

CHOLESTECH CORPORATION

Form DEF 14A

July 15, 2005

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**SCHEDULE 14A**

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

**CHOLESTECH CORPORATION**

(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:
  - 3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
  - 4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

- o Fee paid previously with preliminary materials.
- o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

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**CHOLESTECH CORPORATION**

**Notice of Annual Meeting of Shareholders**

**August 17, 2005**

**10:00 a.m.**

**TO OUR SHAREHOLDERS:**

You are cordially invited to attend the 2005 Annual Meeting of Shareholders of Cholestech Corporation, which will be held at our executive offices located at 3347 Investment Boulevard, Hayward, California 94545-3808, on Wednesday, August 17, 2005, at 10:00 a.m. local time for the following purposes:

1. To elect seven directors to serve until the next annual meeting of shareholders or until their successors are duly elected and qualified.
2. To ratify the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending March 31, 2006.
3. To approve an amendment to our 2000 stock incentive program to increase the aggregate number of shares of common stock that may be issued under such program by 300,000, and to approve the material terms of the 2000 stock incentive program for purposes of Section 162(m) of the Internal Revenue Code.
4. To transact such other business as may properly come before the meeting or any adjournment or postponement of the meeting.

These items of business are more fully described in the proxy statement accompanying this notice. Only shareholders of record at the close of business on June 20, 2005 will be entitled to attend and vote at the annual meeting.

Whether or not you plan to attend the annual meeting, please complete, sign, date and return the enclosed proxy card as promptly as possible in the accompanying reply envelope. You may revoke your proxy in the manner described in the accompanying proxy statement at any time before it has been voted at the annual meeting. Any shareholder attending the annual meeting may vote in person even if he or she has returned a proxy.

For the Board of Directors of  
CHOLESTECH CORPORATION

John F. Glenn  
*Vice President of Finance, Chief Financial Officer,  
Treasurer and Secretary*

July 15, 2005

**YOUR VOTE IS IMPORTANT**

**WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, PLEASE COMPLETE, SIGN AND DATE  
THE ENCLOSED PROXY CARD AS PROMPTLY AS POSSIBLE AND RETURN IT IN THE  
ACCOMPANYING REPLY ENVELOPE.**

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**CHOLESTECH CORPORATION**

**PROXY STATEMENT FOR THE  
2005 ANNUAL MEETING OF SHAREHOLDERS**

**GENERAL INFORMATION**

The enclosed proxy is solicited on behalf of the board of directors of Cholestech Corporation ( Cholestech ) for use at our 2005 annual meeting of shareholders and at any adjournment or postponement of the meeting. The purposes of the annual meeting are set forth in the accompanying notice of annual meeting of shareholders.

The annual meeting will be held at our principal executive offices located at 3347 Investment Boulevard, Hayward, California 94545-3808, on Wednesday, August 17, 2005, at 10:00 a.m. local time. Our telephone number at that location is (510) 732-7200.

These proxy solicitation materials and the Annual Report on Form 10-K for the fiscal year ended March 25, 2005, including financial statements, were first mailed on or about July 15, 2005 to all shareholders entitled to vote at the meeting. **You may receive an additional copy of our Annual Report on Form 10-K or a copy of the exhibits to our Annual Report on Form 10-K without charge by sending a written request to our corporate secretary at the address above.**

**Who May Vote**

You may vote if our records show that you owned your shares as of June 20, 2005. At the close of business on that date, we had a total of 14,630,054 shares of common stock outstanding, which were held by approximately 153 shareholders of record. As of the record date, we had no shares of our preferred stock outstanding.

**Revoking Your Proxy Card**

You may revoke your proxy card at any time before it is voted at the annual meeting. In order to do this, you must either (i) sign and return another proxy card bearing a later date; (ii) provide written notice of the revocation to John F. Glenn, our vice president of finance and chief financial officer, before we take the vote at the annual meeting; or (iii) attend the meeting and vote in person.

**Quorum Requirement**

A quorum, which is a majority of our outstanding shares as of the record date, must be present in order to hold the annual meeting and to conduct business. Your shares will be counted as being present at the meeting if you attend the meeting in person or if you submit a properly executed proxy card.

**Voting**

You are entitled to one vote for each share held. In voting for the election of directors (Proposal One), you may cumulate your votes. This means you may give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of shares held by you, or distribute your votes on the same principle among as many candidates as you may select, provided that you cannot cast votes for more candidates than the number of directors to be elected (seven). However, you will not be entitled to cumulate votes unless the candidate's name has been placed in nomination prior to voting and you have given notice at the meeting, prior to the voting, of your intention to cumulate your votes. On all other matters, you are entitled to one vote for each share held.

