

PAY IN COMPUTER AND SOFTWARE COMPANIES -- \$1.00 TO \$72 MILLION

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When it comes to the pay of chief executive officers, there seems to be a difference of opinion in Silicon Valley: There's the Take-Everything-You-Can Get School (Think Larry Ellison); or the Do-the-Job-For-Nothing School (Think Steve Jobs).

Well, not nothing. Jobs' pay as CEO of Apple Inc. is actually One Dollar and No/100. He has another colleague in that same pay hairshirt category. That's Jerry Yang of Yahoo! Inc.

Moving to the other end of the pay spectrum, we find Mr. Ellison. Which is where we find him virtually every year. I clocked his total pay at \$72 million. But more on that later.

In between these two extremes, we have 63 other CEOs whose pay I studied. (Pay information used in this report was derived from Equilar, Inc., a leading provider of executive pay data.) Each CEO was running a company that, at the time I drew data, had a market cap of \$3 billion or higher.

Total Pay Defined

Before proceeding further, let me define what I mean by total pay. It is the sum of:

- Base salary.
- Bonus for annual performance.
- The value at grant of free shares granted during the year.
- My estimate for the present value at grant (using the Black-Scholes model) of stock options granted during the year. (The terms "present value" and "grant date fair value" are synonymous.)
- The "target" value of prospectively-granted performance shares or units awarded during the year.
- The present value of pension accruals made during the year.
- And, as defined by the U.S. Securities and Exchange Commission, miscellaneous compensation.

Regression Results

A multiple regression study showed that, after excluding four outliers, twenty-one percent of the variation in total pay could be explained by two factors:

- The net sales of the company.
- The percent of the total pay package that was received in the form of 2007 stock option grants. Such grants carry more risk than the other elements in the pay package. Hence, this percentage becomes an indicator, if a crude one, of the pay risk the CEO is taking.

I also included a third variable as a predictor of total pay, namely, the company's excess return for its fiscal year 2007. Excess return is the company's actual return less the return on the Standard & Poor's 500 Index for the same period.

After controlling for net sales and pay risk, I found that the excess return factor could not explain any further variation in pay at a statistically-significant level.

The four outlying cases that were excluded in constructing the aforementioned model include not only Messrs. Jobs and Yang but also:

- Steven Ballmer of Microsoft. His total pay was \$1.3 million, a pay level that, if read through my pay model, would have put him 89 percent below a competitive rate.
- Eric Schmidt of Google Inc. With total pay of \$481,000, he was positioned 94 percent below a competitive rate.

Larry Ellison's Pay Package

Let's go back to Oracle's Ellison. His \$72 million pay package consisted of these elements:

- A base salary of \$1 million.
- A bonus of \$10.8 million.
- An option covering 7 million shares with a strike price of \$20.49 a share and a term of 10 years. The \$20.49 strike price matched the closing price on the July 5, 2007 grant date. I scored this option as having a present value at grant of \$58.8 million.
- Miscellaneous compensation of \$1.4 million.

In its proxy statement filed on this Aug. 20, Oracle said that Mr. Ellison's option was worth much more than \$58.8 million – specifically, \$71.4 million.

My analysis suggests that in obtaining that \$71.4 million valuation, Oracle used a term assumption of 10 years; in other words, the entire term. That is a terribly conservative approach, and it stands in stark contrast to the 5.6-year term assumption used in 331 other option grants (made by a variety of companies in different industries and all with 10-year terms) that I studied earlier.

After controlling for company size and pay risk, Mr. Ellison's \$72 million pay package positioned him 211 percent above a competitive pay level.

But that 211 percent overage ranked him, not as the most relatively-highly-paid CEO, but rather as the fourth most relatively-highly-paid CEO.

T.J. Rodgers' Pay Package

The winner of the pay derby, when you take account of both company size and pay risk, was T.J. Rodgers, the longtime CEO and co-founder of Cypress Semiconductor Corp.

