Radford Review:
2016 Say-on-Pay Results and Equity Share Plan Proposals in the US Technology Sector

Prepared by Radford
Radford is part of Aon Hewitt, a business unit of Aon plc.

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Introduction

- This report highlights some of the biggest takeaways from the 2016 Say-on-Pay voting season
- It has been just six years since advisory votes on Say-on-Pay began showing up on annual meeting agendas, and in that time, investors have increasingly demanded pay levels that correspond to company performance
- This year in the technology sector, average support levels for Say-on-Pay are at an all time high
- Using ISS' analytics for Management Say-on-Pay, this report highlights:
  - Year-over-year trends for key Say-on-Pay metrics across the entire life sciences sector
  - With specific industry breakouts for GICS codes 4510 (Software & Services), 4520 (Hardware & Equipment), 4530 (Semiconductors & Semiconductor Equipment) and 5010 (Telecommunication Services)
  - We also take a closer look at outright Say on Pay failures and the problematic pay practices contributing to such votes
  - Finally, we share insights on equity incentive plan proposals gleaned from the 2016 voting season

An Overview of Say-on-Pay in its Sixth Year

- Average Say on Pay vote levels in the technology sector remain strong
  - Even with significant swaths of the technology sector underperforming the Russell 3000, 2016 support levels are coming in at 92%, vs. 91% a year ago
  - The vast majority of technology companies receive support levels of well above 90%, with a minority receiving support levels in the 70% to 90% range
  - Only about 4% of technology companies receive support of 70% or less, which is the ISS prescribed standard below which companies should take remedial action

- ISS's support of Say on Pay votes in the technology sector is also at its highest point ever
  - In the past, ISS has voted "Against" Say-on-Pay at life sciences companies at almost 1.5x the rate for the broader Russell 3000 (in Software, the multiple was almost 2x)
  - 2016 is the first year ISS support for the sector is in line with that for broader Russell 3000

- Outright Say-on-Pay failures (votes below 50%) remain rare in the technology sector (although tech companies do fail more frequently than the Russell 3000)
  - Based on data year-to-date, about one-in-five ISS "Against" recommendations have led to outright Say-on-Pay vote failures
  - This trend reflects the effectiveness of company strategies to engage with shareholders in contested situations and address ISS and investor concerns

Say on Pay in Technology: A Five Year Lookback

	2012	2013	2014	2015	2016	Russell 3000
Say-on-Pay Failures	1.6%	2.4%	3.2%	1.6%	1.6%	1.7%
Average Shareholder Support for Say-on-Pay	89.7%	91.0%	88.7%	91.6%	91.8%	91.5%
ISS “Against” Recommendations	13.1%	13.1%	15.6%	14.1%	7.8%	8.5%

- Say-on-Pay failures in technology are low and trending flat (after a short-lived surge in 2013-2014)
- Average shareholder votes are at an all-time high in favor of technology Say-on-Pay, and adverse ISS recommendations at an all-time low

Say-on-Pay in Technology: 2016 By the Numbers

Average shareholder support levels in 2016

91.8%

Technology vs. Russell 3000 Average Shareholder Support Levels – Support levels in 2016 are unchanged from 2015, reflecting generally strong and sustained support for executive pay plans. Average support for the full technology sector is on par with the broader Russell 3000 (91.5%).

Technology companies receiving "Against" vote from ISS in 2016

7.8%

Technology vs. Russell 3000 ISS Support Rate – This year, the prevalence of ISS "Against" recommendations in the technology sector is at 7.8%, significantly lower than 2015 rate of 14.1%. ISS has recommended against 10.0% of the Say-on-Pay proposals in 2016 at Russell 3000 companies compared to 10.6% in 2015.

Say-on-Pay failure rate

1.6%

Say-on-Pay Failures – Outright failures on Say-on-Pay continue to be very rare. This reflects companies' effectiveness at engaging directly with investors to explain and rationalize their pay programs.

