

EMPLOYEE STOCK OPTIONS

1. What is a Stock Option?

A stock option is a right to buy a certain number of shares in the Company at a fixed price for a certain number of years. The fixed price is called the "grant," "exercise" or "strike" price and is typically the market value of the stock at the time the option is granted.

2. Is having a stock option the same as owning shares in the Company?

No, stock options do not provide for immediate direct ownership, but rather provide the opportunity to buy stock in the future at a discount.

3. Are there different types of stock options?

Yes, there are two main types of employee stock options: incentive stock options and non-qualified stock options.

4. What is an incentive stock option (ISO)?

An incentive stock option (ISO) is an option that meets the Internal Revenue Code's requirements for preferential tax treatment. Generally, an ISO enables an employee to 1) defer taxation on the option from the date of exercise until the date of sale of the underlying shares of stock and 2) pay taxes at capital gains rates, rather than ordinary rates, on the gain in the value of the stock when the shares are sold.

To qualify as an ISO, the following conditions must be met:

- ◆ Only employees can qualify for an ISO.
- ◆ The employee must hold the stock for at least one year after the exercise date or two years after the grant date, whichever is later.
- ◆ Only \$100,000 in value of stock options (determined as of the grant date) can first become exercisable in any year.
- ◆ The exercise price must be equal to at least 100% of the market price of the company's stock on the date of the grant.
- ◆ The option must be granted under a written plan that has been approved by shareholders, that specifies how many shares can be issued under the plan, and that identifies the class of employees eligible to receive the options. Options must be granted within 10 years of the date of the adoption of the plan.
- ◆ The option must be exercised within 10 years of the date of the grant.
- ◆ The employee cannot own, at the time of grant, more than 10% of the voting power of all outstanding stock of the company, unless the exercise price is at least 110% of the fair market value of the stock on the date of the grant and the option is not exercisable more than five years from the grant date.

Employee Stock Option Q & A

5. What is a non-qualified stock option (NQSO)?

A non-qualified stock option (NQSO) is any option that is not intended to satisfy the conditions of the Internal Revenue Code for preferential tax treatment. When an employee exercises an NQSO, the “spread” on exercise (the difference, if any, between the exercise price of the option and the market price of the stock on the date of exercise) is taxable to the employee as ordinary income, even if the shares are not sold. Any subsequent gain or loss on the shares after exercise is taxed as capital gains or losses.

6. Why is the Company giving me this benefit?

The Company believes that employees are in the best position to help the Company grow, and that employees should share in the success and value that they help create. The Company believes that granting stock options to all employees can help them think and act like owners by making decisions in their positions that contribute to the Company's long-term success.

7. What is vesting?

Vesting defines how you gain full ownership of your stock option over time. Depending upon when an option was granted to you, the period of time over which your option vests may differ. The terms of the vesting schedule are identified in your stock option agreement. An option does not have to be exercised as soon as it is vested.

8. What does it mean to exercise a stock option?

To exercise your stock option means to buy or purchase your stock option. The amount you pay to buy the shares underlying the options is based on the exercise price and the number of shares you choose to buy. If you decide to exercise your option, you may:

- ◆ **Exercise and Hold** – Exercise your option and purchase the shares in order to become a stockholder of the company.
- ◆ **Exercise and Sell Some of the Shares to Cover the Cost of the Shares (“Sell to Cover”)** – Exercise your option and sell enough shares to pay the cost of the exercise, applicable taxes, and sales commissions. You keep the remaining shares and become a stockholder of the company.
- ◆ **Exercise and Sell All of the Shares** – Exercise your option and sell all of the shares. You receive the proceeds of the sale, less the cost of the exercise, applicable taxes, and sales commissions. You do not own a part of the company, but you may have profited from the spread between the sales price and the exercise price.

On the date you exercise a portion or all of your stock option, you may only buy the number of shares of common stock which have vested as of that date.

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9. How much tax will I pay and when will I pay it?

If you have been granted non-qualified stock options, you will be taxed both when you exercise your option and when you sell the underlying shares:

- ◆ When you exercise your option, the difference between the fair market value on the date of exercise and the exercise price (the “spread”) is taxed as ordinary income.
- ◆ When you sell the underlying shares, any gain or loss from the sale is treated as a capital gain or loss. How long you hold the shares before selling them will determine whether it is a long-term, mid-term or short-term capital gain or loss.

If you have been granted incentive stock options, you will be taxed when you sell the underlying shares, not when you exercise the option **as long as you meet the required holding periods discussed in question 4:**

- ◆ When you sell the underlying shares, any gain or loss from the sale is treated as a capital gain or loss. How long you hold the shares before selling them will determine whether it is a long-term, mid-term or short-term capital gain or loss.

10. How do I sell my shares after I have exercised my option?

If you decide to exercise your option and sell the underlying shares of common stock, you may do so by either:

- ◆ Simultaneously exercising your option and selling the underlying shares of stock through a stock broker with whom the company has set-up a cashless exercise program; or
- ◆ Exercising your option and selling the underlying shares of stock at some later time through the stockbroker of your choice.

11. What is a cashless exercise program?

A cashless exercise program enables you to exercise all or a portion of your option and to sell all or a portion of the underlying shares of stock through a stockbroker with whom the company has set-up a cashless exercise program. Under this program, the exercise price of your options (the amount you are required to pay the company for the underlying shares) is paid out of the proceeds of the sale of the stock as well as any brokerage commissions the stockbroker may charge.

12. How do I make money on a stock option?

A stock option represents an opportunity to buy common stock at the exercise price during the option term. When you exercise an option, you buy shares of common stock at the exercise price. The profit from exercising your option equals the difference between the option exercise price and the sale price for the shares of stock underlying the option.

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Example: Assume you were granted an option to purchase shares of stock in June 2000 at an exercise price of \$13, and, on July 1, 2002 you simultaneously exercise the vested portion of your option and sell the underlying shares at a price of \$23 per share. Your profit from the exercise of the vested portion of the option and the sale of each underlying share would be \$10 per share.

13. What happens to my options if my employment is terminated?

The status of your stock option when your employment is terminated depends on the reason for the termination, as outlined in your individual stock option grant agreement.

14. How do I decide when to exercise my option?

The decision on when to exercise your stock option or to sell the underlying shares of stock is solely yours to make. Legally, the company cannot counsel you about when is the best time to exercise. You should treat your stock option and the underlying shares as seriously as you treat any investment. You may wish to consult a tax advisor before you exercise your option or sell any stock. No one can predict how any company's stock will perform. There are many variables that can affect a company's stock price and the price can fluctuate on a daily basis. You may decide to hold on to your stock longer if you think the company will continue to increase in value or you may decide to exercise sooner because personal circumstances warrant it.