MCDOWALL ASSOCIATES

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DOES SIZE MATTER?

CEO Compensation in Canada

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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 period from 2010 to 2012.

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 2012 with 2010, we found no significant changes occurred in the salaries, total cash compensation or stock option grant values of the CEOs in either group. However, share-based award grant values increased by 38% for the CEOs of the S&P/TSX 60 group, resulting in 16% higher total direct compensation in 2012. Meanwhile, the total direct compensation of the CEOs in the second group increased by only 4%.

(*See page 3*)

Company size continues to be important. Compared to the CEOs of the smaller group in 2012, the CEOs of the larger group had

- 1.8 times the base salaries and total cash compensation
- 2.0 times the stock option grant values
- 3.0 times the share-based award grant values, and
- 2.2 times the total direct compensation

(*See page 4*)

Notwithstanding their lower compensation, the CEO Tax Ratio for the second CEO group in 2012 was 2.5 times higher than their CEO Pay Ratio, vs. 2.6 times for the first CEO group.

In our December 16, 2013 article, we found that the CEO Tax Ratio of the companies in the S&P/TSX 60 group in 2010 was 2.4 times their CEO Pay Ratio. Applying the same methodology to the CEOs of both groups, we found that their CEO Tax Ratios in 2012 were 2.5 to 2.6 times their CEO Pay Ratios notwithstanding the significant differences in their compensation.

(*See page 5*)

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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 three years at around $1.1 million and $2.8 million respectively.
- Average long term incentive (LTI) grant values increased by 30% from $3.4 million in 2010 to $4.4 million in 2012. The increase entirely due to higher share-based compensation award values (e.g. restricted stock units and performance stock units). Stock option awards remained stable over the period with average grant date values of around $1.5 million.
- Average total direct compensation[1] increased by 16% from $6.2 to $7.2 million over the 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 remained stable at around $650,000 and $1.6 million respectively.
- Average LTI grant values increased slightly from $1.6 to $1.7 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 4% from $3.1 to $3.3 million.

Table 1: Groups 1 and 2 CEO Compensation Summary

	Group 1 Averages (millions)		Group 2 Averages (millions)	
	2010	*2012*	*2010*	*2012*
Base Salaries	$1.12	$1.15	$0.60	$0.64
Total Cash	$2.81	$2.83	$1.56	$1.59
LTI	$3.17	$4.39	$1.59	$1.68
Total Direct	$6.21	$7.23	$3.15	$3.28

[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:

- 1.8 times the base salaries and 1.8 times the total cash compensation,
- 3 times the share based award values,
- 2 times the stock option grant date values, and
- 2.2 times the total direct compensation

The difference between the average and the median total direct compensation for the larger CEO group in 2012 was only 3%.

Meanwhile, the average vs. median differential was a much larger 18% for the smaller CEO group. From this we surmise that the compensation committees of the larger group are more focused on targeting the median CEO compensation of their peer groups.

The prevalence of share-based awards and of option-based awards increased in both Group 1 and 2 between 2010 and 2012 as can be seen in the table below.

Table 2: LTI Grant Prevalence

	LTI Grant Prevalence (% of Companies)			
	Group 1		Group 2	
	2010	*2012*	*2010*	*2012*
Share-Based Awards	77%	85%	65%	75%
Option-Based Awards	68%	72%	62%	70%

2012 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

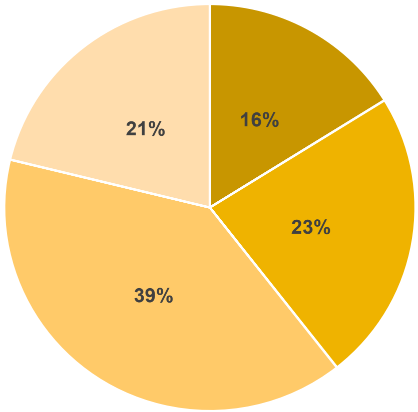
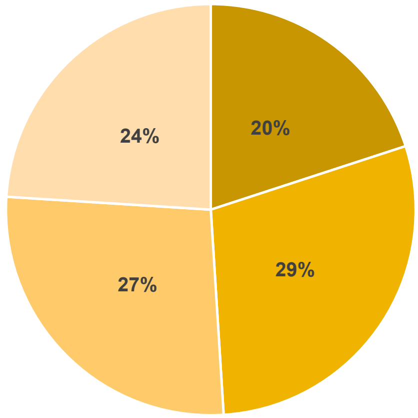


Chart 2: Group 2 CEOs



Average Salary Average Annual Incentive Average Share Based Average Option Based

In addition, while CEO pension benefit values were reported for two thirds of the larger group, only one half were reported for the smaller group.

CEO TAX RATIO ANALYSIS

In our December 16, 2013 article[2], *The CEO Pay Paradox*, we concluded that the CEO Tax Ratios for the companies in the S&P/TSX 60 Index were much higher 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 since conducted a similar analysis of the compensation of Group 2, the CEOs of the next 60 largest publicly traded companies on the TSX.

"High income earners pay a lot of tax - in fact about twice as much for every dollar of their pre-tax income as the tax payable per dollar of income by a typical wage earner. […] the 'CEO Tax Ratio' can be twice that of the 'CEO Pay Ratio'."

Our conclusion is the same for the Group 2 CEOs: while both their CEO Pay Ratios and their CEO Tax Ratios are much lower than for Group 1, the relationship between the two ratios is very similar. The results for 2012 are summarized in the table below.

Table 3: CEO Pay and Income Tax Ratios for 2012[3]

	Group 1 *2012 Averages*	**Group 2** *2012 Average*
CEO Pay	$7.23 million	$3.28 million
Average Industrial Wage	$46,629	$46,629
CEO to AIW Pay Ratio	155:1	70:1
CEO Income Taxes[4]	$3.09 million	$1.36 million
AIW Income Taxes[4]	$7,656	$7,656
CEO to AIW Tax Ratio	403:1	177:1
CEO Tax Ratio vs CEO Pay Ratio	2.6x	2.5x

[2] http://www.mcdowallassociates.com/wp-content/uploads/Do-Canadian-executives-pay-their-fair-share-in-income-tax.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 2012 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 and the Canada Pension Plan and Employment Insurance contribution exemptions. The estimates also assume that 50% of the grant date value of CEO stock options will be taxable on exercise.

CONCLUSION

It will be interesting to see what compensation trends we will find at McDowall Associates when we analyze the results of the 2013 proxy reporting season.

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.

While this article focuses on CEO compensation trends at TSX 120 companies, McDowall Associates can conduct specific analyses identifying implications of pay trends for its clients with a report that can be customized to their needs (e.g. sector, industry, pay for performance analysis).

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