Bay Area 150

Equity Compensation Practices

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Introduction

IN SUMMER 2009, Compensia analyzed the equity compensation practices of the 150 largest high-technology and life sciences companies headquartered in the San Francisco Bay Area (primarily in Silicon Valley). This report – which we call the Bay Area 150 (or BA150) report – covers our findings from these analyses based on data from 2008, and updates our findings from similar analyses conducted in 2007 and 2008.

A list of the companies whose equity compensation data were analyzed in 2009 is provided at the end of this report. Approximately 90% of the companies in the 2009 report were covered in the 2008 report as well.

Overview

This report analyzes equity compensation practices at the BA150 from a number of perspectives, including:

- **Stock Options and Full Value Shares**: Trends in the use of these equity vehicles;
- S**hare Utilization** ("burn rate" and "overhang"): Practices related to how much equity companies allocate to their senior executives and other equity plan participants;
- **Value Delivered through Equity**: The expected dollar value of equity awards granted to participants; and
- **Equity Expense**: The FAS 123R 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**: Revenue less than $250 million (n = 45)
- **Medium**: Revenue of $250 million to $1 billion (n = 50)
- **Large**: Revenue greater than $1 billion (n = 55)

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

- Semiconductor (n = 47)
- Hardware (n = 35)
- Software (n = 29)

Data were collected in May/June 2009 from public filings, and represent the most current practices, based on the most recent fiscal year reported. Annual and cumulative share utilization ("burn rate" and "overhang") analyses are also based on data as of the most recently reported fiscal year.

For purposes of this report, the following definitions apply:

- Gross adjusted annual burn rate is defined as the number of shares/units/options granted divided by the weighted average common shares outstanding. For this calculation, full value shares have been converted into option equivalents using RiskMetrics Group (formerly ISS) multiples ranging from 1.5X to 4x depending on each company's stock price volatility.
- Issued stock overhang is defined as the number of options and unvested full value shares outstanding at fiscal year end divided by the weighted average common shares outstanding.
- Total stock overhang is the same calculation as issued stock overhang except that the numerator also includes shares available for future equity awards.
- Restricted shares/units refer to full value stock awards that vest based solely on continued employment or service (also known as "time-vested" awards).
- Performance shares refer to full value stock awards that vest based on the achievement of pre-established performance goals (often in addition to a continued employment or service requirement).

BA150 Equity Compensation

Executive Summary

Although stock options continue to be the most common equity vehicle used among the BA 150 companies, time-vested restricted share and performance share awards have steadily increased in prevalence. [Figure 1]

After a slight uptick in the previous year's report, burn rates increased significantly during 2008. Issued overhang also increased, as new equity awards outpaced option exercises, full value award vesting and cancellations. Total Stock Overhang declined over the past year, perhaps due to a combination of share exchanges conducted in 2008, increased use of restricted shares/units and companies seeking smaller pools of additional shares (albeit with increased frequency). [Figure 2]

With the increase in burn rates over the past year, the median last fiscal year total equity value granted as a percentage of market capitalization increased significantly year–over–year as depressed stock prices dragged company values down. [Figure 3]

Stock Options and Full Value Shares

Although stock options continued to play a role in the long-term incentive program portfolios of virtually all of the BA150, companies of all sizes have increasingly looked to full value awards such as restricted shares/units and performance shares to deliver long-term incentive opportunities.

There was virtually no change in the percentage of companies that use stock options (97%) relative to the previous year. However, in a sign that the emphasis on stock options may be changing, the prevalence of restricted stock and performance share awards has continued to grow, now standing at 85% and 29% of the BA150 companies, respectively (vs. 68% and 11%, respectively, in last year's report).

