Silicon Valley 135

Equity Compensation Practices

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Compensia
THOUGHTFUL PAY

1731 TECHNOLOGY DRIVE SUITE 810
SAN JOSE, CA 95110
408 876 4025

770 TAMALPAIS DRIVE SUITE 207
CORTE MADERA, CA 94925
415 462 2990

compensia.com

Introduction

IN SUMMER 2008, Compensia analyzed the equity compensation practices of the largest 135 high-technology and life sciences companies headquartered in Silicon Valley. This report—which we call the SV135—covers our findings from these analyses and updates our findings from similar analyses conducted in 2007.

A list of the companies whose equity compensation data were analyzed in 2008 is provided at the end of this report. Roughly 85% of the companies in the 2008 report were covered in the 2007 report as well.

Overview

This report examines equity practices at the SV135 from a number of perspectives, including:

- **Stock options and full-value shares:** Trends in the use of these equity vehicles;
- **Utilization ("burn rate" and "overhang"):** Practices related to how much equity companies allocate to senior executives and other employees;
- **Value delivered through equity:** The expected dollar value of equity granted to employees; and
- **Equity expenses:** The accounting cost associated with equity awards.

Methodology

All data reported in the charts and graphs below represent either medians (50th percentile) or prevalence (as specified in the chart title). Analyses are provided on an All Company basis, as well as by company size and, in some cases, by industry. Company size is divided into three categories:

- **Small:** Less than $250 million in revenue (n =42)
- **Medium:** Revenue of $250M to $1B (n = 47)
- **Large:** Revenue greater than $1B (n = 46)

Where data were analyzed on the basis of industry groupings, we examined the practices within the following industry segments:

- Hardware (n = 32)
- Software (n = 42)
- Semiconductor (n = 23)

Data were collected in May/June 2008 from public filings, and represent the most current practices, based on the most recent fiscal year reported. Annual and cumulative utilization ("burn rate" and "overhang") analyses are also based on data as of last fiscal year. (Burn rate is defined as the number of options and/or shares allocated during the fiscal year divided by weighted average common shares outstanding; for this calculation, full-value shares have been converted into option equivalents using RiskMetrics/ISS multiples between 1.5x to 4x depending on each company's volatility. Overhang is defined as the number of outstanding options and unvested full-vale shares divided by weighted average common shares outstanding.)

In this report, restricted stock/units refers to full-value stock awards that vest based solely on continued employment/service (also known as "time-based" shares). Performance shares refer to full-value stock awards that vest based on the achievement of pre-established performance goals (often in addition to a service requirement).

SV135 Equity Compensation

Executive Summary—Year-Over-Year Highlights

While stock options continue to be the dominant equity vehicle in Silicon Valley, the use of options remained flat between the 2007 and 2008 reports while time-based restricted shares and performance shares continue to increase in prevalence. **[Figure 1]**

After several years of rather significant decreases, burn rates actually increased modestly in 2007. Overhang fell over the same time period as option exercises and award cancellations outpaced grants. **[Figure 2]**

Average FAS123(R) value per employee increased slightly from the 2007 report. **[Figure 3]**

Stock Options and Full Value Shares

As we reported last year, companies are looking beyond stock options to deliver long-term incentive value to their employees. Bearing out this trend, full-value share (restricted stock/units and performance shares) use has increased dramatically in the past year.

