BEAR STEARNS

Equity Research

JULY 2006

Accounting Issues

Answering the Call

A Market-Traded Employee Stock Option Proposal

- **THIS REPORT CONTAINS OUR PROPOSAL FOR CREATING A MARKET TO TRADE EMPLOYEE STOCK OPTIONS.** Last year, the SEC issued a statement with guidance encouraging market participants to create methods in which employee stock options could be traded in the open market. In this report, we join the "space race" and present a proposal created by Dane Mott of our team. We hope that our proposal will stimulate further discussion and development of the issue.

- **WE PRESENT OUR FRAMEWORK FOR THINKING ABOUT EMPLOYEE STOCK OPTIONS.** We argue that employee stock options are not options written on a company's stock, but rather options written on other stock options. We believe the way to derive a market value for employee stock options is to create what we call a "2nd derivative" market-traded stock option. We view the traditional employee stock option as a "3rd derivative" security.

Research Analysts

Pat McConnell, CPA	Janet Pegg, CPA	Dane Mott, CPA	Chris Senyek, CFA, CPA	Adam Calingasan, CPA
(212) 272-4193	(212) 272-4191	(212) 272-4080	(212) 272-2509	(212) 272-8384
pmcconnell@bear.com	jpegg@bear.com	dmott@bear.com	csenyek@bear.com	acalingasan@bear.com

Table of Contents **Page**

BEAR
STEARNS

"While public discussion of specific strategies from individual registrants is not appropriate, I do believe that continuing the public dialogue and research on methods to obtain estimates of fair value of employee stock options is useful."

Donald T. Nicolaisen
Chief Accountant, U.S. Securities and Exchange Commission
September 9, 2005

Staff Accounting Bulletin No. 107, issued by the U.S. Securities and Exchange Commission (SEC) in March 2005, states that the best estimate of fair value is to look at a market-traded equivalent. Unfortunately, given the non-transferability of most employee stock options, there are no market-traded equivalents.

Last year, the SEC released a memorandum prepared by the staff of its Office of Economic Analysis (OEA) with guidance encouraging market participants to attempt to create market-traded instruments that will produce reasonable estimates of the grant date fair value of employee stock options. In this report, we join the "space race" and put forward a proposed methodology created by Dane Mott of our team. We hope that our proposal will stimulate further discussion and development of the issue.

A Brief History on the Issue

Over the past decade, employee stock options have developed a very controversial reputation. We would argue that the majority of this controversy lies outside the structure of the instrument. Employee stock options themselves should not be considered controversial structures.

The first source of the controversy can be traced to the accounting standards that permitted companies to expense these instruments at their grant-date *intrinsic* value rather than their grant-date *fair* value. Over the past decade, the majority of stock options have been expensed at an intrinsic value of zero because their strike price was set equal to the market price of the stock (most likely to engineer the desired intrinsic value of zero, which results in no compensation expense on the income statement from these grants).

The second source of the controversy over stock options is that the grant date fair values of employee stock options are *estimates* because these instruments are not market-traded and are non-transferable instruments granted exclusively to employees.

With FAS No. 123R effective for fiscal years beginning after June 15, 2005, the first source of controversy has diminished in importance. Employee stock options are now expensed on the income statement and, thus, they are treated like all other forms of employee compensation.

With the expensing controversy taking its natural course and finding a conclusion, the focus now turns back to the valuation issue. Over the past several years, we have looked extensively at employee stock option valuation. Most public discussions have

gravitated around whether closed-form formulas, such as the Black-Scholes-Merton formula, or lattice-based models, such as binomial models, are more appropriate. We do not find conclusive evidence to place us in either camp. Black-Scholes-Merton is attractive because the formula is widely understood by and available to analysts and investors. The drawback of the Black-Scholes-Merton formula and its various incarnations is that it often drastically oversimplifies the characteristics of the sophisticated exotic options that are employee stock options. Lattice-based models such as binomial models are attractive because they can be customized to take into consideration many of the special characteristics of employee stock options. However, the primary drawback of lattice-based models is that they are often perceived as "black boxes" that are subject to a significant amount of manipulation and little oversight.

As SEC's SAB 107 states, the best estimate of fair value is to look at a market-traded equivalent. Unfortunately, given the non-transferability of most employee stock options, there are no market-traded equivalents to look to. In our view, the only way to end the circular argument about how options should be valued is to value these instruments by allowing market participants to competitively bid for them. This position essentially marginalizes the closed-form formula versus lattice-based model debate. The closed-form formula versus lattice-based model debate is like arguing whether it is more appropriate for an analyst to use a DCF model or multiples to value a company — it is an issue of the valuer's preference as both methods are commonly accepted. When determining their bid for a particular instrument, market participants are left to use the method that they think is most appropriate. Ultimately, the market is model-neutral in that it does not force universal acceptance of any valuation technique. Market participants bid and those who are willing to pay the highest price take possession of the securities.

SEC GUIDANCE ON MARKET-BASED APPROACHES

On September 9, 2005, Don Nicolaisen, the (former) Chief Accountant of the SEC, released a statement and an August 31, 2005 memorandum prepared by the staff of the SEC's Office of Economic Analysis (OEA) providing guidance on market-based approaches for valuing employee stock options. The OEA concluded, as did the FASB, that using market-based instruments for determining the fair value of employee stock options was preferable to the model-based approach most companies are using today. The OEA stated that in order to produce a reasonable estimate of fair value, a market-based approach must have three elements:

- An instrument that confers net payments on its holder equal in value to all or part on an employee stock option ("instrument design").
- An "information plan," easily accessible by prospective buyers and sellers, that provides credible information to value the instrument.
- A "market pricing mechanism" through which the instrument can be traded to generate a price or value.

The memorandum provides guidance on the first element, instrument design. The market-based approaches the OEA studied fell into two design categories. The first, the tracking approach, was found to provide a reasonable estimate of the fair value. The second, the terms and conditions approach, was deemed not suitable for determining fair value for purposes of FAS 123(R).

Tracking Approach

Under a tracking approach, the instrument is designed to match the future flows of a stock option grant with the net obligation of the employer or the net receipts of the employees. In their simplest forms, instruments under this approach would either replicate the value received by employees from a stock-option grant (intrinsic values upon exercise), or replicate the corresponding obligation the employer faces from issuance of stock-option grants.

The OEA feels that the value of instruments designed under the tracking approach is suitable for valuing employee stock options. However, in order to replicate the fair value of an employee stock option, no restriction can be imposed on the ability of the holder to trade or hedge the instrument. Although employees likely face such restrictions on their stock options, the impacts of those restrictions are realized on the payments received or paid on the tracking instruments. So to place any restrictions on the tracking instrument itself would cause its value to deviate from the value of the underlying employee stock options.

Terms and Conditions Approach

The concept behind the terms and conditions approach is to design and sell to an investor an instrument with all of the terms and conditions of the underlying employee stock option grant (such as non-transferability or prohibition against hedging). The belief is that if the instrument replicates an employee stock option, an investor will value the instrument at the same value that an employee or employer values a stock option.

The OEA does not believe the terms and conditions approach produces valuations consistent with an employee stock option value. First, the memorandum points out that although employees are subject to restrictions on their stock options, many of these restrictions are not placed on the company, and so do not influence the value of the company's obligation. Further, it notes that replicating the terms and conditions of an employee stock option will not necessarily cause the holder of a market-based instrument to behave the same way as an employee, due to factors such as differences in risk profiles and the relationship between the employee and the company.

"Information Plans" and "Market Pricing Mechanisms"

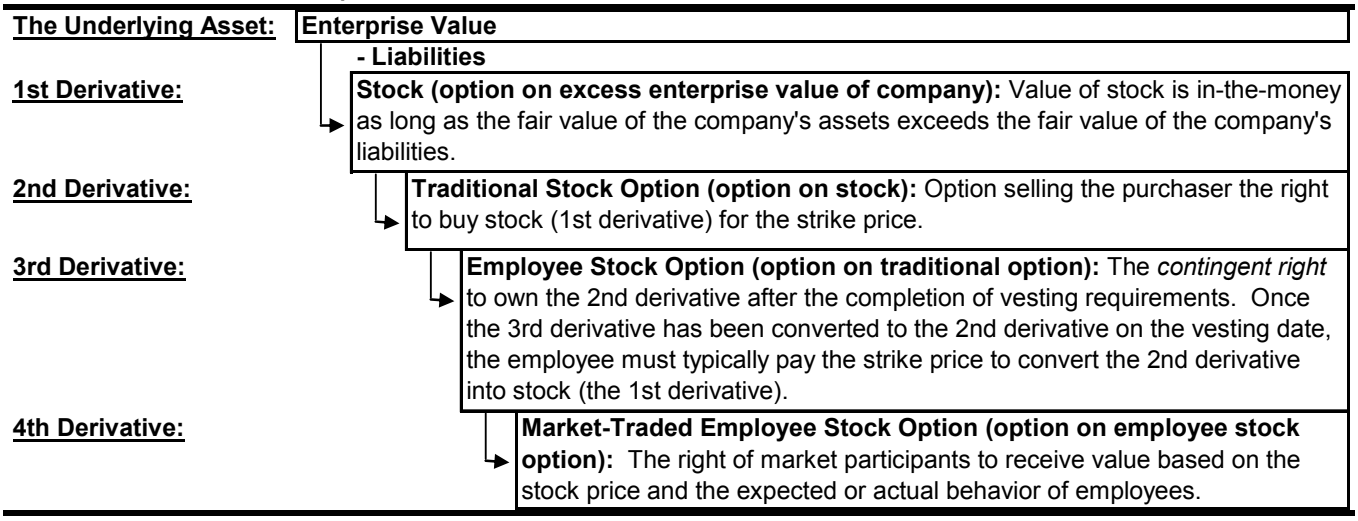
As stated above, according to the OEA memorandum, the SEC feels that instrument design is only the first of three essential aspects a market-based approach needs in order to produce values that could be used in valuing employee stock options. The other two, the need for information plans and market pricing mechanisms, are not dealt with in detail in the memorandum. However, in discussing the sanctioned tracking approach to instrument design, the OEA describes such an instrument as

causing buyers and sellers to "estimate a price equal to fair value by exposing its holder to future payment or obligation flows that are by design equal to what the company faces under the grant." That would appear to lead to the fundamentals of what should be contained in such an information plan: information to assess the timing and amounts of value transferred from employers to employees upon exercise of a stock option grant. This would include information on employee attrition and historical employee exercise behavior. Further, the memorandum cites the need to encourage participation in trading of such instruments, promoting competition between buyers and sellers. This would be the basis of the required market pricing mechanism.

DEFINING THE ISSUE

Before we lay out our proposal, we must first put forward a framework for thinking about stock options that is at the foundation of our proposal. Stock options are derivatives. In our view, employee stock options are not stock option derivatives written on stocks, but rather they are options written on stock options. A call option gives its holder the right to buy an asset at a predetermined price before a predetermined date. An employee stock option, on the other hand, gives its holder the *contingent right* to buy an asset at a predetermined price before a predetermined date. In other words, the employee does not own the option on the grant date. The employee does not *own* anything until the vesting date. He or she will own the call option outright *only if* he or she has satisfied all necessary vesting requirements. However, there are ultimately probabilities that these vesting requirements will or will not be satisfied that can be estimated based on employees' historical and expected behavior (i.e., employee turnover and average duration of employment).

Exhibit 1. Bear Stearns Stock Option Framework



Source: Bear, Stearns & Co. Inc.

As shown in **Exhibit 1**, we view employee stock options as what we describe as "3rd derivative" instruments. Stock itself can be thought of as a derivative. Stock ultimately derives its value from a company's estimated enterprise value adjusted for any estimated liabilities. In our view, employee stock options are not direct derivatives linked to a company's stock. Rather, the underlying instrument of employee stock options is a traditional stock option (what we describe as a 2nd derivative). The traditional stock option's underlying instrument is the company's stock (1st derivative).

In our view, any valid solution seeking to assign an accurate market value to an employee stock option must address the primary problem that exists with employee stock option valuation: the creation of a market-traded option absent of any employee characteristics that would impair the stock option's value (what we describe as the 2nd derivative instrument). While that may seem like an obvious statement, we feel that it is a point that has been missed by market participants who have put forward proposals thus far following the "terms and conditions" approach. We believe proposals that fall into the "terms and conditions" category are what we describe as "4th derivative instruments," and thus they do not confront the issue of the lack of existence of the "2nd derivative instrument."

In our view, you must identify the value of the 2nd derivative instrument before you can put forward a supportable valuation for a 3rd or 4th derivative instrument that can be linked back to the stock price. These valuations are ultimately a chain of dependent valuations. Whenever this chain of derivative valuations is broken, it corrupts the valuations of derivatives further removed from the underlying asset. If you value the 2nd derivative instrument and thus value an option absent all of the employee's exercise characteristics, it becomes much easier to incorporate all of the employee's value impairments that are inherent in 3rd and 4th derivative instruments.

PROPOSAL SUMMARY

This proposal would seek to create three types of instruments to be used in employee stock option compensation programs. Two of these securities would be derivatives and one of these securities would be a zero-coupon fixed income instrument. The three securities are discussed below.

1) The Restricted Stock Option Unit (3rd Derivative Instrument)

The first type of security would be the traditional unvested employee stock option subject to various vesting restrictions (3rd derivative instrument). For all intentional purposes, it is identical to the traditional employee stock option that employees receive today except it is freely tradable upon its vesting date. While the option is restricted, it would be referred to as a restricted stock option unit. It is called a restricted stock option unit because it is a derivative that derives its value from the value of another derivative (the 2nd derivative instrument, which is a market-traded option). In other words, the 3rd derivative instrument is a restricted security giving an employee the right to an unrestricted 2nd derivative stock option once vesting requirements are satisfied. We emphasize this relationship between the 2nd derivative instrument and the 3rd derivative instrument in terms of our Bear Stearns Stock Option Framework in **Exhibit 2**.

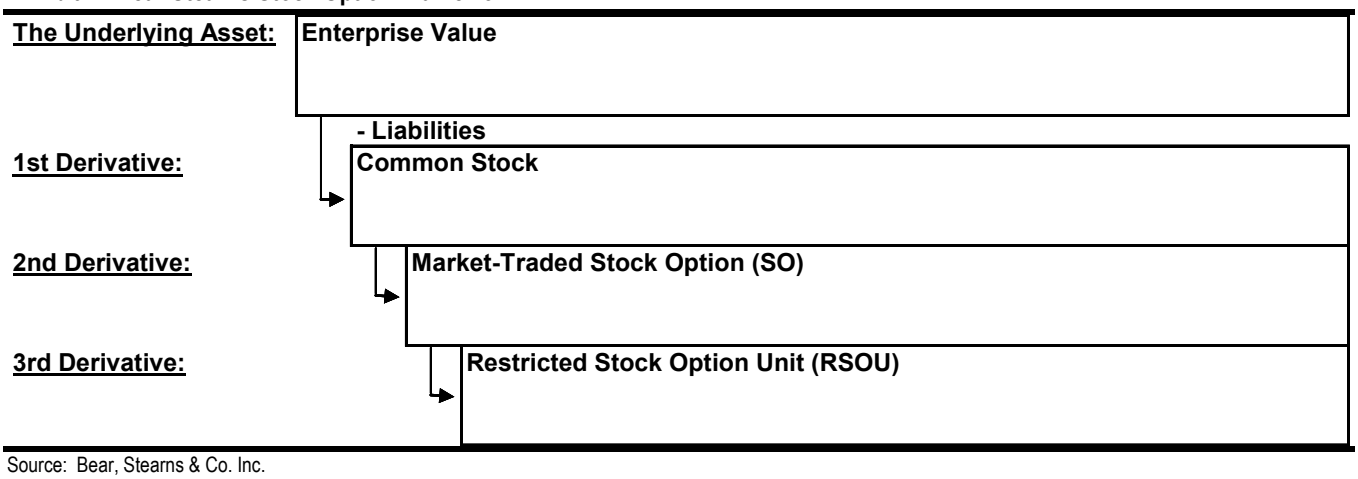
2) The Market-Traded Stock Option (2nd Derivative Instrument)

The second type of security is the unrestricted market-traded stock option (the 2nd derivative instrument). A first tranche of these instruments would be sold in the open market on the day that the 3rd derivative restricted stock option units are granted. Once the employee vesting requirements are met on restricted stock option units (3rd derivative instruments), the restricted stock option units convert into market-traded stock options (2nd derivative instruments).

3) The Restricted Bond Unit (Cash Proceeds from Stock Options)

The third type of security would be a restricted bond unit representing the right to the future cash proceeds from a bond investment that would be financed with the sale of the market-traded stock options on the employees' restricted stock option unit grant date. The proceeds from options that are sold in the open market on the grant date would be invested in low-risk securities such as high-grade or Treasury bonds with terms equal to the vesting period and held in trust for the employee earning interest until the expiration of the vesting period of the employees' restricted stock option units.

Exhibit 2. Bear Stearns Stock Option Framework



Source: Bear, Stearns & Co. Inc.

Side-by-Side Comparison of Current Structure and Our Structure

In **Exhibit 3,** we provide a brief description and comparison of the current employee stock option structure and our proposed three-security structure. The implication of this three-security structure is that options could be market-traded, thus opening up various possibilities that are favorable to investors, companies, and employees alike.

Exhibit 3. Current Employee Stock Option Structure and Bear Stearns Proposed Structure

	CURRENT STRUCTURE	PROPOSED STRUCTURE		
Instrument	**Nonstatutory Employee Stock Option (ESO)**	**Restricted Stock Option Unit (RSOU)**	**Restricted Bond Unit (RBU)**	**Market-Traded Stock Option (SO)**
Description	Option subject to vesting requirements.	Option on an option that is subject to vesting requirements.	Zero-coupon bond issued at grant date with term equal to vesting period. This is funded with the proceeds from the grant-date sale of options in an open-market auction.	Unrestricted call option tradable in market through monthly auctions and OTC. First tranche sold into market on grant date with additional tranches tradable after vesting date.
Tradable/Exercisable	Contingently exercisable into stock	Contingently exercisable into a stock option	Contingently exercisable into cash	Exercisable into stock or tradable in open market
Restrictions	Subject to customizable vesting requirements	Subject to customizable vesting requirements	Subject to customizable vesting requirements	Unrestricted and freely-tradable
Issuance Date	Grant date	Grant date	Grant date	Grant date and vesting date
Tax Date (a)	Exercise date	Vesting date	Vesting date	Trade date or exercise date
Tax Treatment for Employee (a)	Ordinary income on exercise date	Ordinary income on vesting date	Ordinary income on vesting date	Short-term or long-term capital gain/loss on exercise date
Tax Benefit to Company (a)	Tax benefit on exercise date	Tax benefit on vesting date	Tax benefit on vesting date	No tax benefit
Likely FAS 123R GAAP Accounting Treatment	Grant-date fair value expensed over vesting period.	Grant-date fair value expensed over vesting period.	Grant-date fair value expensed over vesting period. Treat as a liability during vesting period.	Not expensed
Analytical Accounting Capabilities	Mark-to-market is not possible but may be fair valued using option pricing models.	Mark-to-market is possible	Mark-to-market is possible	Mark-to-market is possible

(a) Above is our expectation of how these options may be treated for tax purposes, however, it should be emphasized that these are our interpretations of the rules and these interpretations have not been vetted with tax professionals who are experts in this area. Such vetting would be necessary if this structure was further pursued. Please see section titled "Tax Code Considerations" for more details.

