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The Time Has Come for ESPP!

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Webcast Materials

www.sos-team.com/PDFS/espp.pdf

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The Walrus and The Carpenter

"The time has come," the Walrus said,
"To talk of many things:
Of shoes--and ships--and sealing-wax--
Of cabbages--and kings--
And why the sea is boiling hot--
And whether pigs have wings."

– **Lewis Carroll**

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The ESPP and The Stock Plan Manager

"The time has come," the CC said,
"To talk of many things:
Of stock -and match –and shareholders--
Of good discounts -- and offering--
And why dispositions must be tracked--
And the joys of expensing."

– **SOS**

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Agenda

- The Case for ESPP
  - Statistics
  - Benefits for employees & company
- Plan Design, Administrative & Accounting Issues
- Steps to Implement
  - Research / Design
  - Board Approval
  - Vendor Selection
- Case Study – EMCOR Group

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Survey Details

- www.naspp.com | Member Area | Surveys | Stock Plan Design Surveys
  - NASPP/KPMG: 2004 Stock Plan Design and Administration Survey
  - NASPP / Deloitte Consulting: 2007 Domestic Stock Plan Design and Administration Survey
  - NASPP / Deloitte Tax LLP: 2008 International Stock Plan Design and Administration Survey

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Survey Details

- NCEO / CEPI 2009 Employee Stock Purchase Plan Survey
  - 412 companies responded
  - National Center for Employee Ownership
    - www.nceo.org
  - Certified Equity Professional Institute; at Santa Clara University
    - www.scu.edu/business/cepi/
  - Comprehensive survey results available by contacting the NCEO or CEPI

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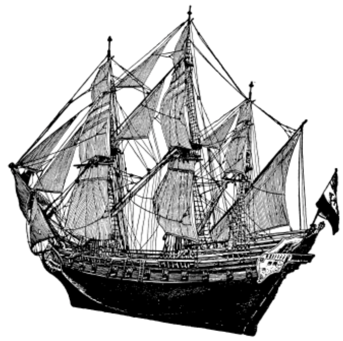

THE CASE FOR ESPP

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ESPP Facts…

- Studies show …
  - Companies with broad-based equity plans show better results than those with narrowly focused plans [1]
- Satisfaction
  - Majority of respondents believe that the ESPP is positive: 30% describe it as "net beneficial" and 35% call it "an excellent use of corporate resources."[2]

[1] Public Companies with Broad-Based Stock Options: Corporate Performance from 1992-1997, Blasi, Kroumova

[2] NCEO./ CEPI .2009 ESPP Survey

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ESPP Facts…

- Employee ownership tends to…
  - Improve company performance by aligning interests of workers and managers
  - Serving as collective incentive to improve teamwork and information sharing
  - 66% feel more invested in their jobs*
  - 50% say ESPP made them less likely to change jobs*
  - 65% say shows employer truly values employees*

*Data from “Bridging the Gap”, July 2008, Fidelity Stock Plan Services

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ESPP Facts…

- Projected that 17% of US employers offer a stock purchase plan
  - As opposed to
    - 16% stock option plans
    - 9% restricted stock
- Are employees satisfied?
  - “very satisfied” or “somewhat satisfied”
  - 76% with plan performance
  - 79% with plan design

