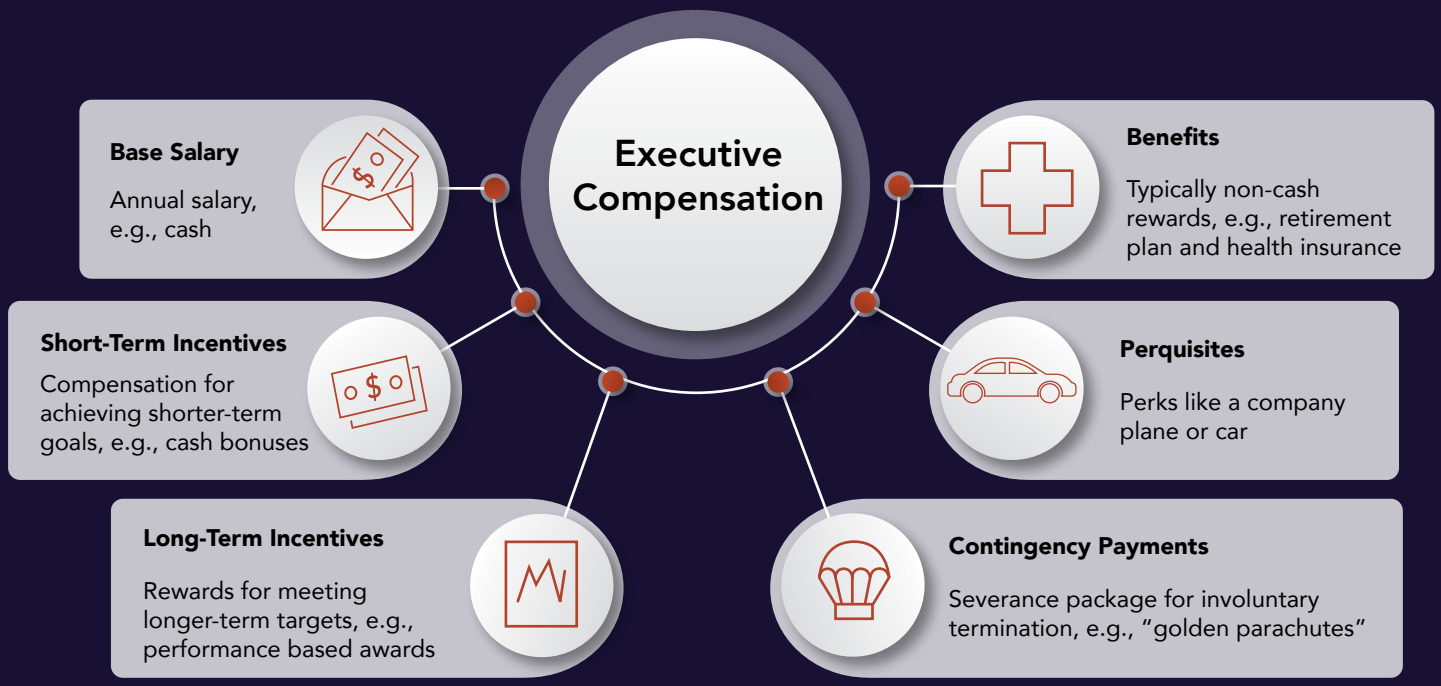
Your Guide to Executive Compensation

Finding the right company fit is as much art as science, and understanding your executive compensation plays a key role. Evaluating all the moving parts can be tricky, but we'll review a few of the most commonly used incentives.

Having consistently supported executives over the years, we have seen the benefits of taking a deliberate and impartial approach to evaluating your compensation. If it gets complex, work with an experienced professional to review current and future ramifications.

