

COHU INC  
Form DEF 14A  
March 30, 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**

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 Under Rule 14a-12

**COHU, INC.**

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(Name of Registrant as Specified in Its Charter)

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(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:
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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:
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- (3) Filing Party:
- (4) Date Filed:



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**COHU**

12367 Crosthwaite Circle  
Poway, California 92064-6817

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**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS  
To Be Held On May 10, 2005**

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TO OUR STOCKHOLDERS:

The Annual Meeting of Stockholders of Cohu, Inc. ( Cohu ) will be held at the Cohu corporate offices, located at 12367 Crosthwaite Circle, Poway, California 92064-6817 on Tuesday, May 10, 2005, at 2:00 p.m. Pacific Time, for the following purposes:

1. To elect two directors, each for a term of three years.
2. To approve the Cohu, Inc. 2005 Equity Incentive Plan.
3. To ratify the appointment of Ernst & Young LLP as Cohu's independent registered public accounting firm for 2005.
4. To act upon such other matters as may properly come before the meeting or any adjournment thereof.

Only stockholders of record of Cohu at the close of business on March 15, 2005 will be entitled to vote at the meeting.

Since the holders of a majority of the outstanding shares of voting stock of Cohu entitled to vote at the meeting must be represented to constitute a quorum, all stockholders are urged either to attend the meeting in person or to vote by proxy.

A complete list of the stockholders of record entitled to vote at the meeting, arranged in alphabetical order and showing the address of each stockholder and the number of shares registered in the name of each stockholder, will be available at Cohu's corporate offices, for the examination of any stockholder during normal business hours for a period of ten days immediately prior to the meeting.

Please sign, date and return the enclosed proxy in the envelope enclosed for your convenience. Alternatively, stockholders may vote by telephone or electronically via the internet. Please refer to the instructions included with the proxy for additional details. If you attend the meeting you may revoke your proxy and vote in person. You may also revoke your proxy by delivering a written notice to the Secretary of Cohu, or by submitting another duly signed proxy bearing a later date.

By Order of the Board of Directors,

John H. Allen  
Secretary

Poway, California  
April 1, 2005

**YOUR VOTE IS IMPORTANT**

**IN ORDER TO INSURE YOUR REPRESENTATION AT THE ANNUAL MEETING, YOU ARE REQUESTED TO COMPLETE, SIGN AND DATE THE ENCLOSED PROXY AS PROMPTLY AS POSSIBLE AND RETURN IT IN THE ENCLOSED POSTAGE PREPAID ENVELOPE OR VOTE BY TELEPHONE OR VIA THE INTERNET.**

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**COHU, Inc.**  
12367 Crosthwaite Circle  
Poway, California 92064-6817

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**PROXY STATEMENT**

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**GENERAL INFORMATION**

This proxy statement is furnished in connection with the solicitation by the Board of Directors of Cohu, Inc., a Delaware corporation ( Cohu or the Company ), of your proxy for use at the Annual Meeting of Stockholders to be held on Tuesday, May 10, 2005, at 2:00 p.m. Pacific Time at the Cohu corporate offices, located at 12367 Crosthwaite Circle, Poway, California 92064-6817 (the Meeting ). This proxy statement, the accompanying proxy card and the Cohu 2004 Annual Report are being mailed to all stockholders on or about April 1, 2005.

On March 15, 2005, the record date fixed by the Board of Directors, Cohu had outstanding 21,639,784 shares of Common Stock. Only stockholders of record as of the close of business on March 15, 2005 will be entitled to vote at the Meeting and any adjournment thereof.

**Voting Procedures**

As a stockholder of Cohu, you have a right to vote on certain business matters affecting Cohu. The proposals that will be presented at the Meeting and upon which you are being asked to vote are discussed under Proposal No 1 , Proposal No. 2 and Proposal No. 3 . Each share of Cohu s common stock you own entitles you to one vote. In the election of directors, stockholders may cumulate their votes as described below.

**Methods of Voting**

You may vote by mail, by telephone, over the Internet or in person at the Meeting. Your shares will be voted in accordance with the instructions you indicate. If you do not indicate your voting instructions, your shares will be voted FOR the two named nominees for directors, FOR the approval of the Cohu, Inc. 2005 Equity Incentive Plan, FOR the ratification of the appointment of Ernst & Young LLP as Cohu s independent registered public accounting firm for 2005 and in the discretion of the proxies (as defined below) as to other matters that may properly come before the Meeting.

**Voting by Mail.** By signing and returning the proxy card in the enclosed prepaid and addressed envelope, you are authorizing the individuals named on the proxy card (known as proxies ) to vote your shares at the Meeting in the manner you indicate. We encourage you to sign and return the proxy card even if you plan to attend the Meeting. In this way, your shares will be voted if you are unable to attend the Meeting. If you received more than one proxy card, it is an indication that your shares are held in multiple accounts. Please sign and return all proxy cards to ensure that all of your shares are voted.

**Voting by Telephone.** To vote by telephone, please follow the instructions included on your proxy card. If you vote by telephone, you do not need to complete and mail your proxy card.

**Voting over the Internet.** To vote over the Internet, please follow the instructions included on your proxy card. If you vote over the Internet, you do not need to complete and mail your proxy card.

**Voting in Person at the Meeting.** If you plan to attend the Meeting and vote in person, we will provide you with a ballot at the Meeting. If your shares are registered directly in your name, you are considered the stockholder of record and you have the right to vote in person at the Meeting. If your shares are held in the name of your broker or other nominee, you are considered the beneficial owner of shares held in street name. If you wish to vote at the Meeting, you will need to bring with you to the Meeting a legal proxy from your broker or other nominee authorizing you to vote such shares.

**Revoking Your Proxy**

You may revoke your proxy at any time before it is voted at the Meeting. In order to do this, you must:

enter a new vote over the Internet, by telephone or by signing and returning another proxy card bearing a later date;

provide written notice of the revocation to Cohu's Secretary; or

attend the Meeting and vote in person.

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### **Quorum Requirement**

A quorum, which is a majority of the outstanding shares entitled to vote as of the record date, March 15, 2005, must be present in order to hold the Meeting and to conduct business. Shares are counted as being present at the Meeting if you appear in person at the Meeting or if you vote your shares over the Internet, by telephone or by submitting a properly executed proxy card. If any broker non-votes (as described below) are present at the Meeting, they will be counted as present for the purpose of determining a quorum.

### **Votes Required for the Proposals**

The votes required and the method of calculation for the proposals to be considered at the Meeting are as follows. For Proposal No. 1, the two nominees receiving the highest number of votes, in person or by proxy, will be elected as directors. You may vote for the nominees for election as directors or you may withhold your vote with respect to one or more nominees. In the election of directors, stockholders may, as provided for in the Cohu Amended and Restated Certificate of Incorporation, cumulate their votes, giving one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which the stockholder's shares are normally entitled, or distribute the stockholder's votes on the same principle among as many candidates as the stockholder thinks fit. A stockholder may not cumulate his or her votes for a candidate unless a stockholder has given notice at the Meeting (whether by proxy or in person) prior to the voting, of his or her intention to cumulate his or her votes. If any stockholder gives such notice all stockholders may then cumulate their votes. Management of Cohu is hereby soliciting discretionary authority to cumulate votes represented by proxies if cumulative voting is invoked.

The affirmative vote of a majority of Cohu common shares, cast at the Meeting, in person or by proxy, is required for approval of Proposal No. 2, the approval of the Cohu, Inc. 2005 Equity Incentive Plan and Proposal No. 3, the ratification of the appointment of Ernst & Young LLP as Cohu's independent registered public accounting firm for 2005

If you return a proxy card that withholds your vote from the election of all directors, your shares will be counted as present for the purpose of determining a quorum but will not be counted in the vote on that proposal.

### **Broker Non-Votes**

If your shares are held in the name of a broker and you do not return a proxy card, brokerage firms have authority to vote your non-voted shares (known as broker non-votes) on certain routine matters. Consequently, if you do not give a proxy to vote your shares, your brokerage firm may either leave your shares unvoted or vote your shares on these routine matters. To the extent your brokerage firm votes shares on your behalf on these proposals, your shares will be included in the determination of whether a quorum is present at the Meeting.

**Proposal No. 2 is NOT considered a routine matter and if a stockholder does not instruct his or her broker on how to vote on this proposal, then such broker will not have the authority to vote such shares.**

### **Abstentions**

If you abstain from voting for or against a proposal, your abstention will be included in determining whether or not a quorum is present.

### **Voting Confidentiality**

Proxies, ballots and voting tabulations are handled on a confidential basis to protect your voting privacy. Information will not be disclosed except as required by law.

## **Voting Results**

Final voting results will be announced at the Meeting and will be published in Cohu's Quarterly Report on Form 10-Q for the second quarter of 2005, filed with the Securities and Exchange Commission. After the report is filed, you may obtain a copy by:

visiting our website at [www.cohu.com](http://www.cohu.com);

contacting our Investor Relations department at 858-848-8100; or

viewing our Form 10-Q for the second quarter of 2005 on the SEC's website at [www.sec.gov](http://www.sec.gov).

## **Proxy Solicitation Costs**

Cohu will bear the entire cost of proxy solicitation, including the preparation, assembly, printing, mailing and distribution of the proxy materials. Cohu has not engaged an outside solicitor in connection with this proxy solicitation. We will reimburse brokerage firms and other custodians for their reasonable out-of-pocket expenses for forwarding the proxy materials to you.

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The Cohu Amended and Restated Certificate of Incorporation divides the directors into three classes whose terms expire at successive annual meetings over a period of three years. One class of directors is elected for a term of three years at each annual meeting with the remaining directors continuing in office. At the Meeting, two Class 1 directors are to be elected for a term expiring in 2008. It is intended that the shares represented by proxies in the accompanying form will be voted by the proxy holders for the election of the two nominees named below. In the event the election of directors is to be by cumulative voting, the proxy holders will vote the shares represented by proxies in such proportions as the proxy holders see fit. Should the nominees decline or become unable to accept nomination or election, which is not anticipated, the proxies will be voted for such substitute nominee as may be designated by a majority of the Board of Directors. There is no family relationship between the nominees, other directors or any of Cohu's executive officers. **The Board of Directors recommends a vote in favor of the two nominees named below.**

**Nominees Whose Terms Will Expire in 2008 (if elected) Class 1**

<b>Name</b>	<b>Age</b>	<b>Principal Occupation</b>	<b>Director Since</b>
Robert L. Ciardella	52	President of Asymtek (a subsidiary of Nordson Corporation) since 1983. Asymtek designs, develops, manufactures and sells semiconductor and circuit board assembly equipment.	2003
Charles A. Schwan	65	Chairman of the Board; Retired Chief Executive Officer of Cohu since June, 2000; Chairman and Chief Executive Officer of Cohu from July, 1999 to June, 2000; President and Chief Executive Officer of Cohu from March, 1996 to July, 1999; Executive Vice President and Chief Operating Officer of Cohu from September, 1995 to March, 1996; Vice President, Finance of Cohu from 1983 until September, 1995.	1990

**INFORMATION CONCERNING OTHER DIRECTORS****Directors Whose Terms Expire in 2006 Class 2**

<b>Name</b>	<b>Age</b>	<b>Principal Occupation</b>	<b>Director Since</b>
Harry L. Casari	68	Retired Partner, Ernst & Young LLP. Mr. Casari is also a	1995

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director of Meade Instruments Corp., Orange 21 Inc. and Axesstel, Inc.

Harold Harrigian      70      Retired Partner and Director of Corporate Finance,  
Crowell, Weedon & Co.      1998

**Directors Whose Terms Expire in 2007    Class 3**

<b>Name</b>	<b>Age</b>	<b>Principal Occupation</b>	<b>Director Since</b>
James W. Barnes	75	Retired President and Chief Executive Officer of Cohu from 1983 to March, 1996.	1983
James A. Donahue	56	President and Chief Executive Officer of Cohu since June, 2000; President and Chief Operating Officer of Cohu from October, 1999 to June, 2000; President of Delta Design, Inc., a wholly owned subsidiary of Cohu, since May, 1983. Mr. Donahue is also a director of Standard Microsystems Corporation.	1999

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**PROPOSAL NO. 2**

**APPROVAL OF THE COHU 2005 EQUITY INCENTIVE PLAN**

At the Meeting, the stockholders will be asked to approve the Cohu, Inc. 2005 Equity Incentive Plan (the 2005 Plan ). The Board of Directors adopted the 2005 Plan on March 11, 2005, subject to its approval by stockholders. The 2005 Plan is intended to replace our 1998 Stock Option Plan, 1996 Outside Directors Stock Option Plan, 1996 Stock Option Plan and 1994 Stock Option Plan (collectively our Prior Plans ), which will, after approval by the stockholders of the 2005 Plan, all be terminated and no new awards granted thereunder. The 2005 Plan does **not** request any additional number of shares to be approved by the Company stockholders, but instead only requests Company stockholder approval of the new form of the 2005 Plan. The 2005 Plan s share reserve shall initially equal the share reserves remaining under each of the Prior Plans and the number of stock options outstanding under all of the Prior Plans which may, if such stock options are cancelled or forfeited unexercised, be again available for grant under the 2005 Plan.

The Board of Directors believes that the Company must offer a competitive equity incentive program if it is to continue to successfully attract and retain the best possible candidates for positions of responsibility within the Company. The Board of Directors expects that the 2005 Plan will be an important factor in attracting, retaining and rewarding the high caliber employees, consultants and directors essential to our success and in motivating these individuals to strive to enhance our growth and profitability. The proposed 2005 Plan is intended to ensure that the Company will continue to have available a reasonable number of shares to meet these goals.

The 2005 Plan is also designed to preserve the Company s ability to deduct in full for federal income tax purposes the compensation recognized by its executive officers in connection with certain awards granted under the 2005 Plan. Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code ), generally denies a corporate tax deduction for annual compensation exceeding \$1 million paid to the chief executive officer or to any of the four other most highly compensated officers of a publicly held company. However, certain types of compensation, including performance-based compensation, are generally excluded from this deductibility limit. To enable compensation in connection with stock options, certain restricted stock grants, performance shares and performance units awarded under the 2005 Plan to qualify as performance-based within the meaning of Section 162(m), the 2005 Plan limits the sizes of such awards as further described below. While the Company believes that compensation in connection with such awards under the 2005 Plan generally will be deductible by the Company for federal income tax purposes, under certain circumstances, such as a change in control of the Company, compensation paid in settlement of performance share and performance unit awards may not qualify as performance-based. By approving the 2005 Plan, the stockholders will be approving, among other things, eligibility requirements for participation in the 2005 Plan, financial performance measures upon which specific performance goals applicable to certain awards would be based, limits on the numbers of shares or compensation that could be made subject to certain awards, and the other material terms of the awards described below.

**Summary of the 2005 Plan**

The following summary of the 2005 Plan is qualified in its entirety by the specific language of the 2005 Plan, a copy of which is available to any stockholder upon request.

**General.** The purpose of the 2005 Plan is to advance the interests of the Company by providing an incentive program that will enable the Company to attract and retain employees, consultants and directors upon whose judgment, interest and efforts the Company s success is dependent and to provide them with an equity interest in the success of the Company in order to motivate superior performance. These incentives are provided through the grant of stock options (including indexed options), stock appreciation rights, restricted stock, restricted stock units,

performance shares, performance units, deferred stock and certain other stock-based awards.

**Authorized Shares.** Assuming the 2005 Plan is approved by the stockholders, all of our Prior Plans shall be terminated and three-million nine-hundred and forty-seven thousand seven hundred and twenty-nine (3,947,729) shares of our Common Stock will have been reserved for the granting of new awards under the 2005 Plan. The Company is **not** requesting any new authorization of shares and will instead transfer to the 2005 Plan the share reserves remaining available for grant under the Prior Plans and which, as of March 11, 2005, equaled seven- hundred and eighty-six thousand five-hundred and twenty-five (786,525) shares. In addition, the actual 2005 Plan share reserve shall also

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include all of the stock options the Company has granted under the Prior Plans which, as of March 11, 2005, equaled three-million one-hundred sixty-one thousand two-hundred and four (3,161,204) shares (collectively the Prior Awards ) to the extent any such Prior Award expires, lapses or otherwise terminates for any reason without having been exercised or settled in full, or if any shares subject to forfeiture or repurchase are forfeited or repurchased by the Company. Consequently, the maximum number of shares which may be granted under the 2005 Plan, assuming all of the Prior Awards actually do expire, terminate or otherwise lapse unexercised and are returned to the 2005 Plan share reserve, shall equal three-million nine-hundred and forty-seven thousand seven-hundred twenty-nine (3,947,729) shares. However, no more than five-hundred thousand (500,000) shares of this 2005 Plan reserve may be issued upon the exercise or settlement of any restricted stock, restricted stock units, performance shares or performance units. If any award granted under the 2005 Plan expires, lapses or otherwise terminates for any reason without having been exercised or settled in full, or if shares subject to forfeiture or repurchase are forfeited or repurchased by the Company, any such shares that are reacquired or subject to such a terminated award will again become available for issuance under the 2005 Plan. Upon any stock dividend, stock split, reverse stock split, recapitalization or similar change in our capital structure, appropriate adjustments will be made to the shares subject to the 2005 Plan, to the award grant limitations and to all outstanding awards.

**Administration.** The 2005 Plan will be administered by the Compensation Committee of the Board of Directors duly appointed to administer the 2005 Plan, or, in the absence of such committee, by the Board of Directors. In the case of awards intended to qualify for the performance-based compensation exemption under Section 162(m) of the Code, administration must be by a compensation committee comprised solely of two or more outside directors within the meaning of Section 162(m). (For purposes of this summary, the term Committee will refer to either such duly appointed committee or the Board of Directors.) Subject to the provisions of the 2005 Plan, the Committee determines in its discretion the persons to whom and the times at which awards are granted, the types and sizes of such awards, and all of their terms and conditions. The Committee may, subject to certain limitations on the exercise of its discretion required by Section 162(m), amend, cancel, renew, or grant a new award in substitution for, any award, waive any restrictions or conditions applicable to any award, and accelerate, continue, extend or defer the vesting of any award. However, the 2005 Plan forbids, without stockholder approval, the repricing of any outstanding stock option and/or stock appreciation right. In addition, the 2005 Plan forbids any restricted stock award to be granted, or subsequently amended to provide, for (1) any acceleration of vesting for any reason other than upon a Change in Control , as defined, or after a participant s death or disability and (2) vesting of one hundred percent (100%) of any such award prior to the passage of three years of service (unless the award will vest after satisfying specified performance measurements). The 2005 Plan provides, subject to certain limitations, for indemnification by the Company of any director, officer or employee against all reasonable expenses, including attorneys fees, incurred in connection with any legal action arising from such person s action or failure to act in administering the 2005 Plan. The Committee will interpret the 2005 Plan and awards granted thereunder, and all determinations of the Committee will be final and binding on all persons having an interest in the 2005 Plan or any award.

