Compensia
THOUGHTFUL PAY

Avoiding Common Mistakes in Structuring Compensation Programs & Processes

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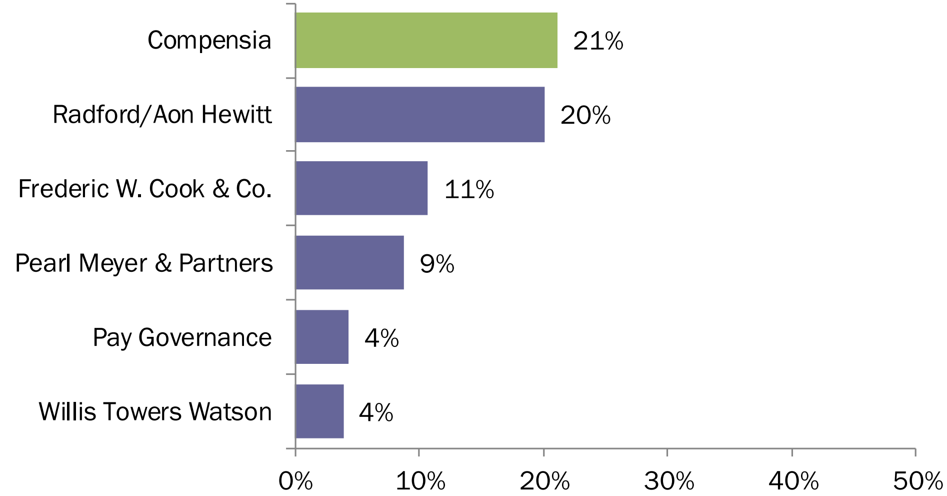
The Compensia Difference

Focused	Our business is highly specialized: we focus on executive, Board, and equity compensation matters for technology and life sciences companies.
Independent	Our advice is not biased by potentially conflicting offerings in HR consulting, benefits brokerage, surveys, etc.
Pre-IPO / IPO Experience	We have unparalleled experience working with pre-IPO companies and assisting them with their transition from private to public ownership.
Collaborative	We advise on issues that rise to the Compensation Committee level and have extensive experience working collaboratively with Committees and management.
Succinct	Our presentations are to the point, providing our clients with the information necessary to make decisions and move forward.
Knowledgeable	We have extensive expertise in market assessment and incentive plan design as well as a deep understanding of the key areas that shape executive compensation, including corporate governance, SEC disclosure, tax and accounting regulations, and institutional investor voting policies.

Compensia is the leading advisor to technology and life science companies

- Compensia provides objective, independent and expert advice to Compensation Committees and senior management on matters related to executive pay and performance
- Formed in 2003 by partners of nationally recognized consulting and law firms, Compensia has established itself as one of the largest executive compensation consulting firms in the country
- ~450 clients and ~300 active public company Compensation Committee engagements
- Compensia has ~45 employees with two principal offices in the SF Bay Area and professionals in Chicago, Washington D.C., San Diego, Oregon and the New York Metro area

Leading Compensation Committee Consultants
Russell 3000 Technology & Health Care



Representative Life Science Clients

(clients Erik Beucler has worked with are highlighted in blue)

- AccessClosure (acquired)
- Accuray
- Aeglea*
- Affymetrix (acquired)
- Alexza Pharmaceuticals
- Alder Biopharmaceuticals
- Align Technology*
- Allos Therapeutics
- Allogene*
- Amyris*
- AnaptysBio*
- Audentes*
- Ardelyx
- Auris Health (acquired)
- Benvenue Medical
- Cadence Pharma
- Cascadian Therap. (acquired)
- ChemoCentryx*
- Codexis
- Cooper Companies
- Eagle Pharmaceuticals*
- Esperion Therapeutics*
- FibroGen*
- Genmark Diagnostics
- Genomic Health
- Gen-Probe
- Gilead Sciences
- Global Blood Therapeutics*
- Halozyme Therapeutics
- Hyperion Therapeutics (acquired)
- Incyte*
- iRhythm Technologies*
- ICU Medical
- Intuitive Surgical*
- Jazz Pharmaceuticals
- Kite Pharma (acquired)
- Marinus Pharmaceuticals*
- MyoKardia*
- Nivalis Therapeutics (acquired)
- Orexigen
- Pacific Biosciences
- Proteus Digital Health
- Pulmonx
- Revolution Medicines*
- Sarepta Therapeutics
- Semler Scientific
- Sequenom
- Somaxon
- Syros Pharmaceuticals*
- Thoratec
- Transcept Pharma (acquired)
- Tricida*
- United Therapeutics
- UroGen Pharma

* Clients where Erik Beucler is currently the advisor to the Compensation Committee

Avoiding Common Mistakes in Structuring Compensation Programs & Processes

1. Use Relevant Market Data and Define Your Compensation Philosophy

What?

