

“To Share Equity or Not to Share Equity, that is the...”



THE VISIONLINK
ADVISORY GROUP

Today's Presenter:

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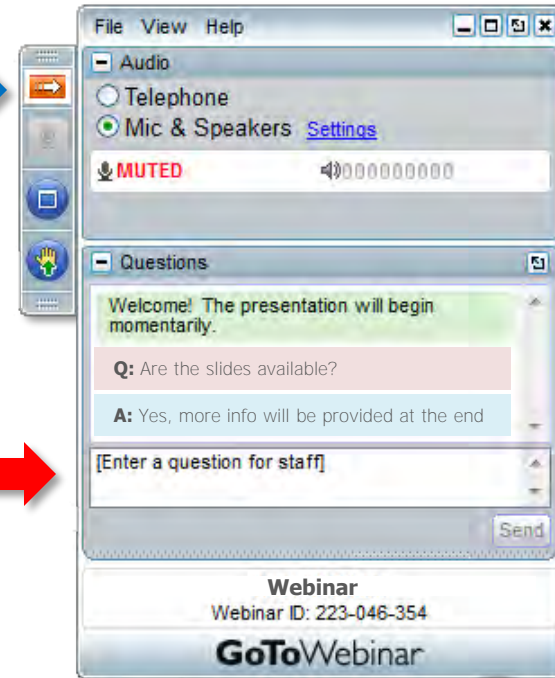
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- Founded in 1996
- Over 450 Clients in North America
- Focus: Compensation design and management that drives growth

Vision: Help You Become a Wealth Multiplier Organization

Transform the way you use
compensation to share value with
employees.

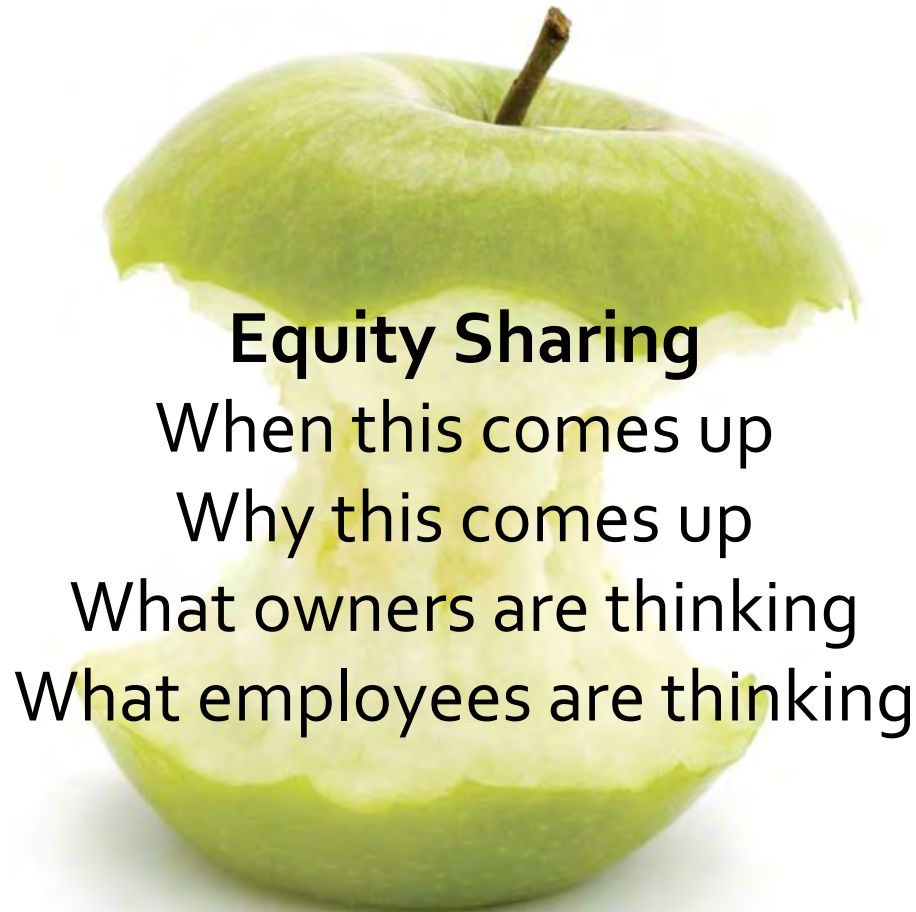


If you do that...

- Quality of talent will improve.
- Employee engagement will expand.
- Performance will be magnified.
- Business growth will be accelerated.
- Shareholder value will increase.



Should I share equity?



Equity Sharing

When this comes up

Why this comes up

What owners are thinking

What employees are thinking

When and Why This Comes Up

Desire to:

- Attract key talent
- Retain key talent
- Reward key contributors
- Unify the financial vision
- Be fair



What Owners Think

First Impression

"I like the idea of shared responsibility and stewardship."

However...

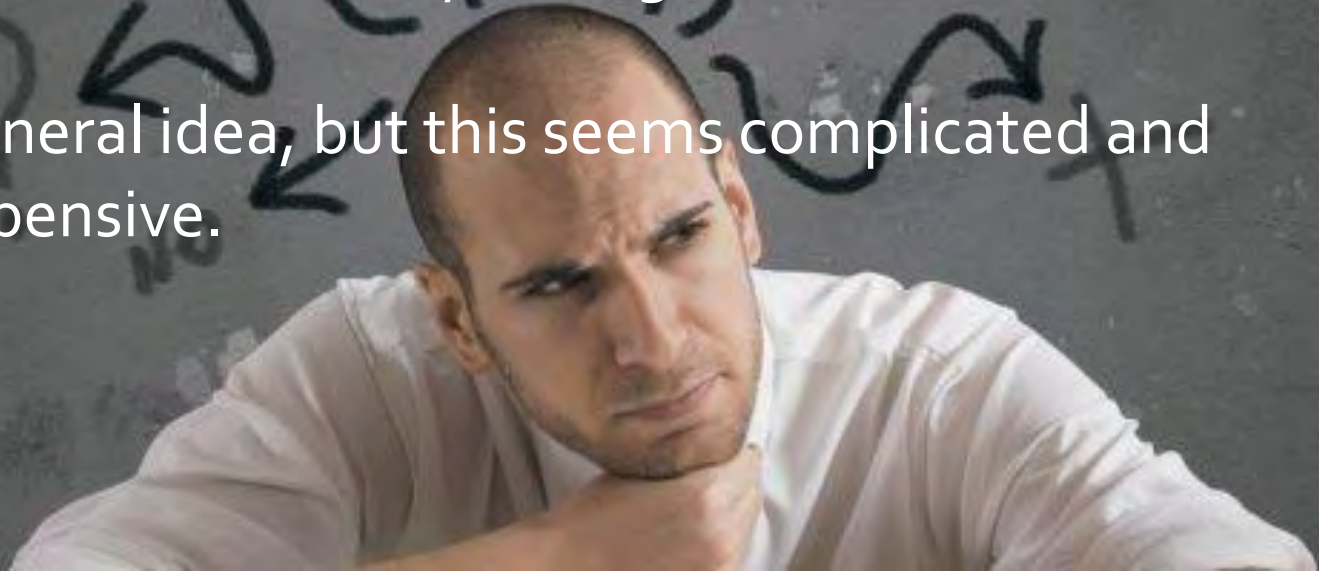


What Owners Think

Questions Arise:

- Will they have access to financial records?
- What if they underperform?
- How will they get the stock?
- And what if they want to sell their stock back?
- Will I have to create a buy-sell agreement?