*Data from “Bridging the Gap”, July 2008, Fidelity Stock Plan Services

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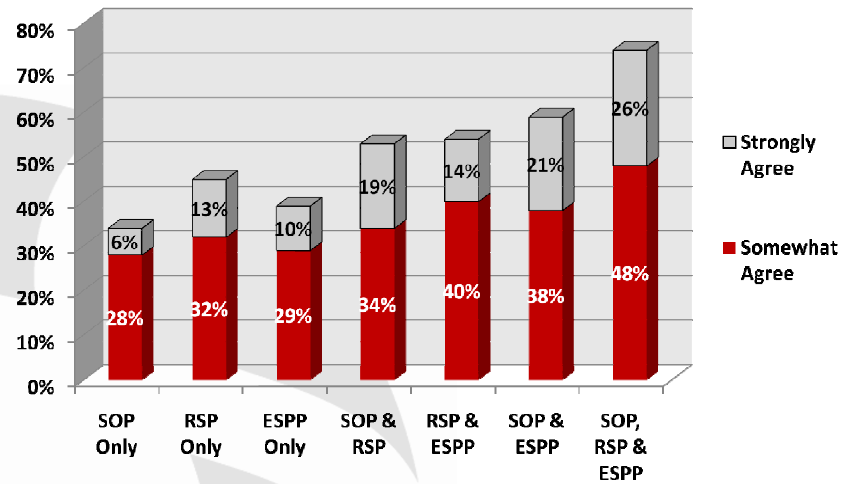
"How much do you agree or disagree that you are more loyal to your current employer as a result of the…plan your company has awarded you?"



*Data from "Bridging the Gap", July 2008, Fidelity Stock Plan Services

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ESPP Facts…

- ESPPs produce cash flow to the company
  - Employees contribute post-tax via payroll contributions to purchase stock
- ESPPs are never underwater
  - With discount / match / look-back, they are always a bargain - sometimes an incredible bargain!
- Company Tax Deductions
  - For qualified plans from disqualifying dispositions
  - Or for company match on non-qualified plans
- Encourages employees to save
  - Without "locking them in"

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ESPP Overview

- What is an employee stock purchase plan (ESPP)?
- An ESPP is a type of broad-based stock plan that allows employees to acquire shares of their company's stock by electively contributing after-tax payroll deductions.
- Often include:
  - Benefit of a discount on the purchase price or a matching contribution made by the employer

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Concerns: Expensing ESPP

- ESPP Expense is a non-cash expense
- Pre FAS 123(R) studies indicate expensing has little effect on stock price*
  - Study 1: companies voluntarily adopting: Stock price increased average 3.65% over six-day window around announcement
  - Study 2: companies voluntarily expensing, conclusion – does not impact stock price
  - Study 3: 140 companies, results not statistically significant…
- Post FAS 123(R) studies*:
  - 53% of sell-side analysts don't consider FAS 123(R) expense
  - Share prices for companies with significant expense underperformed the S&P 500 by about 2%
- Many feel plan's return outweighs effects of expensing

[1]NCEO Issue Brief: The State of Broad-Based Equity Plans, Corey Rosen, NCEO, 2008

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Concerns: Shareholders

- 2003 Hager Study;
  - 91 companies in Canada and 54 in the US were surveyed:
  - Institutional and individual shareholders: more likely to look favorably upon broad-based stock plans than plans that just reward a few employees.
  - Returns found to be higher by about 1.78% in the US & 2.13% in Canada when broad-based plans announced

[1]NCEO : Stock Option Grant Announcements and Shareholder Value

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Why Now?

- In difficult economic times,
  - ESPPs can be a great motivational tool
  - Build
    - Company morale
    - Employee loyalty
    - 'we're all in this together attitude'
- Right now, ESPP gives employees benefit of purchasing potentially undervalued company stock at a discount

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Why Now?

- No bonuses this year?
  - ESPPs provide companies a way to compensate their employees
  - Without having to raise salaries
- Is business slow?
  - ESPP raise capital / cash inflow
- Recent large sweeping changes?
  - Timely introduction of ESPP may help energize employees to contribute to new projects, initiatives, etc.

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PLAN DESIGN, ADMINISTRATIVE & ACCOUNTING ISSUES

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Plan Design: Qualified? Or Non?

	Pros	Cons
Qualified	• Higher participation levels by approx. 10%[1] • Opportunity for favorable tax treatment at purchase	• Tracking dispositions (for all time) • Regulatory requirements (6039, W-2 reporting, etc.) • Must be non-discriminatory
Non-Qualified	• More flexibility in design/participation • Fewer regulatory requirements • Simplified accounting treatment • Easier to explain to employees	• No opportunity for favorable tax treatment at purchase • Some may expect qualified, depending on industry/ prior experience • Shareholder perception may be an issue?

[1]2007 NASPP./ Deloitte Survey .

