How and Why Pre-Commercial Biotech CEO Pay is Different

Part Two: Founders vs. Non-Founders

In this four-part series, we examine the current state of pre-commercial biotech CEO pay, how it is tailored to the sector, and what drives differences between companies. We will explore:

Part One:	***Tailoring Pay to the Business***
Part Two:	***Founders vs. Non-Founders***
Part Three:	***East Coast vs. West Coast***
Part Four:	***Drivers of Say-on-Pay Results***

We encourage you to review Part One of our series for extensive observations and commentary relating to the pre-commercial biotech business model and how the typical CEO pay program within the sector is tailored to that model—but not necessarily aligned with Proxy Advisory Firm ("PAF") preferred practices.

In Part Two, we take a deeper dive to examine whether founder-led companies within the sector demonstrate distinct CEO compensation programs. Founder CEOs are common among pre-commercial small cap biotechnology companies, and led one-third of the 18 benchmark companies in our study.

Across multiple sectors, the presence of a founder CEO often provides for:

- Concentrated insider ownership, which in turn:
  - Mitigates some risk of short-termism in strategic planning
  - Insulates companies from some of the influence of PAF's on proxy voting, including Say-on-Pay ("SOP")
- Relatively stable pay programs over time, with longer-term performance horizons embedded in incentive designs

There are ongoing debates relating to whether founder-led organizations ultimately under- or over-perform relative to other companies. To be clear, the focus of our study is on how *compensation programs* for founders do or do not differ from other pre-commercial biotech companies; we have not explored *performance implications* in this series.

CEO Pay Program Design: Key Takeaways

Our research determined that founder-led pre-commercial biotech companies compare to broader sector benchmarks and PAF preferred practices as follows:

Item	Pre-Commercial Biotech	Does Practice Vary Significantly for Founders?	PAF Perspective
Target Cash Opportunities	• Remarkably consistent across companies • Modest relative to company valuation	• No	• Not an area of intense focus
STI / Bonus Design	• Scorecards emphasizing progress against discovery and pipeline development milestones • Cash management and financing activities receive lower weightings • Payouts discretionary	• Slightly less likely to have formulaic plans • May transition to formulaic plans later in business life cycle vs. non-founder led organizations	• Strong preference for formulaic plans • Skeptical of discretionary payouts
LTI Design	• Stock options dominate (90% of mix) • Time-based RSUs rare for NEOs • Very rare to use performance measures • Reference target percentage of common shares outstanding for benchmarking purposes	• No	• Strong preference for at least 50% weighting to performance-based vehicles • Do not consider stock options to be performance-based • Valuation protocols akin to grant date fair value, but often punitive to stock options (e.g., use full term for valuation purposes)
Aggregate Equity Spend	• Trend towards 5% for burn rate • Overhangs north of 20% common, including high levels of dilution associated with unexercised stock options that remain outstanding much longer than full value awards • Common to have evergreen provisions in equity plans to provide for additional shares without shareholder approval	• Modestly lower burn rate, but overall overhang very similar to non-founder led organizations	• Burn rate caps specific to company size & sector • Strongly oppose evergreen provisions • Consider overhang when assessing vote recommendations for equity plan refresh requests
SOP Support	• Average 96% support • ISS recommends "AGAINST" 11% of companies • ISS "AGAINST" recommendation has modest average negative impact of 10 points	• Modestly *lower* overall SOP support • However, ISS "AGAINST" recommendation carries less weight	• Will closely scrutinize companies with relatively modest SOP results in prior year and/or companies who received AGAINST recommendations in prior year

Overarching takeaway: certain characteristics exhibited by founder-led organizations in other sectors (e.g., greater comfort with relatively risky and leveraged equity instruments such as stock options, relatively informal bonus plan design) are prevalent across both founder-led AND non-founder led pre-commercial biotech. While the higher insider ownership levels that tend to accompany founder CEOs provide some insulation from PAF criticisms, actual pay design is remarkably similar for founder-led vs. non-founder led organizations in this sector.

Developing a Roster of Pre-Commercial Biotech Benchmark Companies

In order to investigate CEO pay practices, we isolated publicly-traded biotech sector companies that:

- Were NYSE or Nasdaq listed;
- Were pre-commercial;
- Had annual meetings that included a SOP vote in the 12 month period ending June 1, 2020; and
- Had no CEO turnover in this period.

