

U.S. CEOs Replace Option Grants With Free Shares: Graef Crystal

Feb. 11 (Bloomberg) -- As the bulk of U.S. companies disclose executive pay for 2003, we will find that stock-option grants have declined in size. That's the good news for those who think chief executive officers are paid too much. The bad news is that free share grants have taken up, or more than taken up, the slack.

These are the key conclusions from an analysis of grants made to the CEOs of companies in the Standard & Poor's 500 Index during the last half of 2003. Equilar Inc., an independent provider of executive pay information, furnished the data.

The following table shows the 15 largest option grants, measured by multiplying the number of shares in the grant by the market price per share on the grant date. The table also shows the options' in-the-money status, determined by multiplying the number of shares by the difference between their strike price and last week's closing stock price.

Largest Option Grants		Size of Grant	In Money
Company	CEO	(000)	(000)
Anheuser-Busch Cos.	Patrick Stokes	\$70,770	-\$352
Cisco Systems Inc.	John Chambers	\$37,020	\$12,460
Gannett Co.	Douglas McCorkindale	\$34,932	-\$988
Gillette Co.	James Kilts	\$32,380	\$4,590
Lehman Brothers Holdings	Richard Fuld	\$32,126	\$4,856
Washington Mutual Inc.	Kerry Killinger	\$30,043	\$3,572
Amgen Inc.	Kevin Sharer	\$29,633	-\$445
Applied Materials Inc.	Michael Splinter	\$24,695	-\$77
Citigroup Inc.	Sanford Weill *	\$24,311	\$980
Campbell Soup Co.	Douglas Conant	\$24,263	\$434
McKesson Corp.	John Hammergren	\$24,052	-\$3,451
American Intl Group Inc.	Maurice Greenberg	\$23,981	\$3,086
Occidental Petroleum	Ray Irani	\$21,791	\$8,701
General Mills Inc.	Stephen Sanger	\$21,612	-\$518
Johnson Controls Inc.	John Barth	\$21,020	\$3,004

* Former CEO

Low \$21,020 -\$3,451 Median \$24,695 \$980 Average \$30,175 \$2,390 High \$70,770 \$12,460

A few observations:

-- The typical option in this group is modestly in the money. One wouldn't expect large numbers here, because the options aren't even one year old.

-- Estimated present values for these grants are far higher than the in-the-money amounts. The median and average values were \$8.1 million and \$10 million, respectively, based on an assumption that their present value equaled 33 percent of the underlying stock's value on the grant date. Statistics derived from an analysis of the S&P 500 show this percentage is typical.

-- Anheuser-Busch's Stokes, the CEO with the largest grant, received exactly the same number of underlying shares in 2003 as he did in each of the two preceding years. One has to wonder how

his board decided the grants should be exactly 1,354,200 shares and not, say, 1,354,000 or 1,355,000.

-- Cisco Systems' Chambers received options on 6 million shares for the fiscal year that ended July 31, 2001, and on the same number for the following year. Subsequently, he voluntarily relinquished one of his 2002 grants, covering 2 million shares. That left him with 4 million. For fiscal 2003, Chambers received new grants on another 4 million shares. One of the grants, for 2 million, appears in the table.

-- Gannett's McCorkindale received a grant in December 2003 for 400,000 shares, the same number as a year earlier.

The following table shows the 15 largest free share grants, as measured by their value as of Friday's close.

Largest Free-Share Grants

Value Company CEO (000) Nextel Communications Inc. Timothy Donahue \$26,940 Exxon Mobil Corp. Lee Raymond \$20,255 Citigroup Inc. Charles Prince \$15,697 Occidental Petroleum Corp. Ray Irani \$14,826 Sanmina-SCI Corp. Jure Sola \$13,090 Anadarko Petroleum Corp. James Hackett \$10,020 Boise Cascade Corp. George Harad \$8,415 Duke Energy Corp. Paul Anderson \$6,239 Robert Half International Inc. Harold Messmer \$6,180 North Fork Bancorp John Kanas \$5,882 CIGNA Corp. Edward Hanway \$5,655 Home Depot Inc. Robert Nardelli \$4,905 Deere & Co. Robert Lane \$4,589 EOG Resources Inc. Mark Papa \$4,326 Morgan Stanley Philip Purcell \$4,216

Low \$4,216

Median \$6,239

Average \$10,082

High \$26,940

A few comments here:

-- The average grant was worth \$10 million, matching the average estimated present value for the 15 largest option grants. This parity would rarely have been observed in recent years, suggesting that free-share grants are rapidly becoming the long-term incentive plan du jour.

-- There's a big difference between the average free-share grant and the average option grant. If the company's stock price drops by half, the free shares will still be worth \$4.7 to \$5 million, while the options will be worth nada. This advantage explains why CEOs are so currently enamored of free shares. After being burned by the steep market declines of the past few years, they are now steering their pay ships to safe harbors, ironically at the very time when stocks are heading up.

Nextel's Donahue

-- Nextel's Donahue, who received the largest free-share grant, had received only option grants in 2000, 2001 and 2002. In 2002, the strike prices of his two option grants, each covering 1 million shares, were \$5.02 and \$5.35. On Feb. 6, Nextel stock closed at \$26.94.

That's a thrilling increase. But it apparently thrilled Donahue too much, because he received free shares -- 1 million of them -- for the first time. To me, this suggests he isn't looking for a steep rise in Nextel's stock price during the next few years and is more interested in protecting against losses.

-- Exxon Mobil's Raymond has become quite fond of free shares. For 2000, 2001 and 2002, he received grants worth \$9 million, \$7.4 million and \$17.3 million, respectively. Last November, he received another 500,000 free shares, worth \$17.9 million at the time and \$20.3 million as of Friday.

Latest Grant

The latest grant came just in time to help restore Raymond's motivational levels. According to Washington Service, he exercised stock options eight times last year. The exercises and subsequent sales totaled 744,000 shares. He received no option grants during the last half of 2003.

-- Citigroup's Prince, the new CEO, received a welcome-to-your-new-job grant covering 318,337 free shares in July 2003. Weill, his predecessor, received none last year.

-- Occidental's Irani was the only executive to make the lists of largest option grants and largest number of free shares. That factoid underscores his longtime eminence as a champion pay abuser. In 2002, for instance, his pay jumped by 39 percent after more than doubling the previous year.

The move to free share grants from option grants will likely result in smaller amounts of CEO income if the stock market keeps going up. Yet I, for one, am not pleased about this switch. What troubles me is all the money some CEOs will make even as their performance falters.

Pay for Performance

Fortunately, a few companies are handing out free share grants with performance conditions attached. Boeing Co., the world's largest planemaker, is one example.

Boeing's top executives have to deliver stock price appreciation of at least 15 percent a year over five years to earn their maximum share awards granted in 2002. If the appreciation is less than 10 percent a year, the share awards are forfeited.

For executives at these kinds of companies, it isn't enough to hang around on the payroll to receive lots of money. They also must contribute something of value. Institutional investors need to encourage plans of that stripe.

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