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Steady Compensation Planning Through Volatility

FW COOK

LEAP HR Life Sciences

Radical Change Through People

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Overview

PTC Therapeutics is used as a case study to illustrate three themes:

1. Adapting the equity compensation program to different sizes and stages

2. How to create and use equity compensation data that remains steady through volatility
   – Applies to regular industry valuation volatility and to the current COVID environment
   – Requires breaking with the tradition of using Black Scholes option values, which are the way that many compensation surveys provide equity compensation data and also still remain required for proxy reporting

3. Connecting HR to the Compensation Committee and to Finance
   – Consistent principles, objective facts, and the proper frame for communications

Typical Stages of Growth

- PTC is now a mature, large commercial public company
- But, in 2015 was “early public,” with an unusually high $1B market cap, ~350 employees, and one commercial product outside the US

Pre-IPO		Early Public		Mature Public	
Pre-Commercial				Commercial	

	Small	**Mid**	**Large**	**Small**	**Mid**	**Large**
Market Cap:	$100M-$900M	$900M-$3B	$3B-$10B	$500M-$1B	$1B-$3B	$3B+
Employees:	20-100	100-200	200-500	200-300	300-500	500+

PTC THERAPEUTICS™

Large Commercial
4 Commercial Products
Multiple Pipeline Candidates (15+)
850+ Employees in 20 Countries
7/31/20 Market Cap = $3.0B

The Problem with Black-Scholes

Subject to Volatility: Black-Scholes converts an option grant into a dollar value, like cash, based on the model's prediction of the final in-the-money option gain; the most direct input is stock price

Not Used as Intended: It was made for option traders trading short-lived options (e.g., 12 months), rather than for compensation options with long lives (e.g., 10 years)

Generally Accepted: It is used for proxy reporting of officer compensation and it is the way that most compensation surveys report their option grant data

The problem is that using Black-Scholes often provides a backwards result:

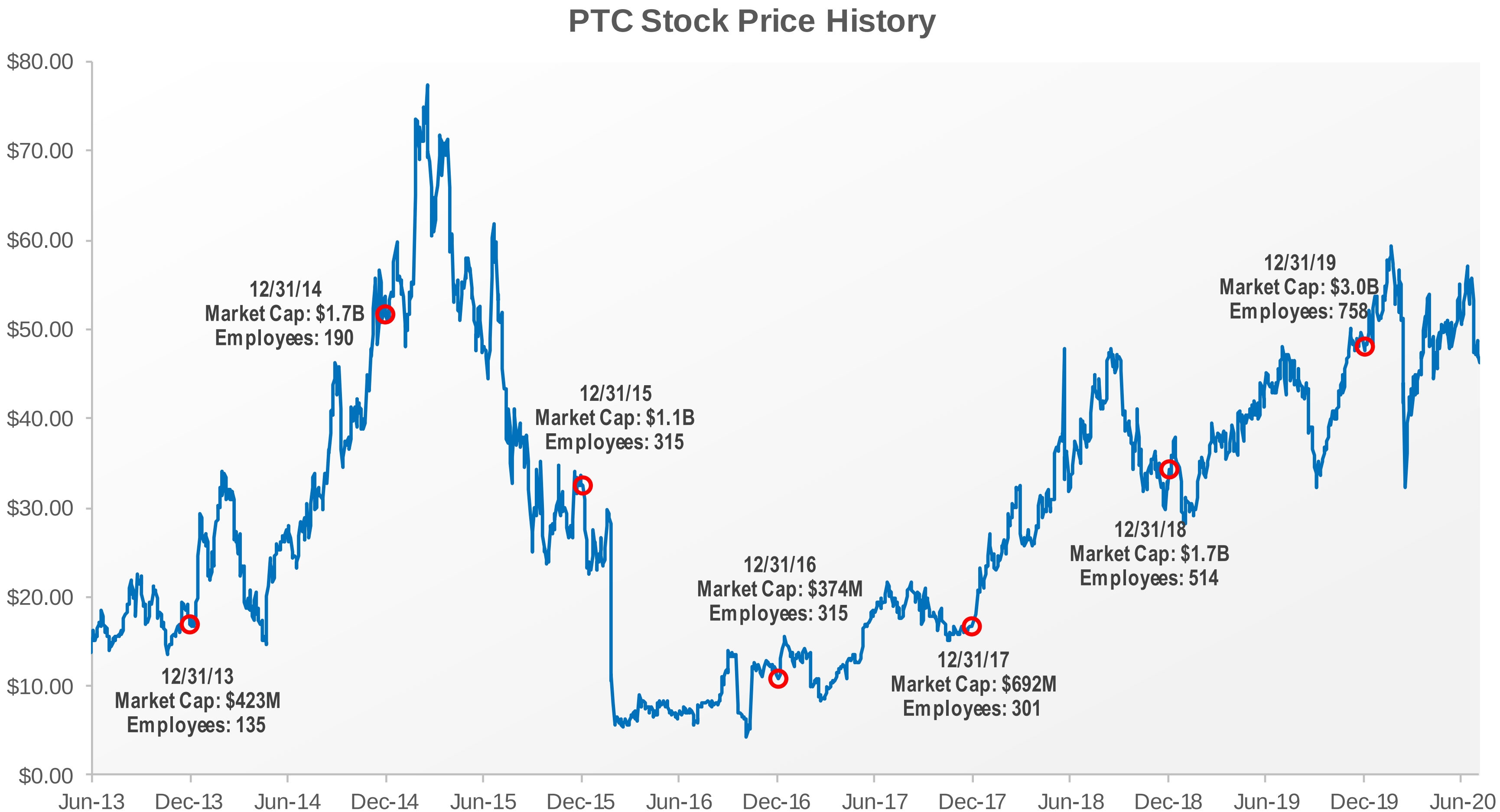
Price	Options	B-S %	B-S Value
$5.00	200,000	50%	$500,000
$10.00	100,000	50%	$500,000
$20.00	50,000	50%	$500,000

Most pay guidelines are a dollar amount (e.g., $500,000), so **Black Scholes tells you to grant more shares as the price falls and to grant fewer shares as the price increases.**

- Employees and Boards instinctively understand the problem.
- "I want 50,000 options at $20.00 as much as 200,000 options at $5.00" --- Nobody ever

PTC's Growth and Volatility after IPO

Stock price has been volatile as the Company scaled from 135 employees in 2013 to almost 900 today.



PTC makes an equity grant each year in the first quarter to maintain its pay at market, provide a portfolio of exercise prices over time, recognize the prior year's performance, and overlap vesting

Ownership Sharing Rates

The way to fix this is to measure the market data as a rate of ownership sharing - e.g., median is 0.1% of the company, rather than $250,000 of B-S value

- Best accomplished by setting aside an option pool that targets a burn rate and then allocating the pool throughout the Company.

Determining grants by allocating a Company option pool created by targeting an option burn rate provides a steady grant amount that does not change with stock price volatility, whether due to typical drug development ups and downs or due to COVID

Other benefits of determining number of options using ownership sharing rates:

1. Ownership sharing and option burn rates are the language of finance, the compensation committee, and investors

2. It scales. Burn rate data remain consistent in small and large cap drug development, but the large companies are spreading the same total options over more people as they scale, so each person is provided a smaller grant

3. It aligns pay and performance proxy disclosure. Reported Black-Scholes value is higher when the price is high and naturally falls if the price is low
   - Makes discussion disclosure and optics a separate topic from “market”

Market Data Show the Path Through Volatility

Median burn rate tends to stay the same (it is ~4% whether peer market cap is $850M or $2.5B), but the burn rate is spread over more employees in larger companies

Median CEO pay is a lower value and a higher percent of the company in smaller companies, and then value increases and the percent of the company falls as the peer group scales

