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Incentive Compensation Strategies to Build Your Company, Win New Business & Develop a Strategic Exit Plan

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ASSURANCE | TAX | CONSULTING

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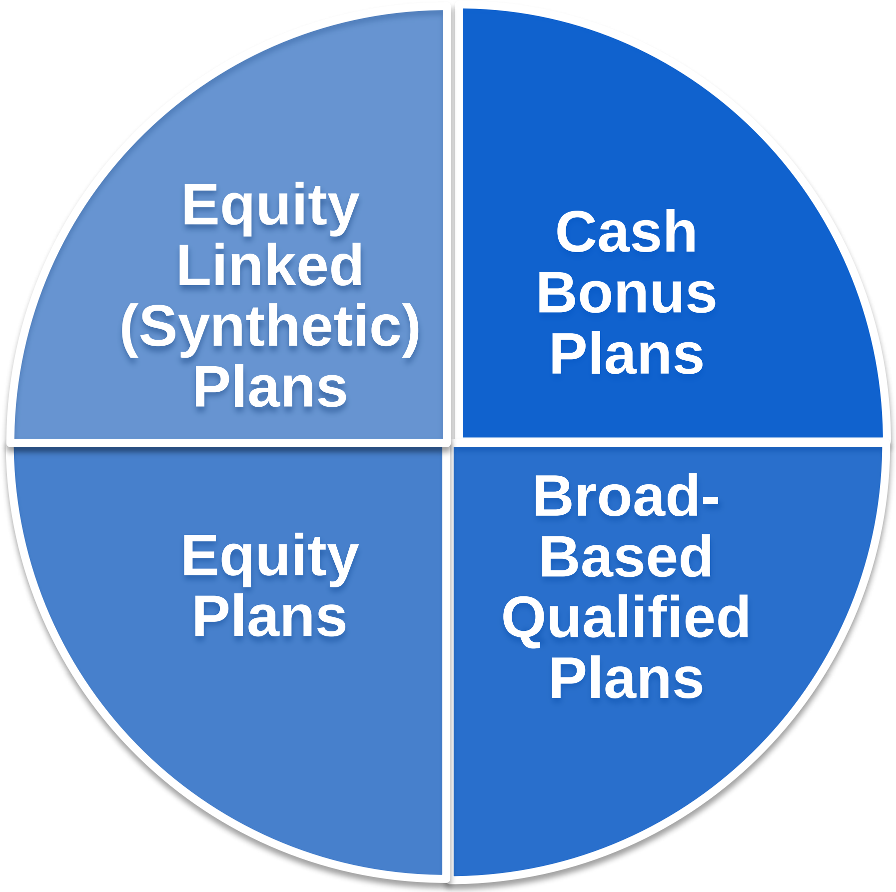
Determine Appropriate "Starting Point"

- Income taxes
- Ownership and rights
- Entity structure
- Payroll taxes
- Securities laws and registration
- Federal acquisition regulation impacts
- Financial statements
- Who are you going reward?
- Valuation
- Administrative burden and cost
- Vesting, forfeitures
- And much more

Universe of Incentive Plans



Equity ***Linked*** vs. Equity Ownership Plans

Equity Linked

Incentives without giving real equity, but tying performance to equity

- SARs plan (settled in cash)
- Phantom stock plan (settled in cash)
- Restricted stock units (settled in cash)