I like the general idea, but this seems complicated and possibly expensive.



What Employees Think

Hmmm....

- The business might sell some day. I may be out of a job.
- If the business sells, I deserve some of the value.
- If it doesn't sell, I should still be rewarded.
- Being an owner will give me greater influence.
- Ownership is a badge of honor.



What Employees Think

Core Issue:

If I create value, the company should reward me for it. It should share some of the value I helped create.



What Employees *Don't* Think

- I didn't put myself at risk to found the business.
- I'm willing to put my finances at risk now for the business.
- I'm aware and agree that minority stock is discounted by 30%-40% in value.
- I'm okay with the idea that minority stock is illiquid.



What *Both* Think

A photograph of two men in a meeting. In the foreground, a man with dark hair is seen in profile, looking towards the right. In the background, a man with a beard and glasses is seated at a table, looking towards the camera. The background is slightly blurred, showing a laptop and some papers on the table.

**Sharing value means
sharing equity**

Why?

Neither realize there are alternatives.

Intent in Sharing Equity

- Alignment
- Commitment
- Vision
- Value Sharing



The REAL Issue

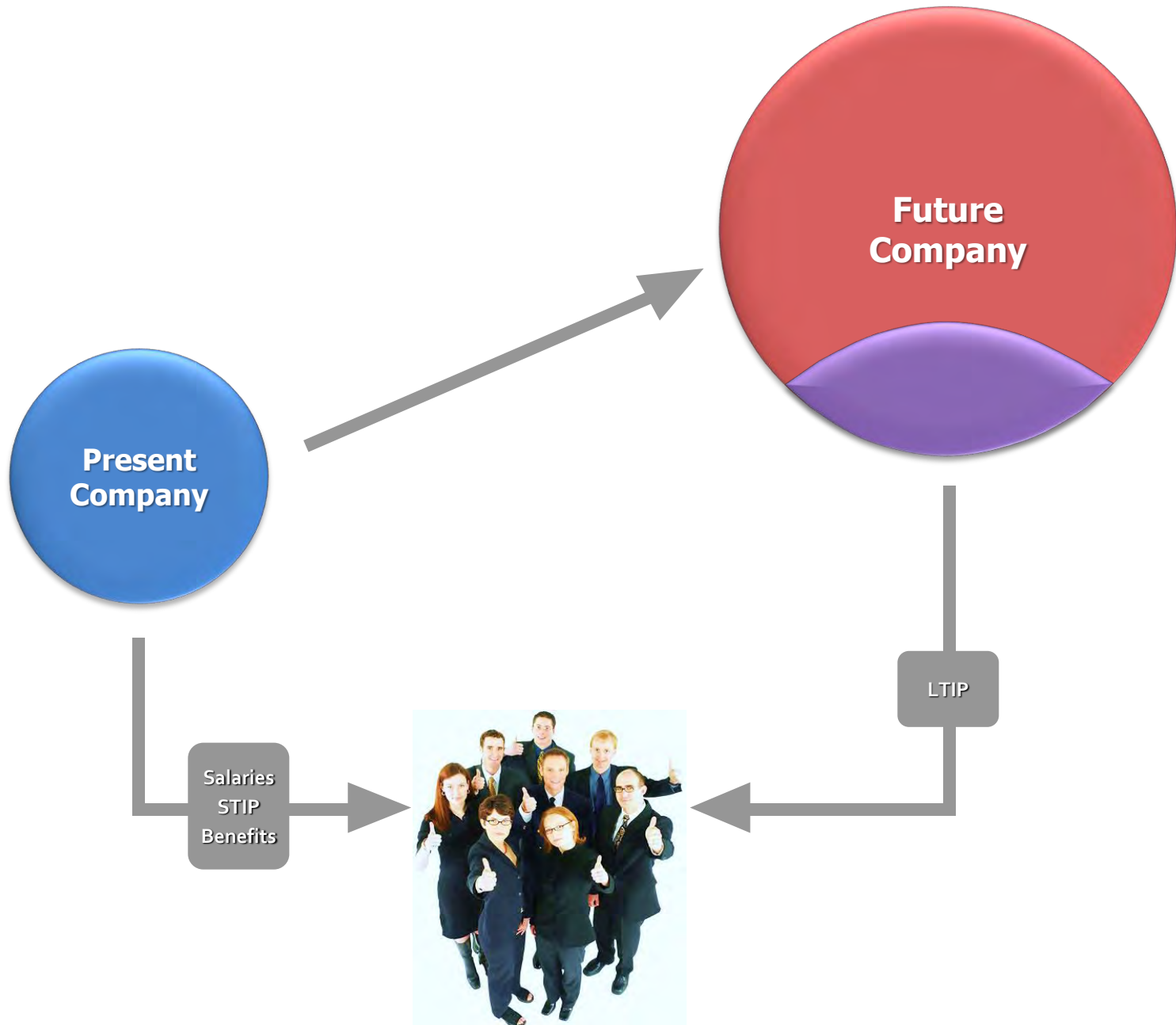
What's the best way to share
long-term value with those who
create it?



