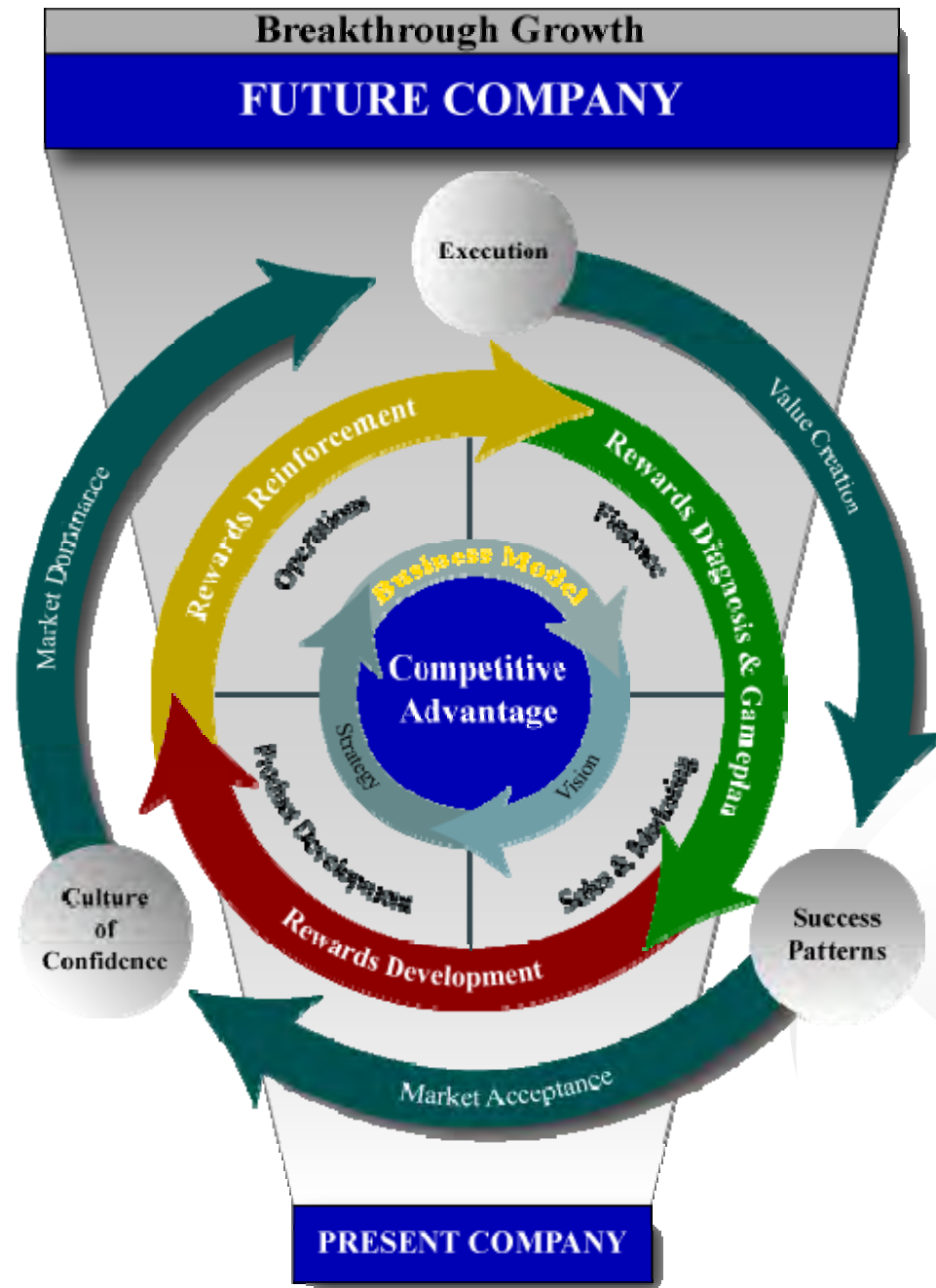
After 5 years, she decides not to sell the business for an indefinite amount of time. Employees are left wondering when they will realize the value they helped create.





So what's the answer?







# Guiding Principles



1. Envision the Future
2. Know Your Philosophy
3. Define Value Creation
4. Identify Clear Roles
5. Share Value (especially long-term value)
6. Employ a Process
7. Adopt a Total Rewards Approach
8. Market a Future

# Envision the Future

- Build and test a financial model
  - Base, Target, Superior
- What has to prove true for those results to be realized?