**Eligibility.** Awards may be granted to employees, directors and consultants of the Company or any present or future parent or subsidiary corporations of the Company. Incentive stock options may be granted only to employees who, as of the time of grant, are employees of the Company or any parent or subsidiary corporation of the Company. As of February 25, 2005, the Company had approximately 900 employees, including 5 named executive officers and 4 directors who would be eligible under the 2005 Plan.

**Stock Options.** Each option granted under the 2005 Plan must be evidenced by a written agreement between the Company and the optionee specifying the number of shares subject to the option and the other terms and conditions of the option, consistent with the requirements of the 2005 Plan. The exercise price of each option may not be less than the fair market value of a share of Common Stock on the date of grant. However, any incentive stock option granted to a person who at the time of grant owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Company or any parent or subsidiary corporation of the Company (a Ten Percent Stockholder )

must have an exercise price equal to at least 110% of the fair market value of a share of Common Stock on the date of grant. The exercise price of each indexed stock option, and the terms and adjustments which may be made to such an option, will be determined by the Committee in its sole discretion at the time of grant. On March 15, 2005, the closing price of the Company's Common Stock on the Nasdaq National Market was \$17.10 per share. Subject to appropriate adjustment in the event of any change in the capital structure of the Company, no employee may be granted in any fiscal year of the Company options which in the aggregate are for more than five

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hundred thousand (500,000) shares, provided however, that the Company may make an additional one-time grant to any newly-hired employee of a stock option for the purchase of up to an additional two hundred and fifty thousand (250,000) shares.

The 2005 Plan provides that the option exercise price may be paid in cash, by check, or in cash equivalent, by the assignment of the proceeds of a sale with respect to some or all of the shares being acquired upon the exercise of the option, to the extent legally permitted, by tender of shares of Common Stock owned by the optionee having a fair market value not less than the exercise price, by such other lawful consideration as approved by the Committee, or by any combination of these. Nevertheless, the Committee may restrict the forms of payment permitted in connection with any option grant. No option may be exercised unless the optionee has made adequate provision for federal, state, local and foreign taxes, if any, relating to the exercise of the option, including, if permitted or required by the Company, through the optionee's surrender of a portion of the option shares to the Company.

Options will become vested and exercisable at such times or upon such events and subject to such terms, conditions, performance criteria or restrictions as specified by the Committee. The maximum term of any option granted under the 2005 Plan is ten years, provided that an incentive stock option granted to a Ten Percent Stockholder must have a term not exceeding five years. The Committee will specify in each written option agreement, and solely in its discretion, the period of post-termination exercise applicable to each option.

Generally, stock options are nontransferable by the optionee other than by will or by the laws of descent and distribution, and are exercisable during the optionee's lifetime only by the optionee. However, a nonstatutory stock option may be assigned or transferred to the extent permitted by the Committee in its sole discretion.

***Automatic Stock Option Grants to Non-employee Directors.*** The 2005 Plan also provides for automatic grants of stock options to non-employee directors in order to provide them with additional incentives and, therefore, to promote the success of our business. The 2005 Plan provides for an initial, automatic grant of an option to purchase 20,000 shares of our common stock to each non-employee director who first becomes a non-employee director after the date the 2005 Plan is effective. The 2005 Plan also provides for an annual grant of an option to purchase 5,000 shares of our Common Stock to each non-employee director on the first anniversary of the grant of the initial, automatic stock option and each successive anniversary which occurs on or after the date the 2005 Plan is effective. Each initial and annual option will have an exercise price per share equal to the fair market value of a share of our Common Stock on the date of grant and will have a term of ten years. The initial options granted to newly elected or appointed non-employee directors will vest and become exercisable ratably over four years after the date of grant of the option. The annual options granted to non-employee directors will vest and become exercisable ratably over two years after the date of grant of the option. All automatic non-employee director options granted under the 2005 Plan will be nonstatutory stock options. In general, in accordance with the individual stock option agreement, stock options must be exercised, if at all, within twelve (12) months after a non-employee director's termination of service with us by reason of death or disability and otherwise within three (3) months after termination of service, but in no event later than the expiration of the option's term. In the event of our merger with another corporation or another change in control event, all automatic non-employee director options will become fully vested and exercisable.

***Stock Appreciation Rights.*** Each stock appreciation right granted under the 2005 Plan must be evidenced by a written agreement between the Company and the participant specifying the number of shares subject to the award and the other terms and conditions of the award, consistent with the requirements of the 2005 Plan.

A stock appreciation right gives a participant the right to receive the appreciation in the fair market value of Company Common Stock between the date of grant of the award and the date of its exercise. The Company may pay the appreciation either in cash or in shares of Common Stock. The Committee may grant stock appreciation rights under the 2005 Plan in tandem with a related stock option or as a freestanding award. A tandem stock appreciation

right is exercisable only at the time and to the same extent that the related option is exercisable, and its exercise causes the related option to be canceled. Freestanding stock appreciation rights vest and become exercisable at the times and on the terms established by the Committee. The maximum term of any stock appreciation right granted under the 2005 Plan is ten years. Subject to appropriate adjustment in the event of any change in the capital structure of the Company, no employee may be granted in any fiscal year of the Company stock appreciation rights which in the aggregate are for more than five hundred thousand (500,000) shares, provided however, that the Company may make an additional one-

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time grant to any newly-hired employee of a stock appreciation right for the purchase of up to an additional two hundred and fifty thousand (250,000) shares.

Stock appreciation rights are generally nontransferable by the participant other than by will or by the laws of descent and distribution, and are generally exercisable during the participant's lifetime only by the participant.

***Restricted Stock Awards.*** The Committee may grant restricted stock awards under the 2005 Plan in the form of a restricted stock bonus, for which the participant furnishes consideration in the form of services to the Company. Restricted stock awards may be subject to vesting conditions based on such service or performance criteria as the Committee specifies, and the shares acquired may not be transferred by the participant until vested. Unless otherwise provided by the Committee, a participant will forfeit any shares of restricted stock as to which the restrictions have not lapsed prior to the participant's termination of service. Participants holding restricted stock will have the right to vote the shares and to receive any dividends paid, except that dividends or other distributions paid in shares will be subject to the same restrictions as the original award. Subject to appropriate adjustment in the event of any change in the capital structure of the Company, no employee may be granted in any fiscal year of the Company more than two hundred thousand (200,000) shares of restricted stock on which the restrictions are based on performance criteria, provided however, that the Company may make an additional one-time grant to any newly-hired employee of a restricted stock award of up to an additional one hundred thousand (100,000) shares.

***Restricted Stock Units.*** The Committee may grant restricted stock units under the 2005 Plan which represent a right to receive shares of Common Stock at a future date determined in accordance with the participant's award agreement. No monetary payment is required for receipt of restricted stock units or the shares issued in settlement of the award, the consideration for which is furnished in the form of the participant's services to the Company. The Committee may grant restricted stock unit awards subject to the attainment of performance goals similar to those described below in connection with performance shares and performance units, or may make the awards subject to vesting conditions similar to those applicable to restricted stock awards. Participants have no voting rights or rights to receive cash dividends with respect to restricted stock unit awards until shares of Common Stock are issued in settlement of such awards. However, the Committee may grant restricted stock units that entitle their holders to receive dividend equivalents, which are rights to receive additional restricted stock units for a number of shares whose value is equal to any cash dividends we pay. Subject to appropriate adjustment in the event of any change in the capital structure of the Company, no employee may be granted in any fiscal year of the Company more than two hundred thousand (200,000) restricted stock units on which the restrictions are based on performance criteria, provided however, that the Company may make an additional one-time grant to any newly-hired employee of a restricted stock award of up to an additional one hundred thousand (100,000) shares.

***Performance Awards.*** The Committee may grant performance awards subject to such conditions and the attainment of such performance goals over such periods as the Committee determines in writing and sets forth in a written agreement between the Company and the participant. These awards may be designated as performance shares or performance units. Performance shares and performance units are unfunded bookkeeping entries generally having initial values, respectively, equal to the fair market value determined on the grant date of a share of Common Stock and a dollar amount per unit which may be determined by the Committee. Performance awards will specify a predetermined amount of performance shares or performance units that may be earned by the participant to the extent that one or more predetermined performance goals are attained within a predetermined performance period. To the extent earned, performance awards may be settled in cash, shares of Common Stock (including shares of restricted stock) or any combination thereof. Subject to appropriate adjustment in the event of any change in the capital structure of the Company, for each fiscal year of the Company contained in the applicable performance period, no employee may be granted performance shares that could result in the employee receiving more than one hundred thousand (100,000) shares of Common Stock or performance units that could result in the employee receiving more than one million dollars (\$1,000,000). A participant may receive only one performance award with respect to any performance

period.

Prior to the beginning of the applicable performance period or such later date as permitted under Section 162(m) of the Code, the Committee will establish one or more performance goals applicable to the award. Performance goals will be based on the attainment of specified target levels with respect to one or more measures of business or financial performance of the Company and each parent and subsidiary corporation consolidated therewith for

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financial reporting purposes, or such division or business unit of the Company as may be selected by the Committee.

The Committee, in its discretion, may base performance goals on one or more of the following such measures: revenue, gross margin, operating margin, operating income, pre-tax profit, earnings before interest, taxes and depreciation, net income, cash flow, expenses, the market price of the stock, earnings per share, return on stockholder equity, return on capital, return on net assets, economic value added, number of customers, market share, return on investment, profit after tax, customer satisfaction, business divestitures and acquisitions, supplier awards from significant customers, new product development and working capital. The target levels with respect to these performance measures may be expressed on an absolute basis or relative to a standard specified by the Committee. The degree of attainment of performance measures will, according to criteria established by the Committee, be computed before the effect of changes in accounting standards, restructuring charges and similar extraordinary items occurring after the establishment of the performance goals applicable to a performance award.

Following completion of the applicable performance period, the Committee will certify in writing the extent to which the applicable performance goals have been attained and the resulting value to be paid to the participant. The Committee retains the discretion to eliminate or reduce, but not increase, the amount that would otherwise be payable to the participant on the basis of the performance goals attained. However, no such reduction may increase the amount paid to any other participant. In its discretion, the Committee may provide for the payment to a participant awarded performance shares of dividend equivalents with respect to cash dividends paid on the Company's Common Stock. Performance award payments may be made in lump sum or in installments. If any payment is to be made on a deferred basis, the Committee may provide for the payment of dividend equivalents or interest during the deferral period.

Unless otherwise provided by the Committee, if a participant's service terminates due to the participant's death, disability or retirement prior to completion of the applicable performance period, the final award value will be determined at the end of the performance period on the basis of the performance goals attained during the entire performance period but will be prorated for the number of months of the participant's service during the performance period. If a participant's service terminates prior to completion of the applicable performance period for any other reason, the 2005 Plan provides that, unless otherwise determined by the Committee, the performance award will be forfeited. No performance award may be sold or transferred other than by will or the laws of descent and distribution prior to the end of the applicable performance period.

***Deferred Stock Awards.*** The 2005 Plan provides that certain participant's who are executives or members of a select group of highly compensated employees may elect to receive, in lieu of payment in cash or stock of all or any portion of such participant's cash and/or stock compensation, an award of deferred stock units. A participant electing to receive deferred stock units will be granted automatically, on the effective date of such deferral election, an award (a Deferred Stock Unit Award) for a number of stock units equal to the amount of the deferred compensation divided by an amount equal to the fair market value of a share of our Common Stock as quoted by the national or regional securities exchange or market system on which the Common Stock is listed on the date of grant. A stock unit is an unfunded bookkeeping entry representing a right to receive one share of our Common Stock in accordance with the terms and conditions of the Deferred Stock Unit Award. Participants are not required to pay any additional cash consideration in connection with the settlement of a Deferred Stock Unit Award. A participant's compensation not paid in the form of a Deferred Stock Unit Award will be paid in cash in accordance with the Company's normal payment procedures.

Each Deferred Stock Unit Award will be evidenced by a written agreement between the Company and the participant specifying the number of stock units subject to the award and the other terms and conditions of the Deferred Stock Unit Award, consistent with the requirements of the 2005 Plan. Deferred Stock Unit Awards are fully vested upon grant and will be settled by distribution to the participant of a number of whole shares of Common Stock

equal to the number of stock units subject to the award on a date set forth in the participant's written agreement in accordance with the terms of the 2005 Plan at the time of his or her election to receive the Deferred Stock Unit Award. A holder of a stock unit has no voting rights or other rights as a stockholder until shares of Common Stock are issued to the participant in settlement of the stock unit. However, participants holding stock units will be entitled to receive dividend equivalents with respect to any payment of cash dividends on an equivalent number of shares of Common Stock. Such dividend equivalents will be credited in the form of additional whole and fractional stock units determined by the fair market value of a share of Common Stock on the dividend payment date. Prior to settlement, no Deferred Stock Unit Award

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may be assigned or transferred other than by will or the laws of descent and distribution.

***Other Stock-Based Awards.*** The Committee may also grant one or more awards not specifically identified by the terms of the 2005 Plan that would provide a participant with either: (i) a share of stock; (ii) the right to purchase a share of stock; (iii) has a value derived from a share of stock; or (iv) an exercise or conversion privilege related to a share of stock. Other stock-based awards may be subject to vesting conditions based on such service or performance criteria as the Committee specifies, and any such award may not be transferred by the participant until vested.

***Change in Control.*** The 2005 Plan defines a Change in Control of the Company as any of the following events upon which the stockholders of the Company immediately before the event do not retain immediately after the event, in substantially the same proportions as their ownership of shares of the Company's voting stock immediately before the event, direct or indirect beneficial ownership of a majority of the total combined voting power of the voting securities of the Company, its successor or the corporation to which the assets of the Company were transferred: (i) a sale or exchange by the stockholders in a single or series of related transactions of more than 50% of the Company's voting stock; (ii) a merger or consolidation in which the Company is a party; (iii) the sale, exchange or transfer of all or substantially all of the assets of the Company; or (iv) a liquidation or dissolution of the Company. If a Change in Control occurs, the surviving, continuing, successor or purchasing corporation or parent corporation thereof may either assume all outstanding awards or substitute new awards having an equivalent value. If a Change in Control occurs, the surviving, continuing, successor or purchasing corporation or parent corporation thereof may either assume all outstanding awards or substitute new awards having an equivalent value.

In the event of a Change in Control and the outstanding stock options and stock appreciation rights are not assumed or replaced, then all unexercisable, unvested or unpaid portions of such outstanding awards will become immediately exercisable, vested and payable in full immediately prior to the date of the Change in Control.

Any award not assumed, replaced or exercised prior to the Change in Control will terminate. The 2005 Plan authorizes the Committee, in its discretion, to provide for different treatment of any award, as may be specified in such award's written agreement, which may provide for acceleration of the vesting or settlement of any award, or provide for longer periods of exercisability, upon a Change in Control.

***Termination or Amendment.*** The 2005 Plan will continue in effect until the first to occur of (i) its termination by the Board or (ii) the date on which all shares available for issuance under the 2005 Plan have been issued and all restrictions on such shares under the terms of the 2005 Plan and the agreements evidencing awards granted under the 2005 Plan have lapsed. However, all incentive stock options granted, if at all, must be granted within ten (10) years from the date the 2005 Plan was adopted by the Board. The Board may terminate or amend the 2005 Plan at any time, provided that no amendment may be made without stockholder approval if the Board deems such approval necessary for compliance with any applicable tax or securities law or other regulatory requirements, including the requirements of any stock exchange or market system on which the Common Stock of the Company is then listed. No termination or amendment may affect any outstanding award unless expressly provided by the Board, and, in any event, may not adversely affect an outstanding award without the consent of the participant unless necessary to comply with any applicable law, regulation or rule.

## **Summary of U.S. Federal Income Tax Consequences**

The following summary is intended only as a general guide to the U.S. federal income tax consequences of participation in the 2005 Plan and does not attempt to describe all possible federal or other tax consequences of such participation or tax consequences based on particular circumstances.

***Incentive Stock Options.*** An optionee recognizes no taxable income for regular income tax purposes as a result of the grant or exercise of an incentive stock option qualifying under Section 422 of the Code. Optionees who neither dispose of their shares within two years following the date the option was granted nor within one year following the exercise of the option will normally recognize a capital gain or loss equal to the difference, if any, between the sale price and the purchase price of the shares. If an optionee satisfies such holding periods upon a sale of the shares, the Company will not be entitled to any deduction for federal income tax purposes. If an optionee disposes of shares within two years after the date of grant or within one year after the date of exercise (a disqualifying disposition), the difference between the fair market value of the shares on the determination date (see discussion under Nonstatutory Stock Options below) and the option exercise price (not to exceed the gain realized

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on the sale if the disposition is a transaction with respect to which a loss, if sustained, would be recognized) will be taxed as ordinary income at the time of disposition. Any gain in excess of that amount will be a capital gain. If a loss is recognized, there will be no ordinary income, and such loss will be a capital loss. Any ordinary income recognized by the optionee upon the disqualifying disposition of the shares generally should be deductible by the Company for federal income tax purposes, except to the extent such deduction is limited by applicable provisions of the Code.

The difference between the option exercise price and the fair market value of the shares on the determination date of an incentive stock option (see discussion under *Nonstatutory Stock Options* below) is treated as an adjustment in computing the optionee's alternative minimum taxable income and may be subject to an alternative minimum tax which is paid if such tax exceeds the regular tax for the year. Special rules may apply with respect to certain subsequent sales of the shares in a disqualifying disposition, certain basis adjustments for purposes of computing the alternative minimum taxable income on a subsequent sale of the shares and certain tax credits which may arise with respect to optionees subject to the alternative minimum tax.

***Nonstatutory Stock Options and Indexed Stock Options.*** Options not designated or qualifying as incentive stock options, or as an indexed stock option, will be nonstatutory stock options having no special tax status. An optionee generally recognizes no taxable income as the result of the grant of such an option. Upon exercise of a nonstatutory stock option, the optionee normally recognizes ordinary income in the amount of the difference between the option exercise price and the fair market value of the shares on the determination date (as defined below). If the optionee is an employee, such ordinary income generally is subject to withholding of income and employment taxes. The determination date is the date on which the option is exercised unless the shares are subject to a substantial risk of forfeiture (as in the case where an optionee is permitted to exercise an unvested option and receive unvested shares which, until they vest, are subject to the Company's right to repurchase them at the original exercise price upon the optionee's termination of service) and are not transferable, in which case the determination date is the earlier of (i) the date on which the shares become transferable or (ii) the date on which the shares are no longer subject to a substantial risk of forfeiture. If the determination date is after the exercise date, the optionee may elect, pursuant to Section 83(b) of the Code, to have the exercise date be the determination date by filing an election with the Internal Revenue Service no later than 30 days after the date the option is exercised. Upon the sale of stock acquired by the exercise of a nonstatutory stock option, any gain or loss, based on the difference between the sale price and the fair market value on the determination date, will be taxed as capital gain or loss. No tax deduction is available to the Company with respect to the grant of a nonstatutory stock option or the sale of the stock acquired pursuant to such grant. The Company generally should be entitled to a deduction equal to the amount of ordinary income recognized by the optionee as a result of the exercise of a nonstatutory stock option, except to the extent such deduction is limited by applicable provisions of the Code.

