

Bankwell Financial Group, Inc.  
Form 10-K  
March 15, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K  
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-36448

Bankwell Financial Group, Inc.

(Exact Name of Registrant as specified in its Charter)

Connecticut	20-8251355
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

220 Elm Street

New Canaan, Connecticut 06840

(203) 652-0166

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

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Non-accelerated filer (Do not check if smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2015 based on the closing price of the common stock as reported on the NASDAQ Global Market: \$97,941,281

As of February 29, 2016, there were 7,529,191 shares of the registrant's common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive proxy statement for its Annual Meeting of Stockholders, expected to be filed pursuant to Regulation 14A within 120 days after the end of the 2015 fiscal year, are incorporated by reference into Part III of this report on Form 10-K

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BANKWELL FINANCIAL GROUP, INC.

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PART 1

Item 1.

Business

Cautionary Note Regarding Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 or the Securities Act, and Section 21E of the Exchange Act. These statements are often, but not always, made with the words or phrases such as “may,” “should,” “believe,” “likely result in,” “expect,” “would,” “intend,” “could,” “predict,” “potentially,” “continue,” “will,” “anticipate,” “seek,” “estimate,” “plan,” “projection,” and “outlook” or the negative version of those words or similar words of a forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management’s beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by these forward-looking statements. Important factors that may cause actual results to differ from those contemplated by these forward-looking statements include, but are not limited to, those disclosed under “Risk Factors” in Part I Item 1A as well as the following factors:

- local, regional and national business or economic conditions may differ from those expected;
- we are subject to credit risk and could incur losses in our loan portfolio;
- our allowance for loan losses may not be adequate to absorb loan losses;
- changes in real estate values could also increase our credit risk;
- we could experience changes in our key management personnel;
- we may not be able to successfully execute our management team’s strategic initiatives;
- our ability to successfully execute our growth initiatives such as branch openings and acquisitions;
- volatility and direction of market interest rates;
- increased competition within our market area may limit our growth and profitability;
- economic, market, operational, liquidity, credit and interest rate risks associated with our business;
-

the effects of and changes in trade, monetary and fiscal policies and laws, including the Federal Reserve Board's interest rate policies;

- changes in accounting policies and practices, as may be adopted by regulatory agencies, the Public Accounting Oversight Board or the Financial Accounting Standards Board;
- changes in law and regulatory requirements (including those concerning taxes, banking, securities and insurance); and
- further governmental intervention in the U.S. financial system.

The foregoing factors should not be construed as exhaustive. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate. Accordingly, you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

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### General

Bankwell Financial Group, Inc. (the Company, we, our, us) is a bank holding company, headquartered in New Canaan, Connecticut and offers a broad range of financial services through our banking subsidiary, Bankwell Bank (the Bank), a Connecticut state non-member bank founded in 2002. Our primary market is the greater Fairfield and New Haven County, Connecticut area, which we serve from our main banking office located in New Canaan, Connecticut and eight other branch offices located throughout the Fairfield and New Haven County area. As of December 31, 2015, on a consolidated basis, we had total assets of approximately \$1.3 billion, net loans of approximately \$1.1 billion, total deposits of approximately \$1.0 billion, and shareholders' equity of approximately \$131.8 million.

We are committed to being the premier "Hometown" bank in Fairfield and New Haven Counties and surrounding areas. We believe that our market exhibits highly attractive demographic attributes and presents favorable competitive dynamics, thereby offering long-term opportunities for growth. We have a history of building long-term customer relationships and attracting new customers through what we believe is our superior customer service and our ability to deliver a diverse product offering. In addition, we believe that our strong capital position and extensive local ownership, coupled with a highly respected and experienced executive management team and board of directors, give us credibility with our customers and potential customers in our market. Our focus is on building a franchise with meaningful market share and consistent revenue growth complemented by operational efficiencies that we believe will produce attractive risk-adjusted returns for our shareholders.

On May 15, 2014, Bankwell Financial Group, Inc. priced 2,702,703 common shares in its IPO at \$18.00 per share, and on May 15, 2014, Bankwell common shares began trading on the Nasdaq Stock Market. The net proceeds from the IPO were approximately \$44.7 million, after deducting the underwriting discount of approximately \$2.5 million and approximately \$1.3 million of expenses.

### Our History and Growth

Bankwell Bank was originally chartered as two separate banks, The Bank of New Canaan (including a separate division, Stamford First Bank) and The Bank of Fairfield, which were subsequently merged and rebranded as "Bankwell Bank." It was chartered with a commitment to building the premier community bank in the market we serve. We began operations in April 2002 with an initial capitalization of \$8.6 million. On November 5, 2013, we acquired The Wilton Bank, and it was merged into Bankwell Bank. On October 1, 2014, we acquired Quinnipiac Bank and Trust Company and it was merged into Bankwell Bank.

With the efforts of our strong management team, we continued our growth and maintained a strong track record of performance. From December 31, 2010 through December 31, 2015, our total assets grew from \$395.7 million to approximately \$1.3 billion; our loans outstanding grew from \$282.6 million to approximately \$1.1 billion and our noninterest bearing deposits grew from \$50.2 million to approximately \$164.6 million. We believe this growth was driven by our ability to provide superior service to our customers and our financial stability. This loan growth was achieved while maintaining our focus on our strong underwriting standards, which has been reflected in our low net charge-off levels.

### Business Strategy

We are focused on being the "Hometown" bank and banking provider of choice in our highly attractive market areas through:

- Responsive, Customer-Centric Products and Services and a Community Focus. We offer a broad array of products and services which we customize to allow us to focus on building long-term relationships with our customers through high-quality, responsive and personal customer service. By focusing on the entire customer relationship, we build the trust of our customers which leads to long-term relationships and generates our organic growth. In addition, we are committed to meeting the needs of the communities that we serve. Our employees are involved in many civic and community organizations which we support through sponsorships. As a result, customers and potential customers within our market know about us and frequently interact with our employees which allows us to develop long-term customer relationships without extensive advertising.





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- Strategic Acquisitions. To complement our organic growth, we focus on strategic acquisitions in or around our existing markets that further our objectives. We believe there are banking institutions that continue to face credit challenges, capital constraints and liquidity issues and that lack the scale and management expertise to manage the increasing regulatory burden and will likely need to partner with an institution like ours. As we evaluate potential acquisitions, we will continue to seek acquisitions that provide meaningful financial benefits, long-term organic growth opportunities and expense reductions, without compromising our risk profile.

- Utilization of Efficient and Scalable Infrastructure. We employ a systematic and calculated approach to increasing our profitability and improving our efficiencies. We continually upgrade our operating infrastructure particularly in the areas of technology, data processing, compliance and personnel. We believe that our scalable infrastructure provides us with an efficient operating platform from which to grow in the near term, and without incurring significant incremental noninterest expenses, while continuing to deliver our high-quality, responsive customer service, which will enhance our ability to grow and increase our returns.

- Disciplined Focus on Risk Management. Effective risk management is a key component of our strong corporate culture. We use our strong risk management process to monitor our existing loan and investment securities portfolios, support operational decision-making and improve our ability to generate earning assets with strong credit quality. To maintain our strong credit quality, we use a comprehensive underwriting process and we seek to maintain a diversified loan portfolio and a conservative investment securities portfolio. Board-approved policies contain approval authorities, as appropriate, and are reviewed at least annually. We have a Risk Management Steering Committee comprised of executive officers who oversee new business initiatives and other activities that warrant oversight of risk and related mitigants. Internal review procedures are performed regarding anti-money laundering and consumer compliance requirements. Our Chief Risk Officer reports directly to the Chair of our Audit Committee.