# Build a Model – P&L Forecast

	C	E	F	G	H	I	J	K	L	M	N	O	P	Q
1	Target	P&L Forecast												
2		2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
3	P&L FORECAST	Actual	Actual	Actual	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected
4	Net Sales	35,015,667	32,524,143	39,156,444	45,000,000	49,000,000	52,000,000	55,000,000	60,000,000	66,000,000	72,600,000	79,860,000	87,846,000	96,630,600
5	Cost of Goods Sold	19,375,516	17,230,214	21,541,211	24,750,000	26,950,000	28,600,000	30,250,000	33,000,000	36,300,000	39,930,000	43,923,000	48,315,300	53,146,830
6	<b>Gross Profit</b>	<b>15,640,151</b>	<b>15,293,929</b>	<b>17,615,233</b>	<b>20,250,000</b>	<b>22,050,000</b>	<b>23,400,000</b>	<b>24,750,000</b>	<b>27,000,000</b>	<b>29,700,000</b>	<b>32,670,000</b>	<b>35,937,000</b>	<b>39,530,700</b>	<b>43,483,770</b>
7	Selling Expenses	466,785	455,120	483,803	546,750	595,350	631,800	668,250	723,000	801,900	862,090	970,299	1,067,329	1,174,062
8	G&A	5,367,425	5,653,767	6,100,910	6,986,250	7,607,250	8,073,000	8,538,750	9,315,000	10,246,500	11,271,150	12,398,265	13,638,092	15,001,901
9	Interest Expense	48,176	45,388	35,503	36,213	36,937	37,676	38,430	39,198	39,982	40,782	41,597	42,429	43,278
10	<b>Income from Operations</b>	<b>9,757,765</b>	<b>9,139,654</b>	<b>10,989,211</b>	<b>12,680,787</b>	<b>13,810,463</b>	<b>14,657,524</b>	<b>15,504,570</b>	<b>16,916,802</b>	<b>18,611,618</b>	<b>20,475,978</b>	<b>22,526,839</b>	<b>24,782,850</b>	<b>27,264,530</b>
11	Interest & Dividend Income	81,135	52,187	14,171	14,454	14,744	15,038	15,339	15,646	15,959	16,278	16,604	16,936	17,274
12	Gain (loss) on Sale of Investments	(15,596)	1,061	-	-	-	-	-	-	-	-	-	-	-
13	Gain on Disposal of Equipment	9,202	1,750	(9,559)	-	-	-	-	-	-	-	-	-	-
14	Increase in Cash Surrender Value of Life Insurance	67,622	72,272	62,044	63,285	64,551	65,842	67,158	68,502	69,872	71,269	72,694	74,148	75,631
15	Other Income	705	29,525	384	-	-	-	-	-	-	-	-	-	-
16	<b>Earnings Before Taxes</b>	<b>9,900,833</b>	<b>9,296,449</b>	<b>11,056,251</b>	<b>12,758,526</b>	<b>13,889,757</b>	<b>14,738,404</b>	<b>15,587,068</b>	<b>17,000,949</b>	<b>18,697,448</b>	<b>20,563,525</b>	<b>22,616,137</b>	<b>24,873,934</b>	<b>27,357,435</b>
17	Provision for Income Taxes	145,400	26,200	104,000	191,378	208,346	221,076	233,806	255,014	280,462	308,453	339,242	373,109	410,362
18	<b>Net Income</b>	<b>9,755,433</b>	<b>9,270,249</b>	<b>10,952,251</b>	<b>12,567,148</b>	<b>13,681,410</b>	<b>14,517,328</b>	<b>15,353,262</b>	<b>16,745,935</b>	<b>18,416,987</b>	<b>20,255,072</b>	<b>22,276,895</b>	<b>24,500,825</b>	<b>26,947,074</b>
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20	Depreciation	966,850	875,917	853,121	878,715	905,076	932,228	960,195	989,001	1,018,671	1,049,231	1,080,708	1,113,129	1,146,523
21	<b>EBITDA</b>	<b>10,915,859</b>	<b>10,217,754</b>	<b>11,944,875</b>	<b>13,673,454</b>	<b>14,831,770</b>	<b>15,708,308</b>	<b>16,585,693</b>	<b>18,029,149</b>	<b>19,756,102</b>	<b>21,653,538</b>	<b>23,738,442</b>	<b>26,029,493</b>	<b>28,547,237</b>
30	Share Price multiple			5	5	5	5	5	5	5	5	5	5	5
31	Formula Value			\$ 55,930,151	\$ 62,750,482	\$ 69,966,626	\$ 75,481,459	\$ 80,077,599	\$ 85,879,065	\$ 93,380,533	\$ 102,228,885	\$ 112,056,874	\$ 122,856,160	\$ 134,723,536
32	Formula Share Price (EOY)			\$ 6.28	\$ 7.00	\$ 7.55	\$ 8.01	\$ 8.59	\$ 9.34	\$ 10.22	\$ 11.21	\$ 12.29	\$ 13.47	
33	Annual Increase in Formula Value				\$ 6,820,330	\$ 7,216,144	\$ 5,514,833	\$ 4,596,140	\$ 5,801,466	\$ 7,501,468	\$ 8,848,361	\$ 9,827,989	\$ 10,799,286	\$ 11,867,378
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37	Assumptions				2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
39	Increase in Net Sales				14.3%	8.3%	6.1%	5.8%	9.1%	10.0%	10.0%	10.0%	10.0%	10.0%
40	Cost of Goods Sold as % of Net Sales				55.0%	55.0%	55.0%	55.0%	55.0%	55.0%	55.0%	55.0%	55.0%	55.0%
41	Selling Expenses as % of Gross Profit				2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%
42	G&A as % of Gross Profit				34.5%	34.5%	34.5%	34.5%	34.5%	34.5%	34.5%	34.5%	34.5%	34.5%
43	Annual Increase in Interest Expense				2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
44	Annual Increase in Interest Income				2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
45	Annual Increase in Gain/Loss on Investments				0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
46	Annual Increase in Gain/Loss on Disposal of Equipment				0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
47	Annual Increase in Cash Surrender Value				2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
48	Annual Increase in Other Income				0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
49	California Franchise Tax				1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
50	Annual Increase in Depreciation				3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%



# Know Your Philosophy



- We believe the company should be paid first
- Beyond an appropriate return on capital, we believe value should be shared with those who help create it
- We believe in rewarding good profits and discouraging bad profits
- We believe rewards should reinforce our business model
- We believe in being at or slightly below market with guaranteed pay but in providing unlimited upside through value sharing

# Define Value Creation



# Pay the Company First



“Basically, up to the company’s operating profit target, all of the profits go to the company; and only after that target is met, do we start funding the incentive pool.”

Example: If UL’s target is \$80 million--

- 100% of first \$80 in profit goes to company
- The next \$20 million goes to the incentive pool
- From there on, 50/50 between company & incentive pool



# Pay the Company First



**ROTRI™**

**Return on Total Rewards Investment™**

Measuring the return on your compensation investment





# How much is the Total Rewards Investment?

- Salaries
- Commissions
- Bonuses
- Deferred award accruals (LTIP)
- Core benefits
- Executive benefits
- Retirement contributions
- Payroll taxes



**What return do you get on that investment?**

\_\_\_\_\_ %



# ROTRI™ Example:

Capital Account	\$ 20,000,000
Cost of Capital	12%
Capital Charge	\$ 2,400,000
Operating Income	\$ 10,000,000
Productivity Profit	\$ 7,600,000
Total Rewards Investment	\$ 25,000,000
<b>ROTRI™</b>	<b>30.4%</b>

(ROTRI™ = Productivity Profit/Total Rewards Investment)

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***Variable Pay Plans (Value Sharing) are financed from Productivity Profit***

