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

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

Prepared by Radford
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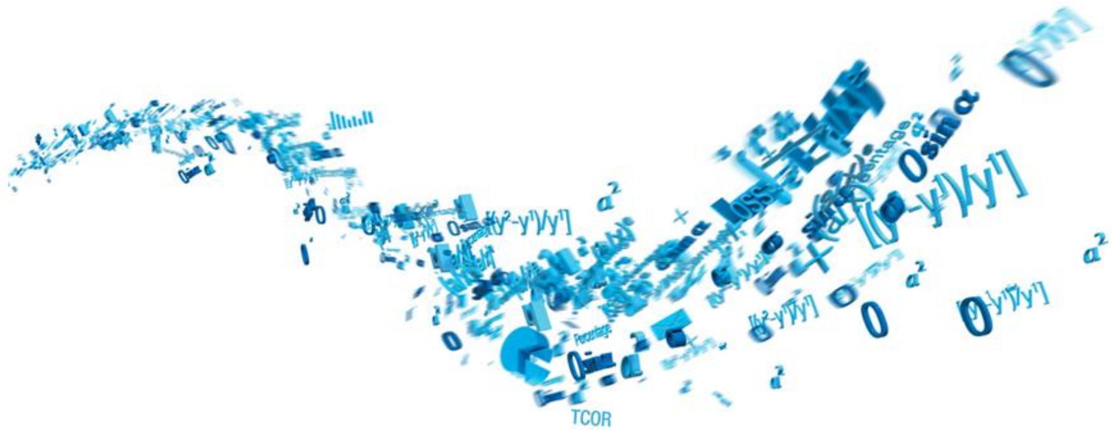


2015 Say-on-Pay Results

2015 Say-on-Pay Results Snapshot

92%

Average shareholder support levels in 2015

- **Technology Average Shareholder Support Level is Aligned with Russell 3000**: Average Say-on-Pay support levels in the fifth year of Say-on-Pay voting recovered to 91.6% following a dip below 90% the year prior. Technology Say-on-Pay voting is in line with that of the broader Russell 3000 across all industries, which is also at 92% average support.

13%

Technology companies receiving "Against" vote from ISS in 2015

- **Technology vs. Russell 3000 ISS Support Rate**: This year the prevalence of ISS "Against" recommendations dropped to 13.0% in the technology sector, down from 15.6% in 2014, but still materially higher than the broader Russell 3000 at 10.6%. The chief factor driving this is lower one-year stock performance in the software sector, which yields a high rate of "pay-for-performance disconnects" under the ISS methodology when stock awards are made at higher values at the start of the year, followed by the stock trending downward.

5 vs. 4

Median Technology ISS QuickScore *(scored on 1-10 scale with 1 representing lowest and 10 the highest level of "compensation risk")*

- **Technology vs. Russell 3000 Median ISS QuickScore**: Technology companies are slightly more penalized by ISS' "QuickScore" governance rankings related to compensation. Based on ISS' standards, prevailing compensation practices among software, hardware and semiconductor companies pose greater levels of "compensation risk" that contribute directly to ISS' greater willingness to recommend against Say on Pay in this sector.

1.6%

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, running at 1.6% thus far in 2015 vs. 3.2% in 2015. This reflects companies' increasing effectiveness at explaining and rationalizing their pay programs to institutional investors, which in turn are increasingly flexible with technology company practices and willing to overrule ISS where circumstances warrant.

30%

Average difference in support between ISS "For" and "Against" votes in Technology

- **Say-on-Pay Failures**: ISS votes continue to weigh considerably 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 taken after the Say-on-Pay vote.

Key Say-on-Pay Metrics

- The following table presents summary Say-on-Pay voting results and shareholder returns for all sub-industries within the Russell 3000 technology sector
- The most marked variance between technology Say-on-Pay vote results and broader industry voting across the Russell 3000 is in the software sector, where ISS recommends against Say on Pay at nearly double the rate it does for the Russell 3000
- One-year total stockholder returns in software have been materially lower than across the rest of the technology sector or the broader Russell 3000
  - This has led directly to a materially larger proportion of software companies receiving negative ISS recommendations and lower levels of shareholder support than in other industries

	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
Software & Services	3%	17%	92%	97%	20%	6.7%	1.1%
Hardware & Equipment	9%	12%	92%	95%	8%	3.5%	1.2%
Semiconductor	16%	15%	92%	97%	11%	5.5%	1.8%
Telecommunications	3%	9%	92%	96%	6%	--	5.6%
Overall Technology Sector	**6%**	**14%**	**92%**	**96%**	**13%**	**4.9%**	**1.6%**
Overall Russell 3000	**8%**	**19%**	**92%**	**97%**	**11%**	**4.7%**	**1.7%**