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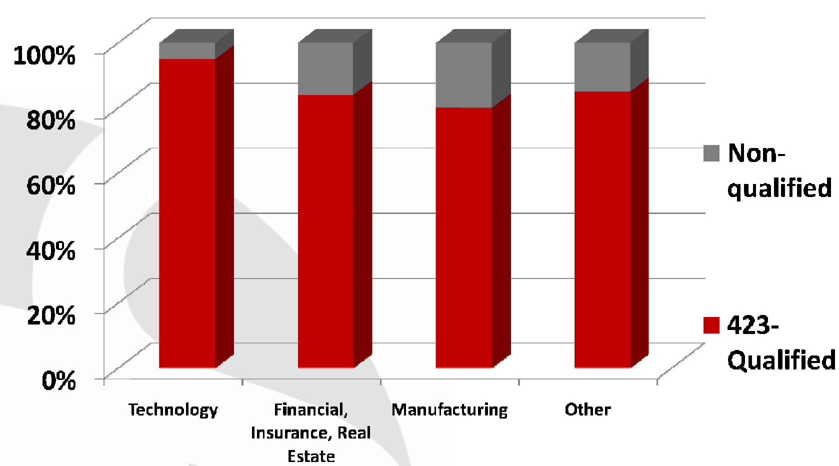
Qualified or Non-qualified?



*Data from NCEO/CEPI 2009 ESPP Survey.

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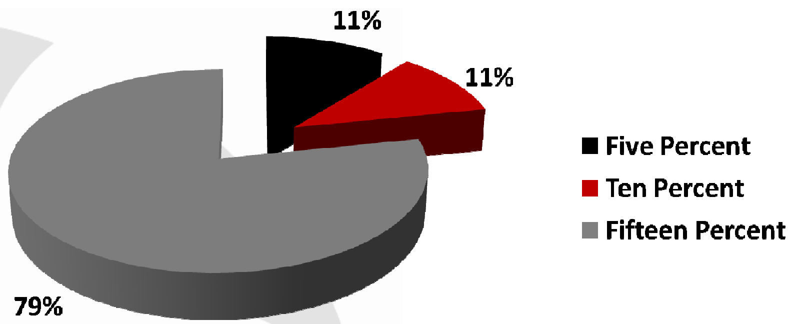
Plan Design: Discount?

Percent of Companies Offering Discount (n=28)



*Data from 2008 NASPP./ Deloitte Tax International Stock Plan Survey.

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Plan Design: To Lookback or Not?

	Pros	Cons
Look-back	• Better benefit to employees • Better participation?	• Requires expensing • Increases expense • Fewer employees understand/value • Reduces cash inflow
No Look-back	• Reduces expense • Can be considered non-compensatory (no expensing) if discount < 5%	• Lower participation? • Opportunity for employee gain less

[1]2007 NASPP./ Deloitte Survey .

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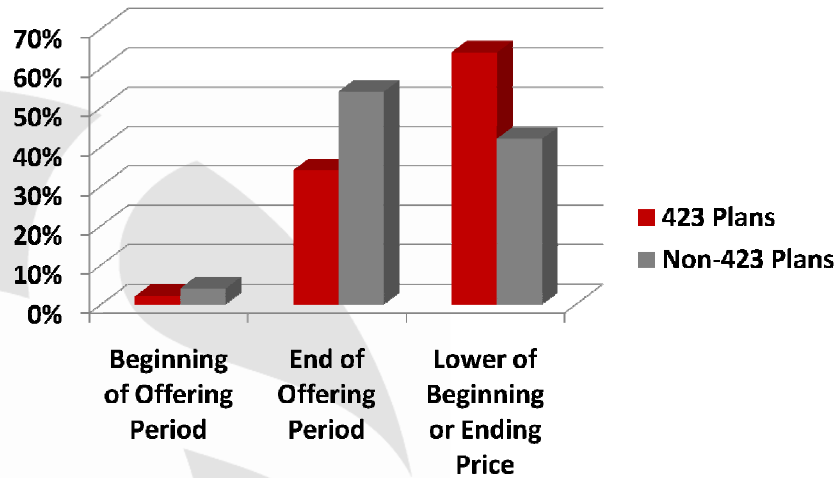
Lookback: When is purchase price determined?



