Ayco's Summer InnerCircle™
Benefits and Compensation Conference

More "Pay For Performance" in Executive Compensation

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Do your job and demand your compensation – but in that order.

Cary Grant

If you pick the right people and give them the opportunity to spread their wings and put compensation as a carrier behind it you almost don’t have to manage them.

Jack Welch

THE ENVIRONMENT

Executive Summary: Big Picture

- Evolving practices in executive compensation reflect a continuation of trends observed in prior years
  - Among large-cap companies, executive pay levels are stable, with target pay growing 3-4% annually
  - Program structure is also relatively unchanged, with long-term incentive ("LTI") grant value focused primarily on performance awards and heavy emphasis on relative-to-peer total shareholder return ("TSR") as a metric
  - There is less program variability as a by-product of Say-on-Pay and proxy advisor voting policies, but pay mix and metric selection are being used to ensure the overall program adequately supports key strategic objectives
  - Problematic pay practices as defined by the proxy advisory firms and large institutional investors have been virtually eliminated, and companies continue to down-weight perquisites, special executive benefits and other entitlements
- Say-on-Pay voting is in transition as it ends its fifth year, with large investment funds acting independently from proxy advisors and focused on pay delivery in relation to GAAP-reported financials and TSR
  - Institutional Shareholder Services ("ISS") is still influential and has shifted its agenda from eliminating problematic pay practices to limiting stock plan costs and <u>opposing "unresponsive" directors</u>
  - Activist investors have substantially increased their power base, and Say-on-Pay issues provide a window of opportunity for activists to align with large institutions and pressure management for change (both pay-related and strategic). <u>This has raised the importance of Say-on-Pay</u>

Say-on-Pay Update

2015 Landscape

- ISS "For" vote recommendation trends are shown below; there is a notable increase in support for Say-on-Pay

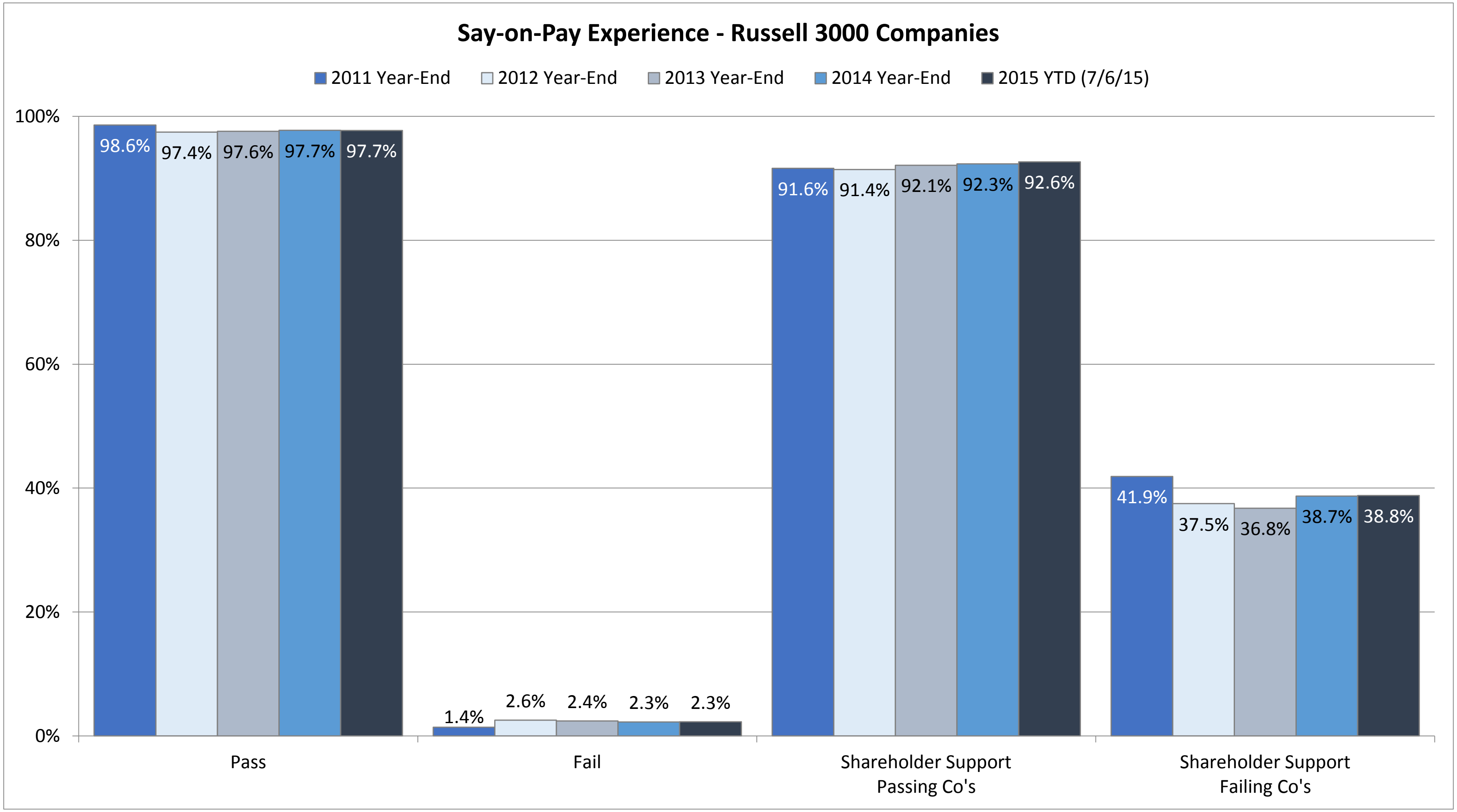
	ISS "For" Vote Recommendations at Russell 3000 Companies		
	2013	**2014**	**2015 YTD**
Say-on-Pay	86.9%	87.1%	89.0%
Director Elections	91.6%	92.3%	91.9%
Equity Plans	78.7%	79.6%	81.0%

- Large investment funds are voting more independently, and their feedback to management where they are more directly engaged on executive compensation issues is that:
  - Budget-based financial goals for determining incentive compensation are often not rigorous enough to support value creation, and <u>higher compensation for overachieving lower goals needs a strong business rationale</u>
  - Other than standard items, non-GAAP adjustments to these financial goals limit downside performance risk and also need a strong business rationale
  - Revenue growth is important where much of the work on cost-cutting has been done, as is ROIC where there is excess cash
  - Stock options may be preferable to restricted stock for executives and not necessarily more dilutive when exercise proceeds are used for share buybacks

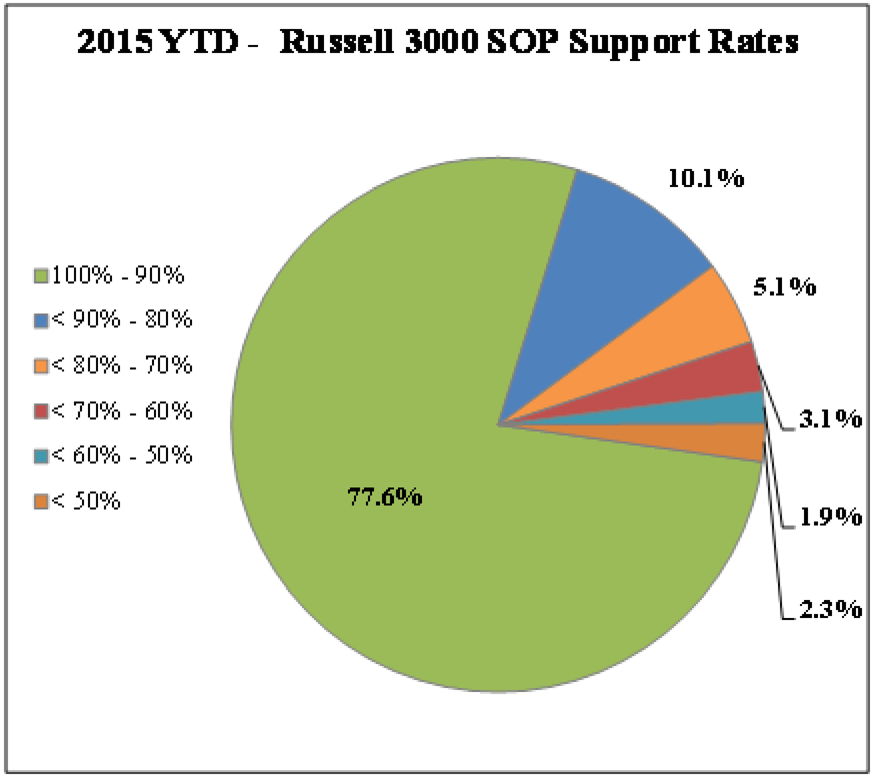
Say-on-Pay Update (cont'd)

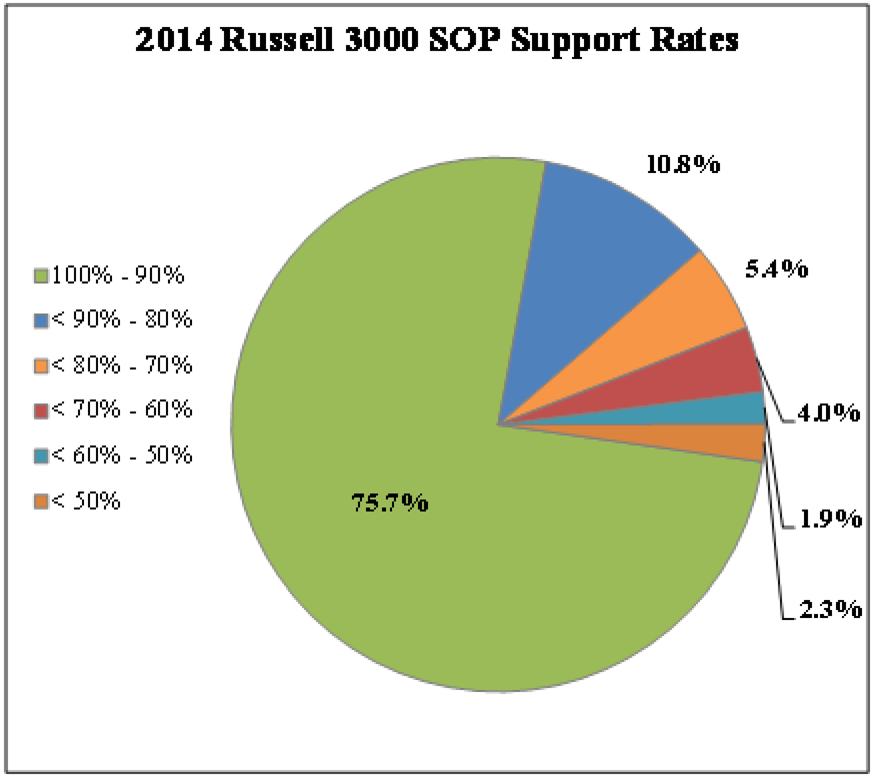
2015 Voting Results

- Year-to-date vote outcomes generally consistent with prior years; three-quarters of companies receive support above 90%



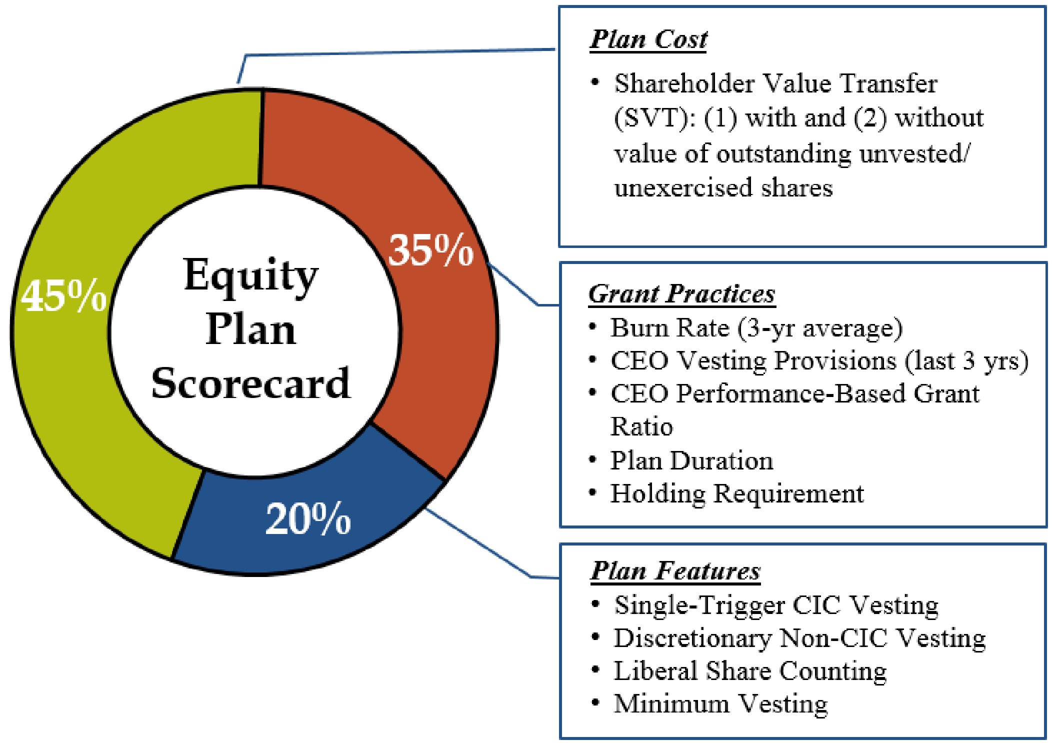
Say-on-Pay Update (cont'd)





ISS Equity Plan Scorecard

- A new policy for determining recommendations on equity plan share authorization requests took effect on 2/1/15.
- Case-by-case evaluation consists of three weighted categories: (1) plan cost, (2) grant practices, and (3) plan features.
    - ➢ Former methodology was only plan cost.
- Overall, the new methodology incorporates a wider variety of positive and negative plan factors, resulting in a "black-box" approach that ISS is aggressively selling as a new consulting product.



