
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 25, 2010

Commission file number 000-49602

SYNAPTICS INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

77-0118518

(I.R.S. Employer
Identification No.)

3120 Scott Blvd.

Santa Clara, California 95054

(Address of principal executive offices) (Zip code)

(408) 454-5100

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Number of shares of Common Stock outstanding at October 29, 2010: 34,112,685

SYNAPTICS INCORPORATED
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2010

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SYNAPTICS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	<u>September 30,</u> <u>2010</u>	<u>June 30,</u> <u>2010</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 230,620	\$ 209,858
Accounts receivable, net of allowances of \$616 and \$500 at September 30, 2010 and June 30, 2010, respectively	115,960	101,509
Inventories	15,114	18,667
Prepaid expenses and other current assets	<u>4,686</u>	<u>4,471</u>
Total current assets	366,380	334,505
Property and equipment at cost, net of accumulated depreciation of \$22,793 and \$20,256 at September 30, 2010 and June 30, 2010, respectively	27,110	25,821
Goodwill	1,927	1,927
Non-current investments	28,359	28,012
Other assets	<u>26,013</u>	<u>24,414</u>
	<u>\$ 449,789</u>	<u>\$ 414,679</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 64,035	\$ 65,618
Accrued compensation	10,163	11,330
Income taxes payable	13,104	10,061
Other accrued liabilities	<u>20,574</u>	<u>18,962</u>
Total current liabilities	107,876	105,971
Notes payable	2,305	2,305
Other liabilities	20,708	19,892
Stockholders' equity:		
Common stock:		
\$0.001 par value; 60,000,000 shares authorized; 45,414,898 and 44,891,834 shares issued, and 34,543,585 and 34,020,521 shares outstanding, at September 30, 2010 and June 30, 2010, respectively	45	45
Additional paid-in capital	360,917	347,764
Treasury stock: 10,871,313 common treasury shares at September 30, 2010 and June 30, 2010, at cost	(281,932)	(281,932)
Accumulated other comprehensive income	2,052	1,515
Retained earnings	<u>237,818</u>	<u>219,119</u>
Total stockholders' equity	<u>318,900</u>	<u>286,511</u>
	<u>\$ 449,789</u>	<u>\$ 414,679</u>

See notes to condensed consolidated financial statements (unaudited).

SYNAPTICS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)
(unaudited)

	Three Months Ended	
	September 30,	
	2010	2009
Net revenue	\$ 153,185	\$ 119,592
Cost of revenue	<u>90,357</u>	<u>71,270</u>
Gross margin	<u>62,828</u>	<u>48,322</u>
Operating expenses:		
Research and development	24,920	19,975
Selling, general, and administrative	<u>15,548</u>	<u>13,764</u>
Total operating expenses	<u>40,468</u>	<u>33,739</u>
Operating income	22,360	14,583
Interest income	211	331
Interest expense	(4)	(1,423)
Impairment (loss)/recovery on investments, net	<u>10</u>	<u>(443)</u>
Income before provision for income taxes	22,577	13,048
Provision for income taxes	<u>3,878</u>	<u>3,244</u>
Net income	<u>\$ 18,699</u>	<u>\$ 9,804</u>
Net income per share:		
Basic	<u>\$ 0.54</u>	<u>\$ 0.29</u>
Diluted	<u>\$ 0.52</u>	<u>\$ 0.27</u>
Shares used in computing net income per share:		
Basic	<u>34,402</u>	<u>34,341</u>
Diluted	<u>35,900</u>	<u>35,968</u>

See notes to condensed consolidated financial statements (unaudited).

SYNAPTICS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(unaudited)

	Three Months Ended	
	September 30,	
	2010	2009
Cash flows from operating activities		
Net income	\$ 18,699	\$ 9,804
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation costs	7,906	7,048
Deferred taxes	(928)	782
Depreciation of property and equipment	2,537	2,088
Amortization of debt issuance costs	—	70
Impairment/(recovery) of investments, net	(10)	443
Amortization of debt discount	—	1,231
Changes in operating assets and liabilities:		
Accounts receivable, net	(14,451)	(6,323)
Inventories	3,553	(728)
Prepaid expenses and other current assets	(215)	(583)
Other assets	(671)	(1,063)
Accounts payable	(1,583)	16,199
Accrued compensation	(1,167)	(71)
Income taxes	3,822	704
Other accrued liabilities	1,649	318
Net cash provided by operating activities	<u>19,141</u>	<u>29,919</u>
Cash flows from investing activities		
Purchases of short-term investments	—	(3,989)
Proceeds from sales and maturities of short-term investments	—	9,296
Proceeds from sales and maturities of non-current investments	200	700
Purchases of property and equipment	(3,826)	(2,086)
Net cash (used in) provided by investing activities	<u>(3,626)</u>	<u>3,921</u>
Cash flows from financing activities		
Purchases of treasury stock	—	(25,471)
Proceeds from issuance of common stock upon exercise of options and stock purchase plan	6,143	3,255
Payroll taxes for deferred stock units	(896)	(620)
Net cash provided by (used in) financing activities	<u>5,247</u>	<u>(22,836)</u>
Net increase in cash and cash equivalents	20,762	11,004
Cash and cash equivalents at beginning of period	209,858	169,036
Cash and cash equivalents at end of period	<u>\$ 230,620</u>	<u>\$ 180,040</u>
Supplemental disclosures of cash flow information		
Cash paid for income taxes	<u>\$ 1,010</u>	<u>\$ 1,765</u>

See notes to condensed consolidated financial statements (unaudited).

SYNAPTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission, or the SEC, and U.S. generally accepted accounting principles, or U.S. GAAP. However, certain information or footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such SEC rules and regulations. In our opinion, the financial statements include all adjustments, which are of a normal and recurring nature, necessary for the fair presentation of the results of the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the operating results for the full fiscal year or any future period. These financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our annual report on Form 10-K for the fiscal year ended June 30, 2010.

The consolidated financial statements include our financial statements and those of our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated upon consolidation.

Our fiscal year is the 52- or 53-week period ending on the last Saturday in June. Our fiscal 2011 will be a 52-week period ending on June 25, 2011. Our fiscal 2010 was a 52-week period ending on June 26, 2010. The fiscal periods presented in this report were 13-week periods for the three months ended September 25, 2010 and September 26, 2009. For ease of presentation, the accompanying consolidated financial statements have been shown as ending on September 30 and calendar quarter end dates for all annual, interim, and quarterly financial statement captions, unless otherwise indicated.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, cost of revenue, inventories, product warranty, share-based compensation costs, provision for income taxes, income taxes payable, investments, and contingencies. We base our estimates on historical experience, applicable laws and regulations, and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

2. Revenue Recognition

We recognize revenue from product sales when there is persuasive evidence that an arrangement exists, delivery has occurred and title has transferred, the price is fixed or determinable, and collection is reasonably assured. We accrue for estimated sales returns and other allowances, based on historical experience, at the time we recognize revenue.

3. Net Income Per Share

The computation of basic and diluted net income per share was as follows (in thousands, except per share data):

	Three Months Ended September 30,	
	2010	2009
Numerator:		
Net income	\$ 18,699	\$ 9,804
Denominator:		
Shares, basic	34,402	34,341
Effect of dilutive share-based awards	1,498	1,627
Shares, diluted	35,900	35,968
Net income per share:		
Basic	\$ 0.54	\$ 0.29
Diluted	\$ 0.52	\$ 0.27

Our basic net income per share amounts for each period presented have been computed using the weighted average number of shares of common stock outstanding. Our diluted net income per share amounts for each period presented include the weighted average effect of potentially dilutive shares. We use the "treasury stock" method to determine the dilutive effect of our share-based awards and Convertible Senior Subordinated Notes, or Notes. No shares associated with our Notes were included in dilutive shares for the periods presented as the weighted average share price during each period was less than the conversion price of \$33.69.

Dilutive net income per share amounts do not include the weighted average effect of 3,756,296 and 2,899,824 share-based awards that were outstanding during the three months ended September 30, 2010 and 2009, respectively. These share-based awards were not included in the computation of diluted net income per share because the proceeds received, if any, from such share-based awards combined with the average unamortized compensation costs adjusted for the hypothetical tax benefit or deficiency creditable or chargeable, respectively, to additional paid-in capital were greater than the average market price of our common stock, and therefore, their effect would have been antidilutive.

4. Cash Equivalents and Auction Rate Securities Investments

Cash equivalents consist of highly liquid investments with original maturities of three months or less. Our non-current investments include auction rate securities, or ARS, which are reported at fair value, with unrealized gains and losses excluded from earnings and are shown separately as a component of accumulated other comprehensive income within stockholders' equity. We charge any other-than-temporary declines in the fair value of a debt security to earnings (within impairment (loss)/recovery on investments, net) if the decline results from a credit loss or to other comprehensive income if the decline results from a noncredit loss. We charge any other-than-temporary declines in the fair value of equity securities to earnings (within impairment (loss)/recovery on investments, net). Other-than-temporary declines result in the establishment of a new cost basis for the security. We include interest earned on investments in interest income.

Our ARS investments, which have a par value of \$40.5 million, have failed to settle in auctions beginning in September 2007. These investments are not liquid, and in the event we need to access these funds prior to their maturity, we will not be able to do so without a loss of principal, unless redeemed by the issuers or a future auction on these investments is successful. During the three months ended September 30, 2010, we recognized a gain of \$10,000 on the redemption at par of \$200,000 of our ARS investments, which is included in impairment (loss)/recovery on investments, net. During the three months ended September 30, 2009, \$700,000 of our ARS investments were redeemed at par, and we recognized a gain of \$6,000 on the redemption of these investments, which is included in impairment (loss)/recovery on investments, net.

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As there are currently no active markets for our various failed ARS investments, we have estimated the fair value as of September 30, 2010 using a trinomial discounted cash flow analysis. The analysis considered, among other factors:

- the collateral underlying the security investments;
- creditworthiness of the counterparty;
- timing of expected future cash flows;
- the probability of a successful auction in a future period;
- the underlying structure of each investment;
- the present value of future principal and interest payments discounted at rates considered to reflect current market conditions;
- consideration of the probabilities of default, passing a future auction, or redemption at par for each period; and
- estimates of the recovery rates in the event of default for each investment.

When possible, our failed ARS investments were compared to other observable market data or securities with similar characteristics. Our estimate of the fair value of our ARS investments could change materially from period to period based on future market conditions.

Contractual maturities for our ARS investments are generally greater than five years, with fair value of \$9.5 million maturing from 2015 to 2017, \$8.9 million maturing from 2034 to 2045, and \$10.0 million having no stated maturity. Of our ARS investments, \$27.0 million par value are investment grade, and the remaining \$13.5 million par value are below investment grade. For the three-month period ended September 30, 2010, we recorded a realized gain of \$10,000 on the redemption of ARS investments. In connection with our fair value analysis for the three-month period ended September 30, 2009, we recognized a \$443,000 other-than-temporary impairment charge on our ARS investments in preferred stock.

The various types of ARS investments we held as of September 30, 2010, including the original cost basis, other-than-temporary impairment included in other comprehensive income, other-than-temporary impairment included in retained earnings, new cost basis, unrealized gain, and fair value consisted of the following (in thousands):

	Original Cost Basis	Cumulative Other-than- temporary Impairment		New Cost Basis	Unrealized Gain	Fair Value
		Included in Other Comprehensive Income	Included in Retained Earnings			
Student loans	\$ 9,350	\$ (606)	\$ (252)	\$ 8,492	\$ 366	\$ 8,858
Closed end municipal and corporate funds	10,650	(1,112)	(93)	9,445	540	9,985
Credit linked notes	13,500	(156)	(8,765)	4,579	3,070	7,649
Preferred stock	5,000	—	(5,000)	—	—	—
Municipals	2,000	(203)	(83)	1,714	153	1,867
Total ARS	<u>\$ 40,500</u>	<u>\$ (2,077)</u>	<u>\$ (14,193)</u>	<u>\$ 24,230</u>	<u>\$ 4,129</u>	<u>\$ 28,359</u>

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The various types of ARS investments we held as of June 30, 2010, including the original cost basis, other-than-temporary impairment included in other comprehensive income, other-than-temporary impairment included in retained earnings, new cost basis, unrealized gain, and fair value consisted of the following (in thousands):

	Original Cost Basis	Cumulative Other-than- temporary Impairment		New Cost Basis	Unrealized Gain	Fair Value
		Included in Other Comprehensive Income	Included in Retained Earnings			
Student loans	\$ 9,550	\$ (617)	\$ (262)	\$ 8,671	\$ 251	\$ 8,922
Closed end municipal and corporate funds	10,650	(1,112)	(93)	9,445	293	9,738
Credit linked notes	13,500	(156)	(8,765)	4,579	2,952	7,531
Preferred stock	5,000	—	(5,000)	—	—	—
Municipals	2,000	(203)	(83)	1,714	107	1,821
Total ARS	<u>\$ 40,700</u>	<u>\$ (2,088)</u>	<u>\$ (14,203)</u>	<u>\$ 24,409</u>	<u>\$ 3,603</u>	<u>\$ 28,012</u>

We have accounted for all of our ARS investments as non-current as we are not able to reasonably determine when the ARS markets will recover or be restructured. Based on our ability to access our cash, our expected operating cash flows, and our other sources of cash, we have the intent and ability to hold these investments until the value recovers or the investments mature. We will continue to monitor our ARS investments and evaluate our accounting for these investments quarterly. Subsequent to recording other-than-temporary impairment charges, certain of our ARS investments have increased in value above their new cost bases, and this increase is included as unrealized gain above and in accumulated other comprehensive income in the accompanying condensed consolidated balance sheets.

5. Fair Value of Cash Equivalents and Investments

Certain financial assets and liabilities have been recognized or disclosed at fair value on a recurring basis. For other financial assets and liabilities, we elected not to apply the fair value option.

Current accounting standards establish a consistent framework for measuring fair value on either a recurring or nonrecurring basis in which inputs, used in valuation techniques, are assigned a hierarchical level.

The following are the hierarchical levels of inputs to measure fair value:

- Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3: Unobservable inputs reflecting our own assumptions incorporated in valuation techniques used to determine fair value. These assumptions must be consistent with market participant assumptions that are reasonably available. Our Level 3 assets consist of long-term ARS investments. We estimated the fair value of our ARS investments based on the following: (i) the underlying structure of each investment; (ii) the present value of future principal and interest payments discounted at rates considered to reflect current market conditions; (iii) consideration of the probabilities of default, passing a future auction, or repurchase at par for each period; and (iv) estimates of the recovery rates in the event of default for each investment.