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If your proxy card is properly dated, executed and returned, your shares will be voted at the annual meeting in accordance with the instructions you indicate on the proxy card. If you submit the proxy card but do not indicate your voting instructions, your shares will be voted as follows:

FOR the election of the seven nominees to the board of directors;

FOR the ratification of the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending March 31, 2006; and

FOR the amendment to our 2000 stock incentive program to increase the aggregate number of shares of common stock that may be issued under such program by 300,000, and to approve the material terms of the 2000 stock incentive program for purposes of Section 162(m) of the Internal Revenue Code.

**Proxy Solicitation Costs**

Our board of directors is making this solicitation of proxies and we will bear the entire cost of proxy solicitation, including the preparation, assembly, printing and mailing of our proxy materials. None of our directors intend to oppose any action for which shareholder approval is being solicited. We have engaged Georgeson Shareholder Communications Inc. to assist in solicitation of proxies at an estimated fee of \$15,000, plus disbursements. In addition, we may reimburse brokerage firms and other persons representing beneficial owners for their expenses in forwarding solicitation materials to such beneficial owners. Certain of our directors, officers and regular employees, without additional compensation, may solicit proxies on behalf of our board of directors, personally or by telephone or facsimile. We expect that a representative from our transfer agent, Computershare Limited, will tabulate the proxies and act as the inspector of elections.

**Abstentions and Broker Non-Votes**

If you return a proxy card that indicates an abstention from voting on all matters, the shares represented will be counted as present for the purpose of determining a quorum, but they will not be voted on any matter at the annual meeting. Consequently, if you abstain from voting on the proposal to elect directors, your abstention will have no effect on the outcome of the vote with respect to this proposal. If you abstain from voting on the proposal to ratify the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm and the proposal to increase the aggregate number of shares of common stock that may be issued under the 2000 stock incentive program and to approve the material terms of such program, your abstention will have the same effect as a vote against these proposals.

Under the rules that govern brokers who have record ownership of shares that are held in street name for their clients, who are the beneficial owners of the shares, brokers have discretion to vote these shares on routine matters but not on non-routine matters. Thus, if you do not otherwise instruct your broker, the broker may turn in a proxy card voting your shares for routine matters but expressly instructing that the broker is NOT voting on non-routine matters. A broker non-vote occurs when a broker expressly instructs on a proxy card that it is not voting on a matter, whether routine or non-routine. Broker non-votes are counted for the purpose of determining the presence or absence of a quorum but are not counted for determining the number of votes cast for or against a proposal. Your broker will have discretionary authority to vote your shares on Proposal One and Proposal Two, which are both routine matters. However, for shares held through a broker or other nominee who is a NYSE member organization, your shares will only be voted in favor of Proposal Three if you have provided specific voting instructions to your broker or other nominee to vote your shares in favor of that proposal. See **Vote Required** following each proposal for further information.

**Voting Results**

The preliminary voting results will be announced at the annual meeting. The final voting results will be calculated by our transfer agent and inspector of elections, Computershare Limited, and published in our Quarterly Report on Form 10-Q for the second quarter of fiscal year 2006.

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**Deadline of Receipt of Shareholder Proposals for 2006 Annual Meeting**

As a shareholder, you may be entitled to present proposals for action at a forthcoming meeting if you comply with the requirements of the proxy rules established by the Securities and Exchange Commission. If you intend to present a proposal at our 2006 annual meeting of shareholders, the proposal must be received by us no later than March 17, 2006 to be considered for inclusion in the proxy statement and form of proxy relating to that meeting.

The Securities and Exchange Commission rules establish a different deadline with respect to discretionary voting for shareholder proposals that are not intended to be included in a company's proxy statement. The discretionary vote deadline for our 2006 annual meeting is May 31, 2006, which is 45 calendar days prior to the anniversary of the mailing date of this proxy statement. If a shareholder gives notice of a proposal after the discretionary vote deadline, our proxy holders will be allowed to use their discretionary voting authority to vote against the shareholder proposal when and if the proposal is raised at our 2006 annual meeting.

**Nomination of Director Candidates**

You may also propose director candidates for consideration by the board's nominating committee. It is our policy that our nominating committee will consider recommendations for candidates to the board of directors from shareholders holding not less than 1% of the total outstanding shares of our common stock and who have held such common stock continuously for at least 12 months prior to the date of the submission of the recommendation. The nominating committee will consider persons recommended by our shareholders in the same manner as a nominee recommended by other board members or management. See Corporate Governance Policy for Director Recommendations and Nominations for additional information.

