

BECTON DICKINSON & CO
Form DEF 14A
December 20, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
 Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
 Definitive Proxy Statement
 Definitive Additional Materials
 Soliciting Material Pursuant to §240.14a-12

Becton, Dickinson and Company
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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(1) Amount Previously Paid:

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(4) Date Filed:

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Becton, Dickinson and Company

1 Becton Drive

Franklin Lakes, New Jersey 07417-1880

www.bd.com

December 20, 2012

Dear Fellow Shareholders:

You are cordially invited to attend the 2013 Annual Meeting of Shareholders of Becton, Dickinson and Company (BD) to be held at 1:00 p.m. EST on Tuesday, January 29, 2013 at the Hilton Short Hills, 41 John F. Kennedy Parkway, Short Hills, New Jersey. You will find directions to the meeting on the back cover of the accompanying proxy statement.

The notice of meeting and proxy statement describe the matters to be acted upon at the meeting. We also will report on matters of interest to BD shareholders.

Your vote is important. Whether or not you plan to attend the Annual Meeting in person, we encourage you to vote so that your shares will be represented and voted at the meeting. You may vote by proxy on the Internet or by telephone, or by completing and mailing the enclosed proxy card in the return envelope provided. You may also vote in person at the Annual Meeting.

Thank you for your continued support of BD.

Sincerely,

Vincent A. Forlenza
Chairman, Chief Executive Officer and President

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NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Becton, Dickinson and Company

1 Becton Drive

Franklin Lakes, New Jersey 07417-1880

December 20, 2012

The 2013 Annual Meeting of Shareholders of Becton, Dickinson and Company (*BD*) will be held as follows:

DATE: Tuesday, January 29, 2013
TIME: 1:00 p.m. EST
LOCATION: Hilton Short Hills

41 John F. Kennedy Parkway

Short Hills, New Jersey

PURPOSE: To consider and act upon the following proposals:

1. The election as directors of the fifteen nominees named in the attached proxy statement for a one-year term;
2. The ratification of the selection of the independent registered public accounting firm;
3. An advisory vote to approve named executive officer compensation;
4. Approval of an amendment to *BD*'s Restated Certificate of Incorporation;
5. Approval of amendments to the 2004 Employee and Director Equity-Based Compensation Plan; and
6. Such other business as may properly come before the meeting.

Shares represented by properly executed proxies will be voted in accordance with the instructions specified therein. Shares represented by properly executed proxies that do not provide specific voting instructions will be voted in accordance with the recommendations of the Board of Directors set forth in this proxy statement.

Important Notice Regarding the Availability of Proxy Materials for the 2013 Annual Meeting of Shareholders to be held on January 29, 2013. *BD*'s proxy statement and 2012 Annual Report, which includes *BD*'s consolidated financial statements, are available at www.bd.com/investors/.

Shareholders of record at the close of business on December 7, 2012 will be entitled to attend and vote at the meeting.

By order of the Board of Directors,

GARY DEFAZIO
Vice President and Corporate Secretary

It is important that your shares be represented and voted,

whether or not you plan to attend the meeting.

YOU CAN VOTE BY PROXY OR SUBMIT VOTING INSTRUCTIONS IN

ONE OF THREE WAYS:

1. VIA THE INTERNET:

Visit the website noted on your proxy/voting instruction card.

2. BY TELEPHONE:

Use the toll-free telephone number noted on your proxy/voting instruction card.

3. BY MAIL:

Promptly return your signed and dated proxy/voting instruction card in the enclosed envelope.

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PROXY STATEMENT

2013 ANNUAL MEETING OF SHAREHOLDERS

Tuesday, January 29, 2013

BECTON, DICKINSON AND COMPANY

1 Becton Drive

Franklin Lakes, New Jersey 07417-1880

GENERAL INFORMATION

Proxy Solicitation

These proxy materials are being mailed or otherwise sent to shareholders of Becton, Dickinson and Company (BD) on or about December 20, 2012 in connection with the solicitation of proxies by the Board of Directors for BD s 2013 Annual Meeting of Shareholders to be held at 1:00 p.m. EST on Tuesday, January 29, 2013 at the Hilton Short Hills, 41 John F. Kennedy Parkway, Short Hills, New Jersey. **Important Notice Regarding the Availability of Proxy Materials for the 2013 Annual Meeting of Shareholders to be held on January 29, 2013. This proxy statement and BD s 2012 Annual Report to Shareholders are also available at www.bd.com/investors/.**

Directors, officers and other BD associates also may solicit proxies by telephone or otherwise. Brokers and other nominees will be requested to solicit proxies or authorizations from beneficial owners and will be reimbursed for their reasonable expenses. BD has retained MacKenzie Partners, Inc. to assist in soliciting proxies for a fee not to exceed \$25,000 plus expenses. The cost of soliciting proxies will be borne by BD.

Shareholders Entitled to Vote; Attendance at the Meeting

Shareholders of record at the close of business on December 7, 2012 are entitled to notice of, and to vote at, the meeting. As of such date, there were 195,850,121 shares of BD common stock outstanding, each entitled to one vote.

If your shares are held in the name of a bank, broker or other nominee (also known as shares held in street name) and you wish to attend the meeting, you must present proof of ownership as of the record date, such as a bank or brokerage account statement, to be admitted. BD also may request appropriate identification as a condition of admission.

Quorum; Required Vote

The holders of a majority of the shares entitled to vote at the meeting must be present in person or represented by proxy to constitute a quorum. Directors are elected by a majority of the votes cast at the meeting (Proposal 1). This means that a director nominee will be elected to the Board only if the number of votes cast for the nominee exceeds the number of votes cast against that nominee.

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Approval of Proposals 2, 3 and 5 requires the affirmative vote of a majority of the votes cast at the meeting. Approval of Proposal 4 requires the affirmative vote of two-thirds of the votes cast at the meeting. Under New Jersey law, abstentions and shares that brokers do not have the authority to vote in the absence of timely instructions from the beneficial owners will not be counted as votes cast, and, accordingly, will have no effect on the outcome of the vote for any of the Proposals. Proposal 2 is a discretionary item, and New York Stock Exchange (NYSE) member brokers that do not receive instructions on how to vote from beneficial owners may cast those votes in their discretion.

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How to Vote

Shareholders of record may cast their votes at the meeting. In addition, shareholders of record may cast their votes by proxy, and participants in the BD plans described below may submit their voting instructions, by:

- (1) using the Internet and voting at the website listed on the enclosed proxy/voting instruction card (the proxy card);
- (2) using the toll-free telephone number listed on the proxy card; or
- (3) signing, completing and returning the proxy card in the enclosed postage-paid envelope.

Votes cast through the Internet and telephone votes are authenticated by use of a personal identification number. This procedure allows shareholders to appoint a proxy, and the various plan participants to provide voting instructions, and to confirm that their actions have been properly recorded. Specific instructions to be followed are set forth on the proxy card. If you vote through the Internet or by telephone, you do not need to return your proxy card. **In order to be timely processed, voting instructions submitted by participants in BD's Global Share Investment Program (GSIP) must be received by 12:00 p.m. EST on January 23, 2013, and voting instructions submitted by participants in all other BD plans must be received by 12:00 p.m. EST on January 25, 2013. All proxies submitted by record holders through the Internet or by telephone must be received by 11:00 a.m. EST on January 29, 2013.**

If you are the beneficial owner of shares held in street name, you have the right to direct your bank, broker or other nominee on how to vote your shares by using the voting instruction form provided to you by them, or by following their instructions for voting through the Internet or by telephone. In the alternative, you may vote in person at the meeting if you obtain a valid proxy from your bank, broker or other nominee and present it at the meeting.

Shares represented by properly executed proxies will be voted in accordance with the instructions specified therein. Shares represented by properly executed proxies that do not specify voting instructions will be voted in accordance with the recommendations of the Board of Directors set forth in this proxy statement.

Savings Incentive Plan (SIP)

Participants in SIP, BD's 401(k) plan, may instruct the SIP trustee how to vote all shares of BD common stock allocated to their SIP accounts. The SIP trustee will vote the SIP shares for which it does not receive instructions in the same proportion as the SIP shares for which it does receive instructions.

Participants in Other Plans

Participants in BD's Deferred Compensation and Retirement Benefit Restoration Plan (DCP), the 1996 Directors' Deferral Plan (DDP), and GSIP (if so provided under the terms of the local country GSIP plan) may provide voting instructions for all shares of BD common stock allocated to their plan accounts. The trustees of these plans will vote the plan shares for which they do not receive instructions in the same proportion as the plan shares for which they do receive instructions.

Proxies representing shares of BD common stock held of record also will serve as proxies for shares held under the Direct Stock Purchase Plan sponsored and administered by Computershare Trust Company, N.A. and any shares of BD common stock allocated to participants' accounts under the plans mentioned above, if the registrations are the same. Separate mailings will be made for shares not held under the same registrations.

Revocation of Proxies or Change of Instructions

A proxy given by a shareholder of record may be revoked at any time before it is voted by sending written notice of revocation to the Corporate Secretary of BD at the address set forth above or delivering such notice at

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the meeting, by delivering a proxy (by one of the methods described above under the heading **How to Vote**) bearing a later date, or by voting in person at the meeting. Participants in the plans described above may change their voting instructions by delivering new voting instructions by one of the methods described above under the heading **How to Vote**.

If you are the beneficial owner of shares held in street name, you may submit new voting instructions in the manner provided by your bank, broker or other nominee, or you may vote in person at the meeting in the manner described above under the heading **How to Vote**.

Other Matters

The Board of Directors is not aware of any matters to be presented at the meeting other than those set forth in the accompanying notice. If any other matters properly come before the meeting, the persons named in the proxy card will vote on such matters in accordance with their best judgment.

OWNERSHIP OF BD COMMON STOCK**Securities Owned by Certain Beneficial Owners**

The following table sets forth as of September 30, 2012, information concerning those persons known to BD to be the beneficial owner of more than 5% of BD's outstanding common stock. This information is as reported by such persons in their filings with the Securities and Exchange Commission (SEC).

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
State Street Corporation State Street Bank and Trust Company, Trustee State Street Financial Center One Lincoln Street Boston, MA 02111	13,108,193(1)	6.6%
Vanguard Group, Inc. 100 Vanguard Boulevard Malvern, PA 19355	10,430,843(2)	5.2%

- (1) The owner has shared investment power with respect to all of these shares and sole voting power with respect to 12,987,207 shares.
(2) The owner has shared investment power with respect to 345,622 shares, sole investment power with respect to 10,085,221 shares, and sole voting power with respect to 351,639 shares.

Securities Owned by Directors and Management

The following table sets forth as of December 1, 2012 information concerning the beneficial ownership of BD common stock by (i) each director, (ii) the executive officers named in the Summary Compensation Table on page 39, and (iii) all nominees for director and executive officers as a group (except that the holdings of Mr. Elkins, who resigned from BD effective November 9, 2012, are shown as of that date). In general, beneficial ownership includes those shares that a director or executive officer has the sole or shared power to vote or transfer, including shares that may be acquired under outstanding equity compensation awards or otherwise within 60 days.

Except as indicated in the footnotes to the table, each person has the sole power to vote and transfer the shares he or she beneficially owns. None of the shares listed below have been pledged as security.

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Name	Amount and Nature of Beneficial Ownership				Percentage of Class
	Shares Owned Directly and Indirectly (1)	Shares That May Be Acquired Within 60 Days (2)	Total Shares Beneficially Owned		
Basil L. Anderson	6,120	17,374	23,494	*	
Henry P. Becton, Jr. (2)	187,207	21,037	208,244	*	
Catherine M. Burzik	0	0	0	*	
Gary M. Cohen	73,116	172,649	245,765	*	
Edward F. DeGraan	11,596	21,037	32,633	*	
David V. Elkins	120	66,398	66,518	*	
Vincent A. Forlenza	79,199	813,662	892,861	*	
Claire M. Fraser	0	11,739	11,739	*	
Christopher Jones	2,266	5,237	7,503	*	
William A. Kozy	65,242	457,162	522,404	*	
Marshall O. Larsen	2,549	10,004	12,553	*	
Adel A.F. Mahmoud	118	11,739	11,857	*	
Gary A. Mecklenburg	4,310	17,374	21,684	*	
James F. Orr	12,122	21,037	33,159	*	
Willard J. Overlock, Jr.	29,448	21,037	50,485	*	
Rebecca W. Rimel	148	1,143	1,291	*	
Bertram L. Scott	10,818	23,818	34,636	*	
Jeffrey S. Sherman	14,454	122,064	136,518	*	
Alfred Sommer	13,222	16,601	29,823	*	
Directors and executive officers as a group (23 persons)	555,960	2,094,758	2,650,718	1.2%	

* Represents less than 1% of the outstanding BD common stock.

- (1) Includes shares held directly, and, with respect to executive officers, indirect interests in BD common stock held under the SIP and the DCP, and, with respect to the non-management directors, indirect interests in BD common stock held under the DDP. Additional information on certain of these plans appears on pages 61-62.
- (2) Includes shares under outstanding stock options or stock appreciation rights that are exercisable or become exercisable within 60 days, and, with respect to those executive officers who are retirement-eligible (including Messrs. Forlenza and Kozy) (i) unvested stock options or stock appreciation rights that become vested upon retirement, and (ii) shares issuable under restricted stock units upon retirement. Also includes, with respect to each non-management director, shares issuable under restricted stock units upon the director's termination of service on the Board, as more fully described in Non-Management Directors' Compensation Equity Compensation on page 14.
- (3) Includes 162,137 shares held by trusts of which Mr. Becton is a co-trustee with shared investment and voting power or held by a limited liability company owned by one of such trusts. Does not include 37,166 shares owned by Mr. Becton's spouse, or 108,712 shares held in trusts for the benefit of his children, and as to each of which he disclaims beneficial ownership.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires BD's directors and executive officers to file initial reports of their ownership of BD's equity securities and reports of changes in such ownership with the SEC and the NYSE. Directors and executive officers are required by SEC regulations to furnish BD with copies of all Section 16(a) forms they file with respect to BD securities. Based solely on a review of copies of such forms and written representations from BD's directors and executive officers, BD believes that, for the period from October 1, 2011 through September 30, 2012, all of its directors and executive officers were in compliance with the reporting requirements of Section 16(a), except that one report with respect to the November 2011 equity compensation grant made to Gary M. Cohen was inadvertently filed late.

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Proposal 1. ELECTION OF DIRECTORS

Members of our Board of Directors are elected to serve a term of one year and until their successors have been elected and qualified. All of the nominees for director have consented to being named in this proxy statement and to serve if elected. Presented below is biographical information for each of the nominees. Each of the nominees is a current member of BD's Board, except for Ms. Burzik. It is anticipated that the Board will appoint Ms. Burzik as a director prior to the Annual Meeting. Ms. Burzik was identified as a candidate for nomination to the Board by Edward J. Ludwig while he was serving as BD's Chairman.

BD directors have a variety of backgrounds, which reflects the Board's continuing efforts to achieve a diversity of viewpoint, experience, knowledge, ethnicity and gender. As more fully discussed below, director nominees are considered on the basis of a range of criteria, including their business knowledge and background, prominence and reputation in their fields, global business perspective and commitment to strong corporate citizenship. They must also have experience and ability that is relevant to the Board's oversight role with respect to BD's business and affairs. Each nominee's biography includes the particular experience and qualifications that led the Board to conclude that the nominee should serve on the Board.

NOMINEES FOR DIRECTOR

Basil L. Anderson, 67, has been a director since 2004. From 2001 until his retirement in 2006, he served as Vice Chairman of Staples, Inc., a supplier of office products. Prior thereto, he was Executive Vice President Finance and Chief Financial Officer of Campbell Soup Company. Mr. Anderson also is a director of Hasbro, Inc., Moody's Corporation and Staples, Inc. He was formerly a director of CRA International, Inc.

Mr. Anderson has an extensive business and financial background as both an operating executive and as a chief financial officer of major multinational public companies. His experience includes strategic, business and financial planning and operations; international operations; and service as a director for public companies in different industries.

Henry P. Becton, Jr., 69, has been a director since 1987. Since 2007, he has served as Vice Chairman of the WGBH Educational Foundation, a producer and broadcaster of public television, radio and Internet programs, and books and other educational materials. He served as President of WGBH Educational Foundation from 1984 to 2007. Mr. Becton also serves as Lead Director of the Belo Corporation, is a director of Public Radio International and the PBS Foundation, and is a director/trustee of various DWS mutual funds.

Mr. Becton possesses a broad range of operational, financial and corporate governance experience developed through his professional and board-related activities in a variety of contexts. This broad background is coupled with Mr. Becton's extensive knowledge of BD, which provides him with a unique perspective on BD.

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Catherine M. Burzik, 62, served as President and Chief Executive Officer of Kinetic Concepts, Inc., a medical device company specializing in the fields of woundcare and regenerative medicine, from 2006 until January 2012 following the sale of the company. Ms. Burzik currently serves as Chair of the Board of Directors of VitaPath Genetics, Inc. and as Chair of the San Antonio Branch of the Dallas Federal Reserve Board. Previously, Ms. Burzik was President of Applied Biosystems; President of Ortho-Clinical Diagnostics, Inc., a Johnson & Johnson company; and held senior executive roles at Eastman Kodak Company. Ms. Burzik was formerly a director of Allscripts Healthcare Solutions, Inc.

Ms. Burzik is a seasoned executive in the healthcare industry, having led major medical device, diagnostic, diagnostic imaging and life sciences businesses. She contributes strong strategic and leadership expertise, and extensive knowledge of the global healthcare field.

Edward F. DeGraan, 69, has been a director since 2003. In 2006, he retired as Vice Chairman of Gillette of the Procter & Gamble Company, a manufacturer of consumer products. Prior thereto, he was Vice Chairman of The Gillette Company, and served as its President and Chief Operating Officer from 2000 until 2003. He also served as Acting Chief Executive Officer of Gillette from October 2000 to February 2001. Mr. DeGraan also is a director of Amica Mutual Insurance Company and a Senior Advisor of Centerview Partners, L.P.

Mr. DeGraan brings extensive operational, manufacturing and executive experience in a consumer industry with a strong manufacturing base. He possesses a broad background in strategic, business and financial planning and operations, deepened by his global perspective developed through his long tenure with a multinational company.

Vincent A. Forlenza, 59, has been a director since October 2011, and became BD's Chairman in July 2012. He was elected BD's Chief Executive Officer in October 2011 and has served as its President since January 2009. He also served as BD's Chief Operating Officer from July 2010 to October 2011, and prior thereto, served as Executive Vice President.

Mr. Forlenza has been with BD for over thirty years in a number of different capacities, including strategic planning, marketing, general management in all three of BD's segments, and overseas roles. Mr. Forlenza brings to the Board extensive business and industry experience, and provides the Board with a unique perspective on BD's strategy and operations, particularly in the area of new product development.

Claire M. Fraser, Ph.D, 57, has been a director since 2006. Since 2007, she has been Director of the Institute for Genome Sciences and a Professor of Medicine at the University of Maryland School of Medicine in Baltimore, Maryland. From 1998 to 2007, she served as President and Director of The Institute for Genomic Research, a not-for-profit center dedicated to deciphering and analyzing genomes.

Dr. Fraser is a prominent scientist with a strong background in infectious diseases and molecular diagnostics, including the development of novel diagnostics and vaccines. She also brings considerable managerial experience in her field.

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Christopher Jones, 57, has been a director since 2010. Mr. Jones retired in 2001 as Chief Executive Officer of JWT Worldwide (previously known as J. Walter Thompson), an international marketing firm. Since 2002, Mr. Jones has been Operating Partner and director at Motion Equity Partners (formerly Cognetas LLP), a pan-European private equity firm. He has been the non-executive Chairman of Results International Group since 2002. He also is Chairman of the Board of The Pavilion Clinic and a member of the Health Advisory Board of The Johns Hopkins University Bloomberg School of Public Health.

Mr. Jones contributes an important international perspective based on his distinguished career as a marketing leader and head of a global marketing firm. He offers substantial marketing, strategic and managerial expertise derived from his broad range of activities in the field.

Marshall O. Larsen, 64, has been a director since 2007. Mr. Larsen retired in July 2012 as Chairman, President and Chief Executive Officer of Goodrich Corporation, a supplier of systems and services to the aerospace and defense industry. Mr. Larsen also is a director of Lowe's Companies, Inc., United Technologies Corp. and the Federal Reserve Bank of Richmond, and is a member of The Business Council.

As a veteran chief executive officer of a public company, Mr. Larsen offers the valuable perspective of an individual with highly-developed executive leadership and financial and strategic management skills in a global manufacturing company. These qualities reflect considerable domestic and international business and financial experience.

Adel A.F. Mahmoud, M.D., Ph.D, 71, has been a director since 2006. In 2006, Dr. Mahmoud retired as Chief Medical Advisor, Vaccines and Infectious Diseases and member of the Management Committee of Merck & Co., Inc., a pharmaceutical company. From 1999 to 2005, he served as President, Merck Vaccines. In 2007, he joined Princeton University as Professor, Department of Molecular Biology and the Woodrow Wilson School of Public and International Affairs. Dr. Mahmoud also is a director of GenVec, Inc. and Inovio Pharmaceuticals, Inc. He is also a member of the Board of the International AIDS Vaccine Initiative (IAVI).

Dr. Mahmoud is a distinguished scientist, physician and business leader with broad and deep knowledge of infectious diseases and vaccines. He brings strong technical, strategic and operational experience as a former senior executive with a major global pharmaceutical company, as well as an extensive academic background.

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Gary A. Mecklenburg, 66, has been a director since 2004. In 2006, he retired as President and Chief Executive Officer of Northwestern Memorial HealthCare, the parent corporation of Northwestern Memorial Hospital, a position he had held since 1986. He also served as President of Northwestern Memorial Hospital from 1985 to 2002. He is currently an Executive Partner of Waud Capital Partners, L.L.C., a private equity investment firm. Mr. Mecklenburg is also a director of LHP Hospital Partners, Inc., and was formerly a director of Acadia Healthcare Company, Inc.

Mr. Mecklenburg's long tenure in hospital administration affords him a broad perspective on the many facets of the delivery of healthcare and a deep knowledge of healthcare financing and administration. As the former leader of a major teaching hospital, Mr. Mecklenburg possesses strong executive management, financial, strategic and operational knowledge as applied in a healthcare setting.

