



2006 Executive Compensation Conference

Introducing Performance Metrics Into Long-Term Incentive Plans

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Performance Metric Design Considerations

■ Performance Metrics & LTI

- **Metric Selection**
 - Industry and Company Drivers
- **Performance Measurement Period**
 - Shorter vs. Longer Measurement
- **Absolute vs. Relative Performance**
 - Measure Performance Against Internal or External Goals
- **Cumulative vs. Point-in-Time Measurement**
- **Performance Cycle Frequency**
 - Consecutive vs. Overlapping
- **Performance/Payout Leverage and Scaling**

■ Creating Value

- **What Performance Measures Drive Shareholder Value?**
- **Which Performance Measures are Valued?**
 - For the industry?
 - For my company?
- **What are the Key Design Considerations?**
- **How do We Think About Driving Value with Pay?**

■ Performance Metric Selection

- **Motivation Reduced for Less Predictable Metrics**
 - Predictability Over Time and Correlation with Share Price
- **Performance Metrics Can Be:**
 - Financial (E.G., Revenue, EBP, EBITDA)
 - Milestone Oriented (E.G., Biotech Needing Drug Approval)
 - Operational (E.G., Reduced Error Rates)
 - Market (E.G., Share Price Appreciation, TSR)
- **Weighting**
- **Interdependence of Metrics**

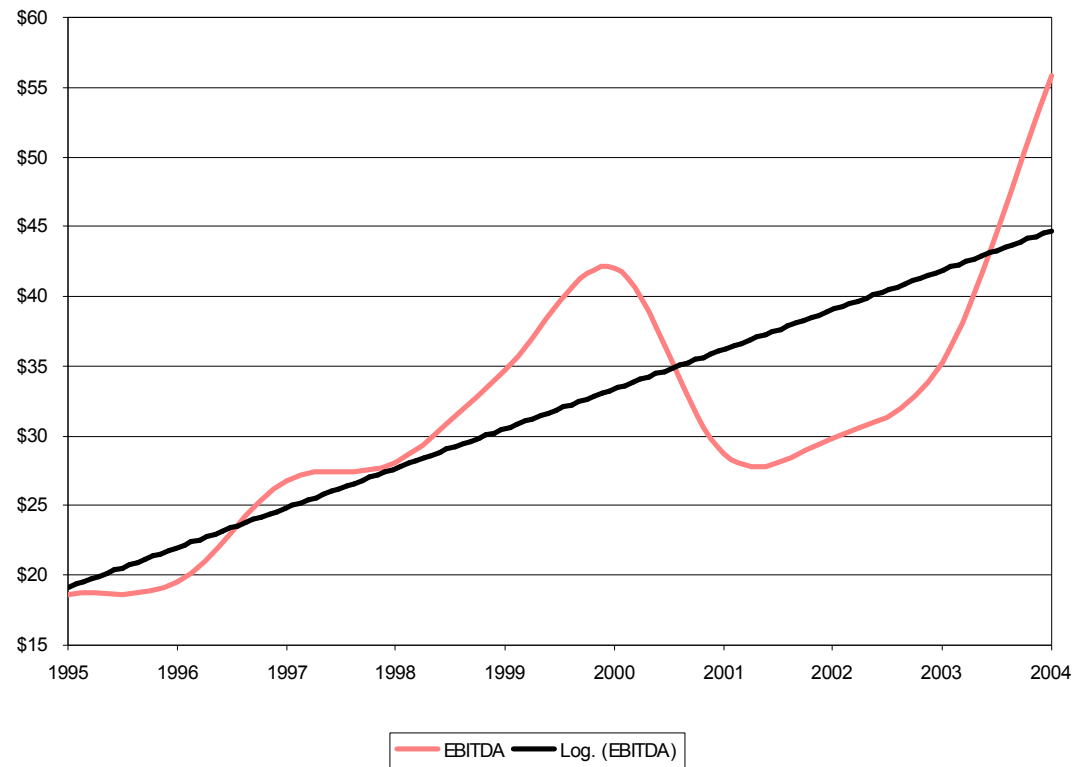
▪ Valued Performance

- **Valued Performance Varies by Industry and Company**
- **Industry Measure Examples**
 - Retail: Same store sales growth
 - Insurance: Return on Equity (ROE)
 - Basic materials/metals: Return on Net Assets (RONA)
 - Gaming: EBITDA/EBITDA growth
 - Pharma/Biotech: R&D pipeline, clinical trials, milestones
- **Company “Value Proposition”**
 - Immature, high growth, technical/innovation focus: revenue growth, product introductions
 - Mature, modest growth, operational focus: profitability and returns
- **What do Analysts Think?**

