SURMODICS INC
Form DEF 14A
December 16, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

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

Filed by the Registrant **x**
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Check the appropriate box:

o Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to Rule §240.14a-12

SurModics, Inc.

(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):

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SURMODICS, INC.

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

The Annual Meeting of Shareholders of SurModics, Inc. will be held on January 30, 2006, at 4:00 p.m. (Minneapolis time), at the Hotel Sofitel, 5601 West 78th Street, Bloomington, Minnesota, for the following purposes:

1. To set the number of directors at nine (9).

2. To elect Class I directors.

3. To approve the Company s Amended and Restated 2003 Equity Incentive Plan.

4. To consider and act upon such other matters as may properly come before the meeting or any adjournment or postponement of the meeting.

Only shareholders of record at the close of business on December 9, 2005 are entitled to notice of and to vote at the meeting or any adjournment thereof.

Your vote is important. We ask that you complete, sign, date and return the enclosed Proxy in the envelope provided for your convenience. The prompt return of Proxies will save the Company the expense of further requests for Proxies.

BY ORDER OF THE BOARD OF DIRECTORS

Dale R. Olseth
Executive Chairman

Eden Prairie, Minnesota
December 16, 2005

SURMODICS, INC.

Annual Meeting of Shareholders
January 30, 2006

PROXY STATEMENT

INTRODUCTION

Your Proxy is solicited by the Board of Directors of SurModics, Inc. (the Company) for use at the Annual Meeting of Shareholders to be held on January 30, 2006, at the location and for the purposes set forth in the notice of meeting, and at any adjournment or postponement thereof.

The cost of soliciting Proxies, including the preparation, assembly and mailing of the Proxies and soliciting material, as well as the cost of forwarding such material to beneficial owners of stock, will be borne by the Company. Directors, officers and regular employees of the Company may, without compensation other than their regular remuneration, solicit Proxies personally or by telephone.

Any shareholder giving a Proxy may revoke it at any time prior to its use at the meeting by giving written notice of such revocation to the Secretary of the Company, by filing a new written Proxy with an officer of the Company or by voting at the meeting. Personal attendance at the meeting is not, by itself, sufficient to revoke a Proxy unless written notice of the revocation or a subsequent Proxy is delivered to an officer before the revoked or superseded Proxy is used at the meeting. Proxies not revoked will be voted in accordance with the choices specified by shareholders by means of the ballot provided on the Proxy for that purpose. Proxies that are signed but which lack any such specification will, subject to the following, be voted in favor of the proposal set forth in the Notice of Meeting and in favor of the slate of directors proposed by the Board of Directors and listed herein. If a shareholder abstains from voting as to any matter, then the shares held by such shareholder shall be deemed present at the meeting for purposes of determining a quorum and for purposes of calculating the vote with respect to such matter, but shall not be deemed to have been voted in favor of such matter. Abstentions, therefore, as to any proposal will have the same effect as votes against such proposal. If a broker returns a non-vote Proxy, indicating a lack of voting instructions by the beneficial holder of the shares and a lack of discretionary authority on the part of the broker to vote on a particular matter, then the shares covered by such non-vote Proxy shall be deemed present at the meeting for purposes of determining a quorum but shall not be deemed to be represented at the meeting for purposes of calculating the vote required for approval of such matter.

The mailing address of the principal executive office of the Company is 9924 West 74th Street, Eden Prairie, Minnesota 55344. The Company expects that this Proxy Statement, the related Proxy and notice of meeting will first be mailed to shareholders on or about December 16, 2005.

OUTSTANDING SHARES AND VOTING RIGHTS

The Board of Directors of the Company has fixed December 9, 2005, as the record date for determining shareholders entitled to vote at the Annual Meeting. Persons who were not shareholders on such date will not be allowed to vote at the Annual Meeting. At the close of business on December 9, 2005, 18,545,836 shares of the Company s Common Stock were issued and outstanding. Common Stock is the only outstanding class of capital stock of the Company entitled to vote at the meeting. Each share of Common Stock is entitled to one vote on each matter to be voted upon at the meeting. Holders of Common Stock are not entitled to cumulative voting rights.

