# Impact of Stock Price Performance on Run Rate

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At some point in every company's life cycle, there will be a period of stock price depression, driven by economic forces or market sentiment. Since the majority of companies now grant their long-term incentive awards based on targeted values, employees typically receive an increased number of shares in these downswings to deliver similar economic value to what they previously received. This can generate unusually high run rates and dilute shareholders. "Run rate" is defined as the number shares granted from the incentive pool during the year divided by the average common shares outstanding used for basic EPS. Last year, the ten top shareholder return performers in the S&P 500 increased their run rate year over year ~5% on average. The bottom ten increased ~40% on average.

## Calibrating Run Rate Relative to Competitors

There are three generally accepted approaches to comparing run rate on a relative basis:

- Gross target number of shares granted
- Gross number of shares earned
- Net number of shares granted (total grants excluding any forfeitures or cancellations)

For an apples-to-apples assessment, Meridian recommends measuring run rate based on the target number of shares granted. U.S.-listed companies disclose grant information in their annual reports but do not necessarily provide for the earned amounts of performance-vested awards. This creates a disconnect in comparison and conflates company performance with company stewardship.

## How to Maintain Reasonable Dilution in a Bear Market

There are several potential paths to rein in run rate while the stock price is depressed. Meridian can assist in determining which approaches are best suited for the current situation.

- **Apply a long-term stock price average to derive the number of shares:** Use a 6- or 12-month stock price average that may smooth out temporary dips.
- **Below the executive level, grant a portion of the intended equity value in restricted cash:** Maintains employee satisfaction and retention without diluting shareholders (at the expense of reducing alignment with shareholders).
- **Reduce equity eligibility:** Reserve equity for positions that are difficult/impossible to recruit and retain without equity awards.
- **Reduce vesting period in connection with a lower grant date value:** Annualized value delivered will feel similar to the employee despite a smaller number of total shares granted.
- **RSUs in lieu of stock options:** RSUs provide greater retention, cannot be underwater and use fewer shares for a given targeted dollar amount.
- **Reduce dollar value of equity awarded:** When a company's share price decrease is precipitous (e.g., energy companies in 2020), companies may decrease the dollar value of equity awarded to manage both the run rate and upside leverage on share price rebound.



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