Our Competitive Strengths

We believe that we are especially well-positioned to create value for our shareholders as a result of the following competitive strengths:

- Our Market. Our current market is defined as the greater Fairfield and New Haven County area. The Stamford market area includes numerous affluent suburban communities of professionals who work and commute into New York City, approximately 50 miles from our headquarters, and many small to mid-sized businesses which support these communities. Fairfield County is the wealthiest county in Connecticut, with a 2010 – 2014 median household income of \$83,163 according to estimates from United States Census Bureau. We believe that this market has economic and competitive dynamics that are favorable to executing our growth strategy.

- Experienced and Respected Management Team with a Proven and Successful Track Record. Our executive management team, is comprised of seasoned professionals with significant banking experience, a history of high performance at local financial institutions and success in identifying, acquiring and integrating financial institutions. Our senior management team includes Christopher R. Gruseke, Chief Executive Officer (one year with us), Heidi S. DeWyngaert, Executive Vice President, Chief Lending Officer (eleven years with us), Ernest J. Verrico, Sr., Executive Vice President, Chief Financial Officer (six years with us), Christine A. Chivily, Executive Vice President, Chief Credit Officer (three years with us), and Michele Johnson, Senior Vice President, Chief Risk Officer (seven years with us).

**Dedicated Board of Directors with Strong Community Involvement.** Our board of directors is comprised of a group of local business leaders who understand the need for strong community banks that focus on serving the financial needs of their customers. One of our directors, Frederick R. Afragola, was instrumental in our organization and growth. Mr. Afragola was the Chief Executive Officer and President of Bankwell from its opening in 2002 until his retirement in 2008 and played an integral role in building our foundation and guiding our growth. The interests of our executive management team and directors are aligned with those of our shareholders

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through common stock ownership. By capitalizing on the close community ties and business relationships of our executive management team and directors, we are positioned to continue taking advantage of the market opportunity present in our primary market.

- **Strong Capital Position.** At December 31, 2015, we had a 9.68% tangible common equity ratio, and the Bank had a 10.84% tier 1 leverage ratio and a 12.18% tier 1 risk-based ratio. We believe that our ability to attract capital has facilitated our growth and is an integral component to the execution of our business plan.

- **Scalable Operating Platform.** We provide banking technology, including remote deposit capture, internet banking and mobile banking, to provide our customers with maximum flexibility and create a scalable platform to accommodate our future growth aspirations. We believe that our advanced technology combined with responsive and personal service provides our customers with a superior banking experience.

### Employees

At December 31, 2015, we had a total of 123 full-time employees, 2 part-time employees and no temporary employees. None of our employees is subject to a collective bargaining agreement.

### Company Website and Availability of Securities and Exchange Commission Filings

Information regarding the Company is available through the Investor Relations tab at [www.mybankwell.com](http://www.mybankwell.com). The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge at [www.sec.gov](http://www.sec.gov) and at [www.mybankwell.com](http://www.mybankwell.com) under the Investor Relations tab. Information on the website is not incorporated by reference and is not a part of this annual report on Form 10-K.

### Competition

The financial services industry in our market and the surrounding area is highly competitive. We compete with commercial banks, savings banks, savings associations, money market funds, mortgage brokers, finance companies, credit unions, insurance companies, investment firms and private lenders in various segments of our business. Many of these competitors have more assets, capital and higher lending limits, and more resources than we do and may be able to conduct more intensive and broader-based promotional efforts to reach both commercial and individual customers. Competition for deposit products can depend heavily on pricing because of the ease with which customers can transfer deposits from one institution to another.

We focus our marketing efforts on small to medium-sized businesses, professionals and individuals and their employees. This focus includes retail, service, wholesale distribution, manufacturing and international businesses. We attract these customers based on relationships and contacts that our management and our board of directors have within and beyond the market area. We do not expect to compete with large institutions for the primary banking relationships of large corporations. Rather, we compete for niches in this business segment and for the consumer business of employees of such entities. Many of our larger commercial bank competitors have greater name recognition and offer certain services that we do not. However, we believe that our presence in our primary market area and focus on providing superior service to professionals at small to medium sized businesses and individual employees of such businesses are instrumental to our success.

We emphasize personalized banking services and the advantage of local decision-making in our banking businesses, and this emphasis has been well received by the public in our market area. We derive a majority of our business from our local market area which includes its primary market area of Fairfield and New Haven Counties.

### Lending Activities

**General.** Our primary lending focus is to serve commercial and middle-market businesses and their executives, high net worth individuals, not-for-profit organizations and consumers with a variety of

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financial products and services, while maintaining strong and disciplined credit policies and procedures. We offer a full array of commercial and retail lending products to serve the needs of our customers. Commercial lending products include owner-occupied commercial real estate loans, commercial real estate investment loans, commercial loans (such as business term loans, equipment financing and lines of credit) to small and mid-sized businesses and real estate construction and development loans. Retail lending products include residential mortgage loans, home equity lines of credit and consumer installment loans. Our retail lending products are offered to the community in general and as an accommodation to our commercial customers, and their executives and employees. We focus our lending activities on loans that we originate from borrowers located in our market. We have established an informal, internal lending limit to one borrower/relationship subject to the statutory maximum of 15% of our unimpaired capital and reserves for loan loss and up to 40% for commercial real estate secured loans.

We market our lending products and services to qualified borrowers through conveniently located banking offices, relationship networks and high touch personal service. We target our business development and marketing strategy primarily on small to medium businesses with between \$5 million and \$50 million in annual revenue. Our relationship managers actively solicit the business of companies entering our market areas as well as long-standing businesses operating in the communities we serve. We seek to attract new lending customers through professional service, relationship networks, competitive pricing and innovative structure, including the utilization of federal and state tax incentives. We pride ourselves on smart, efficient underwriting and timely decision making for new loan requests due to our leaner approval structure and local decision-making. We believe this gives us a competitive advantage over larger institutions that are not as nimble.

Total loans before deferred loan fees and the allowance for loan losses were \$1.1 billion at December 31, 2015. Since December 31, 2011, total loans have increased \$778.2 million from \$369.3 million, reflecting expansion of our branch network, including \$87.4 million of acquired loans from The Wilton Bank and Quinnipiac Bank and Trust Company. The following table summarizes the composition of our loan portfolio for the dates indicated.