**Shareholder Communications to Directors**

Shareholders may communicate directly with our directors by sending an email to *board@cholestech.com*. Our chief financial officer will monitor these communications and will ensure that appropriate summaries of all received messages and all received messages are provided to the board of directors at its regularly scheduled meetings. In addition, all of our directors will have access to this email address. Where the nature of a communication warrants, our chief financial officer may decide to obtain the more immediate attention of the appropriate committee of the board of directors or a non-management director, or our management or independent advisors, as our chief financial officer considers appropriate. After reviewing shareholder messages, our board of directors will determine whether any response is necessary and whether further action is required.

**Other Matters**

Other than the proposals listed above, our board of directors does not intend to present any other matters to be voted on at the 2005 annual meeting of shareholders. Our board of directors is not currently aware of any other matters that will be presented by others for action at the meeting. However, if other matters are properly presented at the 2005 annual meeting of shareholders and you have signed and returned your proxy card, the proxy holders will have discretion to vote your shares on these matters to the extent authorized under the Securities Exchange Act of 1934, as amended.

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ELECTION OF DIRECTORS****General**

A board of seven directors is to be elected at the annual meeting. Unless otherwise instructed, the proxy holders will vote the proxies received by them for the seven nominees named below, all of whom are presently our directors. In any event, the proxy holders cannot vote the proxies for a greater number of persons than seven. In the event that any nominee is unable or declines to serve as a director at the time of the annual meeting, the proxies will be voted for a nominee who shall be designated by the present board of directors to fill the vacancy. In the event that additional persons are nominated for election as directors, the proxy holders intend to vote all proxies received by them in such a manner (in accordance with cumulative voting) as will assure the election of as many of the nominees listed below as possible, and, in such event, the specific nominees to be voted for will be determined by the proxy holders. We are not aware of any nominee who will be unable or will decline to serve as a director. The term of office for each person elected as a director will continue until the next annual meeting of shareholders or until such director's successor has been duly elected and qualified.

**Nominees**

The following table sets forth the names, ages and titles of the nominees as of June 20, 2005:

<b>Name of Nominee</b>	<b>Age</b>	<b>Position with Cholestech</b>	<b>Director Since</b>
John H. Landon(2)(3)(4)(5)	64	Chairman of the Board	1997
Warren E. Pinckert II	61	President, Chief Executive Officer and Director	1993
Michael D. Casey(3)(4)(6)	59	Director	2001
John L. Castello(2)(3)(4)(7)	69	Director	1993
Elizabeth H. Dávila(1)(2)	60	Director	2003
Stuart Heap(1)(2)	56	Director	2003
Larry Y. Wilson(1)(8)	55	Director	1998

- (1) Member of the audit committee.
- (2) Member of the compensation committee.
- (3) Member of the nominating committee.
- (4) Member of the governance committee.
- (5) Chair of the nominating committee.
- (6) Chair of the governance committee.
- (7) Chair of the compensation committee.
- (8) Chair of the audit committee.

There are no family relationships between any director or executive officer.

*John H. Landon* has served as a director since December 1997 and as our chairman since August 2000. Mr. Landon served as the vice president and general manager of Medical Products for E.I. DuPont de Nemours and Company from 1992 until his retirement in 1996. Prior to that, Mr. Landon served in various capacities at DuPont,

including vice president and general manager, Diagnostics and Biotechnology from 1990 to 1992, director of Diagnostics from 1988 to 1990, business director of Diagnostic Imaging from 1985 to 1988 and in various other professional and management positions at DuPont from 1962 to 1985. Mr. Landon is also

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a director of Digene Corporation and Christiana Care Corporation and has previously served as a director of the GenVec, Inc. Advanced Medical Technology Association (AdvaMed) and the DuPont Merck Pharmaceutical Company. Mr. Landon earned a Bachelor of Science degree in Chemical Engineering from the University of Arizona.

*Warren E. Pinckert II* has served as our president, chief executive officer and a director since June 1993.

Mr. Pinckert served as our executive vice president of operations from 1991 to June 1993, as our chief financial officer and vice president of business development from 1989 to June 1993 and as our secretary from 1989 to January 1997. From 1983 to 1989, Mr. Pinckert was chief financial officer of Sunrise Medical Inc., an international durable medical equipment manufacturer. Mr. Pinckert is also a director of PacifiCare Health Systems, Inc. and serves on the Board of Advisors for the San Francisco State University School of Business. Mr. Pinckert earned a Bachelor of Science degree in Accounting and a Masters of Business Administration degree from the University of Southern California.