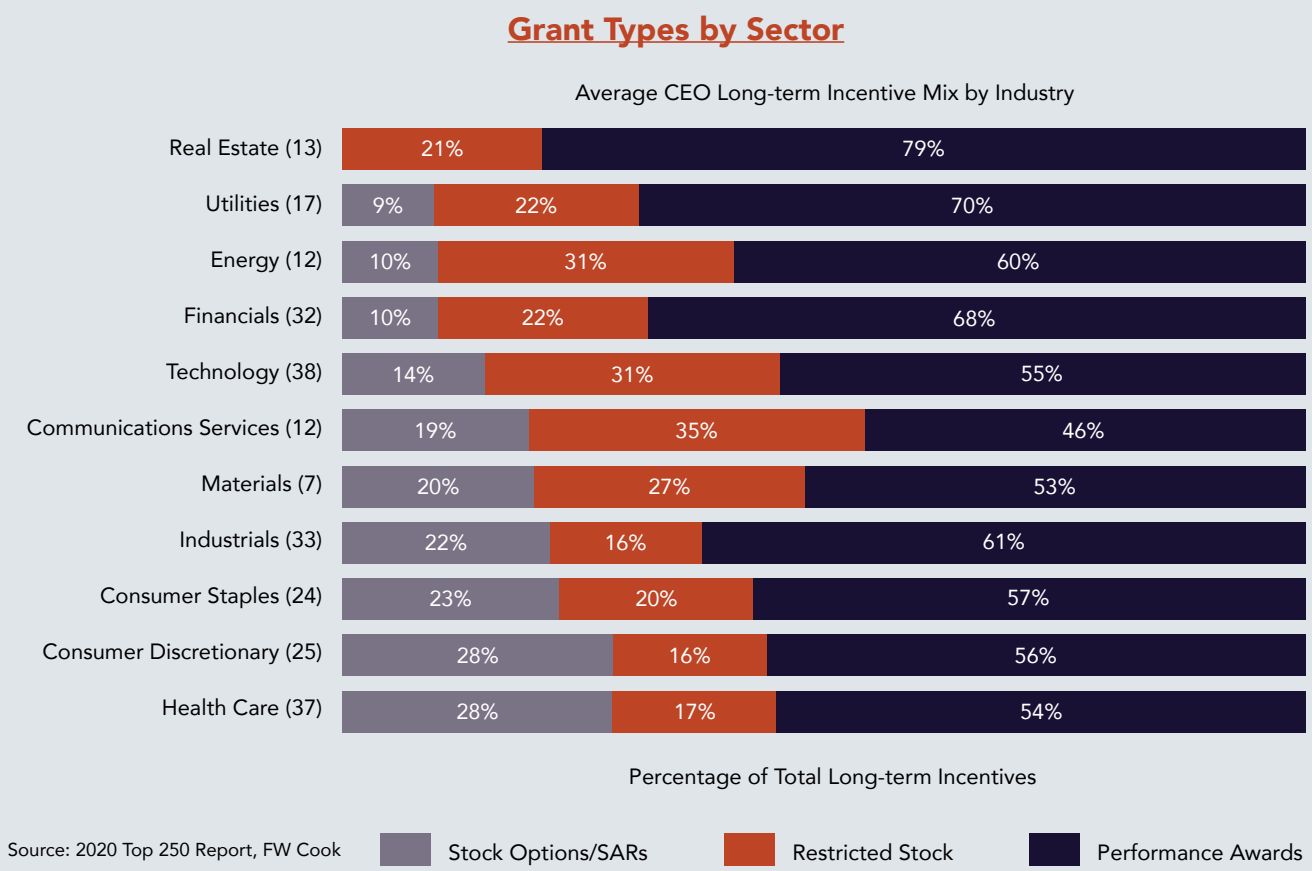
Not Your Average Paycheck

Your compensation will likely be a combination of the following:



Long-Term Incentives

One of the most dynamic components of compensation comes from long-term incentives. Incentives offer "skin in the game" for executives, with the ultimate goal of aligning management behavior with the company's longer-term strategic interests. In the Americas, long-term incentives can account for 75% of executive compensation.



Here are a few of the most commonly issued long-term rewards:

Stock Appreciation Awards

Most commonly granted as stock options, these awards deliver value if the stock price appreciates over a given period of time. Stock options provide you with the opportunity to purchase a predetermined number of shares for a specified price.

Stock Option Award Types

1. Incentive stock options (ISOs) - Also known as statutory stock options, ISOs can qualify for tax benefits, such as being subject to capital gains rather than income tax. However, understanding relevant Alternative Minimum tax liability is crucial, and private company participants may not end up enjoying tax benefits depending on the holding period.

2. Nonqualified stock options (NQSO) – Also known as non-statutory stock options, these are the more common form of stock option compensation. NQSOs are transferable and do not qualify for special tax treatment.

Another commonly used structure is the Stock Appreciation Right (SAR), which pays out based on an increase in share performance, either with cash or more stock. Unlike a stock option, a SAR does not require a stock purchase.

These vehicles provide a windfall if your company share price grows and you exercise your options or SARs. However, if company share prices are below the predetermined strike price, stock options remain worthless.

