

RITCHIE BROS AUCTIONEERS INC

Form 6-K

November 01, 2005

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

**Form 6-K  
REPORT OF FOREIGN PRIVATE ISSUER  
PURSUANT TO RULE 13A-16 OR 15D-16 UNDER  
THE SECURITIES EXCHANGE ACT OF 1934  
For the quarter ended September 30, 2005**

**Commission File Number: 001-13425  
Ritchie Bros. Auctioneers Incorporated**

6500 River Road  
Richmond, BC, Canada  
V6X 4G5  
(604) 273 7564

*(Address of principal executive offices)*

indicate by check mark whether the registrant files or will file annual reports  
under cover Form 20-F or Form 40-F

Form 20-F  Form 40-F

indicate by check mark if the registrant is submitting the Form 6-K in paper  
as permitted by Regulation S-T Rule 101(b)(1):

indicate by check mark if the registrant is submitting the Form 6-K in paper  
as permitted by Regulation S-T Rule 101(b)(7):

indicate by check mark whether by furnishing information contained in this Form,  
the registrant is also thereby furnishing the information to the Commission pursuant to  
Rule 12g3-2(b) under the Securities Exchange Act of 1934

Yes  No

If Yes is marked, indicate below the file number assigned to the registrant in  
connection with Rule 12g3-2(b): 82- \_\_\_\_\_

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**PART 1. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

The accompanying unaudited consolidated financial statements do not include all information and footnotes required by Canadian or United States generally accepted accounting principles for a complete set of annual financial statements. However, in the opinion of management, all adjustments (which consist only of normal recurring adjustments) necessary for a fair presentation of the results of operations for the relevant periods have been made. Results for the interim periods are not necessarily indicative of the results to be expected for the year or any other period. These financial statements should be read in conjunction with the summary of accounting policies and the notes to the consolidated financial statements included in the Company's Annual Report on Form 40-F for the fiscal year ended December 31, 2004, a copy of which has been filed with the Securities and Exchange Commission. These policies have been applied on a consistent basis.

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**RITCHIE BROS. AUCTIONEERS INCORPORATED**

## Consolidated Statements of Operations and Retained Earnings

(Expressed in thousands of United States dollars, except per share amounts)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Auction revenues	\$ 38,430	\$ 31,449	\$ 152,700	\$ 125,115
Direct expenses	4,487	3,005	18,563	15,405
	33,943	28,444	134,137	109,710
Expenses:				
Depreciation and amortization	3,198	3,246	10,061	9,253
General and administrative	23,859	20,989	68,316	60,826
	27,057	24,235	78,377	70,079
Earnings from operations	6,886	4,209	55,760	39,631
Other income (expense):				
Interest expense	(427)	(695)	(1,768)	(2,448)
Gain (loss) on disposition of capital assets	68	(16)	6,570	88
Other	65	234	302	516
	(294)	(477)	5,104	(1,844)
Earnings before income taxes	6,592	3,732	60,864	37,787
Income tax expense (recovery):				
Current	1,779	1,693	21,695	13,463
Future	245	229	(208)	760
	2,024	1,922	21,487	14,223
Net earnings	\$ 4,568	\$ 1,810	\$ 39,377	\$ 23,564
Net earnings per share (in accordance with Canadian and United States GAAP) (note 5):				
Basic	\$ 0.13	\$ 0.05	\$ 1.15	\$ 0.69
Diluted	\$ 0.13	\$ 0.05	\$ 1.13	\$ 0.68
Retained earnings, beginning of period	\$ 210,695	\$ 177,825	\$ 183,438	\$ 161,183
Net earnings	4,568	1,810	39,377	23,564
Cash dividends paid	(6,191)	(3,763)	(13,743)	(8,875)

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Retained earnings, end of period	\$ 209,072	\$ 175,872	\$ 209,072	\$ 175,872
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See accompanying notes to consolidated financial statements.