*Data from NCEO/CEPI 2009 ESPP Survey.

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Plan Design: Length of Offering

- Three months to… 27 months…
- No reason for longer offering if no lookback offered
- Shorter offerings: Employees become shareholders faster and see benefit faster
- Employees less worried about share plans because more variance in purchase price with more frequent purchases

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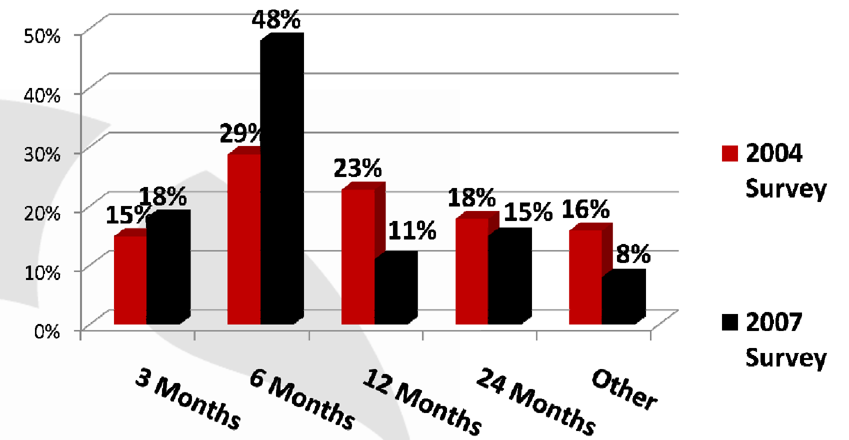
Length of Offering Period: Trends



*Data from 2004 & 2007 NASPP./ Deloitte Surveys .

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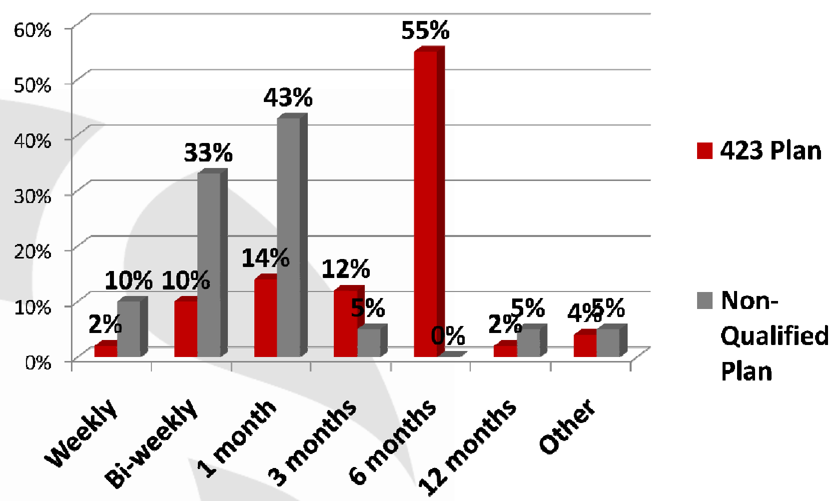
Frequency of Purchase



*Data from 2008 NASPP./ Deloitte Tax International Stock Plan Survey.

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Accounting for 423-ESPP: Overview

- FAS 123(R)
  - If "option-like" features OR > 5% discount = compensatory
    - Grant-date Fair Value – basically Black-Scholes but…
    - Three components:
      - Discount,
      - Call,
      - Put
    - Created using Enrollment Date market value
    - No "expected" term – term is known
  - Non-compensatory – no fair value, no expense

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ESPP Fair Value Components

Plan Feature	Description	Fair Value Component
Discount	% of discount	Discount
Lookback	Ability to purchase at LOWER market value between beginning of offering period market value & purchase date market value. Ability to benefit from increase in stock price.	Call Black-Scholes Option
No beginning price limit	Ability to purchase MORE shares if price declines (number of shares to be purchased not limited by Ability to benefit from decrease in stock price.	Put Black-Scholes Option

