

I am the Chief Executive Officer of California Micro Devices, a small public semiconductor company with 140 employees and annualized revenue between sixty and seventy million dollars. Three years ago, following the collapse of the telecom bubble, CMD was in crisis and in danger of failing. I joined the company at that time and, as the result of the hard work of our employees together with major structural changes in the company, CMD has now completed a successful turnaround, achieving record revenue and net income in the fiscal year which ended in March of this year.

Why is any of this relevant to your deliberations on the accounting treatment of stock options? The answer is that without stock options it is extremely unlikely that we would have been able to attract, retain and motivate our employees to the extent that was required to accomplish what we have over the last three years. During this period more than half of the options granted were granted to employees who were not officers of the company. (Of the options granted to officers, more than sixty percent were initial grants aimed at attracting new senior management talent to CMD.) Furthermore, more than three-quarters of our current employee base have been granted stock options. In addition to helping CMD survive and prosper, these grants have made a real and very positive difference in the lives of our employees as they are only too happy to confirm.

I do not believe that our experience is unusual. I think that you will find that a key ingredient in the success of many small companies has been their ability to use stock options as an important element of their compensation strategy not only for their senior management but for their larger employee population as well. Furthermore, as the authors of **In the Company of Owners** have pointed out, companies that employ broad based option plans have generated more economic value than companies which restrict option grants to their upper echelons.

If the current proposal to require expensing stock options is implemented, it will have a chilling effect on their use. In fact, we have already seen many companies reduce or eliminate stock options grants in anticipation of such a change. Unfortunately, in my opinion, the ultimate consequences for the U.S. are likely to include less innovation, slower economic growth and reduced national competitiveness. It is unclear to me why anyone would want to run that risk without a thorough analysis of the possible outcomes.

In addition, I cannot understand the conceptual grounds for expensing options. I do agree with Warren Buffet that options which vest and are exercised represent a benefit to the employee and a cost of doing business. However, *that cost is borne by the other shareholders and not by the company*. This reality is already reflected in the diluted share count and earnings. As Lawrence B. Lindsay has recently observed, granting an employee stock option does not reduce the net

asset value of the company. Only if the company repurchases shares to offset the dilution does the cost burden shift to the company. Presumably thoughtful shareholders are happy to share their returns with option holders since they recognize that doing so has helped to create those returns in the first place.

If the argument for expensing options granted to employees is that they represent an opportunity cost for the company, then I have an observation and a question. The observation is that if CMD offered to sell options to the market with attributes similar to those of employee stock options, I can assure you that the market value would be negligible and certainly nowhere close to what a Black Scholes calculation would indicate. The question is when did we begin expensing opportunity costs? If this has become the basis for accounting then there are many larger ones that we are currently overlooking.

In closing, I would like to say that expensing stock options represents a serious risk to the vitality of one of the most dynamic segments of our economy that should not be lightly undertaken. Further, the conceptual basis for doing so is far from clear. I urge you to reconsider your position on this very critical topic.

Sincerely,  
Robert V. Dickinson  
President and Chief Executive Officer  
California Micro Devices Corporation