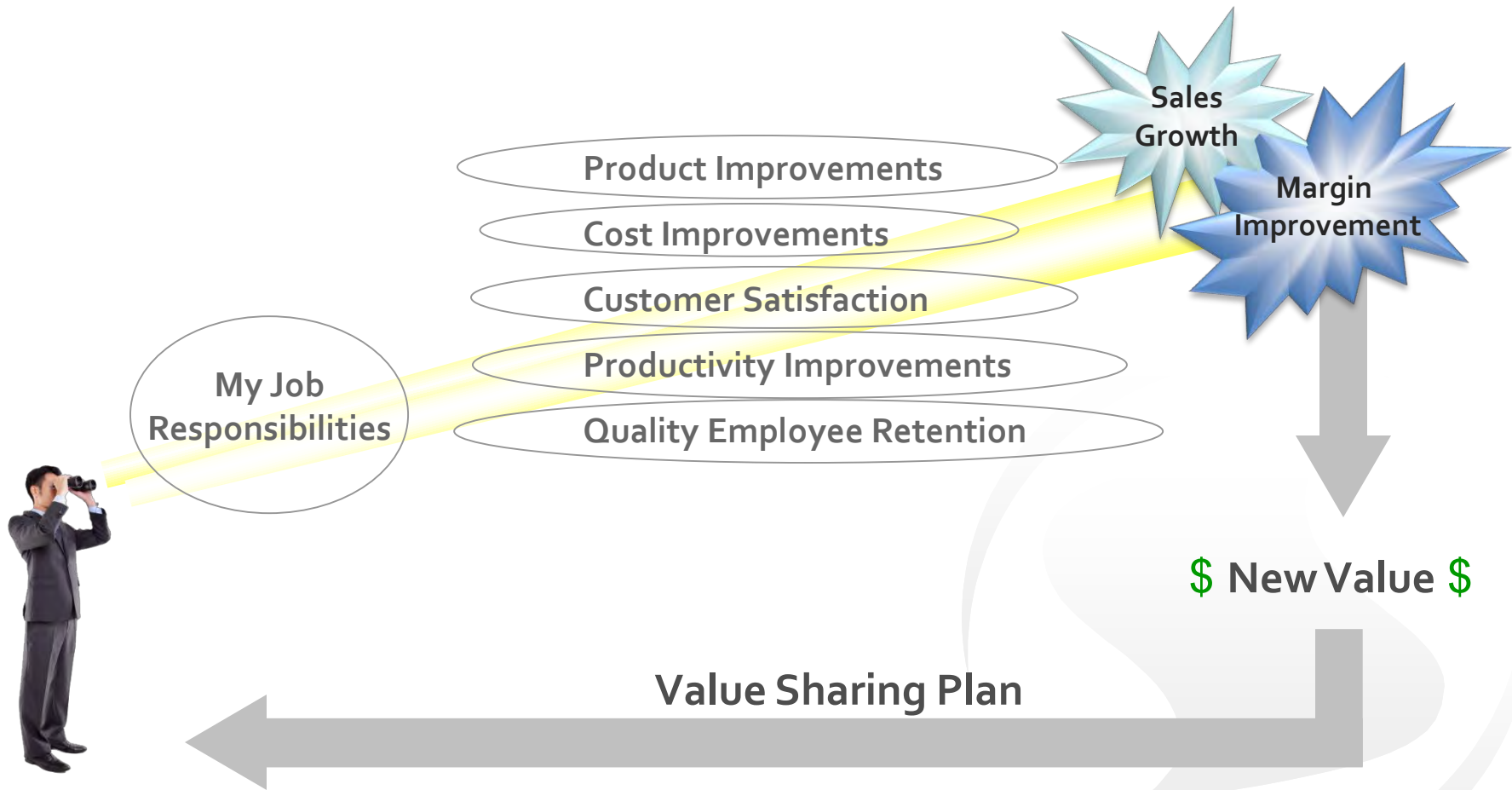
Why Long-Term Value Sharing Matters

1. Attracts premier talent
2. Reinforces the company's business model
3. Protects against bad profits
4. Encourages an ownership mindset
5. Builds trust and accelerates results





Line of Sight



Why Long-Term Plans are Not Used More

- Not as common as short-term plans
- Appear more complicated
- Lack of familiarity
- Concern about disclosure
- **Fear of diluting equity**



what do we need to do?

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

Determining if Stock is Appropriate

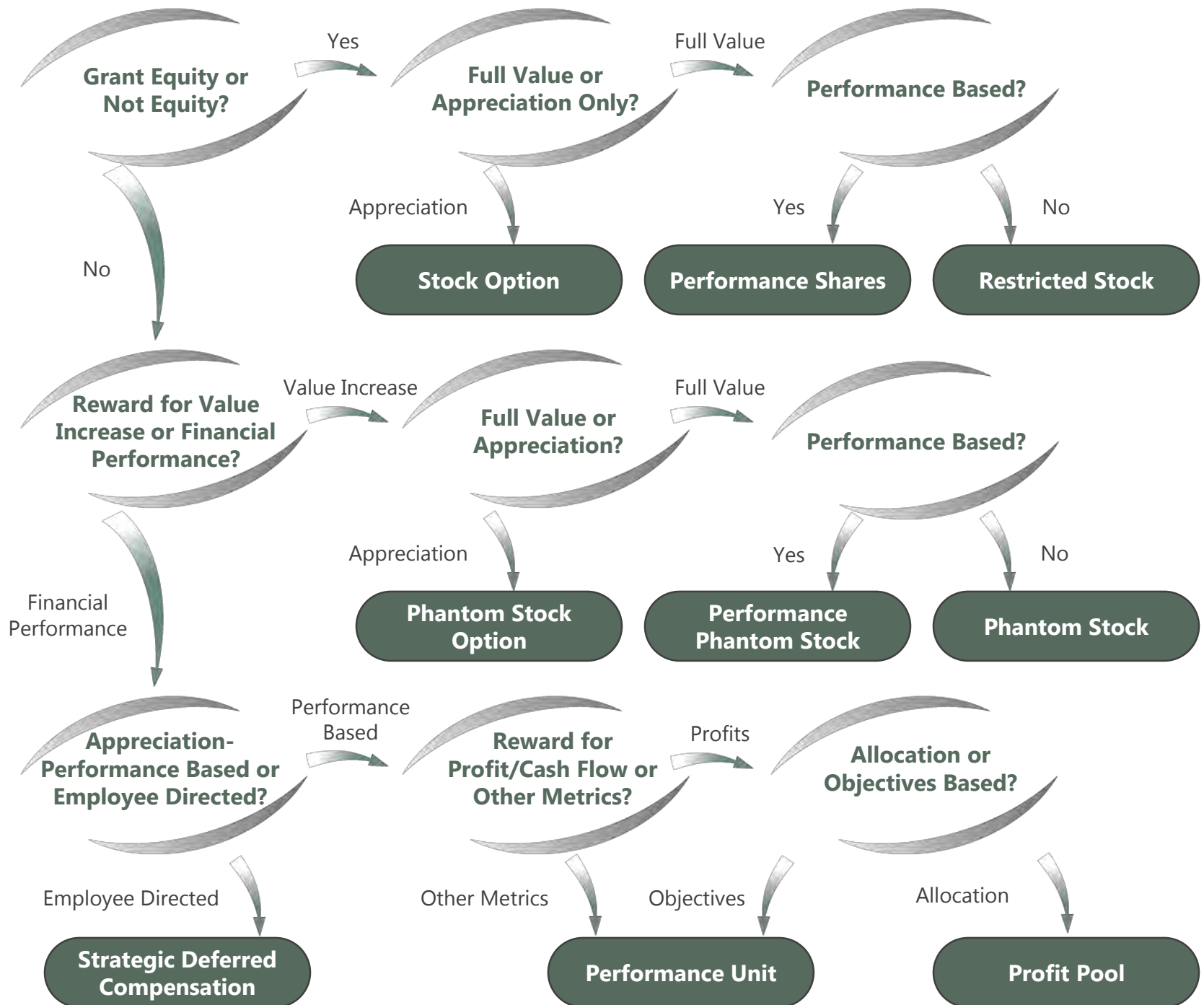


- Competing for talent with public companies?
- Need to share stock to attract or retain vital contributors?
- Have employees who have earned the right to ownership?
- Have means for transferring and repurchasing stock?
- Prepared for the immediate dilution of your equity?

