Tally Sheets: The Accumulated Wealth
Addendum

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Background

- Historically, attention was paid primarily to the expected value of equity grants in a given year
  - Focus was on determining competitive value
  - Initially, equity grants were not significant, so accumulated value was modest
- Equity grants have been at a significant level for 10+ years, translating to sizeable accumulated values
- Minimal attention has been paid to the realized or accumulated value associated with vested equity grants, or potential for value going forward
  - Viewed as not that relevant, since grants were already made and had limited retention value
- It is important that ongoing pay decisions be made within the context of total rewards, as well as performance
Approaches

- The total value of equity grants can be assessed several ways; three potential analyses include:
  - Gains from past equity grants: What value has an individual realized from past equity grants?
  - Current value of outstanding equity: What is the current value of outstanding equity awards?
  - Future wealth potential: What might the value of all wealth creation opportunities be at retirement?
- Performance, both at a Company and individual level, need to be considered in assessing accumulated pay
- These analyses provide decision-quality inputs into how the pay program has worked in the past, and consideration of appropriate grant levels going forward
## Gains From Past Equity Grants

- The table below shows the value of exercised stock options, vested restricted shares and earned performance shares (valued at vesting).
- This chart illustrates the actual value realized through company-provided equity grants.

<table>
<thead>
<tr>
<th>Name</th>
<th>Options Exercised Since Hire</th>
<th>Total Pre-Tax Gain From Options</th>
<th>Restricted Shares Since Hire</th>
<th>Value of Restricted Shares @ Vesting</th>
<th>Earned Performance Shares</th>
<th>Value of Performance Shares When Earned</th>
<th>Total Value of Equity Grants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive A</td>
<td>240,323</td>
<td>$5,776,020</td>
<td>0</td>
<td>$0</td>
<td>100,000</td>
<td>2,033,320</td>
<td>$7,809,340</td>
</tr>
<tr>
<td>Executive B</td>
<td>425,500</td>
<td>$9,000,753</td>
<td>0</td>
<td>$0</td>
<td>175,000</td>
<td>3,605,480</td>
<td>$12,606,233</td>
</tr>
<tr>
<td>Executive C</td>
<td>55,850</td>
<td>$2,643,071</td>
<td>0</td>
<td>$0</td>
<td>20,000</td>
<td>475,425</td>
<td>$3,118,496</td>
</tr>
<tr>
<td>Executive D</td>
<td>15,000</td>
<td>$652,998</td>
<td>0</td>
<td>$0</td>
<td>0</td>
<td>0</td>
<td>$652,998</td>
</tr>
</tbody>
</table>
Gains From Past Equity Grants (cont’d)

- Important items to consider include:
  - Individual’s exercise and hold behavior
  - Individual and Company performance
  - Individual’s tenure with the Company
  - Mix between different grant types
- Past grants typically have little ongoing retention or incentive value (other than on shares retained)
  - Retention value is a key attribute of equity grants
## Current Value of Outstanding Equity

- The table below shows the current value of all outstanding equity awards and the leverage inherent in outstanding grants.

- As shown, each $1 change in stock price can have a significant impact on the accumulated value of outstanding awards.

- Restricted shares will retain leverage at all stock prices, while options will only have leverage at prices above the exercise price.

