

## Case Study – Performance Units Plan (PUP)



### Client

A large family-owned company in the power generation business, company ownership was being transferred to the third generation (G3) of the founding family at the time of engagement with EBS. The company had already been placed in trust, with the three members of G3 as beneficiaries and actively working in the business. The client has had several years of exceptional performance, which was expected to grow at a healthy rate for the foreseeable future.

### What was needed

Company ownership realized that they needed a plan to reward key employees who are driving the company's increased value – without giving up ownership or control of the company. They also needed a plan to reward the three members of G3 and one additional non-family senior manager. In other words, they had two distinct groups of employees, each of which required its own custom solution.

For the first group (key non-family employees), ownership had considered a bonus plan that granted each key employee a share of a central benefit pool. However, they did not implement this plan because they were concerned about cost, employee retention after payout, and the inability to offer rewards based upon individual performance. That's when EBS came into the picture.

### Solution in Brief

In response to the initial need for rewarding key employees, EBS designed and implemented a Performance Units Plan (PUP) for this first group. Similar in concept to the long-term incentive plans currently offered to senior management of many publicly traded companies, the PUP is designed to:

- Promote the long-term profitable growth of the Company by aligning the interests of the Leadership Team with the interests of the shareholders.
- Provide certain key employees an opportunity to share in the future growth and appreciation of the business they help create.

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## PUP: How it Works

Under the terms of the Plan, Participants are granted Performance Units - the value of which is determined by rolling three-year adjusted EBITDA. If EBITDA increases, the value of the Performance Units and the value of Participants' benefits will increase accordingly.

Given the fact that the PUP relies on a logical, consistent method for unit calculation, EBS has developed highly adaptable models that are simultaneously complex yet intuitive. The figure below shows a streamlined picture of w this model is used, with every column built upon variables and clearly defined logic.

Performance Units Plan							
Calculation of Projected Unit Value							
HYPOTHETICAL PROJECTION OF UNIT VALUE							
		(1)	(2)	(3)	(4)	(5)	(6)
Year		Projected EBITDA Growth Rate	Projected EBITDA	Projected 3-Yr Avg EBITDA	Hypothetical Market Multiple	Projected Hypothetical Business Value	Projected Unit Value (1,000,000 Share Units)
1	2023		5,000,000	5,000,000	8	40,000,000	40.00
2	2024		10,743,000	7,871,500	8	62,972,000	62.97
3	2025	25.00%	13,428,750	9,723,917	8	77,791,333	77.79
4	2026	25.00%	16,785,938	13,652,563	8	109,220,500	109.22
5	2027	25.00%	20,982,422	17,065,703	8	136,525,625	136.53
6	2028	25.00%	26,228,027	21,332,129	8	170,657,031	170.66
7	2029	15.00%	30,162,231	25,790,894	8	206,327,148	206.33
8	2030	15.00%	34,686,566	30,358,942	8	242,871,533	242.87
9	2031	15.00%	39,889,551	34,912,783	8	279,302,263	279.30
10	2032	15.00%	45,872,984	40,149,700	8	321,197,603	321.20

With the method for unit calculation determined, a deferred compensation account is established for each participant, performance units are credited to the account when granted, and vest over a period chosen by company ownership – five years in this case. Vested balances are paid out upon retirement. Participants are granted a percentage of their salary in the form of performance units. The percentage granted is determined by their individual achievement on a variable grid.

Another key component of the PUP is the two types of Performance Units granted under the Plan: “Full Value” Units and “Appreciation” Units.

- **Full Value Units:** As the names implies, the value of a Full Value Unit is the total value of the Performance Unit at the time of valuation – the base price, plus the appreciation in value since the date of grant. Full Value Units are often used on a limited basis for extraordinary results and/or during the initial year.
- **Appreciation Units:** In contrast, the value of an Appreciation Unit only reflects the increase in value since the date of grant. Since the Plan is designed primarily to incentivize key employees to focus their attention on the future long-term growth and profitability of the Company, the standard form of award is Appreciation Units.