PRINCIPAL SHAREHOLDERS

The following table provides information concerning persons known to the Company to be the beneficial owners of more than 5% of the Company s outstanding Common Stock as of December 9, 2005. Unless otherwise indicated, the shareholders listed in the table have sole voting and investment power with respect to the shares indicated.

Name and Address of Beneficial Owner	Number of Shares Beneficially Owned	Percent of Class (1)
Dale R. Olseth 9924 West 74th Street Eden Prairie, MN 55344	1,384,280 (2)	7.4%
David A. Koch 9924 West 74th Street Eden Prairie, MN 55344	1,020,495 (3)	5.5%

(1) Shares not outstanding but deemed beneficially owned by virtue of the right of a person to acquire them as of December 9, 2005, or within sixty days of such date are treated as outstanding only when determining the percent owned by such individual and when determining the percent owned by a group of which such individual is a member.

(2) Includes 5,000 shares held by Mr. Olseth s wife, 68,280 shares that may be acquired upon exercise of stock options which are exercisable as of December 9, 2005 or within 60 days of such date.

(3) Includes 16,200 shares which may be acquired by Mr. Koch upon exercise of stock options that are exercisable as of December 9, 2005 or within 60 days of such date, 62,000 shares held by the Greycoach Foundation, over which Mr. Koch has shared voting and investment power, and 172,000 shares held by a Trust for the benefit of Mr. Koch s wife and children, over which Mr. Koch has shared voting and investment power.

MANAGEMENT SHAREHOLDINGS

The following table sets forth the number of shares of Common Stock beneficially owned as of December 9, 2005, by each executive officer of the Company named in the Summary Compensation table, by each current director and nominee for director of the Company and by all directors and executive officers (including the named executive officers) as a group. Unless otherwise indicated, the shareholders listed in the table have sole voting and investment power with respect to the shares indicated.

Name of Beneficial Owner or Identity of Group	Current Holdings	Acquirable within 60 days	Aggregate Number of Common Shares Beneficially Owned	Percent of class (1)
Dale R. Olseth	1,316,000 (2)	68,280	1,384,280	7.4%
David A. Koch	1,004,295 (3)	16,200	1,020,495	5.5%
Kendrick B. Melrose	263,974	16,200	280,174	1.5%
Bruce J Barclay	41,182	35,000	76,182	*
Lise W. Duran, Ph.D.	30,734	41,528	72,262	*
John A. Meslow	28,000	17,800	45,800	*
Kenneth H. Keller, Ph.D.	10,800	33,200	44,000	*
Steven J. Keough	11,129	24,600	35,729	*
Philip D. Ankeny	11,415	22,000	33,415	*
Gerald B. Fischer	10,950	8,600	19,550	*
David S. Wood	7,000	7,000	14,000	*
José H. Bedoya		8,400	8,400	*
John W. Benson	3,600	4,600	8,200	*
All executive officers and directors as a group (19 persons)	2,810,599	380,448	3,191,047	16.9%

* Less than 1%

(1) See footnote (1) to preceding table.

(2) See footnote (2) to preceding table.

(3) See footnote (3) to preceding table.

ELECTION OF DIRECTORS
(Proposals #1 and #2)

General Information

The Bylaws of the Company provide that the number of directors, which shall not be less than three, shall be determined by the shareholders. The Company s Nominating Committee and Board of Directors have recommended that the number of directors continue to be set at nine (9). The Bylaws also provide for the election of three classes of directors with terms staggered so as to require the election of only one class of directors each year. Only directors who are members of Class I will be elected at the Annual Meeting. The Class I directors will be elected to a three-year term and, therefore, will hold office until the Company s 2009 Annual Meeting of Shareholders and until their successors have been duly elected and qualified. The terms of Class II and III directors continue until 2007 and 2008, respectively.

