Executive Compensation Index

ECONOMIC RESEARCH INSTITUTE

111 Academy Drive, Suite 270
Irvine, CA 92617
800-627-3697
www.erieri.com

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About the Index

ERI's Executive Compensation Index is a quarterly report that measures trends in executive compensation using analysis of the companies included in the Russell 3000 index. The Russell 3000 is comprised of 3000 securities traded on U.S. stock exchanges that collectively represent roughly 98% of the investable equity market in the United States. Last updated on June 26, 2015, the Russell 3000 includes 2,986 distinct publicly traded companies. The July 2015 edition of the ERI Executive Compensation Index specifically highlights compensation for three executive positions:

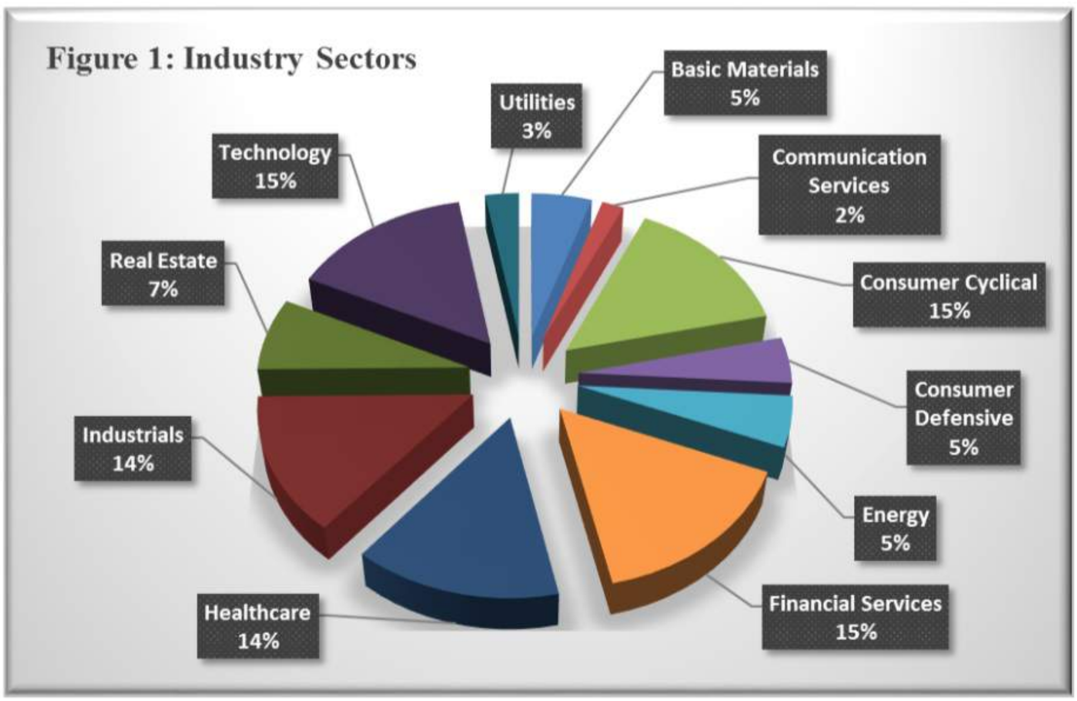
- Chief Executive Officer
- Chief Financial Officer
- Chief Operating Officer

This report will also discuss the fluid landscape for the analysis and benchmarking of executive compensation packages. Analysis of public company disclosures will drive this discussion.

Company-Level Data

Median revenue for the Russell 3000 increased 4.43% from 2013 to 2014. The median revenue for companies in the index was just over $810 million in 2014. From 2008 to 2009, median annual revenue dropped more than 12% for this group. Since 2009, median revenue is up more than 25%. Roughly 80% of companies in the index saw positive revenue growth in 2014, while 56% percent increased revenue by at least 10% over 2013.

Figure 1 illustrates the 2015 Russell 3000 by industry sector. Financial services, technology, and consumer cyclical companies each represent 15% of the index. Not far behind are healthcare and industrial manufacturers at 14%.



