

THE LARGEST POTENTIAL OPTION GAINS

by Graef Crystal

August 2008

I recently studied the amount of paper profits that 494 chief executive officers had amassed in their outstanding stock options as of the end of their 2007 fiscal years. Each CEO was running a company with a market cap of \$3 billion or higher as of the time the data were drawn. (Raw compensation data for this study were supplied by Equilar Inc..)

Collectively, all 494 CEOs were sitting on paper profits that totalled \$10.9 billion, or \$22 million per head. What is more, were they to wait until the last day of their options' terms to exercise them, their potential final profits would likely be around \$23 billion, or \$51 million apiece.

The average CEO had 5.2 years remaining until all of his outstanding options expired.

Only 75 of the 494 CEOs had no paper profits at all, reflecting that though the stock market is not so good at the moment, it had been much better.

The table below shows the 100 CEOs with the largest paper profits in their stock options.

Herewith an explanation of the three key columns in the table:

- AGG_INMON – For each outstanding option at the end of the company's 2007 fiscal year, the product of the number of shares in the option and the amount, if any, by which the closing price on this Aug. 12 exceeded the strike price of the option. The total of all such options was then obtained for each CEO.
- 5_YR_EX_TR – The company's compounded annual total return for the five years ended Dec. 31, 2007 less the return on the Standard & Poors 500 Index (which was 12.8 percent a year). As mentioned above, the average time remaining in outstanding options was 5.2 years. Since the vast majority of options carry 10-year terms, I included this column to give the reader a flavor of the performance of the company during the period between the average date of grant and the end of the company's 2007 fiscal year. I emphasize the word "flavor", because the time remaining in some CEOs' options was obviously more than or less than 5.2 years.
- AGG_PROJ – The aggregate gains that a CEO would likely receive were she to wait until the last day of her options' terms. The projection of future option profits between this Aug. 12 and the end of the options' terms was calculated by using the Capital Asset Pricing Model. That model produced for each individual option an estimated future stock price appreciation, which took into account the following factors:

1. The Risk-Free rate as of this Aug. 12 for a Treasury strip bond carrying a term that approximated the time remaining in each stock option prior to its expiration.
2. The so-called Equity Risk Premium, which Bloomberg estimated on this Aug. 12 to be 6.9 percent. That figure was used with all outstanding stock options.
3. The Beta of the stock as of this Aug. 12.
4. The Current Yield of the stock as of this Aug. 12.
5. The rate of future stock price appreciation was determined by adding together the Risk-Free rate and the product of the Equity Risk Premium and the Beta. From this total was deducted the Current Yield on the stock. However, if the current yield was unusually high, which I arbitrarily defined to be 5 percent or more, then the figure of 5 percent was used in place of the actual current yield.

The numbers at the top of my list are truly awesome. The highest amount of paper profits as of this Aug. 12 was the \$431 million held by John Martin of San Francisco Bay Area-headquartered Gilead Sciences Inc. And the highest amount of likely profits at option expiration was \$699 million, also for Mr. Martin.

There is no question that, on the average, the 100 CEOs in the table that follows performed far better than the remaining CEOs in my study. The average five-year total return for the 100 CEOs was 29.3 percent a year. Subtracting the 12.8 percent return on the S&P 500 Index produced an average excess return of 16.5 percent a year.

In contrast, the average actual return and excess return for the remaining 394 companies was, respectively, 17.8 percent a year and 5 percent a year.

Readers should note that the statistics included in the table that follows assume that any option that was outstanding at the end of 2007 was still outstanding as of this Aug. 12. Given the recent behavior of the stock market, that assumption would likely not be considered heroic. In addition, any stock options granted after the end of 2007 have not been counted at all. But there is likely very little appreciation in those options at the moment.

The table has been arrayed in descending order of AGG_INMON.

COMPANY	CEO	AGG_INMON (millions)	5_YR EX_TR	AGG_PROJ (millions)
GILEAD SCIENCES INC	MARTIN, JOHN	\$431	27.3%	\$699
GENENTECH INC	LEVINSON, ARTHUR	\$339	19.4%	\$540
CONOCOPHILLIPS	MULVA, JAMES	\$330	19.9%	\$526
ULTRA PETROLEUM CORP	WATFORD, MICHAEL	\$247	57.7%	\$145
VORNADO REALTY TRUST	ROTH, STEVEN	\$227	11.7%	\$275
SCHLUMBERGER LTD	GOULD, ANDREW	\$198	24.8%	\$408