Source: Bear, Stearns & Co. Inc.

AN EXAMPLE OF OUR STRUCTURE

Like all complex or new topics, this issue is probably best discussed using an example. In this section we will use an example and a flowchart (see **Exhibit 4**) to provide a brief overview of how our structure would work. This same example is used throughout the report to help communicate and support the mechanics of our proposal.

Assume the following:

1) Company A decides to grant ten million stock options with a vesting requirement of four years representing employee stock-based compensation. Its employees are given the choice between restricted stock option units (which convert to stock options on the vesting date) and restricted bond units (which represent the cash value of stock options sold on the grant date and are held in trust earning interest until the vesting date).

2) Assume that, in aggregate, the employee pool decides to take 3.15 million restricted bond units and 6.85 million restricted stock option units on the grant date. Company A places ten million treasury shares into a trust on the grant date and creates ten million stock options (6.85 million of which will not be issued at the grant date and will be held in trust until employee forfeiture or vesting requirements are met) and 6.85 million restricted stock option units.

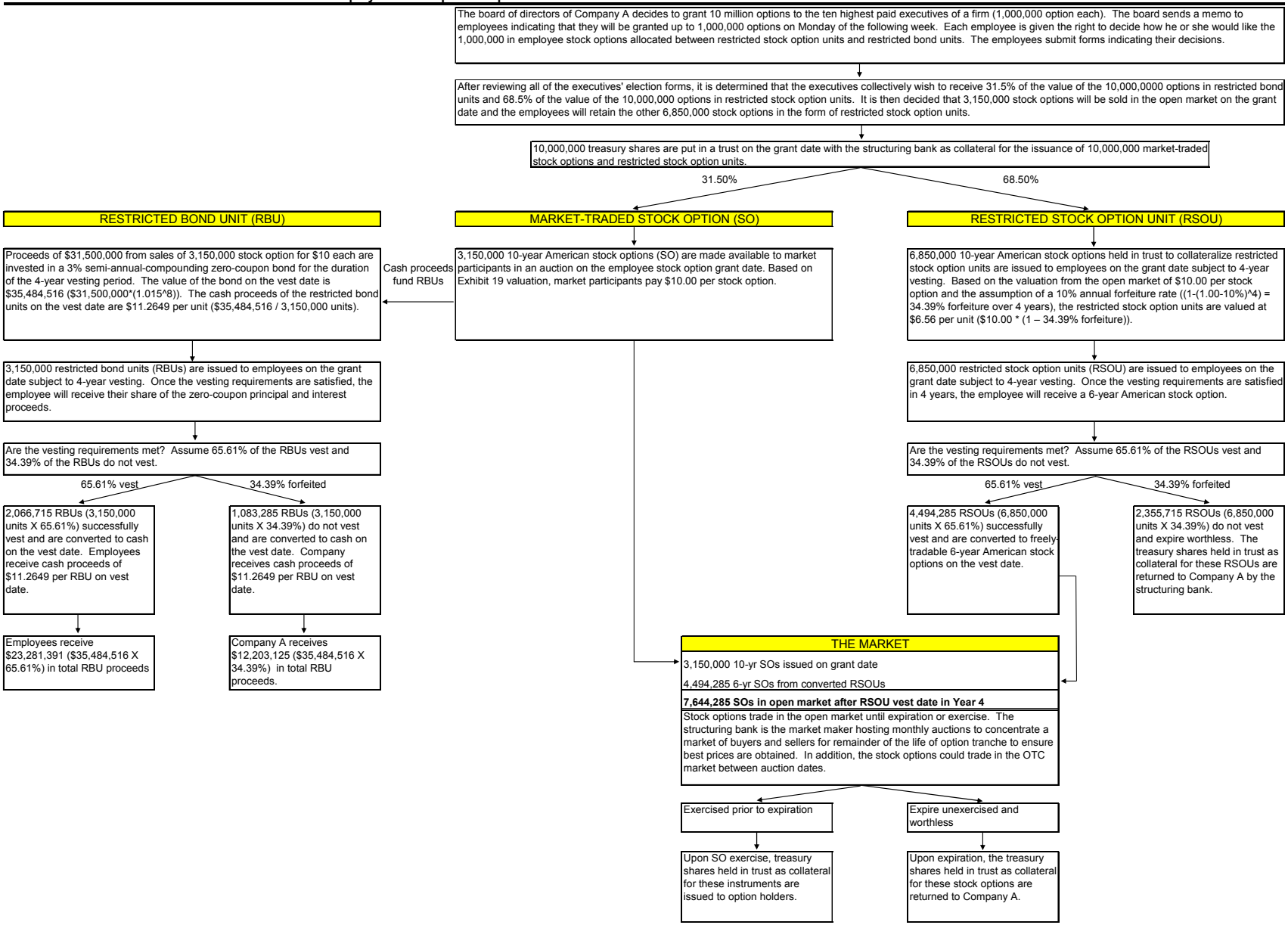
3) To fund the restricted bond units, 3.15 million of the ten million stock options are sold in the open market on the grant date at the open market valuation of $10 each (to see how the $10 option price is determined, see **Exhibit 17**). The proceeds of $31,500,000 from the options sale are invested in four-year, 3% semi-annual-compounding zero-coupon fixed income instruments. At the end of four years, the bond is worth $35,484,516 ($31,500,000 * (1.015^8)). The claim on the proceeds of the bond of $35,484,516 at the end of the vesting term is divided up into 3.15 million units worth $11.2649 each. The employees have calls on the bond proceeds at the vesting date through their restricted bond units. If they meet their vesting requirements, they receive cash distributions from the bond units at the end of the vesting period.

4) At the end of the vesting period (end of year four), the portfolio of restricted bond units and restricted stock option units are divided into two buckets: 1) those meeting the vesting requirements and 2) those not meeting the vesting requirements. Assume 65.61% of restricted stock option units and restricted bond units vest. For the bucket of restricted stock option units and restricted bond units related to employees that satisfied their vesting requirements, the company would 1) distribute the cash proceeds of $23,281,391 ($35,484,516 * 65.61%) from the zero-coupon bonds to the holders of the restricted bond units (each unit is worth $11.2649), and 2) automatically convert 4,494,285 (6,850,000 * 65.61%) restricted stock option units into 4,494,285 freely tradable stock options. Company A takes ownership of the buckets of restricted stock option units and restricted bond units related to employees that did not satisfy their vesting requirements. Company A receives the collateral of treasury stock (2,355,715 shares), the related stock options (2,355,715 stock options), and cash proceeds of $12,203,125 ($35,484,516 * 34.39%) from the 1,083,285 restricted bond units that did not vest.

5) After the vesting date, the options trade in the open market until the stock option expiration date or until exercised. The tranche of options sold to fund the restricted bond unit on the grant date trade in the open market for ten years and the options that are converted from restricted stock option units to stock options on the vesting date trade in the open market for six years. Once restricted stock option units have vested, they are identical to the instruments sold four years earlier on the grant date. That is, the six-year employee-owned stock options and the ten-year market-traded stock option have identical terms from the employees' date of *ownership* in year four until contractual expiration in year ten.

6) After the initial open-market auction on the grant date, the structuring bank holds monthly open-market auctions to build a concentration of buyers and sellers of these securities. Bidders are sent an information plan with five of the six typical Black-Scholes-Merton formula assumptions defined. All bids are expressed in terms of volatility (i.e., the bidder submits the last of the six option pricing assumptions that is needed to arrive at an option valuation). The bidder may or may not have used the Black-Scholes-Merton formula in determining his or her bid, however, the volatility bid is submitted in the context of the Black-Scholes-Merton formula. The options also could trade in the OTC market between the monthly auction dates. The details of the market auction are explained in greater detail in a later section titled "The Creation of a Market-Pricing Mechanism."

Exhibit 4. Flow Chart of Bear Stearns Market-Traded Employee Stock Option Proposal



Note: In our example, the stock options sold on the grant date are American options with 10-year exercise lives. The RSOUs can only be exercised for 6 years due to the 4-year vesting period. We do not assign a material value to the first 4 years of exercisability. If this is deemed to be a material difference between the RSOUs and SOs, then the terms of the SOs could be structured as Bermuda options in which they are European options that cannot be exercised for the first four years and American options for the final six years.

Source: Bear, Stearns & Co. Inc. estimates.

NON-TRANSFERABILITY DESTROYS OPTION VALUE

Under FAS No. 123R, companies use the expected life of the option rather than the contractual life in the computation of the fair value of the option. This adjustment is made to accommodate for the option's non-transferability characteristic. The non-transferability characteristic forces the person conducting the valuation to focus on the expected exercise behavior of the employee receiving the option. Therefore, the option's value becomes a function of the likely behavior of the employee. If the non-transferability characteristic was removed, analysts could ignore the employee-specific demographic characteristics given the options are transferable because the option would be owned by the party that would perceive the most value in the instrument and it would be less likely that the option would be exercised prematurely. Thus, by allowing the stock options to be traded in the market, the life of the option would be extended making it more valuable on the grant date.

Generally speaking, the fair value of a stock option should be higher than its intrinsic value, thus in most cases it is more profitable to sell a stock option rather than to exercise it. Assuming a stock does not pay a dividend, an option holder maximizes the value of a stock option by holding it for a term equal to or close to its contractual life. Given that employees generally exercise employee stock options well before the contractual expiration, the employee holders of these instruments typically destroy the value of these instruments. It is our belief that institutional investors and the company granting the options would likely be the parties that would perceive the most value from these long-term options. Thus, if institutional investors had the ability to buy stock options at the employee grant date and after the employee vesting date, they would likely extend the life and value of the stock options.

Assume Company A has consistently granted its employees $100 million each year in employee stock options. Assume further that the company determines the number of options to grant each year by dividing $100 million by the estimated fair value of one of its employee stock options. The option has an expected life of five years based on employee exercise behavior and a contractual life of ten years. For purposes of U.S. GAAP, employee stock options are valued based on their expected life rather than their contractual life. Using the Black-Scholes-Merton formula, Company A's assumptions for valuation are as follows under current U.S. GAAP accounting:

Exhibit 5. Option Assumptions for Company A's Non-Transferable Employee Stock Options

Stock Price (P)	Exercise Price (E)	Dividend Rate (d)	Volatility (σ)	Life in Years (T)	Risk-free Rate (r)	**Calculated Call Option Value**
$ 18.18	$ 18.18	0.00%	40.00%	5.0	3.00%	**$ 7.17**

Source: Bear, Stearns & Co. Inc. estimates.

Based on Company A's option value of $7.17, the company grants 13,947,002 options to arrive at its $100 million in stock options ($7.17 * 13,947,002).

Now let's assume that the employee's stock option was freely tradable. In this situation, the contractual life rather than the expected life of the option is used as the term assumption in the valuation. Assume Company A held all other assumptions constant from Exhibit 5 but changed its term assumption to ten years in its valuation (note that in real-world practice, dividend rate, volatility, and risk-free rate would

also typically need to be adjusted in response to the new term assumption). As shown below, the fair value of the option increases from $7.17 to $10.00. As a result, by allowing the stock options to be transferable, the number of options that the company must grant to arrive at its $100 million in option grants is reduced from 13,947,002 to 10,000,000. Thus, market-traded options have a potential to reduce the dilutive impact of employee stock option programs.

Exhibit 6. Option Assumptions for Company A's Transferable Employee Stock Options

Stock Price (P)	Exercise Price (E)	Dividend Rate (d)	Volatility (σ)	Life in Years (T)	Risk-free Rate (r)	**Calculated Call Option Value**
$ 18.18	$ 18.18	0.00%	40.00%	10.0	3.00%	**$ 10.00**

Source: Bear, Stearns & Co. Inc. estimates.

CREATING A SUPPLY OF EMPLOYEE STOCK OPTIONS TO BE SOLD ON THE OPEN MARKET

Holders of employee stock options are like holders of all other financial instruments in that they all have their own individual risk preferences. Some employees are more risk-averse than others. If given the opportunity, some option holders would likely look to reduce some or all of their individual employee stock option exposure. If given the opportunity to choose between a portfolio made up of 100% options or a mixed portfolio of risk-free securities and employee stock options, some investors would likely allocate some percentage of their options holdings into risk-free securities. Since employees are already dependent on their employers for their salary and they may already have much of their personal wealth invested in the stock of their employer, it may make sense for some employees to diversify away some of their company-specific risk associated with their employer's stock price.

Assume Company A will grant its $100 million in employee stock options to its ten highest-paid executives. A total of ten million options will be granted, and each executive will be allocated the right to 1,000,000 stock options with a fair value of $10. At each employee's individual discretion, Company A gives the employee the right to direct the company to sell any or all of the employee's allocated 1,000,000 employee stock options in an open-market auction sale on the grant date (the company could also chose to place a floor or cap on the percentage of shares that an employee may direct the company to sell on the grant date). The proceeds from options that are sold in the open market on the grant date will be invested in low-risk securities such as high-grade or Treasury bonds with terms equal to the vesting period and held in trust for the employee until the expiration of the employees' restricted stock option units' vesting period. Over the vesting period this allocation is essentially a restricted fixed income investment, which, as mentioned earlier, we refer to as a restricted bond unit.

Assume the ten executives, based on their individual risk preferences, determine the percentage of their options to be sold on the grant date into the open market. In this example, 3,150,000 options, or 31.5% of the employees' 10,000,000 options, are sold on the grant date in the open market (**Exhibit 7**). The $31,500,000 in proceeds (ignoring transaction fees) is invested in a 3% semi-annual-compounding four-year bond with a duration equal to the vesting period. When the bond expires in four years, there is $35,484,516 in proceeds. Thus, on the vesting date in year four, employees will receive $11.2649 ($35,484,516/3,150,000 RBUs) for each restricted bond unit that they hold as a result of their options being sold in the grant-date

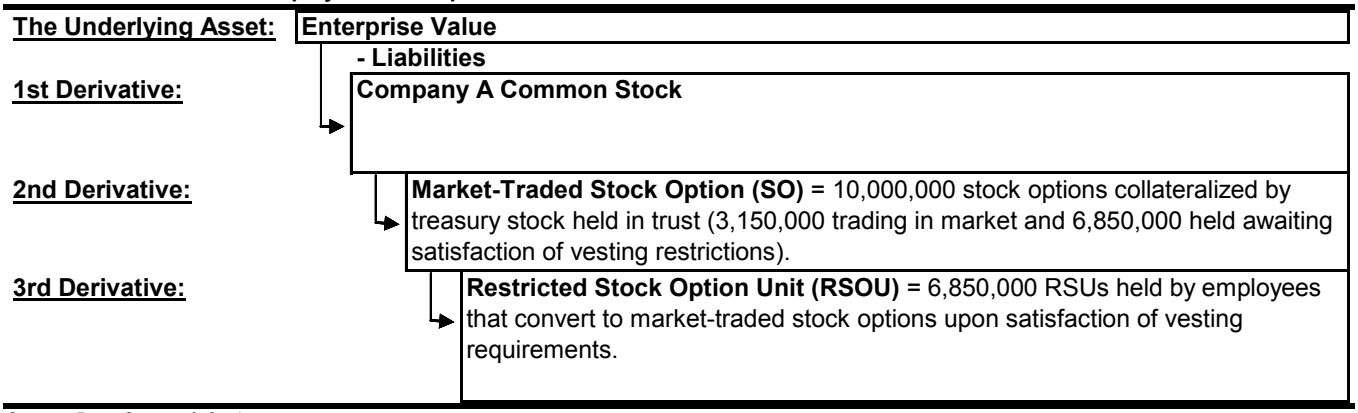
auction. To the extent employees leave the firm before the end of the restricted bond unit vesting period, the company will repossess the employee's restricted bond units and the applicable bond proceeds. If the company chooses, it can use the returned proceeds from forfeited restricted bond units to buy back employee stock options that are held by market participants as a result of the grant-date auction sale.

Exhibit 7. Executive Option Participation Decisions

	# of Options offered to Employees by Company on Grant Date	Estimated Grant Date Fair Value	Estimated Grant Date Fair Value of Traunche	Investment Allocation		Stock Options Held by Employee	Stock Options Sold by Company for Employees on Grant Date	Estimated Grant Date Fair Value of Option Allocation	Estimated Grant Date Fair Value of Bond Allocation
				% Options	% Bonds				
Employee 1	1,000,000	10	10,000,000	100%	0%	1,000,000	-	10,000,000	-
Employee 2	1,000,000	10	10,000,000	90%	10%	900,000	100,000	9,000,000	1,000,000
Employee 3	1,000,000	10	10,000,000	60%	40%	600,000	400,000	6,000,000	4,000,000
Employee 4	1,000,000	10	10,000,000	70%	30%	700,000	300,000	7,000,000	3,000,000
Employee 5	1,000,000	10	10,000,000	30%	70%	300,000	700,000	3,000,000	7,000,000
Employee 6	1,000,000	10	10,000,000	100%	0%	1,000,000	-	10,000,000	-
Employee 7	1,000,000	10	10,000,000	65%	35%	650,000	350,000	6,500,000	3,500,000
Employee 8	1,000,000	10	10,000,000	80%	20%	800,000	200,000	8,000,000	2,000,000
Employee 9	1,000,000	10	10,000,000	50%	50%	500,000	500,000	5,000,000	5,000,000
Employee 10	1,000,000	10	10,000,000	40%	60%	400,000	600,000	4,000,000	6,000,000
TOTAL	10,000,000	100	100,000,000	69%	32%	6,850,000	3,150,000	68,500,000	31,500,000

Source: Bear, Stearns & Co. Inc. estimates.

Exhibit 8. Bear Stearns Employee Stock Option Framework



Source: Bear, Stearns & Co. Inc.

During the vesting period, the restricted stock option units (3rd derivative instruments) that are held by employees cannot be traded since they have not yet vested. As mentioned earlier, the restricted stock option unit is essentially a derivative written on a derivative. In other words, it is a security giving an employee the right to an unrestricted stock option once vesting requirements are satisfied.

Once the options have vested, the employees' vesting restrictions are removed and the employee stock options convert to unrestricted freely tradable stock options that are equivalent to the options that were offered in the open-market auction on the grant date. At that time, the employees can choose to sell their options through one of the future open-market auctions (explained later in this report) or hold and exercise the options at an opportune time in the future.

Consider Employee 9 in Exhibit 7, who kept 50% of his 1,000,000 stock options and converted the other 50% into restricted bond units on the grant date. Employee 9 will receive $5,632,450 ($11.2649 * 500,000) from the restricted bond unit on the vesting date. As shown below in **Exhibit 9**, assuming all option assumptions remain constant over the vesting period, with the exception of the market price of the stock and term of the option due to passage of time, the stock price would have had to increase from $18.18 to $22.54 or higher over the vesting period for it to equal or exceed the $11.26 value per share of Employee 9's restricted bond unit investment on the vesting date. Therefore, the value of the 500,000 restricted bond units would be more valuable on the vesting date than the 500,000 stock options on the vesting date unless the price of the stock was equal to or greater than $22.54. Depending on the movement of the stock between the grant date and the vesting date, the options could be in-the-money or out-of-the-money on the vesting date. With the restricted bond units, the employee would lock in his or her pay-off on the grant date and would only need to focus on satisfying the vesting requirements.