Company Value Drivers

- Determine Predictability of Select Measures Over Time

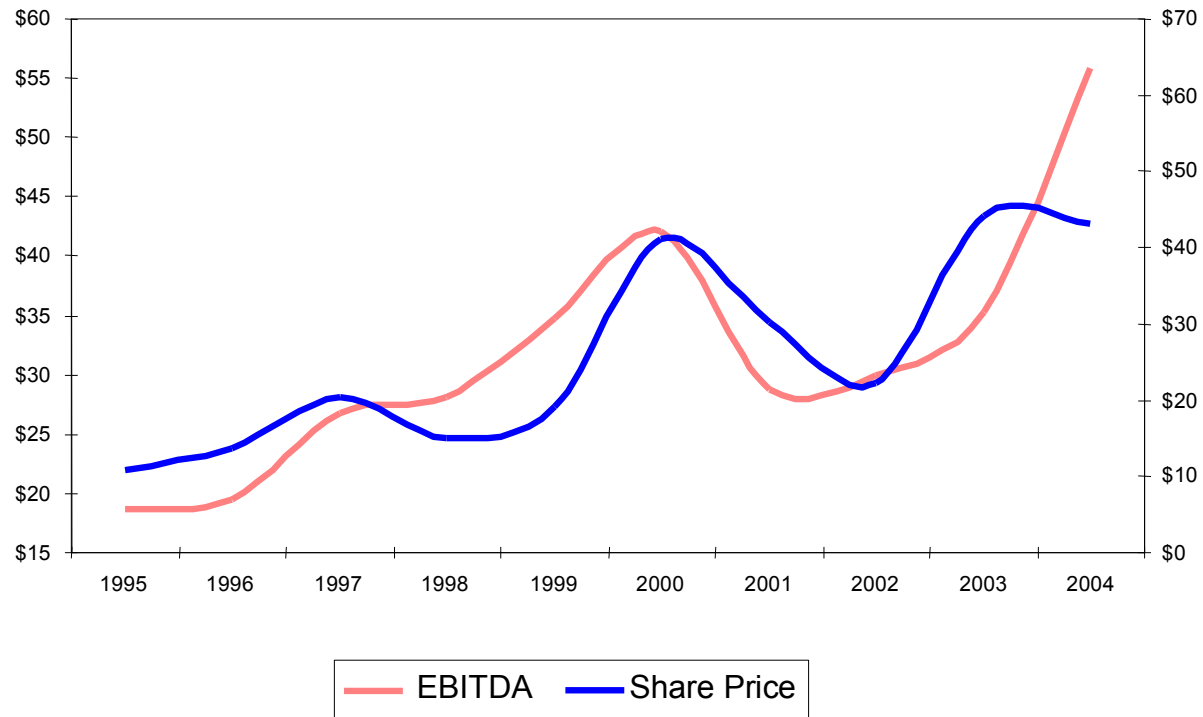
Correlation of EBITDA to Time



Company Value Drivers

- Select Measures and Compare Historical Performance and Stock Price

Example: Correlation of EBITDA to Stock Price



■ Performance Measurement Period

- **Performance Period**
 - Typically 3 To 5 Years
 - Long-term Goal Setting Challenge Will Drive Shorter Periods
- **For Longer Measurement Periods, Consider:**
 - Early-out Disaster Provisions
 - Reference to Performance in Prior Periods
 - Peer-referenced Metrics
- **For Shorter Measurement Periods, Consider:**
 - Subsequent Time Vesting

Absolute vs. Relative Performance

- **Relative Performance Helps w/Long-term Goal Setting**
 - Specific Peer Companies or Index
 - Works Particularly Well With Good Index for Comparison
- **Watch For Mismatch of Fiscal Success and Payouts**

