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Equity Compensation Strategy



LEAP HR
Life Sciences
Radical Change Through People

Michael Reznick

Managing Director in FW Cook's Los Angeles Office

- Shareholder with 30 years of executive compensation consulting experience; with FW Cook since 2000
- Specific experience in designing total compensation strategies for Life Sciences companies, including short- and long-term incentive plans, as well guidelines for initial public offerings and M&A activities for both public and private companies
- Experience in most other industries including Technology, Healthcare, REITs, Financial Services, Professional Services, Hospitality, Airlines, and Natural Resources
- Life Sciences clients include:

Representative Life Sciences Clients

Acadia Pharmaceuticals	Immix Therapeutics	PTC Therapeutics
Alimera Pharmaceuticals	Instil Biopharma	Reata Pharmaceuticals
Arena Pharmaceuticals	Lifecore	ResMed
Arcturus Therapeutics	Longboard Pharmaceuticals	Sutro
Creyon Therapeutics	MEI Pharmaceuticals	Theravance Biopharma
Delcath Systems	Obsidian Therapeutics	Vericel (formerly Aastrom)
Glaukos	Praxis Precision Medicines	Ziopharm (now Alaunos)

- Other work outside of life sciences includes: ChargePoint, Intuit, LendingTree, Microvision, Nature's Sunshine Products, Noom, Phreesia, Sabra Healthcare REIT, SkyWest Airlines, Zeta Global
- Michael holds a Bachelors degree in Economics and in Classics from Brown University; he is also a commercial/instrument rated pilot and surfer



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Equity Strategy Overview

Build wealth and retention through volatility and growth...

- The Problem with Black-Scholes for Setting Option Awards
- Dilution-Based Approach to Equity Compensation:
 - Top Down: Total Equity Spend Using Equity Dilution Rate (“Burn”)
 - Bottom Up: Individual Awards as % Co.
- Options vs RSUs
 - Performance Risk, Retention, Upside Leverage, Tax Complexity
- Never Stop Granting: It All Works Together to Build Retention and Wealth Over Typical 10-Year Commercialization Cycle
 - Vesting Overlap, Financing, and Volatility

The Problem with Black-Scholes

“I want 50,000 options at \$20.00 as much as 200,000 options at \$5.00” – Nobody ever

Most pay guidelines, disclosure, and survey data are a dollar amount (e.g., \$500,000), so **Black-Scholes tells you to grant more shares as the price falls and to grant fewer shares as the price increases**

Generally Accepted: It is used for proxy reporting of officer compensation, and it is the way that most compensation surveys report their option grant data

Subject to Volatility: Black-Scholes converts an option grant into a dollar value, like cash, based on the model’s prediction for in-the-money gain; the most powerful of the five inputs is stock price

Not Used as Intended: It was made for option traders trading short-lived options (e.g., 12 months), rather than for compensation options with long lives (e.g., 10 years)

Using Black-Scholes often provides a backwards result (more shares at lower price):

Price	Options	B-S %	B-S Value
\$5.00	200,000	50%	\$500,000
\$10.00	100,000	50%	\$500,000
\$20.00	50,000	50%	\$500,000

- Employees and Boards instinctively understand the problem

Better Approach to Equity is “% Co.”

A **fixed option guideline** that consistently shares a market-driven % of the **Company** works better than Black Scholes values for option granters and innovators

- Market data as % of the Company can be created from disclosures and surveys

Grant value is an output that **changes with price** at grant, but number of options and amount of Co. shared is steady

% Co. x	Shares Outstanding	= Options	x Price	x B-S %	= B-S Value
0.20% x	50,000,000	= 100,000	\$5.00	50%	\$250,000
0.20% x	50,000,000	= 100,000	\$10.00	50%	\$500,000
0.20% x	50,000,000	= 100,000	\$20.00	50%	\$1,000,000

Each grant provides the same stake in the outcome/upside

Does not vary award size if price up or down

Grant value varies w/ grant price, but it is theoretical if in options

Equity Budget: Top-Down & Bottom-Up

Measure market data as a rate of ownership sharing (e.g., median is 0.1% of the company), rather than as dollars (e.g., not \$250,000 of Black Scholes value), both individually and in total...

Bottom-up Budgeting: Measure individual grants as a % of the Company and then add up the awards to all employees to test the overall equity burn rate (next page)

Top-down Budgeting: Allocate a pool that targets the desired burn rate and provide a **steady grant amount** that does not change with stock price volatility (page 7)

Other benefits of determining number of equity awards using rates of ownership sharing:

1. Relevant and logical. Ownership sharing and option-equivalent burn rates are the language of finance, the compensation committee, ISS, and many growth investors
2. It scales. Burn rate data generally remain consistent in small- and large-cap drug development, but the larger companies spread the **same total equity budget over more people** as they scale, so each person is provided a smaller individual grant
3. Discloses well. **Disclosed compensation and TSR performance align** when disclosed in the proxy because reported Black-Scholes value is higher when stock price is high and falls if the price is low

Makes discussion of proxy disclosure and optics a separate topic from “market”

Bottom Up: Market Grant Guidelines

Align individual employee award levels with the market pay philosophy...

