AMD'S HECTOR RUIZ: A FAILED CEOSHIP – AND TOO MUCH MONEY

by Graef Crystal

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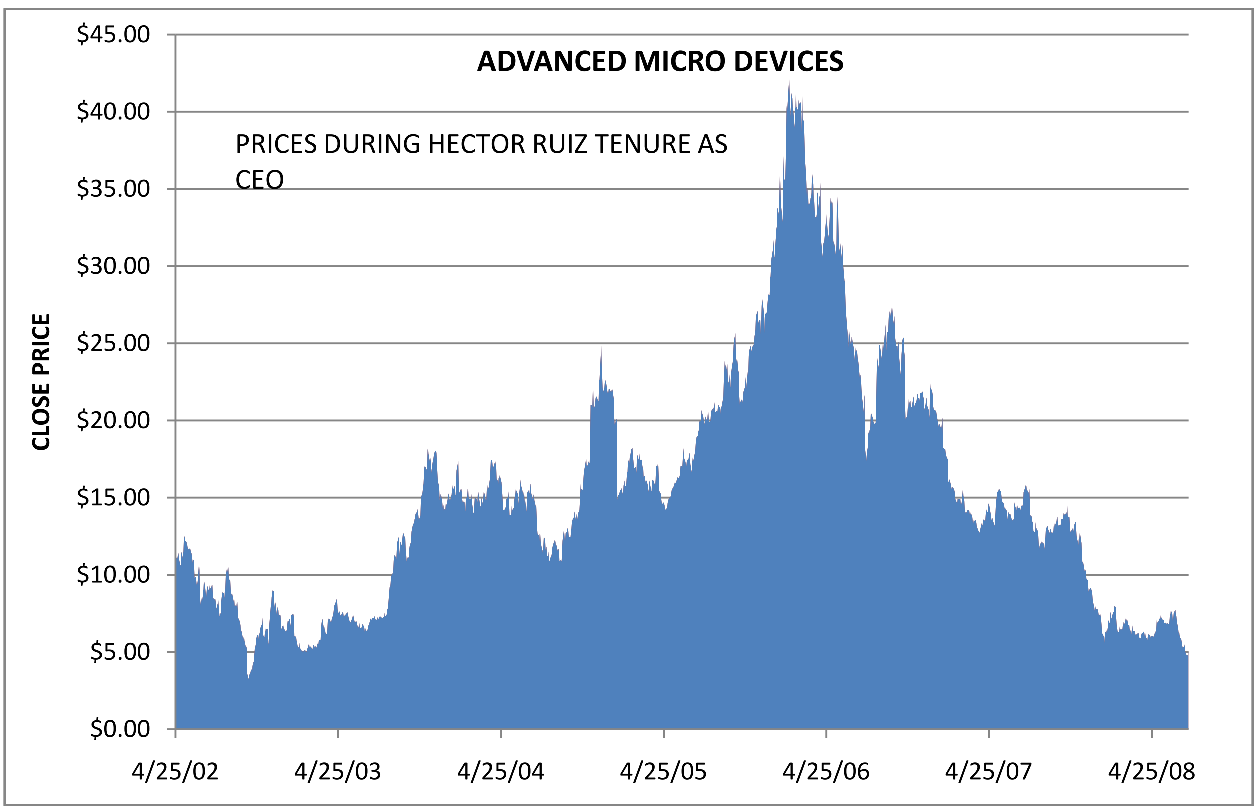
On this July 17, the board of directors of Sunnyvale, California-headquartered Advanced Micro Devices Inc. gathered together to sack their current chief executive officer, Dr. Hector de J. Ruiz. (He holds a Ph.D. in engineering from Rice University.)

In my opinion, the decision came almost two years too late. For AMD's stock peaked at $42.10 on Feb. 1, 2006. After that, it was fundamentally all downhill, with the stock reaching a close price of $5.06 a share on July 16, Dr. Ruiz's last day as CEO. (The 62-year old Ruiz will remain as the non-executive chairman of the board, having been replaced as CEO by Derrick Meyer.)

Ruiz's Performance

Here is a graphic record of the close prices between April 25, 2002, when Dr. Ruiz showed up from Motorola Inc. to become CEO, and this July 16, when he was removed from his CEOship.



