

Len Tatore

From: Sue Bielstein
Sent: Monday, November 11, 2002 9:27 AM
To: Len Tatore
Subject: FW: Stock Option Rip-Off!

Not sure how letters of this type are filed.

Letter of Comment No: SA
File Reference: 1101-SCU
Date Received: 11/11/02

Sue

-----Original Message-----

From: Robert Herz
Sent: Monday, November 11, 2002 7:16 AM
To: Mike Crooch; Neel Foster; Gary Schieneman; Katherine Schipper; Edward Trott; John Wulff; Sue Bielstein; Pat Durbin; Michael Tovey; Jim Leisenring
Subject: FW: Stock Option Rip-Off!

FYI

-----Original Message-----

From: R.W. Glenn [mailto:rwglenn@netzero.com]
Sent: Monday, November 11, 2002 10:04 PM
To: rhherz@fasb.org
Cc: rkuttner@prospect.org
Subject: Stock Option Rip-Off!

Mr. Herz,

This is a follow-up letter to my earlier correspondence to Pfizer concerning stock options. I know you will find this interesting, informative, and helpful. I believe this is seriously undermining investor confidence. I agree with Mr. Kuttner's comments in the Nov 18 Business Week issue where he says, "American capitalism works only to the extent that investors receive truthful information. The AICPA's behavior is scandalous, but the deeper scandal here is the myopia of political leaders who pose as champions of capitalism". May all your efforts to rectify this situation be successful.. R. W. Glenn

Robert W. and Sally B. Glenn
6 Woodstock Court
Greensboro, NC 27408

October 28, 2002

Mrs. Margaret M. Foran
Vice-President-Corporate Governance and Secretary
Legal Division
Pfizer Inc.
235 East 42nd Street
New York, NY 10017-5755

Dear Mrs. Foran:

Thank you for your six page response to my letters of April, May, and July. I hope our dialogue will continue. Without fair and reasonable limitations on stock options and the proper recording of stock option compensation expense, Pfizer stock is doomed because the shareholder's incentive to own is being destroyed!

Pfizer's current method of providing stock options is *not fair and reasonable*. Of Pfizer's \$20.3 billion in net income over the last 3 ½ years, \$8.3 billion was paid to shareholders as dividends but \$9.2 billion or 45% has been used to buy back or "purchase common stock". Because the number of shares outstanding has remained the same over this period, all of the \$9.2 billion has been used to compensate management for their stock options granted/exercised rather than to reduce shares outstanding. Reducing the number of shares outstanding is how most shareholders view the benefit of a company's stock buyback program. To them reducing the outstanding shares means an increase in the earnings per share given the same amount of income.

In addition to excessive stock options, Pfizer's current method of recording compensation expense for stock options is *seriously flawed and needs improvement*. Pfizer's compensation expense is significantly understated and does not fairly present the operations and financial condition of the company as required by the Investor Protection Act of 2002. The estimated value of shares exercised (market value less grant price at the time of exercise) going into the pockets of management was \$12.6 billion over the three year period 1999-2001. Yet only \$1.9 billion was recorded as a reduction in net income as stock option compensation expense using the Black-Scholes. This pricing model which was developed in 1973 was used to value "European" stock warrants! This results in a tremendous over statement of net income. Thus, Pfizer's stock option program has placed \$12.6 billion into management pockets with only \$1.9 billion being recorded against income. The recent Pharmacia acquisition whereby all outstanding Pharmacia stock options become immediately exercisable will greatly increase this over statement of net income.

Without a responsible allocation of Pfizer's **cash flow** between the payment of dividends to its shareholders, the reinvestment of funds back into the company, and reasonable stock option compensation to its management ("paid for" by stock buybacks), Pfizer's stock price as a multiple of cash flow per share will simply fizzle. Both stockholders and management are the losers.

Based on your response to my correspondence and additional information obtained, I would like to change my original shareholder proposal to read:

“Resolved, the Shareholders request the Board of Directors:

- a. Implement a policy limiting annual “purchases of common stock” (or share buybacks) to the lesser of not more than 40% of the previous year’s net income or not more than 90% of the previous year’s common stock dividend paid, and
- b. Define stock option compensation expense as the sum of options exercised; that is, the market price on date of exercise less grant price, plus use of Black-Scholes or similar method on the unexercised above or below water options.”