Exhibit 9. Option Assumptions for Company A's Transferable Employee Stock Options

Stock Price (P)	Exercise Price (E)	Dividend Rate (d)	Volatility (σ)	Life in Years (T)	Risk-free Rate (r)	**Calculated Call Option Value**
$ 22.54	$ 18.18	0.00%	40.00%	6.0	3.00%	**$ 11.26**

Source: Bear, Stearns & Co. Inc. estimates.

ADJUSTING FOR PERFORMANCE-BASED RESTRICTIONS AND EMPLOYEE FORFEITURE

In the exercise above we have only looked at the value of the unrestricted stock option from the perspective of the company. In other words, we have attempted to calculate the value of the resource the company must potentially give up when it issues a stock option that is not subject to employee forfeiture. We valued the 2nd derivative, not the 3rd derivative. From the perspective of the employee, the important valuation is the restricted stock option unit (the 3rd derivative) because the perceived value of the RSOU is lower than the market-traded stock option if there are performance-based requirements or other vesting requirements.

Under FAS No. 123R, adjustments for forfeiture are made to the number of shares granted in calculating stock option expense. Further, under FAS No. 123R, the person conducting the valuation of the stock option must build the impact of performance-based factors into the model assumptions when valuing the stock option. To be consistent with U.S. GAAP accounting rules, our method adjusts for forfeiture by reducing the number of granted restricted stock option units included in the expense calculation, and performance-based restrictions are incorporated by adjusting the fair value of the stock options.

However, for the analytical purpose of determining the value of the restricted stock option unit to the employee, our method adjusts the fair value of the unrestricted stock option unit for both forfeiture and performance-based adjustments rather than adjusting the number of options granted. Ultimately, as shown in Exhibit 10, these alternative valuation techniques result in the same economic value, but the mechanics used to arrive at this economically-equivalent value are different.

Under our method, in arriving at a value of a restricted stock option unit for the employee, the adjustments for forfeiture and performance-based restrictions are made to the restricted stock option unit after the valuation of the stock option is completed. In other words, haircuts to the market value of the market-traded stock options would be computed based on the probability that the restrictions will result in the employee not taking possession of the stock option in the future. The employee's value of the restricted stock option unit is the grant-date market value of a freely traded stock option times the employee's probability of successfully satisfying performance and other vesting requirements.

Consider Company A's stock option grants, which have an open-market fair value of $10.00 per stock option. Under our method, adjustments for performance-based and vesting restrictions are made to this $10.00 market value in arriving at the value of the restricted stock option unit for the employee. Our method still allows for the forfeiture adjustment to be made to the number of options for accounting purposes. Thus, if the forfeiture ultimately is different than the expected forfeiture, these adjustments to the number of options can be made and stock option expense can be adjusted.

Let's assume that the company's restricted stock option units have a performance requirement that an executive must improve the operating margin of his or her respective division by 20% over the four-year vesting period in order for the restricted stock option units to convert into stock options on the vesting date. To build this assumption into the restricted stock option unit's valuation, the company would simply assign a probability representing the executive's chances of meeting the performance requirements. Assume that the company believes that Employee 9 has a 90% probability of meeting the performance requirements. The implication is that from the employee's perspective, the restricted stock option unit would be worth only $9.00 because he would have a 90% chance of collecting the stock option currently valued at $10. This adjustment for the performance-based restrictions is the same adjustment that would be made under our method to adjust the value of the restricted stock option unit for performance-based restrictions for GAAP purposes.

Further, let's assume that Company A's experience has been that 10% of its top executives will leave the firm each year. In the table below, we estimate that 65.61% of the stock options are likely to vest over the four-year period based on this 10% annual forfeiture assumption. This 10% annual forfeiture rate implies that there is a 34.39% chance (1-(1.00-0.10)^4) that its executives will not remain with the firm long enough for their restricted stock option units to vest and convert into stock options. Therefore, the fair value of Employee 9's restricted stock option unit is reduced by the compounded forfeiture rate to arrive at a fair value at grant of $5.94 ($9.00 * (1-.3439)). While we adjust the fair value of the option for forfeiture for the analytical purpose of computing the value of the option to the employee, for GAAP purposes under our method these adjustments are made to the number of options granted.

Therefore, if all executives had the same characteristics and terms as Employee 9, the company would be expensing over the vesting period $59,400,000 ($5.94 * 10,000,000) of the $100,000,000 in fair value option grants that it made to its top ten executives.

Reconciling the Employee's Value of the Stock Option with Its Value Under the Current Structure with Our Proposed Structure

In the following exhibit, we continue the Company A example. Recall from an earlier section of this report that under the current structure Company A would have had to grant 13,947,002 stock options at $7.17 per option to grant employees the opportunity of $100 million in stock options. In addition, recall that under our method, the company would grant 10,000,000 stock options with a Black-Scholes-Merton formula value of $10.00 per unit. Assume that the executives are only subject to forfeiture risk (10% annual forfeiture rate) and were not subject to additional performance-based vesting restrictions. Based on these assumptions, the value of the options would have been $6.56 ($10.00 * (1 – 34.39% forfeiture)) from the employees' perspective. As **Exhibit 10** shows, while the economic value per underlying $10 stock option offered at the grant date was higher than the employee value of $6.56 per restricted stock option unit, the net economic impact from these $100 million in option grants is approximately $65.61 million in all three scenarios because the number of restricted stock option units that vest is lower than the amount that is granted. For GAAP purposes, the $65.61 million in stock option value will be expensed rather than the full $100 million pledged at the grant date.

Exhibit 10. GAAP Valuation Vs. Analytical Valuation of Employee's Restricted Stock Option Unit

CURRENT STRUCTURE:

Valuation for GAAP Purposes:

	Initial Grant-Date Fair Value	Forfeiture-Adjusted Stock Option Total				Estimated Vested Grant-Date Fair Value
		Year 1	Year 2	Year 3	Year 4	
Number of stock options granted and expensed adjusted for a 10% annual rate of employee forfeiture (1)	13,947,002	12,552,302	11,297,072	10,167,364	9,150,628	9,150,628
Fair value of option under current structure	$ 7.17					$ 7.17
Grant-date fair value	$ 100,000,004					$ 65,610,003

BEAR STEARNS PROPOSED STRUCTURE:

Valuation for GAAP Purposes (Valuation of Stock Options):

	Initial Grant-Date Fair Value	Forfeiture-Adjusted Stock Option Total				Estimated Vested Grant-Date Fair Value
		Year 1	Year 2	Year 3	Year 4	
Number of stock options granted and expensed adjusted for a 10% annual rate of employee forfeiture (1)	10,000,000	9,000,000	8,100,000	7,290,000	6,561,000	6,561,000
Fair value of stock option under proposed structure	$ 10.00					$10.00
Grant-date fair value	$ 100,000,000					$ 65,610,000

Valuation for Employees' Purposes (Valuation of Restricted Stock Option Unit):

	Initial Grant-Date Fair Value	Forfeiture-Adjusted Restricted Stock Option Unit Total				Estimated Vested Grant-Date Fair Value
		Year 1	Year 2	Year 3	Year 4	
Number of restricted stock option units granted and expensed not adjusted for employee forfeiture (1)	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
Fair value of restricted stock option unit under proposed structure adjusted for 10% annual rate of forfeiture	$ 6.56					$ 6.56
Grant-date fair value	$ 65,610,000					$ 65,610,000

(1) As discussed in section "Non-Transferability Destroys Option Value," we assume more options must be granted under the current structure than is necessary under our proposed structure due to the impairment of options for non-transferability within the current structure.

Source: Bear, Stearns & Co. Inc. estimates.

IMPACT OF STRUCTURE ON EMPLOYEE STOCK OPTION BUYBACK PROGRAMS

Many companies have stock buyback programs. To a large extent these programs are meant to offset the dilution created by employee stock option programs. If employee stock options were market-traded instruments, companies could potentially begin employee stock option buyback programs, which it appears could be a more efficient method of combating shareholder dilution.

Assume that Company A's stock is trading at $40.00 per share six years after the grant of the 10,000,000 options discussed above. Let's also assume that none of the options have yet been exercised and none of the employees have left the firm, thus all 10,000,000 options are deep in-the-money vested stock options that are trading in the open market. As shown below, based on these assumptions, the fair value of these stock options is $25.09 per option and the entire tranche has a market value of $250,900,000.

Exhibit 11. Option Assumptions for Company A's Transferable Employee Stock Options at Year Six

Stock Price (P)	Exercise Price (E)	Dividend Rate (d)	Volatility (σ)	Life in Years (T)	Risk-free Rate (r)	**Calculated Call Option Value**
$ 40.00	$ 18.18	0.00%	40.00%	4.0	3.00%	**$ 25.09**

Source: Bear, Stearns & Co. Inc. estimates.

At year six, the management at Company A decides that it is almost certain that all 10,000,000 options will likely be exercised just before the year ten expiration date when the stock is expected to be trading at approximately $60. Wanting to avoid substantial shareholder dilution, the company can choose between a share buyback in year six or an employee stock option buyback in year six. Given that the stock options are trading deep in-the-money for $25.09 at the end of year six, a stock option buyback of 10,000,000 stock options would cost $250,900,000. Alternatively, the company can use the $250,900,000 to buy back 6,272,500 shares at the end of year six. Thus, as shown in **Exhibit 12**, the company can use the funds to buy back 3,737,500 more stock options than shares of stock in year six.

Exhibit 12. Stock Option Buyback vs. Stock Buyback

Stock Option Buyback:

End of Year 6	End of Year 10
$250,900,000 buys 10,000,000 stock options @ $25.09.	N/A

Stock Buyback:

End of Year 6	End of Year 10
$250,900,000 buys 6,272,500 shares @ $40.00. The 10,000,000 stock options remain outstanding.	$181,800,000 in stock option exercise proceeds buys:

Scenario Analysis:

4,545,000 shares @ $40.00
3,727,500 shares @ $48.77
3,636,000 shares @ $50.00
3,030,000 shares @ $60.00
2,597,143 shares @ $70.00
2,272,500 shares @ $80.00

Conclusion:

If Year 10 stock price is greater than $48.77, then a stock option buyback would have been a more efficient use of company resources.

If Year 10 stock price is less than $48.77, then a stock buyback would have been a more efficient use of company resources.

Source: Bear, Stearns & Co. Inc. estimates.

If the company chooses to do the stock buyback rather than the stock option buyback, it will also receive exercise proceeds of $181,800,000 ($18.18 exercise price * 10,000,000 stock options) at the end of year ten if we assume the options are exercised right before expiration. If the company did the stock option buyback, it would ultimately never exercise the repurchased stock options and would allow them to expire and become worthless. If the company decides to use the exercise proceeds to buy back stock at the end of year ten, it will only be able to match the impact of the stock option buyback program if it can buy back 3,737,500 stock options for $48.77. If the stock price is above $48.77 at the end of year ten, it ultimately will have been more efficient to do the stock option buyback in year six than the stock buyback in year six.

TAX CODE CONSIDERATIONS

One potential challenge to this proposal will likely be in the area of how employee stock options are treated under the Internal Revenue Code and Treasury Regulations. Below is our expectation of how these options may be treated for tax purposes, however, it should be emphasized that these are our interpretations of the rules and these interpretations have not been vetted with tax professionals who are experts in this area. Such vetting would be necessary if this structure was further pursued.

Employer Tax Considerations

We believe that our proposal is such that these instruments can be structured as non-statutory stock options that are subject to Treasury Regulation 1.83-7 rather than as incentive stock option under Internal Revenue Code §422. There are a number of requirements under §422 that, in our view, make it seemingly impossible to structure market-traded stock options as §422 stock options. Further, options structured under §422 typically must be exercised within 90 days of an employee's termination from the firm; thus the contractual life of the option is truncated. Based on our interpretation of Treasury Regulation 1.83-7, there is no legal requirement that a non-statutory stock option have an accelerated exercise date upon termination. A mandatory requirement to truncate a stock option's contractual life would impair the value of the instrument and would likely make it less desirable to investors.

Additional consideration must be given to the tax treatment of the restricted bond unit (RBU). During the vesting period, the zero-coupon fixed income instrument collateralizing the RBUs will generate interest income for the company. We believe that this interest income would likely be taxable income to the company during the vesting period that would create "leakage." However, proceeds from any RBUs forfeited by employees may make up for some or all of this at the vest date. Our expectation is that companies likely could get a tax deduction on the vest date equal to the value of the underlying RBU fixed income instruments that vest multiplied by the company's tax rate.

Currently, a company receives a tax benefit related to non-statutory employee stock options that is approximately equal to the intrinsic value of the option on the date of exercise times the company's statutory tax rate. We believe the tax treatment for stock options under our proposal would be in line with the tax treatment for restricted stock. On the restricted stock option unit and restricted bond unit vesting date, the employee would be taxed based on the fair value of the bond proceeds and the value of the market-traded stock options at their ordinary income tax rate. The company

would receive a tax benefit for these grants equal to the market value of the employee's stock options on the vesting date multiplied by the company's tax rate.

However, it is important to note that companies may potentially receive smaller tax deductions if the options can be market-traded because they will not capture tax benefits related to stock appreciation after the vesting date (i.e., the tax deduction is reduced by the amount of the option's value that is due to appreciation after the vesting date). While without a tax law change the company may lose the ability to receive as much tax benefits from employee stock options as under the current system, this loss of tax benefits can potentially be made up for if the company is able to employ a market-traded stock option buyback program that is more efficient than its stock buyback program. Also, under our structure, the tax benefit is accelerated from the exercise date to the vesting date and companies can potentially receive tax benefits for many options that are out of the money since the tax benefit is based on the higher fair market values of the options rather than their intrinsic values.

Employer Tax Example

To get a sense of how the company's tax impact under the current structure varies from our proposed structure, we use the Company A example assuming a 35% tax rate. Recall from an earlier section that the expected life of Company A's non-transferable stock options under the current structure is five years. Remember also that under our structure, the option is valued based on the contractual life of ten years rather the expected life of five years.

Recall from Exhibit 10 that Company A must grant 13,947,002 under the current structure to accrue the same amount of expense that the company would accrue under our structure using 10,000,000 stock options. Consistent with Exhibit 10, we will assume that the actual forfeiture rate is equal to the 10% estimated annual forfeiture rate and that 9,150,628 options vest under the current structure and 6,561,000 stock options vest under our proposed structure. Both structures result in a total of $65,610,000 in pretax stock option expense being recorded on the income statement during the vesting period.

Under the current structure, the company's tax benefit is based on the *intrinsic value* at exercise. For the purposes of the current structure example, let's assume that all employees exercise their non-transferable stock options at the end of year five (the expected life of the options). Under our proposed structure, the company's tax benefit is based on the market value (assumed to be *fair value)* of the RSOUs and RBUs on the vest date at the end of year four. In most cases the values of the RSOUs and RBUs will be different on the vest date, however, for simplicity, let's assume that both the RSOUs and RBUs are worth $11.26 on the vest date (consistent with Exhibit 9, this implies a stock price of $22.54).

As shown below in Exhibit 13, our structure results in the company receiving a tax benefit of $3.94 ($11.26 fair value * 35%) per RSOU or RBU at the end of year four. Applied across 6,561,000 RSOUs and RBUs, this results in the company receiving a $25,856,901 ($3.941 tax benefit per RSOU or RBU * 6,561,000) tax benefit at the end of year four.

Exhibit 13. Comparison of Hypothetical Tax Treatment for Company A

	Proposed Structure			Current Structure
	RSOUs	RBUs	**Total**	**Total**
Tax event date	Vest date (a)	Vest date (a)	Vest date (a)	Exercise date (a)
Prices at tax event date:				
Stock Price at tax event date	$ 22.54	$ 22.54	$ 22.54	$ 27.06
RSOU value at tax event date	11.26	N/A	11.26	N/A
RBU at tax event date	N/A	11.26	11.26	N/A
Value of underlying at tax event date	11.26	11.26	11.26	27.06
- Exercise price of option	N/A	N/A	N/A	18.18
	$ 11.26	$ 11.26	$ 11.26	$ 8.88
Tax benefit per security:				
Pretax value per security on tax event date	$ 11.26	$ 11.26	$ 11.26	$ 8.8808
Corporate tax rate	35%	35%	35%	35%
Applicable tax benefit per security	$ 3.94	$ 3.94	$ 3.94	$ 3.1083 ↓
Discounted year 5 tax benefit into year 4 dollars (b)				$ 2.8257
Cost of structures to Company A:				
Applicable tax benefit per security	$ 3.94	$ 3.94	$ 3.94	$ 2.83
Number of securities	4,494,285	2,066,715	6,561,000	9,150,628
Tax benefit per class of security	17,711,977	8,144,924	25,856,901	25,856,901
Applicable pretax stock-based compensation	44,942,850	20,667,150	65,610,000	65,610,000
Post-tax stock-based compensation before RBU tax effects and RBU forfeitures	**$ 27,230,873**	**$ 12,522,226**	**$ 39,753,099**	**$ 39,753,099**
Cash proceeds from forfeited RBUs		12,203,125	12,203,125	
RBU tax obligation on interest income (c)		(1,394,581)	(1,394,581)	
Post-tax stock-based compensation after RBU tax effects and RBU forfeitures	**$ 27,230,873**	**$ 1,713,682**	**$ 28,944,555**	**$ 39,753,099**

(a) Assumes vest date is at the end of year 4 and the exercise date is at the end of year 5. Year five assumption is based on expected life of non-transferable stock options of five years.

(b) Current structure tax benefit per option is discounted at Company A's cost of equity of 10% to convert from year 5 dollars to year 4 dollars.

(c) Tax expense from interest income on RBUs has not been adjusted for time value of money. Taxes of $1,394,581 ($3,984,516 * 35% tax rate) based on the zero-coupon bond interest income of $3,984,516 ($35,484,516 - $31,500,000) over the course of the four-year vesting period.

Source: Bear, Stearns & Co. Inc. estimates.

If we wanted to replicate that tax benefit under the current structure with 9,150,628 stock options, we must first make an adjustment for the timing difference of the tax benefit since we assume that all employees exercise at the end of year five in the current structure instead of year four. To be conservative, let's assume that the cash from tax benefit in our structure received in year four would have been reinvested in Company A and it would have earned the company's cost of equity of 10%. Thus, the year five tax benefit equivalent to the year four tax benefit of $25,856,901 would be $28,442,591 ($25,856,901 * 1.10). If we divide $28,442,591 by 9,150,628 vested options, we arrive at a tax benefit of $3.11 per stock option, which implies an intrinsic value per option at exercise of $8.88 ($3.11 tax benefit / 35% tax rate). Thus, for purposes of this example, for Company A to receive the identical tax benefit under the current structure as under our structure, the stock price would need to be $27.06 ($18.18 exercise price + $8.88 intrinsic value at exercise date) at the end of year five for the current structure to equal the tax benefit it would receive with our structure when the stock price is $22.54 at the end of year four.