***Stock Appreciation Rights.*** No taxable income is reportable when a stock appreciation right is granted to a participant. Upon exercise, the participant will recognize ordinary income in an amount equal to the amount of cash received and the fair market value of any shares of our Common Stock received. Any additional gain or loss recognized upon any later disposition of the shares would be capital gain or loss.

***Restricted Stock Awards.*** A participant acquiring restricted stock generally will recognize ordinary income equal to the fair market value of the shares on the determination date (as defined above under *Nonstatutory Stock Options* ). If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. If the determination date is after the date on which the participant acquires the shares, the participant may elect, pursuant to Section 83(b) of the Code, to have the date of acquisition be the determination date by filing an election with the Internal Revenue Service no later than 30 days after the date the shares are acquired. Upon the sale of shares acquired pursuant to a restricted stock award, any gain or loss, based on the difference between the sale price and the fair market value on the determination date, will be taxed as capital gain or loss. The Company generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant on the determination

date, except to the extent such deduction is limited by applicable provisions of the Code.

***Performance and Restricted Stock Units Awards.*** A participant generally will recognize no income upon the grant of a performance share, performance units or restricted stock units award. Upon the settlement of such awards,

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participants normally will recognize ordinary income in the year of receipt in an amount equal to the cash received and the fair market value of any nonrestricted shares received. If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. If the participant receives shares of restricted stock, the participant generally will be taxed in the same manner as described above (see discussion under *Restricted Stock* ). Upon the sale of any shares received, any gain or loss, based on the difference between the sale price and the fair market value on the determination date (as defined above under *Nonstatutory Stock Options* ), will be taxed as capital gain or loss. The Company generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant on the determination date, except to the extent such deduction is limited by applicable provisions of the Code.

***Deferred Stock Unit Awards.*** A participant generally will recognize no income upon the grant of a Deferred Stock Unit Award. Upon the settlement of such an award, the participant normally will recognize ordinary income in the year of settlement in an amount equal to the fair market value of any unrestricted shares of our Common Stock received. Upon the sale of any shares received, any gain or loss, based on the difference between the sale price and the fair market value on the determination date, will be taxed as capital gain or loss. The Company generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant on the determination date, except to the extent such deduction is limited by applicable provisions of the Code.

***Other Stock-Based Awards.*** A participant generally will recognize income with respect to any other stock-based award at the time and in the manner required by the applicable provisions of the Code and such taxation will depend upon the specifics of any such award. Upon the sale of any shares received, any gain or loss, based on the difference between the sale price and the fair market value on the determination date, will be taxed as capital gain or loss. The Company generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant on the determination date, except to the extent such deduction is limited by applicable provisions of the Code.

**Accounting Treatment**

Under current accounting rules, option grants made to employees that have fixed exercise prices that are equal to or greater than the fair market value per share on the grant date and that have a fixed number of shares as associated with the award do not require a direct charge to Cohu's reported earnings. However, the fair value of those awards is required to be disclosed in the notes to Cohu's financial statements, and Cohu also must disclose, in the notes to its financial statements, the pro forma impact those awards would have upon Cohu's reported earnings and earnings per share were the fair value of those awards at the time of grant treated as compensation expense over the expected life of the award.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment*, (SFAS No. 123R), which addresses all forms of share-based payment ( *SBP* ) awards, including all shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. SFAS No. 123R eliminates the use of current accounting rules and will require Cohu to recognize as compensation expense, in its financial statements, the grant date fair value of all *SBP* awards over the service period. The effective date of SFAS 123R is the first reporting period beginning after June 15, 2005, which is Cohu's third quarter 2005. Cohu expects that the adoption of SFAS 123R on July 1, 2005, will reduce reported earnings and earnings per share by a material amount.

**New Plan Benefits**

Except as otherwise set forth below, awards granted under the 2005 Plan will be granted at the discretion of the Committee, and, accordingly, are not yet determinable. Benefits under the 2005 Plan will depend on a number of

factors, including the fair market value of the Company's Common Stock on future dates, actual Company performance against performance goals established with respect to performance awards and decisions made by the participants. Consequently, other than the non-employee director stock options described below, it is not possible to determine the benefits that might be received by participants under the 2005 Plan. The Company will issue an annual option grant to each non-employee director as provided under the 2005 Plan as follows:

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<b>Name and Position</b>	<b>Shares</b>
James A. Donahue, Chief Executive Officer	0
John H. Allen, Chief Financial Officer	0
James G. McFarlane, Senior Vice President	0
Colin P. Scholefield, Senior Vice President	0
Larry R. Stuckey, Vice President	0
All Current Executive Officers, as a Group	0
All Current Non-Employee Directors Who Are not Executive Officers, as a Group (3 Persons)	15,000
All Employees and Directors, Including all Current Officers who are not Executive Officers, as a Group	15,000

**Required Vote and Board of Directors Recommendation**

**The affirmative vote of a majority of the votes cast at the Meeting, at which a quorum is present, either in person or by proxy, is required to approve the adoption of the 2005 Plan.**

**The Board of Directors believes that the proposed adoption of the 2005 Plan is in the best interests of the Company and its stockholders for the reasons stated above. Therefore, the Board recommends a vote for approval of the adoption of the 2005 Plan.**

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**PROPOSAL NO. 3**

**RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Audit Committee of the Board has appointed Ernst & Young LLP as its independent registered public accounting firm for the year ending December 31, 2005. Ernst & Young LLP served as Cohu's independent registered public accounting firm for the year ended December 31, 2004 and also provided certain tax and other audit related services. See "Principal Accountant Fees and Services" on page 22. Representatives of Ernst & Young LLP are expected to attend the Meeting, where they are expected to be available to respond to appropriate questions and, if they desire, to make a statement.

Our Board recommends a vote FOR the ratification of the appointment of Ernst & Young LLP as Cohu's independent registered public accounting firm for the year ending December 31, 2005. If the appointment is not ratified, the Board will consider whether it should select another independent registered public accounting firm.

**Required Vote and Board of Directors Recommendation**

**The affirmative vote of a majority of shares present, in person or by proxy at the Meeting (provided a quorum is present) is required to approve the ratification of the appointment of Ernst & Young LLP.**

**The Board of Directors recommends that the stockholders approve the ratification of the appointment of Ernst & Young LLP as Cohu's independent registered public accounting firm for the year ending December 31, 2005.**

**BOARD OF DIRECTORS AND COMMITTEES**

***Board Independence***

The Board has determined that each director included under "Independent Directors" in the table below and who is a member of the committees described below has no material relationship with Cohu (either directly or as a partner, shareholder or officer of an organization that has a relationship with Cohu) and is independent as defined under the requirements of the Nasdaq Stock Market independence standards, as currently in effect and the standards adopted by the Cohu Board of Directors.

***Board Structure and Committee Composition***

As of the date of this proxy statement, our Board has six directors and the following three committees: (1) Audit, (2) Compensation and (3) Nominating and Governance. The membership during 2004 and the function of each of the committees are described below. Each of the committees operates under a written charter adopted by the Board. All of the committee charters are available on Cohu's website at [www.cohu.com/investors/corporategovernance](http://www.cohu.com/investors/corporategovernance). During 2004, the Board held seven meetings. Each director attended at least 75% of all Board and applicable Committee meetings. Directors are encouraged to attend annual meetings of Cohu stockholders. All six directors attended the last annual meeting of stockholders held on May 11, 2004.

<b>Name of Director</b>	<b>Audit</b>	<b>Compensation</b>	<b>Nominating and Governance</b>
<b><i>Independent Directors:</i></b>			

James W. Barnes			
Harry L. Casari(1)	X	X*	X
Robert L. Ciardella	X	X	X*
Harold Harrigian(1)	X*	X	X
<b><i>Other Directors:</i></b>			
James A. Donahue			
Charles A. Schwan (Chairman)			
<b>Number of Meetings in 2004</b>	7	5	3

X = Committee member; \* = Chair;

(1) Audit Committee financial expert as defined by Securities and Exchange Commission ( SEC ) Rules.

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### ***Audit Committee***

Cohu has a separately designated standing Audit Committee established in accordance with Section 3(a)(58) of the Securities Exchange Act of 1934, as amended. The Audit Committee assists the Board in fulfilling its responsibilities for general oversight of the integrity of Cohu's financial statements, Cohu's compliance with legal and regulatory requirements, the independent registered public accounting firm's qualifications and independence and risk assessment and risk management. Among other things, the Audit Committee prepares the Audit Committee report for inclusion in the annual proxy statement; annually reviews the Audit Committee charter and the committee's performance; appoints, evaluates and approves the fees of Cohu's independent registered public accounting firm; reviews and approves the scope of the annual audit, the audit fee and the financial statements; reviews Cohu's disclosure controls and procedures, internal controls including such controls over financial reporting, information security policies and corporate policies with respect to financial information and earnings guidance; oversees investigations into complaints concerning financial matters; and reviews other risks that may have a significant impact on Cohu's financial statements. The Audit Committee works closely with management as well as Cohu's independent registered public accounting firm. The Audit Committee has the authority to obtain advice and assistance from, and receive appropriate funding from Cohu for, outside legal, accounting or other advisors as the Audit Committee deems necessary to carry out its duties.

The report of the Audit Committee is included herein beginning on page 21. The charter of the Audit Committee is available at [www.cohu.com/investors/corporategovernance](http://www.cohu.com/investors/corporategovernance).

### ***Compensation Committee***

The Compensation Committee discharges the Board's responsibilities relating to compensation of Cohu's executives and directors; produces an annual report on executive compensation for inclusion in Cohu's proxy statement; provides general oversight of Cohu's compensation structure, including Cohu's equity compensation plans and benefits programs and retains and approves the terms of the retention of any compensation consultants and other compensation experts. Other specific duties and responsibilities of the Compensation Committee include; reviewing and approving objectives relevant to executive officer compensation, evaluating performance and determining the compensation of executive officers in accordance with those objectives; approving employment agreements for executive officers; approving and amending Cohu's incentive compensation and stock option programs (subject to stockholder approval if required); approving any changes to non-equity based benefit plans involving a material financial commitment by Cohu; recommending to the Board director compensation; monitoring director and executive stock ownership; and annually evaluating its performance and its charter.

The report of the Compensation Committee is included herein beginning on page 23. The charter of the Compensation Committee is available at [www.cohu.com/investors/corporategovernance](http://www.cohu.com/investors/corporategovernance).

### ***Nominating and Governance Committee***

The Nominating and Governance Committee identifies individuals qualified to become Board members, consistent with criteria approved by the Board; oversees the organization of the Board to discharge the Board's duties and responsibilities properly and efficiently; and identifies best practices and recommends corporate governance principles, including giving proper attention and making effective responses to stockholder concerns regarding corporate governance. Other specific duties and responsibilities of the Nominating and Governance Committee include: annually assessing the size and composition of the Board; developing membership qualifications for Board committees; defining specific criteria for director independence; monitoring compliance with Board and Board committee membership criteria; annually reviewing and recommending directors for continued service; coordinating and assisting management and the Board in recruiting new members to the Board; annually, and together with the

Chairman of the Compensation Committee, evaluating the performance of the Chairman of the Board and CEO and presenting the results of the review to the Board and to the Chairman and CEO; reviewing and recommending proposed changes to Cohu's charter or bylaws and Board committee charters; assessing periodically and recommending action with respect to stockholder rights plans or other stockholder protections; recommending Board committee assignments; reviewing and approving any employee director standing for election for outside for-profit boards of directors; reviewing governance-related stockholder proposals and recommending Board responses; overseeing the evaluation of the Board and management and conducting a preliminary review of director independence and the financial literacy and expertise of Audit Committee members. The Chair of the Nominating and Governance Committee receives communications directed to non-management directors.

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The charter of the Nominating and Governance Committee is available at [www.cohu.com/investors/corporategovernance](http://www.cohu.com/investors/corporategovernance).

***Stockholder nominees***

The policy of the Nominating and Governance Committee is to consider properly submitted stockholder nominations for candidates for membership on the Board as described below under Identifying and Evaluating Nominees for Directors. In evaluating such nominations, the Nominating and Governance Committee seeks to achieve a balance of knowledge, experience and capability on the Board and to address the membership criteria set forth under Director Qualifications. Any stockholder nominations proposed for consideration by the Nominating and Governance Committee should include the nominee's name and qualifications for Board membership and should be addressed to:

Corporate Secretary  
Cohu, Inc.  
12367 Crosthwaite Circle  
Poway, CA 92064-6817

In addition, the bylaws of Cohu permit stockholders to nominate directors for consideration at an annual stockholder meeting. For a description of the process for nominating directors in accordance with Cohu's bylaws, see Stockholder Proposals 2006 Annual Meeting on page 26.

***Director Qualifications***

Cohu's Corporate Governance Guidelines are available at [www.cohu.com/investors/corporategovernance](http://www.cohu.com/investors/corporategovernance) and contain Board membership criteria that apply to the nominees recommended by the Nominating and Governance Committee for a position on Cohu's Board. Under these criteria, members of the Board should have the highest professional and personal ethics and values, consistent with longstanding Cohu's values and standards. They should have broad experience at the policy-making level in business, government, education, technology or public interest. They should be committed to enhancing stockholder value and should have sufficient time to carry out their duties and to provide insight and practical wisdom based on experience. Their service on other boards of public companies should be limited to a number that permits them, given their individual circumstances, to perform responsibly all director duties. Each director must represent the interests of all stockholders.

***Identifying and Evaluating Nominees for Directors***

Our Nominating and Governance Committee uses a variety of methods for identifying and evaluating nominees for director. The Nominating and Governance Committee assesses the appropriate size of the Board, and whether any vacancies on the Board are expected due to retirement or otherwise. In the event that vacancies are anticipated, or otherwise arise, the Nominating and Governance Committee considers various potential candidates for director. Candidates may come to the attention of the Nominating and Governance Committee through current Board members, professional search firms, stockholders or other persons. These candidates are evaluated at regular or special meetings of the Nominating and Governance Committee, and may be considered at any point during the year. As described above, the Nominating and Governance Committee considers properly submitted stockholder nominations for candidates for the Board. Following verification of the stockholder status of persons proposing candidates, recommendations are aggregated and considered by the Nominating and Governance Committee at a regularly scheduled meeting. If any materials are provided by a stockholder in connection with the nomination of a director candidate, such materials are forwarded to the Nominating and Governance Committee. The Nominating and Governance Committee also reviews materials provided by professional search firms or other parties in connection with a nominee who is not proposed by a stockholder. In evaluating such nominations, the Nominating and

Governance Committee seeks to achieve a balance of knowledge, experience and capability on the Board.

*Executive Sessions*

Executive sessions of independent directors are held at least three times a year. The sessions are scheduled and chaired by the Chair of the Nominating and Governance Committee. Any independent director can request that an additional executive session be scheduled.

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***Communications with the Board***

Individuals may communicate with the Board, including the non-management directors, by submitting an e-mail to Cohu's Board at [corp@cohu.com](mailto:corp@cohu.com) or by sending a letter to the Cohu Board of Directors, c/o Corporate Secretary, Cohu, Inc., 12367 Crosthwaite Circle, Poway, California 92064-6817.

***Directors Compensation***

During 2004, independent directors received (i) an annual retainer of \$20,000; (ii) \$5,000 annually for services as Chairman of a Board committee, if applicable, and (iii) an additional annual fee of \$2,500 with respect to membership on each committee. The Cohu 1996 Outside Directors Stock Option Plan (the "1996 Plan"), as amended, provides that each director who is not a current or former management employee of Cohu will receive an automatic grant of an option to purchase 20,000 shares of Cohu's Common Stock upon their appointment to the Board and an annual grant of an option to purchase 5,000 shares thereafter. If the stockholders approve Proposal No. 2 (Approval of the Cohu 2005 Equity Incentive Plan) the practice of granting options under the 1996 Plan will remain essentially unchanged. Options granted under the 1996 Plan have an exercise price equal to the fair market value on the grant date. Cohu pays the cost of health care insurance premiums and expenses for certain directors and their spouses. Mr. Schwan is paid \$35,000 per annum for his services as Chairman of the Board. Mr. Schwan also participates in the Cohu, Inc. Deferred Compensation Plan.

**CORPORATE GOVERNANCE**

Cohu has adopted Corporate Governance Guidelines (the "Guidelines") that outline, among other matters, the role and functions of the Board, the responsibilities of various Board committees, selection of new directors and director independence. These Guidelines are available, along with other important corporate governance materials, on our website at [www.cohu.com/investors/corporategovernance](http://www.cohu.com/investors/corporategovernance). As the operation of the Board is a dynamic process, the Board regularly reviews changing legal and regulatory requirements, evolving best practices and other developments. The Board may modify the Guidelines, as appropriate, from time to time.

**CODE OF BUSINESS CONDUCT AND ETHICS**

Cohu has adopted a Code of Business Conduct and Ethics (the "Code"). The Code applies to all of Cohu's Board of Directors and employees including the principal executive officer, principal financial officer and principal accounting officer. The Code, among other things, is designed to promote:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. Full, fair, accurate, timely and understandable disclosure in reports and documents that Cohu files with, or submits to, the SEC and in other public communications made by Cohu;
3. Compliance with applicable governmental laws, rules and regulations;
4. The prompt internal reporting of violations of the Code to an appropriate person or persons identified in the Code; and
5. Accountability for adherence to the Code.

The Code is available at [www.cohu.com/investors/corporategovernance](http://www.cohu.com/investors/corporategovernance) and is included as Exhibit 14 to Cohu's Annual Report on Form 10-K for the year ended December 31, 2004.

### **SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth certain information regarding beneficial ownership of Cohu's Common Stock as of February 14, 2005 or as of December 31, 2004 for certain stockholders by (i) each person known by Cohu, based on information provided by such person, to own more than 5% of Cohu's Common Stock; (ii) each director of Cohu; (iii) each named executive officer included in the Summary Compensation Table; and (iv) all directors and executive officers as a group.

