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Technology Options Sink

Silicon Valley Considers Repricing but Risks Riling Investors

By SCOTT MORRISON

Article Comments

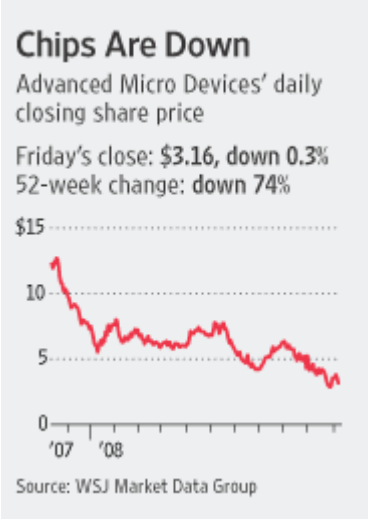
Silicon Valley is drowning in "underwater" options. But with the stock market in turmoil, investors might be uneasy bailing out high-tech employees.

Employees at scores of companies, including Yahoo Inc. and Google Inc., are holding stock options, the right to buy shares at a preset price, that have been rendered virtually worthless because those companies' shares have fallen below the exercise prices.

At chip maker Advanced Micro Devices Inc., the situation has gotten so extreme the company is planning a shareholder meeting to ask permission to reprice 99% of its outstanding options. AMD, whose stock price had fallen about 76% over the past 52 weeks to $3.16 a share at Friday's close, said this is necessary to prevent key employees from leaving.

"The vast majority of the historically granted stock options no longer are effective as incentives to motivate and retain employees," a company proxy statement said. The date of the meeting has yet to be set.

AMD of Sunnyvale, Calif., is at the leading edge of what promises to be a contentious issue for Silicon Valley: how to handle underwater options. Many companies are considering plans to



swap those options with others having lower strike prices, and such plans may be presented at annual shareholder meetings, beginning in early 2009.

They will likely face skeptical investors, who are still grappling with a stock selloff that has erased about $8 trillion in market capitalization since the market hit all-time highs last year. Many are worried that resetting options will only water down their already devalued holdings.

"For investors, the wound is deep and the wound is recent," said Pat McGurn, special counsel at shareholder advisory firm RiskMetrics Group. "I don't think there is a lot of [shareholder] sympathy for broad-based repricing."

Stock options have long been central to Silicon Valley's entrepreneurial culture. A company's ability to hire the sharpest minds is among its biggest competitive advantages. Options are seen as a tool to attract talented employees and align their interests with those of shareholders.

The strategy works well when share prices are rising, creating a virtuous circle that allows both employees and investors to profit. But when stocks fall, options become trickier. Employees, who had been expecting the options to provide part of their compensation, begin feeling underpaid. Meanwhile, shareholders are reluctant to reset prices because the stock given to employees dilutes their holdings.

Silicon Valley's current troubles aren't the first time it has grappled with underwater options.

After the market plunged in 2001, roughly one in 10 tech companies, including big names such as Apple Inc. and Adobe Systems Inc., offered workers the chance to swap underwater options for ones with lower strike prices, according to a San Jose Mercury News survey. Others, such as Siebel Systems Inc., now part of Oracle Corp., let workers trade underwater options for cash or stock, exasperating shareholders because those costs weighed on share prices.

Investor outrage over options after the last downturn prompted regulators to impose new rules requiring companies to account for options as corporate expense and seek shareholder approval before repricing outstanding options.

Now, the problem might be even bigger. More than 80% of Silicon Valley's 150 largest publicly traded companies had some employees holding options that had fallen below the strike price as of Oct. 24, according to Equilar, an executive-compensation research firm. Equilar said about 90% of chief executives at those companies had underwater stock options.

Before the recent selloff, a handful of tech companies, including UTStarcom Inc. and VMware Inc., had already pushed through repricing plans. But for those who haven't, repricing may be more difficult now.

Corporate governance specialists are leery of repricing plans. Kent Hughes, a managing director at Egan-Jones Proxy Services, said he generally recommends shareholders reject such repricing proposals because of dilution and concern they may be seen as rewarding poor management.

Some companies are trying to pre-empt shareholder opposition, designing "value-neutral" plans that allow employees to exchange existing options for a smaller number of new ones at lower exercise prices. That will help protect part of an employee's grant but avoid large-scale dilution or additional accounting charges, said compensation specialists.

"[Executives have] earned advanced degrees in compensation governance," said Brett Harsen, an analyst at compensation advisory firm Radford Surveys + Consulting, who added that half of the valley's companies are considering such plans. "Shareholders have been demanding greater balance between their interests and those of the management on all compensation-rela ted matters."

RiskMetrics' Mr. McGurn said investors will be much more sympathetic to plans that don't include executives and directors, many of whom are seen as overpaid. Shareholders also may want to see vesting schedules, the length of time employees have to work at a company before getting their grants, extended in order to entice employees to stay longer.

"I would probably lean toward [repricing] if it would help keep employees," said Ryan Jacob, chief investment officer at Jacob Asset Management, which holds shares in many major technology companies, including Google, Apple and Yahoo.

Already, grousing about options has become a new Silicon Valley pastime.

One Yahoo executive who asked not to be named said all the options he received since joining the company four years ago are now worthless. "Anyone who's been hired after I was hired, all those people are underwater," he said.

Yahoo declined to comment. Its shares closed Friday at $12.20, below where it was five years ago.

The situation is similar at Google. A third of Google's 20,000 employees hold underwater options, according to an estimate by Sandeep Aggarwal, an analyst at Collins Stewart. If Google doesn't deal with the problem, it could lose key staff, he said.

"This issue definitely has to be addressed," Mr. Aggarwal said.

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