COMPANY	CEO	AGG_INMON (millions)	5_YR EX_TR	AGG_PROJ (millions)
SCHLUMBERGER LTD	GOULD, ANDREW	\$198	24.8%	\$408
DANAHER CORP	CULP, LAWRENCE	\$192	9.0%	\$336
HESS CORP	HESS, JOHN	\$159	29.7%	\$285
OCCIDENTAL PET. CORP	IRANI, RAY	\$154	30.2%	\$365
CF IND. HLDGS. INC.	WILSON, STEPHEN	\$151	N/A	\$338
TD AMERITRADE	MOGLIA, JOSEPH	\$150	23.1%	\$266
YUM BRANDS INC	NOVAK, DAVID	\$149	14.1%	\$252
CTC MEDIA, INC.	RODNYANSKY, ALEX.	\$147	N/A	\$270
UNITED TECH. CORP	DAVID, GEORGE	\$146	9.0%	\$315
MONSANTO CO	GRANT, HUGH	\$138	52.7%	\$269
SOUTHWESTERN ENERGY	KORELL, HAROLD	\$120	68.2%	\$159
ENTERGY CORP	LEONARD, WAYNE	\$116	12.0%	\$189
PROCTER & GAMBLE CO	LAFLEY, ALAN	\$97	0.7%	\$232
NVR INC	SAVILLE, PAUL	\$96	-2.9%	\$145
AFLAC INC	AMOS, DANIEL	\$94	4.3%	\$190
AIR PROD. & CHEM. INC	JONES, JOHN	\$93	7.8%	\$172
CISCO SYSTEMS INC	CHAMBERS, JOHN	\$90	2.8%	\$244
EOG RESOURCES INC	PAPA, MARK	\$87	22.6%	\$124
QUALCOMM INC	JACOBS, PAUL	\$86	4.9%	\$216
INTUITIVE SURGICAL INC	SMITH, LONNIE	\$84	79.3%	\$178
HONEYWELL INTL. INC	COTE, DAVID	\$84	10.6%	\$229
CVS CAREMARK CORP	RYAN, THOMAS	\$81	14.1%	\$137
CHEVRON CORP	O'REILLY, DAVID	\$80	14.2%	\$176
FLIR SYSTEMS INC	LEWIS, EARL	\$80	25.9%	\$160
JOHNSON CTRLS. INC	BARTH, JOHN	\$78	11.0%	\$247
BAXTER INTL. INC	PARKINSON, JR., ROBERT	\$76	4.7%	\$175
ANHEUSER-BUSCH COS	BUSCH, AUGUST	\$76	-9.0%	\$182
BURLINGTON NO. SANTA FE	ROSE, MATTHEW	\$75	15.3%	\$172
TOLL BROTHERS INC	TOLL, ROBERT	\$75	1.9%	\$162
CELANESE CORP	WEIDMAN, DAVID	\$72	N/A	\$166
MARRIOTT INTL INC	MARRIOTT, WILLARD	\$71	3.7%	\$158
GENERAL DYNAMICS CORP	CHABRAJA, NICHOLAS	\$69	6.5%	\$95
MURPHY OIL CORP /DE	DEMING, CLAIBORNE	\$69	20.4%	\$91
HUDSON CITY BANCORP INC	HERMANE, JR., RONALD	\$66	10.8%	\$123
DEERE & CO	LANE, ROBERT	\$65	21.9%	\$155
V F CORP	MCDONALD, MACKEY	\$64	3.8%	\$119
KANSAS CITY SOUTHERN	HAVERTY, MICHAEL	\$61	10.6%	\$81
PRAXAIR INC	ANGEL, STEPHEN	\$61	14.3%	\$130
SUNPOWER CORP	WERNER, THOMAS	\$59	N/A	\$130
HELMERICH & PAYNE INC	HELMERICH, HANS	\$57	11.7%	\$88
FMC CORP	WALTER, WILLIAM	\$57	19.6%	\$89
UNION PACIFIC CORP	YOUNG, JAMES	\$56	5.0%	\$149
C.R. BARD INC	RING, TIMOTHY	\$55	15.0%	\$111
PACCAR INC	PIGOTT, MARK	\$55	23.9%	\$93
APPLERA CORP	WHITE, TONY	\$55	2.1%	\$77
TYCO INTL. LTD	BREEN, EDWARD	\$52	-3.6%	\$111
MEMC ELEC. MATLS. INC	GAREEB, NABEEL	\$52	50.7%	\$251
LOCKHEED MARTIN CORP	STEVENS, ROBERT	\$52	1.7%	\$118
ROHM & HAAS CO	GUPTA, RAJIV	\$50	0.3%	\$73
SHAW GROUP INC	BERNHARD, J. M.	\$50	16.9%	\$112
ALLERGAN INC.	PYOTT, DAVID	\$50	17.9%	\$161
JACOBS ENGIN. GROUP	MARTIN, CRAIG	\$50	27.1%	\$93
NORTHERN TRUST CORP	OSBORN, WILLIAM	\$49	6.1%	\$107
EATON CORP	CUTLER, ALEXANDER	\$49	9.5%	\$108
AXIS CAPITAL HOLDINGS LTD	CHARMAN, JOHN	\$48	N/A	\$68
AMERICAN TOWER CORP	TAICLET, JR., JAMES	\$47	51.7%	\$142
EATON VANCE CORP	HAWKES, JAMES	\$47	15.2%	\$114

