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A 'Holy Cow' Moment in Payland

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EVERYBODY knows that executive compensation at many companies has been obscene. What everybody does not know is how obscene obscene is now.

Some shareholders have a better idea than most, of course. Consider the owners of Analog Devices, a semiconductor maker in Norwood, Mass. Those who bothered to read the company's proxy, filed on Feb. 2, saw in glorious black and white that Jerald G. Fishman, the chief executive, had backed up his truck to corporate headquarters late last year and loaded up the \$144.7 million that he was owed in deferred compensation.

In keeping with a practice that is widespread in corporate America — and that the Securities and Exchange Commission hopes to change soon — the company had previously not disclosed the amount of Mr. Fishman's deferred-compensation balance as it grew each year.

The revelation that struck Analog Devices' holders is known in executive payland as a holy-cow moment — that electrifying instant when shareholders learn how much of their money is being siphoned off by their company's leaders. The S.E.C. wants shareholders to have precise details about how much deferred compensation is growing in the dark, in the basement of their companies, and has proposed new rules that would force companies to shine light on the balances being accrued by executives.

Give Analog Devices a gold star for disclosing the deferred compensation earned by its executives and directors before regulators required it. Maria C. Tagliaferro, a company spokeswoman, said that Analog Devices had made the disclosure because it wanted to be completely transparent to its shareholders.

But Analog Devices is also in the midst of settling a matter that was initiated in late 2004 by the S.E.C. related to its compensation practices — specifically, to the timing of the company's stock option grants to its employees, officers and directors. It seems that in November 1999 and in November 2000 the company may have made grants just before its release of favorable financial reports; it may also have granted options on the wrong dates in 1998, 1999 and 2001.

Although a settlement has not been announced, Analog Devices said in its proxy that it hoped to resolve the matter by paying a \$3 million penalty. Under the proposed deal, Mr. Fishman would pay \$1 million and make an unspecified disgorgement payment. As is customary, the company and its executives would settle without admitting or denying wrongdoing.

STOCK options also played a role in the \$144.7 million that Mr. Fishman took out of the company last year, a money mountain that is remarkable not only for its size but also for what it included.

According to Analog Devices' proxy statement, the \$144.7 million included gains on stock options he had exercised between 1997 and 2003. That is unusual; salary and bonus are the types of compensation

that companies typically allow their executives to defer.

Indeed, a study of the country's 96 largest publicly traded companies conducted last fall by Equilar Inc., a compensation analysis firm in San Mateo, Calif., found that 75 offered deferred compensation arrangements for their executives. Of those companies, only 10 allowed for deferral of stock option grants.

Analog Devices' deferred-compensation program is notable for another reason: the above-market interest that Mr. Fishman and other Analog executives earned on the pay that they chose to defer.

The proxy stated that the interest rate paid to Analog Devices' executives in fiscal 2005 was 6.48 percent — well above the average long-term rate of 4.64 percent that United States Treasury bonds paid last year. This sweet rate helped Mr. Fishman earn \$8.7 million last year in interest on his deferred pay balance. Interest generated by four other top Analog Devices executives totaled an additional \$5.6 million; three directors also earned \$59,000 in interest on their deferred compensation last year.

Ms. Tagliaferro said the interest rate paid by the company is based on the cost that Analog Devices pays to borrow money. The rate is reviewed by the company's compensation committee and approved by its entire board.

Itzhak Sharav, an adjunct professor of accounting at Columbia Business School, said the above-market interest rate paid by Analog Devices was problematic from a shareholder's point of view. "To the extent they pay them above-market interest, somebody has to pay for it, somebody suffers," he said. "And that is the stockholders."

Ms. Tagliaferro defended Mr. Fishman's deferred compensation, saying that it reflected the climb in Analog Devices' stock price during the 11 years, starting in 1995, that his millions multiplied.

"Analog Devices is not at all an example of corporate greed," she said. "I think the company has demonstrated that we've been able to tie our executive comp. to the same success that shareholders would realize and that our employees realize when we achieve those goals."

Analog Devices certainly has produced gains for those lucky enough to have held the stock since the beginning of 1995. From then until the end of last year, the shares have risen at an average annual rate of 18.1 percent. The Philadelphia Semiconductor Index has risen just 12.1 percent, annualized, during that period.

In the last five years, however, the situation has been different. Analog Devices has lost 6.55 percent, annualized, versus a decline of 3.38 percent for the index.

In calculating Mr. Fishman's total pay, Analog Devices' compensation committee said it took into account his "strong leadership in guiding A.D.I. through the downturn in the semiconductor industry, his position as a leading executive in the semiconductor industry and A.D.I.'s performance over the past fiscal year relative to its peer companies." As for linking pay to performance, the committee said Mr. Fishman's bonus was calculated based on the company's operating profit before tax as a percentage of its revenue.

But the company also excluded restructuring charges from the figure used to calculate the bonus. Too bad shareholders' returns can't be similarly adjusted to exclude the restructuring charges their companies take.

MR. FISHMAN, bless his soul, did decide to turn back the options that his board had planned to give him in 2006. Perhaps he concluded that his \$144.7 million in deferred compensation, his \$931,000 salary, his bonus of \$414,000, his 400,000 options at a strike price of \$37.70 each, and the \$2.85 million he received from the exercise of 95,000 options in fiscal 2005 were enough to feed and clothe his family.

As shareholders are learning, executive pay today is like the iceberg that sank the Titanic: scary on the surface, but scarier below it.