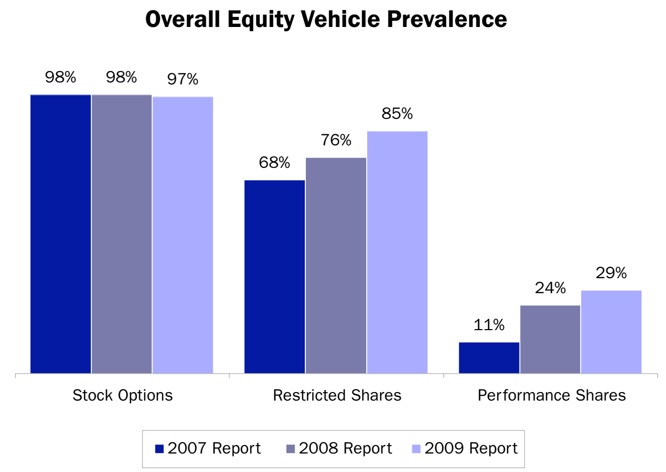
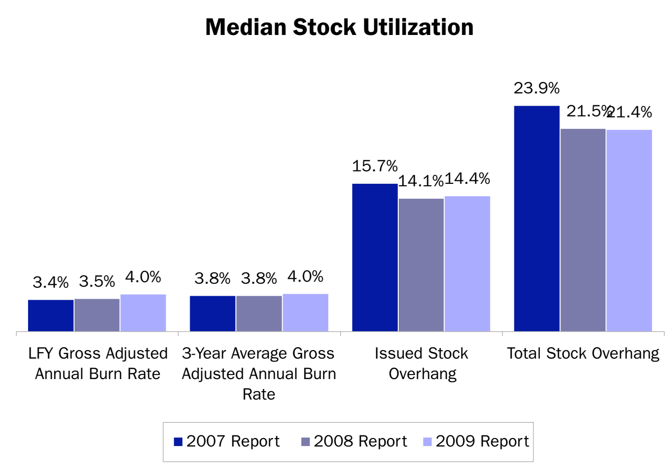


FIGURE 1



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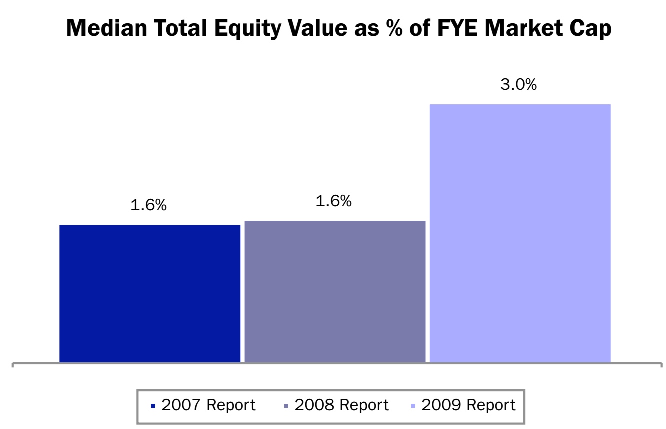

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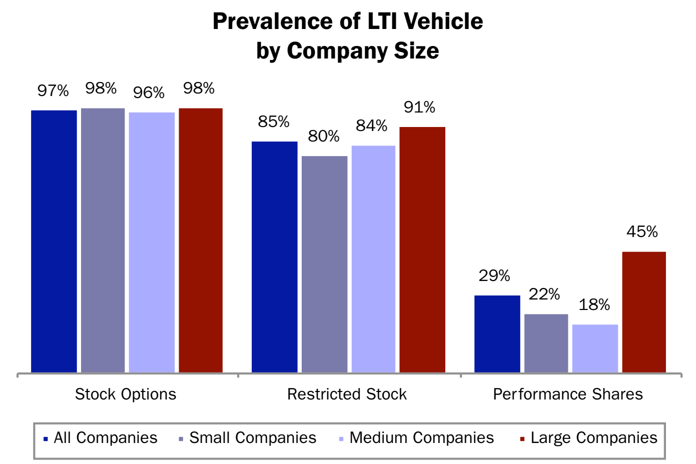

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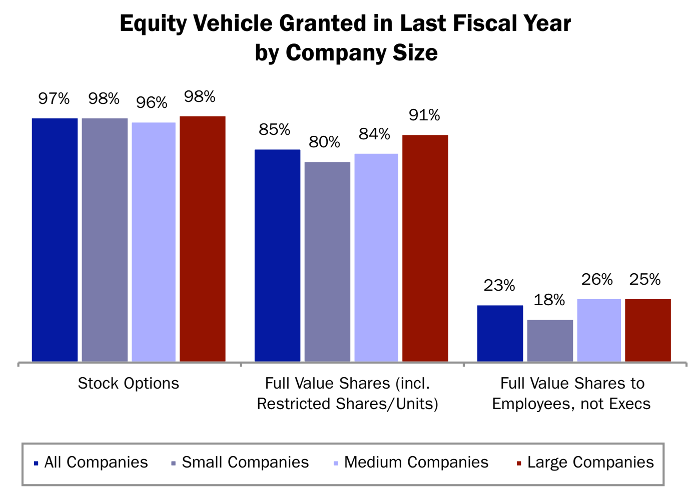

