

Designing and Executing Underwater Option Exchanges

An Expert Panel Discussion

November 13, 2008

Presenters

Wendy Jennings, Director, Riverbed Technology, Inc.

Matt Martin, Vice President, Advanced Micro Devices, Inc.

Joseph Yaffe, Partner, Latham & Watkins LLP

Terry Adamson, Senior Vice President, Radford Surveys + Consulting

Brett Harsen, Vice President, Radford Surveys + Consulting



Agenda

- Introduction
- Background Market and Regulatory Activity
- Discussion of Key Program Design Considerations
- Overview of Implementation Challenges
- Getting Started
- Questions and Answers



Panelists

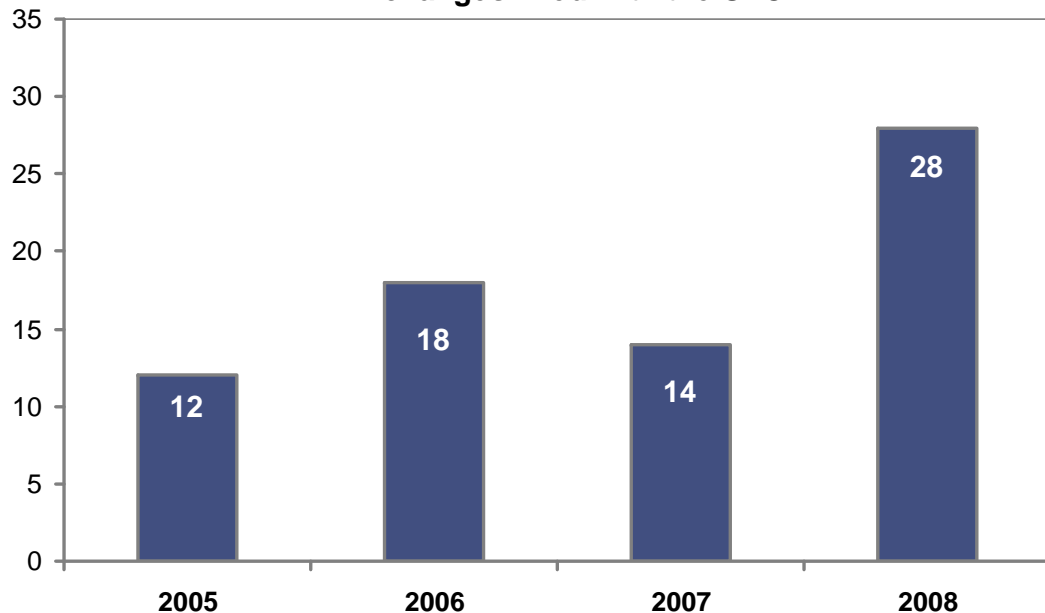
- Matt Martin
Vice President, Compensation & Benefits
- Wendy Jennings
Director, Employee Shareholder Services
- Joseph Yaffe, Partner
- Terry Adamson
Senior Vice President, Radford Valuation Services
Practice Leader
- Brett Harsen (*moderator*)
Vice President, Radford Advisory Services





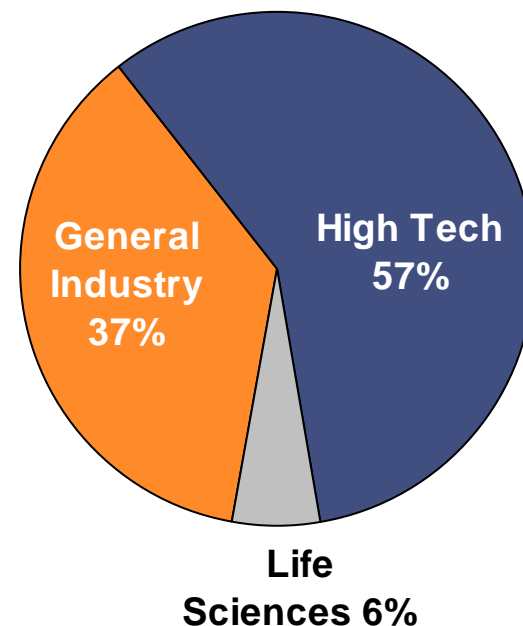
Market Activity from Radford's Tender Offer Research