- Use relevant market data
  - Pre-IPO
    - Industry
    - Capital raised or revenue
  - Public
    - Required Peer Criteria
      - Industry
      - Market capitalization
      - Revenue or FDA Phase
      - Headcount (sometimes)
    - Refinement Peer Criteria
      - Help identify similar organizations
- Define a compensation philosophy, including:
  - Pay program objectives
  - Market data / perspectives
  - Target pay positioning by pay element (i.e. base, bonus, and equity)
  - Key objectives for each element of pay

Why?

- Data:
  - Market data vary considerably based on valuation/market cap., revenue, sub-industry, and other organizational characteristics
- Compensation Philosophy:
  - Facilitates a holistic conversation regarding compensation strategy
  - Enables clear communication with Board of Directors and executive team
  - Provides foundation for consistent decision-making

2. Equity: Formalize Your Refresh Grant Program

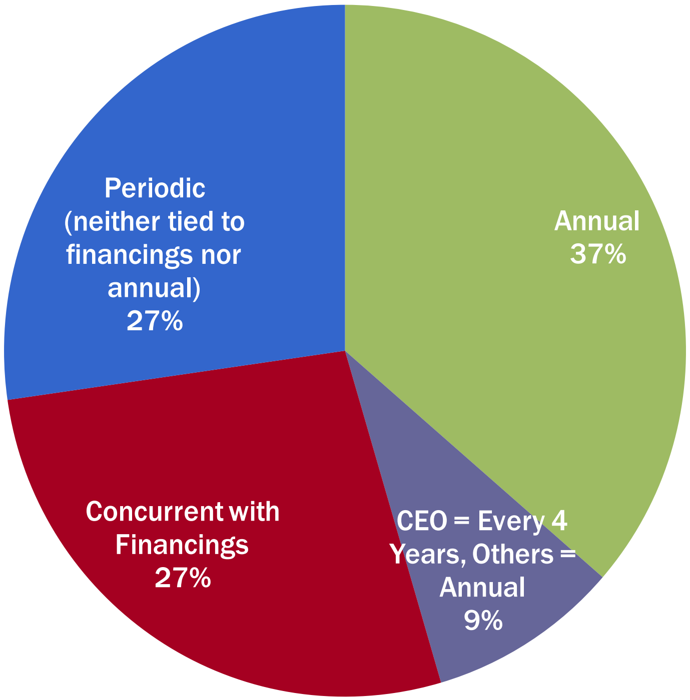
What?

- Formalize a mechanism for providing ongoing equity awards to address ongoing retention and reward objectives
- Avoid providing dilution protection
  - Provide equity on a prospective basis, considering:
    - Current market norms
    - Current role & contribution

Why?

- As company matures and new-hire grants vest and are diluted, a refresh program helps retain employees
- Multiple strategies are common, each with distinct pros and cons
- Formalizing a strategy allows you to apply the program consistently and communicate to your employees (and your Board)

Prevalence of Refresh Grant Approach[1]



1. Including companies that grant equity upon achieving key milestones.

3. Equity: Plan For Your Growth

What?

- Develop competitive guidelines
- Estimate your share needs for full year
- Request Board approval

Why?

- Ensures grants are competitive…and reasonable
  - Candidates won't tell you when you offer too much
  - Often limited insight into current candidate compensation
- Demonstrates to your Board that program terms are sound / uses Board time efficiently
  - Avoids debate at times of offer
  - Ensures pool request is sufficient
- Consistency

4. Get the Evergreen Funding Correct at IPO

What

- An evergreen provision provides for an automatic increase in the available share reserve each year (usually the first day of the fiscal year) for a specified period of time (usually 10 years)
  - >90% of technology, medical device, and biotechnology / pharmaceutical companies adopt an evergreen at IPO
- Evergreens typically add shares equal to the lesser of:
  - 4%-5% of the common shares outstanding
  - A hardwired # of shares
  - A lesser number specified by the Board

Why

- Funding is often constrained by hardwired # of shares rather than intended %
- Amending the equity plan once public is challenging
- Historical market norms (4% in medical device and biotechnology, 5% in technology) may not be sufficient

5. Standardize Severance & Change-of-Control Arrangements

What

- Standardize terms across executives, reflecting market norms and best practices
- Avoid individually-negotiated arrangements

Why

- Saves time and money
- Results in consistency across the team
- Avoids surprises and headaches as you transition to uniform arrangements at IPO