The Nominating Committee recommended and the Board of Directors selected Bruce J Barclay, José H. Bedoya, and John A. Meslow as the Board s nominees for re-election as Class I directors. Each Proxy will be voted for each of such nominees unless the Proxy withholds a vote for one or more nominees. If, prior to the meeting, it should become known that any of the nominees will be unable to serve as a director after the meeting by reason of death, incapacity or other unexpected occurrence, the Proxies will be voted for such substitute nominee as is recommended or selected by the Nominating Committee and the Board of Directors or, alternatively, not voted for any nominee. The Board of Directors has no reason to believe that any nominee will be unable to serve. Under applicable Minnesota law, approval of the proposal to set the number of directors at nine (9) requires the affirmative vote of the holders of a majority of the voting power of the shares represented in person or by Proxy at the Annual Meeting with authority to vote on such matter, but not less than the affirmative vote of 4,636,460 shares, and the election of each Class I director requires the affirmative vote by a plurality of the voting power of the shares present and entitled to vote on the election of directors at the Annual Meeting at which a quorum is present.

The following information is provided with respect to each director nominee as well as each director whose term continues after the Annual Meeting:

Name	Age	Position with Company
Dale R. Olseth	75	Executive Chairman
Bruce J Barclay	49	President and Chief Executive Officer
John W. Benson (1)(4)	61	Director
José H. Bedoya (1)(4)	49	Director
Gerald B. Fischer (2)(3)(4)	62	Director
Kenneth H. Keller, Ph.D. (1)(2)(4)	71	Director
David A. Koch (1)(2)(4)	75	Director
Kendrick B. Melrose	65	Director
John A. Meslow (1)(4)	66	Director

(1) Member of the Organization and Compensation Committee, for which Mr. Meslow is the Chairman.

(2) Member of the Audit Committee, for which Mr. Fischer is the Chairman.

(3) The Board of Directors has determined that Mr. Gerald B. Fischer qualifies as an audit committee financial expert under federal securities laws.

(4) Member of the Nominating Committee, for which Mr. Keller is the Chairman.

Dale R. Olseth (Class III) joined the Company in 1986 as its President, Chief Executive Officer and a director of the Company. Mr. Olseth served as the Company s President and Chief Executive Officer until July 2005. Mr. Olseth continues to serve as the Company s Executive Chairman. Mr. Olseth has been Chairman since 1988. Mr. Olseth also serves on the Board of Directors of The Toro Company and the boards of Otologics LLC and the University of Minnesota Foundation. He served as Chairman, President and Chief Executive Officer of Medtronic, Inc. from 1976 to 1986. From 1971 to 1976, Mr. Olseth served as President and Chief Executive Officer of Tonka Corporation. Mr. Olseth received a B.B.A. degree from the University of Minnesota in 1952 and an M.B.A. degree from Dartmouth College in 1956.

Bruce J Barclay (Class I) joined the Company as its President and Chief Operating Officer in December 2003. He became a director of the Company in July 2004 and Chief Executive Officer of the Company in July 2005. Mr. Barclay has more than 25 years of experience in the health care industry. Prior to joining SurModics, he served as President and Chief Executive Officer of Vascular Architects, Inc., a medical device company that develops, manufactures and sells products to treat peripheral vascular disease, from 2000 to 2003. Prior to Vascular Architects, he served at Guidant Corporation, most recently as an officer and Senior Vice President from 1998 to 2000. Previously, he was a Vice President of Guidant s Interventional Cardiology division with responsibility for the law division, a new therapies technical development team and business development, charged with the acquisition of new products and technologies for the division. Mr. Barclay also has considerable experience in the pharmaceutical area serving in several positions at Eli Lilly and Company. Mr. Barclay also serves on the Board of Directors of Cardiac Science, Inc., which develops, manufactures and markets diagnostic and therapeutic cardiology products and services. Mr. Barclay received a B.S. in chemistry and a B.A. in biology from Purdue University in 1980 and a J.D. from the Indiana University School of Law in 1984. He is also a registered patent attorney.

John W. Benson (Class II) has been a director since May 22, 2003. Mr. Benson retired from 3M Company in February 2003 where he served in various capacities for 35 years. Prior to his retirement, he served as Executive Vice President, Health Care Markets. Mr. Benson currently serves on the Board of Regents at St. Olaf College.

José H. Bedoya (Class I) has been a director of the Company since 2002. Mr. Bedoya is President of Otologics LLC, a Colorado-based technology company he founded in 1996 to develop implantable devices to assist the severely hearing-impaired. From 1986 to 1996, Mr. Bedoya held a number of positions at Storz Instrument Company, then a division of American Cyanamid and later a division of American Home Products, including

Director of Operations, Director of Research and Director of Commercial Development. Prior to that, he served as Vice President of Research and Development for Bausch & Lomb s surgical division.