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<b>Name and address of beneficial owner</b>	<b>Amount and nature of beneficial ownership (1)</b>	<b>Percent of class (2)</b>
Deprince, Race and Zollo, Inc. 201 S. Orange Ave, Suite 850 Orlando, FL 32801	1,722,817(3)	7.96%
Nicholas J. Cedrone One Monarch Drive Littleton, MA 01460	1,336,138(4)	6.18%
Systematic Financial Management, L.P. 300 Frank W. Burr Blvd. Teaneck, NJ 07666	1,269,919(5)	5.87%
Franklin Resources, Inc. One Franklin Parkway San Mateo, CA 94403	1,177,900(6)	5.45%
FMR Corp. 82 Devonshire Street Boston , MA 02109	1,173,247(7)	5.42%
John H. Allen	151,029	*
James W. Barnes	350,819	1.62%
Harry L. Casari	20,350	*
Robert L. Ciardella	5,000	*
James A. Donahue	376,101	1.72%
Harold Harrigian	25,350	*
James G. McFarlane	105,310	*
Colin P. Scholefield	65,006	*
Charles A. Schwan	204,584	*
Larry R. Stuckey	55,356	*
All directors and executive officers as a group (10 persons)	1,358,905	6.10%

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\* Less than 1%

- (1) Includes 132,501, 18,750, 5,000, 263,197, 23,750, 88,752, 65,003, 55,002 and 651,955 shares issuable upon exercise of stock options held by Messrs. Allen, Casari, Ciardella, Donahue, Harrigian, McFarlane, Scholefield and Stuckey and all directors and executive officers as a group, respectively, that were exercisable on or within 60 days of February 14, 2005.
- (2) Computed on the basis of 21,630,596 shares of common stock outstanding as of February 14, 2005, plus, with respect to each person holding options to purchase common stock exercisable within 60 days of February 14, 2005, the number of shares of common stock issuable upon exercise thereof.
- (3) According to Schedule 13G filed with the Securities and Exchange Commission on January 10, 2005.

- (4) According to Schedule 13G filed with the Securities and Exchange Commission on January 20, 2005.
- (5) According to Schedule 13G filed with the Securities and Exchange Commission on February 14, 2005, Systematic Financial Management, L.P. reported that it had sole voting and dispositive power with respect to 1,150,459 and 1,269,919 shares, respectively, and no shared voting or dispositive power with respect to these shares.
- (6) According to Schedule 13G filed with the Securities and Exchange Commission on February 14, 2005, Franklin Resources, Inc. reported that Franklin Advisory Services, LLC had sole voting and dispositive power with respect to 1,176,200 and 1,177,900 shares, respectively, and no shared voting or dispositive power with respect to these shares.
- (7) According to Schedule 13G filed with the Securities and Exchange Commission on February 14, 2005, FMR Corp. reported that it had sole voting and dispositive power with respect to 75,800 and 1,173,247 shares, respectively, and no shared voting or dispositive power with respect to these shares.

**Table of Contents****EXECUTIVE OFFICERS**

Listed below are the executive officers of Cohu and certain executive officers of Cohu's principal subsidiary, Delta Design, Inc. ( Delta Design ), as of February 14, 2005. Executive officers of Cohu serve at the discretion of the Board of Directors.

<b>Name</b>	<b>Age</b>	<b>Position</b>
<b>Cohu:</b>		
James A. Donahue	56	President & Chief Executive Officer
John H. Allen	53	Vice President, Finance & Chief Financial Officer, Secretary
<b>Delta Design:</b>		
Thomas G. Lightner	60	Vice President, Manufacturing
James G. McFarlane	54	Senior Vice President
Colin P. Scholefield	41	Senior Vice President, Sales and Service
Larry R. Stuckey	43	Vice President, Engineering

Mr. Donahue has been employed by Delta Design since 1978 and has been President of Delta Design since May, 1983. In October, 1999, Mr. Donahue was named to the position of President and Chief Operating Officer of Cohu and was appointed to Cohu's Board of Directors. On June 30, 2000, Mr. Donahue was promoted to Chief Executive Officer.

Mr. Allen has been employed by Cohu since June, 1995. He was Director of Finance until September, 1995, became Vice President, Finance and Secretary in September, 1995 and was appointed Chief Financial Officer in October, 1995. Prior to joining Cohu, Mr. Allen held various positions with Ernst & Young LLP from 1976 until June, 1995 and had been a partner with that firm since 1987.

Mr. Lightner has been employed by Delta Design since 2000. He was Director of Manufacturing from 2000 until April 2001 at which time he was promoted to Vice President of Manufacturing.

Mr. McFarlane has been employed by Delta Design since 1989. He was Director of Engineering from 1992 to 1998 and was promoted to Vice President of Engineering in 1998. In 2000, Mr. McFarlane was promoted to Senior Vice President.

Mr. Stuckey has been employed by Delta Design since 1991. He was an engineering project manager from 1991 to 1999 and was promoted to Vice President of Product Development in 2000 and Vice President of Engineering in 2002.

Mr. Scholefield has been employed by Delta Design since 1991 and has held various positions including Customer Support Manager. He was promoted to Vice President of Sales in 2000, Senior Vice President of Sales in 2001 and Senior Vice President of Sales and Service in 2003.

**COMPENSATION OF EXECUTIVE OFFICERS AND OTHER INFORMATION****Summary of Cash and Certain Other Compensation**

The following table discloses compensation paid to Cohu's Chief Executive Officer, the other executive officer and certain executive officers of Delta Design whose aggregate cash compensation exceeded \$100,000 (the Named

Executive Officers ) during the last three years.

**Table of Contents****SUMMARY COMPENSATION TABLE**

Name and Principal Position	Year	Annual Compensation		Long Term Compensation Awards Securities Underlying	All Other Compensation
		Salary (\$)	Bonus (\$) (1)	Options (#)	(\$ (2))
James A. Donahue President and Chief Executive Officer	2004	400,005	250,000	70,000	26,000
	2003	374,062	100,000	70,000	18,962
	2002	315,002	70,000	70,000	15,400
John H. Allen Vice President, Finance & Chief Financial Officer, Secretary	2004	245,003	150,000	30,000	8,200
	2003	231,542	50,000	30,000	7,841
	2002	197,634	30,000	30,000	7,188
James G. McFarlane Senior Vice President, Delta Design	2004	200,013	40,000	15,000	8,200
	2003	199,744	15,000	15,000	7,774
	2002	190,000	10,000	20,000	7,054
Colin P. Scholefield Senior Vice President, Sales & Service Delta Design	2004	190,777	75,000	20,000	8,200
	2003	180,000	25,000	20,000	7,500
	2002	180,000	37,000	25,000	6,900
Larry R. Stuckey Vice President Engineering, Delta Design	2004	181,473	40,000	20,000	7,453
	2003	175,011	25,000	20,000	6,924
	2002	172,125	25,000	20,000	6,344

- (1) The amounts shown in this column reflect payments under Cohu's Incentive Bonus Plan for key executives or other amounts paid at the discretion of the Cohu Board of Directors.
- (2) The amounts shown in this column reflect Cohu's contributions to the Employees' Retirement 401(k) Plan and the Cohu, Inc. Deferred Compensation Plan. These amounts exclude investment earnings (losses) on individual deferred compensation investment accounts.

**Incentive Bonus Plan**

Cohu had an incentive bonus plan for key executives in effect through 2004. Under this plan, corporate officers may receive incentive compensation based on overall corporate earnings performance and the principal executive of each division and subsidiary may receive incentive compensation based upon the earnings performance of the operations they manage. In each case, the incentive compensation is determined with reference to a pre-tax earnings target fixed by the Compensation Committee, or in the case of divisions and subsidiaries, by Cohu's management.

**Retirement Plan**

The Cohu Employees' Retirement 401(k) Plan was implemented on January 1, 1978. The majority of Cohu's employees, including the Named Executive Officers, who are at least 21 years of age and complete six months of service are eligible to enroll in this Plan. The participant may contribute a percentage of his or her annual

compensation subject to maximum annual contribution limitations. Cohu may match participant contributions up to 4% of annual employee compensation not to exceed specified annual limits. The amounts contributed by Cohu are vested 10% after one year of participation, another 10% after two years and an additional 20% each year thereafter to the full 100%. Generally, the maximum nontaxable annual amount that any participant could contribute in 2004 was \$13,000.

### **Cohu, Inc. Deferred Compensation Plan**

Cohu adopted the Cohu, Inc. Key Executive Long Term Incentive Plan in 1994. The Plan was amended, restated and renamed the Cohu, Inc. Deferred Compensation Plan in 2001. Under this Plan, corporate officers, including the Cohu Executive Officers, may elect to defer a portion of their current compensation. Cohu will then match participant contributions up to 4% of the executive's compensation in excess of specified annual limits. These combined funds may be used by Cohu to purchase a specifically designed life insurance policy on the executive's life. Cohu is not entitled to a corporate tax deduction until the year in which the executive recognizes taxable income in connection with the Plan.

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Participant contributions, distributions and investment earnings and losses are accumulated in deferral investment accounts as established by the Plan. The trust assets, consisting primarily of the cash surrender value of life insurance policies, and the payroll obligation to the participant are included in Cohu's consolidated financial statements. The payroll obligation increases or decreases based on changes in the participant's deferral investment account. Participants may elect to receive payment of their deferral account in ten or fifteen annual installments upon retirement and in lump sum or five, ten or fifteen annual installments upon disability, death, termination or change in control, as defined in the Plan.

**Termination Agreements**

Cohu has entered into Termination Agreements with Mr. Donahue and Mr. Allen pursuant to which those executives would be entitled to a payment in the event of a termination of employment for specified reasons following a change of control of Cohu. For this purpose, a change of control of Cohu means a merger or consolidation of Cohu (except with a wholly owned subsidiary), a sale by Cohu of all or substantially all of its assets, the acquisition of beneficial ownership of a majority of the outstanding voting stock of Cohu by any person, entity or affiliated group or a change in the identities of a majority of the directors of Cohu within a period of thirty consecutive months resulting in whole or in part from the election of persons who were not management nominees. Termination of employment for purposes of these agreements means a discharge of the executive by Cohu, other than for specified causes including death, disability, wrongful acts, habitual intoxication, habitual neglect of duties or normal retirement. Termination also includes resignation following the occurrence of an adverse change in the executive's position, duties, compensation or work conditions. The amounts payable under the agreements will change from year to year based on the executive's compensation. In the event of a termination in 2005 following a change of control, the amounts payable to Mr. Donahue and Mr. Allen would be approximately \$1,500,000 and \$900,000, respectively.

**OPTION GRANTS IN LAST FISCAL YEAR**

The following table provides information on grants of options to purchase Cohu's Common Stock made to the Named Executive Officers during the year ended December 31, 2004.

Name	Individual Grants				Potential Realizable Value	
	Number of Securities Underlying Options Granted (#) (1)	Percent of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Sh)	Expiration Date	at Assumed Annual Rates of Stock Price Appreciation for Option Term (2)	
James A. Donahue	70,000	9.6%	17.50	4/19/2014	5% (\$) 770,525	10% (\$) 1,952,650
John H. Allen	30,000	4.1%	17.50	4/19/2014	330,225	836,850
James G. McFarlane	15,000	2.1%	15.04	10/27/2014	141,902	359,606

Colin P. Scholefield	20,000	2.7%	15.04	10/27/2014	189,203	479,475
Larry R. Stuckey	20,000	2.7%	15.04	10/27/2014	189,203	479,475

- (1) Consists of stock options, which (i) were granted at an exercise price of 100% of the market price of the underlying shares on the date of grant, (ii) become exercisable over four years at the rate of one-fourth each year and (iii) expire ten years from the date of grant. The options were granted under Cohu's 1998 Stock Option Plan.
- (2) The potential realizable value shown represents the potential gains based on annual compound stock price appreciation of 5% and 10% from the date of grant through the full 10-year option term, net of exercise price, but before taxes associated with the exercise. The amounts represent assumed rates of appreciation only based on the Securities and Exchange Commission rules and do not represent Cohu's estimate of the possible future appreciation in Cohu's Common Stock or gains, if any, that may ultimately be realized by the above option holders. If the price of Cohu's Common Stock does not increase above the exercise price, no value will be realizable from these options.

**Table of Contents****AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR  
AND FISCAL YEAR-END OPTION VALUES**

The following table provides information on option exercises in 2004 by the Named Executive Officers and the value of such officers' unexercised options at December 31, 2004.

Name	Shares	Value Realized (\$)(1)	Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)		Value of Unexercised In-the-Money Options at Fiscal Year-End (\$) (2)	
	Acquired on Exercise (#)		Exercisable	Unexercisable	Exercisable	Unexercisable
James A. Donahue	18,092	230,130	228,197	157,499	936,781	312,021
John H. Allen	-	-	117,501	67,499	386,679	133,721
James G. McFarlane	-	-	88,752	41,248	475,595	143,555
Colin P. Scholefield	4,100	56,457	65,003	52,497	349,461	179,189
Larry R. Stuckey	-	-	55,002	49,998	263,361	161,939

- (1) The value realized is based on the difference between the market price of the shares purchased on the exercise date and the exercise price multiplied by the number of shares acquired and before taxes associated with such exercise.
- (2) Calculated solely on the basis of the fair market value of Cohu's Common Stock at December 31, 2004, minus the aggregate exercise price and before taxes associated with such exercise. Accordingly, such amounts may bear no relationship to gains, if any, that may be realized upon the ultimate disposition of the shares. The closing price of Cohu's Common Stock on December 31, 2004 as reported on the Nasdaq Stock Market was \$18.56.

**EQUITY COMPENSATION PLAN INFORMATION**

The following table summarizes our equity compensation plan information as of December 31, 2004.

Number of securities to be issued upon exercise of outstanding options, warrants and	Weighted average exercise price of outstanding options, warrants and rights	Number of securities available for future issuance under equity compensation plans (excluding securities
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Plan Category	rights (1)		reflected in column (a))(c)
	(a)	(b)	
	<i>(In thousands, except per share amounts)</i>		
Equity compensation plans approved by security holders	3,054	\$ 14.95	1,364(2)
Equity compensation plans not approved by security holders	-	-	-
	3,054	\$ 14.95	1,364

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- (1) Includes only options outstanding under Cohu's stock option plans, as no stock warrants or rights were outstanding as of December 31, 2004.
- (2) Includes 436 shares of common stock reserved for future issuance under the Cohu 1997 Employee Stock Purchase Plan.

### AUDIT COMMITTEE REPORT

*The information contained in this report shall not be deemed to be soliciting material or filed with the SEC or subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act) except to the extent that Cohu specifically incorporates it by reference into a document filed under the Securities Act of 1933, as amended (the Securities Act) or the Exchange Act.*

#### Composition

The Audit Committee of the Board of Directors is composed of three independent directors, as defined by current rules of The Nasdaq Stock Market, Inc., and operates under a written charter adopted by the Board of Directors. The current members of the Audit Committee are Harold Harrigan (Chairman), Harry L. Casari and Robert L. Ciardella.

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### **Responsibilities**

The Audit Committee assists the Board in fulfilling its responsibilities for general oversight of the integrity of Cohu's financial statements, Cohu's compliance with legal and regulatory requirements, the independent registered public accounting firm's qualifications and independence and risk assessment and risk management. The Audit Committee manages Cohu's relationship with its independent registered public accounting firm (who report directly to the Audit Committee). The Audit Committee has the authority to obtain advice and assistance from outside legal, accounting or other advisors as the Audit Committee deems necessary to carry out its duties and receive appropriate funding, as determined by the Audit Committee, from Cohu for such advice and assistance.

Cohu's management has primary responsibility for preparing Cohu's financial statements and Cohu's financial reporting process. Cohu's independent registered public accounting firm, Ernst & Young LLP, is responsible for expressing an opinion on (i) the conformity of Cohu's audited financial statements with accounting principles generally accepted in the United States and (ii) management's assessment and their own as to the effectiveness of internal control over financial reporting.

### **Review with Management and Independent Auditors**

In this context, the Audit Committee has met and held discussions with management and Ernst & Young LLP. Management represented to the Audit Committee that Cohu's consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States and that Cohu's internal control over financial reporting was effective as of December 31, 2004, and the Audit Committee has reviewed and discussed the consolidated financial statements and Cohu's effectiveness of internal control over financial reporting with management and the independent registered public accounting firm. The Audit Committee also discussed with Ernst & Young LLP matters required to be discussed under Statement on Auditing Standards No. 61, *Communication with Audit Committees*.

Ernst & Young LLP also provided to the Audit Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*, and the Audit Committee discussed with them, the firm's independence.

### **Summary**

Based upon the Audit Committee's discussions with management and the independent registered public accounting firm and the Audit Committee's review of the representations of management, and the reports of Ernst & Young LLP to the Audit Committee, the Audit Committee recommended that the Board of Directors include the audited consolidated financial statements in Cohu's Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Securities and Exchange Commission.

SUBMITTED BY THE AUDIT COMMITTEE OF COHU'S BOARD OF DIRECTORS:

Harold Harrigian (Chairman)

Harry L Casari

Robert L. Ciardella

### **PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The following table shows the fees billed to Cohu for the audit and other services provided by Ernst & Young LLP for the years ended December 31, 2004 and 2003 (*in thousands*).

	<b>2004</b>	<b>2003</b>
Audit Fees <sup>(1)</sup>	\$ 552	\$ 304
Audit-Related Fees <sup>(2)</sup>	48	29
Tax Fees:		
Tax Compliance <sup>(3)</sup>	79	251
Tax Planning and Advice	11	39
	90	290
All Other Fees		
Total	\$ 690	\$ 623

In 2003, the Audit Committee established pre-approval policies and procedures concerning the engagement of Cohu's independent registered public accounting firm to perform any services. These policies require that all

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services rendered by Cohu's independent registered public accounting firm be pre-approved by the Audit Committee within specified, budgeted fee amounts. In addition to the approval of all audit fees in 2004 and 2003, 100% and 90% of the non audit fees, respectively, were pre-approved by the Audit Committee.

The Audit Committee has delegated to the Chair of the Audit Committee the authority to pre-approve audit-related and non-audit services not prohibited by law to be performed by Cohu's independent registered public accounting firm and associated fees up to a maximum for any one non-audit service of \$10,000, provided that the Chair shall report any decisions to pre-approve such audit-related or non-audit services and fees to the full Audit Committee at its next regular meeting.

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- (1) Audit fees represent fees for professional services provided in connection with the audit of our financial statements and review of our quarterly financial statements and audit services provided in connection with other statutory or regulatory filings. In 2004, audit fees included fees for Section 404 of the Sarbanes-Oxley Act of 2002.
  - (2) Audit-related fees consisted primarily of accounting consultations, employee benefit plan audits, services related to business acquisitions and divestitures and other attestation services.
  - (3) Tax compliance fees consisted primarily of assistance with (i) preparation of Cohu's Federal, State and Foreign tax returns; (ii) tax return examinations and (iii) expatriate tax return filings.

### **COMPENSATION COMMITTEE REPORT**

*The information contained in this report shall not be deemed to be soliciting material or filed with the SEC or subject to the liabilities of Section 18 of the Exchange Act except to the extent that Cohu specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.*

The Compensation Committee (the Committee) of the Board of Directors determines and administers Cohu's executive compensation policies and programs. During 2004, Messrs. Casari, Ciardella and Harrigan served as members of the Committee.