James F. Orr, 67, has been a director since 2000. In 2007, he retired as Chairman of the Board of Convergys Corporation, a provider of customer management, employee care and outsourced billing services, a position he had held since 2000. He also served as Convergys' Chief Executive Officer from 1998 until his retirement in 2007, and also as its President from 1998 to 2005. Mr. Orr also is a director of Ohio National Financial Services, Inc.

Mr. Orr contributes the important insights of a former chief executive officer of a public company. His background reflects extensive managerial, strategic, operational and financial experience from the perspective of a service industry. He also possesses a depth of understanding of corporate governance and enterprise risk management.

Willard J. Overlock, Jr., 66, has been a director since 1999. He retired in 1996 as a partner in Goldman, Sachs & Co., where he served as a member of its Management Committee, and retains the title of Senior Director to The Goldman Sachs Group, Inc. Mr. Overlock also is a trustee of Rockefeller University and a member of the Board of Directors of The Albert and Mary Lasker Foundation.

Mr. Overlock has broad financial and investment banking experience based on his senior leadership roles in these areas. He contributes financial and transactional expertise and acumen in mergers and acquisitions and complex financial transactions.

Rebecca W. Rimel, 61, has been a director since July 2012. Since 1994, she has served as President and Chief Executive Officer of The Pew Charitable Trusts, a public charity that provides grants to improve public policy and support community service. Ms. Rimel previously served as Assistant Professor in the Department of Neurosurgery at the University of Virginia Hospital and also as Head Nurse of its medical center emergency department. Ms. Rimel also is a director of CardioNet, Inc., a director/trustee of various DWS mutual funds, and a trustee of Washington College.

Ms. Rimel was added to the Board due to her executive leadership and her extensive experience in public policy and advocacy, particularly in the area of healthcare. She also brings to the Board the perspective of someone with a strong background in the healthcare field.

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Bertram L. Scott, 61, has been a director since 2002. Mr. Scott is the President and Chief Executive Officer of Affinity Health Plan. He previously served as President, U.S. Commercial of CIGNA Corporation from June 2010 to December 2011. Prior thereto, Mr. Scott served as Executive Vice President of TIAA-CREF from 2000 to 2010 and as President and Chief Executive Officer of TIAA-CREF Life Insurance Company from 2000 to 2007. Mr. Scott also is a director of AXA Financial, Inc.

Mr. Scott possesses strong strategic, operational and financial experience from the variety of executive roles in which he has served during his career. He brings experience in corporate governance and business expertise in the insurance and healthcare fields.

Alfred Sommer, M.D., M.H.S., 70, has been a director since 1998. He is Professor of International Health, Epidemiology, and Ophthalmology at The Johns Hopkins University (JHU) Bloomberg School of Public Health (the Bloomberg School) and the JHU School of Medicine, positions he has held since 1986. He is Dean Emeritus of the Bloomberg School, having served as Dean from 1990 to 2005. He is a member of the National Academy of Sciences and the Institute of Medicine. He is a recipient of the Albert Lasker Award for Medical Research. Dr. Sommer also is a director of T. Rowe Price Group, Inc., and Chairman of the Board of Directors of The Albert and Mary Lasker Foundation.

Dr. Sommer is a renowned clinician, researcher and academic administrator with substantial and broad experience in medicine and the public health field, and has valuable board experience in the for-profit and nonprofit realms. These attributes enable him to offer deep insights into global healthcare issues and medical technology.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR EACH OF THE NOMINEES FOR DIRECTOR.

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BOARD OF DIRECTORS

The Board and Committees of the Board

BD is governed by a Board of Directors that currently consists of 14 members, 13 of whom have been determined by the Board to be independent. The Board has established four operating committees (the Committees): the Audit Committee; the Compensation and Benefits Committee (the Compensation Committee); the Corporate Governance and Nominating Committee (the Governance Committee); and the Science, Innovation and Technology Committee. These Committees meet regularly. The Board has also established an Executive Committee that meets only as needed. Committee meetings may be called by the Committee chair, the Chairman of the Board or a majority of Committee members. The Board has adopted written charters for each of the Committees that are posted on BD's website at www.bd.com/investors/corporate_governance/. Printed copies of these charters, BD's 2012 Annual Report on Form 10-K, and BD's reports and statements filed with or furnished to the SEC, may be obtained, without charge, by contacting the Corporate Secretary, BD, 1 Becton Drive, Franklin Lakes, New Jersey 07417-1880, telephone 201-847-6800.

Committee Membership and Function

Set forth below is a summary description of each of the Committees.

AUDIT COMMITTEE

Function

Retains and reviews the qualifications, independence and performance of BD's registered public accounting firm (the independent auditors).

Reviews BD's public financial disclosures and financial statements, and its accounting principles, policies and practices; the scope and results of the annual audit by the independent auditors; BD's internal audit process; and the effectiveness of BD's internal control over financial reporting.

Reviews BD's guidelines and policies relating to enterprise risk assessment and risk management, and management's plan for risk mitigation or remediation.

Oversees BD's ethics and enterprise compliance practices.

Reviews financial strategies regarding currency, interest rates and use of derivatives, and reviews BD's insurance program.

Functions as a qualified legal compliance committee, if necessary.

Members

Basil L. Anderson Chair

Christopher Jones

Marshall O. Larsen

Gary A. Mecklenburg

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James F. Orr

Rebecca W. Rimel

Bertram L. Scott

The Board has determined that the members of the Audit Committee meet the independence and financial literacy requirements of the NYSE for audit committee members. The Board also has determined that each of Messrs. Anderson, Larsen, Orr and Scott qualifies as an audit committee financial expert under the rules of the SEC. The Audit Committee regularly meets separately with BD's internal auditors and the independent auditors to ensure full and frank communications with the Audit Committee.

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COMPENSATION AND BENEFITS COMMITTEE

Function

Reviews BD's compensation and benefits policies, recommends the compensation of the Chief Executive Officer to the non-management members of the Board for their approval, and approves the compensation of BD's other executive officers.

Approves all employment, severance and change of control agreements of BD with executive officers.

Serves as the granting and administrative committee for BD's equity compensation plans.

Oversees certain other BD benefit plans.

Members

Edward F. DeGraan Chair

Basil L. Anderson

Marshall O. Larsen

James F. Orr

Willard J. Overlock, Jr.

Bertram L. Scott

The Board has determined that each member of the Compensation Committee meets the independence requirements of the NYSE.

Procedure for Determining Executive Compensation

The Compensation Committee oversees the compensation program for the named executive officers listed in the Summary Compensation Table on page 39 and for BD's other executive officers. The Compensation Committee recommends compensation actions regarding the Chief Executive Officer to the full Board and is delegated the authority to take compensation actions with respect to BD's other executive officers. The Compensation Committee may not delegate these responsibilities to another Committee, an individual director or members of management.

Role of Management

The Compensation Committee's meetings are typically attended by BD's Chief Executive Officer, Senior Vice President Human Resources and others who support the Compensation Committee in fulfilling its responsibilities. The Compensation Committee considers management's views relating to compensation matters, including the performance metrics and targets for BD's performance-based compensation. Management also provides information (which is reviewed by our Internal Audit Department) to assist the Committee in determining the extent to which performance targets have been achieved. This includes any recommended adjustments to BD's operating results when assessing BD's performance. The Chief Executive Officer and Senior Vice President Human Resources also work with the Compensation Committee chair in establishing meeting agendas.

The Compensation Committee meets in executive session with no members of management present for part of each of its regular meetings. The Compensation Committee also meets in executive session when considering compensation decisions regarding our executive officers.

Role of the Independent Consultant

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The Compensation Committee is also assisted in fulfilling its responsibilities by its independent consultant, Pay Governance LLC (Pay Governance). Pay Governance is engaged by, and reports directly to, the Compensation Committee. The Compensation Committee is not aware of any conflict of interest on the part of Pay Governance relating to the services performed by Pay Governance for the Compensation Committee. During fiscal year 2012, Pay Governance was not engaged to perform any services for BD or BD 's management. The Compensation Committee has adopted a policy prohibiting Pay Governance from providing any services to BD

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or BD's management without the Compensation Committee's prior approval, and has expressed its intention that such approval will be given only in exceptional cases. No other consultant was used by the Compensation Committee or management with respect to the 2012 compensation of BD's executive officers.

Pay Governance reviews all materials prepared for the Compensation Committee by management, prepares additional materials as may be requested by the Compensation Committee, and attends Compensation Committee meetings. In its advisory role, Pay Governance assists the Compensation Committee in the design and implementation of BD's compensation program. This includes assisting the Compensation Committee in selecting the key elements to include in the program, the targeted payments for each element, and the establishment of performance targets. Pay Governance also provides market comparison data, which is one of the factors considered by the Compensation Committee in making compensation decisions, and makes recommendations to the Compensation Committee regarding the compensation of BD's Chief Executive Officer.

Pay Governance also conducts an annual review of the compensation practices of select peer companies. Based on this review, Pay Governance advises the Compensation Committee with respect to the competitiveness of BD's compensation program in comparison to industry practices, and identifies any trends in executive compensation.

Setting Compensation

At the end of each fiscal year, the Board conducts a review of the Chief Executive Officer's performance. At the following Board meeting, the Board sets the compensation of the Chief Executive Officer after considering the results of the review, market comparison data and the recommendations of the Compensation Committee. Neither the Chief Executive Officer nor any other members of management are present during this session. The Chief Executive Officer does not play a role in determining or recommending his own compensation.

The Compensation Committee is responsible for determining the compensation of BD's other executive officers. The Chief Executive Officer, in consultation with the Senior Vice President - Human Resources, reviews the performance of the other executive officers with the Compensation Committee and makes compensation recommendations for its consideration. The Compensation Committee determines the compensation for these executives, in consultation with Pay Governance, after considering the Chief Executive Officer's recommendations, market comparison data regarding compensation levels among peer companies and the views of Pay Governance. All decisions regarding the compensation of BD's other executive officers are made in executive session.

The Board has delegated responsibility for formulating recommendations regarding non-management director compensation to the Governance Committee, which is discussed below.

SCIENCE, INNOVATION AND TECHNOLOGY COMMITTEE

Function

Oversees BD's research and development activities.

Oversees BD's strategic marketing activities as they relate to BD's innovation agenda.

Oversees BD's policies, practices and procedures relating to regulatory compliance and product quality and safety.

Members

Alfred Sommer - Chair

Henry P. Becton, Jr.

Claire M. Fraser

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Christopher Jones

Adel A.F. Mahmoud

Gary A. Mecklenburg

Rebecca W. Rimel

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CORPORATE GOVERNANCE AND NOMINATING COMMITTEE

Function

Identifies and recommends candidates for election to the Board.

Reviews the composition, structure and function of the Board and its Committees, as well as the performance and compensation of non-management directors.

Monitors BD's corporate governance and Board practices, and oversees the Board's self-evaluation process.

Oversees BD's policies, practices and procedures impacting BD's image and reputation and its standing as a responsible corporate citizen, including, without limitation, issues relating to communications with BD's key stakeholders, community relations, and public policy and government relations activities.

Members

Henry P. Becton, Jr. Chair

Edward F. DeGraan

Claire M. Fraser

Adel A.F. Mahmoud

Willard J. Overlock, Jr.

Alfred Sommer

The Board has determined that each member of the Governance Committee meets the independence requirements of the NYSE. As stated above, the Governance Committee reviews the compensation program for the non-management directors and makes recommendations to the Board regarding their compensation, and may not delegate these responsibilities to another Committee, an individual director or members of management. The Governance Committee has retained Pay Governance as an independent consultant for this purpose. Pay Governance's responsibilities include providing market comparison data on non-management director compensation at peer companies, tracking trends in non-management director compensation practices, and advising the Governance Committee regarding the components and levels of non-management director compensation. The Governance Committee is not aware of any conflict of interest on the part of Pay Governance arising from these services. Executive officers do not play any role in either determining or recommending non-management director compensation.

Board, Committee and Annual Meeting Attendance

The Board and its Committees held the following number of meetings during fiscal year 2012:

Board	6
Audit Committee	11
Compensation and Benefits Committee	7
Corporate Governance and Nominating Committee	5
Science, Innovation and Technology Committee	5

The Executive Committee did not meet during fiscal year 2012.

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Each director attended 75% or more of the total number of the meetings of the Board and the Committees on which he or she served during fiscal year 2012. BD's non-management directors met in executive session at each of the Board meetings held during fiscal year 2012.

The Board has adopted a policy pursuant to which directors are expected to attend the Annual Meeting of Shareholders in the absence of a scheduling conflict or other valid reason. All but one of the fifteen directors then serving attended BD's 2012 Annual Meeting of Shareholders.

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Non-Management Directors Compensation

The Board believes that providing competitive compensation is necessary to attract and retain qualified non-management directors. The key elements of BD's non-management director compensation are a cash retainer, equity compensation, Committee chair fees and Lead Director fees. Of the base compensation paid to the non-management directors (which does not include Committee chair and Lead Director fees), approximately two-thirds currently is equity compensation that directors are required to retain until they complete their service on the Board. See Corporate Governance Significant Governance Practices Equity Ownership by Directors on page 20. This retention feature serves to better align the interests of the directors and BD shareholders and ensure compliance with the director share ownership guidelines. Mr. Forlenza does not receive compensation related to his service as a director.

Cash Retainer

Each non-management director currently receives an annual cash retainer of \$81,000 for services as a director. Directors do not receive meeting attendance fees.

Equity Compensation

Each non-management director elected at an Annual Meeting of Shareholders is granted restricted stock units then valued at \$162,000 (using the same methodology used to value awards made to executive officers). Directors newly elected to the Board receive a restricted stock unit grant that is pro-rated from the effective date of their election to the next Annual Meeting. The shares of BD common stock underlying the restricted stock units are not issuable until a director's separation from the Board.

Committee Chair/Lead Director Fees

An annual fee of \$10,000 is paid to each Committee chair, except that the fee for the Audit Committee chair is \$15,000 in recognition of the Audit Committee's responsibilities. An annual fee of \$25,000 is paid to the Lead Director. No fee is paid to the Chair of the Executive Committee.

Other Arrangements

BD reimburses non-management directors for travel and other business expenses incurred in the performance of their services for BD. Directors may travel on BD aircraft in connection with such activities, and, on limited occasions, spouses of directors have joined them on such flights. No compensation is attributed to the director for these flights in the table below, since the aggregate incremental costs of spousal travel were minimal. Directors are also reimbursed for attending director education courses. BD occasionally invites spouses of directors to Board-related business events, for which they are reimbursed their travel expenses.

Directors are eligible, on the same basis as BD associates, to participate in BD's Matching Gift Program, pursuant to which BD matches contributions made to qualifying nonprofit organizations. The aggregate annual limit per participant is \$5,000.

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The following table sets forth the compensation received by BD's non-management directors during fiscal year 2012.

Fiscal Year 2012 Non-Management Directors Compensation

Name	Fees Earned		Change in Pension Value and Nonqualified Deferred Compensation Earnings(3)	All Other Compensation(4)	Total
	or Paid in Cash(1)	Stock Awards(2)			
Basil L. Anderson	\$ 94,000	\$ 167,170			\$ 261,170
Henry P. Becton, Jr.	114,000	167,170	\$ 1,158		282,328
Edward F. DeGraan	89,000	167,170			256,170
Claire M. Fraser	79,000	167,170			246,170
Christopher Jones	79,000	167,170		\$ 5,000	251,170
Marshall O. Larsen	79,000	167,170	1,226		247,396
Adel A.F. Mahmoud	79,000	167,170			246,170
Gary A. Mecklenburg	79,000	167,170			246,170
Cathy E. Minehan (5)	25,000	0			25,000
James F. Orr	79,000	167,170			246,170
Willard J. Overlock, Jr.	79,000	167,170			246,170
Rebecca W. Rimel	15,481	84,172			99,653
Bertram L. Scott	79,000	167,170	986		247,156
Alfred Sommer	89,000	167,170		5,000	261,170

- (1) Reflects a cash retainer at the rate of \$75,000 per annum for part of the year, and a cash retainer at the rate of \$81,000 per annum for the remainder of the year.
- (2) The amounts shown in the "Stock Awards" column reflect the grant date fair value under FASB ASC Topic 718 of restricted stock units awarded to non-management directors during the fiscal year. The amounts shown are slightly different than the \$162,000 target award value, since a 20-day average of BD's stock price is used to value the units granted rather than the grant date price. For a discussion of the assumptions made by us in arriving at the grant date fair value of these awards, see Note 7 to the consolidated financial statements that are included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

Listed below are the aggregate outstanding restricted stock unit awards and option awards held by each non-management director at the end of fiscal year 2012. Stock options have not been issued to non-management directors since 2005.

Name	Stock Awards Outstanding at September 30, 2012 (#)	Option Awards Outstanding at September 30, 2012 (#)
	Basil L. Anderson	15,214
Henry P. Becton, Jr.	16,601	7,217
Edward F. DeGraan	16,601	4,436
Claire M. Fraser	11,739	0
Christopher Jones	5,237	0
Marshall O. Larsen	10,004	0
Adel A.F. Mahmoud	11,739	0

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Gary A. Mecklenburg	15,214	2,160
James F. Orr	16,601	4,436
Willard J. Overlock, Jr.	16,601	4,436
Rebecca W. Rimel	1,143	0
Bertram L. Scott	16,601	7,217
Alfred Sommer	16,601	0

- (3) Represents interest on deferred directors' fees in excess of 120% of the federal long-term rate.
- (4) Amounts shown represent matching gifts under BD's Matching Gift Program, which is more fully discussed on the previous page.
- (5) Ms. Minehan left the Board on January 31, 2012.

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Directors' Deferral Plan

Directors may defer receipt of all or part of their annual cash retainer and other cash fees pursuant to the provisions of the 1996 Directors Deferral Plan. Directors may also defer receipt of shares issuable to them under their restricted stock unit awards upon leaving the Board. A general description of the 1996 Directors' Deferral Plan appears on page 62.

Communication with Directors

Shareholders or other interested parties wishing to communicate with the Board, the non-management directors or any individual director (including complaints or concerns regarding accounting, internal accounting controls or audit matters) may do so by contacting the Lead Director either:

by mail, addressed to BD Lead Director, P.O. Box 264, Franklin Lakes, New Jersey 07417-0264;

by calling the BD Ethics Help Line, an independent toll-free service, at 1-800-821-5452 (callers from outside North America should use AT&T Direct to reach AT&T in the U.S. and then dial the above toll-free number); or

by email to *ethics_office@bd.com*.

All communications will be kept confidential and promptly forwarded to the Lead Director, who shall, in turn, forward them promptly to the appropriate director(s). Such items that are unrelated to a director's duties and responsibilities as a Board member may be excluded by our corporate security department, including, without limitation, solicitations and advertisements, junk mail, product-related communications, job referral materials and resumes, surveys, and material that is determined to be illegal or otherwise inappropriate.

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CORPORATE GOVERNANCE

Corporate Governance Principles

BD's commitment to good corporate governance is embodied in our Corporate Governance Principles (the "Principles"). The Principles set forth the Board's views and practices regarding a number of governance topics, and the Governance Committee assesses the Principles on an ongoing basis in light of current practices. The Principles cover a wide range of topics, including voting for directors; board leadership structure; the selection of director nominees; director independence; annual self-evaluations of the Board and its Committees; conflicts of interest; charitable contributions to entities with which BD's executive officers and directors are affiliated, and other significant governance practices. The Principles are available on BD's website at www.bd.com/investors/corporate_governance/. Printed copies of the Principles may be obtained, without charge, by contacting the Corporate Secretary, BD, 1 Becton Drive, Franklin Lakes, New Jersey 07417-1880, phone 1-201-847-6800.

Board Leadership Structure

The Board's goal is to achieve the best board leadership structure for effective oversight and management of BD's affairs. The Board believes that there is no single, generally accepted approach to providing board leadership, and that each possible leadership structure must be considered in the context of the individuals involved and the specific circumstances facing a company. Accordingly, what the Board believes is the right board leadership structure may vary as circumstances warrant.

In connection with Vince A. Forlenza's appointment as Chief Executive Officer in October 2011, succeeding Edward J. Ludwig, Mr. Ludwig continued to serve as the Chairman of the Board during Mr. Forlenza's transition to his new role. Upon Mr. Ludwig's departure from the Board in June of this year, the Board appointed Mr. Forlenza to the additional role of Chairman. The Board believes it is in BD's best interests to have Mr. Forlenza also serve as Chairman, as this arrangement permits a clear, unified strategic vision for BD that ensures alignment between the Board and management, provides clear leadership for BD and helps ensure accountability for BD's performance. As the individual with primary responsibility for managing BD's day-to-day operations and with in-depth knowledge and understanding of BD, Mr. Forlenza is best positioned to lead the Board through reviews of key business and strategic issues.

At the same time, the role of Lead Director, currently being served by Henry P. Becton, Jr., allows the non-management directors to provide independent Board leadership and oversight of management. The Principles provide for the appointment of a Lead Director from among the independent directors whenever the Chairman is not independent. The responsibilities of the Lead Director include:

Presiding over executive sessions of the non-management directors and over Board meetings in the absence of the Chairman;

Consulting on and approving Board agendas and meeting schedules;

Ensuring the adequacy of the flow of information to the non-management directors;

Together with the Chair of the Compensation Committee, coordinating the evaluation of the Chief Executive Officer by the non-management directors;

Acting as a liaison between the non-management directors and the Chief Executive Officer; and

Serving as a contact person to facilitate communications between BD's associates, shareholders and other constituents and the non-management directors.

The Board believes having an independent Lead Director provides independent oversight of management, including risk oversight, while avoiding the risk of confusion regarding the Board's oversight responsibilities and the day-to-day management of the business. As such, this structure provides independent Board leadership and engagement, while deriving the benefit of having the Chief Executive Officer also serve as

Chairman.

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Board's Oversight of Risk

BD's management engages in a process referred to as enterprise risk management (ERM) to identify, assess, manage and mitigate a broad range of risks across BD's businesses, regions and functions and to ensure alignment of our risk assessment and mitigation efforts with BD's corporate strategy. The Audit Committee, through the authority delegated to it by the Board of Directors, is primarily responsible for overseeing BD's ERM activities to determine whether the process is functioning effectively and is consistent with BD's business strategy. At least twice a year, senior management reviews the results of its ERM activities with the Audit Committee, including the process used within the organization to identify risks, management's assessment of the significant categories of risk faced by BD (including any changes in such assessment since the last review), and management's plans to mitigate the potential exposures. On at least an annual basis, the significant risks identified through BD's ERM activities and the related mitigation plans are reviewed with the full Board. Often, particular risks are reviewed in-depth with the Audit Committee or the full Board at subsequent meetings.

