

Horton, Toll, KB Home Pay-Performance Inverted: Graef Crystal

March 10 (Bloomberg) -- If you want some serious evidence of the not-infrequent inversion between pay and performance, where the best performer earns the least and the worst performer earns the most, take a look at three U.S. homebuilders and their chief executives.

The companies are D.R. Horton Inc., Toll Brothers Inc. and KB Home. Their CEOs are, respectively, Donald Tomnitz, Robert Toll and Bruce Karatz, and their companies are, respectively, the fourth, 11th and fifth-largest homebuilders in the U.S.

A review of their performance from Nov. 12, 1998, the earliest date all three of these CEOs were in their positions at the same time, to last Friday's close of trading shows:

-- Horton's cumulative total return was 480 percent. In stock price appreciation alone, the Arlington, Texas-based Horton would have ranked eighth against companies in the Standard & Poor's 500 Index.

-- Toll Brothers' performance is also impressive, though not nearly as good as Horton's. Its cumulative total return was 294 percent, and it would have ranked 20th in stock-price appreciation.

-- The caboose of this three-car train is KB Home, with cumulative total return of 212 percent. The firm ranked 42nd among the S&P 500 group.

In sum, we have three excellently performing companies, some more excellent than others.

Total Pay

Now, what about the total pay for each of these CEOs? Here's the inversion. (Total pay includes base salary, annual bonus, my estimate of the present value at grant of stock options granted during 2003 using the Black-Scholes model, the value at grant of free share grants made during 2003, payouts in 2003 under other forms of long-term incentive compensation and miscellaneous compensation.)

For the year ended Dec. 31, 2003, Tomnitz earned \$5.8 million. Pay statistics for 2003 for other U.S. CEOs aren't yet widely available, but looking at the 2002 pay of 302 CEOs running U.S. companies with net sales in the \$2.5 billion to \$9 billion range (which encompasses the 2003 net sales of the three companies), a pay level of \$5.8 million would rank Tomnitz in the 63rd percentile, meaning that his pay would have exceeded all but 37 percent of the companies in the group. (Pay data on the 302 companies were furnished by Equilar Inc., an independent provider of executive compensation information.)

2002 vs 2003

Is it fair to compare the 2003 compensation of the three homebuilders with the 2002 pay of other companies? It may not be as unfair as it first appears to be, because my preliminary analyses of early 2003 pay trends suggest that, on the whole, year-over-year pay for CEOs looks to be fairly flat.

A 63rd percentile pay-rank for a company with Horton's performance suggests strongly that its shareholders are sitting on a much undervalued asset, namely, the company's CEO. That's even more the case, because CEO pay is strongly correlated with company size, and Horton is by far the biggest of the three companies. Its 2003 net sales of \$8.7 billion were 3.2 times Toll Brothers' net sales of \$2.8 billion and 1.5 times KB Home's net sales of \$5.9 billion.

Horton was the best performer over the time period reviewed, and No. 1 among the three in 2003, with total return of 152 percent. Tomnitz is the best "buy" among the three.

Robert Toll

For a fine 2003 performance with a total return of 80 percent, a bit more than half of Horton's, Robert Toll didn't receive just \$5.8 million. His total compensation was \$23 million, with \$20.3 million of it being his annual bonus.

In an article on March 4, 2003 ("Toll Boosts Robert Toll's Bonus 46 Percent"), I warned that Toll's new bonus plan had the potential to create runaway compensation. His \$20.3 million bonus was more than double his already-huge bonus of \$9.6 million for the year ended Oct. 31, 2002. Against the 302 similarly sized companies, the Huntingdon Valley, Pennsylvania-based Toll outranked all but 4 percent.

Finally, there is Karatz of Los Angeles-based KB Home. His performance was the lowest of the three in the time period studied. He also had the lowest 2003 total return of 55 percent. Karatz's total pay for 2003 weighed in at \$27 million. Against the 302-company group, Karatz came out higher than all but 3 percent of the companies.

So the best performer among the three homebuilders earns the least, while the lowest performer earns the most. And that, friends, passes for pay-for-performance in early 21st century America.

Go figure.

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