Global Long-Term Incentives: Trends and Predictions

Results from the 2014 iQuantic® Global Long-Term Incentive Practices Survey

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Speakers

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Agenda

Introduction
• About the Survey Demographics

Decisions, Decisions—How Companies Decide Whether and How to Proceed with Equity-Based LTI
• 2014 Survey Results
• Summary

Participation
• Who is receiving equity?

Types of Equity
• What type of equity is being delivered?

Grant Reasons
• Why are companies granting equity?

Value Provided
• How much is being delivered?

Vesting of Grants
• When do employees receive equity?
Introduction

About the Survey
The iQuantic® Global Long-Term Incentive Practices (LTI) Survey covers the fundamentals of LTI plan design:

<table>
<thead>
<tr>
<th>Major Area of Plan Design</th>
<th>Survey Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Who?</td>
<td>• Participation</td>
</tr>
</tbody>
</table>
| What?                     | • Type of equity being granted  
                            | • How it is delivered |
| Why?                      | • Annual  
                            | • New hire, miscellaneous/special grants  
                            | • Performance-based grants |
| How Much?                 | • Number of shares/units  
                            | • Value |
| When?                     | • Vesting; term |
The 2014 iQuantic® Global LTI Practices Survey

40 countries

Americas
Argentina
Brazil
Canada
Mexico
United States

Asia Pacific
Australia
China
Hong Kong
India
Indonesia
Japan
Malaysia
New Zealand
Philippines
Singapore
South Korea
Taiwan
Thailand

Middle East/Africa
Israel
South Africa
Turkey
United Arab Emirates

Europe
Austria
Belgium
Czech Republic
Denmark
France
Finland
The Netherlands
Norway
Germany
Hungary
Ireland
Italy
Poland
Russian Federation
Spain
Switzerland
Sweden
United Kingdom
Our 20th Anniversary: A Trusted Resource Through Enormous Change

Events that have had an impact on equity programs since our launch:

- Tech bubble steadily grows through the 90s → War for talent
- Tech bubble pops → Underwater options
- Enron scandal → Sarbanes Oxley
- FAS 123(R) → Mandatory option expensing
- Financial crisis → TARP and Dodd Frank
- Recovery → War for talent

NASDAQ Composite Adjusted Closing Prices
Highlights from GLTI, Circa 2000

Well over half of all participating companies granted new-hire options to **ALL** employees.

Only 40% of the participating companies reported having a restricted stock plan and 0% actually granted them.

- Stock options were king.

Almost all international plans mirrored the grants being given at the US Headquarters company.

- Only 11% reported having formal regional differences in their granting practices.
This Year’s Survey

107 participants in 2014
55 participants in the LTI practices section
83 participants in the market LTI pay section

<table>
<thead>
<tr>
<th>Revenue ($000)</th>
<th>FTEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>75th</td>
<td>$16,500,000</td>
</tr>
<tr>
<td>50th</td>
<td>$4,623,000</td>
</tr>
<tr>
<td>25th</td>
<td>$1,800,000</td>
</tr>
</tbody>
</table>

Type of industry:
- Technology: 47%
- Life Sciences: 13%
- Other Industries: 40%
Decisions, Decisions—How Companies Decide Whether and How to Proceed with Equity-Based LTI
Decision-Making Process

Factors influencing the process

• Company-wide objectives
• Local market conditions
• Regulatory challenges
• Tax implications
• Cost of compliance
• Staffing to administer
What to Offer

- Stock Options
- Employee Stock Purchase Plan (ESPP)
- Restricted Stock Units (RSUs)
- Restricted Stock Awards (RSAs)
- Phantom Awards
- Cash LTI
- Nothing
What to Offer, and How Much

• How are the award types selected?
• How much do you modify award sizes for different locations?
• Do you offer the same thing everywhere or do you tailor for local considerations (tax, regulatory, cultural, etc.)?
Where to Offer

- Select countries or worldwide?
- Small number of employees?
- Countries with continued growth?
- How to respond to local executives’ challenges when their country has been excluded from eligibility?
Whom to Offer

- Broad-based awards
- Key employee awards
- Different awards to different levels
Overview of Survey Results/Global Trends

- Overall participation has continued to drop
  - Very targeted grants below the Director level
- Participation among senior management remains high
- Full-value awards continue to be the biggest component of the equity pay mix, but stock options continue to hang on to play a role in many companies
- The use of cash LTI has appeared to plateau
- While participation has gone down overall, the values of grants have increased somewhat
Who is receiving equity?

Participation rates
Slight drops or no changes in participation across the Americas and Europe, but slight increases in several Asia Pacific countries.