In addition, the full Board reviews the risks associated with BD's strategic plan and discusses the appropriate levels of risk in light of BD's objectives. This is done through an annual strategy review process, periodically throughout the year as part of its ongoing review of corporate strategy, and otherwise as necessary. The full Board also regularly oversees other areas of potential risk, including BD's capital structure, acquisitions and divestitures, and succession planning for BD's Chief Executive Officer and other members of senior management.

The various Committees of BD's Board are also responsible for monitoring and reporting on risks associated with their respective areas of oversight. The Audit Committee oversees BD's accounting and financial reporting processes and the integrity of BD's financial statements, BD's processes to ensure compliance with laws, and its hedging activities and insurance coverages. The Compensation Committee oversees risks associated with BD's compensation practices and programs, and the Governance Committee oversees risks relating to BD's corporate governance practices, including director independence, related person transactions and conflicts of interest. In connection with its oversight responsibilities, each Committee often meets with members of management who are primarily responsible for the management of risk in their respective areas, including BD's Chief Financial Officer, Senior Vice President Human Resources, General Counsel, Senior Vice President Regulatory Affairs, Chief Ethics and Compliance Officer and other members of senior management.

Risk Assessment of Compensation Programs

With respect to our compensation policies and practices, BD's management reviewed our policies and practices to determine whether they create risks that are reasonably likely to have a material adverse effect on BD. In connection with this risk assessment, management reviewed the design of BD's compensation and benefits programs (in particular our performance-based compensation programs) and related policies, potential risks that could be created by the programs, and features of our programs and corporate governance generally that help to mitigate risk. Among the factors considered were the mix of cash and equity compensation, and of fixed and variable compensation, paid to our associates; the balance between short- and long-term objectives in our incentive compensation; the performance targets, mix of performance metrics, vesting periods, threshold performance requirements and funding formulas related to our incentive compensation; the degree to which programs are formulaic or provide discretion to determine payout amounts; caps on payouts; our clawback and share ownership policies; and our general governance structure. Management reviewed and discussed the results of this assessment with the Compensation Committee. Based on this review, we believe that our compensation policies and practices do not create risks that are reasonably likely to have a material adverse effect on BD.

Director Nomination Process

The Governance Committee reviews potential director candidates and recommends nominees for director to the full Board for approval. In making its recommendations, the Committee assesses the overall composition of the Board, including diversity, age, skills, international background, and experience and prominence in areas of

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importance to BD. The Board seeks to achieve among its directors a diversity of viewpoint, experience, knowledge, ethnicity and gender that fits the needs of the Board at that particular time.

When considering individual director candidates, the Governance Committee will seek individuals with backgrounds and qualities that, when combined with those of BD's other directors, provide a blend of skills and experience that will further enhance the Board's effectiveness. From time-to-time, the Governance Committee has retained an executive search firm to assist it in its efforts to identify and evaluate potential director candidates.

The Governance Committee believes that any nominee for director must meet the following minimum qualifications:

Candidates should be persons of high integrity who possess independence, forthrightness, inquisitiveness, good judgment and strong analytical skills.

Candidates should demonstrate a commitment to devote the time required for Board duties, including, but not limited to, attendance at meetings.

Candidates should be team-oriented and be committed to the interests of all shareholders as opposed to those of any particular constituency.

The Governance Committee assesses the characteristics and performance of incumbent director nominees against the above criteria as well, and, to the extent applicable, considers the impact of any change in the principal occupations of such directors during the last year. Upon completion of the individual director evaluation process, the Governance Committee reports its conclusions and recommendations for nominations to the full Board.

It is the Governance Committee's policy to consider referrals of prospective nominees for the Board from other Board members and management, as well as shareholders and other external sources, such as retained executive search firms. The Governance Committee utilizes the same criteria for evaluating candidates irrespective of their source.

To recommend a candidate for consideration, a shareholder should submit a written statement of the qualifications of the proposed nominee, including full name and address, to the Corporate Secretary, BD, 1 Becton Drive, Franklin Lakes, New Jersey 07417-1880.

Significant Governance Practices

Described below are some of the significant corporate governance practices that have been instituted by the BD Board.

Annual Election of Directors

BD's directors are elected annually. The Board believes that annual elections of directors reflect a corporate governance best practice, as it provides shareholders the opportunity to express their views on the performance of the entire Board each year.

Voting for Directors

Under our By-Laws, in uncontested elections (where the number of nominees does not exceed the number of directors to be elected), nominees for director must receive the affirmative vote of a majority of the votes cast in order to be elected to the Board of Directors. Any incumbent director who fails to receive the requisite

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affirmative vote is required to offer to submit his or her resignation to the Board following the shareholder vote. The Governance Committee will consider and recommend to the Board whether to accept the resignation offer. The Board will act on such recommendation and publicly disclose its decision within 90 days following the shareholder vote. This structure allows the Board the opportunity to identify and assess the reasons for the vote, including whether the vote is attributable to dissatisfaction with a director's overall performance or is the result of shareholder views on a particular issue, and enables it to avoid undesirable and disruptive governance consequences.

Board Self-Evaluation

Each year the Board conducts a self-evaluation of its performance and effectiveness. As part of this process, each director completes an evaluation form on specific aspects of the Board's role, organization and meetings. The collective comments are then presented by the Chair of the Governance Committee to the full Board. As part of the evaluation, the Board assesses the progress in the areas targeted for improvement a year earlier, and develops actions to be taken to enhance the Board's effectiveness over the next year. The Board's evaluation covers many areas (a complete list is available on BD's website at www.bd.com/investors/corporate_governance). Additionally, each Committee conducts an annual self-evaluation of its performance through a similar process.

Equity Ownership by Directors

The Board believes that directors should hold meaningful equity ownership positions in BD. To that end, a significant portion of non-management director compensation is in the form of restricted stock units that are not distributable until a director completes his or her service on the Board. The Board believes these equity interests help to better align the interests of the non-management directors with shareholders. Under the Board's share ownership guidelines, each non-management director is required to own shares of common stock (which includes restricted stock units) valued at five times the annual cash retainer and must comply with the guidelines within three years of joining the Board.

Annual Report of Charitable Contributions

In furtherance of BD's commitment to good governance and disclosure practices, the Principles require that BD's charitable contributions or pledges in an aggregate amount of \$50,000 or more (not including contributions under BD's Matching Gift Program) to entities with which BD's directors and their families are affiliated must be approved by the Governance Committee. In addition, BD is required by the Principles to post on its website, at www.bd.com/investors/corporate_governance/, an Annual Report of Charitable Contributions (the Contributions Report) listing all contributions and pledges made by BD to organizations affiliated with any director or executive officer during the preceding fiscal year in an amount of \$10,000 or more. The Contributions Report, which BD has voluntarily issued since 2002, includes a discussion of BD's contributions philosophy and the alignment of BD's philanthropic activities with its philosophy, together with additional information about each contribution or pledge.

Enterprise Compliance

Under the oversight of the Audit Committee, BD's enterprise compliance function seeks to ensure that BD has policies and procedures designed to prevent and detect violations of the many laws, regulations and policies affecting its business, and that BD continuously encourages lawful and ethical conduct. Launched in 2005, BD's enterprise compliance function supplements the various compliance and ethics functions that are also in place at BD, and seeks to ensure better coordination and effectiveness through program design, prevention, and promotion of an organizational culture of compliance. A Compliance Committee comprised of members of senior management oversees the activities of the Chief Ethics and Compliance Officer. Another key element of this program is training. Courses offered include a global on-line compliance training program focused on BD's Code of Conduct, as well as other courses covering various compliance topics such as antitrust, anti-bribery, conflicts of interest, financial integrity, industry marketing codes and information security.

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Political Contributions

We have a policy that prohibits the expenditure of company assets for political campaigns without the express authorization of the Chief Executive Officer or Chief Financial Officer, compliance with company policies and all applicable laws, and clearance from BD's internal law department. Contributions outside the United States must also be approved by the relevant country leaders. In 2012, no corporate funds were used to support political campaigns. BD's general prohibition on the use of corporate funds for political campaigns extends to super PACs. We have also advised the major industry associations in which BD has membership that we do not authorize them to use any portion of our dues or other funds for super PACs or any other political campaign purpose.

Director Independence; Policy Regarding Related Person Transactions

Under the NYSE rules and our Principles, a director is deemed not to be independent if the director has a direct or indirect material relationship with BD (other than his or her relationship as a director). The Governance Committee annually reviews the independence of all directors and nominees for director and reports its findings to the full Board. To assist in this review, the Board has adopted director independence guidelines (Independence Guidelines) that are contained in the Principles. The Independence Guidelines set forth certain categories of relationships (and related dollar thresholds) between BD and directors and their immediate family members, or entities with which they are affiliated, that the Board, in its judgment, has deemed to be either material or immaterial for purposes of assessing a director's independence. In the event a director has any relationship with BD that is not addressed in the Independence Guidelines, the independent members of the Board review the facts and circumstances to determine whether such relationship is material. The Principles are available on BD's website at www.bd.com/investors/corporate-governance/. The Independence Guidelines are contained in Principle No. 7.

The Board has determined that the following nominees for director are independent under the NYSE rules and our Independence Guidelines: Basil L. Anderson, Henry P. Becton, Jr., Catherine M. Burzik, Edward F. DeGraan, Claire M. Fraser, Christopher Jones, Marshall O. Larsen, Adel A.F. Mahmoud, Gary A. Mecklenburg, James F. Orr, Willard J. Overlock, Jr., Rebecca W. Rimel, Bertram L. Scott and Alfred Sommer. The Board had also previously determined that Cathy E. Minehan, who had served on the Board up to last year's annual meeting, was independent under the NYSE rules and the Principles. Vincent A. Forlenza is an employee of BD and, therefore, is not independent under the NYSE rules and the Principles.

In determining that each of the nominees is independent, the Board reviewed BD's transactions or other dealings with organizations with which a director may be affiliated. Such affiliations included service by the director or an immediate family member as an officer, employee, or member of a governing or advisory board. In conducting its review, the Board determined that, in each instance, the nature of the relationship, the degree of the director's involvement with the organization and the amount involved would not impair the director's independence under the Independence Guidelines. In addition, in most instances, the director played no active role in the organization's relationship with BD, and, in some instances, the relationship involved a unit of such organization other than the one with which the director is involved. Accordingly, the Board determined that none of these relationships was material or impaired the director's independence or judgment.

The types of transactions with director-affiliated organizations considered by the Board consisted of payments related to the purchase or sale of products and/or services (in the cases of Anderson, Becton, Burzik, Fraser, Jones, Larsen, Mecklenburg, Minehan, Orr, Overlock, Scott, and Sommer), the licensing of intellectual property rights (in the cases of Fraser, Mahmoud and Sommer) and charitable contributions (in the cases of Jones, Overlock and Sommer).

The Board has also established a written policy (the Policy) requiring Board approval or ratification of transactions involving more than \$120,000 per year in which a director, executive officer or shareholder owning more

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than 5% of BD's stock (excluding certain passive investors) or their immediate family members has, or will have, a material interest. The Policy is available on BD's website at www.bd.com/investors/corporate_governance/. The Policy excludes certain specified transactions, including certain charitable contributions, transactions available to associates generally, and indemnification and advancement of certain expenses. The Governance Committee is responsible for the review and approval or ratification of transactions subject to the Policy. The Governance Committee will approve or ratify only those transactions that it determines in its business judgment are fair and reasonable to BD and in (or not inconsistent with) the best interests of BD and its shareholders, and that do not impact the director's independence.

During fiscal year 2012, BD paid affiliates of State Street Corporation (State Street), a holder of more than 5% of BD common stock, \$870,000 for banking services and investment management of various 401(k) funds. These transactions were not required to be approved under the Policy, since State Street is considered a passive investor in BD.

Code of Conduct

BD maintains a Code of Conduct (the Code) that is applicable to all directors, officers and associates of BD, including its Chief Executive Officer, Chief Financial Officer, principal accounting officer and other senior financial officers. It sets forth BD's policies and expectations on a number of topics, including conflicts of interest, confidentiality, compliance with laws (including insider trading laws), preservation and use of BD's assets, and business ethics. The Code also sets forth procedures for the communicating and handling of any potential conflict of interest (or the appearance of any conflict of interest) involving directors or executive officers, and for the confidential communication and handling of issues regarding accounting, internal controls and auditing matters.

BD also maintains an Ethics Help Line telephone number (the Help Line) for BD associates as a means of raising concerns or seeking advice. The Help Line is serviced by an independent contractor and is available to all associates worldwide. Associates using the Help Line may choose to remain anonymous and all inquiries are kept confidential to the extent practicable in connection with investigation of an inquiry. All Help Line inquiries are forwarded to BD's Chief Ethics and Compliance Officer for investigation. The Audit Committee is informed of any matters reported to the Chief Ethics and Compliance Officer, whether through the Help Line or otherwise, involving accounting, internal control or auditing matters, or any fraud involving management or persons who have a significant role in BD's internal controls.

The Chief Ethics and Compliance Officer leads the BD Ethics Office, which administers BD's ethics program. In addition to the Help Line, the ethics program provides for broad communication of BD's Core Values, associate education regarding the Code and its requirements, and ethics training sessions.

Any waivers from any provisions of the Code for executive officers and directors will be promptly disclosed to shareholders. In addition, certain amendments to the Code, as well as any waivers from certain provisions of the Code given to BD's Chief Executive Officer, Chief Financial Officer or principal accounting officer, will be posted at the website address set forth below.

The Code is available on BD's website at www.bd.com/investors/corporate_governance/. Printed copies of the Code may be obtained, without charge, by contacting the Corporate Secretary, BD, 1 Becton Drive, Franklin Lakes, New Jersey 07417-1880, phone 1-201-847-6800.

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REPORT OF THE COMPENSATION AND BENEFITS COMMITTEE

The primary objective of the BD compensation program is to fully support the strategic business goal of delivering superior long-term shareholder returns through sustained revenue growth, EPS growth, return on capital and other metrics. As such, we intend to ensure a high degree of alignment between pay and the long-term value and financial soundness of BD. The Compensation and Benefits Committee of the Board of Directors (the Committee) has established the following compensation principles to meet this objective:

Aligning the interests of executives and shareholders

Through equity compensation and equity ownership guidelines for executives, we seek to align the interests of executives with those of the company's shareholders. This represents the largest portion of our compensation structure in terms of target value.

Linking rewards to performance

We maintain a pay-for-performance philosophy based on actual performance as against clear, measurable company performance targets, particularly those metrics that support the creation of long-term shareholder value.

Delivering superior business and financial results

Performance targets are set to reward executives for achieving short- and long-term results in line with our objective of enhancing long-term shareholder value. In setting short-term goals and in rewarding performance, we will take care to ensure that we do not create incentives to take inappropriate risks.

Offering a competitive compensation structure

We have established and intend to maintain a competitive structure that supports the recruitment and retention of high-performance executives essential to driving the business results required to execute our strategy and create long-term value for shareholders. This structure is determined, in part, by evaluating peer group data, which is provided and analyzed by the Committee's independent consultant, Pay Governance LLC.

Maintaining a transparent compensation structure

The Committee strives to provide absolute transparency to executives, employees and shareholders of all aspects of BD's compensation and benefits structure. This includes disclosure of performance targets, payout formulas, details of other earned benefits and the Committee's use of discretion in determining award payouts.

Maintaining Committee independence

The Committee is made up exclusively of independent directors and utilizes an independent compensation consultant, Pay Governance LLC, which, by Committee policy, is prohibited from performing any services for BD or its management without the

Committee's prior approval.

Retaining prerogative to adjust programs

The Committee retains the prerogative to change or modify compensation and benefit programs to reflect prevailing economic, market or company financial conditions.

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The Committee has reviewed and discussed the Compensation Discussion and Analysis with management, and, based on such review and discussions, has recommended to the Board of Directors that the Compensation Discussion and Analysis be included in BD's Annual Report on Form 10-K for the year ended September 30, 2012 and in this proxy statement.

COMPENSATION AND BENEFITS COMMITTEE

Edward F. DeGraan Chair

Basil L. Anderson

Marshall O. Larsen

James F. Orr

Willard J. Overlock, Jr.

Bertram L. Scott

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COMPENSATION DISCUSSION AND ANALYSIS

This section discusses our executive compensation program and the compensation actions taken with respect to the executive officers named in the Summary Compensation Table on page 39. We sometimes refer to these individuals as the named executive officers or NEOs. Mr. Elkins, who served as BD's Executive Vice President and Chief Financial Officer during fiscal year 2012, resigned from BD effective November 9, 2012.

All references in this section to years are references to our fiscal year, which ends on September 30, unless otherwise noted.

This section includes a discussion of performance targets in the limited context of our executive compensation program. These targets are not statements of management's expectations of our future results or other guidance. Investors should not use or evaluate these targets in any other context or for any other purpose.

Executive Summary

Overview of our compensation program

Our goal is to provide an executive compensation program that best serves the long-term interests of our shareholders. We believe that attracting and retaining superior talent is a key to delivering long-term shareholder returns, and that a competitive compensation plan is critical to that end. Therefore, we intend to provide a competitive compensation package to our executives that ties a significant portion of pay to performance and utilizes components that align the interests of our executives with those of BD's shareholders.

The following is a summary of important aspects of our executive compensation program discussed later in this section.

The key elements of our program are salary, annual cash incentives under our Performance Incentive Plan (PIP) and long-term equity compensation consisting of stock-settled stock appreciation rights (SARs), Performance Units and Time-Vested Units (TVUs).

We emphasize pay-for-performance to align executive compensation with our business strategy and the creation of long-term shareholder value.

While we emphasize at risk pay tied to performance, we believe our program does not encourage excessive risk taking by management.

Our executives are subject to robust share ownership guidelines and are prohibited from hedging against the economic risk of such ownership.

We offer our named executive officers very limited perquisites, and none of them have employment agreements.

We have a compensation recovery policy that gives the Board discretion to recover incentive compensation paid to senior management in the event of a restatement of our financial statements due to misconduct.

We have double-trigger change of control agreements with our executives to provide continuity of management in the event of a change of control of BD.

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The independent consultant to the Compensation and Benefits Committee (the Compensation Committee) did not provide any other services to BD or BD management in 2012.

Overview of 2012 operating performance and executive compensation

BD delivered solid results in 2012, driven by strong growth in safety-engineered device sales and in emerging markets. Similar to 2011, the medical device industry continued to face difficult macroeconomic conditions that adversely affected our underlying growth and profitability during the year. These conditions

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continued to put downward pressure on healthcare utilization in Western Europe and the U.S. and increased pricing pressure for certain products in our Medical segment. Our Biosciences segment was also unfavorably impacted in developed markets by an uncertain academic research spending environment for high-end instruments and increased competitiveness in research reagents.

Despite these ongoing challenges, management continued to execute on BD's strategy and delivered solid results for the year. Highlights of our performance include:

Reported revenues grew about 1.6%, which included a 2.7% negative effect from currency translation. Underlying revenue growth was 4.3%.

We reported earnings per share from continuing operations (EPS) of \$5.30. While this was a slight decrease from the prior year, after excluding a \$0.06 per share charge resulting from primarily non-cash pension settlements and a negative effect of \$0.21 per share from foreign currency translation, our EPS was \$5.58 (adjusted for rounding), representing about 5% underlying growth for the year. This growth came even after absorbing additional costs from unbudgeted acquisitions during the year.

We continued to use our strong financial condition to position BD for long-term growth, including investments in high-growth areas in emerging markets and research and development spending. To this end, BD launched a number of new products during the year across all three of its business segments, and emerging markets accounted for almost a quarter of BD's 2012 sales.

Significant progress was made on BD's operating efficiency initiatives. These include the initial roll-out of Project Everest (our enterprise resource planning upgrade), savings realized from ReLoCo (our program to reduce manufacturing costs), and our efforts to reduce overhead expense through the establishment of shared service centers and other projects. These savings allow BD to invest in higher-growth opportunities, such as emerging markets.

We completed the acquisition of Kiestra Lab Automation, a maker of innovative automation solutions for microbiology laboratories, and of Sirigen Group Limited, a developer of unique dyes for flow cytometry, as part of our strategy to supplement internal growth with growth from strategic acquisitions.

We announced plans to sell the majority of our Discovery Labware business, which allows us to focus our resources on the growth drivers for our BD Biosciences segment. This sale was completed in October 2012.

We returned \$1.9 billion to shareholders through dividends and share repurchases. BD has increased its dividend for 40 consecutive years.

Based on BD's performance, BD's revenues were slightly above the revenue target and its EPS was at 98% of the EPS target for the year under the PIP, which resulted in available funding for PIP awards at 97% of target. The PIP awards made to our named executive officers, as a percentage of their target awards, were generally in line with this funding factor. In addition, the lower revenue growth BD experienced during the 2010-2012 fiscal years relative to the Performance Unit targets for that period resulted in there being no payout of the Performance Units covering the 2010-2012 performance cycle, continuing a trend over the last four performance cycles of below-target payouts for these awards. Consistent with our past practice, equity compensation represented a significant component of compensation in 2012. The increase in the equity compensation for Mr. Forlenza from 2011 was due to his election as Chief Executive Officer at the beginning of the fiscal year. The other increases in equity compensation paid to NEOs were based on performance, increased responsibilities assumed during the year and/or to align award values with market practices.

Objectives of Our Executive Compensation Program

The objectives of our executive compensation program include:

Offering competitive compensation. We seek to offer a competitive compensation package that helps us attract and retain our executives.

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Linking compensation to performance. We seek to implement a pay-for-performance philosophy by tying a significant portion of pay to financial and other goals that support long-term shareholder value.

Aligning executives with our shareholders. We seek to align the interests of our executives with those of our shareholders through equity compensation and share ownership guidelines.

