IPO remuneration guide

A guide for companies listing on the FTSE All-Share

May 2023

Ellason LLP
www.ellasonllp.com

Introduction

Welcome to the Ellason 2023 IPO remuneration guide for FTSE Main Market listings

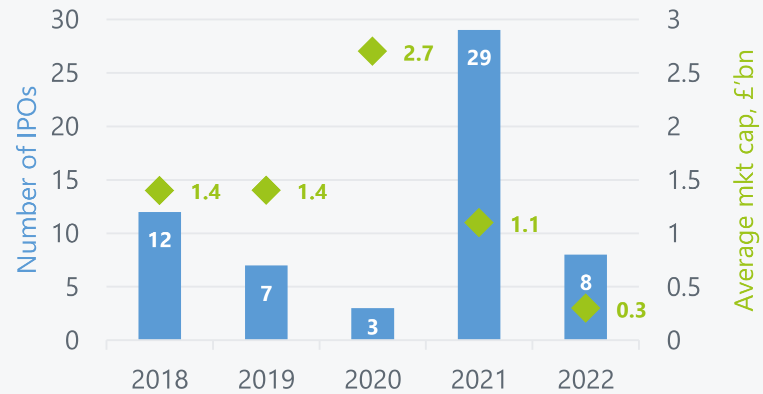
- Joining a public market is one of the biggest decisions a business will take and brings significant changes to remuneration and governance. We have developed this guide to help companies navigate the remuneration implications of the IPO process and provide an insight into executive reward practices in the listed company environment.
- 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 trend reports for the FTSE100, FTSE250, FTSE SmallCap and AIM 100 – please 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. Wider governance agenda

Snapshot of the UK IPO Market

Listings on the Main Market*



Following a large jump in the number of FTSE listings 2021, 2022 saw just eight* Main Market IPOs, reflecting ongoing economic uncertainty in the market. The number of premium listings has decreased dramatically in recent years, from >90% of all listings in 2018-2020 to 50% in 2021, and only one company in 2022.

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 companies listing on the Main Market between January 2018 and December 2022 (see Appendix for those listing in 2022). Companies without at least one full-time executive director disclosed in the Prospectus are excluded.*

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. **FTSE and sector practice –** many newly-listed companies adopt relatively conventional remuneration packages, to minimise the risk of any 'governance discount' being applied to the listing valuation. Identifying relevant size and sector peers can provide a useful guide to accepted market norms.

2. **Company culture –** notwithstanding FTSE norms, to be effective, the pay policy will need to motivate, attract and retain talent; to do so, the policy should also reflect the company's culture and market for talent.

3. **Business strategy –** the policy should support the strategy. Strategy will guide aspects such as the appropriate balance between fixed and variable pay, the time horizon for performance periods and relevant performance metrics.

4. **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 (e.g. if low votes on pay are to be avoided at future AGMs).

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

The governance landscape for remuneration in a listed company

- An IPO is often the first time that a company's remuneration practices are made public through the listing documents and subsequent annual reporting; investors will often use the pay disclosures as a lens through which to assess the governance and strategy of the newly-listed company.
- UK-incorporated companies listing on the Main Market are required to seek binding shareholder approval of the Board director remuneration policy at the first AGM post-listing, and an advisory vote on its implementation annually.
- Proper planning, a well-designed framework and good execution can help a company decide upon, and implement, a remuneration policy that can withstand this external scrutiny, 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 –** it can be challenging to make significant upwards adjustments to salaries post-listing, therefore most companies seek to **align salaries to the market** rate at IPO. In many cases, this can result in a **significant uplift to the pre-IPO salary,** with median salary increases of c.40% and c.45% for CEO and FDs respectively at IPO. Post-listing, salary increases for executive directors are generally expected to be no higher than the average workforce increase; where companies have awarded larger-than-usual increases to their employees over the past year due to high inflation, institutional shareholders have advised that executive increases should be lower (in % salary terms) in recognition of the higher variable pay opportunity available to them.