Gerald B. Fischer (Class II) has been a director of the Company since 2002. He is President and Chief Executive Officer of the University of Minnesota Foundation, a position he has held since 1990. From 1985 to 1989, Mr. Fischer was with First Bank System, now U.S. Bancorp, serving as Executive Vice President, Chief Financial Officer and Treasurer. Previous to that he spent 18 years in various finance positions at Ford Motor Company and its affiliates.

Kenneth H. Keller, Ph.D. (Class III) has been a director of the Company since 1997. He has served as Professor of Science and Technology Policy in the Hubert H. Humphrey Institute of Public Affairs at the University of Minnesota since 1996. Dr. Keller joined the Chemical Engineering and Materials Science faculty of the University of Minnesota in 1964, and through the years assumed increasing administrative responsibilities, including serving as the President of the University from 1985 to 1988. Dr. Keller was a Senior Fellow at the Council on Foreign Relations from 1989 to 1997.

David A. Koch (Class III) has been a director of the Company since 1988. He has served as the Chairman Emeritus of Graco Inc. since May 2001, as its Chairman from 1985 to 2001, as its Chief Executive Officer from 1985 to 1996 and as its President and Chief Executive Officer from 1962 to 1985. He has served as Chairman of SoftPac Industries Inc. since 2000.

Kendrick B. Melrose (Class II) has been a director of the Company since 1988. He currently serves as Executive Chairman of The Toro Company. From 1987 until March, 2005 he served as its Chairman and Chief Executive, its Chief Executive Officer from 1983 to 1987 and as its President from 1981 to 1983.

John A. Meslow (Class I) has been a director of the Company since 2000. He served as Senior Vice President and President Neurological Business of Medtronic, Inc. from 1985 until his retirement in 2000.

CORPORATE GOVERNANCE

The Company s business affairs are conducted under the direction of the Board of Directors in accordance with the Minnesota Business Corporation Act and the Company s Articles of Incorporation and Bylaws. Members of the Board of Directors are informed of the Company s business through discussions with management, by reviewing materials provided to them and by participating in meetings of the Board of Directors and its committees. Certain corporate governance practices that the Company follows are summarized below.

Code of Ethics and Business Conduct

We have adopted the SurModics Code of Ethics and Business Conduct (the Code of Conduct), a code of conduct that applies to our directors, officers and employees. The Code of Conduct is publicly available on our website at www.surmodics.com. If we make any substantive amendments to the Code of Conduct or grant any waiver, including any implicit waiver from a provision of the Code of Conduct to our directors or executive officers, we will disclose the nature of such amendment or waiver on our website or in a report on Form 8-K.

Majority of Independent Directors; Committees of Independent Directors

Our Board of Directors has determined that Messrs. Benson, Bedoya, Fischer, Keller, Koch and Meslow, constituting a majority the Board of Directors, are independent directors in accordance with rules of the NASD since none of them are believed to have any relationships that, in the opinion of the Board of Directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

Messrs. Olseth and Barclay are precluded from being considered independent by NASD rules since they currently serve as executive officers of the Company. Mr. Melrose is also precluded from being considered independent by NASD rules since he serves as an executive officer of an entity at which one of the Company s executive officers served as a member of the compensation committee within the past three years.

Each member of the Company s Audit Committee, Organization and Compensation Committee and Nominating Committee has been determined, in the opinion of the Board of Directors, to be independent in accordance with NASD rules.

Committee and Board Meetings

The Company s Board of Directors has three standing committees the Audit Committee, the Organization and Compensation Committee and the Nominating Committee. During fiscal 2005, the Board of Directors held 7 formal meetings and the standing committees had the number of formal meeting noted below. Each incumbent director attended 75% or more of the total number of meetings of the Board and of Committee(s) of which he was a member in fiscal year 2005.

Audit Committee

The Audit Committee is responsible for reviewing the Company s internal control procedures and the quarterly and annual financial statements of the Company, and reviewing with the Company s independent public accountants the results of the annual audit. The Audit Committee held four formal meetings during fiscal 2005.