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Financial assets and liabilities measured at fair value on a recurring basis, by level within the fair value hierarchy consisted of the following (in thousands):

	September 30, 2010		June 30, 2010	
	Level 1	Level 3	Level 1	Level 3
Money market	\$ 228,217	\$ —	\$ 208,040	\$ —
Auction rate securities	—	28,359	—	28,012
Total available-for-sale securities	<u>\$ 228,217</u>	<u>\$ 28,359</u>	<u>\$ 208,040</u>	<u>\$ 28,012</u>

Money market balances are included in cash and cash equivalents as of September 30, 2010 and June 30, 2010. ARS are included in non-current investments as of September 30, 2010 and June 30, 2010.

Changes in fair value of our Level 3 financial assets as of September 30, 2010 were as follows (in thousands):

Balance as of June 30, 2010	\$ 28,012
Net change in other comprehensive income from Level 3 financial assets	537
Realized gain on redeemed securities	10
Redemptions	(200)
Balance as of September 30, 2010	<u>\$ 28,359</u>

There were no transfers in or out of our Level 1 or 3 assets during the three months ended September 30, 2010.

The fair values of our cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate their carrying values because of the short-term nature of those instruments. We base the fair value of short-term investments on current trading values and the fair value of our ARS on a trinomial discounted cash flow model.

6. Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market (estimated net realizable value) and consisted of the following (in thousands):

	September 30, 2010	June 30, 2010
Raw materials	\$ 8,993	\$ 12,251
Finished goods	6,121	6,416
	<u>\$ 15,114</u>	<u>\$ 18,667</u>

Periodically, we purchase inventory from our contract manufacturers when a customer delays its delivery schedule or cancels its order. In those circumstances in which our customer has cancelled its order and we purchase inventory from our contract manufacturers, we consider a write-down to reduce the carrying value of the inventory purchased to its net realizable value. We charge write-downs to reduce the carrying value of obsolete, slow moving, and non-usable inventory to net realizable value to cost of revenue. The effect of these write-downs is to establish a new cost basis in the related inventory, which we do not subsequently write up.

7. Product Warranties, Indemnifications, and Contingencies

Product Warranties

We generally warrant our products for a period of 12 months or more from the date of sale and estimate probable product warranty costs at the time we recognize revenue. Factors that affect our warranty liability include historical and anticipated rates of warranty claims, materials usage, and service delivery costs. Warranty costs incurred have not been material in recent years. However, we assess the adequacy of our warranty obligations periodically and adjust the accrued warranty liability on the basis of our estimates.

Indemnifications

In connection with certain third-party agreements, we are obligated to indemnify the third party in connection with any technology infringement by us. We have also entered into indemnification agreements with our officers and directors. Maximum potential future payments cannot be estimated because these agreements do not have a maximum stated liability. However, historical costs related to these indemnification provisions have not been significant. We have not recorded any liability in our consolidated financial statements for such indemnification obligations.

Contingencies

We may receive notices from third parties that claim our products infringe their rights. From time to time, we receive notice from third parties alleging infringement of their intellectual property rights. We cannot be certain that our technologies and products do not or will not infringe issued patents or other proprietary rights of third parties.

Any infringement claims, with or without merit, could result in significant litigation costs and diversion of management and financial resources, including the payment of damages, which could have a material adverse effect on our business, financial condition, and results of operations.

8. Convertible Senior Subordinated Notes

In December 2004, we issued an aggregate of \$125 million of Notes maturing December 1, 2024 in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended, or the Securities Act. In connection with issuing the Notes, we incurred debt issuance costs of \$4.3 million, consisting primarily of the initial purchasers' discount and costs related to legal, accounting, and printing, which were amortized over five years. We used the net proceeds for working capital and general corporate purposes.

In fiscal 2009, we repurchased and retired \$59.7 million of our outstanding Notes at a discount from par of approximately 7%, which resulted in a \$1.1 million net loss on retirement of debt after deducting the associated unamortized debt discount and debt issuance costs. In fiscal 2010, we repurchased and retired \$63.0 million par value of our Notes when investors exercised their rights to require us to repurchase their Notes. Accordingly, as of September 30, 2010, \$2.3 million par value of our Notes remained outstanding and have been classified as long-term as the next date Noteholders can require us to repurchase all or a portion of their Notes is beyond one year.

Interest expense includes the amortization of debt discount and debt issuance costs. We recorded \$4,000 and \$1.4 million of interest expense on the Notes during the three-month periods ended September 30, 2010 and 2009, respectively. As of December 31, 2009, the amortization of the discount and debt issuance costs was complete, and the if-converted value of the Notes did not exceed the principal amount of the Notes.

9. Share-Based Compensation

The purpose of our various share-based compensation plans is to attract, motivate, retain, and reward high-quality employees, directors, and consultants by enabling such persons to acquire or increase their proprietary interest in our common stock in order to strengthen the mutuality of interests between such persons and our stockholders and to provide such persons with long-term performance incentives to focus their best efforts in the creation of stockholder value. Consequently, share-based compensatory awards issued subsequent to the initial award to our employees and consultants are determined primarily on individual performance. Our share-based compensation plans with outstanding awards consist of our 1996 Stock Option Plan, our 2000 Nonstatutory Stock Option Plan, our 2001 Incentive Compensation Plan, as amended, and our 2001 Employee Stock Purchase Plan, as amended.

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Share-based compensation and the related tax benefit recognized in our consolidated statements of income for the three-month periods ended September 30, 2010 and 2009 were as follows (in thousands):

	Three Months Ended	
	September 30,	
	2010	2009
Cost of revenue	\$ 308	\$ 448
Research and development	3,427	2,798
Selling, general, and administrative	4,171	3,802
Total	\$ 7,906	\$ 7,048
Tax benefit recorded on share-based compensation	\$ 2,363	\$ 2,201

We utilize the Black-Scholes option pricing model to estimate the grant date fair value of certain employee share-based compensatory awards, which requires the input of highly subjective assumptions, including expected volatility and expected life. Historical and implied volatilities were used in estimating the fair value of our share-based awards, while the expected life of our options and estimated forfeitures for share-based awards that are not expected to vest were estimated based on historical trends since our initial public offering. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. We charge the estimated fair value less estimated forfeitures to earnings on a straight-line basis over the vesting period of the underlying awards, which is generally four years for our stock options and deferred stock units and up to two years for our employee stock purchase plan. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options having no vesting restrictions and being fully transferable. As our stock option and employee stock purchase plan awards have characteristics that differ significantly from traded options and, as changes in the subjective assumptions can materially affect the estimated value, our estimate of fair value may not accurately represent the value assigned by a third party in an arms'-length transaction. While our estimate of fair value and the associated charge to earnings materially affects our results of operations, it has no impact on our cash position.

We recognize tax benefit upon expensing certain share-based awards associated with our share-based compensation plans, including nonqualified stock options and deferred stock units, but we cannot recognize tax benefit concurrent with the recognition of share-based compensation expenses associated with incentive stock options (qualified stock options) and employee stock purchase plan shares. For qualified stock options that vested after we began expensing share-based compensation, we recognize tax benefit only in the period when disqualifying dispositions of the underlying stock occur, which historically has been up to several years after vesting and in a period when our stock price substantially increases. For qualified stock options that vested prior to when we began expensing share-based compensation, we record the tax benefit directly to additional paid-in capital.

We determine excess tax benefit using the long-haul method in which we compare the actual tax benefit associated with the tax deduction from share-based award activity to the hypothetical tax benefit on the grant date fair values of the corresponding share-based awards. Tax benefit associated with excess tax deduction creditable to additional paid-in capital is not recognized until the deduction reduces taxes payable. During the three-month periods ended September 30, 2010 and 2009, we did not recognize any tax benefit as additional paid-in capital.

Historically, we have issued new shares in connection with our share-based compensation plans; however, treasury shares were also available for issuance as of September 30, 2010. Any additional shares repurchased under our stock repurchase program would be available for issuance under our share-based compensation plans.

Stock Options

Our share-based compensation plans with outstanding stock option awards include our 1996 Stock Option Plan, 2000 Nonstatutory Stock Option Plan, and 2001 Incentive Compensation Plan, as amended (the "Plans"). Under the Plans, we may grant employees, consultants, and directors incentive stock options or nonqualified stock options to purchase shares of our common stock at not less than 100% or 85% of the fair market value, respectively, on the date of grant. Stock options granted to our employees generally are incentive stock options, or qualified options under the Internal Revenue Code, subject to calendar year vesting limitations with any balance being nonqualified stock options.

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Stock option activity and weighted average exercise prices for the three months ended September 30, 2010, and for options outstanding and options exercisable, the weighted average exercise prices, and the aggregate intrinsic value as of September 30, 2010 were as follows:

	Stock Option Awards <u>Outstanding</u>	Weighted Average Exercise Price	Aggregate Intrinsic Value (thousands)
Balance at June 30, 2010	7,748,570	\$ 22.43	
Granted	457,295	31.73	
Exercised	(267,391)	12.68	
Forfeited	(96,905)	29.00	
Balance at September 30, 2010	<u>7,841,569</u>	23.22	\$ 45,424
Exercisable at September 30, 2010	<u>4,440,167</u>	\$ 20.18	\$ 37,445

The aggregate intrinsic value is based on the closing price of our common stock on September 24, 2010 and excludes stock options with exercise prices above the closing price of \$27.74. Options issued under the Plans generally vest over four years from the vesting commencement date. Options not exercised ten years after the date of grant are cancelled.

Deferred Stock Units

Our 2001 Incentive Compensation Plan, as amended ("2001 Plan"), enables us to grant deferred stock units, or DSUs, to our employees, consultants, and directors. A DSU is a promise to deliver shares of our common stock at a future date in accordance with the terms of the DSU grant agreement.

DSU activity, including DSUs granted, delivered, and forfeited, during the three months ended September 30, 2010, and the balance and aggregate intrinsic value of DSUs as of September 30, 2010 were as follows:

	Deferred Stock Unit Awards <u>Outstanding</u>	Aggregate Intrinsic Value (thousands)
Balance at June 30, 2010	821,146	
Granted	145,668	
Delivered	(109,083)	
Forfeited	(36,768)	
Balance at September 30, 2010	<u>820,963</u>	\$ 22,774

The aggregate intrinsic value is based on the closing price of our common stock on September 24, 2010 of \$27.74.

DSUs granted under the 2001 Plan generally vest over four years from the vesting commencement date. Delivery of shares under the plan takes place on the quarterly vesting dates. At the delivery date, we withhold shares to cover statutory minimum tax withholding by delivering a net number of shares. Until delivery of shares, the grantee has no rights as a stockholder.

Of the shares delivered, 28,227 shares valued at \$896,000 were withheld to meet statutory minimum tax withholding requirements.

Employee Stock Purchase Plan

Our 2001 Employee Stock Purchase Plan, as amended ("ESPP"), became effective on January 29, 2002, the effective date of the registration statement for our initial public offering. The ESPP allows employees to designate up to 15% of their base compensation, subject to legal restrictions and limitations, to purchase shares of common stock at 85% of the lesser of the fair market value, or FMV, at the beginning of the offering period or the exercise date. The offering period extends for up to two years and includes four exercise dates occurring at six month intervals. Under the terms of the plan, if the FMV at an exercise date is less than the FMV at the beginning of the offering period, the current offering period will terminate and a new two-year offering period will commence.

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Shares purchased, weighted average purchase price, cash received, and the aggregate intrinsic value for ESPP purchases during the three-month period ended September 30, 2010 were as follows (in thousands, except for shares purchased and weighted average purchase price):

Shares purchased	174,817
Weighted average purchase price	\$ 15.75
Cash received	\$ 2,753
Aggregate intrinsic value	\$ 2,054

The early termination of an offering period followed by the commencement of a new offering period represents a modification to the terms of the underlying awards. Under the terms of our ESPP, the offering period that commenced on July 1, 2007 was terminated on December 31, 2008 and a new offering period commenced on January 1, 2009. The December 31, 2008 modification affected approximately 257 employees. The modification resulted in incremental compensation costs, which are not material and which will be recognized on a straight-line basis over the two-year period ending December 31, 2010.

10. Income Taxes

We account for income taxes under the asset and liability method. We consider the operating earnings of our foreign subsidiaries to be indefinitely invested outside the United States. Accordingly, no provision has been made for the U.S. federal or state or foreign taxes that may result from future remittances of undistributed earnings of our foreign subsidiaries.

The provision for income taxes of \$3.9 million and \$3.2 million for the three months ended September 30, 2010 and 2009, respectively, represented estimated federal, foreign, and state taxes. The effective tax rate for the three months ended September 30, 2010 was 17.2% and diverged from the combined federal and state statutory rate primarily because of foreign income taxed at lower tax rates and state research credits, partially offset by net unrecognized tax benefit associated with qualified stock options. The effective tax rate for the three months ended September 30, 2009 was 24.9% and diverged from the combined federal and state statutory rate primarily as a result of foreign income taxed at lower tax rates, the benefit of federal and state research tax credits, and the impact of tax-exempt interest income, partially offset by net unrecognized tax benefit associated with qualified stock options, the impairment of an investment for which a valuation allowance was established, and the establishment of a valuation allowance on certain deferred tax assets.

Unrecognized Tax Benefits

The total liability for gross unrecognized tax benefits increased \$924,000 during the quarter ended September 30, 2010 to \$19.9 million from \$19.0 million at June 30, 2010. The liability for gross unrecognized tax benefit, if recognized, would reduce the effective tax rate on income from continuing operations. The increase consisted of an addition of \$924,000 for a current year tax position. The total interest and penalties accrued related to unrecognized tax benefits as of the end of fiscal 2010 was \$1.2 million. The liability for gross interest expense and penalties increased by \$153,000 to \$1.4 million for the quarter ended September 30, 2010. We classify interest and penalties, if any, as components of income tax expense.

No material unrecognized tax benefit is expected to be paid within one year, and we cannot make a reliable estimate when cash settlement with a taxing authority may occur. Any prospective adjustments to our unrecognized tax benefits will be recorded as an increase or decrease to income tax expense and cause a corresponding change to our effective tax rate. Accordingly, our effective tax rate could fluctuate materially from period to period.

It is reasonably possible that the amount of the liability for unrecognized tax benefits may change within the next twelve months. An estimate of the range of possible changes cannot be made at this time because of the high uncertainty of the resolution of our tax positions with the various tax jurisdictions in which we operate. Accordingly, the unrecognized tax benefits from prior year tax positions that may be necessary to accrue or reverse for the next twelve months cannot be reasonably estimated at this time.

Our major tax jurisdictions are the United States, California, and Hong Kong SAR and fiscal 2003 onward remain subject to examination by one or more of these jurisdictions.

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The federal research tax credit expired December 31, 2009. In the past, the federal research credit has expired and has been retroactively reinstated. It is not clear if the research credit will be retroactively reinstated or reinstated at all. If the research credit is not reinstated, our tax rate in future periods will continue to be negatively impacted.

California Proposition 24 proposes to repeal certain tax laws scheduled to take effect in 2011. This proposition will be voted on by California residents on November 2, 2010. If passed, our effective tax rate for the quarter ending December 31, 2010 would benefit from a material one-time net credit, primarily to remove valuation allowances associated with certain California deferred tax assets.