Prevalent Demands

- The most prevalent executive compensation-related shareholder proposals were to limit change in control (CIC) equity vesting acceleration to a pro rata amount based on service, rather than full acceleration

- Other prevalent proposals were those related to recovery of incentive compensation for financial restatements and/or misconduct (clawback policies) and stock ownership/retention guidelines

Type of Proposal	Number of Proposals		Average Support (%)*	
	2015	2014	2015	2014
Limit CIC Equity Vesting	**29**	23	**34.3**	35.9
Clawback of Incentive Payments	**15**	3	**28.4**	28.7
Stock Ownership/Retention/Holding Period	**13**	28	**23.3**	22.3
Link Executive Pay to Social Criteria	**4**	1	**6.4**	2.5
Report on Government Service "Golden Parachutes"	**4**	0	**21.5**	n/a
Shareholder Approval of Performance Metrics	**3**	3	**2.4**	12.8
Performance-Based Options	**2**	1	**28.4**	28.8
Other	**4**	11	**n/a**	n/a

** Votes "For" as percentage of votes "For" plus "Against" for votes held as of 6/30/2015*

Equity Vesting Acceleration

- The proposals received majority support at two companies (FirstMerit and Rite Aid) this year that have not yet responded, and four companies (Boston Properties, Dean Foods, Gannett, and Valero Energy) last year where we know the response:
  - At Boston Properties, Dean Foods, and Gannett, the companies moved to double-trigger from single-trigger vesting, but pro-rata vesting was not adopted.
    - Boston Properties and Gannett received the same proposal in 2015, but shareholder support was much lower.
  - Valero adopted double-trigger vesting acceleration as well as pro-rata vesting for performance shares for 2014 and future grants.

Shareholder Proposals to Limit Equity Vesting Acceleration upon a Change in Control

2014 Meetings			2015 Meetings	
Company	**Support %**		**Company**	**Support %**
Abercrombie & Fitch Co.	41.1		Abercrombie & Fitch Co.	36.3
Avon Products, Inc.	31.3		Allegiant Travel Company	43.6
Boston Properties, Inc.	**53.1**		Baxter International Inc.	39.4
Comcast Corporation	23.6		Boston Properties, Inc.	28.2
Comstock Resources, Inc.	39.7		Chipotle Mexican Grill, Inc.	36.8
Dean Foods Company	**60.6**		Comcast Corporation	26.0
DIRECTV	25.3		Comstock Resources, Inc.	36.5
Du Pont	28.3		ConocoPhillips	29.1
First Solar, Inc.	18.5		Con-way Inc.	24.5
FirstEnergy Corp.	25.1		Duke Energy Corporation	29.5
Gannett Co., Inc.	**52.2**		Expeditors Intl.	42.9
Honeywell International Inc.	28.6		**FirstMerit Corporation**	**59.2**
IBM	29.8		Gannett Co., Inc.	25.8
McKesson Corporation	44.3		General Electric Company	40.4
Oshkosh Corporation	41.5		Hasbro, Inc.	22.5
Precision Castparts Corp.	35.3		IBM	29.3
The Charles Schwab Corporation	28.3		International Paper Company	36.8
The Walt Disney Company	24.5		Mack-Cali Realty Corporation	45.2
Time Warner Cable Inc.	33.3		McDonald's Corporation	35.0
United Natural Foods, Inc.	31.2		Merck & Co., Inc.	24.6
Valero Energy Corporation	**56.2**		PepsiCo, Inc.	28.9
Vornado Realty Trust	39.8		**Rite Aid Corporation**	**58.4**
Windstream Holdings, Inc.	34.7		The Charles Schwab Corporation	30.1
			The Walt Disney Company	24.2
Average	**35.9**		Walgreens Boots Alliance, Inc.	29.7
			Waste Management, Inc.	31.6
			YUM! Brands, Inc.	32.2
			McKesson	Pending
			Time Warner Cable Inc.	Pending
			Average	**34.3**

Regulatory Developments

Dodd-Frank Act Implementation

- <u>Proposed</u> hedging policy disclosure, pay-for-performance disclosure and clawback requirement rules were issued in 2015; <u>final</u> rules on CEO pay ratio disclosure and hedging policy disclosure are expected by April 2016

Final

Say-on-Pay & Say-on-Golden Parachute Vote
- Final
- January 25, 2011

Compensation Consultant Independence
- Final
- July 1, 2013

Compensation Committee Independence
- Final
- January 15, 2014

Pending

CEO Pay Ratio Disclosure
- Proposed
- September 18, 2013
- Per SEC calendar, final rule expected by April 2016

Hedging Policy Disclosure
- Proposed
- February 9, 2015
- Per SEC calendar, final rule expected by April 2016

Pay-for-Performance Disclosure
- Proposed
- April 29, 2015
- SEC has not indicated timing for final rule

Pending

Clawback Requirement
- Proposed
- July 1, 2015
- SEC has not indicated timing for final rule
- Some companies are encountering accounting issues when the clawback trigger is discretionary (i.e., variable accounting)

Regulatory Developments (cont'd)

CEO Pay Ratio Disclosure

- The SEC's proposed rule to implement the CEO-median employee pay ratio was released in 2013, but has not been finalized although vote appears imminent
- Rule requires disclosure in the proxy of:
  - Median annual total compensation of all employees other than CEO
  - Ratio of above amount to reported annual total compensation for CEO
- As proposed, "all employees" applies company-wide and includes international, part-time, temporary and seasonal employees
  - Rumor: Can exclude 5% of international (big deal!)
- Statistical sampling or other reasonable method allowed for identifying median employee; no prescribed pay definition for this identification
- Once identified, must calculate pay based on proxy rules
- On June 4, 2015, the SEC's Division of Economic and Risk Analysis (DERA) released additional analysis that considers the economic/statistical impact of various methods of calculating the required pay ratio disclosures
  - This implies that the final rule may permit the exclusion of certain employees from the determination of the ratio to simplify the calculation
- Assuming the rule is finalized in 2016, it is expected that pay ratio disclosure will first be required during the 2018 proxy season for calendar-year companies

Regulatory Developments (cont'd)

Hedging Policy Disclosure

- The proposed rule:
  - Generally applies to all public issuers
  - Covers employees, officers or directors, or any of their "designees"
  - Relates to disclosure requirements only (i.e., it does not require companies to either prohibit hedging or adopt hedging policies)
  - Requires disclosure in the proxy statement of permitted and prohibited transactions designed to hedge or offset any decrease in the market value of the company's equity securities
    - Covers any/all transactions with "economic consequences" comparable to purchase of specified hedging instruments
    - Companies must indicate whether certain prohibitions apply only to certain categories of individuals (e.g., directors and executive officers) and not to all other employees
- SEC sought comments on rule provisions including (1) whether "employee" should be limited to employees in a strategic operating position, and (2) the proper scope of covered transactions

Regulatory Developments (cont'd)

Pay-for-Performance Disclosure

- The SEC's proposed rule was released on April 29, 2015 with an open comment period for 60 days
- Required disclosure would show "actual pay" for covered executives and TSR performance for the company and peers in each of the prior five years, subject to a phase-in period covering three years in the first year of disclosure, four in the second, and five in the third
- Covered executives would include the Principal Executive Officer (PEO) and other Named Executive Officers (NEO), where pay would be the average for the group
- The following table would be used, supplemented by a narrative description:

Year (a)	Summary Compensation Table Total For PEO (b)	Compensation Actually Paid to PEO (c)	Average Summary Compensation Table Total for non-PEO Named Executive Officers (d)	Average Compensation Actually Paid to non-PEO Named Executive Officers (e)	Total Shareholder Return (f)	Peer Group Total Shareholder Return (g)

Regulatory Developments (cont'd)

Pay-for-Performance Disclosure (cont'd)

- Actual compensation is determined by starting with the Summary Compensation Table total and adjusting the values as follows:

Objective of Modifications	Summary Compensation Table Total
1. **Equity:** Adjust equity to replace grant value with value at vesting	*Subtract*: fair value of equity granted in the fiscal year *Add*: fair value of equity vesting in the fiscal year
2. **Pension:** Modify changes in actuarial present value of benefits to exclude increases not attributable to the fiscal year (i.e. changes in interest rate, age, and other inputs)	*Subtract*: Change in actuarial present value of all defined benefit and pension plans *Add*: Actuarially determined service cost for services during the fiscal year
	Executive Compensation Actually Paid

- The value at vesting is the fair market value for full-value awards (i.e., restricted stock and performance share units earned multiplied by share price on the vesting date) and the Black-Scholes value of stock options taking into account the change in stock price since grant and revisions to other valuation assumptions (e.g., adjusted option term, risk free interest rate, etc.)

- Companies would have flexibility regarding the location of the new disclosure in the proxy, and it would not be required to be included in the CD&A

- Companies may supplement the required disclosure with additional performance measures and/or explanatory text or graphics

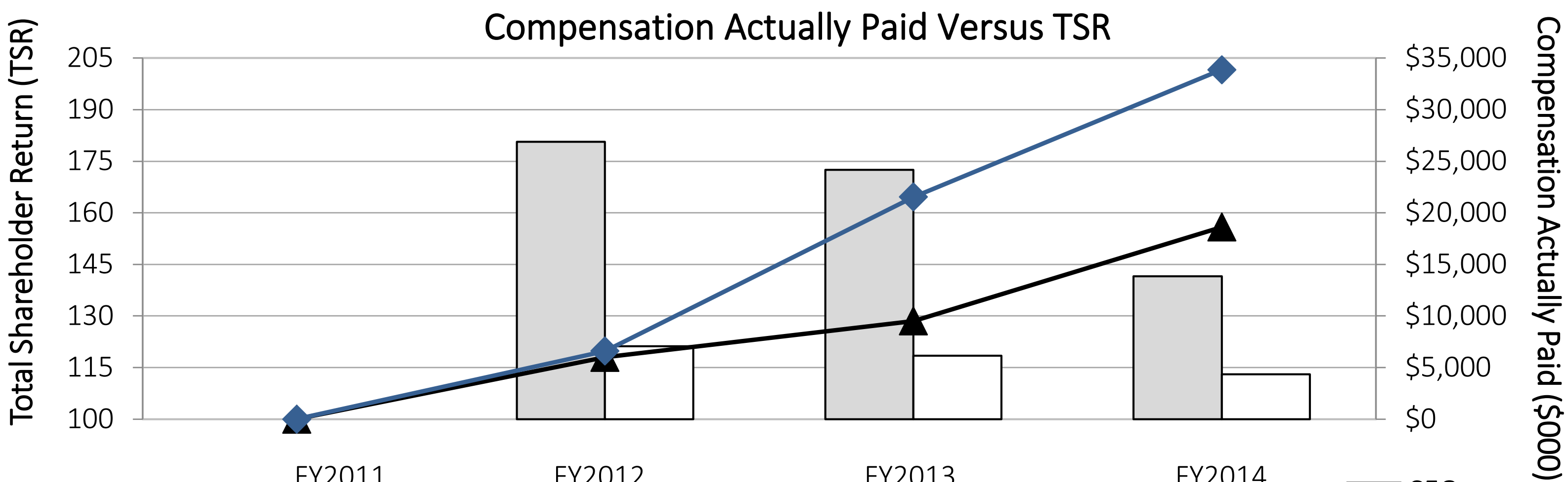
Sample SEC Proposed Pay-for-Performance Disclosure