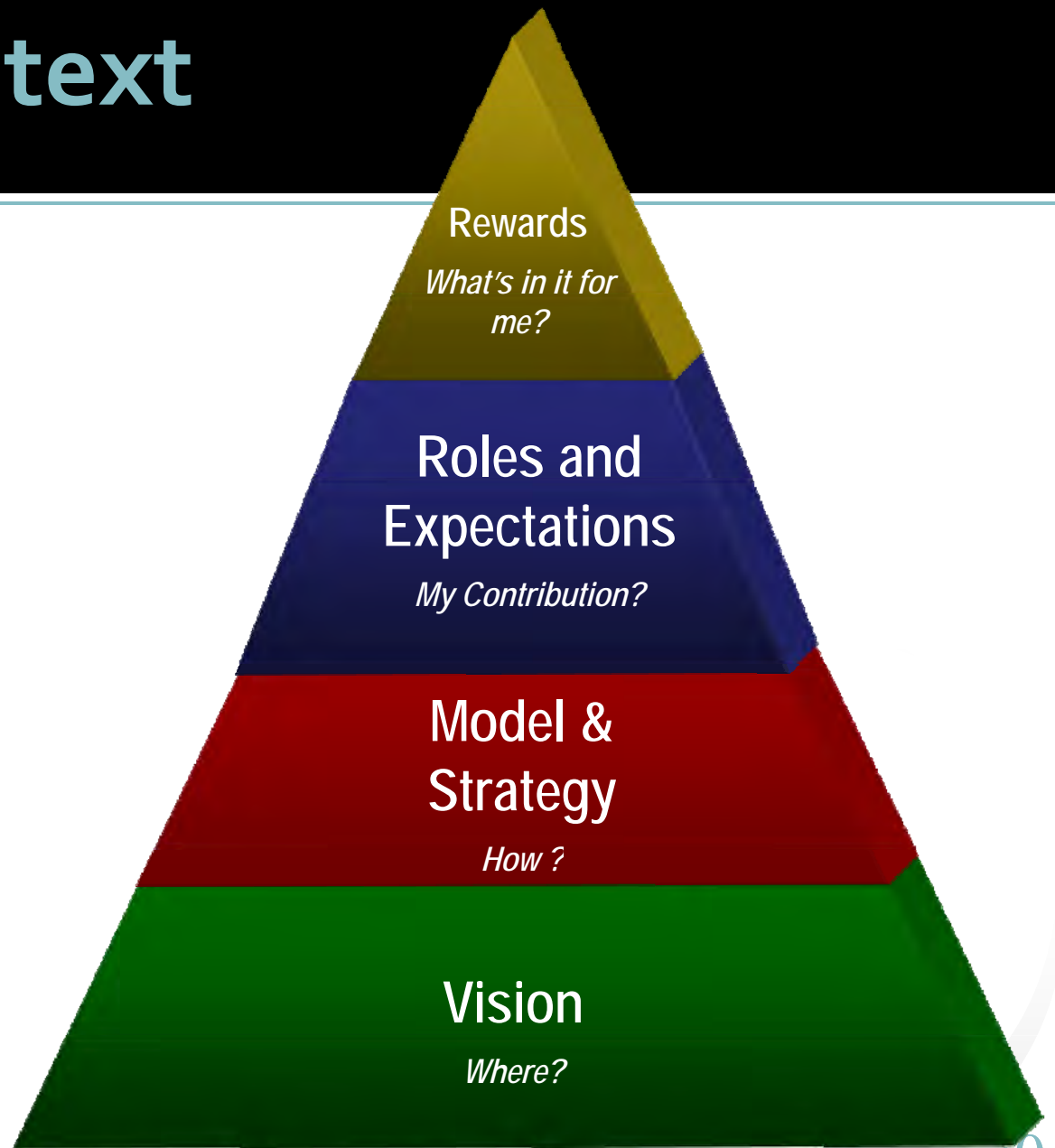
# Identify Clear Roles

- What outcome is needed?
- What talent is needed to drive that outcome?
- Does that talent exist in the organization?
- What value proposition will attract or retain that talent?