Performance Based Awards

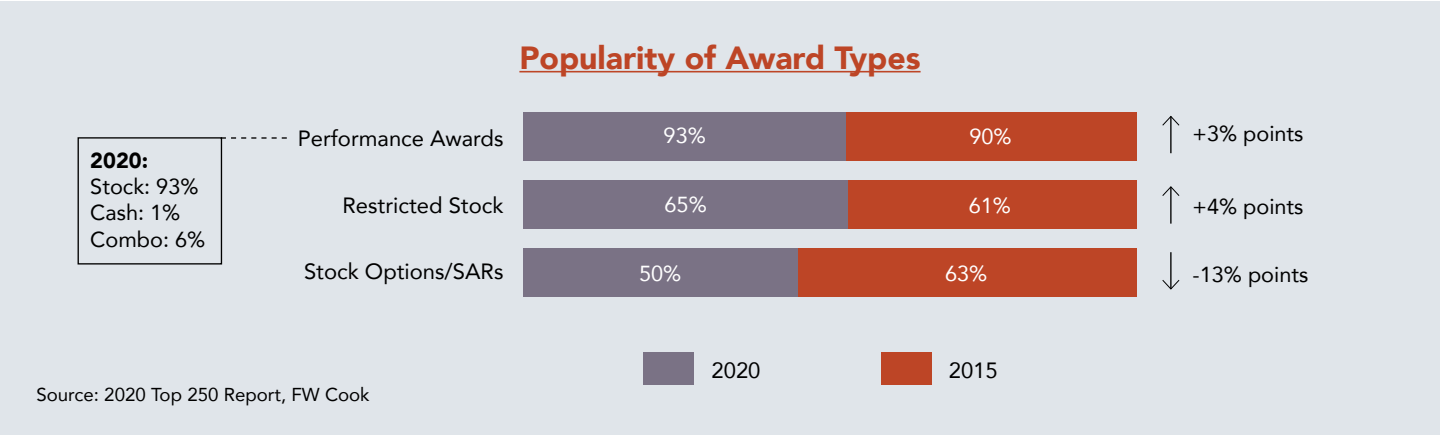
Cash or stock grants that depend on achieving performance goals have gained popularity as a method of tying payout to results. This type of long-term incentive has specific performance metrics. For example, a company might have specific profit, shareholder return, capital efficiency, cash flow, or environmental, social, and governance (ESG) goals.

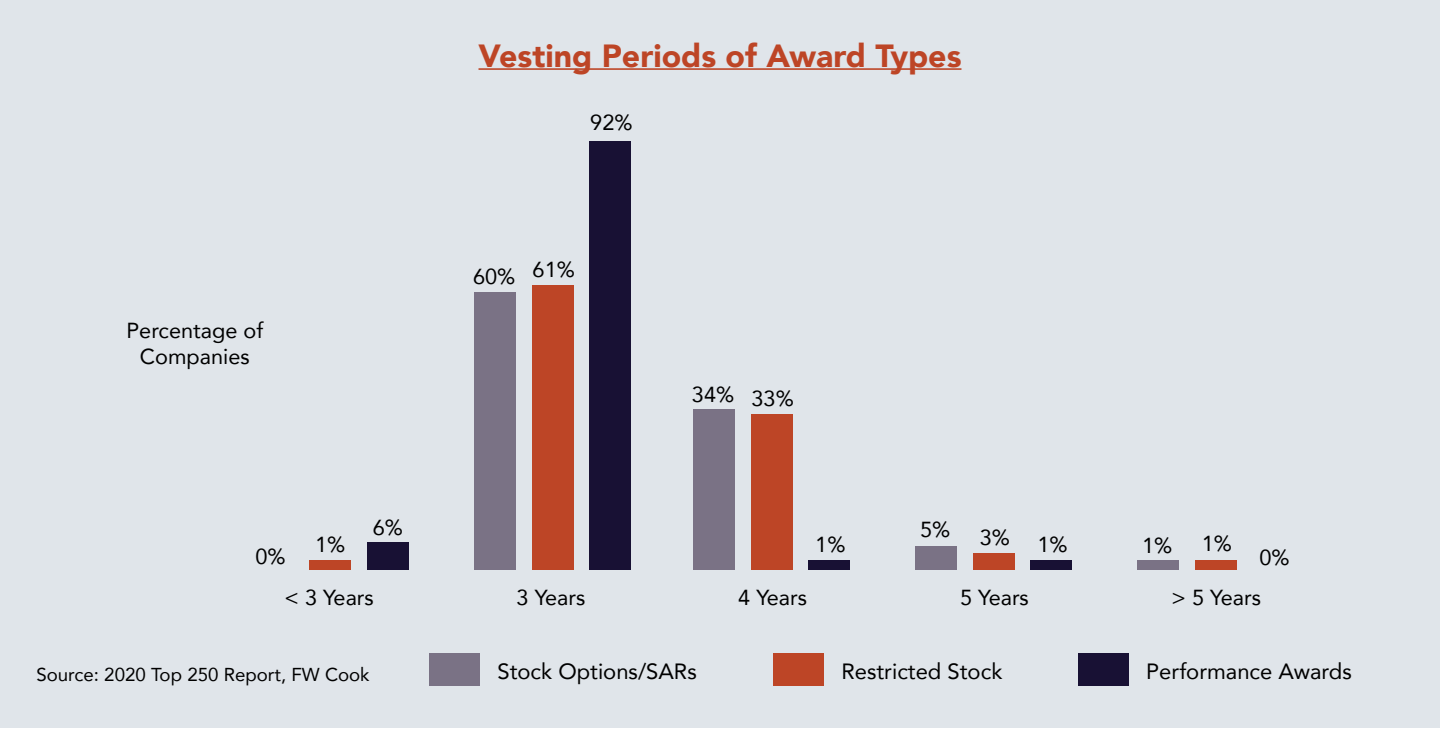
Unlike stock appreciation-based awards, performance-based grants may still be paid if your share price suffers. That said, if you don't meet the agreed-upon targets, these awards could still end up without value.