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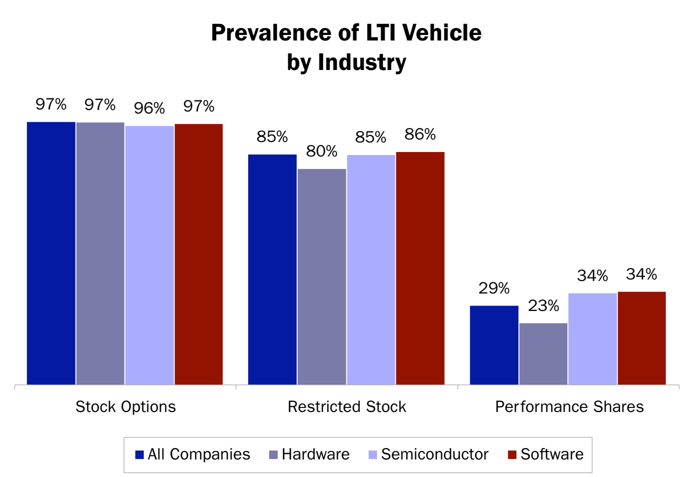


FIGURE 6

Company size appears to have had the greatest impact on the selection of long-term incentive vehicles when it comes to the use of performance shares. Nearly half (45%) of the large companies in this report used performance shares, as compared to less than 25% of both small and medium companies. [Figure 4]

Although still a minority practice, the use of time-vested full value share awards that exclude the named executive officer group ("top 5 executives") is growing. Twenty-three percent (23%) of all companies took this approach, compared to only 10% of companies the previous year. This practice is most common among medium and large companies. [Figure 5]

On a sector basis, there was very little difference in terms of the prevalence of stock options and restricted stock awards, both of which are commonplace. The use of performance shares, however, was less common among the Hardware companies in the BA150 than among those who operate in the Software or Semiconductor sectors. [Figure 6]

Allocation within the Company

The BA150 companies allocated about 7% of their total equity awards to their CEO (an increase from 5% for the previous year). Similar to last year's findings, the other named executive officers received about 10%, with the allocation to other employees falling slightly from 85% to 82% over the past year. [Figure 7]

Generally, large companies grant proportionally less equity (relative to the total equity granted) to executives, as compared to small companies. This reflects not only the head-count differential between large and small companies but also the significantly greater value of the total grant pool at large companies, which allows a smaller percentage of the total pool to still deliver significant value. This principle held true among the BA 150 companies, as CEOs at small companies were granted 9% of total awards, compared to 5% at large companies.

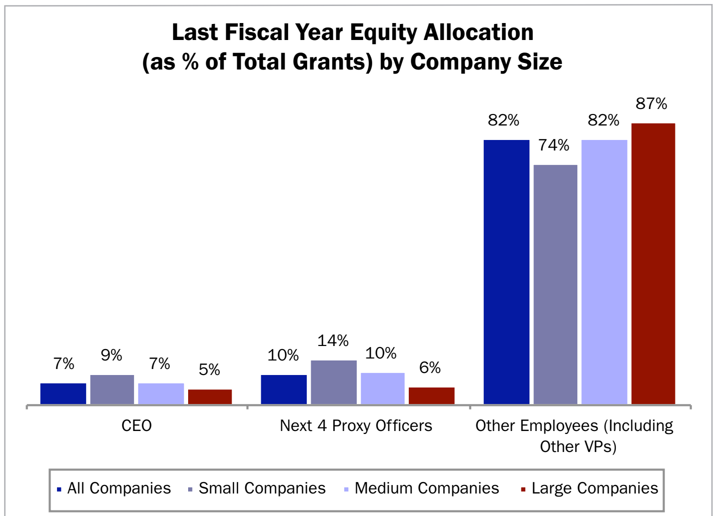
Share Utilization

A company's annual share utilization, or "burn rate", is the number of shares/units/options granted to participants during the year (as adjusted for option equivalents) divided by the weighted average common shares outstanding.

