

A low-angle, upward-looking photograph of several modern skyscrapers with glass facades. The buildings are illuminated from within, creating a warm, golden glow that contrasts with the clear blue sky. The perspective makes the buildings appear to converge towards the top of the frame, creating a sense of height and architectural grandeur.

Deloitte.

Directors' pay and disclosure in the AIM 100

January 2016

Overview from Juliet Halfhead



AIM companies are subject to a more light-touch governance regime than those listed on the Main Market. This provides AIM companies with greater flexibility when setting their remuneration arrangements for senior executives and is reflected in the wide variety of pay policies within AIM.

Nevertheless setting an appropriate and competitive remuneration package for the senior individuals responsible for delivering the business strategy remains a vital component in the financial and strategic success of an AIM company.

Moreover certain institutional investors are expressing an expectation that governance around directors' remuneration in AIM companies should be in line with guidelines applicable for FTSE All-Share companies. This has led to an increasing number of AIM companies seeking a shareholder vote on the remuneration report. Institutional Shareholder Services recently released updates to its Proxy Voting Guidelines for smaller companies including those listed on AIM. The updated guidelines have been expanded in places in order to align with the guidelines that are applied to larger companies including the need for share awards granted to executive directors to have a performance period of at least three years and disclosure of pay practices to be more in line with larger companies.

Although directors' pay arrangements within the AIM 100 are more bespoke, certain companies do follow 'best practice' principles, as they apply to fully listed companies. This document draws out some insights on remuneration policy within AIM 100 companies.

Juliet Halfhead

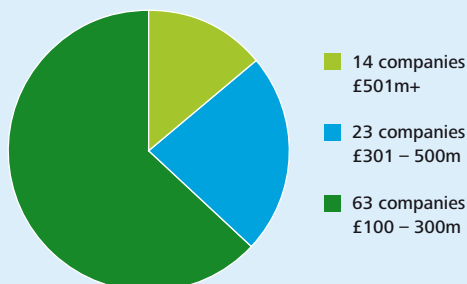
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Introduction

Scope of document

Figure 1. Distribution of AIM 100 companies by market capitalisation



The FTSE AIM 100 index, made up of the top 100 companies on the London Stock Exchange's Alternative Investment Market, is a broad collection of companies with market caps ranging from around £100m up to £3,000m (as of July 2015). The chart across shows the distribution of AIM 100 companies by financial size. Most AIM 100 companies are relatively small (compared to Main Market listed companies) with market caps of less than £300m. There are 14 AIM companies with a market cap in excess of £500m, which on the Main Market would lead to the company being eligible to be in the FTSE 250.

Key issues facing AIM 100 companies in 2016

Based on our experience, here are some of the key issues facing AIM 100 companies in 2016:



Volatility – The AIM 100 is more volatile than the FTSE 100 with constituents changing regularly. Market caps can be subject to rapid change and this presents many challenges for Remuneration Committees: how do you benchmark salary and variable pay? Who do you benchmark pay against? Following periods of high growth how do companies seek to replicate the significant levels of award which employee shareholders will have earned? As share price falls, what is the impact on in-flight share plans whose value is being eroded?



Funding share awards – Share awards can be funded with new issue or market purchase shares. New issue impacts dilution while market purchase has a direct cash cost (which can be more impactful on AIM companies who are often more cash-restricted).



Dilution – Although not subject to the Investment Association guidelines larger AIM companies are expected to take into account the '10% in 10 years' dilution limit for all share plans and, depending upon the shareholder base, may be expected to apply the '5% in 10 years' limit too. These limits can create problems when cash-restricted companies are using shares to reward or seeking to build a sense of ownership through the use of extended share schemes.



Governance and disclosure – AIM companies are not subject to the same regulations and level of scrutiny in remuneration reports as fully listed companies. However some larger AIM companies, or those with certain institutions on their register, are expected to disclose more in line with the Main Market. For instance some institutional investors expect a vote on the remuneration report and sufficient disclosure to demonstrate 'pay for performance'. This is shifting expectations more generally across the AIM 100 on levels of disclosure on pay and whether to put the remuneration report to the vote.

