Radford Review: 2015 Say-on-Pay Results and Governance Trends in the US Life Sciences Sector

A reflection on five years of Say-on-Pay votes

Prepared by Radford
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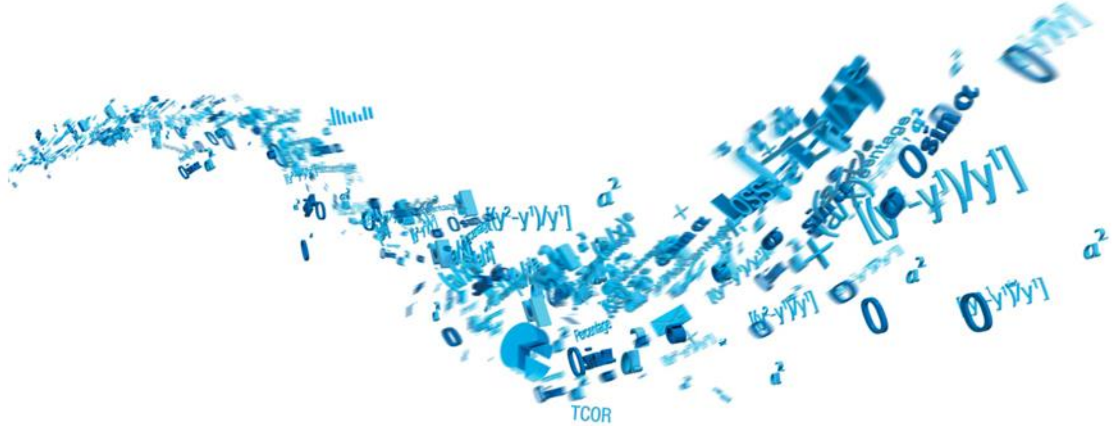


2015 Say-on-Pay Results

2015 Say-on-Pay Results Snapshot

91%
Average shareholder support levels in 2015

- **Life Sciences vs. Russell 3000 Average Shareholder Support Levels**: Support levels in the fifth year of Say-on-Pay voting are up nominally from 2014– 91.1% this year vs. 90.6% in 2014– reflecting generally strong continued support of Say on Pay. Average support for life sciences companies is comparable to that across the Russell 3000.

15%
Life sciences companies receiving "Against" vote from ISS in 2015

- **Bio/Pharma vs. Russell 3000 ISS Support Rate**: ISS "Against" recommendations are significantly more prevalent among bio/pharma companies where ISS opposes Say-on-Pay proposals at more than 1.5x the clip that it does across the broader Russell 3000 (10%). Bio/pharma companies are less likely to align with ISS' qualitative "best practices" in executive pay, and high stock volatility in the sector yields more quantitative "pay-for-performance disconnects."

6 vs. 4
Median biotech ISS QuickScore *(scored on 1-10 scale with 1 representing lowest and 10 the highest level of "compensation risk")*

- **Bio/Pharma vs. Russell 3000 Median ISS QuickScore**: Bio/Pharma companies are especially penalized by ISS' "QuickScore" governance rankings related to compensation. Based on ISS' standards, prevailing compensation practices among bio/pharma companies pose greater levels of "compensation risk" that contribute directly to ISS' greater willingness to recommend against Say on Pay in this sector.

1.7%
Say-on-Pay failure rate

- **Say-on-Pay Failures**: Still, outright failures on Say-on-Pay are rare and materially *lower* than a year ago; 1.7% thus far in 2015 vs. 3.5% in 2014. This reflects companies' increasing effectiveness at explaining and rationalizing their pay programs to institutional investors, who in turn are increasingly flexible with life sciences practices and willing to overrule ISS where circumstances warrant.

26%
Average difference in support between ISS "For" and "Against" votes in Life Sciences

- **Say-on-Pay Failures**: ISS votes continue to have considerable weight in the final vote outcome for companies receiving an adverse recommendation. Companies passing with less than 70% support are at greatly increased risk of receiving continuing "Against" votes from ISS in subsequent years unless they can point to formal shareholder engagement efforts and concrete changes to compensation programs made after the Say-on-Pay vote.