In 2007, there was virtually no change in the percentage of companies that deliver stock options; at median 98% of all companies did so. However, grants of full-value shares to employees grew from 68% (in 2006) to 76% across all companies, with the use of full-values shares at Large Companies now rivaling stock options (93% of Large Companies grant full-value shares and 98% grant stock options). **[Figure 4]**

FIGURE 1

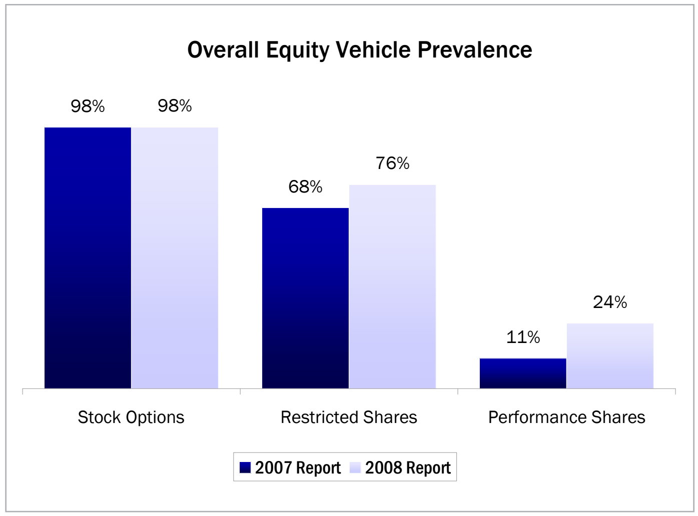
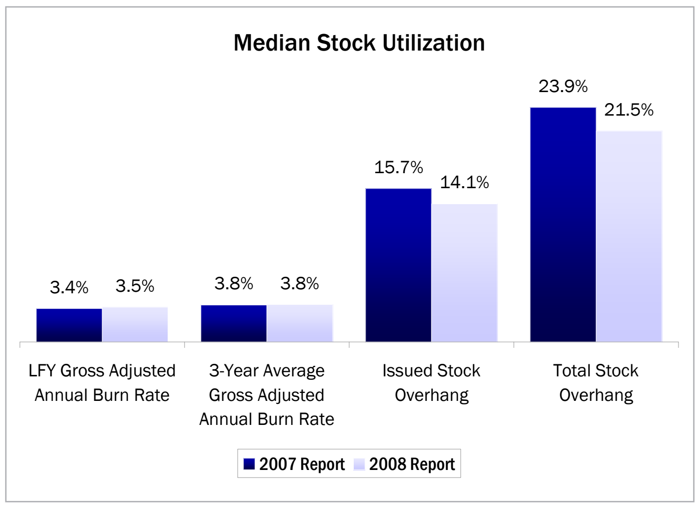


FIGURE 2



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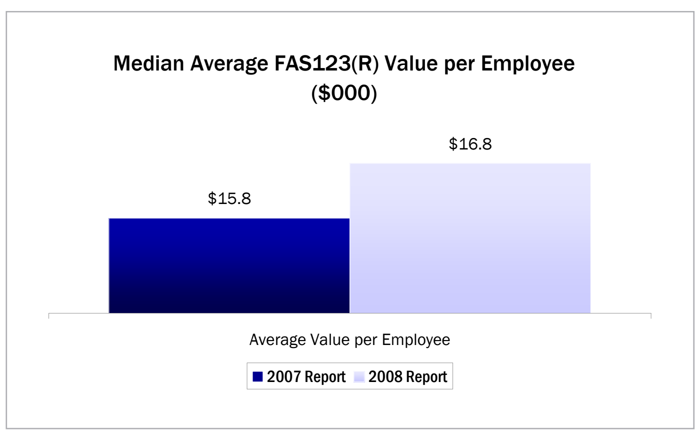