The directors' remuneration policy, particularly with respect to variable pay, plays a critical role in acting as a retention mechanism as well as incentivising high performance. AIM companies may have the advantage of being able to create more bespoke arrangements but in an environment of less liquid stock (if shares are illiquid 'dry charges' can arise when directors are unable to sell shares to cover the tax cost) and sometimes cash constraints on the business this can be challenging.

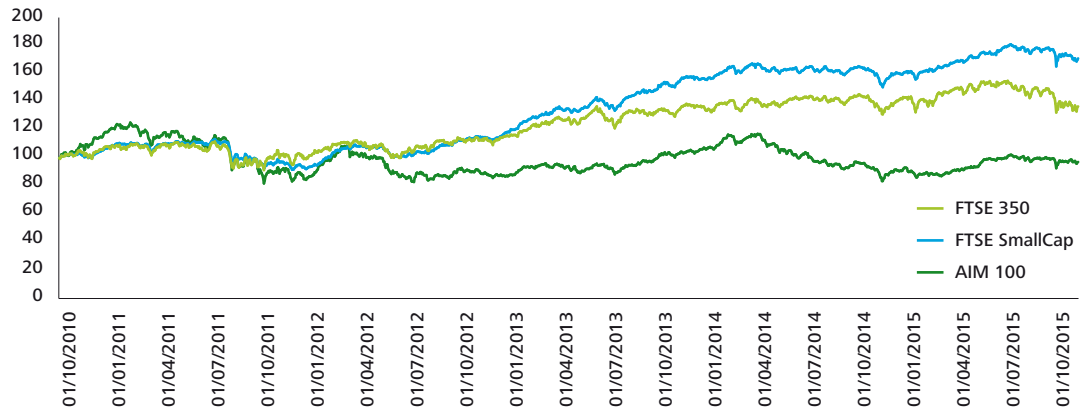
Whilst there is no 'one size fits all' solution to these issues, recognising them and understanding the most effective way forward, can help ensure that companies are using their reward spend wisely. Potential solutions might include, for example, the design of bespoke one-off arrangements linked with the creation and sharing of shareholder value, the use of an employee benefit trust to manage liquidity, 'net settling' share options to help with dilution, or a review of the profile of underwater options so as to better manage any headroom restrictions.

Recent performance of the AIM 100

The graph overleaf shows the performance of the AIM 100 against the FTSE 350 and FTSE SmallCap over the last five years. The AIM 100 mirrored the performance of the Main Market up until mid-2012. Since then the Main Market has outperformed the AIM 100.

The fall in AIM performance reflects the highs and lows of share price movement associated with riskier, more entrepreneurial stock. The gains by certain companies are negated by the losses in others and that is consistent with AIM performance since its inception 20 years ago.

Figure 2. Five-year performance of UK listed companies (indices rebased to 100)