That chart looks more than faintly reminiscent of a normal distribution, i.e., the old bell-shaped curve that applies to random events. So if what happened to AMD's stock prices was a case of randomness, how is it that Dr. Ruiz earned the money he did?

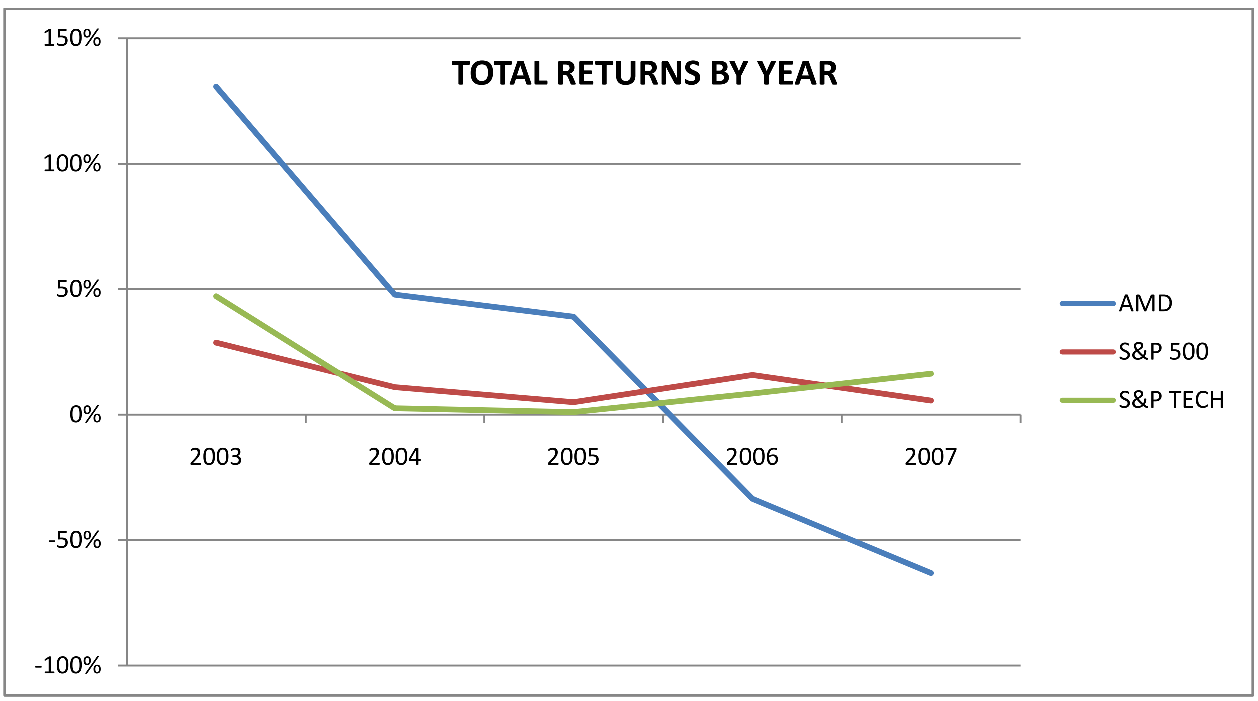
AMD's performance under Dr. Ruiz's leadership certainly did degrade. Consider the following additional facts:

- The company's operating income for 2003, Dr. Ruiz's first full year as CEO, came in at negative $233 million. Operating income turned positive in 2004 and 2005, with AMD posting, respectively, $222 million and $232 million. That last figure was the high water mark.

- Because in 2006 and 2007, the red ink showed up once again – negative $47 million for 2006 and negative $2.9 billion for 2007.

- In that last year, diluted EPS were negative $6.06 a share.

The following chart shows total returns in the full years during which Dr. Ruiz was CEO. The comparisons are to the S&P 500 Index and the S&P 500 Information Technology Index:



As for total returns between Dec. 31, 2007 and the close on July 30, AMD's was negative 43.6%, while those for the S&P 500 and the S&P 500 Information Technology Indices were, respectively, negative 11.5 percent and negative 13.6 percent.

