Understanding U.S. Equity Compensation Analysis

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About Glass Lewis

Glass Lewis is the world's choice for governance solutions. We enable institutional investors and publicly listed companies to make sustainable decisions based on research and data. We cover 30,000+ meetings each year, across approximately 100 global markets. Our team has been providing in-depth analysis of companies since 2003, relying solely on publicly available information to inform its policies, research, and voting recommendations.

Our customers include the majority of the world's largest pension plans, mutual funds, and asset managers, collectively managing over $40 trillion in assets. We have teams located across the United States, Europe, and Asia-Pacific giving us global reach with a local perspective on the important governance issues.

Investors around the world depend on Glass Lewis' **Viewpoint** platform to manage their proxy voting, policy implementation, recordkeeping, and reporting. Our industry leading **Proxy Paper** product provides comprehensive environmental, social, and governance research and voting recommendations weeks ahead of voting deadlines. Public companies can also use our innovative **Report Feedback Statement** to deliver their opinion on our proxy research directly to the voting decision makers at every investor client in time for voting decisions to be made or changed.

The research team engages extensively with public companies, investors, regulators, and other industry stakeholders to gain relevant context into the realities surrounding companies, sectors, and the market in general. This enables us to provide the most comprehensive and pragmatic insights to our customers.

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Overview

Glass Lewis reviews equity-based compensation plans on a case-by-case basis by analyzing a variety of criteria we believe are key to equity value creation. We conduct a detailed examination of each equity plan, evaluating the number of shares requested and their granting pattern, the costs of the plan and several relevant structural and design features.

We analyze most equity plans using a detailed model and analyst review. The results of our model include a suggested recommendation based on a standardized scoring framework. The weightings and parameters of individual tests are dynamic and vary based on Company industry and size. While passing or failing a test is binary, the impact is not. For most tests, the severity of the failed result and other relevant factors may increase or decrease the score attributable to this test. Finally, analysts review all failed tests and the formulaic recommendations generated by the model to ensure that the final recommendation and the contributing factors are reasonable and appropriate in light of all available disclosure. In a small minority of cases, Glass Lewis analysts will deviate from the model recommendation and provide their own explanation of the final recommendation.

Where factors such as recent, significant changes to the Company's outstanding shares or an absence of equity granting history limit results from our key tests, we will analyze equity plans with with greater attention to a narrower set of applicable calculations and to the qualitative features outlined below. Finally, many of Glass Lewis's investor clients have adopted additional rules and policies based which use the tests and data underlying Glass Lewis's model to establish new voting policies that do not always line up with the Glass Lewis recommendation.

Calculations

Shares requested as a % of outstanding shares = shares requested / shares outstanding at FYE

Potential dilution based on shares requested = shares requested / (shares outstanding at FYE + shares requested)

Simple Overhang = (options outstanding + full-value awards outstanding + awards available for future issuance + shares requested) / shares outstanding at FYE

Fully diluted overhang = (options outstanding + full-value awards outstanding + awards available for future issuance + shares requested) / (shares outstanding at FYE + options outstanding + full-value awards outstanding + awards available for future issuance + shares requested)

Burn rate = (options granted + full-value awards granted) / shares outstanding at FYE

Program and Share Request Size Analysis

Failures under the below tests generally indicate that the Company's results are more than one standard deviation above the sector-based peer group mean.

Existing Size of Pool

Test Weighting: Medium
Basis: Absolute, quantitative

This test considers whether the Company's existing share pool appears to be sufficient in the near term based on projected granting practices, excluding the proposed increase in shares reserved for issuance.

Pro-Forma Available Pool

Test Weighting: Medium
Basis: Absolute, quantitative

This test assesses the size of the requested program, comparing the number of shares requested in addition to shares currently available for grants against the projected granting practices. Factors such as growth in the number of the Company's employees or significant changes to share counts occurring after the fiscal year end may also be included as part of the assessment under this test. 2

Grants to Executives

Test Weighting: Low
Basis: Absolute, quantitative

This test compares the grants made to named executive officers as a percentage of the total grant made during the fiscal year.

Pace of Historical Grants

Test Weighting: Medium to High
Basis: Absolute, quantitative

This test considers the Company's net recent grants against the Company's outstanding shares as an indicator of the Company's share usage under its equity plans.