	At December 31,					
	2015		2014		2013	
	Amount	Percent of Loan Portfolio	Amount	Percent of Loan Portfolio	Amount	Percent of Loan Portfolio
	(In thousands)					
Real estate loans:						
Residential	\$ 177,184	15.44%	\$ 175,031	18.83%	\$ 155,874	24.66%
Commercial	697,542	60.79	521,181	56.06	316,533	50.08
Construction	82,273	7.17	63,229	6.80	51,545	8.16
Home equity	15,926	1.39	18,166	1.95	13,892	2.20
	972,925	84.79	777,607	83.64	537,844	85.10
Commercial business	172,853	15.06	149,259	16.05	93,566	14.80
Consumer	1,735	0.15	2,896	0.31	602	0.10
Total loans	\$ 1,147,513	100.00%	\$ 929,762	100.00%	\$ 632,012	100.00%

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At December 31,			
2012		2011	
Amount	Percent of Loan Portfolio	Amount	Percent of Loan Portfolio
(In thousands)			

Real estate loans:

The Audit Committee has selected BDO Seidman, LLP, as the independent registered public accounting firm to audit the Company's consolidated financial statements for the fiscal year ending December 31, 2007 and internal control over financial reporting. Although action by the stockholders on this matter is not required, the Audit Committee and the Board of Directors believe it is appropriate to seek stockholder ratification of this selection in light of the role played by the independent registered public accounting firm in reporting on the Company's consolidated financial statements. Ratification requires the affirmative vote of a majority of eligible shares present at the Annual Meeting, in person or by proxy, and voting thereon. If this appointment is not ratified by the stockholders, the Audit Committee may reconsider its selection. One or more representatives of BDO Seidman, LLP are expected to attend the Annual Meeting. They will have an opportunity to make a statement if they desire to do so and will be available to respond to appropriate questions.

**The Board of Directors recommends a vote FOR ratification of the appointment of BDO Seidman, LLP as the Company's independent registered public accounting firm.**

### Principal Accountant Fees and Services

The following table shows the aggregate fees billed to, and paid by the Company, for the fiscal year ended December 31, 2006, and the aggregate fees billed to, and paid by, H&E LLC, a predecessor company of the Company, for the fiscal year ended December 31, 2005, for professional services rendered by the Company's principal accounting firm, BDO Seidman, LLP:

	2006	2005
Audit Fees	\$ 598,590(1)	\$ 778,193(2)
Audit-Related Fees		
Tax Fees(3)		3,500
All Other Fees		
	\$ 598,590	\$ 781,693

- (1) Includes \$126,046 of fees related to the Company's issuance of \$250 million of senior unsecured notes in August 2006. Remainder of fees were for professional services rendered for the audit of the Company's annual consolidated financial statements, for the reviews of the consolidated financial statements included in the Company's quarterly reports on Form 10-Q and for reviews of other SEC registration statements.



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- (2) Includes \$413,193 of fees related to SEC Filings associated with the Company's initial public offering. Remainder of fees were for professional services rendered for the audit of the Company's annual consolidated financial statements and for the reviews of the consolidated financial statements included in the Company's quarterly reports on Form 10-Q.
- (3) Fees were for tax compliance and consulting services rendered to the Company.

The Audit Committee believes that BDO Seidman, LLP's provision of non-audit services is compatible with maintaining such firm's independence.

**Pre-approval of services**

All audit and permissible non-audit services provided by the Company's independent registered public accounting firm, BDO Seidman, LLP, require pre-approval by the Audit Committee in accordance with the Audit Committee Charter. The Company's Audit Committee approves the accountant's engagement prior to the accountant rendering any non-audit services. The Audit Committee charter is reviewed on an annual basis by the Audit Committee and is subject to amendment from time to time. The Audit Committee pre-approved 100% of the total of the 2006 fees.

**COMPENSATION COMMITTEE REPORT**

The Compensation Committee of the Company has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management and, based on such review and discussion, the Compensation Committee recommended to the Board that the Compensation Discussion and Analysis be included in the Company's Proxy Statement for the 2007 Annual Meeting of Stockholders.

***COMPENSATION COMMITTEE***

Paul N. Arnold, Chairman  
Keith E. Alessi  
Lawrence C. Karlson

**COMPENSATION DISCUSSION AND ANALYSIS**

**Introduction**

This Compensation Discussion and Analysis ( CD&A ) provides an overview of the Company's executive compensation program together with a description of the material factors underlying the decisions which resulted in the compensation provided to the Company's Chief Executive Officer ( CEO ), Chief Financial Officer ( CFO ) and certain other executive officers (collectively, the named executive officers ( NEOs )) for 2006 (as presented in the tables which follow this CD&A).

**Compensation Committee**

The Compensation Committee (the Committee ) of the Board of Directors is composed of three non-employee directors, all of whom are independent directors under the listing standards of The Nasdaq Stock Market LLC and the Securities and Exchange Commission rules. The Committee has responsibility for determining and implementing the Company's philosophy with respect to executive compensation. Accordingly, the Committee has overall responsibility for approving and evaluating the various components of the Company's executive compensation program. The

Committee meets at least twice per year (and more often as necessary) to discuss and review the compensation of the NEOs. The Committee annually reviews and approves the compensation of the CEO. The Committee also reviews and approves the compensation of the other NEOs after considering the recommendations of management. In establishing and reviewing compensation for the NEOs, the Committee considers the financial results of the Company and evaluates the compensation paid to NEOs against market data for comparable equipment companies. Currently, the Committee does not engage a compensation consultant.



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The Committee operates under a written charter adopted by the Board of Directors of the Company on January 23, 2006. A copy of this charter is available on our website under the Investors section at [www.he-equipment.com](http://www.he-equipment.com).

### **Executive Compensation Philosophy and Objectives**

The Committee's goals in structuring the Company's compensation program for its NEOs are to:

- provide incentives to achieve Company financial objectives;
- provide long-term incentives for the executive officers; and
- set compensation levels sufficiently competitive to attract and retain high quality executives and to motivate them to contribute to the Company's success.

The Committee has determined that to achieve these objectives, the Company's executive compensation program should reward both individual and Company short-term and long-term performance. To this end, the Committee believes that executive compensation packages provided by the Company to its executive officers, including its NEOs, should include both cash and stock-based compensation. However, the Committee does not rely on any policy or formula in determining the appropriate mix of cash and equity compensation.

### **Setting Executive Compensation**

In making compensation decisions, the Committee considers the recommendations of management. The Committee also considers corporate and executive performance, an executive's level of experience and responsibility, an executive's current compensation level and historical compensation practices. In addition, the Committee looks at market data for comparable equipment companies when considering bonus levels. In determining bonuses and base salary, the Committee reviewed compensation data for the following equipment rental companies: United Rental, Finning, Toromont, NationsRent, Neff, NES, and Ahern (these companies are referred to elsewhere in this CD&A as the peer group companies). The peer group companies were not considered in making equity compensation decisions.

### **Committee Processes; Role of Executives in Setting Compensation**

A complete description of the Committee's processes and the role of executives in setting compensation can be found earlier in this proxy in the section entitled "Corporate Governance - Committees of the Board of Directors - Compensation Committee."

### **2006 Executive Compensation Components**

The Company's executive compensation program is composed of three principal components:

- base salary;
- cash bonuses; and
- long-term incentives, consisting of equity awards.

The Company was also party to an employment contract with the CEO, Mr. Engquist, during 2006. This contract expired on December 31, 2006. In addition to the compensation components listed above, the contract provided for

post-employment severance payments and benefits in the event of termination under certain circumstances. None of the other NEOs currently have employment contracts or had employment contracts in effect during 2006.

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### **Base Salaries**

*In General.* The Company provides NEOs with base salaries to compensate them for services rendered during the fiscal year. In determining base salaries, the Committee reviews base salaries paid at comparable equipment companies and considers other factors, including:

historical information regarding compensation previously paid to NEOs;

the individual's experience and level of responsibility; and

the performance of the Company and the executive.

In the absence of a promotion or special circumstances, the Committee reviews executive salaries once annually.

*Consideration of 2006 Base Salaries.* Based on the above factors, the Committee determined current base salary levels were sufficient for the NEOs for 2006.