COMPANY	CEO	AGG_INMON (millions)	5_YR EX_TR	AGG_PROJ (millions)
CSX CORP	WARD, MICHAEL	\$47	14.1%	\$69
PLAINS EXPL. & PROD. CO	FLORES, JAMES	\$46	28.0%	\$58
CONSOL ENERGY INC	HARVEY, J. BRETT	\$45	42.1%	\$98
INTL. BUS. MACHINES CORP	PALMISANO, SAMUEL	\$45	-4.8%	\$130
AMB PROPERTY CORP	MOGHADAM, HAMID	\$45	8.2%	\$76
CAMPBELL SOUP CO	CONANT, DOUGLAS	\$45	-1.5%	\$94
BECTON DICKINSON & CO	LUDWIG, EDWARD	\$45	10.9%	\$68
FOSTER WHEELER LTD	MILCHOVICH, RAYMOND	\$45	33.4%	\$71
MARATHON OIL CORP	CAZALOT, JR., CLARENCE	\$45	32.6%	\$111
NUANCE COMMUN., INC.	RICCI, PAUL	\$44	16.3%	\$77
BARR PHARM. INC	DOWNEY, BRUCE	\$44	0.1%	\$89
PUBLIC SVC. ENT. GRP. INC	IZZO, RALPH	\$43	17.4%	\$84
PEPSICO INC	NOOYI, INDRA	\$43	1.6%	\$84
ADOBE SYSTEMS INC	CHIZEN, BRUCE	\$43	15.3%	\$88
JOHNSON & JOHNSON	WELDON, WILLIAM	\$43	-6.2%	\$111
AVON PRODUCTS INC	JUNG, ANDREA	\$42	-2.9%	\$94
MEDCO HLTH. SOL. INC	SNOW, JR., DAVID	\$42	N/A	\$109
GOLDMAN SACHS GROUP	BLANKFEIN, LLOYD	\$41	14.1%	\$178
MCDONALDS CORP	SKINNER, JAMES	\$40	19.5%	\$66
ABBOTT LABORATORIES	WHITE, MILES	\$40	-1.7%	\$118
PRUDENTIAL FINANCIAL INC	RYAN, ARTHUR	\$40	12.7%	\$121
UNITED STATES STEEL CORP	SURMA, JOHN	\$40	44.5%	\$75
RANGE RESOURCES CORP	PINKERTON, JOHN	\$39	57.8%	\$50
NOBLE ENERGY INC	DAVIDSON, CHARLES	\$39	21.3%	\$67
ALLEGHENY ENERGY, INC	EVANSON, PAUL	\$38	40.3%	\$72
DUN & BRADSTREET CORP	ALESIO, STEVEN	\$38	8.2%	\$74
SUN MICROSYSTEMS, INC.	SCHWARTZ, JONATHAN	\$36	-5.0%	\$92
BLACK & DECKER CORP	ARCHIBALD, NOLAN	\$36	-0.9%	\$81
DST SYSTEMS INC	MCDONNELL, THOMAS	\$35	5.5%	\$66
ROCKWELL COLLINS INC	JONES, CLAYTON	\$35	14.0%	\$67
PRICE T ROWE GROUP INC	KENNEDY, JAMES	\$34	24.1%	\$77
EXELON CORP	ROWE, JOHN	\$33	16.5%	\$67
COACH INC	FRANKFORT, LEW	\$33	17.2%	\$179
VARIAN MEDICAL SYSTEMS INC	GUERTIN, TIMOTHY	\$33	3.2%	\$85
ST JUDE MEDICAL INC	STARKS, DANIEL	\$33	2.6%	\$65
URBAN OUTFITTERS INC	SENK, GLEN	\$32	43.2%	\$84
EDISON INTERNATIONAL	BRYSON, JOHN	\$31	25.4%	\$72
BURGER KING HLDGS.	CHIDSEY, JOHN	\$31	N/A	\$56