Senior Executive Incentive Design Practices Study

Retail, Consumer Durables, and Restaurants

2019/2020

Meridian
Compensation Partners, LLC

Independent Advice. Effective Solutions.

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About Meridian

Meridian Compensation Partners, LLC is an independent executive compensation consulting firm which provides trusted counsel to Boards and Management at hundreds of major companies. We consult on executive and Board compensation and governance practices. Our consultants throughout the U.S. and Canada have decades of experience in pay solutions that are responsive to shareholders, reflect good governance principles and align pay with performance. Our partners average 25 years of executive compensation experience and collectively service over 600 clients. Over 90% of our engagements are directly at the Board level.

Our Retail Industry Team

Meridian is dedicated to serving the retail industry. We have team members across our offices who "live and breathe" the issues facing the retail industry, and we have built our reputation through long-term relationships and proactive, high-quality advice. We understand the unique diversity of retail organizations, transformation into digital and ecommerce channels, and how to align each client's unique strategy, culture and philosophies into customized pay programs that best meet their individual needs. Our work spans retail and related companies of all sizes, including consumer durables and restaurants.

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If you have any questions on the issues or data presented in this study, please do not hesitate to contact us.

This is Meridian’s first study on senior executive incentive practices in the Retail, Consumer Durables, and Restaurant industries. Our study represents data from Meridian’s review of 2019 proxies for a total of 68 public companies with revenue greater than $1 billion in these industries as of December 1, 2019. Practices used by these organizations provide an indication of the emerging themes and trends likely to cascade down to smaller organizations in these industries. We look forward to continuing to monitor these evolving practices.

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About This Study

As companies review their executive compensation program designs and related corporate governance policies, current market practices and recent trends can provide competitive benchmarks that are helpful in understanding emerging standards, as well as facilitating productive boardroom discussions.

In order to inform these perspectives, Meridian’s first annual Senior Executive Incentive Design Practices Study covering the Retail, Consumer Durables, and Restaurant industries provides insights in the current incentive design structures used by companies today. This study presents market practices on senior executive incentive design separately for these three industry sectors for companies with revenue greater than $1 billion.

Results are reflective of 68 U.S. publicly traded companies with median revenues and market capitalization as of December 1, 2019 of $3.85B and $3.76B, respectively. All information was obtained from publicly disclosed documents. See Profile of Study Companies for more information on the study sample.

The remainder of our study provides a summary of incentive practices reported in 2019. Future studies will cover trends and changes in practices year-over-year.
Findings and Observations

Annual Incentive Practices

Number of Metrics Used

Across the study groups, Retail companies tend to have the fewest annual incentive metrics, while Restaurant companies are more likely to have the greatest number of metrics.

Practices among Retail companies stand out relative to the other two sectors reviewed, with nearly 60% of companies using a single metric in the annual incentive plan. Among Restaurant companies, nearly two-thirds use two to three metrics. Companies in Consumer Durables fall between the practices of the other two sectors with a fairly even distribution of companies using one to three metrics (100%).

The use of performance modifiers is a minority practice among all three groups and least often used by Retail companies.
Performance Metric Categories
The most prevalent performance metric category used by all companies studied in the three groups is Earnings\(^1\). It is common to combine an Earnings metric with a Revenue metric as seen by nearly three-quarters of Restaurant companies (73%) and 30% and 40% of Retail and Consumer Durable companies, respectively. While increasing in prevalence, due in part to the elimination of tax deductions on performance-based pay for executives from the Tax Cut and Jobs Act, non-financial objectives like individual or strategic performance goals remain a minority practice for most companies. However, 60% of Restaurant companies use individual or strategic goals in their annual incentive plans. Cash Flow and Returns measures were only used at a small minority of companies studied.

\(^1\) Most often defined as Operating Income or EBITDA.
**Performance Metric Prevalence**

Operating Income, EBIT, and EBITDA, are the most prevalent earnings definitions used by study companies across all three groups. This is consistent with the most prevalent metrics used by S&P 500 companies from Meridian’s [2019 Corporate Governance & Incentive Design Survey](#). Other earnings metrics such as Net Income and EPS are a minority practice. Similarly, among S&P 500 companies, only 32% use EPS and 10% use Net Income.