### **Annual Bonuses**

*In General.* Annual cash bonuses are included as part of the executive compensation program because the Committee believes that a significant portion of each NEO's compensation should be contingent on the annual performance of the Company, as well as the individual contribution of the NEO. Accordingly, each NEO is eligible for an annual bonus under the Company's management incentive guidelines, payable at the discretion of the Committee. The guidelines were determined by the Committee in consultation with the CEO. The guidelines are based on the Company's achievement of financial targets and the amount of compensation paid to executive officers in similar positions at the peer group companies. The Committee reviews and approves these guidelines after discussions among themselves and with the CEO. Once the guidelines are approved, the guidelines are to act as a guide to the Committee and CEO in determining bonuses. The Committee and CEO retain discretion and actual bonus amounts may differ from those provided under the guidelines if the Committee or the CEO determines that adjustment is appropriate.

*Consideration of 2006 Annual Bonus.* For the fiscal year 2006, the Committee approved bonus guidelines for each of the NEOs except Mr. Fox based on the Company's achievement of specified levels of earnings per share (EPS) and return on gross net assets (ROGNA). For the Committee's purposes, ROGNA is defined as net income (loss) from continuing operations before interest, income taxes, depreciation and amortization (or EBITDA) divided by the sum of the average of gross rental equipment, gross property and gross equipment and net working capital. These financial objectives had previously been determined by the Committee to be the most appropriate measures of Company performance because they take into account earnings and return on assets. These financial objectives are also consistent with the Compensation Committee's compensation philosophy of linking executive performance to the Company's financial performance.

Under the guidelines, separate bonus amounts were calculated based on EPS levels and ROGNA levels, as compared to target EPS and ROGNA levels approved by the Committee. The bonus ranges based on EPS were given a weighting of 70% and the bonus ranges based on ROGNA were given a weighting of 30% in determining the recommended bonus amount. Bonuses are calculated as a percentage of base salary and increase incrementally based on increases in EPS and ROGNA as compared to the target EPS and ROGNA levels. The target EPS and ROGNA levels were determined based on the Company's 2005 performance, the Company's forecast for 2006 and economic conditions in the Company's industry. The target amounts were set at a level designed to recognize the Company's achievement of its financial objectives as well as performance above and below expectations. The Committee also

authorized the CEO to recommend adjustments to the bonus amounts determined under these guidelines as he considered appropriate based on the other factors described above.

For the 2006 fiscal year, Company's EPS and ROGNA exceeded the targets set forth in the guidelines for Mr. Engquist, Ms. Magee, Mr. Barber and Mr. Jones. In accordance with the guidelines, the Committee approved a bonus of \$783,750 for Mr. Engquist, or approximately 157% of his base salary. The Committee determined that this amount was appropriate in light of the fact that the Company's performance far surpassed the planned financial objectives, and Mr. Engquist's contributions to this performance.

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In addition, the Committee approved bonuses of \$250,800, \$282,150 and \$175,000 for Ms. Magee, Mr. Barber and Mr. Jones, respectively, or approximately 125%, 125% and 95% of their respective base salaries. The Committee determined that these amounts were appropriate in light of the fact that the Company's performance far surpassed the planned financial objectives, and consideration of each executive's contributions to this performance.

Bonuses to Messrs. Engquist, Barber and Jones and Ms. Magee for 2006 were paid partially in cash and partially deferred. The deferred portion of each bonus was 36% and the immediately payable portion was 64%. The deferred portion will be paid in two equal annual installments over the next two years. The decision to defer a portion of these bonuses was made in accordance with the above-described guidelines. The deferred portion of each bonus will accrue interest at 8.25%, the prime rate as of January 1, 2007.

Mr. Fox was not evaluated pursuant to the guidelines described above due to the historical practice of the Company to treat Mr. Fox consistent with other divisional managers for bonus purposes. However, the Committee approved a discretionary bonus to Mr. Fox for 2006 of \$100,000, or approximately 42.7% of his base salary. This bonus amount was based on the recommendation of the CEO and on the performance of the group within his area of responsibility. No portion of Mr. Fox's bonus was deferred.

## **Long-Term Incentives**

*In General.* The Committee believes that NEOs should be compensated in part with equity interests in the Company in order to more closely align the long-term interests of stockholders and executives. The Committee also believes that equity awards are an important means of attracting and retaining qualified executives. Accordingly, the Committee provides long-term incentives by means of periodic grants of stock options and restricted stock awards under the Company's 2006 Stock-Based Incentive Compensation Plan (the "Incentive Plan"). Stock awards available under the Incentive Plan include restricted stock, stock options and deferred stock.

All grants of equity compensation to NEOs are made by the Committee. Whether grants are made and the type and size of any grants are based upon Company and individual performance, position held, years of service, level of experience and potential of future contribution to the Company's success. The Committee may also consider long-term incentive grants previously awarded to the NEOs, long-term incentive grants given to other executive officers throughout the Company's history and grant practices at comparable equipment companies.

*2006 Equity Grants.* On February 22, 2006, the Committee granted each of Ms. Magee, Mr. Barber and Mr. Jones \$1 million worth of restricted shares of the Company's common stock, based on the closing price of such stock on the grant date. This resulted in a grant of 40,650 restricted shares to each executive, based on a market price of \$24.60 per common share. These awards were granted to reward these executives for their contributions to the Company's pre-initial public offering performance and in particular their superior performance in implementing the Company's initial public offering in early 2006. In addition, prior to the granting of this award, none of these executives had significant holdings in the Company.

The restricted shares will vest, and the restrictions will cease to apply, in three equal tranches, on the first, second and third anniversaries of the grant date. The Committee believes that this vesting schedule serves to motivate and retain the recipients, providing continuing benefits to the Company beyond those achieved in the year of grant.

*Stock Ownership/Retention Guidelines.* The Company does not require its NEOs to maintain a minimum ownership interest in the Company.

## **Other Compensation and Perquisite Benefits**

In addition to the principal categories of compensation described above, the Company provides its NEOs with coverage under its broad-based health and welfare benefits plans, including medical, dental, disability and life insurance. The Company also sponsors a 401(k) plan. The 401(k) plan is a tax-qualified retirement savings plan pursuant to which all employees, including the NEOs, are able to contribute to the 401(k) plan up to the limit prescribed by the Internal Revenue Code on a before-tax basis. The Company makes a matching contribution of 50% of the first 4% of pay contributed by the employee to the 401(k) plan. Annual salary subject to the Company

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match is capped at a maximum amount prescribed by the IRS each year. All contributions made by a participant vest immediately and matching contributions by the Company vest over the employee's first five years of service with the Company's matching contributions vesting 25% on the second year and another 25% on each year thereafter.

The NEOs are not generally entitled to benefits that are not otherwise available to all of our employees. In this regard it should be noted that the Company does not provide pension arrangements (other than the 401(k) Plan), post-retirement health coverage or similar benefits for its executives. However, the NEOs are entitled to long-term disability benefits, annual automobile allowances and other automobile allowances such as fuel costs, which are noted in the All Other Compensation column in the Summary Compensation table shown on page 18. Mr. Engquist does not receive the automobile allowances. In 2004, the Company purchased a vehicle for Mr. Engquist's use and also provides other automobile benefits such as fuel and maintenance costs. The Company and the Committee believe that these benefits are consistent with the goal of attracting and retaining superior executive talent.