To analyze executive pay, the Russell 3000 companies were divided into three groups by the most recent market capitalization. The market cap groups were defined as follows:

- Small Cap – less than $750 million (948 companies)
- Medium Cap – between $750 million and $4 billion (1,176 companies)
- Large Cap – greater than $4 billion (862 companies)

Chief Executive Officer

Table 1 shows the median total direct compensation for Russell 3000 Chief Executive Officers in 2014. Total direct compensation includes salary, annual cash incentive, and the grant-date value of stock and option awards in a fiscal year. This measure of CEO compensation increased by 17%, 20%, and 13% in 2014 for market cap groups 1, 2, and 3 respectively.

Table 1 - 2014 CEO Total Direct Compensation

Market Cap Group	Total Direct Compensation ($)		
	25th Percentile	Median	75th Percentile
1	926,856	1,680,901	2,867,292
2	2,004,291	3,358,097	5,223,317
3	4,988,645	7,857,661	11,756,937

Figure 2 displays median values for the four components of total direct compensation, separated by market cap group. It also shows values for two other traditional summary compensation table elements. *Pension* refers to above-market earnings in, or direct payouts to, retirement or non-qualified deferred compensation plans. *Other* refers to executive benefits and perquisites (e.g. use of the company aircraft) that are not included in one of the other categories.

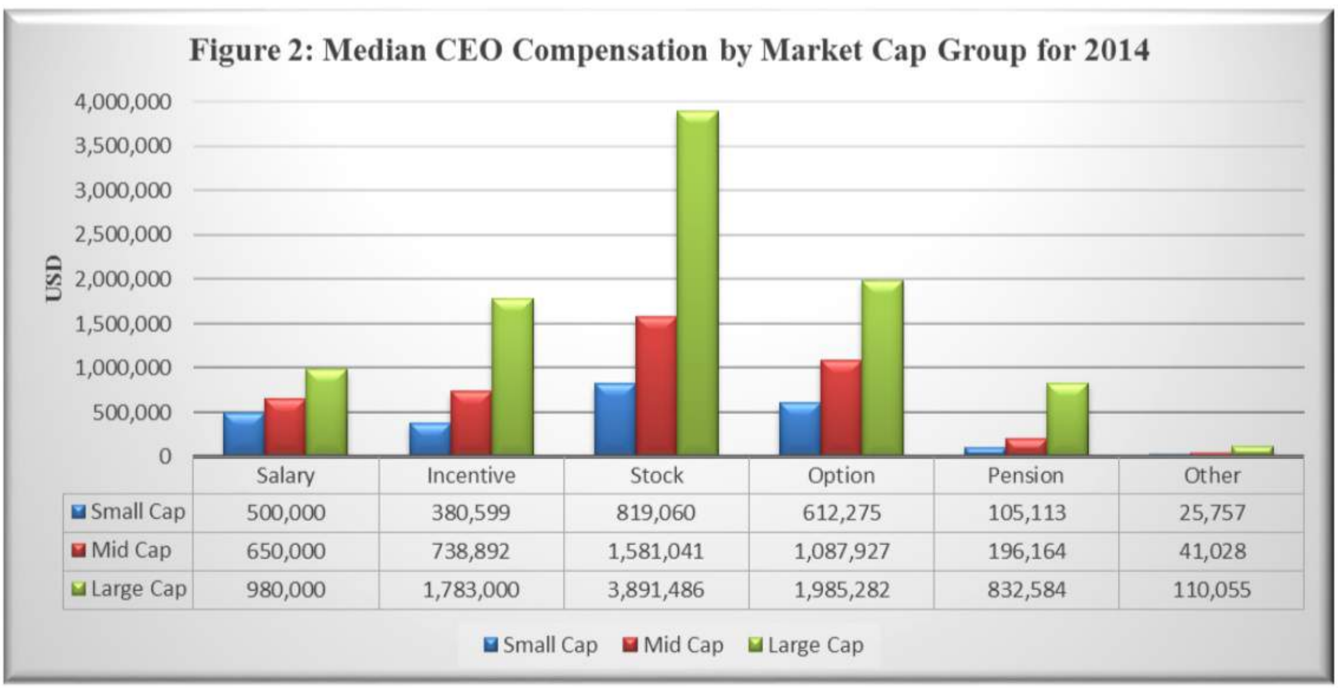


Figure 2: Median CEO Compensation by Market Cap Group for 2014

CEO Salary

CEO salaries increased across the board in 2014. The medium and large market cap groups saw salary increases of roughly 8%, while the small group median salary increased 10%. The median salary for the top executives at small cap companies was exactly $500,000. The typical large cap company CEO earned a base salary roughly twice as high as his small cap counterpart.