Organization and Compensation Committee

The Organization and Compensation Committee recommends to the Board of Directors from time to time the salaries and incentive compensation to be paid to executive officers, key employees and directors of the Company and organizational planning and changes at the executive level. The Organization and Compensation Committee held four formal meetings during fiscal 2005.

Nominating Committee; Procedures and Policy

The Nominating Committee is responsible for evaluating and nominating or recommending candidates for the Company s Board of Directors. The Nominating Committee held one formal meeting during fiscal year 2005. The Nominating Committee s nominating policy provides for the consideration of candidates recommended by shareholders, directors, third parties, search firms and others. In evaluating director nominees, the Nominating Committee considers the following factors and qualifications:

- the appropriate size and the diversity of the Company s Board of Directors;
- the needs of the Board with respect to the particular talents and experience of its directors;
- the knowledge, skills and experience of nominees, including experience in the industry in which the Company operates, business, finance, management or public service, in light of prevailing business conditions and the knowledge, skills and experience already possessed by other members of the Board;
- familiarity with domestic and international business matters;
- age and legal and regulatory requirements;
- experience with accounting rules and practices;
- appreciation of the relationship of the Company s business to the changing needs of society; and
- the desire to balance the considerable benefit of continuity with the periodic injection of the fresh perspective provided by new members.

The Nominating Committee will consider the attributes of the candidates and the needs of the Board and will review all candidates in the same manner, regardless of the source of the recommendation.

A shareholder who wishes to recommend one or more directors must provide a written recommendation to the Secretary of the Company at the address below. Notice of a recommendation must include:

with respect to the shareholder:

- name, address, the class and number of shares such shareholder owns;

with respect to the nominee:

- name, age, business address, residence address,
- current principal occupation,
- five year employment history with employer names and a description of the employer s business,
- the number of shares beneficially owned by the nominee,

- whether such nominee can read and understand basic financial statements, and
- Board membership, if any.

The recommendation must be accompanied by a written consent of the nominee to stand for election if nominated by the Board of Directors and to serve if elected by the shareholders. The Company may require any nominee to furnish additional information that may be needed to determine the eligibility of the nominee. Such recommendation must be submitted to the Secretary of the Company no later than 120 days prior to the mailing of the proxy statement for the next Annual Meeting of Shareholders.

The Nominating Committee believes that candidates for directors should have certain minimum qualifications, including being able to read and understand basic financial statements, having familiarity with the Company s business and industry, having high moral character and mature judgment, being able to work collegially with others, and not currently serving on more than four Boards of public companies. The Nominating Committee may modify these minimum qualifications from time to time.

Procedures for Shareholder Communications to Directors

Shareholders may communicate directly with the Board of Directors. All communications should be directed to our Corporate Secretary at the address below and should prominently indicate on the outside of the envelope that it is intended for the Board of Directors or for non-management directors. If no director is specified, the communication will be forwarded to the entire Board. Shareholder communications to the Board should be sent to:

Corporate Secretary
Attention: Board of Directors
SurModics, Inc.
9924 West 74th Street
Eden Prairie, MN 55344-3523

Director Attendance Policy

Directors attendance at our annual meetings of shareholders can provide our shareholders with an opportunity to communicate with directors about issues affecting the Company. Accordingly, all directors are expected and encouraged to attend annual meetings of shareholders. All of the Company s directors attended the last annual meeting of shareholders, which was held in January 2005.

Directors Fees

Each director who is not an employee of the Company receives $10,000 as an annual retainer and $1,000 for each Board meeting attended. Further, each committee member receives $500 for each committee meeting attended and each committee chair receives $2,000 as an annual retainer fee. Each non-employee director is granted an option under the 2003 Equity Incentive Plan to purchase 10,000 shares of Company Common Stock upon his or her first election to the Board of Directors, and each non-employee directors is granted annually an option under such Plan to purchase 5,000 shares of Company Common Stock.

