THE BDO 600

2019 CEO and CFO Compensation Practices: Trends in the Healthcare Industry

The powerful forces propelling the healthcare sector's growth—an aging population; increases in the incidence of chronic diseases; population growth; and advances in medicine, pharmaceuticals, therapeutics, and technology—are increasing healthcare costs. The entire spectrum of healthcare stakeholders from providers to payers to related service organizations are feeling the pressure of rising expenditures.

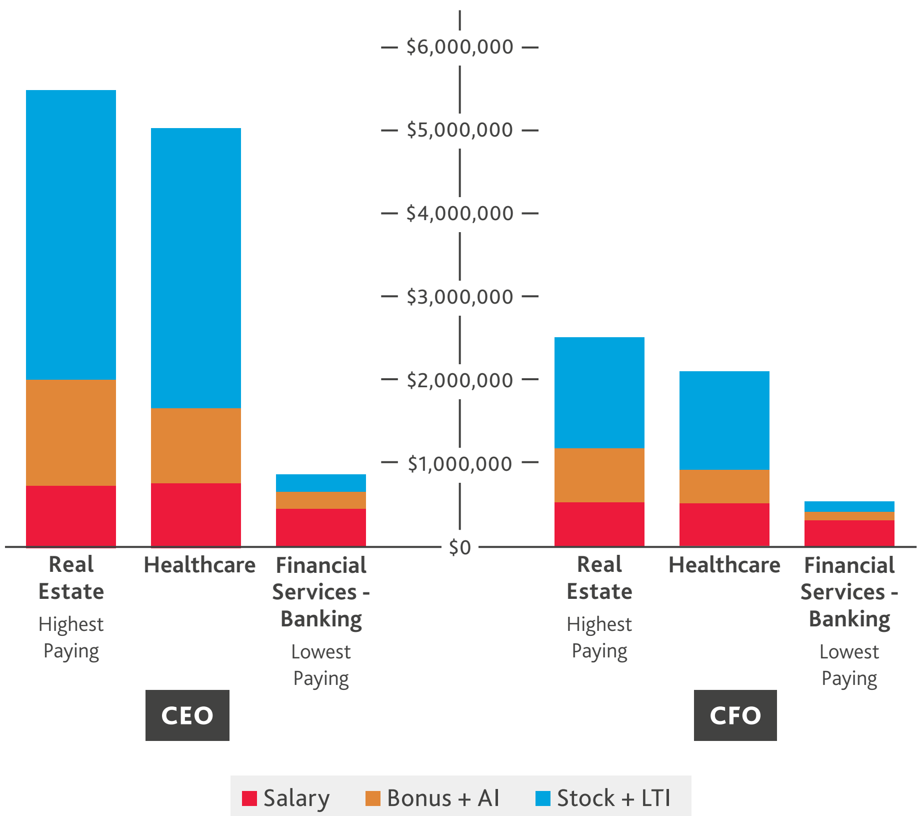
Healthcare leaders are challenged with managing increasingly complex issues, including clinical, operational, regulatory/compliance, a new competitive landscape, and financial obstacles that are transforming their businesses in a fast-moving environment— all while they work to create more sustainable strategies. The pressures are further exacerbated by the fact that everyone is impacted by healthcare. Moreover, the acceleration of complexity means companies need to ensure they have the types of leaders required to manage these challenges. Few leaders are up to the task, so finding and retaining the best talent has become exceedingly difficult. Executive pay levels and the structure of pay packages are directly affected, as illustrated in BDO's analysis of CEO and CFO compensation.

Another driving force for industry growth is merger and acquisition (M&A) activity. Developing pay packages that attract, retain, and reward executives for both long-term vision and short-term successes while simultaneously navigating deals and integrations is critical.

The BDO 600 shows that, as the complexity of healthcare rises, so do pay levels. The BDO 600 study found:

- The average Total Direct Compensation (TDC) levels for both CEOs and CFOs ranked third out of the study's eight industries, with the average TDC at $5.1 million for CEOs and $1.8 million for CFOs.
- Average CEO TDC for healthcare companies is only 8% below the study's highest paying industry (real estate) but is 5.7 times higher than the study's lowest paying industry (banking).

