Growing and Protecting Wealth in ESOP Companies

July 2017

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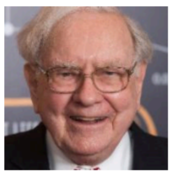
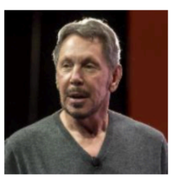
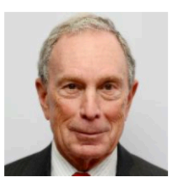
Prudent Use of Stock Concentration
- Harness the Unlimited Upside Potential
- Mitigate the Substantial Downside Risk

Benefits to ESOPs
- Reap the Benefits of Employee Ownership
- Reduce or Eliminate the Drawbacks (e.g. Catastrophic Risk)
  - Lawsuits
  - DOL Investigations
  - Corporate and Personal Liability
  - Negative Media Coverage
  - Attacks on Tax Benefits Encouraging ESOP Formation

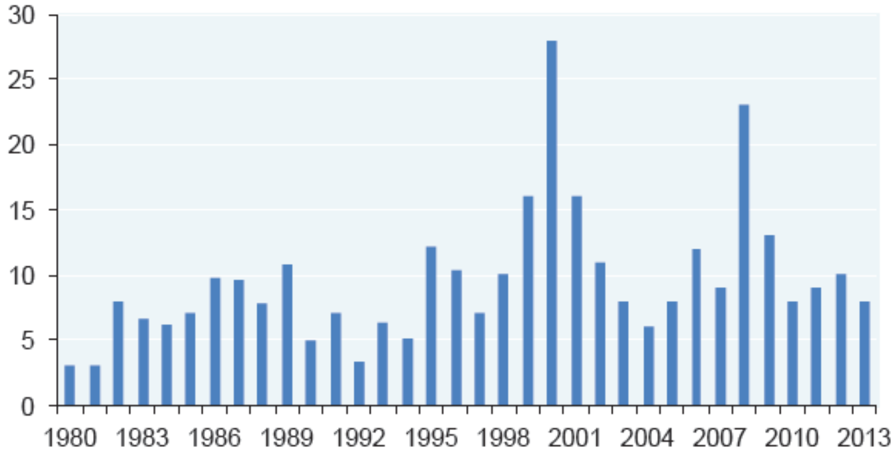
Wealth Created by Stock Concentration

	#1	Bill Gates	$81 B	61	Medina, WA	Microsoft
	#2	Jeff Bezos	$67 B	53	Seattle, WA	Amazon.com
	#3	Warren Buffett	$65.5 B	86	Omaha, NE	Berkshire Hathaway
	#4	Mark Zuckerberg	$55.5 B	33	Palo Alto, CA	Facebook
	#5	Larry Ellison	$49.3 B	72	Woodside, CA	Oracle
	#6	Michael Bloomberg	$45 B	75	New York, NY	Bloomberg LP

Source: *Forbes 400*

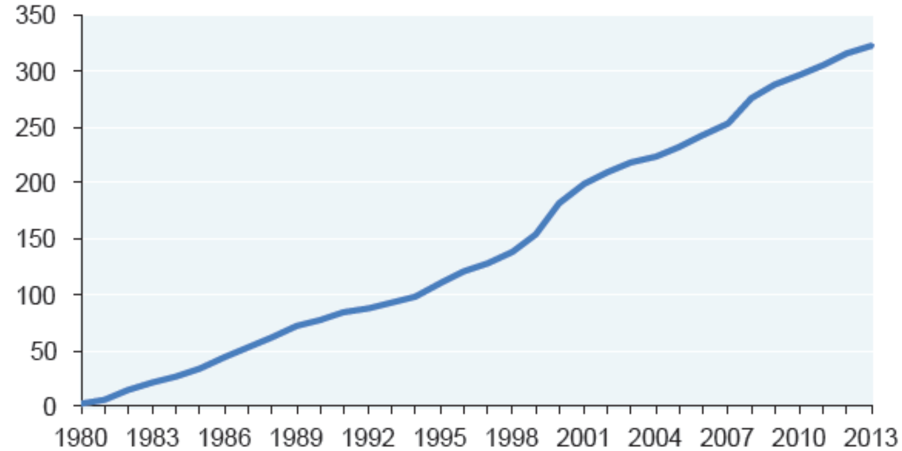
Wealth Destroyed by Stock Concentration

Number of companies removed from the S&P 500 due to distress by year, Number of companies



Source: FactSet, Bloomberg, Standard & Poor's, JPMAM. 2013.

