

Did Home Depot Hammer Shareholder Wealth?: John Wasik

June 9 (Bloomberg) -- If you want to see how the stormy relationship between chief executive officer pay and shareholder returns is playing out, look at Atlanta-based Home Depot Inc., which has a market value of \$74 billion and has become a crucible for corporate governance.

At the world's largest home-improvement retailer, shareholders are challenging everything from director independence to making the CEO and board chairman roles separate.

If you're a stockholder, however, the question of the day shouldn't be "Is the CEO paid too much?" It should be "How did the CEO and board of directors increase my wealth?"

In the case of Home Depot, it's hard to justify CEO Robert Nardelli's salary and bonus of \$4 million, a \$10 million loan, \$8.4 million in restricted stock awards and \$5.2 million in other compensation, which are all noted in the proxy statement for the fiscal year 2002. The ex-General Electric Co. executive has been under the gun at Home Depot for the company's troubling performance last year.

CEO compensation has been a traditional place to start in asking whether management delivered for shareholders. Last year, median CEO pay packages rose 14 percent to \$13.2 million against a 22 percent loss in the S&P 500, according to Equilar, a compensation-data service.

You have to look beyond CEO pay, though, and examine the benchmarks of company performance to see if managers are worth their extravagant packages.

Aligned with Shareholders?

Home Depot shareholders have a good reason to request some remodeling of the company's management structure.

Let's look at the period from Dec. 29, 2000, the first month of Nardelli's tenure at the company, through Dec. 31, 2002. Here's how the company compared with widely accepted industry benchmarks:

-- Stacked up against other retailers as represented by the broad S&P Retail Stores composite index, Home Depot trailed that index by 39 percentage points during that period, according to Bloomberg data.

-- Against its closest peers on the S&P Home Improvement Retail Index, the company underperformed by 17 percent.

-- The real pounding comes when you compare Home Depot to arch-rival Lowe's Cos., Inc. Home Depot lagged Lowe's in total return by 116 percent.

How much of the company's troubled performance is due to Nardelli and his management cadre? He can't take the entire blame over a five-year period. On page 111 of the 145-page statement, the company shows that \$100 invested over five years in Home Depot would be worth \$112.79 on Feb. 2, 2003.

Investing in a group of retailers through the S&P Retail Composite index -- the index the company chose as a benchmark -- you would have turned your \$100 into \$139.09. So if the index did 23 percent better, why own Home Depot?

Performance-Management Link

Despite record-low mortgage rates and rising home sales that propelled overall demand for HD's products and services, Home Depot's stock price dropped and lagged its closest competitor last year.

If you had invested in 1,000 Home Depot shares on Dec. 31, 2001, and held for a year, your investment would have declined by 52 percent with dividends reinvested, according to Bloomberg data. The stock price fell from \$51 to \$24 a share during that period.

At the company's annual meeting on May 30 Arthur Dersch, a shareholder who's seen his stock drop from \$68 to the mid \$30s, called for Nardelli's resignation. He told me, ``If a guy drives a stock price down, he's not worth it."

Shareholder activist Evelyn Davis even called to task lead director and co-founder Kenneth Langone at the meeting, questioning his independence as a director and his investment firm's involvement in a National Association of Securities Dealers probe.

When companies are performing well, few shareholders challenge the CEO or board. As investors increasingly link director and CEO performance to total return on the stocks they own, every possible conflict is in the klieg lights.

Human Factors

Speaking at the company's annual meeting, Nardelli acknowledged the performance shortfall, although he didn't comment on his compensation package.

``We did not achieve our forecast revenue growth of 15 percent to 18 percent," Nardelli said. ``Shareholders who saw the stock drop were certainly disappointed."

Yet managing a large company involves a wheelbarrow full of human factors, so the story doesn't stop there.

Larry Puglia, who manages the \$5.8 billion T. Rowe Price Blue Chip growth fund, said he won't sell the stock, which he's held for the past 10 years. Overall, T. Rowe Price owns close to 20 million shares and is one of the largest holders of Home Depot.

While he agrees that last year the company fell short, Puglia says management has directly addressed many of its problems.

``Clearly Home Depot was struggling and management made some mistakes and the stock didn't perform well," says Puglia. ``The stock is up 32 percent this year and has good performance in the year to date owing to management improvements."

Bottom Line

Despite the troubling numbers at Home Depot last year, shareholders overwhelmingly approved executive compensation packages and the slate of directors, which is the case at most annual meetings.

The lone pro-shareholder victory by Home Depot dissenters was a management-opposed proposal to allow shareholders to vote on ``poison-pill" measures to thwart takeovers. Another shareholder proposal to separate the CEO and chairman's jobs received more than one-third of shareholder votes.

As shareholders around the world register their protests over corporate governance and poor returns, they are becoming more vigilant in asserting their rights.

The Council of Institutional Investors, among other corporate- governance groups, is urging the U.S. Securities and Exchange Commission to allow shareholders greater freedom to nominate board directors.

You can register your opinion with the SEC by sending your comments to rule-comments@sec.gov referencing ``file #S7-10-03'' in the subject line.

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