

SYNAPTICS INC
Form DEF 14A
September 13, 2004

SCHEDULE 14A

(Rule 14a-101)

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Under Rule 14a-12

Confidential, for Use of the Commission Only
(as permitted by Rule 14a-6(e)(2))

Synaptics Incorporated

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

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1) Amount previously paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
October 19, 2004**

The Annual Meeting of Stockholders of Synaptics Incorporated, a Delaware corporation, will be held at 9:00 a.m., on Tuesday, October 19, 2004, in the San Jose Room at the Network Meeting Center located at 5201 Great America Parkway, Santa Clara, California 95054 for the following purposes:

1. To elect two directors to serve for three-year terms expiring in 2007.
2. To approve our 2001 Incentive Compensation Plan for purposes of Section 162(m) of the Internal Revenue Code of 1986, as amended.
3. To ratify the appointment of KPMG LLP, an independent registered public accounting firm, as our independent auditor for the fiscal year ending June 25, 2005.
4. To transact such other business as may properly come before the meeting or any adjournment or adjournments thereof.

The foregoing items of business are more fully described in the proxy statement accompanying this notice.

Only stockholders of record at the close of business on September 1, 2004 are entitled to notice of and to vote at the meeting.

All stockholders are cordially invited to attend the meeting in person. To assure your representation at the meeting, however, you are urged to mark, sign, date, and return the enclosed proxy as promptly as possible in the postage-prepaid envelope enclosed for that purpose. Any stockholder of record attending the meeting may vote in person even if the stockholder previously has returned a proxy.

Sincerely,

San Jose, California
September 13, 2004

Russell J. Knittel
Secretary

SYNAPTICS INCORPORATED
2381 Bering Drive
San Jose, California 95131

PROXY STATEMENT

VOTING AND OTHER MATTERS

General

The enclosed proxy is solicited on behalf of Synaptics Incorporated, a Delaware corporation, by our Board of Directors for use at our Annual Meeting of Stockholders to be held on Tuesday, October 19, 2004 at 9:00 a.m., or at any adjournment thereof, for the purposes set forth in this proxy statement and in the accompanying meeting notice. The meeting will be held in the San Jose Room at the Network Meeting Center located at 5201 Great America Parkway, Santa Clara, California 95054.

These proxy solicitation materials were first mailed on or about September 15, 2004 to all stockholders entitled to vote at the meeting.

Voting Securities and Voting Rights

Stockholders of record at the close of business on September 1, 2004, which we have set as the record date, are entitled to notice of and to vote at the meeting. On the record date, there were issued and outstanding 25,113,208 shares of our common stock, \$0.001 par value per share.

The presence, in person or by proxy, of the holders of a majority of the total number of shares of common stock outstanding constitutes a quorum for the transaction of business at the meeting. Each stockholder voting at the meeting, either in person or by proxy, may cast one vote per share of common stock held on all matters to be voted on at the meeting. Assuming that a quorum is present, the two persons receiving the highest number of for votes of common stock of our company present in person or represented by proxy at the meeting and entitled to vote (a plurality) will be elected as directors. Assuming that a quorum is present, the affirmative vote of a majority of the shares of common stock of our company present in person or represented by proxy at the meeting and entitled to vote is required for the approval of our 2001 Incentive Compensation Plan for purposes of Section 162(m) of the Internal Revenue Code of 1986, as amended, and for the ratification of the appointment of KPMG LLP, an independent registered public accounting firm, as our independent auditor for the fiscal year ending June 25, 2005.

Votes cast by proxy or in person at the meeting will be tabulated by the election inspectors appointed for the meeting and will determine whether a quorum is present. The election inspectors will treat abstentions as shares that are present and entitled to vote for purposes of determining the presence of a quorum, but as unvoted for purposes of determining the approval of any matter submitted to the stockholders for a vote. If a broker indicates on the proxy that it does not have discretionary authority as to certain shares to vote on a particular matter, those shares will not be considered as present and entitled to vote with respect to that matter.

Voting of Proxies

When a proxy is properly executed and returned, the shares it represents will be voted at the meeting as directed. If no specification is indicated, the shares will be voted (1) for the election of the nominees for directors set forth in this proxy statement; (2) for the approval of our 2001 Incentive Compensation Plan for purposes of Section 162(m) of the

Internal Revenue Code of 1986, as amended; (3) for the ratification of the appointment of

KPMG LLP as our independent auditor for the fiscal year ending June 25, 2005; and (4) as the persons specified in the proxy deem advisable on any such other matters as may come before the meeting.

Revocability of Proxies

Any stockholder giving a proxy may revoke the proxy at any time before its use by delivering to us either a written notice of revocation, by delivering to us a duly executed proxy bearing a later date, or by attending the meeting and voting in person.

Solicitation

We will bear the cost of this solicitation. In addition, we may reimburse brokerage firms and other persons representing beneficial owners of shares for expenses incurred in forwarding solicitation materials to such beneficial owners. Proxies also may be solicited by certain of our directors and officers, personally or by telephone or e-mail, without additional compensation.

Annual Report and Other Matters

Our 2004 Annual Report to Stockholders, which was mailed to stockholders with or preceding this proxy statement, contains financial and other information about our company, but is not incorporated into this proxy statement and is not to be considered a part of these proxy soliciting materials or subject to Regulations 14A or 14C or to the liabilities of Section 18 of the Securities Exchange Act of 1934. The information contained in the Compensation Committee Report on Executive Compensation, Audit Committee Report, and Performance Graph below shall not be deemed filed with the Securities and Exchange Commission (SEC) or subject to Regulations 14A or 14C or to the liabilities of Section 18 of the Exchange Act.

We will provide upon written request, without charge to each stockholder of record as of the record date, a copy of our Annual Report on Form 10-K for the fiscal year ended June 26, 2004 as filed with the SEC. Any exhibits listed in the Form 10-K report also will be furnished upon request at the actual expense we incur in furnishing such exhibits. Any such requests should be directed to our company's Secretary at our executive offices set forth in this proxy statement.

ELECTION OF DIRECTORS

Nominees

Our certificate of incorporation and bylaws provide that the number of directors shall be fixed from time to time by resolution of our Board of Directors. Currently, the number of directors is fixed at five and that number of directors is divided into three classes, with one class standing for election each year for a three-year term. The Board of Directors has nominated Federico Faggin and W. Ronald Van Dell for election as Class 2 directors for three-year terms expiring in 2007 or until their successors have been elected and qualified.