The total pay figure used for him was \$20.3 million, a level that positioned him 398 percent above a competitive pay level.

But to be fair to Dr. Rodgers, there is some ambiguity here.

In its proxy statement filed on April 7, 2008, Cypress said it contingently-granted Dr. Rodgers a performance share award of 800,000 shares. Given a price of \$21.44 on the May 11, 2007 grant date, the award was worth \$17.2 million.

But that is not what Cypress said the 800,000 share grant was worth. The figure it used was a much lower \$3.4 million, a value sufficient only to explain 160,000 of the 800,000 shares.

In discussing this grant, Cypress' board compensation committee said that each year, over a five-year period, it would set goals for Dr. Rodgers to achieve. If he achieved them, he would earn 160,000 free shares, or 800,000 for all five years.

For 2007, three goals were used. They were:

- A goal for non-GAAP operating income in the company's semiconductor business.
- A goal for the growth in semiconductor operating income against that of a comparator group.
- A goal for relative stock price appreciation.

All three goals were achieved, and Dr. Rodgers was vested in the first 160,000 shares.

And the last goal – relative stock price appreciation – was achieved in spades. Cypress’ total return for 2007 was 113.6 percent, or 108 percentage points higher than the 5.5 percent return on the S&P 500 Index.

One view of this 800,000 share grant is that only the \$3.4 million value of the 160,000 shares should have been charged to Dr. Rodgers’ 2007 pay, with the remainder of the \$17.2 million grant to be charged in future years, provided it is earned. That is the view that Cypress implicitly took.

If only 160,000 of the shares were counted as 2007 compensation, Dr. Rodgers’ total pay would drop to \$6.6 million from \$20.3 million. On that basis, he would rank as the seventh most relatively highly-compensated CEO, not the first.

But the proxy statement was careful to explain that while the stock awards made to other senior executives must last until at least 2010, the 800,000 shares contingently-granted to Dr. Rodgers contained no such limitations.. Thus, he could be awarded more shares at any time, if his compensation committee so desired.

Indeed, the proof of this last statement lies in a decision by Cypress’ board compensation committee to grant Dr. Rodgers 40,000 more free shares in February 2008.

Further confusing the understanding of this grant is that the entire 800,000 shares were shown as outstanding at yearend 2007 in another portion of Cypress’ proxy statement, with a value of \$17.2 million.

I have long taken the view that: “You grant it, I count it.” That philosophy, combined with the fact that Dr. Rodgers might be given further awards at any future point -- and has already been given such an award -- led me to count all 800,000 shares against his pay package for 2007.

I concede that there is room for argument here. That’s why I felt it necessary to provide a fuller explanation.

Still, one thing is certain: Dr. Rodgers’ pay package for 2007 contained no stock options – formerly the lifeblood of virtually every pay package in Silicon Valley.

As it turns out, options accounted for just 56 percent of the long-term incentive packages of the 62 non-outliers in my study. And if the monster option grant made to Mr. Ellison is excluded from that computation, the percentage drops to 47 percent.

Charges to earnings for stock options was one principal reason for this dampening of the use of stock options. And the recent performance of the stock market was another.

But face it, the days are now gone when Silicon Valley CEOs looked down at the CEOs of other companies as wimps because they took free share grants.

One final point: I tested the pay levels of the computer and software CEOs against other CEOs in my 507-company, multi-industry database of CEO pay among companies with market caps of \$3 billion or higher. What I found is that after controlling for company size and pay risk, the computer and software CEOs were not paid significantly more nor significantly less than CEOs in other industries.

Herewith a table showing for each CEO in my study:

- The company's excess return (i.e., its actual total return for its 2007 fiscal year less the return on the Standard & Poor's 500 Index for the same period). While this factor did not prove predictive in explaining differences in total pay, it has been reproduced here to give the reader a flavor of how well or how poorly the particular company performed for its shareholders.
- The total pay for 2007.
- The percent by which total pay was higher or lower than a competitive standard obtained by controlling for company size and pay risk.
- The table has been arrayed in descending order of the last-mentioned percentage.

