



RADFORD ALERT

ISS Releases Updated Industry Burn Rate Cap Tables for 2012

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In late December, Institutional Shareholder Services (ISS) released its updated proxy voting guidelines for 2012. Among the numerous items covered by this release, ISS provided fresh guidance on burn rate caps for both Russell 3000 and non-Russell 3000 companies in all industries. Burn rates, a measure of the speed with which companies use (or burn) shares available for grant in their equity compensation plans, is an important factor for investors concerned about shareholder dilution. Developed in time for the upcoming proxy voting season, ISS' new burn rate guidelines go into effect for companies with shareholder meetings on or after February 1, 2012.

ISS uses burn rate caps as an enforcement vehicle to vote against stock plan proposals when a company's three-year average burn rate exceeds the allowable cap for its respective industry. Industry caps are calculated and revised by ISS on an annual basis based on an industry's mean (average) burn rate plus one standard deviation (σ). In the event the mean burn rate plus one standard deviation for any given industry generates a cap of less than two percent, ISS will automatically adjust the cap to two percent.

When determining company-specific burn rates, ISS considers "gross burn rate," which is calculated as total options and restricted shares (or RSUs) granted divided by a company's weighted-average total common shares outstanding. Unlike "net burn rate" calculations, cancelled or forfeited equity awards are excluded from consideration. ISS also considers performance shares, but not when they are granted. Performance shares enter into the analysis once earned. To convert full-value shares granted into option-equivalents before running final burn rate calculations, ISS also applies a multiplier based on stock price volatility as follows:

| Company 200-Day Stock Price Volatility | Multiplier |
|--|--|
| 54.6% and higher | 1 full-value award will count as 1.5 option shares |
| 36.1% or higher and less than 54.6% | 1 full-value award will count as 2.0 option shares |
| 24.9% or higher and less than 36.1% | 1 full-value award will count as 2.5 option shares |
| 16.5% or higher and less than 24.9% | 1 full-value award will count as 3.0 option shares |
| 7.9% or higher and less than 16.5% | 1 full-value award will count as 3.5 option shares |
| Less than 7.9% | 1 full-value award will count as 4.0 option shares |

In the table below, Radford has reproduced the full ISS burn rate cap table for both Russell 3000 and non-Russell companies. For reference, Radford clients typically appear in the 1010, 3510, 3520, 4510, 4520, 4530 and 5010 GICS code categories.

| ISS Industries | | Russell 3000 Companies | | | Non-Russell 3000 Companies | | |
|------------------|----------------------------------|------------------------|--------------------|--------------------|----------------------------|--------------------|--------------------|
| GICS Code** | Description | Mean | Standard Deviation | 2012 Burn Rate Cap | Mean | Standard Deviation | 2012 Burn Rate Cap |
| 1010 | Energy | 1.99% | 2.03% | 4.02% | 2.82% | 4.64% | 7.46% |
| 1510 | Materials | 1.64% | 1.44% | 3.08% | 2.48% | 3.56% | 6.04% |
| 2010 | Capital Goods | 1.72% | 1.21% | 2.93% | 3.53% | 5.29% | *8.69% |
| 2020 | Commercial Services & Supplies | 2.52% | 2.09% | 4.61% | 2.88% | 2.93% | 5.81% |
| 2030 | Transportation | 1.68% | 1.15% | 2.83% | 1.51% | 1.37% | 2.88% |
| 2510 | Automobiles & Components | 1.85% | 1.55% | 3.40% | 4.48% | 6.32% | *6.99% |
| 2520 | Consumer Durables & Apparel | 2.84% | 1.96% | 4.81% | 2.81% | 3.46% | 6.27% |
| 2530 | Consumer Services | 2.70% | 3.11% | 5.81% | 2.81% | 4.18% | 6.99% |
| 2540 | Media | 2.91% | 2.65% | 5.56% | 2.75% | 2.91% | 5.65% |
| 2550 | Retailing | 2.43% | 1.59% | 4.02% | 3.38% | 4.70% | *6.62% |
| 3010, 3020, 3030 | Consumer Staples | 1.64% | 1.39% | 3.03% | 3.18% | 6.61% | *7.17% |
| 3510 | Health Care Equipment & Services | 2.95% | 1.74% | 4.69% | 5.23% | 7.28% | *11.92% |
| 3520 | Pharmaceuticals & Biotechnology | 3.59% | 3.90% | 7.49% | 6.01% | 8.02% | *12.58% |
| 4010 | Banks | 1.31% | 1.50% | 2.81% | 1.20% | 2.29% | 3.49% |
| 4020 | Diversified Financials | 5.02% | 5.97% | *9.15% | 4.78% | 6.52% | 11.31% |
| 4030 | Insurance | 1.58% | 1.22% | 2.80% | 0.69% | 0.98% | *2.31% |
| 4040 | Real Estate | 1.15% | 1.19% | 2.34% | 1.35% | 2.11% | 3.46% |
| 4510 | Software & Services | 4.41% | 3.35% | 7.76% | 5.43% | 7.12% | *11.58% |
| 4520 | Technology Hardware & Equipment | 3.41% | 2.32% | 5.73% | 3.74% | 3.95% | 7.69% |
| 4530 | Semiconductor Equipment | 3.94% | 1.90% | 5.83% | 5.42% | 4.74% | *9.78% |
| 5010 | Telecommunication Services | 3.02% | 4.62% | *6.50% | 7.23% | 13.28% | *9.08% |
| 5510 | Utilities | 0.76% | 0.48% | *2.00% | 3.88% | 6.47% | *5.64% |

* The cap is generally the Mean + Standard Deviation, subject to minimum cap of 2% (de minimus allowance) and maximum +/- 2 percentage points relative to prior year burn rate cap for same industry/index group.

** The GICS code classification system is produced by S&P and is used by ISS to define industry classifications.

Additional Equity Plan Considerations

Clients should note burn rate caps are only one factor considered by ISS when evaluating equity-based and other incentive plans up for shareholder approval. ISS will vote against equity plans if any one of the following issues is found to exist:

- > The total cost of the company's equity plans is "unreasonable," as measured by ISS' shareholder value transfer metric (SVT);
- > The equity plan expressly permits the re-pricing of stock options or stock appreciation rights (including the exchange of underwater options) without prior shareholder approval;
- > A pay-for-performance misalignment is found for the company's CEO, especially where a significant portion of the CEO's "misaligned" pay is determined to result from non-performance-based equity awards;
- > The company's three year burn rate exceeds the burn rate cap of its industry group;
- > The equity plan has a liberal change-of-control definition, where for example, equity awards are accelerated due to the announcement or commencement of a tender offer, a "potential" takeover, or an approved merger rather as opposed to a fully completed change-of-control; or
- > The equity plan is a vehicle for problematic pay practices.

Next Steps

For additional information on the latest ISS policy releases, clients can visit the ISS Policy Gateway here: http://www.issgovernance.com/policy/2012/policy_information. For assistance with burn rate, shareholder value transfer and equity usage modeling, contact Radford's Valuation Services or Consulting teams.

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