<table>
<thead>
<tr>
<th>Name</th>
<th>Current Option Holdings</th>
<th>Weighted Avg. Exercise Price</th>
<th>Unvested Restricted Shares</th>
<th>Owned Shares</th>
<th>Total Stock Holdings</th>
<th>Current Value at $42.00</th>
<th>Leverage - Gain on $1 Stock Price Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive A</td>
<td>Vested 87,010</td>
<td>$25.67</td>
<td>0</td>
<td></td>
<td></td>
<td>128,677</td>
<td>$142,419</td>
</tr>
<tr>
<td></td>
<td>Unvested 41,667</td>
<td>$38.09</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>128,677</td>
<td>$29.69</td>
<td>0</td>
<td>13,742</td>
<td>142,419</td>
<td>$2,160,701</td>
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<tr>
<td>Executive B</td>
<td>Vested 55,199</td>
<td>$19.95</td>
<td>0</td>
<td></td>
<td></td>
<td>70,200</td>
<td>$70,200</td>
</tr>
<tr>
<td></td>
<td>Unvested 15,001</td>
<td>$38.52</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Total</td>
<td>70,200</td>
<td>$23.92</td>
<td>0</td>
<td>0</td>
<td>70,200</td>
<td>$1,269,462</td>
<td></td>
</tr>
<tr>
<td>Executive C</td>
<td>Vested 73,899</td>
<td>$22.34</td>
<td>0</td>
<td></td>
<td></td>
<td>98,900</td>
<td>$102,678</td>
</tr>
<tr>
<td></td>
<td>Unvested 25,001</td>
<td>$38.52</td>
<td>2,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>98,900</td>
<td>$26.43</td>
<td>2,000</td>
<td>1,778</td>
<td>102,678</td>
<td>$1,698,808</td>
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<tr>
<td>Executive D</td>
<td>Vested 7,666</td>
<td>$43.90</td>
<td>0</td>
<td></td>
<td></td>
<td>32,001</td>
<td>$45,167</td>
</tr>
<tr>
<td></td>
<td>Unvested 32,001</td>
<td>$37.53</td>
<td>5,500</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>39,667</td>
<td>$38.76</td>
<td>5,500</td>
<td>0</td>
<td>45,167</td>
<td>$359,637</td>
<td></td>
</tr>
</tbody>
</table>
Current Value of Outstanding Equity (cont’d)

Important items to consider include:

- Mix of vested and unvested awards
- Source of owned shares
- Recent and anticipated performance
- Anticipated remaining tenure (i.e., retirement eligible?)
Future Wealth Potential

The table below shows the anticipated future value of current holdings and expected equity grants, along with anticipated retirement benefits.

This analysis provides a total projected wealth creation scenario and illustrates the relative value of equity grants and retirement benefits.

The findings of this and the proceeding analyses often produce an “ah ha” moment for the Compensation Committee.

<table>
<thead>
<tr>
<th>Name</th>
<th>Current Equity Holdings</th>
<th>Future LTI Grants</th>
<th>Retirement Benefits</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive A</td>
<td>$18.5</td>
<td>$16.7</td>
<td>$4.0</td>
<td>$39.2</td>
</tr>
<tr>
<td>Executive B</td>
<td>$21.9</td>
<td>$59.7</td>
<td>$3.2</td>
<td>$84.9</td>
</tr>
<tr>
<td>Executive C</td>
<td>$19.4</td>
<td>$64.8</td>
<td>$3.3</td>
<td>$87.5</td>
</tr>
<tr>
<td>Executive D</td>
<td>$4.5</td>
<td>$6.7</td>
<td>$2.9</td>
<td>$14.1</td>
</tr>
</tbody>
</table>

Estimated future values are shown in millions.

1. Current holdings includes shares owned outright, vested and unvested stock options and restricted shares as of 1/1/06
2. Assumes annual 3% per year growth in the expected value of LTI grants and current LTI grant practices continue
3. Retirement benefits assume lump sum present value at retirement date
Important items to consider include:

- Definition and details of retirement plans
- Performance
- Tenure (past and future)
- Past exercise and sell behavior
**Alternative View: Realizable Wealth vs. Performance**

- The prior slides looked at value realized or future projected value.
- Another way to assess pay is to compare value that could be realized based on accumulated grants to actual performance of the company.

**Total Wealth Creation Analysis**
**Company XYZ vs. Peers**
**2000 - 2004**
This type of analysis focuses on the potential value of past grants, normalizing for actual exercise behavior.

It provides an assessment of the structure of pay programs that too often focus only on the expected value of grants (i.e., Black-Scholes value).

Analysis shows if pay targets, relative to performance, are actually being met.

Desired outcome would be for the positioning (e.g., 50th percentile) of realizable pay to equate to the appropriate performance level (e.g., 50th percentile).
**Action Items**

- Consider accumulated and future projected wealth in ongoing pay decisions
- Apply judgment, taking into account decision quality information; there is no single right answer
- Don’t look at the expected value of grants in isolation; consider realizable value and performance
- Take a total rewards perspective (including all forms of compensation)
- Think through the implications of the findings; avoid one-size-fits-all solutions