Unless otherwise instructed, the proxy holders will vote the proxies received by them for the nominees named above. Messrs. Faggin and Van Dell currently are directors of our company. In the event that Mr. Faggin or Mr. Van Dell is unable or declines to serve as a director at the time of the meeting, the proxies will be voted for any nominee designated by the current Board of Directors to fill the vacancy. It is not expected that either Mr. Faggin or Mr. Van Dell will be unable or will decline to serve as a director.

The Board of Directors recommends a vote **for** the nominees named herein.

The following table sets forth certain information regarding our directors and the nominees for directors:

Name	Age	Position	Term Expires
Federico Faggin	62	Chairman of the Board	2004
Francis F. Lee	52	President, Chief Executive Officer, and Director	2005
Keith B. Geeslin	51	Director	2006
Richard L. Sanquini	69	Director	2005
W. Ronald Van Dell	47	Director	2004

Federico Faggin co-founded our company and has served as its Chairman of the Board since January 1999. He served as a director, President and Chief Executive Officer from March 1987 to December 1998. Mr. Faggin is currently President, Chief Executive Officer, and a director of Foveon, Inc., a private company that develops advanced image sensing technology. He is also a director of BlueArc, Inc.; Zilog, Inc., a public company that is a designer, manufacturer, and marketer of integrated microcontroller products; and Chairman of the Board of Integrated Device Technology, Inc., a public company that is a producer of integrated circuits. Mr. Faggin also co-founded Cygnet Technologies, Inc. in 1982 and Zilog, Inc. in 1974. Mr. Faggin served as Department Manager in Research and Development at Intel Corporation from 1970 to 1974 and led the design and development of the world's first microprocessor and more than 25 integrated circuits. In 1968, Mr. Faggin was employed by Fairchild Semiconductor and led the development of the original MOS Silicon Gate Technology and designed the world's first commercial integrated circuit to use such technology. He is the recipient of many honors and awards, including the 1988 International Marconi Fellowship Award, the 1994 IEEE W. Wallace McDowell Award, and the 1997 Kyoto Prize. In addition, in 1996, Mr. Faggin was inducted in the National Inventor's Hall of Fame for the co-invention of the microprocessor. Mr. Faggin holds a doctorate in physics, summa cum laude, from the University of Padua, Italy. He also holds honorary doctorate degrees in computer science from the University of Milan, Italy and in electrical engineering from the University of Rome, Italy.

Francis F. Lee has served as a director and the President and Chief Executive Officer of our company since December 1998. He was a consultant from August 1998 to November 1998. From May 1995 until July 1998, Mr. Lee served as General Manager of NSM, a Hong Kong-based joint venture between National Semiconductor Corporation and S. Megga. Mr. Lee held a variety of executive positions for National Semiconductor from 1988 until August 1995. These positions included Vice President of Communication and Computing Group, Vice President of Quality and Reliability, Director of Standard Logic Business Unit, and various other operations and engineering management positions. Mr. Lee has been a director of Foveon, Inc. since March 2004. Mr. Lee holds a Bachelor of Science degree, with honors, in electrical engineering from the University of California at Davis.

Keith B. Geeslin has been a director of our company since 1986. Mr. Geeslin has been a General Partner of Francisco Partners, a firm specializing in structured investments in technology companies undergoing strategic, technological, and operational inflection points, since January 2004. From 2001 until October 2003, Mr. Geeslin served as Managing General Partner of the Sprout Group, a venture capital firm, with which he became associated in 1988. In addition, Mr. Geeslin served as a general or limited partner in a series of investment funds associated with the Sprout Group, a division of DLJ Capital Corporation, which is a subsidiary of Credit Suisse First Boston (USA), Inc. Mr. Geeslin is currently a director of Paradyne Networks Inc., a public company that produces communication products for network service providers and business customers. Mr. Geeslin is also a director of several privately held companies. He has also served as a director of the Western Association of Venture Capitalists. Mr. Geeslin holds a Bachelor of Science degree in Electrical Engineering and a Masters of Science degree in Engineering and Economic Systems from Stanford University and a Masters of Arts degree in Philosophy, Politics, and Economics from Oxford

University.

Richard L. Sanquini has been a director of our company since 1994. Mr. Sanquini is currently a consultant for Foveon, Inc., National Semiconductor, and several privately held companies. From January 1999 to November 1999, Mr. Sanquini served as Senior Vice President and General Manager of the Consumer and Commercial Group of National Semiconductor; from April 1998 to December 1998, he served as Senior Vice President and General Manager of the Cyrix Group of National Semiconductor; from November 1997 to March 1998, he served as Senior Vice President and General Manager of the Personal Systems Group of National Semiconductor; from April 1996 to October 1997, he served as Senior Vice President and Chief Technology Officer of the Corporate Strategy, Business

Development, and Intellectual Property Protection Group of National Semiconductor; and from December 1995 to March 1996, he served as Senior Vice President of the Business Development and Intellectual Property Protection Group of National Semiconductor. Prior to National Semiconductor, he was with RCA, where he directed its memory and microprocessor businesses. Mr. Sanquini holds a Bachelor of Science degree in electrical engineering from the Milwaukee School of Engineering, Wisconsin.

W. Ronald Van Dell has been a director of our company since April 2002. Mr. Van Dell has been President and Chief Executive Officer of Primarion, Inc., a mixed signal semiconductor company, since March 2004. Mr. Van Dell served as the President and Chief Executive Officer of Legerity, a fabless analog/mixed-signal semiconductor company, from December 2000 until February 2004. Prior to joining Legerity, from July 1999 until December 2000, Mr. Van Dell served as General Manager for Dell Computer's Dimension product line. Prior to joining Dell Computer, Mr. Van Dell served from November 1997 until July 1999 as Vice President and General Manager of the communication integrated circuit business, and from August 1995 until October 1997 as Vice President and General Manager of worldwide marketing and sales, for Harris Semiconductor (now Intersil Corporation). Mr. Van Dell has been a member of the Switzerland-based World Economic Forum and holds a Bachelor of Science degree in electrical engineering from Michigan Technological University.

Information Relating to Corporate Governance and the Board of Directors

Our Board of Directors has determined, after considering all the relevant facts and circumstances, that Messrs. Faggin, Geeslin, Sanquini, and Van Dell are independent directors, as independence is defined by Nasdaq, because they have no relationship with us that would interfere with their exercise of independent judgment. Mr. Lee is an employee director.