Pay Versus Performance Table						
Year (a)	Summary Compensation Table Total for CEO (b)	Compensation Actually Paid to CEO (c)	Average Summary Compensation Table Total for non-CEO NEOs (d)	Average Compensation Actually Paid to non-CEO NEOs (e)	Total Shareholder Return (f)	Peer Group Total Shareholder Return (g)
FY14	$11,497	$16,848	$3,701	$4,353	$201.6	$155.9
FY13	$10,031	$27,154	$2,886	$6,145	$164.6	$128.5
FY12	$12,841	$29,901	$4,030	$7,056	$119.8	$118.0

Sample SEC Proposed Pay-for-Performance Disclosure (cont'd)

($000)	Chief Executive Officer			Average Other NEO		
	FY12	FY13	FY14	FY12	FY13	FY14
SCT Total Compensation	$12,841	$10,031	$11,497	$4,030	$2,886	$3,701
Less:						
-- Stock and Option Awards Granted	$7,731	$7,862	$8,294	$1,822	$1,344	$1,458
-- Change in Pension / NQDC	$2,535	$620	$3,814	$851	$233	$606
Plus:						
-- Stock and Option Awards Vested	$22,869	$22,449	$12,459	$5,219	$4,621	$2,717
-- Actuarial Service Cost	$1,457	$156	$--	$481	$215	$--
Compensation Actually Paid	**$26,901**	**$24,154**	**$13,848**	**$7,056**	**$6,145**	**$4,353**

Sample SEC Proposed Pay-for-Performance Disclosure (cont’d)



	FY2011	FY2012	FY2013	FY2014
CEO		$26,901	$24,154	$13,848
Avg. NEO		$7,056	$6,145	$4,353
Co.'s Indexed TSR	100	120	165	202
Peer Indexed TSR	100	118	129	156

Regulatory Developments (cont'd)

Clawback Requirement

- The SEC's proposed rule was released on July 1, 2015, with an open comment period for 60 days
- Proposed rule would direct stock exchanges to require listed companies to implement clawback policies to recover excess incentive-based compensation received by a current or former executive officer during the three fiscal years preceding an accounting restatement to correct a material error
  - Clawback would be on a "no-fault" basis
  - Excess compensation would be the amount over the compensation the officer would have received as determined using the restated financial statements
    - For incentive compensation based on stock price or TSR, the amount would be based on the company's reasonable estimate of the effect of the restatement
  - Clawback not required if company determines that the direct expense of doing so would exceed the amount recovered
- Executive officers are the same individuals who are specified as the company's Section 16 officers
- Time-based awards such as stock options and other equity awards that vest exclusively on the basis of service (i.e., without any performance condition), and bonus awards that are discretionary or based on subjective goals or goals unrelated to financial reporting measures, are not considered incentive-based compensation and therefore not subject to clawback
- Clawback disclosure would be required to be included with the company's other executive compensation disclosure and tagged in XBRL, with the policy filed as an exhibit to the company's annual report

Regulatory Developments (cont'd)

Clawback Requirement (cont'd)

- Companies would not be subject to the requirements of the proposed rules until the stock exchanges propose and adopt new listing standards

  - However, once the new listing standards are in effect, companies will be required to comply with the applicable rules within 60 days thereafter

  - A company that fails to adopt and adhere to a clawback policy that complies with the stock exchange rule may be delisted

  - Notwithstanding the date on which the stock exchange listing rules become effective, the clawback policy as proposed will apply to performance periods <u>ending</u> after the date the SEC rules are finalized

    - For example, if the SEC finalizes the rule in 2015, "in cycle" awards that are based on 12/31/15 financial results will be subject to the policy

    * Companies will, therefore, need to consider whether it is appropriate to delay the adoption of a compliant policy until the stock exchange listing rules are final

Compensation Litigation Developments

- Starting in 2012, several suits have been brought by a law firm named Faruqi & Faruqi LLP that target Say-on-Pay and shareholder proposals requesting incentive plan amendments, including additional shares
  - Most are filed shortly after a company files its proxy and seek to enjoin the shareholder meeting until a deficiency in disclosure is corrected; plaintiffs allege a breach of fiduciary duty by directors for seeking shareholder approval on the basis of misleading, incomplete, or incorrect data
  - Objective is quick cash settlement from companies that do not want to risk that the annual meeting will be enjoined until the lawsuit is settled
    - ➢ Risk of suit appears greatest where increase in equity plan shares is on the ballot; most courts have considered the issue and rejected arguments for an injunction
- I.R.C. Section 162(m) Lawsuits
  - ➢ Claims under Section 162(m) are not new, but the pace of claims has accelerated recently
  - ➢ Claims are being brought even where the Internal Revenue Service has not asserted noncompliance with Section 162(m); allegation typically involves corporate waste, unjust enrichment and/or breach of fiduciary duties by directors on the basis that:
    - Directors failed to structure the executive compensation program in compliance with Section 162(m) and thus failed to secure an available tax deduction
    - Company failed to comply with Section 162(m) where the proxy statement stated that it would do so
- A potential new litigation trend involves lawsuits (most recently against Citrix) alleging that directors breached their fiduciary duty by granting themselves compensation under a shareholder-approved equity plan without adequate limits on the amount of compensation that could be awarded to directors

Compensation Litigation Developments (cont'd)

- <u>Seinfeld v. Slager</u> (2012)
  - Director compensation claim subject to entire fairness review where equity awards at issue were granted under a shareholder approved plan with no "meaningful limit" on director compensation
  - Director fees exceeded the customary range
- <u>Cambridge Retirement System v. Bosnjak</u> (2014)
  - Granted motion to dismiss fiduciary duty claims with respect to equity awards specifically approved by shareholders and therefore protected by the business judgment rule
  - Refused to dismiss fiduciary duty claim related to cash awards, which were not granted under a shareholder approved plan
- <u>Calma v. Templeton</u> (2015)
  - Board decision to grant equity awards to non-employee directors of Citrix Systems, Inc. was subject to the entire fairness standard of review even though awards were made under stockholder-approved equity plan where there was no "meaningful limit" or specific guidelines for non-employee directors awards and no appropriate peer group
  - Only limit on compensation under Citrix equity plan was that no participant could receive an award covering more than 1M shares per calendar year

  * Put in a total compensation limit next time secure shareholder approval

Accounting Developments

Illiquidity Discount

- All four major national audit firms have indicated support for application of a discount to the grant-date accounting value for full-value awards with post-vesting hold/retention requirements
  - ➢ Such restrictions must be mandatory and must preclude sale, transfer, and hedging of the equity for a specified period after vesting, irrespective of continued service with the company
  - ➢ If the discount is applied, it would either reduce the disclosed value or enable the granting of more shares without an increase in cost
  - ➢ However, the accounting rules applicable to this issue are somewhat unclear, and our experience with clients is that the opinion of national office staff does not always align with that of local office audit partners
- The expense discount is company-specific and influenced by the length of the holding period after vesting, stock price volatility, and risk-free interest rate
  - ➢ One approach is “cost-of-carry method;” i.e., collard strategy
  - ➢ Basically the risk free rate over the holding period with risk adjustment
  - ➢ Other approaches use option pricing models
- For example, holding periods of 1-5 years result in discount of 15%-30%
- Interest in adding the provision for <u>non-employee directors</u>’ full-value share grants is high, as many companies already require mandatory deferral after vesting
- A few companies are using for executive stock awards (e.g., Goldman Sachs, Williams Cos.), and we are aware of others implementing in 2015

Accounting Developments (cont'd)

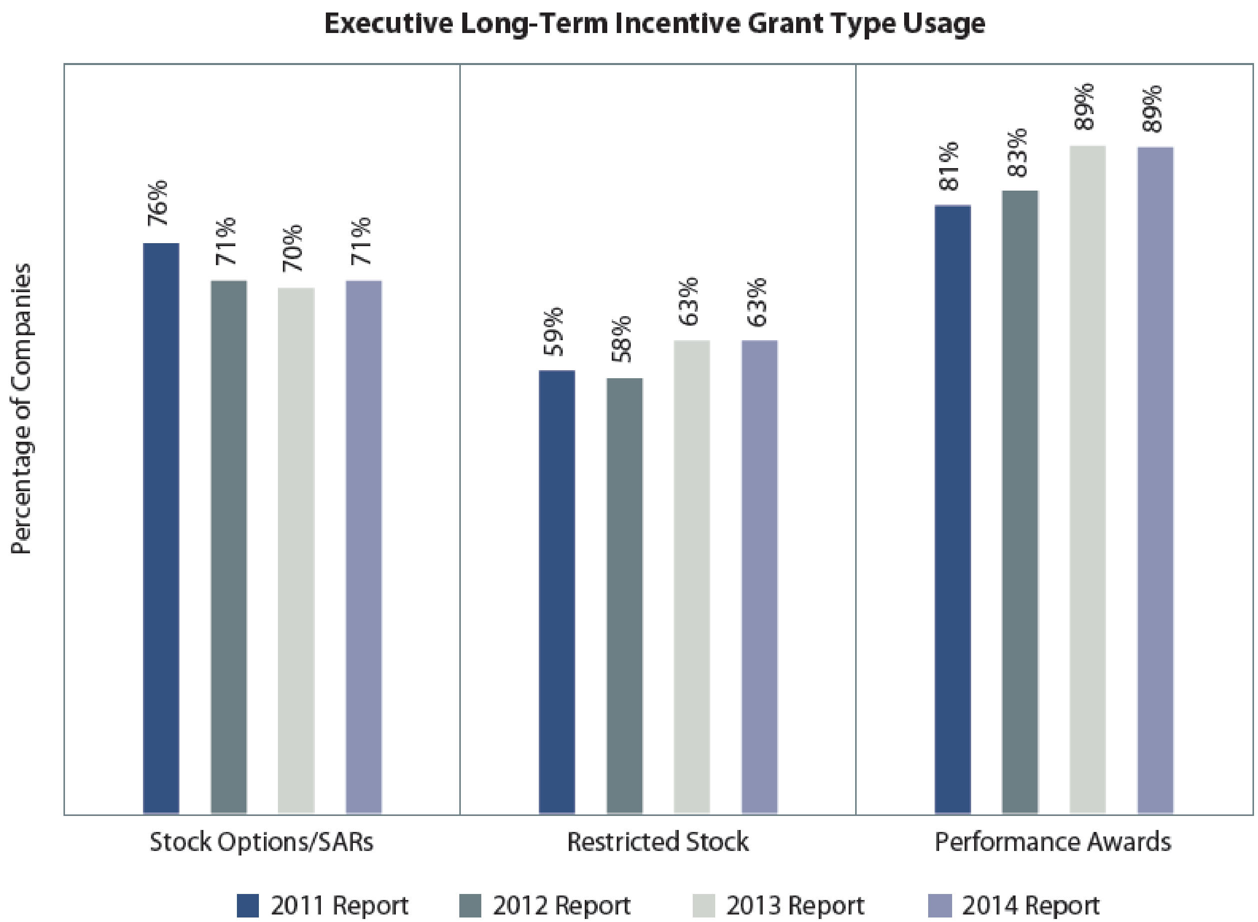
FASB Stock Compensation Project

- FASB issued proposed revisions to stock compensation accounting standards on June 8, 2015
  - This is a narrow-scope fast-track project to improve and simplify accounting for stock compensation under ASC Topic 718
- A significant revision that will benefit companies and LTI participants would permit companies to use stock-for-tax withholding up to the highest applicable marginal tax rate for each tax jurisdiction without jeopardizing fixed grant-date accounting treatment
  - Current accounting standards require stock-for-tax withholding to be limited to minimum statutory withholding rates or face mark-to-market accounting for the entire award
- The proposal to run all income tax effects through the income statement could be controversial and draw adverse reaction during the comment period due to the potential increase in the variability of reported income tax expense from period to period

PAY AND PERFORMANCE

Trends in Executive Compensation

- Looking at the 2015 "Top 250", we found a leveling off in vehicle selection
  - ➢ But expect a slight return to stock options



Trends in Executive Compensation (cont'd)

