ELLASON LLP

IPO remuneration guide

A guide for companies seeking admission on AIM

Ellason LLP
www.ellasonllp.com

Introduction

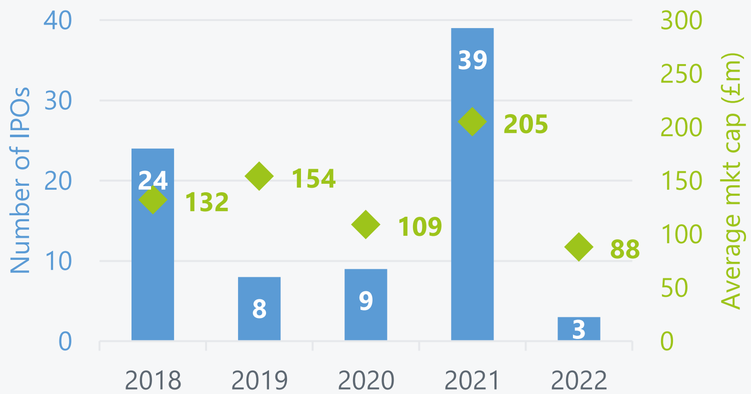
Welcome to the Ellason 2023 IPO remuneration guide for AIM admissions

- Joining a public market is one of the biggest decisions a business will take, and doing so brings significant changes to remuneration and governance. We have developed this guide to help companies navigate the remuneration implications of the IPO process and provide an insight into executive reward practices for companies being admitted on AIM.
- Do not hesitate to share this report with colleagues, and/or contact the Ellason team if you have any questions on this report or have any other remuneration matters you would like to discuss.
- The Ellason library also includes detailed pay trends reports for the AIM100, FTSE SmallCap, FTSE250 and FTSE100 – contact one of the team if you would like a copy.

Steps to a successful remuneration policy at IPO:

1. Agreeing the remuneration philosophy
2. Designing the post-IPO package
3. Transitional and other arrangements
4. The wider governance agenda

Snapshot of the UK IPO Market
Admissions on AIM*



After a significant jump in AIM admissions in 2021, 2022 saw just 3 AIM IPOs, reflecting the current level of economic uncertainty in the market.

Email our senior consultants:

peter.smith@ellasonllp.com
ed.mottley@ellasonllp.com
lorna.dodson@ellasonllp.com
stuart.harrison@ellasonllp.com
jenni.blyton@ellasonllp.com

** Data in this survey is based on 83 companies being admitted on AIM between January 2018 and December 2022, with a market cap on Admission of >£50m and at least one full-time executive director (see Appendix for 2022 admissions).*

Steps to a successful remuneration policy at IPO

Agreeing the remuneration philosophy upfront will help set the framework and principles for the detailed design phase. Key considerations include:

1. **Company culture** – to be effective, a company's remuneration policy will need to motivate, attract and retain talent; to do so, pay policy should reflect the company's culture and recruitment market.

2. **Business strategy** – the remuneration policy should support the strategy, which will guide aspects such as the appropriate balance between fixed and variable pay, the time horizon for performance periods, the structure of incentives and relevant performance metrics.

3. **Risk appetite** – the risk appetite of management will influence the potential stretch in the packages (e.g. high risk, high reward); while the risk appetite of the Board and shareholders (current and future) will impact on the appetite to deviate from generally-accepted practices.

4. **Time horizon for existing executives** – depending on the wealth creation opportunities created through the IPO, one-off arrangements may be required to support retention and motivation over appropriate timeframes. If executives are also major shareholders, this may influence the pay philosophy and design.

5. **AIM and sector practice** – Boards will also often look to practices in other comparable AIM companies (and, in some cases, similar-sized companies listed on the Main Market) as a guide to typical pay structures and competitive market rates. This can also help provide a guide as to what external shareholders may deem appropriate. Identifying relevant size and sector peers can therefore provide a useful guide to accepted market norms.