In all reported countries, 50th percentile participation rate is 0% for non-exempt employees.
Participation by Revenue
Select Countries

Median participation rates by company size (revenue)

Mixed bag of participation rates by company size. Generally, in the US and Canada smaller companies have higher participation rates while equity is granted more often at larger companies outside of North America. Japan and UK are the notable exceptions.
Participation by Functional Area

Percent of employees receiving LTI by functional area (technology industry)
Participation by Level
United States* – Historical

US median participation rates (2005-2014)

Participation rates for senior management generally stable over the period

Continued decline in participation at manager level and below

* Data for other selected countries located in Appendix.
What type of equity is being delivered?

Award Mix
Types of Equity
Award Mix – Select Countries

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>61%</td>
<td>59%</td>
<td>69%</td>
</tr>
<tr>
<td>Brazil</td>
<td>10%</td>
<td>14%</td>
<td>10%</td>
</tr>
<tr>
<td>Brazil</td>
<td>10%</td>
<td>16%</td>
<td>11%</td>
</tr>
<tr>
<td>Brazil</td>
<td>11%</td>
<td>21%</td>
<td>8%</td>
</tr>
<tr>
<td>Brazil</td>
<td>11%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Brazil</td>
<td>9%</td>
<td>17%</td>
<td>12%</td>
</tr>
<tr>
<td>Brazil</td>
<td>18%</td>
<td>9%</td>
<td>18%</td>
</tr>
<tr>
<td>Brazil</td>
<td>9%</td>
<td>9%</td>
<td>9%</td>
</tr>
</tbody>
</table>

- **Time-based restricted stock** continues to increase at non-executive levels.
- **Performance-contingent restricted stock** has seen a decline at non-executive levels.
- **Stock options** still playing a role though no longer the main attraction; Cash LTI receding or at a plateau.
Types of Equity
Award Mix – Select Countries

LTI pay mix among all employees

Much of the same trends in these select Asia-Pacific countries, with China experiencing the biggest shift toward time-based restricted stock over the prior years.
Much of the same trends in these select European countries
**Types of Equity by Employee Level**

**Award Mix – United States**

### US LTI pay mix by employee level (2012-2014)

<table>
<thead>
<tr>
<th>Year</th>
<th>CEO</th>
<th>Vice President</th>
<th>Individual Contributor</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>8%</td>
<td>26%</td>
<td>24%</td>
<td>43%</td>
</tr>
<tr>
<td>2013</td>
<td>7%</td>
<td>25%</td>
<td>25%</td>
<td>43%</td>
</tr>
<tr>
<td>2014</td>
<td>7%</td>
<td>33%</td>
<td>22%</td>
<td>38%</td>
</tr>
</tbody>
</table>

- **Time-Based Restricted Stock**
- **Performance Restricted Stock**
- **Stock Options/SARs**
- **Cash LTI**

**Time-based RS continues to lose favor at the CEO level**

**The lower in the organization you go, the greater the shift to service-based full-value shares**

**A stock option comeback or just a fluke?**
Why are companies granting equity?

Grant Reasons
Grant reasons

Distribution of grant reasons (by value delivered)

- **Proportion of ongoing/annual grants remains steady at ~80-85%**
- **A greater percentage of stock delivered were appropriated to Miscellaneous grants over New Hire grants**
Approximately half use these other types of awards. Grants for special skill sets have become popular. Companies regularly use equity in connection with retention, promotion and recognition.
Performance Awards

Performance Shares have dropped off somewhat (as noted earlier)

Most companies continue to use the “portfolio approach” at the executive level with two or three LTI vehicles making up the total package
Measuring “Performance”

