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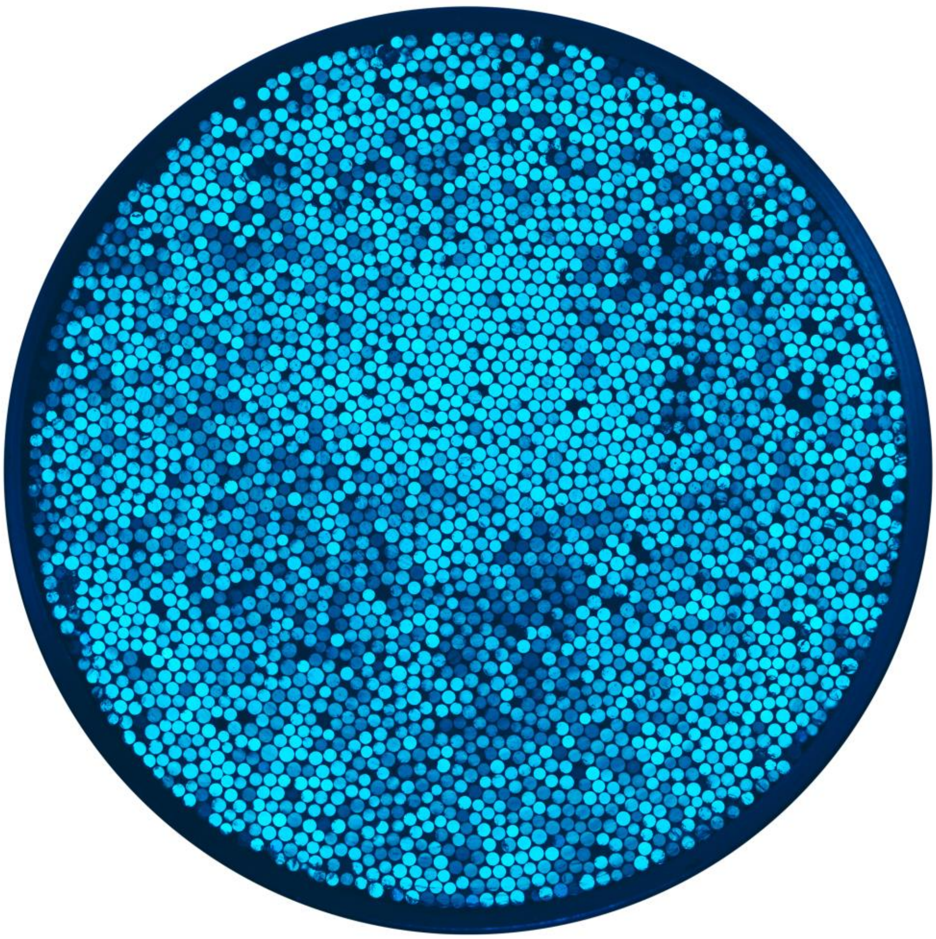


Biotech IPO

Remuneration considerations for biotechs considering an IPO on the Nasdaq

August 2018

The biotech IPO landscape

This paper examines the executive remuneration planning involved for biotechs seeking to list on the Nasdaq. 2017 saw renewed growth in US biotech stocks and an increase in the number of European biotechs listing on the Nasdaq. There are currently some 40 European biotech companies listed on the Nasdaq, with more listings anticipated over 2018. The rationale behind this US market interest centres around higher valuations, liquidity, follow-on financing as well as greater analyst coverage, relative to Europe.

We also see a greater willingness among US investors to invest in biotechs at earlier stages of development. The proportion of US IPOs completed at the early stages of development has increased significantly in recent years. European investors, on the other hand, continue to back more developed companies with existing partnerships with large pharma and/or marketed products.

Subject to certain SEC criteria (most notably a requirement for 50% or less of voting securities to be held by US residents or if this is not the case, for certain "business contacts" tests to be met), European biotechs may qualify as foreign private issuers (FPIs). FPIs enjoy certain exemptions from SEC compensation reporting rules. For example, FPIs are exempt from proxy rules, 10Q and 8K filings, as well as requirements to have a majority of independent board members, tabular disclosure for individual directors and a shareholder vote on pay or any material changes to pay.

Listing securities on the Nasdaq has a significant impact on the reward profile of the organisation. European-based biotechs with a Nasdaq listing are more directly connected to the US securities and talent market. This drives decisions around remuneration which often translates into more leveraged incentives, higher levels of equity dilution and a preference for market value options vesting on a phased rather than cliff basis. The table below summarises the key differences for European and US listed biotechs.