Time Contingent Awards

Restricted stock is a prime example of time-based grant of share units. With restricted stock, the company gradually transfers shares to an employee on a pre-determined vesting schedule. Unlike a stock option, the award has value regardless of share price (you don't have to buy any stock at a particular price, as it is simply awarded to you).

These awards promote continued loyalty to the company, are non-transferrable, and cannot be sold until vested. Since they aren't linked to any performance metrics, they are a form of "guaranteed" compensation as long as you stay with the company.





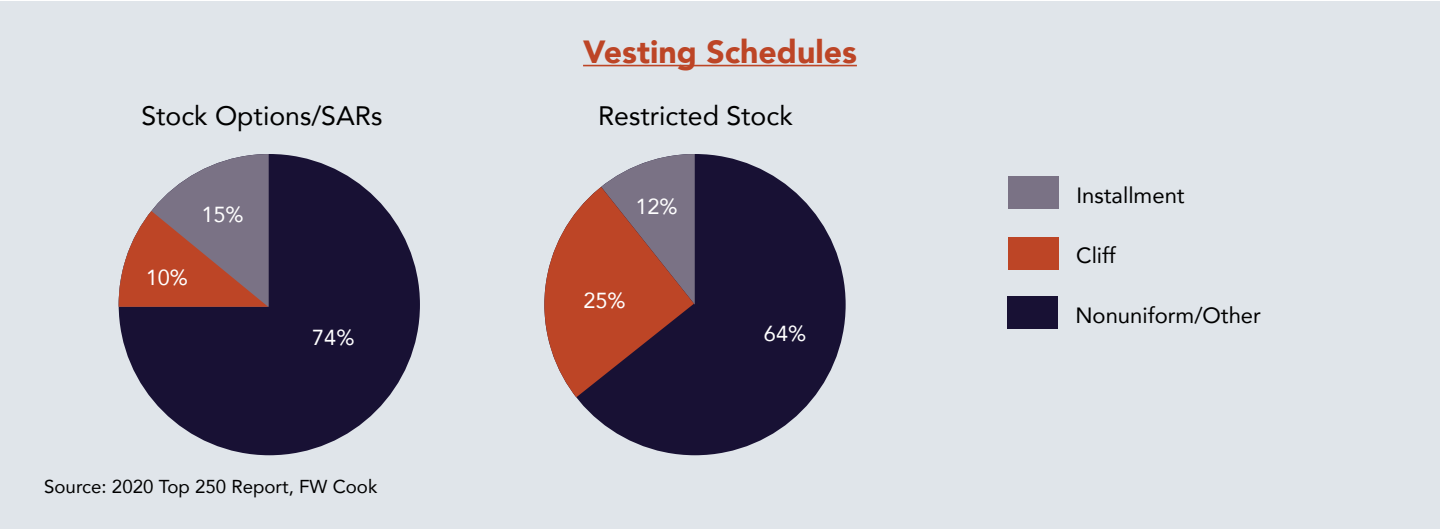
How Vesting Works

To encourage executive retention, your incentives usually must vest over a period of three to five years. Performance awards, in particular, seem to primarily vest at the three-year mark among the 250 largest US companies in the S&P 500.

Two common vesting schedules include:

Cliff Vesting - You receive the full award at a predetermined time; ex: You will receive full vesting on September 1, 2025

Graduated Vesting - You receive a percentage of the reward over a period of time; ex: You receive 25% vesting each year, receiving 100% vesting after 4 years



A majority of executive compensation is not guaranteed. Therefore, your decision to accept a compensation package requires weighing the value of your benefits with the odds of achieving them, as well as the mission and culture of the firm.

If the company succeeds, you reap outsized benefits, so it's worth taking a long hard look at whether you can commit to its long-term goals, both for your personal and financial wellness.

Steering Your Own Ship

Choosing between compensation packages can seem like comparing apples to oranges, and the implications on your long-term finances may not be immediately obvious.

Having consistently supported executives over the years, we have seen the benefits of taking a deliberate and impartial approach to evaluating your compensation. If it gets complex, work with an experienced professional to review current and future ramifications.

Don't hesitate to reach out - we're here to help.

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