

3M CO

FORM 10-K (Annual Report)

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Telephone	6517332204
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NOTE 16. Stock-Based Compensation

In May 2008, shareholders approved 35 million shares for issuance under the "3M 2008 Long-Term Incentive Plan", which replaced and succeeded the 2005 Management Stock Ownership Program (MSOP), the 3M Performance Unit Plan, and the 1992 Directors Stock Ownership Program. Shares under this plan may be issued in the form of Incentive Stock Options, Nonqualified Stock Options, Progressive Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Other Stock Awards, and Performance Units and Performance Shares. Awards denominated in shares of common stock other than options and Stock Appreciation Rights, per the 2008 Plan, will be counted against the 35 million share limit as 3.38 shares for every one share covered by such award. The remaining total shares available for grant under the 3M 2008 Long Term Incentive Plan are 15,507,162 as of December 31, 2009.

In 2009, the Company changed the timing of its annual stock option and restricted stock unit grant dates from May to February, in order to provide a stronger and more immediate link between the performance of individuals during the preceding year and the size of their annual stock option grants. In 2008 and prior, the Company issued options to eligible employees annually in May using the closing stock price on the grant date, which was the date of the Annual Stockholders' Meeting. Accounting rules require recognition of expense under a non-substantive vesting period approach, requiring compensation expense recognition when an employee is eligible to retire. 3M employees in the United States are eligible to retire at age 55 and after having completed five years of service. Approximately 25 percent of the stock-based compensation award expense dollars are for this retiree-eligible population. Therefore, in 2009 the retiree-eligible impact shifted stock-based compensation expense to the first quarter, whereas in 2008 and prior this impact was recognized in the second quarter (because of the May grant date).

In addition to these annual grants, the Company makes other minor grants of stock options, restricted stock units and other stock-based grants. The Company issues cash settled Restricted Stock Units and Stock Appreciation Rights in certain countries. These grants do not result in the issuance of Common Stock and are considered immaterial by the Company. There were approximately 14,008 participants with outstanding options, restricted stock, or restricted stock units at December 31, 2009.

Effective with the May 2005 MSOP annual grant, the Company changed its vesting period from one to three years with the expiration date remaining at 10 years from date of grant. Beginning in 2007, the Company reduced the number of traditional stock options granted under the MSOP plan by reducing the number of employees eligible to receive annual grants and by shifting a portion of the annual grant away from traditional stock options primarily to restricted stock units. However, associated with the reduction in the number of eligible employees, the Company provided a one-time "buyout" grant of restricted stock units to the impacted employees, which resulted in increased stock-based compensation expense in 2007. The income tax benefits shown in the following table can fluctuate by period due to the amount of Incentive Stock Options (ISOs) exercised since the Company receives the ISOs tax benefit upon exercise. The Company last granted ISOs in 2002. Amounts recognized in the financial statements with respect to stock-based compensation programs, which include stock options, restricted stock, restricted stock units and the General Employees' Stock Purchase Plan (GESPP), are as follows:

Stock-Based Compensation Expense

(Millions, except per share amounts)	Years ended December 31		
	2009	2008	2007
Cost of sales	\$ 38	\$ 43	\$ 47
Selling, general and administrative expenses	144	122	137
Research, development and related expenses	35	37	44
Operating income (loss)	\$ (217)	\$ (202)	\$ (228)
Income tax benefits	\$ 62	\$ 71	\$ 93
Net income (loss) attributable to 3M	\$ (155)	\$ (131)	\$ (135)

The following table summarizes stock option activity during the twelve months ended December 31:

Stock Option Program

	2009		2008		2007	
	Number of Options	Exercise Price*	Number of Options	Exercise Price*	Number of Options	Exercise Price*
Under option —						
January 1	75,452,722	\$ 71.96	74,613,051	\$ 70.50	82,867,903	\$ 67.41
Granted:						
Annual	6,649,672	53.93	5,239,660	77.22	4,434,583	84.81
Progressive (Reload)	68,189	77.37	78,371	79.53	461,815	87.12
Other	4,654	50.85	20,389	79.25	51,730	82.93
Exercised	(6,930,544)	49.83	(3,797,663)	49.38	(12,498,051)	55.34
Canceled	(976,528)	73.50	(701,086)	79.12	(704,929)	77.36
December 31	74,268,165	\$ 72.39	75,452,722	\$ 71.96	74,613,051	\$ 70.50
Options exercisable December 31	62,414,398	\$ 73.73	63,282,408	\$ 70.01	58,816,963	\$ 66.83

* Weighted average

Outstanding shares under option include grants from previous plans. For options outstanding at December 31, 2009, the weighted-average remaining contractual life was 58 months and the aggregate intrinsic value was \$844 million. For options exercisable at December 31, 2009, the weighted-average remaining contractual life was 50 months and the aggregate intrinsic value was \$636 million. As of December 31, 2009, there was \$68 million of compensation expense that has yet to be recognized related to non-vested stock option-based awards. This expense is expected to be recognized over the remaining vesting period with a weighted-average life of 1.7 years.