# Provide Context

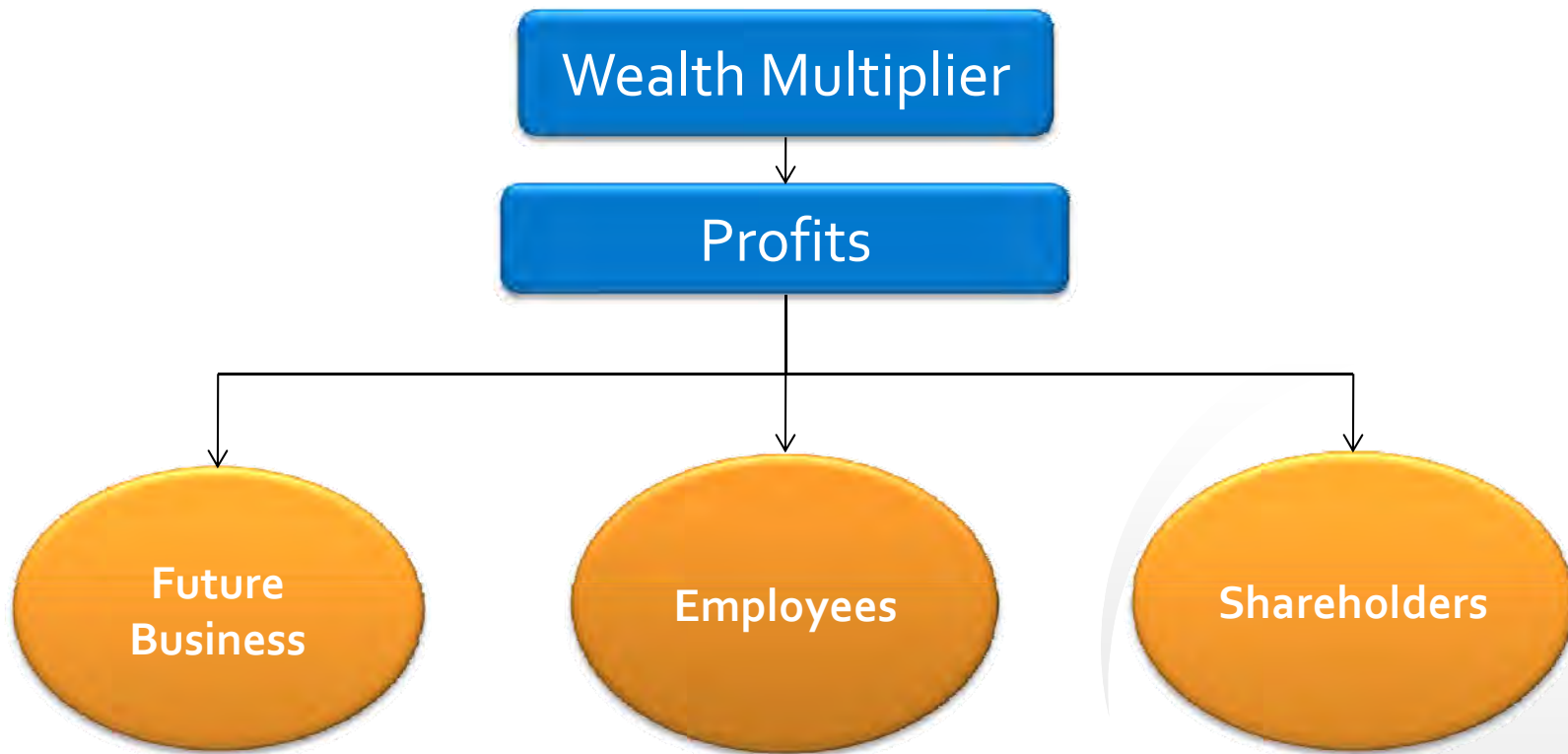
## Line of Sight



# Share Value

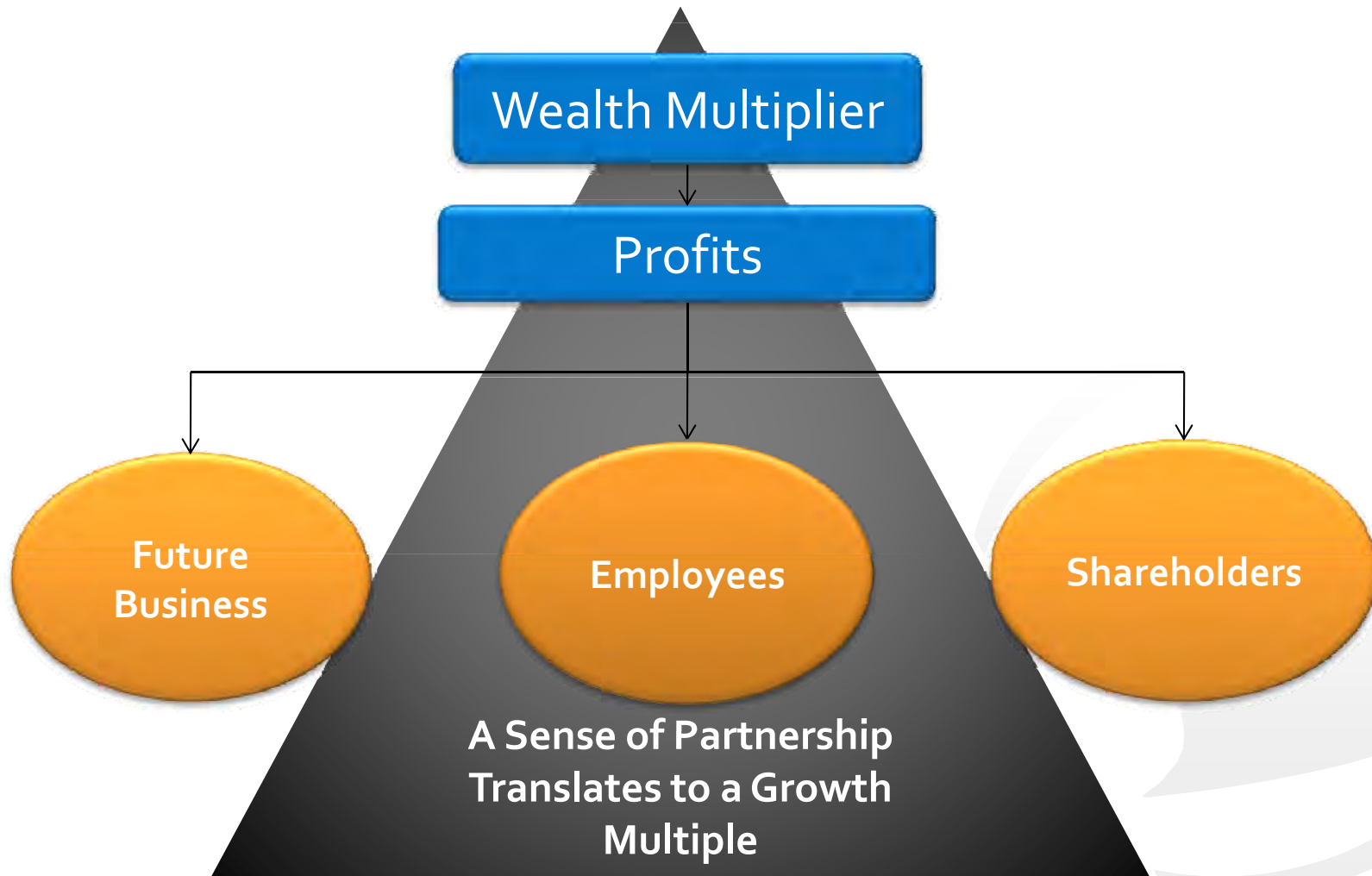


# The Value of Profit





# The Value of Profit



Current Equity Value	EOY	10% GR (Threshold)	11% GR	12% GR	13% GR	14% GR	15% GR
25,000,000	1	27,500,000	27,750,000	28,000,000	28,250,000	28,500,000	28,750,000
	15	104,431,204	119,614,737	136,839,144	156,356,759	178,448,449	203,426,541
	Annual increase in value		15,183,533	17,224,407	19,517,615	22,091,690	24,978,091
	Cum Value Increase Above Threshold		15,183,533	32,407,940	51,925,555	74,017,245	98,995,336
	% Shared		10%	15%	20%	25%	30%
	\$ Shared		1,518,353	4,861,191	10,385,111	18,504,311	29,698,601
	Net Increase for SH		13,665,180	27,546,749	41,540,444	55,512,934	69,296,736
	New SH Value		118,096,384	131,977,953	145,971,648	159,944,138	173,727,940
		IRR	10.9%	11.7%	12.5%	13.2%	13.8%

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31	Formula Value			\$ 55,930,151	\$ 62,750,482	\$ 69,966,626	\$ 75,481,459	\$ 80,077,599	\$ 85,879,065	\$ 93,380,533	\$ 102,228,885	\$ 112,056,874	\$ 122,856,160	\$ 134,723,536
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41	Selling Expenses as % of Gross Profit				2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%
42	G&A as % of Gross Profit				34.5%	34.5%	34.5%	34.5%	34.5%	34.5%	34.5%	34.5%	34.5%	34.5%
43	Annual Increase in Interest Expense				2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
44	Annual Increase in Interest Income				2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
45	Annual Increase in Gain/Loss on Investments				0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
46	Annual Increase in Gain/Loss on Disposal of Equipment				0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
47	Annual Increase in Cash Surrender Value				2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
48	Annual Increase in Other Income				0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
49	California Franchise Tax				1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
50	Annual Increase in Depreciation				3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%