The Process for Setting Executive Compensation

The role of the Compensation Committee, its consultant and management

The Compensation Committee oversees the compensation program for the named executive officers and our other executive officers. The Compensation Committee is assisted in fulfilling its responsibilities by its independent consultant, Pay Governance LLC (Pay Governance), and BD s senior management. Additional information about our process for setting executive compensation, including the role of Pay Governance and management, may be found on pages 11-12. In order to maintain the independence of its outside consultant, the Compensation Committee has established a policy that prohibits its consultant from performing any services for BD or BD s management without the Compensation Committee s prior approval. In accordance with this policy, Pay Governance did not perform services for BD or its management in 2012.

Approximately 95% of the shares voted last year were cast in support of BD s advisory vote on executive compensation. The Compensation Committee viewed the results of this vote as general broad shareholder support for our executive compensation program. Based on this result and our ongoing review of our compensation policies and decisions, we believe that our existing compensation program effectively aligns the interests of our named executive officers with the long-term goals of BD.

The use of market comparison data

The Compensation Committee considers a number of factors in structuring our program and making compensation decisions. This includes the compensation practices of select peer companies in the healthcare industry, which we refer to as the Comparison Group. These companies were chosen by the Compensation Committee after considering the recommendations of Pay Governance and management, and were selected because they have significant lines of business that are similar to BD s. The Compensation Committee believes that reference to the Comparison Group is appropriate when reviewing BD s compensation program because it believes we compete with these companies for executive talent. The Compensation Committee reviews the composition of the Comparison Group at least annually. The companies in the Comparison Group for 2012 were:

Abbott Laboratories	Johnson & Johnson
Agilent Technologies, Inc.	Medtronic, Inc.
Allergan, Inc.	PerkinElmer, Inc.
C.R. Bard, Inc.	Roche Diagnostics
Baxter International Inc.	St. Jude Medical, Inc.
Boston Scientific Corporation	Stryker Corporation
Covidien plc	Thermo Fisher Scientific Inc.
Hospira, Inc.	Zimmer Holdings, Inc.

Abbott Laboratories, Johnson & Johnson and Roche Diagnostics are included in the Comparison Group in order to increase the number of comparable positions for which compensation data is gathered when reviewing the compensation of Messrs. Kozy and Cohen. Compensation data from these three companies was not considered by the Compensation Committee when reviewing the compensation of Messrs. Forlenza, Elkins and Sherman.

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The table below sets forth revenue and market capitalization information regarding the Comparison Group:

	Revenue (in millions) for the twelve months ended September 30, 2012	Market Capitalization on September 30, 2012 (in millions)
25 th Percentile	\$ 4,998	\$ 10,293
Median	\$ 7,276	\$ 21,176
75 th Percentile	\$ 13,269	\$ 30,754
BD	\$ 7,708	\$ 15,677
Percentile Rank	52nd	45th

The Compensation Committee attempts to set the compensation of our executive officers at levels that are competitive with the companies listed above, and uses market comparison data regarding these companies as a guide. The Compensation Committee estimates the median salary, annual cash incentive and long-term equity compensation (and the combined total of these elements) of persons holding the same or similar positions at the companies listed above, based on the most recent market data available. The Compensation Committee then generally seeks to set the compensation of our executive officers for each of these elements within a competitive range of the median, assuming payout of performance-based compensation at target. An executive's actual compensation may vary from the target amount set by the Compensation Committee based on the individual's and BD's performance and changes in our stock price. The use of market comparison data, however, is just one of the tools the Compensation Committee uses to determine executive compensation, and the Compensation Committee retains the flexibility to set target compensation at levels it deems appropriate for an individual or for a specific element of compensation. The Compensation Committee believes that the target compensation set for the named executive officers in 2012 was competitive with median levels, except that Mr. Forlenza's salary and equity compensation were set towards the lower end of the range for CEOs at the Comparison Group companies used for comparison purposes, due to the fact that he was new to the position in 2012.

Because the Compensation Committee reviews each compensation element individually, compensation decisions made with respect to one element of compensation generally do not affect decisions made with respect to other elements. It is also for this reason that no specific formula is used to determine the allocation between cash and equity compensation, although it is the Compensation Committee's intent that equity compensation represent the largest percentage in terms of target value of total target compensation. In addition, because an executive's compensation target is set by reference to persons with similar duties at the Comparison Group companies, the Compensation Committee does not establish any fixed relationship between the compensation of our CEO and that of the other named executive officers.

The use of tally sheets

The Compensation Committee is from time-to-time provided a tally sheet report prepared by management for each named executive officer. The tally sheet includes, among other things, total annual compensation, the value of unexercised or unvested equity compensation awards, and amounts payable upon termination of employment under various circumstances, including retirement or following a change of control. The Compensation Committee uses tally sheets to provide perspective on the wealth the executives have accumulated from prior equity awards and plan accruals and their retentive value, consider any changes to our program that may be appropriate (including the mix of compensation elements), and provide additional context for their compensation decisions.

Our emphasis on pay-for-performance*Performance-based compensation*

While we do not use a specific formula to determine the mix of performance-based and fixed compensation, PIP awards and performance-based long-term equity compensation represent a significant portion of the compensation paid to our named executive officers. (We view PIP awards, Performance Units and SARs as performance-based pay for this purpose.) In 2012, 73% of Mr. Forlenza's target compensation and an average of 68% of the target compensation of the other named executive officers was performance-based and not guaranteed.

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2012 Total Target Compensation

The above charts are based on the target values of performance-based compensation. Actual amounts received (and the percentage of total compensation coming from performance-based compensation) may differ based on actual performance and BD's stock price.

How BD measured performance in 2012

The goal of our compensation program is to provide incentives for management to deliver near-term and long-term performance. The vehicle for rewarding near-term performance is the PIP. For 2012, the Compensation Committee evaluated performance under this plan based primarily on BD's EPS for the year. The Compensation Committee used EPS because it is the primary basis on which BD sets performance expectations for the year and it is a widely-used measure of overall company performance. However, because the Compensation Committee believes sustained revenue growth is necessary to create long-term shareholder value, it also set a revenue target for the year, although not weighted as heavily as EPS.

The vehicle for rewarding long-term performance is equity compensation, including Performance Units. The Compensation Committee evaluates long-term performance based on how well BD is executing on its strategy for profitable growth. For the Performance Units granted in 2012, the two metrics the Compensation Committee used to measure performance were long-term revenue growth and return on invested capital (ROIC), which measures profitability and how effectively company assets are being used. These two metrics require the named executive officers to effectively manage a number of different aspects of the business, including new product introductions, productivity improvements and expansion into geographic markets.

The other way equity compensation is tied to our long-term performance is its linkage to the BD stock price. We believe that sustained performance should, over time, result in the creation of long-term shareholder value and be reflected in our stock price. If the named executive officers are not successful in creating this shareholder value, the value of their equity compensation will be reduced.

When setting performance targets for the PIP and Performance Units, the Compensation Committee considers the environment in which BD is operating. As discussed before, the global economy generally, and the healthcare industry specifically, has been facing very challenging conditions over the last several years. The Compensation Committee seeks to reward what it deems to be superior performance by management in light of the economic conditions and growth trends in the markets BD serves, and sets what it believes are reasonably achievable performance targets for BD at the time. The Compensation Committee also structures these plans so that payouts are aligned with BD's performance against these targets. For instance, as discussed further below, a 1% shortfall in performance against a PIP performance measure target would result in a 2.5% decrease in funding with respect to that measure. Likewise, a 1% shortfall in performance against the revenue growth target set under the Performance Units we issued in 2012 would reduce the payout of the awards by 12%.

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Changes to performance-based compensation for 2013

Previously, BD's compensation programs have been focused on key financial indicators of operating success, including revenue growth, EPS and ROIC. Over the past few years, our industry has changed and become more challenging based on a variety of factors. Looking ahead, we believe the strategic objectives for BD will include not only revenue growth, EPS and ROIC, but also operational efficiency, which frees up funds that BD can use to invest in its future. Therefore, it will be important that going forward, our compensation program reinforce and reward behaviors that support a balance of growth, profitability and operating efficiency. In addition, given the current market conditions, we believe it is important to incorporate a measure of BD's performance that relates BD's performance to peer companies facing these same market conditions.

With this in mind, during 2012, the Compensation Committee, with input and recommendations from Pay Governance and management, conducted a review of BD's annual and long-term incentive compensation to identify ways to improve the overall design of our executive compensation program. Based on this evaluation, the Compensation Committee approved the following changes for 2013.

PIP. Free cash flow as a percentage of sales will be added as a third performance metric, in addition to the existing revenue and EPS metrics. EPS will be weighted 50%, and the revenue and free cash flow metrics will each be weighted 25%. Free cash flow means cash flow from our operating activities, less capital expenditures and capitalized software. The free cash flow as a percentage of sales metric was added because efficient use of cash is an important driver of our ability to fund ongoing product development and innovation, a key strategic priority for BD. Adding this free cash flow metric also provides for a more balanced set of performance targets that focus on both profitability and operating efficiency.

Equity Compensation. The Compensation Committee changed the performance metrics for the Performance Units issued in 2013, replacing revenue growth with relative total shareholder return (TSR). Relative TSR measures BD's stock performance (assuming reinvestment of dividends) during the performance period against that of peer companies. Relative TSR and ROIC will both be weighted 50% in determining Performance Unit payouts. The Compensation Committee chose relative TSR as a new performance metric because it allows payouts to be based on how BD's performance, as reflected in our stock price over time, compares to peer companies facing similar business conditions, and it is directly tied to shareholder outcomes. A majority of Comparison Group companies that include performance-based stock units in their equity compensation use relative TSR as a performance metric.

Our risk analysis of performance-based compensation

While a significant portion of executive compensation is performance-based, we do not believe that our program encourages excessive or unnecessary risk-taking. While risk-taking is a necessary part of operating and growing a business, the Compensation Committee focuses on aligning BD's compensation policies with our long-term strategy and attempts to avoid short-term rewards for management decisions that could pose long-term risks to BD. This includes:

Limits on PIP Awards. We do not overweight short-term incentives as a proportion of total pay. PIP awards are also capped at 200% of an executive's target award to protect against disproportionately large short-term incentives, and the Compensation Committee has discretion to lower PIP awards based on such factors it deems appropriate, including whether management has taken unnecessary or excessive risk.

Share Ownership Guidelines. Our share ownership guidelines ensure that our executives have a significant amount of their personal wealth tied to long-term holdings in BD stock.

Use of Long-Term Equity Compensation. The largest portion of total target compensation is long-term equity compensation that vests over a period of years, which encourages our executives to focus on sustaining BD's long-term performance.

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Use of Performance Units. A significant portion of each executive’s equity compensation consists of Performance Units that have a three-year performance cycle, which focuses management on sustaining BD’s long-term performance. We also cap the payout of these awards at 200% of target.

Performance Metrics. We use a variety of performance metrics (including EPS, revenue growth and ROIC) that we believe correlate to long-term shareholder value and that are affected by management decisions.

The Key Elements of Our Compensation Program

The key elements of our executive compensation program are summarized in the table below.

Component	Description	Purpose
Base salary	Fixed cash compensation that is set based on performance, scope of responsibilities, experience, and competitive pay practices.	Provide a fixed, baseline level of compensation.
Performance Incentive Plan	Cash payment tied to performance during the fiscal year.	Reward executives for BD’s performance for the year and individual contributions to such performance.
Long-term equity compensation:		
Stock appreciation rights	Right to receive shares equal in value to the difference between exercise price and current BD stock price.	
Performance Units	Performance-based restricted stock units tied to BD’s performance over three-year performance period.	
Time-Vested Units		Increase executive ownership, promote executive retention, align compensation with the achievement of long-term performance objectives and reward the creation of shareholder value.
	Restricted stock units that vest three years after grant.	

The Compensation Committee believes this combination of cash and equity compensation furthers the objectives of our executive compensation program. Based on prevailing market practices, the Compensation Committee believes this mix of salary, annual cash incentive and equity compensation offers a competitive compensation package to our executives. This structure also promotes our pay-for-performance philosophy by linking pay levels to both our near-term performance (through PIP awards) and long-term performance (through equity compensation). A significant portion of compensation is also provided through equity compensation awards, which align the interests of the executives with our shareholders, promote executive retention and reward the creation of shareholder value.

How PIP Payments and Equity Compensation Are Awarded

PIP

The PIP provides our executives an opportunity to receive a cash award for BD’s performance for the fiscal year and their contribution to that performance, as part of our pay-for-performance philosophy.

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Target awards. Target PIP awards for the named executive officers are expressed as a percentage of base salary earned during the year. The Grants of Plan-Based Awards in Fiscal Year 2012 table on page 41 shows the range of possible awards under the PIP, based on certain assumptions.

The factors the Compensation Committee considers when setting PIP awards include BD's overall performance for the year compared to the performance targets and the level of available funding (discussed below), as well as the executive's target award and performance. CEO performance is measured against the performance goals for the year established by the Board. For the other named executive officers, the CEO provides an assessment to the Compensation Committee of how those executive officers performed against the performance objectives set for the businesses or functions they oversee. In each case, the performance objectives for a named executive officer involve a combination of quantitative and qualitative goals. However, no specific formula or weighting of individual performance objectives is used to determine a named executive officer's PIP award, nor is the achievement of any particular individual performance objective a condition to receiving an award. Instead, the Compensation Committee uses its business judgment to determine the appropriate PIP award to recognize BD's performance and the executive's contribution.

Performance targets. Available funding for PIP awards is based on how BD performs during the year against the performance targets set by the Compensation Committee. For 2012, these included EPS and revenue targets, with EPS performance weighted 75% and revenue performance weighted 25%. The EPS and revenue targets were based on BD's business plan for the fiscal year. Revenues for the year are measured after eliminating the estimated effects of foreign currency translation so that only BD's underlying performance is considered.

As previously discussed, we use EPS as a performance target because it is the primary basis on which we set our performance expectations for the year and EPS is a widely-used measure of overall company performance. For this reason, EPS is more heavily weighted than revenues. The revenue target was added to increase management's focus on achieving strong top-line growth, consistent with our business strategy. We believe that consistent EPS and revenue growth will result in the creation of long-term shareholder value. We also use these targets because they are clear, measurable and easy for our associates to understand.

Funding for PIP awards is determined by a formula. For both EPS and revenues, the Compensation Committee measures how BD performed against the target goal to arrive at a funding factor. For every 1% of performance above target for one of the measures, funding increased 5%, and for every 1% below target, funding decreased 2.5%. Performance below 90% of target would have resulted in no funding for that particular performance measure. The performance factors for both measures are then weighted, as described above, to arrive at a final funding amount. In the Compensation Committee's discretion, actual awards, as a percentage of a named executive officer's target, may be more or less than the overall funding factor.

When comparing BD's operating results against the performance targets, the Compensation Committee has the discretion to adjust BD's results to account for acquisitions and divestitures, and for items that are not considered part of our ordinary operations. This ensures that management makes decisions based on the best interests of BD, rather than the possible effects on compensation. This discretion is also used to make sure our executives are not unfairly penalized or benefitted by these types of events.

Long-term equity compensation

The equity compensation awards made to the named executive officers in 2012 consisted of SARs, Performance Units and TVUs. A description of each type of award is on page 42. TVUs were added in 2012 to reduce the volatility in amounts realized from equity compensation that can arise when purely performance-based equity compensation is used. The Compensation Committee uses this mix of equity vehicles to promote the objectives of our program. SARs are intended to reward the executives for the creation of shareholder value over the term of the award. Performance Units are intended to reward the named executive officers for sustained long-term performance, regardless of movements in our stock price. All three types of awards align the interests of our executives with our shareholders and help promote executive retention.

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How equity awards are determined. The Compensation Committee determines the grant date dollar value of the award to be made to each named executive officer based on market compensation comparison data and individual performance. SARs, Performance Unit and TVU awards are then made, with SARs and Performance Units each making up approximately 40% of the total award value, and TVUs the remaining 20%. Performance Units and TVUs are valued at grant based on a 20-day average stock price, while SARs are valued using an option valuation model that uses certain assumptions, such as stock volatility, dividend yield and the expected life of the SARs. The values given to equity compensation awards by the Compensation Committee are only estimates and are not intended to be predictive of the actual value that will be realized from the awards.

Performance Unit targets. The performance measures used for the Performance Units granted in 2012 were average annual revenue growth and average annual ROIC, with each weighted 50%. In setting revenue growth and ROIC targets, the Compensation Committee considered BD's business plan at the time of the grant and what the Compensation Committee believed was a reasonable range of performance over the performance period, as well as economic trends in the segments in which we operate. The Compensation Committee's goal is to set challenging but achievable targets. As we discussed earlier, revenue growth and ROIC were used as performance metrics because they are directly tied to our long-term growth strategy. As with the PIP, revenues are measured after eliminating the estimated effect of foreign currency translation so that only underlying performance is counted.

Performance Unit awards are given a share target. The actual number of shares issued is determined by a grid, and can range anywhere from zero (if BD fails to meet the minimum performance threshold for both revenue growth and ROIC) to 200% of the share target (if BD meets or exceeds the maximum performance threshold for both revenue growth and ROIC). In determining payouts, the Compensation Committee has the discretion to adjust BD's operating results to account for events that occur during the performance period, similar to its discretion under the PIP.

Compensation Actions

Below is a discussion of compensation actions taken with respect to the named executive officers.

Salary adjustments

The base salaries of the named executive officers are reviewed each November, and any adjustments go into effect on January 1 of the following calendar year. In connection with Mr. Forlenza's election as Chief Executive Officer, his salary was increased from \$750,000 to \$900,000, effective October 1, 2011. Mr. Kozy received an approximate 11% increase in salary to account for additional duties he assumed in his role as Executive Vice President, including oversight of our three business segments. Mr. Kozy received the additional title of Chief Operating Officer in November 2012. The salary increases of the other named executive officers were in-line with salary increases at BD generally.

PIP awards

The threshold performance, target performance and maximum performance under the PIP for 2012, along with BD's performance during the year (adjusted as described below), were as follows:

	Minimum Performance	Target Performance	Maximum Performance	BD's Adjusted Performance	Percentage of Target Achieved
EPS (75% weighting)	\$ 4.97	\$ 5.52	\$ 6.07	\$ 5.41	98.0%
Currency-neutral revenues (25% weighting)*	\$ 7,025	\$ 7,806	\$ 8,587	\$ 7,822	100.2%

* Amounts in millions.

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Reported EPS for the year was \$5.30. In reviewing BD's EPS performance against the performance target, the Compensation Committee used its discretion to eliminate the \$0.04 per share dilution from our Kiestra and Sirigen acquisitions (which were not budgeted for the year) and the \$0.06 per share charge BD took during the year relating to pension settlements, since it did not relate to BD's underlying performance. This resulted in adjusted EPS of \$5.41 (adjusted for rounding). Revenues from those acquisitions were also excluded from the revenues for the year. Under the PIP funding formula, this performance resulted in funding for awards at 97% of target.

The following table shows the PIP awards granted for 2012. These awards are also set forth in the Summary Compensation Table on page 39 under the heading Non-Equity Incentive Plan Compensation.

Name	Target Incentive Award	Actual Incentive Award
Vincent A. Forlenza	\$ 1,080,000	\$ 1,080,000
David V. Elkins	618,750	599,900
William A. Kozy	707,575	724,500
Gary M. Cohen	481,020	250,000
Jeffrey S. Sherman	437,625	444,300

The PIP awards made to the named executive officers, as a percentage of their target awards, were generally in-line with the PIP funding factor, and where they did exceed the factor, did not do so by more than 5%. In making these awards, the Compensation Committee considered a number of factors, including individual contributions to BD's performance for the year. Despite the continuing industry challenges in the medical device industry, BD exceeded its revenue goal and substantially met its EPS goal under the PIP, while still maintaining its level of investment in research and development and emerging markets. BD's performance also reflected management's continued progress on growth initiatives intended to position BD for long-term success, including a number of new product launches during the year and expanding our presence in emerging markets. In addition, BD executed on its strategy to supplement internal growth with strategic acquisitions by completing the Kiestra and Sirigen transactions. Management also completed the initial rollout of BD's enterprise resource planning system upgrade and took other steps toward improving operating efficiency, including the opening of new shared service centers to reduce overhead expense.

Equity compensation awards

The Compensation Committee made the equity compensation awards to the named executive officers shown on page 41. The increase in equity compensation for Mr. Forlenza compared to 2011 was in connection with his election as BD's Chief Executive Officer at the beginning of 2012. The other changes in equity-based compensation paid to NEOs were based on performance and to align award values with market practices, and, in the case of Mr. Kozy, to reflect an increase in responsibilities.

The Performance Units included in these awards cover the 2012-2014 performance period. The target revenue growth for these awards is 4.3% and target ROIC is 24%. The Compensation Committee believes the revenue growth target for these awards represents a challenging goal for management given the economic climate BD continues to operate in and its expected impact on BD's operating results.

Payout of prior Performance Unit awards**2009-2011 performance period**

In November 2011, Performance Units covering the 2009-2011 performance period vested. These awards had performance targets of 8.5% currency-neutral revenue growth and 31% ROIC. Our adjusted revenue growth and ROIC over the performance period were 4.5% and 29%, respectively. This resulted in a payout of these awards at 20% of the share target. In determining the payout, the Compensation Committee used its discretion to

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eliminate the effects of acquisitions and divestitures, and a charge relating to the pending settlement of certain antitrust cases, since this settlement did not relate to BD's underlying performance. These adjustments increased the payout from 15% to 20%.

2010-2012 performance period

In November 2012 (fiscal year 2013), Performance Units covering the 2010-2012 performance period vested. These awards had performance targets of 7% currency-neutral revenue growth and 32% ROIC. Our revenue growth and ROIC over the performance period were 3.9% and 27.2%, respectively. Based on our results over the performance period, there was no payout for these awards.

Performance Unit payout trend

As was stated earlier, BD has been operating in a challenging economic environment the last several years. The impact of global economic conditions on BD's revenue growth and ROIC has been reflected in Performance Unit payouts over this period, with the last four payouts being 77%, 44% and 20% of target for the 2007-2009, 2008-2010 and 2009-2011 performance cycles, respectively, and no payout for 2010-2012. We believe BD's revenue growth over this time reflects slower growth in the medical technology industry generally as a result of these macroeconomic conditions, rather than weaker growth of BD relative to industry trends. However, we believe these payouts demonstrate a high degree of alignment between pay and BD's performance against the preset targets, as shown in the table below.