Measures	Advantages	Disadvantages
Absolute	<ul style="list-style-type: none"> ■ Linkage to company plan. ■ Easy to measure/communicate. ■ Consistent w/cashflow ability to pay. 	<ul style="list-style-type: none"> ■ Reliance on ability to forecast. ■ Encourages lower goal setting. ■ Lack of retention in down market.
Relative	<ul style="list-style-type: none"> ■ Encourages high performance in up or down market. ■ Better retention in down market. 	<ul style="list-style-type: none"> ■ Outcome inconsistent w/investors. ■ Outcome inconsistent w/cashflow. ■ Measurement issues (PG change).

■ Cumulative vs. Point-in-Time

- **Cumulative Goal Requires Attainment of Goal in Final Year Incorporating Prior Year Goals**
- **Point-in-time Goal Requires Goal Attainment in Final Year**
- **Cumulative Relative Measurement Very Powerful**

Multi-Year Performance	Advantages	Disadvantages
Cumulative	<ul style="list-style-type: none"> ■ Requires consistent performance. ■ Allows for carryover of good results. ■ Easier to predict. 	<ul style="list-style-type: none"> ■ More difficult metric to meet-if too difficult can lose motivation. ■ Can be complicated to communicate.
Point-in-Time	<ul style="list-style-type: none"> ■ Easy to communicate. 	<ul style="list-style-type: none"> ■ Does not drive consistent results. ■ Provides no credit for over-performance in earlier years.

■ Performance Cycle Frequency

- **Two Common Plan Frequencies:**
 - Consecutive (End-to-end)
 - Overlapping
- **Consecutive Plans Generally Preferred Due to:**
 - Ease in Goal Setting
 - Ease in Communication
 - Lack of Confusion with Multiple Goals in Same Year
 - Ability to Better Focus Participants on One Set of Goals
- **Generally, Should Start with Consecutive Plan**
 - Can Always Move to Overlapping Plan; Hard to Go the Other Way


Scaling of LTI Awards

- Set Reasonable Thresholds and Achievable Targets
- More Pay at Risk Should Translate to > Upside Opportunity
- Example:

Grant Scale	Threshold	Target	Maximum
Performance (e.g., revenue)	At 95% of Target	100% of Target	At 110% of Target
Payout Opportunity	Vest 50% of Target # Shares	Vest 100% of Target # Shares	Vest 150% of Target # Shares

Thoughts for Consideration

- **What are You Trying To Achieve?**
 - Has Past Pay Been Commensurate with Performance?
 - Will Any of This Change Behavior?
- **Stock Options May Still Be The Best Choice**
 - Simplifies the Discussion
 - Can be Balanced with Some Time Vested Full Value Shares
- **Keep it Simple – Everything in Moderation**
- **Balance LTI With Other Elements of Pay**
- **Provide Multiple Performance Periods for Vesting**
 - Miss First Hurdle; Still Vest if Second (Higher) Hurdle Met
- **Keep Some Discretion**
- **Ease Into Performance Based LTI – Don't Initially Make The Entire Grant Performance Oriented**



Douglas Seipel
VP, Global Rewards

Performance Metrics in Long-Term Incentive Design

UNISYS

Summary

- **My personal history and perspective on LTI and performance metrics:**
 - Sears Roebuck
 - Baxter International
 - Unisys

I've always wanted to be a lawyer, so....

These materials are based on my recollection, experiences, and opinions with long-term incentive performance plans. I've limited descriptions of plans to publicly available information. I'm not representing anyone else's view or developments prior or after my involvement.