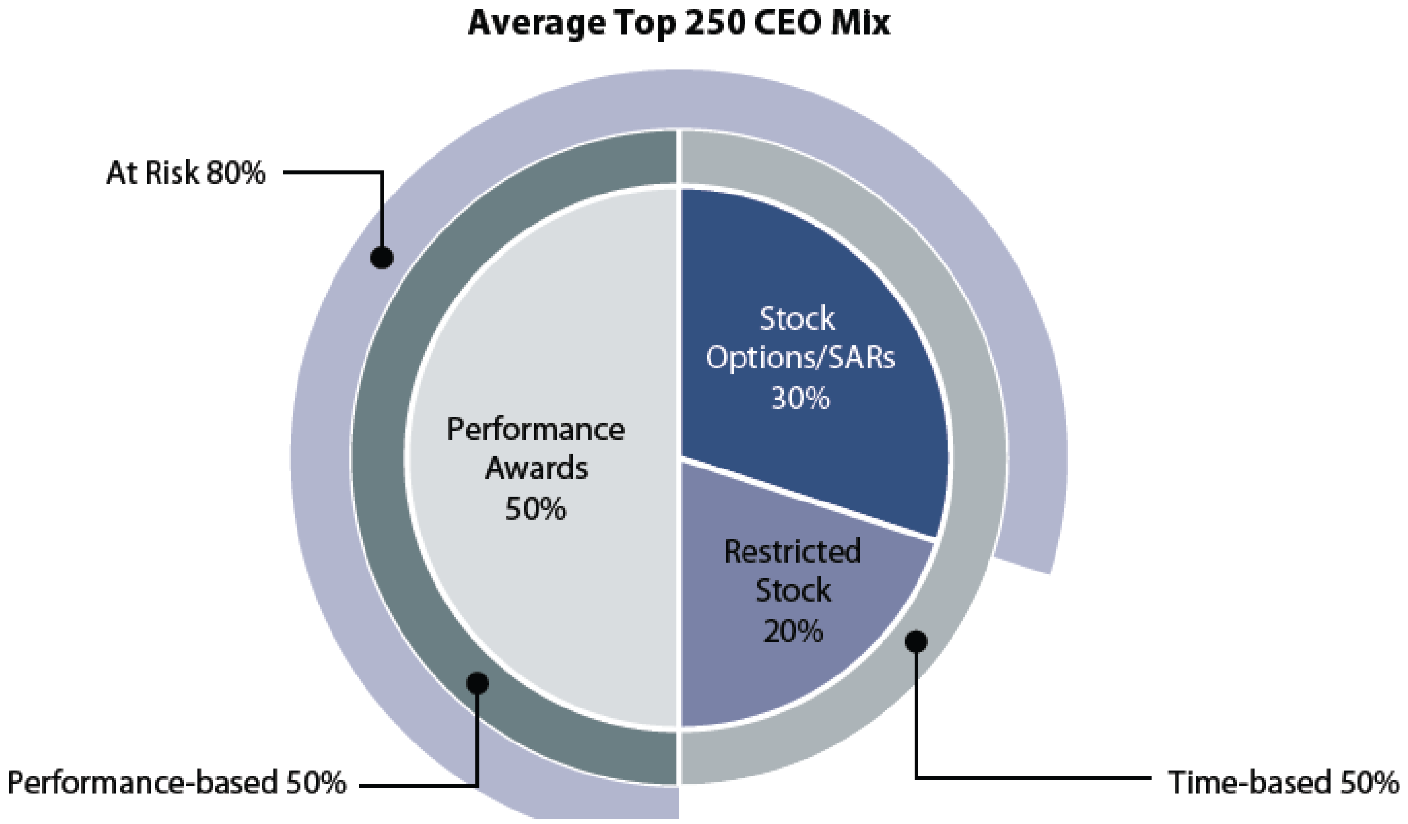
- Most companies are using 2-3 vehicles

Number of Grant Types	Percent of Companies Using			
	2011 Report	2012 Report	2013 Report	2014 Report
1 Type	17%	17%	14%	14%
2 Types	45%	48%	46%	46%
3 Types	36%	34%	39%	39%
4 Types	2%	1%	1%	1%

Industry Sector (# of companies in each sector)	Number of Grant Types by Sector			
	1 Type	2 Types	3 Types	4 Types
Financials (49)	10%	61%	27%	2%
Health Care (36)	20%	33%	44%	3%
Consumer Discretionary (32)	22%	47%	31%	0%
Industrials (30)	3%	34%	60%	3%
Information Technology (30)	17%	50%	33%	0%
Consumer Staples (24)	17%	38%	38%	7%
Energy (23)	13%	30%	57%	0%
Materials (12)	8%	42%	50%	0%
Utilities (11)	9%	73%	18%	0%
Telecommunication Services (3)	0%	100%	0%	0%

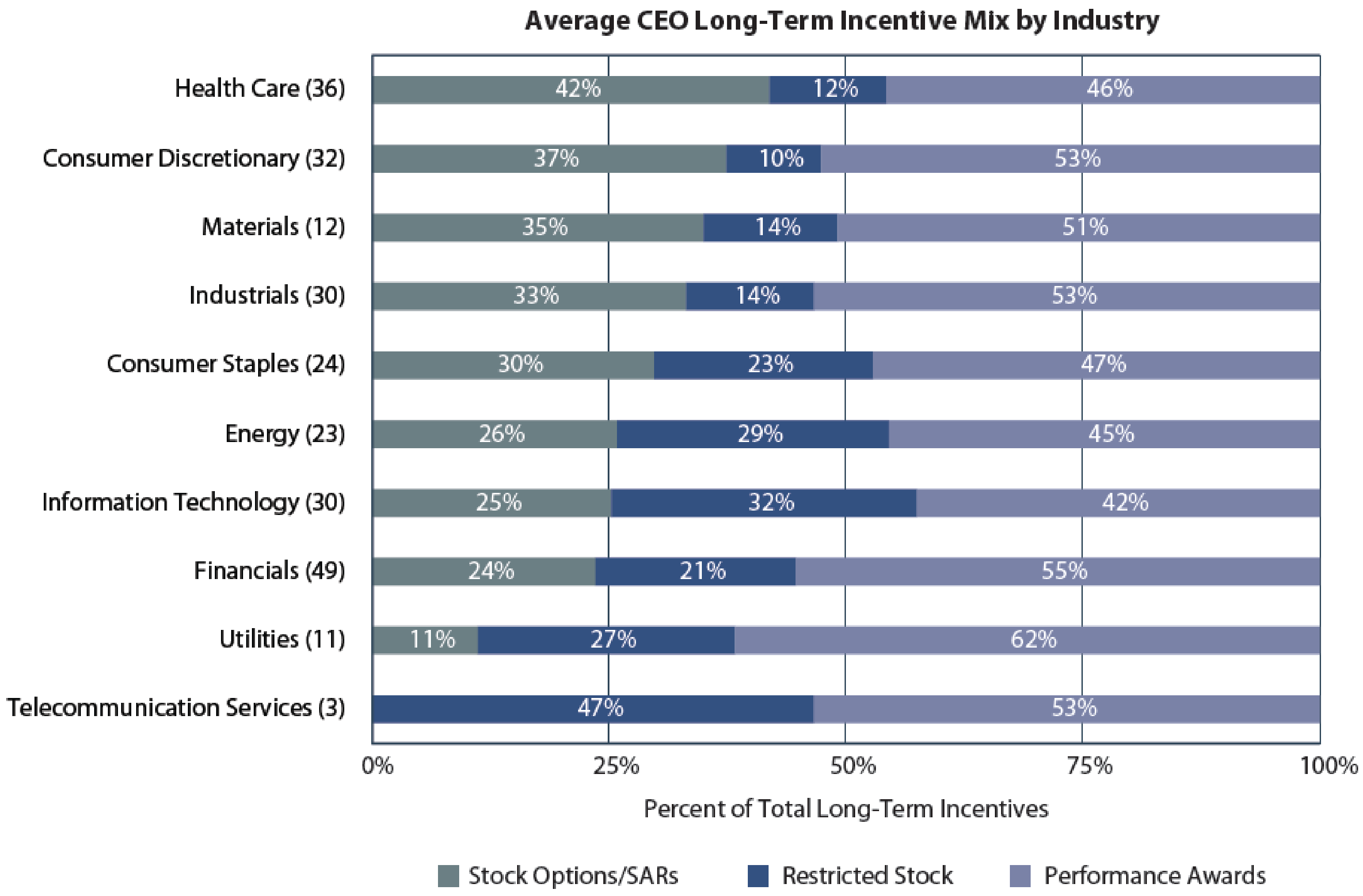
Trends in Executive Compensation (cont'd)

- Clearly ISS has had an influence on pay mix at the CEO level



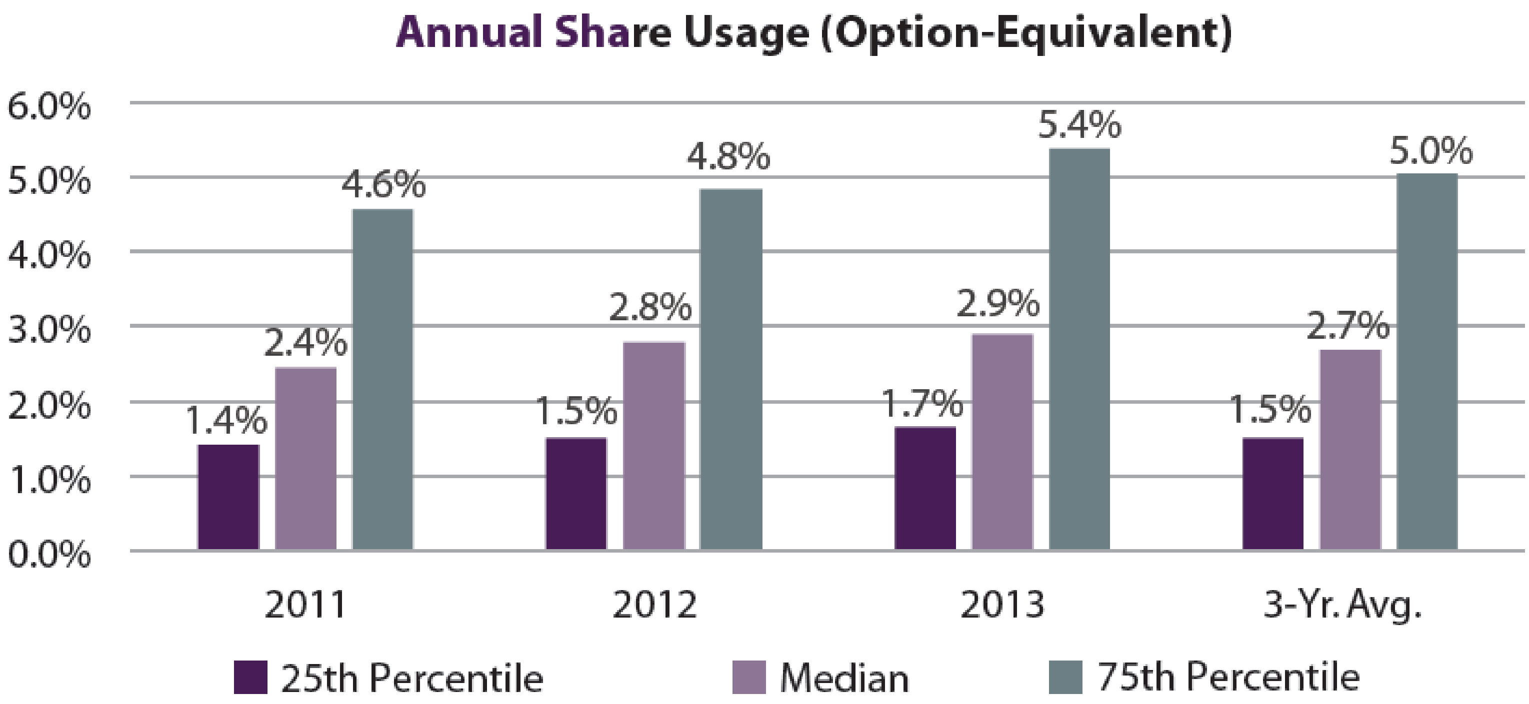
Trends in Executive Compensation (cont'd)