Example shows that median annual refresh awards can be built for everyone using a % of the Co. framework.

Grade	Description
9	VP
8	Sr. Director
7	Director
6	Assoc. Director
5	Sr. Mgr./Sr. Scientist
4	Supervisors/Intermediate Prof.
3	Sr. Indv. Contributor/ Entry Prof
2	Individual Contributor
1	Entry Level

Median Annual Refresh		
Annual Options (~50P)		
Low	Target	High
0.064%	0.127%	0.191%
0.032%	0.064%	0.096%
0.019%	0.038%	0.056%
0.014%	0.029%	0.043%
0.009%	0.019%	0.028%
0.007%	0.014%	0.022%
0.005%	0.010%	0.015%
0.003%	0.006%	0.009%
0.002%	0.004%	0.006%

Median Annual Refresh		
Annual Options (~50P)		
Low	Target	High
23,000	45,000	69,000
11,500	23,000	34,400
6,800	14,000	20,300
5,200	10,000	15,600
3,400	6,700	10,200
2,600	5,200	7,800
1,800	3,600	5,500
1,000	2,100	3,100
700	1,500	2,200

Top Down: Equity Burn Rate and Stock Plan Budget

Check the individual grant guidelines to ensure overall use of equity and resulting equity “burn rate” as a % of the Co. are reasonable.

- **Does it make sense?:** Hypothetical company is growing rapidly, expects to add 100 non-executive employees, and this is budgeting a 70P burn rate of 7.9% of shares outstanding.

Award Type	2024 Equity Budget	
	50P Guidelines	
	# Options	% Total
C-Suite Executives		
Annual Grants at 50P	840,000	27%
Employees (VPs & Below)		
Annual Grants (n = 100)	750,000	24%
New Hire Grants (n = 100)	1,400,000	44%
Sub-total Employees	2,150,000	68%
Non-Employee Directors³	160,000	5%
Total	3,150,000	
Common Shares Outstanding	40,000,000 ÷	
Option-Equiv. Burn Rate⁴	7.88%	
Percent Rank v. Peers		70P

Another Key Question:

Does the stock plan have enough shares?

Options or RSUs?

Performance risk, retention, upside leverage, tax complexity...

- Options reward value creation more than RSUs but only have unvested retention value if the price increases after grant
 - Options are dilutive only when in-the-money, while RSUs instantly dilute
- RSUs reward employment retention but have lower upside leverage
 - RSUs use fewer shares, which may stretch a limited stock plan authorization, and are more valuable to employees until the stock price [doubles]; RSUs have only [50%] of the upside leverage once options pass them
- Options are not taxed until exercised, while RSUs are taxed at vesting
 - How is RSU tax paid? (Co. Withholding? Market Sales? Personal Funds?)

100,000 Option-Equivalents When Trading at \$10

	Price	Options 100,000	RSUs 50,000
		In-the-Money Value	
	\$5.00	\$0	\$250,000
GRANT	\$10.00	\$0	\$500,000
	\$15.00	\$500,000	\$750,000
Cross Over	\$20.00	\$1,000,000	\$1,000,000
	\$30.00	\$2,000,000	\$1,500,000
	\$40.00	\$3,000,000	\$2,000,000

RSUs > Options

Options = RSUs

Options > RSUs

Summary of Market Practice:

Pre-commercial < \$1B = ~20% RSUs or less

Pre-commercial ≥ \$1B = ~40% RSUs

Commercial = ~50% RSUs

Putting it All Together

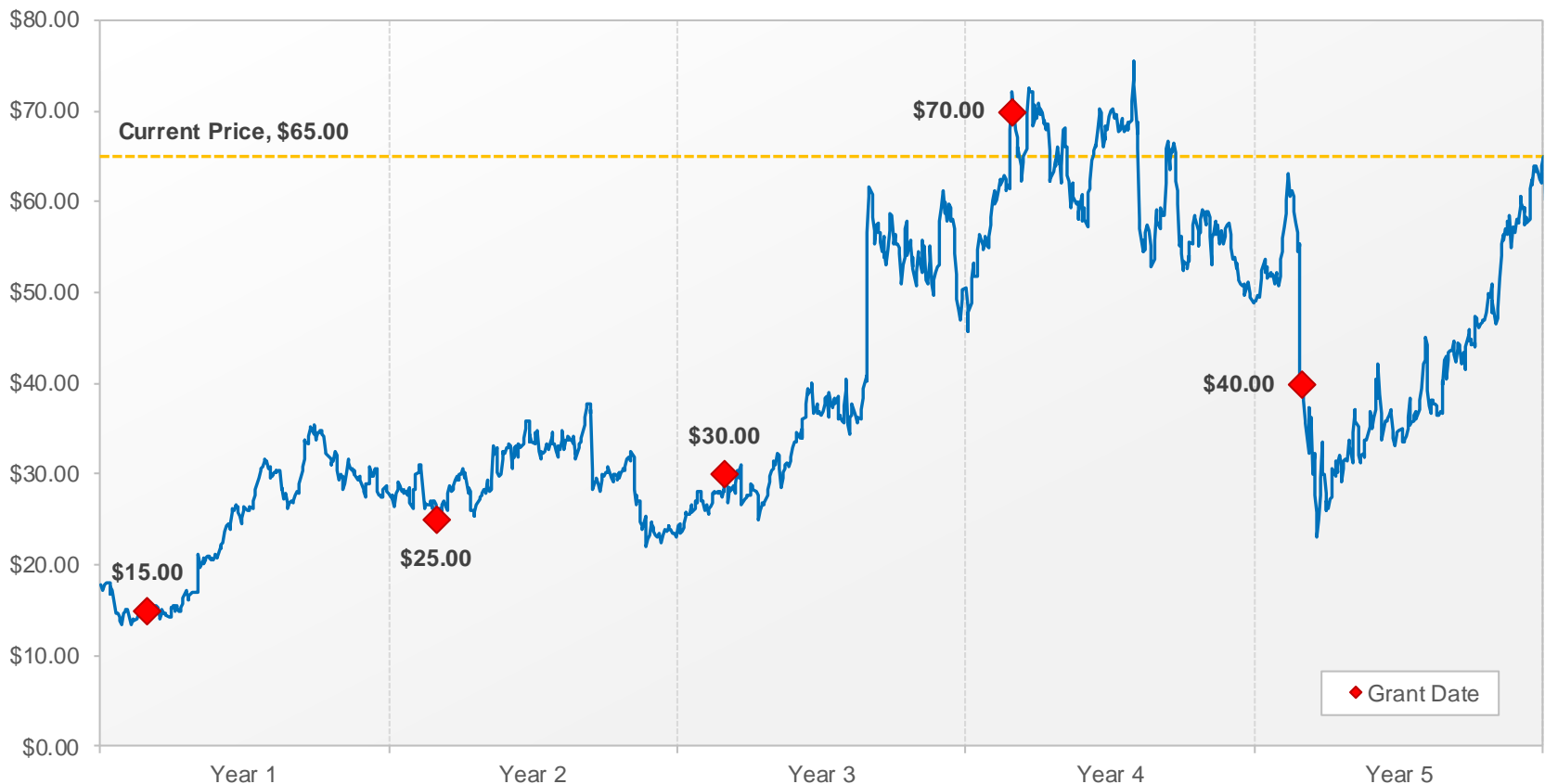
Never stop granting!

Anonymous 6-Year Case Study

- Neutralize Volatility, Adapt to Financing, and Build Wealth with Retention over time.

Grant Every Year

- Stock prices go up and down, but the Co. never stops granting
- **Always back in the game:** New annual grants over six years **builds a portfolio** of stock options between \$15 and \$70...



Dilution-Based Grants in Action: SVP

- The Co. is growing and raising outside money, which means the number of shares grows, despite awards shrinking as a % of the Co.

Year	Total Common Shares	Market Cap (\$Mils)	Annual Equity Grant			Cumulative Options Granted	
			% of Company	Shares Granted	Exercise Price	Shares	% Co.
Year 1	14,207,018	\$213	0.20%	28,000	\$15.00	28,000	0.20%
Year 2	21,878,808	\$547	0.20%	44,000	\$25.00	72,000	0.33%
Year 3	28,223,662	\$847	0.20%	56,000	\$30.00	128,000	0.45%
Year 4	40,077,600	\$2,805	0.18%	72,000	\$70.00	200,000	0.50%
Year 5	44,486,136	\$1,779	0.18%	80,000	\$40.00	280,000	0.63%