▪ Sears Roebuck

Context

- **Turnaround and transformation**
 - Spin-offs
 - Reorganizations
 - “Big Boxes” under pressure
- **Refocusing Culture – Three Ps**
- **Focusing on Business Drivers (Three Compellings):**

Work → Shop → Invest

- **Need to focus top 200 via long-term incentive**



Sears Roebuck

LTI Design

- **Long-Term Incentive based on two components:**
 - Stock Option Plan
 - Long-Term Performance Plan (depending on cycle: cash, stock, options if threshold financial measures weren't met, cash with election for restricted stock with 20% premium)

- **Long-Term Design:**
 - Three year overlapping cycles

1997	1998	1999	
	1998	1999	2000

- Payout for cycle based on Total Performance Indicators:

Element	Weighting	How Measured
Work	1/3	Associate attitudes
Shop	1/3	Customer satisfaction and retention/loyalty
Invest	1/3	Cumulative shareholder value added and Relative TSR

■ Sears Roebuck

Learnings/Thoughts

- **Business changed very quickly - completed only one full three-year cycle**
- **Metrics changed over time as did the method to measure them**
- **Entire cycle can be sunk (or even made) in first year**
- **More focus on annual incentive as more immediate and more controllable**
- **Saw shift over time from more heavily weighting of financial measures to 1/3 each, prior to a complete conversion to a pure financially based plan**
- **Providing line-of-sight is critical:**
 - Executive Compensation website
 - » Ability to model LTI payout
 - » Drill down to identify action that would drive performance measures and thus payout
- **Communicate, communicate, communicate!**

■ **Baxter International**

Context

- **View of stock options (later similar appreciation recognition vehicles) as key tool to motivate increases in shareholder return**
- **Desire to reward for appreciation, but also modify for relative shareholder value creation**

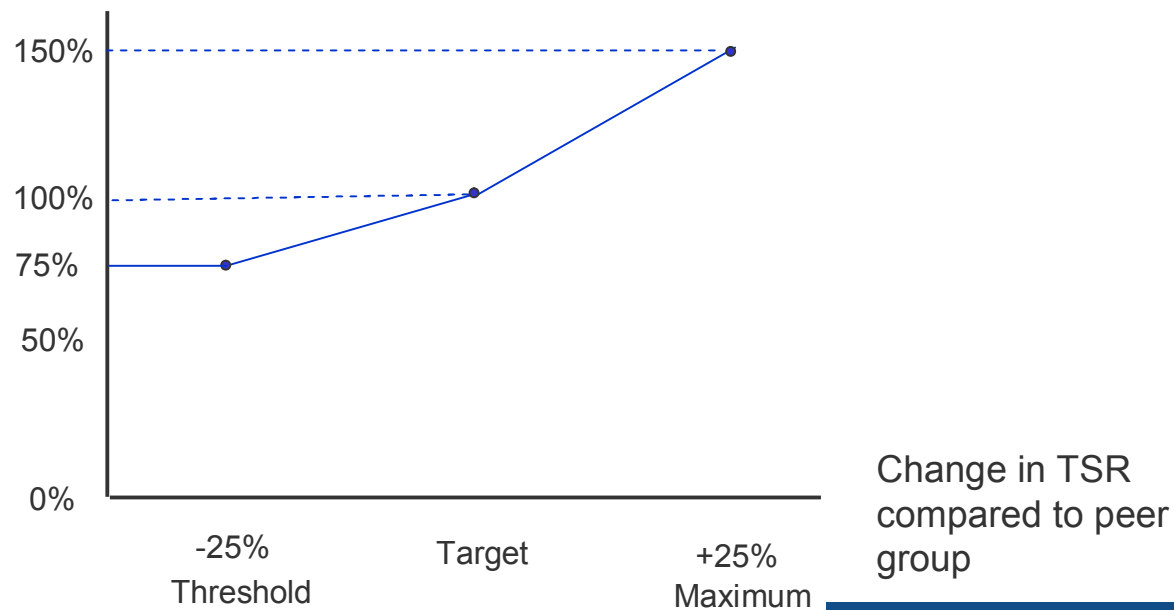


Baxter International

LTI Design

- Annual stock option grant (later 70% stock options and 30% RSUs)
- Total Shareholder Return multiplier on current year's grant based on performance against peer companies in "prior year"

Grant Multiplier



■ **Baxter International**

Learnings/Thoughts

- **Seemed to hit max or min every year, no in between**
- **Depending where you're coming from, easy or difficult**
- **Impacting this year's grant for last year's performance**
- **More upside than down**



■ Unisys

Context

- **Previously an all stock option program**
- **Almost all stock options underwater – perceived value issue**
- **Need to focus on top line growth and profitability**
- **Business in transformation**
 - Pension program changes
 - Business changes
 - Restructuring