Ruiz's Pay

At the end of 2007, Dr. Ruiz was sitting on 32 option grants, every single one of them underwater. More than that, were he to keep all those options until the last day of their terms, they still would be underwater based on likely stock growth calculated according to the Capital Assets Pricing Model. The strike prices of these 32 grants ranged from $11.33 a share to $33.95 a share.

He also received two option grants thus far in 2008. The first, granted on Feb. 15, 2008, covered 62,500 shares and carried a strike price of $6.45 a share. The term was seven years.

The second, granted on May 15, 2008, covered 137,500 shares and carried a strike price of $7.41 a share. The term was also seven years.

Both these grants were underwater as of July 30, when the stock closed at $4.23 a share.

Note, though, how low these two most recent strike prices are compared to earlier strike prices. The probability that Dr. Ruiz will gain from these two grants is much higher than his earlier grants and serves to reinforce the notion that there is more than a single way to make good money from options. To be sure, an-ever rising stock price is pure gold. But if you have immense stock price volatility, as AMD has, then just keep collecting more and more grants. In poor times, you can chase the strike price down, and when the stock recovers even a bit, you've made another few millions.

Still, even though AMD's stock price during Dr. Ruiz's tenure as CEO ended up lower than it started, he nonetheless reaped some handsome option gains, including:

- $3.1 million in 2005.

- $9.3 million in 2006.

How can this be? Well, when you combine high stock price volatility with early exercise provisions, you effectively transform what is supposed to be a long-term incentive into a short-term incentive. In at least one case, a substantial part of Dr. Ruiz's option grant vested within three months of its grant date.

In my view, if you want to turn stock options into the long-term incentives they are supposed to be, you don't allow any options to be vested for five years. Had that occurred, it is doubtful that Dr. Ruiz would have received any option gains.

But you've got to give him some credit, because at least his options were not repriced. Dr. Ruiz's predecessor, the flamboyant Jerry Sanders, managed to reprice his options six times in that many years. That practice went out with him.

Leaving aside repricings, there once were the good old days, when the only long-term incentive vehicle in Silicon Valley was stock options. But the good old days featured soaring stock prices.

Now the stock price chart of many Valley companies looks soaring only if you hold it upside down.

So how do you make money in the new environment? The short-form answer is that you don’t rely on options any more, or at least you don’t rely totally on options.

And that is what AMD has done. Besides his option grants, Dr. Ruiz received free shares grants in 2005, 2006 and 2007. The aggregate value of those three grants was $16.5 million, measured as of the grant dates. And on May 15th of this year, he received another free share grant, this one covering 275,000 shares worth $2 million at the time they were granted.

Dr. Ruiz also receievd $7.8 million of bonuses during the years 2003 through 2006, although he received no bonus in 2007.

AMD has also followed in some years the practice of granting bonuses semi-annually. With volatile results, that practice helps the executive, since he can receive a bonus either for the first half of the year or for the second half of the year, when, if bonuses were predicated on the results of the entire year, he might receive no bonus at all.

There is, finally, the question of why it took AMD’s board so long to move on a failing CEO. Sure, maybe you cut someone some slack in, say, 2006, when the total return was negative 34 percent. After all, it had been positive 39 percent the year before. But as 2007 proceeded, and it became increasingly evident that an even bigger disaster was in the cards (a negative return of 63 percent), AMD’s board, in my opinion, should have faced realities and replaced Dr. Ruiz as CEO.

Instead, he was allowed to hang on through this July 17. And even now, he isn’t gone. He is the non-executive chairman of the board, with who knows what sort of pay package.

For the sake of AMD’s shareholders, I hope he isn’t offering his successor any advice. And I hope that if he is, his successor isn’t taking it.

In sum, Hector Ruiz earned a lot of money for no good reason.

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End Note on a Different Subject

Lawyer, accountant and mathematician, Steve O’Byrne, the president of Larchmont, New York-based Shareholder Advisors, has been my close friend for years. I became his mentor when he joined Towers Perrin decades ago. After quickly running out of things to teach him, it became apparent to me that I needed to become his pupil, not his mentor. And it has pretty much been that way ever since.

In perusing the tables included in my recent article on CFO pay, Steve discovered one women among the 30 most relatively-overpaid CFOs. But he discovered six women among the 30 most relatively-underpaid CFOs.

Progress on equality is doubtless being made, but Steve's finding shows that we're not there yet.