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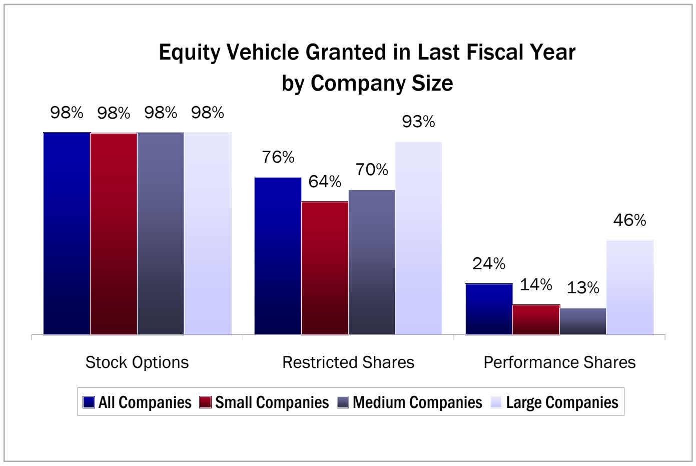
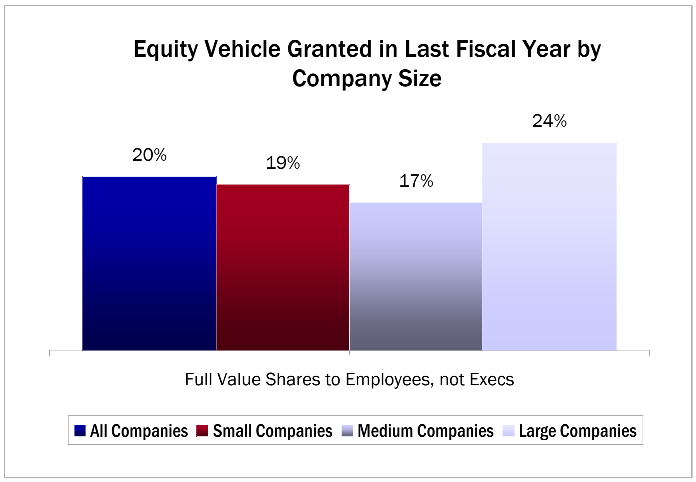


FIGURE 5



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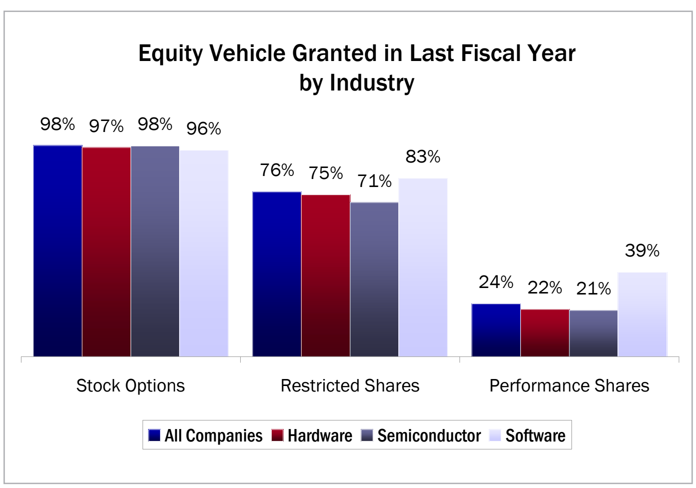


While the use of full-value share awards outside the named executive officer ("top 5") group remains comparatively low, the growth in that practice has been high, with 20% of all companies using them in 2007, compared to 10% in 2006. **[Figure 5]**

While Large Companies are still more likely to grant full-value share awards to employees below the named executive officer group, the growth in the use of these vehicles at Small and Medium companies is higher. About 19% of Small Companies and 17% of Medium Companies now use them, compared to 5% and 8%, respectively, in 2006.

On a sector basis, 83% of the software companies surveyed granted time-based restricted shares to their employees in 2007, up from 70% in 2006, and almost 40% granted performance shares. **[Figure 6]**

Allocation Within the Company

Technology companies allocated about 5% of their total equity awards to the CEO (a decrease from 7% in 2006), with the remaining named executive officers receiving about 10%, compared to 11% in 2006. Other Employees received a slightly higher proportion of the equity granted in 2007 (85% in 2007, compared with 82% in 2006). **[Figure 7]**

As a rule, Large Companies grant proportionally less equity (relative to the total equity granted) to executives, as compared to Small Companies. For example, CEOs at Small Companies were granted 9%, compared to 3% at Large Companies. This reflects the significantly larger value of the total grant pool at Large Companies, allowing a smaller percentage of the total pool to still deliver significant value.