While in many cases the RBU may result in the company receiving a smaller tax benefit per unit than the tax benefit of the RSOU, the company does get some reparations for capping its tax benefit in the form the cash proceeds from the employee-forfeited RBUs. As shown in Exhibit 4, we estimate that Company A will receive $12,206,674 in pretax RBU proceeds in year four due to employee-forfeiture. However, as mentioned earlier in this section, there is likely to be some amount of tax "leakage" from this instrument because the interest income on the instrument would likely be taxable. For purposes of the example, we assume that the company

must pay taxes of $1,394,581 ($3,984,516 * 35% tax rate) on the zero-coupon bond interest income of $3,984,516 ($35,484,516 - $31,500,000) over the course of the four-year vesting period. Ignoring the time value of money, the company is left with post-tax RBU proceeds of $10,808,544 ($35,484,516 zero-coupon proceeds - $23,281,391 employee-vested RBUs - $1,394,581 RBU tax obligation on interest income). As a result, as shown in Exhibit 13, while the RBUs represent $20,667,150 in pretax stock-based compensation on the income statement over the vesting period, the RBUs produce tax benefits and income that result in the RBUs having a net impact on Company A of only $1,713,682.

Further, if we consider the tax benefit from RBOUs and RSOUs in concert with the net tax proceeds of the employee-forfeited RBUs in our example, we estimate that the net impact of the stock option grants in our structure would have been $28,944,555 ($65,610,000 pretax stock option expense - $25,856,901 tax benefit + $1,394,581 RBU tax obligation - $12,203,125 employee-forfeited RBU proceeds). This compares to post-tax stock option expense of $39,753,099 ($65,610,000 pretax stock option expense - $25,856,901 tax benefit) under the current structure.

Lastly, we should note that we believe that our structure would result in more stable tax benefits. Under the current structure, the company will only receive tax benefits at the option exercise date based on the intrinsic value. However, ultimately, there is no guarantee that a tax benefit will be captured on each exercisable option because not all options will have positive intrinsic values during their exercise period. Under our method, the tax benefit is based on the market value (fair value) at vest date, which should be positive in most cases. Thus, a tax benefit should be available for most if not all vested stock options.

In **Exhibit 14,** we present a table indicating the estimated stock price of Company A stock at the end of year four that is necessary for the company to capture a tax benefit ranging from $0.01 to $25 per option. For example, under the current structure, it would take a stock price of $21.01 to produce an intrinsic value of $2.86 ($21.04 stock price - $18.18 exercise price) and a tax benefit of $1.00 ($2.86 intrinsic value * 35% tax rate). Under our structure, it would take a stock price of $10.64 ($7.54 below the strike price) to produce an fair value of $2.86 (Black-Scholes-Merton formula calculation used as a proxy for the market price) and a tax benefit of $1.00 ($2.86 fair value * 35% tax rate).

Exhibit 14. Tax Benefit Scenario Analysis

Tax Benefit per Option (a)	Pretax Value per Option (b)	Current Structure Implied Stock Price (c)	Proposed Structure Implied Stock Price (d)	Differences Between Stock Prices in Structures
0.01	0.03	18.21	2.00	(16.21)
0.25	0.71	18.89	5.75	(13.14)
0.50	1.43	19.61	7.68	(11.93)
0.75	2.14	20.32	9.27	(11.05)
1.00	2.86	21.04	10.64	(10.40)
2.00	5.71	23.89	15.21	(8.68)
3.00	8.57	26.75	19.13	(7.62)
4.00	11.43	29.61	22.74	(6.87)
5.00	14.29	32.47	26.17	(6.30)
6.00	17.14	35.32	29.47	(5.85)
7.00	20.00	38.18	32.69	(5.49)
8.00	22.86	41.04	35.84	(5.20)
9.00	25.71	43.89	38.94	(4.95)
10.00	28.57	46.75	42.01	(4.74)
11.00	31.43	49.61	45.05	(4.56)
12.00	34.29	52.47	48.07	(4.40)
13.00	37.14	55.32	51.05	(4.27)
14.00	40.00	58.18	54.03	(4.15)
15.00	42.86	61.04	56.99	(4.05)
16.00	45.71	63.89	59.94	(3.95)
17.00	48.57	66.75	62.88	(3.87)
18.00	51.43	69.61	65.81	(3.80)
19.00	54.29	72.47	68.74	(3.73)
20.00	57.14	75.32	71.64	(3.68)
21.00	60.00	78.18	74.56	(3.62)
22.00	62.86	81.04	77.47	(3.57)
23.00	65.71	83.89	80.36	(3.53)
24.00	68.57	86.75	83.26	(3.49)
25.00	71.43	89.61	86.16	(3.45)

(a) Assume 35% tax rate.

(b) The pretax value is the intrinsic value per option on the exercise date for the current structure and the market price (fair value) of the stock option on the vest date for our proposed structure.

(c) Exercise price of $18.18 + intrinsic value of option at exercise date.

(d) Black-Scholes-Merton calculation assuming exercise price of $18.18, no dividend, volatility of 40%, remaining life of 6 years, and risk-free rate of 3%. Stock prices listed are the prices that were placed into the formula to arrive at the pretax option value listed in the second column.

Source: Bear, Stearns & Co. Inc. estimates.

Employee Tax Considerations

As noted above, we believe the tax treatment for stock options under our proposal would be in line with the tax treatment for restricted stock. The projected tax treatments are presented in **Exhibit 15**. On the restricted stock option unit and restricted bond unit vesting date, the employees would be taxed based on the fair value of the bond proceeds and/or the value of the market-traded stock options at their ordinary income tax rate. If an employee continues to hold the option and it lapses unexercised because the underlying stock declines in value, the employee will have a short- or long-term capital loss equal to the value of the option on the vesting date. If the loss is long term, the employee will be out of pocket the amount of tax paid on the vesting date net of any benefit from the utilization of the long-term capital loss created by the option's expiration. If the loss is short term and can be used to offset tax on short-term capital gains or ordinary income, the tax benefit will equal the tax that was paid by the employee on the vesting date. The employee will be out of pocket only the time value of the tax paid on the vesting date.

Exhibit 15. Projected Tax Treatments of RSOUs and RBUs for Employees

Conversion from restricted stock option unit to market-traded stock option:
Market value of the stock option on the vest date * employee's ordinary income tax rate

Conversion from restricted bond unit to cash:
Cash proceeds on the vest date * employee's ordinary income tax rate

Exercise of stock option (conversion into common stock):
No tax event

Sale of stock option in open market:
If held for less than one year after the vesting date:
(trade date market value - vest date market value) * employee's ordinary income tax rate

If held for more than one year after the vesting date:
(trade date market value - vest date market value) * long-term capital gains income tax rate

Tax benefit created if option expires unexercised:
If held for less than one year after the vesting date:
(expiration date market value - vest date market value) * employee's ordinary income tax rate

If held for more than one year after the vesting date:
(expiration date market value - vest date market value) * long-term capital gains income tax rate

Sale of common stock after option conversion:
If held for less than one year after the vesting date:
(sale date market value - option exercise price) * employee's ordinary income tax rate

If held for more than one year after the vesting date:
(sale date market value - option exercise price) * long-term capital gains income tax rate

Source: Bear, Stearns & Co. Inc. estimates.

However, this change in tax treatment will not necessarily reduce the employee's payoff relative to previous stock option treatment if the underlying stock continues to appreciate in value. Since these options will command higher prices on the open market than the employee would get by exercising the option for its lower intrinsic value well before the option expiration date, the employee is likely to receive more value per option. Further, any gains or losses that the employee receives after the vesting date from either exercising or trading the stock options would be taxed at the appropriate short-term or long-term capital gains tax rate and the company would not receive a tax benefit for these tax events. Since the value after the vesting date would be taxed at a capital gains rate rather than at a higher ordinary income tax rate, the employee would likely pay lower taxes in many scenarios.

For example, consider the value of Employee 9's options on the vesting date in the earlier example. Let's assume that he is in the 35% tax bracket. On the vesting date, Employee 9's options had an intrinsic value of only $4.36 ($22.54 - $18.18) and a fair value of $11.26. In year six the options have a fair value of $25.09 and an intrinsic value of $21.82 ($40.00 - $18.18). Under the current treatment based on the intrinsic value of the option on the exercise date, the employee's tax obligation from the exercise of a stock option in year six would be approximately $7.64 per option ($21.82 * 35%). Under our proposal, if the option were treated like restricted stock for tax purposes and the employee exercises the option and sells the stock on exercise in year six, the employee would be taxed $3.94 per share ($11.26 * 35%) on the vesting date in year four and $1.58 [(($40.00 - $18.18) - 11.26) * 15% long-term capital gains rate] on the year six exercise date for a total tax obligation of $5.52 ($3.94 + $1.58). (Note that if the employee exercised the option but continued to hold the stock, we believe that the employee would owe no tax at the exercise date. The employee would have a taxable gain or loss when the stock received on exercise was sold. The gain or loss would be equal to the value received for the stock when sold less the exercise price of the option plus the fair value of the option on the vesting date.) As a result, in this example, the employee's tax obligation for the exercise of a market-traded option and immediate sale of the stock in year six is $2.12 ($7.64 - $5.52) lower per option than the tax obligations for conventional non-transferable employee stock options without considering the time value of money.

If the employee chose to sell the option into the open market in year six rather than exercising it, the employee's tax obligation would be $3.94 per share ($11.26 * 35%) on the vesting date and $2.07 [($25.09 - $11.26) * 15% long-term capital gains rate] on the trade date for a total tax obligation of $6.01 ($3.94 + $2.07). Therefore, if the employee chose to sell the option rather than exercise it, the employee would pay $1.63 ($7.64 - $6.01) per option less in taxes than if the option had been non-transferable. As the table below shows, the employee's tradable stock option payoffs assuming exercise and immediate sale or trade in year six are both higher than the employee's payoff assuming exercise and immediate sale of a non-tradable stock option in year six without taking into consideration the time value of money.

If Employee 9 holds the stock option for the duration of its contractual life and never exercises it, it will expire worthless. The employee will recognize a long-term capital loss of $11.26 and receive a $1.69 tax benefit (($0 expiration date market value - $11.26 vest date market value) * 15% long-term capital loss). This tax benefit at or after expiration can be used to offset some of the impact of the vest date tax payment of $3.94. Thus, ignoring the time value of money, Employee 9's net cost of the expired stock options is $2.25 per option.

Exhibit 16. Comparison of Hypothetical Tax Treatment for Employees

	Payoffs Assuming Exercise or Trade at End of Year 6 or Expiration at End of Year 10			
	Non-Tradable Stock Options	Non-Tradable Stock Options		
	Exercise	Exercise	Trade	Expire
Total Proceeds	$ 21.82	$ 21.82	$ 25.09	$ -
Vesting Date Tax	N/A	(3.94)	(3.94)	(3.94)
Exercise Date Tax (a)	(7.64)	(1.58)	N/A	N/A
Trade Date Tax	N/A	N/A	(2.07)	N/A
Expiration Date Tax Benefit (b)	N/A	N/A	N/A	1.69
Net Proceeds	$ 14.18	$ 16.30	$ 19.08	$ (2.25)

Note: These payoffs have not been adjusted for the time value of money.
(a) For the purpose of this example, we have assumed that the common stock is sold on the date that the stock option is exercised. If the employee exercised the option but continued to hold the stock, we believe that the employee would owe no tax at the exercise date.
(b) The loss is assumed to be a long-term capital loss. Tax benefit of $1.50 is calculated as follows: ($0 expiration date market value - $11.26 vest date market value) * 15% long-term capital gains income tax rate.

Source: Bear, Stearns & Co. Inc. estimates.

ACCOUNTING TREATMENT

We believe our proposal would be permissible under FAS No. 123R, the U.S. GAAP accounting standard governing the expensing of stock-based compensation. Under our method, the company would use the market to make most of the grant-date valuation assumptions. Once the company received the grant-date market valuation of the 2nd derivative instrument, it would then haircut the option valuations by assigning weighted-average best estimates of the probabilities of employee-specific performance assumptions. To aid market transparency, companies could disclose the final assumptions used in the option sale auctions and the additional assumptions about probability of employee forfeiture and expected probability of employees satisfying performance requirements in footnotes to the financial statements.

In **Exhibit 17**, we present an example of a basic disclosure a company using our structure might make in its financial statements. For purposes of this exhibit only, we assumed that the company's estimate of a 65.61% vesting rate over the vesting period ultimately proved to be inaccurate and the actual vesting rate was 80% over the period. As we demonstrate below, the company would still have the flexibility to adjust the aggregate compensation expense recorded over the vesting period from $65,651,000 to $80,000,000 by simply adjusting the number of RSOUs and RBUs that vest from the amount estimated on the grant date to the amount that vest on the vesting date.

Exhibit 17. Example of Potential Footnote Disclosures

RSOU and RBU Allocations:		
RSOU allocation	6,850,000	
RBU allocation	3,150,000	(funded by sale of 3,150,000 market-traded options on the RSOU grant date)
Stock options offered to employees on grant date	10,000,000	

2nd derivative stock option valuation based on open-market auction on the grant date (ignoring employee impairments):		
Assumptions inherent in the market valuation are:		
P: Stock price	$ 18.18	
E: Exercise price	$ 18.18	
d: Dividend rate	0.0%	
r: Risk-free rate	3.0%	
T: Contractual life in years	10.00	
σ: Volatility	40%	
Black-Scholes-Merton formula valuation	$ 10.00	

3rd derivative stock option valuation (option value including employee impairments):	**Grant-date FV Estimate**	
Market price of options sold in grant-date auction	$ 10.00	
Probability of the RSOUs or RBUs vesting	65.61%	based on a 10% annual forfeiture probability compounded over a four-year period
Grant-date value of RSOUs and RBUs	$ 6.56	

Computation of estimated and actual compensation expense:	**Grant-date Expense Estimate**	**Vest-date Expense Actual**
Number of RSOUs and RBUs granted	10,000,000	10,000,000
Probability of the RSOUs or RBUs vesting	65.61%	80.00%
Number of vested RSOUs and RBUs	6,561,000	8,000,000
Grant date value of market-traded option	$ 10.00	$ 10.00
Total pretax comp. recognized over vesting period	$ 65,610,000	$ 80,000,000
Total deferred tax asset	$ (22,963,500)	
Est. Agg. Post-tax compensation expense	$ 42,646,500	

Source: Bear, Stearns & Co. Inc. estimates.

We believe the accounting treatment for these instruments would be very similar to the treatment for restricted stock under FAS No. 123R. However, one difference would be that the restricted bond unit would likely need to be treated as a liability on the balance sheet.

In **Exhibit 18**, we present the income statement impacts of the hypothetical example used in this report under both the current structure and under our structure. The financial statement impacts, journal entries, and diluted EPS calculations supporting these income statement impacts can be found in **Appendices A** (our proposed structure) and **B** (the current structure). In this example, our structure resulted in slightly higher net income and diluted EPS during the vesting period. While our structure created less dilution than the current structure in this example, it is important to recognize that there are situations where our structure can create lower diluted EPS than the current structure.

Exhibit 18. Flow Chart of Bear Stearns Market-Traded Employee Stock Option Proposal

Assume:

1. Net income before the impact of the stock option grant program was $100,000,000 and there were 100,000,000 basic shares outstanding.
2. The estimated and actual forfeiture rate is 10% annually during the 4-year vesting period of the instruments.
3. The company grants $100,000,000 worth of option grants. See Exhibit 10 for more details. The post-tax impact under the current structure is $42,646,500 and $41,755,821 under our structure. The difference in net income is due to the interest income earned on the RBU instruments under our structure.
4. To grant the $100,000,000 worth of stock options, the company grants 13,947,002 options under the current structure or 10,000,000 options under our structure. Under the current structure, 9,150,628 stock options ultimately vest. While under the proposed structure only 6,561,000 of the 10,000,000 will vest with employees, 7,644,285 options will ultimately be issued by the end of year 4 since the market-traded stock options funded by the 3,150,000 RBUs are not subject to vesting or forfeiture.
5. All vested stock options are exercised on December 31 of year 6 and the proceeds are not used to buy back stock.

Note: See Appendices A and B for the calculations and journal entries made to arrive at these income statement impacts.

INCOME STATEMENT UNDER OUR STRUCTURE

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Net income before impact of stock option program	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000
Impact of stock option program on net income	(10,448,800)	(10,442,367)	(10,435,740)	(10,428,913)	-	-	-	-	-	-
Net income after impact of stock option program	89,551,200	89,557,633	89,564,260	89,571,087	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000
Basic EPS before impact of stock option program	1.00	1.00	1.00	1.00	1.00	1.00	0.93	0.93	0.93	0.93
Basic EPS after impact of stock option program	0.90	0.90	0.90	0.90	1.00	1.00	0.93	0.93	0.93	0.93
Diluted EPS before impact of stock option program	1.00	1.00	1.00	0.99	0.98	0.97	0.93	0.93	0.93	0.93
Diluted EPS after impact of stock option program	0.90	0.90	0.90	0.89	0.98	0.97	0.93	0.93	0.93	0.93
Basic shares	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	107,644,285	107,644,285	107,644,285	107,644,285
Diluted shares	100,000,000	100,000,000	100,000,000	100,701,529	102,192,080	103,616,862	107,644,285	107,644,285	107,644,285	107,644,285

INCOME STATEMENT UNDER CURRENT STRUCTURE

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Net income before impact of stock option program	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000
Impact of stock option program on net income	(10,661,625)	(10,661,625)	(10,661,625)	(10,661,625)	-	-	-	-	-	-
Net income after impact of stock option program	89,338,375	89,338,375	89,338,375	89,338,375	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000
Basic EPS before impact of stock option program	1.00	1.00	1.00	1.00	1.00	1.00	0.92	0.92	0.92	0.92
Basic EPS after impact of stock option program	0.89	0.89	0.89	0.89	1.00	1.00	0.92	0.92	0.92	0.92
Diluted EPS before impact of stock option program	1.00	1.00	0.99	0.98	0.97	0.97	0.92	0.92	0.92	0.92
Diluted EPS after impact of stock option program	0.89	0.89	0.88	0.88	0.97	0.97	0.92	0.92	0.92	0.92
Basic shares	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	109,150,628	109,150,628	109,150,628	109,150,628
Diluted shares	100,000,000	100,000,000	101,251,353	101,781,154	102,705,827	103,514,495	109,150,628	109,150,628	109,150,628	109,150,628

DIFFERENCE

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Net income before impact of stock option program	-	-	-	-	-	-	-	-	-	-
Impact of stock option program on net income	212,825	219,258	225,885	232,712	-	-	-	-	-	-
Net income after impact of stock option program	212,825	219,258	225,885	232,712	-	-	-	-	-	-
Basic EPS before impact of stock option program	-	-	-	-	-	-	0.01	0.01	0.01	0.01
Basic EPS after impact of stock option program	0.00	0.00	0.00	0.00	-	-	0.01	0.01	0.01	0.01
Diluted EPS before impact of stock option program	-	-	0.01	0.01	0.00	(0.00)	0.01	0.01	0.01	0.01
Diluted EPS after impact of stock option program	0.00	0.00	0.01	0.01	0.00	(0.00)	0.01	0.01	0.01	0.01
Basic shares	-	-	-	-	-	-	(1,506,343)	(1,506,343)	(1,506,343)	(1,506,343)
Diluted shares	-	-	(1,251,353)	(1,079,624)	(513,747)	102,367	(1,506,343)	(1,506,343)	(1,506,343)	(1,506,343)

Source: Bear, Stearns & Co. Inc. estimates.

THE DEMAND FOR A MARKET FOR EMPLOYEE STOCK OPTIONS

Currently, most market-traded stock options have lives less than two years. The creation of an employee stock option market-trading mechanism would open up a whole new class of long-duration market-traded options that could grow to encompass a larger market beyond employee stock options.