11. Segment, Customers, and Geographic Information

We operate in one segment: the development, marketing, and sale of custom-designed capacitive interface solutions that enable people to interact more easily and intuitively with a wide variety of electronic devices and products. We generate our revenue from two broad product categories: the personal computing, or PC, market and digital lifestyle product markets. The PC market accounted for 51% and 62% of net revenue for the three months ended September 30, 2010 and 2009, respectively.

Net revenue within geographic areas based on our customers' locations for the periods presented was as follows (in thousands):

	Three Months Ended September 30,	
	2010	2009
China	\$ 101,147	\$ 95,733
Taiwan	25,139	6,011
Japan	17,221	8,061
Korea	5,429	9,632
Other	4,249	155
	<u>\$ 153,185</u>	<u>\$ 119,592</u>

Major customers as a percentage of net revenue for the periods presented were as follows:

	Three Months Ended September 30,	
	2010	2009
Customer A	*	12%
Customer B	*	11%

* Less than 10%

We sell our products primarily to contract manufacturers that provide manufacturing services to Original Equipment Manufacturers, or OEMs. We extend credit based on an evaluation of a customer's financial condition, and we generally do not require collateral. Major customer accounts receivable as a percentage of accounts receivable for the periods presented were as follows:

	As of September 30, 2010	As of June 30, 2010
	Customer A	11%
Customer B	*	12%

* Less than 10%

12. Comprehensive Income

Our comprehensive income generally consists of net income plus the effect of unrealized gains and losses on our investments primarily due to changes in market value of certain of our ARS investments and interest rate fluctuations on our fixed interest rate investments. In addition, we recognize the noncredit portion of other-than-temporary impairment in comprehensive income. We recognize remeasurement adjustments in our consolidated statement of income as the U.S. dollar is the functional currency of our foreign entities.

Our comprehensive income for the three months ended September 30, 2010 and 2009 was as follows (in thousands):

	Three Months Ended September 30,	
	2010	2009
Net income	\$ 18,699	\$ 9,804
Net unrealized gain on available-for-sale investments, net of tax	537	1,183
Total comprehensive income	<u>\$ 19,236</u>	<u>\$ 10,987</u>

We recorded an unrealized gain of \$537,000 and \$1.2 million for the three months ended September 30, 2010, and 2009, respectively, primarily related to the temporary recovery in fair value of certain ARS investments.

13. Subsequent Events

We have evaluated all events or transactions that occurred after September 30, 2010 through the date of filing this report and determined there were no material recognizable subsequent events.

At our annual meeting of stockholders held on October 19, 2010, our stockholders approved an amendment to our Certificate of Incorporation to increase the total number of our authorized shares of common stock from 60,000,000 to 120,000,000. In addition, our stockholders also approved both our 2010 Incentive Compensation Plan to replace our expiring 2001 Incentive Compensation Plan and our 2010 Employee Stock Purchase Plan to replace our expiring 2001 Employee Stock Purchase Plan.

Subsequent to quarter end, Thomas J. Tieman resigned as President, Chief Executive Officer, and a director of our company. Mr. Tieman also withdrew as a nominee for election to our Board of Directors. In accordance with Mr. Tieman's Separation Agreement and Release we will accrue approximately \$1.0 million for salary continuation, bonus and benefits and \$1.4 million for share based compensation costs in our quarter ending December 31, 2010. Following Mr. Tieman's resignation, Russell J. Knittel, a long-time executive of our company, was elected Interim President and Chief Executive Officer. The Board of Directors has launched an immediate search for a successor President and Chief Executive Officer.

Subsequent to quarter end, as of November 1, 2010, we purchased 732,940 shares of our common stock under our common stock purchase program, at an average cost of \$26.98.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements and Factors That May Affect Results

You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and notes in Item 1 and with our audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended June 30, 2010.

In addition to the historical information contained in this report, this report contains forward-looking statements, including those related to our operating model and strategies; our market penetration and market share in the PC and digital lifestyle product markets; competition factors in the PC and digital lifestyle product markets; revenue from the PC and digital lifestyle product markets; industry estimates of growth rates of these markets; average selling prices; product design mix; manufacturing costs; cost-improvement programs; gross margins; customer relationships; research and development expenses; selling, general, and administrative expenses; liquidity and anticipated cash requirements; and our ability to provide local sales, operational, and engineering support to customers. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially.

We caution that these statements are qualified by various factors that may affect future results, including the following: economic conditions; changes in the market for our products and the success of our customers' products; our success in moving products from the design phase into the manufacturing phase; changes in the competitive environment; infringement claims; warranty obligations related to product failures; the failure of key technologies to deliver commercially acceptable performance; our dependence on certain key markets; penetration into new markets; the absence of both long-term purchase and supply commitments; and our lengthy development and product acceptance cycles. This report should be read in conjunction with our Annual Report on Form 10-K for the year ended June 30, 2010, including particularly Item 1A — Risk Factors.

Overview

We are a leading worldwide developer and supplier of custom-designed human interface solutions that enable people to interact more easily and intuitively with a wide variety of mobile computing, communications, entertainment, and other electronic devices. We believe our results to date reflect the combination of our customer focus, the strength of our intellectual property, and our engineering know-how, which allow us to develop or engineer products that meet the demanding design specifications of OEMs.

Many of our customers have migrated their manufacturing operations from Taiwan to China, and many of our OEM customers have established design centers in that region. With our expanded global presence, including offices in Canada, China, Finland, Hong Kong, Japan, Korea, Switzerland, Taiwan, and the United States, we are well positioned to provide local sales, operational, and engineering support services to our existing customers, as well as potential new customers, on a global basis.

Our manufacturing operations are based on a variable cost model in which we outsource all of our production requirements and generally drop ship our products directly to our customers from our contract manufacturers' facilities, eliminating the need for significant capital expenditures and allowing us to minimize our investment in inventories. This approach requires us to work closely with our contract manufacturers to ensure adequate production capacity to meet our forecasted volume requirements. We provide our contract manufacturers with six-month rolling forecasts and issue purchase orders based on our anticipated requirements for the next 90 days. However, we do not have any long-term supply contracts with any of our contract manufacturers. We use two third-party wafer manufacturers to supply wafers and two third-party packaging manufacturers to package our proprietary ASICs. In certain cases, we rely on a single source or a limited number of suppliers to provide other key components of our products. Our cost of revenue includes all costs associated with the production of our products, including materials, logistics, manufacturing, assembly, and test costs paid to third-party manufacturers and related overhead costs associated with our indirect manufacturing operations personnel. Additionally, we charge all warranty costs, yield losses, and any inventory provisions or write-downs to cost of revenue.

Our gross margin generally reflects the combination of the added value we bring to our OEM customers' products in meeting their custom design requirements and the impact of our ongoing cost-improvement programs. These cost-improvement programs include reducing materials and component costs and implementing design and process improvements. Our newly introduced products may have lower margins than our more mature products, which have realized greater benefits associated with our ongoing cost-improvement programs. As a result, new product introductions may initially negatively impact our gross margin.

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Our research and development expenses include personnel costs and supplies and materials costs related to product development, as well as the engineering costs incurred to design capacitive interface solutions for OEM customers prior to and after their commitment to incorporate those solutions into their products. These expenses have generally increased, reflecting our continuing commitment to the technological and design innovation required to maintain our position in our existing markets and to adapt our existing technologies or develop new technologies for new markets.

Selling, general, and administrative expenses include expenses related to sales, marketing, and administrative personnel; internal sales and outside sales representatives' commissions; market and usability research; outside legal, accounting, and consulting costs; and other marketing and sales activities. These expenses have generally increased, primarily reflecting incremental staffing and related support costs associated with our increased business levels, growth in our existing markets, and penetration into new markets.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, cost of revenue, inventories, product warranty, provision for income taxes, income taxes payable, intangible assets, and contingencies. We base our estimates on historical experience, applicable laws, and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The methods, estimates, interpretations, and judgments we use in applying our most critical accounting policies can have a significant impact on the results that we report in our consolidated financial statements. The SEC considers an entity's most critical accounting policies to be those policies that are both most important to the portrayal of the entity's financial condition and results of operations and those that require the entity's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about matters that are inherently uncertain. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

We recognize revenue from product sales when there is persuasive evidence that an arrangement exists, delivery has occurred or title has transferred, the price is fixed or determinable, and collection is reasonably assured. We accrue for estimated sales returns and other allowances, based on historical experience, at the time we recognize revenue.

Investments

We record available-for-sale securities at fair value, with unrealized gains and losses being reported as a component of other comprehensive income and we assess whether our investments with loss positions are other-than-temporarily impaired. We follow the hierarchical approach to determine fair value of our investments.

The accounting standards define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Our fair value estimates consider, among other factors, the collateral underlying the security investments, creditworthiness of the counterparty, timing of expected future cash flows, and, in the case of ARS investments, the probability of a successful auction in a future period. We follow the guidance provided to estimate fair value when the volume and level of activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability and to determine circumstances that may indicate that a transaction is not orderly.

Further, we use judgment in evaluating whether a decline in fair value is temporary or other-than-temporary and consider the following indicators: changes in credit ratings or asset quality; changes in the economic environment; length of time and extent to which fair value has been below cost basis; changes in market conditions; and changes in expected cash flows. We do not intend to sell the investments and it is more likely than not that we will not be required to sell the investments before recovery of their amortized cost basis. Temporary declines in fair value are recorded as charges to accumulated other comprehensive income in the equity section of our balance sheet, while other-than-temporary declines in fair value are bifurcated between credit losses, which are charged to earnings, and noncredit losses, which depending on the type of investment, may be charged to other comprehensive income or earnings.

Inventory

We state our inventories at the lower of cost or market. We base our assessment of the ultimate realization of inventories on our projections of future demand and market conditions. Sudden declines in demand, rapid product improvements, or technological changes, or any combination of these factors, can cause us to have excess or obsolete inventories. On an ongoing basis, we review for estimated obsolete or unmarketable inventories and write down our inventories to their net realizable value based upon our forecasts of future demand and market conditions. If actual market conditions are less favorable than our forecasts, additional inventory write-downs may be required. The following factors influence our estimates: changes to or cancellations of customer orders, unexpected decline in demand, rapid product improvements and technological advances, and termination or changes by our OEM customers of any product offerings incorporating our product solutions.

Periodically, we purchase inventory from our contract manufacturers when a customer delays its delivery schedule or cancels its order. In those circumstances in which our customer has cancelled its order and we purchase inventory from our contract manufacturers, we consider a write-down to reduce the carrying value of the inventory purchased to its net realizable value. We charge write-downs to reduce the carrying value of obsolete, slow moving, and non-usable inventory to net realizable value to cost of revenue. The effect of these write-downs is to establish a new cost basis in the related inventory, which we do not subsequently write up.

Share-Based Compensation Costs

We utilize the Black-Scholes option pricing model to estimate the grant date fair value of employee share-based compensatory awards, which requires the input of highly subjective assumptions, including expected volatility and expected life. Historical and implied volatilities were used in estimating the fair value of our share-based awards, while the expected life for our options was estimated based on historical trends since our initial public offering. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. Further, we estimate forfeitures for share-based awards that are not expected to vest. We charge the estimated fair value less estimated forfeitures to earnings on a straight-line basis over the vesting period of the underlying awards, which is generally four years for our stock options and DSUs and up to two years for our ESPP.

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. As our stock option and ESPP awards have characteristics that differ significantly from traded options, and as changes in the subjective assumptions can materially affect the estimated value, our estimate of fair value may not accurately represent the value assigned by a third party in an arms-length transaction. There currently is no market-based mechanism to verify the reliability and accuracy of the estimates derived from the Black-Scholes option pricing model or other allowable valuation models, nor is there a means to compare and adjust the estimates to actual values. While our estimate of fair value and the associated charge to earnings materially affects our results of operations, it has no impact on our cash position.

There are significant variations among allowable valuation models, and there is a possibility that we may adopt a different valuation model or refine the inputs and assumptions under our current valuation model in the future, resulting in a lack of consistency in future periods. Our current or future valuation model and the inputs and assumptions we make may also lack comparability to other companies that use different models, inputs, or assumptions, and the resulting differences in comparability could be material.

Income Taxes

We recognize federal, foreign, and state current tax liabilities or assets based on our estimate of taxes payable or refundable in the then current fiscal year for each tax jurisdiction. We also recognize federal, foreign, and state deferred tax liabilities or assets for our estimate of future tax effects attributable to temporary differences and carryforwards and record a valuation allowance to reduce any deferred tax assets by the amount of any tax benefits that, based on available evidence and our judgment, are not expected to be realized. If our assumptions, and consequently our estimates, change in the future, the valuation allowance we have established for our deferred tax assets may be changed, which could impact income tax expense.

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We use a two-step approach to recognizing and measuring uncertain tax positions. The first step is to determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement with a taxing authority. The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of highly complex tax laws. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material impact on our consolidated financial position, result of operations, or cash flows. We believe we have adequately provided for reasonably foreseeable outcomes in connection with the resolution of income tax uncertainties. However, our results have in the past, and could in the future, include favorable and unfavorable adjustments to our estimated tax liabilities in the period a determination of such estimated tax liability is made or resolved, upon the filing of an amended return, upon a change in facts, circumstances, or interpretation, or upon the expiration of a statute of limitation. Accordingly, our effective tax rate could fluctuate materially from period to period.

We recognize tax benefit upon expensing nonqualified stock options and DSUs issued under our share-based compensation plans. However, under current accounting standards, we cannot recognize tax benefit concurrent with expensing incentive stock options and employee stock purchase plan shares (qualified stock options) issued under our share-based compensation plans. For qualified stock options that vested after our adoption of new accounting standards, we recognize tax benefit only in the period when disqualifying dispositions of the underlying stock occur, which historically has been up to several years after vesting and in periods when our stock price substantially increases. For qualified stock options that vested prior to our adoption of new accounting standards, we record the tax benefit directly to additional paid-in capital. Accordingly, because we cannot recognize the tax benefit for share-based compensation expense associated with qualified stock options until the occurrence of future disqualifying dispositions of the underlying stock and such disqualified dispositions may happen in periods when our stock price substantially increases, and because a portion of that tax benefit may be directly recorded to additional paid-in capital, our future quarterly and annual effective tax rates will be subject to greater volatility and, consequently, our ability to estimate reasonably our future quarterly and annual effective tax rates is greatly diminished.