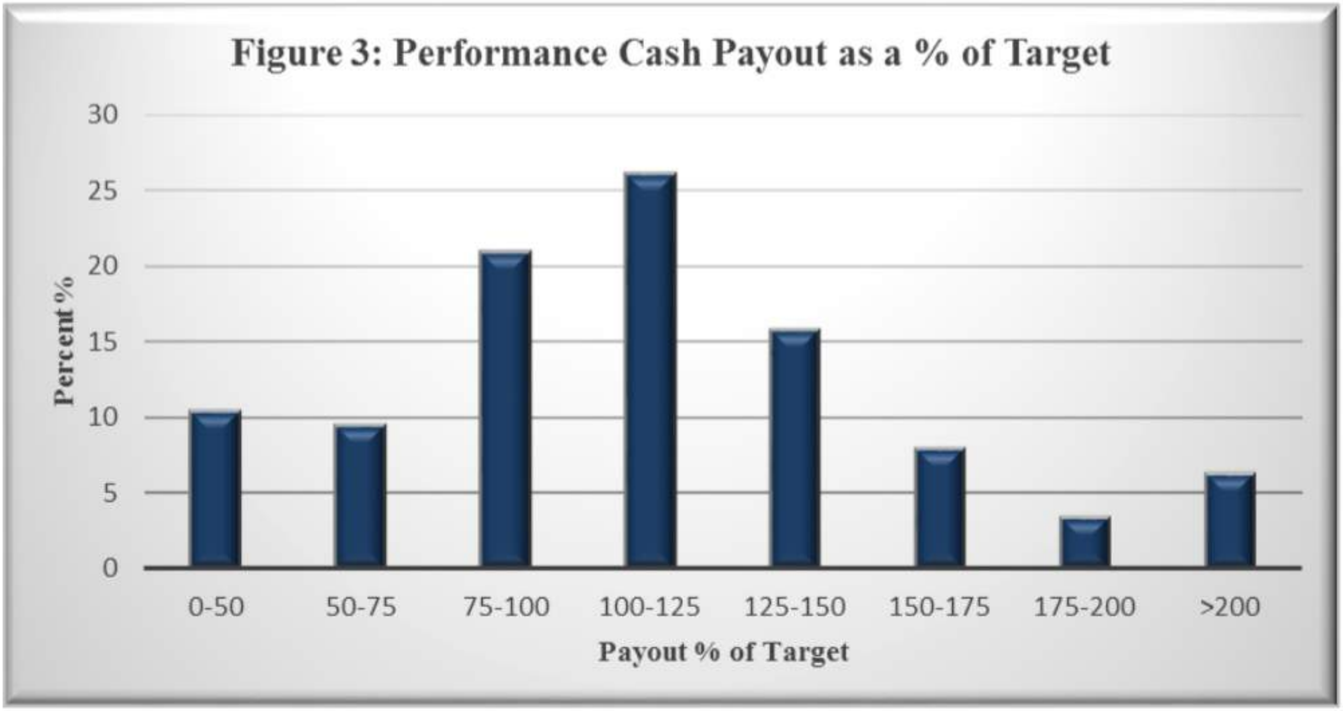
CEO Annual Cash Incentive

Annual cash incentives also generally increased from 2013 levels. In both 2013 and 2014, one third of CEOs received cash incentives of at least $1 million.

These types of payouts typically fall into one of three categories. They can be based on individual or company performance in a *reactive* way, in which case the compensation committees make a somewhat subjective decision regarding payout amounts at the end of given period. They can also be *proactive*, in which specific plan targets and performance goals, set at the beginning of a period, determine payout amounts. Lastly, they may not be based on performance at all. Examples of non-performance cash include sign-on and retention bonuses, as well as cash bonuses resulting from a merger agreement. Executive compensation packages often include annual cash incentives with components in more than one of these categories. When this is the case, the *proactive* piece is reported separately. ERI's Executive Compensation Index refers to target-based and objective-driven cash incentives as "performance cash" and all other cash incentives as "discretionary bonuses".

