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A New S&P Policy Change Requires Vigilance in Measuring Indexed TSR Plan Performance

Benchmarking your Relative TSR plan against the S&P 500 index seems fairly straightforward, but it gets complicated now that new classes of stock are doubly counted.

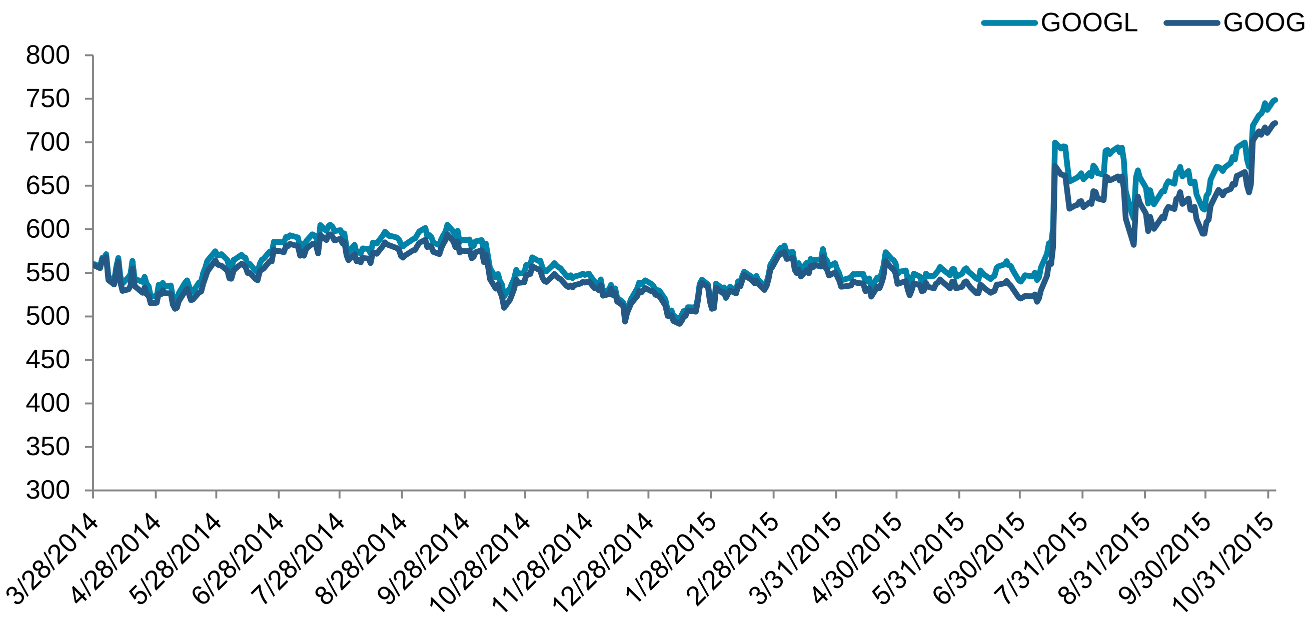
Let's begin with a short trivia quiz: How many different companies currently make up the S&P 500? Is your answer 500? If so, you're correct! Now, here's where things get hairy: How many different stocks make up the S&P 500? The answer is 504. What? Allow us to explain.

Some companies issue multiple classes of stock for a variety of reasons. Traditionally, these additional classes were excluded from the major indices. Standard & Poor's (S&P) has taken a new stance regarding the different stock classes, and now allows multiple share classes in the same index— some with more or less voting rights than others, but all tied to the same valuation of the same company. S&P originally announced two years ago that multiple classes of stock would stay in their indices only temporarily, but based on feedback from clients, S&P has decided to keep all classes that meet liquidity and float criteria.

A recent example of this phenomenon is Google's new parent company, Alphabet. It has two classes of stock: GOOG and GOOGL. Both are worth similar amounts and yield similar returns, but a share of GOOG (Class C Capital Stock) carries no voting rights, whereas a share of GOOGL (Class A Common Stock) carries regular voting rights. Alphabet did this hoping to attract new investors that didn't need or want voting rights. This allows Alphabet to pay out certain awards in Class C shares to avoid diluting their Class A shares.

So, why does this matter for your company's equity performance plan? Well, if your plan's performance is judged on the performance of the S&P 500 index, as many plans are these days, the results give undue weight to a handful of companies with multiple classes of stock instead of treating the underlying performance of each company equally. These different classes of stock usually move in near tandem, as the following chart illustrates for both GOOG and GOOGL since the 2nd share class was created in March of 2014.

Stock Prices for Google's Two Classes of Stock



There are four cases of multiple stock classes for one company in the S&P 500: Alphabet, Discovery, Fox, and News Corp (plus Central Pet & Garden for the S&P 600). To avoid competing against the same company twice, firms with indexed Relative TSR plans should determine which share class is considered the 'primary' issue by our data provider, S&P Capital IQ. They base their decisions on price history, stock liquidity and data availability of estimates. In all cases, these criteria also match up with the class that has the more desirable voting rights. Based on that research, we recommend choosing these tickers for your Relative TSR plan.

Company	Ticker to Keep	Ticker to Remove
Alphabet Inc.	GOOGL	GOOG
Discovery Communications, Inc.	DISCA	DISCK
Twenty-First Century Fox, Inc.	FOXA	FOX
News Corporation	NWSA	NWS
Central Garden & Pet Company	CENT	CENT.A

However, the situation is always changing and warrants ongoing vigilance to ensure your relative TSR plan has the correct peer group constituents, and is following your award agreement's intention. For instance, Comcast Corporation reclassified both of their shares into one, streamlined ticker at the end of 2015 to reduce confusion to shareholders over the two classes of shares and improve trading liquidity of the stock. Up until a couple months ago, there were 505 classes of stock comprising the S&P 500.

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