



TenStep Supplemental Paper

25 March 2004

Stock Watch

SARs (stock appreciation rights) are a way to pay employees a deferred bonus or incentive compensation. The amount is determined by the appreciation in value of the company's stock over a period of time. When employees exercise their right to receive the payment, SARs are used to pay that amount to the employee. The amount paid at exercise or expiration is equal to the difference between the value of a specified number of shares of company stock on a specified date, usually the date the SARs are granted, and the value of the stock on the date the SARs are exercised or expire.

SAR payouts are generally made in cash, but they also may be paid in company stock or in a combination of cash and company stock. SARs may be granted alone, or they may be granted in addition to stock options or along with stock options.

SARs generally are effective for a fixed number of years (usually five or ten years from the date granted), but they may end sooner in the event of the employee's termination of employment. The SAR may be forfeited in whole or in part if the employee terminates employment prior to one or more designated vesting dates. Employees often may choose when to exercise their SARs, thereby giving them some control over the timing and, subject to fluctuations, the value at the time of exercise. If not exercised earlier, or if the SAR does not give the employee the ability to choose the time of exercise, the value is paid when the term of the SAR expires.

Like SARs, Phantom Stock also is used to provide deferred or incentive bonus compensation to employees and also involves an unsecured promise by the company to pay an amount to an employee at some future date. Typically, a share or unit of Phantom Stock is designed to equal either the actual fair market value of a share of company common stock or an amount determined under an equity-based formula for valuing the stock, such as book value, value determined under a capitalized earnings formula, or a combination of these or other valuation approaches. Phantom Stock units may be awarded to employees or "purchased" by employees through salary reductions, etc. Adjustments to Phantom Stock may be made to reflect any stock splits, stock dividends or other changes to the company's common stock. In some cases, the value of Phantom Stock units increases by any cash dividends paid on the company's common stock.

"Performance units" or "performance shares" are terms often used to refer to variations on Phantom Stock in which employees receive a right to future payment of an amount based upon the attainment of specified company performance goals. Examples of performance goals include achieving a targeted level of earnings, net income, sales, return on equity, etc. over a specified period, which might range from one year to five years. Each performance unit or share has an assigned "par" or "target" value if the performance goals are met exactly, and a scale for increasing the value (e.g., up to 150% or 200% of assigned par value) if the performance goals are exceeded by specified amounts. A reduced or zero value might apply if performance falls below the



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performance goals. Phantom Share payments are typically made shortly after the end of the performance measurement period, but could be further delayed if desired.