Discretionary variable cash has decreased steadily in CEO pay packages in the past decade. In 2005, 84% of Russell 3000 CEOs earned some discretionary annual cash bonus. In 2014, only 22% earned such a bonus. In an effort to display pay for performance, these payouts have largely been replaced by non-equity incentives, or performance cash.

Figure 3 illustrates CEO payouts from performance-based annual cash incentive plans in 2014. Of those CEOs that earned performance cash in 2014, 60% received payouts that were equal to or greater than the predetermined plan target. More than one third of performance cash payouts were at least 25% above target.

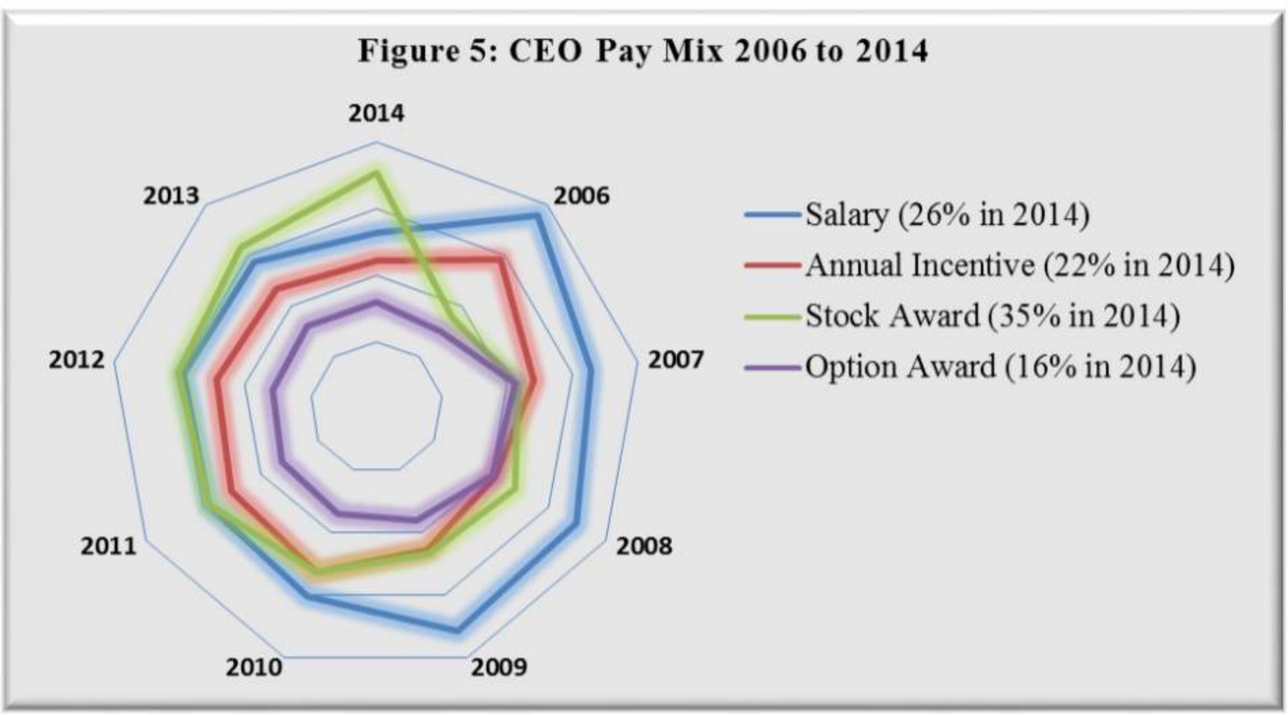


More than 75% of Russell 3000 companies reported using more than one performance measure in determining performance cash payouts in 2014. The most common plan designs included between two and 5 metrics. Naturally, most plan designs included measures of earnings growth and returns to shareholders, but non-financial goals were reported in about one in ten cases. Where the outcomes could be measured objectively, factors such as workplace safety and customer satisfaction also affected executive cash incentives. Many companies use a weighted approach, assigning more weight to those performance goals that are considered more important to overall company success.