Difference in average support between ISS "For" and "Against"

29%

ISS Impact – ISS continues to exert considerable influence on the final vote when it recommends against Say-on-Pay, with average levels of support dropping 36% in instances where ISS recommends "Against".

Key 2016 Say-on-Pay Metrics

- Average shareholder support for 2016 Say-on-Pay votes is line with the Russell 3000
- Average support among software companies is much higher this year compared to 2015, which comes as a bit of a surprise given the poor one-year TSR of software stocks

	Median TSR Performance		% For			
			2016 Voting Results		2015 Voting Results	
Industry Groupings	1-Year TSR	3-Year TSR	Average	Median	Average	Median
Software	-14.6%	-5.1%	92.1%	96.3%	88.8%	96.6%
Hardware	-14.5%	-1.5%	92.0%	96.1%	90.2%	95.3%
Semiconductor	-9.9%	6.9%	91.4%	96.3%	90.6%	96.5%
Telecommunications	-9.0%	1.6%	91.0%	94.7%	92.4%	95.1%
Technology Sector	-13.8%	-1.2%	91.8%	96.1%	89.8%	95.9%
Russell 3000	-4.5%	8.4%	91.5%	95.8%	91.2%	96.1%

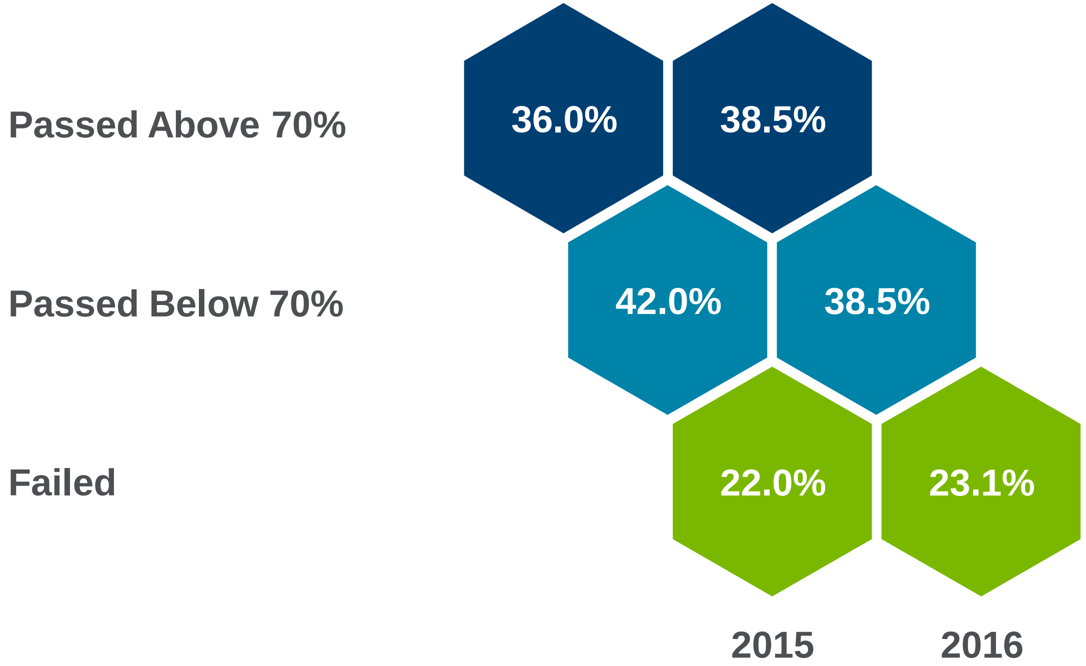
Key 2016 Say-on-Pay Metrics

- Telecommunications is the only industry to see higher ISS “Against” recommendations and a substantially higher percentage of companies with below 70% Say-on-Pay support
- The software industry is also seeing a high rate of “Against” recommendations, although the percentage of companies has dropped dramatically from 2015 to 2016; this mirrors the trend seen in the overall sector where “Against” votes are also down this year

