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INVESTING

By Brian Grow

Home Depot's CEO Cleans Up

CEO Robert Nardelli is a rarity among managers of major corporations: \$3 million of his annual bonus is guaranteed

It's been a flush five years for Home Depot Chief Executive Robert Nardelli. Since he took the helm of the Atlanta home-improvement retailer in December, 2000, revenues at the company have grown 12% per year, to \$81.5 billion, and profits have more than doubled, to \$5.8 billion.

To the ire of many investors, however, Home Depot's total return to shareholders, a key benchmark of corporate performance, is down 13%, according to Institutional Shareholder Services ([ISS](#)). Still, Home Depot ([HD](#)) has rewarded Nardelli, 58, handsomely in that period, with some \$200 million in salary, bonus, stock, stock options, and other perks. In 2005, Nardelli took home a hefty \$38.1 million in total compensation.

That rich payday has attracted the attention of large institutional investors, but one lucrative element of the package is not as well-known: Nardelli's guaranteed minimum annual bonus. Of course, many CEOs are eligible for a bonus each year, usually if they hit certain financial and operating targets. Others have more limited guarantees, such as an assured payout in the first year of service. But Nardelli's employment contract shows that \$3 million of his annual bonus, defined as the "target amount," is a sure thing. "For each year during the period of employment," says the agreement, "the executive will receive an annual bonus of no less than the full target amount." Last year, Nardelli earned a total bonus of \$7 million.

LONG-TERM HAUL. What's more, as Home Depot prepares for its annual shareholder meeting on May 25, an analysis of CEO employment agreements by executive compensation consulting firm the Delves Group shows Nardelli's guaranteed bonus is not only lucrative, but also rare. No other chief executive among the 200 largest U.S. companies by revenue, the sample analyzed by Delves, has a comparable payout. The group also includes General Electric ([GE](#)), Wal-Mart Stores ([WMT](#)), and Exxon Mobil ([XOM](#)).

Compensation experts say it is highly unusual for an executive to accumulate \$15 million in locked-in bonus payments over five years. "It is outrageous and unspeakable to have a guaranteed bonus as long and as big as Nardelli's," says Shekhar Purohit, principal at the Delves Group.

Home Depot declined to confirm whether \$3 million of Nardelli's annual bonus is guaranteed. In its 2006 proxy statement, the company says Nardelli's 2005 compensation was based on a combination of factors, including "20.4% growth in diluted earnings per share" and "net sales growth of 11.5%." It acknowledges that Home Depot's total return to shareholders has been relatively poor, vs. the Standard & Poor's 500-stock index and S&P's Retail Composite index.

BONUS OR JUST PAY? But the proxy appears to reiterate a guarantee on Nardelli's minimum bonus. Citing compensation levels for CEOs running similarly sized companies and the need for top-notch strategic, financial, and leadership skills, the board determined "his annual bonus shall not be less than \$3,000,000."

To be sure, some companies dole out smaller, one- or two-year guarantees to CEOs, usually when an executive arrives or when the company is in the middle of a turnaround, according to executive compensation specialists. Bankrupt telecom giant Worldcom, for example, assured former CEO Michael Capellas a bonus equivalent to 100% of his \$1.5 million base salary in the first year after the company exited bankruptcy in 2004, according to the Delves Group. Nardelli's \$3 million guarantee, however, applies every year, according to his contract, which is renewed every three years, most recently on Jan. 1. "A guaranteed bonus is no longer a bonus. It's just pay," says Charles Elson, director of the Weinberg Center for Corporate Governance at the University of Delaware.

Indeed, how Home Depot accounts for the tax deductibility of Nardelli's \$3 million guaranteed bonus is an unanswered question. Under Section 162(m) of the Internal Revenue Code, which governs tax treatment for compensation to the five highest-paid executives at publicly-traded firms, no more than \$1 million of an executive's pay can be deducted from corporate tax returns unless it is determined to be "performance-based" with goals that are "substantially uncertain to be met" when they are set. Home Depot guarantees Nardelli a minimum salary of \$1.5 million each year. The IRS does not consider

more than \$1 million of a guaranteed bonus to be tax-deductible. Home Depot declined to comment on the tax issue.

FIRED-UP SHAREHOLDERS. Nardelli's bonus, with its locked-in portion, is not being showered on a slacker. The former head of General Electric's Power Systems unit who lost out in a three-way battle to replace legendary GE chief Jack Welch in 2000, Nardelli regularly puts in six-day workweeks. And he's spearheading a tricky expansion of Home Depot into the industrial supply business. But his rewards for these efforts are more than ample. Data provided by Equilar, a compensation-research firm in San Mateo, Calif., shows the median CEO bonus for the 500 largest U.S. companies last year was \$1.5 million. For the largest retailers in that group, including Wal-Mart and Home Depot rival Lowe's Cos. (**LOW**), the median was \$770,849, just over one-tenth of Nardelli's total bonus.

Such outsize pay, at a time when the company's stock trades below its value when Nardelli started, is firing up shareholders. And outside pressure for change is building. In a May 22 letter to Home Depot compensation committee chairwoman Bonnie Hill, CtW Investment Group, a union-affiliated financial group, demanded that Hill personally explain her committee's pay decisions at this week's Home Depot annual meeting. Last week, the California Public Employees' Retirement System, the nation's largest pension fund and the owner of 10.3 million Home Depot shares, announced plans to support a shareholder proposal to require an advisory vote by stockholders on the company's executive compensation committee report.

Nardelli's guaranteed bonus has helped fuel the fire. In a May 12 report by ISS, a corporate governance advisory service, shareholders are advised to withhold votes for 10 of Home Depot's 12 directors up for reelection, in part, because Nardelli's employment agreement "contains egregious guarantees such as minimum cash bonuses." The Corporate Library, another governance watchdog, rates Home Depot an "F" on compensation, due partly to the guaranteed bonus. "It's representative of the whole employment agreement, which is a complete disconnect between executive compensation and company performance," says Paul Hodgson, senior research associate at the Corporate Library.

SORE SPOT. So far, Home Depot's board of directors has remained steadfastly behind Nardelli and his pay package. The company opposes all three proposals advocating more shareholder involvement in setting or disclosing Home Depot's executive compensation scheduled for a vote at the May 25 shareholder meeting. And it shows no signs of altering Nardelli's guaranteed bonus. "People who do not sit in the board room make decisions based on looking in the rear-view mirror. Directors have to make decisions based on looking forward," says Home Depot board member Hill, founder of corporate governance consulting firm B. Hill Enterprises LLC and chair of Home Depot's Leadership Development & Compensation Committee.

Still, Nardelli's hefty bonus is a sore spot with Home Depot's rank and file. At MSN's Orange Blood Bank, an Internet chat room frequented mostly by workers in Home Depot stores (orange refers to the color of the retailer's logo) complaints often erupt about their CEO's pay. And the disconnect between Nardelli and the company's retail workers is growing. Nardelli's total bonus, which Home Depot says is based on overall company performance, rose from \$5.75 million in 2004 to \$7 million last year. But Home Depot's Success Sharing program, which doles out bonuses primarily to Home Depot's 319,000 non-salaried employees based on store financial performance, fell from \$90 million in 2004 to \$44 million in 2005. The average payout to workers: \$137.93. No portion of those bonuses is guaranteed.

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