Ultimately, we identified 18 companies (listed in the Appendix) with median key statistics including:

	All Statistics as of Fiscal-Year End for Year CEO Compensation Reported				
Summary Median Statistics	**Market Cap (millions)**	**Employees**	**Revenue (millions)**	**Operating Expense (millions)**	**Cash & Short-Term Investments (millions)**
Founder-Led (n=6)	*$295*	*199*	*$28*	*$97*	*$135*
Others (n=12)	*$542*	*113*	*$9*	*$85*	*$194*
Total Sample (n=18)	**$397**	**118**	**$10**	**$88**	**$162**

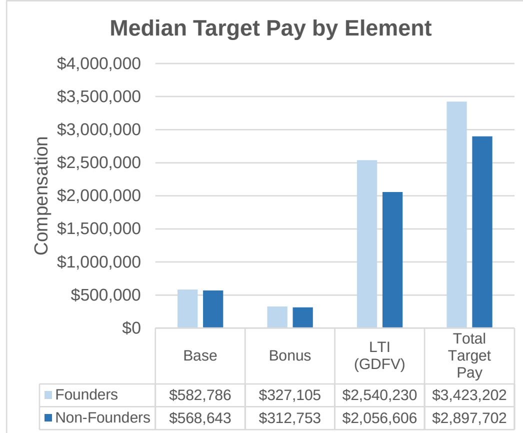
In the remainder of this report, we provide further detail relating to general pay practices, bonus/short-term incentive and long-term incentive design for CEOs, aggregate equity usage statistics and SOP support for the benchmark companies.

CEO General Pay Practices

Total Target Pay Opportunity

Key Takeaways

- Very similar salary and target total cash
- Founders had higher LTI Grant Date Fair Value ("GDFV"), despite lower median market capitalization
- Findings are contrary to the popular belief that founders are paid at a discount (due to potential wealth accumulation from a high ownership position)
- In fact, at median the founders commanded similar—if not higher—rates of annual pay in this sector



Our Consulting Experience

- While sector pay practices for founders vs. non-founders do converge at median, founders are still more likely to exhibit outlier pay practices (in part due to the additional flexibility offered by large ownership positions)
- Consequently, care should be taken in peer group selection to determine if the presence of founder-led organizations introduces anomalous pay patterns in the market frame of reference

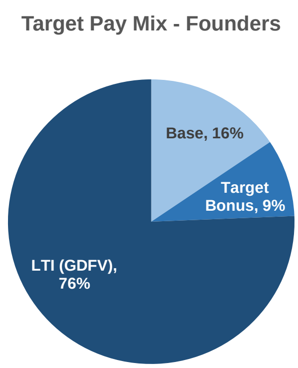
Pay Mix

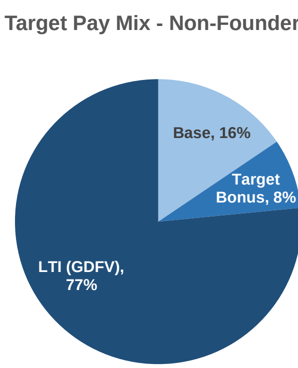
Key Takeaways

- Similar mix for founders vs. non-founders
- Strong emphasis on LTI

Our Consulting Experience

- Where founder pay does veer from more prevalent market practice, it most often places a heavier emphasis on LTI

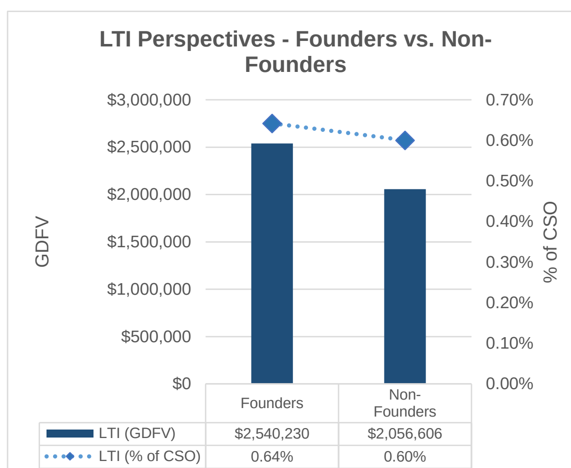




Setting LTI Amounts

Key Takeaways

- At median, founders and non-founders had very similar LTI grants from a % of Common Shares Outstanding ("CSO") approach
- However, non-founders exhibited a wider 25th to 75th percentile spread (0.37% - 0.94%, vs only 0.54% - 0.80% for founders)



Our Consulting Experience

- Most companies of this sector and stage will reference a % of CSO benchmark rather than targeting a grant date fair value amount when setting pay for executives
- The % of CSO approach is generally a more stable benchmark and accommodates the significant stock price volatility in the sector

CEO Short-Term Incentive / Bonus Design

Plan Type & Performance Measures	**Key Takeaways** • Running counter to established practices in the vast majority of sectors, common to have non-formulaic programs • Founders were slightly less likely to have formulaic plans, where payout is predicated upon achievement against pre-established performance goals (33% of founders, 42% of non-founders) • In both cases, the majority of companies have discretionary programs, where ultimate payout is informed by a consideration of progress relative to a "scorecard" of different performance categories and possibly milestones—but there is no range of goals within those categories that formulaically determine payout • Among companies disclosing goals, no clear distinction in categories of performance measured (it is universal practice in both groups to consider drug discovery milestones, and a majority practice to consider clinical trial progress) **Our Consulting Experience** • Founder-led organizations tend to transition to formulaic-driven plans later in their business lifecycle, feeling less need to conform with market prevalent practice so long as the discretionary approach remains effective for holding management accountable for execution against key strategic priorities