Our bylaws authorize our Board of Directors to appoint among its members one or more committees, each consisting of one or more directors. Our Board of Directors has established three standing committees: an Audit Committee, a Compensation Committee, and a Nominations and Corporate Governance Committee. The members of our Audit Committee, Compensation Committee, and Nominations and Corporate Governance Committee consist entirely of independent directors.

Our Board of Directors has adopted charters for the Audit, Compensation, and Nominations and Corporate Governance Committees describing the authority and responsibilities delegated to each committee by the board. Our Board of Directors has also adopted Corporate Governance Guidelines, a Code of Conduct, and a Code of Ethics for the CEO and Senior Financial Officers. We post on our website at www.synaptics.com, the charters of our Audit, Compensation, and Nominations and Corporate Governance Committees; our Corporate Governance Guidelines, Code of Conduct, and Code of Ethics for the CEO and Senior Financial Officers, and any amendments or waivers thereto; and any other corporate governance materials contemplated by SEC or Nasdaq regulations. These documents are also available in print to any stockholder requesting a copy in writing from our corporate secretary at our executive offices set forth in this proxy statement.

We regularly schedule executive sessions at which independent directors meet without the presence or participation of management. The presiding director of such executive session rotates among the Chairs of the Audit Committee, Compensation Committee, and the Nominations and Corporate Governance Committee.

Interested parties may communicate with our Board of Directors or specific members of our Board of Directors, including our independent directors and the members of our various board committees, by submitting a letter addressed to the Board of Directors of Synaptics Incorporated c/o any specified individual director or directors at the address listed herein. Any such letters are sent to the indicated directors.

The Audit Committee

The purpose of the Audit Committee is to oversee the financial and reporting processes of our company and the audits of the financial statements of our company and to provide assistance to our Board of Directors with respect to the oversight of the integrity of the financial statements of our company, our company's compliance with legal and regulatory matters, the independent auditor's qualifications and independence, and the performance of our company's independent auditor. The primary responsibilities of the Audit Committee are set forth in its charter and include various matters with respect to the oversight of our company's accounting and financial reporting process and audits of the financial statements of our company on behalf of our Board of Directors. The Audit Committee

also selects the independent auditor to conduct the annual audit of the financial statements of our company; reviews the proposed scope of such audit; reviews accounting and financial controls of our company with the independent auditor and our financial accounting staff; and reviews and approves transactions between us and our directors, officers, and their affiliates.

The Audit Committee currently consists of Messrs. Geeslin, Sanquini, and Van Dell, each of whom is an independent director of our company under Nasdaq rules as well as under rules adopted by the SEC pursuant to the Sarbanes-Oxley Act of 2002. The Board of Directors has determined that Mr. Geeslin (whose background is detailed above) qualifies as an audit committee financial expert in accordance with applicable rules and regulations of the SEC. Mr. Geeslin serves as the Chairman of the Audit Committee.

The Compensation Committee

The purpose of the Compensation Committee includes determining, or recommending to our Board of Directors for determination, the compensation of the Chief Executive Officer and other executive officers of our company and discharging the responsibilities of our Board of Directors relating to compensation programs of our company. The Compensation Committee currently consists of Messrs. Faggin, Geeslin, and Sanquini, with Mr. Sanquini serving as Chairman.

The Nominations and Corporate Governance Committee

The purposes of the Nominations and Corporate Governance Committee include the selection or recommendation to the Board of Directors of nominees to stand for election as directors at each election of directors, the oversight of the selection and composition of committees of the Board of Directors, the oversight of the evaluations of the Board of Directors and management, and the development and recommendation to the Board of Directors of a set of corporate governance principles applicable to our company. The Nominations and Corporate Governance Committee currently consists of Messrs. Geeslin, Sanquini, and Van Dell, with Mr. Van Dell serving as Chairman.

The Nominations and Corporate Governance Committee will consider persons recommended by stockholders for inclusion as nominees for election to our Board of Directors if the names, biographical data, and qualifications of such persons are submitted in writing in a timely manner addressed and delivered to our company's corporate secretary at the address listed herein. The Nominations and Corporate Governance Committee identifies and evaluates nominees for our Board of Directors, including nominees recommended by stockholders, based on numerous factors it considers appropriate, some of which may include strength of character, mature judgment, career specialization, relevant technical skills, diversity, and the extent to which the nominee would fill a present need on our Board of Directors. As discussed above, the members of the Nominations and Corporate Governance Committee are independent, as that term is defined by Nasdaq.

The Board of Directors held a total of four meetings during the fiscal year ended June 26, 2004. The Audit Committee met separately at five meetings during the fiscal year ended June 26, 2004. The Compensation Committee held a total of five meetings during the fiscal year ended June 26, 2004. The Nominations and Corporate Governance Committee did not meet during the fiscal year ended June 26, 2004. Each of our directors attended at least 75% of the aggregate of (1) the total number of meetings of our Board of Directors held during fiscal 2004, and (2) the total number of meetings held by all committees of our Board of Directors on which such person served during fiscal 2004.

Director Compensation

We pay each non-employee director an annual retainer of \$10,000 in cash or stock at the director's election, provided such election is made six months in advance of the annual retainer payment date. We also pay a fee of

\$2,000 to each non-employee director for attendance at each board meeting in person and \$500 for attendance at each board meeting by teleconference as well as a fee of \$1,000 (or \$2,000 for the committee chair) for each committee meeting attended. In addition, directors are eligible to receive grants of stock options under our 2001 incentive compensation plan, with the option grant for the Chairman of the Board fixed at options for 18,750 shares annually. Newly elected non-employee directors receive an initial option grant to purchase 50,000 shares of our common stock in lieu of any annual option grant during the first year of service. We reimburse non-employee directors for their expenses for attending board and committee meetings.

During fiscal 2004, we granted options to purchase shares of common stock to the following non-employee directors: options to purchase 18,750 shares at an exercise price of \$16.40 were granted to Mr. Faggin; options to purchase 12,500 shares at an exercise price of \$16.40 per share were granted to Mr. Geeslin; options to purchase 12,500 shares at an exercise price of \$16.40 were granted to Mr. Sanquini; and options to purchase 12,500 shares at an exercise price of \$16.40 were granted to Mr. Van Dell. Twenty-five percent of the options granted to each director will vest and become exercisable on the first anniversary of the date of grant, and options to purchase 1/48th of the total number of options granted to each director will vest and become exercisable each month thereafter.