Additional Considerations for Stock Options

- Employees who should participate in future growth but not in present value?
- Employees can fund the purchase?
- Means for transferring and repurchasing stock?

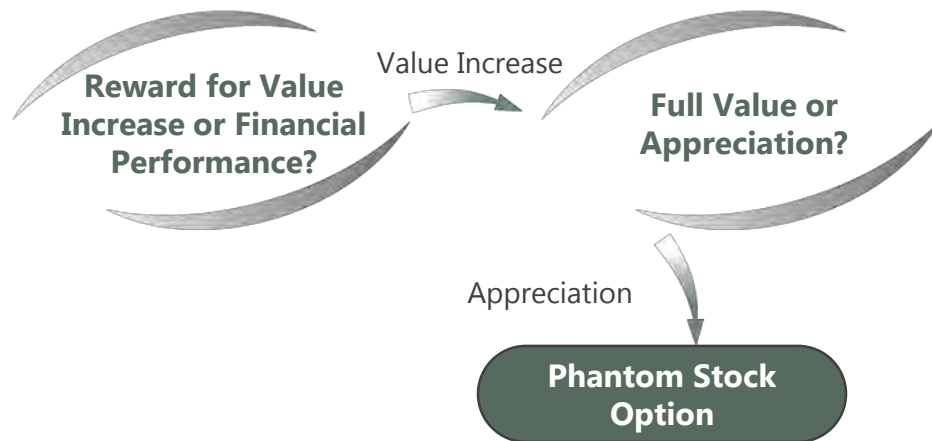




**Grant Equity or
Not Equity?**

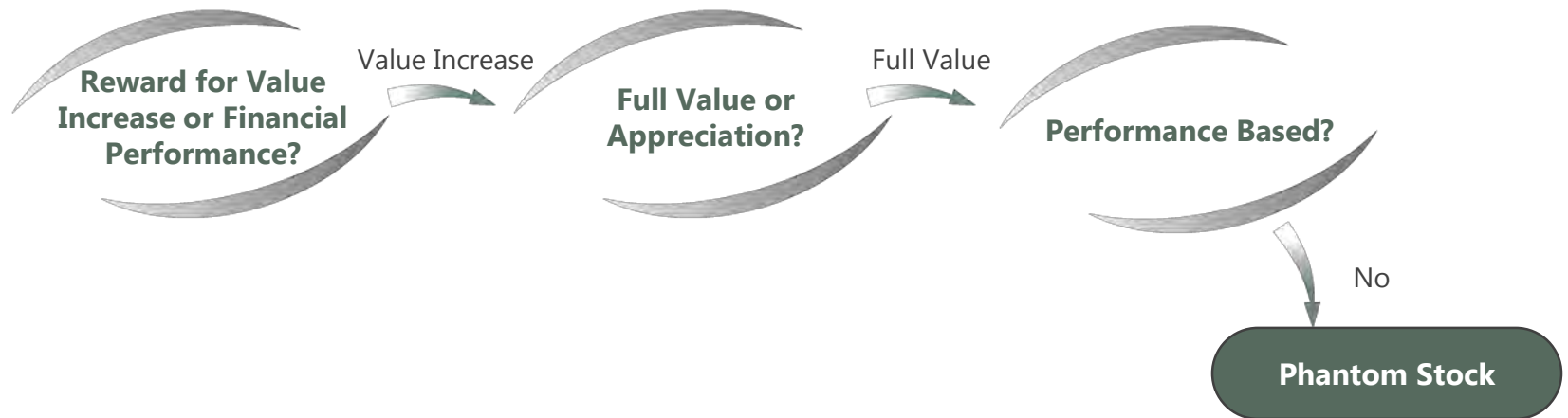
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**Reward for Value
Increase or Financial
Performance?**



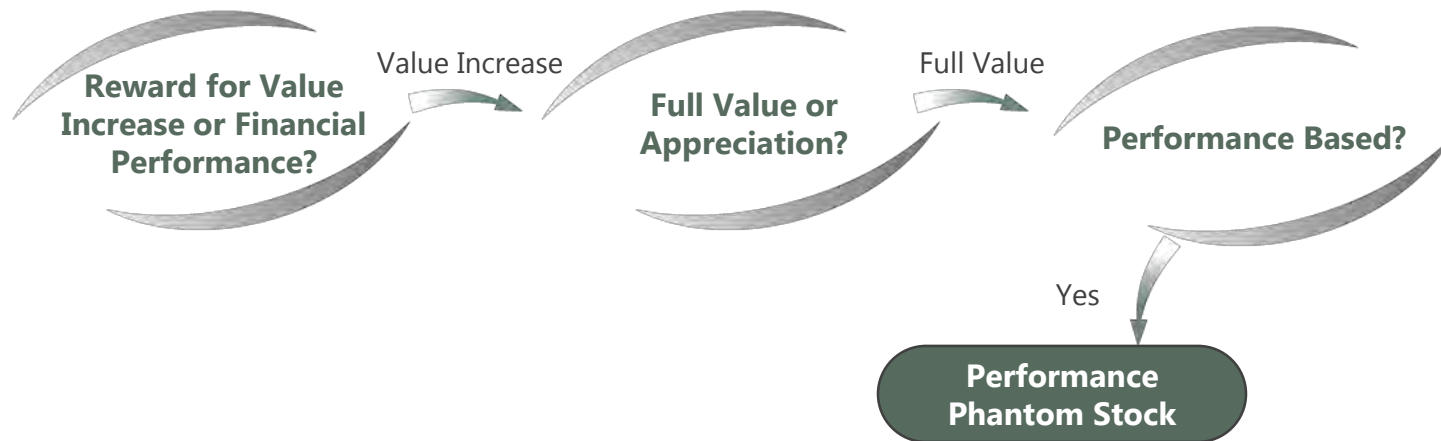
Phantom Stock Options

- Employees given a promise of cash payment at a future date
- The value will be based on the appreciation in stock price from the date of award to the date of redemption (*like stock appreciation rights*)
- Like stock options but without the need to pay for shares
- Rewards employees for contributing to the increase in enterprise value
- Can be part of the employee's annual pay package