The governance landscape for remuneration in an AIM company

- An IPO is often the first time that a company's remuneration practices are made public through the admission documents and subsequent annual reporting; and investors will often use the pay disclosures as a lens through which to assess the governance and strategy of the newly-quoted company.
- Whilst the disclosure requirements are less onerous on AIM than for companies listing on the FTSE Main Market, summary details of the remuneration arrangements for the Directors will need to be disclosed in the Admission Document and in subsequent annual reports.
- Proper planning, a well-designed framework and good execution can help a company decide upon, and implement, a remuneration framework that can withstand the external scrutiny that arises from the admission process; help support the strategy; and motivate, reward and retain key talent.

Designing the post-IPO package

Getting the building blocks of fixed pay right

1. **Base salaries** – most companies seek to **align salaries to the market** rate at IPO, which in many cases can result in a significant uplift in base salaries.

   Some companies choose to set lower base salaries to offset higher variable pay, or where the directors have material equity ownership (e.g. founder directors). However, the challenge with this approach is that it can act as a restraint on salary levels lower down the organisation, potentially leading to future recruitment and retention issues below Board.

2. **Benefits** – benefits typically comprise life assurance, medical benefits and group income protection. Some companies also provide a company car (or cash allowance in lieu). Shareholders generally expect any material relocation benefits to be provided for a limited time period only.

3. **Pension** – gradual reductions to the annual and lifetime allowance have resulted in some directors in AIM companies opting out of company-funded pension arrangements altogether. The median contribution rate is 4-5% of salary (typical range 3-10%). This follows a broader trend across the FTSE for pension rates for executive directors, or payments in lieu, to be **aligned with those available to the workforce** (as recommended under the 2018 UK Corporate Governance Code applicable to premium-listed companies on the Main Market, but also followed by some larger AIM companies).

Typical salary levels on AIM
(admissions in the past five years)

Chief Executive

Market cap at IPO	Lower quartile	Median	Upper quartile
<£100m	£201k	£225k	£250k
£100m-150m	£200k	£250k	£300k
>£150m	£250k	£322k	£372k

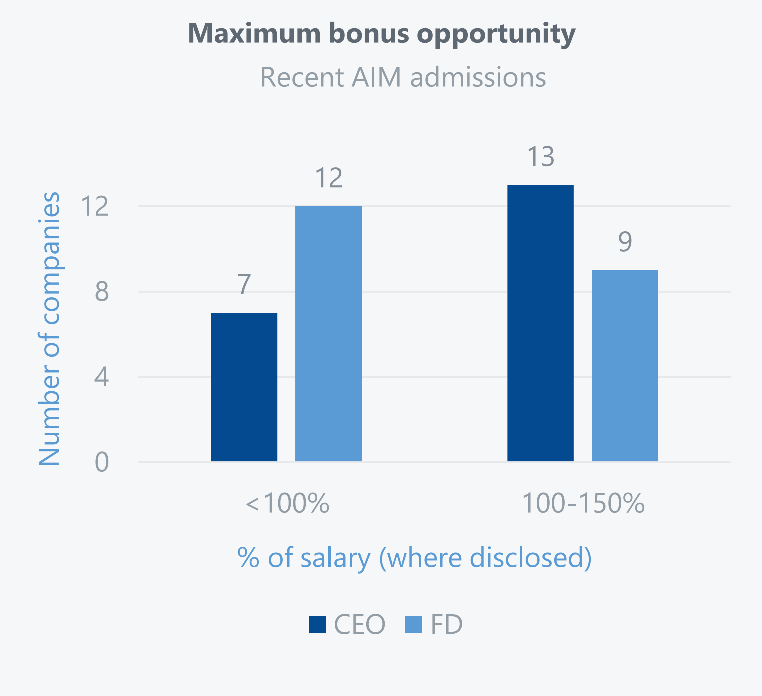
Finance Director

Market cap at IPO	Lower quartile	Median	Upper quartile
<£100m	£138k	£165k	£200k
£100m-150m	£165k	£197k	£212k
>£150m	£173k	£213k	£257k

There is a correlation between base salary levels and company size, as on the FTSE Main Market. However, CEO and FD salaries are more closely aligned on AIM, the FD salary being typically set at 72% of the CEO's. The equivalent figure for the Main Market is c.67%.