Stock Utilization

The annual utilization—or burn rate—is defined as the number of options and/or shares (converted to option equivalents) allocated to employees, divided by weighted average common shares outstanding. Burn rates had been on a sustained downward trend for the past eight years, as companies had sought to minimize shareholder dilution and stock option-related expense.

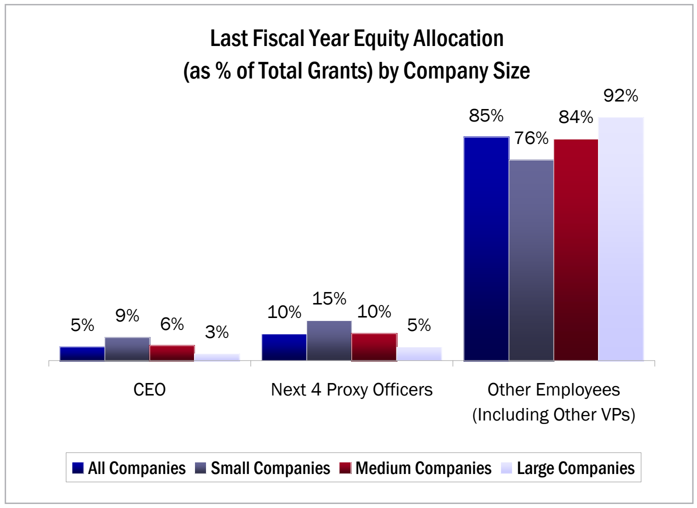
While overall burn rates rose slightly in 2007, companies still held to their previous lower burn rates levels. The 2007 median burn rate for the SV135 companies was 3.5%, up from 3.4% in 2006. Three-year burn rates were generally unchanged from 2006, except in the case of Small Companies, where the three-year rate dropped to 5.1% in 2007 from 5.3% the year before. [Figure 8]

Industry segment continues to be a factor in driving utilization rates, with semiconductor companies having predictably lower annual burn rates (3.3%) than their hardware (3.9%) and software (4.2%) counterparts. [Figure 9]

Issued stock overhang (that is, the number of outstanding options and unvested full value shares divided by weighted average common shares outstanding) in 2007 also varied by company size. [Figure 10]

Overhang across all companies analyzed was 14.1%, down considerably from 15.7% in 2006. As was the case last year, semiconductor companies had the highest overhang, at 15.6%, down from 16.7% in 2006. [Figure 11]

FIGURE 7



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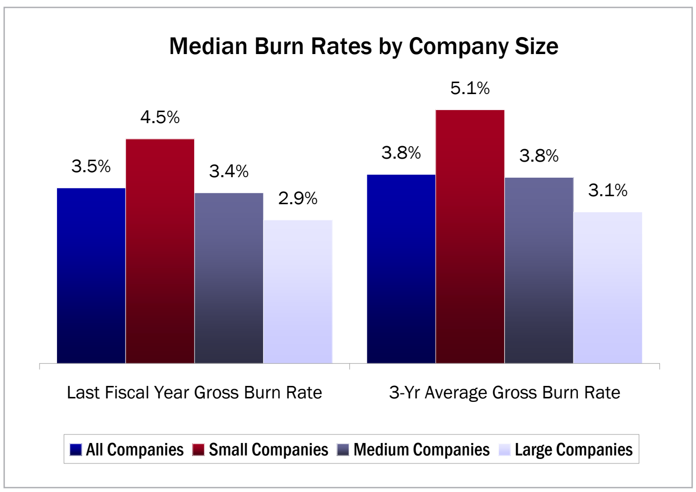