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**RITCHIE BROS. AUCTIONEERS INCORPORATED**

## Consolidated Balance Sheets

(Expressed in thousands of United States dollars)

	September 30, 2005	December 31, 2004
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 174,994	\$ 132,632
Accounts receivable	78,840	19,281
Inventory	8,607	13,091
Advances against auction contracts	9,706	968
Funds committed for debt repayment (note 4)	3,714	1,857
Prepaid expenses and deposits	4,484	2,323
Other assets	1,099	654
Future income tax asset	386	496
	281,830	171,302
Capital assets (note 3)	242,352	226,624
Funds committed for debt repayment (note 4)	1,393	5,108
Other assets	1,408	1,876
Goodwill	38,400	37,499
	\$ 565,383	\$ 442,409
Liabilities and Shareholders' Equity		
Current liabilities:		
Auction proceeds payable	\$ 151,293	\$ 47,581
Accounts payable and accrued liabilities	36,777	45,334
Income taxes payable	8,550	6,383
Current portion of long-term debt (note 4)	27,729	35,133
	224,349	134,431
Long-term debt (note 4)	17,400	10,792
Other liabilities	516	1,563
Future income tax liability	6,104	6,359
Shareholders' equity:		
Share capital (note 5)	79,730	76,445
Additional paid-in capital	8,722	7,859
Retained earnings	209,072	183,438

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Foreign currency translation adjustment	19,490	21,522
	317,014	289,264
Commitments and contingencies (note 6)		
Subsequent events (notes 4 and 5(b))		
	\$ 565,383	\$ 442,409

See accompanying notes to consolidated financial statements.

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**RITCHIE BROS. AUCTIONEERS INCORPORATED**

## Consolidated Statements of Shareholders' Equity

(Expressed in thousands of United States dollars)

(Unaudited)

	Share Capital	Additional Paid-In Capital	Retained Earnings	Foreign Currency Translation Adjustment	Total Shareholders Equity
Balance, December 31, 2004	\$ 76,445	\$ 7,859	\$ 183,438	\$ 21,522	\$ 289,264
Exercise of stock options	1,502	(222)			1,280
Stock compensation tax adjustment		126			126
Stock compensation expense		418			418
Net earnings			13,675		13,675
Cash dividends paid			(3,771)		(3,771)
Foreign currency translation adjustment				(2,202)	(2,202)
Balance, March 31, 2005	77,947	8,181	193,342	19,320	298,790
Exercise of stock options	1,470	(398)			1,072
Stock compensation tax adjustment		95			95
Stock compensation expense		346			346
Net earnings			21,134		21,134
Cash dividends paid			(3,781)		(3,781)
Foreign currency translation adjustment				(4,178)	(4,178)
Balance, June 30, 2005	79,417	8,224	210,695	15,142	313,478
Exercise of stock options	313	135			448
Stock compensation tax adjustment		13			13
Stock compensation expense		350			350
Net earnings			4,568		4,568
Cash dividends paid			(6,191)		(6,191)
Foreign currency translation adjustment				4,348	4,348
Balance, September 30, 2005	\$ 79,730	\$ 8,722	\$ 209,072	\$ 19,490	\$ 317,014

See accompanying notes to consolidated financial statements.

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**RITCHIE BROS. AUCTIONEERS INCORPORATED**

## Consolidated Statements of Cash Flows

(Expressed in thousands of United States dollars)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Cash provided by (used in):				
Operating activities:				
Net earnings	\$ 4,568	\$ 1,810	\$ 39,377	\$ 23,564
Items not involving cash:				
Depreciation and amortization	3,198	3,246	10,061	9,253
Stock compensation expense	350	357	1,114	1,106
Future income taxes	245	470	(208)	870
Net (gain) loss on disposition of capital assets	(68)	16	(6,570)	(88)
Changes in non-cash working capital:				
Accounts receivable	1,789	(8,972)	(59,559)	(52,084)
Inventory	(5,679)	(607)	4,484	(2,517)
Advances against auction contracts	(6,704)	(9)	(8,738)	(1,893)
Prepaid expenses and deposits	(293)	(881)	(2,161)	(375)
Income taxes payable	(7,507)	(4,650)	2,401	(3,121)
Auction proceeds payable	(26,597)	(7,704)	103,712	97,133
Accounts payable and accrued liabilities	(5,552)	(1,840)	(10,236)	(5,712)
Other	(538)	(1,570)	1,912	(427)
	(42,788)	(20,334)	75,589	65,709
Investing activities:				
Acquisition of business				(1,171)
Capital asset additions	(10,729)	(5,703)	(29,879)	(15,263)
Proceeds on disposition of capital assets	377	495	9,135	1,410
Decrease (increase) in other assets	124	(2,124)	448	(2,122)
	(10,228)	(7,332)	(20,296)	(17,146)
Financing activities:				
Issuance of share capital	448	161	2,800	3,030
Dividends on common shares	(6,191)	(3,763)	(13,743)	(8,875)
Issuance of long-term debt	12,266		16,016	
Repayment of long-term debt	(12,323)	(51)	(17,190)	(6,832)
Increase (decrease) in other liabilities		(1,011)	23	(983)
Increase in short-term debt		3,276		3,276
Decrease (increase) in funds committed for debt repayment			1,858	(3,715)
	(5,800)	(1,388)	(10,236)	(14,099)
Effect of foreign currency rates on cash and cash equivalents	1,589	2,182	(2,695)	451