### **Compensation Philosophy**

One of the Committee's primary objectives in establishing compensation policies is to maintain competitive programs to attract, retain and motivate high caliber executives and maximize the long-term success of Cohu by appropriately rewarding such individuals for their achievements. Another objective is to provide an incentive to executives to focus their efforts on long-term goals for Cohu by closely aligning their financial interests with those of the stockholders. To attain these goals, the Committee has designed Cohu's executive compensation program to include base salary, annual cash bonus incentives and long-term incentives in the form of stock options. The Committee believes that Cohu's executive compensation programs, as summarized below, have met these objectives.

### **Base Salary**

The Committee generally determines base salary levels for executive level positions prior to the annual stockholders' meeting in May. The process involved in the determination of executive base salaries for 2004 is summarized below.

In July 2003, the Compensation Committee decided to increase the annual base salary of the Chief Executive Officer from \$350,000 to \$400,000 and from \$220,000 to \$245,000 for the Chief Financial Officer. These salary increases were based on a careful review of the base salaries of similar positions at other high technology companies

of comparable size and complexity. There were no raises granted to the Chief Executive Officer or the Chief Financial Officer in 2004. The base salaries for the other three Named Executive Officers, all of whom are officers of Delta Design, were determined by the President and Chief Executive Officer of Cohu. Their salaries were adjusted in 2004 based on a compensation study of similar sized technology companies prepared by an independent compensation consulting firm.

### **Annual Incentives**

Bonuses are designed to be a significant component of cash compensation. Incentives for Cohu executive level positions are generally determined according to Cohu's Incentive Bonus Plan (the Incentive Plan), based upon company performance. In general, the Incentive Plan performance target objectives must be achieved before any bonuses may be paid to participants under this plan.

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In February, 2005, the Committee reviewed the Company's financial performance for the year ended December 31, 2004 to assess whether any bonuses had been earned in accordance with Cohu's Incentive Plan. The Committee decided to award bonuses to the Chief Executive Officer and Chief Financial Officer consistent with the Incentive Plan and based on various factors the Committee deemed relevant including the participant's contributions during the last year, the achievement of strategic initiatives, a comparison to bonuses paid to other comparable sized technology companies in related industries and Cohu's financial performance relative to other semiconductor equipment companies. The 2004 bonuses paid to the other three Named Executive Officers, all of whom are officers of Delta Design, were determined by the President and Chief Executive Officer of Cohu. These bonuses were based on the individual's contributions and performance during the year, the achievement of strategic objectives and the financial performance of Delta Design.

## **Stock Options**

The Committee grants stock options to focus the executive on the long-term performance of Cohu and on maximizing stockholder value. The grant of stock options is tied to individual executive performance. The Committee grants such stock options after a review of various factors, including the executive's current equity ownership in Cohu, potential future contributions to Cohu and job responsibilities. The Committee members weigh these subjective factors individually and arrive at final determinations for option grants through consensus. Stock options are granted with an exercise price equal to the current fair market value of Cohu's stock and utilize vesting periods to encourage retention of executive officers. The size of an option grant to an executive officer has generally been determined with reference to similarly sized high technology companies in Cohu's industry, the responsibilities and expected future contributions of the executive officer, previous grants to that officer, as well as recruitment and retention considerations. In 2004, the Committee approved stock option grants to the Named Executive Officers consistent with these criteria. See Option Grants in Last Fiscal Year. The Committee believes stock options serve to align the interests of executive officers with those of other stockholders.

## **Chief Executive Officer's Compensation**

During 2004, the Committee determined that it was appropriate to maintain Mr. Donahue's base salary at the level set by the Committee in July, 2003 and that any increase in total compensation should be derived from Mr. Donahue's participation in the Incentive Plan and from stock options. The decisions made with respect to the 2004 compensation of the Chief Executive Officer were intended to continue Cohu's philosophy of aligning the interests of the Chief Executive Officer with the interests of the Company and its stockholders. The 2004 cash bonus paid to Mr. Donahue was earned based on performance targets established in the Incentive Plan and other individual goals achieved during the year.

## **Tax Deductibility Of Executive Compensation**

Section 162(m) of the Code restricts deductibility of executive compensation paid to Cohu's chief executive officer and each of the four other most highly compensated executive officers holding office at the end of any year to the extent such compensation exceeds \$1,000,000 for any of such officers in any year and does not qualify for an exception under Section 162(m) or related regulations. The Committee's policy is to qualify its executive compensation for deductibility under applicable tax laws to the extent practicable. The Company believes that compensation related to stock options or bonuses that may be granted under the 2005 Plan, if approved by stockholders, will generally be deductible for federal income tax purposes.

SUBMITTED BY THE COMPENSATION COMMITTEE OF COHU'S BOARD OF DIRECTORS:

Harry L. Casari (Chairman)

Robert L. Ciardella

Harold Harrigian

**COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

None of the current Compensation Committee members or Named Executive Officers have any relationships which must be disclosed under this caption.

**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

There were no such reportable relationships or transactions during 2004.

**Table of Contents****SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Exchange Act requires that Cohu's executive officers and directors and persons who own more than 10% of a registered class of Cohu's equity securities, file an initial report of ownership on Form 3 and changes in ownership on Form 4 or 5 with the SEC. Such officers, directors and 10% stockholders are also required by SEC rules to furnish Cohu with copies of all Section 16(a) forms they file.

Based solely on its review of the copies of such forms received by it, or written representations from certain reporting persons that no Forms 5 were required for such persons, Cohu believes that during the year ended December 31, 2004 its executive officers, directors and 10% stockholders complied with all Section 16(a) filing requirements applicable to them.

**COMPARATIVE STOCK PERFORMANCE GRAPH**

*The information contained in this Stock Performance Graph section shall not be deemed to be soliciting material or filed with the SEC or subject to the liabilities of Section 18 of the Exchange Act except to the extent that Cohu specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.*

The graph below compares the cumulative total stockholder return on the Common Stock of Cohu for the last five fiscal years with the cumulative total return on a Peer Group Index and a Nasdaq Market Index over the same period (assuming the investment of \$100 in Cohu's Common Stock, Peer Group Index and Nasdaq Market Index on December 31, 1999 and reinvestment of all dividends). The Peer Group Index set forth on the Performance Graph is the index for Coredata Industry Group 834, Semiconductor Equipment/Material. Industry Group 834 is comprised of approximately 50 publicly-held semiconductor equipment and other related companies. Historical stock price performance is not necessarily indicative of future stock price performance.

	1999	2000	2001	2002	2003	2004
Cohu	\$ 100	\$ 45	\$ 65	\$ 49	\$ 65	\$ 63
Peer Group	\$ 100	\$ 61	\$ 67	\$ 40	\$ 73	\$ 57
Nasdaq	\$ 100	\$ 63	\$ 50	\$ 35	\$ 53	\$ 57

**OTHER MATTERS**

The Board of Directors is unaware of any other business to be presented for consideration at the Meeting. If, however, such other business should properly come before the Meeting, the proxies will be voted in accordance with the best judgment of the proxy holders. The shares represented by proxies received in time for the Meeting will be voted and if any choice has been specified the vote will be in accordance with such specification.

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**STOCKHOLDER PROPOSALS 2006 ANNUAL MEETING**

Stockholders are entitled to present proposals for action, including nominations for candidates for membership on Cohu's Board of Directors, at a forthcoming stockholders' meeting if they comply with the requirements of the proxy rules and Cohu's bylaws. Any proposals intended to be presented at the 2006 Annual Meeting of Stockholders of Cohu must be received at Cohu's offices on or before December 1, 2005 in order to be considered for inclusion in Cohu's proxy statement and form of proxy relating to such meeting.

If a stockholder intends to submit a proposal at the 2006 Annual Meeting of Stockholders of Cohu, which proposal is not intended to be included in Cohu's proxy statement and form of proxy relating to such meeting, the stockholder should provide Cohu with appropriate notice no later than December 1, 2005. If Cohu fails to receive notice of the proposal by such date, any such proposal will be considered untimely and Cohu will not be required to provide any information about the nature of the proposal in its proxy statement and the proposal will not be submitted to the stockholders for approval at the 2006 Annual Meeting of Stockholders of Cohu.

**ANNUAL REPORT ON FORM 10-K**

Copies of Cohu's Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Securities and Exchange Commission are available to stockholders without charge upon written request addressed to Investor Relations, Cohu, Inc., 12367 Crosthwaite Circle, Poway, California 92064. The Annual Report on Form 10-K is also available at [www.cohu.com](http://www.cohu.com).

By Order of the Board of Directors,

John H. Allen  
Secretary

Poway, California  
April 1, 2005

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**APPENDIX A**

**COHU, INC.  
2005 EQUITY INCENTIVE PLAN**

**1. ESTABLISHMENT, PURPOSE AND TERM OF PLAN.**

**1.1 Establishment.** The Cohu, Inc. 2005 Equity Incentive Plan (the *Plan* ) is hereby established effective as of \_\_\_\_, 2005, the date of its approval by the stockholders of the Company (the *Effective Date* ).

**1.2 Purpose.** The purpose of the Plan is to advance the interests of the Participating Company Group and its stockholders by providing an incentive to attract, retain and reward persons performing services for the Participating Company Group and by motivating such persons to contribute to the growth and profitability of the Participating Company Group. The Plan seeks to achieve this purpose by providing for Awards in the form of Options, Stock Appreciation Rights, Restricted Stock, Performance Shares, Performance Units, Restricted Stock Units, Deferred Stock and Other Stock-Based Awards. After the Effective Date, the Company shall terminate, and no longer issue any awards from under, the Company's 1998 Stock Option Plan, 1996 Outside Directors Stock Option Plan, 1996 Stock Option Plan and 1994 Stock Option Plan.

**1.3 Term of Plan.** The Plan shall continue in effect until the earlier of its termination by the Board or the date on which all of the shares of Stock available for issuance under the Plan have been issued and all restrictions on such shares under the terms of the Plan and the agreements evidencing Awards granted under the Plan have lapsed. However, all Incentive Stock Options shall be granted, if at all, within ten (10) years from the Effective Date.

**2. DEFINITIONS AND CONSTRUCTION.**

**2.1 Definitions.** Whenever used herein, the following terms shall have their respective meanings set forth below:

(a) *Affiliate* means (i) an entity, other than a Parent Corporation, that directly, or indirectly through one or more intermediary entities, controls the Company or (ii) an entity, other than a Subsidiary Corporation, that is controlled by the Company directly, or indirectly through one or more intermediary entities. For this purpose, the term control (including the term controlled by ) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of the relevant entity, whether through the ownership of voting securities, by contract or otherwise; or shall have such other meaning assigned such term for the purposes of registration on Form S-8 under the Securities Act.

(b) *Award* means any Option, SAR, Restricted Stock, Performance Share, Performance Unit, Restricted Stock Unit, Deferred Stock or Other Stock-Based Award granted under the Plan.

(c) *Award Agreement* means a written agreement between the Company and a Participant setting forth the terms, conditions and restrictions of the Award granted to the Participant. An Award Agreement may be an Option Agreement, a SAR Agreement, a Restricted Stock Agreement, a Performance Share Agreement, a Performance Unit Agreement, a Restricted Stock Unit Agreement, a Deferred Stock Unit Agreement, or an Other Stock-Based Award Agreement.

(d) *Board* means the Board of Directors of the Company. If one or more Committees have been appointed by the Board to administer the Plan, *Board* also means such Committee(s).

(e) **Code** means the Internal Revenue Code of 1986, as amended, and any applicable regulations promulgated thereunder.

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(f) ***Committee*** means the Compensation Committee or other committee of the Board duly appointed to administer the Plan and having such powers as shall be specified by the Board. Unless the powers of the Committee have been specifically limited, the Committee shall have all of the powers of the Board granted herein, including, without limitation, the power to amend or terminate the Plan at any time, subject to the terms of the Plan and any applicable limitations imposed by law.

(g) ***Company*** means Cohu, Inc., a Delaware corporation, or any successor corporation thereto.

(h) ***Consultant*** means a person engaged to provide consulting or advisory services (other than as an Employee or a Director) to a Participating Company, provided that the identity of such person, the nature of such services or the entity to which such services are provided would not preclude the Company from offering or selling securities to such person pursuant to the Plan in reliance on a Form S-8 Registration Statement under the Securities Act.

(i) ***Covered Employee*** means an Employee who is, or could be, a covered employee within the meaning of Section 162(m).

(j) ***Deferred Stock*** means a bookkeeping entry representing a right granted to a Participant pursuant to Section 10.3 of the Plan to receive a share of Stock on a date determined in accordance with the Plan and the Participant's Award Agreement.

(k) ***Director*** means a member of the Board or of the board of directors of any other Participating Company.

(l) ***Disability*** means the inability of the Participant, in the opinion of a qualified physician acceptable to the Company, to perform the major duties of the Participant's position with the Participating Company Group because of the sickness or injury of the Participant.

(m) ***Dividend Equivalent*** means a credit, made at the discretion of the Board or as otherwise provided by the Plan, to the account of a Participant in an amount equal to the cash dividends paid on one share of Stock for each share of Stock represented by an Award held by such Participant.

(n) ***Employee*** means any person treated as an employee (including an Officer or a Director who is also treated as an employee) in the records of a Participating Company and, with respect to any Incentive Stock Option granted to such person, who is an employee for purposes of Section 422 of the Code; provided, however, that neither service as a Director nor payment of a director's fee shall be sufficient to constitute employment for purposes of the Plan. The Company shall determine in good faith and in the exercise of its discretion whether an individual has become or has ceased to be an Employee and the effective date of such individual's employment or termination of employment, as the case may be. For purposes of an individual's rights, if any, under the Plan as of the time of the Company's determination, all such determinations by the Company shall be final, binding and conclusive, notwithstanding that the Company or any court of law or governmental agency subsequently makes a contrary determination.

(o) ***Exchange Act*** means the Securities Exchange Act of 1934, as amended.

(p) ***Fair Market Value*** means, as of any date, the value of a share of Stock or other property as determined by the Board, in its discretion, or by the Company, in its discretion, if such determination is expressly allocated to the Company herein, subject to the following:

(i) If, on such date, the Stock is listed on a national or regional securities exchange or market system, the Fair Market Value of a share of Stock shall be the closing price of a share of Stock (or the mean of the closing bid and asked prices of a share of Stock if the Stock is so quoted instead) as quoted on the Nasdaq National Market, The Nasdaq SmallCap Market or such other national or regional securities exchange or

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market system constituting the primary market for the Stock, as reported in The Wall Street Journal or such other source as the Company deems reliable. If the relevant date does not fall on a day on which the Stock has traded on such securities exchange or market system, the date on which the Fair Market Value shall be established shall be the last day on which the Stock was so traded prior to the relevant date, or such other appropriate day as shall be determined by the Board, in its discretion.

(ii) If, on such date, the Stock is not listed on a national or regional securities exchange or market system, the Fair Market Value of a share of Stock shall be as determined by the Board in good faith without regard to any restriction other than a restriction which, by its terms, will never lapse.

(q) ***Incentive Stock Option*** means an Option intended to be (as set forth in the Award Agreement) and which qualifies as an incentive stock option within the meaning of Section 422(b) of the Code.

(r) ***Indexed Option*** means an Option with an exercise price which either increases by a fixed percentage over time or changes by reference to a published index, as determined by the Board and set forth in the Option Agreement.

(s) ***Insider*** means an Officer, a Director of the Company or other person whose transactions in Stock are subject to Section 16 of the Exchange Act.

(t) ***Net-Exercise*** means a procedure by which the Participant will be issued a number of shares of Stock determined in accordance with a formula  $X = Y(A-B) / A$ , where:

X = the number of shares of Stock to be issued to the Participant upon exercise of the Option;

Y = the total number of shares with respect to which the Participant has elected to exercise the Option;

A = the Fair Market Value of one (1) share of Stock;

B = the exercise price per share (as defined in the Participant's Award Agreement).

(u) ***Nonstatutory Stock Option*** means an Option not intended to be (as set forth in the Award Agreement) or which does not qualify as an Incentive Stock Option.

(v) ***Officer*** means any person designated by the Board as an officer of the Company.

(w) ***Option*** means a right to purchase Stock pursuant to the terms and conditions of the Plan. An Option may be either an Incentive Stock Option, a Nonstatutory Stock Option or an Indexed Option.

(x) ***Other Stock-Based Award*** means an Award granted or denominated in Stock or units of Stock pursuant to Section 10.5 of the Plan.

(y) ***Outside Director*** means a Director who is not a current or former management Employee of the Company or of any Parent Corporation or Subsidiary Corporation.

(z) ***Parent Corporation*** means any present or future parent corporation of the Company, as defined in Section 424(e) of the Code.

(aa) ***Participant*** means any eligible person who has been granted one or more Awards.

(bb) ***Participating Company*** means the Company or any Parent Corporation or

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Subsidiary Corporation or Affiliate.

(cc) ***Participating Company Group*** means, at any point in time, all corporations collectively which are then Participating Companies.

(dd) ***Performance-Based Award*** means an Award granted to selected Covered Employees pursuant to Sections 9 and 10, but which are subject to the terms and conditions set forth in Section 11. All Performance-Based Awards are intended to qualify as qualified performance-based compensation under Section 162(m).

(ee) ***Performance Bonus Award*** means the cash award set forth in Section 10.6

(ff) ***Performance Goal*** means the criteria that the Committee uses to establish qualified performance-based compensation under Section 162(m) and the formulas for determining whether such performance targets have been obtained. Such Performance Goals may be based upon one or more Performance Measures, subject to the following: Performance Measures shall have the same meanings as used in the Company's financial statements, or, if such terms are not used in the Company's financial statements, they shall have the meaning applied pursuant to generally accepted accounting principles, or as used generally in the Company's industry. Performance Measures shall be calculated with respect to the Company and each Subsidiary Corporation consolidated therewith for financial reporting purposes or such division or other business unit as may be selected by the Committee. For purposes of the Plan, the Performance Measures applicable to a Performance-Based Award shall be calculated in accordance with U.S. generally accepted accounting principles, but prior to the accrual or payment of any Performance-Based Award for the same Performance Period and excluding the effect (whether positive or negative) of any change in accounting standards or any extraordinary, unusual or nonrecurring item, as determined by the Committee, occurring after the establishment of the Performance Goals applicable to the Performance-Based Award. Performance targets may include a minimum, maximum, target level and intermediate levels of performance, with the final value of a Performance-Based Award determined under the applicable Performance-Based Award formula by the level attained during the applicable Performance Period. A Performance target may be stated as an absolute value or as a value determined relative to a standard selected by the Committee.

(gg) ***Performance Measures*** may be one or more of the following, or a combination of the any of the following, as determined by the Committee: (i) revenue; (ii) gross margin; (iii) operating margin; (iv) operating income; (v) pre-tax profit; (vi) earnings before interest, taxes and depreciation; (vii) net income; (viii) cash flow; (ix) expenses; (x) the market price of the Stock; (xi) earnings per share; (xii) return on stockholder equity; (xiii) return on capital; (xiv) return on net assets; (xv) economic value added; (xvi) number of customers; (xvii) market share; (xviii) return on investment; (xix) profit after tax; (xx) customer satisfaction; (xxi) business divestitures and acquisitions; (xxii) supplier awards from significant customers; (xxiii) new product development and (xxiv) working capital.