EXECUTIVE COMPENSATION

The following table sets forth, for the periods indicated, the total compensation earned for services provided to us in all capacities by our Chief Executive Officer and our four next most highly compensated executive officers whose aggregate compensation exceeded \$100,000 during fiscal 2004, whom we refer to as the named executive officers.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation(1)		Long-Term Compensation	All Other Compensation (\$)(3)
		Salary (\$)	Bonus (\$)	Awards	
				Securities Underlying Options (#)(2)	
Francis F. Lee President and Chief Executive Officer	2004	\$280,000	\$470,000	200,000	\$ 800
	2003	278,000	175,000	200,000	
	2002	230,000	230,000	200,000	
Donald E. Kirby Senior Vice President and General Manager PC Products	2004	\$221,001	\$200,000	50,000	\$ 651
	2003	213,000	75,000	50,000	
	2002	205,000	133,000	55,000	
Russell J. Knittel Senior Vice President, Chief Financial Officer, Chief Administrative Officer, and Secretary	2004	\$210,000	\$210,000	55,000	\$ 1,050
	2003	208,000	74,000	50,000	
	2002	200,000	125,000	15,000	
Shawn P. Day, Ph.D. Vice President of Research and Development	2004	\$185,000	\$131,000	30,000	\$ 660
	2003	183,000	46,000	20,000	
	2002	178,000	69,000	25,000	
Thomas D. Spade Vice President of Worldwide Sales	2004	\$325,401		30,000	\$ 702
	2003	259,108		30,000	
	2002	242,211		25,000	

(1)

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Executive officers received certain perquisites, the value of which did not exceed the lesser of \$50,000 or 10% of that officer's salary and bonus during fiscal 2004.

- (2) The exercise price of all stock options granted was equal to the fair market value of our common stock on the date of grant.
- (3) Amounts shown represent matching contributions to our company's 401(k) Plan during fiscal 2004.

Option Grants

The table below provides information about the stock options granted to the named executive officers during the fiscal year ended June 26, 2004. These options were granted under our 2001 incentive compensation plan and have a term of 10 years. The options may terminate earlier if the optionholder stops providing services to us.

The percentage of total options in the table below was calculated based on options to purchase an aggregate of 1,260,500 shares of our common stock granted to our employees in fiscal 2004.

OPTION GRANTS IN LAST FISCAL YEAR

Name	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(2)	
	Number of Securities Underlying Options Granted(1)	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price(\$/Sh)	Expiration Date	5%	10%
Francis F. Lee	200,000	15.9%	\$ 16.40	01/21/2014	\$2,062,774	\$5,227,475
Donald E. Kirby	50,000	4.0%	\$ 9.96	08/07/2013	\$ 313,190	\$ 793,684
Russell J. Knittel	55,000	4.4%	\$ 9.96	08/07/2013	\$ 344,508	\$ 873,052
Shawn P. Day, Ph.D.	30,000	2.4%	\$ 9.96	08/07/2013	\$ 187,914	\$ 476,210
Thomas D. Spade	30,000	2.4%	\$ 9.96	08/07/2013	\$ 187,914	\$ 476,210

- (1) Twenty-five percent of the options granted to each of the named officers will vest and become exercisable on the first anniversary of the date of grant, and 1/48th of the total number of options granted to each of the named officers will vest and become exercisable each month thereafter.
- (2) Potential gains are net of the exercise price, but before taxes associated with the exercise. Amounts represent hypothetical gains that could be achieved for the respective options if exercised at the end of the option term. The assumed 5% and 10% rates of stock price appreciation are provided in accordance with the rules of the SEC and do not represent our estimate or projection of the future price of our company's common stock. Actual gains, if any, on stock option exercises will depend upon the future market prices of our common stock.

Option Exercises and Option Holdings

The following table describes, for the named executive officers, the number of shares acquired and the value realized upon exercise of stock options during fiscal 2004 and the exercisable and unexercisable options held by them as of June 26, 2004.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

	Shares Acquired on Exercise (#)	Value Realized (\$)	Number of Securities Underlying Unexercised Options at June 26, 2004 (#)		Value of Unexercised In-The-Money Options at June 26, 2004 (\$) (1)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Francis F. Lee	0	\$ 0	558,332	666,668	\$9,775,811	\$6,771,189
Donald E. Kirby	75,499	\$ 1,059,787	216,269	103,232	\$3,509,987	\$1,232,751
Russell J. Knittel.	50,000	\$ 725,335	140,102	124,898	\$2,292,856	\$1,418,744
Shawn P. Day, Ph.D.	30,000	\$ 490,000	81,664	83,336	\$1,372,526	\$1,034,574
Thomas D. Spade	83,580	\$ 1,110,958	28,756	85,835	\$ 446,872	\$1,060,709

(1) Calculated based upon the June 25, 2004, Nasdaq National Market closing price of \$19.96 per share, multiplied by the number of shares held, less the aggregate exercise price for such shares.

Employment Agreements

We have no written employment contracts with our executive officers or directors. We do have, however, Change of Control and Severance Agreements or signed terms-and-conditions agreements with certain employees. We offer our employees medical, dental, vision, life, a 401(k) match, employee stock purchase plan, and disability insurance benefits. Our executive officers and other key personnel are eligible to receive incentive bonuses and are eligible to receive stock options under our stock option plans.

Severance Policy

We maintain a severance policy for certain executive officers designated by our Board of Directors and who have completed at least one full year of employment with our company. Under the policy, we will pay base salary and targeted bonus and maintain benefits following a termination of employment without cause for one year in the case of the Chief Executive Officer and six months in the case of the other designated executive officers and continue to vest stock options for one year in the case of the Chief Executive Officer and six months in the case of the other designated executive officers unless the options provide otherwise. In the event of death, we will pay to the estate of the executive the executive's base salary and targeted bonus for one year in the case of the Chief Executive Officer and 50% of the base salary and targeted bonus in the case of the other designated executive officers. Messrs. Lee, Kirby, and Knittel currently are subject to the severance policy.

At the commencement of his employment in April 2000, our company agreed to provide Mr. Knittel with six months severance pay in the event of a change of control or a constructive termination as a result of reduced responsibilities or stature within our company. Various outstanding stock options are not covered by the severance policy. Messrs. Lee, Kirby, and Knittel hold options for 200,000, 50,000, and 50,000 shares, respectively, that provide for immediate vesting of 100% of unvested options upon a change of control. Messrs. Faggin, Lee, and Knittel hold other options that provide for an acceleration of vesting in the event of a change of control; however, these options are now fully vested based on the standard 48-month vesting terms provided for in the original stock option grant agreements. Subsequent to the fiscal year end, Mr. Kirby and Mr. Knittel were granted options for 50,000 and 55,000 shares, respectively, that provide for vesting upon a change of control in accordance with the terms of the Change of Control and Severance Agreements described below.

