AN INDEPENDENT MEMBER OF BDO ALLIANCE USA

Case Study

Creating Long-Term Value for Companies & Their Executives

Tools & Strategies Involved

Business Succession Planning - Ownership Transition - Key Employee Rewards

Buy/Sell Planning

- Entity stock redemption—fewer shares outstanding—no basis change
- Cross purchase--owners insure each other and buy deceased shares—Basis increase
- Hybrid

Split Dollar Life Insurance

- Used often when the person or entity that needs the proceeds does not have the resources to pay for insurance, or as an executive benefit.
- Endorsement method
- Collateral assignment

Estate Tax Planning

- With two generations (or more) involved, we are presented with challenges and opportunities. Challenges primarily are to avoid increasing the senior generations estate without giving up control. Opportunities are to bypass the traditional taxable transfers and thereby legally avoiding estate tax

Long Term Incentive For Key Employees

- We all know the challenges of retaining & rewarding key people in successful family businesses. How can we help our clients win the war for talent?

409A often is the answer.

“ABC” Company Has 3 Huge Problems

Closest Trusted Advisor calls “ABC” Company’s accountant who then calls Fulcrum Partners.

PROCESS:

- Gather all facts and objectives, and listen
- Use all transfer tax minimization strategies available that do not conflict with objectives
- Design Plans
- Establish budgets
- Execute

Two Families - One Business

"ABC" Company

Ralph & Alice Kramden
Ralph Age 60

Ricky & Lucy Ricardo
Ricky Age 65

The Family Business

Tom
Richard
Harry

Work For KRV

Lucie
Little Ricky

Not in Business

$ 200,000,000 Valuation

The Good News: They make a lot of money
The Bad News: They have to!

Those Huge Problems Are:

Business Succession/ Continuity

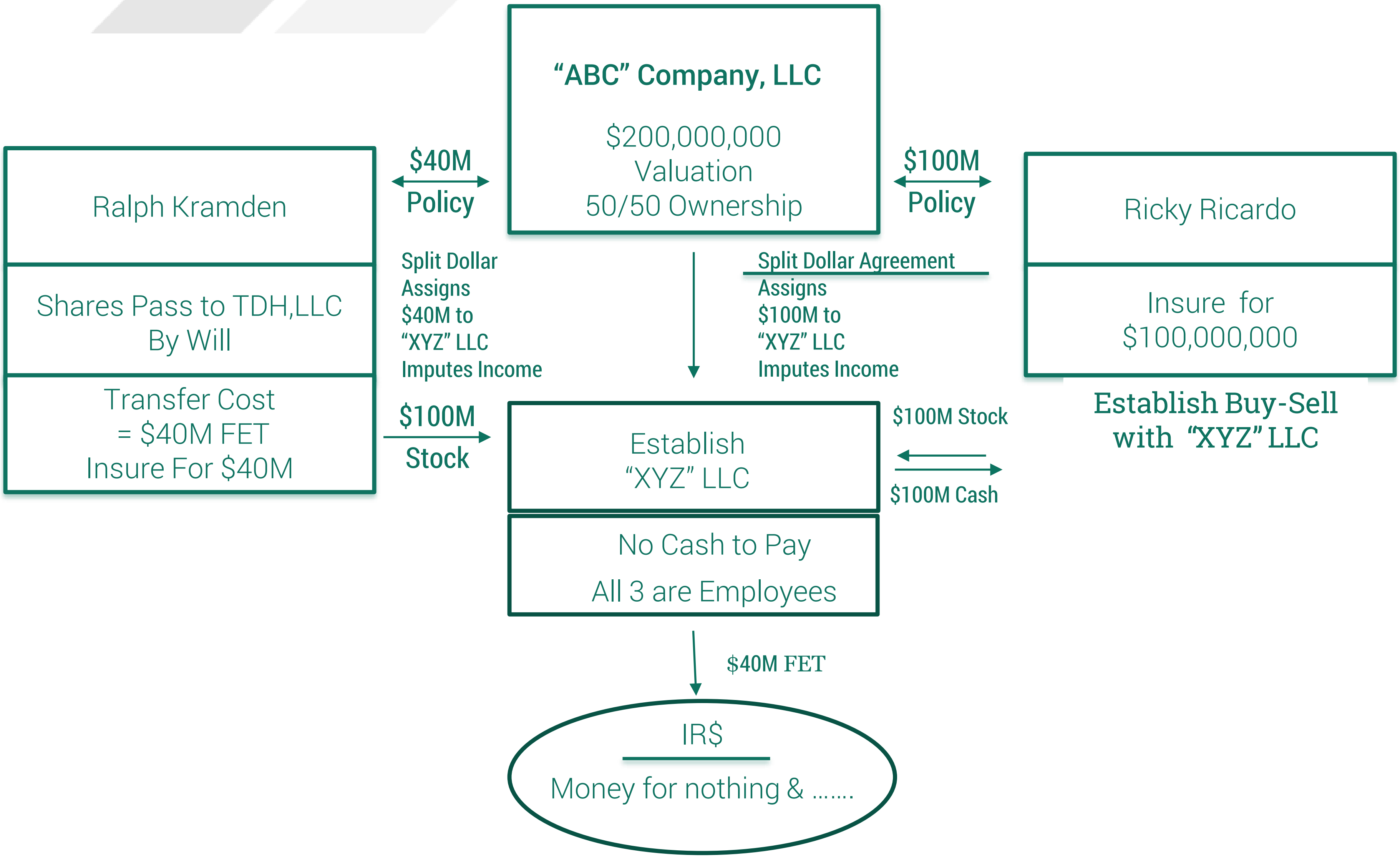
- Ralph wants to pass business on to Tom, Dick, and Harry
- Ricky's kids have no interest; Lucie & Little Ricky are living off royalties
- Very outdated shareholder agreement