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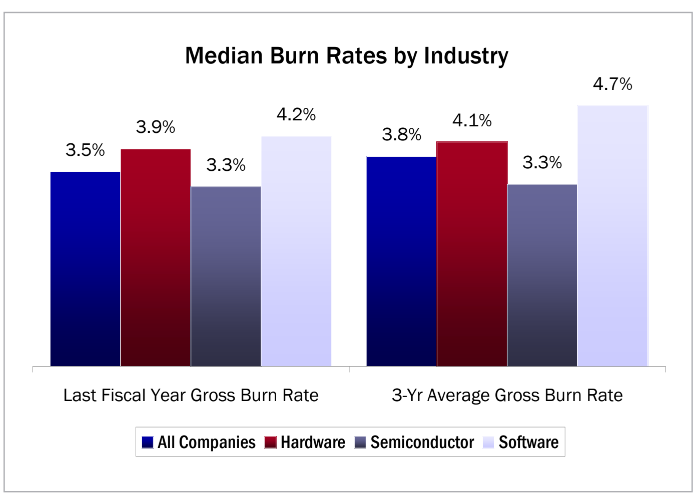


Equity Value and Expense

Last year, we looked at an emerging measure of relative equity use: the annual equity award value as a percentage of market capitalization. This is defined as the FAS123(R) value of the equity grants awarded during the year (not what is expensed for accounting purposes) divided by market capitalization.

As we discussed then, this is arguably a better metric than the traditional burn rate (or even adjusted burn rate) measure because it ignores whether a company grants more options or full-value shares than comparable companies. Moreover, this metric does not require companies or investors to establish a somewhat arbitrary exchange ratio to convert full-value shares to option equivalents in order to make an "apples-to-apples" comparison across companies.

At the median, SV135 companies granted $25 million in equity, or 1.6% of market capitalization, in 2007 (which was unchanged from 2006.) **[Figure 12]**

The average employee at an SV135 company received about $16,800 in equity value in 2007, a slight increase of about $1,000 from 2006.

At the median, SV135 companies recognized $14.0 million in stock option-related expense in 2007 (a decrease from $15.6 in 2006), or 3.4% of revenue (effectively flat compared to 2006).