Performance Period	Revenue Growth	ROIC	Performance Unit Payout
2007-2009	6.1%	31.7%	77%
2008-2010	5.8%	30.8%	44%
2009-2011	4.5%	29.0%	20%
2010-2012	3.9%	27.2%	0%

These reduced Performance Unit payouts have resulted in significant differences between the original grant date value of these awards and the amounts actually realized by the named executive officers, as shown below for the last three payouts.

Name	2008-2010 Grant		2009-2011 Grant		2010-2012 Grant	
	Grant Date Value	Realized Value	Grant Date Value	Realized Value	Grant Date Value	Realized Value
Vincent A. Forlenza	\$ 472,248	\$ 202,150	\$ 679,000	\$ 163,980	\$ 1,064,038	\$ 0
David V. Elkins	N/A	N/A	N/A	N/A	638,393	0
William A. Kozy	472,248	202,150	470,188	113,563	782,014	0
Gary M. Cohen	472,248	202,150	470,188	113,563	782,014	0
Jeffrey S. Sherman	321,972	137,855	322,500	77,865	505,435	0

Note: Realized values are determined based on the closing BD stock price on the vesting date and include deemed dividend reinvestment during the vesting period. Mr. Elkins' first Performance Unit award was made in 2010 for the 2010-2012 period.

Other Benefits Under Our Executive Compensation Program**Company transportation**

Mr. Forlenza is encouraged to use BD aircraft for his personal and business travel in order to make more efficient use of his travel time, for personal security and to reduce business continuity risk. Mr. Forlenza entered into a time-sharing arrangement with BD under which he makes payments to BD for his personal use of BD aircraft. Mr. Forlenza did not take any personal flights on BD aircraft in 2012.

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Deferred compensation

Our Deferred Compensation and Retirement Benefit Restoration Plan is an unfunded, nonqualified plan that, among other things, allows eligible associates to defer receipt of cash compensation and shares issuable under certain equity compensation awards. The plan is offered to our eligible associates as part of a competitive compensation program. It gives eligible associates the opportunity to defer compensation on a pre-tax basis in addition to what is allowed under our tax-qualified 401(k) plan. We do not provide any guaranteed earnings on amounts deferred by the named executive officers. Earnings on these accounts are based on their individual investment elections. BD provides matching contributions on cash amounts deferred under the plan, subject to certain limits. A more complete description of the deferred compensation provisions of the plan begins on page 47.

Pension benefits

We offer retirement benefits for all of our U.S. associates. Because the Internal Revenue Code limits the maximum annual benefit that may be paid to an individual under our qualified Retirement Plan, we provide additional retirement benefits through our nonqualified Deferred Compensation and Retirement Benefit Restoration Plan. Together, these plans are designed to provide a market-competitive level of income replacement for our retirement-eligible associates, reduce associate turnover and contribute towards a competitive compensation package. The named executive officers participate in these plans on the same basis as all eligible associates. We do not include the value of equity compensation in calculating pension benefits. A more complete description of our pension benefits begins on page 45.

Change of control agreements

We have entered into agreements with our named executive officers relating to their employment following a change of control. This agreement provides the executive with continued employment for a period of two years following a change of control of BD, and provides certain benefits to the executive in the event his employment is terminated without cause or he leaves his employment for good reason (also known as a constructive termination) during this period. Generally, these benefits include a severance payment equal to a multiple of the executive's salary and PIP award, and certain other benefits. A more complete description of the terms and potential payouts of our change of control agreements begins on page 50.

General purpose. Our change of control agreements are intended to retain the executives and provide continuity of management in the event of an actual or potential change of control of BD. These change of control benefits are reviewed from time-to-time by the Compensation Committee to ensure that they are consistent with our compensation objectives and market practices. Based on information provided by Pay Governance, change of control arrangements are used by a substantial majority of the companies in the Comparison Group, and the terms of our agreements, including the severance multiple, are consistent with the prevailing practices at those companies. The Compensation Committee believes the benefits provided under these agreements are appropriate and are consistent with our objective of attracting and retaining highly qualified executives.

Triggering events. Our agreements contain a double trigger that is, there must be a change of control of BD *and* a termination of the executive's employment in order for any payments to be made. We opted for a double-trigger, rather than a single trigger that provides for severance payments solely on the basis of a change of control, since a double trigger is consistent with the purpose of encouraging the continued employment of the executive following a change of control.

Tax reimbursement payments. In certain instances, payments made to a named executive officer on account of his termination may be subject to a 20% excise tax. To offset the effect of the excise tax, we will reimburse the named executive officer for the excise tax. We provide for these payments because they allow an executive to recognize the full intended economic benefit of his agreement and eliminate unintended disparities between executives that the excise tax can arbitrarily impose, owing to the particular structure of this tax.

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provision. However, while we believe these tax reimbursement provisions serve a valid purpose, in light of trends in executive compensation practices, any new change of control agreements that we enter into with our executive officers will not contain these provisions.

Other change of control provisions

Upon a change of control, all outstanding equity compensation awards granted to our associates, including the named executive officers, immediately vest. Unlike the double trigger discussed above, no termination of employment is required for the accelerated vesting of the awards. This single-trigger vesting provides our associates with the same opportunity as our shareholders to realize the value created by the transaction.

Significant Policies and Additional Information Regarding Executive Compensation

Recovery of prior compensation

We have a policy that gives the Board the discretion to require a member of the BD Leadership Team to reimburse BD for any PIP award or Performance Unit payout that was based on financial results that were subsequently restated as a result of that person's misconduct. The Board also has the discretion to cancel any equity compensation awards (or recover payouts under such awards) that were granted to such person with respect to the restated period, and require the person to reimburse BD for any profits realized on any sale of BD stock occurring after the public issuance of the financial statements that were subsequently restated. The BD Leadership Team consists of 57 members of senior management, and includes the named executive officers.

The policy also gives the Board the authority to require those members of the BD Leadership Team who were not involved in the misconduct to reimburse BD for the amount by which their PIP award or Performance Unit payouts exceeded the amount they would have received based on the restated results.

Share retention and ownership guidelines

In order to increase executive share ownership and promote a long-term perspective when managing our business, our share retention and ownership guidelines require the named executive officers and other members of the BD Leadership Team to retain, in shares of BD stock, 75% of the net after-tax proceeds from any equity compensation awards until the person achieves the required ownership level. The required ownership levels are as follows:

Chief Executive Officer	5 times salary
Other Executive Officers (9 persons, including the NEOs other than the Chief Executive Officer)	3 times salary
Other BD Leadership Team Members	1 times salary

Shares held directly, shares held indirectly through our 401(k) plan and deferred compensation plan, and time-vested restricted stock units are included in determining a person's share ownership. Messrs. Forlenza, Kozy, Cohen and Sherman each have holdings in excess of his ownership requirement. We have a policy that prohibits our associates from pledging BD shares or engaging in options, puts, calls or other transactions that are intended to hedge against the economic risk of owning BD shares.

Timing of equity award grants

The Compensation Committee has adopted a policy that prohibits the backdating of any equity compensation award and requires our annual equity compensation awards and any off-cycle awards approved by our CEO to be made on fixed dates. The policy also prohibits manipulating the timing of either the public release of information or the grant of an award in order to increase the value of the award. Under the policy, the exercise price of any stock option or SAR award will be the closing price of BD stock on the grant date.

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Tax considerations

Section 162(m) of the Internal Revenue Code precludes BD from taking a federal income tax deduction for compensation paid in excess of \$1 million to a named executive officer. This limitation does not apply, however, to performance-based compensation. While the Compensation Committee generally attempts to preserve the deductibility of compensation paid to the named executive officers, the Compensation Committee believes the primary purpose of our compensation program is to support BD's business strategy and the long-term interests of our shareholders. Therefore, the Compensation Committee maintains the flexibility to award compensation that may be subject to the limits of Section 162(m) if doing so furthers the objectives of our executive compensation program.

Table of Contents**COMPENSATION OF NAMED EXECUTIVE OFFICERS**

The following table shows the compensation provided by BD to each of the named executive officers.

2012 SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary(1)	Bonus	Stock Awards(2)	Option Awards(2)	Non-Equity Incentive Plan Compensation(3)	Change in Pension Value and Nonqualified Deferred Compensation Earnings(4)	All Other Compensation(5)	Total
Vincent A. Forlenza Chairman, Chief Executive Officer	2012	\$ 900,000	0	\$ 3,441,639	\$ 2,292,422	\$ 1,080,000	\$ 1,662,465	\$ 41,750	\$ 9,418,276
	2011	725,000	0	1,393,622	1,434,250	723,077	709,038	33,867	5,018,854
	2010	650,000	0	1,064,038	1,078,417	510,000	1,019,476	36,352	4,358,283
and President									
David V. Elkins(6) Former Executive Vice-President and Chief Financial Officer	2012	618,750	0	1,200,221	799,461	599,900	49,307	35,175	3,302,814
	2011	575,000	0	846,106	870,794	550,000	42,863	70,693	2,955,456
	2010	500,000	\$ 250,000(7)	638,393	647,047	325,000	36,394	52,145	2,448,979
William A. Kozy Executive Vice- President and Chief Operating Officer	2012	643,250	0	1,369,703	912,346	724,500	1,116,174	44,622	4,810,595
	2011	588,500	0	846,106	870,794	500,000	575,624	33,701	3,414,725
	2010	575,000	0	782,014	792,630	372,000	993,335	41,657	3,556,636
Gary M. Cohen Executive Vice- President	2012	601,275	0	899,409	599,114	250,000	1,300,415	43,556	3,693,769
	2011	583,500	0	846,106	870,794	470,000	356,996	33,696	3,161,092
	2010	570,000	0	782,014	792,630	319,000	586,216	34,022	3,083,882
Jeffrey S. Sherman(8) Senior Vice- President and General Counsel	2012	486,250	0	839,910	559,430	444,300	116,370	34,300	2,480,560

- (1) *Salary.* BD's fiscal year ends September 30. The amounts shown in the Salary column reflect three months of salary at one calendar year rate and nine months at the following calendar year rate. Mr. Forlenza's salary increased from \$750,000 to \$900,000, effective October 1, 2011, in connection with his election as our Chief Executive Officer.
- (2) *Stock Awards and Option Awards.* The amounts shown in the Stock Awards column (which includes performance-based and time-vested restricted stock units) and Option Awards column (which includes stock appreciation rights) reflect the grant date fair value of the awards under FASB ASC Topic 718 (disregarding estimated forfeitures). For a description of the methodology and assumptions used to determine the amounts reflected in these columns, see the notes to the consolidated financial statements contained in our Annual Reports on Form 10-K for the fiscal years ended September 30, 2012, 2011 and 2010, respectively.

Amounts shown in the Stock Awards column for 2012 include awards of Performance Units, which are performance-based restricted stock units. The amounts included in this column are the grant date fair values of these awards at target payout, which we believe is the most probable outcome based on the applicable performance conditions. Below are the grant date fair values of these awards, assuming maximum payout (200% of target):

Name	Value at maximum payout
Vincent A. Forlenza	\$ 4,588,851
David V. Elkins	1,600,343
William A. Kozy	1,826,223
Gary M. Cohen	1,199,211
Jeffrey S. Sherman	1,119,879

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(3) *Non-Equity Incentive Plan Compensation.* Includes amounts earned under BD's Performance Incentive Plan. These amounts are paid in January following the fiscal year in which they are earned, unless deferred at the election of the named executive officer.

(4) *Change in Pension Value and Nonqualified Deferred Compensation Earnings.*

Pension Amounts shown are the aggregate changes in the actuarial present value of accumulated benefits under our defined benefit pension plans (including our restoration plan). These amounts represent the difference between the present value of accumulated pension benefits at normal retirement age (or, in the case of Messrs. Forlenza and Kozy, the earliest date they can retire without any reduction in benefits) at the beginning and end of the fiscal year. Information regarding our pension plans begins on page 45. BD's pension plans allow for early retirement without any reduction in benefits if a participant's combined age and years of service reach a certain amount.

Deferred Compensation Earnings on nonqualified deferred compensation are not included in this column, since no named executive officer earned above-market or preferential earnings on nonqualified deferred compensation during the fiscal years shown. Information on the named executive officers' nonqualified deferred compensation accounts is on page 48.

(5) *All Other Compensation.* Amounts shown for fiscal year 2012 include the following:

	Vincent A. Forlenza	David V. Elkins	William A. Kozy	Gary M. Cohen	Jeffrey S. Sherman
Matching contributions under plans	\$ 40,800	\$ 35,175	\$ 38,925	\$ 42,916	\$ 31,800
Matching charitable gifts			5,000		2,500
Term life insurance	950		697	640	
Total	\$ 41,750	\$ 35,175	\$ 44,622	\$ 43,556	\$ 34,300

The following is a description of these benefits:

Matching Contributions Under Plans The amounts shown reflect matching contributions made by BD pursuant to our 401(k) plan and deferred compensation plan.

Matching Charitable Gifts The amounts shown are matching contributions under BD's Matching Gift Program, under which BD matches up to \$5,000 of contributions made by an associate to qualifying non-profit organizations.

Term Life Insurance BD provides incremental term life insurance benefits to certain named executive officers beyond those provided to BD associates generally. The amounts shown reflect the dollar value of the insurance premiums paid by BD for this incremental insurance.

(6) Mr. Elkins resigned from BD effective November 9, 2012.

(7) Represents amount paid pursuant to Mr. Elkins' sign-on agreement to compensate him for the forfeiture of equity awards he had received from his former employer.

(8) Mr. Sherman was not a named executive officer in 2010 or 2011 and, therefore, his compensation is not disclosed for those years.

Table of Contents**INFORMATION REGARDING PLAN AWARDS IN FISCAL YEAR 2012**

Set forth below is information regarding awards granted to the named executive officers in fiscal year 2012. The non-equity incentive awards were made under the BD Performance Incentive Plan. The equity awards were made under BD's 2004 Employee and Director Equity-Based Compensation Plan.

Grants of Plan-Based Awards in Fiscal Year 2012

Name	Award Type(1)	Grant Date	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards(2)			Estimated Future Payouts Under Equity Incentive Plan Awards(3)			All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards (\$/Sh)(4)	Grant Date Fair Value of Stock and Option Awards(5)
			Threshold (\$)	Target (\$)	Maximum (\$)	Threshold (#)	Target (#)	Maximum (#)				
Vincent A. Forlenza	PIP	N/A	810,000	1,080,000	2,160,000							
	TVU	11/22/2011							15,907		1,147,213	
	PU	11/22/2011				3,181	31,814	63,628			2,294,426	
	SAR	11/22/2011								181,794	72.12	2,292,422
David V. Elkins	PIP	N/A	464,063	618,750	1,237,500							
	TVU	11/22/2011							5,547		400,050	
	PU	11/22/2011				1,110	11,095	22,190			800,171	
	SAR	11/22/2011								63,399	72.12	799,461
William A. Kozy	PIP	N/A	530,681	707,575	1,415,150							
	TVU	11/22/2011							6,331		456,592	
	PU	11/22/2011				1,266	12,661	25,322			913,111	
	SAR	11/22/2011								72,351	72.12	912,346
Gary M. Cohen	PIP	N/A	360,765	481,020	962,040							
	TVU	11/22/2011							4,157		299,803	
	PU	11/22/2011				831	8,314	16,628			599,606	
	SAR	11/22/2011								47,511	72.12	599,114
Jeffrey S. Sherman	PIP	N/A	328,219	437,625	875,250							
	TVU	11/22/2011							3,882		279,970	
	PU	11/22/2011				776	7,764	15,528			559,940	
	SAR	11/22/2011								44,364	72.12	559,430

(1) Award Type:

PIP = Performance Incentive Plan

TVU = Time-Vested Unit

PU = Performance Unit

SAR = Stock Appreciation Right

(2) The amounts shown represent the range of possible dollar payouts that a named executive officer could earn under the BD Performance Incentive Plan for fiscal year 2012, based on certain assumptions. Actual payments under the Performance Incentive Plan for fiscal year 2012 are reflected in the Non-Equity Incentive Plan Compensation column of the Summary Compensation Table on page 39. The amount in the Threshold column assumes BD achieved the minimum performance level, resulting in available funding for awards at 75% of target, and that the named executive officer received a payment equal to 75% of his award target. Because the Compensation Committee has

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discretion in setting PIP awards, actual awards may be lower than the threshold amount shown. The maximum column reflects an award at 200% of target, the maximum award an individual may receive under the plan.

- (3) The amounts shown represent the range of potential share payouts under Performance Unit awards. The amount in the Threshold column shows the number of shares that will be paid out, assuming BD achieves the minimum performance levels required for the payment of shares. The payout amounts shown in the above table do not reflect shares that may be issued pursuant to dividend equivalent rights.
- (4) The exercise price is the closing price of BD common stock on the date of grant, as reported on the New York Stock Exchange.
- (5) The amounts shown in this column reflect the grant date fair value of the awards under FASB ASC Topic 718 used by BD for financial statement reporting purposes (disregarding estimated forfeitures). For a discussion of the assumptions made to determine the grant date fair value of these awards, see Note 7 to the consolidated financial statements that are included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

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Description of Awards

Performance Incentive Plan

The BD Performance Incentive Plan (PIP) provides an opportunity for annual cash incentive payments to eligible associates. A more detailed discussion of the PIP and the performance targets established under the PIP for fiscal year 2012 appears in the Compensation Discussion and Analysis section of this proxy statement. Total awards to BD s executive officers may not, in the absence of special circumstances, exceed 3% of our reported after-tax net income for the fiscal year.

Equity Compensation Awards

Performance Units. Performance Units are performance-based restricted stock units that vest three years after grant. The potential payouts under these awards range from zero to 200% of the award s share target. The actual payout will be based on BD s performance against the performance targets over the three-year performance period covering fiscal years 2012-2014. The performance goals are established at the beginning of the performance period and include an average annual revenue growth target of 4.3% (after excluding the effects of foreign currency translation) and an average return on invested capital target of 24%. Performance Units were issued in tandem with dividend equivalent rights (see below). Performance Units are not transferable, and holders may not vote shares underlying the award until the shares have been distributed.

Time-Vested Units. A Time-Vested Unit (TVU) is a restricted stock unit that represents the right to receive one share of BD common stock upon vesting. TVUs vest three years after grant. TVUs were issued in tandem with dividend equivalent rights (see below). TVUs are not transferable, and holders may not vote shares underlying the award until the shares have been distributed.

Stock-Settled Stock Appreciation Rights. A stock appreciation right (SAR) represents the right to receive, upon exercise, shares of BD common stock equal in value to the difference between the market price of BD common stock at the time of exercise and the exercise price. SARs have a ten-year term, and become exercisable in four equal annual installments, beginning one year following the grant date.

Dividend Equivalent Rights. Performance Units and TVUs are issued in tandem with dividend equivalent rights. Under these rights, the awards accrue dividend equivalents each time BD pays a dividend, which are deemed to be reinvested in BD shares. Dividend equivalents accrue on these awards at the same rate as dividends are paid on outstanding shares of BD stock. The accrued dividend equivalents are paid, in the form of shares, only if the underlying award vests. The value of the dividend equivalent rights is included in the amounts shown in the above table and the Stock Awards column of the Summary Compensation Table.

Change of Control. Performance Units, TVUs and SARs fully vest upon a change of control (see Accelerated Vesting of Equity Compensation Awards Upon a Change of Control on page 51).

Table of Contents**OUTSTANDING EQUITY AWARDS**

The following table sets forth the outstanding equity awards held by the named executive officers at the end of fiscal year 2012.

Outstanding Equity Awards at 2012 Fiscal Year-End

Name	Grant Date	Option Awards				Stock Awards			
		Number of Securities Underlying Unexercised Options (#) Exercisable (1)	Number of Securities Underlying Unexercised Options (#) (1)	Option Exercise Price (\$/Sh)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)(2)	Market Value of Shares or Units of Stock That Have Not Vested (\$)(3)	Equity Incentive Plan Awards: Number of Unearned Shares, or Other Rights That Have Not Vested (#)(4)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, or Other Rights That Have Not Vested (\$)(3)
Vincent A. Forlenza	11/24/2003	26,000	0	\$ 38.78	11/24/2013				
	11/23/2004	22,923	0	\$ 54.41	11/23/2014				
	11/21/2005	21,118	0	\$ 59.16	11/21/2015				
	11/21/2006	18,073	0	\$ 71.72	11/21/2016				
	11/20/2007	18,157	0	\$ 84.33	11/20/2017				
	11/25/2008	25,908	8,636	\$ 62.50	11/25/2018				
	11/24/2009	23,370	27,372	\$ 75.63	11/24/2019				
	11/23/2010	21,343	64,029	\$ 76.64	11/23/2020				
	11/22/2011	0	181,794	\$ 72.12	11/22/2021				
	Various					44,087	3,463,475	51,570	4,051,339
David V. Elkins	11/24/2009	16,422	16,423	\$ 75.63	11/24/2019				
	11/23/2010	12,958	38,875	\$ 76.64	11/23/2020				
	11/22/2011	0	63,399	\$ 72.12	11/22/2021				
	Various					5,679	446,142	22,894	1,798,553
William A. Kozy	11/23/2004	22,923	0	\$ 54.41	11/23/2014				
	11/21/2005	21,118	0	\$ 59.16	11/21/2015				
	11/21/2006	18,073	0	\$ 71.72	11/21/2016				
	11/20/2007	18,157	0	\$ 84.33	11/20/2017				
	11/25/2008	17,940	5,982	\$ 62.50	11/25/2018				
	11/24/2009	20,116	20,119	\$ 75.63	11/24/2019				
	11/23/2010	12,958	38,875	\$ 76.64	11/23/2020				
	11/22/2011	0	72,351	\$ 72.12	11/22/2021				
	Various					38,739	3,043,336	24,498	1,924,563
	Gary M. Cohen	11/23/2004	23,177	0	\$ 54.41	11/23/2014			
11/21/2005		21,353	0	\$ 59.16	11/21/2015				
11/21/2006		18,073	0	\$ 71.72	11/21/2016				
11/20/2007		18,157	0	\$ 84.33	11/20/2017				
11/25/2008		17,940	5,982	\$ 62.50	11/25/2018				
11/24/2009		20,116	20,119	\$ 75.63	11/24/2019				
11/23/2010		12,958	38,875	\$ 76.64	11/23/2020				
11/22/2011		0	47,511	\$ 72.12	11/22/2021				
Various						28,113	2,208,557	20,047	1,574,892
Jeffrey S. Sherman		11/23/2004	16,301	0	\$ 54.41	11/23/2014			
	11/21/2005	15,017	0	\$ 59.16	11/21/2015				
	11/21/2006	12,769	0	\$ 71.72	11/21/2016				
	11/20/2007	12,380	0	\$ 84.33	11/20/2017				
	11/25/2008	12,306	4,102	\$ 62.50	11/25/2018				
	11/24/2009	13,000	13,002	\$ 75.63	11/24/2019				
	11/23/2010	9,299	27,899	\$ 76.64	11/23/2020				
	11/22/2011	0	44,364	\$ 72.12	11/22/2021				

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Various	20,452	1,606,709	16,227	1,274,793
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(1) Stock options and SARs are included in these columns. Stock options and SARs become exercisable in four equal annual installments, beginning one year following the date of grant.