Keeping Their Key People

- Competitive pay and discretionary bonus
- Equity ownership is not an option

Earnings Flat -- EBITDA $40M +/- in last several years.

I. Business Succession



II. Keeping Great People / III. Flat Earnings

"ABC" Company has Great People

F & I: Moe
New Sales: Larry
Used Sales: Curly
Service: Shemp

+ Another 10 High Performers that "ABC" Company CAN NOT LOSE.

How to Retain & Reward Key People?

Almost all forms of deferred compensation fall under 409A

- We usually don't have the luxury of just increasing an already competitive Base & Bonus package
- This industry is notoriously generous with retirement programs – NOT!
- We have to build something that will drive behavior in such a way that the program pays for itself.

Design Objectives

- Two Groups:
  1) Moe, Larry, Curly, Shemp
  2) Next 10 Top Performers
- Discretionary awards must be performance driven = pay for themselves
- Establish performance metric(s) and threshold hurdles
  1) ROE, ROI, EBITDA /adjustments …
  2) Bank Covenants …

Establish Performance Metric Award Ranges

Fulcrum Partners designs are based on flexible platforms that will allow changes as required to drive desired performance. Based on the annual achievement of predetermined performance criteria, below are sample ranges for awards. Below threshold, no award is earned. The performance metrics may vary among participants and may change from year to year.

Typically the LTIP will start at the top one or two levels. Over time, we see it cascades down few levels at lesser award opportunities.

Annual Award Range

Group	2015 Salary	Bonus Average	Projected LTIP Target		Projected LTIP Range		
			%Salary	Target $	%Salary	Low ($)	High ($)
I (4)	$200,000	100%	50%	$100,000	25-75%	$50,000	$150,000
II(10)	$125,000	50%	30%	$ 37,500	15-75%	$18,750	$ 56,250
Totals	$2,060,000	$1,425,000		$778,000		$387,500	$1,162,500

Assume EBITDA = $40,000,000

Annual Level	EBITDA Growth 3 Yr. Average	Year-Over-Year Growth $	Awards	Share Rate
Threshold	3.0%	$1,200,000	$387,500	32%
Target	4.5%	$1,800,000	$775,000	43%
Max	7.0%	$2,800,000	$1,162,500	42%

What is the cost of attrition?