UNISYS



LTI Design

- New mix of time-based and performance-based restricted stock:**

Vehicle	Mix	Structure	Objectives
Time-based Restricted Stock	25%	1/3 vesting each year	(1) Retention (2) Increase value perception
Performance-based Restricted Stock (really performance shares)	75%	<p>First year:</p> <ul style="list-style-type: none"> 1/3 on 2006 1/3 on '06-'07 1/3 on '06-'08 <p>50% of the units based on revenue and 50% on pre-tax profit (independent of each other)</p> <p>50% of units at threshold, 100% at target and 150% at maximum</p> <p>With 2007 grant, one three-year overlapping cycle</p>	Focus leadership on corporate revenue and pre-tax profit

■ Unisys

Learnings/Thoughts

- **Still too early to call**
- **Difficult to communicate given relative complexity**
- **Difficult to assess progress on vesting of performance component due to caveats on pension expense, restructuring and other business changes**
- **Concern over an entire grant with a three-year cycle given dynamic nature of business**





**Douglas Van Tornhout,
Sr. Director, Executive Compensation & HR
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LTIP -- Performance Measures --Private Company Perspective



LTIP – Performance Measures - Privately-Held Company Perspective

➤ Personal History

- 19 Years at Bristol-Myers Squibb



Bristol-Myers Squibb Company

Involved in Development of a broad range of long-term incentive plans

- 4 Years at Purdue



Many discussions of long-term incentive plans regarding design and potential implementation

Discussion reflects my perspective, not that of Purdue and its owners.



LTIP – Performance Measures - Privately-Held Company Perspective

- **Long-Term Incentive Plans at Bristol-Myers Squibb**
- **Plans included many vehicles:**
 - Stock Options
 - Performance-Based Stock Options
 - Long-Term Cash Plan
 - Performance Shares
- **Performance Measures Used**
 - Earnings per Share
 - Cash Flow
 - Total Shareholder Return relative to Peers
- **Measure selection based on management viewpoint as well as discussions with investment community**

LTIP – Performance Measures - Privately-Held Company Perspective

Privately-Held Company Issues

- **Basic Performance Measures not Available**
 - Stock Price
 - Earnings per Share
 - Other financials may not be comparable to Publicly held companies
- **Confidentiality of Financial Information**
 - No / Limited Public Disclosure
 - Internal dissemination limited
- **Organization Structure Different / Changing**
 - Frequently reflects ownership structure as partnership
 - Ownership Specific



LTIP – Performance Measures - Privately-Held Company Perspective

Privately-Held Company Issues

- **Focus on Discloseable Measures**
 - Sales / Revenue measures
 - Gross Margin / Higher level earnings measures
 - Pre-tax earnings

- **Create financial measures for managing / understanding business rather than reporting to investor community.**

LTIP – Performance Measures - Privately-Held Company Perspective

Phantom Based Plans

- **Create a stock price or other valuation unit**
 - Replicates basic measures through phantom calculation
 - Explicit formula or calculation
 - For confidentiality, may use “Black Box” approach
 - Pre-tax earnings
- **Example – Hypothetical Stock Price**
 - Earnings = \$100 million
 - Assume 50 million shares
 - EPS of \$2.00
 - Industry average P/E ratio of \$15
 - Stock price of \$30 would be assumed

LTIP – Performance Measures - Privately-Held Company Perspective

Phantom Based Plans

- **Vehicles based on Phantom price**
 - Stock price appreciation
 - Absolute value units
 - Use as relative to industry
- **Price changes:**
 - Company performance changes price
 - Industry valuation changes (P/E)
- **Issues**
 - Its hypothetical
 - Differences in private / public valuation
 - Ownership decisions have different context



LTIP – Performance Measures - Privately-Held Company Perspective

Alternatives

➤ Annual Measures

- Annual performance creates multiplier for cash-based unit
- Eliminates need for long-term continuity of financial measures

➤ Non-quantifiable Measures

- Annual multiplier (value) set based upon judgment of attainment of business objectives / overall performance
- No legal / IRS constraints on measures
- No issue of public perception