The non-employee directors currently hold nonqualified stock options to purchase an aggregate of 171,400 shares of Common Stock. All such options have an exercise price equal to the fair market value of a share of Common Stock on the date of grant and expire ten years after the date of grant. Such options are exercisable as to 20% commencing on the date of grant and become exercisable for an additional 20% on each of the next four anniversaries of the date of grant. In addition, all directors are reimbursed for their travel-related expenses incurred in attending meetings of the Board of Directors.

EXECUTIVE COMPENSATION AND OTHER INFORMATION

Organization and Compensation Committee Report on Executive Compensation

Compensation Committee Interlocks and Insider Participation

The Organization and Compensation Committee (Committee) of the Board of Directors of the Company is currently composed of five of the Company s outside directors. None of the members of the Committee is an employee or executive officer of the Company. Dale R. Olseth, the Company s Executive Chairman, served until March 2003 as a member of the compensation committee of The Toro Company. Kendrick B. Melrose, who was

a member of the Company s Organization and Compensation Committee until May 2003, serves as the Executive Chairman of The Toro Company.

Compensation Philosophy

The Committee s executive compensation policies are designed to enhance the financial performance of the Company, and thus shareholder value, by aligning the financial interests of executive officers and employees with those of shareholders. The executive compensation program is viewed in total considering all of the component parts: base salary, annual performance incentives, benefits and long-term incentive opportunities in the form of stock options, restricted stock grants, restricted stock units, performance awards and stock ownership. The Committee s position is that stock ownership by executive officers and employees is beneficial in aligning management s and shareholders interests in the enhancement of shareholder value.

Base Salary

Base salaries for executive officers of the Company are reviewed by the Committee. The Committee assesses the executive officer s level of responsibility, experience, individual performance, and accountabilities relative to other Company executive officers and external market practices. The Company s annual base salaries for its executive officers are generally conservative when compared to base salaries offered by comparable companies. However, the Committee believes that executive officers base salaries, when combined with incentive plans based on the Company s financial performance, are generally competitive with compensation levels at comparable companies. The Company s pay-for-performance philosophy places a substantial portion of executive officers total compensation at risk while providing compensation opportunities which are comparable to the market levels.

Incentives

The Company may grant some executive officers long-term awards, including restricted stock units, performance awards, stock options, and restricted stock. The purposes of the awards are to:

(i) focus executives on the achievement of performance objectives that enhance shareholder value;

(ii) emphasize the importance of balancing present business needs and long-term goals critical to the future success of the Company; and

(iii) attract and retain executive officers of superior ability.

Annual Incentive Plan. The Company has annually established a cash bonus plan that enables the Company s employees, including its executive officers, to earn a bonus, calculated as a percentage of their annual base salary, based on the achievement of certain financial and operational goals by the Company. The actual percentage award for all employees is determined based on the achievement of certain revenue and operating income goals for the fiscal year, and at times the particular year s plan has contained higher threshold financial goals for executive officers. The maximum bonus under the FY 2005 Bonus Plan was 26.67% of the officer s base salary.

2003 Equity Incentive Plan. Under the Company s current 2003 Equity Incentive Plan, 2,400,000 shares of Common Stock were reserved for issuance to executive officers, directors, consultants and employees. Options granted under the plan may be either incentive stock options within the meaning of Section 422 of the Internal Revenue Code or nonqualified stock options that do not qualify for special tax treatment under Section 422 of the Internal Revenue Code. The options are granted at 100% of the fair market value of the Common Stock on the date of grant. Options typically expire seven to ten years from the date of grant or upon termination of employment, and are exercisable at a rate of 20% per year from the date of grant or 20% per year commencing one year after the date of grant. The 2003 Plan also allows the grant of stock awards, with or without forfeiture restrictions. As of September 30, 2005 there were approximately 1,529,935 shares of Common Stock to be issued upon the exercise of outstanding options and 1,216,450 available for grant under the 2003 Plan. The Amended and Restated 2003 Equity Incentive Plan (see Proposal #3) will, if approved by the shareholders, allow for the granting of additional types of awards in addition to options and restricted stock awards.

Shareholders approved the 2003 Equity Incentive Plan at the 2003 Annual Meeting of Shareholders and an amendment to the Plan at the 2005 Annual Meeting to increase the cumulative reserve under the Plan to 2,400,000 shares. Following the original approval of the 2003 Plan, no further options or stock awards were or will be granted from the *1997 Incentive Stock Option Plan,* the *Nonqualified Stock Option Plan,* or the *Restricted Stock Plan* described below.