Cumulative number of companies removed from the S&P 500 due to distress, Number of companies



Source: FactSet, Bloomberg, Standard & Poor's, JPMAM. 2013.

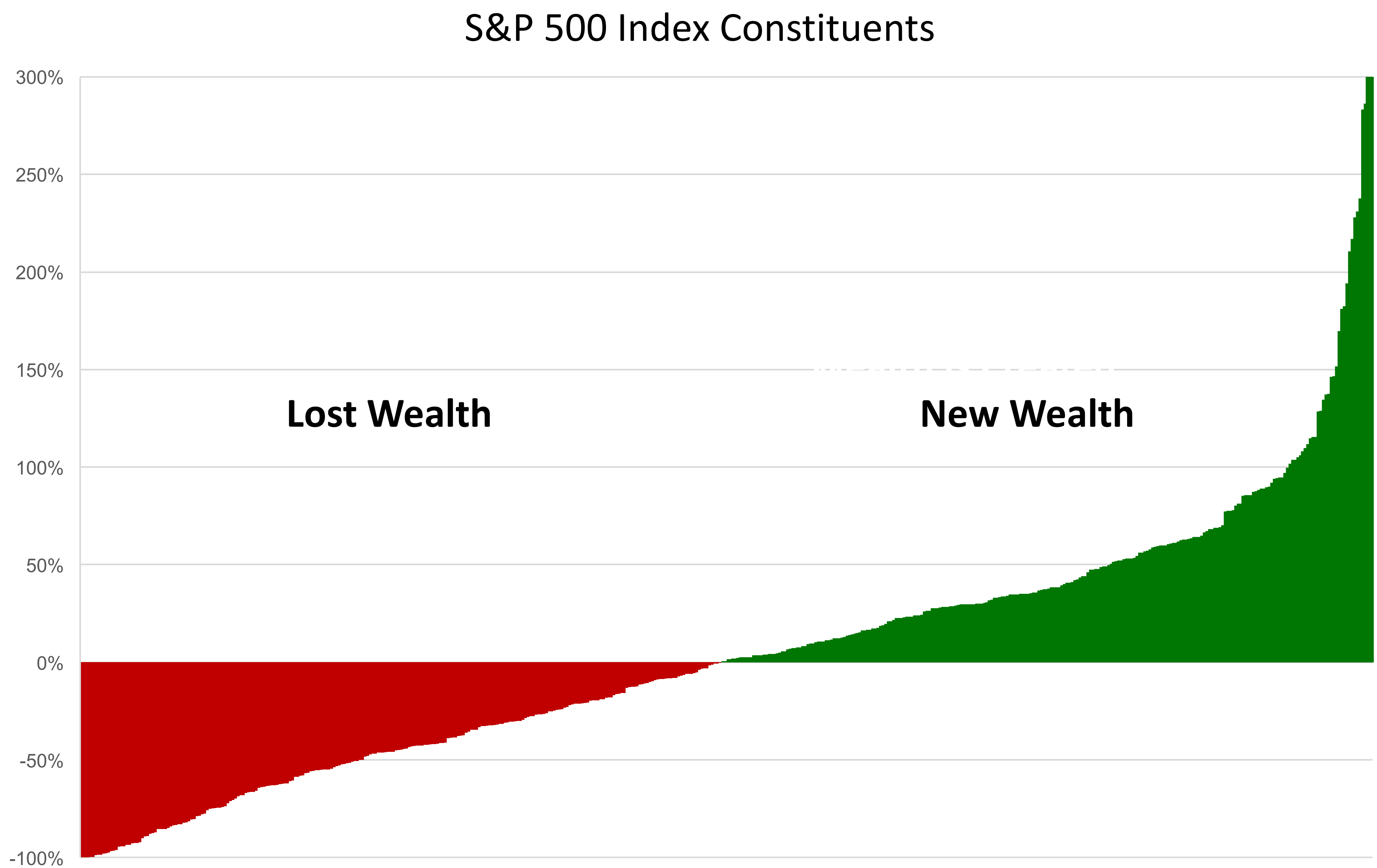
Sector	Total % of companies experiencing "catastrophic loss", 1980 - 2014
All sectors	40%
Consumer Discretionary	43%
Consumer Staples	26%
Energy	47%
Materials	34%
Industrials	35%
Health Care	42%
Financials	25%
Information Technology	57%
Telecommunication Services	51%
Utilities	13%

Source: FactSet, J.P. Morgan Asset Management.