Set forth below is the value of the exercisable options and SARs held by named executive officers at the end of fiscal year 2012. The value represents the difference between \$78.56, the closing price of BD common stock on September 30, 2012, and the exercise price of each exercisable option or SAR held by the named executive officer. These values may not reflect the value actually realized by the named executive officers upon exercise.

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Name	Value of Vested Options and SARs	
Vincent A. Forlenza	\$	2,658,670
David V. Elkins		72,996
William A. Kozy		1,458,940
Gary M. Cohen		1,469,634
Jeffrey S. Sherman		1,025,992

- (2) The amounts shown in this column include grants of restricted stock unit awards that are not performance-based. These include TVUs granted on November 22, 2011, which vest three years after grant. The amounts shown for the named executive officers (other than Mr. Elkins) also include awards that vest at, or one year following, the retirement of the named executive officer. No shares are included for the Performance Units covering the 2010-2012 fiscal year period as there was no payout for these awards.
- (3) Market value has been calculated by multiplying the number of unvested units by \$78.56, the closing price of BD common stock on September 30, 2012. These values may not reflect the value actually realized by the named executive officers.
- (4) The amounts in this column represent the Performance Unit awards shown below. The amounts shown reflect the target shares issuable under the awards plus accrued dividend shares. The actual number of shares issued under these awards will be based on BD's performance over the applicable performance period.

Cash	\$	10,874	\$	\$ 10,874
Commercial paper		9,996	(4)	9,992
Money market mutual funds		5,142		5,142
Cash and cash equivalents		26,012	(4)	26,008
Short-term investments:				
Government sponsored enterprises		69,345	(459)	68,886
Corporate bonds		32,967	(103)	32,864
Short-term investments		102,312	(562)	101,750
Cash and cash equivalents and short-term investments	\$	128,324	\$ (566)	\$ 127,758

The Company considers debt securities with maturities of three months or less, when purchased, to be cash equivalents. Purchases and sales of securities are recorded on a trade-date basis. Interest is recorded when earned. All of the Company's investments are classified as available-for-sale and are carried at fair value with unrealized gains and losses recorded as a component of accumulated other comprehensive income. The Company determines the appropriate classification of its investments in debt securities at the time of purchase and re-evaluates such determination at each balance sheet date. There have been no reclassifications between available-for-sale and held-to-maturity investment categories. The Company's investments in government sponsored enterprises include debt securities that may not be backed by the full faith and credit of the U.S. Government. As of December 31, 2007, remaining maturities of marketable debt securities ranged from January 2008 to October 2010. As of December 31, 2006, remaining maturities of marketable debt securities ranged from January 2007 to May 2009. Proceeds from available-for-sale securities that were sold, matured or called during 2007 were \$87.2 million with gross realized losses of \$0.2 million and no gross realized gains. Proceeds from available-for-sale securities that matured or were called during 2006 were \$85.7 million with gross realized losses of \$0.2 million and no gross realized gains. Proceeds from available-for-sale securities that were sold,

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

matured or called during 2005 were \$26.5 million with gross realized losses of \$18,000 and no gross realized gains. Specific identification of the individual securities was used to determine the basis on which the gain or loss was calculated.

The following table shows the gross unrealized losses and fair value of the Company's investments, with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2007.

(in thousands)	Less than 12 months		12 months or greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Description of Securities						
Government sponsored enterprises	\$ 16,081	\$ (5)	\$ 11,801	\$ (10)	\$ 27,882	\$ (15)
Corporate bonds	21,706	(181)	7,113	(10)	28,819	(191)
Totals	\$ 37,787	\$ (186)	\$ 18,914	\$ (20)	\$ 56,701	\$ (206)

The Company analyzes its investments for impairments on an ongoing basis. Factors considered in determining whether a loss is temporary include the length of time and extent to which the securities have been in an unrealized loss position and the Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated market recovery. The unrealized losses on the Company's investments in commercial paper, government sponsored enterprises, corporate bonds and municipal bonds were caused by interest rate increases. The Company has the ability and intent to hold these investments until anticipated recovery of fair value, which may be maturity, therefore, the Company does not consider these investments to be other-than-temporarily impaired as of December 31, 2007.

(g) Trade accounts receivable

Trade accounts receivable balances, which consist of billed and unbilled amounts, were \$45.9 million and \$32.0 million as of December 31, 2007 and 2006, respectively. Trade accounts receivable includes \$4.1 million and \$2.5 million as of December 31, 2007 and 2006, respectively, for services earned under time and material arrangements that had not been invoiced at the end of the respective period.

(h) Other current assets

Other current assets consist of the following:

(in thousands)	December 31, 2007	December 31, 2006
Deferred income tax assets	\$ 2,148	\$ 2,962
Deferred cost of services	1,022	1,593
Interest receivables	1,729	1,776
Income tax receivable	1,308	1,331
Prepaid expenses	787	842
Reimbursable expenses	71	349
Sales tax receivable	175	212
Balance at the end of period	\$ 7,240	\$ 9,065

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(i) Concentration of credit risk**

Financial instruments that potentially subject the Company to a concentration of credit risk consist of short-term investments, trade accounts receivable and license installments receivable. The Company records long-term license installments in accordance with its revenue recognition policy, which results in long-term installment receivables from customers (due in periods exceeding one year from the reporting date, primarily from large organizations with strong credit ratings). The Company grants credit to customers who are located throughout the world. The Company performs credit evaluations of customers and generally does not request collateral from customers. Future installments due under term licenses as of December 31, 2007 were as follows:

(in thousands)		License
Year ended December 31,		installments (1)
2008	\$	19,183
2009		3,500
2010		2,780
2011		2,176
2012		1,267
		28,906
Unearned installment interest income		(1,456)
Total license installments receivable, net	\$	27,450

- (1) These amounts have previously been recognized as license revenue, net of unearned installment interest income and consist of approximately \$19.2 million of short-term license installments and approximately \$8.3 million of long-term license installments included in the accompanying consolidated balance sheet as of December 31, 2007. For these agreements, we recognized the present value of future term license payments upon customer acceptance, provided that no significant obligations or contingencies exist related to the software, other than maintenance support, and provided all other criteria for revenue recognition have been met.

(j) Equipment and improvements

Equipment and improvements are recorded at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets, which are three years for equipment, including software, and five years for furniture and fixtures. Leasehold improvements are amortized over the lesser of the life of the lease or the useful life of the asset. Repairs and maintenance costs are expensed as incurred.

(k) Restricted cash

The Company has approximately \$0.7 million of restricted cash related to amounts deposited to secure a letter of credit for its Cambridge office operating lease and is included in long-term other assets in the accompanying consolidated balance sheet.

(l) Long-lived assets

The Company evaluates its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Impairment is generally assessed by comparison of undiscounted cash flows expected to be generated by an asset to its carrying value, with the exception that goodwill impairment is assessed by use of a fair value model. If such assets are considered to

be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. There were no impairments in 2007, 2006, and 2005.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(m) Accrued expenses**

Accrued expenses consist of the following:

(in thousands)	December 31, 2007	December 31, 2006
Accrued income taxes	\$ 3,625	\$ 2,350
Dividends payable	1,085	1,059
Accrued other	5,695	3,608
Balance at the end of period	\$ 10,405	\$ 7,017

(n) Research and development and software costs

Research and development costs, other than certain software related costs, are expensed as incurred. Capitalization of computer software developed for resale is accounted for in accordance with FASB Statement of Financial Accounting Standards (SFAS) No. 86 Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed (SFAS 86). Accordingly, capitalization of software costs begins upon the establishment of technical feasibility, generally demonstrated by a working model or an operative version of the computer software product. Such costs have not been material to date and, as a result, no internal costs were capitalized during 2007, 2006, and 2005. Amortization of capitalized software is included in the cost of software license. No amortization expense for internally developed capitalized software costs was charged to cost of software license during 2007, 2006, and 2005.

(o) Earnings per share

Basic earnings per share is computed using the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted-average number of common shares outstanding during the period, plus the dilutive effect of outstanding options, warrants and restricted stock units (RSUs), using the treasury stock method and the average market price of our common stock during the applicable period. Potential shares related to certain of our outstanding stock options and warrants were excluded from the computation of diluted earnings per share because they were anti-dilutive in the periods presented, but could be dilutive in the future.

(in thousands, except per share data)	Year Ended December 31,		
	2007	2006	2005
Basic			
Net income	\$ 6,595	\$ 1,842	\$ 5,192
Weighted-average common shares outstanding	35,875	35,229	35,774
Earnings per share, basic	\$ 0.18	\$ 0.05	\$ 0.15
Diluted			
Net income	\$ 6,595	\$ 1,842	\$ 5,192
Weighted-average common shares outstanding	35,875	35,229	35,774
Effect of assumed exercise of stock options, warrants and RSUs	1,558	1,905	688

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Weighted-average common shares outstanding, assuming dilution	37,433	37,134	36,462
Earnings per share, diluted	\$ 0.18	\$ 0.05	\$ 0.14
Anti-dilutive outstanding stock options and warrants	1,121	2,971	5,727

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(p) Segment reporting**

The Company currently operates in one operating segment rules based Business Process Management (BPM) software. The Company derives substantially all of its operating revenue from the sale and support of one group of similar products and services. Substantially all of the Company's assets are located within the U.S. The Company derived its operating revenue from the following geographic areas (sales outside the U.S. are principally through export from the U.S.) for the years ended December 31:

(Dollars in thousands)	2007		2006		2005	
U.S.	\$ 104,952	65%	\$ 79,903	63%	\$ 66,459	66%
United Kingdom	34,278	21%	19,741	16%	18,161	18%
Europe, other	8,755	5%	11,606	9%	10,732	11%
Other	13,964	9%	14,773	12%	4,857	5%
	\$ 161,949	100%	\$ 126,023	100%	\$ 100,209	100%

The following table summarizes the Company's concentration of credit risk associated with customers accounting for more than 10% of the Company's total revenue, outstanding trade receivables and long and short-term license installments for the years ended December 31:

	2007	2006	2005
Total Revenue			
Customer Revenue > 10%	None	None	None
Trade Receivables			
Customer A	19%		
Customer B	14%		
Customer C		11%	
Customer D		10%	
Customer E			19%
Long and short-term license installments			
Customer F	24%	12%	
Customer G	15%		
Customer H			13%

(q) Stock-Based Compensation

Upon adoption of FASB Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment (SFAS 123(R)) on January 1, 2006, the Company began to recognize stock-based compensation expense associated with equity awards in its consolidated statements of income based on the fair value of these awards at the date of grant. Pro forma disclosure is no longer an alternative. The Company adopted the provisions of SFAS 123(R) using the modified prospective method, and, accordingly prior period amounts have not been restated. Stock-based compensation is recognized over the requisite service period, which is generally the vesting period of the equity award, and adjusted each period for anticipated forfeitures. The Company recognizes stock-based compensation under the ratable method, which treats each vesting tranche as if it were an individual grant.

The Company estimates the fair value of stock options using the Black-Scholes option valuation model, which requires management to make estimates of key assumptions including the expected term of the option, the

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

expected volatility of the Company's stock price over the option's expected term, the risk-free interest rate over the option's expected term, and the expected annual dividend yield. The expected term of options granted is derived from historical data on employee exercises and post-vesting employment termination behavior. The expected volatility is based on the historical volatility of our stock price. The expected annual dividend yield is based on the expected annual dividend of \$0.12 per share divided by the average stock price.

Prior to January 1, 2006, the Company accounted for share-based compensation plans in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB 25) and related interpretations, as permitted by SFAS 123 Accounting for Stock-Based Compensation (SFAS 123), and, accordingly, did not recognize compensation expense for the issuance of stock options to employees and non-employee Directors with an exercise price equal to or greater than the market price at the date of grant. The Company also followed the disclosure requirements of SFAS 123 as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS 148). Had the fair value based method as prescribed by SFAS 123 been applied to the Company's financial statements, the effect on net income and earnings per share would have been as follows:

(in thousands, except per share amounts)	Year ended December 31, 2005
Net income	\$ 5,192
Add: Share based compensation expense for stock options included in reported net income, net of income taxes	
Less: Total share based compensation expense for stock options determined under fair value method, net of income taxes (1)	(8,065)
Net income (loss), pro-forma	\$ (2,873)
Earnings (loss) per share:	
Basic as reported	\$ 0.15
Basic pro forma	\$ (0.08)
Diluted as reported	\$ 0.14
Diluted pro forma	\$ (0.08)

- (1) Includes approximately \$4.0 million of stock-based compensation expense associated with the acceleration of certain unvested stock options in the second quarter of 2005. During the second quarter of 2005, the Compensation Committee approved accelerating the vesting of certain out-of-the-money unvested stock options held by certain current employees, excluding officers as defined under Section 16(a) of the Securities Exchange Act of 1934. Unvested options having an exercise price greater than \$7.00 per share, representing the right to purchase a total of approximately 1,600,000 shares, became exercisable as a result of the vesting acceleration. All other terms and conditions in the original grants remained unchanged. The acceleration of vesting did not result in the recognition of compensation expense for the year ended December 31, 2005 as the exercise price was in excess of the fair market value on the date of modification resulting in no intrinsic value under APB 25. The decision to accelerate vesting of these options was made primarily to reduce compensation expense that would otherwise be recognized after the adoption of SFAS 123(R).

See Note 4 STOCK-BASED COMPENSATION for further discussion of SFAS 123(R).

(r) Fair value of financial instruments

The principal financial instruments held consist of cash equivalents, investments, accounts receivable and accounts payable, capital lease obligations, and license installment receivables arising from license transactions.

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PEGASYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The carrying values of cash equivalents, investments, accounts receivable and accounts payable approximate their fair value due to their relatively short-term nature. The fair value of license installment receivables approximates carrying value at December 31, 2007 and 2006.

(s) Acquired technology and goodwill

Intangible assets are recorded at cost and principally represent technology acquired in business combinations or from third parties. Amortization is recognized on a straight-line basis over the assets' estimated useful lives. As of December 31, 2007 and 2006, intangible assets consisted of \$1.4 million of technology acquired in a business combination with a net carrying value of \$0 and accumulated amortization of \$1.4 million. Amortization expense for this acquired technology was \$0, \$29,000, and \$0.4 million for the years ended December 31, 2007, 2006, and 2005, respectively.

Goodwill represents the residual purchase price paid in a business combination after all identified assets have been recorded. Goodwill is not amortized, but is tested annually for impairment by comparing estimated fair value to its carrying value. During the fourth quarter of 2007, the Company reduced its valuation allowance related to the realization of \$0.4 million of certain tax loss and credit carry forwards that were acquired in the Imind Corporation (Imind) in 2002, which resulted in a corresponding reduction in goodwill.

The Company performed the annual impairment test in the fourth quarters of 2007 and 2006 and determined that goodwill was not impaired.

(t) Income taxes

As a global company, we use significant judgment to calculate and provide for income taxes in each of the tax jurisdictions in which we operate. In the ordinary course of our business, there are transactions and calculations undertaken whose ultimate tax outcome cannot be certain. Some of these uncertainties arise as a consequence of transactions and arrangements made among related parties, transfer pricing for transactions with our subsidiaries, and potential challenges to nexus and credit estimates. We estimate our exposure to unfavorable outcomes related to these uncertainties and estimate the probability for such outcomes in accordance with the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109 (FIN 48), which we adopted on January 1, 2007. As a result of the implementation of FIN 48, we recorded a \$1.5 million reduction to January 1, 2007 retained earnings. In accordance with FIN 48, as of December 31, 2007, the amount of unrecognized tax benefits totaled approximately \$9.8 million, of which \$3.9 million, if recognized would favorably affect our effective tax rate. We do not expect the changes in the unrecognized benefits within the next twelve months to be material.

We account for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes (SFAS 109), which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. We record a valuation allowance to reduce our deferred taxes to an amount we believe is more likely than not to be realized. We consider future taxable income and prudent and feasible tax planning strategies in assessing the need for a valuation allowance.

(u) Other recent pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair values, establishes a framework for measuring fair value and expands the disclosure requirements

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PEGASYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

about fair value measurements. In February 2008, the FASB issued Staff Position No. FAS 157-2 (FSP 157-2) that defers the effective date of applying the provisions of SFAS 157 to the fair value measurement of nonfinancial assets and nonfinancial liabilities until fiscal years beginning after November 15, 2008. The Company was required to adopt the provisions of SFAS 157 that pertain to financial assets and liabilities on January 1, 2008. The adoption of SFAS 157 did not have a material impact on the Company's consolidated financial position or results of operations. The Company is currently evaluating the effect FSP 157-2 will have on its consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115*, (SFAS 159). SFAS 159 allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain nonfinancial instruments that are similar to financial instruments) at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, the Statement specifies that all subsequent changes in fair value for that instrument shall be reported in earnings. The Company was required to adopt SFAS 159 on January 1, 2008. The adoption of SFAS 159 did not have a material effect on the Company's consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141 (revised), *Business Combinations* (SFAS 141(R)). SFAS 141(R) changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for preacquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer's income tax valuation allowance. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, except for certain tax adjustments for prior business combinations. Accordingly, the Company will adopt this statement on January 1, 2009. The Company is evaluating the effect SFAS 141(R) will have on its consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of ARB No. 51 (SFAS 160). SFAS 160 changes the accounting for noncontrolling (minority) interests in consolidated financial statements including the requirements to classify noncontrolling interests as a component of consolidated stockholders' equity, and the elimination of minority interest accounting in results of operations with earnings attributable to noncontrolling interests reported as part of consolidated earnings. Additionally, SFAS 160 revises the accounting for both increases and decreases in a parent's controlling ownership interest. SFAS 160 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The Company does not expect the adoption of this statement to have a material impact on its consolidated financial position or results of operations.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****2. VALUATION AND QUALIFYING ACCOUNTS**

The Company maintains allowances for doubtful accounts based on factors such as the composition of accounts receivable, historical bad debts, changes in payment patterns, customer creditworthiness and current economic trends. These estimates are adjusted periodically to reflect changes in facts and circumstances. The Company's allowance for doubtful accounts was \$0.4 million at December 31, 2007, 2006, and 2005. The following reflects the activity of the allowance for doubtful accounts for each of three years ended December 31:

(in thousands)	2007	2006	2005
Balance as of beginning of year	\$ 365	\$ 365	\$ 365
Provision for doubtful accounts			
Write-offs			
Balance as of end of year	\$ 365	\$ 365	\$ 365

The Company records allowances for estimates of potential sales credit memos when the related revenue is recorded and reviews those allowances periodically. The Company based these estimates on historical analyses of sales credit memos, and assumptions about future events and experience with customer disputes. The Company's allowance for sales credit memos was \$1.0 million as of December 31, 2007, \$1.2 million as of December 31, 2006 and \$0.5 million as of December 31, 2005. During the first quarter of 2005, the Company refined its estimate of allowances for sales credit memos, which resulted in an increase in services revenue of \$0.3 million. The following reflects the activity of the allowance for sales credit memos for each of three years ended December 31:

(in thousands)	2007	2006	2005
Balance at beginning of year	\$ 1,238	\$ 470	\$ 642
Provision for credit memos	1,160	2,375	378
Credit memos issued	(1,412)	(1,607)	(550)
Balance at end of period	\$ 986	\$ 1,238	\$ 470

3. EQUIPMENT AND IMPROVEMENTS AND COMPUTER SOFTWARE FOR INTERNAL USE*(a) Equipment and improvements*

Equipment and improvements are recorded at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets, which are generally three years for equipment and five years for furniture and fixtures. Leasehold improvements are amortized over the lesser of the life of the lease or the useful life of the asset. Repairs and maintenance costs are expensed as incurred. The cost and accumulated depreciation of equipment and improvements consisted of the following:

(in thousands)	December 31, 2007	December 31, 2006
Computer equipment	\$ 5,461	\$ 4,240
Furniture and fixtures	2,424	2,199
Leasehold improvements	3,631	2,778

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Equipment under capital leases	594	594
	12,110	9,811
Less: accumulated depreciation and amortization	(8,497)	(7,358)
Equipment and improvements, net of accumulated depreciation	\$ 3,613	\$ 2,453

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Depreciation expense was approximately \$1.5 million, \$1.3 million, and \$0.7 million for the years ended December 31, 2007, 2006, and 2005.

During the years ended December 31, 2007, 2006, and 2005, the Company recorded disposals of approximately \$0.4 million, \$0.4 million, and \$0.7 million, respectively, of computer equipment, furniture and fixtures and leasehold improvements. Nearly all of the assets written off during 2007, 2006, and 2005 were fully depreciated, resulting in immaterial losses on disposal.

(b) Computer software for internal use

The Company capitalized and amortized costs associated with computer software developed or purchased for internal use in accordance with AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). The Company amortized capitalized software costs generally over three years commencing on the date the software is placed into service. During 2007, the Company did not capitalize any costs for computer software developed for internal use. During 2006, the Company capitalized costs totaling \$0.4 million for computer software developed for internal use. The amortization expense was approximately \$0.2 million for the year ended December 31, 2007. The cost and accumulated amortization of computer software for internal use consisted of the following:

(in thousands)	December 31, 2007	December 31, 2006
Computer software purchased	\$ 2,278	\$ 2,441
Computer software developed for internal use	721	721
	2,999	3,162
Less: accumulated depreciation and amortization	(2,430)	(2,108)
Computer software for internal use, net of accumulated amortization	\$ 569	\$ 1,054

Amortization expense was approximately \$0.5 million, \$0.4 million, and \$0.3 million for the years ended December 31, 2007, 2006, and 2005.