***Tax and Accounting Implications***

***Deductibility of Certain Compensation***

Section 162(m) of the Internal Revenue Code limits the deductions that may be claimed by a public company for compensation paid to certain individuals to \$1,000,000 except to the extent that any excess compensation is performance-based compensation. None of the compensation paid to the NEOs for 2006 was considered performance-based under Section 162(m) and therefore all such compensation is subject to the \$1,000,000 limit. The Committee intends to maintain flexibility to pay compensation that is not entirely deductible when the best interests of the Company make that advisable. In approving the amount and form of compensation for the NEOs, the Committee will continue to consider all elements of cost to the Company of providing such compensation, including the potential impact of Section 162(m).

The Committee considers the accounting impact in connection with equity compensation matters, however, these considerations do not significantly affect decisions on grants of equity compensation.

**COMPENSATION COMMITTEE INTERLOCKS  
AND INSIDER PARTICIPATION**

The Company's Board of Directors made all decisions concerning executive compensation prior to the creation of the Compensation Committee and the consummation of the Company's initial public offering. None of the Company's executives serve as a member of the board of directors or compensation committee of an entity that has an executive officer serving as a member of the Company's Board of Directors. Messrs. Alessi, Arnold and Karlson currently serve on the Compensation Committee. No member of the Compensation Committee is a former or current executive officer or employee of the Company or any of its subsidiaries.

**Table of Contents****2006 SUMMARY COMPENSATION TABLE**

The table below summarizes the total compensation paid or earned by each of our named executive officers for the fiscal year ended December 31, 2006.

<b>Name and Principal Position</b>	<b>Year</b>	<b>Salary (\$)(1)</b>	<b>Bonus (\$)(2)</b>	<b>Stock Awards (\$)(3)</b>	<b>All Other Compensation (\$)(4)</b>	<b>Total (\$)</b>
John M. Engquist Chief Executive Officer, President and Director	2006	500,000	783,750		18,222	1,301,972
Leslie S. Magee Chief Financial Officer and Secretary	2006	200,000	250,800	284,719	15,494	751,013
Bradley W. Barber Executive Vice President and General Mgr.	2006	242,308	282,150	284,719	17,389	826,566
John D. Jones Vice President Product Support	2006	188,462	175,000	284,719	16,187	664,368
William W. Fox Vice President Cranes and Earthmoving	2006	234,465	100,000		21,256	355,721

- (1) Amounts represent base salaries for the named executive officers. Mr. Barber's amount also includes \$17,308 of additional paid compensation pursuant to the Company's paid time off policy. Specifically, an employee may request, with certain restrictions, payment of paid time off hours earned in lieu of actually taking the hours off.
- (2) The payout structure of the 2006 bonus amounts for Mr. Engquist, Ms. Magee, Mr. Barber and Mr. Jones is as follows: (a) 64% was paid in cash during the first quarter of 2007; and (b) 36% is deferred. The deferred portion is to be paid out annually over two years in equal 50% installments beginning in 2008. The deferred portion of the bonus earns interest at the Prime interest rate in effect at January 1, 2007 (8.25%) annually and interest earned is paid at the time of the respective payments of the deferred amounts. Mr. Fox's bonus amount was paid 100% in cash during the first quarter of 2007.
- (3) Amounts shown are the dollar amounts recognized as compensation expense for financial reporting purposes in 2006 under Statement of Financial Accounting Standard No. 123 (revised 2004), Share-Based Payment (FAS 123(R)), (excluding amounts for forfeitures) for shares of restricted stock granted in 2006. The fair value of all the awards is equal to the market price of our Common Stock on the date of grant. Although the amounts included in the table do not reflect estimated forfeitures, the amounts actually recognized in our consolidated financial statements are reduced, in accordance with FAS 123(R), for estimated forfeitures. There were no named executive forfeitures in 2006. Ms. Magee, Mr. Barber and Mr. Jones each received 40,650 shares of restricted stock in 2006. More information on the awards can be found in the Grant of Plan-Based Awards table on page 19.



(4) The amounts reported for each of the named executive officers in All Other Compensation are shown below:

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Name	Year	Perquisites and Other Personal	Insurance	Company Contributions to 401(k)	Total
		Benefits \$(a)	Premiums \$(b)	Plan (\$)	
John M. Engquist	2006	15,284	630	2,308	18,222
Leslie S. Magee	2006	11,488	630	3,376	15,494
Bradley W. Barber	2006	12,759	630	4,000	17,389
John D. Jones	2006	12,090	630	3,467	16,187
William W. Fox	2006	16,570	630	4,056	21,256

(a) Amounts shown in this column include the following for each named executive officer:

Name	Year	Company Provided	Automobile	Other Automobile	Club Dues	Total Perquisites and Other Personal
		Automobile \$(c)	Allowance (\$)	Benefits (\$)	(\$)	Benefits (\$)
John M. Engquist	2006	6,110		1,935	7,239	15,284
Leslie S. Magee	2006		9,000	2,488		11,488
Bradley W. Barber	2006		9,000	3,759		12,759
John D. Jones	2006		9,000	3,090		12,090
William W. Fox	2006		9,000	4,303	3,267	16,570

(b) Includes payment by the Company on behalf of the named executive officer related to long-term disability premiums.

(c) The value of Mr. Engquist's company-provided automobile is calculated based on 100% of the annual lease value of the automobile.

**2006 GRANTS OF PLAN-BASED AWARDS TABLE**

The table below sets forth information regarding grants of plan-based awards made to each of the named executive officers during 2006.

Estimated Future Payouts	Estimated Future Payouts	All Other Stock Awards:	All Other Option Awards:	Grant Date Fair
		Number of	Number of	

Name	Grant Date	Under Non-Equity Incentive Plan Awards			Under Equity Incentive Plan Awards			Shares of Stock or Underlying Units (#)(1)	Base Price of Securities Underlying Options Awards (\$/Sh)	Value of Stock and Option Awards (\$)
		Threshold	Target	Maximum	Threshold	Target	Maximum			
John M. Engquist										
Leslie S. Magee	2/22/2006						40,650		999,990	
Bradley W. Barber	2/22/2006						40,650		999,990	
John D. Jones	2/22/2006						40,650		999,990	
William W. Fox										

(1) Represents the number of shares of Common Stock issuable upon vesting of restricted stock awards granted in February 2006 under our 2006 Stock-Based Incentive Compensation Plan.

**Table of Contents****OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END 2006 TABLE**

The table below sets forth the number of securities underlying outstanding plan awards for each named executive officer as of December 31, 2006.

Name	Option Awards				Stock Awards(1)				
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Exercised Options (#)	Number of Unearned Options (#)	Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested	Market Value of Shares or Units of Stock That Have Not Vested (\$)	Number of Unearned Shares, Units or Other Rights That Have Not Vested (2)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
John M. Engquist									
Leslie S. Magee								40,650	1,006,901
Bradley W. Barber								40,650	1,006,901
John D. Jones								40,650	1,006,901
William W. Fox									

(1) All amounts are as of December 31, 2006, and dollar values are based on the closing price of the Company's Common Stock on December 31, 2006 of \$24.77.

(2) Represents shares of restricted stock granted to each named executive officer on February 22, 2006 under our 2006 Stock-Based Incentive Compensation Plan. One-third of the shares of restricted stock will vest on each of 2/22/07, 2/22/08 and 2/22/09. All restricted stock shares shown above are unvested as of December 31, 2006.