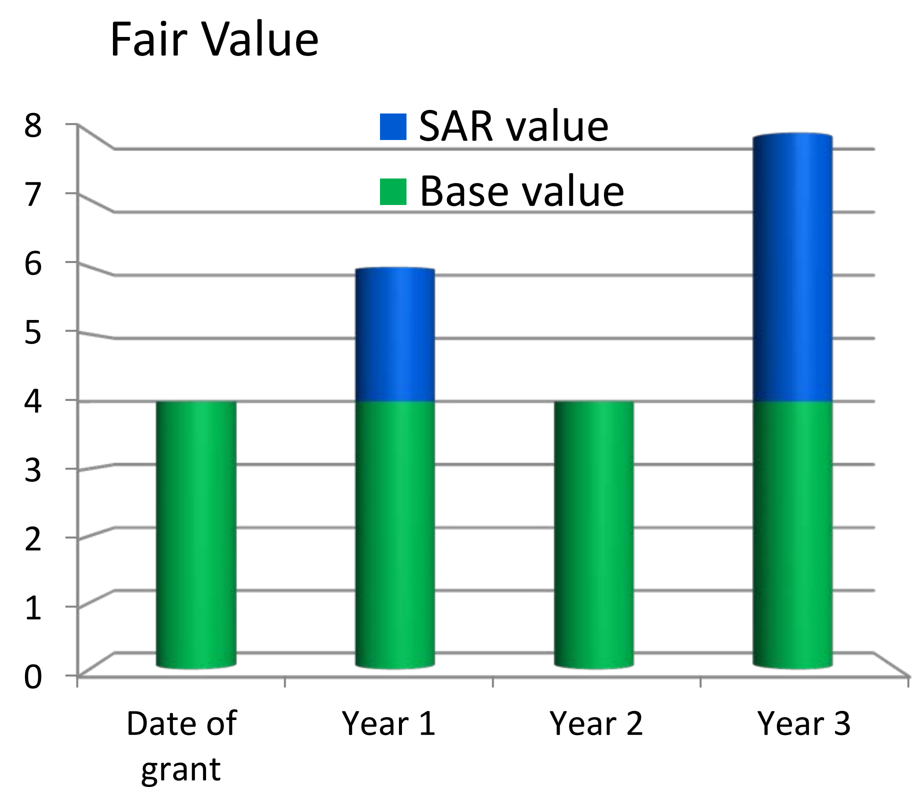
Equity Ownership

Sharing in "real" equity through:

- Stock option plan
- Restricted stock plan
- Employee stock purchase plans
- Restricted stock units (settled in stock)
- SARs plan (settled in stock)

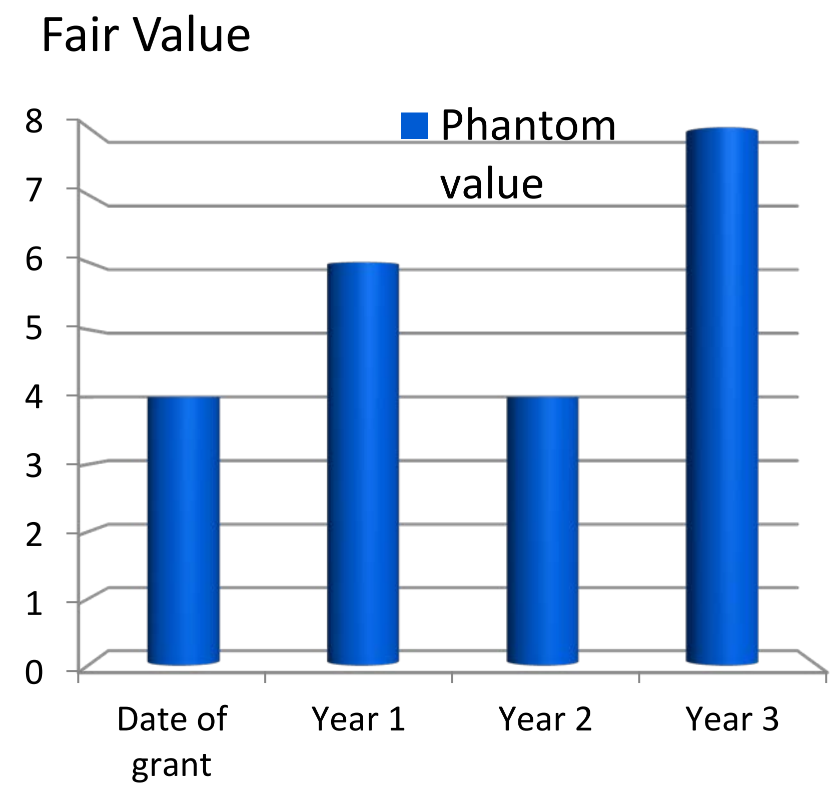
Equity ***Linked*** Incentives: Stock Appreciation Rights (SAR/UAR)

- Not real equity/ownership
- Base value fixed/set at date of grant
- No investment required
- Typically established to motivate increasing equity value (versus retention)
- Separate account to track increases and decreases
- Benefit = appreciation above floor value
- No appreciation = NO BENEFIT



