

Management Equity Program (MEP) | Case study Sino

Comparison of MEPs and management perspectives





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 a disproportionate amount into the shares. If the company is sold at a certain threshold, this leads to an excess return to management vis-a-vis the PE investor.
- For the incoming PE sponsor “Zeros” it is important that certain managers, who are currently invested in the equity of the company and who are involved in the sales process, are not only sellers but also buyers. Therefore, they expect those managers to re-invest 50% of their net proceeds from the disposal into the equity instruments of the new acquisition vehicle from Zeros. Besides those managers Zeros also wants to incentivise those managers who are important for the value generation of the subsequent years but who might not have joined the prior MEP.
- 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 proceeds from the current investment. Managers who already joined the first buy-out invested initially between one and two times their annual total cash compensation.
- Zeros aims to divest after 4 years at a 2,5x MoM in 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. 6 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

Questions

- 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?

Definitions

- 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		Financing assumptions			Exit assumptions	
Year	31.12.04	Debt		128,21	Year	31.12.08
Enterprise value	171,97	Equity		52,37	Enterprise value	224,35
EBITDA	21,50	Shareholder loan	87,0%	45,56	EBITDA	32,05
EV multiple	8,00x	Shares	13,0%	6,81	EV multiple	7,00x
Costs	8,60	SHL interes (PIK)		10%	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		Financing assumptions			Exit assumptions	
Year	31.12.00	Debt		87,50	Year	31.12.04
Enterprise value	117,46	Equity		35,83	Enterprise value	207,84
EBITDA	14,68	Shareholder loan	51,6%	18,50	EBITDA	24,45
EV multiple	8,00x	Shares	48,4%	17,33	EV multiple	8,50x
Costs	5,87	SHL interes (PIK)		10%	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

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