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Increase (decrease) in cash and cash equivalents	(57,227)	(26,872)	42,362	34,915
Cash and cash equivalents, beginning of period	232,221	180,796	132,632	119,009
Cash and cash equivalents, end of period	\$ 174,994	\$ 153,924	\$ 174,994	\$ 153,924
Supplemental information:				
Interest paid	\$ 525	\$ 780	\$ 1,412	\$ 2,316
Income taxes paid	\$ 8,924	\$ 5,571	\$ 18,980	\$ 16,475

See accompanying notes to consolidated financial statements.

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**RITCHIE BROS. AUCTIONEERS INCORPORATED**

Notes to Consolidated Financial Statements

Nine months ended September 30, 2005 and 2004

(Tabular dollar amounts expressed in thousands of United States dollars, except share and per share amounts)

(Information as at September 30, 2005 and for the nine-month periods ended September 30, 2005 and 2004 is unaudited)

**1. Significant accounting policies:**

(a) Basis of presentation:

These unaudited consolidated financial statements present the financial position, results of operations, changes in shareholders' equity and cash flows of Ritchie Bros. Auctioneers Incorporated (the Company) and its subsidiaries. All significant intercompany balances and transactions have been eliminated.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) applicable to interim financial information and are based on accounting principles and practices consistent with those used in the preparation of the annual consolidated financial statements. These consolidated financial statements are not materially different from those that would be presented in accordance with United States GAAP. The interim consolidated financial statements should be read in conjunction with the December 31, 2004 audited consolidated financial statements.

(b) Revenue recognition:

Auction revenues are comprised mostly of auction commissions, which are earned by the Company acting as an agent for consignors of equipment, but also include net profits on the sale of inventory, incidental interest income, Internet and proxy purchase fees, and handling fees on the sale of certain lots. All revenue is recognized when the auction sale is complete and the Company has determined that the auction proceeds are collectible.

Auction commissions represent the percentage earned by the Company on the gross proceeds from equipment sold at auction. The majority of auction commissions is earned as a pre-negotiated fixed rate of the gross selling price. Other commissions are earned when the Company guarantees a certain level of proceeds to a consignor. This type of commission includes a pre-negotiated percentage of the guaranteed gross proceeds plus a percentage of proceeds in excess of the guaranteed amount. If actual auction proceeds are less than the guaranteed amount, commission is reduced; if proceeds are sufficiently lower, the Company can incur a loss on the sale. Losses, if any, resulting from guarantee contracts are recorded in the period in which the relevant auction is completed. If a loss relating to a guarantee contract to be sold after a period end is known at the financial statement reporting date, the loss is accrued in the financial statements for that period. The Company's exposure from these guarantee contracts fluctuates over time (see note 6).

**RITCHIE BROS. AUCTIONEERS INCORPORATED**

Notes to Consolidated Financial Statements

Nine months ended September 30, 2005 and 2004

(Tabular dollar amounts expressed in thousands of United States dollars, except share and per share amounts)  
(Information as at September 30, 2005 and for the nine-month periods ended September 30, 2005 and 2004 is unaudited)

**1. Significant accounting policies (continued):**

(b) Revenue recognition (continued):

Auction revenues also include net profit on the sale of inventory items. In some cases, incidental to its regular commission business, the Company temporarily acquires title to items for a short time prior to a particular auction sale. The auction revenue recorded is the net gain or loss on the sale of the items.