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As a complement to each other, Full Value Units and Appreciation Units address different goals. Full Value Units have substantial worth so long as the company remains in business, and work well to assure participants of the value offered by the PUP should the business experience a reduction in EBITDA. Appreciation Units, meanwhile, are generally awarded on an annual basis and have very significant value if the participants help to drive increased EBITDA. By tying the value of all units to a three-year rolling adjusted EBITDA, both the participants and the company are protected from volatility. The appreciation units are intended to offer the bulk of value to participants – if they continue to drive increased EBITDA.

Participants receive regular statements reflecting their account balance, and these statements are reviewed during performance conversations between management and key employees. This consistent and transparent approach further incentivizes employees to drive EBITDA, remain working with the company, and recognize the direct link from their personal wealth to the success of the business.

## Funding

Company ownership did not want an unfunded plan liability on their books and EBS undertook a formal plan funding study. After determining the final design for participants, EBS was able to accurately model the liability of the plan and match it to a funding model. The figure below depicts a streamlined picture of how our models provide data needed to determine funding. Of course, the model below has been abbreviated for the purposes of this case study, but the full version used with the client provides more specific details and longer timeframes, all of which are highly adjustable

<b>PERFORMANCE UNITS PLAN</b>									
<b>HYPOTHETICAL PROJECTION OF BENEFITS</b>									
			<b>Granting Units</b>		<b>Accrued and Vested Account Value</b>				
			<b>Appreciation &amp; Full Value</b>		<b>Combined Units</b>				
			(1)	(2)	(3)	(4)	(5)	(6)	(7)
<b>Year</b>	<b>Active</b>	<b>Payout</b>	<b>BOY Unit Value Based on Prev Yrs' Financial Results</b>	<b>Full Value Units Granted [BOY]</b>	<b>Apprec Units Granted [BOY]</b>	<b>Cum Number [EOY]</b>	<b>Distribs [BOY]</b>	<b>Accrued Value [EOY]</b>	<b>Vested Value [EOY]</b>
1 2025	6	0	62.97	6,500	4,108	10,608	0	566,524	0
2 2026	6	0	77.79	0	3,425	14,033	0	1,007,583	224,982
3 2027	6	0	109.22	0	2,513	16,546	0	1,459,381	645,088
4 2028	6	0	136.53	0	2,071	18,617	0	2,094,801	1,361,384
5 2029	6	0	170.66	0	1,706	20,323	0	2,819,725	2,418,394
6 2030	6	0	206.33	0	1,454	21,777	0	3,615,534	3,275,950
7 2031	6	0	242.87	0	1,272	23,048	0	4,455,204	4,162,726
8 2032	6	0	279.30	0	1,139	24,188	0	5,468,549	5,198,415
9 2033	6	0	321.20	0	1,020	25,208	0	6,683,053	6,417,241
10 2034	6	0	369.38	0	914	26,122	0	7,946,627	7,814,837
11 2035	4	2	417.75	0	434	14,674	(779,975)	8,007,685	7,886,311
12 2036	4	2	465.64	0	401	15,075	(779,975)	8,035,869	7,926,936
13 2037	4	2	512.21	0	376	15,451	(779,975)	8,119,809	8,016,361
14 2038	4	2	563.43	0	352	15,803	(779,975)	8,267,341	8,164,339
15 2039	4	2	619.77	0	329	16,132	(779,975)	8,487,187	8,382,005
				<b>6,500</b>	<b>21,514</b>			<b>(3,899,877)</b>	

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## Stay Tuned

That's where Part One of this case study concludes, with the solutions for the first group designed and custom models built to determine the level of funding needed. Return for Part Two where we'll discuss the solution implemented for the second group and the funding approach taken for both.

*Disclaimer: No case study is used to imply future performance. Case studies are intended to illustrate services available through the adviser. They do not necessarily represent the experience of any clients. Hypothetical example(s) are for illustrative purposes only and are not intended to represent the past or future performance of any specific investment for actual clients.*



EBS is an independent executive benefits consulting firm which provides total plan management services with respect to programs specifically designed for key employees and professionals. Those services include:

- Consulting with respect to plan design,
- The structuring of related financing and benefit security arrangements,
- The design and management of the participant communication, education and enrollment processes,
- Management of any informal funding assets and,
- On-going plan administration and technical support.

More information about the firm can be found at: [www.executivebenefitsolutions.com](http://www.executivebenefitsolutions.com).

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