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The Crystal Report on Executive Compensation



Disney's Robert Iger: High Pay, A Lot Less Risk

by Graef Crystal

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When Robert Iger became CEO of The Walt Disney Co. on Oct. 1, 2005, I thought he was going to have a lower risk, lower reward pay package than his predecessor, Michael Eisner. I couldn't have been more wrong.

Iger's Pay and Performance in FY2008

Let's review Mr. Iger's total pay for the three years of his CEOship:

- \$24.6 million for the fiscal year ended Sept. 30, 2006, his first year as CEO. Hardly what you'd call "lower reward".
- \$27.2 million for FY2007.
- And \$49.9 million for FY2008. (The company's proxy statement was issued on this Jan. 16.)

(Total pay is the sum of: base salary; annual bonus; my estimate for the present value at grant of stock options granted in the particular year, using the Black-Scholes model; the value at grant of free share awards made during the year; the "target" value of performance share awards made during the year; the accrued value in the particular year of deferred compensation and pensions; and miscellaneous compensation. The total compensation figures for 2006 and 2007 were derived from data supplied by Equilar, Inc., a leading provider of executive compensation information.)

That last pay figure of \$49.9 million is a whopper. (Sounds something like a retail price point: "This week only, folks, we're asking just \$49.90.")

For that sort of money, you'd expect to find superlative performance.

Instead, that rounded \$50 million only bought you:

- A 6.6 percent increase in net sales compared to the previous year.
- An 8.4 percent increase in operating income.
- A 5.5 percent DECREASE in net income.
- And a 1.3 percent increase in diluted EPS.

My heavens. If it took \$50 million to get that sort of performance from Mr. Iger, think of what the pay tab would be for really fine performance. That number would not trip over anyone's tongue, except for former Treasury Secretary Henry Paulson and President Barack Obama.

Here are the elements of Mr. Iger's \$50 million pay package:

- A base salary of \$2 million.
- A bonus of \$13.9 million. That bonus would have been \$2.4 million higher, but Mr. Iger graciously asked his board not to pay it to him. What's that phrase lawyers use: "Consciousness of guilt?"
- Two different option grants totalling 3.4 million shares and having, by my estimate, a Black-Scholes value at grant of \$27.1 million. (The company put an even higher price tag on these two grants: \$28.4 million.)
- A performance share grant covering a maximum award of 200,000 free shares. The company assigned a grant date fair value of \$5.9 million to this grant.
- \$157,000 of deferred compensation and pension accruals.
- And \$773,000 of other compensation, the largest item of which was \$645,000 for security services. (With a pay package this large, Mr. Iger presumably needs protection: From his shareholders, I would say.)

The \$2.4 million of bonus money that Mr. Iger did not take involved one of the performance factors in his bonus plan, that for Disney's total return performance during 2008 compared to the return on the Standard & Poors 500 Index. For that year, Disney's total return was negative 9.8 percent, while the S&P 500 Index return was negative 22 percent. This performance factor was set to deliver as much as 20 percent more bonus money if Disney outperformed the S&P 500 Index by 15 or more percentage points. Based on Disney's actual performance, the positive adjustment, according to the company's proxy, would have been 17.55 percent. (The bonus could also have been reduced as much as 20 percent had the company's relative performance gone the other way.)

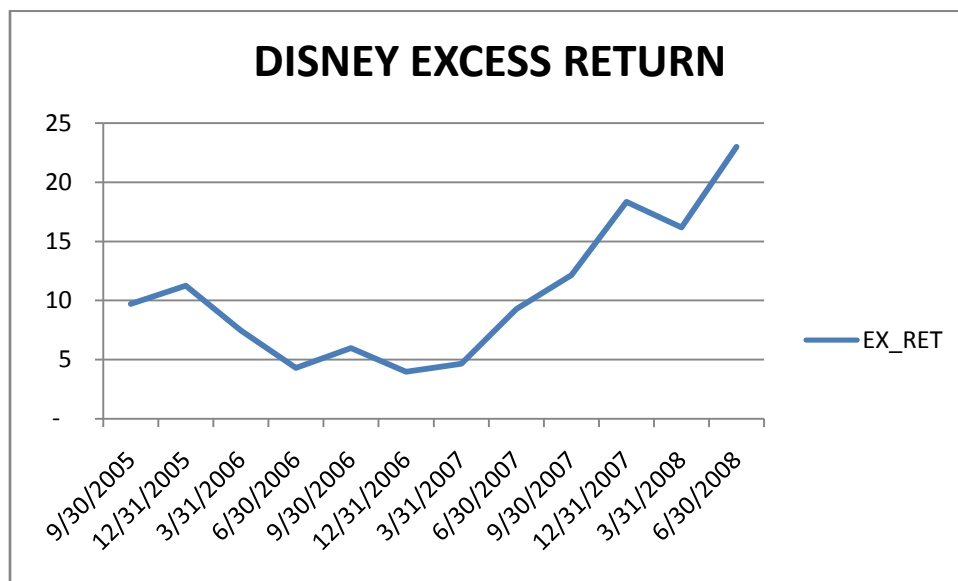
Looking at the individual performance of the companies comprising the S&P 500 Index, Disney's total return for the year ended Sept. 30, 2008 ranked it at the 66th percentile, meaning that it outperformed all but 34 percent of the companies comprising the index.