...A whole lot more than the cost of the award!

What Do We Do With the Awards?

Almost all forms of deferred compensation fall under 409A - So we must navigate successfully through 409A

- Let's follow Moe's Award at target
- Moe is 48 years old
- Each award vests ratably over 3 years (rolling vesting)
- Half of award is paid in cash as vesting occurs (instant reward)
- Half of award is deferred until retirement and paid over 5 years (retention)
- We often use restrictive covenants that will forfeit unpaid balances for breach

Vesting & Current Cash Awards (at Target)

ANNUAL AWARD: VESTS OVER 3 YEARS - MOE AGE 48										
Salary Growth 3%										
Award Date	Age	Target Award	12/2017	12/2018	12/2019	12/2020	12/2021	12/2022	12/2023	12/2024
1/1/2017	49	$100,000	$33,333	$33,333	$33,333	$ 0	$ 0	$ 0	$ 0	$ 0
1/1/2018	50	$103,000	0	34,333	34,333	34,333	0	0	0	0
1/1/2019	51	$106,090	0	0	35,363	35,363	35,363	0	0	0
1/1/2020	52	$109,273	0	0	0	36,424	36,424	36,424	0	0
1/1/2021	53	$112,551	0	0	0	0	37,517	37,517	37,517	0
1/1/2022	54	$115,927	0	0	0	0	0	38,643	38,643	38,643
1/1/2023	55	$119,405	0	0	0	0	0	0	39,802	39,802
1/1/2024	56	$122,987	0	0	0	0	0	0	0	40,996
1/1/2025	57	$126,677	0	0	0	0	0	0	0	0
1/1/2026	58	$130,477	0	0	0	0	0	0	0	0
1/1/2027	59	$134,392	0	0	0	0	0	0	0	0
1/1/2028	60	$138,423	0	0	0	0	0	0	0	0
1/1/2029	61	$142,576	0	0	0	0	0	0	0	0
1/1/2030	62	$146,853	0	0	0	0	0	0	0	0
1/1/2031	63	$151,259	0	0	0	0	0	0	0	0
1/1/2032	64	$155,797	0	0	0	0	0	0	0	0
1/1/2033	65	$160,471	0	0	0	0	0	0	0	0
Annual Vesting			$33,333	$67,666	$103,029	$106,120	$109,304	$112,583	$115,962	$119,441
Annual Cash Payout at 50%			$16,667	$33,833	$51,515	$53,060	$54,652	$56,292	$57,981	$59,720

Deferred Award at (Target)