(hh) ***Performance Period*** means a period established by the Committee pursuant to Section 11 of the Plan at the end of which one or more Performance Goals are to be measured.

(ii) ***Performance Share*** means a right granted to a Participant pursuant to Section 10.1, to receive Stock, the payment of which is contingent upon achieving certain Performance Goals or other performance based targets established by the Committee.

(jj) ***Performance Unit*** means a bookkeeping entry representing a right granted to a Participant pursuant to Section 10.2 of the Plan to receive a payment equal to the value of a Performance Unit, as determined by the Committee, based upon achieving certain Performance Goals or other performance based targets.

(kk) **Prior Plan Award** means, any option or other award granted pursuant to the Company's 1998 Stock Option Plan, 1996 Outside Directors Stock Option Plan, 1996 Stock Option Plan or 1994 Stock Option Plan which is outstanding on or after the Effective Date.

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(ll) ***Restricted Stock*** means Stock granted to a Participant pursuant to Section 9 of the Plan that is subject to certain conditions (including any applicable Vesting Conditions), and may be subject to risk of forfeiture.

(mm) ***Restricted Stock Unit*** or ***Stock Unit*** means a bookkeeping entry representing a right granted to a Participant pursuant to Section 10.4 of the Plan to receive the value associated with a share of Stock on a date determined in accordance with the provisions of the Plan and the Participant's Award Agreement.

(nn) ***Restriction Period*** means the period established in accordance with Section 9 of the Plan during which shares subject to a Restricted Stock Award are subject to Vesting Conditions.

(oo) ***Rule 16b-3*** means Rule 16b-3 under the Exchange Act, as amended from time to time, or any successor rule or regulation.

(pp) ***SAR*** or ***Stock Appreciation Right*** means a bookkeeping entry representing, for each share of Stock subject to such SAR, a right granted to a Participant pursuant to Section 8 of the Plan to receive payment of an amount equal to the excess, if any, of the Fair Market Value of a share of Stock on the date of exercise of the SAR over the exercise price.

(qq) ***Section 162(m)*** means Section 162(m) of the Code.

(rr) ***Securities Act*** means the Securities Act of 1933, as amended.

(ss) ***Service*** means a Participant's employment or service with the Participating Company Group, whether in the capacity of an Employee, a Director or a Consultant. A Participant's Service shall not be deemed to have terminated merely because of a change in the capacity in which the Participant renders Service to the Participating Company Group or a change in the Participating Company for which the Participant renders such Service, provided that there is no interruption or termination of the Participant's Service. Furthermore, a Participant's Service with the Participating Company Group shall not be deemed to have terminated if the Participant takes any military leave, sick leave, or other bona fide leave of absence approved by the Company; provided, however, that if any such leave exceeds ninety (90) days, on the ninety-first (91st) day of such leave the Participant's Service shall be deemed to have terminated unless the Participant's right to return to Service with the Participating Company Group is guaranteed by statute or contract. Notwithstanding the foregoing, unless otherwise designated by the Company or required by law, a leave of absence shall not be treated as Service for purposes of determining vesting under the Participant's Option Agreement. The Participant's Service shall be deemed to have terminated either upon an actual termination of Service or upon the corporation for which the Participant performs Service ceasing to be a Participating Company. Subject to the foregoing, the Company, in its discretion, shall determine whether the Participant's Service has terminated and the effective date of such termination.

(tt) ***Stock*** means the common stock of the Company, as adjusted from time to time in accordance with Section 4.2.

(uu) ***Subsidiary Corporation*** means any present or future subsidiary corporation of the Company, as defined in Section 424(f) of the Code.

(vv) ***Ten Percent Owner Participant*** means a Participant who, at the time an Option is granted to the Participant, owns stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of a Participating Company (other than an Affiliate) within the meaning of Section 422(b)(6) of the Code.

(ww) ***Vesting Conditions*** mean those conditions established in accordance with the Plan prior to the satisfaction of which shares subject to a Restricted Stock Award or Restricted Stock Unit Award, respectively, remain subject to forfeiture or a repurchase option in favor of the Company upon the Participant's

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termination of Service.

**2.2 Construction.** Captions and titles contained herein are for convenience only and shall not affect the meaning or interpretation of any provision of the Plan. Except when otherwise indicated by the context, the singular shall include the plural and the plural shall include the singular. Use of the term or is not intended to be exclusive, unless the context clearly requires otherwise.

**3. ADMINISTRATION.**

**3.1 Administration by the Board.** The Plan shall be administered by the Board. All questions of interpretation of the Plan or of any Award shall be determined by the Board, and such determinations shall be final and binding upon all persons having an interest in the Plan or such Award.

**3.2 Authority of Officers.** Any Officer shall have the authority to act on behalf of the Company with respect to any matter, right, obligation, determination or election which is the responsibility of or which is allocated to the Company herein, provided the Officer has apparent authority with respect to such matter, right, obligation, determination or election. The Board may, in its discretion, delegate to a committee comprised of one or more Officers the authority to grant one or more Awards, without further approval of the Board or the Committee, to any Employee, other than a person who, at the time of such grant, is an Insider; provided, however, that (a) such Awards shall not be granted for shares in excess of the maximum aggregate number of shares of Stock authorized for issuance pursuant to Section 4.1, (b) the exercise price per share of each Option shall be not less than the Fair Market Value per share of the Stock on the effective date of grant (or, if the Stock has not traded on such date, on the last day preceding the effective date of grant on which the Stock was traded), and (iii) each such Award shall be subject to the terms and conditions of the appropriate standard form of Award Agreement approved by the Board or the Committee and shall conform to the provisions of the Plan and such other guidelines as shall be established from time to time by the Board or the Committee.

**3.3 Powers of the Board.** In addition to any other powers set forth in the Plan and subject to the provisions of the Plan, the Board shall have the full and final power and authority, in its discretion:

- (a) to determine the persons to whom, and the time or times at which, Awards shall be granted and the number of shares of Stock or units to be subject to each Award;
- (b) to designate Options as Incentive Stock Options, Nonstatutory Stock Options or Indexed Options;
- (c) to determine the type(s) of Other Stock-Based Awards, and their terms and conditions that may be granted under the Plan;
- (d) to determine the Fair Market Value of shares of Stock or other property;
- (e) to determine the terms, conditions and restrictions applicable to each Award (which need not be identical) and any shares acquired upon the exercise thereof, including, without limitation, (i) the exercise or purchase price of shares purchased pursuant to any Award, (ii) the method of payment for shares purchased pursuant to any Award, (iii) the method for satisfaction of any tax withholding obligation arising in connection with the Award, including by the withholding or delivery of shares of Stock, (iv) the timing, terms and conditions of the exercisability of the Award or the vesting of any Award of any shares acquired pursuant thereto, (v) the Performance Goals applicable to any Award and the extent to which such Performance Goals have been attained, (vi) the time of the expiration of any Award, (vii) the effect of the Participant's termination of Service with the Participating Company Group on any of the foregoing, and (viii) all other terms, conditions and restrictions applicable to any Award or shares acquired pursuant

thereto not inconsistent with the terms of the Plan;

(f) to determine whether an Award will be settled in shares of Stock, cash, or in any combination thereof;

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(g) to approve one or more forms of Award Agreement;

(h) to amend, modify, extend, cancel or renew any Award or to waive any restrictions or conditions applicable to any Award or any shares acquired pursuant thereto;

(i) to accelerate, continue, extend or defer the exercisability of any Award or any shares acquired pursuant thereto, including with respect to the period following a Participant's termination of Service with the Participating Company Group;

(j) to prescribe, amend or rescind rules, guidelines and policies relating to the Plan, or to adopt sub-plans or supplements to, or alternative versions of, the Plan, including, without limitation, as the Board deems necessary or desirable to comply with the laws or regulations of, or to accommodate the tax policy, financial accounting or custom of, foreign jurisdictions whose citizens may be granted Awards;

(k) to authorize, in conjunction with any applicable Company deferred compensation plan, that the receipt of cash or Stock subject to any Award under this Plan, may be deferred under the terms and conditions of such Company deferred compensation plan; and

(l) to correct any defect, supply any omission or reconcile any inconsistency in the Plan or any Award Agreement and to make all other determinations and take such other actions with respect to the Plan or any Award as the Board may deem advisable to the extent not inconsistent with the provisions of the Plan or applicable law.

**3.4 Administration with Respect to Insiders.** With respect to participation by Insiders in the Plan, at any time that any class of equity security of the Company is registered pursuant to Section 12 of the Exchange Act, the Plan shall be administered in compliance with the requirements, if any, of Rule 16b-3.

**3.5 Committee Complying with Section 162(m).** If the Company is a publicly held corporation within the meaning of Section 162(m), the Board may establish a Committee of outside directors within the meaning of Section 162(m) to approve the grant of any Option which might reasonably be anticipated to result in the payment of employee remuneration that would otherwise exceed the limit on employee remuneration deductible for income tax purposes pursuant to Section 162(m).

**3.6 No Repricing.** Without the affirmative vote of holders of a majority of the shares of Stock cast in person or by proxy at a meeting of the stockholders of the Company at which a quorum representing a majority of all outstanding shares of Stock is present or represented by proxy, the Board shall not approve a program providing for either (a) the cancellation of outstanding Options and/or SARs and the grant in substitution therefore of any new Awards, including specifically any new Options and/or SARs having a lower exercise price or (b) the amendment of outstanding Options and/or SARs to reduce the exercise price thereof. This paragraph shall not be construed to apply to issuing or assuming a stock option in a transaction to which section 424(a) applies, within the meaning of Section 424 of the Code.

**3.7 No Restricted Stock Award Acceleration.** Notwithstanding any provision of the Plan to the contrary, no Restricted Stock Award may be granted which provides, or subsequently amended to provide, for (i) any acceleration of vesting for any reason other than upon a Change in Control or after the Participant's death or Disability and (ii) vesting of one hundred percent (100%) of any such Restricted Stock Award prior to the passage of three (3) years of Service (unless such Restricted Stock Award will vest in accordance with the satisfaction of any Performance Goal).

**3.8 Indemnification.** In addition to such other rights of indemnification as they may have as members of the Board or officers or employees of the Participating Company Group, members of the Board and any officers or employees of the Participating Company Group to whom authority to act for the Board or the Company is delegated shall be indemnified by the Company against all reasonable expenses, including attorneys' fees, actually and necessarily incurred in connection with the defense of any action, suit or proceeding, or in connection with any appeal therein, to which they or any of them may be a party by reason of any action taken or failure to act under or in

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connection with the Plan, or any right granted hereunder, and against all amounts paid by them in settlement thereof (provided such settlement is approved by independent legal counsel selected by the Company) or paid by them in satisfaction of a judgment in any such action, suit or proceeding, except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that such person is liable for gross negligence, bad faith or intentional misconduct in duties; provided, however, that within sixty (60) days after the institution of such action, suit or proceeding, such person shall offer to the Company, in writing, the opportunity at its own expense to handle and defend the same.

**4. SHARES SUBJECT TO PLAN.**

**4.1 Maximum Number of Shares Issuable.** Subject to adjustment as provided in Section 4.2, the maximum aggregate number of shares of Stock that may be issued under the Plan shall be Three-Million Nine-Hundred and Forty-Seven Thousand Seven-Hundred and Twenty-Nine (3,947,729). This share reserve shall consist of authorized but unissued or reacquired shares of Stock or any combination thereof. However, the share reserve, determined at any time, shall be reduced by the number of shares subject to the Prior Plan Awards (which as of March 11, 2005 equaled 3,161,204). If any outstanding Award, including any Prior Plan Award, for any reason expires or is terminated or canceled without having been exercised or settled in full, or if shares of Stock acquired pursuant to an Award subject to forfeiture or repurchase, including any Prior Plan Award, are forfeited or repurchased by the Company, the shares of Stock allocable to the terminated portion of such Award, including any Prior Plan Award, or such forfeited or repurchased shares of Stock shall again be available for grant under the Plan. Shares of Stock shall not be deemed to have been granted pursuant to the Plan (a) with respect to any portion of an Award that is settled in cash or (b) to the extent such shares are withheld in satisfaction of tax withholding obligations pursuant to Section 16. Upon payment in shares of Stock pursuant to the exercise of a SAR, the number of shares available for grant under the Plan shall be reduced only by the number of shares actually issued in such payment. If the exercise price of an Option is paid by tender to the Company, or attestation to the ownership, of shares of Stock owned by the Participant, the number of shares available for grant under the Plan shall be reduced by the net number of shares for which the Option is exercised.

**4.2 Adjustments for Changes in Capital Structure.** In the event of any stock dividend, stock split, reverse stock split, recapitalization, combination, reclassification or similar change in the capital structure of the Company, appropriate adjustments shall be made in the number and class of shares subject to the Plan and to any outstanding Awards, in the Section 162(m) Grant Limit set forth in Section 5.4 and in the exercise price or purchaser price of any outstanding Awards. If a majority of the shares which are of the same class as the shares that are subject to outstanding Awards are exchanged for, converted into, or otherwise become (whether or not pursuant to an Ownership Change Event, as defined in Section 13.1) shares of another corporation (the *New Shares*), the Board may unilaterally amend the outstanding Awards to provide that such Awards are accurately reflected for New Shares. In the event of any such amendment, the number of shares subject to, and the exercise price and/or purchase price per share of, the outstanding Awards (if any) shall be adjusted in a fair and equitable manner as determined by the Board, in its discretion. Notwithstanding the foregoing, any fractional share resulting from an adjustment pursuant to this Section 4.2 shall be rounded down to the nearest whole number, and in no event may the exercise price and/or purchase price of any Award be decreased to an amount less than the par value, if any, of the stock subject to the Award. The adjustments determined by the Board pursuant to this Section 4.2 shall be final, binding and conclusive.

**5. ELIGIBILITY AND AWARD LIMITATIONS.**

**5.1 Persons Eligible for Awards.** Awards may be granted only to Employees, Consultants, and Directors. For purposes of the foregoing sentence, Employees, Consultants and Directors shall include prospective Employees, prospective Consultants and prospective Directors to whom Awards are granted in connection with written offers of an employment or other service relationship with the Participating Company Group; provided, however, that no Stock

subject to any such Award shall vest, become exercisable or be issued prior to the date on which such person commences Service.

**5.2 Participation.** Awards are granted solely at the discretion of the Board. Eligible persons may be granted more than one (1) Award. However, eligibility in accordance with this Section shall not

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entitle any person to be granted an Award, or, having been granted an Award, to be granted an additional Award.

**5.3 Incentive Stock Option Limitations.**

(a) **Persons Eligible.** An Incentive Stock Option may be granted only to a person who, on the effective date of grant, is an Employee of the Company, a Parent Corporation or a Subsidiary Corporation (each being an **ISO-Qualifying Corporation** ). Any person who is not an Employee of an ISO-Qualifying Corporation on the effective date of the grant of an Option to such person may be granted only a Nonstatutory Stock Option. An Incentive Stock Option granted to a prospective Employee upon the condition that such person become an Employee of an ISO-Qualifying Corporation shall be deemed granted effective on the date such person commences Service with an ISO-Qualifying Corporation, with an exercise price determined as of such date in accordance with Section 6.1.

(b) **Fair Market Value Limitation.** To the extent that options designated as Incentive Stock Options (granted under all stock option plans of the Participating Company Group, including the Plan) become exercisable by a Participant for the first time during any calendar year for stock having a Fair Market Value greater than One Hundred Thousand dollars (\$100,000), the portion of such options which exceeds such amount shall be treated as Nonstatutory Stock Options. For purposes of this Section, options designated as Incentive Stock Options shall be taken into account in the order in which they were granted, and the Fair Market Value of stock shall be determined as of the time the option with respect to such stock is granted. If the Code is amended to provide for a different limitation from that set forth in this Section, such different limitation shall be deemed incorporated herein effective as of the date and with respect to such Options as required or permitted by such amendment to the Code. If an Option is treated as an Incentive Stock Option in part and as a Nonstatutory Stock Option in part by reason of the limitation set forth in this Section, the Participant may designate which portion of such Option the Participant is exercising. In the absence of such designation, the Participant shall be deemed to have exercised the Incentive Stock Option portion of the Option first. Upon exercise, shares issued pursuant to each such portion shall be separately identified.

**5.4 Award Limits.**

(a) **Aggregate Limit on Restricted Stock, Performance Shares and Performance Units.** Subject to adjustment as provided in Section 4.2, in no event shall more than Five Hundred Thousand (500,000) shares of Stock in the aggregate be issued under the Plan pursuant to the exercise or settlement of Restricted Stock, Restricted Stock Units, Performance Shares and Performance Units.

(b) **Section 162(m) Award Limits.** The following limits shall apply to the grant of any Award if, at the time of grant, the Company is a publicly held corporation within the meaning of Section 162(m).

(i) **Options and SARs.** Subject to adjustment as provided in Section 4.2, no Employee shall be granted within any fiscal year of the Company one or more Options or Freestanding SARs which in the aggregate are for more than Five Hundred Thousand (500,000) shares of Stock, provided, however, that the Company may make an additional one-time grant to any newly-hired Employee of an Option and/or SAR for the purchase of up to an additional Two Hundred and Fifty Thousand (250,000) shares of Stock. An Option which is canceled (or a Freestanding SAR as to which the exercise price is reduced to reflect a reduction in the Fair Market Value of the Stock) in the same fiscal year of the Company in which it was granted shall continue to be counted against such limit for such fiscal year.

(ii) **Restricted Stock and Restricted Stock Units.** Subject to adjustment as provided in Section 4.2, no Employee shall be granted within any fiscal year of the Company one or more Restricted Stock Awards or Restricted Stock Units, subject to Vesting Conditions based on the attainment of Performance Goals, for more than Two Hundred Thousand (200,000) shares of Stock, provided, however, that the Company may make an additional one-time

grant to any newly-hired Employee of a Restricted Stock Award or Restricted Stock Units of up to an additional One Hundred Thousand (100,000) shares of Stock.

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(iii) **Performance Shares and Performance Units.** Subject to adjustment as provided in Section 4.2, no Employee shall be granted (A) Performance Shares which could result in such Employee receiving more than One Hundred Thousand (100,000) shares of Stock for each full fiscal year of the Company contained in the Performance Period for such Award, or (B) Performance Units which could result in such Employee receiving more than \$1,000,000 for each full fiscal year of the Company contained in the Performance Period for such Award. No Participant may be granted more than one Performance Share or Performance Unit for the same Performance Period.

(iv) **Performance Bonus Awards.** No Employee shall be paid a Performance Bonus Award pursuant to Section 10.6 which is greater than \$1,000,000 for each full fiscal year of the Company contained in the Performance Period for such award.