(c) Comparative figures:

Certain comparative figures have been reclassified to conform with the presentation adopted in the current period.

**2. Seasonality of operations:**

The Company's operations are both seasonal and event driven. Auction revenues tend to be highest during the second and fourth calendar quarters. The Company generally conducts more auctions during these quarters than during the first and third calendar quarters. Mid-December through mid-February and July through August are traditionally less active periods.

In addition, the Company's revenue is dependent upon the timing of such events as fleet upgrades and realignments, contractor retirements, and the completion of major projects, among other things. These events are not predictable and are usually unrelated to fiscal quarters, making quarter-to-quarter comparability difficult.

**RITCHIE BROS. AUCTIONEERS INCORPORATED**

Notes to Consolidated Financial Statements

Nine months ended September 30, 2005 and 2004

(Tabular dollar amounts expressed in thousands of United States dollars, except share and per share amounts)

(Information as at September 30, 2005 and for the nine-month periods ended September 30, 2005 and 2004 is unaudited)

**3. Capital assets:**

September 30, 2005	Cost	Accumulated depreciation	Net book value
Buildings	\$ 120,214	\$ 20,088	\$ 100,126
Land and improvements	113,568	4,369	109,199
Land and buildings under development	12,005		12,005
Automotive equipment	12,509	4,499	8,010
Yard equipment	10,176	5,307	4,869
Office equipment	6,512	4,092	2,420
Computer equipment	5,748	3,401	2,347
Computer software	11,859	10,706	1,153
Leasehold improvements	3,506	1,283	2,223
	\$ 296,097	\$ 53,745	\$ 242,352
December 31, 2004	Cost	Accumulated depreciation	Net book value
Buildings	\$ 113,742	\$ 18,588	\$ 95,154
Land and improvements	100,154	4,125	96,029
Land and buildings under development	13,538		13,538
Automotive equipment	11,389	4,272	7,117
Yard equipment	9,540	4,685	4,855
Office equipment	6,169	3,799	2,370
Computer equipment	5,784	2,940	2,844
Computer software	11,114	8,766	2,348
Leasehold improvements	3,321	952	2,369
	\$ 274,751	\$ 48,127	\$ 226,624

During the nine months ended September 30, 2005, the Company capitalized interest of \$299,000 (nine months ended September 30, 2004 \$184,000) to the cost of land and buildings under development.

**RITCHIE BROS. AUCTIONEERS INCORPORATED**

Notes to Consolidated Financial Statements

Nine months ended September 30, 2005 and 2004

(Tabular dollar amounts expressed in thousands of United States dollars, except share and per share amounts)

(Information as at September 30, 2005 and for the nine-month periods ended September 30, 2005 and 2004 is unaudited)

**4. Long-term debt:**

	September 30, 2005	December 31, 2004
Term loans, unsecured, bearing interest between 5.95% and 7.15%, due in minimum annual installments of \$2.9 million (\$0.75 million towards principal, \$1.4 million towards a sinking fund), with final payments occurring in 2005 and 2006.	\$ 12,250	\$ 17,000
Term loan, denominated in Canadian dollars, secured by a general security agreement, bearing interest at 4.429%, due in monthly installments of interest only, with the full amount of the principal due in 2010.	12,904	
Revolving loans, unsecured, bearing interest at 4.465% (2004 between 3.165% and 3.175%), due in monthly installments of interest only, with the full amount of the principal due in 2005.	19,250	15,500
Term loan, denominated in Australian dollars, secured by deeds of trust on specific property, bearing interest between the Australian prime rate and 6.5%, due in quarterly installments of AUD75,000, plus interest, with final payment occurring in 2008.	725	920
Revolving loans, denominated in Canadian dollars, unsecured, bearing interest at the Canadian Prime Rate plus 0.25%, due in monthly installments of interest only. The loans were repaid in full in 2005.		12,505
	45,129	45,925
Current portion	(27,729)	(35,133)
Non-current portion	\$ 17,400	\$ 10,792

Subsequent to the quarter end, the Company signed a commitment letter to replace certain of the term loans and revolving loans outstanding at September 30, 2005 with a new five-year term loan. This loan will be unsecured and will be due in quarterly installments of interest only, with the full amount of the principal due in 2010. If this arrangement is completed as contemplated, all of the funds committed for debt repayment in the balance sheet at September 30, 2005 will become cash and cash equivalents and available for general purposes in the fourth quarter of 2005.

