

Update: Small- & Mid-Cap TSX LTIP Practices

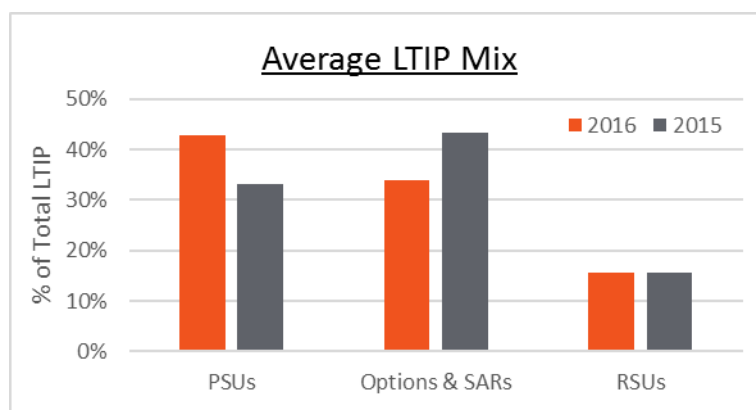
By: Camille Jovanovic & Josh Lampen | Fall 2017

HUGESSEN
CONSULTING

In Fall 2016, we published a review of CEO LTIP practices (reviewing 2015 pay data) among small- and mid-cap issuers on the TSX, which indicated, among other things, that stock options were the most prevalent instrument, although PSUs were increasing in prevalence. Our analysis this fall, of 2016 pay data, indicates that PSUs have now surpassed options in becoming the most prevalent LTIP instrument within the data sample. This “update” briefing provides a summary of these developments.

PSUs Became the Most Prevalent Instrument in 2016

- The prevalence of PSUs in CEOs’ LTIP mix increased from an average of 33% in 2015 to 43% in 2016
- This increase in PSUs was accompanied by a commensurate reduction in the prevalence of stock options (while the prevalence of RSUs has been flat)
- This trend mirrors the shift towards using PSUs among larger Canadian issuers in recent years; our [TSX60 proxy review](#) found that in 2016, PSUs accounted for 50% of CEO LTIP mixes on average



Reminder of Key Terms:

LTIP: “long-term incentive plan”

RSUs: “restricted share units” are phantom shares that track the value of the underlying shares of the company on the public markets

PSUs: “performance share units” are similar to RSUs, but vesting and settlement of the grant are subject to achievement against performance conditions

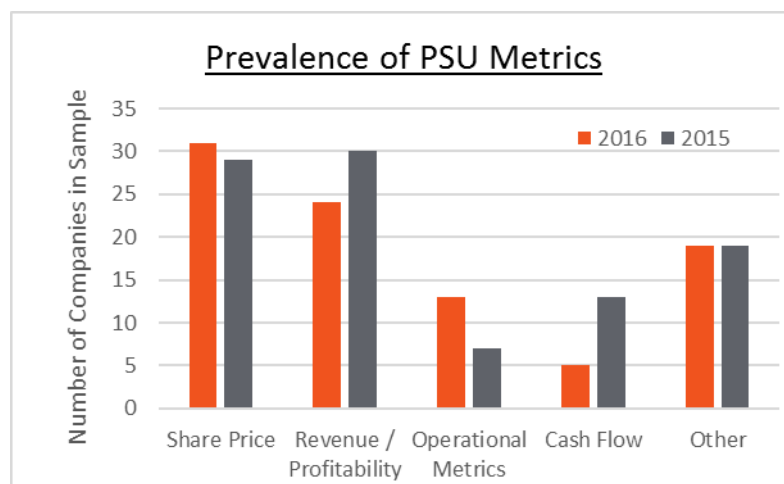
Stock Options: a right given to purchase shares of a Company at a specified price in the future

TSR: “total shareholder return” is a measure of the total return of a stock to an investor, including share price appreciation + dividends

Methodology: this analysis is based on a review of 94 TSX issuers across a broad selection of industries with: (i) market capitalizations ranging from \$500M to \$1.5B, (ii) headquarters in Canada, and (iii) non-zero revenues (i.e. excluding early-stage mining, oil and gas, and pharmaceutical companies)

Increase in Use of Operational Performance Metrics

- In line with the TSX60, TSR and financial metrics remain the most prevalent performance metrics used in PSU programs
- However, several issuers have moved towards incorporating industry-specific operational metrics; this may be in response to concerns from issuers and the shareholder community regarding the overreliance on relative TSR



Considerations for Small- and Mid-Cap Issuers

This review of LTIP practices indicates that small- and mid-cap companies are beginning to follow many of the “best practices” being adopted by large Canadian companies. In addition to this market context, consider some other factors that could lead more companies to adopt performance-conditioned LTIP:

- Focusing on larger companies, proxy advisors seek a minimum of 50% of equity awards to have performance conditions; these guidelines are beginning to apply to smaller companies as well
- Institutional shareholders continue to criticize the increasing prevalence of outside-of-plan awards (e.g., one-time or “special” awards, make-whole awards, etc.); a recent study from CPPIB and OTTP noted that only a small portion of total outside-of-plan awards granted in 2016 had performance conditions
- With the CRA recently clarifying its stance on the deductibility of treasury-settled full-value shares for corporate tax purposes and pending changes to the taxation of stock options, the attractiveness of RSUs and PSUs could continue to grow

For more information, please contact:

Camille Jovanovic, Associate
cjovanovic@hugessen.com

Josh Lampen, Analyst
jlampen@hugessen.com

About Hugessen Consulting:

Hugessen Consulting helps Boards make the right decisions on executive compensation and its governance, within an environment of heightened complexity and scrutiny. Our people work with public and private company Boards who understand that experience and judgment, not just data, drive decision making. Since 2006, as a pioneering independent executive compensation advisory firm, our goal has been to create the deep and long-lasting relationships that result from the commitment we make to our clients and the value we deliver to them. Hugessen Consulting is an employee-owned firm with offices in Toronto, Calgary and Montréal, and affiliates in New York City (Steven Hall & Partners).

Toronto Office

Royal Bank Plaza, South Tower
200 Bay Street, Suite 3200, P.O. Box 155
Toronto, Ontario M5J 2J4

Calgary Office

Jamieson Place
Suite 501—308 4th Ave SW
Calgary, Alberta T2P 0H7