Number of Underwater Option Exchanges Filed with the SEC



n=72

Industry Breakdown



www.UnderwaterExchange.com



Regulatory Activity

- NYSE and NASDAQ shareholder approval rules for equity-based compensation plans
- FAS123(R) mandatory implementation



Exchange Alternatives

Approach	Description	Advantages	Disadvantages
Options-for-Options (44% of offers)	Cancellation of underwater options followed by an immediate regrant of (<i>typically fewer</i>) new options	<ul style="list-style-type: none"> • Ease of communication (employees generally understand options) • Employees maintain control of taxable event (options taxed at exercise) • Some reduction in issued stock overhang (assuming fewer new options are granted than were canceled) 	<ul style="list-style-type: none"> • Potential remains for newly issued options to go underwater in the future • May not be received positively by employees if stock options have not provided value historically
Options-for-Stock (48% of offers)	Cancellation of underwater options followed by an immediate regrant of (<i>significantly fewer</i>) new shares of restricted stock/units	<ul style="list-style-type: none"> • Eliminates additional future underwater options (restricted stock cannot fall underwater) • Greater reduction in issued equity overhang from higher exchange ratios 	<ul style="list-style-type: none"> • Employees lose control of taxable event (shares taxed at vest/receipt) • Number of shares returned to employee typically reduces future upside leverage compared to using stock options
Options-for-Cash (8% of offers)	Cancellation of underwater options for a (<i>typically immediate</i>) cash payment	<ul style="list-style-type: none"> • Greatest possible reduction in issued equity overhang (no new equity shares are issued) • Eliminates additional future underwater options 	<ul style="list-style-type: none"> • Requires a cash outlay by the company • Employees lose opportunity to participate in future upside stock price growth • Lacks retention if no additional vesting used



Four Primary Design Considerations

Design Consideration	General Shareholder Advisor Voting Guidelines
Option Holder Eligibility	<ul style="list-style-type: none"> • Exclude members of the Board of Directors • Exclude executive officers
Grant Eligibility	<ul style="list-style-type: none"> • Exclude any awards that are not significantly underwater (e.g. strike price less than or equal to the 52-week high) • Exclude any awards that are less than a year old
Exchange Rate	<ul style="list-style-type: none"> • Value neutral share-for-share exchange rates (as determined by binomial models)
New Award Vesting	<ul style="list-style-type: none"> • Reset vesting for retention purposes