As mentioned earlier, employees are not the class of investors that will likely perceive the highest value or need for these long-term stock options. In our view, the group of investors that would be most likely to perceive the highest value in these instruments would be institutional investors such as investment companies that already hold large, long-term positions in many large-cap stocks. For example, an investment company that would have otherwise bought a long-term position of 100,000 shares of Company A stock for $1,818,000 (100,000 shares * $18.18 stock price) could also consider reducing its investment to $1,000,000 and buy 100,000 stock options or it could maintain its decision to make a $1,818,000 investment and buy 181,800 10-year stock options. While the stock option alternatives the investor can chose between with stock options are of higher risk, they also have the ability to create higher rates of return.

Further, the long-term stock option market could create another class of investment. For example, a company could build and market an investment vehicle with the sole purpose of proactively building a portfolio of various technology and growth companies' stock options.

Additionally, as was discussed earlier, the company itself may be an "investor." It appears that companies may see advantages to creating employee stock option repurchase programs that work in cooperation with or in place of their stock buyback programs.

THE CREATION OF A MARKET-PRICING MECHANISM

The mechanics of these transactions would work in a manner similar to private placements and Treasury auctions. Prior to the grant date, the structuring bank would organize a group of institutional investors with a desire to invest in non-restricted long-term stock options. On the grant date, the structuring bank would announce that it was receiving a basket of employee stock options from the issuing company and it would provide a general description of the options in the basket through an information plan including all the major option terms (strike price, dividend yield, contractual term, assumed interest rate, etc.) other than volatility. After receiving the basket description, each institutional investor would have the opportunity to submit a bid for a portion of the basket or the entire basket.

The auction would be conducted as a modified Dutch auction. Each bidder would submit a volatility bid. The volatility bid would be the last assumption that would be added to the other fixed and stated Black-Scholes-Merton formula assumptions and would make it possible to compute the bidder's perceived value of the options. Volatility would be used to adjust for the reality that different bidders may use different valuation methodologies. The bidder can adjust its submitted volatility bid from its actual estimate of volatility if the bidder does not believe that the other assumptions in the structuring bank's released description explicitly represent the true characteristics of the option.

Once all of the bidders have submitted their bids during the stated bidding period, the structuring bank would average the collected volatility bids to calculate an average volatility that would be used to compute the ultimate sale price. All successful bidders would receive the options at a price based of the average of the volatility bids received rather than based on each bidder's individual submitted volatility bid. Alternatively, the volatility assumption could be calculated based on an average of all *successful* bidders' volatility bids.

Given that the size of the option tranche may be relatively small and the holders of these instruments may be long-term investors, there may be a limited ability to continuously trade these instruments. To concentrate the volume of trading of this market, the structuring bank would create a contractual relationship with the issuing company in which the bank would agree to have periodic auctions of these instruments. The exclusivity of the placement with the bank would be a benefit to market participants. The existence of a structuring bank's exclusive auction right to the instruments would centralize all buyers and sellers into one market where the most competitive prices could be received.

For example, the bank may dictate that it will conduct auctions of these instruments every first Tuesday of a month. At that time, any potential buyer or seller of options would contact the bank and indicate their interest of participating in the auction. If the parties did not have the ability or desire to wait until the monthly auction, the parties could organize option sales through the OTC market.

An Example of the Market Mechanism

This is an extension of the Company A example. Assume the structuring bank receives bids from nine institutional investors for Company A's bucket of 3,150,000 stock options. The assumed number of options, market price, exercise price, dividend rate, life in years, and risk-free rate are included in the description of the basket sent to clients by the structuring bank. The structuring bank would set the minimum volatility bid that would be accepted at 33% (a volatility assumption that the structuring bank believes is a very conservative estimate of the expected volatility of the firm over the next ten years). Based on the terms released by the structuring bank, the following bids are submitted:

Exhibit 19. Hypothetical Bids for Stock Options by Market Participants

Basket Duration:	10 Years
Basket Size:	3,150,000
Volatility Floor Bid:	33%

Bids:

Bidding Firm	Volatility Bid	Bid Rank High to Low	Bid Quantity	Bid Quantity Filled	Purchase Price Per Option	Total Purchase Price
Firm C	49%	1	1,575,000	1,575,000	$ 10.00	$ 15,750,000
Firm D	47%	2	425,250	425,250	$ 10.00	$ 4,252,500
Firm I	46%	3	94,500	94,500	$ 10.00	$ 945,000
Firm F	42%	4	630,000	630,000	$ 10.00	$ 6,300,000
Firm A	41%	5	700,000	425,250	$ 10.00	$ 4,252,500
Firm G	40%	6	750,000	-	$ 10.00	$ -
Firm B	33%	7	2,000,000	-	$ 10.00	$ -
Firm E	33%	7	100,000	-	$ 10.00	$ -
Firm H	33%	7	3,000,000	-	$ 10.00	$ -
Average Volatility Bid:	**40%**	**Totals:**	**9,274,750**	**3,150,000**	**$ 10.00**	**$ 31,500,000**

Stock Price (P)	Exercise Price (E)	Dividend Rate (d)	Volatility (σ)	Life in Years (T)	Risk-free Rate (r)	**Calculated Call Option Value**
$ 18.18	$ 18.18	0.00%	40.00%	10.0	3.00%	**$ 10.00**

Source: Bear, Stearns & Co. Inc. estimates.

As shown in **Exhibit 19**, Firm C with a bid of 49% volatility submitted the highest volatility bid and will have its order filled first. In arriving at its value of the stock options, Firm C actually used a very complex binomial option pricing model rather than the Black-Scholes-Merton formula. Using its own modeling techniques, Firm C arrived at a valuation of each option of $11.36. In order to make its bid of $11.36 consistent with the structuring bank's bidding format using the Black-Scholes-Merton formula, Firm C adjusted its volatility bid to 49%. The 49% volatility assumption along with the assumption released by the structuring back resulted in a Black-Scholes-Merton formula valuation of $11.36.

Firm A was the last successful bidder with a partially-filled order of its bid. While Firm A's bid requested 700,000 options, there were only 425,250 options available to fill its order.

The average bid of all the bidders was 40%. Once the 40% volatility assumption is placed into the Black-Scholes-Merton formula with all of the other relevant assumptions, it is determined that the price that all successful bidders will pay is $10.00 per market-traded stock option.

As we stated earlier, our market mechanism is a model-neutral approach. While we used the Black-Scholes-Merton formula to create a standardized bidding process, the market participants are ultimately not required to use that particular methodology to arrive at their perceived value of the stock options. In **Appendix C**, we present an

example of a table that could be included as part of the information plan sent to prospective bidders. In Appendix A, five of the six Black-Scholes-Merton formula assumptions are set by the structuring firm. The table then provides the range of option values given volatility assumptions between 0% and 140%. By having the buyers bid volatility on the option, the process is trying to isolate the most important assumption in an option's valuation, yet there is also room within those bids to assume differences of opinion with regard to an appropriate valuation model. These tables can also be adjusted as they are in Appendix A to accommodate the issuance of multiple tranches of options with varying contractual lives. For example, instead of granting ten million, ten-year options, the company could have granted ten million options in multiple tranches with durations ranging from one year to ten years.

CONCLUSION

In this proposed structure we see a number of potentially positive implications for employers, employees, and market participants alike. From the perspective of the corporation, it gains a market value for its stock options, and the process of valuing employee stock options becomes significantly more transparent. The market will value the stock option and the company is left only with the responsibility to make responsible estimates of the adjustments that should be made for forfeiture and performance-based vesting requirements. We believe it is generally positive for investors when management assumptions can be replaced by market values.

In addition, a company could expose itself to less potential dilution with this structure than with a traditional employee stock option plan. The presence of the market increases the value of a vested instrument from its intrinsic value to its fair value. Theoretically, a company that intends to grant a fixed value of stock-based compensation can grant fewer stock options if the employees capture the fair value of the instrument rather than its lower intrinsic value. Also, as we have shown in this report, there is the legitimate potential that companies may have the opportunity to conduct more efficient share count management if they can also consider buying back deep in-the-money stock options rather than stock.

From a human resources perspective, the employees are still subject to the same vesting requirements that they would have been under the previous structure. Further, employees have the ability to structure their compensation between restricted stock option units and restricted bond units to meet their individual needs. This could potentially result in lower forfeiture levels because even if stock options ultimately are under-the-water and nearly worthless, the value of the restricted bond units is fixed and certain.

APPENDIX A. Company A Financial Statement Impacts and Journal Entries Under Our Structure

IMPACTS ON INCOME STATEMENT

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Compensation expense										
Compensation expense - RSOU and RBU	$ (16,402,500)	$ (16,402,500)	$ (16,402,500)	$ (16,402,500)	$ -	$ -	$ -	$ -	$ -	$ -
Compensation expense - RBU interest accrual	(624,665)	(643,545)	(662,996)	(683,035)	-	-	-	-	-	-
Compensation expense	(17,027,165)	(17,046,045)	(17,065,496)	(17,085,535)	-	-	-	-	-	-
Interest income	952,087	980,864	1,010,511	1,041,054	-	-	-	-	-	-
Impact on pretax net income	(16,075,077)	(16,065,181)	(16,054,985)	(16,044,482)	-	-	-	-	-	-
Tax expense:										
Current tax expense	(333,231)	(343,303)	(353,679)	(364,369)	23,878,484	-	-	-	-	-
Deferred tax expense	5,959,508	5,966,116	5,972,924	5,979,937	(23,878,484)	-	-	-	-	-
Total tax expense	5,626,277	5,622,813	5,619,245	5,615,569	-	-	-	-	-	-
Impact on net income	$ (10,448,800)	$ (10,442,367)	$ (10,435,740)	$ (10,428,913)	$ -	$ -	$ -	$ -	$ -	$ -
Impact on basic EPS	$ (0.10)	$ (0.10)	$ (0.10)	$ (0.10)	$ -	$ -	$ -	$ -	$ -	$ -
Impact on diluted EPS	$ (0.10)	$ (0.10)	$ (0.10)	$ (0.10)	$ -	$ -	$ -	$ -	$ -	$ -
Basic shares outstanding	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	107,644,285	107,644,285	107,644,285	107,644,285
Diluted shares outstanding	100,000,000	100,000,000	100,000,000	100,701,529	102,192,080	103,616,862	107,644,285	107,644,285	107,644,285	107,644,285

IMPACTS ON BALANCE SHEET

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
ASSETS:										
Cash										
Option exercise proceeds	$ -	$ -	$ -	$ -	$ -	$138,973,101	$138,973,101	$138,973,101	$138,973,101	$138,973,101
Tax benefit at vesting date	-	-	-	-	25,856,901	25,856,901	25,856,901	25,856,901	25,856,901	25,856,901
RBU proceeds	-	-	-	-	12,203,125	12,203,125	12,203,125	12,203,125	12,203,125	12,203,125
RBU taxes on interest	(333,231)	(676,533)	(1,030,212)	(1,394,581)	(1,394,581)	(1,394,581)	(1,394,581)	(1,394,581)	(1,394,581)	(1,394,581)
Total cash impact	(333,231)	(676,533)	(1,030,212)	(1,394,581)	36,665,445	175,638,547	175,638,547	175,638,547	175,638,547	175,638,547
Marketable Securities										
Held-to-maturity	31,500,000	31,500,000	31,500,000	31,500,000	-	-	-	-	-	-
Held-to-maturity - accrued interest	952,087	1,932,952	2,943,463	3,984,516	-	-	-	-	-	-
Total marketable securities	32,452,088	33,432,952	34,443,463	35,484,516	-	-	-	-	-	-
Deferred tax asset (assume 35% tax rate)	5,959,508	11,925,623	17,898,547	23,878,484	-	-	-	-	-	-
Total impact on assets	**$ 38,078,364**	**$ 44,682,042**	**$ 51,311,798**	**$ 57,968,420**	**$ 36,665,445**	**$175,638,547**	**$175,638,547**	**$175,638,547**	**$175,638,547**	**$175,638,547**
LIABILITIES:										
Deferred RBU liability	$ 5,791,452	$ 11,601,785	$ 17,431,568	$ 23,281,391	$ -	$ -	$ -	$ -	$ -	$ -
EQUITY:										
Common stock	-	-	-	-	-	76,443	76,443	76,443	76,443	76,443
Additional paid-in capital										
Common stock	-	-	-	-	-	217,317,925	217,317,925	217,317,925	217,317,925	217,317,925
SO	31,500,000	31,500,000	31,500,000	31,500,000	31,500,000	-	-	-	-	-
RSOU	11,235,713	22,471,425	33,707,138	44,942,850	46,921,267	-	-	-	-	-
Additional paid-in capital	42,735,713	53,971,425	65,207,138	76,442,850	78,421,267	217,394,368	217,394,368	217,394,368	217,394,368	217,394,368
Retained earnings	(10,448,800)	(20,891,168)	(31,326,908)	(41,755,821)	(41,755,821)	(41,755,821)	(41,755,821)	(41,755,821)	(41,755,821)	(41,755,821)
Total impact on liabilities and equity	**$ 38,078,364**	**$ 44,682,042**	**$ 51,311,798**	**$ 57,968,420**	**$ 36,665,445**	**$175,638,547**	**$175,638,547**	**$175,638,547**	**$175,638,547**	**$175,638,547**

Source: Bear, Stearns & Co. Inc. estimates.

APPENDIX A (Cont'd). Company A Financial Statement Impacts and Journal Entries Under Our Structure

JOURNAL ENTRIES

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
JE 1: Record compensation expense based on (((($10 per option * 10,000,000 options) * 65.61% retention) / 4 years). Expense is allocated 68.5% to SOs and 31.5% to RBUs.										
Dr. Compensation expense	16,402,500	16,402,500	16,402,500	16,402,500	-	-	-	-	-	-
Cr. Additional paid-in capital - RSOU (68.5%)	11,235,713	11,235,713	11,235,713	11,235,713	-	-	-	-	-	-
Cr. Deferred RBU liability (31.5%)	5,166,788	5,166,788	5,166,788	5,166,788	-	-	-	-	-	-
JE 2: Record deferred tax benefit equal to compensation expense multiplied by 35% tax rate.										
Dr. Deferred tax assets	5,740,875	5,740,875	5,740,875	5,740,875	-	-	-	-	-	-
Cr. Deferred tax expense	5,740,875	5,740,875	5,740,875	5,740,875	-	-	-	-	-	-
JE 3: Cash proceeds of $31,500,000 from open market sale of 3,150,000 unrestricted stock options for $10.00 each										
Dr. Cash	31,500,000	-	-	-	-	-	-	-	-	-
Cr. Additional paid-in capital (SO)	31,500,000	-	-	-	-	-	-	-	-	-
JE 4: Invest stock option sale proceeds into 4-year, zero-coupon, 3% semi-annual compounding Treasury bond.										
Dr. Marketable securities	31,500,000	-	-	-	-	-	-	-	-	-
Cr. Cash	31,500,000	-	-	-	-	-	-	-	-	-
JE 5: Record interest income on Treasury bond interest income.										
Dr. Marketable securities - Interest receivable	952,087	980,864	1,010,511	1,041,054	-	-	-	-	-	-
Cr. Interest income	952,087	980,864	1,010,511	1,041,054	-	-	-	-	-	-
JE 6: Record increase in deferred RBU liability as a result of employee's estimated share of Treasury bond interest income.										
Dr. Compensation expense (RBU interest accrual)	624,665	643,545	662,996	683,035	-	-	-	-	-	-
Cr. Deferred RBU liability (65.61% of interest)	624,665	643,545	662,996	683,035	-	-	-	-	-	-
JE 7: Record deferred tax benefit equal to compensation expense multiplied by 35% tax rate.										
Dr. Deferred tax assets	218,633	225,241	232,049	239,062	-	-	-	-	-	-
Cr. Deferred tax expense	218,633	225,241	232,049	239,062	-	-	-	-	-	-
JE 8: Pay taxes on interest income from Treasury bond.										
Dr. Current tax expense	333,231	343,303	353,679	364,369	-	-	-	-	-	-
Cr. Cash - Interest income taxes	333,231	343,303	353,679	364,369	-	-	-	-	-	-
JE 9: Receive cash proceeds from Treasury bond on vest date.										
Dr. Cash	-	-	-	-	35,484,516	-	-	-	-	-
Cr. Marketable securities	-	-	-	-	31,500,000	-	-	-	-	-
Cr. Marketable securities - Interest receivable	-	-	-	-	3,984,516	-	-	-	-	-
JE 10: Pay employees their share of the Treasury bond proceeds on the vest date.										
Dr. Deferred RBU liability	-	-	-	-	23,281,391	-	-	-	-	-
Cr. Cash	-	-	-	-	23,281,391	-	-	-	-	-
JE 11: Receive a tax benefit on the vesting date based on the value of the employee stock options [$25,856,901 = ((11.26 vesting-date fair value * (4,494,285 vested RSOUs + 2,066,715 vested RBUs)) * 35% tax rate)].										
Dr. Current income tax payable					25,856,901	-				
Cr. Current income tax benefit					23,878,484	-				
Cr. Additional paid-in capital - RSOU					1,978,417	-				
JE 12: Reverse deferred tax asset recorded over vesting period.										
Dr. Deferred tax expense	-	-	-	-	23,878,484	-	-	-	-	-
Cr. Deferred tax asset	-	-	-	-	23,878,484	-	-	-	-	-
JE 13: Reduction of income tax payable results in a cash saving due to lower cash taxes.										
Dr. Cash	-	-	-	-	25,856,901	-	-	-	-	-
Cr. Current income tax payable	-	-	-	-	25,856,901	-	-	-	-	-

Source: Bear, Stearns & Co. Inc. estimates.