[Table of Contents](#)**Results of Operations**

Certain of our condensed consolidated statements of income data for the periods indicated, together with comparative absolute and percentage changes in these amounts, were as follows (in thousands, except percentages):

	Three Months Ended September 30,			
	2010	2009	\$ Change	% Change
PC applications	\$ 78,853	\$ 74,565	\$ 4,288	5.8%
Digital lifestyle product applications	74,332	45,027	29,305	65.1%
Net revenue	<u>153,185</u>	<u>119,592</u>	<u>33,593</u>	<u>28.1%</u>
Gross margin	<u>62,828</u>	<u>48,322</u>	<u>14,506</u>	<u>30.0%</u>
Operating expenses:				
Research and development	24,920	19,975	4,945	24.8%
Selling, general, and administrative	<u>15,548</u>	<u>13,764</u>	<u>1,784</u>	<u>13.0%</u>
Income from operations	<u>22,360</u>	<u>14,583</u>	<u>7,777</u>	<u>53.3%</u>
Interest income	211	331	(120)	(36.3%)
Interest expense	(4)	(1,423)	1,419	(99.7%)
Impairment (loss)/recovery of investment, net	<u>10</u>	<u>(443)</u>	<u>453</u>	<u>(102.3%)</u>
Income before provision for income taxes	22,577	13,048	9,529	73.0%
Provision for income taxes	<u>3,878</u>	<u>3,244</u>	<u>634</u>	<u>19.5%</u>
Net income	<u>\$ 18,699</u>	<u>\$ 9,804</u>	<u>\$ 8,895</u>	<u>90.7%</u>

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Certain of our condensed consolidated statements of income data as a percentage of net revenue for the periods indicated were as follows:

	Three Months Ended September 30,		Percentage Point Increase (Decrease)
	2010	2009	
PC applications	51.5%	62.3%	(10.8%)
Digital lifestyle product applications	48.5%	37.7%	10.8%
Net revenue	100.0%	100.0%	
Gross margin	41.0%	40.4%	0.6%
Operating expenses:			
Research and development	16.3%	16.7%	(0.4%)
Selling, general, and administrative	10.1%	11.5%	(1.4%)
Income from operations	14.6%	12.2%	2.4%
Income before provision for income taxes	14.7%	10.9%	3.8%
Provision for income taxes	2.5%	2.7%	(0.2%)
Net income	12.2%	8.2%	4.0%

Net Revenue.

Net revenue was \$153.2 million for the quarter ended September 30, 2010 compared with \$119.6 million for the quarter ended September 30, 2009, an increase of \$33.6 million, or 28.1%. Of our first quarter fiscal 2011 net revenue, \$78.9 million, or 51.5%, was from PC products and \$74.3 million, or 48.5%, was from digital lifestyle products, including \$72.4 million from mobile smartphones. The increase in net revenue for the quarter ended September 30, 2010 was attributable to a \$29.3 million, or a 65.1%, increase in net revenue from digital lifestyle product applications and a \$4.3 million, or 5.8%, increase in net revenue from PC applications. The overall increase in net revenue was primarily attributable to a 24% increase in unit shipments reflecting higher market penetration of our products in the PC and digital lifestyle markets, as well as a slightly higher priced product mix.

Based on calendar year 2011 industry estimates, the notebook market is anticipated to increase approximately 24% and the mobile smartphone market is anticipated to increase approximately 22% over 2010 levels.

Gross Margin.

Gross margin as a percentage of net revenue was 41.0%, or \$62.8 million, for the quarter ended September 30, 2010 compared with 40.4%, or \$48.3 million, for the quarter ended September 30, 2009.

As each custom-designed module we sell utilizes our capacitive sensing technology in a design that is generally unique or specific to a customer's application, gross margin varies on a product-by-product basis, making our cumulative gross margin a blend of our product specific designs and independent of the vertical markets that our products serve.

Operating Expenses.

Research and Development Expenses. Research and development expenses decreased as a percentage of net revenue to 16.3% from 16.7%, while the cost of research and development activities increased \$4.9 million, or 24.8%, to \$24.9 million for the three-month period ended September 30, 2010 compared with \$20.0 million for the three-month period ended September 30, 2009. The increase in research and development expenses primarily reflected a \$2.1 million increase in employee compensation costs from our annual merit adjustments, additional staffing, and employee benefits costs, a \$1.0 million increase in temporary services, a \$1.0 million increase in facility and related costs to support the additional staffing, and a \$629,000 increase in share-based compensation costs.

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Selling, General, and Administrative Expenses. Selling, general, and administrative expenses decreased as a percentage of net revenue to 10.1% from 11.5%, while the cost of selling, general, and administrative activities increased to \$15.5 million for the three-month period ended September 30, 2010 compared with \$13.8 million for the three-month period ended September 30, 2009. The increase in selling, general, and administrative expenses primarily reflected a \$1.0 million increase in employee compensation costs from our annual merit adjustments, additional staffing, and employee benefits costs, a \$369,000 increase in share-based compensation costs, as well as an increase of \$329,000 of travel and entertainment costs.

Interest Expense. All of our interest expense related to our Notes issued in December 2004. Interest expense was \$4,000 for the three months ended September 30, 2010 compared with interest expense of \$1.4 million, of which \$1.2 million represents debt issuance cost amortization, for the three months ended September 30, 2009. During fiscal 2010, \$63.0 million of Notes were retired, leaving \$2.3 million outstanding as of June 30, 2010 and September 30, 2010.

Provision for Income Taxes.

We account for income taxes under the asset and liability method. We consider the operating earnings of our foreign subsidiaries to be indefinitely invested outside the United States. Accordingly, no provision has been made for the U.S. federal or state or foreign taxes that may result from future remittances of undistributed earnings of our foreign subsidiaries.

The provision for income taxes of \$3.9 million and \$3.2 million for the three months ended September 30, 2010 and 2009, respectively, represented estimated federal, foreign, and state taxes. The effective tax rate for the three months ended September 30, 2010 was 17.2% and diverged from the combined federal and state statutory rate primarily because of foreign income taxed at lower tax rates and state research credits, partially offset by net unrecognized tax benefit associated with qualified stock options. The effective tax rate for the three months ended September 30, 2009 was 24.9% and diverged from the combined federal and state statutory rate, primarily as a result of foreign income taxed at lower tax rates, the benefit of federal and state research tax credits, and the impact of tax-exempt interest income, partially offset by net unrecognized tax benefit associated with qualified stock options, the impairment of an investment for which a valuation allowance was established, and the establishment of a valuation allowance on certain deferred tax assets.

Tax benefit associated with share-based compensation was approximately \$2.4 million and \$2.2 million for the three months ended September 30, 2010 and 2009, respectively. Excluding the impact of share-based compensation and the related tax benefit, the effective tax rate for the three months ended September 30, 2010 and 2009 would have been 20.5% and 27.1%, respectively.

The federal research tax credit expired December 31, 2009. In the past, the federal research credit has expired and has been retroactively reinstated. It is not clear if the research credit will be retroactively reinstated or reinstated at all. If the research credit is not reinstated, our tax rate in future periods will be negatively impacted.

California Proposition 24 proposes to repeal certain tax laws scheduled to take effect in 2011. This proposition will be voted on by California residents on November 2, 2010. If passed, our effective tax rate for the quarter ending December 31, 2010 would benefit from a material one-time net credit primarily to remove valuation allowances associated with certain California deferred tax assets.

Liquidity and Capital Resources

Our cash and cash equivalents were \$230.6 million as of September 30, 2010 compared with \$209.9 million as of June 30, 2010, an increase of \$20.7 million. The increase primarily reflected \$19.1 million provided from operating cash flows and \$6.1 million of proceeds from common stock issued under our share-based compensation plans, partially offset by \$3.8 million used for the purchase of capital equipment.

Cash Flows from Operating Activities. Operating activities during the three months ended September 30, 2010 generated cash of approximately \$19.1 million compared with approximately \$29.9 million of cash generated during the three months ended September 30, 2009. For the three months ended September 30, 2010, net cash provided by operating activities was primarily attributable to net income of \$18.7 million plus adjustments for non-cash charges of \$9.5 million, in addition to a \$9.1 million net increase in operating assets and liabilities. The net increase in operating assets and liabilities was primarily attributable to a \$14.5 million increase in accounts receivable reflecting the increase in our net revenue during the period. Our days sales outstanding increased from 63 to 68 days from June 30, 2010 to September 30, 2010 and our inventory turns increased from 19 to 24 days for the same period.

Cash Flows from Investing Activities. Our investing activities typically relate to purchases of government-backed securities and investment-grade fixed income instruments and purchases of property and equipment. Investing activities during the three months ended September 30, 2010 used net cash of \$3.6 million compared with \$3.9 million of net cash generated during the three months ended September 30, 2009. During the three months ended September 30, 2010, net cash used in investing activities consisted of \$3.8 million used for the purchase of property and equipment, partially offset by proceeds of \$200,000 on non-current investments.

Cash Flows from Financing Activities. Net cash provided by financing activities for the three months ended September 30, 2010 was approximately \$5.2 million compared with \$22.8 million net cash used in financing activities for the three months ended September 30, 2009. Cash provided by financing activities for the three months ended September 30, 2010 was primarily related to \$6.1 million of proceeds from common stock issued under our share-based compensation plans, partially offset by \$896,000 used for the payment of payroll taxes for deferred stock units.

Common Stock Repurchase Program. Our Board of Directors has cumulatively authorized \$420 million for our common stock repurchase program. The program authorizes us to purchase our common stock in the open market or in privately negotiated transactions depending upon market conditions and other factors. The number of shares repurchased and the timing of repurchases is based on the level of our cash balances, general business and market conditions, and other factors, including alternative investment opportunities. Common stock repurchased under this program is held as treasury stock. From April 2005 through September 30, 2010, we repurchased 10,871,313 shares of our common stock in the open market for an aggregate cost of \$281.9 million. Treasury shares purchased prior to August 28, 2008 were not subject to the stock split on that date, if adjusted for the stock split the average cost would be \$18.29. As of September 30, 2010, we had \$138.1 million available under our common stock repurchase program, which expires in April 2012.

Bank Credit Facility. We currently maintain a \$40.0 million unsecured working capital line of credit with Wells Fargo Bank. The Wells Fargo Bank revolving line of credit, which expires on September 1, 2011, provides for an interest rate equal to the prime lending rate or 250 basis points above LIBOR, depending on whether we choose a variable or fixed rate, respectively. We had not borrowed any amounts under the line of credit as of September 30, 2010.

Convertible Senior Subordinated Notes. In December 2004, we issued an aggregate of \$125 million of Notes maturing December 1, 2024 in a private offering pursuant to Rule 144A under the Securities Act. In connection with issuing the Notes, we incurred debt issuance costs of \$4.3 million, consisting primarily of the initial purchasers' discount and costs related to legal, accounting, and printing. We have purchased and retired \$122.7 million of the Notes. The remaining \$2.3 million of Notes outstanding as of September 30, 2010 have been classified as long-term as the next date Noteholders can require us to repurchase all or a portion of the Notes is beyond one year.

\$250 Million Shelf Registration. We have registered an aggregate of \$250 million of common stock (including the associated rights), preferred stock, debt securities, depository shares, warrants, purchase contracts, and units (collectively "securities") for issuance to raise funds for general corporate purposes, which may include the repayment of indebtedness outstanding from time to time, working capital, capital expenditures, acquisitions, and repurchases of our common stock or other securities. Securities issued under the shelf registration generally will be freely tradeable after their issuance unless held by an affiliate of our company, in which case such shares will be subject to the volume and manner of sale restrictions of Rule 144.

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\$100 Million Shelf Registration. We have registered an aggregate of \$100 million of common stock and preferred stock for issuance in connection with acquisitions, which shares generally will be freely tradeable after their issuance under Rule 145 of the Securities Act unless held by an affiliate of the acquired company, in which case such shares will be subject to the volume and manner of sale restrictions of Rule 144.

Liquidity and Capital Resources. We believe our existing cash and cash equivalents balances and anticipated cash flows from operating activities will be sufficient to meet our working capital and other cash requirements over the course of at least the next twelve months. Our future capital requirements will depend on many factors, including our rate of revenue growth or decline, the timing and extent of spending to support product development efforts, costs related to protecting our intellectual property, the expansion of sales and marketing activities, the timing of introductions of new products and enhancements to existing products, the costs to ensure access to adequate manufacturing capacity, the continuing market acceptance of our product solutions, our common stock purchase program, and the amount and timing of our investments in, or acquisitions of, other technologies or companies. Further equity or debt financing may not be available to us on acceptable terms or at all. If sufficient funds are not available or are not available on acceptable terms, our ability to take advantage of unexpected business opportunities or to respond to competitive pressures could be limited or severely constrained.

Our non-current investments consist of ARS investments, which have failed to settle in auctions. These failures generally resulted in the interest rates resetting on the regularly scheduled auction dates. These investments are not liquid, and in the event we need to access these funds, we will not be able to do so without a loss of principal, unless redeemed by the issuers or a future auction on these investments is successful. At September 30, 2010, the fair value of our ARS investments was \$28.4 million compared with an original cost basis of \$40.5 million. In the first three months of 2010, \$200,000 of our ARS investments were redeemed at par and we recognized a gain of \$10,000 on the redemption. In connection with our fair value analysis for the three months ended September 30, 2010, there was no other-than-temporary impairment charge recorded.

Based on our ability to access our cash and other short-term investments, our expected operating cash flows, and our other sources of cash, we do not anticipate the lack of liquidity on these investments will affect our ability to operate our business as usual.

Contractual Obligations and Commercial Commitments

Our material contractual obligations and commercial commitments as of September 30, 2010 were as follows (in millions):

Contractual Obligations	Payments due by period				
	Total	Less than 1 year	1-3 Years	3-5 Years	More than 5 Years
Convertible senior subordinated notes (1)	\$ 3	\$ —	\$ —	\$ —	\$ 3
Leases	7	2	4	1	—
Purchase obligations and other commitments	17	6	6	5	—
Total	<u>\$ 27</u>	<u>\$ 8</u>	<u>\$ 10</u>	<u>\$ 6</u>	<u>\$ 3</u>

(1) Represents both principal and interest payable through the maturity date of the underlying contractual obligation.

As of September 30, 2010, we were unable to make a reasonably reliable estimate of when cash settlement with a taxing authority may occur in connection with our unrecognized tax benefits of \$19.9 million.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risk has not changed significantly from the interest rate and foreign currency risks disclosed in Item 7A of our Annual Report on Form 10-K for the fiscal year ended June 30, 2010.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures, which included inquiries made to certain other of our employees. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have each concluded that our disclosure controls and procedures are designed and are effective to ensure that information required to be disclosed is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure and are effective and sufficient to ensure that we record, process, summarize, and report information required to be disclosed by us in our periodic reports filed under the Securities Exchange Act of 1934, as amended, within the time periods specified by the SEC's rules and forms.

As reflected in the subsequent events note in the notes to condensed consolidated financial statements (unaudited), our Chief Executive Officer resigned and has been replaced by an interim Chief Executive Officer who was an existing officer of our company. There has been no change in any internal controls as a result of this change.