FIGURE 10

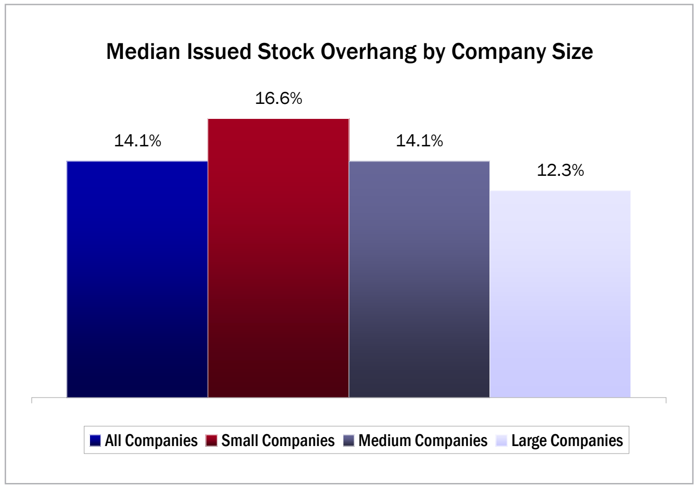


FIGURE 11

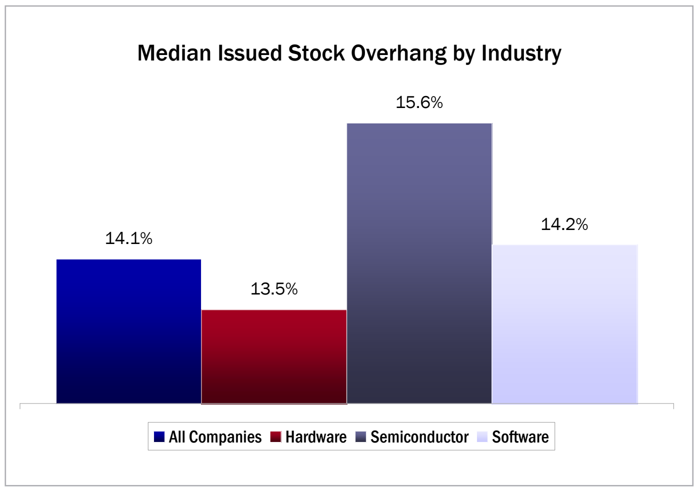
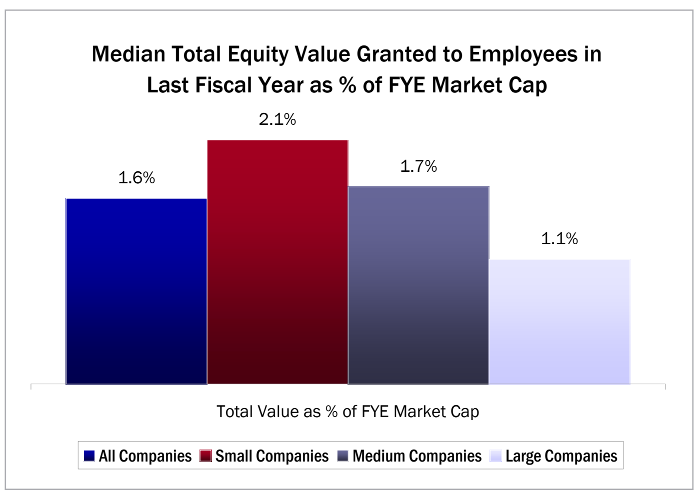


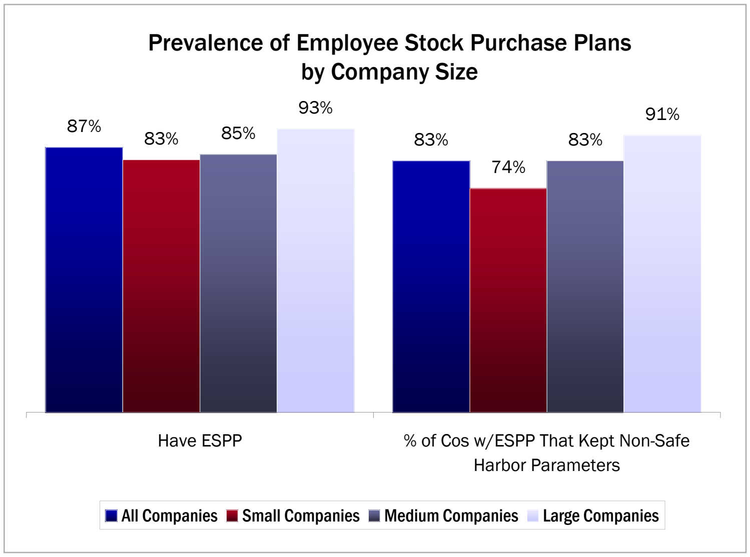
FIGURE 12



Employee Stock Purchase Plans (ESPP)

SV135 companies also continue to rely heavily on broad-based employee stock purchase plans, and are highly likely to offer those plans with discounted share prices and generous "look-back" pricing provisions, a practice many companies in other industries abandoned several years ago. **[Figure 13*]**

FIGURE 13



This continued reliance on ESPPs at high-technology companies is partly a reflection of the overall reduction of stock option grants throughout the organization, a practice which began when stock options lost their favorable accounting treatment, and shareholders began to agitate for less equity dilution.

Conclusion

While stock options continue to be the currency of the realm, full-value awards, such as restricted stock, restricted stock units, and performance shares, have made significant inroads in the past year. No longer limited exclusively to Large Companies, these awards are increasingly viewed as effective vehicles for incenting executive performance, retaining valuable employees and driving shareholder value.