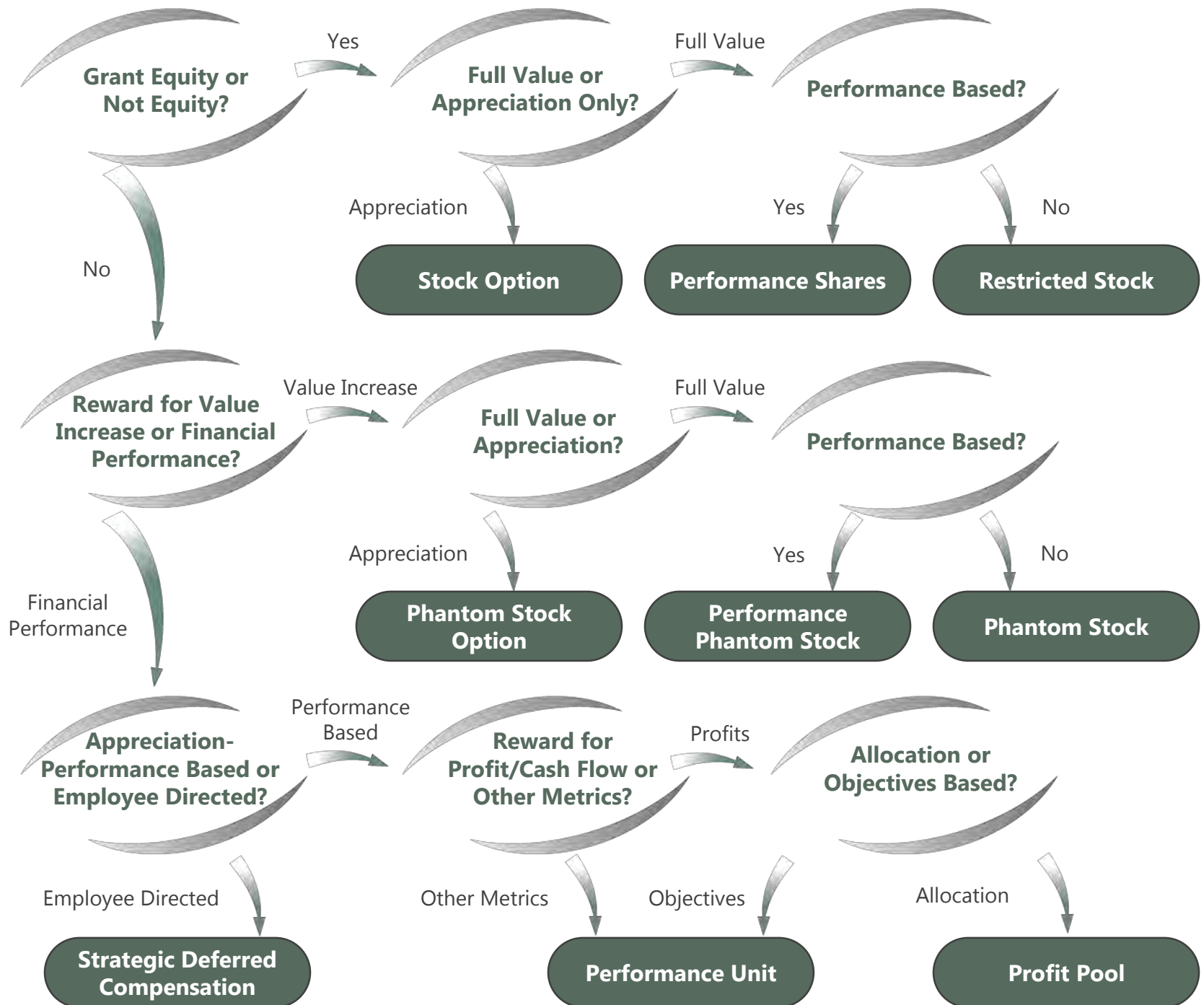
Phantom Stock

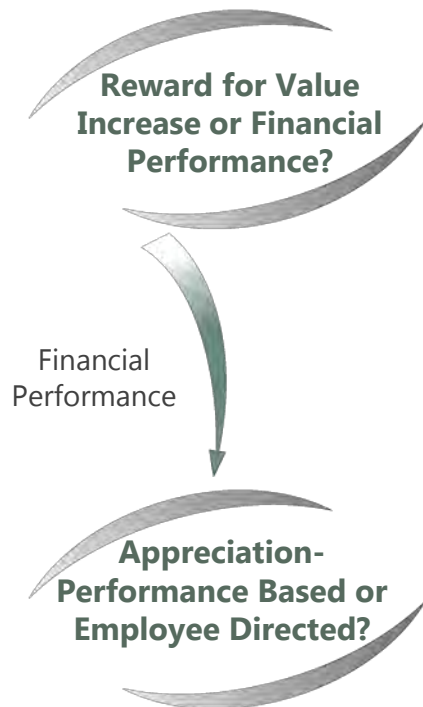
- Employees given an award that has current value essentially equivalent to company stock value (subject to vesting schedule)
- No rights of ownership
- Rewards for past contributions and future growth
- Payments will be made in cash (or stock) at pre-determined dates
- Full value awards create a direct link to ownership



Performance Phantom Stock

- Employees given the promise to receive phantom shares upon fulfillment of pre-determined (often annual) financial goals
- Shares can be full value or appreciation
- “Double” pay-for-performance concept
 - You earn shares based on performance
 - Share values go up based on performance

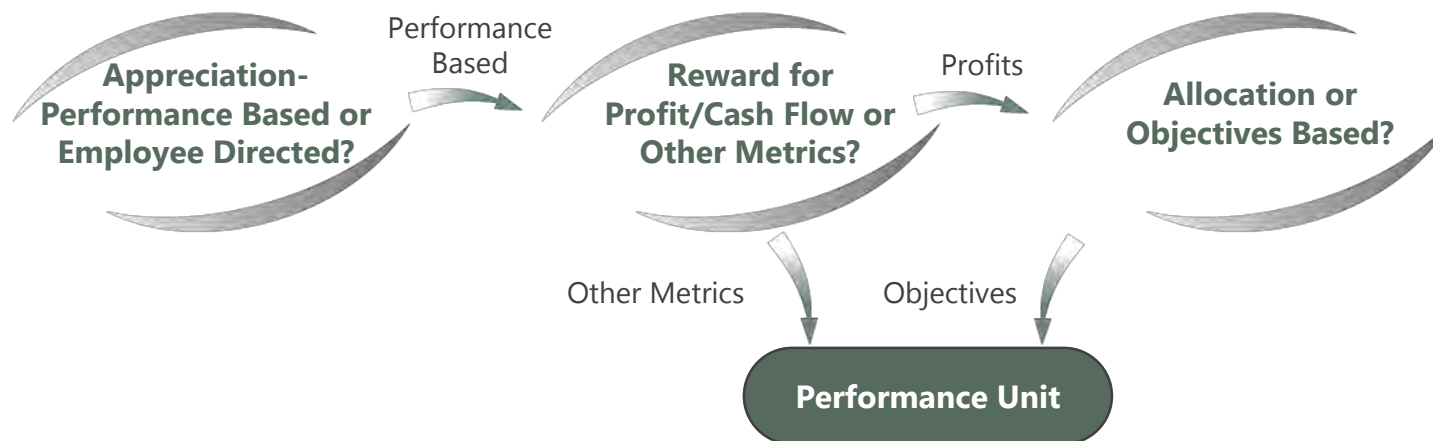






Profit Pool

- Employees given a right to participate in an annual distribution from an accumulating profit pool
- A percentage of profits is credited to a pool that is to be distributed to selected participants in future years
- Each participant is allocated a percentage of the pool
- Typically, distributions may begin at the end of year 3 and recur annually
- Productivity Profit concept calls for a reduction in pool for “capital profits” attribution