Key 2015 Say-on-Pay Metrics

- The following table presents summary 2015 Say-on-Pay voting results and shareholder returns for both sub-industries within the Russell 3000 life sciences sector

	TSR Performance		2015 Voting Results		Prevalence of Poor Outcomes		
Industry Groupings	**Median 1-Year TSR**	**Median 3-Year TSR**	**Average % For**	**Median % For**	**ISS Rec. Against**	**Below 70% Threshold**	**Below 50% Threshold**
Biopharmaceuticals	13%	21%	90%	96%	18%	9.2%	2.6%
Healthcare Equipment	16%	23%	92%	95%	13%	4.9%	1.0%
Overall Life Sciences Sector	**14%**	**22%**	**91%**	**95%**	**15%**	**6.7%**	**1.7%**
Overall Russell 3000	**8%**	**19%**	**92%**	**97%**	**11%**	**4.7%**	**1.7%**

- Although stock returns in the life sciences sector exceed those across the broader Russell 3000, Say-on-Pay voting support is nominally lower in life sciences, and the prevalence of negative ISS recommendations and aggregate support levels of 70% or lower is markedly higher in life sciences than the Russell 3000
  - This is attributable in part to more variation in pay-vs.-performance outcomes in life sciences as a result of stock volatility
  - Also, the qualitative pay practices in life sciences generally lag the “best practices” promulgated by ISS that are more prevalent in other industries

5-Year Say-on-Pay Snapshot

- The following grids track notable metrics around Say-on-Pay voting in the Life Sciences sector, from Say-on-Pay's advent in 2011 through 2015

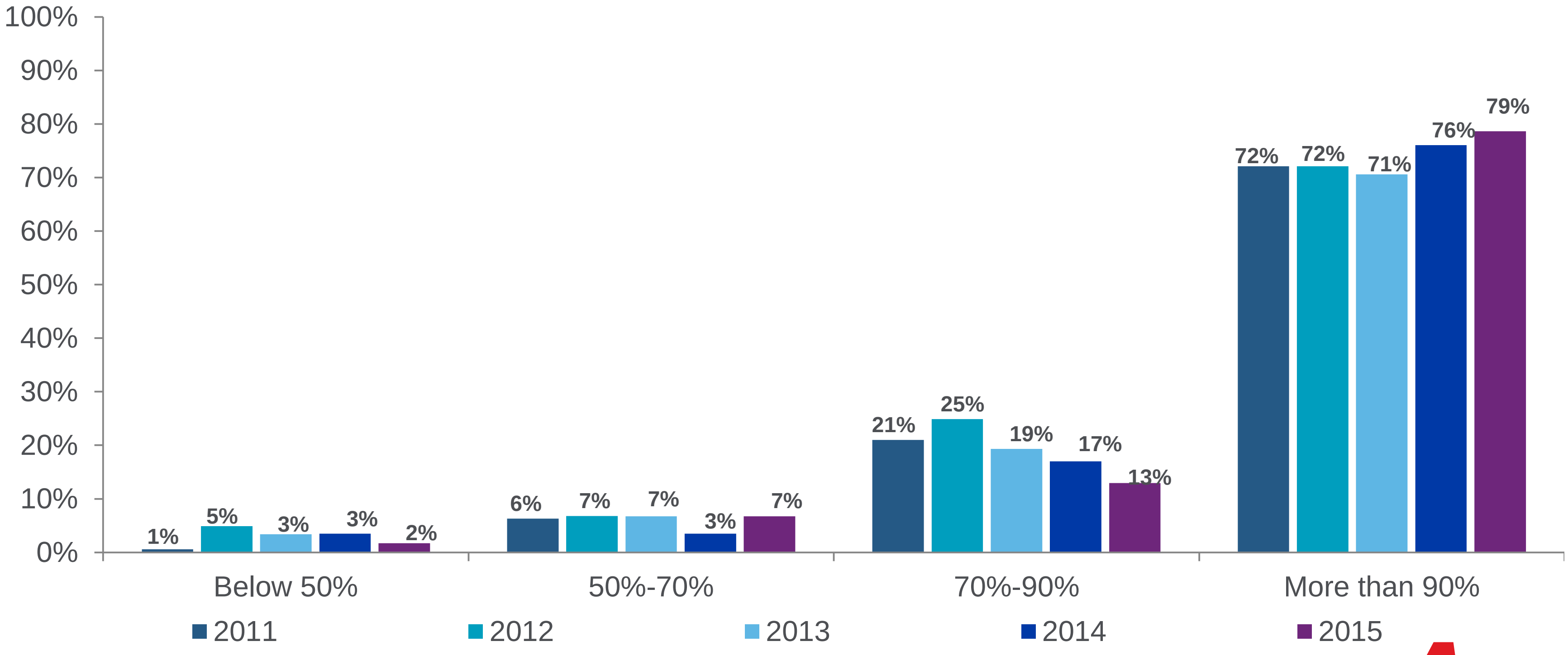
	2011	2012	2013	2014	2015
Say-on-Pay Failures	0.6%	4.9%	3.4%	3.5%	1.7%
Average Shareholder Support (% of total votes cast for Say-on-Pay)	91%	87%	90%	91%	91%
ISS "Against" Recommendations	12%	19%	14%	12%	15%
ISS "Win" Rate (% of cases where ISS "Against" yielded a failed Say-on-Pay vote)	5%	25%	24%	28%	11%