Iger's Performance Since Becoming CEO

Mr. Iger became CEO on Oct. 1, 2005. I measured his annualized total return performance in 12 different time windows, with all 12 windows ended Sept. 30, 2008. The widest window began on Sept. 30, 2005, the day before he became CEO. Then each succeeding window started with a date three months following the preceding window's start date, e.g., Sept. 30, 2005, Dec. 31, 2005, March 31, 2006, etc.

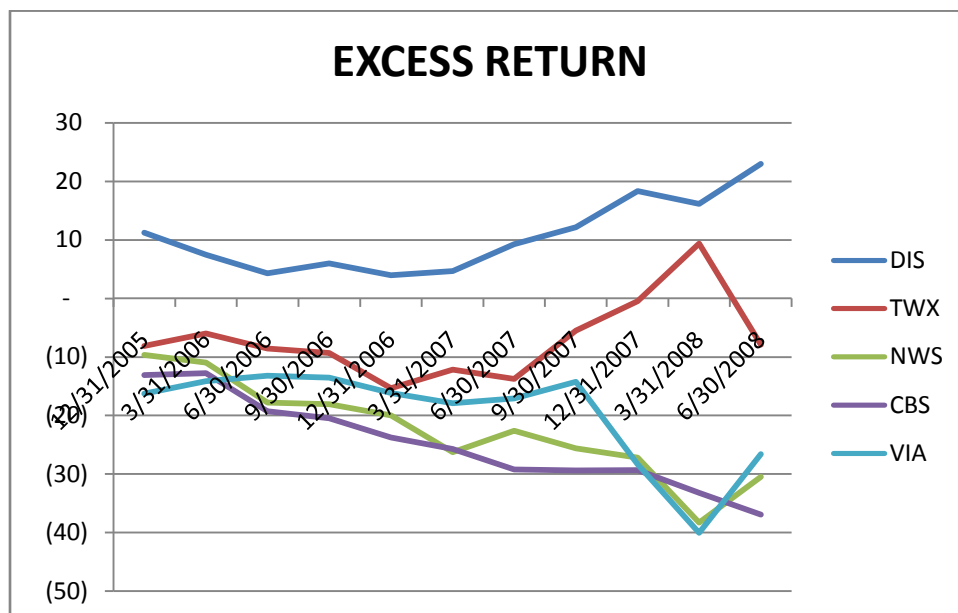
In each case, I compared Disney's total return performance to that of the S&P 500. By subtracting the S&P 500 figure from Disney's figure, I thereby obtained what economists call Disney's "excess return".

As can be seen from the following chart covering Disney's excess return, Mr. Iger has performed quite well historically.



He has also performed quite well compared to some key peers.

The following chart compares Disney's annualized excess return in 11 time windows to that of Time Warner Inc. (TWX), News Corp. (NWS), CBS Corp. (CBS), and Viacom Inc. (VIA). (I could not begin this series with the time window beginning Sept. 30, 2005, because Viacom stock was not publicly traded at that time.)



Looking at all these performance comparisons, it's not that Mr. Iger is not worth a fair amount of money. But \$50 million? That's way too much, in my opinion.

Michael Eisner

Disney has a rich tradition of paying richly, especially during the 20 years that Michael Eisner ran the company.

Indeed, the company paid so richly that it ended up in Delaware court over what many deemed the excessive severance pay granted to former Disney president, Michael Ovitz. Unfortunately for the plaintiffs in the case, Delaware Chancery Court Chancellor William Chandler III was not one of those "deemers". Disney won.

Herewith a disclosure: I was the consultant to Disney's board compensation committee from 1984 until 1996.