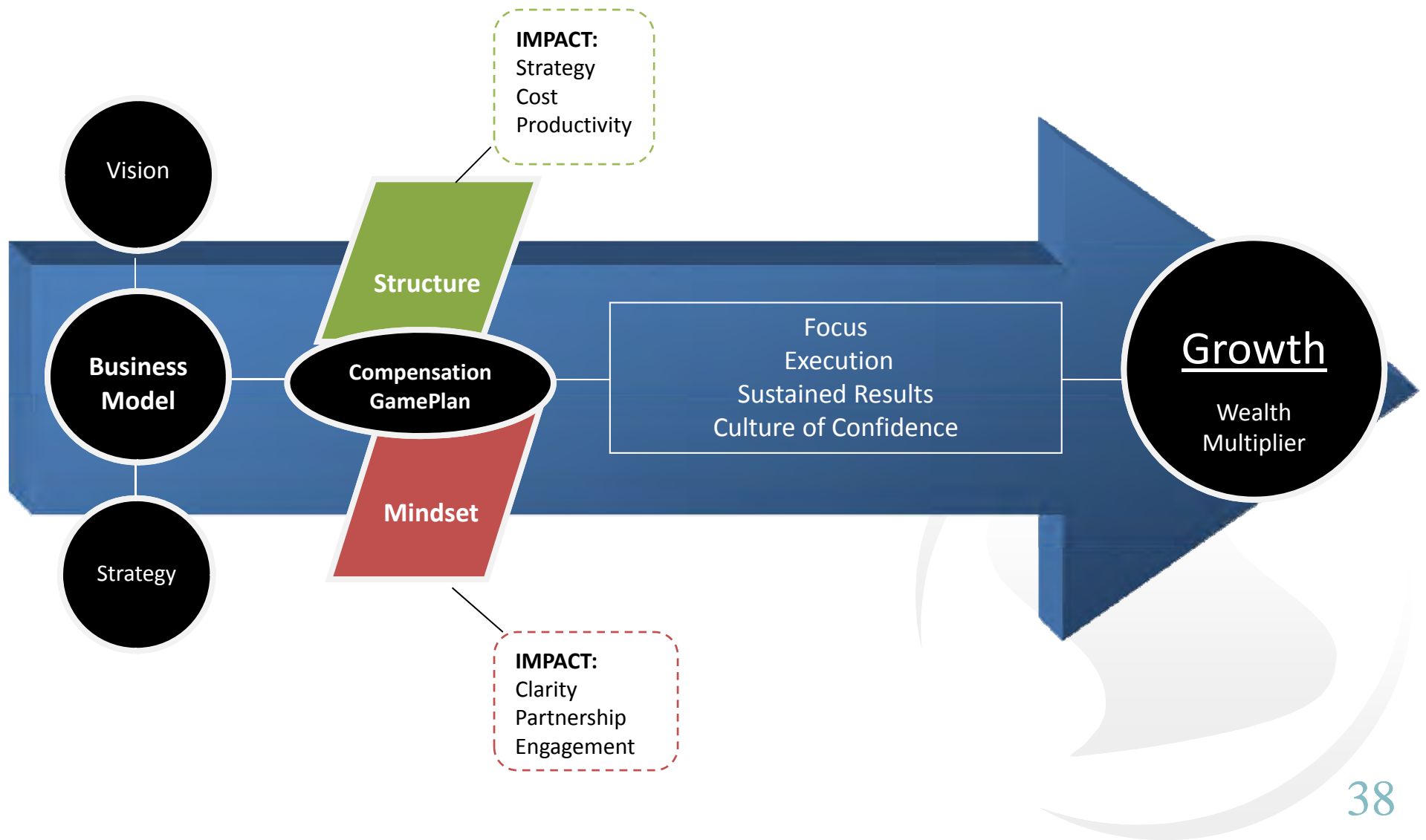
# Employ a Process



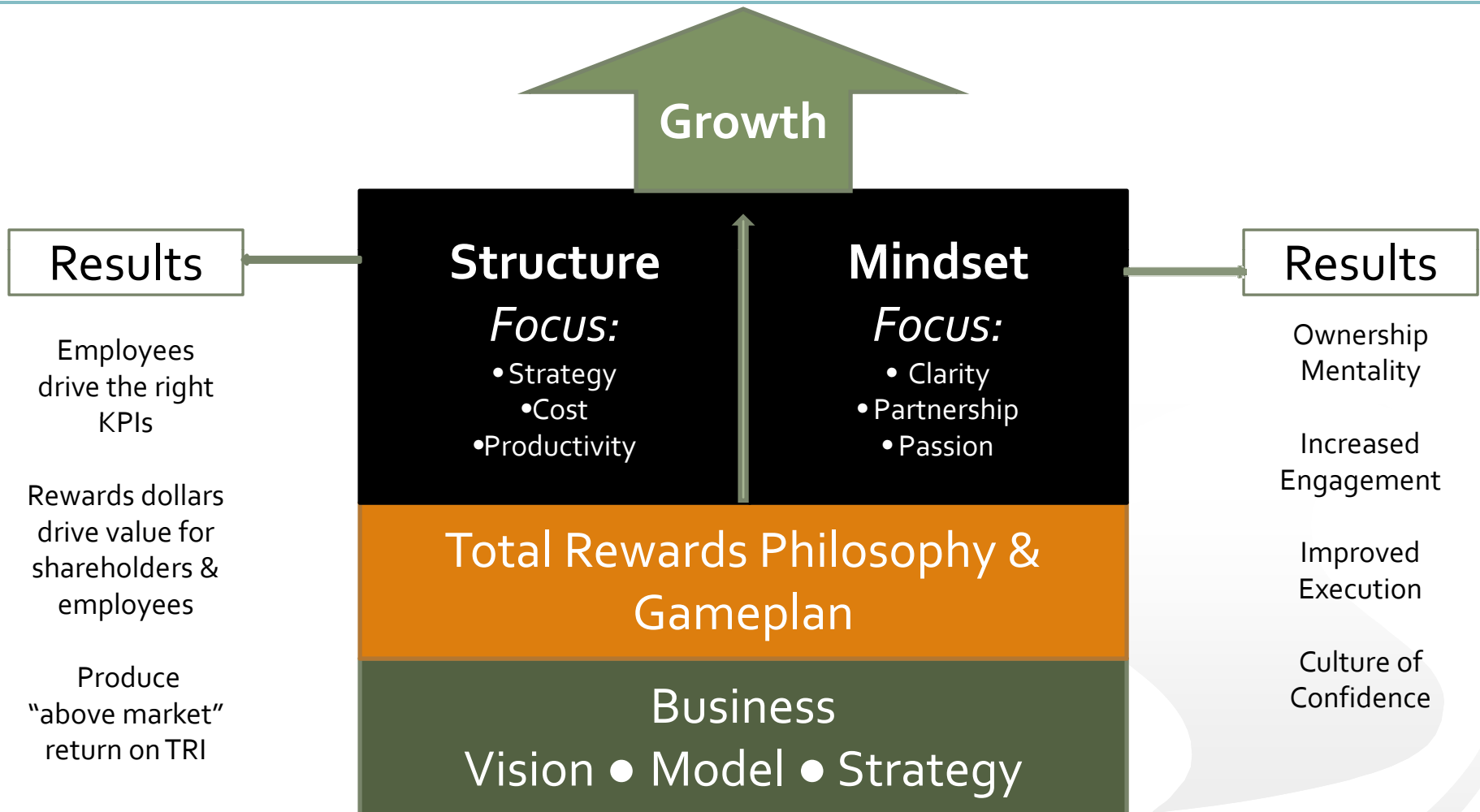
- Start with the right framework
- Address both “structure” and “mindset” issues
- Examine compensation alternatives in the context of preferred “outcomes”
- Define the decisions to be made