Burn rates had been on a sustained downward trend for the past eight years, as companies focused on minimizing dilution and stock compensation expense. This trend reversed in 2008, as a number of the BA150 companies responded to declining stock prices and the corresponding reductions in the retention value of their awards by increasing the number of shares they awarded. At the median, the 2008 burn rate for the BA150 was 4.0%, up significantly from 3.5% reported for the previous year. [Figure 8]

Industry segment continued to be a factor in driving share utilization rates. Although Software companies continued to have the highest burn rates, Semiconductor companies have narrowed the gap, with a median 2008 burn rate of 4.0% (up significantly from 3.3% in 2007). [Figure 9]

Issued stock overhang (that is, the number of outstanding options and unvested full value shares outstanding at fiscal year end divided by the weighted average common shares outstanding) also varied by company size. Issued stock overhang continued to be highest among small companies and lowest among large companies. [Figure 10]



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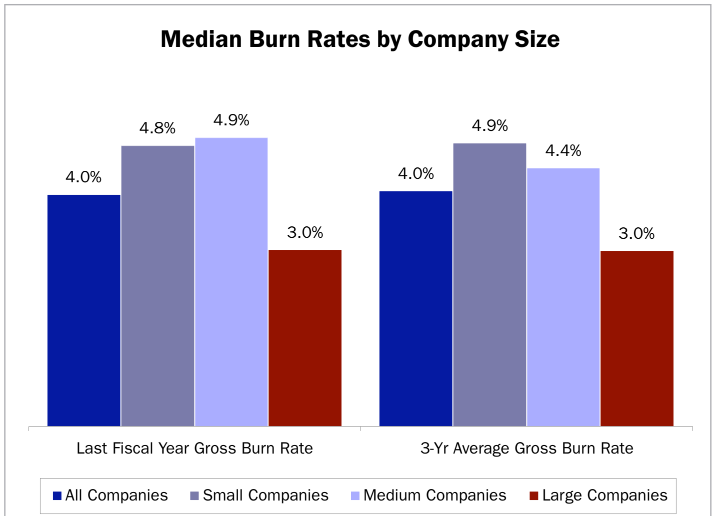

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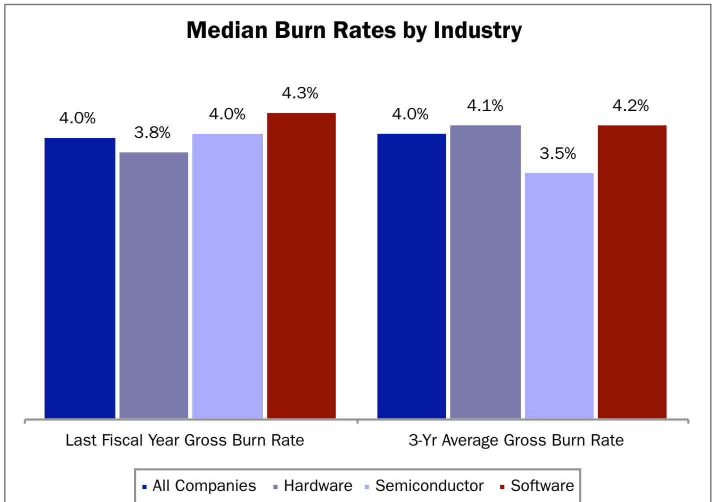
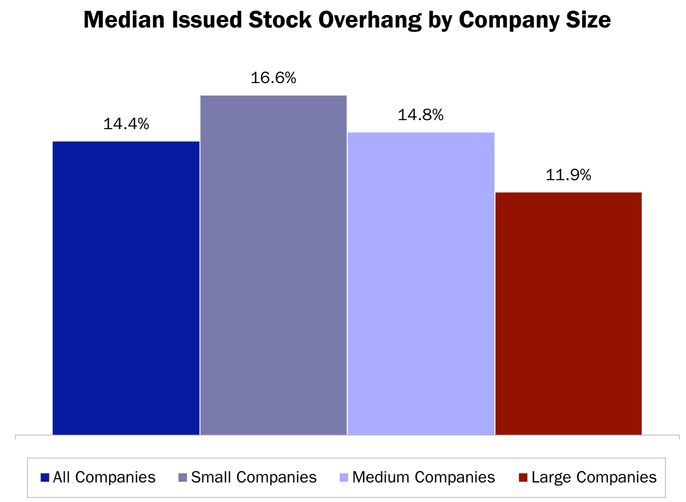