*Michael D. Casey* has served as a director since February 2001. Mr. Casey served as the chairman, president, chief executive officer and a director of Matrix Pharmaceutical, Inc. from 1997 until his retirement in February 2002. From November 1995 to December 1996, Mr. Casey was executive vice president at Schein Pharmaceutical, Inc. In December 1996, he was appointed president of the retail and specialty products division of Schein. From June 1993 to November 1995, he served as president and chief operating officer of Genetic Therapy, Inc. Mr. Casey was president of McNeil Pharmaceutical (a unit of Johnson & Johnson) from 1989 to June 1993 and vice president, sales and marketing for Ortho Pharmaceutical Corp. (a subsidiary of Johnson & Johnson) from 1985 to 1989. Mr. Casey is also a director of Celgene Corporation, Bone Care International, Inc., Allos Therapeutics, Inc., OrthoLogic Corporation and Durect Corporation.

*John L. Castello* has served as a director since August 1993. Mr. Castello is the chairman, president and chief executive officer of Xoma Ltd., a biotechnology company. Mr. Castello joined Xoma in April 1992 as president and chief executive officer and became chairman in 1993. He served as president of Ares Serono Diagnostics from 1986 to 1988, president and chief operating officer of The Ares Serono Group from 1988 to 1991 and chairman of Ares Serono Inc. from 1991 to 1992. From 1960 to 1986, Mr. Castello held various senior management positions at Amersham International plc, Abbott Laboratories, General Foods and Honeywell Corp. Mr. Castello earned a Bachelor of Science degree in Mechanical and Industrial Engineering from Notre Dame University.

*Elizabeth H. Dávila* has served as a director since August 2003. Ms. Dávila served as chairman of the board and chief executive officer of VISX, Incorporated, a developer of proprietary technologies and systems for laser vision correction, from 2001 until May 2005 when VISX was acquired by Advanced Medical Optics, Inc. She is currently a member of the board of directors of Advanced Medical Optics. From 1995 to 2001, Ms. Dávila held the positions of president, executive vice president and chief operating officer at VSX and served as a director since December 1995 at VISX. Prior to joining VISX, Ms. Dávila was at Syntex Corporation from 1977 to 1994 where she held senior management positions in its medical device, medical diagnostics, and pharmaceutical divisions. Ms. Dávila also serves on the board of directors of Nugen Technologies, Inc. She holds a masters degree in chemistry from Notre Dame and an MBA from Stanford University.

*Stuart Heap* has served as a director since March 2003. Mr. Heap is the chief executive officer of Regent Medical, a manufacturer of surgical gloves for the healthcare industry. From January 2002 to June 2004, Mr. Heap served as chief executive officer and president of SSL-Americas. From January 1998 to December 2001, Mr. Heap served as the president of the contact lens division of CIBA Vision Corp., a subsidiary of Novartis AG. Mr. Heap was the head of global marketing for CIBA Vision from June 1995 to June 1997. Mr. Heap earned a Bachelor of Science degree in Engineering from Salford University in the United Kingdom.

*Larry Y. Wilson* has served as a director since May 1998. Since January 2002, Mr. Wilson has served as senior vice president and chief financial officer for Northern California for Kaiser Foundation Health Plan, Inc. From 1987 to June 2001, Mr. Wilson served as the executive vice president and chief operating officer of

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Catholic Healthcare West. Mr. Wilson served as the executive vice president and chief financial officer of Mercy Health System, a predecessor of Catholic Healthcare, from 1983 to 1986 and as a principal of the Health and Medical Division of Booz Allen & Hamilton, a consulting company, from 1979 to 1983. From 1995 to December 2001, Mr. Wilson also served as an officer and director of the California Healthcare Association and as its chairman in 2000. Mr. Wilson earned a Bachelor of Arts degree in English from Harvard University and a Masters of Business Administration degree from Stanford University.

**Vote Required and Board Recommendation**

If a quorum is present, the seven nominees receiving the most FOR votes (among votes properly cast in person or by proxy) will be elected to the board of directors. Abstentions and broker non-votes will have no effect on the outcome of the vote with respect to this proposal. **The board of directors recommends that shareholders vote FOR the election of each of the seven nominees named above.**

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**PROPOSAL TWO**  
**RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED**  
**PUBLIC ACCOUNTING FIRM**

The board of directors, acting upon the recommendation of the audit committee of the board of directors, has selected PricewaterhouseCoopers LLP, independent registered public accounting firm ( PwC ), to audit our consolidated financial statements for the fiscal year ending March 31, 2006, and recommends that the shareholders vote for the ratification of such appointment. In the event of a negative vote on such ratification, the board of directors will reconsider its selection.