- By industry, slight variation



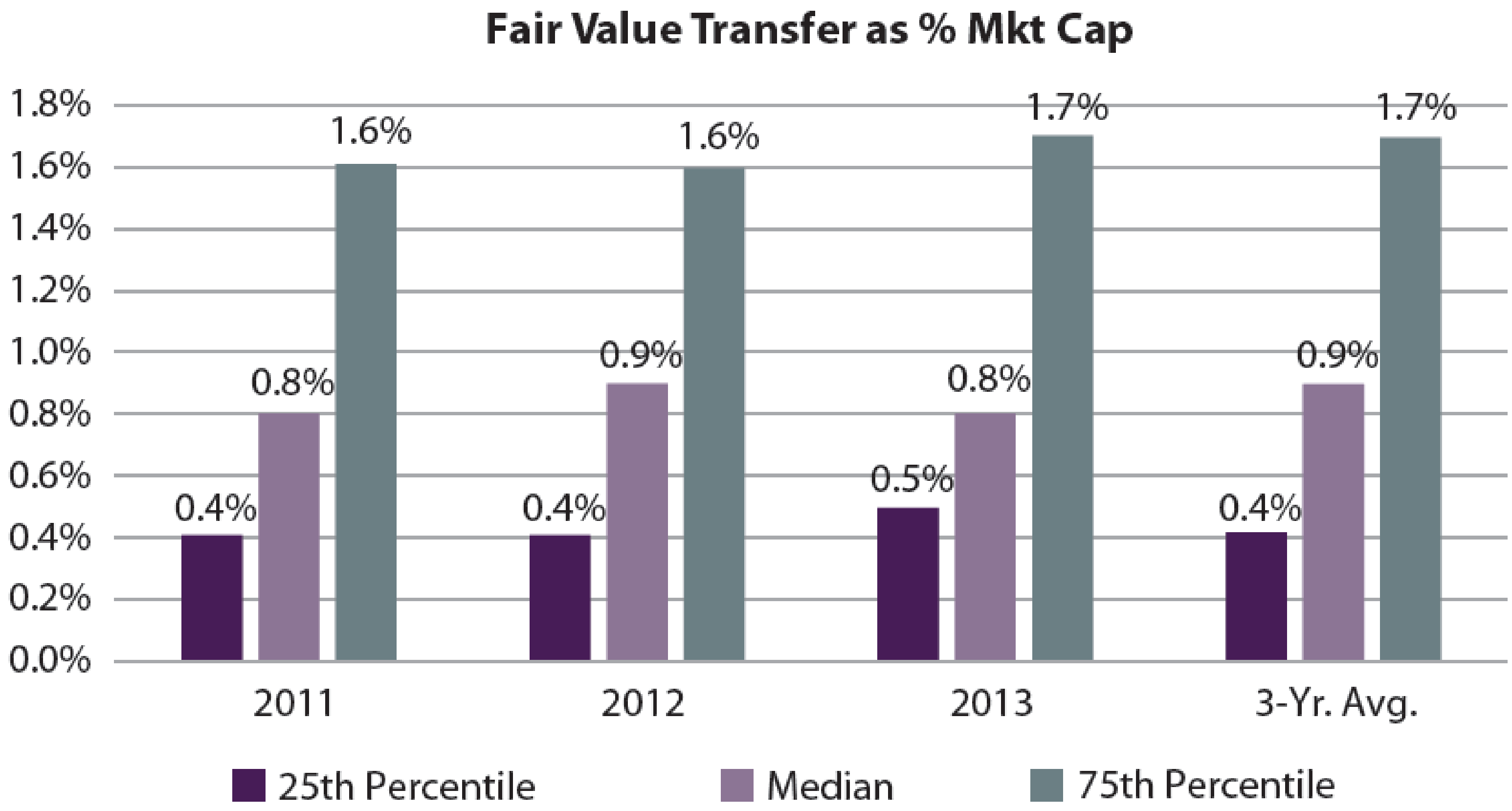
Annual Share Usage (Option-Equivalent)

