MCDOWALL ASSOCIATES

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DOES SIZE MATTER?

CEO Compensation in Canada: 2013 Update

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EXECUTIVE SUMMARY

McDowall Associates is pleased to provide an overview of our latest research into the compensation of the Chief Executive Officers (CEOs) of two groups of Canadian publicly traded companies for the four year period from 2010 to 2013.

The first CEO group includes the 60 companies in the S&P/TSX 60 Index, while the second CEO group consists of the 60 next largest companies listed on the Toronto Stock Exchange (TSX) based on their market capitalization.

Comparing 2013 with 2010, we found no significant changes occurred in the salaries or in the total cash compensation of the CEOs in first group. However, their share-based award grant values increased by 79% resulting in 17% higher total direct compensation. Meanwhile, the total direct compensation of the CEOs in the second group increased over the four year period by 25%.

(*See page 3*)

Company size continues to be important. Compared to the CEOs of the smaller group in 2013, the CEOs of the larger group had

- 1.5 times the base salaries and 2.0 the total cash compensation
- 1.6 times the stock option grant values
- 2.6 times the share-based award grant values, and
- 2.1 times the total direct compensation

(*See page 4*)

The 2013 Pay Ratios of the two CEO Groups were 158 times and 76 times the 2013 Average Industrial Wage (AIW) respectively.

Their corresponding Tax Ratios were 465 and 215 times the AIW Tax Ratio, or almost three times their Pay Ratios.

High income earners, such as CEOs, pay a lot of tax—in fact about three times as much for every dollar of their pre-tax income as typical wage earners pay on their income.

(*See page 5*)

McDowall Associates is pleased to provide an overview of our latest research into the compensation of the Chief Executive Officers (CEOs) of two groups of Canadian publicly traded companies. To provide a historical perspective, our study focuses on the four year period from 2010 to 2013.

The first CEO group includes 59 of the 60 companies in the S&P/TSX 60 Index, while the second CEO group consists of 59 of the 60 next largest companies listed on the Toronto Stock Exchange (TSX) based on their market capitalization. *[Note: BlackBerry has been excluded from the first CEO group and Onex from the second CEO group due to special one time long term incentive LTI awards that would otherwise significantly distort our market analysis.]*

KEY CEO COMPENSATION FINDINGS

S&P/TSX 60 CEOs (Group 1)

- Average base salaries and total cash compensation for the senior group remained stable over the four years at around $1.1 million and $2.9 million respectively.
- Average long term incentive (LTI) grant values increased by 37% from $3.5 million in 2010 to $4.9 million in 2013. The increase was largely due to 79% higher share-based compensation award values (e.g. restricted stock units and performance stock units). Stock option grant values meanwhile increased by only 15% over the period to an average grant date value of around $1.8 million.
- Average total direct compensation[1] increased by 17% from $6.4 to $7.5 million over the four year period as a result of the higher LTI award grant date values.

TSX 61-120 CEOs (Group 2)

- Average salaries and total cash compensation for the second group of CEOs increased 34% and 20% respectively.
- Average LTI grant values increased by 47% from $1.5 to $2.2 million, split almost evenly between share-based compensation award values and stock option grant date values.
- Average total direct compensation for the second CEO group increased over the period by 25% from $2.9 to $3.6 million.

Table 1: Groups 1 and 2 CEO Compensation Summary

	Group 1 Averages (millions)			Group 2 Averages (millions)		
	2010	*2013*	*% Increase*	*2010*	*2013*	*% Increase*
Base Salaries	$1.13	$1.13	0%	$0.58	$0.77	34%
Total Cash	$2.89	$2.94	2%	$1.39	$1.67	20%
LTI	$3.52	$4.88	37%	$1.48	$2.17	47%
Total Direct	$6.41	$7.50	17%	$2.87	$3.58	25%

[1] "Total direct compensation" includes annual base salary, annual incentive awards and the present value of long-term incentives awarded in the year, such as restricted stock units, performance stock units and stock options, as reported to shareholders in the Summary Compensation Table of the management proxy circular.

In terms of the average compensation, compared to the CEOs of the Group 2 companies, the CEOs of the larger Group 1 companies have:

- 1.5 times the base salaries and 1.8 times the total cash compensation,
- 2.6 times the share-based award values,
- 1.6 times the stock option grant date values, and
- 2.1 times the total direct compensation

There was little difference between the average and the median total direct compensation (TDC) results for the larger CEO group in 2013.

Meanwhile, the average TDC was 23% higher than the median for the smaller CEO group. From this we surmise that the compensation committees of the larger group continue to be more focused on targeting the median CEO compensation of their peer groups.

The prevalence of both share-based awards and of option-based awards increased in both Groups 1 and 2 between 2010 and 2013, as can be seen in the table below.