Overhang

Test Weighting: Medium to High
Basis: Relative and absolute, quantitative

This test considers the overhang of the Company's equity compensation arrangements, including any proposed increases, with results compared to an absolute threshold and a sector-based peer group.

Program Cost Analyses

Failures under the below tests generally indicate that the Company's results are more than one standard deviation above the sector-based peer group mean.

Projected Cost As a % of Operating Metrics

Test Weighting: Medium to High
Basis: Relative, quantitative

This test considers the projected cost of grants under this plan as a percentage of certain operating metrics for the Company's last twelve months.

Projected Cost as a % of Enterprise Value

Test Weighting: Medium to High
Basis: Relative, quantitative

This test compares the projected cost of grants under the plan as a percentage of enterprise value. 3

Expensed Costs as a % of Operating Metrics

Test Weighting: Low to Medium
Basis: Relative, quantitative

This test compares the reported cost of stock-based compensation for the most recently completed fiscal year to certain financial metrics for that same year.

Expensed Costs as a % of Enterprise Value

Test Weighting: Low to Medium
Basis: Relative, quantitative

This test considers the reported cost of stock-based compensation for the most recently completed fiscal year to the Company's enterprise value.

Qualitative Features

Program Features

Test Weighting: Low, unless otherwise noted
Basis: Absolute, qualitative

- **Repricing (very high weighting)**. Glass Lewis strongly opposes repricing provisions, which give the administrators the express right to reprice options that become underwater without shareholder approval. We do not believe that employees should have no downside risk in the event that the Company's stock falls dramatically. Separately, we believe that plans which allow the administrator to buy out a participant's options and do not sufficiently protect against similar "pay for failure" situations similarly warrant serious concern. As such, Glass Lewis will generally recommend against plans with such provisions.

- **Evergreen Provisions (high weighting)**. Generally, plans have a fixed share limit that decreases with usage, although some plans provide for automatic replenishment of the shares available for grant. Plans with these so-called "evergreen" provisions have the effect of reducing or eliminating the need for management to come back to shareholders to authorize additional stock for the equity-based compensation program. As noted above, we believe that companies should come to their shareholders at reasonably frequent intervals to seek expansion of the award pool. We believe that shareholders should retain the right to approve increases in shares granted under equity plans, thereby having input into the number of shares granted, based on their evaluation of the Company's prior equity granting history.

- **Reload Options (high weighting)**. A participant with a reload option who pays for stock in whole or in part with stock owned may be granted another option to purchase the number of shares tendered, effectively doubling the number of shares subject to the award. Such provisions may significantly increase the cost and dilution resulting from the plan.

- **Below Fair Market Value**. Plans which allow for the grant of non-qualified options with exercise prices that may be less than the fair market value of the Company's common stock on the date of grant can increase the cost of the Company's non-qualified options.

- **Management of the Program**. We believe that the administrator of a plan (the board, committee, or other entity as specified in a plan) should be comprised entirely of independent outsiders.

- **Loans to Employees for Exercise**. Does the program allow for loans or promissory notes for settlement of the exercise price? In our view, programs should not allow for loans or promissory loans for settlement of the exercise price of stock options. We believe that employees should use their own money and have tangible downside risk in the stock, like other shareholders.

- **History of Repricing**. Glass Lewis is firmly opposed to repricing of employee and director options. We believe that option grantees and actual shareholders should have similar economic exposure; the closer their fates, the more likely employees are to be motivated to take appropriate risks and seek appropriate opportunities for the Company.

- **Change of Control Provisions**. Glass Lewis believes that plans should not provide for immediate vesting of equity awards in the event of a change in control. Such provisions may discourage potential buyers from making an offer for the Company both because the purchase price will be higher and because of the increased cost and challenge of retaining employees who receive a substantial change in control payment. In short, we believe that this sort of provision may lower the chances of a deal, lower the premium paid to shareholders in a takeover transaction or both. Finally, other factors such as the specific terms of the change in control provisions may be considered by analysts qualitatively.

- **Full-Value Award Multiplier**. In our view, plans which allow for the grant of both full-value and appreciation-based awards (stock options or other equivalent awards) should account for the difference in the value between the two award types as it relates to the share count and usage. Without a multiplier or an aggregate limit on the number of full-value awards, companies which elect to use full-value awards may see plans last longer than they otherwise would and at a greater total cost to shareholders.

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