A Match Made in Heaven?
Making Mergers and Acquisitions Manageable

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Types of Corporate Transactions

- **Merger**
  - Two similar size organizations agree to go operate as a single new company
  - Both companies’ stocks are surrendered and new company stock is issued in its place
  - Real life – few true mergers of equals

- **Acquisition**
  - One company takes over another
  - Target company ceases to exist
  - Buyer remains and stock continues to trade
  - Generally, unfriendly deals are acquisitions

- **Spin-Off**
  - Company separates a division, subsidiary, or part of its business from the parent company
  - New independent company is formed
Arthur J. Gallagher & Co. Overview

- Founded in 1927, publicly traded since 1984
- Operations in 35 countries and client-service capabilities in more than 140 countries around the world
- Among the world’s top 4 insurance brokers
- Second largest U.S. property and casualty third-party administrator

**Key Statistics**

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<tbody>
<tr>
<td>Annual Revenue (2015)</td>
<td>$4.05B</td>
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<tr>
<td>Total Employees</td>
<td>21,700</td>
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<tr>
<td>Employees Receiving LTI Equity</td>
<td>3.5%</td>
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<tr>
<td>Global Reach</td>
<td>35 Countries 68% Domestic, 32% International</td>
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**Equity Programs:**

- Stock Options 12 countries
- RSUs
- Performance Plan
- ESPP 6 countries

**Simple Business Model**

We sell insurance and adjust claims, without underwriting risk
Culture at AJG

- **Family Legacy.** Strong sense of family; now led by third-generation Gallagher. Long-term focused.


- **Dynamic and Acquisition Focused.** History of acquiring smaller brokers as growth engine; recent larger acquisitions have increased international footprint.

- **Need for Flexibility.** Fast-paced sales environment with decentralized decision making. High customization of compensation programs required.

- **Value New Talent.** Industry-renowned intern program. High investment in young talent. Excellent conversion to employees, with formal program.

- **Performance Driven.** Sales mentality and high recognition of top performance. Programs designed to recognize performance. Little focus on level or hierarchy.
Long Term Incentive Program

- All are eligible
  - Nomination process based on individual performance

- No guarantee to participate
  - No automatic participation by level and no commitments in employee agreements
  - High rotation of participants—36% new to the program in 2015; less than 50% of executives participate in any year

- Participants receive a mix of all three vehicles—all employees receive stock options, RSUs, and performance units (PUPs); officers receive PSUs
  - Mix of vehicles varies; higher concentration of performance awards at top levels
  - Uncommon practice to use performance vehicles so broadly; drives common goal across organization and allows expanded participation

Performance Unit Mechanics:
- Units Awarded
  - Year 0
- Units Earned
  - Year 1
- Unit Valuation Begins
  - Year 2
- Units Valued & Paid
  - Year 3
Acquisition Focus

- Rapid growth: 138% employee growth and 154% core business earnings growth since 2007

- Increasing international focus: five large international acquisitions in 18 months in Canada, UK, Australia, and New Zealand

![Graph showing the number of acquisitions and acquired employees over years](image)

1. **# of Acquisitions**
   - 2012: 60
   - 2013: 30
   - 2014: 70
   - 2015: 50
   - 2016: YTD

2. **# of Acquired Employees**
   - 2012: 500
   - 2013: 1000
   - 2014: 3500
   - 2015: 2500
   - 2016: YTD
Pfizer, Inc.

- Founded in 1849, Pfizer Inc., a biopharmaceutical company, has remained dedicated to discovering and developing new, and better, ways to prevent and treat disease and improve the health and well being for people around the world

- 3 major business segments:
  - Global Innovative Pharmaceutical segment: focuses on developing and commercializing novel, value-creating medicines that significantly improve patients’ lives
  - Global Vaccines, Oncology and Consumer Healthcare (VOC) segment: focuses on the development and commercialization of vaccines and products for oncology and consumer healthcare
  - Global Established Pharmaceutical segment: includes legacy brands that have lost or will soon lose market exclusivity in both developed and emerging markets, branded generics, generic sterile injectable products, biosimilars, and infusion systems

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<td>$49.0B</td>
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<tr>
<td><strong>Total Employees</strong></td>
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<td>97,900</td>
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<td><strong>Stock Delivered Globally in</strong></td>
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<td>Over 80 Countries</td>
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<td><strong>% NA Based LTI Recipients</strong></td>
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<tr>
<td>56%</td>
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<tr>
<td><strong>% Global (Non-NA) LTI Recipients</strong></td>
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<td>44%</td>
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<th>Executive Award Types</th>
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<tr>
<td>Restricted Stock Units</td>
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<td>Performance Share Awards</td>
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<td>5-Year Total Shareholder Return Units</td>
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<td>7-Year Total Shareholder Return Units</td>
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<tr>
<th>Non-Executive Award Types</th>
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<tr>
<td>5-Year Total Shareholder Return Units or Stock Options</td>
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<tr>
<td>Restricted Stock Units and/or Performance awards</td>
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<th>Employee Stock Purchase</th>
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<td>N/A</td>
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<th>Cash Plans</th>
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Long Term Incentive Program