"No matter how well you know your industry and your company, no one is impervious to event risk and industry changes. The factors outside management control…are a formidable list, and have grown in complexity since we first drafted this report 10 years ago. *This is perhaps the most important epiphany we gained from the study: that exogenous forces may overwhelm the things we can control."*

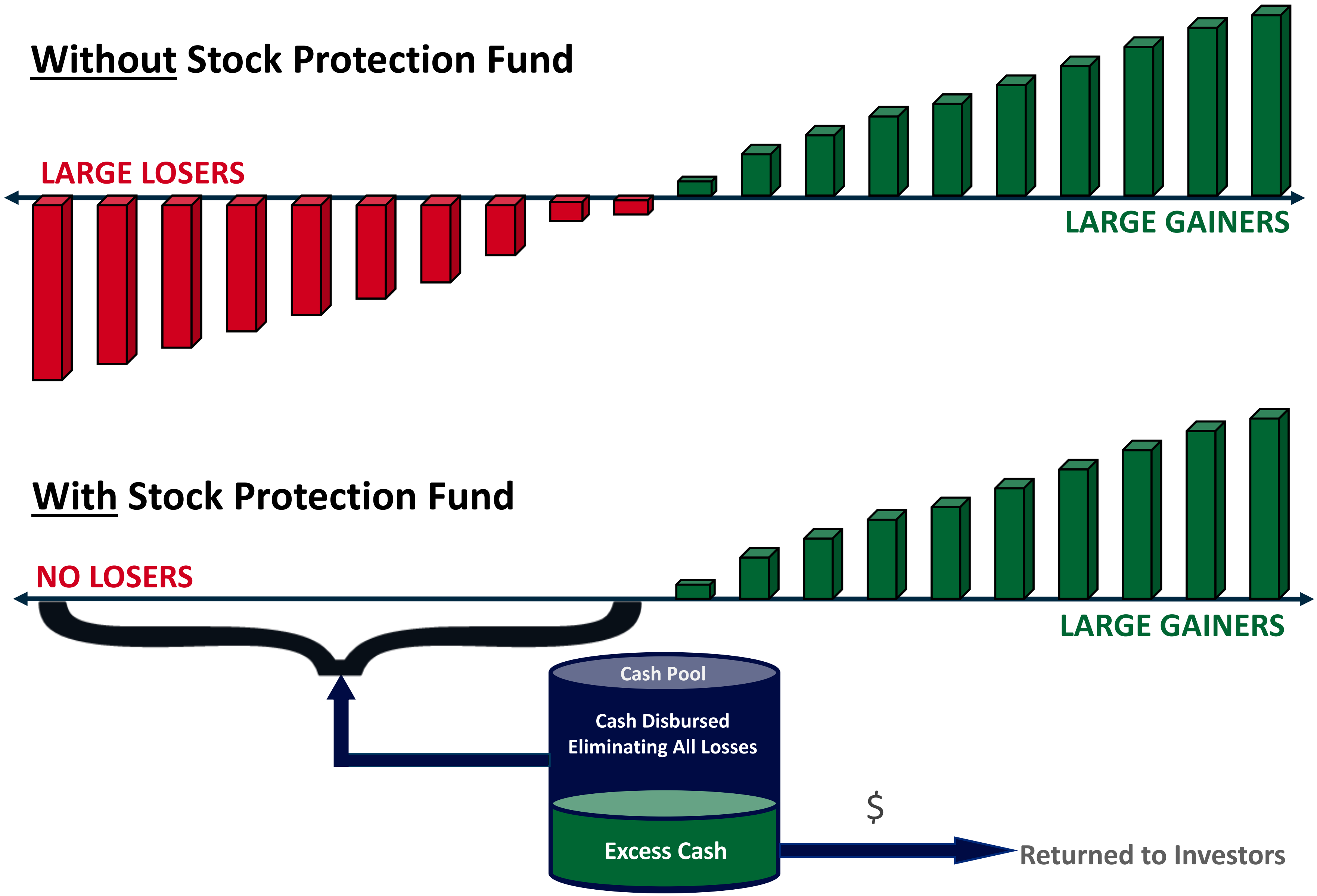
Source: *The Agony & The Ecstasy: The Risks and Rewards of a Concentrated Stock Position*, by Michael Cembalest, J.P. Morgan Asset Management

Dispersion of 500 Stocks (12/31/03 - 12/31/08)