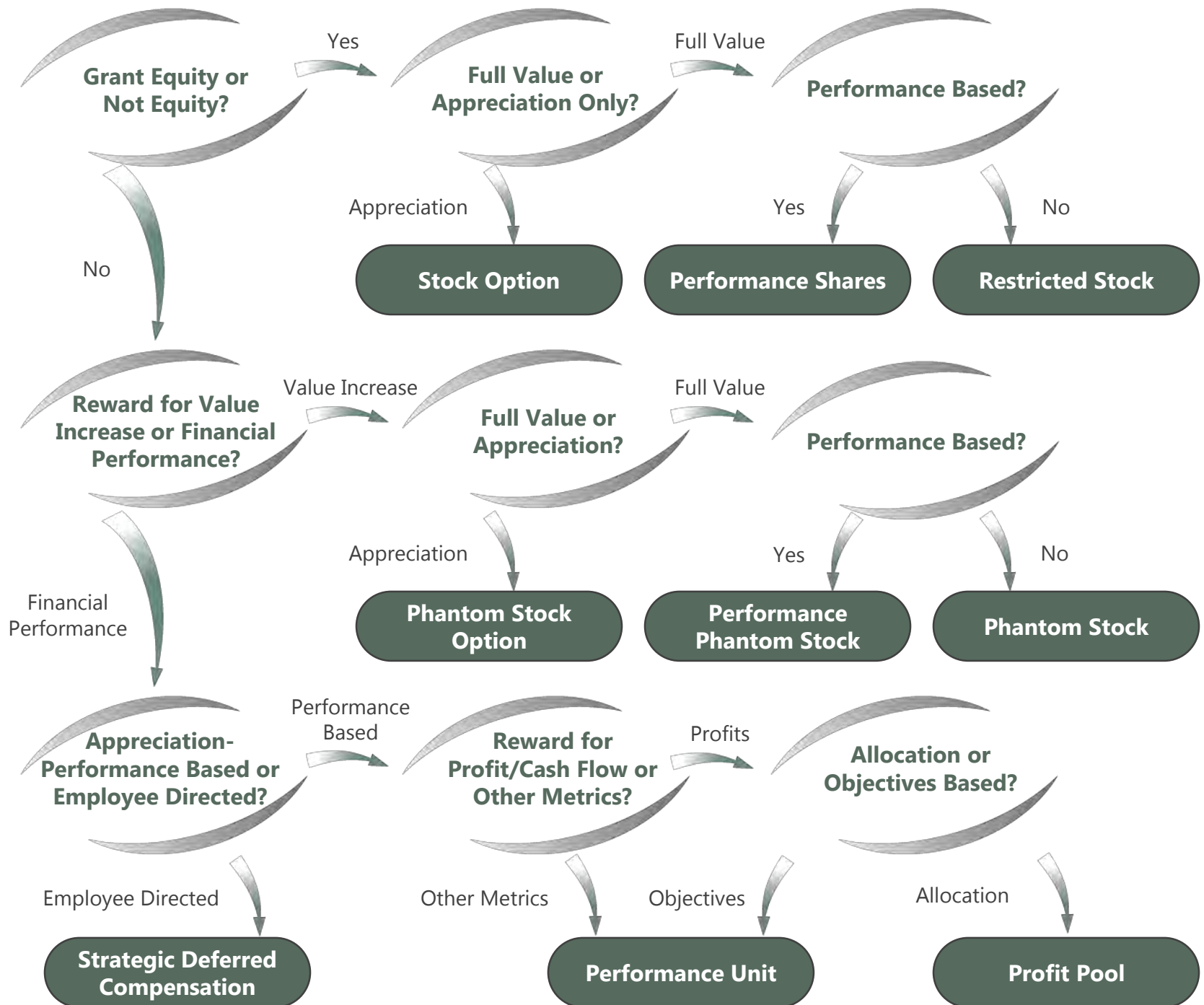
Performance Unit Plan

- Employees given award units (PUPs) with a current value (e.g., \$10 or \$100) that will be redeemable in a future year (3 years most common)
- Payment is made in cash at the end of the period
- The value of the PUP at redemption will depend on improvement in 2 (or 3) performance metrics
- Value of the PUP may be much higher than starting amount, or much lower (even \$0)
- New PUP cycle starts each year, thus ultimately resulting in an annual payout



Strategic Deferred Compensation

- Employees earn a credit to a nonqualified retirement account
- The amount credited typically varies depending on pre-set company performance achievements (e.g., revenue and/or profit goals)
- The funds in the account are “self-directed” (employees may choose between alternative investment options)
- Vested account paid in cash upon termination or retirement
- Employee may add voluntary deferrals



Let's Compare the Numbers (stock options vs phantom stock options)

- Employee (EE) received options awarding her 1% of the increase in the company value
- Company (ER) has a starting value of \$8 million
- Company value at exercise is \$18 million
- The employee's shares are redeemed 5 years later at a company value of \$28 million (no further dilution)

A. Taxation Impact of a Stock Option

Employee Award	1%
Base Value	\$ 8,000,000
Value at Exercise	\$ 18,000,000
Value at Redemption	\$ 28,000,000

Employer Impact

Value of EE's options at Exercise	\$ 100,000
Tax Benefit to ER at Exercise	\$ 44,000
Cash Received from EE	\$ 80,000
Cost to ER at Redemption	\$ (280,000)
Tax Benefit to ER at Redemption	\$ -
Net Cost of Transaction	\$ (156,000)

Employee Impact

Payment made by EE to ER to Exercise	\$ (80,000)
Tax Paid by EE at Exercise	\$ (44,000)
EE Basis	\$ 124,000
Value Received by EE at Redemption	\$ 280,000
Tax Paid by EE at Redemption (LTCG)	\$ (47,424)
Net Value Received by EE	\$ 108,576