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 expect any relocation benefits to be provided for a limited time period only.

3. **Pension –** the UK Corporate Governance Code recommends that pension rates for executive directors, or payments in lieu, should be **aligned with those available to the workforce**. This has resulted in a significant reduction in pension rates in recent years. The median pension rate for companies listing since 2019 (when the revised Code came into force) is 5% of salary (typical range 3-10%). Around half of these companies have disclosed that their executive pension rate is aligned with that of the wider workforce.

Typical salary levels in the FTSE
(all listed companies)

Chief Executive	Lower Quartile	Median	Upper Quartile
FTSE 100	£777k	£940k	£1,129k
FTSE 250	£540k	£621k	£727k
FTSE SmallCap	£400k	£453k	£530k

Finance Director	Lower Quartile	Median	Upper Quartile
FTSE 100	£504k	£596k	£730k
FTSE 250	£364k	£414k	£462k
FTSE SmallCap	£267k	£314k	£362k

There is a strong correlation between base salary levels and company size, and broad consistency in the ratio between CEO and FD salaries (the FD salary being typically set at c.67% of the CEO's)

Designing the post-IPO package

Aligning pay with performance: annual bonus

Typical annual bonus opportunity in the FTSE
(all listed companies, maximum as % salary)

Chief Executive	Lower Quartile	Median	Upper Quartile
FTSE 100	150%	200%	215%
FTSE 250	125%	150%	175%
FTSE SmallCap	100%	125%	150%

Finance Director	Lower Quartile	Median	Upper Quartile
FTSE 100	150%	175%	200%
FTSE 250	125%	150%	150%
FTSE SmallCap	100%	110%	125%

ISS, one of the most influential investor advisor agencies, recommends that the target bonus should be no more than 50% of the maximum opportunity

4. **Bonus opportunity –** listed companies are expected to specify a maximum amount (typically expressed as a percentage of salary) that can be paid out based on in-year performance. Just over half of companies listing in recent years have specified the **maximum annual bonus opportunity** in the listing Prospectus, with the median CEO and CFO opportunities at 150% of salary (range 75-200% of salary). Around 40% of recently listed companies who disclose the maximum opportunities for both executives **have a lower maximum for the Finance Director**. Where the FD does have a lower bonus opportunity, it is typically set at 75% of the CEO maximum. Across the broader FTSE we also see variation in award opportunity by company size and, in some cases, sector.

   Bonus deferral – the Investment Association recommends that, where the maximum bonus opportunity is >100% of salary, **a proportion of the bonus should be deferred in shares**. Mandatory bonus deferral is required at >95% FTSE350 companies (91% FTSE SmallCap companies) and 53% of companies recently listing disclosed their deferral policy in the Prospectus. The most common approach was to defer 33-50% of any bonus paid for three years.

   Bonus measures – disclosure on bonus metrics in Prospectuses is mixed, but across the broader FTSE**, financial measures typically account for 70-80% of the bonus**. The balance of the opportunity is based on non-financial measures set around strategic or personal metrics. There has also been an increased focus on the use of ESG-related metrics in incentive plans in recent years. **Full retrospective disclosure of targets is expected** to justify any pay-outs made.

Designing the post-IPO package

Aligning pay with performance: long-term incentives

5. **Plan type –** the most common long-term incentive vehicle is a **performance share plan** (‘PSP’, under which shares vest subject to the achievement of performance targets); of the surveyed companies who disclosed their policy on post-IPO long-term incentives, 86% introduced a performance share plan. Whilst they remain minority practice, other plans increasing in popularity in the FTSE include **restricted shares** (shares which vest subject to continued employment only) and **value creation plans** (whereby participants share in the upside growth in value of the company).