A policy of *limiting the amount of cash used to buyback shares* would place no restrictions on the number of shares granted or exercised per se; however, any options granted/exercised which **exceed** the shares allowed to be purchased under the stock buyback program will result in an **increase** in the number of outstanding shares. Under the current program, there has been no increase in the number of shares outstanding. This is because the Pfizer share buyback program has been cleverly buying in the open market the almost exact number of shares needed to offset the number of shares granted/exercised under the current stock option program. Hence, although a lot of cash is being used (\$9.2 billion over the last 3 ½ years) to buyback shares there has been no dilution in earnings per share. That’s called “eating your cake and having it too!” “Free” cash flow per share has become a small fraction of earnings per share. Professional Investment managers are not being fooled with the gross understatement of stock option compensation expense and the huge amounts of cash being used to buyback shares with no reduction in the number of outstanding shares.

This proposed Shareholder Proposal (which limits the amount of cash used for share buybacks) “**penalizes**” or “**rewards**” earnings per share based on whether or not stock options granted/exercised are greater or less than the number of shares “allowed to be bought back” under the stock buyback program. Earnings per share will *decrease* when the number of shares granted/exercised *exceeds* the number of shares allowed to be bought back. Earnings per share will *increase* when the number of shares granted/exercised is *less than* the number of shares allowed to be bought back.

If the Board of Directors is *truly* interested in increasing the Pfizer share price over the long term, they will limit the amount of cash flow used to buyback shares and they will seek to have management record stock option compensation expense that properly reflects the cost of doing business. Without action, the incentive to own Pfizer’s stock is being destroyed.

Please let me know if I can provide any additional information.

Sincerely,



R. W. Glenn

Enclosure

Copies to Pfizer Board of Directors

Dr. Allan Greenspan
Mr. Harvey L. Pitt
Mr. David L. Shedlarz
And Others

Shareholder Proposal Relating to Common Stock Purchases and Stock Option Compensation Expense

“Resolved, the Shareholders request the Board of Directors:

- a. Implement a policy limiting annual “purchases of common stock” (or share buybacks) to the lesser of not more than 40% of the previous year’s net income or not more than 90% of the previous year’s common stock dividend paid, and
- b. Define stock option compensation expense as the sum of options exercised; that is, the market price on date of exercise less grant price, plus use of Black-Scholes or similar method on the unexercised above or below water options.”

Proponent’s Statement in Support of the Resolution

For the three years 1999-2001, Pfizer granted 239.2 million shares to employees in options with a market value of \$9.2 billion. Options granted over the three year period were 56% of *net income* compared to 36% for the ten companies comprising the Peer Group*. Pfizer’s options granted were 137% of *dividends paid* versus 90% for the Peer Group. Pfizer shares granted were significantly higher than the Peer Group.

The estimated value of shares exercised (market value less grant price at the time of exercise) going into the pockets of management was \$12.6 billion over the same three year period. Yet only \$1.9 billion was recorded as a reduction in net income as stock option compensation expense using the Black-Scholes pricing model.

During this period, Pfizer used \$7.2 billion in cash (44% of its \$16.5 billion net income) to buy back 177.5 million shares with less than a 1% reduction in the shares outstanding. For the six months ending 6/30/2002, this has increased to 51% of net income versus 40% for the Peer Group. The recent Pharmacia acquisition will make the comparison significantly worse.

For the same three years, Pfizer paid out \$6.7 billion in *dividends*. Cash used by Pfizer to buyback their stock was 107% of *dividends paid*. For the six months 6/30/2002, cash used to buyback stock was 125% of dividends paid versus 87% for the Peer Group.

For 2001 under this proposal, the cash used to purchase shares by Pfizer would have been limited to \$1.5 billion (40% of the previous year’s net income) rather than the \$3.7 billion which purchased 88.8 million shares @ \$41.26 in 2001. The \$1.5 billion would have only purchased 36.4 billion shares (@\$41.26). This \$2.2 billion difference reinvested in the company, or used to increase dividends, or even to reduce drug selling prices could have been more effectively used rather than going into **management’s pocket** as additional compensation with no reduction in the shares outstanding.