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File Reference: 1102-100

Stacey Sutay

Subject: FW: File Reference No. 1102-100

-----Original Message-----
From: Randy Weaver [mailto:rweaver@nai-online.com]
Sent: Monday, May 17, 2004 8:04 PM
To: Director - FASB
Subject: File Reference No. 1102-100

This letter replaces the letter which was inadvertently sent earlier today. Please use this version of the letter for circulation and review.

To the FASB:

I am the President of Natural Alternatives International, Inc. a NASDAQ listed company with annual revenues for our 2003 fiscal year of approximately $55 million. We expect to complete our 2004 fiscal year ending in June with higher revenues and hope to continue our growth trend. Three years ago, NAII was in a difficult financial situation. Now, we are posting regular, growing profits and are well positioned for future growth.

A significant reason for our turnaround, growth and growing profitability is that we have been able to attract quality management throughout the organization and have continued to invest in equipment, facilities, research, product development and quality. We have accomplished this with the judicious use of stock options as an incentive to increase shareholder value. In addition to options being awarded to top management, we have issued options to many in a position to have a direct impact on increasing shareholder value.

What does all this have to do with the issue of expensing stock options? I have looked at the potential impact of expensing stock options on smaller companies and have come to the conclusion that smaller companies may have to dramatically reduce, or even eliminate, the issuance of stock options especially as a broad based incentive for employees.

Regardless of how limited the option grants may be, expensing options may have a material impact on the income statements of smaller companies. If options are granted and expensed, in order to offset the earnings reduction from the stock option expense, companies may be forced to make some very tough choices. They may be forced to report significantly lower earnings or reduce investments in research, facilities, equipment, product development or quality. If smaller companies elect not to issue options, and eliminate options as a part of the compensation program, it may be difficult for a relatively small company to recruit and retain the skilled management necessary to continue growing. Larger companies have additional flexibility. The value of options for a few key executives is not likely to have a material impact on their earnings, and they are able to offer cash and other compensation that smaller companies may not be able to match. Larger companies with broad based option programs may also be negatively impacted as well.

One of the other uses of stock options is to recruit and retain qualified Board members. Typically, smaller company Board members are paid very little in cash compensation. It can sometimes be difficult for smaller companies to recruit skilled, independent Board members. With the added burden of expensing options, and the likely reduction in the options to be issued, it may become even more difficult or expensive to recruit and retain effective, skilled and independent Board members. Without a continued move toward independent Boards that provide improved oversight, shareholder value and corporate governance for smaller companies could be negatively impacted.

At most smaller companies Board members, executives and employees are not "getting rich" from stock options as some executives in larger companies may be. Executive compensation programs in most smaller companies are far from excessive. Under the current options methodology, to the extent companies are able to generate additional shareholder value, executives and other option holders are able to participate in the increase in overall value, but only while shareholders receive much greater appreciation. Where there is no future increase in shareholder value, there is no participation for option holders. In contrast, some compensation programs reward executives with excessive pay packages regardless of future performance while shareholders may receive little or nothing in return.

While I am generally supportive of the reforms brought about by recent events, I think the cost to smaller companies has been a significant burden. We abide and will continue to abide by all the requirements promulgated by the appropriate authorities.

In the case of expensing options though, I think the FASB should proceed cautiously. The methods proposed for expensing options are unreliable and could serve to limit growth or diminish shareholder value for smaller companies. The proposed methods don't fully take into account the fact that options are contingent on future increases in shareholder value.

As I see it, options granted to employees are an agreement to apportion the future growth in shareholder value. In effect, shareholders (who I believe are required to approve all option plans) are saying, if performance is such that shareholder value increases, we agree to give you some of our shares. As such, **options are much closer to a stock dividend granted to shareholders than they are to an expense**. In my view, options issued to employees and others are simply a redistribution of equity among third parties rather than a period expense. To treat stock options as a period expense, regardless of the method of measure, is inappropriate.

While the FASB may be under considerable public and political pressure to "do something" about excessive executive compensation, I think there far more effective ways to accomplish the goal. For example, I would suggest that the total compensation of both executives and Board members could be spelled out on the face of the financial statements (quarterly and annual), and the detail compensation by individual, including options issued and exercised, could be spelled out in the notes thereto. I believe such disclosure will help the average investor evaluate executive compensation far more than attempting to decipher a stock option valuation that is difficult to understand at best. In summary, I believe the desire of shareholders is for transparency not for another subjective measurement that could be manipulated and is difficult to compare.

If the FASB wants to highlight the number of options or the theoretical value of options granted, it might be more meaningful to do so as a reconciliation between "Net Income" and "changes in Equity". In that way, investors can choose the measure which is most meaningful to them while the integrity of the income statement will not be compromised.

Regardless of what you decide, many people will be unhappy. I wish you the best in attempting to resolve this rather complex issue.

Thanks,

Randy Weaver
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