



Employee Stock Option Appreciation Rights Securities  
(ESOARS™)



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# ESOARS Overview

- In the post-FAS 123(R) environment, many companies have altered their ESO granting behavior
- Fewer employees get fewer ESOs
- Need: A market-based alternative to models
  - Improve financial reporting by more accurately measuring the cost of ESO grants
  - Enable efficient use of ESOs as incentive compensation

“The fair value of an equity share option or similar instrument shall be measured based on the observable market price of an option with the same or similar terms and conditions if one is available.”

- SFAS 123(R), paragraph 22



# ESOARS Overview

- Employee Stock Option Appreciation Rights Securities
  - ESO tracking securities
  - Public offering of registered and transferable securities
- Give investors a unique opportunity to participate with management and employees in a company's potential upside
  - Available to both individual and institutional investors
  - Offered to investors in an online auction
- Issued by companies to help establish a fair, market-based price for their employee stock option grants
  - Fair market value determined in online Dutch auction
  - Auction held on or near the grant date



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# Market Based ESO Valuation Zions Experience with ESOARS

## A Brief History of Zions' Experience

- 2005
  - Considered both “Terms and Conditions” and “Tracking Securities” approaches
- 2006
  - Settled on Tracking Securities approach
  - Chose public offering over 144A or Reg D private placement
  - Conducted “Beta Test” ESOARS Auction
- 2007
  - Incorporated feedback from the SEC
  - Held a new ESOARS auction
  - Used the results for FAS 123(R)
  - Received SEC approval



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# May 2007 ESOARS Auction Results

Reference ESOs	994,180
ESO Strike Price	\$83.25
ESOARS Assigned	99,418
Vesting / Expiration	3 Years / 7 Years
Market Clearing Price	\$12.06
Proceeds	\$1.2 million
Active Bidders	43
Winning Bidders	21
Institutional Bidders	12
Total Bids Received	874



## SEC Letter to Zions

“We [SEC] do not object to your view that the ESOARS instrument in this case is sufficiently designed to meet the measurement objective of FASB 123R....We do not object to your view that the market-clearing price is a reasonable estimate of the fair value of the underlying employee stock options granted on May 4, 2007.” - *SEC letter October 17, 2007*



