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Stock Splits: Easy Peasy… Not So Fast

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Materials Slides

http://www.sos-team.com/pdfs/stock_splits.pdf

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Agenda

- What is a stock split?
- Complications for equity plans
- Planning/Prepare
- What's really involved
- Tips

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What Is a Stock Split?

- A **stock split** is a decision by the company's board of directors to increase the number of shares that are outstanding by issuing more shares to current shareholders.
- For example, in a 2-for-1 stock split, every shareholder with one stock is given an additional share. A reverse stock split can also take place reducing the number of shares. For example, in a 1-for-10 reverse stock split, every shareholder with 10 shares of stock has their holdings reduced to 1 share.
- Stock splits are generally also applied to all outstanding equity instruments as well as available share pools.

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COMPLICATIONS FOR EQUITY PLANS

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What Makes a Stock Split So Complicated?

- A management decision that rarely involves the equity plan administration team
  - Ratio of 4:1 vs. 4:2; 1:10 vs. 1:30 can have a very different outcomes
- Timing – never enough warning
  - Shareholders are warned but the exact date not determined until weeks or even days prior
- Historical ugliness
  - Prior stock splits with "orphaned" shares
  - Complicated vesting schedules
  - Acquired plans
  - System conversions where small issues were left unresolved (negative exercisable with zero outstanding)

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What Makes a Stock Split So Complicated? (Continued)

- Not being prepared
  - Assuming the plan allows for an adjustment in a corporate action
  - Assuming equity software tool will work smoothly
  - Assuming vendor will manage process and fix all the issues

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PLANNING / PREPARE

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Planning for a Stock Split

- Be **Pro**active, not **Re**active
  - Be aware of your company news/press releases
  - Meet regularly with business ***partners*** to understand what is on the horizon (HR, Accounting, Tax, Treasury, etc.)
  - Read your plan documents – is a split adjustment ***mandated*** *(anti-dilution provision)*
  - Research how your vendor or equity system processes a stock split and lead times

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Planning for a Stock Split

- Provide feedback
  - Plan document issues
  - Management needs to know the key vesting dates – don't assume everyone is aware
  - Management should be provided the vendor/equity software requirements
  - Issues found in audits that might have an impact
- Participant communication
  - Make sure participants are informed of what is happening

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Anti-Dilution Provisions

- "Subject to any required action by the stockholders of the Company, the number and type of shares of Common Stock covered by each option under this Plan which has not yet been exercised and the number and type of shares of Common Stock which have been authorized for issuance under this Plan, including the Annual Increase, but have not yet been placed under option (collectively, the "Reserves"), the Maximum Share Amount, as well as the price per share of Common Stock covered by each option under this Plan which has not yet been exercised, ***shall be proportionately adjusted*** for any increase or decrease in the number of issued and outstanding shares of Common Stock of the Company resulting from a stock split or the payment of a stock dividend (but only on the Common Stock)…"

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Preparing for a Stock Split

- Audit your data
  - Do you have options with negative exercisable shares?
  - Did you have early exercise?
  - Do you have vesting tranches with small share amounts?
    - (1 share in a 1:10 reverse split will cause a zero tranche or a negative share)
- Historical ugliness
  - Prior stock splits with orphaned shares
  - Complicated vesting schedules
  - System conversions where small issues were left unresolved (negative exercisable with zero outstanding)

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Preparing for a Stock Split

- Know your software capabilities
  - Don't assume equity software tool will work smoothly
  - Don't assume vendor will manage process and fix all the issues
  - Testing capabilities

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Create a Project Plan with Key Dates and Owners

CLIENT Reverse Stock Split

Reverse Stock Split Project:

EST START: EST START:

EST END: EST END:

Task #	Action Item	Owner	Target Due Date (TDD)	Actual Completion Date	Notes
1	Logistics				
1.1	What date/time is the split to take place	CLIENT			
1.2	What is the expected turnaround	CLIENT			After testing, determine
1.3	Are there options in the money?	CLIENT			yes
1.4	Are there awards vesting during period?	CLIENT			
1.5	Who is processing the split?	SOS			
1.6	Decimals?	CLIENT			
1.7	Rounding - how to handle fractions	CLIENT			
1.8	Are there any SEC filings required the following day?	CLIENT			No
1.9	Any Internal Auditor requirements?	CLIENT			???
1.10	Has E*TRADE been notified? Blackouts?	CLIENT			
1.11	Will finance want expense recon?	CLIENT			What and how will expense reports need to be run if recon is needed.
2	Practice Reverse Stock Split				
2.1	Identify new data to be input to System prior to applying split tool	client			
2.2	Input all missing data	client			
2.3	Create Sandbox using production file	SOS			
2.4	Run Pre-Split reports	SOS			
2.5	Perform Split using System tool	SOS			
2.6	Run Post-Split reports	SOS			
2.7	Reconcile	SOS			Plan Summaries make sense? Personnel Summary makes sense? Run Personnel Summary for shares exercisable <0 Run Personnel Summary for shares exercisable >0 and <10

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WHAT'S REALLY INVOLVED

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Know Your Parameters

- Expected split ratio or set of ratios
- What time of day will split be effective
  - Record date vs. payable date
- Will there be any blackout/trading blocks
- Round rules – what to do with fractional shares
- Is the Par Value being split?
- Learn how long the split process will take on your specific equity software

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Testing

- Ensure vendor testing environment can be established and locked down
  - Some platforms refresh test environments periodically
  - Test environment should be available for reference during and after live split work
- Test multiple ratios
  - 1:10 (1 new share for 10 old shares) can cause a lot of 1 share tranches
  - 2:3 (2 new shares for 3 old shares) can cause odd tranches depending upon rounding

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Testing (Continued)

- Identify issues
  - Negative exercisable shares
  - Grants that had zero outstanding before, showing shares outstanding after
  - 1 share vest/unvest/cancelled
  - ISO/NQ split issues
- Know how long the process will take

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Pre-Reports, Know Your Starting Point!

- Run a full set of pre-split reports
- Save both in test and production (auditors will want to see – verify what they may want)
  - Summary of plan balances
  - Participant/Grant by grant balances/details
    - Granted, exercised/released, vested, unvested, canceled, outstanding, exercisable/releasable
    - Tranche by tranche grant detail
      - Run several ways to show full picture as well as negative exercisable; orphaned shares, etc. (outstanding >0 and <10; exercisable <0; etc.)
  - Granted, Exercised, Release, Cancelled, Outstanding reports
  - ESPP purchase details
  - Expense / Valuation / Financial Reporting
  - Exports of dispositions, exercises, releases

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Post Test Reports

- Run a full set of post-test reports (using same parameters as pre-split)
- Save as reference for live split work
- Using pre-report, create an expected outcome
- Compare post test to the expected outcome
- Identify areas of concern, dig deep
  - Pre report show zero outstanding, post shows outstanding
  - Pre report shows 100 shares unvested, post shows 200 shares unvested but ratio was 1:10, should be 10 shares unvested
  - Test how to fix issues, how long to fix each

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Reconciliation

- High level share balances are reasonable?
  - Pre shares x split ratio = Post shares
  - Difference is reasonable (within 1 share per grant due to rounding)
- Same number of records?
  - Number of grants, exercises, releases, cancellations, purchases, etc.
- Grants outstanding (shares still available to exercise, release) didn't change?

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Reconciliation (Continued)

- Number of dispositions are the same?
  - Dispositions are sometimes an afterthought – need to make sure they are accurate and properly adjusted
- Valuation records are unchanged?
- Expense is within a reasonable parameter set by auditors?
  - May be slightly different due to the fractional shares/rounding

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Sample Reconciliation

Grant detail before split…know what you have

Shares	Price	Exercised	Vested	Cancelled	Unvested	Outstanding	Exercisable
24,762	$5.90	0	24,762	0	0	24,762	24,762
238	$5.90	0	238	0	0	238	238
36,017	$5.90	0	0	36,017	0	0	0
13,983	$5.90	0	0	13,983	0	0	0
2,025	$49.38	1,772	1,771	253	1	0	(1)
2,286	$43.75	2,286	1,714	0	572	0	(572)
1,000	$4.75	625	625	375	0	0	0
1,306	$76.56	125	81	1,181	44	0	(44)
698	$84.38	44	43	654	1	0	(1)

1 share negative exercisable – is the vesting tranche correct? What happened, is this an old issue? Can this be fixed prior to split?

