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The Crystal Report on Executive Compensation



Larry Ellison Rides Again!

by Graef Crystal

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Most people celebrate the Fourth of July by attending picnics or shooting off fireworks.

Larry Ellison, 64, the CEO of Oracle Corp., has a different way of celebrating. Each year, right around July 4, he rewards himself with a new option covering a staggering 7,000,000 shares.

Of course, the option is officially determined by his board compensation committee, but when we have a CEO who founded the company and owns \$24 billion of stock himself, one has to figure that, whatever the comp committee may or may not think, that CEO, in the end, gets what he wants.

Past Option Grants

Here's a history of Mr. Ellison's last four July 4 celebrations:

- On July 6, 2006, he received a grant covering 7,000,000 shares with a strike price of \$14.57 and a term of 10 years. The company declared the option to have a grant date fair value of \$50 million.
- On July 5, 2007, he received a second grant covering another 7,000,000 shares, with a strike price of \$20.49 and a term of 10 years. The company declared the option to have a grant date fair value of \$71 million.
- On July 3, 2008, he received a third grant again covering 7,000,000 shares, with a strike price of \$20.73 and a term of 10 years. The company's declaration of grant date fair value is not currently known, as the proxy covering the fiscal year ended May 31, 2009 has not yet been filed.

- On July 2, 2009, he received a fourth grant again covering 7,000,000 shares, with a strike price of \$21.04 and a term of 10 years. The company's declaration of grant date fair value is not currently known, as the proxy will not be filed for over a year.

I prepared my own estimates of present value for the last two-mentioned grants. I scored the first as being worth \$63 million and the second as being worth \$54 million.

The reason for the drop in present value for the most recent grant compared to the year-earlier grant lies in the fact that Oracle paid no dividends until April of this year. The current dividend rate is \$0.05 per share per quarter. Other things equal, a higher dividend rate produces a lower grant date present value for the option, because hardly any stock options deliver dividends.

Recent Performance

It is important to observe here that the strike prices of the most recent three grants -- \$20.49 for the grant made on July 5, 2007, \$20.73 for the grant made on July 3, 2008 and \$21.04 for the grant made on July 2, 2009 -- are essentially unchanged. The compounded rate of stock price appreciation between July 5, 2007 and July 2, 2009 was just 1.46 percent per year. And for the single year ended July 2, 2009, Oracle delivered an appreciation of only 1.32 percent.

In turn, that means that the assumption that Mr. Ellison will work harder and smarter to increase his net worth beyond its current \$24 billion is not what you might think of as robust.

There is also the issue of the size of the awards. Looking only at the \$54 million present value of the award just made and comparing it to the total long-term awards (counting stock options, free shares and long-term performance plans) granted during 2008 to the CEOs of 348 companies with current market caps of \$5 billion or more, Mr. Ellison's award would score him as the second highest-paid in long-term compensation. (Raw data for this study were obtained from Equilar Inc., a leader provider of executive compensation information.)

It's one thing for a super-rich CEO to assert that he should be paid like any other CEO because he is working just as hard. But it's another thing entirely for that super-rich CEO to be paid like Croesus when he is already Croesus.

To be fair to Mr. Ellison, while his stock price has gone essentially nowhere in the last few years, the overall stock market has gone to hell. For the fiscal year ended May 31, 2009, Oracle's total return was negative 14 percent. But that beat the return on the Standard & Poor's 500 Index by 19 percentage points. And it beat the S&P Information Technology Index by 14 percentage points.

Still, a conventional stock option is not intended to reward for relative performance, only for absolute performance.

And when it comes to absolute performance for the fiscal years 2008 and 2009, Mr. Ellison shows up as a poor performer.

If the Supreme Court, as it is said, reads the newspapers, how is it that the Oracle board compensation committee fails to read the stock tables? After that sort of performance, why did it approve such a large stock option grant on this July 2?

Long-Term Performance

There's no question though, that in the ultra-long term, Mr. Ellison has been a spectacular performer. His company first went public on April 15, 1986 at a price of \$0.0772 a share. Had you bought a share back then and held it until today, the value of your investment would have increased 325 times. The equivalent figure for the S&P 500 Index: 3.8 times.

But that's how he came to be worth \$24 billion (not counting the billions in Oracle stock that he has already sold). That is not justification for all the more recent largesse.

Finally, seven has always been considered a mystical number. Is that why Mr. Ellison is so inordinately fond of the number seven – or to be more precise, the number seven with six zeroes attached to it?

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A Note on Option Grant Timing

There's a reason – and it's an excellent reason – why Larry Ellison's grants occur around the Fourth of July.

In its proxy filed on Sept. 14, 2007, the compensation committee declared: “We have a policy of generally granting options on preset dates. The Compensation Committee approves these annual option grants during the ten business-day period following the second business day after the announcement of our fiscal year-end earnings report. We implemented this policy in an effort to issue our annual stock option grants during the time when potential material information regarding our financial performance is most likely to be available to the market.”

Oracle's policy stance makes it impossible for a CEO to capitalize on insider information to produce a well-timed option grant – one which turns out in retrospect to have had a low strike price.

But in the years before the Independence Day pattern commenced, Oracle used a variety of granting dates for Mr. Ellison, including: May 31, July 26, Jan. 19, July 13, June 4, July 11, Aug. 25 and June 20.

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The members of the Oracle board compensation committee, according to the proxy statement filed on Aug. 20, 2008 include:

- Jeffrey Berg, 61, chair, CEO International Creative Management Inc.
- Hector Garcia-Molina, 54, professor of computer science and electrical engineering, Stanford University.
- Naomi Seligman, 70, former senior partner of Ostriker von Simson, Inc., a technology research firm.

2009 marks Graef Crystal's 50th 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.