Designing the post-IPO package

Aligning pay with performance: annual bonus



4. **Bonus opportunity** – quoted companies are encouraged to specify a maximum amount (typically expressed as a percentage of salary) that can be paid out based on in-year performance. Only around 25% of companies admitted on AIM in recent years have disclosed the **maximum annual bonus opportunity** in their Admission Documents, with the median CEO opportunity at 100% of salary (approaches range from no bonus at all to an uncapped opportunity). Around 30% of the companies that disclosed this information had a **lower maximum bonus opportunity for the Finance Director** (set, on average, at 70% of the CEO maximum opportunity). The remainder award **consistent bonus opportunities** for the two executive directors.
5. **Bonus deferral** – the Investment Association (which represents the views of major UK institutional investors) recommends that, where the maximum bonus opportunity is >100% of salary, **a proportion of the bonus earned should be deferred in shares**. Five recent AIM admissions stated that they would use deferral in their bonus schemes; just one (Team17 Group) gave details about its maximum opportunity (100% for both CEO and FD) and its **deferral scheme** (any bonus awarded over 50% of salary to be deferred for two years).
6. **Bonus measures** - disclosure on bonus metrics in Admission Documents is very limited but, across the wider AIM market, **financial measures account for the vast majority of the bonus opportunity**. The balance is typically based on non-financial measures set around strategic or personal metrics. There has also been an increased focus on the use of ESG metrics in recent years, particularly at larger companies or in sectors where there is a material environmental or social impact. Retrospective disclosure of bonus targets is encouraged to support payments made, but the level of disclosure remains mixed amongst AIM companies.

Designing the post-IPO package

Aligning pay with performance: long-term incentives

7. **Plan type** – the most common long-term incentive vehicle is a **performance share plan** (where shares vest subject to the achievement of performance targets). 37% of companies surveyed used this type of plan and, of these, more than half appeared in the top 50% when the companies were ranked by **market cap**, suggesting that the larger companies being admitted on AIM are more likely to emulate typical practice on the Main Market (where the majority of companies **use performance shares**). **Market value options** are used by 33%, providing simple, effective incentives for **growth-oriented** companies.

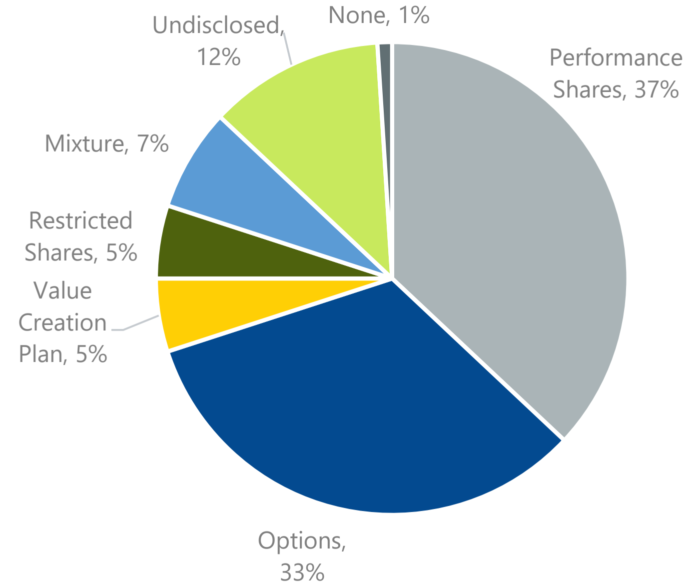
   A handful of companies disclose adopting a **Restricted Share Plan**, where shares vest subject to continued employment only, or a **Value Creation Plan**, where participants are rewarded in a share in the increase in value of the company above a hurdle. A number of companies continue to grant their share awards under an **EMI** or **CSOP** wrapper, taking advantage of their tax-favoured status.

8. **Performance periods** – 64% of companies disclosed their long-term incentive **performance period**, with 91% of them using **3 years**. A small number of companies (16%) disclosed applying a post-vesting holding requirement to extend the time horizon of the long-term incentive.