# Framework:

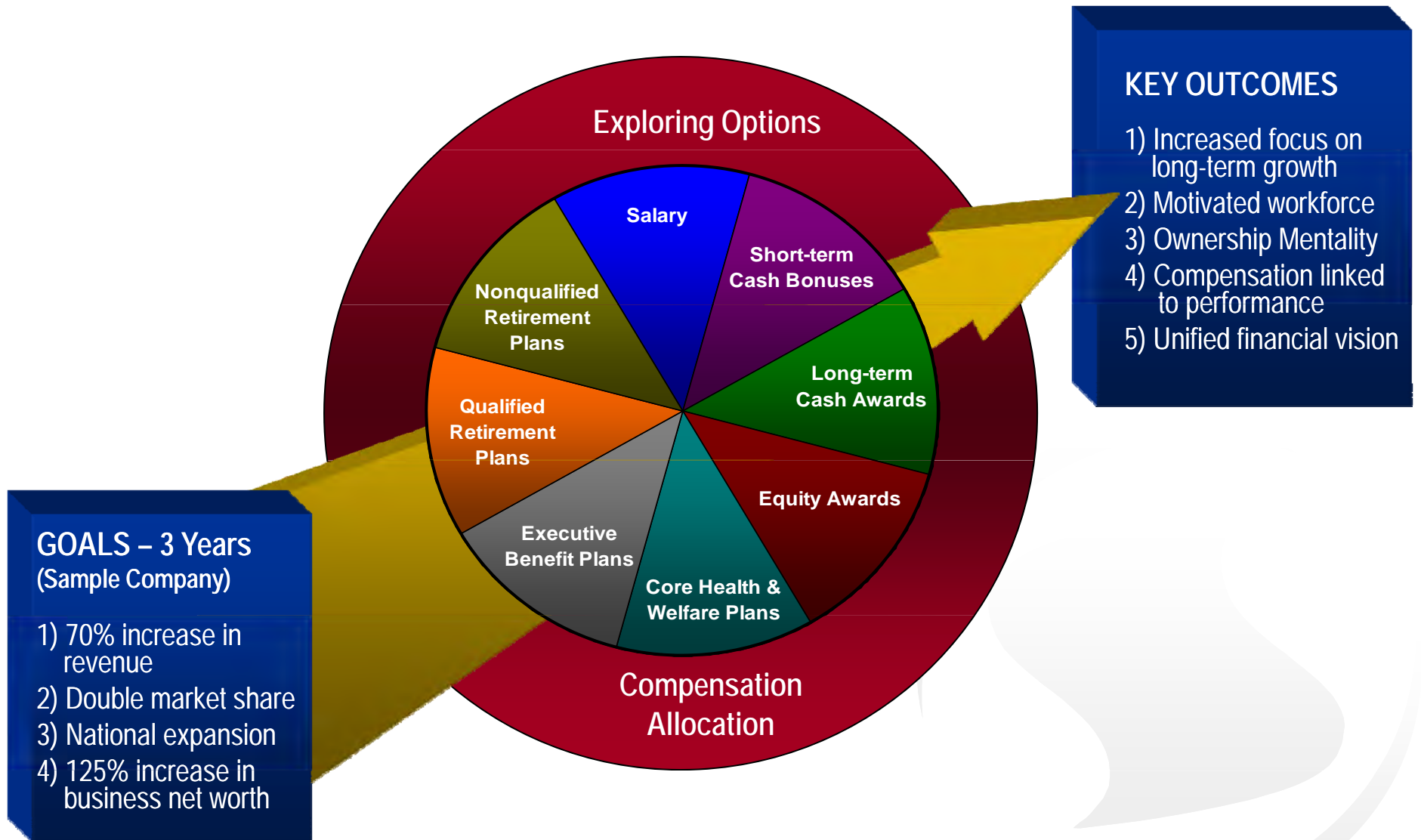
## Building a Unified Financial Vision for Growing the Business



# Structure and Mindset



# Examine Alternatives





# Select the Right Plan Type

Phantom Stock  
Option

Restricted Stock

Profit Pool

Performance Shares

Phantom Stock

Strategic Deferred  
Compensation

Performance  
Phantom Stock

Stock Option

Performance Unit



Form of Pay	Purpose	Standard	Investment	ROI
Salaries	Provide for the current cash needs of our executives	40-50th percentile for peer group	\$500,000	Achieve ROA standard of 0.75%
Short-term Incentives	Enhance current cash payments to executives for achieving top and bottom line annual goals	30-40% of base salary	\$168,000 (Target)	15% revenue growth and 12% margin
Long-term Incentives (Cash)	Retain execs; focus them on long-term earnings growth; align with shareholder interests; meet wealth accumulation needs	15-20% of base salary	\$84,000 (Target)	Long-term growth in earnings (double earnings = share 13% of new value)
Long-term Incentives (Equity)	Retain execs; focus them on long-term earnings growth; align with shareholder interests; meet wealth accumulation needs	15-20% of base salary	\$84,000 (Target)	Long-term growth in earnings (double earnings = share 13% of new value)
Core Benefits	Meet basic security needs of the executives	50th percentile for peer group	\$25,500	ROA of 0.75%
Executive Benefits	Enhance basic security needs and meet market standards for perquisites	50th percentile for peer group	\$24,000	ROA of 0.75%
Qualified Retirement	Provide wealth accumulation opportunity for executives	40th percentile (3% of salary)	\$15,000	ROA of 0.75%
Supplemental Retirement	Strengthen rewards value proposition to help recruit and retain executives; meet wealth accumulation needs	30th percentile compared to banks that have plans	\$135,000	ROA of 0.9%