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# ESOARS Development

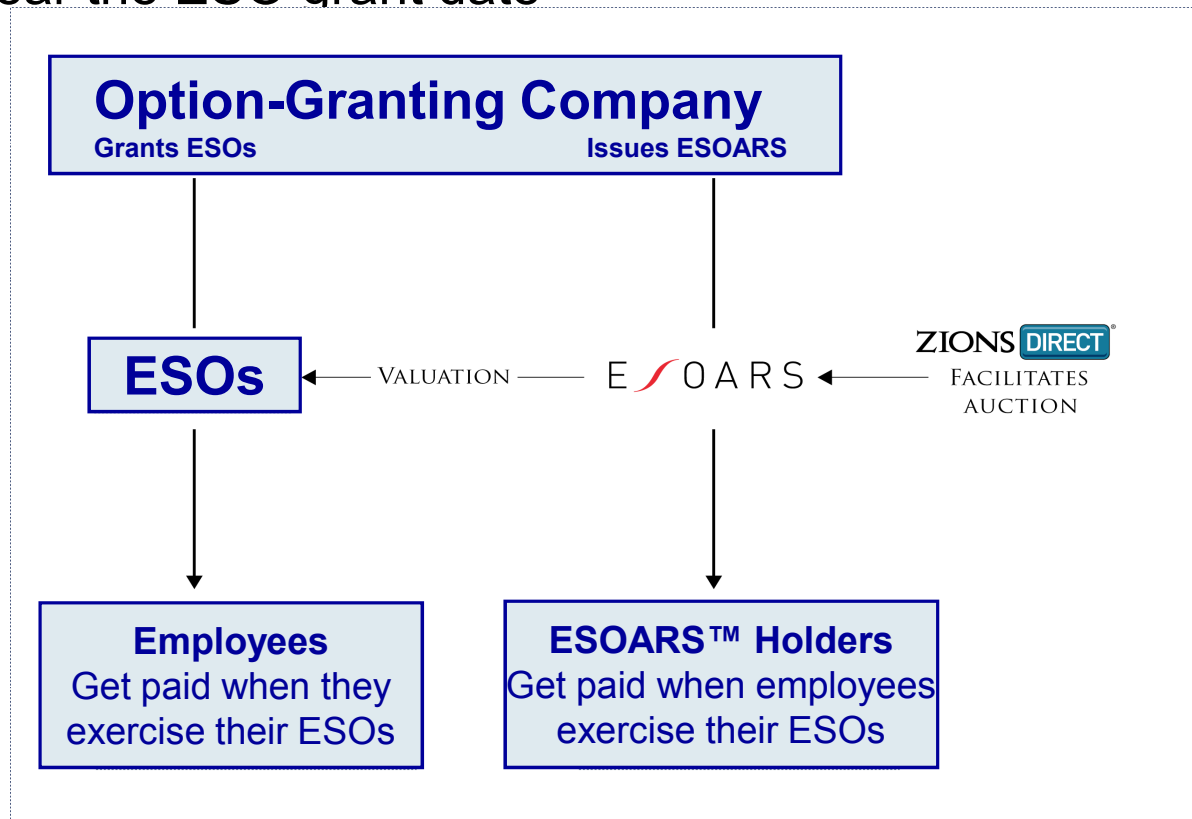
- SEC guidelines say a market-based approach should have three elements:
  - “Market Instrument Design” should be such to confer net payments on its holder that are equal in value to the fair value of all or part of the employee stock options grant.
  - There should be a “Credible Information Plan” to enable prospective buyers and sellers to price the instrument.
  - A “Market Pricing Mechanism” should exist through which the instrument could be traded to generate a price.

*Memo from Office of Economic Analysis, Aug 31, 2005*



# Instrument Design: ESOARS Parallel ESOs

- The option-granting company's ESOARS are sold in an open auction on or near the ESO grant date





# Instrument Design: Investors Bid On The Value Of A Vested Share

100 employee Stock options granted, 90 Vest

10 ESOARS issued, receive the payments grossed up for pre-vesting forfeiture

*The market bids on the average expected value of a vested share.*

Vested ESOs	Strike Price	Stock Price at Exercise	Total Intrinsic Value	Intrinsic Value per ESO
90	\$50	\$60	\$900	\$10

ESOARS	Total Intrinsic Value	10% of Total Intr. Value / (1-PVF)	PMT to ESOARS	Payment /ESOARS Unit
10	\$900	\$100	\$100	\$10



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## Pricing Mechanism

- On-line Auction
  - Modified Dutch auction
- Public offering available to individual and institutional bidders
  - Not a 144a or Reg D private placement
- Investors can go on the website and see the current clearing price at anytime



# Pricing Mechanism: A Dutch Auction Sets the Price

100,000 ESOARS example: The market clearing price is \$40.00. This is the highest price at which all ESOARS units are sold. Each winning bidder pays the market clearing price

Bidder	Price	Units	Amount	Awarded	Price
K	50.00	2,500	125,000.00	2,500	100,000.00
C	41.75	12,500	521,875.00	12,500	500,000.00
B	41.75	15,000	626,250.00	15,000	600,000.00
A	41.00	25,000	1,025,000.00	25,000	1,000,000.00
B	40.75	35,000	1,426,250.00	35,000	1,400,000.00
E	40.00	50,000	2,000,000.00	5,000	200,000.00
G	40.00	50,000	2,000,000.00	5,000	200,000.00
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F	39.90	100,000	3,990,000.00	0	0.00
D	39.90	25,000	997,500.00	0	0.00
H	38.00	1,000	38,000.00	0	0.00
I	36.00	2,500	90,000.00	0	0.00
J	30.00	100,000	3,000,000.00	0	0.00
A	5.00	25,000	125,000.00	0	0.00