During the fiscal quarter covered by this report, there have not been any changes in our internal control over financial reporting that have materially affected, or a reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

Our Board of Directors has cumulatively authorized \$420 million for our common stock repurchase program. The remaining amount authorized for the repurchase of our common stock is \$138.1 million. There were no repurchases under the stock repurchase program during the three-month period ended September 30, 2010.

ITEM 6. EXHIBITS

10.24(a)	2010 Incentive Compensation Plan
10.24(b)	Form of Non-Qualified Stock Option Agreement for 2010 Incentive Compensation Plan (1)
10.24(c)	Form of Incentive Stock Option Agreement for 2010 Incentive Compensation Plan (1)
10.24(d)	Form of Deferred Stock Award Agreement for 2010 Incentive Compensation Plan (1)
10.25	2010 Employee Stock Purchase Plan (1)
31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer
32.2	Section 1350 Certification of Chief Financial Officer
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Incorporated by reference to the registrant's Form 8-K as filed with the SEC on October 22, 2010.

* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SYNAPTICS INCORPORATED

Date: November 2, 2010

By: /s/ Russell J. Knittel
Name: Russell J. Knittel
Title: Interim President and Chief Executive Officer

By: /s/ Kathleen A. Bayless
Name: Kathleen A. Bayless
Title: Chief Financial Officer, Secretary, and Treasurer

SYNAPTICS INCORPORATED

2010 INCENTIVE COMPENSATION PLAN

1. **Purpose.** The purpose of this PLAN (the “Plan”) is to assist SYNAPTICS INCORPORATED, a Delaware corporation (the “Company”) and its Related Entities in attracting, motivating, retaining and rewarding high-quality executives and other Employees, officers, Directors and Consultants by enabling such persons to acquire or increase a proprietary interest in the Company in order to strengthen the mutuality of interests between such persons and the Company’s stockholders, and providing such persons with annual and long term performance incentives to expend their maximum efforts in the creation of stockholder value. The Plan is intended to qualify certain compensation awarded under the Plan for tax deductibility under Section 162(m) of the Code (as hereafter defined) to the extent deemed appropriate by the Committee.

2. **Definitions.** For purposes of the Plan, the following terms shall be defined as set forth below, in addition to such terms defined in Section 1 hereof.

(a) “**Annual Incentive Award**” means a conditional right granted to a Participant under Section 7(c) hereof to receive a cash payment, Stock or other Award, unless otherwise determined by the Committee, after the end of a specified fiscal year.

(b) “**Award**” means any Option, Stock Appreciation Right, Restricted Stock, Deferred Stock Unit, Stock granted as a bonus or in lieu of another award, Dividend Equivalent, Other Stock-Based Award, Performance Award or Annual Incentive Award, together with any other right or interest, granted to a Participant under the Plan.

(c) “**Beneficiary**” means the person, persons, trust or trusts which have been designated by a Participant in his or her most recent written beneficiary designation filed with the Committee to receive the benefits specified under the Plan upon such Participant’s death or to which Awards or other rights are transferred if and to the extent permitted under Section 10(b) hereof. If, upon a Participant’s death, there is no designated Beneficiary or surviving designated Beneficiary, then the term Beneficiary means the person, persons, trust or trusts entitled by will or the laws of descent and distribution to receive such benefits.

(d) “**Beneficial Owner**”, “**Beneficially Owning**” and “**Beneficial Ownership**” shall have the meanings ascribed to such terms in Rule 13d-3 under the Exchange Act and any successor to such Rule.

(e) “**Board**” means the Company’s Board of Directors.

(f) “**Cause**” shall, with respect to any Participant, have the equivalent meaning (or the same meaning as “cause” or “for cause”) set forth in any employment, consulting, change in control or other agreement for the performance of services between the Participant and the Company or a Related Entity or, in the absence of any such agreement or any such definition in such agreement, such term shall mean (i) the failure by the Participant to perform his or her duties as assigned by the Company (or a Related Entity) in a reasonable manner, (ii) any violation or breach by the Participant of his or her employment, consulting or other similar agreement with the Company (or a Related Entity), if any, (iii) any violation or breach by the Participant of his or her non-competition and/or non-disclosure agreement with the Company (or a Related Entity), if any, (iv) any act by the Participant of dishonesty or bad faith with respect to the Company (or a Related Entity), (v) chronic addiction to alcohol, drugs or other similar substances affecting the Participant’s work performance, or (vi) the commission by the Participant of any act, misdemeanor, or crime reflecting unfavorably upon the Participant or the Company or any Related Entity. The good faith determination by the Committee of whether the Participant’s Continuous Service was terminated by the Company for “Cause” shall be final and binding for all purposes hereunder.

(g) “**Change in Control**” means a Change in Control as defined with related terms in Section 9 of the Plan.

(h) “**Code**” means the Internal Revenue Code of 1986, as amended from time to time, including regulations thereunder and successor provisions and regulations thereto.

(i) “**Committee**” means a committee designated by the Board to administer the Plan; provided, however, that the Committee shall consist of at least two directors, and each member of which shall be (i) a “non-employee director” within the meaning of Rule 16b-3 under the Exchange Act, unless administration of the Plan by “non-employee directors” is not then required in order for exemptions under Rule 16b-3 to apply to transactions under the Plan, and (ii) an “outside director” within the meaning of Section 162(m) of the Code, unless administration of the Plan by “outside directors” is not then required in order to qualify for tax deductibility under Section 162(m) of the Code.

(j) “**Consultant**” means any person (other than an Employee or a Director, solely with respect to rendering services in such person’s capacity as a director) who is engaged by the Company or any Related Entity to render consulting or advisory services to the Company or such Related Entity.

(k) “**Continuous Service**” means uninterrupted provision of services to the Company in any capacity of Employee, Director, or Consultant. Continuous Service shall not be considered to be interrupted in the case of (i) any approved leave of absence, (ii) transfers among the Company, any Related Entities, or any successor entities, in any capacity of Employee Director, or Consultant, or (iii) any change in status as long as the individual remains in the service of the Company or a Related Entity in any capacity of Employee, Director, or Consultant (except as otherwise provided in the Option Agreement). An approved leave of absence shall include sick leave, military leave, or any other authorized personal leave.

(l) “**Corporate Transaction**” means a Corporate Transaction as defined in Section 9(b)(i) of the Plan.

(m) “**Covered Employee**” means an Eligible Person who is a Covered Employee as specified in Section 7(e) of the Plan.

(n) “**Deferred Stock Unit**” means a right, granted to a Participant under Section 6(e) hereof, to receive Stock, cash or a combination thereof at the end of a specified deferral period.

(o) “**Director**” means a member of the Board or the board of directors of any Related Entity.

(p) “**Disability**” means a permanent and total disability (within the meaning of Section 22(e) of the Code), as determined by a medical doctor satisfactory to the Committee.

(q) “**Dividend Equivalent**” means a right, granted to a Participant under Section 6(g) hereof, to receive cash, Stock, other Awards or other property equal in value to dividends paid with respect to a specified number of shares of Stock, or other periodic payments.

(r) “**Effective Date**” means the effective date of the Plan, which shall be the date of stockholder approval of this Plan.

(s) “**Eligible Person**” means each Executive Officer of the Company (as defined under the Exchange Act) and other officers, Directors and Employees of the Company or of any Related Entity, and Consultants with the Company or any Related Entity. The foregoing notwithstanding, only employees of the Company, the Parent, or any Subsidiary shall be Eligible Persons for purposes of receiving any Incentive Stock Options. An Employee on leave of absence may be considered as still in the employ of the Company or a Related Entity for purposes of eligibility for participation in the Plan.

(t) “**Employee**” means any person, including an officer or Director, who is an employee of the Company or any Related Entity. The Payment of a director’s fee by the Company or a Related Entity shall not be sufficient to constitute “employment” by the Company.

(u) “**Exchange Act**” means the Securities Exchange Act of 1934, as amended from time to time, including rules thereunder and successor provisions and rules thereto.

(v) “**Executive Officer**” means an executive officer of the Company as defined under the Exchange Act.

(w) “**Fair Market Value**” means the fair market value of Stock, Awards or other property as determined by the Committee, or under procedures established by the Committee. Unless otherwise determined by the Committee, the Fair Market Value of Stock as of any given date shall be the closing sale price per share reported on a consolidated basis for stock listed on the principal stock exchange or market on which Stock is traded on the date as of which such value is being determined or, if there is no sale on that date, then on the last previous day on which a sale was reported.

(x) “**Good Reason**” shall, with respect to any Participant, have the equivalent meaning (or the same meaning as “good reason” or “for good reason”) set forth in any employment, consulting, change in control or other agreement for the performance of services between the Participant and the Company or a Related Entity or, in the absence of any such agreement, such term shall mean (i) the assignment to the Participant of any duties inconsistent in any respect with the Participant’s position (including status, offices, titles and reporting requirements), authority, duties or responsibilities as assigned by the Company (or a Related Entity), or any other action by the Company (or a Related Entity) which results in a diminution in such position, authority, duties or responsibilities, excluding for this purpose an isolated, insubstantial and inadvertent action not taken in bad faith and which is remedied by the Company (or a Related Entity) promptly after receipt of notice thereof given by the Participant; (ii) any failure by the Company (or a Related Entity) to comply with its obligations to the Participant as agreed upon, other than an isolated, insubstantial and inadvertent failure not occurring in bad faith and which is remedied by the Company (or a Related Entity) promptly after receipt of notice thereof given by the Participant; (iii) the Company’s (or Related Entity’s) requiring the Participant to be based at any office or location outside of fifty miles from the location of employment as of the date of Award, except for travel reasonably required in the performance of the Participant’s responsibilities; (iv) any purported termination by the Company (or a Related Entity) of the Participant’s Continuous Service otherwise than for Cause as defined in Section 2(f), or by reason of the Participant’s Disability as defined in Section 2(q). For purposes of this Section 2(y), any good faith determination of “Good Reason” made by the Committee shall be conclusive.

(y) “**Incentive Stock Option**” means any Option intended to be designated as an incentive stock option within the meaning of Section 422 of the Code or any successor provision thereto.

(z) “**Incumbent Board**” means the Incumbent Board as defined in Section 9(b)(ii) of the Plan.

(aa) “**Option**” means a right granted to a Participant under Section 6(b) hereof, to purchase Stock or other Awards at a specified price during specified time periods.

(bb) “**Optionee**” means a person to whom an Option is granted under this Plan or any person who succeeds to the rights of such person under this Plan.

(cc) “**Other Stock-Based Awards**” means Awards granted to a Participant under Section 6(h) hereof.

(dd) “**Parent**” means a “parent corporation,” whether now or hereafter existing, as defined in Section 424(e) of the Code.

(ee) “**Participant**” means a person who has been granted an Award under the Plan which remains outstanding, including a person who is no longer an Eligible Person.

(ff) “**Performance Award**” means a right, granted to an Eligible Person under Section 7 hereof, to receive Awards based upon performance criteria specified by the Committee.

(gg) “**Person**” shall have the meaning ascribed to such term in Section 3(a)(9) of the Exchange Act and used in Sections 13(d) and 14(d) thereof, and shall include a “group” as defined in Section 13(d) thereof.

(hh) “**Related Entity**” means any Parent, Subsidiary, and any business, corporation, partnership, limited liability company, or other entity designated by the Committee in which the Company, a Parent, or a Subsidiary, directly or indirectly, holds a substantial ownership interest.

(ii) “**Restricted Stock**” means Stock granted to a Participant under Section 6(d) hereof, that is subject to certain restrictions and to a risk of forfeiture.

(jj) “**Rule 16b-3**” and “**Rule 16a-1(c)(3)**” means Rule 16b-3 and Rule 16a-1(c)(3), as from time to time in effect and applicable to the Plan and Participants, promulgated by the Securities and Exchange Commission under Section 16 of the Exchange Act.

(kk) “**Stock**” means the Company’s Common Stock, and such other securities as may be substituted (or resubstituted) for Stock pursuant to Section 10(c) hereof.

(ll) “**Stock Appreciation Right**” means a right granted to a Participant under Section 6(c) hereof.

(mm) “**Subsidiary**” means a “subsidiary corporation” whether now or hereafter existing, as defined in Section 424(f) of the Code.

3. Administration.

(a) **Authority of the Committee.** The Plan shall be administered by the Committee. The Committee shall have full and final authority, in each case subject to and consistent with the provisions of the Plan, to select Eligible Persons to become Participants, grant Awards, determine the type, number and other terms and conditions of, and all other matters relating to, Awards, prescribe Award agreements (which need not be identical for each Participant) and rules and regulations for the administration of the Plan, construe and interpret the Plan and Award agreements and correct defects, supply omissions or reconcile inconsistencies therein, and to make all other decisions and determinations as the Committee may deem necessary or advisable for the administration of the Plan. In exercising any discretion granted to the Committee under the Plan or pursuant to any Award, the Committee shall not be required to follow past practices, act in a manner consistent with past practices, or treat any Eligible Person in a manner consistent with the treatment of other Eligible Persons.

(b) **Manner of Exercise of Committee Authority.** Any action of the Committee shall be final, conclusive and binding on all persons, including the Company, its Related Entities, Participants, Beneficiaries, transferees under Section 10(b) hereof or other persons claiming rights from or through a Participant, and stockholders. The express grant of any specific power to the Committee, and the taking of any action by the Committee, shall not be construed as limiting any power or authority of the Committee. The Committee may delegate to officers or managers of the Company or any Related Entity, or committees thereof, the authority, subject to such terms as the Committee shall determine, (i) to perform administrative functions, (ii) with respect to Participants not subject to Section 16 of the Exchange Act, to perform such other functions as the Committee may determine, and (iii) with respect to Participants subject to Section 16, to perform such other functions of the Committee as the Committee may determine to the extent performance of such functions will not result in the loss of an exemption under Rule 16b-3 otherwise available for transactions by such persons, in each case to the extent permitted under applicable law and subject to the requirements set forth in Section 7(d). The Committee may appoint agents to assist it in administering the Plan.

(c) **Limitation of Liability.** The Committee, and each member thereof, shall be entitled to, in good faith, rely or act upon any report or other information furnished to him or her by any Executive Officer, other officer or Employee, the Company’s independent auditors, Consultants or any other agents assisting in the administration of the Plan. Members of the Committee, and any officer or Employee acting at the direction or on behalf of the Committee, shall not be personally liable for any action or determination taken or made in good faith with respect to the Plan, and shall, to the extent permitted by law, be fully indemnified and protected by the Company with respect to any such action or determination.

4. Stock Subject to Plan.

(a) **Limitation on Overall Number of Shares Subject to Awards.** Subject to adjustment as provided in Section 10(c) hereof, the total number of shares of Stock reserved and available for delivery in connection with Awards under the Plan shall be the number of shares of Stock available for issuance under the Company's Amended and Restated 2001 Incentive Compensation Plan (the "2001 Plan") that are not subject to an outstanding award under the 2001 Plan as of the date of stockholder approval of this Plan (and such shares shall no longer be available for issuance under the 2001 Plan). Any shares of Stock delivered under the Plan may consist, in whole or in part, of authorized and unissued shares or treasury shares.