# Adopt a Total Rewards Philosophy



# Link Company & Employee Goals

## Employee "Hierarchy of Needs"

5 Wealth Accumulation

Wealth Multiplier Philosophy

4 Value Sharing

Short & Long-Term Incentive Plans

3 Retirement Planning

Qualified & Executive Retirement Plans

2 Risk Protection

Comprehensive, Flexible Benefits Plan

1 Cash Flow & Living Standard

Salary & Bonus

Clear Pay Philosophy

# Market a Future



- Think transformation, not just change
- Build a sense of partnership
- Demonstrate commitment
  - To the future business
  - To key contributors
- Promote don't just communicate
- Be consistent

# Employee Value Statement

Year	1	2	3	4	5
<b>5-Year Plan Achievement Level</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Current and Inflated Salary</b>	<b>\$ 160,000</b>	<b>\$ 166,400</b>	<b>\$ 173,056</b>	<b>\$ 179,978</b>	<b>\$ 187,177</b>
<b>Cash Incentives Paid at Target</b>	<b>\$ 64,000</b>	<b>\$ 66,560</b>	<b>\$ 69,222</b>	<b>\$ 71,991</b>	<b>\$ 74,871</b>
<b>LTIP Vested Value at Year End</b>	<b>\$ -</b>	<b>\$ 74,000</b>	<b>\$ 186,000</b>	<b>\$ 311,000</b>	<b>\$ 448,000</b>
<b>Retirement Plan Value (at 7%)</b>	<b>\$ 17,120</b>	<b>\$ 36,123</b>	<b>\$ 57,169</b>	<b>\$ 80,428</b>	<b>\$ 106,086</b>
<b>Total Cash Received</b>	<b>\$ 224,000</b>	<b>\$ 232,960</b>	<b>\$ 242,278</b>	<b>\$ 251,970</b>	<b>\$ 262,048</b>
<b>Total Wealth Accumulation</b>	<b>\$ 17,120</b>	<b>\$ 110,123</b>	<b>\$ 243,169</b>	<b>\$ 391,428</b>	<b>\$ 554,086</b>
<b>Total Paid or Accumulated</b>	<b>\$ 241,120</b>	<b>\$ 567,083</b>	<b>\$ 942,407</b>	<b>\$ 1,342,636</b>	<b>\$ 1,767,343</b>

# The Principles in Action





# The Problem

XYZ Company is in growth mode and needs to attract certain people to fill key positions.

**It doesn't want to lock in high salaries and it is in a highly competitive talent market.**



# A Solution that Drives Growth



- Company decides to peg salaries at the 50th percentile of “market pay”
- It provides significant upside potential through value sharing.
  - Up to 100% of salary in additional, incentive income for key producers
  - Divided between short-term and long-term value sharing plans.
  - Fifty percent of the incentive will be earned as an annual bonus and the other 50% will be applied to phantom shares

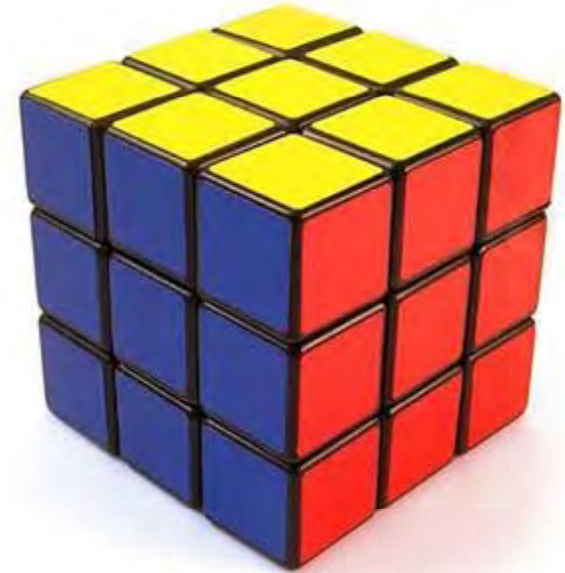
# A Solution the Drives Growth

- The phantom shares vest in three years and pay out value in five.
- Thresholds and metrics of company, department and individual performance are set for accruing benefits under each plan
- Benefits based on a financial model which ensured that value is only paid out when “sufficient” value has been created.
- An employee value statement is developed to demonstrate to the key producer what his total value proposition will be with the company over the next five or ten years if a targeted level of performance is achieved.



# Problems Solved

- Shareholders did not dilute value
- Business only committed to sharing value out of value created (self-financing approach)
- Guaranteed payouts pegged at budget-sensitive, modest levels
- Value proposition appeals to premier talent
- Sense of partnership created with key producers
- Employees able to envision the future with “line of sight”



# Overriding Outcome

A Unified Financial Vision for Growing  
the Business



# THE VISIONLINK SOLUTION™



1. ENVISION	2. CREATE	3. SUSTAIN
<p>Envision how compensation strategy can positively impact the fulfillment of your strategic growth plan</p>	<p>Engineer compensation plans that effectively align roles and expectations with your company vision and strategy</p>	<p>Sustain the focus and motivation of key talent on the performance factors that will lead to the fulfillment of your company's growth goals</p>
<p>WIN THE TALENT WARS</p>	<p>• FOCUS ON KPI'S •</p>	<p>RETURN ON COMPENSATION INVESTMENT</p>

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# Special Offer

One hour of consulting time with a  
VisionLink principal at no charge

(Must include CEO of the company)