Representatives of PwC are expected to be present at the annual meeting with the opportunity to make a statement if they desire to do so and are expected to be available to respond to appropriate questions.

**Fees to PricewaterhouseCoopers LLP for Fiscal 2005 and 2004**

The following table presents fees for professional services rendered by PwC for the audit of our consolidated annual financial statements for fiscal 2005 and 2004 and fees billed for audit services, audit-related services, tax services and all other services rendered by PwC for fiscal 2005 and 2004:

	<b>2005</b>	<b>2004</b>
Audit Fees	\$ 567,380	\$ 141,050
Audit-Related Fees	111,500	40,300
Tax Fees	104,295	192,000
All Other Fees		
<b>Total Fees</b>	<b>\$ 783,175</b>	<b>\$ 373,350</b>

*Audit Fees.* Consists of fees billed for professional services rendered for the audit of our consolidated financial statements and review of the interim consolidated financial statements included in quarterly reports and services that are normally provided by PwC in connection with statutory and regulatory filings or engagements.

*Audit-Related Fees.* Consists of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our consolidated financial statements and are not reported under Audit Fees. These services include primarily of services related to internal controls, attest services that are not required by statute or regulation, and consultations concerning financial accounting and reporting standards.

*Tax Fees.* For 2005, consists of fees billed for professional services for tax compliance (\$67,000) and tax planning (\$37,295). For 2004, consists of fees billed for professional services for tax compliance (\$119,700), tax advice (\$8,000) and tax planning (\$64,300). These services include assistance regarding federal, state and international tax compliance, tax audit defense, customs and duties and international tax planning.

*All Other Fees.* Consists of fees for products and services other than the services reported above.

**Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm**

The audit committee's policy is to pre-approve all audit and permissible non-audit services provided by the independent registered public accounting firm. These services include audit services, audit-related services, tax services and other services. Pre-approval is generally detailed as to the particular service or category of services and is generally subject to a specific budget. The independent registered public accounting firm and management are required to periodically report to the audit committee regarding the extent of services provided by the independent registered public accounting firm in accordance with this pre-approval, and the fees for the services performed to date. The audit committee also pre-approves particular services on a case-by-case basis.

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The audit committee approved all of the services described under the captions Audit Fees, Audit Related Fees, Tax Fees, and All Other Fees and no time expended on PwC's engagement to audit financial statements for the most recent fiscal year was attributed to work performed by persons other than the independent registered public accounting firm's full-time, permanent employees.

In making its recommendation to appoint PwC as our independent registered public accounting firm, the audit committee has considered whether the provision of the non-audit services rendered by PwC is compatible with maintaining the firm's independence. The audit committee has determined that the provision of non-audit services by PwC is compatible with maintaining the firm's independence as our independent registered public accounting firm.

**Vote Required and Board Recommendation**

Shareholder ratification of the selection of PwC as our independent registered public accounting firm is not required by our bylaws or any other applicable legal requirement. However, the board of directors is submitting the selection of PwC to the shareholders for ratification as a matter of good corporate practice. Even if the selection is ratified, the audit committee at its discretion may direct the appointment of a different independent registered public accounting firm at any time during the year if it determines that such a change would be in our best interests and in the best interests of our shareholders.

To be approved, this proposal must receive a FOR vote from a majority of the shares present and voting, either in person or by proxy (which shares voting affirmatively also must constitute at least a majority of the required quorum). Abstentions will have the same effect as a vote against this proposal and broker non-votes will have no effect on the outcome of the vote with respect to this proposal. **The board of directors recommends that shareholders vote FOR ratification of the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm.**



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**PROPOSAL THREE**  
**AMENDMENT TO 2000 STOCK INCENTIVE PROGRAM TO INCREASE**  
**AGGREGATE NUMBER OF SHARES OF COMMON STOCK AUTHORIZED FOR ISSUANCE,**  
**AND APPROVAL OF MATERIAL TERMS OF 2000 STOCK INCENTIVE PROGRAM**  
**FOR PURPOSES OF SECTION 162(m) OF THE INTERNAL REVENUE CODE**