**2006 NONQUALIFIED DEFERRED COMPENSATION TABLE**

The table below sets forth, for each of our named executive officers, information regarding his or her deferred compensation in 2006.

<b>Name</b>	<b>Executive Contributions in Last Fiscal Year (\$)(1)</b>	<b>Registrant Contributions in Last Fiscal Year (\$)</b>	<b>Aggregate Earnings in Last Fiscal Year (\$)</b>	<b>Aggregate Withdrawals/ Distributions (\$)</b>	<b>Aggregate Balance at Last Fiscal Year-End (\$)</b>
John M. Engquist	282,150				282,150
Leslie S. Magee	90,288				90,288
Bradley W. Barber	101,574				101,574
John D. Jones	63,000				63,000
William W. Fox					

- (1) Amounts for Mr. Engquist, Ms. Magee, Mr. Barber and Mr. Jones represent the deferred portion of their respective 2006 bonus amounts. Deferred amounts earn interest at the Prime interest rate in effect at January 1, 2007 (8.25%) annually. See also Summary Compensation Table on page 18 above.

#### **2006 DIRECTOR COMPENSATION TABLE**

During 2006, Messrs. Bruckmann and Bagley did not receive compensation for their service as directors of the Company. All other non-employee directors received a quarterly retainer of \$5,000. In addition, non-employee directors received \$2,000 per board meeting attended and \$1,000 per board conference call attended. Each non-employee director of H&E Equipment Services, Inc. who served on a committee received \$1,000 per committee meeting attended and \$500 per committee call attended. During fiscal year 2006, non-employee directors of H&E Equipment Services, Inc. who served as committee chairs received \$2,000 annually payable in quarterly installments. The Company intends to continue payments in the same amounts for committee service in fiscal year 2007. On February 22, 2006, the Board of Directors approved a one time grant of 15,000 stock options to each of

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Messrs. Alessi, Karlson and Sawyer. An annual grant of 1,500 stock options to each non-employee director beginning in fiscal year 2007 was also approved. All such stock options will vest in three equal parts over a period of three years.

The table below summarizes the compensation paid by the Company to each non-employee director for the year ended December 31, 2006.

Name	Fees Earned or		Option Awards (\$)(2)	All Other Compensation (\$)	Total (\$)
	Paid in Cash (\$)(1)	Stock Awards (\$)			
Keith Alessi	40,500		46,034		86,534
Paul N. Arnold	6,000				6,000
Gary W. Bagley					
Bruce C. Bruckmann					
Lawrence C. Karlson	40,000		46,034		86,034
John T. Sawyer	35,500		46,034		81,534

- (1) Messrs. Bagley and Bruckmann did not receive compensation for their services as directors of the Company. All other non-employee directors received a quarterly cash retainer and meeting fees for the Board and its committees and committee chairmanship retainers. Mr. Arnold, a non-employee director, was named to the Board on November 20, 2006. Mr. Arnold received a quarterly cash retainer for the fourth quarter of 2006.
- (2) Amounts shown are the dollar amounts recognized as compensation expense for financial reporting purposes in 2006 under FAS 123(R)(excluding amounts for forfeitures) for stock options granted in 2006. The fair value of all the awards were estimated using the Black-Scholes option-pricing model We use the Black-Scholes formula to calculate an assumed value of the options for compensation expense purposes; because the formula uses assumptions, the fair values calculated are not necessarily indicative of the actual values of the stock options. The assumptions used were a dividend yield of 0%; a risk-free interest rate of 5.0%; an expected life of six years; and a stock price volatility of 35.0%.

**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS****Reorganization Transactions**

We were formed as a Delaware corporation in September 2005 as a wholly-owned subsidiary of H&E Holdings. As of December 31, 2005 and to the date of our initial public offering, the business was still being conducted through H&E LLC, the operating subsidiary of H&E Holdings. H&E LLC was a Louisiana limited liability company and H&E Holdings was a Delaware limited liability company. In order to have an operating Delaware corporation as the issuer for our initial public offering, immediately prior to the closing of our initial public offering H&E LLC and H&E Holdings were merged with and into us (H&E Equipment Services, Inc.), with us surviving the reincorporation merger as the operating company. Immediately prior to the consummation of our initial public offering, Bruckmann, Rosser, Sherrill, and Co., L.P. and Bruckmann, Rosser, Sherrill & Co. II, L.P. (collectively, BRS ) and their affiliates beneficially owned approximately 58.8% of our common stock and our executives, directors and principal stockholders beneficially owned approximately 93.6% of our common stock. Immediately following the consummation of our initial public offering, BRS and its affiliates beneficially owned approximately 41.2% of our

common stock and our executives, directors and principal stockholders beneficially owned approximately 65.5% of our common stock. Investors purchased shares of our common stock in our initial public offering.

In the merger with H&E Holdings, holders of H&E Holdings received an aggregate of 25,492,019 shares of our common stock.

In the merger with H&E LLC, we became the obligor under the indentures that existed at the time governing the senior secured notes and senior subordinated notes and the senior secured credit facility agreement.

**Table of Contents****Merger Consideration**

As discussed above, immediately prior to the completion of our initial public offering, H&E Holdings and H&E LLC merged with and into us, with us as the surviving corporation and operating company. The table below sets forth the consideration received by certain of our affiliates that were holders of H&E Holdings as a result of the merger. The table below sets forth the beneficial ownership of each affiliate as described in more detail in Security Ownership of Certain Beneficial Owners and Directors and Officers.

Name	H&E Holdings Units Owned Prior to the Reorganization Transactions(1)	Shares of Our Common Stock Issued in the Reorganization Transactions
Bruckmann, Rosser, Sherrill & Co., L.P.	769,617	5,103,243
Bruckmann, Rosser, Sherrill & Co., Inc.	4,354	30,313
Bruckmann, Rosser, Sherrill & Co. II, L.P.	1,312,202	9,314,278
Bruce C. Bruckmann	2,151,203	14,872,046
John M. Engquist	1,189,514	4,511,250
Gary W. Bagley	87,064	314,559
Dale W. Roesener	166,732	602,307
Kristan Engquist Dunne	77,278	407,806
Lawrence C. Karlson		
Keith E. Alessi		
John T. Sawyer		
Bradley W. Barber		
William W. Fox		
Leslie S. Magee		

(1) Represents aggregate ownership of preferred units and common units (without regard to class or series).

**Eagle Acquisition**

The Company completed, effective as of February 28, 2006, the acquisition of all of the capital stock of Eagle High Reach Equipment, Inc. and all of the equity interests of its subsidiary, Eagle High Reach Equipment, LLC (together, Eagle ), for a formula-based purchase price of approximately \$59.9 million, subject to post-closing adjustment, plus assumed indebtedness of approximately \$2.0 million.

Gary W. Bagley, our Chairman, served as the Chief Executive Officer and a manager of Eagle High Reach Equipment, LLC and served also as the interim Chief Executive Officer and a director of Eagle High Reach Equipment, Inc. Mr. Bagley will continue as a manager and director, respectively, of Eagle High Reach Equipment, LLC (now H&E California Holdings, Inc.) and Eagle High Reach Equipment, Inc. (now H&E California Holdings, Inc.). Mr. Bagley held approximately 25.3% of the ownership interests in Eagle High Reach Equipment, Inc. and he received his proportionate share of the net proceeds received by the holders (sellers) of Eagle High Reach Equipment, Inc.



