

SUSTAINABILITY ISSUES

Planning, Repurchase Liability, Valuation and Retirement Readiness

Northwest Chapter Anchorage – Let's Talk ESOPs

September 28, 2017

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Today's Program

- ESOP company sustainability
- Methods for addressing sustainability
- What is required for retirement and what should benefit level be?
- Communicating changes to associates

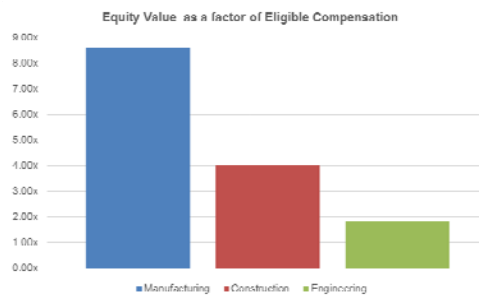
Sustainability of ESOP Structure

- What is the desired long-term ownership structure?
- Is intent to maintain, increase or decrease shares owned by ESOP?
- Repurchase liability competes with cash required for capital expenditures and future growth
- The level of benefit affects share price
- Repurchase strategy affects share price

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How Much Equity Value Do You Have?

Equity value as a multiple of eligible compensation
Which is most desirable? Why is this important?



Company	Average Comp	# of Employees Eligible for ESOP	Eligible Compensation	Equity Value	Value to Compensation
Manufacturing	\$50,000.00	700	\$35,000,000	\$300,000,000	8.57x
Construction	\$76,923.08	325	\$25,000,000	\$100,000,000	4.00x
Engineering	\$122,222.22	4,500	\$550,000,000	\$1,000,000,000	1.82x

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Determining How to Handle Repurchase Liability

- Board determines how to fund repurchase liability; available options include:
 - Company redeems ESOP shares
 - Recycle using current company funding
 - Releverage by company redeeming shares, then ESOP trustee purchasing shares with internal ESOP loan

Method of funding repurchase liability will impact:

- *Share value*
- *Long term versus new associates*
- *Non-ESOP shareholders*

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Aggregate vs. Per Share Value Illustration

Assume company has equity value of \$10 million today, or \$10.00 per share, and needs to repurchase 100,000 shares from ESOP participants for \$1 million

Hypothetical Impact of Redeeming			
	Before	Redemption	After
Aggregate Equity Value	\$ 10,000,000	(\$ 1,000,000)	\$ 9,000,000
Number of Shares Outstanding	1,000,000	(100,000)	900,000
Value per Share	\$ 10.00	\$ 10.00	\$ 10.00

Hypothetical Impact of Recycling			
	Before	Repurchase	After
Aggregate Equity Value	\$ 10,000,000	(\$ 1,000,000)	\$ 9,000,000
Number of Shares Outstanding	1,000,000	(100,000)	1,000,000
Value per Share	\$ 10.00	\$ 10.00	\$ 9.00

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Board of Director's Responsibility to Shareholders

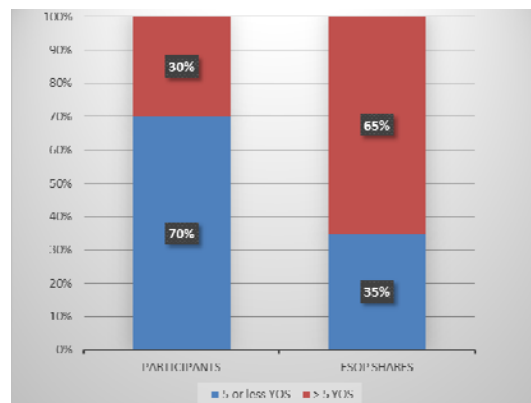
- Decisions made by the BOD or management will affect ESOP participants differently
 - Consider a decision to fund the repurchase liability with employer contribution vs. redeeming the shares
 - An **employer contribution** will benefit associates receiving allocations in the current year, thus benefitting the newer employees
 - **Redemption of stock** reduces the number of shares outstanding resulting in a higher per share value which will benefit participants with the greatest number of shares, such as the longer-term ESOP participants

If the BOD has fiduciary obligation for classes of ESOP participants, how can it make decisions in the best interest of the company when every decision will have winners and losers?

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Who Holds the ESOP shares?