The board of directors has approved an amendment to our 2000 stock incentive program to increase the aggregate number of shares of our common stock that may be issued under the program by 300,000 shares and to permit awards granted under the 2000 stock incentive program to certain officers to qualify for a tax deduction for United States federal income tax purposes. The board of directors believes that the fundamental objectives of a long-term incentive compensation program are to align the interests of our employees, consultants and directors with those of our shareholders and to create long-term shareholder value. The board of directors believes that the 2000 stock incentive program gives us the ability to achieve these objectives and will help us recruit, reward, motivate and retain talented personnel crucial to our success. If the proposed amendment does not receive shareholder approval, we may be unable to attract and retain such personnel. The board of directors believes that the proposed share increase will provide sufficient shares for anticipated grants through fiscal 2007.

At the annual meeting, our shareholders are being asked to approve these amendments to our 2000 stock incentive program, the material terms of which are described more fully below. As of the record date, a total of 1,845,000 shares have been reserved under the 2000 stock incentive program, of which options to purchase 1,108,444 shares of our common stock have been granted pursuant to the plan (552,573 of which were vested) and 736,556 shares remain available for future grant. Our named executive officers and directors have an interest in this proposal.

Key points of the 2000 stock incentive program include:

Our 2000 stock incentive program does not include an evergreen provision (i.e., a provision that automatically the shares reserved for issuance under the program). Rather, assuming approval of this proposal, our 2000 stock incentive program will have 1,036,556 shares of our common stock reserved for future issuance. As stated above, we believe this share reserve should be sufficient for anticipated grants through the end of fiscal year 2007. Periodic submission of stock plan share increase requests to our shareholders give you the opportunity to consider and review our equity compensation practices regularly.

The 2000 stock incentive program prohibits the grant of stock options with exercise prices less than fair market value of our common stock on the date of grant.

The 2000 stock incentive program also generally prohibits the re-pricing of stock options or stock appreciation rights, although awards may be bought out for a payment in cash or our stock.

The 2000 stock incentive program generally provides that at least 90% of the total full value awards (i.e., awards of stock purchase rights) issued under the plan will vest over a minimum period of three years (our standard vesting schedule for full value awards is currently four years), unless such award is to vest based upon achievement of one or more performance objectives, in which case the minimum vesting period will be twelve-months.

We recently finished a study of our overall equity compensation strategy, with the goal of better understanding current competitive practices, aligning the interests of our employees and our shareholders and managing the shareholder dilution (i.e., burn rate and overhang) related to our equity programs. Following a review of this study, we believe that full value awards (e.g., stock purchase rights) can be an important and effective part of an equity compensation strategy, consistent with best practices, the competitive market and reduced shareholder dilution.

Imminent changes in the equity compensation accounting rules, which are currently scheduled to become effective for us on April 1, 2006, may also materially change competitive equity compensation practices, especially as they pertain to the increased use of full value awards.

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Consistent with the equity compensation strategy study and emerging market trends, we have begun to use full value awards as part of our equity compensation program. Although we believe full value awards are an important part of an effective equity compensation strategy, we recognize that the issuance of full value awards can potentially be more costly to our shareholders than appreciation awards, such as stock options. Accordingly, any shares subject to a stock purchase right with a purchase price less than fair market value on the date of grant will be counted against the 2000 stock incentive program's share reserve as two shares for every one share subject to such award. Correspondingly, to the extent that a share that counted as two shares against the 2000 stock incentive program reserve at the time of grant pursuant to the preceding sentence is recycled back into the 2000 stock incentive program (e.g., upon award termination or share repurchase or forfeiture), the 2000 stock incentive program will be credited with two shares that will thereafter be available for future issuance under the 2000 stock incentive program.

We will obtain shareholder approval of any plan amendment as required by applicable law, including but not limited to, any amendment to increase the shares available for issuance under the plan or any increase in the class of eligible service providers under the plan.

We are also asking the shareholders for approval of the material terms of the amended 2000 stock incentive program so that we have the flexibility to qualify stock purchase rights as performance-based compensation within the meaning of Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code). A favorable vote for this proposal will allow us to deduct certain executive compensation each year (including any income associated with performance-based stock purchase rights) and provide us with potentially significant future tax benefits and associated cash flows.

For the reasons stated above, the shareholders are being asked to approve the 2000 stock incentive program. We believe strongly that the approval of the 2000 stock incentive program is essential to our continued success. In particular, we believe that our employees are our most valuable assets and that the awards permitted under the 2000 stock incentive program are vital to our ability to attract and retain outstanding and highly skilled individuals. Such awards also are crucial to our ability to motivate employees to achieve our goals.