CEO Long-Term Incentive Design

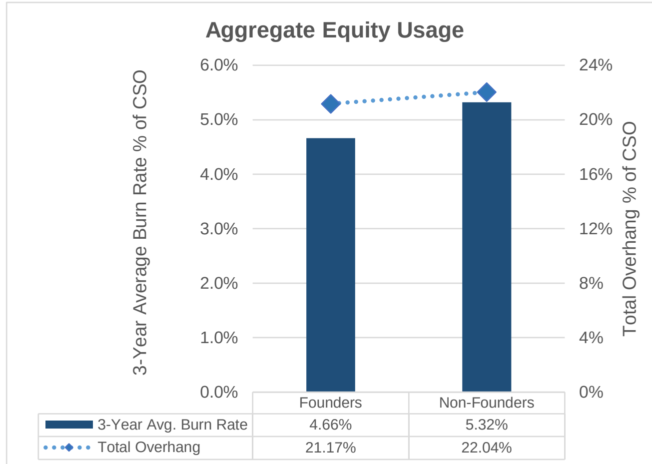
Grant Types & Vesting	**Key Takeaways** • Stock options are by far the most popular vehicle, and are the SOLE equity vehicle used for 83% of founder CEOs and 75% of non-founder CEOs • Extremely rare in this sector and at this stage to use performance shares or performance vesting criteria (only one out of the sixteen companies examined used performance shares…a non-founder led organization) • Typically a 25% cliff vest after one year of service, followed by monthly pro-rata vesting (for both founders and non-founders) **Our Consulting Experience** • Founder CEOs tend to have greater comfort with relatively risky and highly leveraged equity instruments (i.e., stock options) • While it is not surprising that founder CEOs in the study would therefore have LTI programs so heavily weighted towards options, it is interesting that compensation committees in the sector have also endorsed stock options at nearly the same rate for non-founder led organizations

Aggregate Equity Usage

Burn Rate and Total Overhang

Key Takeaways

- Founder-led organizations had modestly lower Burn Rates (shares granted as a percentage of common shares outstanding)
- Total Overhang (shares granted & outstanding plus shares reserved for future grant) was remarkably consistent at median for founder-led and non-founder led organizations



Our Consulting Experience

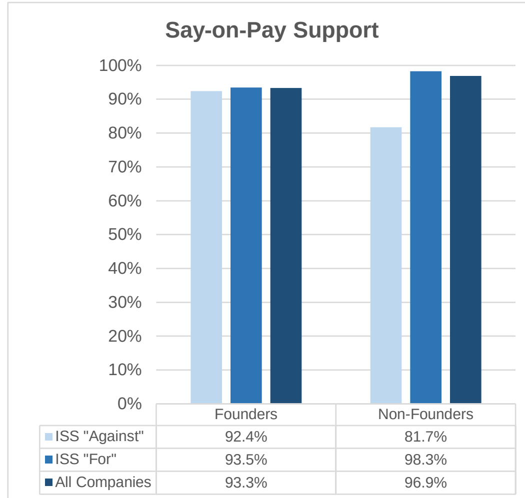
- While the presence of a founder-CEO may provide some insulation from institutional shareholder pressure for a more modest equity spend, other factors have greater influence on aggregate equity usage
- For example, companies may experience a one- or two-year spike in burn rate as they evolve towards commercialization due to increased new hire activity (building a sales force)
- Strong sustained shareholder returns over a multi-year period tend to drive lower equity usage (since prior equity awards are now significantly in-the-money and providing powerful holding power)

Say on Pay Support

Overall Support Levels

Key Takeaways

- ISS recommended ”Against” one company in each group, and for similar reasons: a perceived disconnect between CEO pay and performance, accompanied by a lack of “risk mitigators” (clawbacks, stock ownership guidelines, holding period requirements)
- Of the two companies receiving an ISS “Against” recommendation, the founder-led organization had higher overall insider ownership—and fared better on Say-on-Pay



Our Consulting Experience

- The overall prevalence of compensation-related “risk mitigators” in this sector is lower than is the case across the broader Russell 3000
- Interestingly, many founder-led organizations have been hesitant to implement stock ownership guidelines even though such requirements (e.g., hold shares with value of at least 3 times salary) would be easily met for most founder CEOs given their ownership position

Appendix: Companies Included in Study

ADMA Biologics, Inc.	Denali Therapeutics Inc.
Adverum Biotechnologies, Inc.	Dicerna Pharmaceuticals, Inc.
Albireo Pharma, Inc.	Editas Medicine, Inc.
AnaptysBio, Inc.	Fate Therapeutics, Inc.
Ardelyx, Inc.	GlycoMimetics, Inc.
Cellular Biomedicine Group, Inc.	Mirati Therapeutics, Inc.
CEL-SCI Corporation	Pfenex Inc.
Concert Pharmaceuticals, Inc.	Pieris Pharmaceuticals, Inc.
Corbus Pharmaceuticals Holdings, Inc.	REGENXBIO Inc.