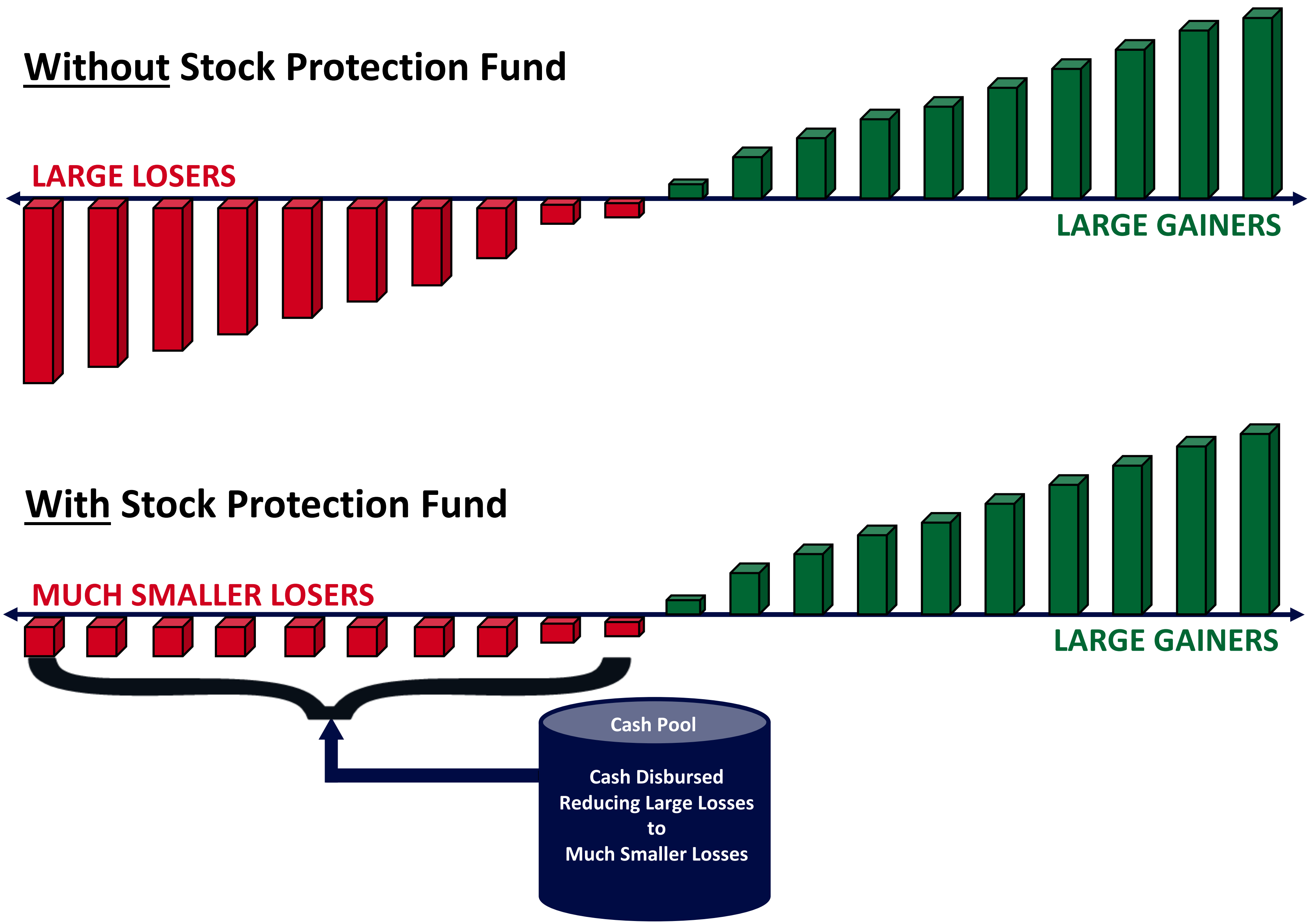


Source: Standard & Poor's

Unpredictable Dispersion Necessitates Risk Management



If Stock Losses Exceed Cash Pool



Proposal for ESOPs

Take Catastrophic Risk "Off the Table" for Your Employees

- Mitigate risk for participants without repurchasing shares
- Protect wealth your participants cannot afford to lose
- Reinforce ESOP culture of caring for employees' security

- Reduce litigation risk – and gain an "affirmative defense" establishing prudence and loyalty to participants
- Reduce corporate and personal liability exposure

Nils Bohlin
Inventor of the Seatbelt (1959)

Proposal for ESOPs

- Ten (10) strong and healthy ESOPs, each owning at least $25mm of stock, contribute $250,000 per year for 5 years into the ESOP Protection Trust (10 X $1.25mm = $12.5mm)
- For 5 years, the cash is invested in 5-year U.S. Treasury Notes
- At the end of the 5-year period, the assets pooled in the Trust are paid according to the number of ESOPs suffering large losses (defined as losing > 50% of enterprise value)