- ISS "Against" recommendations are up, but average levels of shareholder support are holding up and outright Say-on-Pay failures are actually down
- Companies have largely formulated effective strategies for engaging with shareholders in the context of a negative ISS recommendation, and investors have implemented methodologies that allow them to be cognizant of and sensitive to the particular exigencies of life sciences

Year-Over-Year Shareholder Support Levels from 2011 to 2015

- Say-on-Pay voting behavior appears to be stabilizing as investors arrive at sustainable and defined methodologies, with approximately three-fourths of companies receiving strong support of 90% or more annually
- Companies with Say-on-Pay support below 70% are under strong pressure to implement and disclose formal shareholder engagement plans and to make concrete pay reforms in the year after the weak Say-on-Pay vote
- ISS will continue to recommend against Say on Pay and potentially withhold votes from directors at companies that fail to take these steps following a Say-on-Pay vote below 70%

Distribution of Shareholder Support Levels – Annual Voting Results



The Impact of ISS: Say-on-Pay Results Following An “Against” Vote

- While ISS recommendations continue to drive shareholder voting in a meaningful way, fewer companies are actually failing outright as the result of an adverse ISS vote recommendation in 2015
- Instead, we see companies able to persuade shareholders via proactive outreach programs to support Say on Pay in sufficient numbers to pass the proposal, but in many cases with significant holdouts putting the company at below 70% in aggregate support

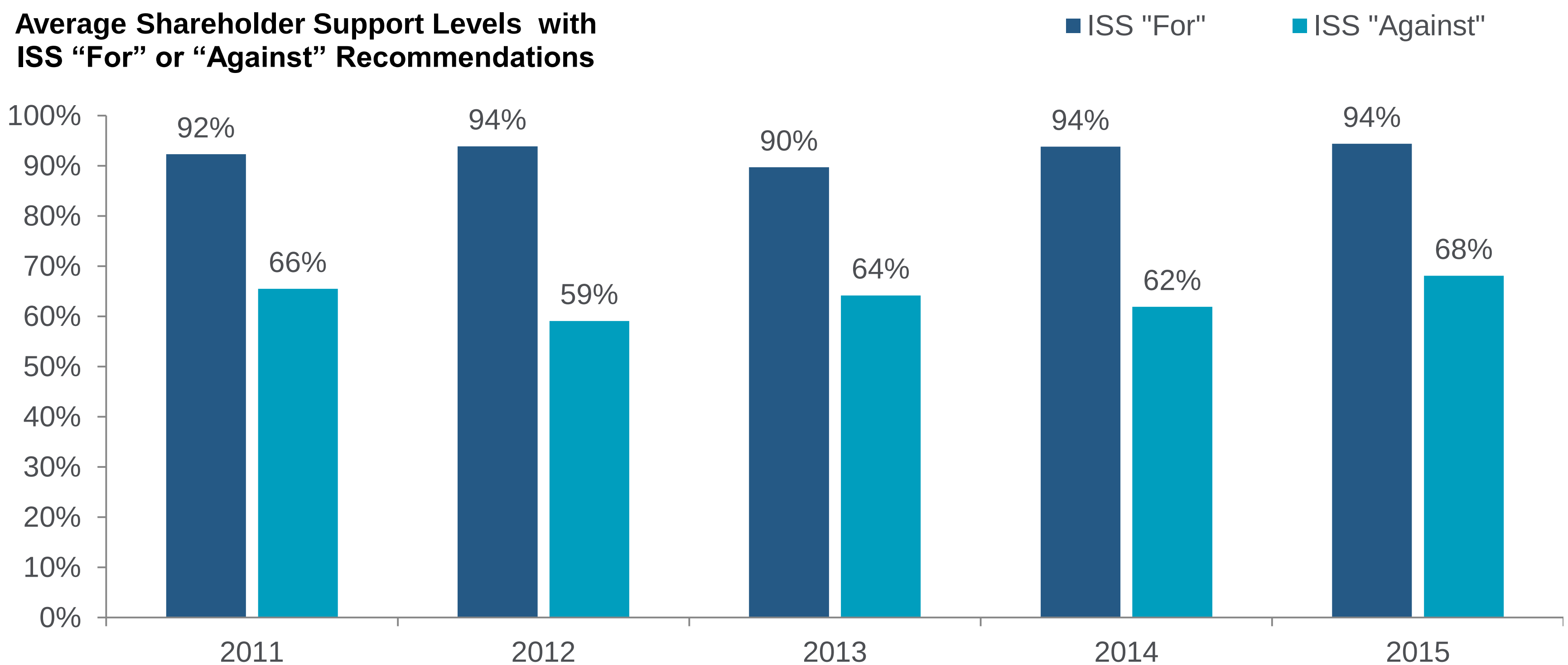
Annual Say-on-Pay Vote Outcomes Following ISS “Against”					
	2011	**2012**	**2013**	**2014**	**2015**
Passed Above 70%	50%	45%	38%	45%	46%
Passed Below 70%	46%	30%	38%	26%	41%
Failed	4%	26%	24%	29%	14%

