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Key Considerations for Biopharma Equity Plan Amendments



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Despite the green shoots of market recovery emerging across the biopharma industry, many companies currently planning their annual equity cycle are still feeling the pain of the last two years. During this difficult period, companies relied heavily on their equity plans for compensation support as they sought to replenish underwater equity with new awards and were forced to tighten their belts on cash compensation spend. This has been evidenced by the fact that burn rates across the industry have been above the long-term average for some time.

It's in times like these that the value of an evergreen provision in the equity plan can be truly appreciated. Except, what if the evergreen feature isn't sufficient for the company's needs or worse, what if the company doesn't have one? Most evergreens authorize 3% to 5%, and recent needs have sometimes exceeded that mark.

Companies with share constraints can consider an option exchange or repricing, although these are generally seen as "third rail" tactics by most investors and can be difficult to pull off with a diverse shareholder base. Therefore, companies with a depleted equity pool can instead consider a plan amendment (or new plan adoption) to seek shareholder approval for more shares and, in doing so, will need to consider various factors and third-party perspectives to ensure a successful vote outcome.

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Pool Size and Duration

The share authorization process can be a costly and time-intensive exercise, especially if any shareholder outreach is required. Therefore, while there are plenty of companies

which request shares every year, authorizing multiple years' worth of shares at one time could be ideal, with two or three years being the most common goal. Of course, enough shares to cover two or three years of awards means authorizing two or three times what you need at a bare minimum to get the company through the next annual award cycle. As such, a key question in structuring the proposal becomes "What level of dilution can the company reasonably ask shareholders to take on and that we are confident will be supported?"

Unfortunately, this is not a bright-line test and there are numerous factors at play. However, based on our review of 2023 biopharma proposals, the median share request size among small- and mid-cap companies was approximately 8% of common shares, with over 90% of those proposals passing at the first attempt. Some proposals received solid support even with up to 10% of common shares being authorized, which should give most companies up to two years or more of equity runway if they are judicious with their spend. From this data, one might incorrectly assume that that shareholder support isn't very sensitive to dilution—it is. Rather, this means that a company should carefully communicate in its proposal the rationale for authorizing the number of shares, ideally including how many years the company expects the new pool to last, and that other plan practices and provisions will play an important role in the overall success of the proposal.

Plan Provisions

The equity plan provisions have arguably as much impact on a vote outcome as the size of the share request itself, particularly if the proposed plan contains an evergreen provision. Our review of 2023 proposals found that the overall level of support for companies whose plans include an evergreen provision drops noticeably, emphasizing how important it is to shareholders that they at least have a say in ongoing dilution. Other features such as whether the plan allows for liberal share recycling, places limits on director compensation, prescribes the treatment of time- and performance-based equity awards upon a change-in-control, and the company's clawback policy also play a role and are part of a slate of best practices that companies should follow to maximize their chances of a successful vote. While these are all important items to think through, some are more important than others and most will be more of interest to proxy advisors.

Proxy Advisor Perspectives

Whether you are an emerging growth company, smaller reporting company, or large accelerated filer, proxy advisors such as ISS and Glass Lewis will evaluate your share authorization request and deliver a recommendation "For" or "Against" the proposal. ISS,

the most influential of the two, generally considers the cost of the plan (the total value of equity as a percentage of market cap including the new share request), historical grant practices (such as burn rate and the CEO's equity award parameters), and other plan features (such as the presence of an evergreen provision and other provisions covered in the previous section) in making a points-based determination of support. While their models are built on generally sound principles, they can fall short in the biopharma industry where the economics and inherent risk present unique challenges.

Our review of 2023 proposals suggests that an Against recommendation from proxy advisors can negatively impact the shareholder vote by 20%. This means that companies would be wise to consider what it takes to get proxy advisor support for their proposal, but they may not want to bend over backwards for it: While ISS voted Against almost half of the biopharma proposals we reviewed, over 90% of them still passed.

Conclusion

There are a lot of factors to consider when asking shareholders to approve more shares, and some of these factors are more important than others. For larger share requests, it's important for companies to clearly describe the plan's proposed duration so that shareholders can better understand future dilution, and that the company adopts as many best practice provisions as possible to maximize the chance of success.

Thanks to Terry Newth and Matt Molberger whose research contributed to this article.

About the Author

Rob has 15 years experience in executive compensation and finance, specializing in life sciences and technology—especially emerging, high-growth companies navigating M&A and IPOs.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term

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