With the exception of Restaurant companies, Total Corporate Revenue is the most common revenue metric used by companies studied. For Restaurant companies, nearly half (47%) disclosed using a Same Store Sales metric, while only nine percent of Retail companies use this metric. Despite most of the Consumer Durables companies studied having at least some retail operations, Same Store Sales is not a reported metric at any of these companies.

As described above, the use of individual or strategic company measures is a common practice for Restaurant companies, with only a minority of Retail and Consumer Durables companies using this approach.

Other metrics infrequently used by study companies include Cash Flow, ROIC, Operating Margin, Customer Satisfaction, and Economic Value Added (EVA)/economic profit. Despite the adoption of EVA in Institutional Shareholder Services’ evaluation of companies’ executive compensation programs, we do not observe a trend in companies in any industry to adopt these measures in annual incentive plans.
Long-Term Incentive ("LTI") Practices

Number of LTI Vehicles Used

Similar to trends observed in general industry, companies in Retail, Consumer Durables, and Restaurants use a portfolio of LTI vehicles to meet multiple objectives and provide a balanced approach to rewarding long-term performance.

The most prevalent approach taken by all three groups is to use two distinct LTI vehicles. For purposes of this study, Meridian defines three distinct LTI vehicles as follows:

1. Performance Shares (PS) – performance-based shares, units or cash with explicit performance criteria attached
2. Restricted Shares (RS or RSUs) – time-vested full value shares or units
3. Stock Options (SO) – share appreciation vehicles, including stock options and stock appreciation rights

For Retail companies, the significant majority (81%) use either two or three LTI vehicles, while a minority (19%) use a single-vehicle approach. A similar number of Consumer Durables companies (73%) also use either two or three LTI vehicles, with a minority (27%) using a single-vehicle approach. All Restaurant companies use either two or three vehicles, with practices split fairly evenly between two approaches.

Proxy advisors and shareholders continue to favor performance-based programs to increase pay-for-performance alignment. For all three study groups, Performance Shares were the most prevalent LTI vehicle used. More than three-quarters of Retail companies (79%) and Consumer Durables companies (82%) use Performance Shares, while all Restaurant companies (100%) studied use this vehicle.

Share-based plans remain the majority practice, with only a small minority of companies across all three sectors (6%) using cash-based LTI plans. Cash-based LTI plans are frequently a preferred alternative to
share-based plans, when companies’ stock prices remain depressed over long periods of time and available share pools become depleted.

Retail and Consumer Durables companies use time-vested Restricted Shares/RSUs with similar frequency as Performance Shares (77% and 82%, respectively); however, this practice is less prevalent among Restaurant companies (53%).

The prevalence of Stock Options is generally lower among Retail and Consumer Durables (49% and 18%, respectively); however, more than three-quarters of Restaurant companies continue to use Stock Options. Proxy advisors do not credit stock options as “performance-based” long-term incentives.
Average LTI Mix
Across all three study groups, companies place the greatest emphasis on Performance Shares in senior executive LTI grant values, ranging from 44% in Retail to 50% in Consumer Durables. Not surprising given the relatively high prevalence in the use of Stock Options, Restaurant companies place the highest average weighting on this vehicle (36%) in the senior executive LTI mix.
**LTI Performance Metric Prevalence**

59% of companies studied use at least two performance measures to ensure LTI programs support the company’s financial and strategic goals. As compared to annual incentives, there is a greater variety observed in companies’ use of LTI metrics across all three study groups, with no single metric having greater than 50% prevalence. The most prevalent metric used by Retail companies is ROIC/RONA (32%) while EPS was the most prevalent metric among Consumer Durables and Restaurants (33% and 47%, respectively). Relative Total Shareholder Return (TSR) was used most frequently among Restaurant companies (33%). These outcomes contrast with Meridian’s 2019 Corporate Governance & Incentive Design Survey which identified 67% of S&P 500 companies that use Relative Total Shareholder Return.