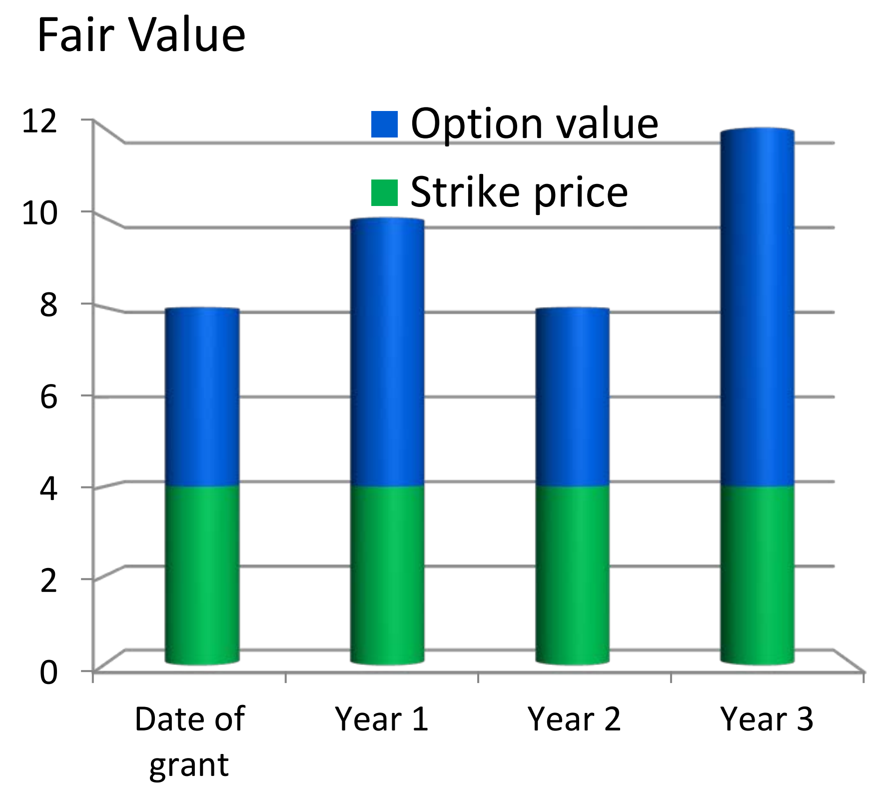
Equity *Linked* Incentives: Phantom Stock

- Not real equity/ownership
- Typically no capital investment required
- Typically structured for immediate value
- Typically established to balance motivating and versus retention
- Separate account to track increases and decreases
- Benefit = full elevator ride in value
- No appreciation = may still provide benefit



Equity (Ownership) Incentives: Stock Option Plan

- Real equity/ownership occurs open exercise
- Typically some capital investment required (exercise). Recipient has financial investment at risk.
- Can be structured for immediate and/or future value
- Benefit = full elevator ride in value, share in ownership rights
- No appreciation = may still provide benefit



Cash Bonus Plans

I. **Smaller, Quick Rewards**

- Spot bonus – special on the "spot" recognition
- Holiday bonus

II. **Transactional Awards**

- Change of control award-contingency
- Retention bonus

III. **Key Metrics/Evaluation/ Goals**

- Commission plans
- Financial and operational metrics

IV. **Discretionary Bonuses**

IV. **Deferred Compensation Plans**

Incentive Plans: Setup and Monitoring

- Establishing a pool – how much equity or equity value is to be shared
- Projecting impact – financial modeling to determine what is best
- Liquidity and timing of payments – what are the triggering events for payment (e.g., sale of the company)
- Vesting – time-based, performance-based or both
- Forfeiture – acts or events by which eligible employee could forfeit awards
- Company changes – things that affect the value of equity linked or equity awards: need to account for these things in drafting of incentive plan documents
  - Results – appreciation or depreciation
  - Turnover and forfeitures
  - Changes in company capitalization (e.g., stock split)

Design 401(k) and Non Qualified Retirement Plans to

WIN NEW BUSINESS IN AN LPTA ENVIRONMENT

Company Profile

- $10M Revenue
- $6M Payroll
- 50% Participation
- 100 Active Participants
- Up to 4% Match
- Immediate Vesting

Considerations for Plan Design

1
- Use Auto Enrollment to increase participation and pass “testing issues”

2
- Reduce match ($.50 up to 4%)

3
- Remove HCEs from match to provide ultimate flexibility

Typical Safe Harbor Retirement Plan

LPTA (or SCA's) 4%	CORE 4%	HCEs 4%
HCEs 4%	HCEs 4%	HCEs 4%

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Redesigned Retirement Plan

LPTA (or SCA's) 0%	CORE $.50 up to 4%	HCEs 0%
HCEs 0%	HCEs 4%	HCEs 4%

Non-Qualified > Plan

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Conclusion

Before

- $6,000,000 Payroll
- 50% Participation
- Cost = 2% Payroll
- Immediately vested

After

- $6,000,000 Payroll
- 50% ≤ Participation
- Cost ≤ 1% Payroll
- Vesting Schedule

Small Business Profile

- $5M - $50M of revenue
- Disadvantaged Business Status (SBA Women Owned, Minority Owned, SDVOSB)
- Small number (1 – 3) of owners
- Beginning to bring on additional key members
- No path to equity, equity like, or enhanced retirement benefits
- No Clear Exit Strategy due to current status

Goal 1:

Owner would like to unlock some equity from the business to secure his/her retirement future.