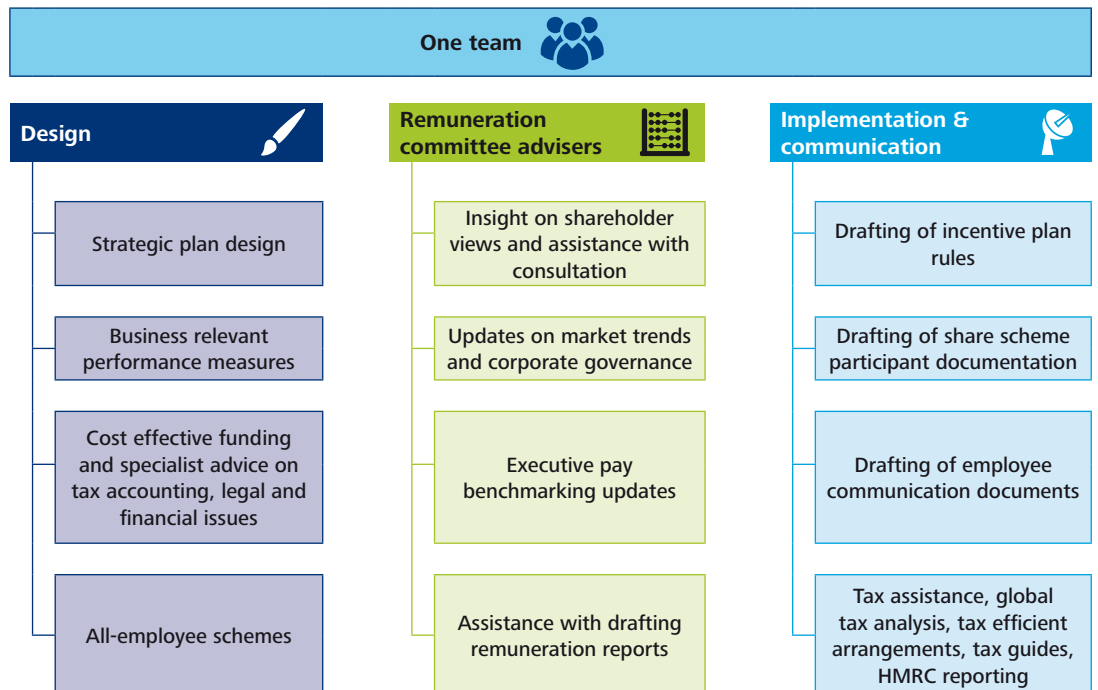


How we can help you

The Deloitte executive compensation consulting practice covers all aspects of senior executive remuneration and share plan services.

Our well-established team comprises over 70 professional staff including remuneration, share plan, tax and accounting specialists, actuaries and lawyers. We provide advice on all areas including implementation, investor relations, accounting, legal and tax issues.

Our practice is built around an integrated model, linking all of these areas, often separated in competitor companies.



The experience and breadth of our practice means that we have particular strengths in the key areas of investor relations and legal implementation of incentive schemes.

We also have access to a wider knowledge base within Deloitte. This allows us to more fully understand industries and provide our clients with strategic solutions for their specific needs.

We are currently Remuneration Committee advisers to a range of different organisations across the FTSE All-Share including around 30% of FTSE 100 companies, 20% of FTSE 250 companies and over 10% of FTSE SmallCap companies. Moreover we are currently Remuneration Committee advisers to a number of AIM companies.

If you would like further information on any of the areas covered in this document please do not hesitate to contact your usual Deloitte contact or any of the names on page 8.

Main findings and insights

Given the variety of pay arrangements in the AIM 100 it is no surprise that trends are more opaque than those in the Main Market. Nonetheless, from publically available data, we have provided some insights on current remuneration practice within the AIM 100.



Governance/disclosure

Figure 3. Is there a separate remuneration report?

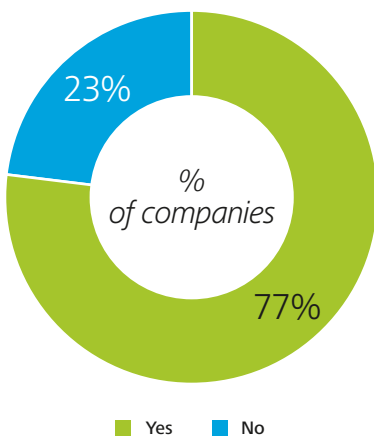


Figure 4. Is the remuneration report put to a shareholder vote?

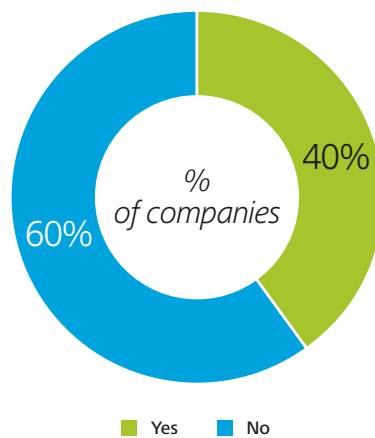
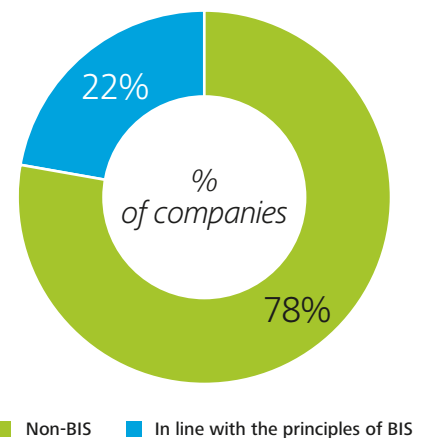


Figure 5. Is the DRR in line with the principles of the reporting regulations introduced by BIS in 2013?



