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*The Crystal Report on Executive Compensation*



## **A Story You're Not Going to Believe**

**by Graef Crystal**

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Harvey Weinstein should stick to making films. His performance as a compensation committee chairman, in my view and not to put too fine a point on it, sucks.

Before going further, permit me to express my thanks to Meg Tirrell of Bloomberg News. Had she not brought this story to my attention, I would never have found it.

The company is Six Flags, Inc., the New York-based operator of regional theme parks.

### **Company Performance**

To say this company is in trouble is a gross understatement. It has been delisted by the New York Stock Exchange because its stock price has plummeted to \$0.17 a share. As of the close on April 24, you could have bought the entire company for \$16.6 million.

Six Flags has been headed since Dec. 2005 by Mark Shapiro. On Nov. 30, 2005, the month before he took the reins, the stock closed at \$7.46 a share. Subsequently, it rose as high as \$11.80 a share, a price reached on Feb. 1, 2006, just a few months into Shapiro's tenure.

Then the sickening descent to the current price of \$0.17 a share began.

The problem doesn't seem to be a lack of profit – or at least a lack of EBITDA, earnings before interest, taxes, depreciation and amortization. EBITDA was \$209 million in 2006, Mr. Shapiro's first year on the job. It subsequently rose to \$215 million in 2007 and \$301 million in 2008.

The problem has been the huge debt load that Mr. Shapiro inherited. Long-term liabilities were \$2.2 billion at the end of 2005 and \$2.3 billion at the end of 2008.

At the end of 1997, Six Flags had total long-term liabilities of \$254 million. One year later, that figure had ballooned to \$2.1 billion. I gathered from a quick examination of the company's Form 10-K covering 1998 that much, if not all, of this added long-term debt was used to acquire various theme parks.

Once that monster amount of debt showed up, the company's income statement went into the tank. By 1999, income before extraordinary items turned negative and has remained in the red every since.

It is those interest charges that are sinking the company.

Essentially, Six Flags has two possible ways out of its debt dilemma:

- Convince its long-term debt holders to convert all or a large portion of their debt into equity. An exchange offer is now underway.
- File for bankruptcy.

### **The “Success Bonus”**

If Mr. Shapiro had any hand in what has transpired, he has a sure career in PR work, even if not as a CEO.

I say that because his board approved a “success bonus” of \$3 million for him on this April 9.

Now I have my definition of success. But it doesn't even begin to encompass what Six Flag's board considers “success”. To them, “success” is either when the company gets out from its debt load (never mind that both the debtholders and the current common shareholders are apt to be royally shafted) or when the company, after declaring bankruptcy, emerges from same (another likely disastrous event for both debt holders and common shareholders).

And that's not all. Senior executives, including Mr. Shapiro, have been signed to new four-year employment agreements. For Mr. Shapiro, that means:

- A base salary of \$1.3 million. No sacrifice there.
- A “target” bonus of \$1.3 million, with a maximum bonus of \$2.6 million. Given the company's definition of “success”, I shouldn't think it would be too hard to score big in the bonus area.
- If Mr. Shapiro qualifies for his \$3 million “success bonus”, he also will receive that number of restricted shares equal to 1.25 percent of shares outstanding, as well as another 1.25 percent in stock options. At a current price of \$0.17 a share, the stock has

almost nowhere to go but up. (As of this April 1, he owned only 90,185 shares, worth, as of the close on April 24, just \$15,331.45. No downside risk for him.)

- When his employment agreement expires, he gets an additional 18 months of salary.

### **\$3 Million More for Performance in 2008**

On top of all this, the company reported in its preliminary proxy statement filed this April 24 that Mr. Shapiro was awarded a bonus of \$3 million for his performance in 2008. He had been given a bonus formula under his former employment agreement – one that was set to start generating a payout once EBITDA reached 90 percent of budgeted amounts. But the compensation committee, brilliantly led by Mr. Weinstein, decided to pay him \$1.2 million more than the formula generated.

Which raises the fallacy of basing bonuses on EBITDA, or at least wholly on EBITDA. Maybe academics can argue about what is the correct level of depreciation or amortization. But interest and income taxes are real costs. Declaring a triumph by ignoring them creates big bonuses for executives and, too often, big losses for shareholders.

Carried to an extreme, why not simply give the top executives a percentage of sales. That way, they can ignore entirely everyone of those nasty little items called “costs”.

The two other members of the compensation committee mentioned in the April 24 filing were:

- Mark Jennings, Managing Partner and co-founder of Generation Partners, a \$325 million private investment firm.
- Perry Rogers, president of Agassi Enterprises, Inc.

As for Mr. Weinstein, his attendance record as a director is not entirely spotless. Alone among his fellow directors, he failed to attend 75 percent or more of the board and committee meetings in 2007. Apparently, he summoned the energy to beat that minimal standard in 2008. But he didn't bother to show up for either the 2007 or the 2008 annual meeting of shareholders.

But I suppose one shouldn't be too tough on him. Maybe all this bizarre stuff went down when he was busy making another movie.

### **POSTSCRIPT**

If there's any good news here, it's that Harvey Weinstein is not standing for re-election as a director. Shareholders win. And given his past performance, moviegoers also win.

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.