6. Build Capabilities to Enable Pay Differentiation

What

- Differentiating compensation based on individual performance and criticality is often necessary to retain and reward key talent. However, it's often easier said than done
- Requires:
  - A clear and well-communicated compensation philosophy
    - What are the tools (e.g. base, bonus, equity)?
    - How are they different?
  - Manager education
  - Calibration to ensure consistency
- Alternatively, companies use the "peanut butter" approach

Why

- As a company grows, budgets typically require that a company be less generous with compensation across all team members
  - Companies typically begin to differentiate pay based on individual performance and criticality
- At a certain point, an organization is sufficiently large that senior management cannot make informed compensation decisions for all employees and decisions must be delegated to managers

7. Build a Compensation Committee Calendar

What

- Build an annual Comp. Committee Calendar with key agenda items for each meeting
- With respect to executive compensation decisions, there are 5 key steps:
  - Peer Group selection & approval
  - Approve compensation philosophy
  - Review of market data and supporting analytics
  - Review of Management recommendations
  - Comp. Committee / Board approval

Why

- Compensation Committee workload continues to increase
- Ensures necessary items are completed each year in an orderly manner
- Ensures adequate time for deliberation and discussion (i.e. avoids the Compensation Committee Crash Landing)
- Few people are at their best (work quality or behavior) when rushed

		2020				
	Topic	February	April	June	September	December
Admin	Review/Update Committee Calendar	X	X	X	X	X
	Review/Approve Committee Minutes	X	X	X	X	X
Governance	Review committee charter		X			
	Review independence of advisors		X			
	Conduct self-evaluation		X			
	Regulatory & trends update, Say-on-Pay Review			X		
	Review and approve CD&A and Comp. Comm. Report		X			
	Review risk assessment		X			
	Review pay equity / diversity		X			
	Review stock ownership guidelines				X (Odd Yrs)	
Bonus Plan	Approve bonus payouts for last FY	X				
	Review corporate goals & bonus plan structure for next FY					X
	Approve annual corporate goals & bonus plan structure for current FY	X				
Setting Compensation	Review Director compensation & recommend to full Board	X				
	Review compensation philosophy			X		
	Review / Approve Peer Group			X		
	Review market assessment of Officer compensation				X	
	Review CEO recommendations for Officer Compensation					X
	Approve Officer Compensation	X				
	Review non-exec. equity grant guidelines and pool/burn rate				X	
	Approve non-executive grant guidelines and pool/burn rate	X				X
	Approve non-executive annual equity grants	X				
	Review & approve severance/change-of-control agreements				X (Even Yrs)	

8. Consider RSUs before it's too late

What

- Consider granting a mix of options and RSUs at larger market capitalization companies
- At public, pre-commercial biotechnology companies, stock options remain the most common equity vehicle

Why

- Assists with retention when stock prices are volatile
- Assists with recruitment when candidates have in-the-money options or RSUs at their current employer
  - Helps avoid large cash signing bonuses
- Helps manage dilution

Appendix

Summary of Biotechnology Compensation Practices: Cash & Benefits

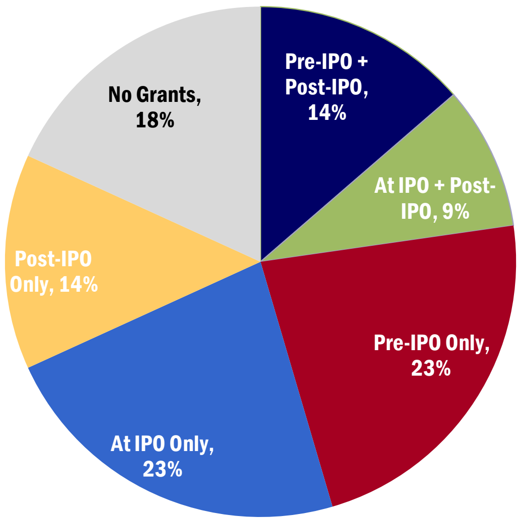
	Pre-IPO Companies	Public Pre-Commercial Biotech Companies
Cash Compensation Levels	■ Executive salaries generally fall below public company norms; non-executive salaries are generally competitive with public company norms ■ Target bonuses (% of salary) often fall below public company norms	■ Executive salaries increase vs. pre-IPO ■ Target bonuses increase slightly (as % of salary) for executives and non-executive
Bonus Plan	■ Discretionary programs are common	■ Formal bonus metrics
Benefits	■ Limited	■ Enhanced health and welfare benefits versus pre-IPO ■ 401K match and ESPP commonplace