CEO Equity Compensation

Median CEO stock and option grants increased in 2014 for all public company sizes. Full-value equity awards are currently behind only base salary in their likelihood to be included in CEO pay packages. 76% of Russell 3000 CEOs earned some full-value stock in 2014. That is compared to the 47% who earned appreciation awards. Figure 4 outlines the separation of these equity pay categories since 2007. As of 2014, public company CEOs are almost twice as likely to receive full-value stock.

Figure 5 summarizes how the mix of CEO total direct compensation has changed since 2006. Full-value stock awards have risen from 17% to more than one third of the total value of CEO pay packages. Through the volatile years following the 2008 recession, fixed cash base salary was the easily the largest component. More recently, however, more investor attention to pay-for-performance, along with an improving economy, has led to the increased importance of equity and variable cash.



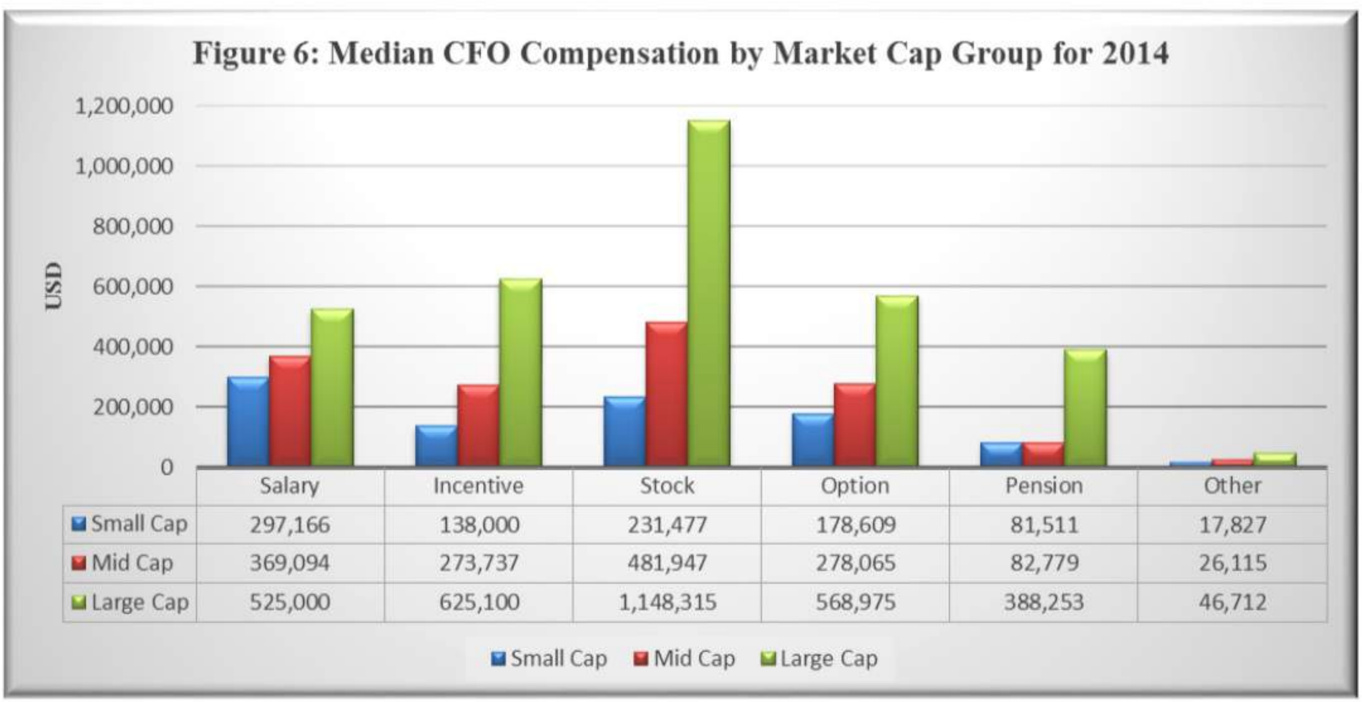
Chief Financial Officer

Table 2 shows the median total direct compensation for Russell 3000 Chief Financial Officers in 2014. The medium cap group saw the largest increase to median total direct compensation at just over 10%. The small and large cap groups saw median increases of 7%.