(b) **Availability of Shares Not Issued pursuant to Awards.** In the event that any Option or other Award granted hereunder is exercised through the withholding of shares of Stock from the Award by the Company or withholding tax liabilities arising from such Option or other Award are satisfied by the withholding of shares of Stock from the Award by the Company, then only the number of shares of Stock issued net of the shares of Stock withheld shall be counted as issued for purposes of determining the maximum number of shares of Stock available for grant under the Plan, subject to Section 4(c) below.

(c) **Limitation on Number of Incentive Stock Option Shares.** Subject to adjustment as provided in Section 10(c) hereof, the number of shares of Stock which may be issued pursuant to Incentive Stock Options shall be the lesser of (i) the number of shares of Stock that may be subject to Awards under Section 4(a), or (ii) 15,000,000.

(d) **Application of Limitations.** The limitation contained in this Section 4 shall apply not only to Awards that are settled by the delivery of shares of Stock but also to Awards relating to shares of Stock but settled only in cash (such as cash-only Stock Appreciation Rights). The Committee may adopt reasonable counting procedures to ensure appropriate counting, avoid double counting (as, for example, in the case of tandem or substitute awards) and make adjustments if the number of shares of Stock actually delivered differs from the number of shares previously counted in connection with an Award.

5. Eligibility; Per-Person Award Limitations. Awards may be granted under the Plan only to Eligible Persons. In each fiscal year during any part of which the Plan is in effect, an Eligible Person may not be granted Awards relating to more than 1,000,000 shares of Stock, subject to adjustment as provided in Section 10(c), under each of Sections 6(b), 6(c), 6(d), 6(e), 6(f), 6(g), 6(h), 7(b) and 7(c). In addition, the maximum amount that may be earned as an Annual Incentive Award or other cash Award in any fiscal year by any one Participant shall be \$2,000,000, and the maximum amount that may be earned as a Performance Award or other cash Award in respect of a performance period by any one Participant shall be \$5,000,000.

6. Specific Terms of Awards.

(a) **General.** Awards may be granted on the terms and conditions set forth in this Section 6. In addition, the Committee may impose on any Award or the exercise thereof, at the date of grant or thereafter (subject to Section 10(e)), such additional terms and conditions, not inconsistent with the provisions of the Plan, as the Committee shall determine, including terms requiring forfeiture of Awards in the event of termination of Continuous Service by the Participant and terms permitting a Participant to make elections relating to his or her Award. The Committee shall retain full power and discretion to accelerate, waive or modify, at any time, any term or condition of an Award that is not mandatory under the Plan. Except in cases in which the Committee is authorized to require other forms of consideration under the Plan, or to the extent other forms of consideration must be paid to satisfy the requirements of Delaware law, no consideration other than services may be required for the grant (but not the exercise) of any Award.

(b) **Options.** The Committee is authorized to grant Options to Participants on the following terms and conditions:

(i) **Stock Option Agreement.** Each grant of an Option under the Plan shall be evidenced by a Stock Option Agreement. Such Stock Option Agreement shall be subject to all applicable terms and conditions of the Plan and may be subject to any other terms and conditions which are not inconsistent with the Plan and which the Committee deems appropriate for inclusion in a Stock Option Agreement. The provisions of the various Stock Option Agreements entered into under the Plan need not be identical.

(ii) **Number of Shares.** Each Stock Option Agreement shall specify the number of shares of Stock that are subject to the Option and shall provide for the adjustment of such number in accordance with Section 10(c) hereof. The Stock Option Agreement shall also specify whether the Option is an Incentive Stock Option or a Non-Qualified Stock Option.

(iii) **Exercise Price.**

(A) **In General.** Each Stock Option Agreement shall state the price at which shares of Stock subject to the Option may be purchased (the "Exercise Price"), which shall be not less than 100% of the Fair Market Value of the Stock on the date of grant.

(B) **Ten Percent Stockholder.** If an individual owns or is deemed to own (by reason of the attribution rules applicable under Section 424(d) of the Code) more than 10% of the combined voting power of all classes of stock of the Company or any Related Entity, the Exercise Price of an Incentive Stock Option must be at least 110% of the Fair Market Value of a share of Stock on the date of grant and such Incentive Stock Option by its terms is not exercisable after the expiration of five years from the date of grant.

(iv) **Time and Method of Exercise.** The Committee shall determine the time or times at which or the circumstances under which an Option may be exercised in whole or in part (including based on achievement of performance goals and/or future service requirements), provided that in the case of an Optionee who is not an officer, Director, or Consultant of the Company or a Related Entity, his or her Options shall become exercisable at least as rapidly as 20% per year, over a 5 year period commencing on the date of the grant, unless a determination is made by counsel for the Company that such vesting requirements are not required in the circumstances under applicable federal or state securities laws. The Committee may also determine the time or times at which Options shall cease to be or become exercisable following termination of Continuous Service or upon other conditions; provided, however, if the Optionee's Continuous Service is terminated for any reason other than Cause, that portion of the Option that is exercisable as of the date of termination shall remain exercisable for at least 6 months from the date of termination if by reason of death or Disability, and for at least 30 days from the date of termination if by reason other than the Optionee's death or Disability. The Committee may determine the methods by which such exercise price may be paid or deemed to be paid (including in the discretion of the Committee a cashless exercise procedure), the form of such payment, including, without limitation, cash, Stock, other Awards or awards granted under other plans of the Company or a Related Entity, or other property (including notes or other contractual obligations of Participants to make payment on a deferred basis), and the methods by or forms in which Stock will be delivered or deemed to be delivered to Participants.

(v) **Incentive Stock Options.** The terms of any Incentive Stock Option granted under the Plan shall comply in all respects with the provisions of Section 422 of the Code. Anything in the Plan to the contrary notwithstanding, no term of the Plan relating to Incentive Stock Options (including any Stock Appreciation Rights in tandem therewith) shall be interpreted, amended or altered, nor shall any discretion or authority granted under the Plan be exercised, so as to disqualify either the Plan or any Incentive Stock Option under Section 422 of the Code, unless the Participant has first requested the change that will result in such disqualification. Thus, if and to the extent required to comply with Section 422 of the Code, Options granted as Incentive Stock Options shall be subject to the following special terms and conditions:

(A) the Option shall not be exercisable more than seven years after the date such Incentive Stock Option is granted; provided, however, that if a Participant owns or is deemed to own (by reason of the attribution rules of Section 424(d) of the Code) more than 10% of the combined voting power of all classes of stock of the Company or any Parent Corporation and the Incentive Stock Option is granted to such Participant, the term of the Incentive Stock Option shall be (to the extent required by the Code at the time of the grant) for no more than five years from the date of grant; and

(B) The aggregate Fair Market Value (determined as of the date the Incentive Stock Option is granted) of the shares of stock with respect to which Incentive Stock Options granted under the Plan and all other option plans of the Company or its Parent Corporation during any calendar year are exercisable for the first time by the Participant during any calendar year shall not (to the extent required by the Code at the time of the grant) exceed \$100,000.

(vi) **Repurchase Rights.** The Committee shall have the discretion to grant Options which are exercisable for unvested shares of Common Stock. Should the Optionee's Continuous Service cease while holding such unvested shares, the Company shall have the right to repurchase, at the exercise price paid per share, any or all of those unvested shares. The terms upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Committee and set forth in the document evidencing such repurchase right.

(c) **Stock Appreciation Rights.** The Committee is authorized to grant Stock Appreciation Rights to Participants on the following terms and conditions:

(i) **Right to Payment.** A Stock Appreciation Right shall confer on the Participant to whom it is granted a right to receive, upon exercise thereof, the excess of (A) the Fair Market Value of one share of stock on the date of exercise, over (B) the grant price of the Stock Appreciation Right as determined by the Committee. The grant price of a Stock Appreciation Right shall not be less than the Fair Market Value of a share of Stock on the date of grant.

(ii) **Other Terms.** The Committee shall determine at the date of grant or thereafter, the time or times at which and the circumstances under which a Stock Appreciation Right may be exercised in whole or in part (including based on achievement of performance goals and/or future service requirements), the time or times at which Stock Appreciation Rights shall cease to be or become exercisable following termination of Continuous Service or upon other conditions, the method of exercise, method of settlement, form of consideration payable in settlement, method by or forms in which Stock will be delivered or deemed to be delivered to Participants, whether or not a Stock Appreciation Right shall be in tandem or in combination with any other Award, and any other terms and conditions of any Stock Appreciation Right. Stock Appreciation Rights may be either freestanding or in tandem with other Awards.

(d) **Restricted Stock.** The Committee is authorized to grant Restricted Stock to Participants on the following terms and conditions:

(i) **Grant and Restrictions.** Restricted Stock shall be subject to such restrictions on transferability, risk of forfeiture and other restrictions, if any, as the Committee may impose, or as otherwise provided in this Plan. The restrictions may lapse separately or in combination at such times, under such circumstances (including based on achievement of performance goals and/or future service requirements), in such installments or otherwise, as the Committee may determine at the date of grant or thereafter provided that the restrictions shall not lapse in less than three years or less than one year in the case of performance-based Restricted Stock except that a total of not more than 400,000 shares of Common Stock may be subject of restricted stock and deferred stock units without regard to such restriction period. Except to the extent restricted under the terms of the Plan and any Award agreement relating to the Restricted Stock, a Participant granted Restricted Stock shall have all of the rights of a stockholder, including the right to vote the Restricted Stock and the right to receive dividends thereon (subject to any mandatory reinvestment or other requirement imposed by the Committee). During the restricted period applicable to the Restricted Stock, subject to Section 10(b) below, the Restricted Stock may not be sold, transferred, pledged, hypothecated, margined or otherwise encumbered by the Participant.

(ii) **Forfeiture.** Except as otherwise determined by the Committee at the time of the Award, upon termination of a Participant's Continuous Service during the applicable restriction period, the Participant's Restricted Stock that is at that time subject to restrictions shall be forfeited (or, in accordance with Section 6(b)(vi), reacquired by the Company); provided that the Committee may provide, by rule or regulation or in any Award agreement, or may determine in any individual case, that restrictions or forfeiture conditions relating to Restricted Stock shall be waived in whole or in part in the event of terminations resulting from specified causes, and the Committee may in other cases waive in whole or in part the forfeiture of Restricted Stock.

(iii) **Certificates for Stock.** Restricted Stock granted under the Plan may be evidenced in such manner as the Committee shall determine. If certificates representing Restricted Stock are registered in the name of the Participant, the Committee may require that such certificates bear an appropriate legend referring to the terms, conditions and restrictions applicable to such Restricted Stock, that the Company retain physical possession of the certificates, and that the Participant deliver a stock power to the Company, endorsed in blank, relating to the Restricted Stock.

(iv) **Dividends and Splits.** As a condition to the grant of an Award of Restricted Stock, the Committee may require that any cash dividends paid on a share of Restricted Stock be automatically reinvested in additional shares of Restricted Stock or applied to the purchase of additional Awards under the Plan. Unless otherwise determined by the Committee, Stock distributed in connection with a Stock split or Stock dividend, and other property distributed as a dividend, shall be subject to restrictions and a risk of forfeiture to the same extent as the Restricted Stock with respect to which such Stock or other property has been distributed.

(e) **Deferred Stock Units.** The Committee is authorized to grant Deferred Stock Units to Participants, which are rights to receive Stock, cash, or a combination thereof at the end of a specified time period, subject to the following terms and conditions:

(i) **Award and Restrictions.** Satisfaction of an Award of Deferred Stock Units shall occur upon expiration of the time specified for such Deferred Stock Units by the Committee (or, if permitted by the Committee, as elected by the Participant). In addition, Deferred Stock Units shall be subject to such restrictions (which may include a risk of forfeiture) as the Committee may impose, if any, which restrictions may lapse at the expiration of the time period or at earlier specified times (including based on achievement of performance goals and/or future service requirements), separately or in combination, in installments or otherwise, as the Committee may determine provided that the restrictions shall not lapse in less than three years or less than one year in the case of performance-based Deferred Stock Units except that a total of not more than 400,000 shares of Common Stock may be the subject of restricted stock and deferred stock units without regard to such restriction period. The terms of an Award of Deferred Stock Units shall be set forth in a written Award Agreement that shall contain provisions determined by the Committee and not inconsistent with the Plan. Deferred Stock Units may be satisfied by delivery of Stock, cash equal to the Fair Market Value of the specified number of shares of Stock covered by the Deferred Stock Units, or a combination thereof, as determined by the Committee at the date of grant or thereafter. Prior to satisfaction of an Award of Deferred Stock Units, an Award of Deferred Stock Units carries no voting or dividend or other rights associated with share ownership. Notwithstanding the foregoing or any other provision of the Plan, (A) all grants of Deferred Stock Units shall comply with the vesting terms of Section 6(b)(iv), and (B) unless otherwise exempt from Section 409A of the Code or otherwise specifically determined by the Committee, each Award of Deferred Stock Units shall be structured to avoid the imposition of any excise tax under Section 409A of the Code.

(ii) **Forfeiture.** Except as otherwise determined by the Committee, upon termination of a Participant's Continuous Service during the applicable time period thereof to which forfeiture conditions apply (as provided in the Award agreement evidencing the Deferred Stock Units), the Participant's Deferred Stock Units (other than those Deferred Stock Units subject to deferral at the election of the Participant) shall be forfeited; provided that the Committee may provide, by rule or regulation or in any Award agreement, or may determine in any individual case, that restrictions or forfeiture conditions relating to Deferred Stock Units shall be waived in whole or in part in the event of terminations resulting from specified causes, and the Committee may in other cases waive in whole or in part the forfeiture of Deferred Stock Units.

(iii) **Dividend Equivalents.** Unless otherwise determined by the Committee at date of grant, any Dividend Equivalents that are granted with respect to any Award of Deferred Stock Units shall be either (A) paid with respect to such Deferred Stock Units at the dividend payment date in cash or in shares of unrestricted Stock having a Fair Market Value equal to the amount of such dividends, or (B) deferred with respect to such Deferred Stock Units and the amount or value thereof automatically deemed reinvested in additional Deferred Stock Units, other Awards or other investment vehicles, as the Committee shall determine or permit the Participant to elect.

(f) **Bonus Stock and Awards in Lieu of Obligations.** The Committee is authorized to grant Stock as a bonus, or to grant Stock or other Awards in lieu of Company obligations to pay cash or deliver other property under the Plan or under other plans provided each such Award shall have a restricted period of not less than three years or not less than one year in the case of performance-based Awards or compensatory arrangements, provided that, in the case of Participants subject to Section 16 of the Exchange Act, the amount of such grants remains within the discretion of the Committee to the extent necessary to ensure that acquisitions of Stock or other Awards are exempt from liability under Section 16(b) of the Exchange Act. Stock or Awards granted hereunder shall be subject to such other terms as shall be determined by the Committee.