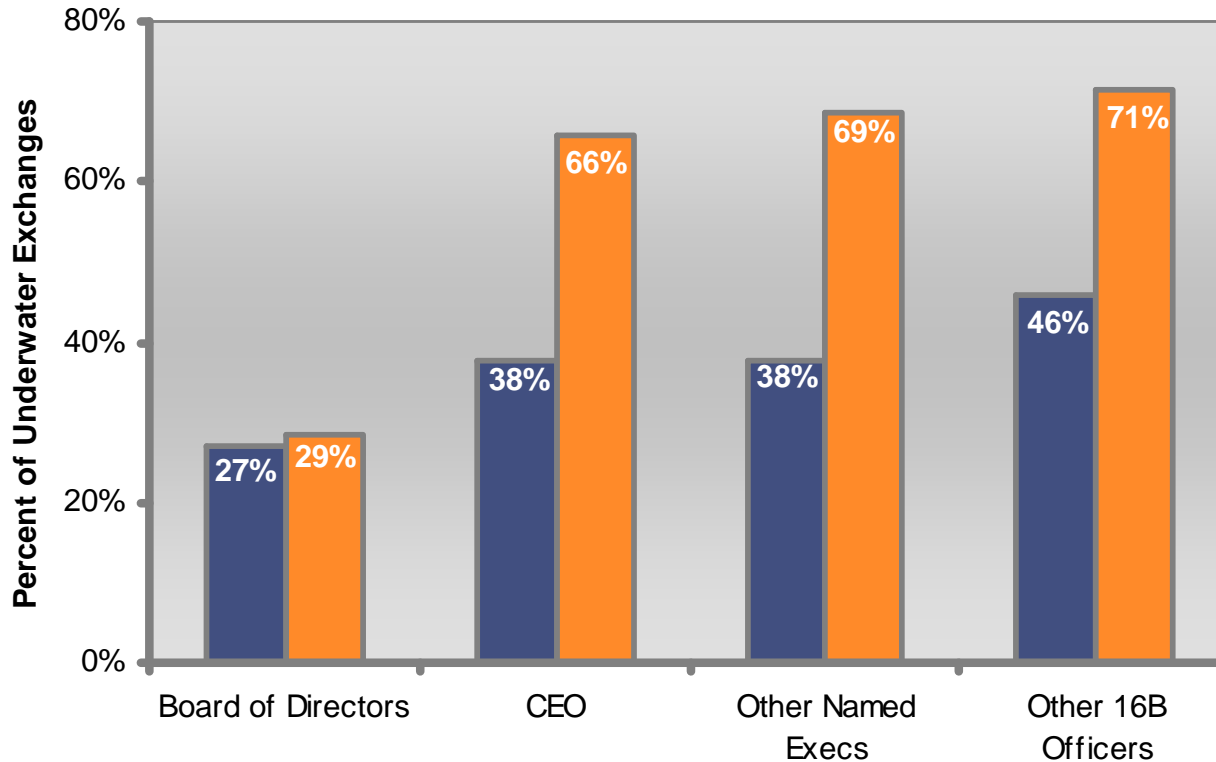
Overview of AMD and Riverbed Programs

Design Consideration	AMD	Riverbed
Approach	Options-for-Options	Options-for-Options
Option Holder Eligibility	Excluded Board and Named Executive Officers	Excluded Board and Named Executive Officers
Price Floor	\$10.00 (currently at approx. \$3.20)	\$16.40 (closed at \$14.28 at start of offer)
Exchange Ratios	\$10.01-\$14.99: 2.0 to 1 \$15.00-\$19.99: 2.5 to 1 \$20.00 and Above: 3.25 to 1	1.18 to 1 for All Awards (85% Replacement)
Vesting of New Awards	“Partial Reset” Vested Options Tendered: 1 year Unvested Options Tendered: 2 years	“Mapped” Old Vesting Credit Applied to New
Current Status	Proposal Filed, Awaiting Shareholder Meeting	Closed May 29, 2008 95% Participation Rate