FIGURE 9



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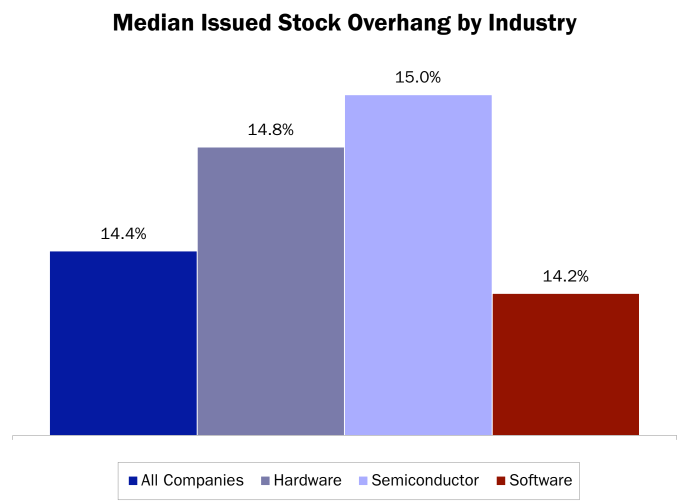

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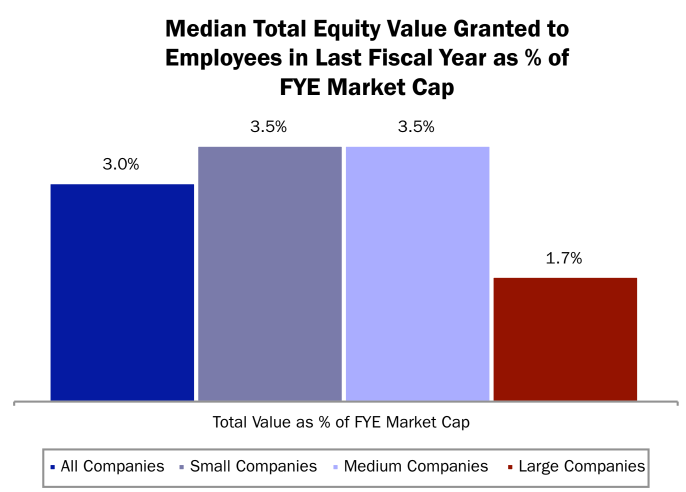

FIGURE 12

Issued stock overhang across all companies analyzed was 14.4%, up slightly from 14.1% for the previous year. As was the case in last year's report, Semiconductor companies had the highest overhang (15.0%). [Figure 11]

Equity Value and Expense

Perhaps the best way to assess relative equity "spend" across companies is to measure the total value of the equity awards each company grants during the year as a percentage of that company's total equity value, commonly referred to as market capitalization. Specifically, the numerator of the calculation is the FAS 123R accounting value of the equity awards granted during the year (rather than the amount expensed during the year) and the denominator is the company's market capitalization.

This approach improves on traditional equity usage methodologies in two important ways. First, it controls for company size, since it measures the equity spent on a percentage or "piece of the pie" basis. Second, it controls for the different mix of equity awards used by companies in the market, since full value awards will carry a higher FAS 123R compensation expense per award (the numerator of the calculation) than stock options.

At the median, the BA150 companies granted just under $22 million in equity in 2008, down from $25 million in 2007. Despite this drop in aggregate dollar value, the median percentage of market capitalization awarded nearly doubled over the previous year (from 1.6% to 3.0%) due to declining market capitalizations. [Figure 12]

The average employee at a BA150 company received about $13,800 in equity value in 2008, a decrease of approximately $3,000 from 2007.

At the median, the BA150 companies recognized $17.0 million in FAS 123R compensation expense in 2008 (an increase from $14.0 million in 2007), or 3.4% of revenue (consistent with 2007).

The BA150 companies continued to rely heavily on broad-based employee stock purchase plans and, in most instances, offered those plans with discounted share purchase prices and generous "look-back" pricing provisions, practices many companies in other industries abandoned several years ago.* [Figure 13]

This continued reliance on ESPPs at the BA150 companies is partly a reflection of the overall reduction of stock option grants throughout organizations, a practice which began when options lost their favorable accounting treatment, and shareholders began to agitate for less equity dilution.