# A Credible Information Plan

- Public Filings
  - Shelf filing
  - ESOARS Prospectus Supplement
    - Details of option grant
    - Security mechanics
    - Historical ESO exercise charts, tables and spreadsheets
      - Equity Methods
- Marketing to Individual and Institutional Investors
  - Articles
  - TV interviews
  - Public announcements in major media (e.g., The Wall Street Journal)
  - Investor presentations



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# Steps to Issuing ESOARS

- Management Team
- Auditors
- Legal
- Auction
- Use of Proceeds
  - General corporate funds
  - Make payments to ESOARS holders over time
- Timeline



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# Timeline

Date	Task	Responsibility
Week 1	Kick-Off Meeting	CC, CA, Issuer, Zions
Week 2 - 3	File S-3	Issuer, CC, Zions
	Draft Prospectus Supplement	
	Collect and Format Historical ESO Data	
	Begin Drafting Marketing Materials	
Week 4	Review Second Draft Prospectus Supplement	Issuer, CC, Zions
	Finalize Ad, and Media Placement	
Week 5	Finalize Prospectus Supplement	Issuer, CC, Zions
	Visit/Call SEC	
Week 6	File Prospectus Supplement	Issuer, CC, Zions
	Begin Running Ads	
Week 7	Investor Presentation (Webinars)	Issuer, Zions
Week 8	Finalize ESO Grant Details	Issuer, CC, Zions
	File Final Prospectus Supplement	
Grant Date	Hold Auction	Issuer, CA, CC, Zions
	Review Auction Results	

CC - Company Council; CA – Company Auditor





# ESOARS Accounting Treatment

- ESOARS currently classified as mark-to-market derivative liability
  - EITF 01-6 – A security can only be indexed to Issuer's own stock
- EITF is considering the accounting treatment of ESOARS and other similar securities
  - EITF 07-5
- Payment to ESOARS investors is in cash or in treasury shares
  - EITF 00-19



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## Conclusions

- ESOARS answer FAS 123(R)'s preference for a market-based approach to valuing ESOs
- ESOARS give ESO granting companies a market-based alternative to models
- A fair market value enables ESO granting companies to:
  - More accurately measure the cost of an average vested ESO
  - Efficiently use ESOs as incentive compensation
- Currently, ESOARS are the only approved market-based approach



## Where To Get More Information

- Website: [www.esoars.com](http://www.esoars.com)
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# Questions?



E  OARS™  
EMPLOYEE  
STOCK  
OPTION  
APPRECIATION  
RIGHTS  
SECURITIES

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## Appendix A: 2006 ESOARS Auction

- 2006 ESOARS Auction
  - Beta Test of Concept
  - Auction was held nearly 2 months after grant date
  - Investor assumed risk of pre-vesting forfeiture
  - Auction web site issues
  - SEC approved concept design and gave recommendations for future auctions



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## Appendix B: SEC Recommendations from 2006 auction

The SEC recommended adopting the following modifications to the ESOARS design

- Forfeitures – Investors should not bear the risk of forfeitures during the vesting period
- Two-Minute Rule
- Technology Platform Performance



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## Appendix B: SEC Letter from 2006 auction

“The prices determined by the auction process for ESOARS need not replicate those produced by one or more models in order to be deemed suitable for use as estimates under Statement 123R.” –SEC Letter January 2007

- The outcome of an ESOARS securities auction may differ from the results of models
- The use of a market-based approach to establish fair value has distinct advantages to a model-based approach
- Management is still required to verify that the results of an ESOARS securities auction can truly be deemed a market price



# June 2006 ESOARS Auction Results

Reference ESOs	936,024
ESO Strike Price	\$81.15
ESOARS Assigned	93,603
Vesting / Expiration	3 Years / 7 Years
Market Clearing Price	\$7.50
Proceeds	\$702,075
Active Bidders	57
Winning Bidders	21
Institutional Bidders	5
Total Bids Received	1,041