

GIBSON DUNN

IPO and Public
Company Readiness:
Focus on Executive
Compensation

September 6, 2018

Presenters



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Outline

- Introduction
- Compensation and Benefits Issues to Consider in the IPO Context
 - Compensation Philosophy
 - Stock Incentive Plans
 - Severance and Employment Agreements
 - Non-Employee Director Compensation
 - Corporate Governance
 - Financial and Wealth Transfer Planning

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Introduction

Introduction

- Why Focus On Executive Compensation?
 - Creation of a public market introduces a number of significant new legal and business factors that have a substantial impact on the appropriate design of a company's long-term compensation and benefits strategy Including:
 - Increased value and liquidity of equity-based awards
 - Public disclosure of financial results
 - Public disclosure of executive compensation for “named executive officers”
 - Increased scrutiny of management performance and compensation decisions, “say-on-pay”
 - Shorter-term focus by investors
- Investor Expectations Regarding Executive Compensation

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Compensation Philosophy

Compensation Philosophy

- Establish a Post-IPO Compensation Philosophy That Accounts for these Material Changes
 - Objectives of the compensation program
 - Driving Performance
 - Retention/Attraction of Executive Officers and Other Employees
 - Reassess total pay mix
 - Cash vs. Equity-Based Compensation
 - Balance of Short-Term and Long-Term Incentives
 - Type of Equity Compensation Used
 - Limited Perquisites

Compensation Philosophy

- Establish appropriate peer group and desired competitive market position
 - Market capitalization peers/direct competitors
 - Similar organizational structure or business model
 - Where is talent lost or recruited from
- Keep in mind public disclosure requirements for “named executive officers”
 - Mandatory “say on pay” (except for EGCs)
 - Institutional investor preferences/“pay-for-performance”
- Reassess approach to benefits and perquisites in public company environment
- Consider engaging an outside compensation consultant to assist Board’s compensation committee

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Stock Incentive Plans

Stock Incentive Plans

- Adoption of New or Amended “Omnibus” Stock Incentive Plan
 - All pre-IPO companies should adopt a new or amended stock incentive plan
 - Include full menu of stock awards, such as options, stock purchases, restricted stock bonuses, and stock appreciation rights
 - Single, unified pool for equity-based awards
 - Strongly consider “evergreen” share reserve
 - Post-IPO stockholder approval required to increase share reserve
 - Section 162(m) transition period and related issues

Stock Incentive Plans

- Adoption of Employee Stock Purchase Plan
 - Allows eligible employees to purchase the company's shares periodically throughout a year (offering periods can be as long as 27 months, although usually not longer than 6 months)
 - Shares are purchased with after-tax dollars withheld from payroll at the employees' election
 - Plans can offer a discount of up to 15% of the trading price either at the beginning or end of the purchase period
 - May be more efficient than stock option or RSU awards in the US (under Section 423 of the IRC there is no immediate taxation on purchase at a discount)
 - Can include an evergreen reserve

Stock Incentive Plans

- Existing Employee Equity Awards
 - “Cheap stock” and Section 409A issues in lead up to IPO
 - Pre-IPO lack of liquidity
 - Increasing use of restricted stock units in lieu of stock options pre-IPO with service-based and liquidity restrictions (“Facebook” RSUs)
 - SEC registration (Form S-8)
 - Introduction of "Same-Day Sale" Program
 - Other post-IPO stock plan administration considerations (in-house vs. outsourcing)

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Severance and Employment Agreements

Severance and Employment Agreements

- Consider severance pay/retention arrangements
 - Private companies may not have in place any severance or retention arrangements
 - Executives with substantial stock holdings may become more of a retention risk post-IPO
 - Public scrutiny of corporate financial performance and executive compensation may also increase need for retention incentives and executives' desire for severance protection
 - Severance/retention arrangements can be limited to senior management or broad-based
 - Plan/policy vs. individual agreements (trend in recent years has been to use plans/policies)

Severance and Employment Agreements

- Consider new or amended executive employment agreements
 - Consider whether existing employment agreements are appropriate in a public company context
 - SEC disclosure requirements for employment agreements with “named executive officers” and other “executive officers”
 - Consider eliminating employment agreements in favor of a severance plan or policy

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Non-Employee Director
Compensation and Corporate
Governance

Non-Employee Director Compensation

- Non-Employee Director Compensation Considerations
 - Minimal cash compensation for directors pre-IPO
 - New/independent board members are added in connection with IPO
 - Compensation mix for non-employee directors post-IPO
 - Automatic annual equity grants in addition to cash compensation
 - Heightened scrutiny on compensation decisions regarding non-employee directors
 - Consider separate shareholder-approved director equity plan and/or lower limits on director awards as compared to employee awards to manage threat of lawsuits alleging directors of self-dealing when compensating themselves

Corporate Governance

- Formalized compensation process
 - Public companies are subject to more stringent corporate governance rules regarding executive officer compensation
 - Stock exchange listing requirements relating to compensation committee duties and independence
 - Stock exchange listing requirements relating to compensation committee authority to engage consultants and advisors and related independence requirements
 - Securities laws (Section 16) require compensation committee approval of executive officer equity awards and transactions in connection therewith (i.e. share withholding)
- Obtain adequate Directors and Officer's liability insurance

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Financial and Wealth Transfer Planning

Financial and Wealth Transfer Planning

- Financial and Wealth Transfer Planning
 - Often overlooked by executives pre-IPO
 - Executives should consider the impact of an IPO on personal financial and estate planning
 - Tax-efficient approaches exist for achieving financial and estate planning objectives
 - Advance planning can prove very beneficial, especially from a tax perspective

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Questions?

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Presenter Profiles

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