- Again, things have stabilized



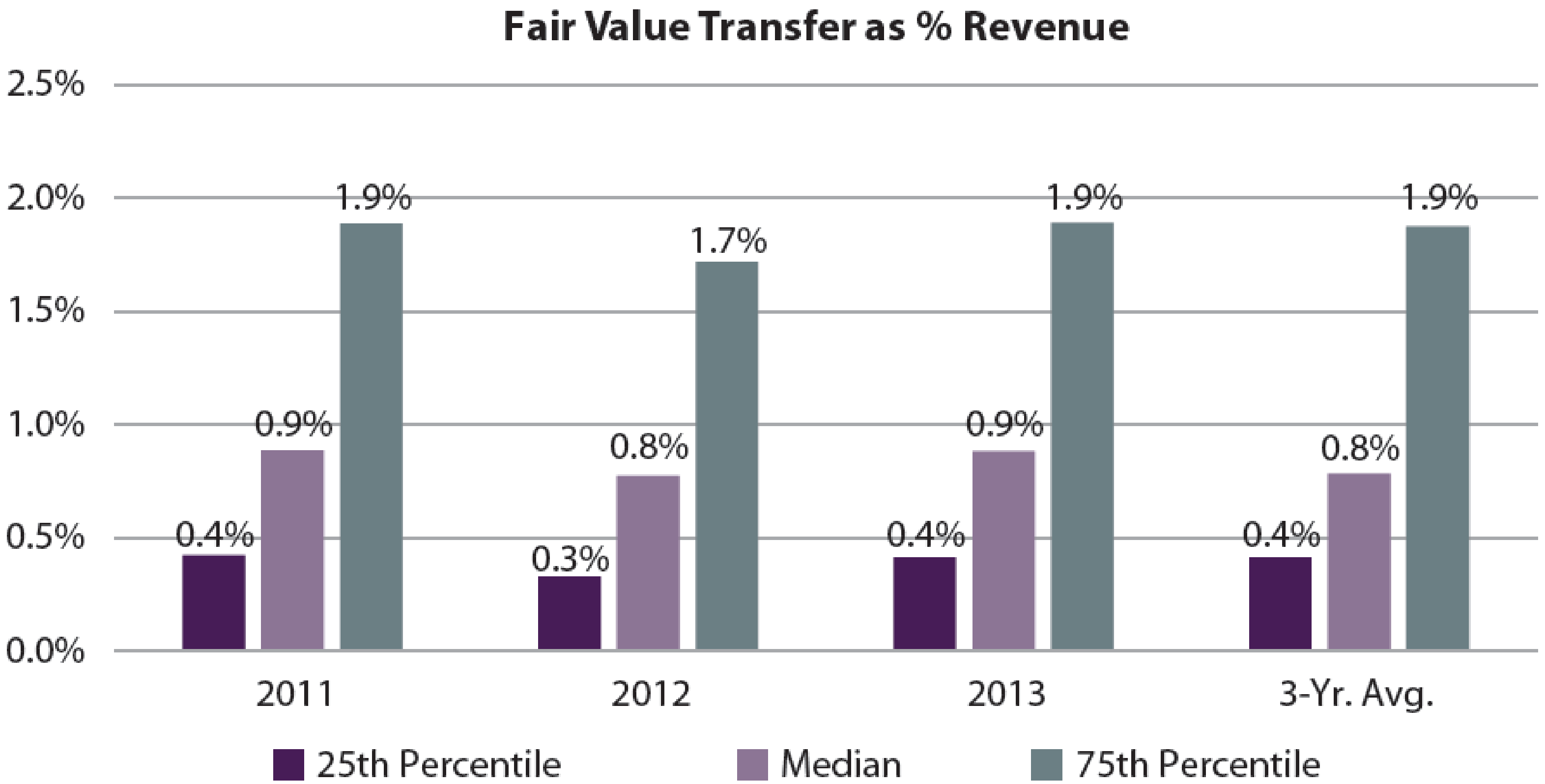
Fair Value Transfer as % Market Cap

- Ditto



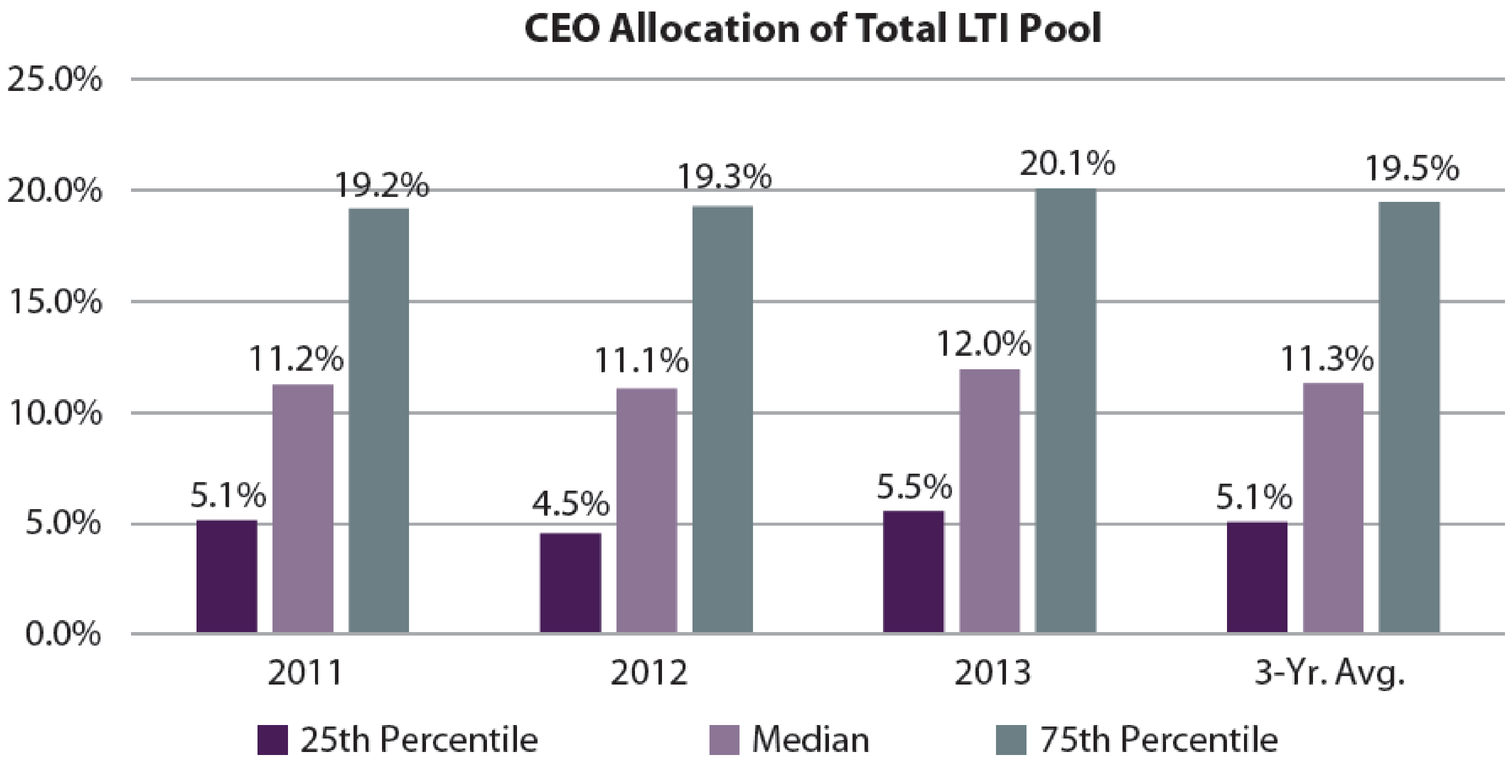
Fair Value Transfer as % Revenue

- Ditto again 



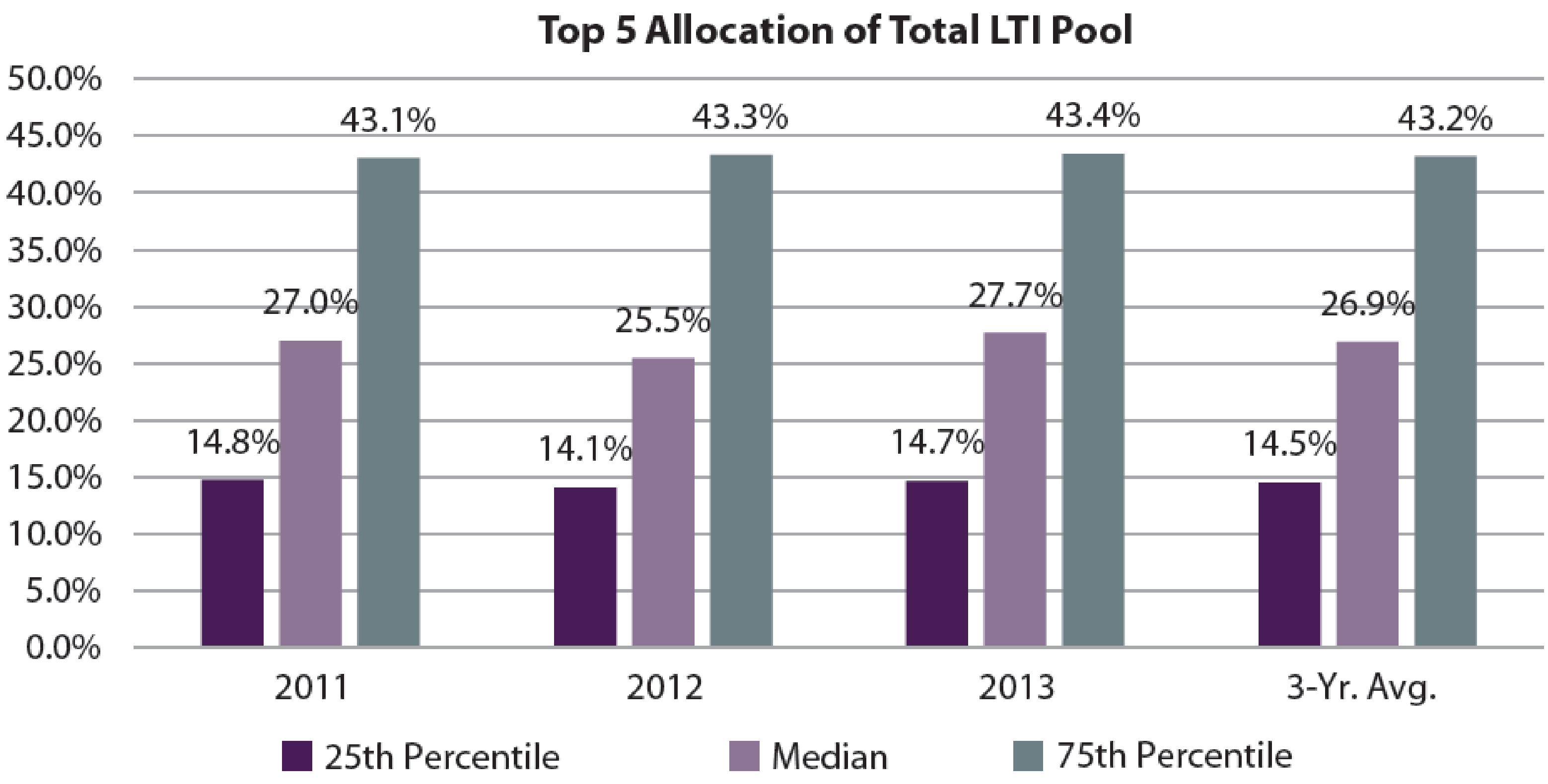
CEO Allocation of Total LTI Pool

- Helpful statistic



Top 5 Allocation of Total LTI Pool

- This as well



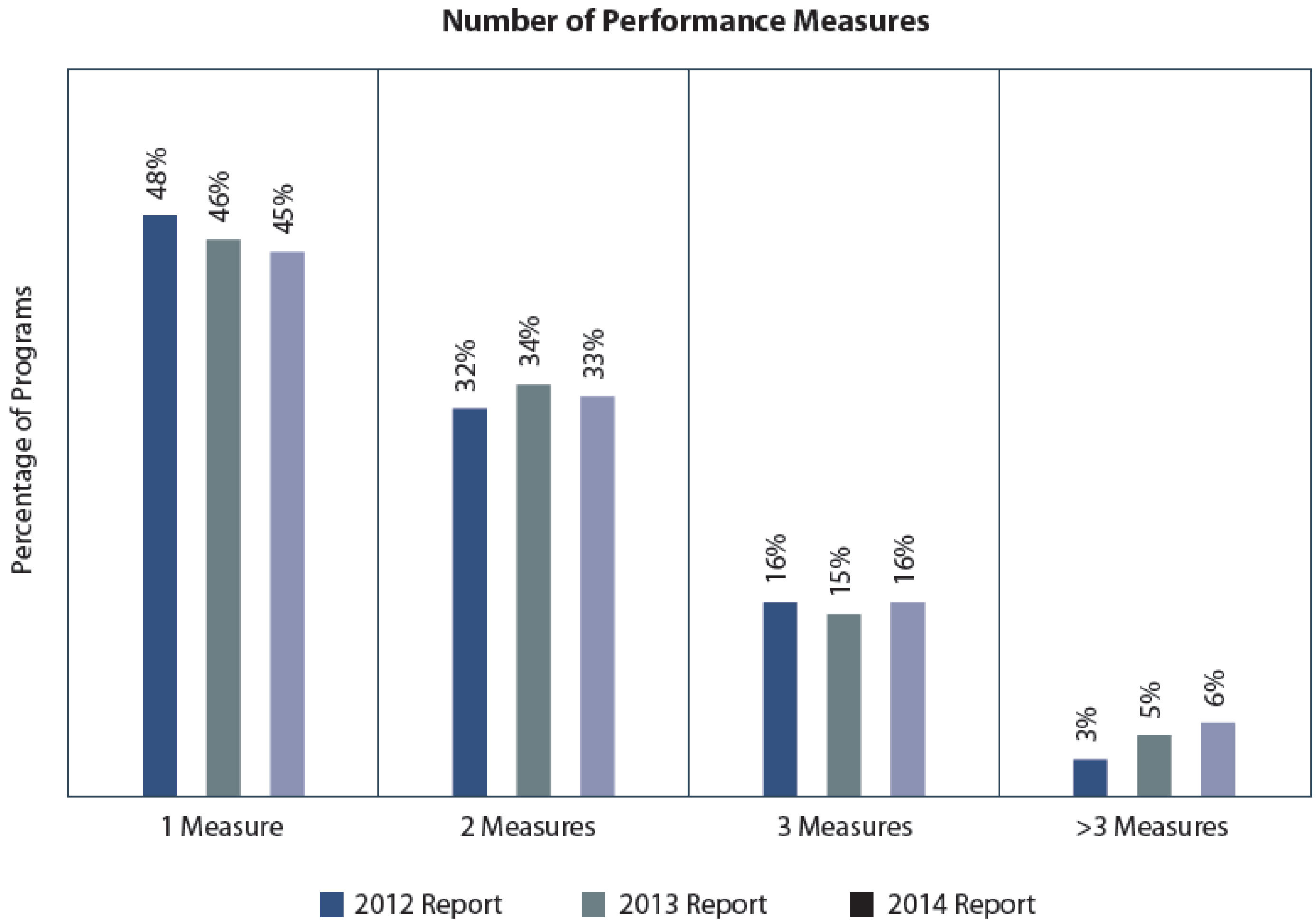
Trends in Executive Compensation

- With all else at median, performance measures differentiate, or do they?

Performance Measure Categories							
		Percent of Companies with Performance Awards Using			Performance Measurement Approach 2014 Report		
Category	Performance Measures	2012	2013	2014	Absolute	Relative	Both
Total Shareholder Return	Stock Price Appreciation Plus Dividends	48%	54%	58%	5%	87%	9%
Profit	EPS, Net Income EBIT, EBITDA Operating/Pretax Profit	50%	49%	50%	87%	12%	2%
Capital Efficiency	Return on Equity Return on Assets Return on Capital	37%	40%	41%	84%	8%	9%
Revenue	Revenue Organic Revenue	20%	20%	21%	87%	13%	0%
Cash Flow	Cash Flow Operating Cash Flow Free Cash Flow	13%	12%	13%	96%	0%	4%
Other	Safety, Quality Assurance New Business Individual Performance	16%	17%	15%	N/A	N/A	N/A

Trends in Executive Compensation (cont'd)

- 1-2 at most

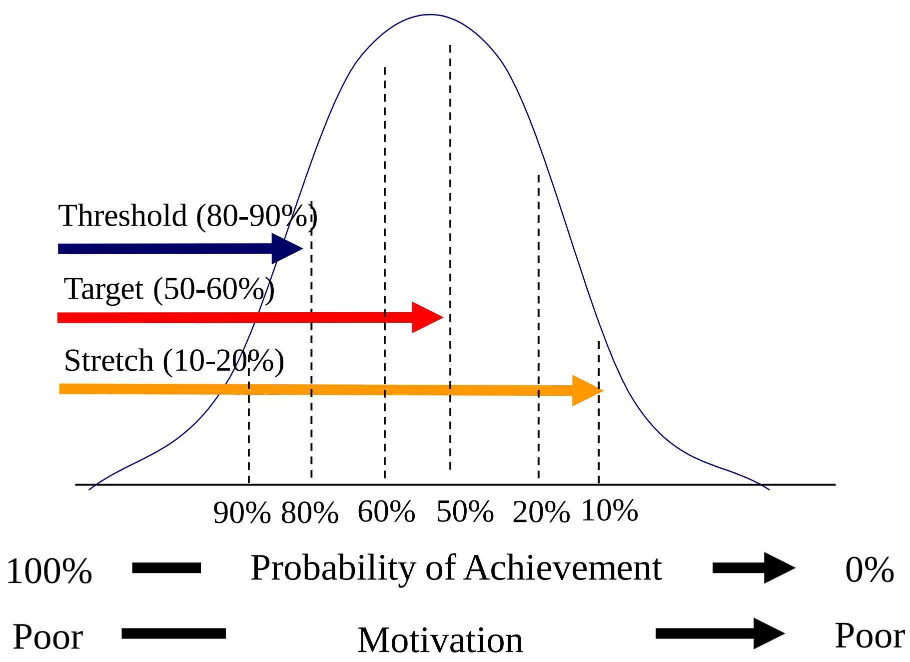


Goal-Setting

Probability Analysis – Overview

- There are general "rules of thumb" for probability achievement in incentive plan goals

This chart below shows a normal distribution with typical threshold, target and stretch performance probabilities

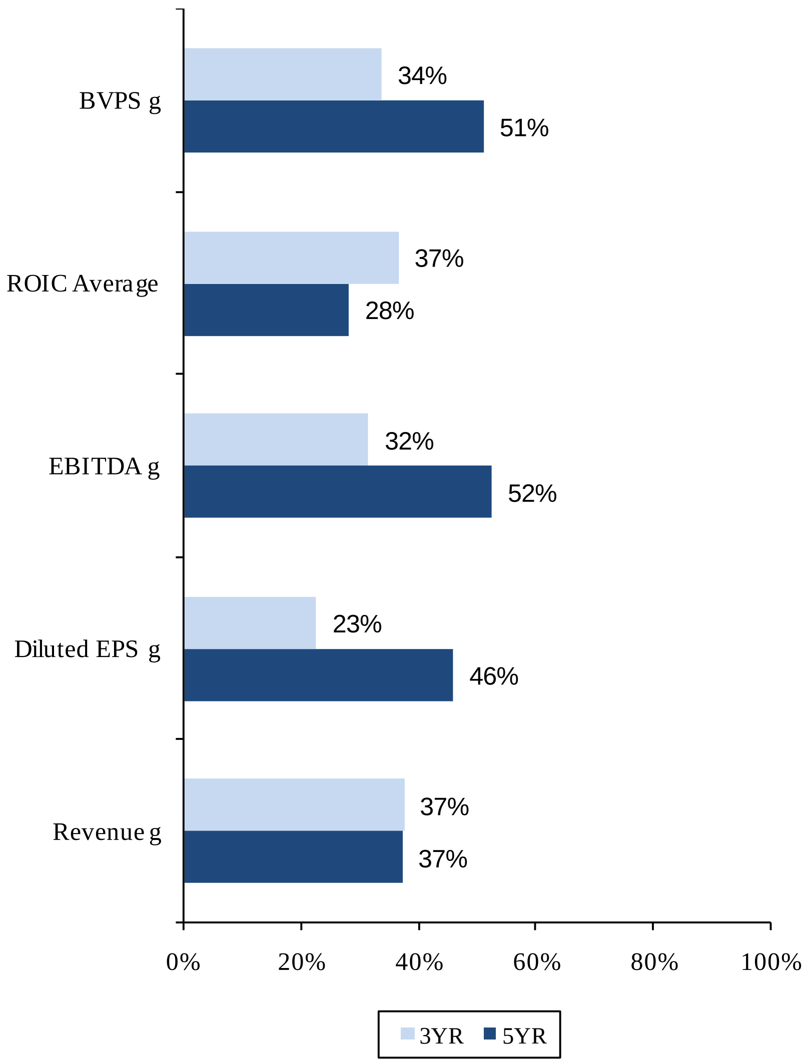


- Threshold goals would be achieved (and threshold awards would be paid) 80 to 90 percent of the time (8 or 9 out of 10 years)
  - This means that there may be no payment 10-20% of the time
- Target performance would be achieved 50 to 60 percent of the time
  - As a motivational driver, a probability somewhat better than even odds is considered optimal
- Outstanding performance would be achieved 10 to 20 percent of the time
  - Most organizations believe maximum payment requires a combination of both optimal market conditions and operational excellence to achieve

Source: Executive Remuneration Perspective, issue 59, Mercer Human Resources Consulting, September 15, 2006

Long-Term Incentive Design and Metric Selection

What correlates best with shareholder returns among the peer companies?