Say-on-Pay Snapshot

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

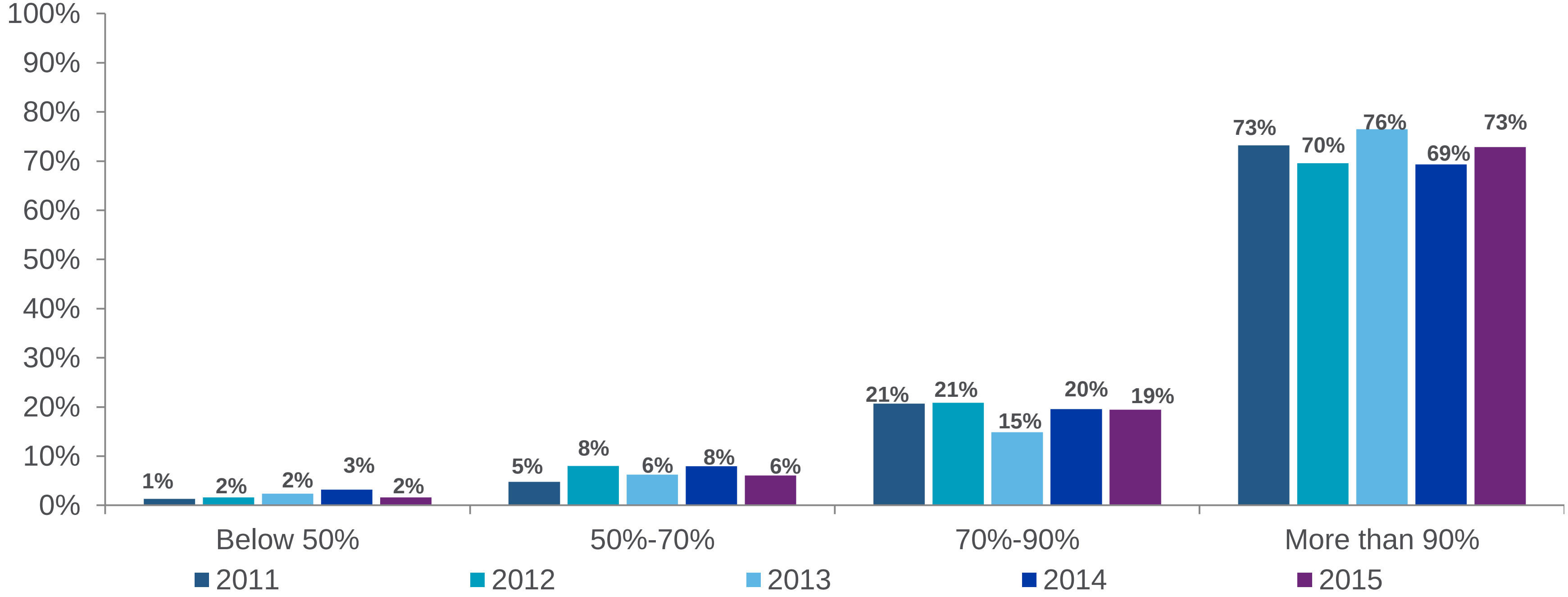
	2011	2012	2013	2014	2015
Say-on-Pay Failures	1.3%	1.6%	2.4%	3.2%	1.6%
Average Shareholder Support **(% of total votes cast "for" Say on Pay)**	92%	90%	91%	89%	92%
ISS "Against" Recommendations	11%	13%	13%	16%	13%
ISS "Win" Rate **(% of cases where ISS "Against" yielded a failed Say-on-Pay vote)**	12%	12%	18%	21%	12%

- The average level of shareholder support, frequency of ISS "Against" recommendations and proportion of outright failures on Say on Pay all returned to historical levels in 2015 following the uptick a year ago
- 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 technology companies

Year-Over-Year Shareholder Support Levels

- High support for executive pay at technology companies rebounded in 2015 with 72.9% of companies receiving over 90% support compared to 69.3% in 2014
- Companies receiving below 70% support fell to the lowest percentage (7.6%) since the first year of Say-on-Pay votes
- 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