APPENDIX A (Cont'd). Company A Financial Statement Impacts and Journal Entries Under Our Structure

JE 14: At the end of year 6, all market traded stock options are exercised for $138,973,101 (7,644,285 stock options * $18.18 exercise price).										
Dr. Cash	-	-	-	-	-	138,973,101	-	-	-	-
Cr. Common stock ($.01 per share * 7,644,285)	-	-	-	-	-	76,443	-	-	-	-
Cr. Additional paid-in capital - common stock	-	-	-	-	-	138,896,658	-	-	-	-
JE 15: Reclass RSOU and SO additional paid-in capital to common stock additional paid-in capital upon exercise of stock options.										
Dr. Additional paid-in capital - SO	-	-	-	-	-	31,500,000	-	-	-	-
Dr. Additional paid-in capital - RSOU	-	-	-	-	-	46,921,267	-	-	-	-
Cr. Additional paid-in capital - common stock	-	-	-	-	-	78,421,267	-	-	-	-

STOCK-BASED COMPENSATION DISCLOSURES

RSOU units:	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Outstanding at beginning of the year	-	6,165,000	5,548,500	4,993,650	4,494,285	4,494,285	-	-	-	-
Grants	6,850,000	-	-	-	-	-	-	-	-	-
Exercises	-	-	-	-	-	(4,494,285)	-	-	-	-
Forfeitures	(685,000)	(616,500)	(554,850)	(499,365)	-	-	-	-	-	-
Outstanding at end of the year	6,165,000	5,548,500	4,993,650	4,494,285	4,494,285	-	-	-	-	-
Market price of stock at end of the year	19.00	25.00	23.00	22.54	30.00	40.00	42.00	49.00	55.00	60.00
Average price of stock during the year	$ 18.59	$ 22.00	$ 24.00	$ 22.77	$ 26.27	$ 35.00	$ 41.00	$ 45.50	$ 52.00	$ 57.50
Market price of stock option at end of the year	10.18	14.62	12.31	11.26	16.83	25.09	26.10	32.06	37.36	10.33
Average market price of stock option during year	10.09	12.40	13.47	11.79	14.04	20.96	25.59	29.08	34.71	23.84
Price of market-traded stock option at year end	$ 10.18	$ 14.62	$ 12.31	$ 11.26	$ 16.83	$ 25.09	$ -	$ -	$ -	$ -
RSOUs outstanding at end of the year	6,165,000	5,548,500	4,993,650	4,494,285	4,494,285	-	-	-	-	-
MV of outstanding RSOUs at year end	62,787,028	81,109,571	61,482,604	50,619,147	75,622,616	-	-	-	-	-
MV of outstanding RSOUs expected to be forfeited	(17,015,284)	(15,410,818)	(6,148,260)	-	-	-	-	-	-	-
MV of outstanding RSOUs expected to vest	45,771,743	65,698,752	55,334,344	50,619,147	75,622,616	-	-	-	-	-

RBU units outstanding:	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Outstanding at beginning of the year	-	2,835,000	2,551,500	2,296,350	2,066,715
Grants	3,150,000	-	-	-	-
Exercises	-	-	-	-	(2,066,715)
Forfeitures	(315,000)	(283,500)	(255,150)	(229,635)	-
Outstanding at end of the year	2,835,000	2,551,500	2,296,350	2,066,715	-
YE value of underlying fixed income instrument	32,452,088	33,432,952	34,443,463	35,484,516	-
RBUs granted	3,150,000	3,150,000	3,150,000	3,150,000	-
Year-end value per RBU	$ 10.30	$ 10.61	$ 10.93	$ 11.26	$ -
Employee share of RBU units	2,835,000	2,551,500	2,296,350	2,066,715	-
Company share of RBU units	315,000	598,500	853,650	1,083,285	-
Total RBU units	3,150,000	3,150,000	3,150,000	3,150,000	-
Current employee YE share of RBU underlying	29,206,879	27,080,691	25,109,284	23,281,391	-
Reserve for expected future forfeiture	(7,915,064)	(5,145,331)	(2,510,928)	-	-
Current RBU liability	$ 21,291,815	$ 21,935,360	$ 22,598,356	$ 23,281,391	$ -

RBU underlying instrument value and income:				
Beginning of the year balance	$ -	$ 32,452,088	$ 33,432,952	$ 34,443,463
New RBU investments	31,500,000	-	-	-
Interest income	952,087	980,864	1,010,511	1,041,054
RBU underlying instrument value at end of year	$ 32,452,088	$ 33,432,952	$ 34,443,463	$ 35,484,516

Source: Bear, Stearns & Co. Inc. estimates.

APPENDIX A (Cont'd). Company A Financial Statement Impacts and Journal Entries Under Our Structure

DILUTED SHARE COUNT CALCULATION

Computation of Basic EPS:

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Net income before stock-based compensation	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000
Compensation expense										
Compensation expense - RSOU and RBU	(16,402,500)	(16,402,500)	(16,402,500)	(16,402,500)	-	-	-	-	-	-
Compensation expense - RBU interest accrual	(624,665)	(643,545)	(662,996)	(683,035)	-	-	-	-	-	-
Compensation expense	(17,027,165)	(17,046,045)	(17,065,496)	(17,085,535)	-	-	-	-	-	-
Interest income	952,087	980,864	1,010,511	1,041,054	-	-	-	-	-	-
Impact on pretax net income	(16,075,077)	(16,065,181)	(16,054,985)	(16,044,482)	-	-	-	-	-	-
Tax expense:										
Current tax expense	(333,231)	(343,303)	(353,679)	(364,369)	23,878,484	-	-	-	-	-
Deferred tax expense	5,959,508	5,966,116	5,972,924	5,979,937	(23,878,484)	-	-	-	-	-
Total tax expense	5,626,277	5,622,813	5,619,245	5,615,569	-	-	-	-	-	-
Net income after stock-based compensation and RBUs	$89,551,200	$89,557,633	$89,564,260	$89,571,087	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000
Basic earnings per share	$0.90	$0.90	$0.90	$0.90	$1.00	$1.00	$0.93	$0.93	$0.93	$0.93
Weighted-average common shares outstanding	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	107,644,285	107,644,285	107,644,285	107,644,285

Computation of assumed proceeds for diluted earnings per share:

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
In-the-money RSOUs and SOs at beginning of the year	10,000,000	9,657,500	9,006,750	8,421,075	7,893,968	7,644,285	-	-	-	-
In-the-money RSOUs and SOs at end of the year	9,657,500	9,006,750	8,421,075	7,893,968	7,644,285	7,644,285	-	-	-	-
Average in-the-money RSOUs and SOs at end of the year	9,828,750	9,332,125	8,713,913	8,157,521	7,769,126	7,644,285	-	-	-	-
Average exercise price	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18
Amount holders would pay if the weighted-average number of options outstanding were exercised	$178,686,675	$169,658,033	$158,418,929	$148,303,736	$141,242,715	$138,973,101	$ -	$ -	$ -	$ -
Average unrecognized compensation cost during year (see computation below)	87,500,000	62,500,000	37,500,000	12,500,000	-	-	-	-	-	-
Excess tax benefit (see computation below)	210,034	4,922,458	6,392,907	2,968,078	1,986,704	1,986,704	-	-	-	-
Assumed proceeds	$266,396,709	$237,080,491	$202,311,836	$163,771,814	$143,229,419	$140,959,805	$ -	$ -	$ -	$ -

Computation of average unrecognized compensation cost each year:

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Beginning of period										
Unrecognized compensation cost (10,00,000 × $10.00)	$100,000,000	$ 75,000,000	$ 50,000,000	$ 25,000,000	$ -	$ -	$ -	$ -	$ -	$ -
End of period										
Beginning of period	$100,000,000	$ 75,000,000	$ 50,000,000	$ 25,000,000	$ -	$ -	$ -	$ -	$ -	$ -
Annual compensation cost recognized, based on estimated forfeitures	(16,402,500)	(16,402,500)	(16,402,500)	(16,402,500)	-	-	-	-	-	-
Annual compensation cost not recognized during the period related to outstanding options at the end of the year, for which the requisite service is not expected to be rendered	(8,597,500)	(8,597,500)	(8,597,500)	(8,597,500)	-	-	-	-	-	-
Total unrecognized compensation cost, end of period, based on actual forfeitures	$ 75,000,000	$ 50,000,000	$ 25,000,000	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Subtotal	$175,000,000	$125,000,000	$ 75,000,000	$ 25,000,000	$ -	$ -	$ -	$ -	$ -	$ -
Average total unrecognized compensation, based on actual forfeitures	$87,500,000	$62,500,000	$37,500,000	$12,500,000	$0	$0	$0	$0	$0	$0

Source: Bear, Stearns & Co. Inc. estimates.

APPENDIX A (Cont'd). Company A Financial Statement Impacts and Journal Entries Under Our Structure

Computation of excess tax benefit:	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Average outstanding RSOUs (see computation below)	6,507,500	5,856,750	5,271,075	4,743,968	4,494,285	4,494,285	-	-	-	-
Average RSOU price for the year	$ 10.09	$ 12.40	$ 13.47	$ 11.79	$ 11.26	$ 11.26	$ -	$ -	$ -	$ -
Total fair value of average outstanding RSOUs	65,675,098	72,631,667	70,976,198	55,919,898	50,619,147	50,619,147	-	-	-	-
Average outstanding RSOUs (see computation below)	6,507,500	5,856,750	5,271,075	4,743,968	4,494,285	4,494,285		-	-	-
Fair value per RSOU (before forfeiture)	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00
Total compensation cost of average outstanding RSOUs	65,075,000	58,567,500	52,710,750	47,439,675	44,942,850	44,942,850	-	-	-	-
Excess tax benefit over estimated tax deduction (ignores RBU tax benefits as there should never be an excess benefit)	600,098	14,064,167	18,265,448	8,480,223	5,676,297	5,676,297	-	-	-	-
Tax rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%
Excess tax benefit benefit	$ 210,034	$ 4,922,458	$ 6,392,907	$ 2,968,078	$ 1,986,704	$ 1,986,704	$ -	$ -	$ -	$ -
Note: the year 5 and year 6 price for the RSOU are assumed to be $11.26 for purposes of the tax benefit calcuation since the tax benefit is based on the price of the RSOU on its vest date.										
In-the-money RSOUs at beginning of the year	6,850,000	6,165,000	5,548,500	4,993,650	4,494,285	4,494,285	-	-	-	-
In-the-money RBUs at beginning of the year	3,150,000	2,835,000	2,551,500	2,296,350	-	-	-	-	-	-
In-the-money RSOUs and SOs at beginning of the year	10,000,000	9,000,000	8,100,000	7,290,000	4,494,285	4,494,285	-	-	-	-
In-the-money RSOUs at end of the year	6,165,000	5,548,500	4,993,650	4,494,285	4,494,285	4,494,285	-	-	-	-
In-the-money RBUs at end of the year	2,835,000	2,551,500	2,296,350	2,066,715	-	-	-	-	-	-
In-the-money RSOUs and RBUs at end of the year	9,000,000	8,100,000	7,290,000	6,561,000	4,494,285	-	-	-	-	-
Exercises					2,066,715	4,494,285				
Forfeitures	1,000,000	1,900,000	2,710,000	3,439,000	3,439,000	5,505,715	-	-	-	-
Initial grant	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	-	-	-	-
Average in-the-money RSOUs at end of the year	6,507,500	5,856,750	5,271,075	4,743,968	4,494,285	4,494,285	-	-	-	-
Average in-the-money RBUs at end of the year	2,992,500	2,693,250	2,423,925	2,181,533	-	-	-	-	-	-
Average in-the-money RSOUs and RBUs at end of the year	9,500,000	8,550,000	7,695,000	6,925,500	4,494,285	4,494,285	-	-	-	-

Assumed repurchase of shares:	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Assumed proceeds (see computation above)	$266,396,709	$237,080,491	$202,311,836	$163,771,814	$143,229,419	$140,959,805	$ -	$ -	$ -	$ -
Average market price of stock during the year	18.59	22.00	24.00	22.77	26.27	35.00	41.00	45.50	52.00	57.50
Repurchased shares at average market price during the year	14,330,108	10,776,386	8,429,660	7,192,438	5,452,205	4,027,423	-	-	-	-
Average in-the-money RSOUs	6,507,500	5,856,750	5,271,075	4,743,968	4,494,285	4,494,285	-	-	-	-
Average in-the-money market-traded SOs	3,150,000	3,150,000	3,150,000	3,150,000	3,150,000	3,150,000	-	-	-	-
Average in-the-money RSOUs and SOs	9,657,500	9,006,750	8,421,075	7,893,968	7,644,285	7,644,285	-	-	-	-
Repurchased shares at average market price during the year	(14,330,108)	(10,776,386)	(8,429,660)	(7,192,438)	(5,452,205)	(4,027,423)	-	-	-	-
Incremental shares to include in diluted share count	-	-	-	701,529	2,192,080	3,616,862	-	-	-	-

Computation of Diluted EPS for the end of the year

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Net income	$89,551,200	$89,557,633	$89,564,260	$89,571,087	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000
Weighted-average common shares outstanding	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	107,644,285	107,644,285	107,644,285	107,644,285
Incremental shares	-	-	-	701,529	2,192,080	3,616,862	-	-	-	-
Diluted shares outstanding	100,000,000	100,000,000	100,000,000	100,701,529	102,192,080	103,616,862	107,644,285	107,644,285	107,644,285	107,644,285
Diluted earnings per share	$0.90	$0.90	$0.90	$0.89	$0.98	$0.97	$0.93	$0.93	$0.93	$0.93

Source: Bear, Stearns & Co. Inc. estimates.

APPENDIX B. Company A Financial Statement Impacts and Journal Entries Under Current Structure

IMPACTS ON INCOME STATEMENT

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Compensation expense	$ (16,402,500)	$ (16,402,500)	$ (16,402,500)	$ (16,402,500)	$ -	$ -	$ -	$ -	$ -	$ -
Impact on pretax net income	(16,402,500)	(16,402,500)	(16,402,500)	(16,402,500)	-	-	-	-	-	-
Tax expense:										
Current tax expense	-	-	-	-	-	22,963,500	-	-	-	-
Deferred tax expense	5,740,875	5,740,875	5,740,875	5,740,875	-	(22,963,500)	-	-	-	-
Total tax expense	5,740,875	5,740,875	5,740,875	5,740,875	-	-	-	-	-	-
Impact on net income	$ (10,661,625)	$ (10,661,625)	$ (10,661,625)	$ (10,661,625)	$ -	$ -	$ -	$ -	$ -	$ -
Impact on basic EPS	$ (0.11)	$ (0.11)	$ (0.11)	$ (0.11)	$ -	$ -	$ -	$ -	$ -	$ -
Impact on diluted EPS	$ (0.11)	$ (0.11)	$ (0.11)	$ (0.10)	$ -	$ -	$ -	$ -	$ -	$ -
Basic shares outstanding	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	109,150,628	109,150,628	109,150,628	109,150,628
Diluted shares outstanding	100,000,000	100,000,000	101,251,353	101,781,154	102,705,827	103,514,495	109,150,628	109,150,628	109,150,628	109,150,628

IMPACTS ON BALANCE SHEET

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
ASSETS:										
Cash										
Option exercise proceeds	$ -	$ -	$ -	$ -	$ -	$166,358,417	$166,358,417	$166,358,417	$166,358,417	$166,358,417
Tax benefit at exercise date	-	-	-	-	-	69,883,346	69,883,346	69,883,346	69,883,346	69,883,346
Total cash impact	-	-	-	-	-	236,241,763	236,241,763	236,241,763	236,241,763	236,241,763
Deferred tax asset (assume 35% tax rate)	5,740,875	11,481,750	17,222,625	22,963,500	22,963,500	-	-	-	-	-
Total impact on assets	**$ 5,740,875**	**$ 11,481,750**	**$ 17,222,625**	**$ 22,963,500**	**$ 22,963,500**	**$236,241,763**	**$236,241,763**	**$236,241,763**	**$236,241,763**	**$236,241,763**
LIABILITIES:										
No impact	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
EQUITY:										
Common stock	-	-	-	-	-	91,506	91,506	91,506	91,506	91,506
Additional paid-in capital										
Common stock	-	-	-	-	-	278,796,757	278,796,757	278,796,757	278,796,757	278,796,757
SO	16,402,500	32,805,000	49,207,500	65,610,000	65,610,000	-	-	-	-	-
Additional paid-in capital	16,402,500	32,805,000	49,207,500	65,610,000	65,610,000	278,888,263	278,888,263	278,888,263	278,888,263	278,888,263
Retained earnings	(10,661,625)	(21,323,250)	(31,984,875)	(42,646,500)	(42,646,500)	(42,646,500)	(42,646,500)	(42,646,500)	(42,646,500)	(42,646,500)
Total impact on liabilities and equity	**$ 5,740,875**	**$ 11,481,750**	**$ 17,222,625**	**$ 22,963,500**	**$ 22,963,500**	**$236,241,763**	**$236,241,763**	**$236,241,763**	**$236,241,763**	**$236,241,763**

Source: Bear, Stearns & Co. Inc. estimates.

APPENDIX B (Cont'd). Company A Financial Statement Impacts and Journal Entries Under Current Structure

JOURNAL ENTRIES

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
JE 1: Record compensation expense based on (((($7.17 per option * 13,947,002 options) * 65.61% retention) / 4 years).										
Dr. Compensation expense	16,402,500	16,402,500	16,402,500	16,402,500	-	-	-	-	-	-
Cr. Additional paid-in capital - SO	16,402,500	16,402,500	16,402,500	16,402,500	-	-	-	-	-	-
					-	-	-	-	-	-
JE 2: Record deferred tax benefit equal to compensation expense multiplied by 35% tax rate.										
Dr. Deferred tax assets	5,740,875	5,740,875	5,740,875	5,740,875	-	-	-	-	-	-
Cr. Deferred tax expense	5,740,875	5,740,875	5,740,875	5,740,875	-	-	-	-	-	-
JE 3: At the end of year 6, all market traded stock options are exercised for $138,973,101 (9,150,628 stock options * $18.18 exercise price) when the stock is trading at $40 per share.										
Dr. Cash	-	-	-	-	-	166,358,417	-	-	-	-
Cr. Common stock ($.01 per share * 9,150,628)	-	-	-	-	-	91,506	-	-	-	-
Cr. Additional paid-in capital - common stock	-	-	-	-	-	166,266,911	-	-	-	-
JE 4: Reclass stock option additional paid-in capital to common stock additional paid-in capital upon exercise of stock options.										
Dr. Additional paid-in capital - SO	-	-	-	-	-	65,610,000	-	-	-	-
Cr. Additional paid-in capital - common stock	-	-	-	-	-	65,610,000	-	-	-	-
JE 5: Receive a tax benefit on the exercise date based on the value of the employee stock options [$69,883,346 = (((($40.00 stock price - $18.18 exercise price) * 9,150,628 options) * 35% tax rate)].										
Dr. Current income tax payable						69,883,346				
Cr. Current income tax benefit						22,963,500				
Cr. Additional paid-in capital - common stock						46,919,846				
JE 6: Reverse deferred tax asset recorded over vesting period.										
Dr. Deferred tax expense	-	-	-	-	-	22,963,500	-	-	-	-
Cr. Deferred tax asset	-	-	-	-	-	22,963,500	-	-	-	-
JE 7: Reduction of income tax payable results in a cash saving due to lower cash taxes.										
Dr. Cash	-	-	-	-	-	69,883,346	-	-	-	-
Cr. Current income tax payable	-	-	-	-	-	69,883,346	-	-	-	-

STOCK-BASED COMPENSATION DISCLOSURES

SO units:	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Outstanding at beginning of the year	-	12,552,302	11,297,072	10,167,364	9,150,628	9,150,628	-	-	-	-
Grants	13,947,002	-	-	-	-	-	-	-	-	-
Exercises	-	-	-	-	-	(9,150,628)	-	-	-	-
Forfeitures	(1,394,700)	(1,255,230)	(1,129,707)	(1,016,736)	-	-	-	-	-	-
Outstanding at end of the year	12,552,302	11,297,072	10,167,364	9,150,628	9,150,628	-	-	-	-	-
Market price of stock at end of the year	$ 19.00	$ 25.00	$ 23.00	$ 22.54	$ 30.00	$ 40.00	$ 42.00	$ 49.00	$ 55.00	$ 60.00
Average price of stock during the year	$ 18.59	$ 22.00	$ 24.00	$ 22.77	$ 26.27	$ 35.00	$ 41.00	$ 45.50	$ 52.00	$ 57.50

Source: Bear, Stearns & Co. Inc. estimates.