Mr. Eisner received an enormous amount of pay. But he also took large risks.

First, he came to Disney as CEO in Oct. 1984 with the same \$750,000 salary that he had earned when he was running Paramount (then a subsidiary of Gulf + Western Industries, Inc.). And he kept that salary frozen for almost 16 years. It was finally increased to \$1 million about 9 months into the fiscal year ended Sept. 30, 2000. In contrast, Mr. Iger earns a current salary of \$2 million.

Indeed, when Mr. Eisner stepped down, to be replaced by Mr. Iger who had been serving as chief operating officer, his salary of \$1 million was less than the \$1.5 million salary being paid to Mr. Iger.

But the big difference is in the long-term incentive packages of both men.

In 1996, Mr. Eisner received on a single day four different option grants:

- 15 million shares carrying a strike price equal to the market price at grant. (This and the immediately succeeding share figures have been adjusted for subsequent stock splits.)
- 3 million shares carrying a strike price equal to 125 percent of the market price at grant,
- 3 million shares carrying a strike price equal to 150 percent of the market price at grant.
- 3 million shares carrying a strike price equal to 200 percent of the market price at grant.

The first of the four grants carried a term of 12 years, while the three out-of-the-money grants carried terms of 15 years. The last of the four grants carried a strike price of \$42.21 a share. Although Disney's stock exceeded \$42.21 by a tiny amount on two occasions (\$43.05 on April 28, 2000 and \$42.43 on May 2, 2000), I doubt that Mr. Eisner has yet exercised his last three million shares. The options covering those shares don't expire until 2011.

In contrast, all of Mr. Iger's past options contained strike prices that were only equal to the market prices at grant.

Iger's Employment Agreement

The entertainment industry follows a curious custom. You can sign an employment agreement extending for, say, five years. But if your board thinks you're really good, you will be offered a new employment agreement well before the expiration of the old one.

So it was with Mr. Iger. On Jan. 31, 2008, he inked a new agreement that extends through Jan. 31, 2013. But his then employment agreement still almost two years to run: It would not have expired until Sept. 30, 2010.

A centerpiece of that new agreement was the grant of an option covering three million shares, which accounted for \$24 million of his \$50 million total pay for 2008. His "target" annual bonus was also increased to \$10 million from \$7.25 million, while the minimum grant date fair value of his annual long-term target incentive awards was increased to \$9 million from \$8 million.

So, for merely average performance, as Disney defines it, Mr. Iger stands to earn \$21 million under his new employment agreement. (That figure includes his \$2 million salary, but it excludes his perks and other lesser items.)

Obviously, there was no absolute need to extend his employment agreement on Jan. 31, 2008, when it had so much time to run before its expiration..

Indeed, there would seem to have been reasons not to have extended it. In the 12 month period prior to the grant date of Jan. 31, 2008, Disney's total return was negative 13.1 percent. With the S&P 500 Index return at negative 2.1 percent, the excess return was negative 10.8 percent.

To be fair, Disney's board could not have anticipated the terrible economic conditions prevailing almost a year later when the company reported its pay on this Jan. 16.

Still, it seems dumb to me to make an option mega grant when your recent performance for shareholders was lousy.

And in the light of hindsight, it was certainly dumb for Mr. Iger. His strike price on his three million option share grant was \$29.51. The stock closed at \$20.61 on this Jan. 23.

Postscript

The grant of three million option shares to Mr. Iger in connection with the renewal of his employment agreement raises an issue that is frequently present in executive pay, namely, when an out-of-the-ordinary action should be counted.

Many companies that have done what Disney did would complain that it is unfair to count the entire \$24 million present value of Mr. Iger's three million share option grant in a single year. Rather, they would argue, it should be amortized over the life of his employment agreement, i.e., essentially one-fifth of the \$24 million each year for five years. It is certainly the case that the company's books will reflect such an approach.

Yet those same companies, down the road a bit, might well complain that pay for a succeeding year is being overstated because I am dragging "ancient history" into the proceedings.

In short, you can't win no matter what you do.

I have developed my own rule for these things: You do it, I count it. After all, if Mr. Iger's board compensation committee wanted to smooth out his pay, it could simply have contracted to grant Mr. Iger, not three million option shares on a single date, but 600,000 option shares for each of the next five years.

That the committee did not possibly suggests that they, Mr. Iger or both were bullish on the future of the company, especially since the stock price was so relatively low.

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, 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. He is now teaching a course in executive compensation at the University of California at Berkeley's Boalt School of Law.