Change of Control and Severance Agreements

We are a party to a Change of Control and Severance Agreement with each of Francis F. Lee, Donald J. Kirby, and Russell J. Knittel. The agreements become effective upon a change of control of our company as defined in the agreements. Under the agreements, each of the executives has agreed to remain employed by our company or its successor for a rolling one-year period after a change of control upon the same terms and conditions that existed immediately prior to the change of control and to refrain from competing with our company during the term of employment and while any severance payments are being made. The agreements provide for the payment by our company, for one year after termination of employment by our company without good cause or by the executive for good reason, as defined in the agreements, or by the executive for any reason during the 30-day period following the first anniversary of the change of control, of compensation equal to the greater of two times the average of the base salary and bonus for the two years prior to such termination or the base salary and targeted bonus for the fiscal year in which such termination occurs in the case of Mr. Lee and the greater of the average of the base salary and bonus for the two years prior to such termination or the base salary and targeted bonus for the fiscal year in which such termination occurs in the case of Messrs. Kirby and Knittel. In the case of such termination, the agreements also provide for the continuation of insurance coverage on the executive and the executive's family for two years in the case of Mr. Lee and one year in the case of Messrs. Kirby and Knittel. In addition, the agreements provide for the continuation of base salary payments and benefit coverage for the executive's family for a period of 12 months after the death of the executive and for the payment in the event of disability of a lump sum equal to the greater of two times the average of the base salary and bonus for the two fiscal years prior to such termination or the executive's base salary and targeted bonus for the fiscal year in which such termination occurs in the case of Mr. Lee and the greater of the average of the base salary and bonus for the two fiscal years prior to such termination or the executive's base salary and targeted bonus for the fiscal year in which such termination occurs in the case of Messrs. Kirby and Knittel. The agreements provide that in the event of a change of control 50% of unvested options vest immediately and the remaining 50% of unvested options vest immediately if the executive is terminated by our company without good cause or by the executive for good reason. All vested options, including those vesting under the terms of the

agreements, will be exercisable during their full term in the event of a change of control.

Indemnification Under our Certificate of Incorporation and Bylaws

Our certificate of incorporation provides that no director will be personally liable to our company or its stockholders for monetary damages for breach of a fiduciary duty as a director, except to the extent such exemption or limitation of liability is not permitted under the Delaware General Corporation Law. The effect of this provision in the certificate of incorporation is to eliminate the rights of our company and its stockholders, either directly or through stockholders' derivative suits brought on behalf of our company, to recover monetary damages from a

director for breach of the fiduciary duty of care as a director except in those instances described under the Delaware General Corporation Law. In addition, we have adopted provisions in our bylaws and entered into indemnification agreements that require us to indemnify our directors, officers, and certain other representatives of our company against expenses and certain other liabilities arising out of their conduct on behalf of our company to the maximum extent and under all circumstances permitted by law. Indemnification may not apply in certain circumstances to actions arising under the federal securities laws.

1986 Incentive Stock Option Plan and 1986 Supplemental Stock Option Plan

Our 1986 incentive stock option plan provided for the grant of incentive stock options to our key employees, including employee directors. Our 1986 supplemental stock option plan provided for the grant of nonstatutory stock options to employees, directors, and consultants. As of June 26, 2004, there were outstanding options to acquire 6,269 shares of our common stock under the two 1986 plans. The 1986 incentive stock option plan and the 1986 supplemental stock option plan expired in November 1996, and no additional options will be issued under those plans. The expiration date, the maximum number of shares purchasable, and the other provisions of the options, including vesting provisions, were established at the time of grant. Options were granted for terms of up to 10 years and became exercisable in whole or in one or more installments at such time as was determined by the administrator upon the grant of the options.

Under the 1986 incentive stock option plan, exercise prices of options are equal to not less than 100% of the fair market value of our common stock at the time of the grant. Under the 1986 supplemental stock option plan, exercise prices of options are equal to not less than 85% of the fair market value of our common stock at the time of the grant. The exercise price for any options granted under the 1986 incentive stock option plan and the 1986 supplemental stock option plan may be paid in cash, in shares of our common stock valued at fair market value on the exercise date, or in any other form of legal consideration that may be acceptable to the Board of Directors or administrator in their discretion. In addition, the administrator may provide financial assistance to one or more optionees in the exercise of their outstanding options by allowing any such individual to deliver an interest-bearing promissory note in payment of the exercise price and any associated withholding taxes incurred in connection with the exercise or purchase. In the event of a change of control of our company, we would expect that options outstanding under the 1986 incentive stock option plan and the 1986 supplemental stock option plan at the time of the transaction would be assumed or replaced with substitute options by the acquiror. If our acquiror did not agree to assume or replace outstanding awards, either the exercise period of all options would accelerate and terminate if not exercised upon consummation of the acquisition, or such options would remain in effect. Outstanding awards under the 1986 incentive stock option plan and the 1986 supplemental stock option plan will be adjusted in the event of a stock split, stock dividend, or other similar change in our capital stock without the receipt of consideration by us.

1996 Stock Option Plan

Our 1996 stock option plan provides for the grant of incentive stock options to employees, including employee directors, and of nonstatutory stock options to employees, directors, and consultants. The purposes of the 1996 stock option plan are to attract and retain the best available personnel, to provide additional incentives to our employees and consultants, and to promote the success of our business. The 1996 stock option plan was originally adopted by our Board of Directors in December 1996 and approved by our stockholders in November 1996. The 1996 stock option plan provides for the issuance of options and rights to purchase up to 5,380,918 shares of our common stock. Unless terminated earlier by the Board of Directors, the 1996 stock option plan will terminate in December 2006.

As of June 26, 2004, options to purchase 2,248,297 shares of common stock were outstanding under the 1996 stock option plan and 2,819,160 shares had been issued upon exercise of outstanding options.

The 1996 stock option plan may be administered by the Board of Directors or a committee of the board, each known as the administrator. The administrator determines the terms of options granted under the 1996 stock option plan, including the number of shares subject to the award, the exercise or purchase price, the vesting and exercisability of the award, and any other conditions to which the award is subject. Incentive stock options granted under the 1996 stock option plan must have an exercise price of at least 100% of the fair market value of the common stock on the date of grant (110% if the option is granted to a stockholder who, at the time the option is granted, owns stock representing more than 10% of the total combined voting power of all classes of our stock).