Payout Criteria (Annual Cost Between 0 and 1%)

Zero Large Losses

- Each ESOP receives their money back: $1.25mm
- Annual Cost of 5 Years of Protection: $0 (0.00% per annum)

One Large Loss

- The cash pool (up to $12.5mm) is used to limit the loss to 50%
- Each of the other 9 ESOPs share pro-rata in any remaining cash
- Annual Cost of 5 Years of Protection: no more than $250,000 (1% per annum) for each ESOP

Two Large Losses

- The cash pool is used to limit losses as much as possible (target limit of 50%)
- Each of the other 8 ESOPs share pro-rata in any remaining cash
- Annual Cost of 5 Years of Protection: no more than $250,000 (1% per annum) for each ESOP

Three Large Losses

- The cash pool is used to limit losses as much as possible (target limit of 50%)
- Each of the other 7 ESOPs share pro-rata in any remaining cash
- Annual Cost of 5 Years of Protection: no more than $250,000 (1% per annum) for each ESOP

Eligibility Criteria

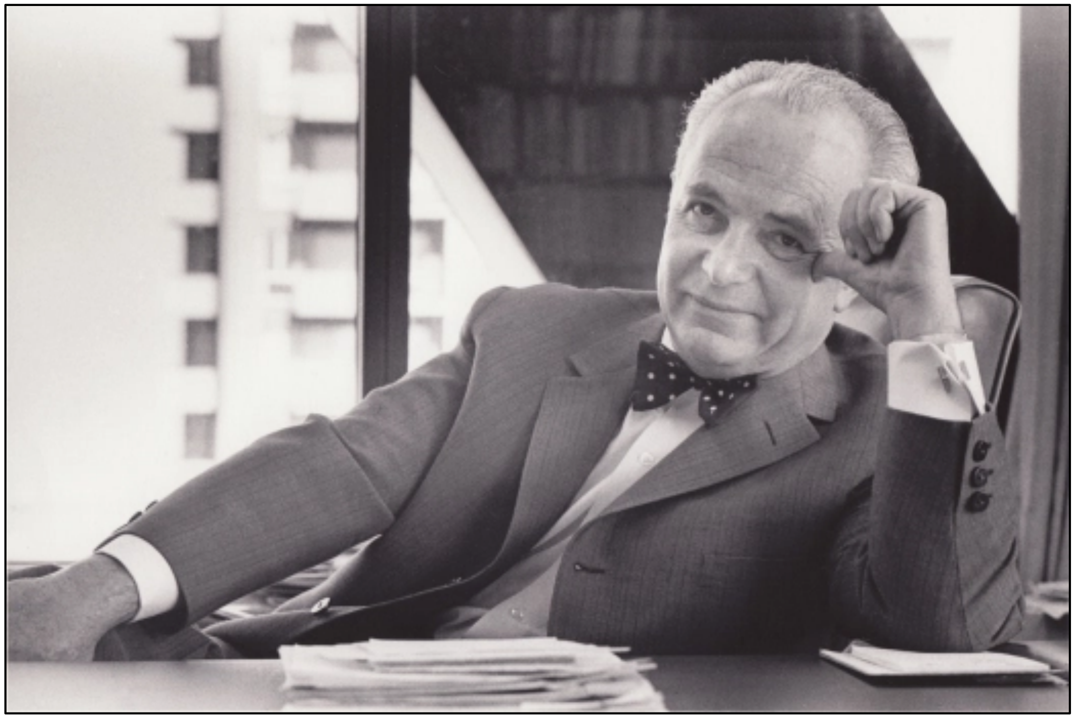
Eligibility Criteria

- ESOP established more than 10 years ago
- 5-year cumulative growth in enterprise value exceeding 30%
- ASA or CFA member valuation firm
- More than 50% employee-owned

Fees & Expenses

- A one-time placement fee equal to 1% of protected ESOP value is charged upon closing (= $25K for each of 5 years)
- Administrative services are covered by the yield on the U.S. Treasury Notes

The Wisdom of Louis Kelso



Louis Kelso
Inventor of the ESOP (1956)

"Where a household is primarily dependent for support upon its ownership of capital, the primary risk to be guarded against is simply the business risk inherent in a competitive and technologically evolving economy. In large measure this risk can be minimized through investment diversification, but beyond this **it should be possible to devise casualty insurance designed to protect the family income against a coincidence of business failures that would materially impair the support derived from capital holdings**" (emphasis added, Page 244 of *The Capitalist Manifesto*)