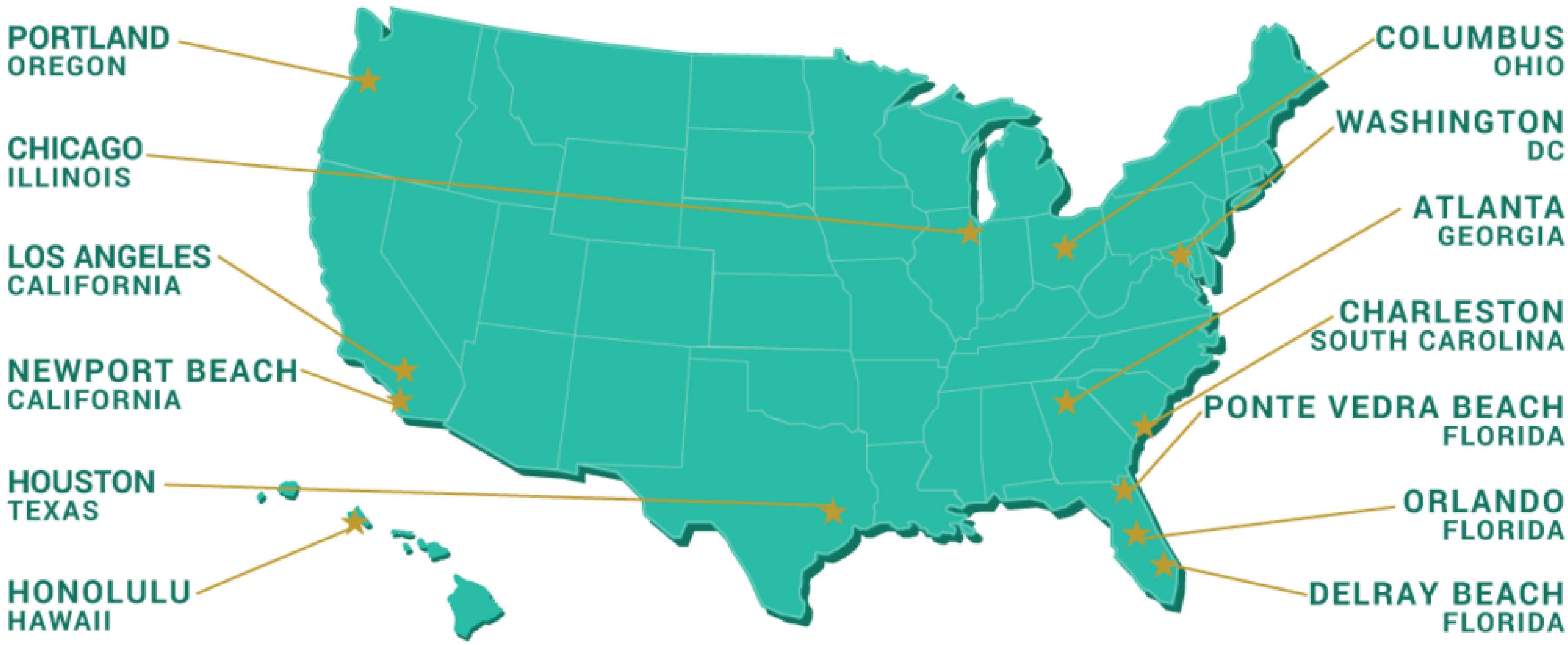
The second half of the awards are deferred until retirement at which time the account balance is paid out over 5 years.

AWARD DISTRIBUTION: 1/2 Deferred Till Retirement, Then Paid Over 5 Years MOE				
Year	Age	BOY Award	Award EOY Balance (5%)	Retirement Distribution
2018	50	$50,000	$52,500	0
2019	51	51,500	106,575	0
2020	52	53,045	162,272	0
2021	53	54,636	219,640	0
2022	54	56,275	278,730	0
2023	55	57,964	339,592	0
2024	56	59,703	402,279	0
2025	57	61,494	466,848	0
2026	58	63,339	533,353	0
2027	59	65,239	601,854	0
2028	60	67,196	672,409	0
2029	61	69,212	745,082	0
2030	62	71,288	819,934	0
2031	63	73,427	897,032	0
2032	64	75,629	976,443	0
2033	65	77,898	1,058,236	0
2034	66	0	866,722	$232,786.5
2035	67	0	665,633	$232,786.5
2036	68	0	454,488	$232,786.5
2037	69	0	232,787	$232,786.5
2038	70	0	0	$232,786.5

LTIP Summary

- Awards based on clear performance metrics
- Performance measures may be different for different participants
- Metrics may change year to year
- Must be communicated well
- Super vesting typically at:
  - Death
  - Disability
  - CIC – Double Trigger
  - Involuntary Termination without cause
  - Can be effective tool to set leadership succession plan in place
  - Restrictive covenant - Forfeiture

Fulcrum Partners LLC: Creating Long Term Value For Companies & Their Executives



Q. & A.

How often are you asked for counsel on…

- Buy Sell Agreements?
- Ownership Succession Planning?
- Estate Tax Planning?
- Split Dollar Insurance?
- Life Insurance in General?
- Long Term Incentive Plan "LTIP" Design?
- Deferred Compensation Plan?

How can incorporating these tools into your off season client conversations add value to your relationship?

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