**Summary of 2000 Stock Incentive Program**

The essential terms of the 2000 stock incentive program (taking into account the proposed share increase discussed above) are summarized below, but are qualified in their entirety by reference to the 2000 stock incentive program:

**Purpose**

The purpose of the 2000 stock incentive program is to attract and retain the best available personnel for positions of substantial responsibility with our company, to provide additional incentive to our employees, directors and consultants. Options and stock purchase rights (each, an award) may be granted under the 2000 stock incentive program. Options granted under the 2000 stock incentive program may be either incentive stock options, as defined in Section 422 of the Code, or nonstatutory stock options.

**Administration**

The 2000 stock incentive program is generally administered by the board or a committee appointed by the board and is currently administered by the compensation committee of the board of directors. With respect made to certain executive officers, the administrator will generally consist of directors who qualify as outside directors under Section 162(m) of the Code (to enable us to receive a federal tax deduction for certain compensation paid under the 2000 stock incentive program) and will meet such other requirements as are established by the Securities and Exchange Commission for plans intended to qualify for exemption under Rule 16b-3 of the Securities Exchange Act of 1934, to the extent the administrator determines it is desirable to meet the requirements of these rules. For the 2000 stock incentive program to qualify for exemption under Rule 16b-3, the administrator must consist of directors who are non-employee directors. Subject to the

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terms of the 2000 stock incentive program, the administrator determines the terms of the awards granted, including the exercise price, number of shares subject to the awards, and the exercisability, and has the authority to amend awards. All questions of interpretation are determined by the administrator and its decisions are final and binding upon all participants.

### **Eligibility; Limitations**

Nonstatutory stock options and stock purchase rights may be granted under the 2000 stock incentive program to our employees, directors and consultants and of any parent or subsidiary of our company. Incentive stock options may be granted only to employees or employees of any parent or subsidiary. The administrator, in its discretion, selects the employees, directors and consultants to whom options and stock purchase rights may be granted, the time or times at which such options and stock purchase rights will be granted, and the number of shares subject to each such grant, subject to the limits discussed below.

Section 162(m) of the Code places limits on the deductibility for federal income tax purposes of compensation paid to our chief executive officer and each our four other highest paid employees. In order to provide us with flexibility to provide compensation to such persons that is fully deductible, the 2000 stock incentive program provides that no employee, director or consultant may be granted, in any fiscal year:

options to purchase more than 300,000 shares of common stock, except that in connection with such individual's initial service with us, he or she may be granted options to purchase up to an additional 300,000 shares of common stock, and

stock purchase rights to purchase more than 150,000 shares of common stock, except that in connection with such individual's initial service with us, he or she may be granted stock purchase rights to purchase up to an additional 150,000 shares of common stock.

### **Terms and Conditions of Options**

A stock option is the right to acquire shares at a fixed exercise price for a fixed period of time. Each option is evidenced by a stock option agreement between us and the optionee, and is subject to the following additional terms and conditions:

*(a) Exercise Price.* The administrator determines the exercise price of options at the time the options are granted. The exercise price of an option may not be less than 100% of the fair market value of the common stock on the date such option is granted; provided, however, the exercise price of an incentive stock option granted to a 10% shareholder may not be less than 110% of the fair market value of the common stock on the date such option is granted. The fair market value of the common stock is generally determined with reference to the closing sale price for the common stock (or the closing bid if no sales were reported) on the date the option is granted.

*(b) Exercise of Option; Form of Consideration.* The administrator determines when options become exercisable, and may, in its discretion, accelerate the vesting of any outstanding option. Stock options granted under the 2000 stock incentive program generally vest and become exercisable over four years. The means of payment for shares issued upon exercise of an option is specified in each option agreement. The 2000 stock incentive program permits payment to be made by cash, check, other shares of our common stock, cashless exercises, a reduction in the amount of any company liability to the optionee, any other form of consideration permitted by applicable law or any combination of the foregoing methods of payment. In light of the Sarbanes-Oxley Act of 2002, we will not allow payment to be made by promissory note from our directors and officers.

*(c) Term of Option.* The term of an incentive stock option may be no more than seven years from the date of grant; provided that in the case of an incentive stock option granted to a 10% shareholder, the term of the option may be no more than five years from the date of grant. No option may be exercised after the expiration of its term.