1997 Incentive Stock Option Plan. Under the Company s 1997 Incentive Stock Option Plan, 1,200,000 shares of Common Stock were reserved for issuance to executive officers and employees. The 1997 Plan requires that the option price per share must be at least 100% of the fair market value of the Common Stock on the date of the option grant. Options typically expire seven years from the date of grant or upon termination of employment, and are exercisable at a rate of 20% per year commencing one year after the date of grant. There are approximately 379,475 shares of Common Stock to be issued upon the exercise of outstanding options, but no further options will be granted from the *1997 Incentive Stock Option Plan*.

Nonqualified Stock Option Plan. Under the Company s Nonqualified Stock Option Plan, 1,944,480 shares of Common Stock were reserved for issuance to outside directors, executive officers and employees. The options are granted at 100% of the fair market value. Options expire seven to ten years from the date of grant, and are exercisable at a rate of 20% per year from the date of grant or 20% per year commencing two years after the date of grant. There are approximately 79,400 shares of Common Stock to be issued upon the exercise of outstanding options, but no further options will be granted from the *Nonqualified Stock Option Plan*.

Restricted Stock Plan. Under the Company s Restricted Stock Plan, 200,000 shares of Common Stock were reserved for issuance to executive officers and key employees. Under the Restricted Stock Plan, grants of restricted stock vest in full five years from the date of grant. No further stock awards will be granted from the *Restricted Stock Plan*.

General

The Company provides medical and insurance benefits to its executive officers which are generally available to all Company employees. The Company also maintains a 401(k) savings plan in which all qualified employees, including the executive officers, may participate. The Company provides matching contributions to the savings plan for all participating employees, allowing such employees to earn up to an additional 3% of their annual base salary. In addition, the Company maintains a Stock Purchase Plan that permits qualified employees, including executive officers, to purchase stock of the Company at favorable prices. The amount of perquisites allowed to executive officers, as determined in accordance with rules of the Securities and Exchange Commission, did not exceed 10% of salary in fiscal 2005.

Chief Executive Officer Compensation

Dale R. Olseth served as the Company s Chief Executive Officer until July 2005 and now serves as it Executive Chairman. Bruce J Barclay became Chief Executive officer in July 2005. Messrs. Olseth and Barclay s annual base salary and eligibility for annual incentives, set forth in the following tables, were determined in accordance with the policies described above as applicable to all executive officers.

Other

Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code), limits the deductibility of certain compensation paid to the chief executive officer and each of the four other most highly compensated executives of a publicly-held corporation to $1 million per executive per year. However, performance-based compensation is excluded from this limit if certain Section 162(m) conditions are met. Although, in fiscal 2005, the Company did not pay compensation within the meaning of Section 162(m) to any of such executive officers in excess of $1 million, the Company has amended and restated its 2003 Equity Incentive Plan to provide for flexibility in granting performance-based awards that will be excluded from the Section 162(m) deductibility cap and to otherwise provide features to awards so as to help avoid having Section 162(m) compensation paid to such executive officers as will exceed the $1 million deductibility.

Members of the Committee:
John A. Meslow, Chairman
José H. Bedoya
John W. Benson
Kenneth H. Keller, Ph.D.
David A. Koch

Summary Compensation Table

The following table sets forth certain information regarding compensation paid during each of the Company s last three fiscal years to the Chief Executive Officers and each of the four most highly compensated executive officers of the Company (the Named Executive Officers) who received total salary and bonus compensation in excess of $100,000 for fiscal 2005.

Summary Compensation Table

	Annual Compensation			Long Term Compensation		
Name and Principal Position	**Fiscal Year**	**Salary ($)**	**Bonus ($) (1)**	**Restricted Stock Award(s) ($) (2)**	**Securities Underlying Options (# of shares)**	**All Other Compensation (3)**
Bruce J Barclay,	2005	$269,564	$65,000	$747,250	75,000	$ 7,993
President and Chief	2004	$189,301	$ 0	$315,000	50,000	$149,643
Executive Officer						