	Corporate Governance	Cash-based compensation	Equity-based compensation
European HQ, European listing	• Local governance regulations • Pending European Shareholder Rights Directive		• Moderate levels, often benchmarked as part of total remuneration • Expected value of annual award between ~80% and ~150% of salary
European HQ, Nasdaq listing	• Typical seek Foreign Private Issuer status • SEC allows choice of US or local governance regulations • Typical use of Emerging Growth provisions under the JOBS Act • European proxy adviser guidelines applied	• Salary levels are relatively similar when adjusted for size with small premium for US companies • Bonus opportunity broadly comparable between US and European biotechs	• Typical to adopt levels closer to US practice • Expected value of annual award between ~200% and ~400% of salary • Use of options, RSUs, PSUs varies based on HQ country and practice • Director equity common
US HQ, Nasdaq listing	• US governance • US proxy adviser guidelines • Typical use of Emerging Growth provisions (JOBS Act)		• Significant component of package • Share option centric • Performance equity a growing practice • Expected value of annual award between ~250% and ~500%+ of salary • Director equity awards represent prevalent practice

Equity planning in the private to public transition

Private biotechs are generally under pressure to invest cash reserves in product development. In attracting the talent necessary to grow the organisation the emphasis is placed on wealth creation through pre-IPO and subsequent equity awards. We outline some of the key considerations below.

	Private biotech	Preparing for IPO	Maturing as a Public Company
Focus	Private company aggregate equity use (overhang)	Individual ownership position at IPO as a % of company	Public company total reward levels and practices
Equity practices	mostly options/warrants as well as specific country tax advantage schemes		Share options, with mix of options and PSU/RSU as company becomes commercial
	Award levels based on target ownership (% of company)		Award levels set on a % of company and salary multiples (value)
	Focus on key talent/early hires then developing towards formal award policy		Annual award cycle
	Refresh grants as funding rounds occur/IPO approaches		New hire awards of 1-2x annual awards
			More systematic equity grant policy

Assessing total overhang (dilution) leading up to IPO

Total equity overhang measures the potential dilutive effect of outstanding employee equity on existing shareholders. This measure includes equity issued but not yet settled (e.g. unexercised options unvested shares) as well as shares available for future grant. This is measured on fully diluted shares in private companies.

Total overhang increases in relation to the IPO as biotechs introduce fresh equity plans with new funding at IPO. Overhang levels among Nasdaq listed biotechs are generally well in excess of European levels, as we show below. Equity overhang analysis following rounds of funding is a key concern in the lead up to IPO.

Nasdaq listed biotech overhang analysis (n = 50 recently listed biotechs)

Stage	Timing relative to IPO	Total Equity Overhang 25th	50th	75th	Observations
Private biotechs (Fully-diluted)	Immediately Prior to IPO	9%	13%	16%	▪ This represents market practice immediately before IPO (and before any new plan funding).
Public biotechs	Immediately following IPO (excluding new plan funding)	8%	10.5%	15%	▪ Total overhang decreases through the dilutive impact of the IPO.
	Following an IPO (including new plan funding)	14.0%	17.5%	23%	• Total overhang increases following new plan funding. • This is the key measure when determining what level of new plan funding to seek at IPO.

Broader remuneration planning

The lead up to the IPO is a busy time from many perspectives. The remuneration issues are shown below.

RemCo/ Board Meeting	RemCo/ Board Meeting	RemCo/ Board Meeting	IPO
Assess aggregate equity use and individual executive ownership levels Determine if refresh awards required	Peer group for imminent public company comparisons approved	• Approve new equity pool prior to IPO • Approve individual awards • Approve equity grant guidelines and cash compensation adjustments/levels	• Any on-IPO awards made • Post-IPO grant guidelines take effect Remuneration Policy as public company effective

Typical inputs prior to IPO:

1 Assess total overhang levels against Pre IPO and post IPO market (after new funding)

- Confirm new equity pool
- Provide guidance on individual awards levels pre IPO

2 Determine peer group for equity and total remuneration comparisons in the public environment

- Prepare total remuneration benchmarks against approved peer group
- Agree market positioning against peer group
- Guidance for Committee for any remuneration changes or phasing-in of changes

3 Remuneration policy developed for the new public entity

- Reward governance approach (disclosure, proxy adviser issues)
- Guidance on incentive opportunity (bonus and equity)
- Ongoing equity grant guidelines for executives (and Directors)

Throughout this process, a number of key issues are resolved. Typical issues examined in the lead up to IPO are shown to the right

- Vesting profile of legacy (and founder) shares and treatment on IPO
- Top-up or refresh awards tolerance pre IPO
- All employee equity usage and planning
- Hiring profile pre and post IPO
- Tax treatment of awards
- Peer practices in respect of remuneration levels and practices
- Positioning of equity levels versus peer practices
- Governance and disclosure implications
- Evergreen provisions
- Proxy adviser management

Working with Deloitte

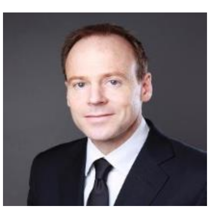
The Deloitte UK Executive Compensation practice advises on all aspects of executive remuneration

Design → Implementation → Communication

One team

Reward, corporate governance and research specialists	Reward strategy alignment to group strategy	Pay levels analysis	Performance measures	Market trends and corporate governance	Pay reporting	Shareholder consultation
Share schemes practitioners and lawyers	Plan rules	Contracts	Leaver provisions			
Tax specialists and network of tax advisors	Tax efficient arrangements including all employee plans		Tax guides	Tax authority reporting		
Accounting and funding experts	Cost effective funding	IFRS2 and Share plan accounting				

For further information, please do not hesitate to contact us:



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