   Performance and holding periods – almost all companies specified a **3-year performance period** (only two companies disclosed using longer). 70% of companies also disclosed applying a **2-year post-vesting holding requirement**, meaning that any shares vesting cannot be sold (other than for tax) until the fifth anniversary of grant. This design feature aligns with the recommendations set out in the UK Corporate Governance Code and wider FTSE practice. 67% of companies who disclose a grant date indicated that the first awards would be made on or shortly after IPO, with around a third indicating that the first awards would be made at a later date.

Typical LTI award levels in the FTSE
(all listed companies, max. face value as % salary)

Chief Executive	Lower Quartile	Median	Upper Quartile
FTSE 100	245%	290%	380%
FTSE 250	175%	200%	250%
FTSE SmallCap	100%	150%	175%

Finance Director	Lower Quartile	Median	Upper Quartile
FTSE 100	200%	250%	300%
FTSE 250	150%	175%	220%
FTSE SmallCap	105%	145%	160%

Award levels – the **median award level was 200% of salary** for both CEOs and FDs, albeit 31% of companies disclosed a lower award level for the FD than the CEO (where this was the case, the FD typically received 75% of the CEO’s opportunity). As with annual bonuses, award levels generally differ according to company size and, in some cases, sector. Executives who are also founders and/or major shareholders typically do not participate in their company’s LTIP or receive only a modest opportunity in recognition of the fact that there is already a substantial overlap between their interests and those of shareholders.

Performance measures – most companies use **two performance measures**; among those who disclose their metrics, 59% use **relative total shareholder return** and 50% use **earnings per share**. Few companies disclose the performance targets in the Prospectus, but shareholders will expect them to be included in the first annual report. LTIP targets are normally **disclosed on a forward-looking basis** at the start of the performance period.

Designing the post-IPO package

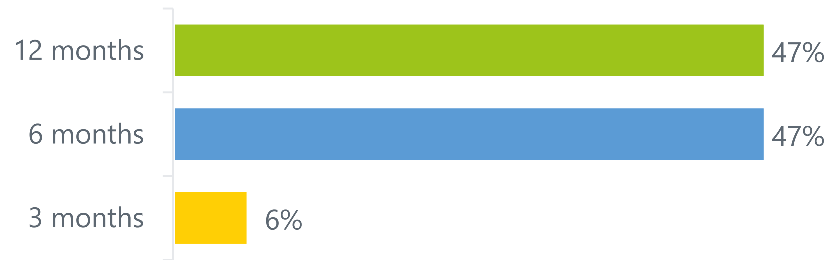
Other aspects of the post-IPO remuneration policy

6. **In-post shareholding guidelines –** the significant majority of listed companies have minimum shareholding requirements for executive directors while in post. Among the companies surveyed, this ranged from 100% to 800% of salary, with the **typical requirement set at 200% of salary** (the minimum level recommended by ISS, the proxy advisory body). This is similar to levels seen across the FTSE generally. More recently, some major shareholders have suggested the holding requirement should be consistent with the total variable pay opportunity (i.e. annual bonus plus LTIP). With the **median CEO shareholding worth £10.5m** immediately post-IPO (£2.5m for FDs), **achievement of the guideline holding requirement will not be an issue** for many executives in newly-listed companies.

7. **Ex-post shareholding requirements –** revisions to the UK Corporate Governance Code in 2018 included guidance on extending the in-post holding requirements for a period post-termination of employment. Guidance from the Investment Association is that the holding requirement should extend for a period of 2 years post-termination at the lower of the in-post holding requirement or the executive's actual holding on departure. **90% of the companies** listing since 2019 (when the Code recommendation came into force) that disclosed an in-post holding requirement in their Prospectus, also **disclosed extending the requirement post-termination** (with most following the Investment Association's guidance).

6. **Notice periods –** summary details of the executive directors' service contracts, including **notice periods**, should be disclosed in the Prospectus and the directors' remuneration policy should include details of how the policy will be applied in the event of a director's departure. Typical practice would be the payment of salary and benefits for the duration of the notice period (typically 6 or 12 months). **Entitlement to any variable pay would generally be forfeited** unless the individual meets the definition of a 'good leaver'.