Table 2 - 2014 CFO Total Direct Compensation

Market Cap Group	Total Direct Compensation ($)		
	25th Percentile	Median	75th Percentile
1	435,985	667,560	1,065,968
2	802,254	1,232,453	1,804,392
3	1,794,063	2,625,278	3,910,657

Figure 6 displays median values for the four components of total direct compensation, as well as medians for the *Pension* and *Other* columns defined in the CEO section of this report. Again these values should be interpreted as the median for those Russell 3000 CFOs earning some compensation in the given form in 2014. All three market cap groups analyzed showed roughly 5% increases to median salary in 2014. Annual cash incentive growth was flat for the small company group, but increased almost 10% for medium and large sized companies. Similar to the story of recent CEO pay, growth in the typical CFO full-value equity award outpaced appreciation award growth by a factor of two.



Chief Operating Officer

Table 3 shows the median total direct compensation for Russell 3000 Chief Operating Officers in 2014. Total direct grew by nearly 10% in 2014 for the medium and large cap groups. The small cap group median increased by roughly 5% to $755,248.

Table 3 - 2014 COO Total Direct Compensation

Market Cap Group	Total Direct Compensation ($)		
	25th Percentile	Median	75th Percentile
1	504,330	755,248	1,315,385
2	961,923	1,527,570	2,427,774
3	2,108,120	3,231,818	4,880,154

Figure 7 breaks total direct compensation into its respective components for Chief Operating Officers. Similar to the other top executives in this report, median COO salaries grew by roughly 5% in 2014. Smallest companies analyzed saw the largest percentage increases in equity grants, but the median full-value stock award for large cap COOs was still more than five times higher than that of the small cap group. Large cap company COO pay showed the most dramatic transition away from appreciation equity and toward full-value equity. Grant-date values for stock awards increased 14%, while grant-date values for option awards decreased 14% in 2014.