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Plan Design: Participation

- Qualified Plans:
  - To ensure plan is non-compensatory,
    - Exclude 5% owners, but include virtually all of your remaining employees with the exception of:
      - Part time employees (less than 20 hours per week)
      - Employees who have been employed less than 2 years
      - Employees who work less than 5 months each year
      - Highly-compensated employees
      - Employees of foreign subsidiaries
  - Groups can be excluded, however many companies try to include all full-time employees even if they have been employed less than 2 years
- Non-qualified – Can include/exclude as design decision

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Plan Design: Shareholder Approval

- 423-Qualified Plans
  - Required for 423-qualified plans
  - Required within 12 months, before or after the plan approved by the Board
  - Approval is only required once except for an increase in the number of shares
- Non-qualified Plans
  - Required by NYSE / NASDAQ – Changed in 2003
  - Even if "arguably" de minimis potential for insider compensation OR material dilution for shareholders

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Plan Design: Enrollment Period

- Choices
  - Window
    - Open window during which employees may enroll in new offering period and make changes to elections.
    - Enrollment choices made for one period roll into next period unless employee elects to make a change
    - Outside of window, employees only allowed to withdraw
- Providing employees with the most flexibility will result in higher overall participation
  - No one wants to be locked in for long periods of time
  - But more administrative burden
  - Depending on changes allowed – may increase expense

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Contribution Limit

- Qualified plans
  - $25K contribution limit
  - Based on the value of shares purchased in the calendar year based on the FMV at the beginning of the offering period
- Companies also limit
  - Number of shares to manage dilution share reserve
  - Share limits not required
  - Add complexity to plan administration and employee communication process
  - May be best practice – can control burn rate
  - May be required for qualified plans under proposed 423 regulations

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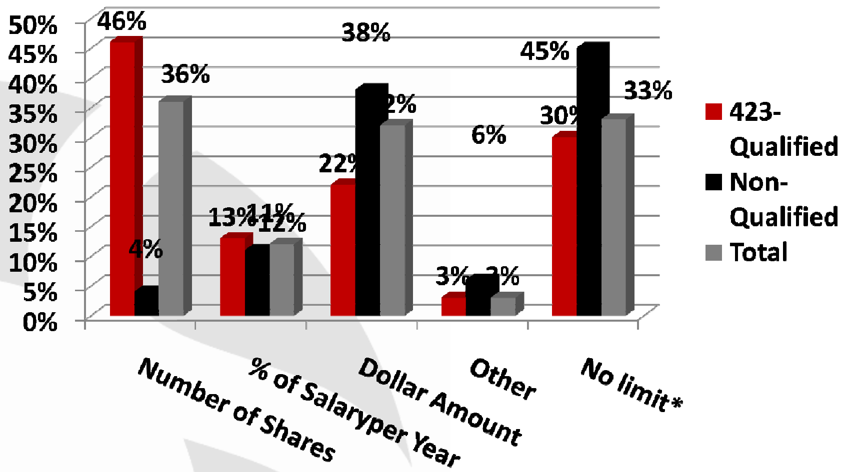
Types of Limits



*Data from NASPP / Deloitte 2007 Survey.

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Plan Design: Contribution Type

- Percent or $ Amount?
  - Dollar amount easier to understand ?
  - Employees know exactly how much will be deducted from their pay each period.
  - Percentages or a combination of both require the employee to calculate the amount of the deduction and can be cumbersome.