Nonstatutory stock options granted under the 1996 stock option plan must have an exercise price of at least 85% of the fair market value of the common stock on the date of grant (110% if the option is granted to a stockholder who, at the time the option is granted, owns stock representing more than 10% of the total combined voting power of all classes of our stock). The exercise price for any options granted under the 1996 stock option plan may be paid in cash, in shares of our common stock valued at fair market value on the exercise date, or in any other form of legal consideration that may be acceptable to the Board of Directors or administrator in their discretion. The option may also be exercised through a same-day sale program without any cash outlay by the optionee. In addition, the administrator may provide financial assistance to one or more optionees in the exercise of their outstanding options by allowing any such individual to deliver an interest-bearing promissory note in payment of the exercise price and any associated withholding taxes incurred in connection with the exercise or purchase.

With respect to options granted under the 1996 stock option plan, the administrator determines the term of options, which may not exceed 10 years, or five years in the case of an incentive stock option granted to a holder of more than 10% of the total voting power of all classes of our stock. An option is nontransferable other than by will or the laws of descent and distribution and may be exercised during the lifetime of the optionee only by the optionee. Stock options are generally subject to vesting, meaning that the optionee earns the right to exercise the option over a specified period of time only if he or she continues to provide services to our company over that period.

If our company or its business is acquired by another corporation, we would expect that options outstanding under the 1996 stock option plan at the time of the transaction would be assumed or replaced with substitute options by our acquiror. If our acquiror did not agree to assume or replace outstanding awards, all options would terminate upon consummation of the acquisition. Outstanding awards and the number of shares remaining available for issuance under the 1996 stock option plan will adjust in the event of a stock split, stock dividend, or other similar change in our capital stock without the receipt of consideration by us. The administrator has the authority to amend or terminate the 1996 stock option plan, but no action may be taken that impairs the rights of any holder of an outstanding option without the holder's consent. In addition, we must obtain stockholder approval of amendments to the plan as required by applicable law.

2000 Nonstatutory Stock Option Plan

Our 2000 nonstatutory stock option plan provides for the grant of nonstatutory stock options to employees and consultants. The purposes of the 2000 nonstatutory stock option plan are to attract and retain the best available personnel, to provide additional incentives to our employees and consultants, and to promote the success of our business. The 2000 nonstatutory stock option plan was adopted by our Board of Directors in September 2000. The 2000 nonstatutory stock option plan provides for the issuance of options to purchase up to 200,000 shares of our common stock. As of June 26, 2004, there were outstanding options to acquire 149,636 shares of our common stock. Unless terminated earlier by the Board of Directors, the 2000 nonstatutory stock option plan will terminate in September 2010.

The 2000 nonstatutory stock option plan may be administered by the Board of Directors or a committee of the board, each known as the administrator. The administrator determines the terms of options granted under the 2000 nonstatutory stock option plan, including the number of shares subject to the award, the exercise or purchase price, the vesting and/or exercisability of the award, and any other conditions to which the award is subject. The exercise price for any options granted under the 2000 nonstatutory stock option plan may be paid in cash, in shares of our common stock valued at fair market value on the exercise date, or in any other form of legal consideration that may be acceptable to the Board of Directors or administrator in their discretion. The option may also be exercised through a same-day sale program without any cash outlay by the optionee. In addition, the administrator may provide financial assistance to one or more optionees in the exercise of their outstanding options by allowing such individuals to deliver an interest-bearing promissory note in payment of the exercise price and any associated withholding taxes incurred in

connection with such exercise or purchase. The term of options granted under the 2000 nonstatutory stock option plan may not exceed 10 years.

If our company or its business is acquired by another corporation, we would expect that options outstanding under the 2000 nonstatutory stock option plan at the time of the transaction would be assumed or replaced with substitute options by our acquiror. If our acquiror did not agree to assume or replace outstanding awards, all options would terminate upon consummation of the acquisition. Outstanding awards and the number of shares remaining available for issuance under the 2000 nonstatutory stock option plan will be adjusted in the event of a stock split, stock dividend, or other similar change in our capital stock. The administrator has the authority to amend or

terminate the 2000 nonstatutory stock option plan, but no action may be taken that impairs the rights of any holder of an outstanding option without the holder's consent.

2001 Incentive Compensation Plan

Our 2001 incentive compensation plan is designed to attract, motivate, retain, and reward our executives, employees, officers, directors, and independent contractors, by providing such persons with annual and long-term performance incentives to expend their maximum efforts in the creation of stockholder value. The 2001 incentive compensation plan was adopted by our Board of Directors in March 2001 and approved by our stockholders in November 2001. Under the 2001 incentive compensation plan, an aggregate of 2,379,782 shares of common stock as of the end of fiscal 2004 may be issued pursuant to the granting of options to acquire common stock, the direct granting of restricted common stock and deferred stock, the granting of stock appreciation rights, or the granting of dividend equivalents. On the first day of each calendar quarter, an additional number of shares equal to 1 1/2% of the total number of shares then outstanding will be added to the number of shares that may be subject to the granting of awards. As of June 26, 2004, there were outstanding options to acquire 3,026,479 shares of our common stock under the 2001 incentive compensation plan and 260,932 shares had been issued upon exercise of outstanding options.

The 2001 incentive compensation plan may be administered by the Board of Directors or a committee of the board. The Board of Directors or committee determines the persons to receive awards, the type and number of awards to be granted, the vesting and exercisability of the awards, and any other conditions to which the awards are subject. Awards may be settled in the form of cash, shares of common stock, other awards, or other property in the discretion of the committee or the Board of Directors.

The Board of Directors or committee may, in its discretion, accelerate the exercisability, the lapsing of restrictions, or the expiration of deferral or vesting periods of any award, and such accelerated exercisability, lapse, expiration, and, if so provided in the award agreement, vesting will occur automatically in the case of a change in control of our company. In addition, the committee or the Board of Directors may provide in an award agreement that the performance goals relating to any performance-based award will be deemed to have been met upon the occurrence of any change in control. Upon the occurrence of a change in control, if so provided in the award agreement, stock options and certain stock appreciation rights may be cashed out based on a change in control price, which will be the higher of (1) the cash and fair market value of property that is the highest price per share paid in any reorganization, merger, consolidation, liquidation, dissolution, or sale of substantially all assets of our company, or (2) the highest fair market value per share at any time during the 60 days before and 60 days after a change in control.