Table 2: LTI Grant Prevalence

	LTI Grant Prevalence (% of Companies)			
	Group 1		Group 2	
	2010	*2013*	*2010*	*2013*
Share-Based Awards	77%	90%	65%	69%
Option-Based Awards	68%	75%	62%	68%

2013 CEO PAY MIX

The mix of total direct compensation for the Group 1 CEOs places a much heavier emphasis on share-based and option-based compensation than the Group 2 CEOS, as can be seen below:

Chart 1: Group 1 CEOs

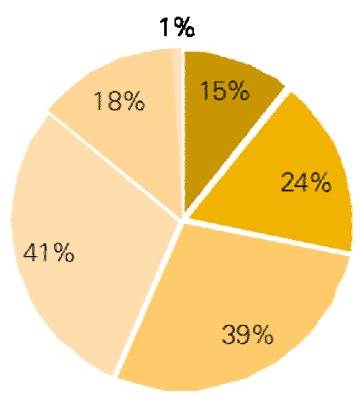
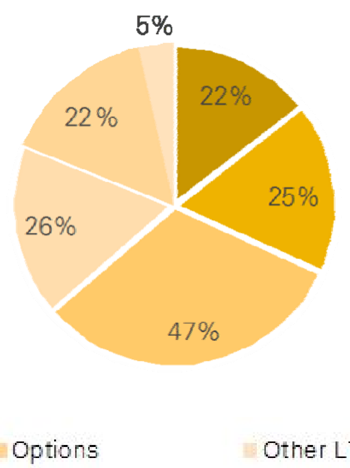


Chart 2: Group 2 CEOs



In addition, CEO pension benefit values were reported for 63% of the larger group as compared to 53% for the smaller group.

CEO TAX RATIO ANALYSIS

While much public focus is placed on the magnitude of CEO compensation, little recognition is given to their significant contribution to our economy as individual taxpayers. McDowall Associates has developed the "CEO Tax Ratio" to help fill this void.

For this purpose, we look at the income tax payable by a CEO on his or her compensation and compare that to the income tax payable by a typical employee.

In our April 2014 article[2], *Does Size Matter?*, we concluded that the CEO Tax Ratios for the first and second groups were much higher in 2012 than their CEO Pay Ratios: both ratios were calculated in relation to a typical wage earner as represented by the Average Industrial Wage (AIW).

We have updated this analysis for 2013. The results for 2013 are summarized in the table below.

Table 3: CEO Pay and CEO Tax Ratios for 2013[3]

	Group 1 *2013 Averages*	**Group 2** *2013 Averages*
CEO Pay	$7.50 million	$3.58 million
Average Industrial Wage	$47,358	$47,358
CEO to AIW Pay Ratio	158.3	75.7
CEO Income Taxes[4]	$3.34 million (45%)	$1.54 million (43%)
AIW Income Taxes[4]	$7,174 (15%)	$7,174 (15%)
CEO to AIW Tax Ratio	465:1	214.6
CEO Tax Ratio vs CEO Pay Ratio	2.9	2.8

While both the CEO Pay Ratios and the CEO Tax Ratios are much lower for the Group 2 CEOs than for Group 1, the relationship between the two ratios is very similar and very significant.

We believe CEO Tax Ratio analysis is important to consider given the distinct possibility that disclosure of CEO Pay Ratios in due course will be mandated in Canada.

[2] http://www.mcdowallassociates.com/wp-content/uploads/Does-Size-Matter-CEO-Compensation-in-Canada.pdf

[3] Assumptions:

a. The AIW earner's compensation is all paid in current cash.
b. The CEO's long-term incentive awards for the year will actually pay out at the values reported to the shareholders in the Summary Compensation Table.

[4] Income tax estimates are based on the 2013 Federal and Ontario rates for a single taxpayer with no offsetting tax deductions (such as registered pension plan contributions) and with refundable tax credits being limited to the basic exemption, the Canada Pension Plan and Employment Insurance contribution credits and the federal employment credit. The estimates also assume that 50% of the grant date value of CEO stock options will be taxable on exercise.

CONCLUSION

CEO compensation levels continue to be heavily scrutinized and often criticized.

One should not assume, however, that the compensation of CEOs of publicly traded companies is "money in the bank". In fact, more than half of their reported compensation is deferred and heavily dependent on future performance.

At a macro level, the total taxes payable by the 59 Group 1 CEOs equal the taxes payable by over 27,000 AIW level employees; furthermore, the taxes payable by the 59 Group 2 CEOs equal the taxes payable by over 13,000 AIW level employees.

While this article focuses on CEO compensation trends of publicly traded companies, McDowall Associates has clients in many sectors, including privately held companies, industry associations, non-profits and various government organizations. We can conduct specific analyses identifying implications of pay trends for clients with reports that can be customized to their needs (e.g. sector, industry, pay for performance analysis).

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