Notice periods for CEOs
(% companies listing since 2018)



Transitional and other arrangements

Consideration will also need to be given as 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 is mixed at the companies surveyed. Among those that disclosed this information, 48% crystallised the value of previous awards at IPO**, with the shares either vesting immediately (33%) or released in tranches over a period (15%). At 42% of companies, the awards converted into shares in the newly-listed entity and continued to vest on the original timescale. One company extended the exercise period for outstanding options to three years post-IPO; another set a share price hurdle to be met before selling outstanding phantom shares.
2. **One-off awards at IPO to executives –** 36% of the companies surveyed reported making **one-off awards to the directors or senior management team** either immediately prior to or at Admission. These comprised a mix of equity-based and cash awards. Reasons included **rewarding performance to IPO** (particularly where previous equity ownership had not been evenly distributed), to **assist with retention and incentivisation** in the immediate period post-IPO and to **bridge the gap** until awards vest under the post-IPO remuneration policy.
3. **Selling down shares –** an IPO often provides the opportunity for management to realise value from their existing ownership. The **median value of shares sold at IPO was £16m for CEOs and £1.4m for FDs.**

   Immediately after Admission, the **median aggregate shareholding held by the directors and senior management team was 12.3% of the issued share capital**; with 3.9% of issued shares being held by CEOs and 0.6% by Finance Directors (compared to 29.6%, 6.9% 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 shares sales for a minimum period. **71% of the companies surveyed specified a 12-month lock-up period** (10% had a shorter period; 19% longer).

Examples of one-off awards at IPO (2022)

- **Ithaca Energy:** Cash awards totalling £2.3m were made to senior managers (including the CEO and FD) and NEDs on IPO, 'to recognise their exceptional contribution to Admission'. Certain managers (excluding the EDs) were granted restricted shares, which vest one-third on each of the first, second and third anniversaries of the IPO. The executive Chairman will also receive a one-off cash payment of $1 million, six months after IPO in recognition of its successful completion.
- **Hellenic Dynamics:** The CEO received options equivalent to 2% of ISC on IPO. 50% of these become exercisable on achievement of a set of strategic goals (e.g. completion of construction works, certification from official bodies), with the other 50% becoming exercisable on the achievement of a second set of (different) strategic goals. Both sets of objectives must be achieved within two years of the IPO. Options with the same performance conditions were also granted to other managers and members of the Advisory Board.

Transitional and other arrangements

All-employee arrangements should also be considered

5. **All-employee share plans –** 36% of the companies surveyed mentioned **introducing all-employee share plans** at IPO. The most common form of plan was a **Share Incentive Plan** (SIP), closely followed by **Save As You Earn** (SAYE), with 38% of companies who disclosed this information introducing both.

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

   A SAYE scheme provides employees with an option to buy shares at a discounted price. No income tax or national insurance is payable when the option is exercised. Two companies mentioned introducing an Employee Stock Purchase Plan (ESPP), the US equivalent to an SAYE scheme.

5. **One-off awards at IPO to all employees –** 17% of the companies surveyed disclosed making one-off awards to all employees at IPO to **aid retention and celebrate the success of the IPO**. Examples include:

Aston Martin Lagonda (2018)

- Eligible managers (c.70, below senior manager level) received a cash award equal to 1x salary (paid over 6-30 months)
- Other eligible employees (c.2,200) received £1,000 at IPO + 2 week's salary (paid 15 months later)

Deliveroo (2021)

- Eligible riders in all markets received cash payments of between £200 and £10,000 on Admission
- Eligible riders had to have completed their first order >12 months prior to IPO, completed at least one order in the last 90 days and >2,000 lifetime orders

DWF (2019)

- Free shares worth up to 18% of salary made to all employees on Admission (who had been employed for at least 12 months and were rated 'fully achieving')
- Qualifying employees also received a cash bonus on Admission, equivalent to 2% of salary

