

Letter of Comment No: 4407  
File Reference: 1102-100

# COGNEX

Vision for Industry

Stacey Sulay

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email: [director@fasb.org](mailto:director@fasb.org)  
fax: 203-849-9714  
Original by Mail

Director  
Financial Accounting Standards Board  
401 Merritt 7,  
Norwalk, CT 06856-5116

Dear Sir:

This correspondence is in reference to File Reference No. 1102-100, and is in regard to the issue of establishing the proper accounting treatment of employee stock options ("to expense or not expense," that is the question).

Cognex Corporation (NASDAQ: CGNX) is the leader in its field. We design, manufacture and market machine vision systems which are very sophisticated computers that can "see." Our vision systems ensure that products...ranging from chocolate chips to computer chips...are produced at the highest quality and at the lowest cost in factories around the world. Cognex's annual revenues will likely exceed \$200 Million this calendar year; we have a strong track record of profitability which has allowed us to build a very strong balance sheet with over \$330 Million cash and no debt. And, today, because of our continued success, Cognex has a market capitalization in excess of \$1.5 Billion!

But, on the day that I started Cognex in 1981, there was nothing other than a vague plan and three employees who believed in my dream for what Cognex could one day become. My dream became a reality, in large part because I granted stock options to those early employees...and to every employee who joined the company in the following 23 years. Those stock options successfully aligned the interests of the employees with the interests of the company's stockholders and its customers. The company became a public company in July of 1989, and since that time, the stock has always traded far above that opening price. The stockholders won, the employees won and the customers won. And, of course, the U.S. economy won! We've paid millions in taxes and we've created hundreds of high paying, high-tech jobs. All, because Cognex was able to attract and retain smart, hard-working individuals who were willing to take a risk in exchange for the potential upside made possible by those stock options.

I imagine that most knowledgeable people will agree that stock options are a great incentive for employees...that's why we grant them. Most people will also agree that they are valuable...that's why people work harder and work longer hours when they have them. So, to argue that they aren't valuable is foolish. The key question is how to value them and how to reflect that value in companies' financial statements. The remainder of this correspondence will give you my view on this topic.

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I have two assumptions. First, I assume that FASB and all of the companies that currently grant employee stock options will agree that stock options are an important benefit to society, and, therefore, that nothing should be done to decrease a company's ability or willingness to continue the practice of granting options. Next, although I do not agree with the expensing of stock options, I assume that FASB will pass some rule or regulation that requires companies to show that "expense" in its financial statements.

Based on the first assumption above, it is crucial that companies continue to be able to grant options as readily and as generously as their shareholders have allowed them to in the past. Any increase in the complexity of granting stock options (e.g. calculating the value of those options for accounting purposes, or allocating that value to various components of the P&L) and any method for accounting for those options that affects reported earnings will immediately lead to a decrease in the number of options granted. Some companies will just stop granting options entirely (as Microsoft has done), while others will grant fewer options, and likely limit those that they do grant to the most senior executives. The effect of expensing of stock options will be devastating, UNLESS (a)the "value" of the options is calculated in a very understandable and objective way that EVERY company must follow, and (b)the "expense" associated with those options is stated in the P&L in a way that can be readily "backed out" so that shareholders/analysts/fund managers can calculate each company's performance without the effect of non-cash charges such as employee options.

With regard to deciding upon a method for valuing the options, I believe that FASB should conclude that the value of the option is determined NOT at the time when the option is granted but at the time that the option is exercised. And, that the value of the option at that time is equal to the number of option shares exercised multiplied by the difference between the then trading price of the stock and the option exercise price. This valuation method that I propose has the following clear benefits:

- It doesn't depend on any assumptions (e.g. the likelihood that the employee will meet all of the vesting criteria and will get to exercise the option, the future price of the stock, etc.), and, therefore, every company will compute the value in the SAME way.
- It depends only on objective data (it can't be "fudged")
- It is easy to calculate and for auditors to check
- It accurately reflects the financial benefit that the employee received
- It is identical to the IRS's determination of the financial benefit to the employee
- It is identical to the IRS's determination of the "expense" to the company
- It accurately reflects the true "cost" to the company (since the company could have sold those shares for the then current market price).
- It reflects the cost to the company at the time that the cost actually occurs

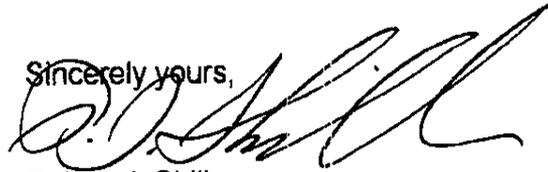
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The only negative of my proposed method is that the full expense comes at the time when the employee exercises the option, rather than spreading that expense over the full vesting period. In my view, this negative is small compared to the benefits that I've listed. And, if the P&L states this expense in a way that can be "backed out," it really shouldn't matter that the entire expense occurs at one point in time.

Employee stock options have played a crucial role in the success of my company and of many other high-tech companies. I urge you and the members of FASB to carefully consider my proposal for the accounting treatment of employee stock options.

Sincerely yours,



Robert J. Shillman  
Chairman and C.E.O.

RJS/dp