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## **RUPERT MURDOCH: CHAMPION PAY PORKER**

**by Graef Crystal**

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I use the phrase “champion pay porker” sparingly. But, in my opinion, what else is there to call a chief executive officer who pays himself \$30 million for the fiscal year ended June 30, 2008 and then adds in another \$29 million for his chief operating officer, while at the same time delivering to his shareholders a staggering negative total return of 32.7 percent.

So how does Rupert Murdoch, the chief executive officer of New York-headquartered News Corp. (NWS) get away with carting out so much money and so lavishly rewarding his chief subordinate? Well, for a start, he owns 12.5 percent of the combined Class A and Class B shares of his company. But only the Class B shares are eligible to vote, and of these Mr. Murdoch owns 38.6 percent. That doesn't give him outright majority control, but it's enough to allow him to do more or less what he wants.

The value of Mr. Murdoch's shareholdings as of the close on Sept. 5 was \$4.5 billion.

### **Performance Under Rupert Murdoch**

Let's start by looking at News Corp.'s long- and short-term performance.

I like to concentrate on total shareholder return, because shareholders can't eat EPS, nor can they eat ROE. They can only eat share price appreciation and dividends. Besides, total shareholder return is the one stat that can be compared in an objective manner to the performance of other companies. Other stats like EPS allow for accounting wiggle room or like ROE can be distorted by historical cost contamination and the inclusion of Goodwill.

I also like to look at total returns two ways:

- Through slowly narrowing time windows that show how a shareholder would have fared by buying the stock at a number of different times and then holding it to the end of the period chosen. Given the randomness in the stock market, it is the totally inept CEO who cannot claim with a clear conscience to have been a great success if you start the period

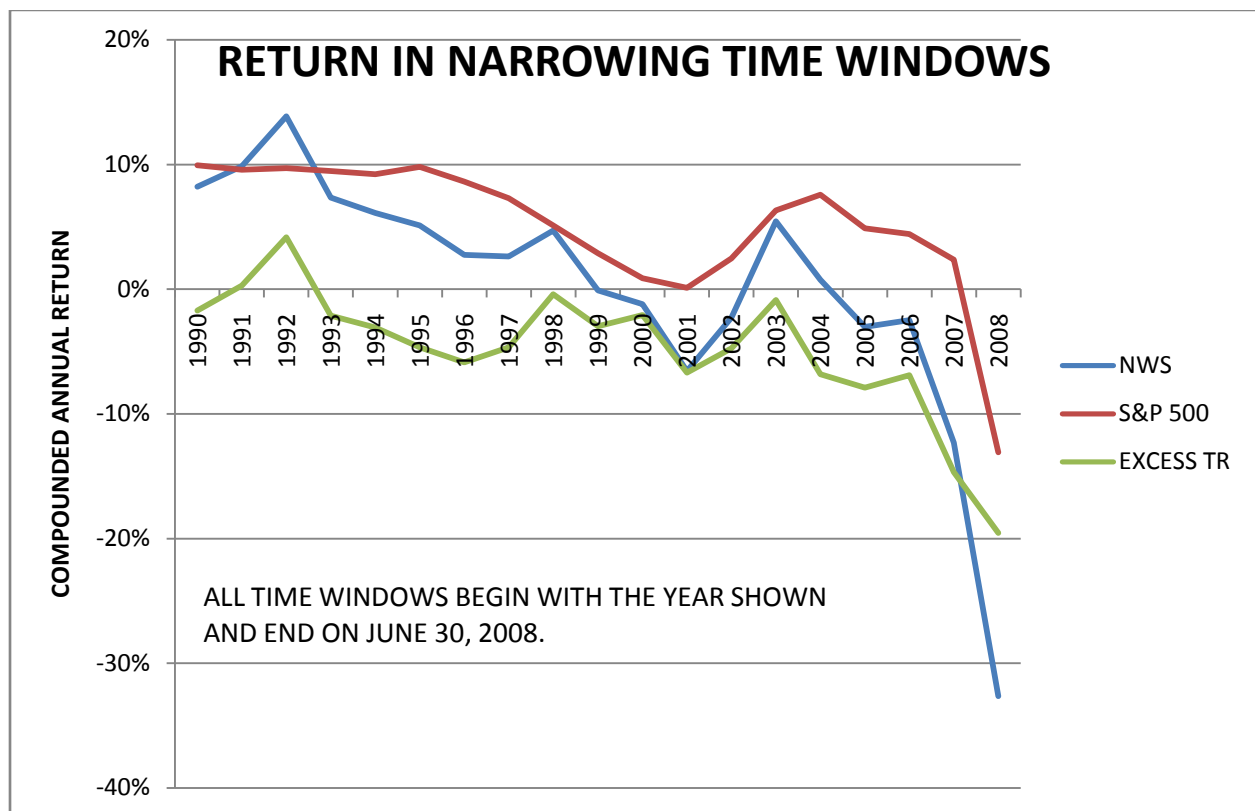
of measurement on the date he selects and ends it another date he selects. But by looking at multiple time windows, the effects of randomness are attenuated.