Measures utilized to determine performance rewards

<table>
<thead>
<tr>
<th>Revenue</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>28%</td>
<td>40%</td>
<td>47%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Value creation</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic value added (EVA)</td>
<td>0%</td>
<td>4%</td>
<td>6%</td>
</tr>
<tr>
<td>Economic profit</td>
<td>2%</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>Return on capital vs. weighted average cost of capital</td>
<td>2%</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>Stock price</td>
<td>9%</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>Total shareholder return (TSR)</td>
<td>32%</td>
<td>32%</td>
<td>31%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Profit</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating profit</td>
<td>11%</td>
<td>21%</td>
<td>19%</td>
</tr>
<tr>
<td>Pretax profit</td>
<td>2%</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>After tax profit</td>
<td>2%</td>
<td>4%</td>
<td>0%</td>
</tr>
<tr>
<td>EBITDA</td>
<td>9%</td>
<td>13%</td>
<td>13%</td>
</tr>
<tr>
<td>EBIT</td>
<td>2%</td>
<td>6%</td>
<td>6%</td>
</tr>
<tr>
<td>Earnings per share (EPS)</td>
<td>28%</td>
<td>26%</td>
<td>13%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Profitability</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross margin</td>
<td>4%</td>
<td>13%</td>
<td>9%</td>
</tr>
<tr>
<td>Net margin</td>
<td>0%</td>
<td>2%</td>
<td>6%</td>
</tr>
<tr>
<td>Net interest margin</td>
<td>0%</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>Return on equity (ROE)</td>
<td>2%</td>
<td>4%</td>
<td>6%</td>
</tr>
<tr>
<td>Return on assets (ROA)</td>
<td>2%</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>Return on sales (ROS)</td>
<td>0%</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>Return on invested capital (ROIC)</td>
<td>19%</td>
<td>8%</td>
<td>13%</td>
</tr>
<tr>
<td>Cash flow return on invested capital (CFROIC)</td>
<td>0%</td>
<td>2%</td>
<td>3%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash flow</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash flow</td>
<td>2%</td>
<td>4%</td>
<td>9%</td>
</tr>
<tr>
<td>Operating cash flow</td>
<td>6%</td>
<td>4%</td>
<td>9%</td>
</tr>
<tr>
<td>Free cash flow</td>
<td>0%</td>
<td>6%</td>
<td>6%</td>
</tr>
<tr>
<td>Cash earnings per share</td>
<td>2%</td>
<td>6%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Most common performance share metrics are:
- Revenue
- TSR

Biggest loser -- EPS
Biggest winner -- ROIC

We typically see two quantitative metrics used in a plan for executives
How much is being delivered?

Value being provided
Grant values have increased or remained flat globally – with the exception of China and France where overall values were less than previous years.

Note: Values in this chart represent the overall average of all ongoing/annual grants made to ALL employees in that location.
Value as a Percent of Base Salary
Historical - Select Countries

Median value of equity as a percent of base salary (2012-2014)

With a focus on grants to higher-paid employees (VPs and Directors), it is not surprising to see the absolute values of the grants go up in the US, but go down when viewed as an overall % of base salary.
Value by Employee Level

Select Countries

Median value of equity (VPs)

- Brazil
- Canada
- United States
- China
- India
- Japan
- Philippines
- Singapore
- Finland
- France
- Germany
- United Kingdom

Comparison of median value of equity (VPs) for different countries in 2013 and 2014.
Value by Employee Level

Select Countries

Median value of equity (Directors)
Value by Employee Level

Select Countries

Median value of equity (Managers)

- Brazil
- Canada
- United States
- China (Asia)
- India
- Japan
- Philippines
- Singapore
- Finland (Europe)
- France
- Germany
- United Kingdom

2013 vs 2014
Value by Employee Level

Select Countries

Median value of equity (Individual Contributor - exempt)

- Brazil
- Canada
- United States
- China
- India
- Japan
- Philippines
- Singapore
- Finland
- France
- Germany
- United Kingdom

2013
2014
While participation rates vary by company size, smaller companies generally consistently deliver higher valued grants.
Value
Headquarters Comparison

Grants as a percent of HQ country

- **US** is benchmark for companies based in US
- With a few exceptions, values as percent of HQ dipped last year and have since come back to 2012 levels
When do employees vest in their equity?

Vesting Term Frequency
Not much change here in vesting and term in recent years—three- and four-year vesting most prevalent for both options and full-value awards.

Cash LTI plans tend to not go beyond 3 years as most companies find it difficult to set targets beyond 3 years.
Vesting Periods

Period when first portion of award vests (2014)

The majority of companies mark their first vesting tranche at the 1-year anniversary of grant.

Annual vesting (as opposed to monthly or quarterly) is the most common vesting schedule after the first tranche.

Stock Options/SARS
Full Value Shares
Cash LTI
What’s in Store for 2015?

• Looking into the crystal ball
  – Participation in the US will plateau and possibly even increase as the economy continues to strengthen
  – Time-based restricted shares will continue to be at the forefront for non-executive recipients
  – Options potentially making a comeback of sorts, but remains to be seen
  – A year ago would have said cash would continue to increase, but seems to have hit a plateau

• Keep an eye out for our Summary Trends report due out next month
Questions

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Appendix
Participation
India – Historical

India median participation rates (2008-2014)

- 2011 an apparent anomaly
- Very high participation for senior management
- Participation rates at all Exempt levels saw a slight increase in 2014
Participation
China – Historical

China median participation rates (2008-2014)

Stable at the VP level with slight bump in rates at Director level

Continued declines at Manager and below
Participation
Germany – Historical

Germany median participation rates (2008-2014)

- Stable at the VP and Director levels
- Steady drop for managers since 2011, but steady increase for lower exempt levels
Value by Employee Level

US Tech Industry

Grant values on steady increase at VP levels since 2009 after course corrections with this year being the first to see a slight decrease.

Continued material disparity between VP and other employee levels.