Although 77 AIM 100 companies have a separate directors' remuneration report (DRR) **only 31 of those put the DRR to a shareholder vote (40%)**. When the DRR is put to a shareholder vote it is generally a single advisory vote on the DRR as a whole (compared to two separate votes for Main Market companies, which are subject to the revised remuneration reporting regulations introduced in 2013).

There is a range of approaches adopted with respect to directors' pay disclosure in AIM 100 companies' annual report and accounts. Based on our assessment **about a fifth of companies with a DRR (17 companies) have prepared it in line with the principles of the revised remuneration reporting regulations** as they apply to Main Market companies (although the degree to which disclosure complies with the revised regulations varies from company to company).

Of the other 60 companies with a DRR the level of disclosure varies widely but many have provided disclosure above the required minimum (although do not seem to have used the revised regulations as a basis for the DRR – e.g. no policy table, single figure table etc.)

There is limited correlation between the size of AIM companies and the DRR being put to a shareholder vote. However it tends to be the larger AIM companies that prepare their DRR in line with the principles of the revised regulations – i.e. six of the 17 companies that prepare their DRR in line with the principles of the revised regulations are among the 20 largest AIM 100 companies.

Base salary

Trends in year-on-year salary increases are difficult to determine due to the lack of clarity within AIM company disclosure and can also be misleading due to various legacy arrangements, which are often in play in AIM companies. For example the impact of founder shareholders who are managing the business can often result in a lower salary as compared to companies of a similar size on the Main Market or the use of share options as a non-cash drain on the business to balance out lower salaries.

Bonus

Almost half of AIM 100 companies do not disclose a maximum opportunity but, of those that do, **by far the most common is 100% of salary** (which is the same as median bonus opportunity in the FTSE SmallCap). Performance metrics if disclosed are most commonly profit-based with a range up and down the P&L from EBITDA to EPS. In those companies when bonus is set by reference to a % of salary there is no clear correlation between the size of an AIM company and bonus opportunity.

Bonus deferral

Over 20 companies operate some form of bonus deferral – most are mandatory but about a quarter are voluntary arrangements with a matching share element. This compares with around 40% of FTSE SmallCap companies in which part of the bonus is paid in deferred shares. Only 6% of all FTSE SmallCap companies have deferred bonus matching arrangements.

Bonus target disclosure

Bonus target disclosure is less transparent than Main Market companies – this has become a significant shareholder issue in the Main Market with limited transparency on the link between pay and performance becoming a voting issue for proxy advisers as well as investors. No AIM 100 companies disclose prospective bonus targets, which is in line with typical Main Market practice but there is also very limited retrospective disclosure on bonus targets. Six companies cite commercial sensitivities and most others say nothing at all on the reason for non-disclosure. Following the latest Investment Association guidelines this is one area where we anticipate a significant improvement in disclosure over the coming 12-24 months.



