



Mastering Performance-Based Equity: New Frontiers in Executive Pay

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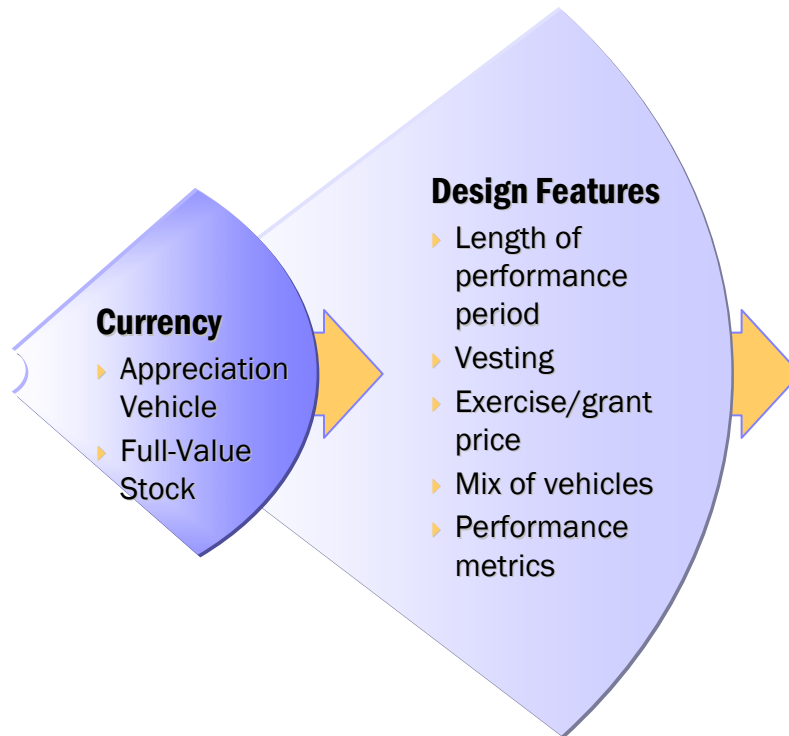
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Today's Agenda

- ▶ The Current Marketplace
- ▶ Equity Incentive Alternatives
- ▶ Developing a Performance-Based Equity Incentive Program
 - Identifying Your Objectives
 - Key Design Considerations
 - Key Administrative and Other Considerations
- ▶ Anticipating the Unexpected – How to Handle Termination Scenarios
- ▶ Questions