(g) **Dividend Equivalents.** The Committee is authorized to grant Dividend Equivalents to a Participant entitling the Participant to receive cash, Stock, other Awards, or other property equal in value to dividends paid with respect to a specified number of shares of Stock, or other periodic payments. Dividend Equivalents may be awarded on a free-standing basis or in connection with another Award. The Committee may provide that Dividend Equivalents shall be paid or distributed when accrued or shall be deemed to have been reinvested in additional Stock, Awards, or other investment vehicles, and subject to such restrictions on transferability and risks of forfeiture, as the Committee may specify. Notwithstanding any other provision of the Plan, unless otherwise exempt from Section 409A of the Code or otherwise specifically determined by the Committee, each Dividend Equivalent shall be structured to avoid the imposition of any excise tax under Section 409A of the Code.

(h) **Other Stock-Based Awards.** The Committee is authorized, subject to limitations under applicable law, to grant to Participants such other Awards that may be denominated or payable in, valued in whole or in part by reference to, or otherwise based on, or related to, Stock, as deemed by the Committee to be consistent with the purposes of the Plan, including, without limitation, convertible or exchangeable debt securities, other rights convertible or exchangeable into Stock, purchase rights for Stock, Awards with value and payment contingent upon performance of the Company or any other factors designated by the Committee, and Awards valued by reference to the book value of Stock or the value of securities of or the performance of specified Related Entities or business units. The Committee shall determine the terms and conditions of such Awards provided each such Award shall have a restricted period of not less than three years or not less than one year in the case of performance-based Awards. Stock delivered pursuant to an Award in the nature of a purchase right granted under this Section 6(h) shall be purchased for such consideration (including without limitation loans from the Company or a Related Entity), paid for at such times, by such methods, and in such forms, including, without limitation, cash, Stock, other Awards or other property, as the Committee shall determine. The Committee shall have the discretion to grant such other Awards which are exercisable for unvested shares of Common Stock. Should the Optionee's Continuous Service cease while holding such unvested shares, the Company shall have the right to repurchase, at the exercise price paid per share, any or all of those unvested shares. The terms upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Committee and set forth in the document evidencing such repurchase right. Cash awards, as an element of or supplement to any other Award under the Plan, may also be granted pursuant to this Section 6(h). Notwithstanding any other provision of the Plan, unless otherwise exempt from Section 409A of the Code or otherwise specifically determined by the Committee, each such Award shall be structured to avoid the imposition of any excise tax under Section 409A of the Code.

7. Performance and Annual Incentive Awards.

(a) **Performance Conditions.** The right of a Participant to exercise or receive a grant or settlement of any Award, and the timing thereof, may be subject to such performance conditions as may be specified by the Committee. The Committee may use such business criteria and other measures of performance as it may deem appropriate in establishing any performance conditions, and may exercise its discretion to reduce the amounts payable under any Award subject to performance conditions, except as limited under Sections 7(b) and 7(c) hereof in the case of a Performance Award or Annual Incentive Award intended to qualify under Code Section 162(m).

(b) **Performance Awards Granted to Designated Covered Employees.** If and to the extent that the Committee determines that a Performance Award to be granted to an Eligible Person who is designated by the Committee as likely to be a Covered Employee should qualify as “performance-based compensation” for purposes of Code Section 162(m), the grant, exercise and/or settlement of such Performance Award shall be contingent upon achievement of pre-established performance goals and other terms set forth in this Section 7(b).

(i) **Performance Goals Generally.** The performance goals for such Performance Awards shall consist of one or more business criteria and a targeted level or levels of performance with respect to each of such criteria, as specified by the Committee consistent with this Section 7(b). Performance goals shall be objective and shall otherwise meet the requirements of Code Section 162(m) and regulations thereunder including the requirement that the level or levels of performance targeted by the Committee result in the achievement of performance goals being “substantially uncertain.” The Committee may determine that such Performance Awards shall be granted, exercised and/or settled upon achievement of any one performance goal or that two or more of the performance goals must be achieved as a condition to grant, exercise and/or settlement of such Performance Awards. Performance goals may differ for Performance Awards granted to any one Participant or to different Participants.

(ii) **Business Criteria.** One or more of the following business criteria for the Company, on a consolidated basis, and/or specified Related Entities or business units of the Company (except with respect to the total stockholder return and earnings per share criteria), shall be used exclusively by the Committee in establishing performance goals for such Performance Awards: (1) total stockholder return; (2) such total stockholder return as compared to total return (on a comparable basis) of a publicly available index such as, but not limited to, the Standard & Poor’s 500 Stock Index or the S&P Specialty Retailer Index; (3) net income; (4) pretax earnings; (5) earnings before interest expense, taxes, depreciation and amortization; (6) pretax operating earnings after interest expense and before bonuses, service fees, and extraordinary or special items; (7) operating margin; (8) earnings per share; (9) return on equity; (10) return on capital; (11) return on investment; (12) operating earnings; (13) working capital or inventory; (14) operating earnings before the expense for share based awards; and (15) ratio of debt to stockholders’ equity. One or more of the foregoing business criteria shall also be exclusively used in establishing performance goals for Annual Incentive Awards granted to a Covered Employee under Section 7(c) hereof that are intended to qualify as “performance-based compensation under Code Section 162(m).

(iii) **Performance Period; Timing For Establishing Performance Goals.** Achievement of performance goals in respect of such Performance Awards shall be measured over a performance period of up to seven years, as specified by the Committee. Performance goals shall be established not later than 90 days after the beginning of any performance period applicable to such Performance Awards, or at such other date as may be required or permitted for “performance-based compensation” under Code Section 162(m).

(iv) **Performance Award Pool.** The Committee may establish a Performance Award pool, which shall be an unfunded pool, for purposes of measuring Company performance in connection with Performance Awards. The amount of such Performance Award pool shall be based upon the achievement of a performance goal or goals based on one or more of the business criteria set forth in Section 7(b)(ii) hereof during the given performance period, as specified by the Committee in accordance with Section 7(b)(iii) hereof. The Committee may specify the amount of the Performance Award pool as a percentage of any of such business criteria, a percentage thereof in excess of a threshold amount, or as another amount which need not bear a strictly mathematical relationship to such business criteria.

(v) **Settlement of Performance Awards; Other Terms.** Settlement of such Performance Awards shall be in cash, Stock, other Awards or other property, in the discretion of the Committee. The Committee may, in its discretion, reduce the amount of a settlement otherwise to be made in connection with such Performance Awards. The Committee shall specify the circumstances in which such Performance Awards shall be paid or forfeited in the event of termination of Continuous Service by the Participant prior to the end of a performance period or settlement of Performance Awards.

(c) **Annual Incentive Awards Granted to Designated Covered Employees.** The Committee may, within its discretion, grant one or more Annual Incentive Awards to any Eligible Person, subject to the terms and conditions set forth in this Section 7(c).

(i) **Annual Incentive Award Pool.** The Committee may establish an Annual Incentive Award pool, which shall be an unfunded pool, for purposes of measuring Company performance in connection with Annual Incentive Awards. In the case of Annual Incentive Awards intended to qualify as “performance-based compensation” for purposes of Code Section 162(m), the amount of such Annual Incentive Award pool shall be based upon the achievement of a performance goal or goals based on one or more of the business criteria set forth in Section 7(b)(ii) hereof during the given performance period, as specified by the Committee in accordance with Section 7(b)(iii) hereof. The Committee may specify the amount of the Annual Incentive Award pool as a percentage of any such business criteria, a percentage thereof in excess of a threshold amount, or as another amount which need not bear a strictly mathematical relationship to such business criteria.

(ii) **Potential Annual Incentive Awards.** Not later than the end of the 90th day of each fiscal year, or at such other date as may be required or permitted in the case of Awards intended to be “performance-based compensation” under Code Section 162(m), the Committee shall determine the Eligible Persons who will potentially receive Annual Incentive Awards, and the amounts potentially payable thereunder, for that fiscal year, either out of an Annual Incentive Award pool established by such date under Section 7(c)(i) hereof or as individual Annual Incentive Awards. In the case of individual Annual Incentive Awards intended to qualify under Code Section 162(m), the amount potentially payable shall be based upon the achievement of a performance goal or goals based on one or more of the business criteria set forth in Section 7(b)(ii) hereof in the given performance year, as specified by the Committee; in other cases, such amount shall be based on such criteria as shall be established by the Committee. In all cases, the maximum Annual Incentive Award of any Participant shall be subject to the limitation set forth in Section 5 hereof.

(iii) **Payout of Annual Incentive Awards.** After the end of each fiscal year, the Committee shall determine the amount, if any, of (A) the Annual Incentive Award pool, and the maximum amount of potential Annual Incentive Award payable to each Participant in the Annual Incentive Award pool, or (B) the amount of potential Annual Incentive Award otherwise payable to each Participant. The Committee may, in its discretion, determine that the amount payable to any Participant as an Annual Incentive Award shall be reduced from the amount of his or her potential Annual Incentive Award, including a determination to make no Award whatsoever. The Committee shall specify the circumstances in which an Annual Incentive Award shall be paid or forfeited in the event of termination of Continuous Service by the Participant prior to the end of a fiscal year or settlement of such Annual Incentive Award.

(d) **Written Determinations.** All determinations by the Committee as to the establishment of performance goals, the amount of any Performance Award pool or potential individual Performance Awards and as to the achievement of performance goals relating to Performance Awards under Section 7(b), and the amount of any Annual Incentive Award pool or potential individual Annual Incentive Awards and the amount of final Annual Incentive Awards under Section 7(c), shall be made in writing in the case of any Award intended to qualify under Code Section 162(m). The Committee may not delegate any responsibility relating to such Performance Awards or Annual Incentive Awards if and to the extent required to comply with Code Section 162(m).

(e) **Status of Section 7(b) and Section 7(c) Awards Under Code Section 162(m).** It is the intent of the Company that Performance Awards and Annual Incentive Awards under Section 7(b) and 7(c) hereof granted to persons who are designated by the Committee as likely to be Covered Employees within the meaning of Code Section 162(m) and regulations thereunder shall, if so designated by the Committee, constitute “qualified performance-based compensation” within the meaning of Code Section 162(m) and regulations thereunder. Accordingly, the terms of Sections 7(b), (c), (d) and (e), including the definitions of Covered Employee and other terms used therein, shall be interpreted in a manner consistent with Code Section 162(m) and regulations thereunder. The foregoing notwithstanding, because the Committee cannot determine with certainty whether a given Participant will be a Covered Employee with respect to a fiscal year that has not yet been completed, the term Covered Employee as used herein shall mean only a person designated by the Committee, at the time of grant of Performance Awards or an Annual Incentive Award, as likely to be a Covered Employee with respect to that fiscal year. If any provision of the Plan or any agreement relating to such Performance Awards or Annual Incentive Awards does not comply or is inconsistent with the requirements of Code Section 162(m) or regulations thereunder, such provision shall be construed or deemed amended to the extent necessary to conform to such requirements.

8. Certain Provisions Applicable to Awards or Sales.

(a) **Stand-Alone, Additional, Tandem, and Substitute Awards.** Awards granted under the Plan may, in the discretion of the Committee, be granted either alone or in addition to, in tandem with, or in substitution or exchange for, any other Award or any award granted under another plan of the Company, any Related Entity, or any business entity to be acquired by the Company or a Related Entity, or any other right of a Participant to receive payment from the Company or any Related Entity. Such additional, tandem, and substitute or exchange Awards may be granted at any time. If an Award is granted in substitution or exchange for another Award or award, the Committee shall require the surrender of such other Award or award in consideration for the grant of the new Award. In addition, Awards may be granted in lieu of cash compensation, including in lieu of cash amounts payable under other plans of the Company or any Related Entity in which the value of Stock subject to the Award is equivalent in value to the cash compensation.

(b) **Term of Awards.** The term of each Award shall be for such period as may be determined by the Committee or the Board; provided that in no event shall the term of any Option or Stock Appreciation Right exceed a period of seven years (or such shorter term as may be required in respect of an Incentive Stock Option under Section 422 of the Code).

(c) **Form and Timing of Payment Under Awards; Deferrals.** Subject to the terms of the Plan and any applicable Award agreement, payments to be made by the Company or a Related Entity upon the exercise of an Option or other Award or settlement of an Award may be made in such forms as the Committee shall determine, including, without limitation, cash, other Awards or other property, and may be made in a single payment or transfer, in installments, or on a deferred basis. The settlement of any Award may be accelerated, and cash paid in lieu of Stock in connection with such settlement, in the discretion of the Committee or upon occurrence of one or more specified events (in addition to a Change in Control). Installment or deferred payments may be required by the Committee (subject to Section 10(e) of the Plan) or permitted at the election of the Participant on terms and conditions established by the Committee. Payments may include, without limitation, provisions for the payment or crediting of a reasonable interest rate on installment or deferred payments or the grant or crediting of Dividend Equivalents or other amounts in respect of installment or deferred payments denominated in Stock.

(d) **Exemptions from Section 16(b) Liability.** It is the intent of the Company that this Plan comply in all respects with applicable provisions of Rule 16b-3 or Rule 16a-1(c)(3) to the extent necessary to ensure that neither the grant of any Awards to nor other transaction by a Participant who is subject to Section 16 of the Exchange Act is subject to liability under Section 16(b) thereof (except for transactions acknowledged in writing to be non-exempt by such Participant). Accordingly, if any provision of this Plan or any Award agreement does not comply with the requirements of Rule 16b-3 or Rule 16a-1(c)(3) as then applicable to any such transaction, such provision will be construed or deemed amended to the extent necessary to conform to the applicable requirements of Rule 16b-3 or Rule 16a-1(c)(3) so that such Participant shall avoid liability under Section 16(b).

(e) **Code Section 409A.** If and to the extent that the Committee believes that any Awards may constitute a “nonqualified deferred compensation plan” under Section 409A of the Code, the terms and conditions set forth in the Award Agreement for that Award shall be drafted in a manner that is intended to comply with, and shall be interpreted in a manner consistent with, the applicable requirements of Section 409A of the Code, unless otherwise agreed to in writing by the Participant and the Company.

(f) **No Option Repricing.** Other than pursuant to Section 10(c), without approval of the Company’s stockholders, the Committee shall not be permitted to (A) lower the exercise price per share of Stock of an Option after it is granted, (B) cancel an Option when the exercise price per share of Stock exceeds the Fair Market Value of the underlying share of Stock in exchange for another Award or cash, or (C) take any other action with respect to an Option that may be treated as a repricing.