## Management Agreement

Each of Head & Engquist and ICM were acquired by affiliates of Bruckmann, Rosser, Sherrill & Co., Inc. ( BRS Inc. ) in 1999, pursuant to separate recapitalization transactions. In connection with those transactions, we entered into management services agreements with BRS Inc. and Bruckmann, Rosser, Sherrill & Co., L.L.C. ( BRS L.L.C. ), affiliates of BRS, pursuant to which BRS Inc. and BRS L.L.C. agreed to provide certain advisory and consulting services to us, relating to business and organizational strategy, financial and investment management and merchant and investment banking. In exchange for such services, we agreed to pay BRS Inc. and BRS L.L.C. (i) \$7.2 million of transaction fees in connection with the ICM and Head & Engquist recapitalization transactions, (ii) an annual fee during the term of this agreement equal to the lesser of \$2.0 million, or 1.75%, of our yearly

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EBITDA before operating lease expense on rental fleet equipment, plus all reasonable out-of-pocket fees and expenses, and (iii) a transaction fee in connection with each material acquisition, divestiture or financing or refinancing we enter into in an amount equal to 1.25% of the aggregate value of such transaction plus all reasonable out-of-pocket fees and expenses. For the period January 1, 2006 up to the date of the date of our initial public offering, the Company paid BRS L.L.C. approximately \$302,000 under the agreement. The management services agreement was terminated as of the closing of our initial public offering, with the payment of a termination fee by us to BRS L.L.C. of \$8.0 million.

## **Consulting Agreement**

On July 31, 2004, H&E LLC, the predecessor company to H&E Equipment Services, Inc., entered into a consulting and noncompetition agreement with Gary W. Bagley, our current Chairman. Such agreement provides for, among other things:

an initial term of five years; thereafter this agreement may be renewed on a year to year basis, subject to mutual agreement of the parties;

a consulting fee of \$150,000 per year plus reimbursement of all reasonable and actual out-of-pocket expenses;

welfare benefits, including medical, dental, life and disability insurance; and

confidentiality of information obtained during employment, non-competition and nonsolicitation.

## **Securityholders Agreement**

In connection with the formation of H&E Holdings and the related combination of the ICM and Head & Engquist businesses (the 2002 Transactions ), H&E Holdings entered into a securityholders agreement with affiliates of BRS, certain members of management and other members of H&E Holdings. The Company entered into an amended and restated securityholders agreement with certain stockholders in connection with the Reorganization Transactions, which eliminated certain provisions which would not be appropriate for a company with publicly traded equity securities and, among other things, provided for restrictions on the transfer of equity interests.

## **Registration Rights Agreement**

In connection with the financing of the 2002 Transactions, H&E Holdings entered into a registration rights agreement with affiliates of BRS, certain members of management and other members of H&E Holdings. In connection with the Reorganization Transactions, the parties amended and restated the registration rights agreement to provide that the registration rights agreement thereafter applies to our common stock held by the parties. The amendment provides that the registration rights that previously applied to units of H&E Holdings thereafter apply to the common stock held by the parties thereto.

## **Investor Rights Agreement**

In connection with the financing of the 2002 Transactions, H&E Holdings entered into an investor rights agreement with affiliates of BRS, Credit Suisse First Boston Corporation and other members of H&E Holdings. Certain provisions of the investor rights agreement, including the provisions concerning tag-along rights, consent to a sale of H&E Holdings, and the grant of preemptive rights terminated upon the consummation of our initial public offering in February 2006. In connection with the Reorganization Transactions and our initial public offering, the parties amended and restated the investor rights agreement to provide that the non-voting observer rights of one of the holders

of our senior subordinated notes will be terminated. Pursuant to the terms of the investor rights agreement, subject to certain conditions, on any two occasions after 180 days after the first public offering, the holders of 33% or more of the equity interests issued to the investor on the date of the investor rights agreement (or successor securities) have the right to require H&E Holdings to register all or part of such equity interests under the Securities Act at H&E Holdings expense. In addition, the investor is entitled to request the inclusion of any equity interests subject to the investor rights agreement in any registration statement at the expense of H&E Holdings

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whenever H&E Holdings proposes to register any of its equity interests under the Securities Act. In connection with all such registrations, H&E Holdings has agreed to indemnify the investor against certain liabilities, including liabilities under the Securities Act. In connection with the Reorganization Transactions, the parties amended and restated the investor rights agreement to provide that the investor rights agreement thereafter applies to our common stock held by the parties.

### **Limited Liability Company Agreement**

In connection with the 2002 Transactions, affiliates of BRS, certain members of management and the other members of H&E Holdings entered into a limited liability company agreement of H&E Holdings. This operating agreement governed the relative rights and duties of the members of H&E Holdings.

*Membership Interests.* The ownership interests of the members in H&E Holdings consisted of Preferred Units and Common Units. The Common Units represented the common equity of H&E Holdings and consisted of Class A Common Units and Class B Common Units. The Preferred Units consisted of Series A Preferred Units, Series B Preferred Units, Series C Preferred Units and Series D Preferred Units (the Voting Preferred Units). Each member was entitled to (x) two votes per Class A Common Unit held by such member, (y) one vote per Class B Common Unit held by such member and (z) one vote for each Voting Preferred Unit held by such member. Holders of the Preferred Units were entitled to return of capital contributions prior to any distributions made to holders of the Common Units.

*Distributions.* Subject to any restrictions contained in any agreements involving payments to third parties, the board of directors of H&E Holdings could make distributions, whether in available cash or other assets of H&E Holdings, at any time or from time to time in the following order of priority:

*First,* to the holders of Series A Preferred Units in proportion to and to the extent of the Series A Preferred Redemption Values (as defined and described in the limited liability company agreement) of such Series A Preferred Units.

*Second,* to the holders of Series B Preferred Units in proportion to and to the extent of the Series B Preferred Redemption Values (as defined and described in the limited liability company agreement) of such Series B Preferred Units.

*Third,* to the holders of Series C Preferred Units, in proportion to and to the extent of the Series C Preferred Redemption Values (as defined and described in the limited liability company agreement) of such Series C Preferred Units.

*Fourth,* to the holders of the Series D Preferred Units, in proportion to and to the extent of the Series D Preferred Redemption Values (as defined and described in the limited liability company agreement) of such Series D Preferred Units.

*Fifth,* pro rata to the holders of Common Units, based upon the number of Common Units held.

The limited liability company agreement placed certain restrictions on the ability of H&E Holdings to make distributions attributable to the Preferred Units prior to June 30, 2022.

*Board of Directors.* The board of directors of H&E Holdings consisted of Class A Directors and Class B Directors. Each Class A Director was entitled to two votes and each Class B Director is entitled to one vote. At no time was the authorized number of Class B Directors to exceed that number which would provide all of the then authorized Class B Directors with a number of votes that exceeded 50% of the number of votes of the then authorized number of Class A

Directors. The Class A Directors were elected by the members which owned a majority of the number of votes of all Common Units then-outstanding. The Class B Directors were elected by the members which owned a majority of the number of votes of all of the Voting Preferred Units then-outstanding.

In connection with the Reorganization Transactions, the H&E Holdings operating agreement was terminated.

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**Related Party Transactions**

The Company has a policy that the Audit Committee review any transaction in which the Company and its directors, executive officers or their immediate family members are participants to determine whether a related person has a direct or indirect material interest. The Audit Committee is responsible for reviewing and, if appropriate, approving or ratifying any such related party transaction. This policy is evidenced in the Company's Code of Conduct and has been further communicated orally by the Board.