Long-Term Equity Incentive Alternatives



Long-term Incentive Plan Design Alternatives

1. **Stock Options:**

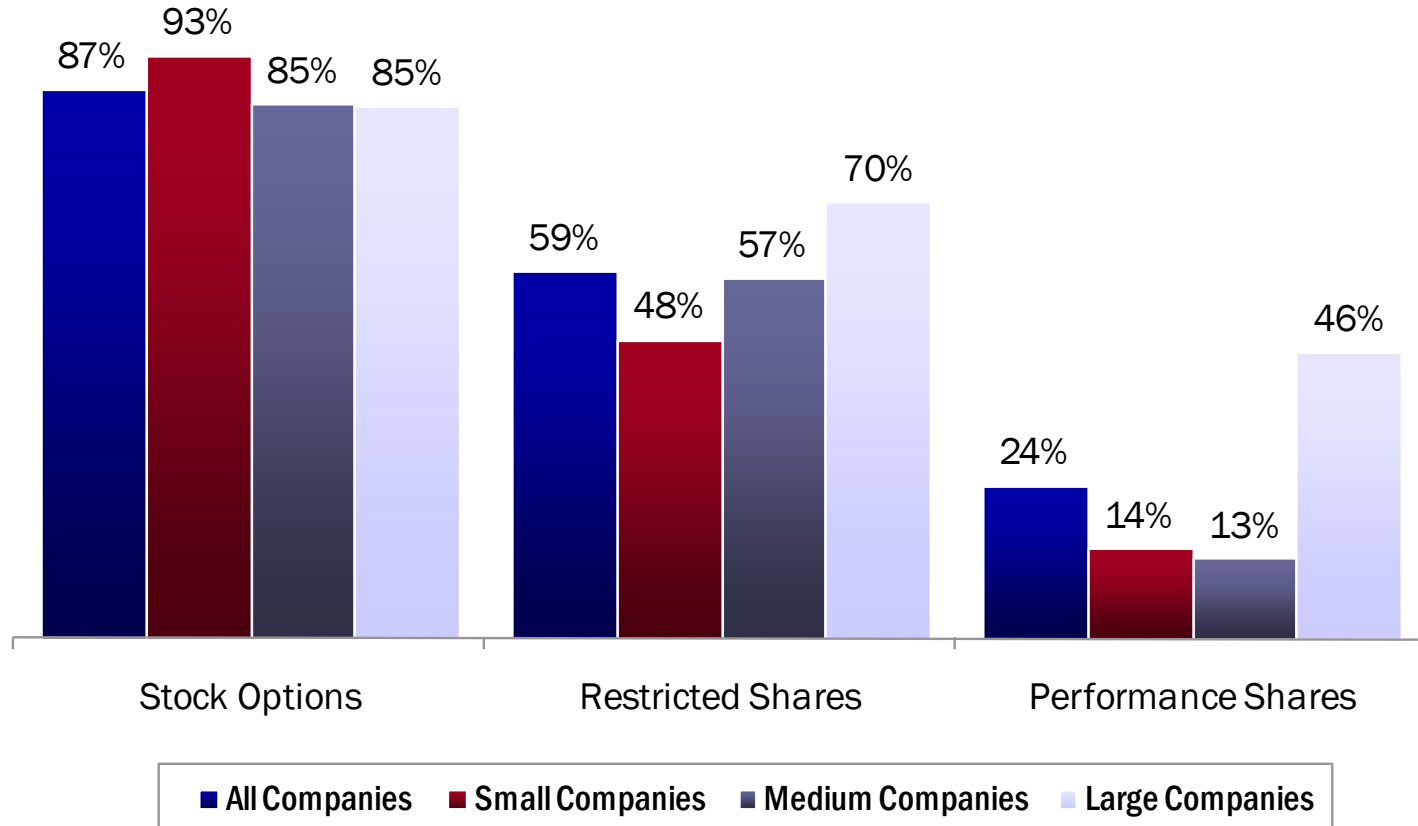
- ▶ Traditional stock options (time-based vesting)
- ▶ Performance-based stock options
- ▶ Indexed stock options
- ▶ Premium-priced stock options

2. **Full-Value Shares:**

- ▶ Restricted stock/units (time-based vesting)
- ▶ Performance-accelerated restricted stock/units
- ▶ Career stock
- ▶ Performance shares