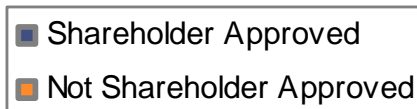


Option Holder Eligibility

Senior Leadership Eligibility



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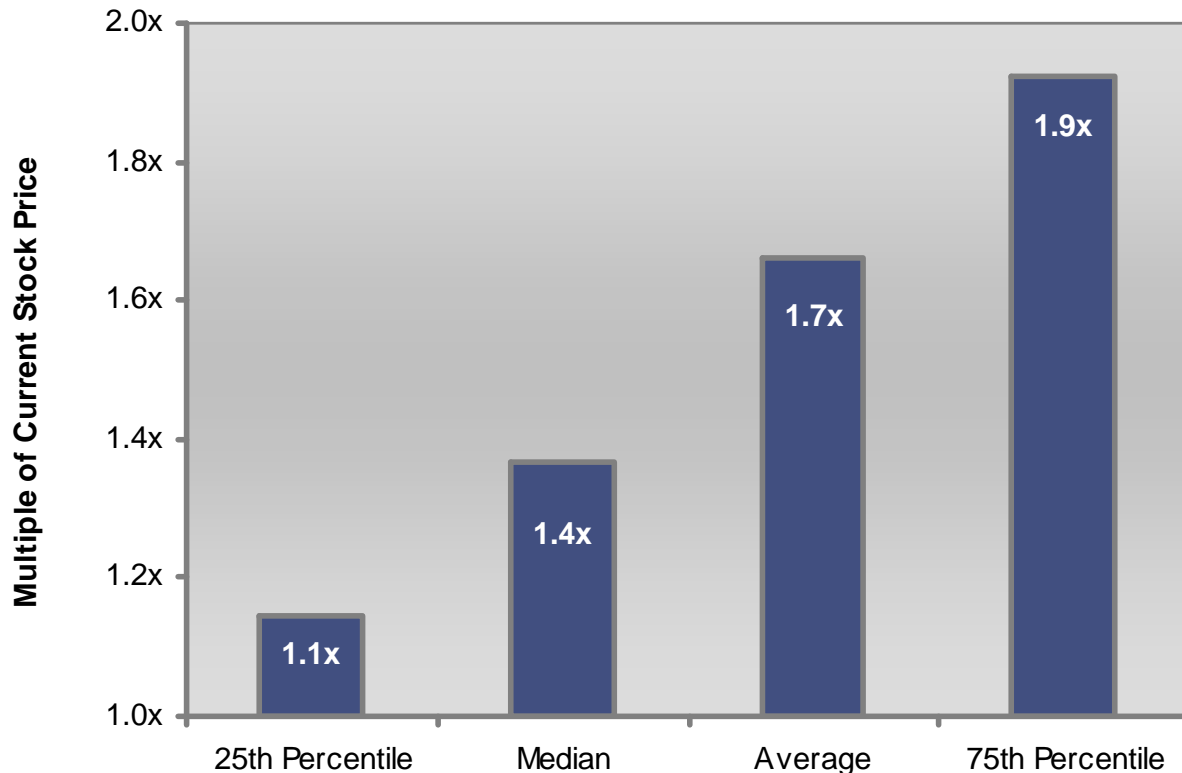


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Price Floors

Price Floor for Grant Eligibility



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RiskMetrics/ISS' guideline is to establish a floor no lower than the stock's 52-week high at the time of the offer. However, a minority of offers studied have met this guideline:

- 31% of shareholder approved plans set floor at or above 52-week high
- 16% of non-shareholder approved plans set floor at or above 52-week high



Exchange Ratios

- Modification accounting under FAS123(R)
 - Cost of original award must be accrued (cannot be reversed or decreased)
 - Incremental expense if value immediately after modification is greater than value immediately prior (recognized over remaining vesting period)
 - Cost neutral rates:

Approach	Value of Old Option	Value of New Award	Cost Neutral Exchange Ratio
Options-for-Options	\$3.00	\$9.00	3:1
Options-for-Stock	\$3.00	\$18.00	6:1



