

New CEO of Minnesota-Based Industrial Giant 3M Gets Hefty Options Package

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3M Co. will pay a pretty penny for its new chief executive, former General Electric executive James McNerney.

McNerney, the first outsider to lead the Maplewood-based industrial giant, will collect an annual salary of \$1.3 million and a minimum bonus in 2001 of \$2.4 million in cash and stock. McNerney also gets options to buy shares of 3M stock that will push the total value of his 2001 compensation -- assuming he delivers results over time -- above \$10 million.

The options portion of McNerney's employment contract, which was part of a filing Tuesday with the Securities and Exchange Commission, is meant both to compensate him for money he gave up when he left GE and to give him an incentive to drive up the value of 3M's stock. Options give a person the right to buy stock at a preset price; the option has value only if the stock goes up.

Company officials said the compensation reflects McNerney's talent. "He was aggressively recruited by a number of companies," said John Cornwell, a 3M spokesman. "He's highly regarded. He's had an immediate impact on 3M. It's reasonable for him to have a good package."

McNerney's arrival has given 3M's stock its biggest lift in years. Between January 1997 and November 2000, the price of 3M's stock appreciated only 17 percent, while the Standard & Poor's 500 stock index rose 67 percent; since Dec. 1 -- before McNerney was named the next CEO -- the stock has risen 14.3 percent, even after sliding from a 52-week high. 3M's market value has increased nearly \$4.3 billion since Dec. 1.

But to collect all of his compensation, McNerney will need to deliver more than a one-time pop to the stock. According to Jim Fox, chairman of Fox Lawson & Associates, an executive-compensation consulting firm in Roseville, McNerney's package gives him plenty of reasons to make short-term fixes, but he's got just as much incentive to deliver results over the long haul.

"I think what they've got here is a couple of short-term issues they're addressing through the bonus and performance units. But they're also concerned about holding on to the guy . . . and they're also looking for long-term growth because they have long-term money on the table," Fox said.

McNerney's total compensation package comes from a variety of sources.

Along with the cash and guaranteed bonus, McNerney was granted 400,000 initial options and another 200,000 "make whole" options that compensate him for options

he gave up at GE. Both groups of options were set on Dec. 4 at the average of the high and low prices, or \$103.05. At Tuesday's closing price of \$113.84, those options are about \$6.5 million in the money, but they don't immediately vest, or become available.

In May, the board will grant McNerney still more options that will have an estimated current value of about \$7 million, according to the contract. The board also granted 10,000 "performance units" that can be redeemed at the end of 2003 at between \$100 and \$200 each, based on performance. That means McNerney can earn as much as \$2 million over three years for "intermediate" company goals.

But the board also wants McNerney for the long haul. It granted McNerney 110,000 shares of stock -- worth \$12.5 million at Tuesday's closing price -- but he must work there 10 years to collect all of them. By Fox's calculations, the combination of stock and options means McNerney has just more than half of his annual compensation in long-term incentives and very little for reaching intermediate, three-year goals.

All in all, the package is fairly standard for CEOs in the new millennium (the performance units, Fox said, aren't common but aren't unheard of either). GE's chairman and CEO, Jack Welch, earned \$3.3 million in salary and a \$10 million bonus in 1999, according to SEC filings. Dennis Koslowski, chairman and CEO of Tyco International, a large diversified manufacturer, got \$4.6 million in salary and cash bonus in 1999 plus some \$25 million in restricted stock awards, according to filings.

But McNerney's pay package is a departure for 3M, where CEO salaries have rarely been headline-grabbers. McNerney's predecessor, Livio DeSimone, received salary last year of a little more than \$1 million and a cash bonus of \$947,502. DeSimone also received more than 155,000 long-term options that then had an estimated value of about \$3 million, according to last year's proxy statement.

DeSimone's 1999 cash and bonus would not have put him in the top five at GE, where the fifth-highest paid executive -- the head of GE's plastics division -- was paid \$2.1 million. McNerney, who headed GE's aircraft engines division, didn't make the top five either, but he was presumably among GE's highest-paid executives. He was one of three finalists to replace Welch.

Fox said 3M had to change its compensation structure for its top job largely because it chose to go outside the company. That meant 3M had to make up for what the new hire would give up in taking the job -- a common practice these days -- as well as raise its pay to market rates.

"That happens when you go out for anybody and you've been so insular," Fox said. 3M typically could set salaries based on what others in the company are making and what the person made before. "You go out in the market and you find the market is much higher, and you have to pay them -- you have to give them an incentive to jump."