9. Change in Control.

(a) **Effect of “Change in Control.”** If and to the extent provided in the Award, in the event of a “Change in Control,” as defined in Section 9(b):

(i) The Committee may, within its discretion, accelerate the vesting and exercisability of any Award carrying a right to exercise that was not previously vested and exercisable as of the time of the Change in Control, subject to applicable restrictions set forth in Section 10(a) hereof;

(ii) The Committee may, within its discretion, accelerate the exercisability of any Stock Appreciation Rights and provide for the settlement of such Stock Appreciation Rights for amounts, in cash;

(iii) The Committee may, within its discretion, lapse the restrictions, deferral of settlement, and forfeiture conditions applicable to any other Award granted under the Plan and such Awards may be deemed fully vested as of the time of the Change in Control, except to the extent of any waiver by the Participant and subject to applicable restrictions set forth in Section 10(a) hereof; and

(iv) With respect to any such outstanding Award subject to achievement of performance goals and conditions under the Plan, the Committee may, within its discretion, deem such performance goals and other conditions as having been met as of the date of the Change in Control.

(b) **Definition of “Change in Control.”** A “Change in Control” shall be deemed to have occurred upon:

(i) Approval by the stockholders of the Company of a reorganization, merger, consolidation or other form of corporate transaction or series of transactions, in each case, with respect to which persons who were the stockholders of the Company immediately prior to such reorganization, merger or consolidation or other transaction do not, immediately thereafter, own more than 50% of the combined voting power entitled to vote generally in the election of directors of the reorganized, merged or consolidated company’s then outstanding voting securities, or a liquidation or dissolution of the Company or the sale of all or substantially all of the assets of the Company (unless such reorganization, merger, consolidation or other corporate transaction, liquidation, dissolution or sale (any such event being referred to as a “Corporate Transaction”) is subsequently abandoned or otherwise does not occur);

(ii) Individuals who, as of the date on which the Award is granted, constitute the Board (the “Incumbent Board”) cease for any reason to constitute at least a majority of the Board, provided that any person becoming a director subsequent to the date on which the Award was granted whose election, or nomination for election by the Company’s stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the Directors of the Company) shall be, for purposes of this Agreement, considered as though such person were a member of the Incumbent Board; or

(iii) the acquisition (other than from the Company) by any person, entity or “group”, within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act, of more than 50% of either the then outstanding shares of the Company’s Common Stock or the combined voting power of the Company’s then outstanding voting securities entitled to vote generally in the election of directors (hereinafter referred to as the ownership of a “Controlling Interest”) excluding, for this purpose, any acquisitions by (1) the Company or a Related Entity, (2) any person, entity or “group” that as of the date on which the Award is granted owns beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Securities Exchange Act) of a Controlling Interest or (3) any employee benefit plan of the Company or a Related Entity.

10. General Provisions.

(a) **Compliance With Legal and Other Requirements.** The Company may, to the extent deemed necessary or advisable by the Committee, postpone the issuance or delivery of Stock or payment of other benefits under any Award until completion of such registration or qualification of such Stock or other required action under any federal or state law, rule or regulation, listing or other required action with respect to any stock exchange or automated quotation system upon which the Stock or other Company securities are listed or quoted, or compliance with any other obligation of the Company, as the Committee, may consider appropriate, and may require any Participant to make such representations, furnish such information and comply with or be subject to such other conditions as it may consider appropriate in connection with the issuance or delivery of Stock or payment of other benefits in compliance with applicable laws, rules, and regulations, listing requirements, or other obligations. The foregoing notwithstanding, in connection with a Change in Control, the Company shall take or cause to be taken no action, and shall undertake or permit to arise no legal or contractual obligation, that results or would result in any postponement of the issuance or delivery of Stock or payment of benefits under any Award or the imposition of any other conditions on such issuance, delivery or payment, to the extent that such postponement or other condition would represent a greater burden on a Participant than existed on the 90th day preceding the Change in Control.

(b) Limits on Transferability; Beneficiaries.

(i) **General.** Except as provided herein, a Participant may not assign, sell, transfer, or otherwise encumber or subject to any lien any Award or other right or interest granted under this Plan, in whole or in part, including any Award or right which constitutes a derivative security as generally defined in Rule 16a1(c) under the Exchange Act, other than by will or by operation of the laws of descent and distribution, and such Awards or rights that may be exercisable shall be exercised during the lifetime of the Participant only by the Participant or his or her guardian or legal representative.

(ii) **Permitted Transfer of Option.** The Committee, in its sole discretion, may permit the transfer of an Option (but not an Incentive Stock Option, or any other right to purchase Stock other than an Option) as follows: (A) by gift to a member of the Participant's Immediate Family or (B) by transfer by instrument to a trust providing that the Option is to be passed to beneficiaries upon death of the Optionee. For purposes of this Section 10(b)(ii), "Immediate Family" shall mean the Optionee's spouse (including a former spouse subject to terms of a domestic relations order); child, stepchild, grandchild, child-in-law; parent, stepparent, grandparent, parent-in-law; sibling and sibling-in-law, and shall include adoptive relationships. If a determination is made by counsel for the Company that the restrictions contained in this Section 10(b)(ii) are not required by applicable federal or state securities laws under the circumstances, then the Committee, in its sole discretion, may permit the transfer of Awards (other than Incentive Stock Options and Stock Appreciation Rights in tandem therewith) to one or more Beneficiaries or other transferees during the lifetime of the Participant, which may be exercised by such transferees in accordance with the terms of such Award, but only if and to the extent permitted by the Committee pursuant to the express terms of an Award agreement (subject to any terms and conditions which the Committee may impose thereon, and further subject to any prohibitions and restrictions on such transfers pursuant to Rule 16b-3). A Beneficiary, transferee, or other person claiming any rights under the Plan from or through any Participant shall be subject to all terms and conditions of the Plan and any Award agreement applicable to such Participant, except as otherwise determined by the Committee, and to any additional terms and conditions deemed necessary or appropriate by the Committee.

(c) Adjustments.

(i) **Adjustments to Awards.** In the event that any dividend or other distribution (whether in the form of cash, Stock, or other property), recapitalization, forward or reverse split, reorganization, merger, consolidation, spin-off, combination, repurchase, share exchange, liquidation, dissolution or other similar corporate transaction or event affects the Stock and/or such other securities of the Company or any other issuer such that a substitution, exchange, or adjustment is determined by the Committee to be appropriate, then the Committee shall, in such manner as it deems equitable, substitute, exchange, or adjust any or all of (A) the number and kind of shares of Stock which may be delivered in connection with Awards granted thereafter, (B) the number and kind of shares of Stock by which annual per-person Award limitations are measured under Section 5 hereof, (C) the number and kind of shares of Stock subject to or deliverable in respect of outstanding Awards, (E) the exercise price, grant price or purchase price relating to any Award and/or make provision for payment of cash or other property in respect of any outstanding Award, and (F) any other aspect of any Award that the Committee determines to be appropriate.

(ii) **Adjustments in Case of Certain Corporate Transactions.** In the event of a proposed sale of all or substantially all of the Company's assets or any reorganization, merger, consolidation, or other form of corporate transaction in which the Company does not survive, or in which the shares of Stock are exchanged for or converted into securities issued by another entity, then the successor or acquiring entity or an affiliate thereof may, with the consent of the Committee, assume each outstanding Option or substitute an equivalent option or right. If the successor or acquiring entity or an affiliate thereof, does not cause such an assumption or substitution, then each Option shall terminate upon the consummation of sale, merger, consolidation, or other corporate transaction. The Committee shall give written notice of any proposed transaction referred to in this Section I 0(c)(ii) a reasonable period of time prior to the closing date for such transaction (which notice may be given either before or after the approval of such transaction), in order that Optionees may have a reasonable period of time prior to the closing date of such transaction within which to exercise any Options that are then exercisable (including any Options that may become exercisable upon the closing date of such transaction). An Optionee may condition his exercise of any Option upon the consummation of the transaction.

(iii) **Other Adjustments.** In addition, the Committee is authorized to make adjustments in the terms and conditions of, and the criteria included in, Awards (including Performance Awards and performance goals, and Annual Incentive Awards and any Annual Incentive Award pool or performance goals relating thereto) in recognition of unusual or nonrecurring events (including, without limitation, acquisitions and dispositions of businesses and assets) affecting the Company, any Related Entity or any business unit, or the financial statements of the Company or any Related Entity, or in response to changes in applicable laws, regulations, accounting principles, tax rates and regulations or business conditions or in view of the Committee's assessment of the business strategy of the Company, any Related Entity or business unit thereof, performance of comparable organizations, economic and business conditions, personal performance of a Participant, and any other circumstances deemed relevant; provided that no such adjustment shall be authorized or made if and to the extent that such authority or the making of such adjustment would cause Options, Stock Appreciation Rights, Performance Awards granted under Section 8(b) hereof or Annual Incentive Awards granted under Section 8(c) hereof to Participants designated by the Committee as Covered Employees and intended to qualify as "performance-based compensation" under Code Section 162(m) and the regulations thereunder to otherwise fail to qualify as "performance-based compensation" under Code Section 162(m) and regulations thereunder.

(d) **Taxes.** The Company and any Related Entity are authorized to withhold from any Award granted, any payment relating to an Award under the Plan, including from a distribution of Stock, or any payroll or other payment to a Participant, amounts of withholding and other taxes due or potentially payable in connection with any transaction involving an Award, and to take such other action as the Committee may deem advisable to enable the Company and Participants to satisfy obligations for the payment of withholding taxes and other tax obligations relating to any Award. This authority shall include authority to withhold or receive Stock or other property and to make cash payments in respect thereof in satisfaction of a Participant's tax obligations; either on a mandatory or elective basis in the discretion of the Committee.

(e) **Changes to the Plan and Awards.** The Board may amend, alter, suspend, discontinue or terminate the Plan, or the Committee's authority to grant Awards under the Plan, without the consent of stockholders or Participants, except that any amendment or alteration to the Plan shall be subject to the approval of the Company's stockholders not later than the annual meeting next following such Board action if (i) such stockholder approval is required by any federal or state law or regulation (including, without limitation, Rule 16b-3 or Code Section 162(m)) or the rules of any stock exchange or automated quotation system on which the Stock may then be listed or quoted, or (ii) the amendment or alteration to the Plan materially increases the benefits accruing to the participants under the Plan, materially increases the number of securities that may be issued under the Plan, or materially modifies the requirements for participant in the Plan, and the Board may otherwise, in its discretion, determine to submit other such changes to the Plan to stockholders for approval; provided that, without the consent of an affected Participant, no such Board action may materially and adversely affect the rights of such Participant under any previously granted and outstanding Award. The Committee may waive any conditions or rights under, or amend, alter, suspend, discontinue or terminate any Award theretofore granted and any Award agreement relating thereto, except as otherwise provided in the Plan; provided that, without the consent of an affected Participant, no such Committee action may materially and adversely affect the rights of such Participant under such Award.

(f) **Limitation on Rights Conferred Under Plan.** Neither the Plan nor any action taken hereunder shall be construed as (i) giving any Eligible Person or Participant the right to continue as an Eligible Person or Participant or in the employ of the Company or a Related Entity; (ii) interfering in any way with the right of the Company or a Related Entity to terminate any Eligible Person's or Participant's Continuous Service at any time, (iii) giving an Eligible Person or Participant any claim to be granted any Award under the Plan or to be treated uniformly with other Participants and Employees, or (iv) conferring on a Participant any of the rights of a stockholder of the Company unless and until the Participant is duly issued or transferred shares of Stock in accordance with the terms of an Award.

(g) **Unfunded Status of Awards; Creation of Trusts .** The Plan is intended to constitute an "unfunded" plan for incentive and deferred compensation. With respect to any payments not yet made to a Participant or obligation to deliver Stock pursuant to an Award, nothing contained in the Plan or any Award shall give any such Participant any rights that are greater than those of a general creditor of the Company; provided that the Committee may authorize the creation of trusts and deposit therein cash, Stock, other Awards or other property, or make other arrangements to meet the Company's obligations under the Plan. Such trusts or other arrangements shall be consistent with the "unfunded" status of the Plan unless the Committee otherwise determines with the consent of each affected Participant. The trustee of such trusts may be authorized to dispose of trust assets and reinvest the proceeds in alternative investments, subject to such terms and conditions as the Committee may specify and in accordance with applicable law.

(h) **Nonexclusivity of the Plan.** Neither the adoption of the Plan by the Board nor its submission to the stockholders of the Company for approval shall be construed as creating any limitations on the power of the Board or a committee thereof to adopt such other incentive arrangements as it may deem desirable including incentive arrangements and awards which do not qualify under Code Section 162(m).

(i) **Payments in the Event of Forfeitures; Fractional Shares.** Unless otherwise determined by the Committee, in the event of a forfeiture of an Award with respect to which a Participant paid cash or other consideration, the Participant shall be repaid the amount of such cash or other consideration. No fractional shares of Stock shall be issued or delivered pursuant to the Plan or any Award. The Committee shall determine whether cash, other Awards or other property shall be issued or paid in lieu of such fractional shares or whether such fractional shares or any rights thereto shall be forfeited or otherwise eliminated.

(j) **Governing Law.** The validity, construction and effect of the Plan, any rules and regulations under the Plan, and any Award agreement shall be determined in accordance with the laws of the State of Delaware without giving effect to principles of conflicts of laws, and applicable federal law.

(k) **Plan Effective Date and Stockholder Approval; Termination of Plan .** The Plan shall become effective on the Effective Date, provided the Plan is approved within 12 months of its adoption by the Board by stockholders of the Company eligible to vote in the election of directors, by a vote sufficient to meet the requirements of Code Sections 162(m) (if applicable) and 422, Rule 16b-3 under the Exchange Act (if applicable), applicable NASDAQ requirements, and other laws, regulations, and obligations of the Company applicable to the Plan. The Plan shall terminate no later than 10 years from the date the Plan is adopted by the Board or 10 years from the date the Plan is approved by the stockholders, whichever is earlier.

Certification of Chief Executive Officer

I, Russell J. Knittel, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Synaptics Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 2, 2010

/s/ Russell J. Knittel

Russell J. Knittel
Interim Chief Executive Officer

Certification of Chief Financial Officer

I, Kathleen A. Bayless, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Synaptics Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 2, 2010

/s/ Kathleen A. Bayless
Kathleen A. Bayless
Chief Financial Officer

Section 1350 Certification of Chief Executive Officer

In connection with the Quarterly Report on Form 10-Q of Synaptics Incorporated (the "Company") for the quarterly period ended September 25, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Russell J. Knittel, Chief Executive Officer of the Company, certify, to the best of my knowledge and belief, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Russell J. Knittel

Russell J. Knittel
Interim Chief Executive Officer
November 2, 2010

Section 1350 Certification of Chief Financial Officer

In connection with the Quarterly Report on Form 10-Q of Synaptics Incorporated (the "Company") for the quarterly period ended September 25, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Kathleen A. Bayless, Chief Financial Officer of the Company, certify, to the best of my knowledge and belief, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Kathleen A. Bayless

Kathleen A. Bayless
Chief Financial Officer
November 2, 2010