B. Tax Impact of a Phantom Stock Option

Total Shares	1%
Base Value	8,000,000
Value at Exercise	NA
Value at Redemption	\$ 28,000,000

Employer Impact

Value of EE's options at Exercise	NA
Tax Benefit to ER at Exercise	\$ -
Cash Received from EE	\$ -
Cost to ER at Redemption	\$ (200,000)
Tax Benefit to ER at Redemption	\$ 88,000
Net Cost of Transaction	\$ (112,000)

Relative to Stock Option **\$ 44,000**

Employee Impact

Payment made by EE to ER to Exercise	\$ -
Tax Paid by EE at Exercise	\$ -
EE Basis	\$ -
Value Received by EE at Redemption	\$ 200,000
Tax Paid by EE at Redemption (Ord)	\$ (88,000)
Net Value Received by EE	\$ 112,000

Relative to Stock Option **\$ 3,424**

A. Taxation Impact of a Stock Option

Employee Award	1%
Base Value	\$ 8,000,000
Value at Exercise	\$ 18,000,000
Value at Redemption	\$ 28,000,000

Employer Impact

Value of EE's options at Exercise	\$ 100,000
Tax Benefit to ER at Exercise	\$ 44,000
Cash Received from EE	\$ 80,000
Cost to ER at Redemption	\$ (280,000)
Tax Benefit to ER at Redemption	\$ -
Net Cost of Transaction	\$ (156,000)

Employee Impact

Payment made by EE to ER to Exercise	\$ (80,000)
Tax Paid by EE at Exercise	\$ (44,000)
EE Basis	\$ 124,000
Value Received by EE at Redemption	\$ 280,000
Tax Paid by EE at Redemption (LTCG)	\$ (47,424)
Net Value Received by EE	\$ 108,576

C. ER PSO Cost Matched to Stock Option

Total Shares	1.39%
Base Value	8,000,000
Value at Exercise	NA
Value at Redemption	\$ 28,000,000

Employer Impact

Value of EE's options at Exercise	\$ 139,000
Tax Benefit to ER at Exercise	\$ 61,160
Cash Received from EE	\$ -
Cost to ER at Redemption	\$ (278,000)
Tax Benefit to ER at Redemption	\$ 122,320
Net Cost of Transaction	\$ (155,680)

Relative to Stock Option **\$ 320**

Employee Impact

Payment made by EE to ER to Exercise	\$ -
Tax Paid by EE at Exercise	\$ -
EE Basis	\$ -
Value Received by EE at Redemption	\$ 278,000
Tax Paid by EE at Redemption (Ord)	\$ (122,320)
Net Value Received by EE	\$ 155,680

Relative to Prof Int **\$ 47,104**

Steps

1. Determine eligible group (allow for future participants)
2. Build a financial growth model
3. Assess new value being created for shareholders
4. Determine the percentage or amount of the future value (or increase in value) to be shared
5. Select a grant schedule (typically annual) and begin illustrating the grants



Steps

6. Test the model for Base, Target and Superior standards
7. Determine vesting schedule
8. Allow for turnover and future employees
9. Test cash flow (and determine if pre-funding is appropriate)
10. Document and launch



Conclusions

- There are limited reasons to share equity in a private company.
- You don't have to give away stock to share long-term value.
- There are at least six LTIP alternatives to sharing stock.
- Stock alternatives are often better for both employees and owners.