The continuing stabilization of equity burn rates has had a pronounced effect of improving dilution ratios, although it remains to be seen whether this is just an interim lull or a long-term trend. Certainly, it is a reflection of the more responsible equity award practices that have emerged in the wake of the Sarbanes-Oxley Act and the recent stock option backdating scandals. ■

* Note: Safe Harbor refers to ESPP practices occurring under a threshold below which no expense is incurred. The Safe Harbor allows for discounts up to a maximum of 5% and no look-back period.

Company List

Accuray
Actel
Adaptec
Adobe Systems
Advanced Micro Devices
Affymetrix
Agilent Technologies
Align Technology
Altera
Apple
Applied Materials
Applied Micro Circuits
Applied Signal Technology
Ariba
Aruba Networks
Asyst Technologies
Atheros Communications
Atmel
Avanex
Aviza Technology
BigBand Networks
Blue Coat Systems
Bookham
Brocade Communications Systems
Cadence Design Systems
Cepheid
Chordiant Software
Cisco Systems
Coherent
Covad Communications
CPI International
Credence Systems
CyberSource
Cypress Semiconductor
Data Domain
Dionex
DSP Group
eBay
Echelon
Electronic Arts
Electronics For Imaging
Equinix
Exponent
Extreme Networks
Finisar
Foundry Networks
Gilead Sciences
Google
Harmonic
Hewlett-Packard Company
Infinera
Informatica
Integrated Device Technology
Integrated Silicon Solution
Intel
Intersil
Interwoven
Intevac
Intuit
Intuitive Surgical
iPass
IXYS
JDS Uniphase
Juniper Networks
KLA-Tencor
Lam Research
Linear Technology
LSI
Macrovision
Magma Design Automation
Mattson Technology
McAfee
Micrel
Monolithic Power Systems
Nanometrics
National Semiconductor
Natus Medical
Nektar Therapeutics
NetApp
Netflix
NetGear
Novellus Systems
NVIDIA
Omnicell
OmniVision Technologies
Openwave Systems
Oplink Communications
Oracle
Packeteer
Palm
PDL BioPharma
Pericom Semiconductor
Plantronics
PMC-Sierra
Power Integrations
Quantum
Rackable Systems
Rambus
SanDisk
Sanmina-SCI
ShoreTel
Shutterfly
Sigma Designs
Silicon Graphics
Silicon Image
Silicon Storage Technology
SiRF Technology
SMART Modular Technologies
SonicWALL
Spansion
SumTotal Systems
Sun Microsystems
SunPower
Super Micro Computer
Symantec
Symmetricom
Symyx Technologies
Synaptics
SYNNEX
Synopsys
Tessera Technologies
TIBCO Software
TiVo
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Effectiveness	Pay programs are aligned with the Company's compensation philosophy and business strategy, appropriately rewarding performance.
Balance	Compensation delivered balances the interests of the executive, other employees and shareholders given industry and specific business performance.
Market Competitiveness	Reward opportunities are consistent with business and labor market peers of comparable size and performance.
Transparency	Rules of the game are clearly communicated to and understood by all constituencies and the "line of sight" between results and rewards is clear.
Independence	Compensation programs are designed and approved by the Compensation Committee.
Simplicity	Program design features are easy to understand, explain and administer.

In short, we partner with companies to promote the attraction, retention and motivation of key executive talent in a manner that is responsible to and aligned with shareholders. We offer a full range of consulting services to meet this objective:

- Compensation Committee advisory services
- Total rewards strategy
- Comparable pay and performance benchmarking
- Compensation program review/audit
- Incentive plan design
- Equity/long-term compensation strategy
- Stock ownership retention
- Employment, change-in-control and severance arrangements
- Merger and acquisition/restructure incentives
- 280G analytics
- Board of Directors compensation

For more information about this survey or Compensia, contact:

Michael I. Benkowitz, Principal
mbenkowitz@compensia.com
415 462 2986

Anna-Lisa Espinoza, Principal
alespinoza@compensia.com
858 509 1179

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SAN JOSE • SAN FRANCISCO
408 876 4025 • 415 462 2990
compensia.com