APPENDIX B (Cont'd). Company A Financial Statement Impacts and Journal Entries Under Current Structure

DILUTED SHARE COUNT CALCULATION

Computation of basic EPS:	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Net income before stock-based compensation	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000
Compensation expense	16,402,500	16,402,500	16,402,500	16,402,500	-	-	-	-	-	-
Tax expense	(5,740,875)	(5,740,875)	(5,740,875)	(5,740,875)	-	-	-	-	-	-
Post-tax compensation expense	10,661,625	10,661,625	10,661,625	10,661,625	-	-	-	-	-	-
Net income after stock-based compensation	$89,338,375	$89,338,375	$89,338,375	$89,338,375	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000
Basic earnings per share	$0.89	$0.89	$0.89	$0.89	$1.00	$1.00	$0.92	$0.92	$0.92	$0.92
Weighted-average common shares outstanding	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	109,150,628	109,150,628	109,150,628	109,150,628

Computation of assumed proceeds for diluted earnings per share:	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
In-the-money SOs at beginning of the year	13,947,002	12,552,302	11,297,072	10,167,364	9,150,628	9,150,628	-	-	-	-
In-the-money SOs at end of the year	12,552,302	11,297,072	10,167,364	9,150,628	9,150,628	9,150,628	-	-	-	-
Average in-the-money SOs and SOs at end of the year	13,249,652	11,924,687	10,732,218	9,658,996	9,150,628	9,150,628	-	-	-	-
Average exercise price	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18	$ 18.18
Amount employees would pay if the weighted-average number of options outstanding were exercised	$240,878,672	$216,790,804	$195,111,724	$175,600,552	$166,358,417	$166,358,417	$ -	$ -	$ -	$ -
Average unrecognized compensation cost during year (see computation below)	87,500,000	62,500,000	37,500,000	12,500,000	-	-	-	-	-	-
Excess tax benefit (see computation below)	(31,348,676)	(13,981,695)	(5,070,973)	(8,722,074)	2,946,502	30,906,246	-	-	-	-
Assumed proceeds	$297,029,995	$265,309,109	$227,540,751	$179,378,478	$169,304,919	$197,264,663	$ -	$ -	$ -	$ -

Computation of average unrecognized compensation cost each year:										
Beginning of period	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Unrecognized compensation cost (13,947,002 × $7.17)	$100,000,000	$ 75,000,000	$ 50,000,000	$ 25,000,000	$ -	$ -	$ -	$ -	$ -	$ -
End of period										
Beginning of period	$100,000,000	$ 75,000,000	$ 50,000,000	$ 25,000,000	$ -	$ -	$ -	$ -	$ -	$ -
Annual compensation cost recognized, based on estimated forfeitures	(16,402,500)	(16,402,500)	(16,402,500)	(16,402,500)	-	-	-	-	-	-
Annual compensation cost not recognized during the period related to outstanding options at the end of the year, for which the requisite service is not expected to be rendered	(8,597,500)	(8,597,500)	(8,597,500)	(8,597,500)	-	-	-	-	-	-
Total unrecognized compensation cost, end of period, based on actual forfeitures	$ 75,000,000	$ 50,000,000	$ 25,000,000	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Subtotal	$175,000,000	$125,000,000	$ 75,000,000	$ 25,000,000	$ -	$ -	$ -	$ -	$ -	$ -
Average total unrecognized compensation, based on actual forfeitures	$87,500,000	$62,500,000	$37,500,000	$12,500,000	$0	$0	$0	$0	$0	$0

Source: Bear, Stearns & Co. Inc. estimates.

APPENDIX B (Cont'd). Company A Financial Statement Impacts and Journal Entries Under Current Structure

Computation of excess tax benefit:	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Average stock price for the year	$ 18.59	$ 22.00	$ 24.00	$ 22.77	$ 26.27	$ 35.00	$ 41.00	$ 45.50	$ 52.00	$ 57.50
Exercise price per option	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18
Intrinsic value per option	$ 0.41	$ 3.82	$ 5.82	$ 4.59	$ 8.09	$ 16.82	$ 22.82	$ 27.32	$ 33.82	$ 39.32
Average outstanding SOs (see computation below)	13,249,652	11,924,687	10,732,218	9,658,996	9,150,628	9,150,628	-	-	-	-
Total intrinsic value of average outstanding SOs	$ 5,432,357	$ 45,552,303	$ 62,461,509	$ 44,334,793	$ 74,028,581	$153,913,563	$ -	$ -	$ -	$ -
Average outstanding SOs (see computation below)	13,249,652	11,924,687	10,732,218	9,658,996	9,150,628	9,150,628	-	-	-	-
Fair value per SO (before forfeiture)	$ 7.17	$ 7.17	$ 7.17	$ 7.17	$ 7.17	$ 7.17	$ 7.17	$ 7.17	$ 7.17	$ 7.17
Total compensation cost of average outstanding SOs	$ 95,000,004	$ 85,500,004	$ 76,950,003	$ 69,255,003	$ 65,610,003	$ 65,610,003	$ -	$ -	$ -	$ -
Excess tax benefit over estimated tax deduction	$ (89,567,647)	$ (39,947,700)	$ (14,488,494)	$ (24,920,210)	$ 8,418,578	$ 88,303,560	$ -	$ -	$ -	$ -
Tax rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%
Excess tax benefit	$ (31,348,676)	$ (13,981,695)	$ (5,070,973)	$ (8,722,074)	$ 2,946,502	$ 30,906,246	$ -	$ -	$ -	$ -
In-the-money SOs at beginning of the year	13,947,002	12,552,302	11,297,072	10,167,364	9,150,628	9,150,628	-	-	-	-
In-the-money SOs at end of the year	12,552,302	11,297,072	10,167,364	9,150,628	9,150,628	9,150,628	-	-	-	-
Average in-the-money SOs and RBUs at end of the year	13,249,652	11,924,687	10,732,218	9,658,996	9,150,628	9,150,628	-	-	-	-

Assumed repurchase of shares:	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Assumed proceeds (see computation above)	$297,029,995	$265,309,109	$227,540,751	$179,378,478	$169,304,919	$197,264,663	$ -	$ -	$ -	$ -
Average market price of stock during the year	$ 18.59	$ 22.00	$ 24.00	$ 22.77	$ 26.27	$ 35.00	$ 41.00	$ 45.50	$ 52.00	$ 57.50
Repurchase shares at average market price during the year	15,977,945	12,059,505	9,480,865	7,877,843	6,444,801	5,636,133	-	-	-	-
In-the-money SOs at end of the year	13,249,652	11,924,687	10,732,218	9,658,996	9,150,628	9,150,628	-	-	-	-
Repurchase shares at average market price during the year	(15,977,945)	(12,059,505)	(9,480,865)	(7,877,843)	(6,444,801)	(5,636,133)	-	-	-	-
Incremental shares to include in diluted share count	-	-	1,251,353	1,781,154	2,705,827	3,514,495	-	-	-	-

Computation of diluted EPS for the end of the year:	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Net income	$89,338,375	$89,338,375	$89,338,375	$89,338,375	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000
Weighted-average common shares outstanding	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	109,150,628	109,150,628	109,150,628	109,150,628
Incremental shares	-	-	1,251,353	1,781,154	2,705,827	3,514,495	-	-	-	-
Total shares outstanding	100,000,000	100,000,000	101,251,353	101,781,154	102,705,827	103,514,495	109,150,628	109,150,628	109,150,628	109,150,628
Diluted earnings per share	$0.89	$0.89	$0.88	$0.88	$0.97	$0.97	$0.92	$0.92	$0.92	$0.92

Source: Bear, Stearns & Co. Inc. estimates.

APPENDIX C. Sample of an Information Sheet to Help Bidders Bid Volatility Assumptions

Assumptions Used in Black-Scholes-Merton Formula Calculations:										
P: Stock Price	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18
E: Exercise Price	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18
d: Dividend Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
r: Risk-free Rate	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.0%
T: Life in Years	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**

σ	Contractual Life									
Volatility	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
1%	$ 0.38	$ 0.77	$ 1.20	$ 1.65	$ 2.11	$ 2.59	$ 3.09	$ 3.60	$ 4.12	$ 4.65
2%	$ 0.40	$ 0.79	$ 1.20	$ 1.65	$ 2.11	$ 2.60	$ 3.09	$ 3.60	$ 4.12	$ 4.65
3%	$ 0.45	$ 0.83	$ 1.24	$ 1.67	$ 2.13	$ 2.60	$ 3.10	$ 3.61	$ 4.13	$ 4.65
4%	$ 0.51	$ 0.90	$ 1.30	$ 1.73	$ 2.17	$ 2.64	$ 3.12	$ 3.62	$ 4.14	$ 4.66
5%	$ 0.58	$ 0.98	$ 1.39	$ 1.80	$ 2.24	$ 2.70	$ 3.17	$ 3.66	$ 4.17	$ 4.68
6%	$ 0.64	$ 1.07	$ 1.48	$ 1.90	$ 2.33	$ 2.78	$ 3.25	$ 3.73	$ 4.22	$ 4.73
7%	$ 0.71	$ 1.16	$ 1.58	$ 2.01	$ 2.44	$ 2.89	$ 3.34	$ 3.82	$ 4.30	$ 4.80
8%	$ 0.78	$ 1.25	$ 1.69	$ 2.12	$ 2.55	$ 3.00	$ 3.46	$ 3.92	$ 4.40	$ 4.89
9%	$ 0.85	$ 1.34	$ 1.79	$ 2.24	$ 2.68	$ 3.12	$ 3.58	$ 4.04	$ 4.51	$ 5.00
10%	$ 0.92	$ 1.44	$ 1.91	$ 2.36	$ 2.81	$ 3.26	$ 3.71	$ 4.17	$ 4.64	$ 5.12
11%	$ 0.99	$ 1.53	$ 2.02	$ 2.48	$ 2.94	$ 3.39	$ 3.85	$ 4.31	$ 4.78	$ 5.25
12%	$ 1.06	$ 1.63	$ 2.13	$ 2.61	$ 3.07	$ 3.53	$ 3.99	$ 4.45	$ 4.92	$ 5.39
13%	$ 1.13	$ 1.73	$ 2.25	$ 2.74	$ 3.21	$ 3.68	$ 4.14	$ 4.60	$ 5.07	$ 5.53
14%	$ 1.20	$ 1.82	$ 2.36	$ 2.86	$ 3.35	$ 3.82	$ 4.29	$ 4.76	$ 5.22	$ 5.69
15%	$ 1.27	$ 1.92	$ 2.48	$ 2.99	$ 3.49	$ 3.97	$ 4.44	$ 4.91	$ 5.38	$ 5.84
16%	$ 1.34	$ 2.02	$ 2.59	$ 3.12	$ 3.63	$ 4.12	$ 4.60	$ 5.07	$ 5.54	$ 6.00
17%	$ 1.41	$ 2.12	$ 2.71	$ 3.26	$ 3.77	$ 4.27	$ 4.75	$ 5.23	$ 5.70	$ 6.17
18%	$ 1.49	$ 2.22	$ 2.83	$ 3.39	$ 3.91	$ 4.42	$ 4.91	$ 5.39	$ 5.86	$ 6.33
19%	$ 1.56	$ 2.31	$ 2.95	$ 3.52	$ 4.06	$ 4.57	$ 5.07	$ 5.55	$ 6.03	$ 6.50
20%	$ 1.63	$ 2.41	$ 3.06	$ 3.65	$ 4.20	$ 4.72	$ 5.23	$ 5.72	$ 6.19	$ 6.67
21%	$ 1.70	$ 2.51	$ 3.18	$ 3.78	$ 4.34	$ 4.87	$ 5.38	$ 5.88	$ 6.36	$ 6.83
22%	$ 1.77	$ 2.61	$ 3.30	$ 3.91	$ 4.48	$ 5.03	$ 5.54	$ 6.04	$ 6.53	$ 7.00
23%	$ 1.84	$ 2.71	$ 3.42	$ 4.05	$ 4.63	$ 5.18	$ 5.70	$ 6.21	$ 6.70	$ 7.17
24%	$ 1.91	$ 2.80	$ 3.53	$ 4.18	$ 4.77	$ 5.33	$ 5.86	$ 6.37	$ 6.87	$ 7.35
25%	$ 1.98	$ 2.90	$ 3.65	$ 4.31	$ 4.91	$ 5.48	$ 6.02	$ 6.54	$ 7.03	$ 7.52
26%	$ 2.05	$ 3.00	$ 3.77	$ 4.44	$ 5.06	$ 5.63	$ 6.18	$ 6.70	$ 7.20	$ 7.69
27%	$ 2.12	$ 3.10	$ 3.88	$ 4.57	$ 5.20	$ 5.79	$ 6.34	$ 6.86	$ 7.37	$ 7.86
28%	$ 2.20	$ 3.20	$ 4.00	$ 4.70	$ 5.34	$ 5.94	$ 6.50	$ 7.03	$ 7.54	$ 8.03
29%	$ 2.27	$ 3.29	$ 4.12	$ 4.83	$ 5.49	$ 6.09	$ 6.65	$ 7.19	$ 7.70	$ 8.20
30%	$ 2.34	$ 3.39	$ 4.23	$ 4.97	$ 5.63	$ 6.24	$ 6.81	$ 7.35	$ 7.87	$ 8.36
31%	$ 2.41	$ 3.49	$ 4.35	$ 5.10	$ 5.77	$ 6.39	$ 6.97	$ 7.52	$ 8.04	$ 8.53
32%	$ 2.48	$ 3.59	$ 4.47	$ 5.23	$ 5.91	$ 6.54	$ 7.12	$ 7.68	$ 8.20	$ 8.70
33%	$ 2.55	$ 3.68	$ 4.58	$ 5.36	$ 6.05	$ 6.69	$ 7.28	$ 7.84	$ 8.37	$ 8.87
34%	$ 2.62	$ 3.78	$ 4.70	$ 5.49	$ 6.19	$ 6.84	$ 7.44	$ 8.00	$ 8.53	$ 9.03
35%	$ 2.69	$ 3.88	$ 4.81	$ 5.61	$ 6.33	$ 6.98	$ 7.59	$ 8.16	$ 8.69	$ 9.20
36%	$ 2.76	$ 3.98	$ 4.93	$ 5.74	$ 6.47	$ 7.13	$ 7.74	$ 8.31	$ 8.85	$ 9.36
37%	$ 2.83	$ 4.07	$ 5.04	$ 5.87	$ 6.61	$ 7.28	$ 7.90	$ 8.47	$ 9.01	$ 9.52
38%	$ 2.90	$ 4.17	$ 5.16	$ 6.00	$ 6.75	$ 7.42	$ 8.05	$ 8.63	$ 9.17	$ 9.68
39%	$ 2.97	$ 4.26	$ 5.27	$ 6.13	$ 6.88	$ 7.57	$ 8.20	$ 8.78	$ 9.33	$ 9.84
40%	$ 3.04	$ 4.36	$ 5.39	$ 6.25	$ 7.02	$ 7.71	$ 8.35	$ 8.94	$ 9.49	$ 10.00
41%	$ 3.11	$ 4.46	$ 5.50	$ 6.38	$ 7.16	$ 7.86	$ 8.50	$ 9.09	$ 9.64	$ 10.16
42%	$ 3.18	$ 4.55	$ 5.61	$ 6.51	$ 7.29	$ 8.00	$ 8.65	$ 9.24	$ 9.80	$ 10.31
43%	$ 3.25	$ 4.65	$ 5.73	$ 6.63	$ 7.43	$ 8.14	$ 8.79	$ 9.39	$ 9.95	$ 10.47
44%	$ 3.32	$ 4.74	$ 5.84	$ 6.76	$ 7.56	$ 8.28	$ 8.94	$ 9.54	$ 10.10	$ 10.62
45%	$ 3.39	$ 4.84	$ 5.95	$ 6.88	$ 7.70	$ 8.42	$ 9.08	$ 9.69	$ 10.25	$ 10.77
46%	$ 3.46	$ 4.93	$ 6.06	$ 7.01	$ 7.83	$ 8.56	$ 9.23	$ 9.84	$ 10.40	$ 10.92
47%	$ 3.53	$ 5.03	$ 6.17	$ 7.13	$ 7.96	$ 8.70	$ 9.37	$ 9.98	$ 10.55	$ 11.07
48%	$ 3.60	$ 5.12	$ 6.28	$ 7.25	$ 8.09	$ 8.84	$ 9.51	$ 10.13	$ 10.69	$ 11.21
49%	$ 3.67	$ 5.22	$ 6.40	$ 7.37	$ 8.22	$ 8.98	$ 9.65	$ 10.27	$ 10.84	$ 11.36
50%	$ 3.74	$ 5.31	$ 6.51	$ 7.50	$ 8.35	$ 9.11	$ 9.79	$ 10.41	$ 10.98	$ 11.50
51%	$ 3.81	$ 5.41	$ 6.62	$ 7.62	$ 8.48	$ 9.25	$ 9.93	$ 10.55	$ 11.12	$ 11.64
52%	$ 3.88	$ 5.50	$ 6.73	$ 7.74	$ 8.61	$ 9.38	$ 10.07	$ 10.69	$ 11.26	$ 11.78
53%	$ 3.95	$ 5.59	$ 6.83	$ 7.86	$ 8.74	$ 9.51	$ 10.21	$ 10.83	$ 11.40	$ 11.92
54%	$ 4.02	$ 5.69	$ 6.94	$ 7.98	$ 8.87	$ 9.65	$ 10.34	$ 10.97	$ 11.54	$ 12.06
55%	$ 4.09	$ 5.78	$ 7.05	$ 8.10	$ 8.99	$ 9.78	$ 10.47	$ 11.10	$ 11.67	$ 12.19
56%	$ 4.16	$ 5.87	$ 7.16	$ 8.21	$ 9.12	$ 9.91	$ 10.61	$ 11.24	$ 11.81	$ 12.32
57%	$ 4.23	$ 5.97	$ 7.27	$ 8.33	$ 9.24	$ 10.03	$ 10.74	$ 11.37	$ 11.94	$ 12.46
58%	$ 4.30	$ 6.06	$ 7.37	$ 8.45	$ 9.36	$ 10.16	$ 10.87	$ 11.50	$ 12.07	$ 12.58
59%	$ 4.36	$ 6.15	$ 7.48	$ 8.57	$ 9.49	$ 10.29	$ 11.00	$ 11.63	$ 12.20	$ 12.71
60%	$ 4.43	$ 6.24	$ 7.59	$ 8.68	$ 9.61	$ 10.41	$ 11.12	$ 11.76	$ 12.32	$ 12.84
61%	$ 4.50	$ 6.33	$ 7.69	$ 8.80	$ 9.73	$ 10.54	$ 11.25	$ 11.88	$ 12.45	$ 12.96
62%	$ 4.57	$ 6.42	$ 7.80	$ 8.91	$ 9.85	$ 10.66	$ 11.38	$ 12.01	$ 12.57	$ 13.08
63%	$ 4.64	$ 6.52	$ 7.90	$ 9.02	$ 9.97	$ 10.78	$ 11.50	$ 12.13	$ 12.70	$ 13.20
64%	$ 4.71	$ 6.61	$ 8.01	$ 9.14	$ 10.09	$ 10.90	$ 11.62	$ 12.25	$ 12.82	$ 13.32
65%	$ 4.77	$ 6.70	$ 8.11	$ 9.25	$ 10.20	$ 11.02	$ 11.74	$ 12.37	$ 12.94	$ 13.44
66%	$ 4.84	$ 6.79	$ 8.21	$ 9.36	$ 10.32	$ 11.14	$ 11.86	$ 12.49	$ 13.05	$ 13.55
67%	$ 4.91	$ 6.88	$ 8.32	$ 9.47	$ 10.44	$ 11.26	$ 11.98	$ 12.61	$ 13.17	$ 13.66
68%	$ 4.98	$ 6.97	$ 8.42	$ 9.58	$ 10.55	$ 11.38	$ 12.10	$ 12.73	$ 13.28	$ 13.78
69%	$ 5.05	$ 7.05	$ 8.52	$ 9.69	$ 10.66	$ 11.49	$ 12.21	$ 12.84	$ 13.39	$ 13.88
70%	$ 5.11	$ 7.14	$ 8.62	$ 9.80	$ 10.78	$ 11.61	$ 12.32	$ 12.95	$ 13.50	$ 13.99

Source: Bear, Stearns & Co. Inc. estimates.

