Letter of Comment No: 3067 File Reference: 1102-100

Ralph J. Folz Molecular Inc. 343 Arsenal Street Watertown, MA 02472 June 3, 2004

FASB

By E-mail: director@fasb.org

Dear FASB,

Please consider this a comment letter in response to File Reference Number 1102-100, Proposed Statement of Financial Accounting Standards – Share Based Payment. Below is a high level paragraph with my comments, followed by a specific response to a few of the issues where comments were specifically requested.

I have two major issues with the Share Based Payment Exposure Draft.

Public vs. Private Companies:

For every public company in Massachusetts, there is an order of magnitude more of private companies. These private companies do not have a stock price that is driven by free markets and changes every day. It is this issue that will cause any valuation method to be highly suspect.

Companies that issue stock options tend to be venture backed. The deal structures of venture investing includes things such as accrued dividends, ratchets, preference rights, and multiple rounds with multiple investors that layer on top of each other. Determining a exercise price for common stock options is already challenging and somewhat of a black art. Are we going to let this black art bleed into our financial statements?

Realization of Value:

My company is ten years old this year. We are a technology consulting company. If you look back at the last five years, many of our competitors (both public and private) are gone. Some were acquired, but the vast majority went out of business.

Starting a company is hard. It isn't always successful. We have all seen the stats about how many companies are still around 5 years after they have started. What are the chances of a company being started, funded, and ending in a successful liquidity event (acquisition or IPO)? It is certainly less than 50%. I bet the percentage is even closer to 10%.

My firm has over 100 employees. When I have a company meeting and we are discussing stock options I ask people to raise their hands if they made money with stock options in their past employment history. Very few, if any, people raise their hands. Some of them had options in the money at one point, but even that small minority didn't realize value at the end of the day.

Even though the chances are remote, I am a big believer in stock options. Every person in my company has stock options. We set expectations appropriately that options are not compensation. They are a chance to participate in something should we build a great company of value together. It's a <u>chance</u>. They are motivating, but it is a <u>chance</u>.

In summary, how can we distort the financial statements of every firm, for the very small few where the options actually turn into value?

<u>Issue #1</u>: I do not believe stock options are compensation, in fact we go out of our way to avoid calling them compensation. They are a tool to align employee interest with investor interest and keep everyone on the same page. They are a chance to partake financially if something of value is created.

<u>Issue #4(a)</u>: FASB could provide more guidance to private companies with venture investing on how to set exercise prices of options based on a variety of factors. The challenge here is that once FASB defines how private companies should factor in preference rights, accrued dividends, and other venture mechanisms into an exercise price, the venture community will have ten new mechanisms they use to insure value in their investments.

<u>Issue #4(b):</u> A real example:

- We were a private company from 1994 until April of 2000. In that period, certainly possible for a Board to assume a valuation based on public comparables.
- In April of 2000, we received a \$20M investment at a ten times revenue valuation (\$125M valuation). At this point, exercise price becomes more complicated. This deal had preference rights, accrued dividends, and many other components.
- In 2001 and 2002, the Internet bubble burst. At one point, the accrued dividends and preference were so much, and public firms were valued so little, that one could argue the options had zero value (the investor essentially owned the whole company). Therefore, we went from \$125M valuation in 2000, to options worth nothing in 2002.
- In 2003, we bought out our preferred stock from our investor. Paid some cash and they still have a note that is convertible to common stock in the future. What is the exercise price of our options now? Do we assume they convert to common stock?

This is a real example. Our actual exercise prices over time varied by a factor of 50 and this was with the advice of our big-5 audit firm over this time period.

Commenting on the additional issues results in the same points I am driving home above. While I have highlighted primarily private company issues above, I fear this Exposure Draft would end stock options as we know them today for firms of all types. Please do not eliminate this powerful tool of the United States entrepreneurial engine.