**6. TERMS AND CONDITIONS OF OPTIONS.**

Options shall be evidenced by Award Agreements specifying the number of shares of Stock covered thereby, in such form as the Board shall from time to time establish. No Option or purported Option shall be a valid and binding obligation of the Company unless evidenced by a fully executed Award Agreement. Award Agreements evidencing Options may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

**6.1 Exercise Price.** The exercise price for each Option shall be established in the discretion of the Board; provided, however, that (a) the exercise price per share for an Option shall be not less than the Fair Market Value of a share of Stock on the effective date of grant of the Option, (b) no Incentive Stock Option granted to a Ten Percent Owner Participant shall have an exercise price per share less than one hundred ten percent (110%) of the Fair Market Value of a share of Stock on the effective date of grant of the Option, and (c) notwithstanding anything to the contrary in this Section 6.1, in the case of an Indexed Option, the Board shall determine the exercise price of such Indexed Option and the terms and conditions that affect, if any, any adjustments to the exercise price of such Indexed Option. Notwithstanding the foregoing, an Option may be granted with an exercise price lower than the minimum exercise price set forth above if such Option is granted pursuant to an assumption or substitution for another option in a manner qualifying under the provisions of Section 424(a) of the Code.

**6.2 Exercisability and Term of Options.** Options shall be exercisable at such time or times, or upon such event or events, and subject to such terms, conditions, performance criteria and restrictions as shall be determined by the Board and set forth in the Award Agreement evidencing such Option; provided, however, that (a) no Option shall be exercisable after the expiration of ten (10) years after the effective date of grant of such Option, (b) no Incentive Stock Option granted to a Ten Percent Owner shall be exercisable after the expiration of five (5) years after the effective date of grant of such Option, and (c) no Option granted to a prospective Employee, prospective Consultant or prospective Director may become exercisable prior to the date on which such person commences Service with a Participating Company. Subject to the foregoing, unless otherwise specified by the Board in the grant of an Option, any Option granted hereunder shall terminate ten (10) years after the effective date of grant of the Option, unless earlier terminated in accordance with its provisions.

**6.3 Payment of Exercise Price.**

(a) **Forms of Consideration Authorized.** Except as otherwise provided below, payment of the exercise price for the number of shares of Stock being purchased pursuant to any Option shall be made (i) in cash, by check or cash equivalent, (ii) by tender to the Company, or attestation to the ownership, of shares of Stock owned by the Participant having a Fair Market Value not less than the exercise price, (iii) by delivery of a properly executed notice of exercise together with irrevocable instructions to a broker providing for the assignment to the Company of the proceeds of a sale or loan with respect to some or all of the shares being acquired upon the exercise of the Option (including,

without limitation, through an exercise complying with the provisions of Regulation T as promulgated from time to time by the Board of Governors of the Federal Reserve System) (a *Cashless Exercise* ), (iv) by delivery of a properly executed notice of exercise electing a Net-Exercise, (v) by such other consideration as may be approved by the Board from time to time to the extent permitted by applicable law, or

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(vi) by any combination thereof. The Board may at any time or from time to time, by approval of or by amendment to the standard forms of Award Agreement described in Section 12, or by other means, grant Options which do not permit all of the foregoing forms of consideration to be used in payment of the exercise price or which otherwise restrict one or more forms of consideration.

***(b) Limitations on Forms of Consideration.***

(i) **Tender of Stock.** Notwithstanding the foregoing, an Option may not be exercised by tender to the Company, or attestation to the ownership, of shares of Stock to the extent such tender or attestation would constitute a violation of the provisions of any law, regulation or agreement restricting the redemption of the Company's stock. Unless otherwise provided by the Board, an Option may not be exercised by tender to the Company, or attestation to the ownership, of shares of Stock unless such shares either have been owned by the Participant for more than six (6) months (and not used for another Option exercise by attestation during such period) or were not acquired, directly or indirectly, from the Company.

(ii) **Cashless Exercise.** The Company reserves, at any and all times, the right, in the Company's sole and absolute discretion, to establish, decline to approve or terminate any program or procedures for the exercise of Options by means of a Cashless Exercise, including with respect to one or more Participants specified by the Company notwithstanding that such program or procedures may be available to other Participants.

(iii) **Net-Exercise.** The Company reserves, at any and all times, the right, in the Company's sole and absolute discretion, to grant Incentive Stock Options, or to grant, or amend, any Nonstatutory Options to provide that such Options may be exercised by the means of a Net-Exercise, including with respect to one or more Participants specified by the Company notwithstanding that such program or procedures may be available to other Participants. No Option will be granted (or amended in the case of a Nonstatutory Stock Option) to permit a Net-Exercise prior to the effectiveness of the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123R.

**6.4 Effect of Termination of Service.** An Option shall be exercisable after a Participant's termination of Service to such extent and during such period as determined by the Board, in its discretion, and set forth in the Award Agreement evidencing such Option.

**6.5 Transferability of Options.** During the lifetime of the Participant, an Option shall be exercisable only by the Participant or the Participant's guardian or legal representative. Prior to the issuance of shares of Stock upon the exercise of an Option, the Option shall not be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance, or garnishment by creditors of the Participant or the Participant's beneficiary, except transfer by will or by the laws of descent and distribution. Notwithstanding the foregoing, to the extent permitted by the Board, in its discretion, and set forth in the Award Agreement evidencing such Option, a Nonstatutory Stock Option shall be assignable or transferable subject to the applicable limitations, if any, described in the General Instructions to Form S-8 Registration Statement under the Securities Act. Notwithstanding any of the foregoing, the Board may permit further transferability of any Option, on a general or specific basis, and may impose conditions and limitations on any permitted transferability.

**7. TERMS AND CONDITIONS OF OUTSIDE DIRECTOR OPTIONS.**

Outside Director Options shall be evidenced by Award Agreements specifying the number of shares of Stock covered thereby, in such form as the Board shall from time to time establish. Outside Director Award Agreements may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the terms and conditions of Section 6 to the extent not inconsistent with this Section and the following terms and conditions:

7.1 **Automatic Grant.** Subject to the execution by an Outside Director of an appropriate Award Agreement, Options shall be granted automatically and without further action of the Board, as follows:

(a) **Initial Option.** Each person who first becomes an Outside Director after the

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Effective Date shall be granted on the date such person first becomes an Outside Director an Option to purchase Twenty Thousand (20,000) shares of Stock (an ***Initial Option*** ).

(b) ***Annual Option***. Each Outside Director shall be granted on the first anniversary of the grant of the Initial Option and each successive anniversary, an Option to purchase Five Thousand (5,000) shares of Stock (an ***Annual Option*** ).

(c) ***Right to Decline Outside Director Option***. Notwithstanding the foregoing, any person may elect not to receive an Outside Director Option by delivering written notice of such election to the Board no later than the day prior to the date such Option would otherwise be granted. A person so declining an Outside Director Option shall receive no payment or other consideration in lieu of such declined Outside Director Option. A person who has declined an Outside Director Option may revoke such election by delivering written notice of such revocation to the Board no later than the day prior to the date such Outside Director Option would be granted pursuant to Section 7.1(a) or (b), as the case may be.

**7.2 Exercisability and Term of Outside Director Options**. Each Outside Director Option shall vest and become exercisable as set forth below and shall terminate and cease to be exercisable on the tenth (10th) anniversary of the date of grant of the Outside Direct Option, unless earlier terminated in accordance with the terms of the Plan or the Award Agreement evidencing such Outside Director Option.

(a) ***Initial Options***. Except as otherwise provided in the Plan or in the Award Agreement evidencing such Outside Director Option, each Initial Option shall vest and become exercisable in four (4) substantially equal installments on each of the first four (4) anniversaries of the date of grant of the Initial Option, provided that the Outside Director's Service has not terminated prior to the relevant date.

(b) ***Annual Options***. Except as otherwise provided in the Plan or in the Award Agreement evidencing such Outside Director Option, each Annual Option shall vest and become exercisable in two (2) substantially equal installments on each of the first two (2) anniversaries of the date of grant of the Annual Option, provided that the Outside Director's Service has not terminated prior to the relevant date.

**7.3 Effect of Change in Control on Outside Director Options**. In the event of a Change in Control, as defined in Section 13.1, any unexercisable or unvested portions of outstanding Outside Director Options and any shares acquired upon the exercise thereof held by Outside Directors whose Service has not terminated prior to such date shall be immediately exercisable and vested in full as of the date ten (10) days prior to the date of the Change in Control. The exercise or vesting of any Outside Director Option and any shares acquired upon the exercise thereof that was permissible solely by reason of this Section 7.3 shall be conditioned upon the consummation of the Change in Control. In addition, the surviving, continuing, successor, or purchasing corporation or parent corporation thereof, as the case may be (the ***Acquiring Corporation*** ), may either assume the Company's rights and obligations under outstanding Outside Director Options or substitute for outstanding Options substantially equivalent options for the Acquiring Corporation's stock. Any Outside Director Options which are neither assumed or substituted for by the Acquiring Corporation in connection with the Change in Control nor exercised as of the date of the Change in Control shall terminate and cease to be outstanding effective as of the date of the Change in Control. Notwithstanding the foregoing, if the corporation the stock of which is subject to the outstanding Outside Director Options immediately prior to an Ownership Change Event described in Section 13.1(a)(i) constituting a Change in Control is the surviving or continuing corporation and immediately after such Ownership Change Event less than fifty percent (50%) of the total combined voting power of its voting stock is held by another corporation or by other corporations that are members of an affiliated group within the meaning of Section 1504(a) of the Code without regard to the provisions of Section 1504(b) of the Code, the outstanding Outside Director Options shall not terminate.

8. **TERMS AND CONDITIONS OF STOCK APPRECIATION RIGHTS.**

Stock Appreciation Rights shall be evidenced by Award Agreements specifying the number of shares of Stock subject to the Award, in such form as the Board shall from time to time establish. No SAR or purported SAR shall be a valid and binding obligation of the Company unless evidenced by a fully executed Award

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Agreement. Award Agreements evidencing SARs may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

**8.1 Types of SARs Authorized.** SARs may be granted in tandem with all or any portion of a related Option (a *Tandem SAR* ) or may be granted independently of any Option (a *Freestanding SAR* ). A Tandem SAR may be granted either concurrently with the grant of the related Option or at any time thereafter prior to the complete exercise, termination, expiration or cancellation of such related Option.

**8.2 Exercise Price and Other Terms.** The Board, subject to the provisions of the Plan, will have complete discretion to determine the terms and conditions of each SAR granted under the Plan; provided, however, that (a) the exercise price per share subject to a Tandem SAR shall be the exercise price per share under the related Option and (b) the exercise price per share subject to a Freestanding SAR shall be not less than the Fair Market Value of a share of Stock on the effective date of grant of the SAR.

**8.3 Exercise of SARs.** SARs will be exercisable on such terms and conditions as the Board, in its sole and absolute discretion, will determine.

**8.4 Award Agreement.** Each SAR grant will be evidenced by an Award Agreement that will specify the exercise price, the term of the SAR, the conditions of exercise, and such other terms and conditions as the Board, in its sole discretion, will determine.

**8.5 Expiration of SARs.** Each SAR grant under the Plan will expire upon the date determined by the Board, in its sole discretion, and set forth in the Award Agreement. Notwithstanding the foregoing, the requirements of Sections 6.2, 6.3, 6.4 and 6.5 also will apply to SARs to the extent not replaced or superseded by the terms of any Award Agreement.

**9. TERMS AND CONDITIONS OF RESTRICTED STOCK AWARDS.**

Restricted Stock Awards shall be evidenced by Award Agreements specifying the number of shares of Stock subject to the Award, in such form as the Board shall from time to time establish. No Restricted Stock Award or purported Restricted Stock Award shall be a valid and binding obligation of the Company unless evidenced by a fully executed Award Agreement. Award Agreements evidencing Restricted Stock Awards may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

**9.1 Grant of Restricted Stock.** The Board is authorized to make Awards of Restricted Stock to any Participant selected by the Board in such amounts and subject to such terms and conditions as determined by the Board.

**9.2 Issuance and Restrictions.** Restricted Stock Awards will be subject to such restrictions on transferability and other restrictions as the Board may impose (including, without limitation, limitations on the right to vote shares of Stock or the right to receive dividends on the Stock). These restrictions may lapse separately or in combination at such times, pursuant to such circumstances, in such installments, or otherwise, as the Board determines at the time of the grant of the Award or thereafter. The minimum period for such restrictions shall be a period of three (3) years. Notwithstanding the foregoing however, Restricted Stock Awards may become one hundred percent (100%) vested earlier than after the passage of three (3) years upon (i) the occurrence of a Change in Control, as provided in any applicable Award Agreement, or (ii) achievement of such the Awards applicable Performance Goals.

**9.3 Forfeiture.** Except as otherwise determined by the Board at the time of grant of the Award or thereafter, upon termination of Service during the applicable Restriction Period, Restricted Stock that is at that time subject to restrictions will be forfeited; provided, however, that the Board may (a) provide in any Restricted Stock Award

Agreement that restrictions or forfeiture conditions will be waived in whole or in part in the event of terminations resulting from specified causes, and (b) in other cases waive in whole or in part restrictions or forfeiture conditions.

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**9.4 Voting Rights; Dividends and Distributions.** Except as may be provided in any Award Agreement, during the Restriction Period applicable to shares subject to a Restricted Stock Award, the Participant shall have all of the rights of a stockholder of the Company holding shares of Stock, including the right to vote such shares and to receive all dividends and other distributions paid with respect to such shares. However, in the event of a dividend or distribution paid in shares of Stock or any other adjustment made upon a change in the capital structure of the Company as described in Section 4.2, then any and all new, substituted or additional securities or other property (other than normal cash dividends) to which the Participant is entitled by reason of the Participant's Restricted Stock Award shall be immediately subject to the same Vesting Conditions as the shares subject to the Restricted Stock Award with respect to which such dividends or distributions were paid or adjustments were made.

**10. TERMS AND CONDITIONS OF OTHER TYPES OF AWARDS.**

Other types of Awards, such as Performance Shares, Performance Units, Deferred Stock, Restricted Stock Units, Other Stock-Based Awards and Performance Bonus Awards (collectively *Other Types of Award*) shall be evidenced by Award Agreements specifying the type of Award and the number of shares of Stock subject to the Award, in such form as the Board shall from time to time establish. No Other Type of Award or purported Award shall be a valid and binding obligation of the Company unless evidenced by a fully executed Award Agreement. Award Agreements evidencing any Other Type of Award may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

**10.1 Performance Shares.** Any Participant selected by the Committee may be granted one or more Performance Share awards which will be denominated in a number of shares of Stock and which may be linked to any one or more of the Performance Goals or other specific performance criteria determined appropriate by the Committee, in each case on a specified date or dates or over any period or periods determined by the Committee. In making such determinations, the Committee will consider (among other such factors as it deems relevant in light of the specific type of Award) the contributions, responsibilities and other compensation of the particular Participant.

**10.2 Performance Units.** Any Participant selected by the Committee may be granted one or more Performance Unit awards which will be denominated in units of value, which, without limitation, may include the dollar value of shares of Stock, and which may be linked to any one or more of the Performance Goals or other specific performance criteria determined appropriate by the Committee, in each case on a specified date or dates or over any period or periods determined by the Committee. In making such determinations, the Committee will consider (among other such factors as it deems relevant in light of the specific type of Award) the contributions, responsibilities and other compensation of the particular Participant.

**10.3 Deferred Stock.** Any Participant selected by the Board may be granted an award of Deferred Stock in the manner determined from time to time by the Board. The number of shares of Deferred Stock will be determined by the Board and may be linked to the Performance Goals or other specific performance criteria determined to be appropriate by the Board, in each case on a specified date or dates or over any period or periods determined by the Board. Stock underlying a Deferred Stock award will not be issued until the Deferred Stock award has vested, pursuant to a vesting schedule or performance criteria set by the Committee, or upon such settlement date as may be elected by the Participant. Unless otherwise provided by the Board, a Participant awarded Deferred Stock will have no rights as a Company stockholder with respect to such Deferred Stock until such time as the Award has vested and the Stock underlying such Award has been issued. In addition, Deferred Stock may be granted automatically with respect to such number of shares of Stock and upon such other terms and conditions as established by the Board in lieu of:

(a) cash or shares of Stock otherwise issuable to such Participant upon the exercise or settlement of a Restricted Stock Award or Performance Award; or

(b) any cash to be otherwise paid to the Participant in the form of salary, bonus, commissions, or such other compensation program maintained by the Company.

10.4 **Restricted Stock Units.** The Board is authorized to make Awards of Restricted Stock

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Units to any Participant selected by the Board in such amounts and subject to such terms and conditions as determined by the Board. The number of Restricted Stock Units will be determined by the Board and may be linked to the Performance Goals or other specific performance criteria determined to be appropriate by the Board, in each case on a specified date or dates or over any period or periods determined by the Board. At the time of grant, the Board will specify the date or dates on which the Restricted Stock Units will become fully vested and nonforfeitable, and may specify such conditions to vesting as it deems appropriate. At the time of grant, the Board will specify the settlement date applicable to each grant of Restricted Stock Units which will be no earlier than the vesting date or dates of the Award and may be determined at the election of the Participant. On the settlement date, the Company will transfer to the Participant either (i) one unrestricted, fully transferable share of Stock or (ii) cash equal to the value of one such share of Stock for each Restricted Stock Unit scheduled to be paid out on such date and which was not previously forfeited. The Board will specify the purchase price, if any, to be paid by the Participant to the Company for such shares of Stock.

**10.5 Other Stock-Based Awards.** Any Participant selected by the Board may be granted one or more awards that provide Participants with shares of Stock or the right to purchase shares of Stock or that have a value derived from the value of, or an exercise or conversion privilege at a price related to, or that are otherwise payable in shares of Stock and which may be linked to any one or more of the Performance Goals or other specific performance criteria determined appropriate by the Board, in each case on a specified date or dates or over any period or periods determined by the Board. In making such determinations, the Board will consider (among such other factors as it deems relevant in light of the specific type of award) the contributions, responsibilities and other compensation to the particular Participant.

**10.6 Performance Bonus Awards.** Any Participant selected by the Committee may be granted one or more Performance-Based Award in the form of a cash bonus payable upon the attainment of Performance Goals that are established by the Committee, in each case on a specified date or dates or over any period or periods determined by the Committee. Any such Performance Bonus Award paid to a Covered Employee will be based upon objectively determinable bonus formulas established in accordance with Section 11.

**10.7 Term of Other Type Awards.** Except as otherwise provided herein, the term of any Other Type Award will be set by the Board in its sole and absolute discretion and set forth in any applicable Award Agreement.

**10.8 Exercise or Purchase Price.** The Board may establish the exercise or purchase price, if any, of any Other Type Award; provided, however, that such price will not be less than the par value of a share of Stock on the date of grant, unless otherwise permitted by applicable law.