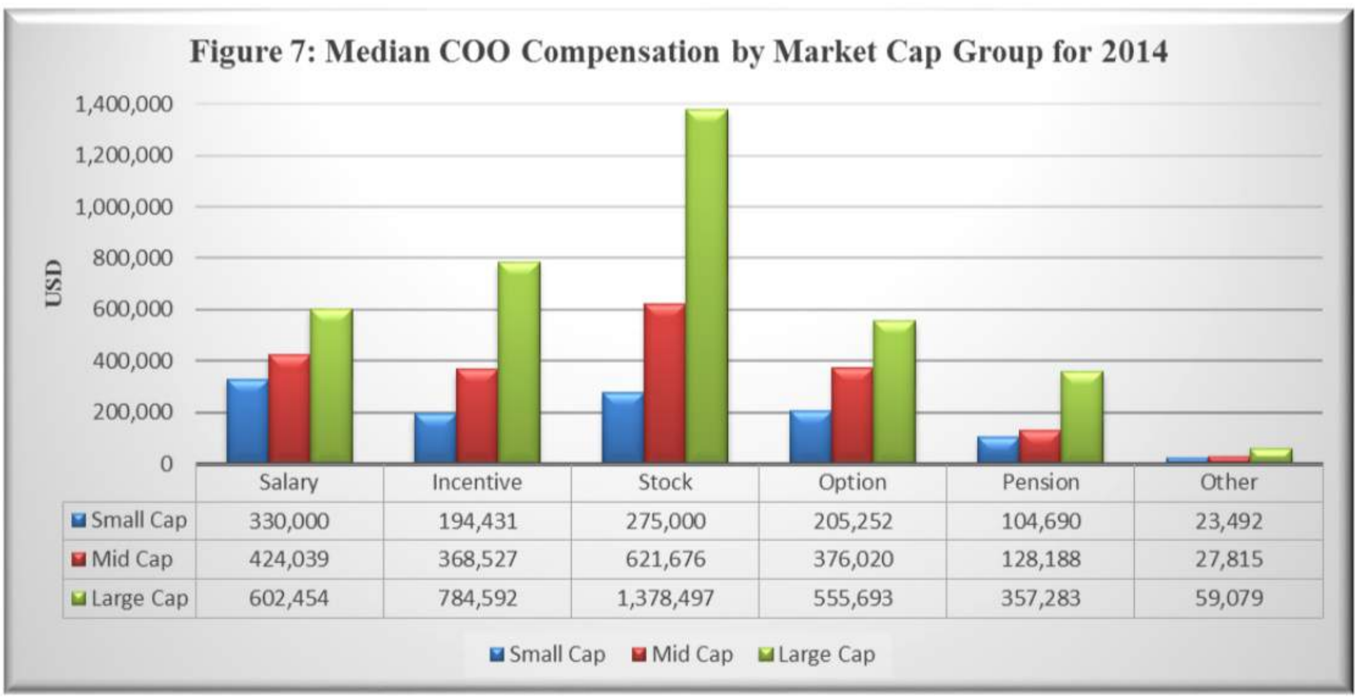


Figure 7: Median COO Compensation by Market Cap Group for 2014

Supplemental Information

New SEC Disclosure Rules on Pay for Performance

In April 2015, the SEC issued a proposal for new rules related to executive compensation and pay for performance. The proposed guidelines serve as amendments to section 953(a) of Dodd-Frank and will require companies to disclose the compensation paid to executives alongside the company's total shareholder return. The information will be provided in the form of an additional table in a given company's annual proxy statement. The pay component will include total compensation for the CEO, as well as an average of the remaining top executives for whom compensation disclosure requirements already exist. Total compensation is already part of the summary compensation table found in a typical annual proxy, but the new guidelines will require that "total" be displayed a bit differently. In particular, equity compensation will be measured as the value of those stock or option awards that have vested in a given period rather than the grant-date values found in the summary compensation table. Also, any increases to pension or retirement plan values will be excluded from total compensation if they do not apply to services in the given period. Click here to find more information about these new rules via ERI's blog post on the topic.

Peer Group Analysis

One of the inputs public companies generally use in designing executive pay programs is benchmark comparison data based on a list of peers. In 2014, the typical comparison group included between 15 and 20 companies based on similar industries, company sizes, or both. Companies will sometimes report comparison groups of up to 40 peers.

Krispy Kreme Donuts generated $490 million is revenue in 2014. They reported in their April 2015 proxy that a list of 18 restaurant and food and beverage manufacturing companies, ranging in revenue from $179 million to $1.3 billion, was used to benchmark both company success and executive compensation.

Realizable Versus Realized Equity Compensation

When talking about executive equity compensation, it is important to distinguish between values often referred to as *realized* versus *realizable* compensation. In their annual proxy statements, public companies disclose in summary compensation tables the grant-date fair value of equity awarded in a given period. This measure can be thought of as only *realizable* income. In other words, it represents an estimate of the potential wealth gained by the executive in some future period. The actual wealth gained resulting from a stock award vesting or an option being exercised, what is *realized*, can be quite different than the grant-date estimate from several years back. Fortunately, companies also provide data on realized equity compensation in a given period. Table 4 summarizes typical amounts in these categories over the past two years. Keep in mind that this discussion is not intended to suggest any relationship between the grants in a given period, and the actual wealth gained in that period. Doing so would not really be like comparing apples to oranges, but rather apple seeds to apples. The point here is that these values can be very different, especially when looking at individual executives.

Table 4: Median CEO Equity Compensation

	Full-Value Stock Awards ($)		Appreciation Option Awards ($)	
Year	Realizable	Realized	Realizable	Realized
2014	1,946,477	1,516,447	1,762,281	2,277,570
2013	1,559,997	1,172,345	1,013,378	1,842,221

Stock Ownership Guidelines

Many companies report stock ownership guidelines as one of the methods used to align executive compensation with short-term and long-term business objectives. These guidelines are often measured in comparison to the executive's salary. As an example, Comcast Corp reports in their April 2015 proxy that CEO Brian Roberts was required to maintain common stock ownership of at least ten times his base salary in 2014. As of the end of 2014, Roberts owned just over 5.7 million shares of Comcast's Class A shares. All other Comcast named executive officers were required to have equity stakes in the company of at least three times their 2014 base salary. Using this measure of stock ownership, CEOs in the Russell 3000 had the highest median employer equity stake at just over 18 times base salary at the end of 2014. The median Chief Operating Officer maintained 8 times his/her base salary in employer stock, and the median Chief Financial Officer maintained a level 6.2 times higher.