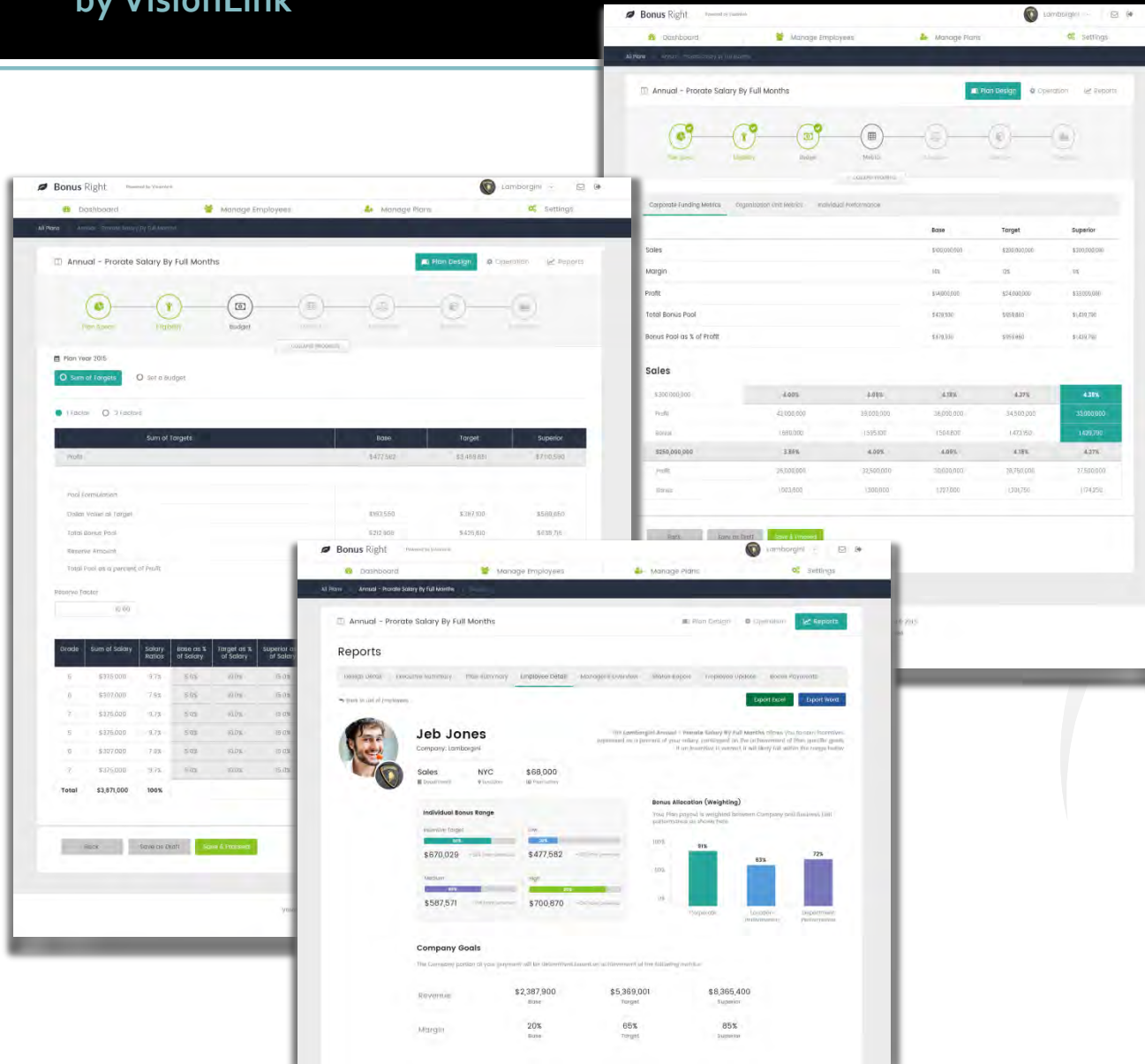


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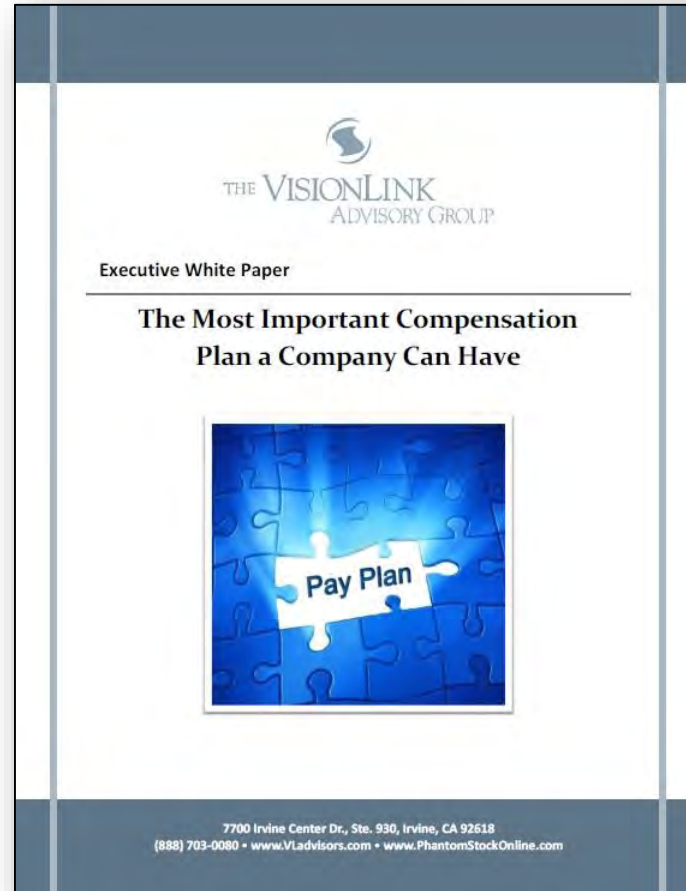
Who You Should be Hiring and How to Pay Them	April 26th
Guaranteed vs. Incentive Pay: What's the Right Balance?	May 24th
Rules for Keeping Pay Competitive (HR Specific Webinar)	June 14th
Pay's Role in a Performance Culture	June 28th
What Millennials Want in a Pay Plan	July 26th
How to Share Value without Diluting Equity <i>4 Alternatives to Sharing Stock</i>	August 23rd
Aligning Pay to Your "Audience": Millennials to Boomers (HR Specific Webinar)	September 13th

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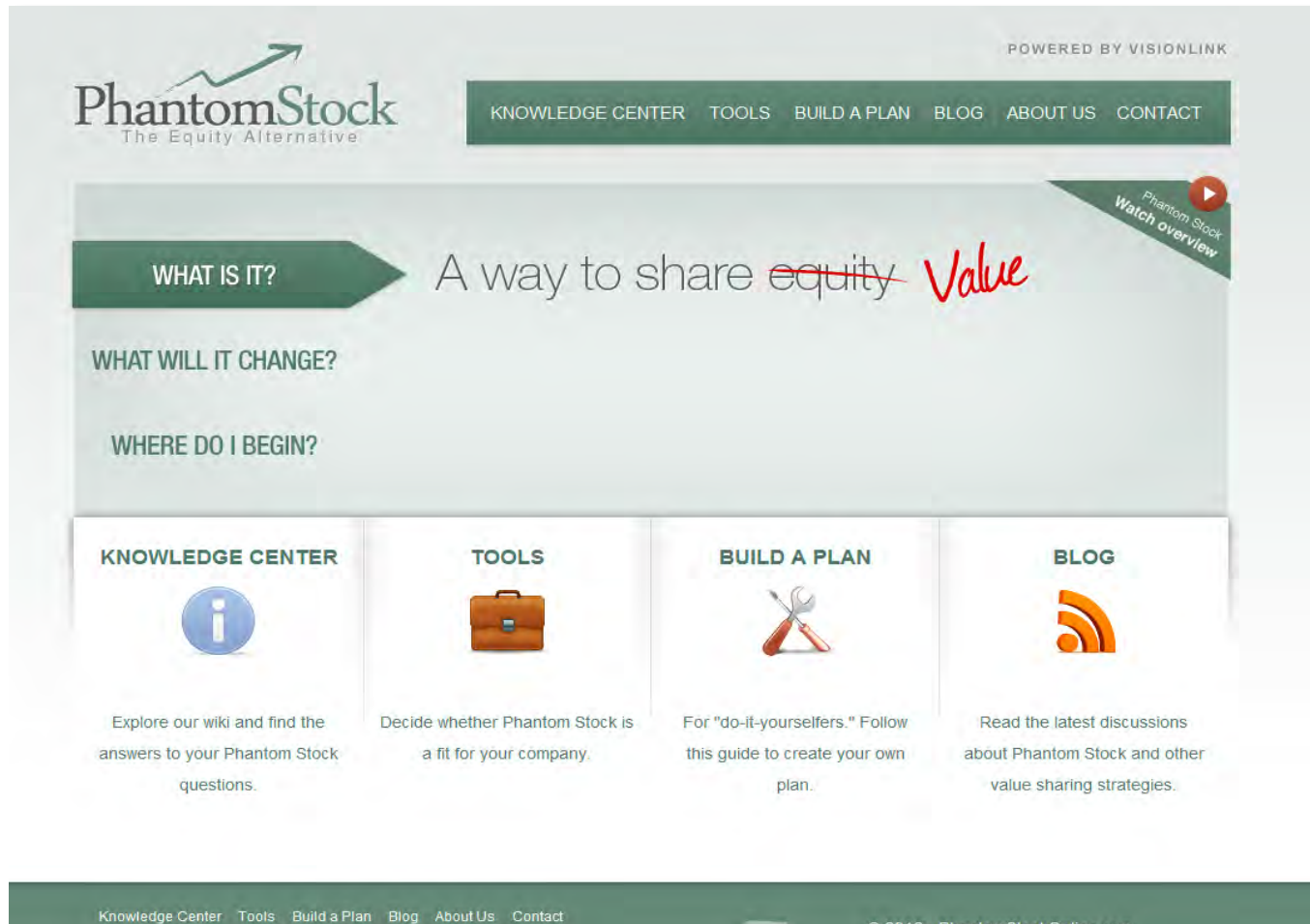
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Q&A



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