APPENDIX C (Cont'd). Sample of an Information Sheet to Help Bidders Bid Volatility Assumptions

Assumptions Used in Black-Scholes-Merton Formula Calculations:

P: Stock Price	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18
E: Exercise Price	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18	18.18
d: Dividend Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
r: Risk-free Rate	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.0%
T: Life in Years	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**

σ	**Contractual Life**									
Volatility	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
71%	$ 5.18	$ 7.23	$ 8.72	$ 9.91	$ 10.89	$ 11.72	$ 12.44	$ 13.06	$ 13.61	$ 14.10
72%	$ 5.25	$ 7.32	$ 8.82	$ 10.01	$ 11.00	$ 11.83	$ 12.55	$ 13.17	$ 13.72	$ 14.20
73%	$ 5.31	$ 7.41	$ 8.92	$ 10.12	$ 11.11	$ 11.94	$ 12.66	$ 13.28	$ 13.82	$ 14.30
74%	$ 5.38	$ 7.50	$ 9.02	$ 10.22	$ 11.21	$ 12.05	$ 12.77	$ 13.39	$ 13.93	$ 14.40
75%	$ 5.45	$ 7.58	$ 9.12	$ 10.33	$ 11.32	$ 12.16	$ 12.87	$ 13.49	$ 14.03	$ 14.50
76%	$ 5.52	$ 7.67	$ 9.22	$ 10.43	$ 11.43	$ 12.27	$ 12.98	$ 13.60	$ 14.13	$ 14.60
77%	$ 5.58	$ 7.76	$ 9.31	$ 10.54	$ 11.53	$ 12.37	$ 13.08	$ 13.70	$ 14.23	$ 14.69
78%	$ 5.65	$ 7.84	$ 9.41	$ 10.64	$ 11.64	$ 12.48	$ 13.19	$ 13.80	$ 14.32	$ 14.78
79%	$ 5.72	$ 7.93	$ 9.51	$ 10.74	$ 11.74	$ 12.58	$ 13.29	$ 13.90	$ 14.42	$ 14.88
80%	$ 5.78	$ 8.01	$ 9.60	$ 10.84	$ 11.84	$ 12.68	$ 13.39	$ 13.99	$ 14.51	$ 14.96
81%	$ 5.85	$ 8.10	$ 9.70	$ 10.94	$ 11.95	$ 12.78	$ 13.49	$ 14.09	$ 14.61	$ 15.05
82%	$ 5.91	$ 8.18	$ 9.79	$ 11.04	$ 12.05	$ 12.88	$ 13.58	$ 14.18	$ 14.70	$ 15.14
83%	$ 5.98	$ 8.27	$ 9.89	$ 11.14	$ 12.15	$ 12.98	$ 13.68	$ 14.28	$ 14.78	$ 15.22
84%	$ 6.05	$ 8.35	$ 9.98	$ 11.23	$ 12.24	$ 13.08	$ 13.78	$ 14.37	$ 14.87	$ 15.30
85%	$ 6.11	$ 8.44	$ 10.07	$ 11.33	$ 12.34	$ 13.17	$ 13.87	$ 14.46	$ 14.96	$ 15.38
86%	$ 6.18	$ 8.52	$ 10.16	$ 11.43	$ 12.44	$ 13.27	$ 13.96	$ 14.54	$ 15.04	$ 15.46
87%	$ 6.24	$ 8.60	$ 10.26	$ 11.52	$ 12.53	$ 13.36	$ 14.05	$ 14.63	$ 15.12	$ 15.54
88%	$ 6.31	$ 8.69	$ 10.35	$ 11.62	$ 12.63	$ 13.45	$ 14.14	$ 14.72	$ 15.20	$ 15.62
89%	$ 6.37	$ 8.77	$ 10.44	$ 11.71	$ 12.72	$ 13.55	$ 14.23	$ 14.80	$ 15.28	$ 15.69
90%	$ 6.44	$ 8.85	$ 10.53	$ 11.80	$ 12.81	$ 13.64	$ 14.31	$ 14.88	$ 15.36	$ 15.76
91%	$ 6.50	$ 8.93	$ 10.62	$ 11.89	$ 12.90	$ 13.72	$ 14.40	$ 14.96	$ 15.43	$ 15.83
92%	$ 6.57	$ 9.01	$ 10.71	$ 11.98	$ 12.99	$ 13.81	$ 14.48	$ 15.04	$ 15.51	$ 15.90
93%	$ 6.63	$ 9.10	$ 10.79	$ 12.07	$ 13.08	$ 13.90	$ 14.57	$ 15.12	$ 15.58	$ 15.97
94%	$ 6.70	$ 9.18	$ 10.88	$ 12.16	$ 13.17	$ 13.98	$ 14.65	$ 15.20	$ 15.65	$ 16.04
95%	$ 6.76	$ 9.26	$ 10.97	$ 12.25	$ 13.26	$ 14.07	$ 14.73	$ 15.27	$ 15.72	$ 16.10
96%	$ 6.82	$ 9.34	$ 11.05	$ 12.34	$ 13.35	$ 14.15	$ 14.81	$ 15.34	$ 15.79	$ 16.16
97%	$ 6.89	$ 9.42	$ 11.14	$ 12.43	$ 13.43	$ 14.23	$ 14.88	$ 15.42	$ 15.86	$ 16.22
98%	$ 6.95	$ 9.49	$ 11.22	$ 12.51	$ 13.51	$ 14.31	$ 14.96	$ 15.49	$ 15.92	$ 16.28
99%	$ 7.01	$ 9.57	$ 11.31	$ 12.60	$ 13.60	$ 14.39	$ 15.03	$ 15.56	$ 15.99	$ 16.34
100%	$ 7.08	$ 9.65	$ 11.39	$ 12.68	$ 13.68	$ 14.47	$ 15.11	$ 15.62	$ 16.05	$ 16.40
101%	$ 7.14	$ 9.73	$ 11.48	$ 12.77	$ 13.76	$ 14.55	$ 15.18	$ 15.69	$ 16.11	$ 16.46
102%	$ 7.20	$ 9.81	$ 11.56	$ 12.85	$ 13.84	$ 14.62	$ 15.25	$ 15.76	$ 16.17	$ 16.51
103%	$ 7.27	$ 9.88	$ 11.64	$ 12.93	$ 13.92	$ 14.70	$ 15.32	$ 15.82	$ 16.23	$ 16.56
104%	$ 7.33	$ 9.96	$ 11.72	$ 13.01	$ 14.00	$ 14.77	$ 15.39	$ 15.88	$ 16.29	$ 16.61
105%	$ 7.39	$ 10.04	$ 11.80	$ 13.09	$ 14.07	$ 14.84	$ 15.45	$ 15.94	$ 16.34	$ 16.66
106%	$ 7.46	$ 10.11	$ 11.88	$ 13.17	$ 14.15	$ 14.91	$ 15.52	$ 16.00	$ 16.40	$ 16.71
107%	$ 7.52	$ 10.19	$ 11.96	$ 13.25	$ 14.22	$ 14.98	$ 15.58	$ 16.06	$ 16.45	$ 16.76
108%	$ 7.58	$ 10.26	$ 12.04	$ 13.33	$ 14.30	$ 15.05	$ 15.65	$ 16.12	$ 16.50	$ 16.81
109%	$ 7.64	$ 10.34	$ 12.12	$ 13.40	$ 14.37	$ 15.12	$ 15.71	$ 16.18	$ 16.55	$ 16.85
110%	$ 7.70	$ 10.41	$ 12.19	$ 13.48	$ 14.44	$ 15.19	$ 15.77	$ 16.23	$ 16.60	$ 16.90
111%	$ 7.77	$ 10.49	$ 12.27	$ 13.55	$ 14.51	$ 15.25	$ 15.83	$ 16.29	$ 16.65	$ 16.94
112%	$ 7.83	$ 10.56	$ 12.35	$ 13.63	$ 14.58	$ 15.32	$ 15.89	$ 16.34	$ 16.70	$ 16.98
113%	$ 7.89	$ 10.63	$ 12.42	$ 13.70	$ 14.65	$ 15.38	$ 15.95	$ 16.39	$ 16.74	$ 17.02
114%	$ 7.95	$ 10.71	$ 12.50	$ 13.77	$ 14.72	$ 15.44	$ 16.00	$ 16.44	$ 16.79	$ 17.06
115%	$ 8.01	$ 10.78	$ 12.57	$ 13.85	$ 14.79	$ 15.51	$ 16.06	$ 16.49	$ 16.83	$ 17.10
116%	$ 8.07	$ 10.85	$ 12.65	$ 13.92	$ 14.86	$ 15.57	$ 16.11	$ 16.54	$ 16.87	$ 17.14
117%	$ 8.13	$ 10.92	$ 12.72	$ 13.99	$ 14.92	$ 15.63	$ 16.17	$ 16.59	$ 16.92	$ 17.17
118%	$ 8.19	$ 10.99	$ 12.79	$ 14.06	$ 14.98	$ 15.68	$ 16.22	$ 16.63	$ 16.96	$ 17.21
119%	$ 8.25	$ 11.06	$ 12.86	$ 14.12	$ 15.05	$ 15.74	$ 16.27	$ 16.68	$ 17.00	$ 17.24
120%	$ 8.31	$ 11.13	$ 12.93	$ 14.19	$ 15.11	$ 15.80	$ 16.32	$ 16.72	$ 17.03	$ 17.28
121%	$ 8.37	$ 11.20	$ 13.00	$ 14.26	$ 15.17	$ 15.85	$ 16.37	$ 16.77	$ 17.07	$ 17.31
122%	$ 8.43	$ 11.27	$ 13.07	$ 14.32	$ 15.23	$ 15.91	$ 16.42	$ 16.81	$ 17.11	$ 17.34
123%	$ 8.49	$ 11.34	$ 13.14	$ 14.39	$ 15.29	$ 15.96	$ 16.46	$ 16.85	$ 17.14	$ 17.37
124%	$ 8.55	$ 11.41	$ 13.21	$ 14.45	$ 15.35	$ 16.01	$ 16.51	$ 16.89	$ 17.18	$ 17.40
125%	$ 8.61	$ 11.48	$ 13.28	$ 14.52	$ 15.41	$ 16.06	$ 16.56	$ 16.93	$ 17.21	$ 17.43
126%	$ 8.67	$ 11.55	$ 13.35	$ 14.58	$ 15.47	$ 16.11	$ 16.60	$ 16.96	$ 17.24	$ 17.45
127%	$ 8.73	$ 11.61	$ 13.41	$ 14.64	$ 15.52	$ 16.16	$ 16.64	$ 17.00	$ 17.27	$ 17.48
128%	$ 8.79	$ 11.68	$ 13.48	$ 14.70	$ 15.58	$ 16.21	$ 16.68	$ 17.04	$ 17.30	$ 17.51
129%	$ 8.84	$ 11.75	$ 13.54	$ 14.76	$ 15.63	$ 16.26	$ 16.73	$ 17.07	$ 17.33	$ 17.53
130%	$ 8.90	$ 11.81	$ 13.61	$ 14.82	$ 15.68	$ 16.31	$ 16.77	$ 17.11	$ 17.36	$ 17.56
131%	$ 8.96	$ 11.88	$ 13.67	$ 14.88	$ 15.74	$ 16.35	$ 16.81	$ 17.14	$ 17.39	$ 17.58
132%	$ 9.02	$ 11.94	$ 13.74	$ 14.94	$ 15.79	$ 16.40	$ 16.84	$ 17.17	$ 17.42	$ 17.60
133%	$ 9.08	$ 12.01	$ 13.80	$ 15.00	$ 15.84	$ 16.44	$ 16.88	$ 17.20	$ 17.45	$ 17.62
134%	$ 9.13	$ 12.07	$ 13.86	$ 15.06	$ 15.89	$ 16.49	$ 16.92	$ 17.24	$ 17.47	$ 17.65
135%	$ 9.19	$ 12.14	$ 13.92	$ 15.11	$ 15.94	$ 16.53	$ 16.95	$ 17.27	$ 17.50	$ 17.67
136%	$ 9.25	$ 12.20	$ 13.98	$ 15.17	$ 15.99	$ 16.57	$ 16.99	$ 17.29	$ 17.52	$ 17.69
137%	$ 9.30	$ 12.26	$ 14.04	$ 15.22	$ 16.03	$ 16.61	$ 17.02	$ 17.32	$ 17.54	$ 17.71
138%	$ 9.36	$ 12.33	$ 14.10	$ 15.28	$ 16.08	$ 16.65	$ 17.06	$ 17.35	$ 17.57	$ 17.72
139%	$ 9.42	$ 12.39	$ 14.16	$ 15.33	$ 16.13	$ 16.69	$ 17.09	$ 17.38	$ 17.59	$ 17.74
140%	$ 9.47	$ 12.45	$ 14.22	$ 15.38	$ 16.17	$ 16.73	$ 17.12	$ 17.40	$ 17.61	$ 17.76

Source: Bear, Stearns & Co. Inc. estimates.

Addendum

Important Disclosures

For important disclosure information regarding the companies in this report, please contact your registered representative at 1-888-473-3819, or write to Sandra Pallante, Equity Research Compliance, Bear, Stearns & Co. Inc., 383 Madison Avenue, New York, NY 10179.

Ratings for Stocks (vs. analyst coverage)
Outperform (O) — Stock is projected to outperform analyst's industry coverage universe over the next 12 months.
Peer Perform (P) — Stock is projected to perform approximately in line with analyst's industry coverage universe over the next 12 months.
Underperform (U) — Stock is projected to underperform analyst's industry coverage universe over the next 12 months.

Ratings for Sectors (vs. regional broader market index)
Market Overweight (MO) — Expect the industry to perform better than the primary market index for the region (S&P 500 in the U.S.) over the next 12 months.
Market Weight (MW) — Expect the industry to perform approximately in line with the primary market index for the region (S&P 500 in the U.S.) over the next 12 months.
Market Underweight (MU) — Expect the industry to underperform the primary market index for the region (S&P 500 in the U.S.) over the next 12 months.

Bear, Stearns & Co. ratings distribution as of June 30, 2006
(% rated companies/% banking client in the last 12 months):
Outperform (Buy): 45.6%/10.0%
Peer Perform (Neutral): 45.7%/9.4%
Underperform (Sell): 8.7%/2.0%

For individual coverage industry data, please contact your account executive or visit www.bearstearns.com.

Addendum

Important Disclosures

Analyst Certification
The Research Analyst(s) who prepared the research report hereby certify that the views expressed in this research report accurately reflect the analyst(s) personal views about the subject companies and their securities. The Research Analyst(s) also certify that the Analyst(s) have not been, are not, and will not be receiving direct or indirect compensation for expressing the specific recommendation(s) or view(s) in this report.
Pat McConnell, CPA

The costs and expenses of Equity Research, including the compensation of the analyst(s) that prepared this report, are paid out of the Firm's total revenues, a portion of which is generated through investment banking activities.

This report has been prepared in accordance with the Firm's conflict management policies. Bear Stearns is unconditionally committed to the integrity, objectivity, and independence of its research. Bear Stearns research analysts and personnel report to the Director of Research and are not subject to the direct or indirect supervision or control of any other Firm department (or members of such department).

This publication and any recommendation contained herein speak only as of the date hereof and are subject to change without notice. Bear Stearns and its affiliated companies and employees shall have no obligation to update or amend any information or opinion contained herein, and the frequency of subsequent publications, if any, remain in the discretion of the author and the Firm.

The analysts that prepared this report may be actively associated with various industry groups such as the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB).

Other Disclaimers

This report has been prepared by Bear, Stearns & Co. Inc., Bear, Stearns International Limited or Bear Stearns Asia Limited (together with their affiliates, "Bear Stearns"), as indicated on the cover page hereof. This report has been adopted and approved for distribution in the United States by Bear, Stearns & Co. Inc. for its and its affiliates' customers. If you are a recipient of this publication in the United States, orders in any securities referred to herein should be placed with Bear, Stearns & Co. Inc. This report has been approved for publication in the United Kingdom by Bear, Stearns International Limited, which is authorized and regulated by the United Kingdom Financial Services Authority. Private Customers in the U.K. should contact their Bear, Stearns International Limited representatives about the investments concerned. This report is distributed in Hong Kong by Bear Stearns Asia Limited, which is regulated by the Securities and Futures Commission of Hong Kong. Additional information is available upon request.

Bear Stearns and its employees, officers, and directors deal as principal in transactions involving the securities referred to herein (or options or other instruments related thereto), including in transactions which may be contrary to any recommendations contained herein. Bear Stearns and its employees may also have engaged in transactions with issuers identified herein. Bear Stearns is affiliated with a specialist that may make a market in the securities of the issuers referred to in this document, and such specialist may have a position (long or short) and may be on the opposite side of public orders in such securities.

This publication does not constitute an offer or solicitation of any transaction in any securities referred to herein. Any recommendation contained herein may not be suitable for all investors. Although the information contained in the subject report (not including disclosures contained herein) has been obtained from sources we believe to be reliable, the accuracy and completeness of such information and the opinions expressed herein cannot be guaranteed. This publication and any recommendation contained herein speak only as of the date hereof and are subject to change without notice. Bear Stearns and its affiliated companies and employees shall have no obligation to update or amend any information or opinion contained herein.

This publication is being furnished to you for informational purposes only and on the condition that it will not form the sole basis for any investment decision. Each investor must make their own determination of the appropriateness of an investment in any securities referred to herein based on the tax, or other considerations applicable to such investor and its own investment strategy. By virtue of this publication, neither Bear Stearns nor any of its employees nor any data provider or any of its employees shall be responsible for any investment decision.

This report may discuss numerous securities, some of which may not be qualified for sale in certain states and may therefore not be offered to investors in such states. This document should not be construed as providing investment services. Investing in non-U.S. securities including ADRs involves significant risks such as fluctuation of exchange rates that may have adverse effects on the value or price of income derived from the security. Securities of some foreign companies may be less liquid and prices more volatile than securities of U.S. companies. Securities of non-U.S. issuers may not be registered with or subject to Securities and Exchange Commission reporting requirements; therefore, information regarding such issuers may be limited.

NOTE TO ACCOUNT EXECUTIVES: For securities that are not listed on the NYSE, AMEX, or Nasdaq National Market System, check the Compliance page of the Bear Stearns Intranet site for State Blue Sky data prior to soliciting or accepting orders from clients.

CIR 230 Disclaimer

Bear Stearns does not provide tax, legal or accounting advice. You should consult your own tax, legal and accounting advisors before engaging in any transaction.

In order for Bear Stearns to comply with Internal Revenue Service Circular 230 (if applicable), you are notified that any discussion of U.S. federal tax issues contained or referred to herein is not intended or written to be used, and cannot be used, for the purpose of: (A) avoiding penalties that may be imposed under the Internal Revenue Code; nor (B) promoting, marketing or recommending to another party any transaction or matter discussed herein.