Possible Solutions:

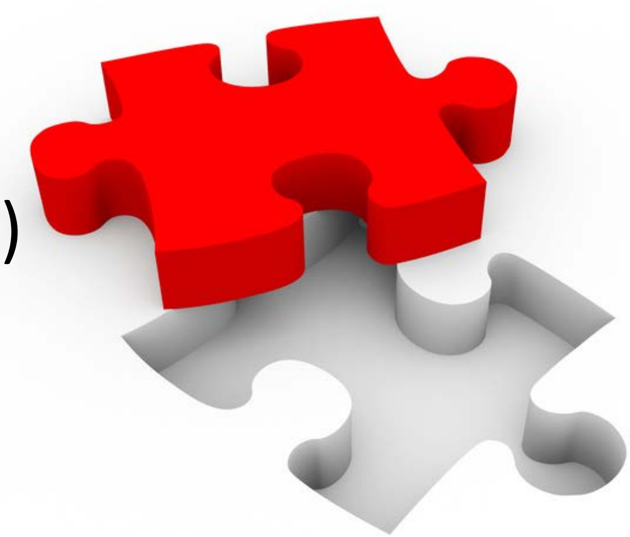
- DB/PSP
- ESOP
- Sell portion of business to execs
- Private equity

Goal 2:

Owner realizes he/she need to offer certain incentive plans other than salary and typical benefits to recruit, reward and retain top talent.

Possible Solutions:

- Equity plans
- Synthetic Equity (SARS, Phantom)
- Non Qualified Deferred Compensation Plans (SERPS)

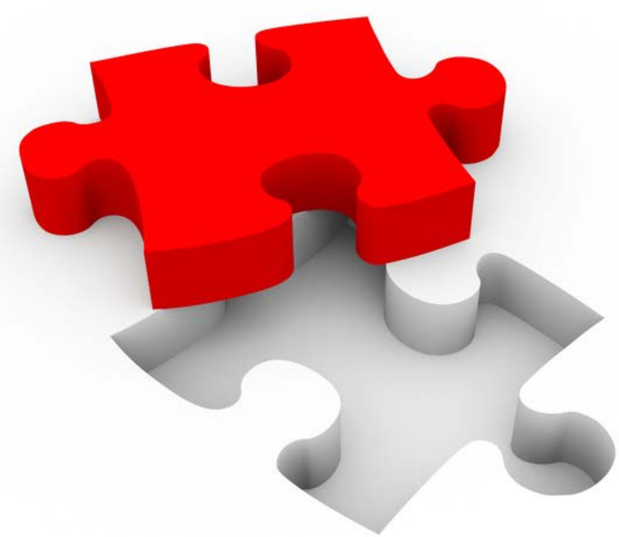


Goal 3:

Concerns about shelf-life of current disadvantaged status and maintaining contracts after the program.

Possible Solutions:

Hire business development and/or contract capture talent into the company to expand or diversify current business lines.

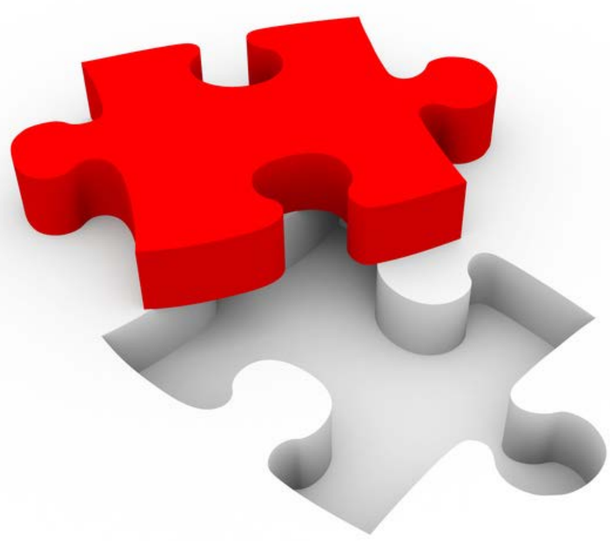


Goal 4:

Build value/revenue to create a viable 3rd party sale scenario.

Possible Solutions:

- Consider strategic acquisition
- Hire business development and/or contract capture talent into the company to expand or diversify current business lines.



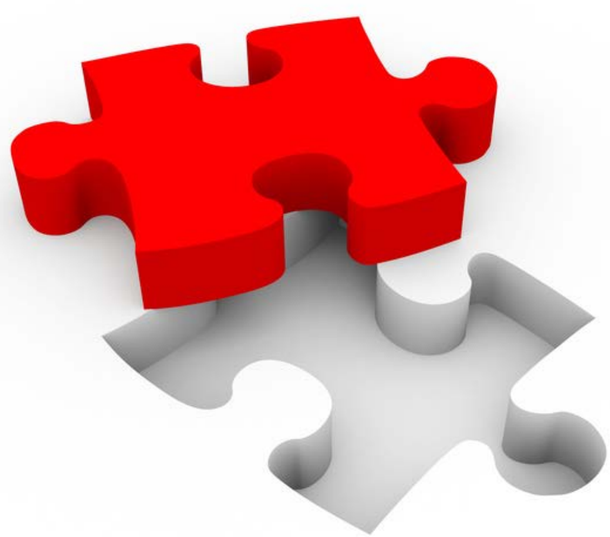
Goal 5:

Put contingency plans in place for owners and key execs as “Plan B” if a 3rd party sale is not an option.

