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From: Fillat, Andy [AFILLAT@AdventInternational.com]

Sent: Wednesday, May 26, 2004 4:55 PM

To: Director - FASB

Subject: Options Expensing Comments

Gentlemen/Ladies,

I am currently a Managing Director at Advent International Corp., a diversified private equity manager covering the US, Europe, Latin America, and Asia. We do deals ranging from startups to substantial companies of revenue levels of several hundred million dollars.

While I understand your focus is mainly on accounting principles, I would first comment that the expensing of options is fundamentally bad economic policy. For the sake of a perceived accuracy of accounting (which I mightily dispute), you are putting at risk some of the most vibrant and growing parts of our economy. If it were possible to value options properly, there could be an intelligent debate on this matter. But given the inherent uncertainty of assessing the true value of options, you are taking a policy risk that is drastically disproportionate to the potential benefit. The fact that the political winds are in your favor because of the heinous behavior of some managers attempting to become rich by inflating their option (or stock) values is no reason to resort to putting a ball and chain on the incentive systems of our economic growth engines.

But I will end that issue there and turn to the specific matters associated with expensing stock options. I understand only too well the problems of valuing assets with highly uncertain intrinsic value. All venture capital portfolios contain assets of highly uncertain value. We constantly try to figure out how to balance the need to provide information with the competing issues of accuracy, incentives to be conservative, incentives to be optimistic, and the intrusion of unforeseen events. In the end, the value of most of our investments is simply and purely unknowable for much of their lives. So we carry our portfolio mostly at cost with occasional write-ups when an outside transaction validates the company's value at a point in time, and write-downs for both a financing event and when there is a concern that value may be impaired based on circumstances. Most of those write-downs are wholly subjective. Frankly we have never been able to identify any meaningful correlation between our carrying values and the ultimate values of the companies until they are near the end of their life-cycle with us.

I go into this because the conundrum of valuing options in a private company is directly tied to this uncertainty. Putting aside until later the issues with public companies, trying to value options in private companies that are encumbered by senior securities standing above them (the case 99% of the time) in the face of never really knowing what a company is worth is ludicrous on its face. Further, it serves no useful purpose whatsoever. Until a sale or public offering puts a true value on the stock, the value of options is unknowable and can only be estimated with the thinnest of guideposts. Attempting to expense options based on Black Shoals or polynomial or Black Magic can only be based on purely theoretical assumptions (e.g. what does a beta value mean for a company whose value is not truly known for long periods and changes only in sudden increments?) Recording expense based on third-party valuations is also ridiculous, as NOBODY can actually value the companies with any true accuracy anyway, and it imposes an awful burden of expense and time on small companies trying to create something of true intrinsic value to its shareholders. Bottom line, there is no common sense to expensive private company options at all other than the pursuit of some theoretical accounting purity. I grant that many assets are of only estimated value. We don't attempt to revalue hard assets all the time; we only try to respond to obvious big events. Why is this attempt to value options necessary by comparison?

On the public company side, there is obviously some continuous tracking value for a company as measured by its stock price. That does suggest that options can be valued. But haven't they been valued by the common stock equivalent calculation used to determine EPS? Plus, no matter how good any formula may be, it simply cannot predict the market value of the stock and hence the options. Letting the CSE calculation fluctuate with time and events does a very adequate job of showing how stock price fluctuations affects operating results.

Finally, let me relate a real-life experience with one of my companies when it was public to illustrate the absurdity of using formulas to value options. We granted a very important consultant 100,000 options at the then-market price of $10. Of course, under the normal rules, we recorded zero expense. A quarter later, the stock had sunk to $5 because of legitimate operating problems. But our accountants insisted that under variable accounting rules we had to now record a compensation expense. Because the stock had gone down quickly, according to Black Shoals, the options were now worth more than they were when the stock was at $10. Certainly the consultant didn't think so. Nobody with a double digit IQ or higher would believe the formulaic answer. By the way, the options ended up being valueless.

I cannot see why you would wish to inflict so much of this counter-intuitive reporting orthodoxy on the investor world. Since nobody can predict the future, how can any valuation of options even in a public company be more than a gross approximation with its own high beta of accuracy. Has the investor really been served? The answer is no, and the only motivation of expensing options is to limit their use by virtue of the reporting being so inaccurate and hence burdensome. That takes us back to the policy question raised first.

Please get off this crusade. You are playing with fire and a lot of people will get burned badly, far more than have ever suffered because corrupt managers were trying line their own pockets. They would have done it no matter what the form of their equity or earnings-driven compensation.

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