Management equity participation (MEP) | Case study Sino

December, 2014

MPT Management Partner Transaction

MEP | Case description (1/2)

- You are a second level manager of the company Sino that is about to be sold the third time to a private equity ("PE") investor. You are currently invested via a Management Equity Program ("MEP"). Selected managers currently hold together approximately 29% of the shares ("MEP current").
- An MEP allows certain managers to invest alongside the PE investor into the various equity instruments of the company. Managers usually invest disproportionately into the shares. In case of an exit and the fulfilment of a minimum deal multiple, this leads to an excess return to management vis-a-vis the PE investor.
- For the next PE sponsor "Zeros" it is important that those managers who are currently invested in the equity of the company and who are involved in the sales process are not only seller but also buyers. Therefore they expect those managers to re-invest 50% of their proceeds from the disposal into the equity instruments of new Acquisition Company from Zeros. Besides those managers Zeros also wants to incentivise those managers who are important for the value generation of the subsequent years.
- The selected group of managers, in total 5, is expected to invest €1,6m. For you this means an investment of €300k, which is approximately 50% of your after tax return from the current investment. Managers who already joined the first buy-out invested between one and two times their annual total cash compensation.
- Zeros is planning to exit after 4 years and to achieve 2,5x its investment or an IRR of 25%.

MEP | Case description (2/2)

- In the current portfolio phase top management changed. The previous CEO, who invested a substantial amount of money under the current management equity program, has retired but is still holding on to his MEP shares. He will not be part of the MEP with Zeros.
- The value generation of the current investment is primarily driven by the role out of the product “FP 207”. Going forward the key growth driver is expected from sales expansion in the Asian / Pacific market. 12 months ago a new manager “Sunwoo” was hired, who is not part of the existing MEP.
- No specific investment terms have been communicated yet, but from your current investment you already know, that an MEP investment goes along with specific rules and regulations regarding for example a potential cessation of employment, requirements to support exit processes etc.
- You are positive about the business outlook and the business plan that was presented by the management team and the CFO has no concerns about the suggest debt financing.
- Zeros has put the following proposal on the table (see following pages).
- In comparison thereto the current MEP proposal at the time of investment 4 years ago.

MEP | Questions & definitions

<u>Questions</u>

- How would you assess the MEP proposal from Zeros?
- What would you like to negotiate with Zeros?
- Do you know any comparable incentive situation? How is the incentive structure set up in these situations?

<u>Definitions</u>

- MEP = Management Equity Program
- PE = Private equity investor
- MoM = Multiple of Money; Cash return / cash invested; e.g. an investment of €1 resulting in cash return of €6 has a MoM of 6,0x (6 /1).
- Entry Envy = average price per 1 % share for PE / average price per 1 % share for management
- Exit Envy = Management MoM / PE MoM
- PIK = pay in kind; e.g. Interest paid at repayment of loan

MEP | Investment proposal Zeros (in €m)

Entry assumptions	
Year	31.12.04
Enterprise value	171,97
EBITDA	21,50
EV multiple	8,00x
Costs	8,60

Financing assumptions		
Debt		128,21
Equity		52,37
Shareholder loan	87,0%	45,56
Shares	13,0%	6,81
SHL interes (PIK)		10%

Exit assumptions	
Year	31.12.08
Enterprise value	224,35
EBITDA	32,05
EV multiple	7,00x
Costs	5,61

	Entry data		Exit data	
Total sources		180,57		218,74
Debt		128,21		84,62
Shareholder loan		45,56		66,72
thereof management		0,63		0,92
thereof pe		44,93		65,80
Shares		6,81		67,40
thereof management	13,8%	0,94		9,33
thereof pe	86,2%	5,86		58,07
Total equity		52,37		134,12
thereof management	3,0%	1,57	7,6%	10,25
thereof pe	97,0%	50,79	92,4%	123,87
Price for 1% shares		0,524	Deal MoM	2,56x
for management		0,113	Mgt MoM	6,53x
for pe		0,590	PE MoM	2,44x
Envy		5,20x	Envy	2,68x

EBITDA exit sensitivity	28,84	32,05	35,25
	-10%		10%
Management equity at exit	7,15	10,25	13,36
Management MoM	4,55x	6,53x	8,50x

MEP | I Investment proposal current PE investor (in €m)

Entry assumptions	
Year	31.12.00
Enterprise value	117,46
EBITDA	14,68
EV multiple	8,00x
Costs	5,87

Financing assumptions		
Debt		87,50
Equity		35,83
Shareholder loan	51,6%	18,50
Shares	48,4%	17,33
SHL interes (PIK)		10%

Exit assumptions	
Year	31.12.04
Enterprise value	207,84
EBITDA	24,45
EV multiple	8,50x
Costs	5,20

	Entry data		Exit data	
Total sources		123,33		202,65
Debt		87,50		57,75
Shareholder loan		18,50		27,09
thereof management		0,00		0,00
thereof pe		18,50		27,09
Shares		17,33		117,80
thereof management	28,8%	5,00		33,98
thereof pe	71,2%	12,33		83,82
Total equity		35,83		144,90
thereof management	14,0%	5,00	23,5%	33,98
thereof pe	86,0%	30,83	76,5%	110,91
Price for 1% shares		0,36	Deal MoM	4,04x
for management		0,17	Mgt MoM	6,80x
for pe		0,43	PE MoM	3,60x
Envy		2,50x	Envy	1,89x

EBITDA exit sensitivity	22,01	24,45	26,90
	-10%		10%
Management equity at exit	27,99	33,98	39,98
Management MoM	5,60x	6,80x	8,00x

MPT | CVs

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Literature:

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