**Incentive Plan Leverage**

Consistent with general industry practices, studied companies typically establish a maximum 200% of target cap on both short-term and long-term incentives.
Profile of Study Companies

Meridian reviewed the senior executive incentive design practices of 68 publicly traded companies with revenue greater than $1 billion in the Retail, Consumer Durables, and Restaurant industries through the most recently available publicly filed documents (typically 2019 proxy statements). Financial highlights of the companies are provided below, followed by a full listing of the companies used in the study. All figures shown are as of 12/1/2019.

<table>
<thead>
<tr>
<th></th>
<th>Revenues ($M)</th>
<th>Market Value ($M)</th>
<th>Employees</th>
<th>Stores/Locations</th>
<th>EBITDA ($M)</th>
<th>Annualized TSR (3-Year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Median</td>
<td>$6,436</td>
<td>$3,840</td>
<td>27,950</td>
<td>1,261</td>
<td>$659</td>
<td>-0.9%</td>
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<tr>
<td>Consumer Durables Median</td>
<td>$2,270</td>
<td>$4,019</td>
<td>5,925</td>
<td>271</td>
<td>$243</td>
<td>9.6%</td>
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<tr>
<td>Restaurants Median</td>
<td>$3,087</td>
<td>$3,084</td>
<td>38,700</td>
<td>1,785</td>
<td>$387</td>
<td>6.3%</td>
</tr>
</tbody>
</table>

**Retail**

- Abercrombie & Fitch Co.
- Advance Auto Parts, Inc.
- American Eagle Outfitters, Inc.
- Ascena Retail Group, Inc.
- At Home Group, Inc.
- AutoZone, Inc.
- Bed Bath & Beyond Inc.
- Big 5 Sporting Goods Corporation
- Big Lots, Inc.
- Burlington Stores, Inc.
- Caleres, Inc.
- The Children’s Place, Inc.
- Chico’s FAS, Inc.
- Designer Brands, Inc.
- DICK’S Sporting Goods, Inc.
- Dillard’s, Inc.
- Dollar General Corporation
- Dollar Tree, Inc.
- Express, Inc.
- Five Below, Inc.
- Foot Locker, Inc.
- The Gap, Inc.
- Genesco Inc.
- Hibbett Sports, Inc.
- J.C. Penney Company, Inc.
- Kohl’s Corporation
- L Brands, Inc.
- Macy’s, Inc.
- MarineMax, Inc.
- The Michaels Companies, Inc.
- Nordstrom, Inc.
- Office Depot, Inc.
- Ollie’s Bargain Outlet Holdings, Inc.
- O’Reilly Automotive, Inc.
- RH
- Ross Stores, Inc.
- The TJX Companies, Inc.
- Tractor Supply Company
- Ulta Beauty
- Urban Outfitters, Inc.
- Wayfair, Inc.
- Williams-Sonoma, Inc.
- Zumiez Inc.

**Consumer Durables**

- Columbia Sportswear Company
- Crocs, Inc.
- Deckers Outdoor Corporation
- Fossil Group, Inc.
- G-III Apparel Group, Ltd.
- Lululemon Athletica Inc.
- Oxford Industries, Inc.
- Skechers U.S.A., Inc.
- Steven Madden, Ltd.
- Wolverine World Wide, Inc.

**Restaurants**

- BJ’s Restaurants, Inc.
- Bloomin’ Brands, Inc.
- Brinker International, Inc.
- The Cheesecake Factory Incorporated
- Chipotle Mexican Grill, Inc.
- Cracker Barrel Old Country Store, Inc.
- Darden Restaurants, Inc.
- Dave & Buster’s Entertainment, Inc.
- Domino’s Pizza, Inc.
- Dunkin’ Brands Group, Inc.
- McDonald’s Corporation
- Papa John’s International, Inc.
- Texas Roadhouse, Inc.
- The Wendy’s Company
- YUM! Brands, Inc.