The Board of Directors may amend, alter, suspend, discontinue, or terminate the 2001 incentive compensation plan or the committee's authority to grant awards without further stockholder approval, except stockholder approval must be obtained for any amendment or alteration if such approval is required by law or regulation or under the rules of any stock exchange or quotation system on which shares of our common stock are then listed or quoted. Unless terminated earlier by the Board of Directors, the 2001 incentive compensation plan will terminate at such time as no shares of common stock remain available for issuance under the plan and we have no further rights or obligations with respect to outstanding awards under the plan.

2001 Employee Stock Purchase Plan

Our 2001 employee stock purchase plan is designed to encourage stock ownership in our company by our employees, thereby enhancing employee interest in our continued success. The plan was adopted by our Board of Directors in February 2001 and approved by our stockholders in November 2001. One million shares of our common stock were initially reserved for issuance under the plan. An annual increase is made equal to the lesser of 500,000 shares, 1% of all shares of common stock outstanding, or a lesser amount determined by the Board of Directors. As of

June 26, 2004, there were 904,642 shares reserved for issuance under the plan. During fiscal 2004, 165,833 shares of common stock were issued under the plan.

The plan is currently administered by our Board of Directors. Under the plan's terms, however, the board may appoint a committee to administer the plan. The plan gives broad powers to the board or the committee to administer and interpret the plan.

The plan permits employees to purchase our common stock at a favorable price and possibly with favorable tax consequences to the participants. All employees of our company or of those subsidiaries designated by the board who are regularly scheduled to work at least 20 hours per week for more than five months per year are eligible to participate in any of the purchase periods of the plan after completing 90 days of continuous employment. However, any participant who would own (as determined under the Internal Revenue Code), immediately after the grant of an option, stock possessing 5% or more of the total combined voting power or value of all classes of the stock of our company will not be granted an option under the plan.

The plan is implemented in a series of successive offering periods, each having a maximum duration of 24 months. If the fair market value per share of our common stock on any purchase date is less than the fair market value per share on the start date of a 24-month offering period, then that offering period will automatically terminate, and a new 24-month offering period will begin on the next business day. All participants in the terminated offering will be transferred to the new offering period.

Eligible employees may elect to participate in the plan on January 1 or July 1 of each year. Subject to certain limitations determined in accordance with calculations set forth in the plan, a participating employee is granted the right to purchase shares of common stock on the last business day on or before each June 30 and December 31 during which the employee is a participant in the plan. Upon enrollment in the plan, the participant authorizes a payroll deduction, on an after-tax basis, in an amount of not less than 1% and not more than 15% of the participant's compensation on each payroll date. Payment on the initial purchase date in the first offering period will be a lump-sum payment unless the participant elects otherwise. Unless the participant withdraws from the plan, the participant's option for the purchase of shares will be exercised automatically on each exercise date, and the maximum number of full shares subject to the option will be purchased for the participant at the applicable exercise price with the accumulated plan contributions then credited to the participant's account under the plan. The option exercise price per share may not be less than 85% of the lower of the market price on the first day of the offering period or the market price on the exercise date, unless the participant's entry date is not the first day of the offering period, in which case the exercise price may not be lower than 85% of the greater of the market price on the first day of the offering period or the market price of the common stock on the entry date.

As required by tax law, no participant may receive an option under the plan for shares that have a fair market value in excess of \$25,000 for any calendar year, determined at the time the option is granted. Any funds not used to purchase shares will remain credited to the participant's bookkeeping account and applied to the purchase of shares of common stock in the next succeeding purchase period. No interest is paid on funds withheld, and those funds are used by our company for general operating purposes.

No plan contributions or options granted under the plan are assignable or transferable, other than by will or by the laws of descent and distribution or as provided under the plan. During the lifetime of a participant, an option is exercisable only by that participant. The expiration date of the plan will be determined by the board and may be made any time following the close of any six-month exercise period, but may not be longer than 10 years from the date of the first grant. If our company dissolves or liquidates, the offering period will terminate immediately prior to the consummation of that action, unless otherwise provided by the board. In the event of a merger or a sale of all or substantially all of our company's assets, each option under the plan will be assumed or an equivalent option substituted by the successor corporation, unless the board, in its sole discretion, accelerates the date on which the options may be exercised. The unexercised portion of any option granted to an employee under the plan will be automatically terminated immediately upon the termination for any reason, including retirement or death, of the employee's employment.

The plan provides for adjustment of the number of shares for which options may be granted, the number of shares subject to outstanding options, and the exercise price of outstanding options in the event of any increase or decrease in

the number of issued and outstanding shares as a result of one or more reorganizations, restructurings, recapitalizations, reclassifications, stock splits, reverse stock splits, or stock dividends.

The board or the committee may amend, suspend, or terminate the plan at any time, provided that such amendment may not adversely affect the rights of the holder of an option and the plan may not be amended if such amendment would in any way cause rights issued under the plan to fail to meet the requirements for employee stock purchase plans as defined in Section 423 of the Internal Revenue Code, or would cause the plan to fail to comply with Rule 16b-3 under the Exchange Act.

Our stockholders will not have any preemptive rights to purchase or subscribe for the shares reserved for issuance under the plan. If any option granted under the plan expires or terminates for any reason other than having been exercised in full, the unpurchased shares subject to that option will again be available for purposes of the plan.

401(k) Retirement Savings Plan

In July 1991, we adopted a 401(k) retirement savings plan for which our employees generally are eligible. The plan is intended to qualify under Section 401(k) of the Internal Revenue Code, so that contributions to the plan by employees or by us and the investment earnings on the contributions are not taxable to the employees until withdrawn. Our contributions are deductible by us when made. Our employees may elect to reduce their current compensation by an amount equal to the maximum of 25% of total annual compensation or the annual limit permitted by law and to have those funds contributed to the plan. We provide matching funds of 10% of the employee's contribution up to a maximum of \$1,300.

EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information with respect to our common stock that may be issued upon the exercise of stock options under our 1986 incentive stock option plan and 1986 supplemental stock option plan, 1996 stock option plan, 2000 nonstatutory stock option plan, and 2001 incentive compensation plan as of June 26, 2004.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants, and Rights	(b) Weighted- Average Exercise Price of Outstanding Options, Warrants, and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column(a))
Equity Compensation Plans Approved by Stockholders	5,281,045	\$ 6.90	2,595,463
Equity Compensation Plans Not Approved By Stockholders	<u>149,636</u>	\$ 5.85	<u>34,000</u>
Total	<u><u>5,430,681</u></u>	<u><u>\$ 6.87</u></u>	<u><u>2,629,463</u></u>

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

Introduction

The Compensation Committee of the Board of Directors of our company consists exclusively of non-employee directors. The committee is responsible for reviewing and establishing compensation practices, executive salary levels, and variable compensation programs, both cash-based and equity-based. The committee generally reviews base salary levels for executive officers at the beginning of each fiscal year and sets actual bonuses at the end of each fiscal year based upon individual executive performance and the performance of our company.