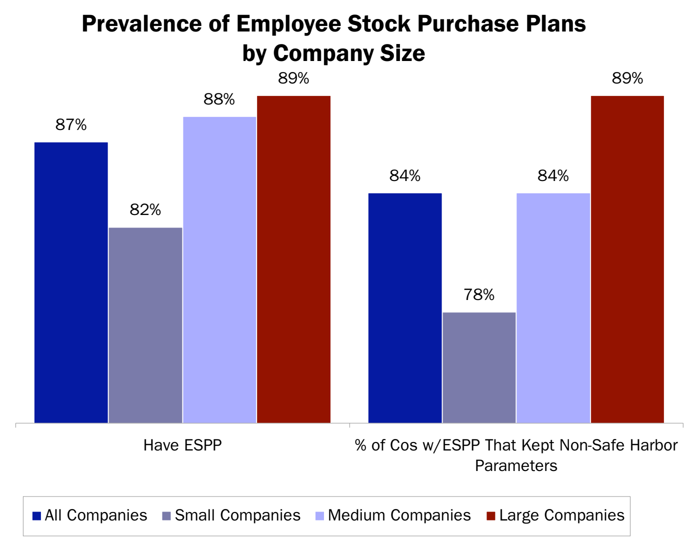

FIGURE 13

Conclusion

Although 2008 began with business as usual, almost no company ended the year untouched by the credit crisis and the precipitous decline in the stock market. In turn, 2008 was also a tumultuous year for equity compensation practices. With substantially depressed stock prices, companies struggled to balance the competing objectives of retaining their key employees and delivering competitive award values with minimizing shareholder dilution and emphasizing pay for performance.

Looking back on 2008, it appears that the BA150 companies responded to the economic crisis by continuing to focus on equity compensation as an important retention tool (as evidenced by increased burn rates and the growing use of restricted stock awards), but also exercised caution to manage equity award dilution and shareholder expectations (as shown by the decline in overall award values and the increase in the prevalence of performance share awards). ■

* 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 lookback period.

Company List

3PAR
Accuray
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Actuate
Adobe Systems
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Align Technology
Altera
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Applied Signal Technology
Ariba
Aruba Networks
Asyst Technologies
Atheros Communications
Atmel
Autodesk
Avanex (now Oclaro)
Aviza Technology
BigBand Networks
Bio-Rad Laboratories
Blue Coat Systems
Bookham (now Oclaro)
Brocade Communications Systems
Cadence Design Systems
Cepheid
Cisco Systems
Coherent
CPI International
CyberSource
Cypress Semiconductor
Data Domain
Dionex
Dolby Laboratories
DSP Group
eBay
Echelon
Electronic Arts
Electronics For Imaging
Equinix
Exelixis
Exponent
Extreme Networks
Finisar
FormFactor
Gilead Sciences
Google
Harmonic
Hewlett-Packard Company
iGATE
Impax Laboratories
Infinera
Informatica
Integrated Device Technology
Integrated Silicon Solution
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Logitech International SA
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Marvell Technology Group
Mattson Technology
Maxim Integrated Products
McAfee
Micrel
Monolithic Power Systems
National Semiconductor
Natus Medical
NetApp
Netflix
NetGear
NetLogic Microsystems
NetSuite
Novellus Systems
NVIDIA
Omnicell
OmniVision Technologies
Onyx Pharmaceuticals
Openwave Systems
Oplink Communications
Opnext
Oracle
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Rackable Systems
Rambus
Riverbed Technology
Rovi (formerly Macrovision)
salesforce.com
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Sanmina-SCI
ShoreTel
Shutterfly
Sigma Designs
Silicon Graphics
Silicon Image
Silicon Storage Technology
SiRF Technology Holdings
SMART Modular Technologies
SonicWALL
Spansion
SumTotal Systems
Sun Microsystems
SunPower
Super Micro Computer
Sybase
Symantec
Symmetricom
Symyx Technologies
Synaptics
SYNNEX
Synopsys
Tessera Technologies
The Cooper Companies
Thoratec
Tibco Software
TiVo
Trident Microsystems
Trimble Navigation Limited
Ultra Clean Holdings
Ultratech
UTStarcom
Varian
Varian Medical Systems
VeriFone Holdings
Verisign
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Effectiveness	Pay programs are aligned with the Company's compensation philosophy and business strategy.
Balance	Compensation opportunities delivered balance 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	The "rules of the game" are clearly communicated to and understood by all constituencies, and the "line of sight" between the individual's actions and rewards is clear.
Independence	Compensation programs are designed and approved by an informed Compensation Committee.
Simplicity	The program design features are easy to understand, explain and administer.

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