



Letter of Comment No: 4771  
File Reference: 1102-100

June 17, 2004

FASB Director  
File Reference No.: 1102-100 Stock Option Expensing

Dear FASB:

I am writing to express my deep concern over the proposal to expense stock options. As CEO of Entropic Communications, I would like to express my strong disapproval in treating options as an expense item. By way of background, Entropic is a privately-held venture-backed start-up company in San Diego, California. Entropic is focused on developing a breakthrough technology that will allow consumers to share their digital video recorder (DVR) content and other multimedia, including internet, digital music, and personal photos and videos with any TV or PC in the house using the existing coaxial cable in the house. We have been able to attract some of the brightest people in the consumer electronics and communications semiconductor industry to our team by the use of stock options. Start-up companies like ours use stock options to attract and retain key employees to high risk ventures, and provide them the proper risk/reward ratio versus established enterprises.

In my view, it does not make sense to expense stock options. First, it is very difficult to place a value on stock options, even for a company with a publicly traded stock. The Black-Scholes method was designed for publicly traded options that are fully tradable and fully vested. Employee incentive stock options and non-qualified stock options do not meet that test. In fact, it is very difficult to devise a method to place an accurate value on an employee stock option. This becomes even more difficult in a venture-backed privately-held company like ours, where there is no liquidity in the underlying stock security.

The current method for accounting-for a stock option, by taking into account the impact of the option into fully-diluted earnings per share, makes a lot more sense to recognize the impact of stock options to investors. By expensing stock options, using an inaccurate valuation method, it significantly distorts the actual financial performance of an enterprise. It also means that you are "double counting" the effects of the stock option by also including the impact of options in fully diluted earning per share. All of these effects are exacerbated in a privately-held venture-backed start-up where the stock has no liquidity, and potentially no value. If you look at historical returns on venture capital funds, it is clear, even with an aggregated basket of venture-backed companies, that it is very difficult, if not impossible, to accurately assign a value to the stocks of a new enterprise, much less assign a value to an illiquid derivative security in that enterprise.

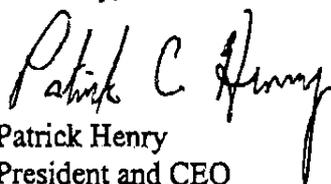
Specifically, expensing stock options will significantly curtail the use of stock options as an incentive to attract key employees to start-up ventures. As mentioned above, small venture-backed companies are unable to compete with larger companies based on cash compensation, so we use stock options to attract key employees and provide a significant potential upside to reward for the significant risk associated with joining a small venture-backed company.

Most of the innovation in the US today is from smaller private venture-backed start-up companies, and the US's competitiveness is contingent on the viability of our innovating new technologies and products. The US is at a significant disadvantage to other countries relative to our labor costs and other factors, and taking away the key method for attracting top talent to start-ups would be another blow to US competitiveness in the global economy.

In addition to the fact that it just does not make sense to expense stock options, small companies cannot afford the accounting overhead associated with expensing stock options. The overhead associated with this accounting treatment is just another burden on an already difficult cost model for starting a new company that is developing innovative technologies.

Although there is tremendous political pressure to "do something" after the various financial accounting scandals, expensing options will not help. In fact, it will significantly distort financial performance. I respectfully request that you consider these factors and recommend against the expensing of stock options, especially for privately-held start-up companies.

Sincerely,



Patrick Henry  
President and CEO  
Entropic Communications, Inc.