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Impact of Changing Discount / Look-back

- ESPPs administered by Fidelity that reduced their discount rate from 15% to 5%
  - Average participation rates dropped 50%[1]
- Other Changes:
  - Lowering discount to 10%
  - Removing lookback, or
  - shortening the offering period
  - had "no substantial impact" on plan participation[2]

[1] Fidelity StockSense Spring 2007 Newsletter

[2] NASPP Stock Plan Advisor, September-October 2007

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Automatic Resets

- If price drops during offering period, after next purchase
  - Price is reset or
  - Participant is automatically re-enrolled at new, lower price
- Excellent benefit to participants, but…
  - Triggers modification accounting
  - Few systems can support
  - Manual workarounds/spreadsheets often required

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Plan Design: Share Funding

- Treasury/Reserve (authorized/unissued) is most common
- Open market purchase
  - May have an impact on your stock price based on the number of shares required for purchase / trading volume

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Plan Design: Restrictions

- Often done to ease tracking dispositions for 423-plans
  - Any restriction on transfer/sale
  - Direct impact on the level of participation
  - Vendors can assist with disposition tracking to avoid any restrictions on sales or transfers
- Also used to encourage ownership
  - Instead of flipping shares immediately after purchase for quick gain

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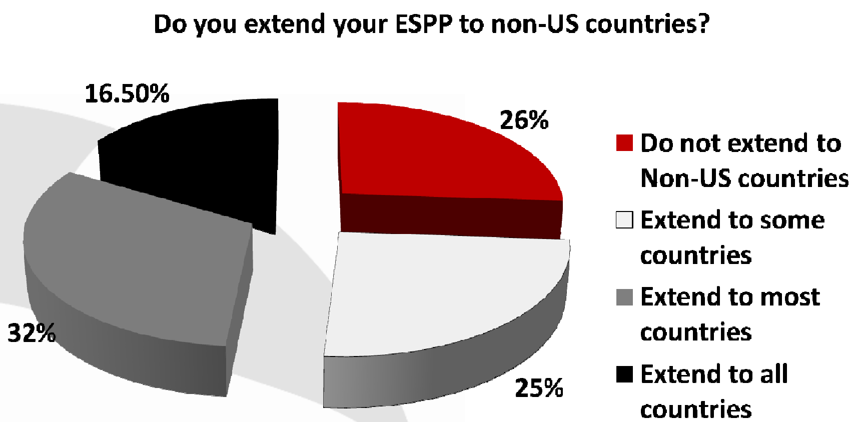
International Plans



*Data from NCEO/CEPI 2009 ESPP Survey.

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Ways to Reduce Expense

- Fair Value
  - Shorten offering period
  - Eliminate lookback
  - Reduce discount
  - Eliminate automatic reset
  - Limit employee ability to change contributions
- Administrative
  - Leverage your provider – disposition tracking, communication, etc.

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	Characteristics	Tax Benefit	Provides Discount	Used in Performance Incentive Program	No Shareholder Approval Required
Qualified					
Section 423-Qualified Plans	Stock offered to all employees, often at discount, using treasury or authorized / unissued shares.	☒	☒	☒	
Non-qualified					
Contributory Plans	Company contributes specified $ amount and/or non-qualified $ toward employee stock purchased on open market.		☒	☒	
Discount / Match Plans	Stock offered to employees at a discounted price or can contribute % or all in a match.		☒	☒	☒[1]
Open Market Plans	Shares purchased on open market with payroll deductions. No discount or company contribution.				☒

[1] Required by NYSE / NASDAQ for many plans.
Grid adapted from Computershare ESPP materials.

IMPLEMENTING ESPP

Steps for Implementing

- Determine Plan Design
  - Type of plan (qualified/non-qualified)
  - Amount of discount or match
  - Offering and purchase frequency
  - Amount of shares required & type (treasury, open market, authorized/unissued)
- Present to Board of Directors
- Seek shareholder approval
- Select a provider for administration and communication

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Presenting to Board and Shareholders

- Highlight benefits of offering an ESPP
  - For employee AND
  - Company
- Provide high-level estimate of cost of implementing an ESPP (can vary based on the amount of discount/match)
  - Number of expected participants
  - Amount of discount/match
  - Administrative costs
- Engage an expert to gauge likelihood of shareholder approval

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Selecting a Provider

- Industry experience
- Partnership approach
- User-friendly systems and reports
- Communication expertise
- Fees

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Implementation Overview

- Prepare implementation project plan with timeline and milestones
- Discovery process and procedural requirements
- Database and administrative platform setup
- Establish system interfaces with payroll and HRIS systems/employee and plan sponsor website/IVR
- Prepare communications strategy

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CASE STUDY: ESPP AT EMCOR GROUP, INC.