	2016 Prevalence of Poor Outcomes			2015 Prevalence of Poor Outcomes		
Industry Groupings	ISS Against	50% to 70%	Below 50%	ISS Against	50% to 70%	Below 50%
Software	12.5%	3.8%	1.3%	19.5%	8.9%	3.8%
Hardware	3.4%	2.0%	2.0%	9.7%	5.0%	2.0%
Semiconductor	2.5%	2.6%	2.6%	10.3%	7.5%	1.5%
Telecommunications	11.1%	12.5%	--	12.5%	--	4.3%
Technology Sector	7.8%	3.8%	1.6%	14.1%	6.0%	3.7%
Russell 3000	10.0%	5.0%	1.7%	11.0%	5.2%	2.6%

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

- ISS “Against” recommendations appear to be as or more likely to result in a failed Say-on-Pay vote in 2016 compared to prior years, suggesting that proxy advisory influence on shareholder voting is still strong
- Companies with Say-on-Pay votes < 70% should launch a shareholder outreach campaign and consider compensation and governance program reforms to avoid a second negative ISS vote recommendation the following year



Avoiding and Responding to Poor Say-on-Pay Results

Key Factors Contributing to Say-on-Pay Problems

- A review of ISS reports revealed four key factors accounted for a substantial majority of 2016's "below 70%" Say-on-Pay votes in the technology sector:

1. Disconnects between pay and performance
   - Where TSR performance fell below the peer group median and/or operating performance declined on an absolute basis vs. 2015 and executive pay increased, remained flat or didn't decrease enough
2. "Poor" incentive pay practices
   - Payout of incentives above target despite poor performance relative to prior year results
   - Over-reliance on non-performance-based compensation (particularly heavy use of time-based stock/option awards with no performance-based component)
   - "Sub-standard" design of performance-based LTI programs (frequently one-year performance periods, overlap of metrics with STI plan)
3. Poor disclosure
   - Lack of detailed discussion linking payouts under variable incentive programs to corporate and/or individual performance
4. Lack of responsiveness to 2015 Say-on-Pay concerns
   - Lack of detailed discussion linking payouts under variable incentive programs to corporate and/or individual performance

Best Practices to Turn Around a Say-on-Pay Challenge

- Companies receiving weak support (defined as below the ISS 70% threshold) for Say-on-Pay increasingly may need to consider substantive reforms to avoid a repeat the following year
- Based on a review of 2016 proxy filings in technology, the most typical remedial actions taken by companies that received weak 2015 votes have included:

1. Meetings and organized dialogue and engagement with shareholders, often representing up to 60% of total shareholder base
2. Changed equity mix to include greater emphasis on performance-vested vehicles
3. New performance metrics added to equity incentive plans, including relative TSR and return on invested capital
4. Extended performance periods for long-term incentives (moving from a one-year performance period to three years)
5. Enhanced disclosure of short-term incentive plan goal setting and payout determination

- These steps are effective: shareholder support in 2016 is up by 35% on average among life sciences companies that received less than 70% shareholder support in 2015

2016 Stock Incentive Plan Proposals – an Initial Snapshot

2016 Stock Incentive Plan Proposals

- The following table provides a snapshot of 2016 year-to-date ISS recommendations and vote outcomes for Stock Incentive Plan proposals for the following sectors:
  - Software
  - Hardware
  - Semiconductor
  - Russell 3000
- Shareholder support for equity share plans has remained relatively constant in 2016
- However, the prevalence of “Against” recommendations from ISS has nearly doubled in the tech industry year-over-year, compared to a 10% increase among the Russell 3000

Industry Groupings	# of Proposals	# of ISS “Against” votes	ISS “Against” (as % of all proposals)	Avg. Support (all proposals)	Avg. Support (for ISS “Against” only)	# of Failed
Software	40	15	38%	84%	76%	0
Hardware	20	6	30%	89%	81%	0
Semiconductor	12	1	8%	80%	61%	1
Russell 3000	477	99	21%	90%	79%	2

- Radford is separately evaluating the factors contributing to positive vs. negative proxy advisor recommendations on stock incentive plans, which we expect to publish later in the fall

About Radford

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