- This will compel a large proportion of life sciences companies to provide detailed discussion of shareholder engagement efforts and concrete pay decisions made in response to the 2015 Say-on-Pay vote in their next CD&A, or risk ISS “withhold” recommendations on Directors

Measuring the Future Impact of ISS

- Average support levels for companies where ISS recommends “Yes” on Say-on-Pay are at their highest level ever in 2015
- Voting support at companies that receive a “No” recommendation from ISS are also at a 5-year high
  - Investors are increasingly willing to support Say on Pay even over the objections of ISS
  - Companies are getting more effective at making a compelling case to investors to overrule ISS

Average Shareholder Support Levels with ISS “For” or “Against” Recommendations



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Investor Concerns and Governance Developments

Problematic Pay Practices: Top Investor and Proxy Advisor Concerns

Radford has examined the most oft-cited reasons for voting against Say on Pay among the most active institutional investors:

Issue	Why Investors Care
Mega-Grants	One-time retention or new-hire grants have become an emerging issue; ISS' tolerance for these awards appears to have dipped sharply in 2015 compared to a year ago, and institutional investors seem to be following ISS' lead
Poor Disclosure	Investors show concern over lack of detail around how payouts for variable incentive programs are linked to company and/or individual performance
Lack of Responsiveness	Failure to adequately respond to prior year's low Say-on-Pay votes, including engagement and action to remove problematic pay practices
Lack of Performance Goals	If aggregate pay levels are high, it is critical to be able to point to specific performance metrics tied to equity and annual cash incentives; TSR-based programs are the "safest harbor" for equity programs, although they can pose serious challenges for highly volatile, development stage life sciences companies

Dodd-Frank Update

- Long delayed as a result of the complexity of implementation and political gridlock, outstanding rulemaking under Dodd Frank appears poised to move forward, potentially very rapidly
  - The SEC in April issued proposed rules related to pay-vs.-performance disclosure with final rules expected later this year to take effect during 2016 proxy season
  - Clawback and hedging rules were proposed in July; implementation is expected in 2016
  - A final pay ratio rule, when announced, would be subject to a one year implementation period during which companies would compile the mandated data, with actual disclosure in the next CD&A (e.g. final rule in 2015 → compile pay ratio data in 2016 and disclose in 2017)

Dodd-Frank Rule	Status with SEC	Expected Implementation
Say-on-Pay	Final and Active	Active
Say-on-Golden Parachutes	Final and Active	Active
Committee Independence	Final and Active	Active
Consultant Independence	Final and Active	Active
Pay-for-Performance Disclosure	Proposed Rule in April 2015	2016 Disclosures
Pay Ratio Disclosure	Proposed Rule Still Pending	2017 Disclosure (if Final Rule is adopted in 2015)
Anti-Hedging	Expect Rule Proposal in 2015	2016 Disclosures
Clawbacks	Proposed Rule in July 2015	2016 Disclosure

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