



UNDERWATER STOCK OPTIONS

Equity Consulting Solutions from Radford

Underwater stock options present significant challenges for a growing number of companies in today's economic environment. Radford's equity consultants are the foremost experts on underwater option exchange programs, having worked with more than 100 companies on these programs in a wide array of industries. Our thought-leading consultants and nationally-recognized Topic 718 accounting experts offer an unmatched combination of experience in assessing, designing and implementing innovative underwater stock option exchange programs that create measurable value for our clients, their shareholders and employees.

"We chose to work with Radford because of their specific expertise with these unique programs. Their combination of extensive client experience with underwater exchanges and deep FAS123(R) valuation knowledge is unmatched. Radford was able to work with our senior-level, cross-functional team and facilitate decision making on complex design issues, carefully balancing both shareholder and employee perspectives in the process."

Billy Vitense
Director, Stock
Starbucks Corporation

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Radford Locations

Austin, Atlanta, Boston,
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Our Approach: Radford's End-to-End Exchange Assessment, Design and Execution

Radford consultants work directly with the HR, Legal and Finance team, as well as C-level executives and the Board, to guide the evaluation, design and execution phases, including:

- > Evaluation of our client's current equity situation, clarification of objectives and initial recommendations
- > Potential interim solutions before an exchange program should be considered
- > Insight on market practices and shareholder voting patterns on actual underwater exchange proposals
- > Exchange program alternatives (options-for-options, options-for-restricted-stock, and options-for-cash)
- > Exploration of pros and cons of alternatives from perspectives of shareholders, employees, company
- > Counsel for all major design elements, including eligibility by participant and for existing grants
- > Determination of underwater-to-new share exchange ratios, and vesting requirements
- > Sophisticated option valuations required for stock option expensing under Topic 718
- > Calculations for potential impact to shareholder dilution and equity plan share reserves
- > Advice on maximizing shareholder approval potential
- > Assistance for tender offer administration, external audit procedures and employee communications

Exchange Project Example

In our experience assisting many companies through this process we generally see three distinct phases:

1. Alternatives Evaluation and Initial Modeling
2. Design Finalization
3. Implementation

Phase 1 – Alternatives Evaluation and Initial Modeling

Because the modification of outstanding stock options will have an impact on many areas of the organization, we recommend clients assemble a multi-disciplined team for the engagement. Representatives from Human Resources, Finance and Legal are critical. During this phase, we will:

- > Understand the current situation and material background information
- > Clarify primary objectives and potential challenges
- > Discuss shareholder approval requirements under company plan(s)
- > Provide an overview of exchange program alternatives (options-for-options, options-for-restricted stock or options-for-cash)
- > Discuss critical design considerations and their implications from multiple perspectives (employees, company and shareholders)

At the end of Phase 1, we will analyze outstanding stock options using Radford's proprietary valuation and exchange models to quantify the impact of alternative designs. We will summarize our methodologies, assumptions and final program design recommendations in a report to be reviewed and discussed with the Compensation Committee of the Board.

Phase 2 – Design Finalization

Radford will assist in facilitating decisions among senior management and the Board to finalize program design terms, including:

- > Option holder eligibility
- > Grant eligibility
- > Exchange ratios
- > Vesting of new awards
- > Treatment of net share recaptures

In this stage, Radford will play a key role in preparing information for review by other outside advisors (e.g., auditors, external counsel), performing customized ad hoc analyses to support key design decisions and providing general project coordination. If shareholder approval is required, we will conduct an analysis of the company's shareholders' voting patterns and assist in engaging shareholder advisory firms for a review of program design, if desired.

Phase 3 – Implementation

We have experience in all phases of implementation including:

- > Development and delivery of employee communications
- > Review of tender offer plan documents (drafted by SEC counsel)
- > Review of shareholder request/proxy language (drafted by SEC counsel)
- > Assistance with external audit procedures
- > Evaluation of third party tender offer administrators (if required)

We will integrate our services with other providers in a coordinated and cost-effective manner to ensure the successful rollout of the underwater exchange program.

To Learn More

Radford's Underwater Option Portal (www.UnderwaterExchange.com) provides a variety of complimentary resources for companies considering an option exchange, including updated company lists and summaries of recently executed programs, white papers, insight on shareholder voting on past exchange proposals, accounting considerations, an exchange ratio calculator and more. Further information on Radford's underwater exchange team, including bios, contact information and recent press coverage, is also available on the portal.