- Align compensation with short- and long-term performance
- Provide compensation and incentives needed to attract, motivate, and retain talent
- Eligibility and targets based on internal pay grades
- Approximately 30% of Pfizer employees are eligible for long-term awards
- Award mix:
  - Executives receive 25% of their award in each of the following equity vehicles:
    - 5 YR Total Shareholder Return Units (TSRUs), 7 YR TSRUs, Performance Shares (PSAs), and Restricted Stock Units (RSUs)
  - Non-executives receive their award in each of the following equity vehicles:
    - 5 YR TSRUs or Stock Options (based on country), Restricted Stock Units (RSUs) and/or Portfolio Performance Shares (PPSs)
Acquisition/Divestiture Focus

- **History:**
  - From 2011 through 2016 to date – 10 small- to medium-sized acquisitions
  - 1 spin-off in 2013 of Zoetis Animal Health

- **Business Strategy:**
  - Products that are synergistic with Pfizer’s existing products or innovative products that will compliment our overall portfolio
  - Enhance pipeline with approved products and candidates for approval
  - Enhance current research and development including intellectual property that compliments Pfizer’s robust research portfolio
  - Divest businesses not core to Pfizer’s overall business strategy

- **Overall items to consider and plan for:**
  - Integration of acquired company
  - Legal issues – Work Councils, different country laws
  - Retention levers for retaining key talent and critical subject expertise, e.g. cash or stock – limited basis adjust base salary and bonuses
PROJECT CONSIDERATIONS
Looking Through the Administrator Lens

- Your stock plan administrator is a partner and a resource – include them on the planning team
  - Experience with all types of corporate actions
    - Begin to discuss timeframes, project plans, and special considerations
    - Capital Markets implications
    - Best practices for participant communications
    - Is the acquired company a client of your administrator? Will the company spun off continue to work with your administrator?

- The majority of the administrator’s work will be done before the corporate action – planning is key

- Is there an opportunity to connect with other internal benefit teams?
Best Practices—Equity Awards

● Review documentation
  – All equity plans and related agreements should be reviewed in light of the transaction
  – Do not forget the “special” award agreements, or severance/retention agreements which might supersede the standard plan document

● Plan for participant communication
  – Affected employees are uncertain; this is an opportunity
  – A thoughtful communication plan decreases the amount of work close to the actual event
Tax and Accounting Implications: Stock Options

- Non-qualified stock options
  - NQSOs can be assumed in an acquisition without tax acceleration
    - Economics should be maintained (i.e., comply with “spread” test under Code Section 424)
    - If not, may be viewed as a new grant to be tested under Reg. §1.83-7
Tax and Accounting Implications: Restricted Stock

- An exchange of target company restricted stock for restricted consideration (either restricted stock or restricted cash) may be taxable if the transaction itself is generally taxable for the shareholders
  - For example, if the transaction does not qualify as a tax-free reorganization

- In a tax-free reorganization, restricted property that is assumed by the purchaser maintains tax-deferred status as long as substantial risk of forfeiture remains
Many equity awards now contain performance conditions; what happens in a corporate transaction?

- Will the awards be cancelled if the performance goals are not achieved at the time of the transaction?
- Will the company decide to waive the performance conditions?
- Will the Board have discretion to waive some or all of the performance conditions?
Tax and Accounting Implications: General U.S. GAAP Considerations

- Incremental Expense
  - Generally continue to account for original award plus any incremental cost of the new grant
  - Incremental expense = the excess of the new award fair value over the fair value of the original award at modification date
    - Incremental value expensed immediately for vested options
    - Incremental value added to unrecognized original value of unvested options and expensed over remaining vesting period
  - If the new award fair value is less than the current fair value of the original award, no incremental expense is recorded
  - The original expense associated with the original award cannot be reduced by the incremental expense
Global Considerations

- Need to assess on a country-by-country basis:
  - Current qualified plan and tax situations
  - Tax withholding and reporting obligations for “cross-employer” awards
  - Alternatives available under local tax laws
  - Tax, securities, and legal filing requirements
  - Communications to colleagues
  - Chargeback opportunities under new structure
  - Administration issues – conversion and ongoing
Global Considerations: Terms/Documentation

- Clearly communicate to employees how the conversion will work and how it may affect the taxation of their awards.

- Check to make sure that award agreements have been signed, and may want employees to execute a new award agreement.

- Make sure that “new” terms are clearly documented and understood (is this really a substitution or an assumption of existing terms?)
In Summary…

- Prework = less work, less worry
- Coordinate early with internal and external partners and experts, including industry peers
- Be ready to play a coordinator role – as administrator, you know a lot about many topics
- Think globally, act locally
- While developing the overall message, remember the impact on each individual participant – uncertainty leads to work
- Leave room in the project plan for contingencies – things change
Thank You!

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