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EMCOR Group, Inc.

- Fortune 500 Company with over 25,000 employees
- A leading provider of critical infrastructure systems
- EMCOR builds, powers, services and protects for maximum performance
- Markets include energy, transportation, health care, water, government, education, technology, hospitality

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EMCOR's ESPP

- Background
  - EMCOR has annual management conference each fall
  - Employees submit questions for a company-wide webcast
  - In Fall of 2006, commitment was made to employees to explore offering an ESPP

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Process -- 2007

- Explored alternatives, design issues, cost and administration methods
- First: Winter 2007
  - Established purpose of ESPP
  - Fleshed out design alternatives and associated requirements (i.e., qualified/non qualified, FAS 123R, tax considerations) for presentation to executive management committee (EMC)

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Process -- 2007

- Next: Spring – Fall 2007
  - 3 discussions with EMC
    - First meeting to provide full scope of alternatives and sense general direction
    - Second discussion to narrow down alternatives and follow up on questions
    - Third discussion to solidify decisions
      - Numerous scenarios were presented to model various levels of company match/discount, participation and stock price assumptions
  - Initial proposal presented to BOD by CEO to gain approval to proceed

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Process -- 2008

- Winter 2008
  - Vetted final design with stock plan consultant
  - Determined number of shares to reserve
  - General Counsel determined type of shares to reserve for Plan (authorized/unissued shares)
  - Final proposal approved by Board of Directors

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EMCOR's ESPP Design

- Nonqualified ESPP
  - offer only to non-union employees (around 8,000)
  - Offer a flexible design
- Quarterly offering periods; monthly purchases
- Employees contribute 1 – 6% of pay
- 10% company match
- No holding periods required
- Purchase whole and fractional shares

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Implementation Process -- 2008

- Searched for consultant to partner with on vendor search
- Selected consultant and commenced search in April
- Consultant had robust, diligent selection process
- Obtained shareholder approval in June
- Selected Vendor in June

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Implementation Process -- 2008

- Held first kick-off meeting with Consultant and Vendor teams in July 2008
- Held weekly team meetings with EMCOR, Consultant and Vendor
  - Vendor prepared enrollment guide to supplement plan document & prospectus (from Legal)
- Successfully implemented ESPP on time for October 1, 2008 quarterly enrollment
- Held subsequent weekly meetings with Vendor and Consultant until November

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Enrollment Statistics

- 4 quarterly enrollment periods
  - October 2008: 500 participants (6.2%)
  - January 2009: 600 participants (7.7%)
  - April 2009: 675 participants (8.1%)
  - July 2009: 700 participants (8.5%)
  - Average contribution 3.5%
- Introduced in tough economy
- Expect participation to grow over time

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APPENDIX

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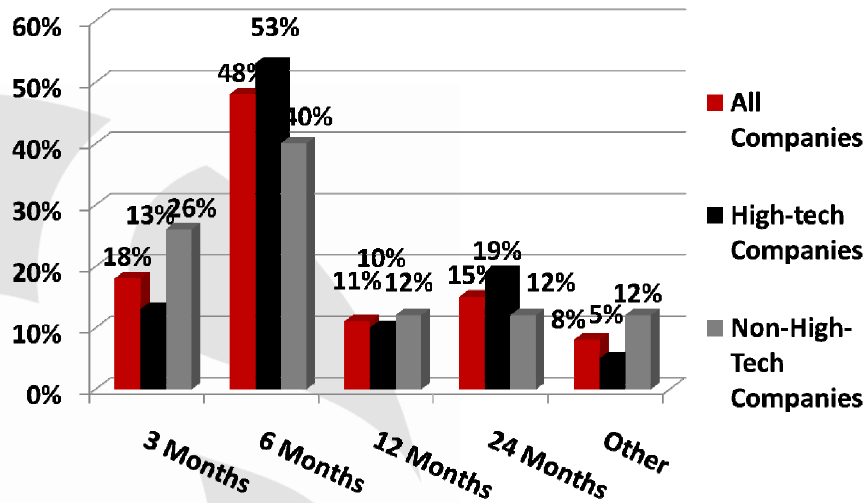
Length of Offering Period: 423 Plans



*Data from 2008 NASPP./ Deloitte Tax International Stock Plan Survey.

