Info Sabius

Sujet: La comptabilisation du coût des options aux dirigeants ferait chuter les bénéfices des sociétés de haute technologie de 38%.

23 avril 2004

Source : UBS, 7 avril 2004

Global Equity Research

United States

Valuation & Accounting

US GAAP

UBS Investment Research

Stock Options: The End of the Line?

7 April 2004

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Not Just Another Accounting Rule Change

- **FASB to Require Option Expensing**

FASB issued an Exposure Draft of a new US GAAP standard mandating employee stock option expensing for public companies. The comment period is until June 30, 2004. Following this period the Board intends to issue a final standard effective for fiscal years ending after December 15, 2004.

- **Expensing Would Cut S&P 500 2003 Earnings by 7.3%**

Expensing options would have cut S&P 500 First Call earnings by 7.3% in 2003. It would have cut technology sector earnings by 38.2%. We are not aware of any accounting rule change that has negatively affected any sector's earnings as significantly or as disproportionately as this rule may affect technology.

- **A Difficult Transition Ahead**

This proposed standard is far more than just another accounting rule change. It will require a significant shift in corporate behavior if reported earnings are to remain intact. We encourage managers to search for more efficient forms of compensation and we expect cash and restricted stock to largely replace options.

- **Bitter Medicine**

In our view, this long past due change is bitter, but much needed, medicine for the long-term health of companies and investors. It will shed light on the true profitability of many companies, helping to separate those that deserve investor capital from those that do not.

Les renseignements contenus aux présentes ont été obtenus de sources que nous croyons fiables mais ne sont pas garantis par nous et pourraient être incomplets. Les opinions exprimées sont basées sur notre analyse et interprétation de ces renseignements et ne doivent pas être interprétées comme une sollicitation d'offre d'achat ou de vente des valeurs ci-mentionnées. La Firme peut agir à titre de conseiller financier, d'agent fiscal ou de souscripteur pour certaines des compagnies mentionnées aux présentes et peut recevoir une rémunération pour ses services. La Firme et/ou ses officiers, ses administrateurs, représentants, associés peuvent être détenteurs des valeurs mentionnées aux présentes et peuvent exécuter des achats et/ou des ventes de ces valeurs de temps à autre sur le marché ou autrement.

Membre FCPE

Executive Summary

The US accounting standard setter, the Financial Accounting Standards Board (FASB), issued its long awaited proposal for expensing stock options on March 31, 2004. The proposal would mandate expensing of the grant-date fair value of employee stock options, starting January 2005. This proposed rule would apply to new options as well as unvested pre-existing options. The Exposure Draft is open to public comment until June 30, 2004. The FASB will also hold public hearings on the proposal later this year before it becomes part of US GAAP.

We expect the FASB to issue a final standard by the end of the year and that the US will be the third major jurisdiction, following Canada and the EU, to require companies to account for employee stock options as an expense.

The most significant impact of the proposed rule is lower reported earnings. We estimate that expensing options would have cut S&P 500 First Call earnings by 7.3% ($4.00/sh) for 2003 vs. 11.4% ($5.15/sh) for 2002. It would have cut the technology sector's earnings by 38% for 2003 as opposed to 84% in 2002. As many non-tech companies voluntarily expensed stock options in 2003, our concern on this issue is increasingly concentrated on technology companies.

We expect more corporate lobbying and rhetoric against option expensing in the coming months. However, we are confident that such resistance will prove futile and that this time investors will prevail. We remind readers that Chairman Donaldson of the SEC, which empowers the FASB to set US GAAP, has expressed formal support for mandatory option expensing. Chairman Senator Shelby of the Senate Banking Committee, which oversees the SEC, has expressed formal support for FASB and mandatory stock options expensing. The Senate has taken no action and appears unwilling to take any action to interfere on this issue. The administration has expressed its desire to support FASB and its decisions, as the country's independent accounting standards setter. Any Bill from the House would have a long way to go before having any material impact on the process.

The current practice at many companies of not expensing the fair value of employee stock option grants overstates earnings and impairs investors' ability to compare such companies that rely on option compensation with those that rely on other equity based or cash compensation. The proposal would improve both the quality and comparability of reported earnings.

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As we've published in the past, diluted EPS fails to capture the current and ongoing cost of a company using stock options as a form of compensation. The diluted share count only reflects the intrinsic value of options granted in past periods, thereby treating option grants as a financing or a one-time event. Only a deduction of the expense from earnings captures the ongoing nature of the cost. This is the most critical reason for expensing option grants.