**10.9 Exercise Upon Termination of Service.** Any Other Type of Award will only be exercisable or payable while the Participant is an Employee, Consultant or Director, as applicable; provided, however, that the Board in its sole and absolute discretion may provide that any Other Type of Award may be exercised or paid subsequent to a termination of Service, as applicable, or following a Change in Control, or because of the Participant's retirement, death or disability, or otherwise; provided, however, that any such provision with respect to Performance Shares, Performance Units or Performance Bonus Awards will be subject to the requirements of Section 162(m) that apply to such award and/or compensation.

**10.10 Form of Payment.** Payments with respect to any Other Type of Award will be made in cash, in Stock or a combination of both, as determined by the Board and as set forth in any applicable Award Agreement.

**10.11 Award Agreement.** All Other Types of Awards will be subject to such additional terms and conditions as determined by the Board and will be evidenced by a written Award Agreement.

**10.12 Voting Rights; Dividend Equivalent Rights and Distributions.** Participants shall have no voting rights with respect to shares of Stock represented by any Other Type of Award until the date of the issuance of such shares, if any (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company). However, the Board, in its discretion, may provide in the Award

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Agreement evidencing any Other Type of Award that the Participant shall be entitled to receive Dividend Equivalents with respect to the payment of cash dividends on Stock having a record date prior to the date on which such shares of Stock underlying any such award are settled or forfeited. Such Dividend Equivalents, if any, shall be credited to the Participant in the form of additional whole shares of Stock, or such cash equivalent, depending on the type of award, as of the date of payment of such cash dividends on Stock. The number of additional shares of Stock (rounded to the nearest whole number) to be so credited shall be determined by dividing (a) the amount of cash dividends paid on such date with respect to the number of shares of Stock represented by the shares of Stock underlying such award previously credited to the Participant by (b) the Fair Market Value per share of Stock on such date. Dividend Equivalents may be paid currently or may be accumulated and paid to the extent that such award becomes nonforfeitable, as determined by the Board. Settlement of Dividend Equivalents may be made in cash, shares of Stock, or a combination thereof as determined by the Board, and may be paid on the same basis as settlement of the related award. In the event of a dividend or distribution paid in shares of Stock or any other adjustment made upon a change in the capital structure of the Company as described in Section 4.2, appropriate adjustments shall be made in the Participant's Other Type of Awards so that it represents the right to receive upon settlement any and all new, substituted or additional securities or other property (other than normal cash dividends) to which the Participant would be entitled by reason of the shares of Stock issuable upon settlement of the award, and all such new, substituted or additional securities or other property shall be immediately subject to the same Performance Goals as are applicable to the Award.

**10.13 Nontransferability of Awards.** Prior to settlement or payment of any Other Type of Award in accordance with the provisions of the Plan, no such award shall be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance, or garnishment by creditors of the Participant or the Participant's beneficiary, except transfer by will or by the laws of descent and distribution. All rights with respect to such award granted to a Participant hereunder shall be exercisable during his or her lifetime only by such Participant or the Participant's guardian or legal representative.

## **11. TERMS AND CONDITIONS OF ANY PERFORMANCE-BASED AWARD.**

**11.1 Purpose.** The purpose of this Section 11 is to provide the Committee the ability to qualify Awards (other than Options and SARs) that are granted pursuant to Sections 9 and 10 as qualified performance-based compensation under Section 162(m). If the Committee, in its discretion, decides to grant a Performance-Based Award subject to Performance Goals to a Covered Employee, the provisions of this Section 11 will control over any contrary provision in the Plan; provided, however, that the Committee may in its discretion grant Awards to such Covered Employees that are based on Performance Goals or other specific criteria or goals but that do not satisfy the requirements of this Section 11.

**11.2 Applicability.** This Section 11 will apply to those Covered Employees which are selected by the Committee to receive any Award subject to Performance Goals. The designation of a Covered Employee as being subject to Section 162(m) will not in any manner entitle the Covered Employee to receive an Award under the Plan. Moreover, designation of a Covered Employee subject to Section 162(m) for a particular Performance Period will not require designation of such Covered Employee in any subsequent Performance Period and designation of one Covered Employee will not require designation of any other Covered Employee in such period or in any other period.

**11.3 Procedures with Respect to Performance Based Awards.** To the extent necessary to comply with the performance-based compensation of Section 162(m), with respect to any Award granted subject to Performance Goals, no later than ninety (90) days following the commencement of any fiscal year in question or any other designated fiscal period or period of service (or such other time as may be required or permitted by Section 162(m)), the Committee will, in writing, (a) designate one or more Participants who are Covered Employees, (b) select the Performance Goals applicable to the Performance Period, (c) establish the Performance Goals, and amounts of such

Awards, as applicable, which may be earned for such Performance Period, and (d) specify the relationship between Performance Goals and the amounts of such Awards, as applicable, to be earned by each Covered Employee for such Performance Period. Following the completion of each Performance Period, the Committee will certify in writing whether the applicable Performance Goals have been achieved for such Performance Period. In determining the amounts earned by a Covered Employee, the Committee will have the right

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to reduce or eliminate (but not to increase) the amount payable at a given level of performance to take into account additional factors that the Committee may deem relevant to the assessment of individual or corporate performance for the Performance Period.

**11.4 Payment of Performance Based Awards.** Unless otherwise provided in the applicable Award Agreement, a Covered Employee must be employed by the Participating Company Group on the day a Performance-Based Award for such Performance Period is paid to the Covered Employee. Furthermore, a Covered Employee will be eligible to receive payment pursuant to a Performance-Based Award for a Performance Period only if the Performance Goals for such period are achieved.

**11.5 Additional Limitations.** Notwithstanding any other provision of the Plan, any Award which is granted to a Covered Employee and is intended to constitute qualified performance based compensation under Section 162(m) will be subject to any additional limitations set forth in the Code (including any amendment to Section 162(m) or any regulations and ruling issued thereunder that are requirements for qualification as qualified performance-based compensation as described in Section 162(m), and the Plan will be deemed amended to the extent necessary to conform to such requirements.

## **12. STANDARD FORMS OF AWARD AGREEMENT.**

**12.1 Award Agreements.** Each Award shall comply with and be subject to the terms and conditions set forth in the appropriate form of Award Agreement approved by the Board and as amended from time to time. Any Award Agreement may consist of an appropriate form of Notice of Grant and a form of Agreement incorporated therein by reference, or such other form or forms as the Board may approve from time to time.

**12.2 Authority to Vary Terms.** The Board shall have the authority from time to time to vary the terms of any standard form of Award Agreement either in connection with the grant or amendment of an individual Award or in connection with the authorization of a new standard form or forms; provided, however, that the terms and conditions of any such new, revised or amended standard form or forms of Award Agreement are not inconsistent with the terms of the Plan.

## **13. CHANGE IN CONTROL.**

### **13.1 Definitions.**

(a) An **Ownership Change Event** shall be deemed to have occurred if any of the following occurs with respect to the Company: (i) the direct or indirect sale or exchange in a single or series of related transactions by the stockholders of the Company of more than fifty percent (50%) of the voting stock of the Company; (ii) a merger or consolidation in which the Company is a party; (iii) the sale, exchange, or transfer of all or substantially all of the assets of the Company (other than a sale, exchange or transfer to one or more subsidiaries of the Company); or (iv) a liquidation or dissolution of the Company.

(b) A **Change in Control** shall mean an Ownership Change Event or a series of related Ownership Change Events (collectively, a **Transaction**) in which the stockholders of the Company immediately before the Transaction do not retain immediately after the Transaction, in substantially the same proportions as their ownership of shares of the Company's voting stock immediately before the Transaction, direct or indirect beneficial ownership of more than fifty percent (50%) of the total combined voting power of the outstanding voting securities of the Company or, in the case of an Ownership Change Event described in Section 13.1(a)(iii), the entity to which the assets of the Company were transferred (the **Transferee**), as the case may be. For purposes of the preceding sentence, indirect beneficial ownership shall include, without limitation, an interest resulting from ownership of the voting securities of

one or more corporations or other business entities which own the Company or the Transferee, as the case may be, either directly or through one or more subsidiary corporations or other business entities. The Board shall have the right to determine whether multiple sales or exchanges of the voting securities of the Company or multiple Ownership Change Events are related, and its determination shall be final, binding and conclusive.

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**Table of Contents****13.2 Effect of Change in Control on Options and SARs.**

(a) ***Accelerated Vesting.*** Notwithstanding any other provision of the Plan to the contrary, the Board, in its sole discretion, may provide in any Award Agreement or, in the event of a Change in Control, may take such actions as it deems appropriate to provide for the acceleration of the exercisability and vesting in connection with such Change in Control of any or all outstanding Options and SARs and shares acquired upon the exercise of such Options and SARs upon such conditions and to such extent as the Board shall determine.

(b) ***Assumption or Substitution.*** In the event of a Change in Control, the Acquiring Corporation may, without the consent of the Participant, either assume the Company's rights and obligations under outstanding Options and SARs or substitute for outstanding Options and SARs substantially equivalent options and stock appreciation rights for the Acquiring Corporation's stock. In the event that the Acquiring Corporation elects not to assume or substitute for outstanding Options and SARs in connection with a Change in Control, or if the Acquiring Corporation is not a publicly held corporation within the meaning of Section 162(m), the exercisability and vesting of each such outstanding Option, SAR and any shares acquired upon the exercise thereof held by a Participant whose Service has not terminated prior to such date shall be accelerated, effective as of the date ten (10) days prior to the date of the Change in Control. The exercise or vesting of any Option, SAR and any shares acquired upon the exercise thereof that was permissible solely by reason of this Section 13.2 and the provisions of such applicable Award Agreement shall be conditioned upon the consummation of the Change in Control. Any Options and SARs which are neither assumed or substituted for by the Acquiring Corporation in connection with the Change in Control nor exercised as of the date of the Change in Control shall terminate and cease to be outstanding effective as of the date of the Change in Control. Notwithstanding the foregoing, shares acquired upon exercise of an Option prior to the Change in Control and any consideration received pursuant to the Change in Control with respect to such shares shall continue to be subject to all applicable provisions of the applicable Award Agreement evidencing such Option or SAR except as otherwise provided in such applicable Award Agreement. Furthermore, notwithstanding the foregoing, if the corporation the stock of which is subject to the outstanding Options and SARs immediately prior to an Ownership Change Event described in Section 13.1(a)(i) constituting a Change in Control is the surviving or continuing corporation and immediately after such Ownership Change Event less than fifty percent (50%) of the total combined voting power of its voting stock is held by another corporation or by other corporations that are members of an affiliated group within the meaning of Section 1504(a) of the Code without regard to the provisions of Section 1504(b) of the Code, the outstanding Options and SARs shall not terminate unless the Board otherwise provides in its discretion.

(c) ***Cash-Out.*** The Board may, in its sole discretion and without the consent of any Participant, determine that, upon the occurrence of a Change in Control, each or any Option or SAR outstanding immediately prior to the Change in Control shall be canceled in exchange for a payment with respect to each vested share of Stock subject to such canceled Option or SAR in (i) cash, (ii) stock of the Company or of a corporation or other business entity a party to the Change in Control, or (iii) other property which, in any such case, shall be in an amount having a Fair Market Value equal to the excess of the Fair Market Value of the consideration to be paid per share of Stock in the Change in Control over the exercise price per share under such Option or SAR (the ***Spread***). In the event such determination is made by the Board, the Spread (reduced by applicable withholding taxes, if any) shall be paid to Participants in respect of their canceled Options and SARs as soon as practicable following the date of the Change in Control.

**13.3 Effect of Change in Control on Restricted Stock and Other Type of Awards.** The Board may, in its discretion, provide in any Award Agreement evidencing a Restricted Stock or Other Type of Award that, in the event of a Change in Control, the lapsing of any applicable Vesting Condition, Restriction Period or Performance Goal applicable to the shares subject to such Award held by a Participant whose Service has not terminated prior to the Change in Control shall be accelerated and/or waived effective immediately prior to the consummation of the Change in Control to such extent as specified in such Award Agreement. Any acceleration, waiver or the lapsing of any restriction that was permissible solely by reason of this Section 13.3 and the provisions of such Award Agreement

shall be conditioned upon the consummation of the Change in Control.

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**14. PROVISION OF INFORMATION.**

Each Participant shall be given access to information concerning the Company equivalent to that information generally made available to the Company's common stockholders.

**15. COMPLIANCE WITH SECURITIES LAW.**

The grant of Options and the issuance of shares of Stock upon exercise of Options shall be subject to compliance with all applicable requirements of federal, state and foreign law with respect to such securities. Options may not be exercised if the issuance of shares of Stock upon exercise would constitute a violation of any applicable federal, state or foreign securities laws or other law or regulations or the requirements of any stock exchange or market system upon which the Stock may then be listed. In addition, no Option may be exercised unless (a) a registration statement under the Securities Act shall at the time of exercise of the Option be in effect with respect to the shares issuable upon exercise of the Option or (b) in the opinion of legal counsel to the Company, the shares issuable upon exercise of the Option may be issued in accordance with the terms of an applicable exemption from the registration requirements of the Securities Act. The inability of the Company to obtain from any regulatory body having jurisdiction the authority, if any, deemed by the Company's legal counsel to be necessary to the lawful issuance and sale of any shares hereunder shall relieve the Company of any liability in respect of the failure to issue or sell such shares as to which such requisite authority shall not have been obtained. As a condition to the exercise of any Option, the Company may require the Participant to satisfy any qualifications that may be necessary or appropriate, to evidence compliance with any applicable law or regulation and to make any representation or warranty with respect thereto as may be requested by the Company.

**16. TAX WITHHOLDING.**

**16.1 Tax Withholding in General.** The Company shall have the right to deduct from any and all payments made under the Plan, or to require the Participant, through payroll withholding, cash payment or otherwise, including by means of a Cashless Exercise of an Option, to make adequate provision for, the federal, state, local and foreign taxes, if any, required by law to be withheld by the Participating Company Group with respect to an Award or the shares acquired pursuant thereto. The Company shall have no obligation to deliver shares of Stock, to release shares of Stock from an escrow established pursuant to an Award Agreement, or to make any payment in cash under the Plan until the Participating Company Group's tax withholding obligations have been satisfied by the Participant.

**16.2 Withholding in Shares.** The Company shall have the right, but not the obligation, to deduct from the shares of Stock issuable to a Participant upon the exercise or settlement of an Award, or to accept from the Participant the tender of, a number of whole shares of Stock having a Fair Market Value, as determined by the Company, equal to all or any part of the tax withholding obligations of the Participating Company Group. The Fair Market Value of any shares of Stock withheld or tendered to satisfy any such tax withholding obligations shall not exceed the amount determined by the applicable minimum statutory withholding rates.

**17. TERMINATION OR AMENDMENT OF PLAN.**

The Board may terminate or amend the Plan at any time. However, subject to changes in applicable law, regulations or rules that would permit otherwise, without the approval of the Company's stockholders, there shall be (a) no increase in the maximum aggregate number of shares of Stock that may be issued under the Plan (except by operation of the provisions of Section 4.2), (b) no change in the class of persons eligible to receive Incentive Stock Options, and (c) no other amendment of the Plan that would require approval of the Company's stockholders under any applicable law, regulation or rule. No termination or amendment of the Plan shall affect any then outstanding Option unless expressly provided by the Board. In any event, no termination or amendment of the Plan may adversely affect

any then outstanding Option without the consent of the Participant, unless such termination or amendment is required to enable an Option designated as an Incentive Stock Option to qualify as an Incentive Stock Option or is necessary to comply with any applicable law, regulation or rule.

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18. **STOCKHOLDER APPROVAL.**

The Plan or any increase in the maximum aggregate number of shares of Stock issuable thereunder as provided in Section 4.1 (the *Authorized Shares* ) shall be approved by the stockholders of the Company within twelve (12) months of the date of adoption thereof by the Board. Options granted prior to stockholder approval of the Plan or in excess of the Authorized Shares previously approved by the stockholders shall become exercisable no earlier than the date of stockholder approval of the Plan or such increase in the Authorized Shares, as the case may be.

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**PROXY**

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS OF  
COHU, INC.**

The undersigned hereby appoints JAMES A. DONAHUE and JOHN H. ALLEN, and each of them, with full power to act without the other and with power of substitution, as proxies and attorneys-in-fact and hereby authorizes them to represent and vote, as provided on the other side, all the shares of COHU, INC. Common Stock which the undersigned is entitled to vote, and, in their discretion, to vote upon such other business as may properly come before the Annual Meeting of Stockholders of Cohu to be held May 10, 2005 or at any adjournment or postponement thereof, with all powers which the undersigned would possess if present at the Meeting.

**THIS PROXY WILL BE VOTED AS DIRECTED, OR IF NO DIRECTION IS INDICATED, WILL BE VOTED FOR THE PROPOSALS.**

**(Continued, and to be marked, dated and signed, on the other side)**

**Address Change/Comments (Mark the corresponding box on the reverse side)**

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**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR ITEMS 1, 2 AND 3.**

Please Mark Here for Address Change or Comments  
**SEE REVERSE SIDE**

	FOR	WITHHELD FOR ALL	
ITEM 1. ELECTION OF DIRECTORS	<input type="radio"/>	<input type="radio"/>	
Nominees:			
01 Robert L. Ciardella			
02 Charles A. Schwan			
	FOR	AGAINST	ABSTAIN
ITEM 2. TO APPROVE THE COHU 2005 EQUITY INCENTIVE PLAN	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
	FOR	AGAINST	ABSTAIN
ITEM 3. TO RATIFY THE APPOINTMENT OF ERNST & YOUNG LLP AS COHU S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR 2005	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Withheld for the nominees you list below: (Write that nominee s name in the space provided below.)

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**Signature**

**Signature**

**Date**

**NOTE: Please sign as name appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such.**

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**5 Detach here from proxy voting card 5**

**Vote by Internet or Telephone or Mail**

**24 Hours a Day, 7 Days a Week**

**Internet and telephone voting is available through 11:59 PM Eastern Time  
the day prior to May 10, 2005.**

**Your Internet or telephone vote authorizes the named proxies to vote your shares in the same manner  
as if you marked, signed and returned your proxy card.**

**Internet**  
**<http://www.proxyvoting.com/cohu>**

Use the Internet to vote your proxy.  
Have your proxy card in hand when  
you access the web site.

**OR**

**Telephone**  
**1-866-540-5760**

Use any touch-tone telephone  
to vote your proxy. Have your  
proxy card in hand when you  
call, and follow the  
instructions.

**OR**

**Mail**

Mark, sign and date  
your proxy card  
and  
return it in the  
enclosed postage-paid  
envelope.

**If you vote your proxy by Internet or by telephone,  
you do NOT need to mail back your proxy card.**

**You can view the Annual Report and Proxy Statement  
on the internet at: <http://www.cohu.com>**