Possible Solutions:

Look at qualified and non-qualified solutions that target deductible retirement benefits for select groups (PSP’s, DB, NQ Arrangements)

- Can use QRP’s for possible ESOP
- Can use NQRP for exec buyout



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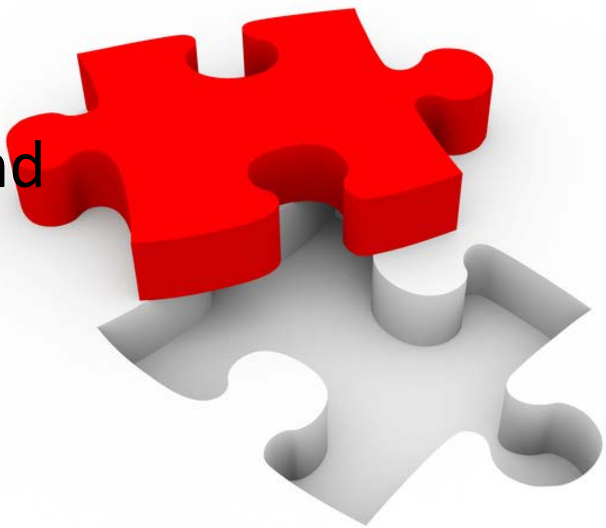
Goal 6:

Obtain clarity of impacts to financial statements in evaluating incentive plan alternatives.

Possible Solutions:

- Perform financial and tax modeling of incentive plan alternatives
- Understand bank facility covenants and impact to indirect rates
- Big picture view



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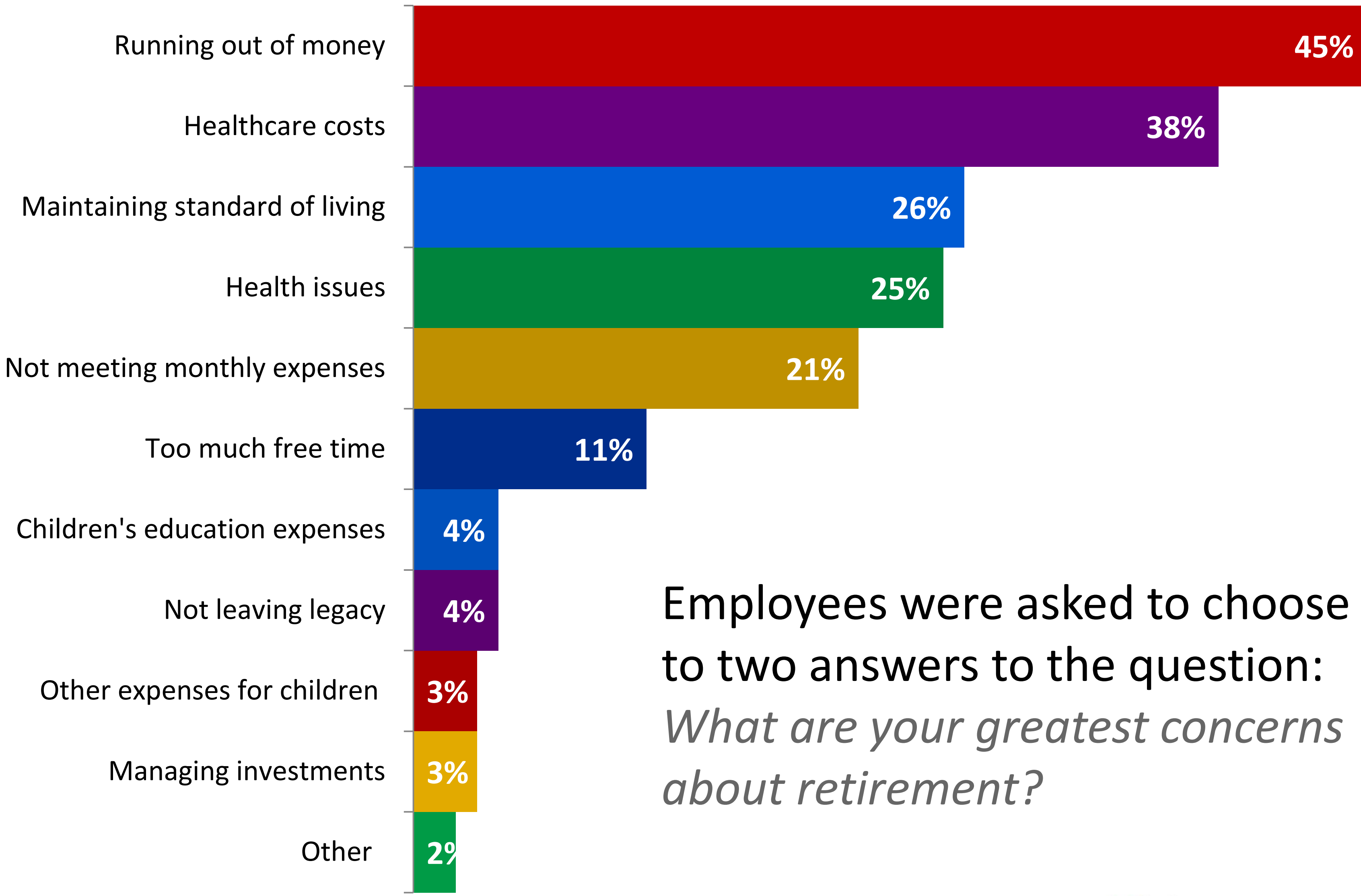
Goal	Solution
Unlock equity to fund retirement	ESOP, Restructure, Sell to execs, Private equity
Recruit, reward, retain top talent	Stock plans, Synthetic stock, Non Qualified Deferred Comp
Loss of disadvantaged status	Modify Qualified and Non Qualified solutions
Build revenue for 3rd party sale	Hire outside talent / diversify
Contingency plans if no 3rd party sale	Modify Qualified and Non Qualified solutions
Clarity of financial statements	Perform modeling, understand bank covenants