9. **Award levels** – the median award level was **100% of salary** (face value of shares at grant). Companies making awards to both the CEO and FD typically award the same opportunity to both, unlike on the Main Market where around a third of companies award a lower opportunity to the FD – typically 75% of the CEO's.

10. **Share dilution** – the majority of AIM companies follow Main Market practice and adopt a **dilution limit of 10% over 10 years** (the percentage of share capital that may be issued under share plans in any rolling 10-year period). However, this is not a compulsory limit and six companies disclosed higher dilution limits (ranging from 12% to 15% of share capital).

Types of long-term incentive plans adopted by AIM companies on IPO



Designing the post-IPO package

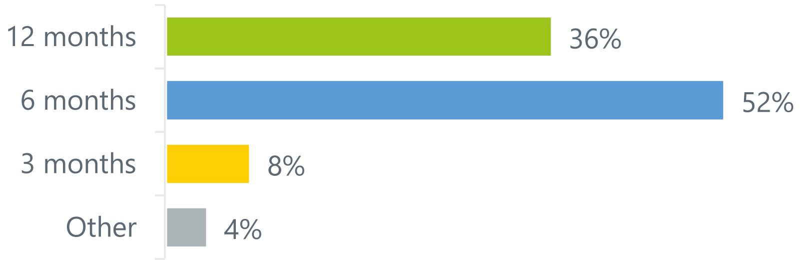
Other aspects of the post-IPO remuneration policy

11. **Shareholding guidelines** – while executive directors on the Main Market are generally encouraged to build up **significant shareholdings**, executive directors of AIM companies are often founders, already with large shareholdings, and formal shareholding guidelines are considerably less common. Only two companies disclosed a formal shareholding guideline following IPO, at 100% of salary. The median CEO shareholding post-IPO is 6.3% of the company's issued share capital; for the majority of newly-admitted companies on AIM, a minimum guideline shareholding (as a multiple of salary) is therefore not typically an issue.

    Whilst a significant recent development at Main Market listed companies, post-exit shareholding requirements (which extend the shareholding requirement beyond termination of employment) are uncommon on AIM. None of the companies surveyed disclosed a post-exit shareholding requirement (compared to 90% of recently-listed companies on the Main Market).

12. **Notice periods** – summary details of the executive directors' service contracts, including notice periods, are normally disclosed in the Admission Document. The most common notice period disclosed was 6 months.

Notice periods for Executive Directors



Transitional and other arrangements

Consideration will also need to be given to the treatment of existing arrangements

1. **Treatment of existing equity plans** – what happens to existing pre-IPO incentive awards will depend on the terms on which they were granted. **Practice was mixed at the companies surveyed**; some stated that all outstanding awards would vest at IPO, but at most companies, awards were converted into shares or share options in the newly-admitted entity and continued to vest on the original timescale.
2. **One-off awards at IPO to executives** – around a third of the companies surveyed (36%) reported making **one-off awards to executive directors**, most of them either immediately prior to or at Admission. These comprised a mix of options, performance shares, restricted shares and cash.
3. **Selling down shares** – an IPO often provides an opportunity for executives to realise value from their existing ownership, and in some cases is seen as an opportunity for incoming executives to build their ownership. Just over half of CEOs who owned equity pre-IPO sold shares on Admission. The **median value of shares sold by the CEO was £4.2m** (the median value of shares sold by FDs was £0.8m).

   Immediately after Admission, the median **shareholding of the CEO was 6.3% of the issued share capital** and 0.5% by the FD (compared to 14.2% and 0.9% respectively immediately prior to Admission).
4. **Lock-up periods** – the selling shareholders and senior management team are typically subject to a lock-up period immediately post-IPO which prohibits further share sales for a minimum period. **71% of the companies surveyed specified a 12-month lock-up period** (8% had longer, 4% shorter, and 17% did not disclose a lock-up period).