Ticker	Company	Executive	2007 EXCESS TOTAL RETURN	TOTAL PAY (millions)	PERCENT ABOVE/ (BELOW) MARKET
CY	CYPRESS SEMICONDUCTOR	RODGERS, THURMAN	108.1%	\$20.3	398%
WDC	WESTERN DIGITAL CORP	COYNE, JOHN	-22.9%	\$25.5	256%
ADI	ANALOG DEVICES INC	FISHMAN, JERALD	-7.3%	\$19.6	244%
ORCL	ORACLE CORP	ELLISON, LAWRENCE	24.5%	\$72.0	211%
BMC	BMC SOFTWARE INC	BEAUCHAMP, ROBERT	10.7%	\$10.8	75%
VRSN	VERISIGN INC	ROPER, JR., WILLIAM	50.9%	\$11.8	70%
AMAT	APPLIED MATERIALS INC	SPLINTER, MICHAEL	-1.6%	\$11.3	60%
NCR	NCR CORP	NUTI, WILLIAM	17.7%	\$12.4	59%
INTU	INTUIT INC	BENNETT, STEPHEN	-23.4%	\$7.9	59%
IBM	INTL. BUSINESS MACHINES	PALMISANO, SAMUEL	7.3%	\$24.2	55%
MU	MICRON TECHNOLOGY INC	APPLETON, STEVEN	-48.9%	\$8.5	42%
ONNN	ON SEMICONDUCTOR CORP	JACKSON, KEITH	11.8%	\$8.2	41%
NSM	NATIONAL SEMICONDUCTOR	HALLA, BRIAN	-14.4%	\$6.0	41%
RHT	RED HAT INC	WHITEHURST, JAMES	-19.4%	\$7.4	36%
MCHP	MICROCHIP TECHNOLOGY	SANGHI, STEVE	0.4%	\$4.8	33%
ERTS	ELECTRONIC ARTS INC.	RICCITIELLO, JOHN	4.2%	\$19.5	33%
LRCX	LAM RESEARCH CORP	NEWBERRY, STEPHEN	-10.6%	\$5.8	25%
HPQ	HEWLETT PACKARD CO	HURD, MARK	19.8%	\$22.2	19%
CA	CA, INC.	SWAINSON, JOHN	-7.5%	\$5.5	0%