Long-term incentive

Figure 6. Form of long-term incentives

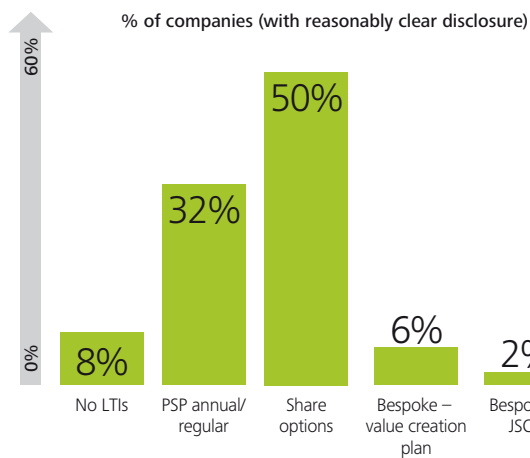
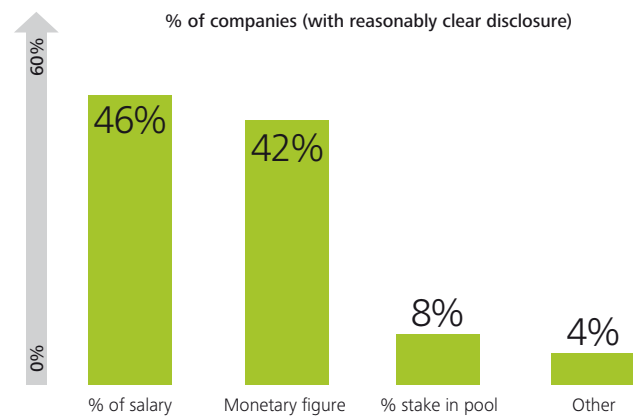


Figure 7. How is the LTIP opportunity expressed?



There continues to be a greater prevalence of **share option plans** in the AIM 100 in which gain is only delivered to individuals for growing the business above its current value. Where we can identify share practice half of those companies use share options as the primary incentive mechanism. Practice varies between those that grant share options on an infrequent ‘as and when’ basis and those with a more regular award pattern. Up to a third of those companies where we can identify share practice use **Performance Share Plan (PSP)**-style awards (this equates to around a quarter of AIM 100 companies). The balance have bespoke arrangements or no form of long-term incentive at all.

Overall, **more AIM 100 companies have an irregular award pattern (most commonly in the form of share options) rather than annual/regular award cycles**. This compares with the FTSE SmallCap where over 80% of companies operate a PSP for their executive directors and with the use of options being much more limited.

26 AIM 100 companies grant awards on an annual or regular basis. In most cases these annual grants take the form of a PSP-style award with performance measures that are not dissimilar from FTSE SmallCap companies (e.g. EPS, Total Shareholder Return) although there is a wider use of share price targets on AIM.

Five AIM 100 companies disclosed operating a **value creation plan** and two companies disclosed operating a **joint share ownership plan (JSOP)** (these plans only deliver value if certain share price/growth hurdles are met). Two AIM 100 companies disclosed operating a **phantom share plan**.

The use of long-term incentives by certain AIM 100 companies also often reflects the personal holdings of the executive directors and particularly when founder directors have significant holdings in the business. In these circumstances certain companies choose not to operate long-term equity incentives for these directors or significantly scale back the size and/or regularity of the award.

Just over half of the AIM 100 provide detailed information within their company accounts about how the quantum of any long-term incentives is set. They are set by reference to a **% of salary in 46% of such companies** and by reference to an **absolute figure** (e.g. 50,000 share options) **in 42% of such companies**. In **8% of companies**, where sufficient information is disclosed, the quantum is determined by reference to a **% stake in a shared reward pool** with other senior executives (for example in a value creation plan).

Shareholding guidelines

More than 10% of AIM 100 companies have guidelines in place in which the executive director is required to hold a certain proportion of salary in shares. In these companies a guideline of **1x salary is most common**, which follows median practice in the FTSE SmallCap. These AIM companies vary in size and are not necessarily the larger AIM companies. Only 3 of the 20 largest AIM companies have disclosed shareholding guidelines.

Malus/clawback

From the analysis **around 20% of AIM 100 companies operate some form of malus** (reduction or cancellation of variable pay prior to vesting/payment) **or clawback** (taking back shares delivered or amounts paid under variable pay awards). These are not necessarily just the largest AIM companies – only a third of the 20 largest AIM companies have malus and/or clawback.

All-employee share plans

The use of tax-advantaged all-employee plans (i.e. SAYE and SIP) is not widespread across the AIM 100. Only around a third disclosed having such plans although not all of those companies necessarily operate them.

Post-vesting holding periods

Holding periods are still relatively rare although five AIM 100 companies disclosed having a requirement to hold shares after they have vested under a long term incentive plan (holding periods range from six months to five years – two companies disclosed having a two-year holding period). This is slightly behind the proportion in the FTSE SmallCap in which around 15% of companies have holding periods.

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