During the years ended December 31, 2007, 2006, and 2005 the Company recorded disposals of approximately \$0.2 million, \$0.4 million, and \$0, respectively, of purchased software. Nearly all of the assets written off during 2007, 2006, and 2005 were fully depreciated, resulting in immaterial losses on disposal.

4. STOCK-BASED COMPENSATION

In accordance with SFAS 123(R) and beginning on January 1, 2006, the Company recognizes stock-based compensation expense associated with equity awards in its consolidated statements of income based on the fair value of these awards at the date of grant. Pro forma disclosure is no longer an alternative. The Company adopted the provisions of SFAS 123(R) using the modified prospective method, and, accordingly prior period amounts have not been restated. Stock-based compensation is recognized over the requisite service period, which is generally the vesting period of the equity award, and adjusted each period for anticipated forfeitures. Under this approach, the Company is required to record compensation cost for all share-based payments granted after the date of adoption based on the grant date fair value, estimated in accordance with the provisions of SFAS 123(R), and for the unvested portion of all share-based payments previously granted that remain outstanding based on the grant date fair value, estimated in accordance with the original provisions of SFAS 123. The majority of the

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Company's stock-based compensation arrangements vest over either a four or five year vesting schedule and have a ten-year term. The Company recognizes stock-based compensation under the ratable method, which treats each vesting tranche as if it were an individual grant.

During the fourth quarter of 2007, the Company's Board of Directors approved changes to its equity compensation program, including the granting of restricted stock units (RSUs) in addition to stock options, for periodic equity compensation grants. RSUs deliver to the recipient a right to receive a specified number of shares of the Company's common stock upon vesting. Unlike stock options, there is no cost to the employee at share issuance. The Company values its RSUs at the fair value of our common stock on the grant date, which is the closing price of our common stock on the grant date, less the present value of expected dividends, as the employee is not entitled to dividends during the requisite service period. In December 2007, the Company granted approximately 408,000 stock options and approximately 204,000 RSUs to certain employees.

During the fourth quarter of 2007, the Company's Board of Directors also approved the election by employees to receive 50% of their 2008 target incentive compensation under the Company's Corporate Incentive Compensation Plan (the Plan) in the form of RSUs. If elected by an employee, the equity amount will be equal in value on the date of grant to 50% of his or her target incentive opportunity, based on the employee's January 2008 base salary. The number of RSUs granted will be determined by dividing 50% of the employee's target incentive opportunity by the fair value of a RSU on the grant date. If elected, the equity grant will occur during the open trading period following the release of the prior year's financial results and will vest 100% on the Plan payout date of the following year for all participants. Vesting is conditioned upon threshold funding of the Plan and on continued employment; if threshold funding does not occur, the equity grant cannot be exercised and will expire. The Company will recognize the associated stock-based compensation expense over the requisite service period beginning on the grant date and ending on the vest date.

Upon vesting of the RSUs, the Company will withhold shares of common stock in an amount sufficient to cover its minimum statutory tax withholding obligations and will issue shares of its common stock for the remaining amount. The compensation expense incurred by the Company for RSUs is based on the closing market price of the Company's common stock on the date of grant less the future present value of dividends and is amortized ratably on a straight-line basis over the requisite service period.

Beginning in December 2007, the Company began issuing options that will allow the settlement of vested stock options on a net share basis, at the employee's option, such that the employee will not tender any cash or shares upon exercise. Rather, the Company will withhold the number of shares having a fair value equal to the option exercise price and its minimum statutory tax withholding obligations from the shares that would otherwise be issued upon exercise.

Share-Based Compensation Plans:***(a) 1994 Long-term incentive plan***

In 1994, the Company adopted a 1994 Long-Term Incentive Plan (the 1994 Plan) to provide employees, Directors and consultants with opportunities to purchase stock through incentive stock options and non-qualified stock options. In addition to options, participants under the 1994 Plan were eligible to receive stock appreciation rights, restricted stock and long-term performance awards. The Compensation Committee of the Board of Directors (Compensation Committee) administers the 1994 Plan. Generally, the exercise price of options granted under the plan was equal to the fair market value of the underlying common stock on the date of grant. Options granted under the 1994 Plan generally vest over four years and expire no later than ten years from the date of grant. As of December 31, 2007, options to purchase an aggregate of approximately 3,800,000 shares of common stock were outstanding under the 1994 Plan. The Company does not intend to issue any additional options or make any other awards under the 1994 Plan in the future.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****(b) 1996 Non-employee Director stock option plan***

In 1996, the Company adopted a 1996 Non-Employee Director Stock Option Plan (the Director Plan), which provides for the grant to non-employee Directors of the Company of options to purchase shares of its common stock. Originally, the Director Plan provided for the grant to non-employee Directors on the date he or she first became a Director of an option to purchase 30,000 shares of common stock at a price equal to the fair market value thereof on the date of grant, such options to vest in equal annual installments over five years. In 1999, the Director Plan was amended to provide for (i) the grant to non-employee Directors on the date he or she first became a Director of an option to purchase 30,000 shares of common stock at a price per share equal to the fair market value thereof on the date of grant, such options to vest in equal annual installments over three years and (ii) the grant to each non-employee Director at the time of the regular meeting of the Board of Directors following the annual meeting of stockholders (commencing in 2000), of a fully vested option to purchase 10,000 shares of common stock at a price per share equal to the fair market value thereof on the date of grant. The Compensation Committee administers the Director Plan. As of December 31, 2007, options to purchase an aggregate of approximately 210,000 shares of common stock were outstanding under the Director Plan. The Company does not intend to issue any options under the Director Plan in the future.

(c) 1996 Employee stock purchase plan

In 1996, the Company adopted a 1996 Employee Stock Purchase Plan (the 1996 Stock Purchase Plan) pursuant to which its employees were entitled to purchase up to an aggregate of 1,000,000 shares of common stock at a price equal to the lesser of 85% of the fair market value of the Company's common stock on either the commencement date or completion date for offerings under the plan. During 2005, the Company amended the 1996 Stock Purchase Plan to provide that, for each offering period beginning on May 1, 2005 or later, employees are entitled to purchase shares of common stock at a price equal to 95% of the fair market value on the completion date of the offering period. As of December 31, 2007, there had been 15 offerings under the plan and approximately 800,000 shares had been issued thereunder. The 1996 Stock Purchase Plan is tax qualified and as of December 31, 2007 no compensation expense related to shares issued under the plan had been recognized for financial statement purposes. The 1996 Stock Purchase Plan terminated on November 1, 2006.

(d) 2004 Long-term incentive plan

In 2004, the Company adopted a 2004 Long-Term Incentive Plan (the 2004 Plan) to provide employees, non-employee Directors and consultants with opportunities to purchase stock through incentive stock options and non-qualified stock options. In addition to options, eligible participants under the 2004 Plan may be granted stock purchase rights and other stock-based awards. As of December 31, 2007, a total of 7,000,000 shares of common stock had been authorized under the 2004 Plan and approximately 3,225,000 shares were subject to outstanding options and stock-based awards. Beginning in June 2006, each member of the Company's Board of Directors (except the Company's Chairman and Chief Executive Officer) is entitled to receive on an annual basis a number of shares of unrestricted common stock equal to \$55,000 divided by the fair market value of its common stock on the grant date. The Compensation Committee administers the 2004 Plan. Generally, the exercise price of options granted under the plan is equal to the fair market value of the underlying common stock on the date of grant. Options granted under the 2004 Plan generally vest over five years and expire no later than ten years from the date of grant.

(e) 2006 Employee stock purchase plan

In 2006, the Company adopted a 2006 Employee Stock Purchase Plan (the 2006 Stock Purchase Plan) pursuant to which the Company's employees are entitled to purchase up to an aggregate of 500,000 shares of

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

common stock at a price equal to 85% of the fair market value of the Company's common stock on either the commencement date or completion date for offerings under the plan, whichever is less, or such higher price as the Company's Board of Directors may establish from time to time. Until the Company's Board of Directors determines otherwise, the Board has set the purchase price at 95% of the fair market value on the completion date of the offering period. As a result, the 2006 Stock Purchase Plan is non-compensatory under SFAS 123(R) and is tax qualified. Therefore as of December 31, 2007, no compensation expense related to shares issued under the plan had been recognized for financial statement purposes. The first offering period under the 2006 Stock Purchase Plan began November 1, 2006. As of December 31, 2007, there had been two offerings under the plan and approximately 18,000 shares had been issued thereunder.

Shares reserved

As of December 31, 2007, there were approximately 3,127,000 shares available for future issuance under the Company's stock plans, consisting of approximately 2,645,000 shares under the 2004 Plan and approximately 482,000 shares under the 2006 Stock Purchase Plan. There were no shares available for future issuance under the 1994 Plan, the Director Plan or the 1996 Stock Purchase Plan.

Equity grants, Assumptions and Activity

The Company periodically grants stock options and RSUs for a fixed number of shares to employees and non-employee Directors. The exercise price for stock options is greater than or equal to the fair market value of the shares at the date of the grant. In July 2007, the Company granted unrestricted common stock to members of its Board of Directors (other than the Company's Chairman and Chief Executive Officer) in lieu of the annual stock option grant historically made. The Company recorded approximately \$0.3 million of compensation expense for this award. During 2007, the Company recorded \$1.3 million of compensation expense for employee stock options and \$42,000 of compensation expense for RSUs. The following table presents the stock-based compensation expense included in the Company's consolidated statements of income for 2007 and 2006.

(in thousands, except per share amounts)	Year ended December 31, 2007	Year ended December 31, 2006
Stock-based compensation expense:		
Cost of services	\$ 490	\$ 286
Selling and marketing	427	520
Research and development	139	135
General and administrative	562	527
Total stock-based compensation before tax	1,618	1,468
Income tax benefit	(430)	(520)
Net stock-based compensation expense	\$ 1,188	\$ 948
Effect on earnings (loss) per share:		
Basic	\$ (0.03)	\$ (0.03)
Diluted	\$ (0.03)	\$ (0.03)

The Company estimates the fair value of stock options using a Black-Scholes option valuation model. Key inputs used to estimate the fair value of stock options include the exercise price of the award, the expected term of the option, the expected volatility of the Company's common stock over the option's expected term, the risk-free interest rate over the option's expected term, and the Company's expected annual dividend yield. The amount of stock-based compensation recognized during a period is based on the value of the portion of the

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

awards that are ultimately expected to vest. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based on the review of historical forfeiture data for the Company's employees, an annual forfeiture rate of 18% has been applied and is re-evaluated and adjusted as necessary. Ultimately, the Company recognizes the actual expense over the vesting period only for the shares that vest.

The weighted-average assumptions used in the Black-Scholes option valuation model are as follows:

	Year ended December 31, 2007	Year ended December 31, 2006	Year ended December 31, 2005
Expected volatility (1)	53%	75%	70%
Weighted-average grant date fair value	\$ 5.44	\$ 5.20	\$ 2.41
Expected term in years (2)	5.6	6.1	5.0
Risk-free interest rate (3)	4.02%	4.81%	4.27%
Expected annual dividend yield (4)	1.19%	.97%	None

- (1) The expected volatility for each grant is determined based on the average of historical weekly price changes of the Company's common stock over a period of time which approximates the expected option term.
- (2) The expected option term for each grant is determined based on the historical exercise behavior of employees and post-vesting employment termination behavior.
- (3) The risk-free interest rate is based on the yield of zero-coupon U.S. Treasury securities for a period that is commensurate with the expected option term at the time of grant.
- (4) The expected annual dividend yield is based on the weighted-average of the dividend yield assumptions used for options granted during the applicable period. In July 2006, the Company began paying an on-going quarterly cash dividend of \$0.03 per share of common stock. The expected annual dividend yield for the year ended December 31, 2007 is based on the expected dividend of \$0.12 per share, per year (\$0.03 per share, per quarter times 4 quarters) divided by the average stock price. The expected annual dividend yield for the year ended December 31, 2006 includes the weighted average impact of expected dividends beginning July 2006. As the Company did not declare dividends prior to the year ended December 31, 2006, therefore there was no dividend yield assumption in 2005.

Prior to the adoption of SFAS 123(R), the Company presented all tax benefits resulting from the exercise of stock options as operating cash flows in its consolidated statements of cash flows. SFAS 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of compensation cost recognized for the options (excess tax benefits) to be classified as financing cash flows. There was approximately \$2.3 million of excess tax benefit classified as a financing cash inflow that would have been classified as an operating cash inflow for the year ended December 31, 2007, if the Company had not adopted SFAS 123(R).

SFAS 123(R) provides that for the purposes of calculating the pool of excess tax benefits (APIC pool), the Company should include the net excess tax benefits that would have qualified had the Company adopted SFAS 123(R) from inception. The FASB issued FSP 123(R)-3

Transition Election Related to Accounting for the Tax Effect of Share-Based Payment Awards (FSP 123(R)-3), which provides an alternative transition method to calculate beginning pool of excess tax benefits. The Company elected to adopt the alternative transition method (short cut method) in calculating their historical APIC pool of windfall tax benefits in regards to its share based compensation.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the combined stock option activity under the Company's stock option plans for the years ended December 31, 2007, 2006, and 2005:

	Shares (in thousands)	Weighted Average Exercise Price per share	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Options outstanding at January 1, 2005	9,255	\$ 7.70		
Granted	1,682	8.04		
Exercised	(342)	4.33		
Forfeited/expired	(867)	7.91		
Options outstanding at December 31, 2005	9,728	7.86	6.02	
Granted	490	8.11		
Exercised	(640)	5.46		
Forfeited/expired	(1,142)	8.70		
Options outstanding at December 31, 2006	8,436	7.94	5.63	\$ 24,658
Granted	693	11.39		
Exercised	(1,679)	6.39		
Forfeited/expired	(214)	10.03		
Options outstanding at December 31, 2007	7,236	\$ 8.57	5.06	\$ 30,028
Options vested and expected to vest at December 31, 2007	6,781	\$ 8.49	4.80	\$ 29,009
Options exercisable at December 31, 2007	6,092	\$ 8.38	4.37	\$ 27,296

The aggregate intrinsic value of stock options exercised (i.e., the difference between the market price at exercise and the price paid by the employee at exercise) during the years ended December 31, 2007, 2006, and 2005 was \$7.5 million, \$1.6 million, and \$0.8 million, respectively. The aggregate intrinsic value of stock options outstanding and exercisable as of December 31, 2007 is based on the difference between the closing price of the Company's stock of \$11.93 on December 31, 2007 and the exercise price of the applicable stock options.

As of December 31, 2007, the Company had unrecognized compensation expense related to the unvested portion of stock options of approximately \$2.5 million that is expected to be recognized as expense over a weighted-average period of approximately 2.0 years.

Cash received from option exercises under all share-based payment arrangements for the year ended December 31, 2007 was \$10.7 million. The actual tax benefit for the tax deductions from stock option exercises for year ended December 31, 2007 totaled \$2.3 million.

During the second quarter of 2007, 25,535 unrestricted shares of the Company's common stock were granted to members of its Board of Directors under the 2004 Plan. As this award was unrestricted, no awards remain unvested as of December 31, 2007. The weighted-average grant date fair value per share of these awards was \$10.77.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In December 2007, the Company granted approximately 204,000 RSUs to certain employees. The following table presents the RSU activity, under the 2004 Plan for the year ended December 31, 2007:

	Shares (in thousands)	Weighted- average Grant Date Fair Value	Weighted- average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Nonvested at January 1, 2007				
Granted	204	\$ 11.71		
Vested				
Forfeited				
Nonvested at December 31, 2007	204	\$ 11.71	2.65	\$ 2,432
Ending vested and expected to vest at December 31, 2007	123	\$ 11.71	2.31	\$ 1,473
Ending exercisable at December 31, 2007				

The RSUs vest over five years with 20% vesting after one year and the remaining 80% vesting in equal quarterly installments over the remaining four years. The Company expenses its stock-based compensation under the ratable method, which treats each vesting tranche as if it were an individual grant. As of December 31, 2007, the Company had approximately \$1.4 million of unrecognized compensation cost related to RSUs that is expected to be recognized as expense over a weighted-average period of 2.7 years.

5. STOCKHOLDERS EQUITY**(a) Preferred stock**

The Company has authorized 1,000,000 shares of preferred stock, which may be issued from time to time in one or more series. The Board of Directors has the authority to issue the shares of preferred stock in one or more series, to establish the number of shares to be included in each series, and to fix the designation, powers, preferences and rights of the shares of each series and the qualifications, limitations or restrictions thereof, without any further vote or action by the stockholders. The issuance of preferred stock could decrease the amount of earnings and assets available for distribution to holders of common stock, and may have the effect of delaying, deferring or defeating a change in control of the Company. The Company has not issued any shares of preferred stock through December 31, 2007.

(b) Common stock

The Company has 70,000,000 authorized shares of common stock, \$0.01 par value per share, of which 36,191,590 shares were issued and outstanding at December 31, 2007.

Since 2004, the Company's Board of Directors has approved three stock repurchase programs that authorize the Company to repurchase in the aggregate up to \$30.0 million shares of its common stock. Purchases under these programs may be made as market conditions warrant, subject to regulatory and other considerations, from time to time on the open market or in privately negotiated transactions.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table is a summary of our repurchase activity under all of the Company's repurchase programs for the years ended December 31:

(Dollars in thousands)	2007		2006		2005	
	Shares	Amount	Shares	Amount	Shares	Amount
Prior year authorizations at January 1,		\$ 6,872		\$ 4,123		\$ 10,000
Authorizations		10,000		10,000		
Repurchases paid	799,347	(9,135)	962,420	(6,819)	957,112	(5,877)
Repurchases unsettled	48,015	(569)				
Expirations		(5,958)		(432)		
Authorized dollars remaining as of December 31,		\$ 1,210		\$ 6,872		\$ 4,123

Between January 1, 2005 and December 31, 2007, the Company invested approximately \$22.4 million to repurchase approximately 2,767,000 shares of its common stock under three separate programs, including \$0.6 million of repurchases that settled in January 2008. These share repurchases partially offset the shares issued and proceeds received under the Company's various share-based compensation plans in 2007, and more than offset these amounts in 2006 and 2005. Under these share-based compensation plans, the Company received proceeds for shares issued of \$10.9 million, \$3.7 million, and \$1.8 million for the years ended December 31, 2007, 2006, and 2005, respectively.

(c) Dividends

On May 30, 2006, the Company's Board of Directors approved an ongoing quarterly cash dividend of \$0.03 per share, beginning with the second quarter ended June 30, 2006. Accordingly, the Company declared \$0.12 per share and \$0.09 per share for the years ended December 31, 2007 and 2006, respectively, and paid cash dividends of \$4.3 million and \$2.1 million for the years ended December 31, 2007 and 2006, respectively. It is the Company's current intention to pay a quarterly cash dividend of \$0.03 per share to shareholders of record as of the first trading day of each quarter, however, the Board of Directors may terminate or modify this dividend program at any time without notice.

(d) Warrants summary

In December 2005, October 2006, and November 2007, the Company issued 27,766 shares, 2,586 shares and 1,306 shares of its common stock, respectively, in connection with the exercise of warrants originally issued as part of the consideration for its acquisition of Imind in 2002. These warrants were exercised by former stockholders of Imind. In accordance with the net exercise provisions of these warrants, the Company withheld 3,774 shares, 259 shares, and 102 shares of the Company's common stock to cover the exercise price, which shares were valued at approximately \$27,000, \$2,000, and \$1,200, respectively, based on the average closing price of the Company's common stock over the ten consecutive trading days ending on the third trading day prior to the exercise date.

In November 2007, the Company issued 5,815 shares of its common stock in connection with the exercise of previously issued warrants to International Business Machines Corporation (IBM). In accordance with the net exercise provisions of this warrant, the Company withheld 20,923 shares of the Company's common stock to cover the exercise price, which shares were valued at approximately \$0.3 million, based on the average closing price of the Company's common stock over the five consecutive trading days ending on the day prior to the exercise date.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of December 31, 2007, there were outstanding warrants to purchase 11,045 shares of the Company's common stock with a fair value of \$4.50 per share and an exercise price of \$0.85 per share. These warrants expire in 2012.

6. COMMITMENTS AND CONTINGENCIES

As of December 31, 2007, the Company did not have material commitments for capital or operating expenditures other than a purchase commitment for customer support services and operating leases. The purchase commitment for customer support services covers quality assurance and engineering support for legacy software. The Company's principal administrative, sales, marketing, support, and research and development operations are located in an approximate 100,000 square foot leased facility in Cambridge, Massachusetts. The lease for this facility expires in 2013, subject to the Company's option to extend for two additional five-year periods. The Company also leases space for its other offices in the U.S., Canada, Australia, France, and the United Kingdom. These leases expire at various dates through 2010.

In July 2006, the Company entered into an agreement to lease additional space in its Cambridge, Massachusetts facility. The lease for this additional space expires in 2013, subject to the Company's option to extend for two additional five-year periods. Under a tenant improvement allowance, the agreement allows the Company to collect reimbursement from the landlord, up to approximately \$0.9 million of the costs associated with the build-out of this space. As of December 31, 2007, the Company had incurred and had been reimbursed for approximately \$0.9 million of improvement costs, which were recorded as leasehold improvements with a corresponding credit to deferred rent expense to be amortized to rent expense over the lease term.

As of December 31, 2007, the Company's known contractual obligations, including future minimum rental payments required under operating leases with non-cancelable terms in excess of one year were as follows:

(in thousands)	Purchase Obligations	Operating Leases
For the calendar year		
2008	\$ 690	\$ 4,215
2009		4,236
2010		3,955
2011		4,132
2012		4,283
2013		1,443
Net minimum obligations	\$ 690	\$ 22,264

Rent expense under operating leases is recognized on a straight-line basis, to account for scheduled rent increases and landlord tenant allowance. The excess of expense over current payments is recorded as deferred rent and included in other long-term liabilities. As of December 31, 2007, deferred rent of approximately \$0.2 million was included in accrued expenses and approximately \$1.8 million was included in other long-term liabilities in the accompanying consolidated balance sheet. Total rent expense under operating leases was approximately \$4.7 million, \$3.7 million, and \$3.7 million, for the years ended December 31, 2007, 2006, and 2005, respectively.