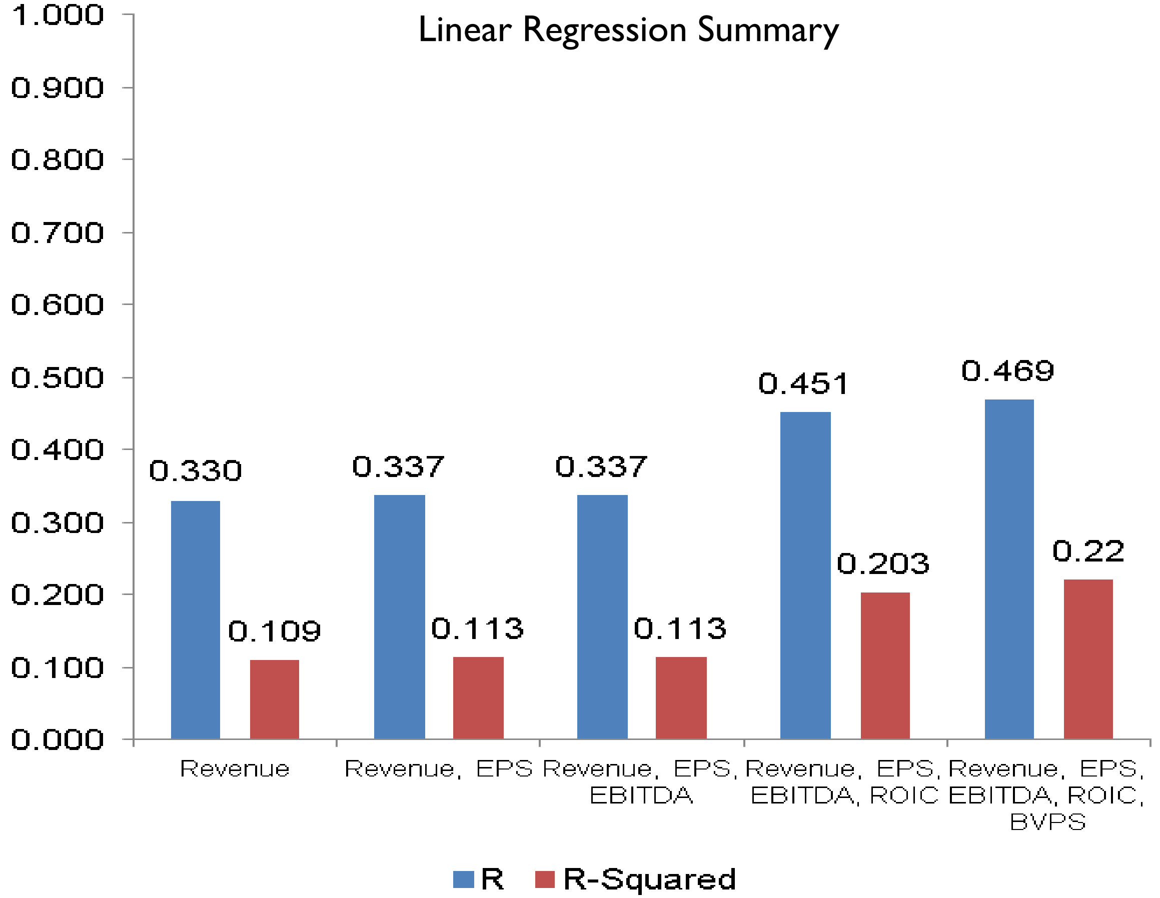


<u>Observations</u>

- Only low to moderately strong correlations were identified
- ROIC and revenue growth are most highly correlated on a 3-yr basis
- EBITDA growth and BVPS growth are most highly correlated on a 5-yr basis
- Any of these metrics could be considered for use in an incentive plan, but none of the measures by themselves are representative of overall corporate performance
  - The combination of ROIC and revenue growth can be an effective combination because it requires high financial returns on incremental capital (revenue growth is a proxy for capital growth)

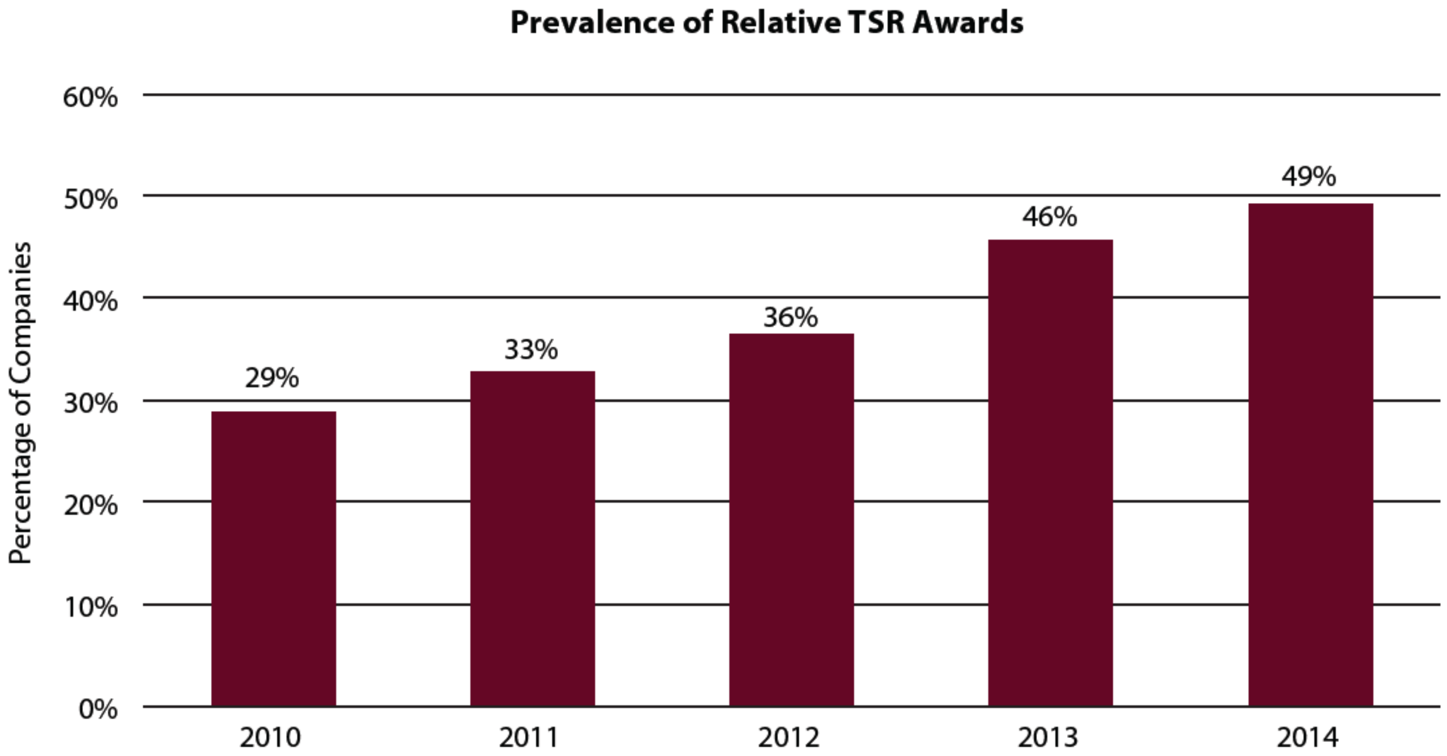
Long-Term Incentive Design and Metric Selection (cont'd)

What impact does the combination of various financial metrics have on the predictability of shareholder returns?



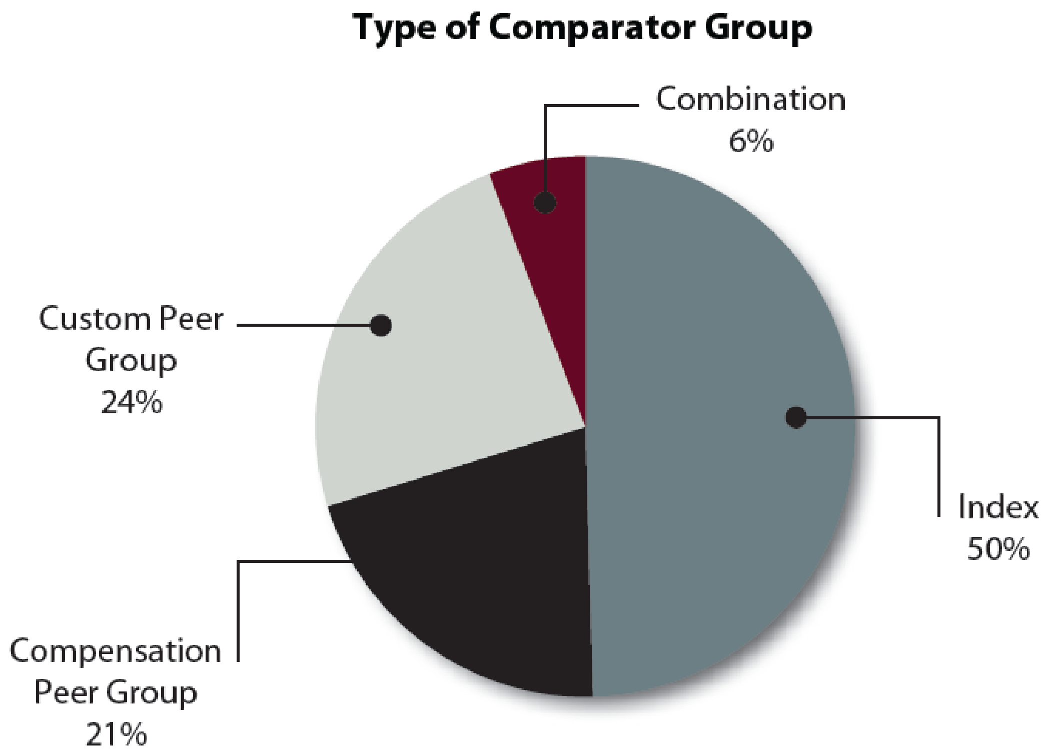
Relative TSR

- Half of the Top 250 using relative TSR



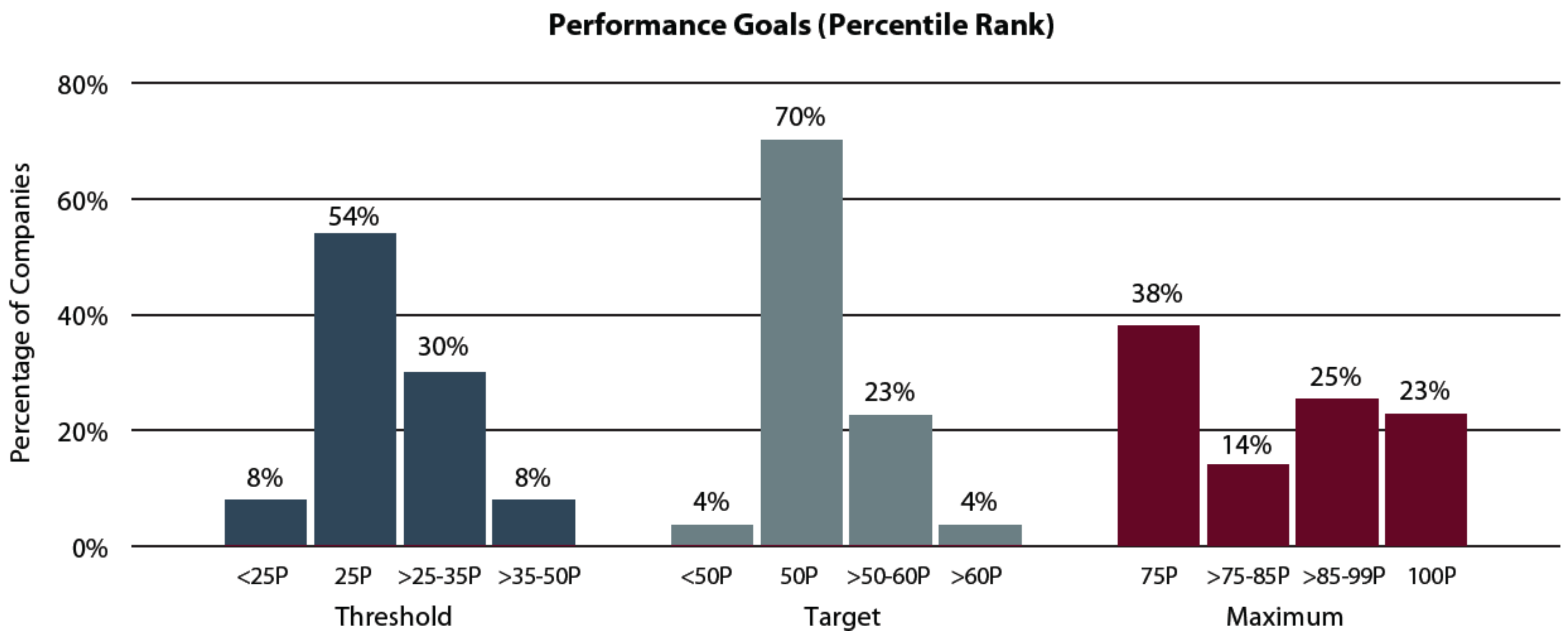
Relative TSR Award Design

- Index seems the way to go – and may even get more prevalent with SEC pay: performance disclsoure