The total intrinsic values of stock options exercised during 2009, 2008 and 2007, respectively, was \$108 million, \$107 million and \$373 million. Cash received from options exercised during 2009, 2008 and 2007, respectively, was \$345 million, \$188 million and \$692 million. The Company's actual tax benefits realized for the tax deductions related to the exercise of employee stock options for 2009, 2008 and 2007, respectively, was \$38 million, \$34 million and \$122 million. Capitalized stock-based compensation amounts were not material for the twelve months ended 2009, 2008, and 2007.

The Company does not have a specific policy to repurchase common shares to mitigate the dilutive impact of options; however, the Company has historically made adequate discretionary purchases, based on cash availability, market trends and other factors, to satisfy stock option exercise activity.

For annual and progressive (reload) options, the weighted average fair value at the date of grant was calculated using the Black-Scholes option-pricing model and the assumptions that follow.

Stock Option Assumptions

	Annual			Progressive (Reload)		
	2009	2008	2007	2009	2008	2007
Exercise price	\$ 54.11	\$ 77.22	\$ 84.79	\$ 77.83	\$ 79.76	\$ 87.12
Risk-free interest rate	2.2%	3.1%	4.6%	1.4%	4.3%	4.6%
Dividend yield	2.3%	2.0%	2.1%	2.0%	2.0%	2.1%
Volatility	30.3%	21.7%	20.0%	30.7%	18.7%	18.4%
Expected life (months)	71	70	69	32	25	25
Black-Scholes fair value	\$ 13.00	\$ 15.28	\$ 18.12	\$ 14.47	\$ 12.00	\$ 13.26

Expected volatility is a statistical measure of the amount by which a stock price is expected to fluctuate during a period. For the 2009, 2008 and 2007 annual grant date, the Company estimated the expected volatility based upon the average of the most recent one year volatility, the median of the term of the expected life rolling volatility, the median of the most recent term of the expected life volatility of 3M stock, and the implied volatility on the grant date. The expected term assumption is based on the weighted average of historical grants.

As previously mentioned, beginning in 2007, the Company expanded its utilization of restricted stock units. Restricted stock unit grants generally vest at the end of three years. The one-time "buyout" restricted stock unit grant in 2007 vests at the end of five years. Restricted stock unit grants issued in 2008 and prior did not accrue dividends during the vesting period. Substantially all restricted stock unit grants made after 2008 accrue dividends during the vesting period, which will be paid out in cash at the vest date on all vested restricted stock units. The following table summarizes restricted stock and restricted stock unit activity during the twelve months ended December 31:

Restricted Stock and Restricted Stock Units

	2009		2008	
	Number of Awards	Grant Date Fair Value*	Number of Awards	Grant Date Fair Value*
Nonvested balance —				
As of January 1	2,957,538	\$ 77.41	2,001,581	\$ 77.63
Granted:				
Annual	1,150,819	53.89	924,120	77.23
Other	522,581	54.82	188,473	73.16
Vested	(157,104)	73.26	(64,806)	68.72
Forfeited	(94,354)	69.57	(91,830)	77.76
As of December 31	4,379,480	\$ 68.85	2,957,538	\$ 77.41

* Weighted average

As of December 31, 2009, there was \$91 million of compensation expense that has yet to be recognized related to non-vested restricted stock and restricted stock units. This expense is expected to be recognized over the remaining vesting period with a weighted-average life of 1.9 years. The total fair value of restricted stock and restricted stock units that vested during the twelve-month periods ended December 31, 2009, 2008 and 2007, respectively, was \$10 million, \$4 million and \$6 million.

General Employees' Stock Purchase Plan (GESPP):

In May 1997, shareholders approved 30 million shares for issuance under the Company's GESPP. Substantially all employees are eligible to participate in the plan. Participants are granted options at 85% of market value at the date of grant. There are no GESPP shares under option at the beginning or end of each year because options are granted on the first business day and exercised on the last business day of the same month.

General Employees' Stock Purchase Plan

	2009		2008		2007	
	Shares	Exercise Price*	Shares	Exercise Price*	Shares	Exercise Price*
Options granted	1,655,936	\$ 50.58	1,624,775	\$ 62.68	1,507,335	\$ 69.34
Options exercised	(1,655,936)	50.58	(1,624,775)	62.68	(1,507,335)	69.34
Shares available for grant —						
December 31	5,659,939		7,315,875		8,940,650	

* Weighted average

The weighted-average fair value per option granted during 2009, 2008 and 2007 was \$8.93, \$11.06 and \$12.24, respectively. The fair value of GESPP options was based on the 15% purchase price discount. The Company recognized compensation expense for GESPP options of \$15 million in 2009 and \$18 million in both 2008 and 2007.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Registration Nos. 33-14791, 33-49842, 33-58763, 33-58767, 333-26957, 333-30689, 333-30691, 333-44760, 333-44692, 333-73192, 333-101727, 333-101751, 333-109282, 333-128251, 333-130150, 333-151039, 333-156626 and 333-156627) and Form S-3 (Registration Nos. 33-48089, 333-42660, 333-98163, 333-109211, 333-112563 and 333-157374) of 3M Company of our report dated February 16, 2010 relating to the financial statements and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Minneapolis, Minnesota
February 16, 2010