Employees Biggest Concerns



Employees were asked to choose up to two answers to the question: *What are your greatest concerns about retirement?*

Source: Price Waterhouse Cooper *Gen X Employees Struggle Most*, June 2013

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Executive Case Study

- 40 year old executive
- Works until age 65
- 30% tax bracket (including state)
- 401(k) balance at $150,000

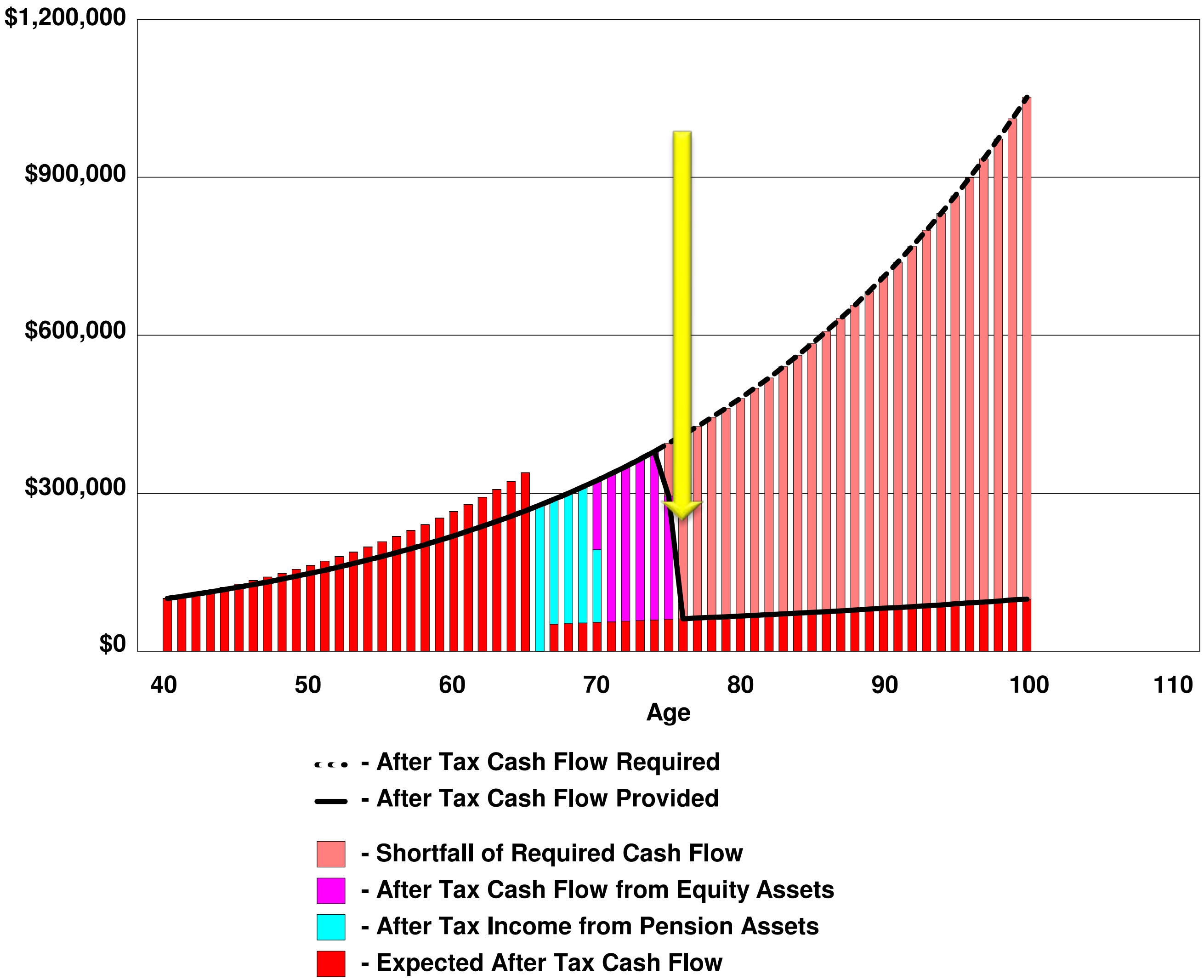
Case Study - Three scenarios

1
- No executive benefit plan

2
- Buyout from stock pays out $1.5M at age 60

3
- Company invests $20,000 per year for executive into SERP plan for 25 years