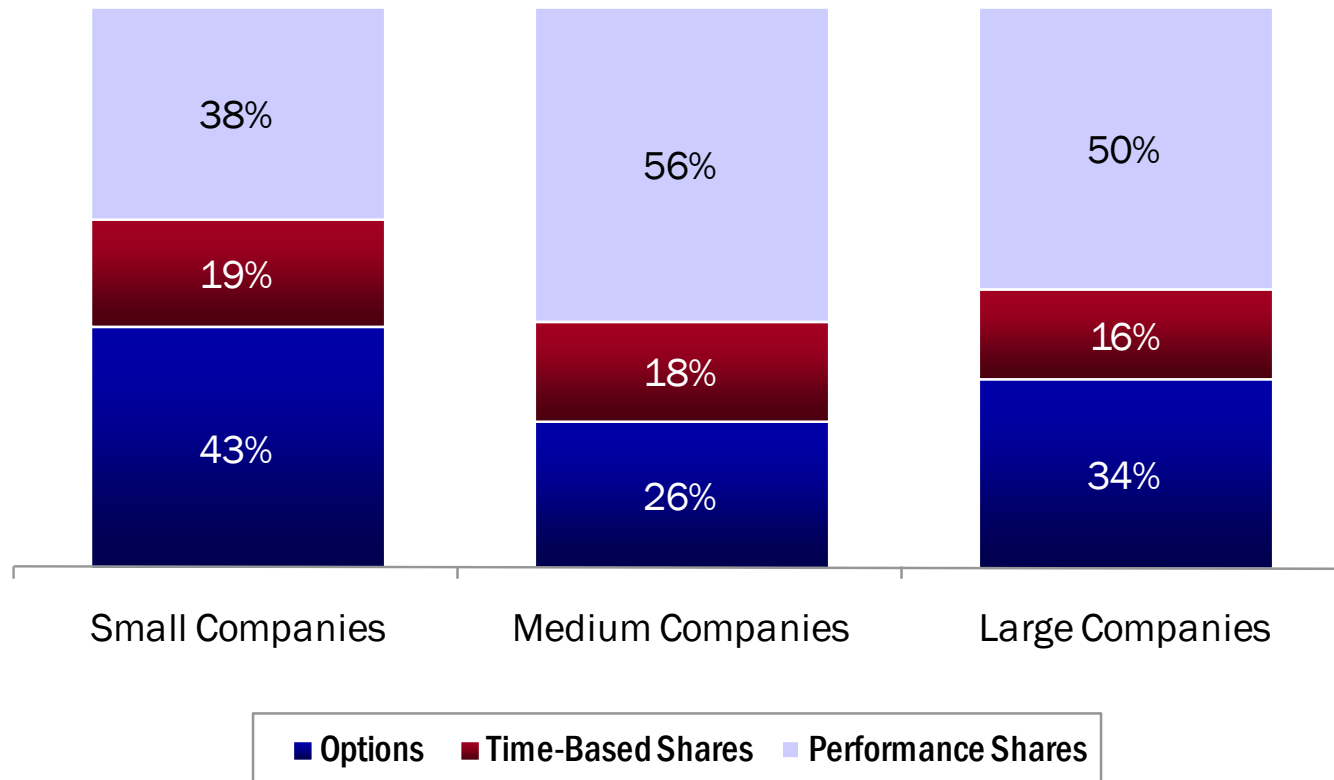
Equity Vehicle Usage

Prevalence of LTI Vehicle



Executive Equity/LTI Mix

Top 5 Executive Average LTI Mix



Performance-Based Equity Incentives

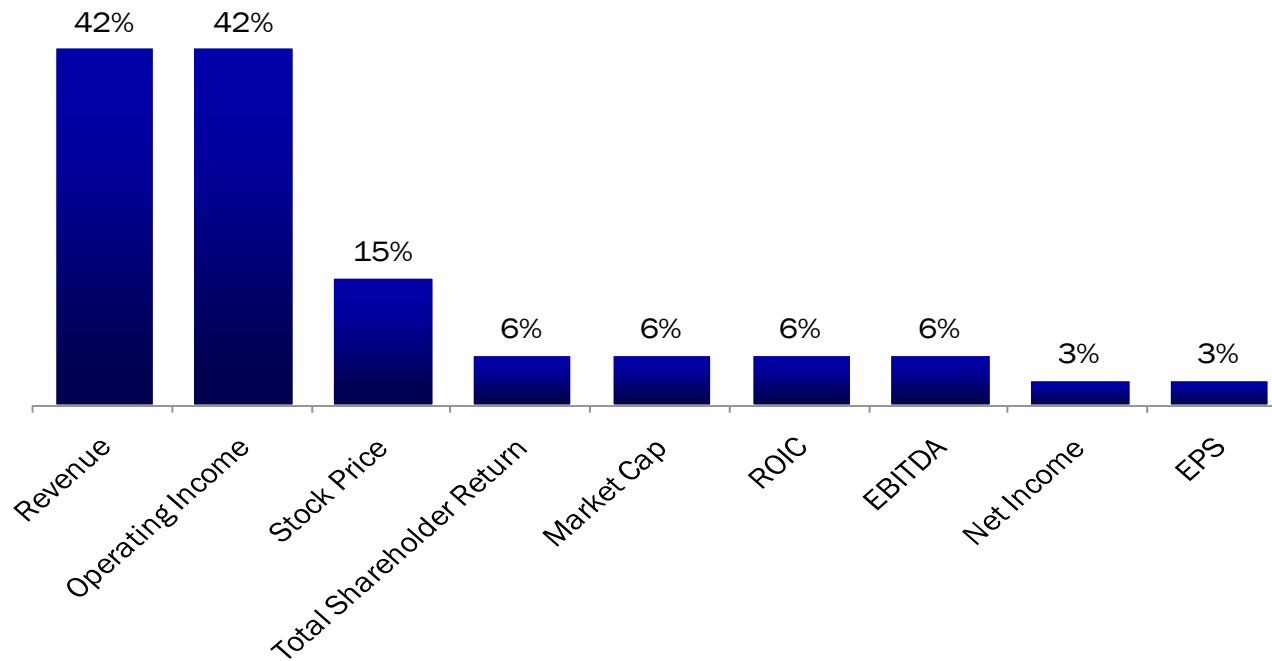
- ▶ Policy considerations
 - Identifying your strategic objectives
 - Alignment with your long-term business outlook (forecast)
 - Impact on competitive positioning of your executive compensation program
 - Relationship to accounting expense recognition requirements