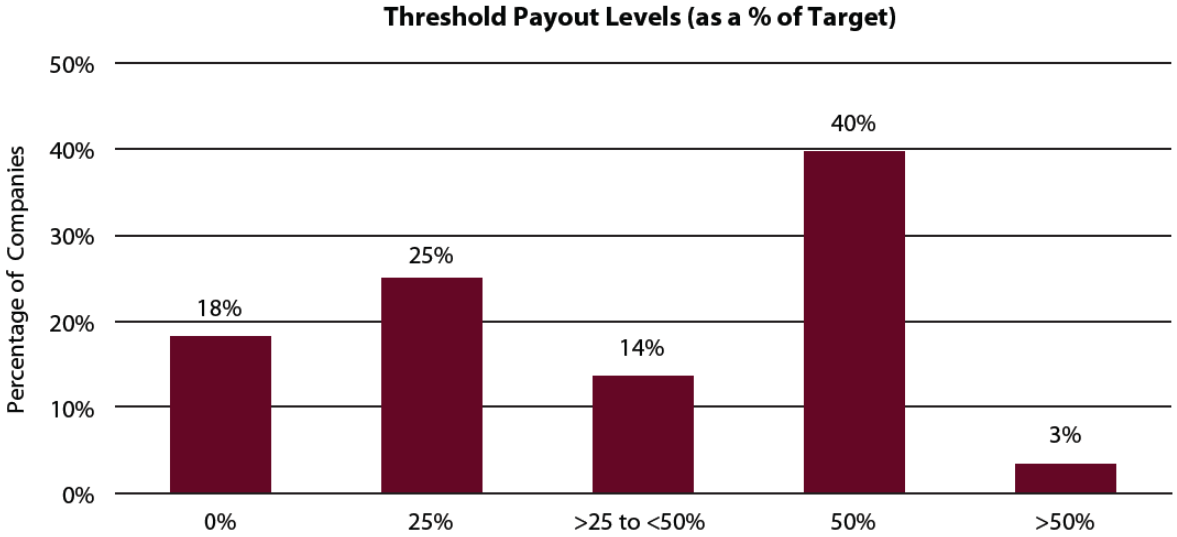
Relative TSR Award Design (cont'd)

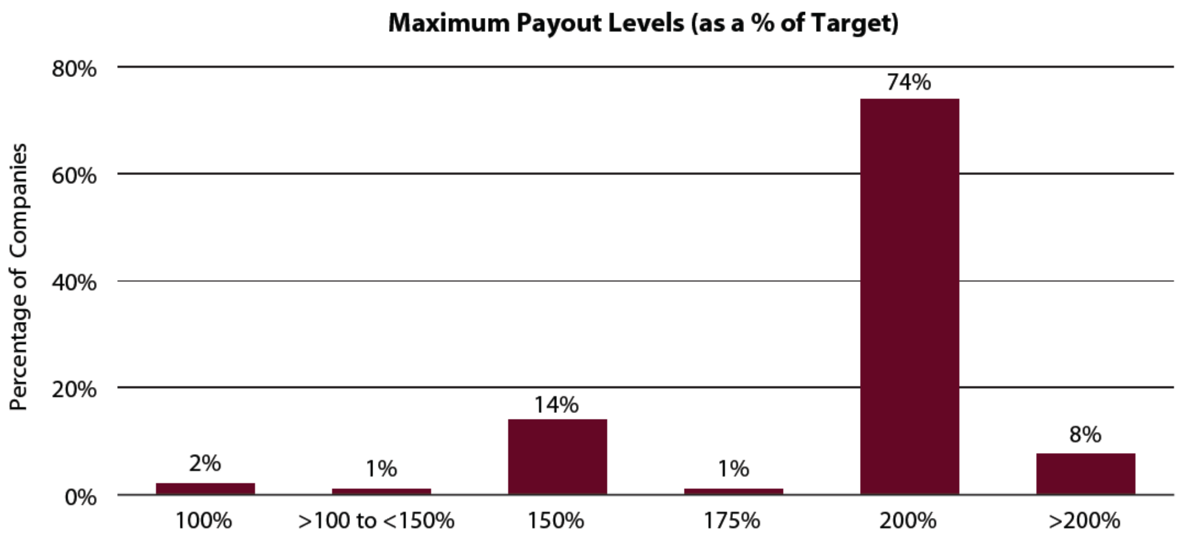
- 25th %ile to 75th %ile typical range



Relative TSR Award Design (cont'd)

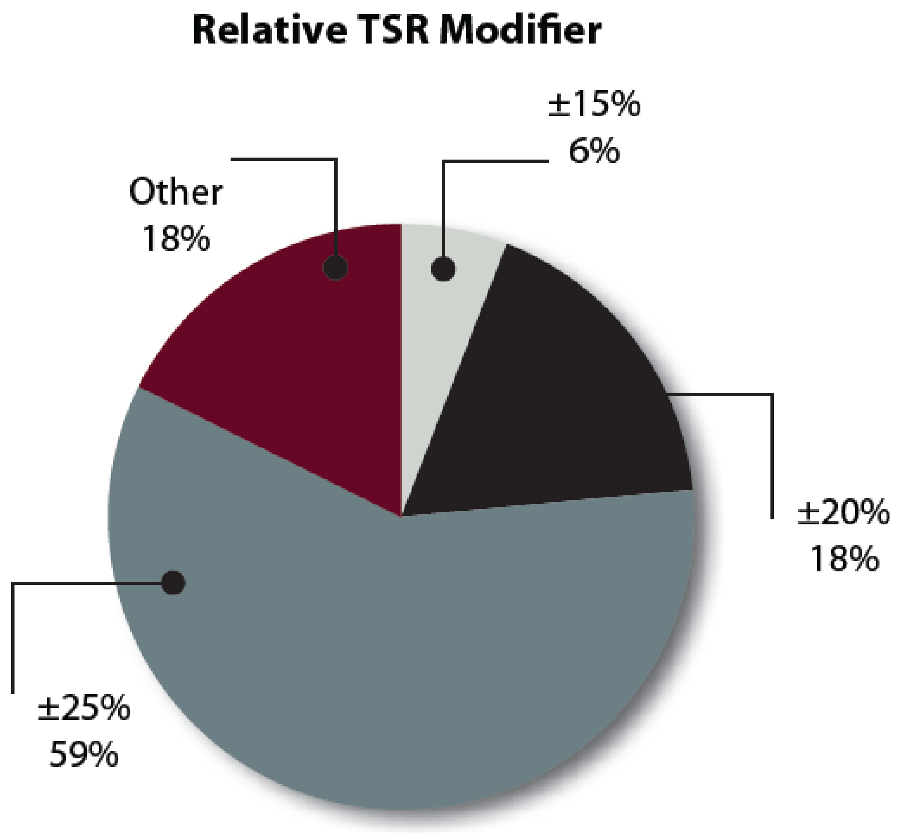
- Questionable result at threshold; trend to lower payout





Relative TSR Award Design (cont'd)

- If go modifier route:



Absolute TSR Goal Setting

- Three possible analyses to test price appreciation goals

<u>Capital Asset Pricing Model ("CAPM"):</u>
Uses a security's tendency to move with the market *(beta)* and historical market performance (market risk premium) to assess the security's cost of equity (implied TSR) under current market conditions (risk-free rate)

→ ***Long-Term Expected Return***

<u>Market Forward P/E Analysis:</u>
Uses current analysts' estimates of a company's future earnings performance to pinpoint a corresponding level of TSR

→ ***Short-Term Expected Return***

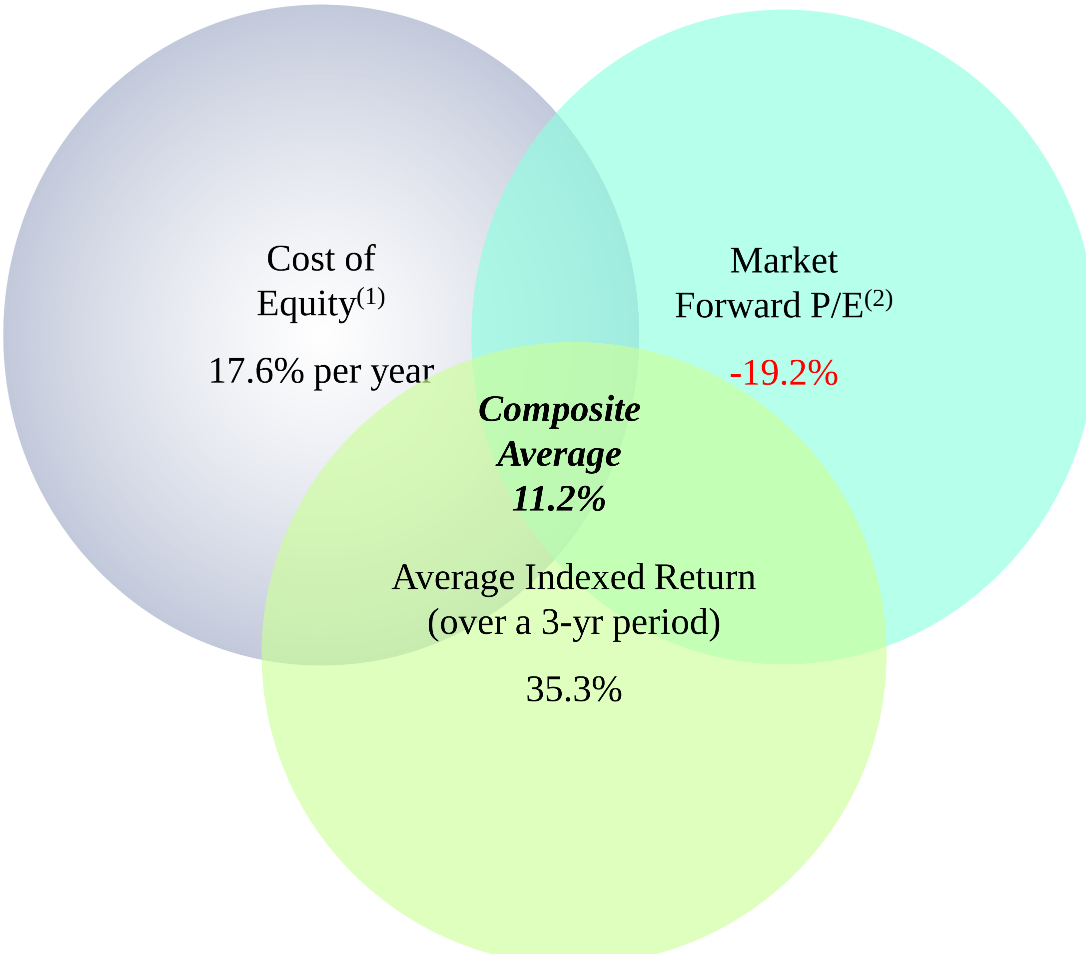
<u>Historical Indexed Returns:</u>

Uses three-year monthly indexed returns to analyze historical levels of aggregate price appreciation

→ ***Historical Test***

Absolute TSR Goal Setting (cont'd)

- The various goal-setting approaches yield a wide range of possible goal levels



Goal-Setting Approaches

Cost of Equity Capital: TSR goal is based on investor required return using the Capital Asset Pricing Model

Market Forward PE: TSR goal is based on the implied stock price growth assuming a constant forward P/E multiple times 2012 consensus EPS estimates

Historical Test: TSR goal is based on historical levels of achievement

1) Cost of equity assumes a beta of 2.40, a risk-free rate of 2.22%, and a market risk premium of 6.39%

2) Assumes 2012 EPS of $2.93, a constant forward PE of 3.43x, and a constant dividend of $0.18 per share

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Frederic W. Cook & Co., Inc. is an independent consulting firm specializing in executive and director compensation and related corporate governance matters. Formed in 1973, our firm has served more than 2,900 corporations, including 40 percent of the current Fortune 200 during the past two years and over half of Business Week's 250 largest market capitalization companies, in a wide variety of industries from our offices in New York, Chicago, Houston, Los Angeles, San Francisco, Atlanta and Boston. Our primary focus in on performance-based compensation programs that help companies attract and retain business leaders, motivate and reward them for improved performance, and align their interests with shareholders. Our range of consulting services include:

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