- Through single-year time windows.

Herewith a chart built on 19 narrowing time windows of performance. The widest window begins June 30, 1989 and ends this June 30, 2008. The second widest window begins June 30, 1990 and also ends on this June 30, 2008. And so on, with the start date of each succeeding window incremented by one year, until finally a single-year time window is reached, i.e., the single year ended June 30, 2008.

Three lines are shown on this chart:

- The compounded annual total return of NWS for the chosen period.
- The compounded annual total return of the Standard & Poor's 500 Index for the same period.
- And the company's excess return (i.e., the amount by which NWS's total return exceeds or is under the return of the S&P 500 Index).



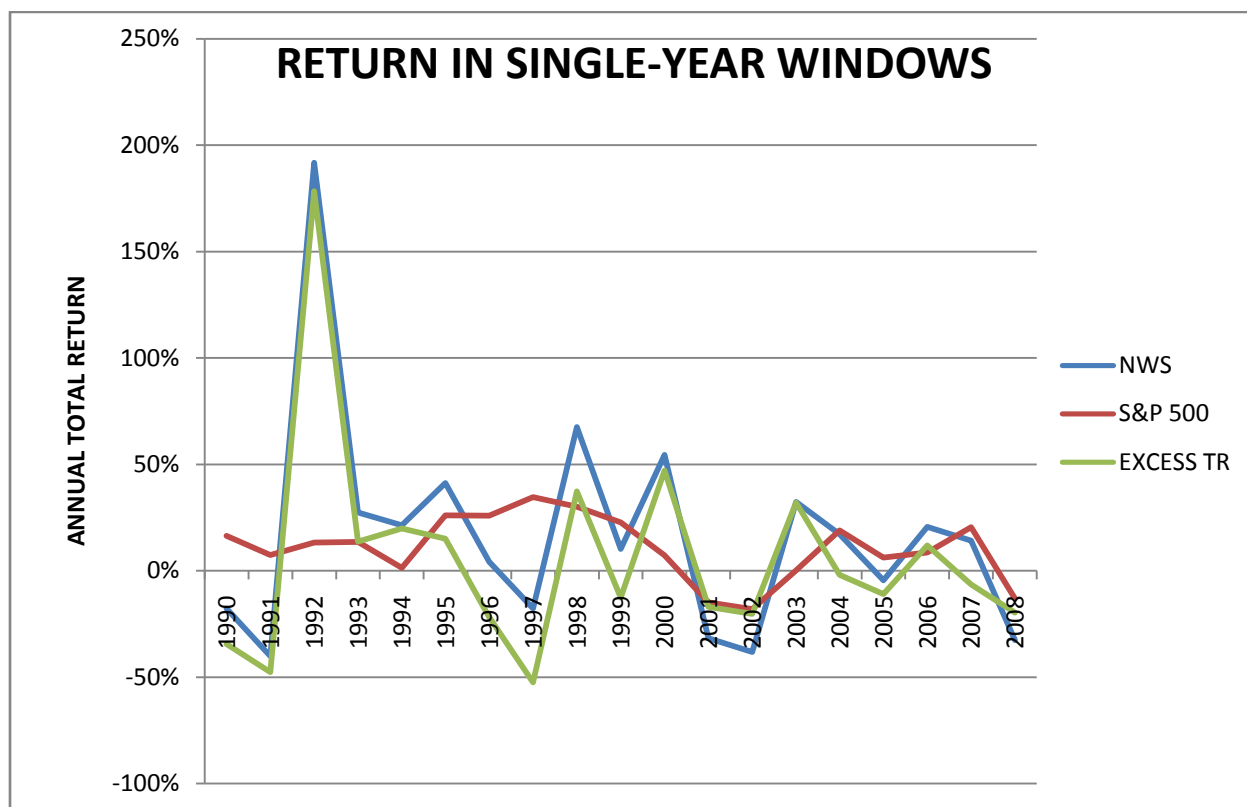
Of the 19 narrowing time windows of performance, NWS managed to beat the S&P 500 Index only twice, and one of those times was by only a minuscule amount. In the median time window, NWS underperformed the S&P 500 Index by 4.7 percentage points a year.

That may not seem like much in the way of underperformance, but don't forget the magic of compounding. Consider here the 14-year period beginning June 30, 1994 and ending June 30, 2008. During this period, the annual total return of NWS underperformed the annual total return of the S&P 500 Index by 4.7 percentage points, exactly equal to the median underage for the 19 time windows. But if you remove the compounding, you find that had you invested \$100 in the S&P 500 Index at the beginning of the period, you would have reaped an eventual profit of \$270 (including reinvested dividends). Had you done the same with NWS, your profit would have been a far lower \$101.

Underlining this sorry performance is the fact that Mr. Murdoch, as of June 30, 2008, was holding an option for 12 million shares, which was granted to him in Nov. 1999. Its strike price was \$42.28 a share. As of the close on this Sept. 5, News Corp. stock was selling at \$13.76 a share.