	2014	2015	2016	2017	2018	2019
Peer Group Median						
- Median Burn Rate*	N/A	3.6%	4.0%	4.7%	4.3%	4.0%
- Median FTEs	N/A	190	185	246	349	490
- Median Market Cap	N/A	$1,271,000,000	$867,000,000	$843,000,000	$2,162,000,000	$2,480,000,000
Median CEO						
- No. Options	N/A	175,000	180,000	240,000	210,000	185,000
- B-S Value	N/A	$2,450,000	$2,730,000	$2,700,000	$4,900,000	$4,700,000
- % of Co.	N/A	0.50%	0.53%	0.59%	0.42%	0.30%
PTC Therapeutics						
- PTC Burn Rate*	5.2%	6.5%	5.1%	5.9%	7.4%	7.6%
- PTC FTEs	190	315	315	301	514	758
- PTC Comm. Shrs. Outst'g	23,800,000	34,271,000	34,318,000	41,433,121	50,454,000	61,630,000
PTC CEO Pay						
- No. Options	200,000	300,000	175,000	180,000	200,000	320,000
- Ex. Price	$27.05	$51.00	$30.86	$11.23	$18.01	$33.02
- B-S Value	$4,055,000	$9,600,000	$3,355,000	$1,460,000	$2,422,000	$6,300,000
- % of Co.	0.84%	0.88%	0.51%	0.43%	0.40%	0.55%

* Burn rates are "option equivalent" in which any RSUs or PSUs are converted to equivalent options

Sources: FW Cook studies for PTC and public filings

Thank You

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Michael Reznick Biography

Managing Director in Frederic W. Cook & Co.'s Los Angeles Office

- Shareholder with 25 years of executive compensation consulting experience; with FW Cook since 2000.

- Specific experience in designing total compensation strategies, including short- and long-term incentive plans, as well guidelines for initial public offerings and M&A activities for both public and private companies.

- Experience in most industries including Technology, Healthcare, Life Sciences, REITs, Financial Services, Professional Services, Hospitality, Airlines, and Natural Resources.

- Life Sciences clients include:

Representative Life Sciences Clients		
Alimera Sciences	Decipher Biosciences	PTC Therapeutics
Arcturus Pharmaceuticals	Galecto Biotech	Regeneron
Arena Pharmaceuticals	Glaukos	ResMed
BlueRock	MEI Pharma	Theravance BioPharma
Dicerna	Olema Pharma	ZIOPHARM Oncology

- BA in Economics and Classics from Brown University.

- Commercial/instrument rated pilot, surfer.

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FW Cook & Co.

History

- FW Cook was founded in 1973 to be the premier provider of independent executive and non-employee director compensation consulting services
- This has been our mission for over 45 years and has never been compromised by cross-selling other lines of business or services
- Our objective is to add value to our clients' compensation programs and processes though an independent viewpoint and distinctive capabilities
- The firm is 100% owned by its principals and therefore is not influenced by outside ownership; results in a business strategy focused on our highest priority – our clients

People and Locations

- We have a team of approximately 100 consultants that offer unparalleled expertise in the technical aspects of executive compensation including legal, tax, accounting, and governance
- Offices in New York, Los Angeles, Atlanta, Chicago, San Francisco, Houston, and Boston
- We have multiple locations but operate under a "one firm" philosophy in which our clients have access to the best resources regardless of geography
- We also maintain formal affiliations with partner firms in the UK and Hong Kong to access technical expertise and pay data on a global basis

Market Leadership

- We have worked diligently to establish and maintain our reputation as highly ethical and technically strong thought leaders on executive pay matters
- FW Cook enjoys a leading position as the board compensation committee advisor across a range of major U.S. indices*:
  - #1 among S&P 500 (~26% market share)
  - #1 among Russell 3000 (~16% market share)
- We have also developed a market-leading position as retained advisors to nonprofit organizations

*Source: As reported by Equilar in 2019.