In determining whether to approve, disapprove or ratify a related party transaction, the Audit Committee will take into account, among other factors it deems appropriate, (i) whether the transaction is on terms no less favorable to the Company than terms that would otherwise be generally available to the Company if the transaction was entered into under the same or similar circumstances with a party unaffiliated with the Company and (ii) the extent of the interest of the related party in the transaction.

Below are the related party transactions which occurred during the fiscal year ended December 31, 2006. All such related party transactions have been approved or ratified by the Company's Audit Committee or are pursuant to contractual arrangements entered into prior to the Company's initial public offering.

John M. Engquist, our Chief Executive Officer and President, and his sister, Kristan Engquist Dunne, each have a 16.7% beneficial ownership interest in a joint venture, from which we lease our Baton Rouge, Louisiana and Kenner, Louisiana facilities. Four trusts in the names of the children of John M. Engquist and Kristan Engquist Dunne hold in equal amounts the remaining 16.6% of such joint venture. The remaining 50% interest is held by Tomarlee Commercial Properties, L.L.C., for which Mr. Engquist and Ms. Engquist Dunne each have a 25% interest and Mr. Engquist's mother has a 50% interest. In 2006, we paid the joint venture a total of approximately \$329,000 in lease payments related to these two branch location leases.

Mr. Engquist has a 62.5% ownership interest in T&J Partnership, from which we lease our Shreveport, Louisiana branch facility. Mr. Engquist's mother beneficially owns 25% of such entities. Kristan Engquist Dunne owns the remaining 12.5% of such entities. In 2006, we paid a total of approximately \$160,000 in lease payments for this facility.

Mr. Engquist and his wife, Martha Engquist, hold a 51% and 49% ownership interest, respectively, in John Engquist LLC, from which we lease our Alexandria, Louisiana branch facility. In 2006, we paid such entity a total of approximately \$71,000 in lease payments for this facility.

We charter an aircraft from Gulf Wide Aviation, L.L.C., in which Mr. Engquist has a 62.5% ownership interest. Mr. Engquist's mother and sister hold interests of 25% and 12.5%, respectively, in this entity. We pay an hourly rate to Gulf Wide Aviation for the use of the aircraft by various members of our management. In addition, a portion of one pilot's salary is paid by us. In 2006, our payments in respect of charter costs to Gulf Wide Aviation and salary to the pilot totaled approximately \$480,000.

Mr. Engquist has a 31.25% ownership interest in Perkins-McKenzie Insurance Agency, Inc. (Perkins-McKenzie), an insurance brokerage firm. Perkins-McKenzie brokers a substantial portion of our commercial insurance policies. Mr. Engquist's mother and sister have a 12.5% and 6.25% interest, respectively, in Perkins-McKenzie. As the broker, Perkins-McKenzie receives a commission from our insurance provider based upon the premiums paid to our insurance provider. In 2006, the commissions paid to Perkins-McKenzie were approximately \$743,000.

We purchase products and services from, and sell products and services to a company, B-C Equipment Sales, Inc. ( B-C Equipment ), in which Mr. Engquist has a 50% ownership interest. In 2006, our purchases from B-C Equipment totaled approximately \$117,000, and our sales to B-C Equipment totaled approximately \$37,000.

Dale W. Roesener, Vice President, Fleet Management, has a 47.6% ownership interest in Aero SRD LLC, from which we lease our Las Vegas, Nevada facility. In 2006, our lease payments to such entity totaled approximately \$523,000.

In connection with the recapitalization of H&E in 1999, we entered into a \$3.0 million consulting and non-competition agreement with Thomas R. Engquist, the father of John M. Engquist, our Chief Executive Officer and

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President. The agreement provided for total payments over a ten-year term, payable in increments of \$25,000 per month. Mr. Thomas Engquist was obligated to provide us consulting services and to comply with the non-competition provision set forth in the Recapitalization Agreement between us and others dated June 19, 1999. The parties specifically acknowledged and agreed that in the event of the death of Mr. Engquist during the term of the agreement, the payments that otherwise would have been payable to Mr. Engquist under the agreement shall be paid to his surviving spouse, Ms. Ruby L. Engquist. Ms. Engquist received \$300,000 during 2006 under this arrangement.

Mr. Engquist's son is one of our employees and received compensation of approximately \$194,000 in 2006.

**HOUSEHOLDING**

Some banks, brokers and other nominee record holders may be participating in the practice of householding proxy statements and annual reports. This means that only one copy of the Company's proxy statement or annual report may have been sent to multiple stockholders in your household. The Company will promptly deliver a separate copy of either document to you if you request one by writing or calling as follows: Investor Relations, 11100 Mead Road, Suite 200, Baton Rouge, LA 70816; Telephone: 225-298-5200. If you want to receive separate copies of the annual report and proxy statement in the future, or if you are receiving multiple copies and would like to receive only one copy for your household, you should contact your bank, broker or other nominee record holder, or you may contact the Company at the above address and phone number.

**OTHER BUSINESS**

The Company is not aware of any other matters that will be presented for stockholder action at the Annual Meeting. If other matters are properly introduced, the person named in the accompanying proxy will vote the shares they represent as recommended by the Board of Directors.

By Order of the Board of Directors

Leslie S. Magee  
*Chief Financial Officer and Secretary*

April 27, 2007



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**H&E Equipment Services, Inc.**  
**ANNUAL MEETING OF STOCKHOLDERS**  
**June 5, 2007**  
**8:00 a.m. Central Daylight Time**  
**Hilton Baton Rouge Capitol Center Hotel**  
**Governor s Room**  
**201 Lafayette Street**  
**Baton Rouge, LA 70801**

**H&E Equipment Services, Inc.**  
**11100 Mead Road, Suite 200**  
**Baton Rouge, LA 70816**

**proxy**

**This proxy is solicited by the Board of Directors for use at the Annual Meeting on June 5, 2007.**

The shares of stock you hold in your account will be voted as you specify on the reverse side.

**If no choice is specified, the proxy will be voted FOR Items 1 and 2.**

By signing the proxy, you revoke all prior proxies and appoint John M. Engquist and Leslie S. Magee, each of them with full power of substitution, to vote your shares on the matters shown on the reverse side and any other matters which may come before the Annual Meeting and all adjournments.

*See reverse for voting instructions.*

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**VOTE BY INTERNET OR TELEPHONE**

*Voting by Internet or telephone is quick, easy and immediate.* As a H&E Equipment Services, Inc. common stockholder of record, you have the option of voting your common shares electronically over the Internet or by telephone, eliminating the need to return this proxy card. Your electronic vote authorizes the named proxies to vote your shares in the same manner as if you marked, signed, dated and returned the proxy card. Votes submitted electronically over the Internet or by telephone must be received by 7:00 p.m. Eastern Daylight Time, on June 4, 2007.

***To Vote Your Proxy Over the Internet***

**[www.continentalstock.com](http://www.continentalstock.com)**

Have your proxy card available when you access the above website. Follow the prompts to vote your common shares.

***To Vote Your Proxy By Phone***

**1 (866) 894-0537**

Use any touch-tone telephone to vote your proxy. Have your proxy card available when you call the above number. Follow the voting instructions to vote your common shares.

**PLEASE DO NOT RETURN THE PROXY CARD IF YOU ARE VOTING OVER THE INTERNET OR BY TELEPHONE.**

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