Potential early exercises? Did plan allow? Identify but no action required?

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Sample Reconciliation

Assumed 3:1 Ratio applied to grant detail before split…know what to expect

Shares	Price	Exercised	Vested	Cancelled	Unvested	Outstanding	Exercisable
74286	$ 1.9667	0	74286	0	0	74286	74286
714	$ 1.9667	0	714	0	0	714	714
108051	$ 1.9667	0	0	108051	0	0	0
41949	$ 1.9667	0	0	41949	0	0	0
6075	$ 16.4600	5316	5313	759	3	0	-3
6858	$ 14.5833	6858	5142	0	1716	0	-1716
3000	$ 1.5833	1875	1875	1125	0	0	0
3918	$ 25.5200	375	243	3543	132	0	-132
2094	$ 28.1267	132	129	1962	3	0	-3

1 share negative exercisable before x 3 should result in -3?

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Sample Reconciliation

Actual system generated result post split…how far off from expectation?

Shares	Price	Exercised	Vested	Cancelled	Unvested	Outstanding	Exercisable
74286	$ 1.9667	0	74286	0	0	74286	74286
714	$ 1.9667	0	714	0	0	714	714
108051	$ 1.9667	0	0	108051	0	0	0
41949	$ 1.9667	0	0	41949	0	0	0
6075	$ 16.4600	5316	5314	759	2	0	-2
6858	$ 14.5833	6858	5142	0	1716	0	-1716
3000	$ 1.5833	1875	1875	1125	0	0	0
3918	$ 25.5200	375	243	3543	132	0	-132
2094	$ 28.1267	132	131	1962	1	0	-1

Post split results show same negative share issue. If not fixed will result in continued out of balance in the future. May require adjusting the vesting tranche by a share to allow for the exercised shares to match vested.

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Reconciliation with Transfer Agent

- Know the record date - on record date – number of shareholders
- Subject to split
- Between record date and payable, if you have exercises, shares must be "made up" by the company
- Broker will send "due bill" shortly after split
- Ensure due bills make sense
- DWAC more shares from TA to broker
- Blackout period during this time
  - Between record date and payable date
  - 3 days, generally during, 3 days before for settlement (T+3)

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TIPS?

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Process Tips

- Don't assume
  - Be prepared with answers
  - Know the process
- Get business partners involved early
- Dig deep into the issues and seek a resolution
  - Some issues are the result of historical issues that were not previously resolved – can they be fixed?
    - Back to engagement of business partners
  - Some issues are new and may need full understanding by management/auditors to resolve

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Process Tips (Continued)

- Find ways to reduce re-work
  - Saving report parameters in system (as you run pre-split reports)
    - Run pre-reports in production, THEN make a "sandbox" copy
    - Also ensures reports are run the same way pre and post-split
    - Check list of parameters to ensure consistency
  - Ensure testing environment is preserved
  - Make sure data is up-to-date
  - Learn "index match" vs. "vlookup"
- Validate your system capabilities
- Know that the larger the split ratio, the reconciling differences may be larger (1:10 vs. 1:40 can impact not only individual grants but can also impact expense)

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Administration Tips

- Know the outcome for your key execs
  - Section 16 filings
  - Questions from Exec
- Be aware of all participant communication
  - Take lead to post company communication material to vendor site if possible
  - Share communication with vendor for participant calls
- Think like an auditor
  - Know your reconciling items
  - Keep notes, testing results, final reconciliation detail
  - One big spreadsheet with TOC (also PDF copies)
  - Have to get sign offs – follow your SOX controls!

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