Richard L. Sanquini is the Chairman of the committee, and Federico Faggin and Keith B. Geeslin are the other committee members.

Philosophy

Our executive compensation program seeks to provide a level of compensation that is competitive with companies similar in both size and industry. The committee obtains the comparative data used to assess competitiveness from a variety of resources. Actual total compensation levels may differ from competitive levels in surveyed companies as a result of annual and long-term company performance, as well as individual performance.

The committee uses its discretion to establish executive compensation when, in its judgment, external, internal, or an individual's circumstances warrant.

Compensation Program

The primary components of executive compensation consist of base salary, annual incentive bonuses, and stock option grants.

Base Salary

The committee establishes salaries for executive officers based on the overall performance of our company and an evaluation of individual executive performance. The committee makes final decisions on any adjustments to the base salary for executives in conjunction with the recommendations of the Chief Executive Officer. The committee's evaluation of the recommendations of the Chief Executive Officer considers the same factors outlined above and is subjective, with no particular weight assigned to any one factor. Base salaries for the executive officers were not materially increased in fiscal 2004.

Annual Incentive Bonuses

Annual bonuses are intended to provide incentive compensation to key officers and employees who contribute substantially to the success of our company. The granting of such awards is based upon the achievement of company performance objectives and predefined individual performance objectives. Individual performance objectives are developed for every senior level manager and key employee early in each fiscal year. After the first half of the year and upon the close of each fiscal year, executive management and the committee conduct an assessment of individual performance achieved versus individual performance objectives for our officers. This assessment may include but not be limited to individual responsibility, performance, and compensation level. Simultaneously, the Board of Directors conducts an assessment of our company's overall performance to date, which may include but not be limited to the achievement of sales, net income, and other performance criteria. The combination of these factors determines any incentive bonuses to be paid.

Based on both individual performances and the assessment of our company's overall performance in fiscal 2004, bonuses were awarded to our named executive officers as set forth under Executive Compensation - Summary Compensation Table.

Stock Option Grants

Our company grants stock options periodically to our employees to provide additional incentive to work to maximize long-term total return to stockholders. Under each stock option plan, the Board of Directors is specified to act as the plan administrator, although the Board of Directors has authorized the Compensation Committee to make decisions regarding grants of options to senior officers of our company. In general, stock options are granted to employees at the onset of employment. If, in the opinion of the plan administrator, the outstanding service of an existing employee merits an increase in the number of options held, however, the plan administrator may elect to issue additional stock options to that employee. The vesting period on grants is generally four years for newly hired employees. The vesting schedule is generally 25% on the first anniversary of the grant date and 1/48th of the total shares each month thereafter in order to encourage optionholders to continue in the employ of our company. Certain officers and key employees may sometimes have longer vesting schedules with vesting starting two or more years after the grant date. In fiscal 2004, the issuance of stock options to certain executive officers and other employees was authorized, including those to our named executive officers as set forth under Executive Compensation - Option Grants in Last Fiscal Year.

Benefits

Our company provides various employee benefit programs to executive officers, including medical, dental, vision, life, and long-term disability insurance benefits, and a 401(k) retirement savings plan. These benefits are generally available to all employees of our company.

Chief Executive Officer Compensation

The committee considers the same factors outlined above for other executive officers in evaluating the base salary and other compensation of Francis F. Lee, the Chief Executive Officer of our company. The committee's evaluation of Mr. Lee's base salary is subjective, with no particular weight assigned to any one factor. Based upon an assessment of overall company performance in fiscal 2004, the committee also determined that Mr. Lee would receive a \$470,000 bonus for fiscal 2004. In January 2004, the committee granted Mr. Lee options to purchase 200,000 shares of common stock in order to provide a long-term incentive program for Mr. Lee.

Compliance with Internal Revenue Code Section 162(m)

Section 162(m) of the Internal Revenue Code generally disallows a tax deduction to public companies for compensation in excess of \$1 million paid to each of any publicly held corporation's chief executive officer and four other most highly compensated executive officers. Qualifying performance-based compensation is not subject to the deduction limit if certain requirements are met. Our company currently intends to structure the performance-based portion of the compensation of executive officers in a manner that complies with Section 162(m).

This report has been furnished by the Compensation Committee to the Board of Directors.

Richard L. Sanquini, Chairman
Federico Faggin
Keith B. Geeslin

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

Our Compensation Committee consists of Messrs. Faggin, Geeslin, and Sanquini. Mr. Faggin is our Chairman of the Board and previously served as our President. No interlocking relationship exists between any member of our Board of Directors or our Compensation Committee and any member of the Board of Directors or Compensation Committee of any other company.

AUDIT COMMITTEE REPORT

The Board of Directors has appointed an Audit Committee consisting of three directors. The current members of the Audit Committee are Keith B. Geeslin, Richard L. Sanquini, and W. Ronald Van Dell. Each of the committee members is independent of our company and management, as that term is defined in Nasdaq rules.

The primary responsibility of the committee is to assist the Board of Directors in fulfilling its responsibility to oversee management's conduct of our company's financial reporting process, including overseeing the financial reports and other financial information provided by our company to governmental or regulatory bodies (such as the SEC), the public, and other users thereof; our company's systems of internal accounting and financial controls; and the annual independent audit of our company's financial statements.

Management has the primary responsibility for the financial statements and the reporting process, including the systems of internal controls. The independent auditor is responsible for auditing the financial statements and expressing an opinion on the conformity of those audited financial statements with accounting principles generally accepted in the United States.

In fulfilling its oversight responsibilities, the committee reviewed and discussed the audited financial statements with management and the independent auditor. The committee discussed with the independent auditor the matters

required to be discussed by Statement of Auditing Standards No. 61. This included a discussion of the auditor's judgments as to the quality, not just the acceptability, of our company's accounting principles and such other matters as are required to be discussed with the committee under generally accepted auditing standards. In addition, the committee received from the independent auditor written disclosures and the letter required by Independence Standards Board Standard No. 1. The committee also discussed with the independent audito