Summary of Biotechnology Compensation Practices: Equity

	Pre-IPO Companies	Public Pre-Commercial Biotech Companies
Grant Size Metrics	■ Focus on aggregate equity holdings (% of co.) ■ Secondary focus on unvested equity position	■ Focus on annual grant value ■ Secondary focus on unvested equity value
Grant Size	■ Primary emphasis on new-hire awards (i.e. recruiting critical talent) ■ Secondary emphasis on refresh awards – Refresh guidelines typically set at 1/4th of new-hire guidelines (implying new-hire guidelines is 4x refresh)	■ Balanced focus on new-hire awards (i.e. recruiting) and annual awards (i.e. ongoing retention / performance recognition) – New-hire guidelines typically reflect 2x refresh grants ■ Grant levels as % of co. tend to decrease from pre-IPO levels <u>at higher-valuation companies</u>
Participation Rates	■ New-hire: participation is typically 100% ■ Refresh: Ad-hoc – Screen for participation is performance, criticality and/or retention needs	■ New-hire: 100% ■ Refresh: 100%
Refresh Grant Timing	■ Often granted as employees approach full vesting of new-hire awards (i.e. 3rd or 4th year of employment)	■ Annual
Equity Vehicles	■ The majority of pre-IPO companies utilize stock options as their only equity vehicle	■ Most companies continue to grant stock options
Vesting (time-vested awards)	■ Four-year vesting is most common – Stock options: typically vest monthly (often with 25% cliff at 1 year, particularly for new-hire awards)	■ Four-year vesting is most common – Stock options: typically vest annually or monthly (often with a 25% cliff at 1 year, particularly for new-hire awards) – RSUs: vest annually
Pool Size Metrics	■ Primary focus on aggregate employee stock option pool (outstanding and exercised options) ■ Burn rate may be considered at late-stage cos.	■ Primary focus on adjusted gross annual “burn rate” ■ Secondary focus on total overhang

Once public, nearly all biotechnology companies adopt an annual equity grant program. In the year of IPO, most companies make grants, although timing varies[1]

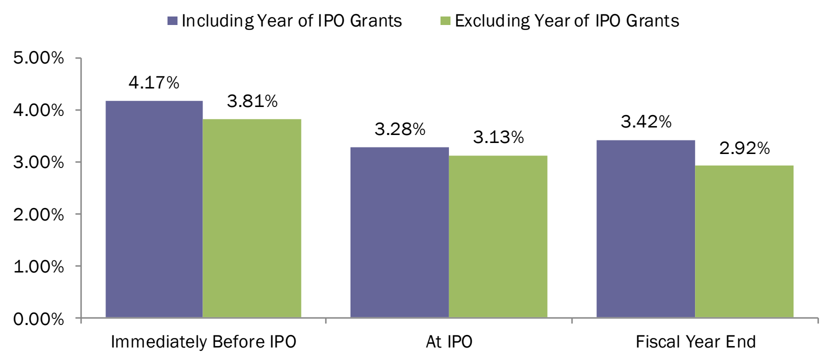
Grants In the Fiscal Year of IPO (prevalence)



- ~80% of companies make grants in the year of IPO, including:
  - Grants Prior to IPO
  - Grants at IPO
  - Grants Following IPO
- ~25% of companies make multiple grants in the year of IPO
  - Prevalence does not distinguish between those companies that did and did not complete a mezzanine financing round in the year of IPO

CEO Ownership Through IPO Process (non-founders[2])

- As a result of grants made in the year of IPO, non-founder CEOs end the year with ~0.5% greater holdings than if no grants were made in the year of IPO
- Year of IPO grants are not equal to full "dilution protection" of the CEO; at the median, CEO ownership exiting the year of IPO is ~0.75% lower than immediately before IPO



1. Per review of CEO awards at 22 pre-commercial biotechnology companies that went public between January 2016 and December 2017.
2. All calculations reflect a fully-diluted denominator. Although public company comparisons are typically presented on a basic shares outstanding basis, we present a fully-diluted denominator to allow for comparisons of pre-IPO to public.

Alternative Refresh Timing: Pros & Cons

Approach	Pros	Cons
Annual Refresh Grant	■ Solves for ongoing retention ■ Multiple grants results in portfolio of exercise prices ■ Allows company to differentiate grant size based on perf. and contribution over time ■ Rewards performance not tied to equity financing (e.g., collaboration agreement)	■ May not be large enough to retain executive if new-hire grant is largely vested before annual grants commence ■ May result in ownership that is somewhat above or below market depending on timing of financing events
Refresh Concurrent with Equity Financings	■ Rewards for performance related to capital raising activity ■ Allows the Company to precisely manage share dilution (re-sizing pool concurrent with equity financing)	■ Less-frequent opportunities to address retention and performance ■ May penalize capital efficiency or reward capital inefficiency ■ Does not address non-dilutive financing (e.g., collaborations) ■ Grants may occur less frequently than annual with less variation in exercise prices