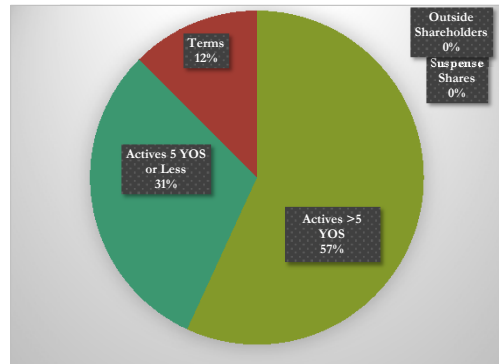
Common demographics for participants with greater than 5 years of service and participants with 5 years of service or less



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How Should Equity Value be Allocated?

Consider the following equity value allocation and watch what happens when changes are made



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Comparison

Redeem vs. Recycle and Redeem vs. Releverage

	Redeem	Recycle	Releverage
Shares outstanding	Reduced	No impact	No impact(*)
ESOP Ownership	Reduced if < 100%	No impact	No impact
Additional shares to Employee ESOP accounts	No	Yes	Yes, overtime
Per share value	Anti-dilution	Diluted	Diluted
Employer contribution	No	Yes and dividends/distribution	Yes and dividends/distribution
Employee group benefited most	EEs with larger share balances	Depends upon funding contribution (ALL) dividends (OLD)	Comp to Comp (ALL)
Corporation's cash flow	Reduce	Not Reduced if =Benefit Expense	Not reduced if =Benefit Expense
Income tax	No deduction	Deduction for employer contribution	Deduction for contribution/dividends

* Assumes that after redemption by company, all shares are sold to ESOP
Is a new "securities acquisition loan" which needs an adequate consideration opinion at time of transaction

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Methods are Available to Target Equity Value to Associates

- Methods for funding repurchase liability and targeting allocations to different classes of associates to meet the company's goals and objectives include:
 - Redeem vs. recycle
 - Employer contributions
 - Dividends
 - Releveraging
 - Combination of the above

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Issues in Releveraging ESOP Loans

- Share value decline due to more shares outstanding
- Reduce future ESOP balances of participants with large balances
 - Participants with large balances are impacted most by share value changes versus current year allocations.
- ESOP trustee due diligence
- What percent of shares should be in suspense?

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Extending ESOP Loan Term

- Reasons to consider extending the ESOP loan include:
 - Reduce future repurchase liability
 - Increase future Company equity value and balance sheet cash
 - Reduce excess ESOP balances which make employees much wealthier in retirement than during their working life.
- Establish a Company policy for the desired level of ESOP allocation as a percentage of wages such as 15% of wages.

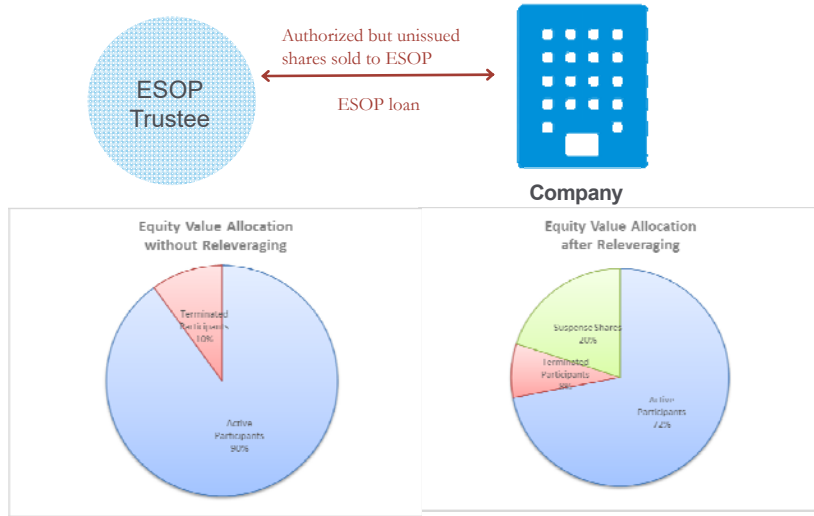
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Releveraging ESOP Loans

- Reasons to consider releveraging ESOP loans include:
 - Reduce future repurchase liability
 - Increase future Company equity value and balance sheet cash
 - Reduce excess ESOP balances which make employees much wealthier in retirement than during their working life.