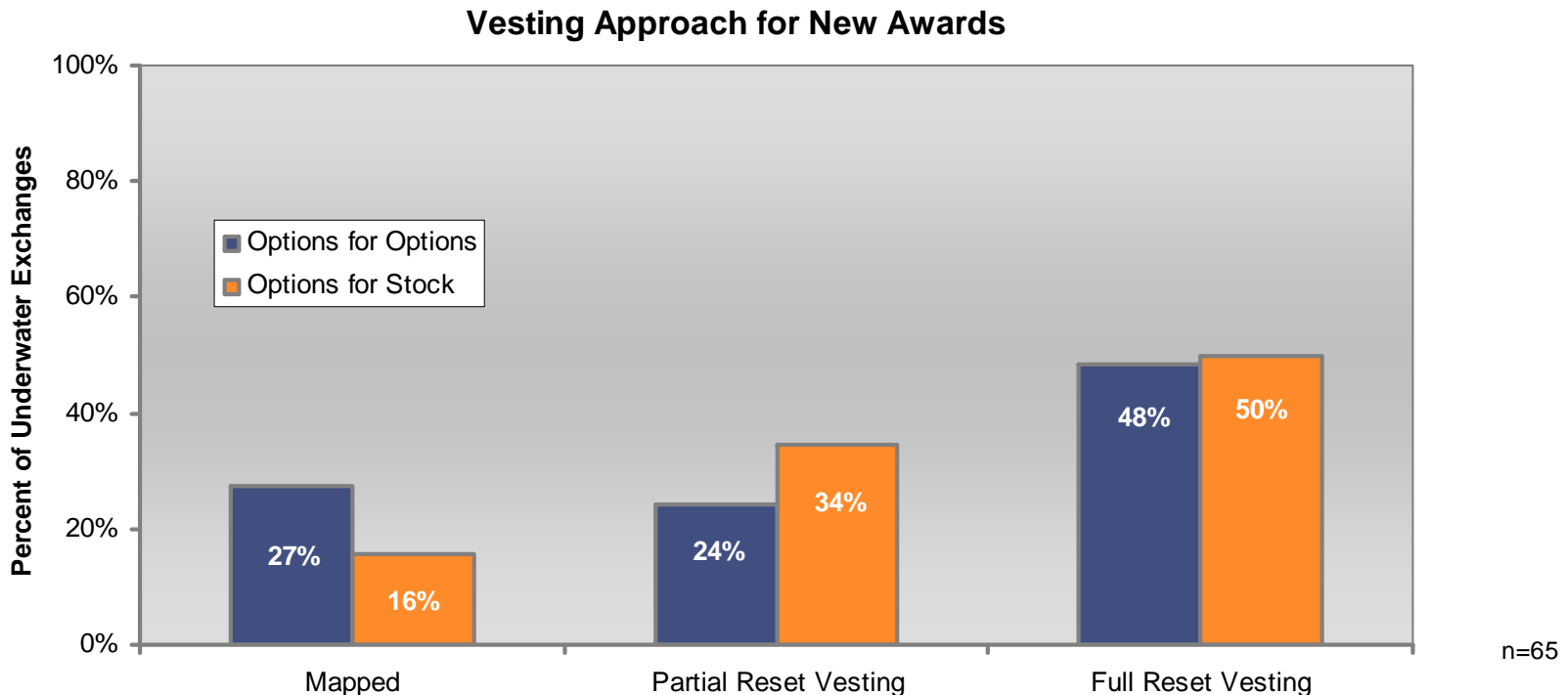
Radford Underwater Valuations

- Important to recognize underwater options must be held longer than at-the-money options
- Monte Carlo simulations to estimate occurrence of “in-the-moneyness”
- Quantify exercise behavior as a function of time **and** spread between stock price and strike price using binomial model (*traditional Black-Scholes uses only time*)

Expected Holding Period From Today (Yrs)

Stock Price/ Exercise Price Ratio	120%	2.0	1.5	1.0
	100%	3.0	2.5	2.0
	80%	4.0	3.5	3.0
Time Already Held:		0.0-2.0 Yrs	2.1-4.0 Yrs	4.1-6.0 Yrs

Vesting of New Awards



Mapped Vesting — transfers the vested position of the underwater award to the new award