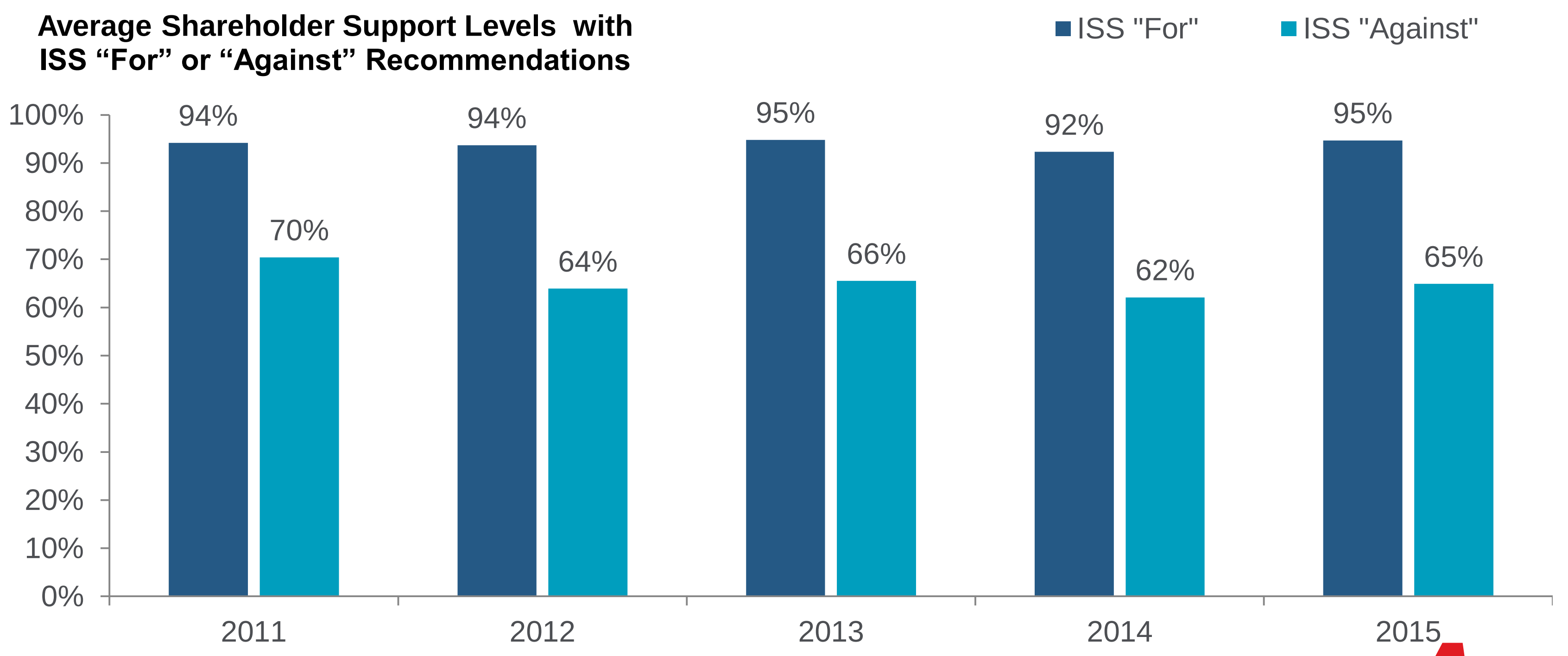
- While ISS recommendations continue to drive shareholder voting in a meaningful way, fewer companies are actually failing outright as the result of an adverse ISS vote recommendation in 2015
- Instead, we see companies able to persuade shareholders via proactive outreach programs to support Say on Pay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

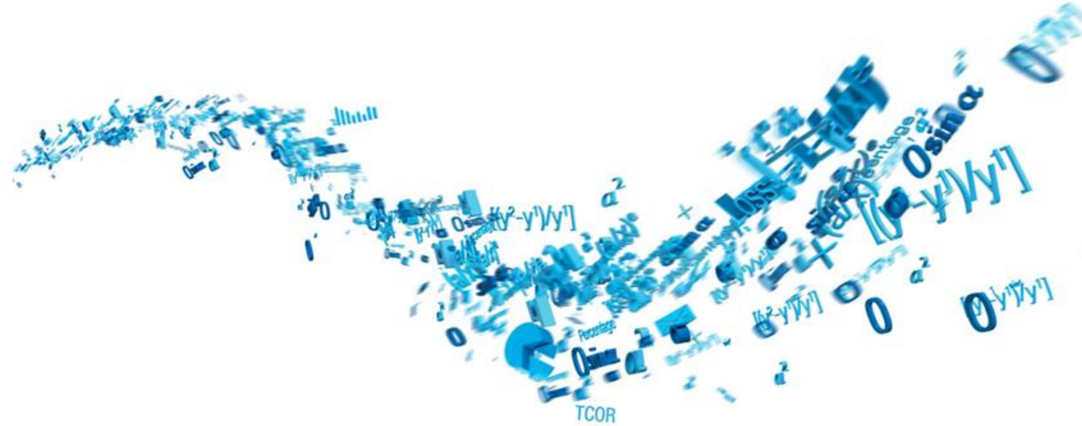
Annual Say-on-Pay Vote Outcomes Following ISS “Against”					
	2011	**2012**	**2013**	**2014**	**2015**
Passed Above 70%	54%	37%	36%	36%	46%
Passed Below 70%	31%	51%	46%	43%	41%
Failed	15%	12%	18%	21%	14%

- This will compel a large proportion of Technology 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 near their historical high in 2015
- While voting support at companies that receive a “No” recommendation from ISS has also rebounded to a strong level
  - 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





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's 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 more volatile, growth-stage technology 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 rules were proposed in July and hedging rules are expected this year
  - 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

About Radford

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