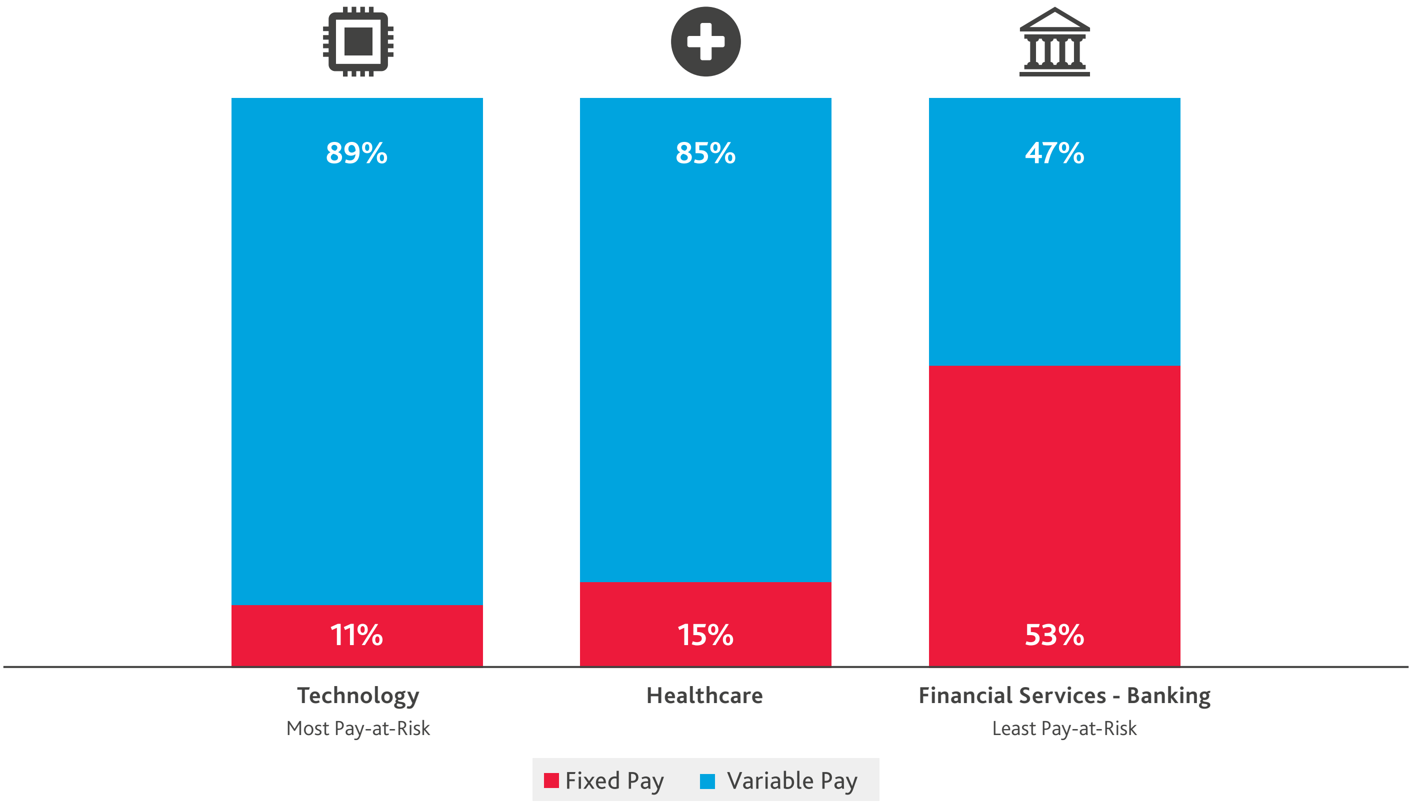
HEALTHCARE VS. HIGHEST AND LOWEST PAYING BDO 600 INDUSTRIES



- CEOs in healthcare also experienced the second largest year-over-year increase in average total direct compensation (11%), behind financial services (nonbanking) (13%).

- The percentage of pay-at-risk (AI and stock/equity grants) for healthcare CEOs is the third largest among the industries examined, at 85% of the total pay package (almost double that of banking, which averages 47%).
- Healthcare CFOs have the fourth-highest percentage of pay-at-risk, at 76%. This underscores the importance of utilizing strategically important metrics and goals that reflect true success.

PERCENTAGE OF PAY-AT-RISK FOR CEOS OF HEALTHCARE COMPANIES RELATIVE TO THE FIRST- AND EIGHTH-RANKED INDUSTRIES



One of the biggest challenges facing boards is selecting performance measures for executive long-term incentive (LTI) plans. Public companies often struggle to balance the measures that encourage long-term growth and stability with those that result in a high total shareholder return (TSR).

BDO's study found that 3-year EBIT[1] growth and 3-year net income growth were the strongest predictors of TSR for healthcare companies. However, these are not necessarily the measures most commonly used in LTI plans.

Long-Term Incentive Metric Prevalence

	All	Healthcare
TSR	44%	47%
Earnings per Share (EPS)	19%	14%
ROIC/ ROE[2]	18%	0%
Revenue	17%	26%
EBITDA[3]	16%	26%
Operating Income (EBIT)	11%	7%
Strategic Goals	4%	2%
Net Profit / Income	4%	7%
Other	4%	0%
Corporate Performance	4%	2%
Free Cash Flow (FCF)	4%	2%
Individual Performance	2%	2%
No Disclosure	1%	3%

Most Common Metric   Second Most Common Metric   Predictor of TSR

Best Predictors of TSR:
EBIT and Net Income

Most Commonly Used LTI Metrics:
TSR, EBITDA, and Revenue

Gap Analysis:
Revenue and EBITDA are the two most commonly used metrics, but BDO's analyses indicate that EBIT and net income growth are better indicators of TSR growth.

1 EBIT – Earnings Before Interest and Taxes
2 ROE – Return on Equity
3 EBITDA – Earnings Before Interest, Tax, Depreciation, and Amortization

Key Takeaways

Healthcare organizations and their boards need to consider the following key factors regarding executive compensation:

Compensation Strategy
Understand the right hire and retention strategy for current and future leaders. Ensure that the compensation program aligns with the organizational strategy and mission.

Performance Metrics
Select the right metrics for incentive plans. Plan metrics should encourage long-term growth, reinvestment, financial stability, and TSR.

Mix of Pay
Balance incentives with fixed pay. Ensure that pay rewards executives for the achievement of the company's strategic goals, including reinvestment, and does not reward excessive risk-taking.

Employment Agreements
Agreements should be appropriately sized to cover the executives' compensation, while not exposing the company to undue financial liability.

Change of Control Agreements
Enable executives to look for opportunities that will benefit the organization without needing to be concerned about their situation.

Succession Planning
The company should have a talent pipeline for senior-level positions.

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