**Indicate interest on final survey**

# Next Online Seminar:

## “Compensation Strategies for a High Income Tax Environment”

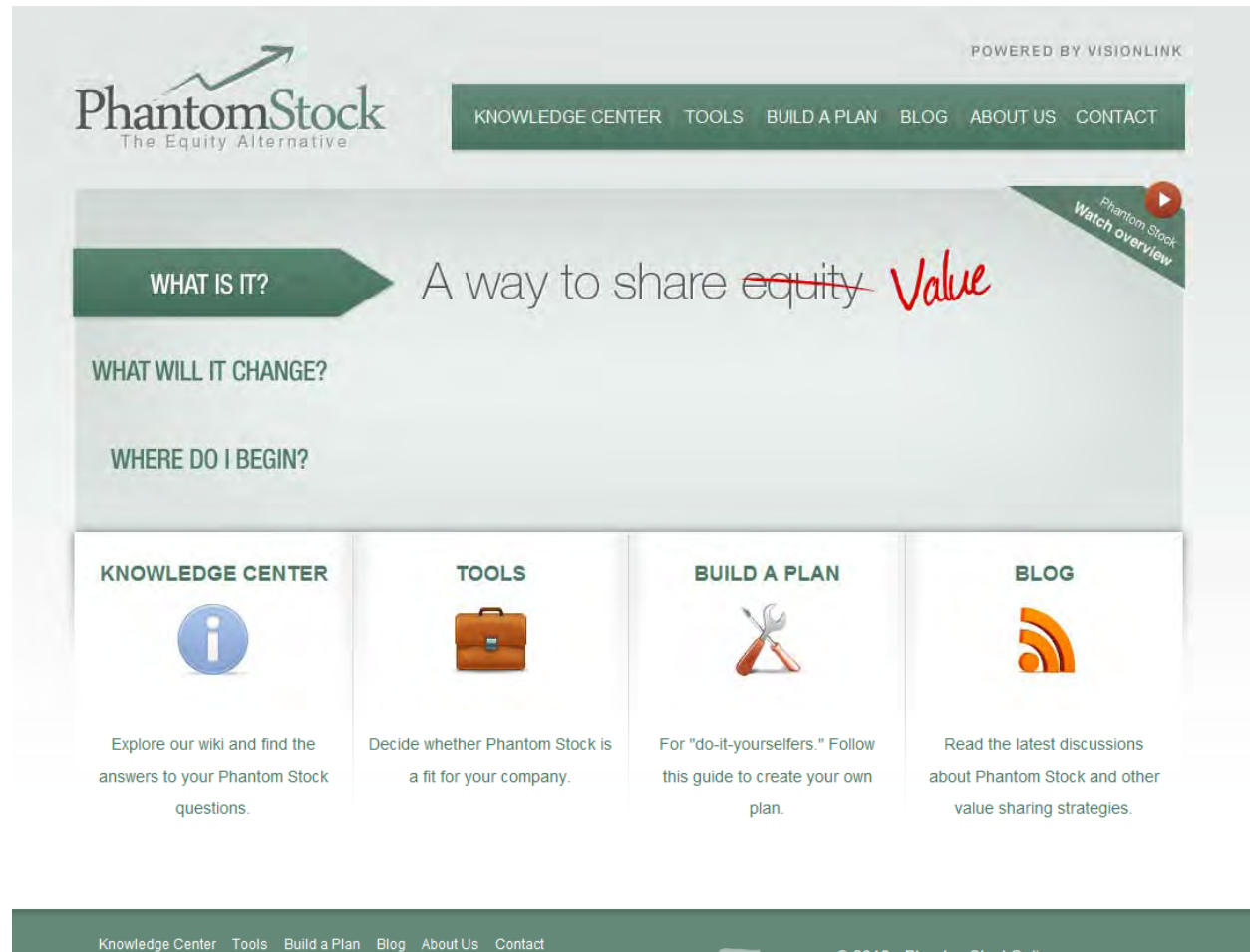
To be held on:  
Tuesday, February 26, 2013

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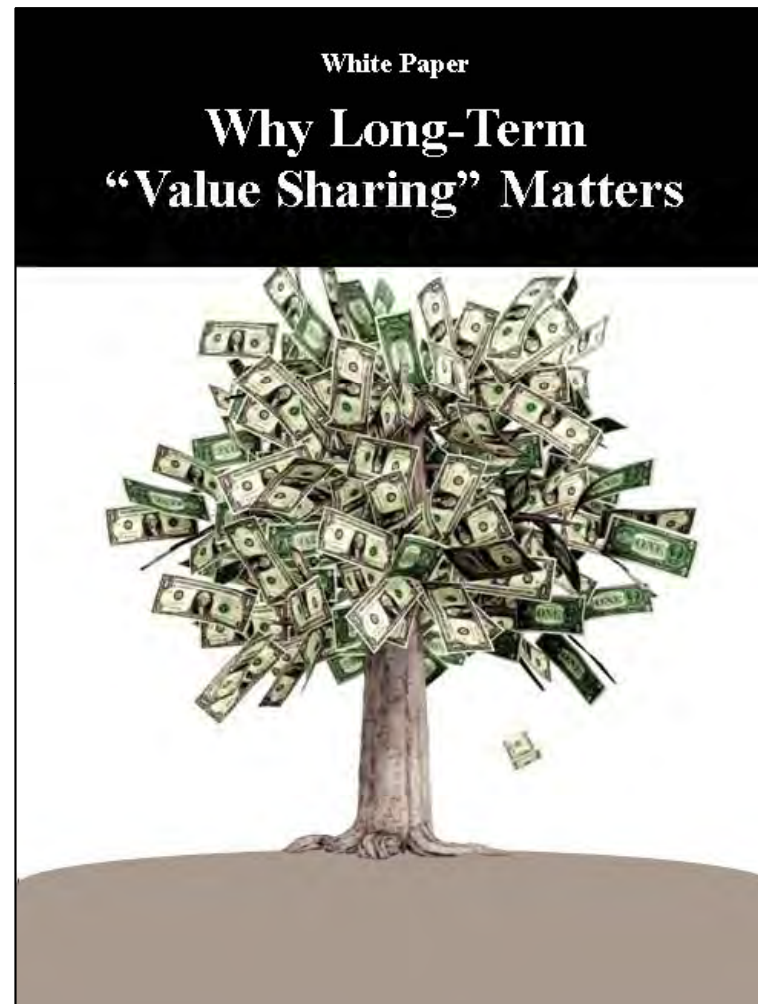
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The screenshot shows the homepage of The VisionLink Advisory Group. At the top left is the logo, and at the top right is a 'Client Login' button. Below the logo is the phone number (888) 703 0080. A navigation bar contains links for Home, About Us,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

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# Thank you for attending

*Please complete our brief survey immediately following our presentation.*

*We value your input.*

*You may request a copy of our slides, the White Paper and the one hour free consultation time with one of our principals.*



**Questions**

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*You may request a copy of our slides, the White Paper and the one hour free consultation time with one of our principals.*



# Thank you!



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