The Company is a party in various contractual disputes, litigation and potential claims arising in the ordinary course of business. The Company does not believe that the resolution of these matters will have a material adverse effect on its financial position or results of operations.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****7. INCOME TAXES**

The components of income before provision (benefit) for income taxes are as follows for the years ended December 31:

(in thousands)	2007	2006	2005
Domestic	\$ 8,343	\$ (643)	\$ 4,397
Foreign	1,599	1,830	922
Total	\$ 9,942	\$ 1,187	\$ 5,319

The components of the provision (benefit) for income taxes are as follows for the years ended December 31:

(in thousands)	2007	2006	2005
Current:			
Federal	\$ 2,281	\$ 422	\$ 213
State	350	187	135
Foreign	879	393	63
Total current	3,510	1,002	411
Deferred:			
Federal	582	(1,328)	(220)
State	(699)	(423)	(143)
Foreign	(46)	94	79
Total deferred	(163)	(1,657)	(284)
Total provision (benefit)	\$ 3,347	\$ (655)	\$ 127

The effective income tax rate differed from the statutory federal income tax rate due to the following:

	2007	2006	2005
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit and tax credits	(2.4)	(24.1)	(2.9)
Permanent differences	3.3	14.2	2.2
Extraterritorial income exclusion and domestic production activities	(3.2)	(59.1)	(18.2)
Federal research and experimentation credits	(4.6)	(20.5)	(3.0)
Tax effects of foreign activities	(.8)	(24.3)	(4.1)
Changes in deferred tax liabilities		7.4	(1.6)
Provision to return adjustments	1.5	1.7	(1.9)
Tax exposure reserve	1.9	13.7	(1.4)
Valuation allowance	1.0	0.9	(2.0)

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Other	2.0	(0.1)	0.3
Effective income tax rate	33.7%	(55.2)%	2.4%

The difference in the Company's effective federal tax rate for 2007 as compared to the statutory rate was primarily the result of changes to the following tax provision items: domestic production activities, federal and state credits, all of which reduced the Company's effective tax rate. These decreases in the rate were offset by permanent differences for meals and entertainment and prior year provision to return adjustments.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company has recorded a FIN 48 liability for uncertain tax matters, both domestic and foreign, which it believes could result in additional tax being due. Any additions or reductions to the FIN 48 liability will be reflected in the Company's effective tax rate in the period that additional facts become known.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of net deferred tax assets and liabilities are as follows:

(in thousands)	2007	2006
Software revenue	\$ 306	\$ (15,368)
Depreciation	872	794
Accruals and reserves	3,584	2,676
Unrealized loss on investments	(5)	224
Net operating loss carry forwards		4,150
Tax credit carry forwards	3,402	8,948
Net deferred tax assets	8,159	1,424
Less valuation allowances	(204)	(806)
Net deferred income taxes	\$ 7,955	\$ 618
Reported as:		
Current deferred tax asset, included in other current assets	\$ 2,148	\$ 2,962
Long-term deferred income tax assets (liabilities)	5,807	(2,344)
Net deferred income taxes	\$ 7,955	\$ 618

A valuation allowance has been provided for certain deferred tax assets when it is more likely than not that the Company will not realize the entire benefit of the assets. The \$0.6 million decrease in the valuation allowance during 2007 was primarily due to realization of approximately \$0.3 million of tax benefits generated on the exercise of stock options, which were recorded directly to equity, and the realization of approximately \$0.4 million of certain tax loss and credit carry forwards that were acquired in the 1mind acquisition and were recorded as a reduction to goodwill. These decreases were offset by an increase in the valuation allowance of \$0.1 million due to additional capital loss carry forwards in the period.

As of December 31, 2006, the Company had alternative minimum tax (AMT), and research and experimentation (R&E) net credit carry forwards for federal and state purposes of approximately \$8.9 million, of which \$5.5 million have been utilized in 2007 to reduce current taxes payable. The Company also had available as of December 31, 2006, \$10.5 million of net operating loss carry-forwards, all of which have been utilized in 2007 to reduce current taxes payable. As of December 31, 2007, the Company has available \$3.4 million of state tax (R&E) and investment tax credits expiring in the years 2008 through 2022.

Undistributed earnings of the Company's foreign subsidiaries amounted to approximately \$7.6 million as of December 31 2007. The Company has not provided any additional federal or state income taxes or foreign withholding taxes on the undistributed earnings as such earnings have been indefinitely reinvested in the business as defined in the provisions of SFAS 109 as well as Accounting Principles Board Opinion No. 23 Accounting for Income Taxes Special Areas (APB 23).

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result, the Company recorded the cumulative effect of applying the provisions of FIN 48 and recorded a \$1.5 million reduction to the January 1, 2007 retained earnings.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows:

(in thousands)	2007
Balance as of January 1, 2007	\$ 9,688
Additions based on tax positions related to the current year	
Additions for tax positions of prior years	137
Reductions for tax positions of prior years	
Settlements	
 Balance as of December 31, 2007	 \$ 9,825

Included in the balance as of December 31, 2007 are \$7.0 million of tax positions for which the ultimate settlement is highly certain but for which there is uncertainty about the timing of such deductibility. Due to the impact of deferred tax accounting, other than interest and penalties, a change in the income recognition period would not affect the annual effective tax rate but would accelerate the payment of cash to the tax authority to an earlier period.

As of December 31, 2007, the total amount of unrecognized tax benefits totaled approximately \$9.8 million, of which \$3.9 million, if recognized, would favorably affect our effective tax rate in any future period. The Company expects that the changes in the unrecognized benefits within the next twelve months would not be material.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. For the year ended December 31, 2007, the Company recognized approximately \$1.6 million of interest expense and \$0.1 million of penalties related to uncertain tax positions.

The Company files income tax returns in the U.S. federal and state jurisdictions and foreign jurisdictions. Generally, the Company is no longer subject to U.S. federal, state, or local, or foreign income tax examinations by tax authorities for the years before 2001. Currently, the Company is under examination in the United Kingdom for the tax years 2001 through 2004. With few exceptions, the statute of limitations remains open in all other jurisdictions for the tax years 2004 to the present.

8. EMPLOYEE BENEFIT PLANS

The Company sponsors a 401(k) defined contribution retirement plan for qualifying employees pursuant to which the Company makes discretionary matching profit sharing contributions. Company contributions under the plan totaled approximately \$1.0 million in 2007, \$0.8 million in 2006, and \$0.6 million in 2005. In addition, the Company has defined contribution plans for qualifying international employees and contributions expensed under those plans totaled approximately \$0.3 million in 2007, approximately \$0.2 million in 2006, and approximately \$0.1 million in 2005.

Table of Contents**PEGASYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. SELECTED QUARTERLY INFORMATION (UNAUDITED)**

(in thousands, except per share data)	2007			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenue	\$ 37,489	\$ 35,663	\$ 42,041	\$ 46,756
Gross profit	21,925	21,343	26,320	27,159
Income (loss) from operations	(244)	(939)	2,957	177
Income before provision for income taxes	1,557	1,080	5,154	2,151
Net income	1,020	647	3,510	1,418
Earnings per share, basic	\$ 0.03	\$ 0.02	\$ 0.10	\$ 0.04
Earnings per share, diluted	\$ 0.03	\$ 0.02	\$ 0.09	\$ 0.04

(in thousands, except per share data)	2006			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenue	\$ 29,199	\$ 27,331	\$ 33,524	\$ 35,969
Gross profit	15,081	16,282	18,357	22,540
Income (loss) from operations	(2,768)	(2,958)	(2,059)	671
(Loss) Income before provision (benefit) for income taxes	(961)	(618)	10	2,756
Net income (loss)	(911)	(259)	(410)	3,422
Earnings per share, basic	\$ (0.03)	\$ (0.01)	\$ (0.01)	\$ 0.10
Earnings per share, diluted	\$ (0.03)	\$ (0.01)	\$ (0.01)	\$ 0.09

Table of Contents**ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

Not applicable.

ITEM 9A CONTROLS AND PROCEDURES*(a) Evaluation of Disclosure Controls and Procedures.*

Our management, with the participation of our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act) as of December 31, 2007. In designing and evaluating our disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and our management necessarily applied its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our management previously reported four material weaknesses in the Company's internal control over financial reporting. These material weakness related to: (1) inadequate and ineffective controls over the accounting for certain complex software revenue recognition transactions; (2) inadequate and ineffective controls over the accounting for service revenue recognition transactions; (3) inadequate and ineffective controls over the accounting for income taxes; and (4) inadequate and ineffective controls related to our financial close process. As described below, management has taken significant steps to remediate certain of these material weaknesses, and has concluded that its controls over the accounting for service revenue recognition transactions, the accounting for income taxes and the periodic financial close process were each effective as of December 31, 2007. However, management has concluded that the controls over the accounting for certain complex software revenue recognition transactions were not effective as of December 31, 2007 and represent a material weakness, as described below in management's report on internal control over financial reporting. Based on this evaluation and the material weakness described below, our CEO and CFO concluded that our disclosure controls and procedures were not effective as of December 31, 2007.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Notwithstanding the existence of the material weakness described below in management's report on internal control over financial reporting, the consolidated financial statements included in this Annual Report on Form 10-K fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented.

(b) Management's Report on Internal Control over Financial Reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act. Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets, provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made in accordance with authorizations of our management and Directors; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisitions, use or disposition of our assets that could have a material effect on our financial statements.

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A material weakness is defined as a deficiency, or a combination of deficiencies, in internal controls over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

Material Weakness in Accounting for Certain Complex Software Revenue Recognition Transactions

Based on our evaluation of the effectiveness of our internal control over financial reporting of December 31, 2007, management identified a material weakness related to the inadequate design and ineffective operation of our controls related to our ability to apply generally accepted accounting principles as they relate to the recognition of revenue on transactions containing complex and non-standard terms. This material weakness resulted in post-closing adjustments proposed to the Company's consolidated financial statements effecting revenue, accounts receivable and deferred revenue. These adjustments, some of which are reflected in the accompanying consolidated financial statements for the year ended December 31, 2007, were not individually or collectively material; however there is a reasonable possibility that a material misstatement of the annual or interim financial statements could occur and not be prevented or detected on a timely basis.

Because of the material weakness described above, management has concluded that we did not maintain effective internal control over financial reporting as of December 31, 2007, based on criteria in Internal Control – Integrated Framework issued by the COSO.

Deloitte & Touche LLP, our independent registered public accounting firm which also audited our consolidated financial statements, has issued an attestation report on our internal control over financial reporting, which is included on page 38.

(c) Changes in Internal Control over Financial Reporting.

We implemented and monitored changes in our internal controls over financial reporting described below with respect to our material weaknesses in accounting for income taxes, accounting for service revenue recognition transactions and the periodic financial close process that, while individually not material in any prior quarter, had in the aggregate by the fourth quarter of 2007 materially affected or were reasonably likely to materially affect, our internal control over financial reporting. During the fourth quarter, we determined that, as a result of these material changes, the controls in each of those areas were operating effectively and remediated the respective material weakness. We also implemented changes in our internal control over financial reporting with respect to our material weakness in accounting for certain complex software revenue recognition transactions described below in management's ongoing remediation plan for accounting for certain complex software revenue recognition transactions. There have been no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act) during the quarter ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Remediation of Material Weakness Accounting for Income Taxes

We added additional technical resources to assist in the preparation and review of our tax decisions. We improved the underlying tax preparation and review procedures. We also conducted additional training and implemented enhanced tax preparation software. In addition, we completed our remedial efforts by hiring an expert in tax accounting during the third quarter of 2007 and implemented additional review procedures during the fourth quarter of 2007. Our management's testing of our internal controls over financial reporting indicated that the controls over accounting for income taxes operated effectively as of December 31, 2007. Therefore, we believe that the previously reported material weakness related to accounting for income taxes has been remediated as of December 31, 2007.

Remediation of Material Weakness Accounting for Service Revenue Recognition Transactions

We revised our accounting procedures to correctly record revenue on services. We assessed the expertise of our staff responsible for revenue recognition and addressed any identified deficiencies. We improved the

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expertise of our staff responsible for revenue recognition with respect to the proper method of accounting for arrangements involving professional services. Our management's testing of our internal controls over financial reporting indicated that the controls over accounting for service revenue recognition transactions operated effectively as of December 31, 2007. Therefore, we believe that the previously reported material weakness related to accounting for service software revenue recognition transactions has been remediated as of December 31, 2007.

Remediation of Material Weakness Periodic Financial Close Process

We implemented additional controls to accurately and consistently identify required adjustments through period-end account analysis and detailed reconciliation processes. We improved our closing process and we hired additional personnel with the required expertise to oversee the closing process. Our management's testing of internal controls over financial reporting indicated that the controls over the periodic financial close process operated effectively as of December 31, 2007. Therefore, we believe that the previously reported material weakness related to the periodic financial close process has been remediated as of December 31, 2007.

Management's Ongoing Remediation Plan - Complex Software Revenue Recognition Transactions

Management has been addressing the remaining material weakness related to accounting for certain complex software revenue recognition transactions and is committed to effectively remediating this weakness. We have assessed the expertise of our staff responsible for revenue recognition and we are in the process of addressing any identified deficiencies. We continue to improve our ability to identify when customer contracts contain non-standard terms. We also continue to improve our research protocol so that we more fully understand the applicable accounting for such terms and we added additional reviews of these arrangements by individuals with revenue recognition expertise. We believe we are taking the steps necessary to remediate this material weakness and will continue to review, revise and improve the effectiveness of our internal controls as appropriate. Although we have made enhancements to our control procedures in this area, this material weakness will not be considered remediated until our controls are operational for a period of time, tested and management concludes that these controls are operating effectively.

ITEM 9B OTHER INFORMATION

Not applicable.

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PART III

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information required by this item with respect to our executive officers is contained under the heading Executive Officers of the Registrant in Part I of this Annual Report on Form 10-K, and the remainder of the required information is contained in our proxy statement for our 2008 Annual Stockholders Meeting (the 2008 proxy statement) under the heading Election of Directors, and is incorporated herein by reference. Information relating to certain filings on Forms 3, 4, and 5 is contained in our 2008 proxy statement under the heading Section 16(a) Beneficial Ownership Reporting Compliance, and is incorporated herein by reference. Information required by this item pursuant to Items 401(h), 401(i), and 401(j) of Regulation S-K relating to an audit committee financial expert, the identification of the audit committee of our Board of Directors and procedures of security holders to recommend nominees to our Board of Directors is contained in the 2008 proxy statement under the heading Corporate Governance and is incorporated herein by reference.

We have adopted a written code of conduct that applies to all of our employees, including our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions.

ITEM 11 EXECUTIVE COMPENSATION

The information required by this item is contained in the 2008 proxy statement under the headings Directors Compensation , Compensation Discussion and Analysis , and Executive Compensation and is incorporated herein by reference.

ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is contained in the 2008 proxy statement under the heading Security Ownership of Certain Beneficial Owners and Management and is incorporated herein by reference.

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is contained in the 2008 proxy statement under the heading Certain Relationships and Related Transactions and is incorporated herein by reference.

ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is contained in the 2008 proxy statement under the heading Independent Registered Public Accounting Firm Fees and Other Matters and is incorporated herein by reference.

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PART IV

ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following are filed as part of this Annual Report on Form 10-K:

(1) Financial Statements

The following consolidated financial statements are included in Item 8:

	Page
<u>Consolidated Balance Sheets as of December 31, 2007 and 2006</u>	41
<u>Consolidated Statements of Income for the years ended December 31, 2007, 2006, and 2005</u>	42
<u>Consolidated Statements of Stockholders' Equity and Comprehensive Income for the years ended December 31, 2007, 2006, and 2005</u>	43
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2007, 2006, and 2005</u>	44

(b) Exhibits

The exhibits listed in the Exhibit Index immediately preceding such exhibits are filed as part of this Annual Report on Form 10-K.

(c) Financial Statement Schedules

All financial statement schedules are omitted because the required information is not present or not present in sufficient amounts to require submission of the schedule or because the information is reflected in the consolidated financial statements or notes thereto.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

PEGASYSTEMS INC.

By: */s/ CRAIG DYNES*
Craig Dynes
Chief Financial Officer and Senior Vice President

(principal financial officer and principal accounting officer)

Date: March 10, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed below on March 10, 2008 by the following persons on behalf of the Registrant and in the capacities indicated.

Signature	Title
<i>/s/ ALAN TREFLER</i>	Chief Executive Officer and Chairman
Alan Trefler	(principal executive officer)
<i>/s/ CRAIG DYNES</i>	Chief Financial Officer and Senior Vice President
Craig Dynes	(principal financial officer and principal accounting officer)
<i>/s/ RICHARD JONES</i>	Vice Chairman and Director
Richard Jones	
Alexander d Arbeloff	Director
<i>/s/ STEVEN KAPLAN</i>	Director
Steven Kaplan	
<i>/s/ JAMES O HALLORAN</i>	Director
James O Halloran	
<i>/s/ WILLIAM WYMAN</i>	Director
William Wyman	

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Exhibit No.	Description
3.3	Restated Articles of Organization, of the Registrant. (Filed as exhibit 99.2 to the Registrant's June 2, 2005 Form 8-K and incorporated herein by reference.)
3.4	Restated By-Laws of the Registrant. (Filed as exhibit 99.3 to the Registrant's June 2, 2005 Form 8-K and incorporated herein by reference.)
4.1	Specimen Certificate Representing the Common Stock. (Filed as exhibit 4.1 to the Registrant's Registration Statement on Form S-1 (Registration No. 333-03807) or an amendment thereto and incorporated herein by reference.)
10.1++	Amended and Restated 1994 Long-Term Incentive Plan. (Filed in the Registrant's Proxy Statement for its 2003 annual stockholders meeting and incorporated herein by reference.)
10.2++	1996 Non-Employee Director Stock Option Plan. (Filed in the Registrant's Proxy Statement for its 2000 annual stockholders meeting and incorporated herein by reference.)
10.3	Lease Agreement dated February 26, 1993 between the Registrant and Riverside Office Park Joint Venture. (Filed as exhibit 10.13 to the Registrant's Registration Statement on Form S-1 (Registration No. 333-03807) or an amendment thereto and incorporated herein by reference.)
10.4	Amendment Number 1 to Lease Agreement dated August 17, 1994 between the Registrant and Riverside Office Park Joint Venture. (Filed as exhibit 10.14 to the Registrant's Registration Statement on Form S-1 (Registration No. 333-03807) or an amendment thereto and incorporated herein by reference.)
10.5	Amendment Number 8 to Lease Agreement dated July 31, 2002 between the Registrant and NOP Riverfront LLC. (Filed as exhibit 10.23 to the Registrant's 2002 Form 10-K and incorporated herein by reference.)
10.6	Letter Amendment to Lease Agreement dated July 31, 2002 between the Registrant and NOP Riverfront LLC. (Filed as exhibit 10.24 to the Registrant's 2002 Form 10-K and incorporated herein by reference.)
+10.7++	2004 Long-Term Incentive Plan, as amended on December 13, 2007.
+10.8++	Form of Employee Stock Option Agreement, as amended on December 13, 2007.
10.9	Form of Non-Employee Director Stock Option Agreement. (Filed as exhibit 10.2 to the Registrant's September 30, 2004 Form 10-Q and incorporated herein by reference.)
10.10++	Offer Letter between the Registrant and Douglas I. Kra dated October 19, 2004. (Filed as exhibit 10.20 to the Registrant's 2004 Form 10-K and incorporated herein by reference.)
10.11	Form of Director Indemnification Agreement. (Filed as Exhibit 99.1 to the Registrant's April 11, 2005 Form 8-K and incorporated herein by reference.)
10.12++	2007 Section 16 Officers Corporate Incentive Compensation Plan. (Filed as Exhibit 99.1 to the Registrant's April 9, 2007 Form 8-K and incorporated herein by reference.)
10.13++	2007 Section 16 Officers Base Salaries and Target Bonus Percentages. (Filed as Exhibit 99.2 to the Registrant's April 9, 2007 Form 8-K and incorporated herein by reference.)
10.14++	Offer Letter between the Registrant and Edward L. Hughes dated February 21, 2006. (Filed as Exhibit 99.2 to the Registrant's February 27, 2006 Form 8-K and incorporated herein by reference.)
+10.15++	2006 Employee Stock Purchase Plan, as amended on February 14, 2008.
10.16++	Compensation program for members of the Registrant's Board of Directors, effective May 30, 2006. (Detailed in Registrant's June 5, 2006 Form 8-K and incorporated herein by reference.)
10.17++	Offer Letter between the Registrant and Craig A. Dynes dated September 7, 2006. (Filed as Exhibit 99.1 to the Registrant's September 7, 2006 Form 8-K and incorporated herein by reference.)

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10.18	Amendment Number 10 to Lease Agreement dated July 24, 2006 between the Registrant and NOP Riverfront LLC. (Filed as exhibit 10.1 to the Registrant's September 30, 2006 Form 10-Q and incorporated herein by reference.)
10.19++	Amendment to Stock Option Agreement between the Registrant and Richard H. Jones dated December 29, 2006. (Filed as Exhibit 99.1 to the Registrant's January 4, 2007 Form 8-K and incorporated herein by reference.)
10.20++	2008 Section 16 Officers Corporate Incentive Compensation Plan. (Filed as Exhibit 99.1 to the Registrant's February 21, 2008 Form 8-K and incorporated herein by reference.)
10.21++	2008 Section 16 Officers Base Salaries and Target Bonus Payments. (Filed as Exhibit 99.2 to the Registrant's February 21, 2008 Form 8-K and incorporated herein by reference.)
10.22++	Notice of Grant of Award and Award Agreement. (Filed as Exhibit 99.1 to the Registrant's December 13, 2007 Form 8-K and incorporated herein by reference.)
+21.1	Subsidiaries of the Registrant.
+23.1	Consent of Independent Registered Public Accounting Firm Deloitte & Touche LLP.
+31.1	Certification pursuant to Exchange Act Rules 13a-14 and 15d-14 of the Chief Executive Officer.
+31.2	Certification pursuant to Exchange Act Rules 13a-14 and 15d-14 of the Chief Financial Officer.
+32.1	Certification pursuant to 18 U.S.C. Section 1350 of the Chief Executive Officer.
+32.2	Certification pursuant to 18 U.S.C. Section 1350 of the Chief Financial Officer.

++ Management contracts and compensatory plan or arrangements required to be filed pursuant to Item 15(c) of Form 10-K.

+ Filed herewith