Please email Matt Skrinjar at matt.skrinjar@erieri.com with questions or comments.

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ERI Economic Research Institute
111 Academy Drive, Suite 270
Irvine, CA 92617
(800) 627-3697
info.eri@erieri.com

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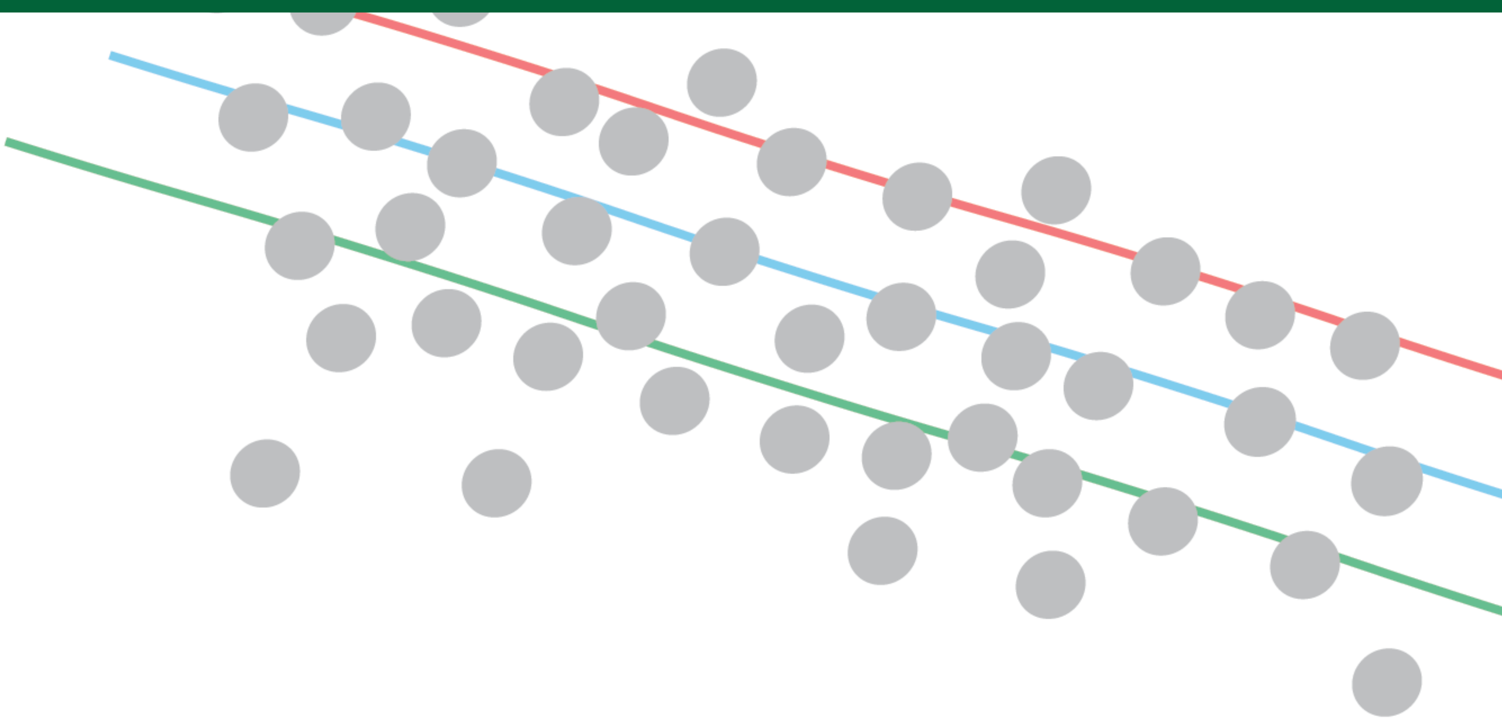

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