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Ways to Reduce Expense

Method	Impact	Why?
Shorter Offering Period	Reduces Fair Value	Shorter "expected term" = lower valuation
Reduce / Eliminate Lookback	Eliminates / reduces "call" part of fair value	• No benefit from increase in stock price • Participants MAY not value lookback as much as discount.[1]
Eliminate auto-reset	Eliminates modification accounting	No changes to "grant" after enrollment – no incremental expense or additional expense for additional shares
Limit Ability to Change Contributions	Eliminates modification accounting	No changes to "grant" after enrollment – no incremental expense or additional expense for additional shares No "wasted" expense
Limit Transfers	More tax deductions	Capture ALL the tax deduction to which company is entitled Reduce survey costs

[1] Fidelity StockSense Spring 2007 Newsletter 62

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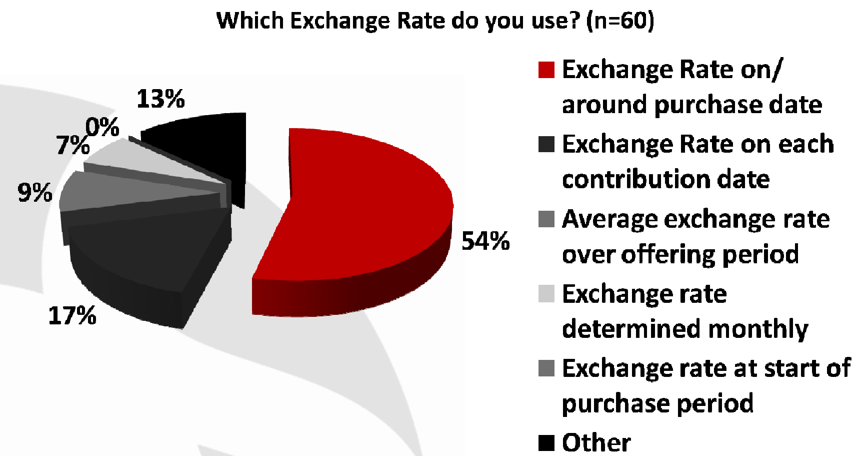
Which Exchange Rate?



*Data from 2008 NASPP./ Deloitte Tax International Stock Plan Survey.

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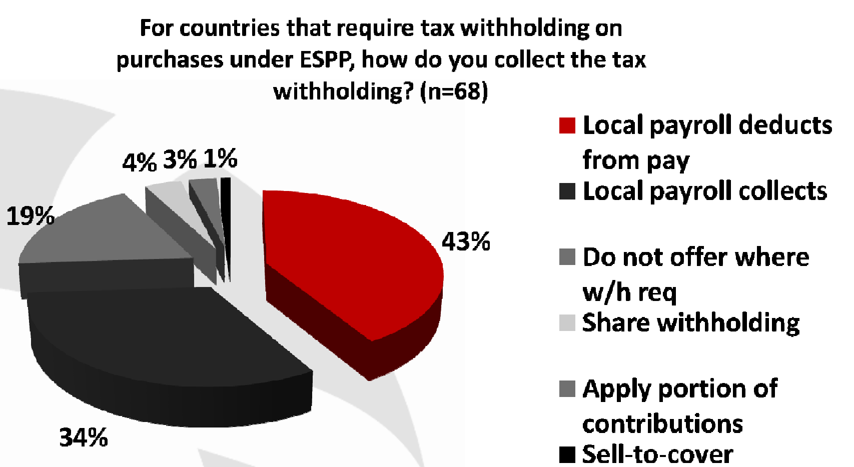
How withholding is done?



*Data from 2008 NASPP./ Deloitte Tax International Stock Plan Survey.

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