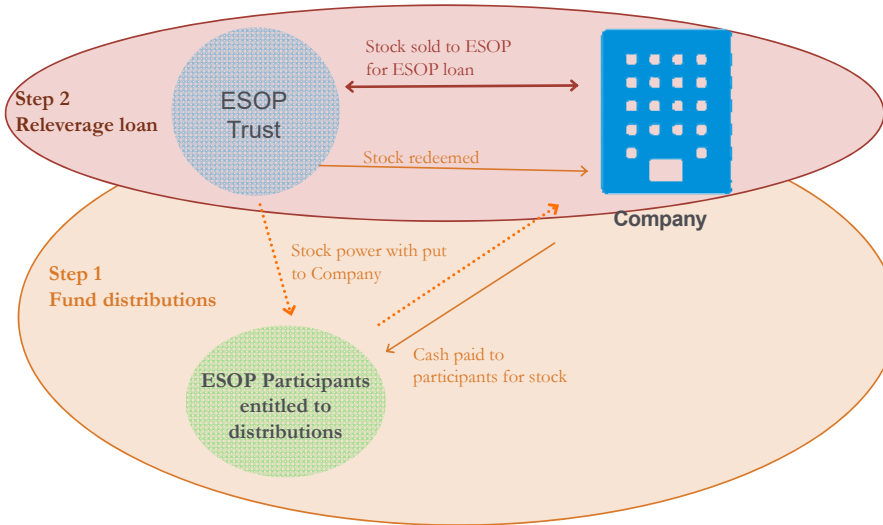
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Releveraging to Increase Shares in Suspense



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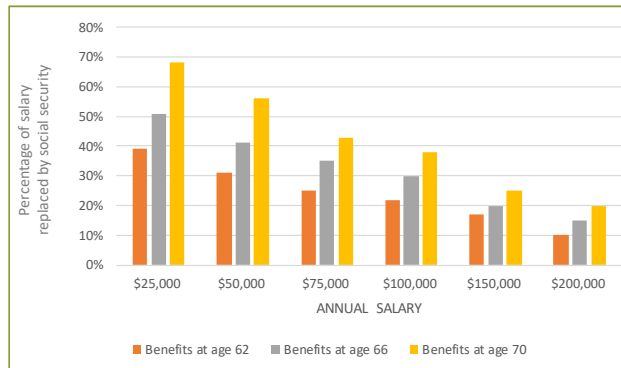
Releveraging to Fund Distributions



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Impact of Social Security in Retirement*

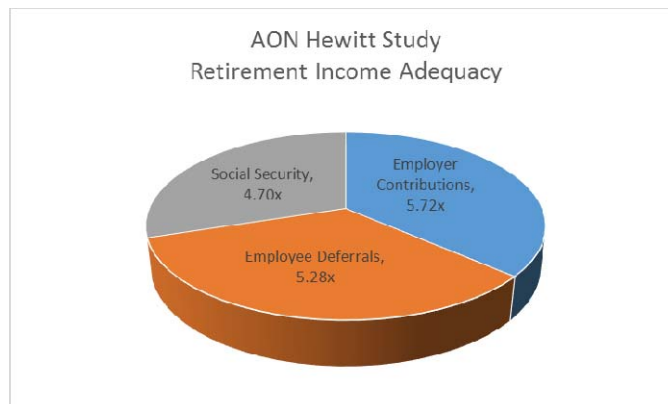
What will your social security benefit be as a percent of needed earnings in retirement?



* Based upon data from benefit calculator on www.ssa.gov website. For illustration purposes; does not reflect the past or future returns of any Principal® product.

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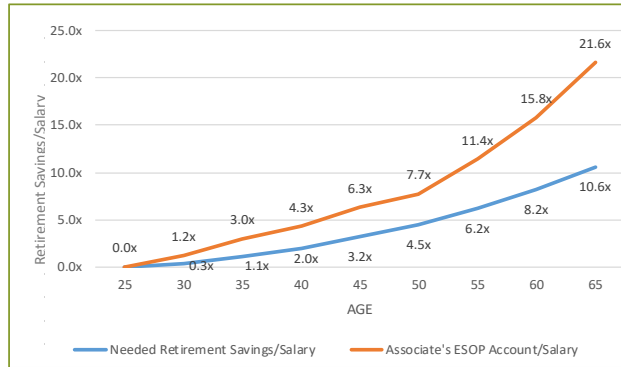
Are Associates Reaching Retirement Income Adequacy?



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Savings-to-Employment Income Ratio Target*

Retirement savings required by age to realize retirement security



* These targets represent a factor that when applied to a current employment income, given the amount of total savings needed at the current age to maintain a 13% savings rate and reach an adequate savings level by the end of age 64. For illustration purposes; does not reflect the past or future returns of any Principal product.

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Questions?

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