Trainline (2019)

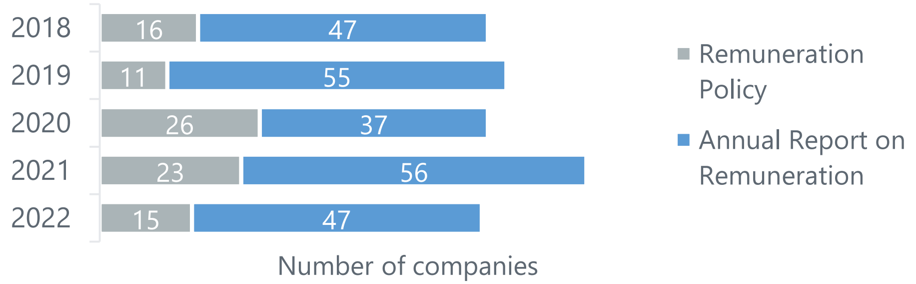
- 1,000 restricted shares granted to each employee on Admission (awards worth £3,500 each)
- Free share award over £3,600 (subject to three-year forfeiture) granted under the Trainline SIP to each employee immediately following Admission

The wider governance agenda

Insights from the 2022 AGM season and key influencers on voting

- Whilst only a simple majority (>50%) is needed to pass a remuneration resolution at a company's AGM, a vote of 20% or more against requires the company's name to be listed on the Investment Association's public register and for the company to respond formally on the voting outcome.

FTSE companies receiving <80% support on remuneration



- Reasons for recent votes against remuneration *policies*: significant increases in annual bonus and/or long-term incentive opportunity; unusual incentive structures such as Value Creation Plans; pensions not aligned to workforce.
- Reasons for recent votes against remuneration *reports*: significant salary increases; changes to targets for 'in-flight' LTIP awards to mitigate the impact of external economic factors; remuneration arrangements for joiners and leavers; incentive outcomes misaligned with company performance and/or the stakeholder experience.
- Getting the right remuneration structures and policies in place ahead of the IPO can help minimise the risk of pay becoming a voting issue in future years.

The proxy advisory bodies

In addition to complying with the UK Corporate Governance Code, companies listing on the Main Market are advised to comply with the guidelines issued by the main proxy advisory bodies if they want to be assured of strong shareholder support on the remuneration resolutions at their first AGM. The key influencers are:

- **The Investment Association**: represents UK insurers and asset managers and highlights areas of concern to members through amber and red flags attaching to its reports. Its *Principles of Remuneration* are generally accepted as best practice for listed companies on the Main Market
- **ISS:** represents global investment managers and asset owners, runs a subscription service reporting to its clients on corporate governance practices, including remuneration. Provides voting recommendations on resolutions being proposed to shareholders and can be highly influential if a *vote against* recommendation is issued
- **Glass Lewis:** established proxy adviser in the US and gaining market share in Europe. Represents investment mangers and asset owners and competes with ISS. Moderate but growing influence.

Appendix

Appendix

Companies listing on the Main Market in 2022

Company	Listing	IPO Date	Sector	Market cap at IPO (£m)
Electric Guitar Plc	Standard	Jan-22	Open end and miscellaneous investment vehicles	2
First Tin Plc	Standard	Apr-22	Industrial metals and mining	86
Genflow Biosciences Plc	Standard	Jan-22	Pharmaceuticals, biotechnology and marijuana producers	27
Graft Polymer (UK) Plc	Standard	Jan-22	Chemicals	23
Hellenic Dynamics Plc	Standard	Dec-22	Open end and miscellaneous investment vehicles	38
Ithaca Energy Plc	Premium	Nov-22	Oil, gas and coal	2,413
RC365 Holding Plc	Standard	Mar-22	Industrial support services	8
URA Holdings Plc	Standard	Mar-22	Industrial metals and mining	4

ELLASON LLP