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*(d) Termination of Employment.* If an optionee's employment or consulting relationship terminates for any reason or the optionee ceases to serve as a director (other than death or disability), then all options held by the optionee under the 2000 stock incentive program will remain exercisable, to the extent vested, and then expire on the earlier of (i) the date set forth in his or her notice of grant, and if no date is so set forth, three months following such termination, or (ii) the expiration date of such option. To the extent the option is exercisable at the time of such termination, the optionee may exercise all or part of such option at any time before expiration.

*(e) Death or Disability.* In the event of an optionee's death or disability, then all options held by such optionee under the 2000 stock incentive program will remain exercisable, to the extent vested, and then expire on the earlier of (i) the date set forth in his or her notice of grant, and if no date is so set forth, 12 months following the date of death or disability, or (ii) the expiration date of such option. To the extent the option is exercisable at the time of such optionee's death or disability, the optionee (or the administrator of the optionee's estate) may exercise all or part of such option at any time before expiration.

*(f) Other Provisions.* The administrator may offer to buy out previously granted options at any time for a payment in cash or stock. However, options cannot be repriced nor can an exchange program be implemented without first obtaining shareholder approval. The stock option agreement may contain other terms, provisions and conditions not inconsistent with the 2000 stock incentive program as may be determined by the administrator.

**Stock Purchase Rights**

Awards of stock purchase rights (also referred to as restricted stock) are shares that vest in accordance with the terms and conditions established by the administrator. Each stock purchase right is evidenced by an award agreement between us and the purchaser. The administrator will determine the purchase price to be paid for the shares, the number of shares subject to an award of stock purchase rights (subject to the award limitations described above), and any other terms and conditions of the award. Unless the administrator determines otherwise, the award agreement will grant us a repurchase option exercisable upon the voluntary or involuntary termination of the purchaser's employment with us for any reason (including death or disability). The repurchase price will be the original price paid by the purchaser and may be paid by cancellation of any indebtedness of the purchaser to us. Our repurchase option will lapse at a rate determined by the administrator, but for at least 90% of the total stock purchase rights issued under the term of the plan, in no event earlier than 1/36th per month over three years; provided, however, that the administrator has determined that the repurchase option will lapse based on the achievement of one or more performance goals, in no event will our repurchase option lapse earlier than the date one year from the date of grant.

**Performance Goals**

As discussed above, under Section 162(m) of the Internal Revenue Code, the annual compensation paid to our chief executive officer and to each of our other four most highly compensated executive officers may not be deductible to the extent it exceeds \$1 million. However, we are able to preserve the deductibility of compensation in excess of \$1 million if the conditions of Section 162(m) are met. These conditions include shareholder approval of the material terms of the amended 2000 stock incentive program, setting limits on the number of shares subject to awards that any individual may receive, and for stock purchase rights, establishing performance criteria that must be met before the award actually vests.

We have amended the 2000 stock incentive program so that it permits us to pay compensation that qualifies as performance-based under Section 162(m). Thus, the administrator (in its discretion) may make performance goals applicable to a participant with respect to a stock purchase right. Performance goals may differ from participant to participant and from stock purchase right to stock purchase right. At the administrator's discretion, one or more of the following performance goals may apply: cash flow, earnings, gross margin, market price of stock, market share, net income, operating income, operating margin, return on capital, return on equity, return on net assets, revenue and sales. Any criteria used may be measured, as applicable, in absolute terms or in relative terms (including passage of time and/or against another company

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or companies), on a per-share basis, against the performance of our company as a whole or any segment of our company, on a growth basis and on a pre-tax or after-tax basis.

**Formula Option Grants to Non-Employee Directors**

The 2000 stock incentive program also provides for non-discretionary grants of nonstatutory stock options to our non-employee directors. The 2000 stock incentive program provides that an initial grant of an option of 20,000 shares will be made when each non-employee director first joins our board, either by way of election by our shareholders or by way of appointment by our board to fill a vacancy. Thereafter, each non-employee director will be automatically granted an option to purchase of 10,000 shares following each annual meeting of our shareholders, provided, if immediately after such meeting, the non-employee director continues to serve on our board and will have served on our board for at least the preceding six months.

The 2000 stock incentive program also provides that the non-employee director who acts as the chairman of our board of directors will be granted an additional option to purchase 10,000 shares following each annual meeting of our shareholders, provided, that after such meeting the non-employee director will continue to serve as the chairman. Further, the 2000 stock incentive program provides that each non-employee director who acts as the chairman of the audit committee or the chairman of the compensation committee will be granted an additional option to purchase 5,000 shares following each annual meeting of our shareholders, provided that after such meeting the non-employee director continues to serve as the chairman of either the audit committee or the compensation committee.

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