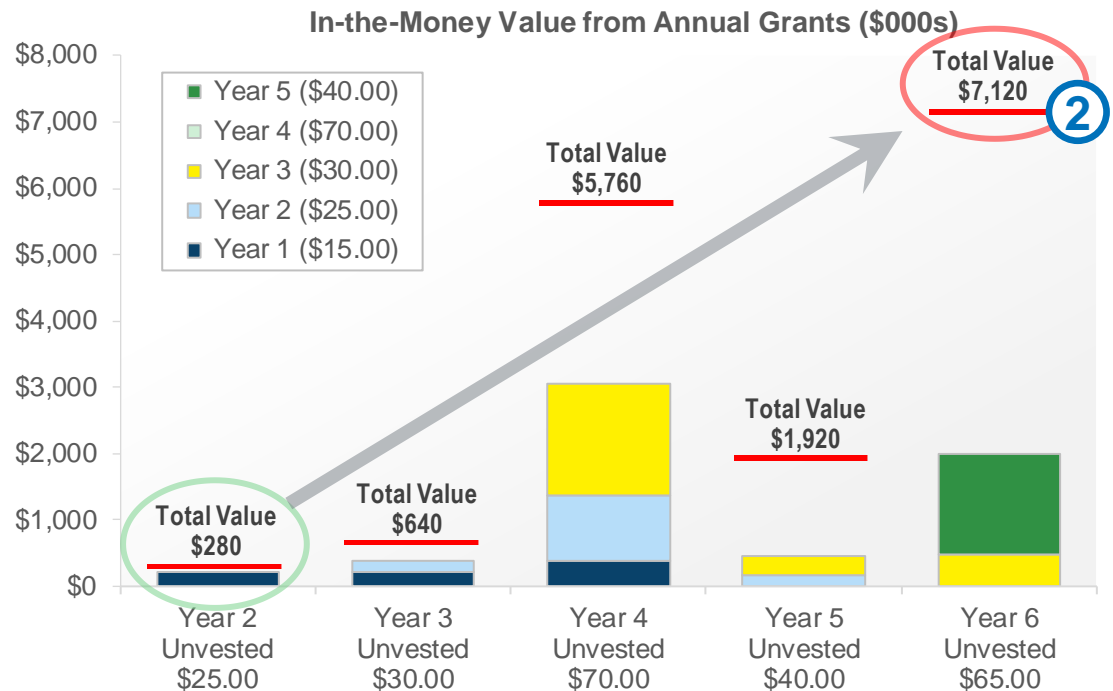
↑ Capital raises increase CSO from 14M to 44.5M over 6 years	↑ Co. valuation grows	↑ New awards get smaller as % of the Co., as market cap grows and Co. becomes commercial	↑ Shares granted increases, even though smaller % Co. Does not vary with stock price	↑ Equity stake builds over time with new awards, despite dilution from new financing Unvested keeps building
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SVP Vesting Overlap

Assume four-year installment vesting for grants that are released over six years...

- ① New options vest every year and yet the number of unvested options grows.
- ② Unvested gets to \$2M in six years and equity wealth grows ~25x from \$280K to \$7.12M
 - Stock price grows 4.3x from \$15 to \$65 (with volatile setbacks some years).

Grant Year	Options Granted	Exercise Price	Shares Vesting by Year				
			Year 2	Year 3	Year 4	Year 5	Year 6
Year 1	28,000	\$15.00	7,000	7,000	7,000	7,000	
Year 2	44,000	\$25.00		11,000	11,000	11,000	11,000
Year 3	56,000	\$30.00			14,000	14,000	14,000
Year 4	72,000	\$70.00				18,000	18,000
Year 5	80,000	\$40.00					20,000
Shares Vesting			7,000	18,000	32,000	50,000	63,000
Total Unvested			21,000	47,000	71,000	93,000	110,000





Thank You

FW Cook & Co.

History



- FW Cook was founded in 1973 to be the premier provider of independent executive and non-employee director compensation consulting services
- This has been our mission for almost 50 years and has never been compromised by cross-selling other lines of business or services
- Our objective is to add value to our clients' compensation programs and processes through an independent viewpoint and distinctive capabilities
- The firm is 100% owned by its principals and therefore is not influenced by outside ownership; results in a business strategy focused on our highest priority – our clients

People and Locations



- We have a team of approximately 100 consultants that offer unparalleled expertise in the technical aspects of executive compensation including legal, tax, accounting, and governance
- Offices in New York, Los Angeles, Atlanta, Chicago, San Francisco, Houston, and Boston
- We have multiple locations but operate under a “one firm” philosophy in which our clients have access to the best resources regardless of geography
- We also maintain formal affiliations with partner firms in the UK and Hong Kong to access technical expertise and pay data on a global basis

Market Leadership



- We have worked diligently to establish and maintain our reputation as highly ethical and technically strong thought leaders on executive pay matters
- FW Cook enjoys a leading position as the board compensation committee advisor across a range of major U.S. indices
- We have also developed a market-leading position as retained advisors to nonprofit organizations