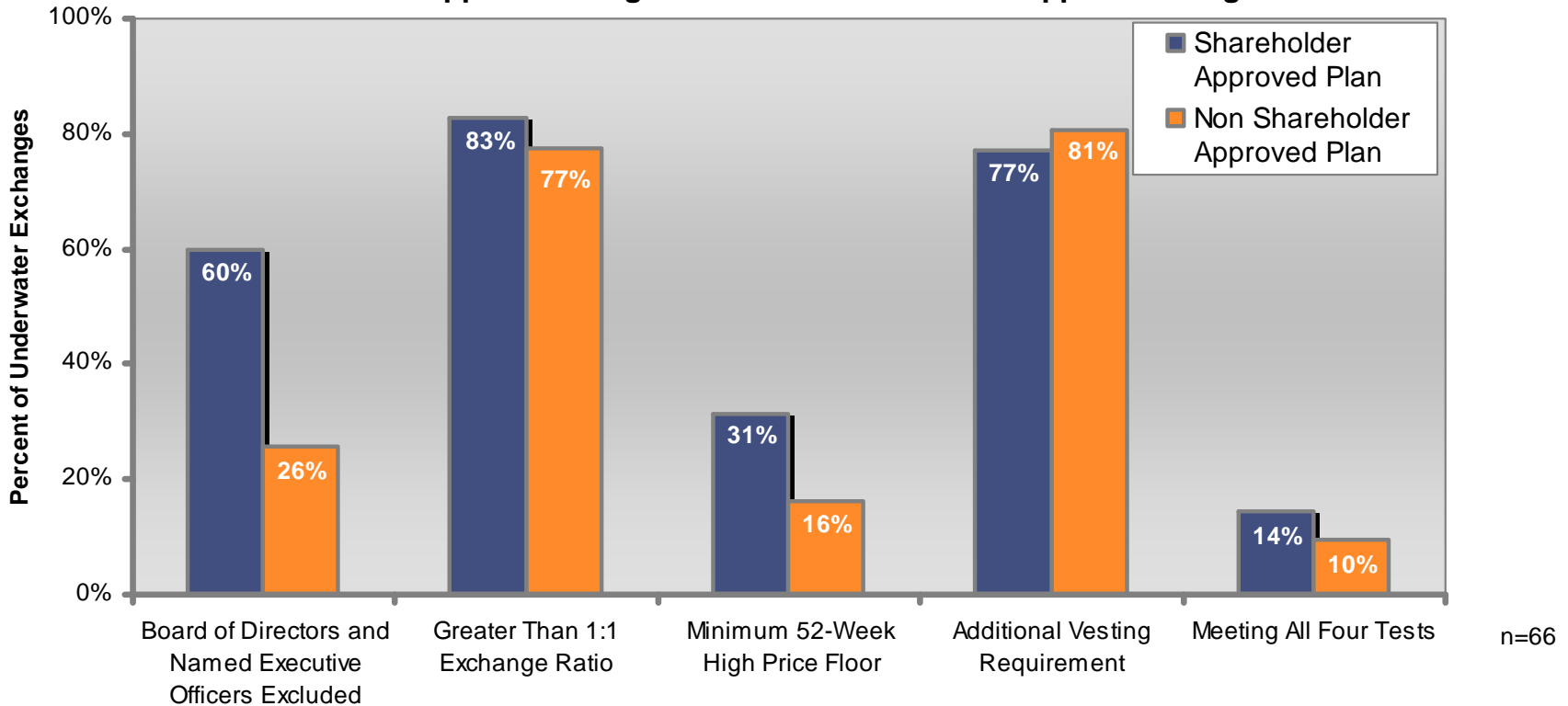
Full Vesting Reset — introduces a fresh vesting schedule to the new award based on typical practices (e.g., four years)

Partial Vesting Reset — new award is reset to zero vested at grant, but uses a shorter schedule than is typically used for equity awards (e.g., two years instead of the normal four year requirement)



Shareholder Friendliness

Pass Rates for Shareholder Friendly "Tests"
Shareholder Approved Programs vs. Non Shareholder Approved Programs





SEC Tender Offer Rules

- Must remain open for at least 20 business days
- Communication restrictions
 - Pre-commencement communication
 - Issuer endorsement of course of action
- Documentation
 - Offer to exchange (purpose, background, material terms/conditions, participation instructions)
 - Letter of transmittal (election forms)
 - Ancillary materials (e-mails, letters, presentations)
- Exemptions from tender offer rules
 - Relief from “all holders” and “best price” rules
 - Offers limited to small groups of company officers



Communication and Administration

- Vehicles used by Riverbed
 - E-mail announcements
 - Employee hotline
- Riverbed's administration
 - Program covered more than 670 option holders with close to 1,000 option awards
 - Web-based administration provided by third party
- Riverbed's lessons and tips
 - Detailed checklist
 - Project timeline



Getting Started

- Assemble cross-functional internal team
 - Human resources
 - Finance
 - Legal
 - Shareholder relations
- Engage external advisors experienced with underwater exchange complexities
 - Compensation consultant
 - SEC attorney
 - FAS123(R) valuation expert
- Begin educating senior management and Board
 - Recent press clippings
 - Radford's tender offer research
 - White papers
 - Case studies



**Questions?
Thank You!**

Radford Underwater Option Portal

www.UnderwaterExchange.com