1. No Executive Benefit Plan



Retirement shortfall at age 75

Have your executives calculated their shortfall age?

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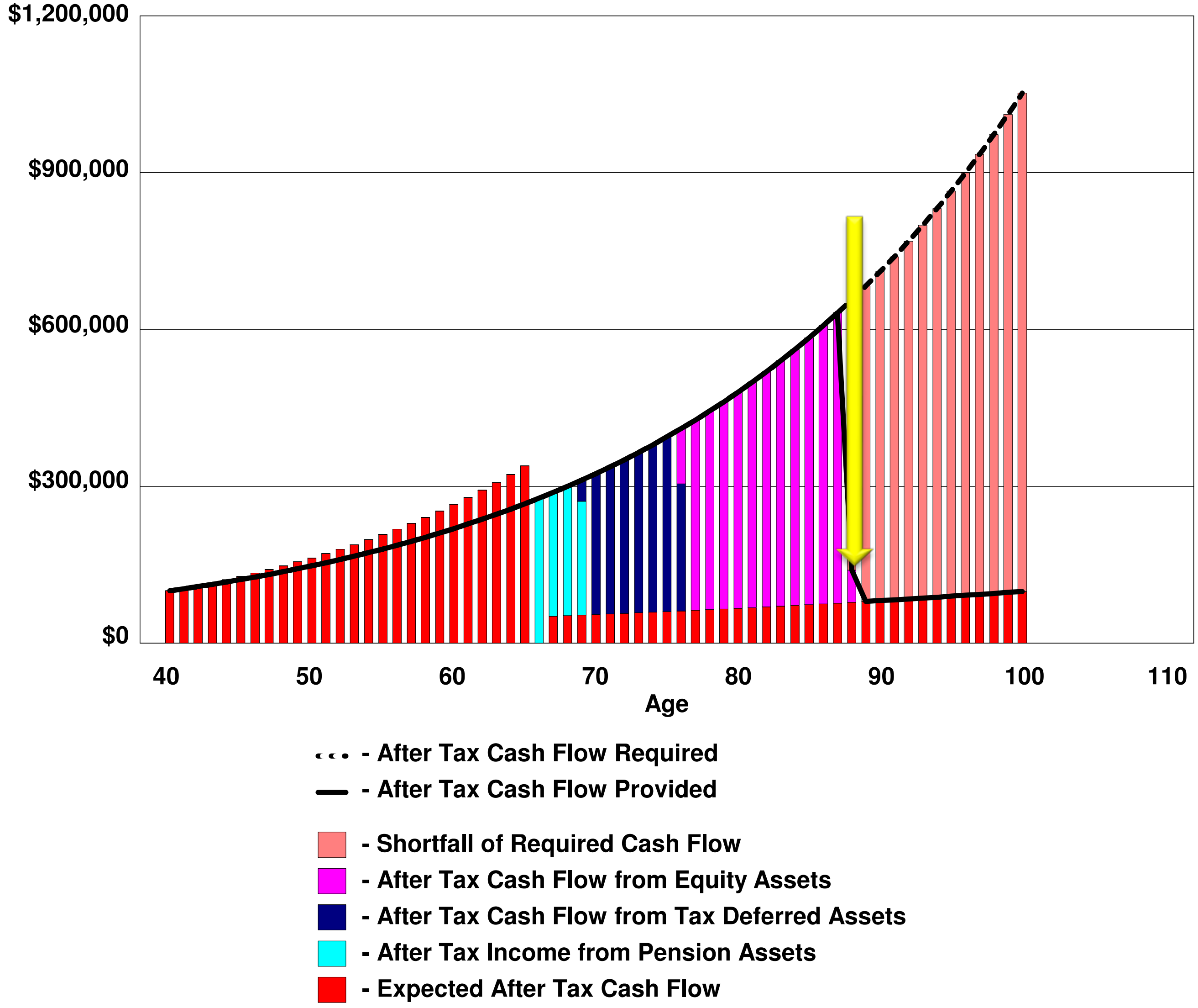
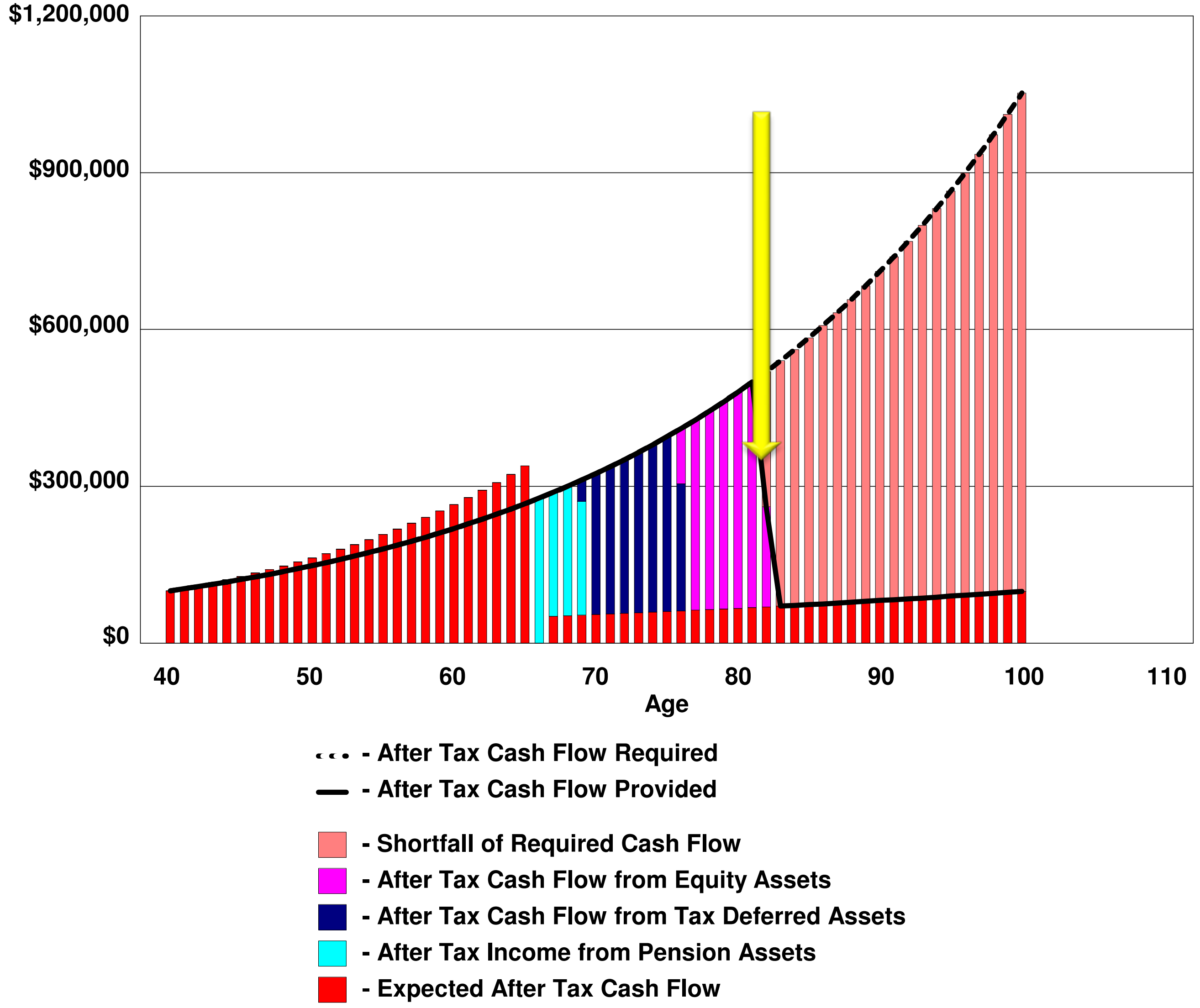
2. Buyout from Stock



Retirement shortfall at age 86

Contingent on sale of company at $1.5M

3. SERP



Retirement shortfall at age 83

Costs owner $20,000/year with no dilution of equity

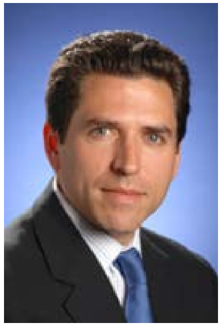
Case Study Conclusions

- Key employees fear of not having enough money in retirement are reality without any additional plan
- Stock plan only works if company sells or company can afford to buy stock back
  - Stock plan will cost $1.5M to the owner whether they buy it out or company is sold to a third party

Case Study Conclusions

- SERP Plan is a more cost effective tool to solve the retirement gap for your executive
  - $500,000 over 25 years
  - Provides some benefit if company does not sell or executive does not stick around to benefit from sale
- Stock buyout and SERP plan provide “golden handcuffs”

THANK YOU



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The slides and the link to the recorded sessions will be sent to all attendees