For another example of how poor performance has been, consider that, also as of June 30, 2008, Peter Chernin, the company's chief operating officer, was holding eight outstanding option grants covering 8 million shares. Were they still to be outstanding as of the close on this Sept. 5, all would be underwater.

The second chart shows the same three lines as the first chart but on a single-year basis.



NWS looks better here. It beats the Standard & Poor's 500 Index in eight of the 19 time windows. But it comes up short in the other 11 time windows.

For the period beginning June 30, 2008 and ending this Sept. 5, total return at NWS was a further, and negative, 10.4 percent, a level of performance that was 7.8 percentage points below the return on the S&P 500 Index.

### **CEO and COO Pay**

The way I see it, Rupert Murdoch, given his performance for his shareholders, should have earned very little for the year ended June 30, 2008.

But look at how he paid himself:

- A base salary of \$8.1 million. That's the highest salary by far paid to any of the 507 CEOs I studied this year, all of whom run companies with market caps of \$3 billion or higher. Occupying the Number Two salary position, with a salary of \$3.3 million is Jeffrey Immelt, who runs General Electric Co., a firm that has 5.1 times the net sales of NWS, 4.1 times its net income and 7.9 times its market cap.
- A bonus of \$17.5 million.
- A free share award worth \$4.1 million at the time it was granted.
- And miscellaneous compensation of \$403,000.

Now if you're delivering a negative total return of 32.6 percent to your shareholders, how is it possible for you to receive a bonus of \$17.5 million?

The answer: You don't base the bonus on total return. You pick a different metric, in this case EPS growth. But you don't simply use the EPS growth figure determined by comparing the Diluted EPS for the current year to the Diluted EPS for the immediately preceding year. Oh no. We have first to make many adjustments as to what we mean by EPS. From NWS's actual EPS, there are excluded:

- Non-cash intangible asset impairment charges and write-downs on investments to realizable values.
- Gains or losses on the sale or other disposition of businesses or investments.
- Items classified as "extraordinary items".
- The impact of changes in accounting for the fiscal year of such change (with the intent being to measure adjusted EPS in each fiscal year on the same bases of accounting). (Note: That item does make sense.)

- Costs of material business restructurings, reorganizations and relocations; and
- Gains and losses from capital and debt issuances and retirements.

Gee, maybe it would be easier to enumerate what gets counted in EPS!

Then there's Mr. Murdoch's free share award worth \$4.1 million. Why does someone who owns \$4.5 billion of stock need any further motivation, in this case with more free shares?

In answer, a Freudian would say "pay envy". That's because Mr. Murdoch's sidekick, Peter Chernin, was given \$4.1 million of free shares in accordance with his employment agreement. As NWS's board compensation committee reports, "For purposes of parity (emphasis is mine) among the named executive officers, the Compensation Committee determined to also award time-vested, cash-settled RSUs in amount equal in value to \$4.1 million to Mr. K. R. Murdoch."

I ran Mr. Murdoch through my 2007, 507-CEO pay model. His \$30 million total pay positioned him 128 percent above the norm, after controlling for both company sales and pay risk (the ratio of stock option present value to total pay, stock options being the most risky form of pay). A deviation this large was recorded in only five percent of the 507 cases.

Finally, consider the composition of Mr. Murdoch's pay package:

- He has a bloated base salary. No risk there.
- The lion's share of his pay package consists of an annual bonus, the payouts of which are a function of EPS growth – as he defines EPS growth.
- His equity grants, which are a comparatively tiny part of his pay package, consist of free shares. No risky options for him. He hasn't had an option grant since Nov. 1999.

Granted, Mr. Murdoch still holds vast numbers of shares owned outright. So he certainly has strong incentive to achieve. But the way he has structured his pay package suggests to me that he's not all that optimistic about the future. And why should he be, given what has happened in the past?

When I started working in the executive compensation field in the late 1950s, a chief operating officer characteristically earned pay equal to about 70-75 percent of that given to his boss, the CEO. Over the years, as the Imperial CEO concept has gained currency, that ratio has dropped.

Or it has dropped at companies other than NWS. There we find the CEO, Mr. Murdoch, earning \$30 million, and the COO, Mr. Chernin, earning \$29 million.

So that's \$59 million for both executives, and for that you get to lose about a third of your investment.

It's hard work managing a company so disastrously. Maybe that's why it takes two blokes to do it.

(The compensation data for this article were obtained from Equilar.com, a leading provider of executive pay information.)

2009 marks Graef Crystal's 50<sup>th</sup> anniversary in the executive compensation field. He has been a director of compensation for General Dynamics and Pfizer, worked as a consultant for Booz, Allen & Hamilton, served as worldwide practice director at Towers Perrin for 18 years, was a professor at the University of California at Berkeley's Haas School of Business for 10 years and a syndicated columnist for Bloomberg News for almost nine years. He has written six books and more than 1,600 articles on executive pay. In the Spring of 2009, he will be teaching a course in executive compensation at the University of California at Berkeley's Boalt School of Law.