Ticker	Company	Executive	2007 EXCESS TOTAL RETURN	TOTAL PAY (millions)	PERCENT ABOVE/ (BELOW) MARKET
MFE	MCAFFEE, INC.	DEWALT, DAVID	26.6%	\$9.4	-1%
TXN	TEXAS INSTRUMENTS INC	TEMPLETON, RICHARD	11.5%	\$10.7	-8%
BRCM	BROADCOM CORP	MCGREGOR, SCOTT	-24.6%	\$8.5	-9%
LLL	L 3 COMMUN. HLDGS.	STRIANESE, MICHAEL	25.4%	\$10.2	-11%
LLTC	LINEAR TECHNOLOGY	MAIER, LOTHAR	-10.4%	\$3.3	-12%
HRS	HARRIS CORP	LANCE, HOWARD	12.1%	\$7.6	-13%
ALTR	ALTERA CORP	DAANE, JOHN	-6.8%	\$3.3	-14%
JNPR	JUNIPER NETWORKS INC	KRIENS, SCOTT	69.8%	\$5.8	-14%
QCOM	QUALCOMM INC	JACOBS, PAUL	1.3%	\$13.3	-14%
EBAY	EBAY INC	WHITMAN, MARGARET	4.9%	\$11.6	-15%
AMD	ADV. MICRO DEVICES	RUIZ, HECTOR	-68.6%	\$6.9	-15%
ADBE	ADOBE SYSTEMS INC	CHIZEN, BRUCE	-2.8%	\$8.2	-22%
CTXS	CITRIX SYSTEMS INC	TEMPLETON, MARK	35.0%	\$4.3	-26%
AKAM	AKAMAI TECHNOLOGIES	SAGAN, PAUL	-40.4%	\$3.0	-30%
ISIL	INTERSIL CORP	BEYER, RICHARD	-1.7%	\$3.7	-31%
ADSK	AUTODESK INC	BASS, CARL	-3.6%	\$7.6	-32%
NVDA	NVIDIA CORP	HUANG, JEN-HSUN	22.7%	\$7.1	-36%
NTAP	NETAPP, INC.	WARMENHOVEN, DANIEL	-30.2%	\$6.8	-37%
KLAC	KLA TENCOR CORP	WALLACE, RICHARD	12.9%	\$2.9	-37%
LXK	LEXMARK INTL.	CURLANDER, PAUL	-57.9%	\$7.7	-38%
EMC	EMC CORP	TUCCI, JOSEPH	34.9%	\$4.7	-39%
INTC	INTEL CORP	OTELLINI, PAUL	28.7%	\$12.7	-39%
CSCO	CISCO SYSTEMS INC	CHAMBERS, JOHN	45.6%	\$15.2	-41%
XLNX	XILINX INC	ROELANDTS, WILLEM	-0.8%	\$2.5	-42%
SNPS	SYNOPSYS INC	DE GEUS, AART	11.0%	\$3.7	-44%
CTV	COMMSCOPE INC	DRENDEL, FRANK	56.0%	\$2.2	-48%
CERN	CERNER CORP	PATTERSON, NEAL	18.5%	\$3.7	-49%
ANSS	ANSYS INC	CASHMAN III, JAMES	85.2%	\$2.9	-50%
MRVL	MARVELL TECH. GRP.	SUTARDJA, SEHAT	-32.8%	\$4.0	-51%
SNDK	SANDISK CORP	HARARI, ELI	-28.4%	\$6.1	-51%
JAVA	SUN MICROSYSTEMS	SCHWARTZ, JONATHAN	6.2%	\$3.8	-52%
LSI	LSI CORP	TALWALKAR, ABHIJIT	-46.5%	\$3.6	-56%
WFR	MEMC ELEC. MATLS.	GAREEB, NABEEL	120.6%	\$1.8	-57%
NUAN	NUANCE COMMUN.	RICCI, PAUL	119.9%	\$1.1	-63%
SYMC	SYMANTEC CORP	THOMPSON, JOHN	1.1%	\$2.2	-63%
MOT	MOTOROLA INC	ZANDER, EDWARD	-26.6%	\$7.5	-68%
WDC	WESTERN DIGITAL	SHAKEEL, ARIF	-22.9%	\$2.2	-68%
ITRI	ITRON INC	NOSBAUM, LEROY	79.6%	\$2.0	-78%
MFE	MCAFFEE, INC.	FULLER, DALE	26.6%	\$0.7	-82%
DELL	DELL INC	DELL, MICHAEL	-14.9%	\$2.0	-84%
SPWR	SUNPOWER CORP	WERNER, THOMAS	245.3%	\$0.5	-84%
STX	SEAGATE TECH.	WATKINS, WILLIAM	-22.8%	\$1.0	-87%
GRMN	GARMIN LTD	KAO, MIN	70.1%	\$0.4	-92%

THE OUTLIERS

Ticker	Company	Executive	2007 EXCESS TOTAL RETURN	TOTAL PAY (millions)	PERCENT ABOVE/ (BELOW) MARKET
MSFT	MICROSOFT CORP	BALLMER, STEVEN	7.6%	\$1,279,821	-89%
GOOG	GOOGLE INC.	SCHMIDT, ERIC	44.7%	\$480,561	-94%
YHOO	YAHOO INC	YANG, JERRY	-14.4%	\$1	-100%
AAPL	APPLE INC	JOBS, STEVEN	82.9%	\$1	-100%