Performance-Based Equity Incentives

- ▶ Design considerations
 - Accounting treatment of performance-based equity incentives
 - Awards with “performance conditions”
 - Awards with “market conditions”
 - Performance measures
 - Performance period
 - Performance measurement
 - Performance levels

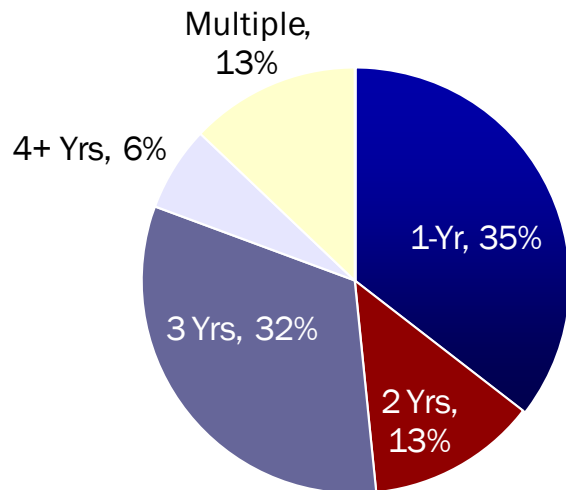
Performance Measures

Prevalence of Performance Share Metrics

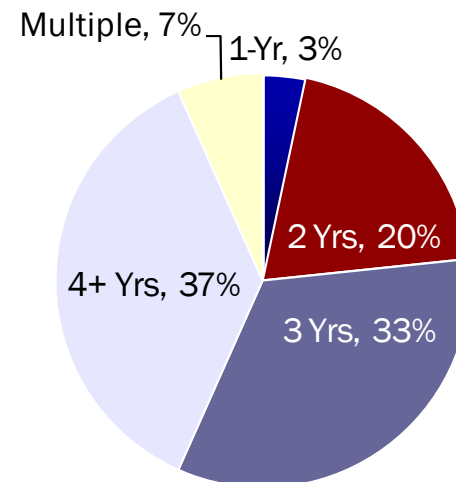


Performance Period

Performance Measurement Period

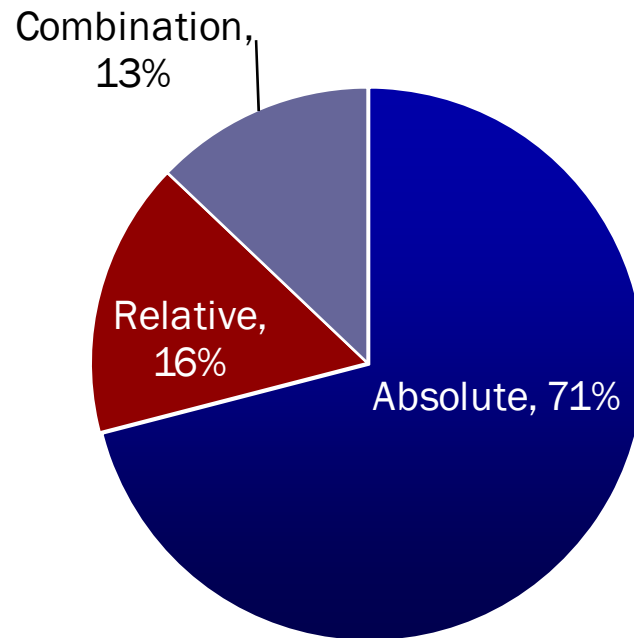


Total Vesting/Earning Period



Performance Measurement

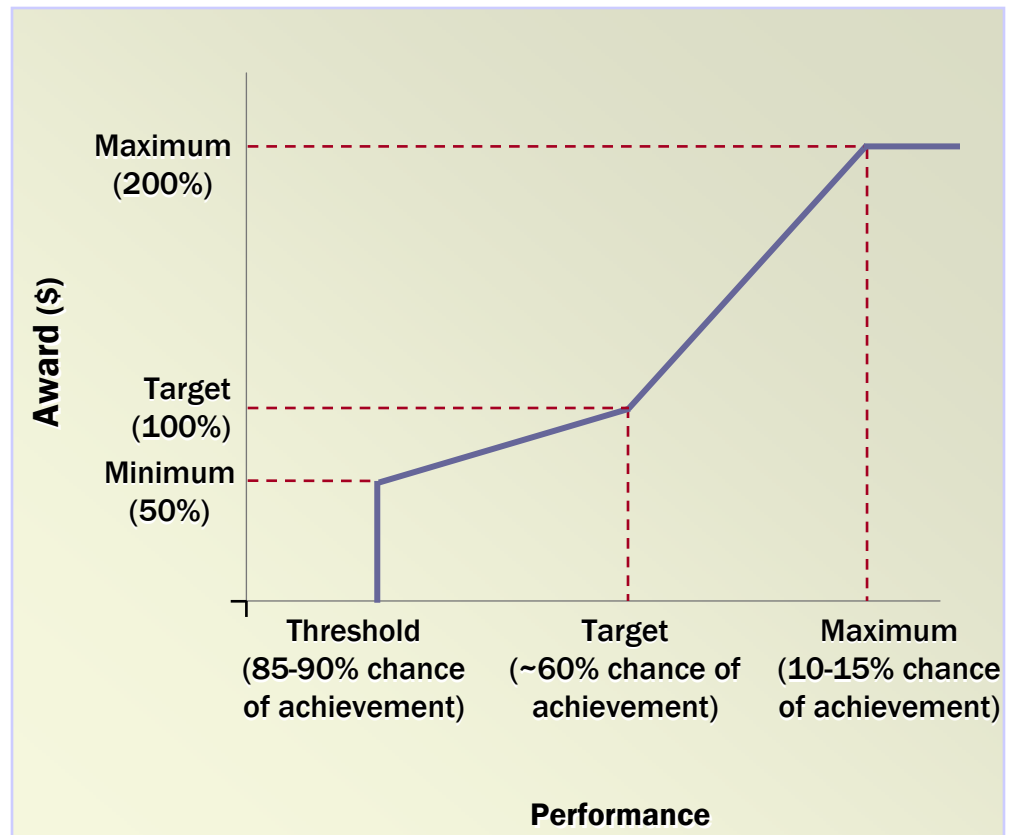
Performance Measure Comparison



Performance Levels

Proper alignment of target performance and payouts is crucial to incentive plan success

- ▶ **Threshold performance levels are typically very achievable (85-90% chance of achievement)**
- ▶ **Target performance levels are more difficult to achieve (~60% chance of achievement)**
- ▶ **Maximum performance levels are “stretch” goals, and very difficult to achieve (10-15% chance of achievement)**



Performance-Based Equity Incentives

- ▶ Administrative and other considerations
 - Employee communications
 - Issuance of shares
 - Performance measure tracking and calculations
 - Tax considerations
 - Shareholder issues
 - Disclosure

Anticipating the Unexpected

- ▶ Disposition of performance-based equity incentives in “special” situations
 - Termination of employment
 - Change in control of company
 - Death or disability of executive

Questions

Questions

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Common Long-Term Equity Incentive Vehicles