Examples of one-off awards to executives at IPO

- **Clean Power Hydrogen (2022):** just prior to Admission, the CEO was awarded c.10 million nominal-cost options, 25% of which become exercisable in 2024, with the remaining 75% conditional on the company achieving certain sales targets.
- **Supreme (2021):** two grants of 2.5% of issued share capital awarded to CEO based on stretching absolute TSR targets over 5 years.
- **Loungers (2019):** one-off discretionary bonuses of £1.1m, £150k and £270k awarded to the CEO, FD and MD of Lounge respectively, to recognise their significant contribution to the Admission process. Awards were substantially granted as nil-cost options vesting over 1, 2 and 3 years.
- **OnTheMarket (2018):** nil-cost options granted to four members of the senior management team (CEO: c.£5.7m, FD: c.£250k), exercisable in tranches over 1, 2 and 5 years.

Transitional and other arrangements

All-employee arrangements should also be considered

5. **All-employee share plans** – 25% of the companies surveyed disclosed **introducing all-employee share plans** at IPO. The most common was a **Share Incentive Plan** (SIP), followed by a **Save As You Earn** (SAYE) scheme, with around a third of companies introducing both.

   A SIP is an HMRC-approved share plan, under which employees can be granted free shares, acquire partnership shares (from pre-tax salary), receive matching shares for each partnership share acquired, and buy additional shares with the dividends received from free, partnership or matching shares. No income tax or national insurance is payable if shares are held in the plan for five years.

   A SAYE scheme provides employees with an option to buy shares at a discounted price, saving over a contract period of three or five years to fund the exercise of the option. No income tax or national insurance is payable when the option is exercised.

6. **One-off awards at IPO to all employees** – approximately 5% of companies disclosed making one-off awards to all employees at IPO to **aid retention and celebrate the success of the IPO**:

OnTheMarket (2018)

Options over 1.3% issued share capital allocated to employees, senior management and directors under the EMI plan on Admission.

SimplyBiz (2018)

Nil-cost options granted to all eligible members, to be exercised in tranches over 2, 3 and 4 years. Aggregate award over 5% of issued share capital.

FRP Advisory Group (2020)

Nil-cost options granted to all eligible employees, vesting after 3 years subject to continued service. Awards over 10% salary for employees with <1 year's service. 20% of salary per completed additional year of service, up to a maximum award of 100% of salary.

Supreme (2021)

All-employee bonus scheme paying a bonus to all participating employees, equivalent to one year's base salary, if the company achieves a market capitalisation of £1bn on or before the fifth anniversary of Admission.

The wider governance agenda

The lighter-touch corporate governance regime is a key attraction of being admitted on AIM

- Companies that wish to be admitted on AIM are governed by the AIM Rules for Companies (AIM Rules). The Admission Document is based on the requirements of an FCA Prospectus with certain optional exclusions.
- AIM companies have to adopt a recognised corporate governance code, **and explain any non-compliance with this in the annual report**. 70% of newly-admitted AIM companies adopted the QCA Code (see right).
- AIM companies (unlike UK-incorporated companies listed on the Main Market) are **not required to submit their pay policy or remuneration report to shareholder votes**. However, 40 companies in the AIM100 currently submit their remuneration report voluntarily to an advisory vote (allowing shareholders to flag concerns on remuneration).
- The lighter-touch governance regime is a key attraction to companies seeking admission on AIM. However, some larger companies also seek to adopt some best practice features of Main Market remuneration policies, in order to reflect good governance and improve credibility with mainstream UK institutional investors (particularly if a move to the Main Market is to be considered at some point in the future).

The corporate governance codes

- **Quoted Companies Alliance (QCA) Code:**
  Most commonly adopted by AIM companies, the Code is based on ten broad, less prescriptive principles for interpretation by the company. The QCA also publishes a separate guide outlining high-level principles on remuneration.
- **UK Corporate Governance Code:**
  A requirement (on a 'comply or explain' basis) for companies on the premium segment of the Main Market and adopted by some larger AIM companies. The Code is comprehensive. It contains 42 provisions; nine of which relate specifically to remuneration.

Appendix

Appendix

Recent AIM IPOs

Companies being admitted on AIM in 2022

Company	IPO date	Sector	Mkt cap at IPO (£m)
Artemis Resources	Feb-22	Industrial metals and mining	59
Clean Power Hydrogen	Feb-22	Alternative energy	142
i(x) Net Zero	Feb-22	Investment banking and brokerage services	62

ELLASON LLP