Equity Vehicle	Description
1. Stock Options	
<i>Traditional Stock Options</i>	▶ A right to buy a set number of shares at a specified price for a specified period of time
<i>Performance-based Stock Options</i>	▶ A right to buy shares that becomes exercisable only as (and to the extent) performance targets are met
<i>Indexed Stock Options</i>	▶ A stock option with a variable exercise price which is reset periodically based on the stock price performance of a comparison index (e.g., the QQQQ, peer companies, etc.)
<i>Premium-Priced Stock Options</i>	▶ A stock option that has an exercise price greater than the market value on the grant date (e.g., 120% of grant date market price)
2. Full-Value Shares	
<i>Restricted Stock Units (RSUs)</i>	▶ A vehicle that represents a promise to pay a set number of shares at a specified point in the future, assuming continued employment
<i>Performance-Accelerated RSUs</i>	▶ Same as time-based RSUs, except that restrictions can also lapse sooner than the time-based schedule upon attainment of pre-established performance targets; targets can be operational or tied to stock price
<i>Career Stock</i>	▶ A promise to pay a set number of shares with a very long vesting time horizon (e.g., 10 years)
<i>Performance Shares (operational goals)</i>	▶ Same as time-based RSUs, except that vesting is tied to attainment of pre-established operational performance targets
<i>Performance Shares (relative stock price goals)</i>	▶ Same as time-based RSUs, except that number of shares earned is tied to attainment of pre-established relative stock price goals; often a minimum number of shares will vest irrespective of stock price performance