**RITCHIE BROS. AUCTIONEERS INCORPORATED**

Notes to Consolidated Financial Statements

Nine months ended September 30, 2005 and 2004

(Tabular dollar amounts expressed in thousands of United States dollars, except share and per share amounts)

(Information as at September 30, 2005 and for the nine-month periods ended September 30, 2005 and 2004 is unaudited)

**5. Share capital:**

(a) Shares issued:

Common shares issued and outstanding are as follows:

Issued and outstanding, December 31, 2004	34,262,300
Issued for cash, pursuant to stock options exercised	152,600
Issued and outstanding, September 30, 2005	34,414,900

The Company's common shares were split on a two-for-one basis on May 4, 2004. All share, per share and stock option information in the consolidated financial statements gives effect to the stock split on a retroactive basis.

(b) Stock option plan:

Stock option activity for the nine months ended September 30, 2005 is as follows:

	Common Shares Under Option		Weighted Average Exercise Price
Outstanding, December 31, 2004	808,998	\$	18.38
Granted	201,800		32.41
Exercised	(152,600)		18.35
Expired	(13,600)		32.41
Outstanding, September 30, 2005	844,598	\$	21.51
Exercisable, September 30, 2005	648,398	\$	18.46

The options outstanding at September 30, 2005 expire on dates ranging to February 23, 2015.

The following is a summary of stock options outstanding and exercisable at September 30, 2005:

	Weighted Average	Options Outstanding Weighted	Options Exercisable Weighted
Board Committee Memberships			
Chairman of the Compensation Committee since May 18, 2010. Member of the Audit and Corporate Governance Committee and the Nominating Committee since October 23, 2008.			

Qualifications & Attributes Dr. Caulfield has many years of experience as an executive officer in the semiconductor industry. In addition to bringing industry experience, Dr. Caulfield brings key senior management, leadership, strategic planning and marketing experience to our Board.

R. Stephen Heinrichs

Age 65

Director Since; Class 2005; Class I

Business Experience and Education Mr. Heinrichs is currently a private investor and a director of Avistar Communications. Most recently, Mr. Heinrichs served as a director of Catapult Communications Corporation from September 2005 through June 2009, when the company was acquired by Ixia, and also served as a director and was the audit committee chairman of Artisan Components, Inc. from January 2003 through 2005, when the company was acquired by ARM Holdings PLC. Prior to his retirement in 2001, Mr. Heinrichs served as Chief Financial Officer of Avistar Communications Corporation, a company he co-founded.

Board Committee Memberships Chairman of the Audit and Corporate Governance Committee since August 1, 2005. Member of the Compensation Committee, Nominating Committee and Strategic Committee since October 23, 2008.

Qualifications & Attributes Mr. Heinrichs received a B.S. in Accounting from California State University Fresno. Mr. Heinrichs received his Certified Public Accountant license in December 1971 and has over 30 years of experience in finance and operations through positions he has held with various companies in public accounting and as a corporate officer. The Board has determined that Mr. Heinrichs is the audit committee's "audit committee financial expert" based on his knowledge and understanding of generally accepted accounting principles and financial statements; experience analyzing and evaluating financial statements that present a breadth and level of complexity of accounting issues relevant to those of the Company; and an understanding of internal control over financial reporting. This financial experience is beneficial to the Company and to Mr. Heinrichs' role as the Chairman of the Audit and Corporate Governance Committee.



Albert Y.C. Yu, Ph.D.

Age 71

Director Since; Class 2005; Class I

**Business Experience and Education** Dr. Yu is active in private venture capital investing and serves on the board of directors of several private technology companies and on the board of directors of Preferred Bank, a public independent commercial bank. Previously, Dr. Yu had been employed with Intel Corporation for almost 30 years until his retirement in 2002. At Intel, he held numerous technical and executive management positions, including Senior Vice President and a member of the Corporate Management Committee, with responsibilities for corporate strategy, microprocessors, chipsets, and software. Dr. Yu received a B.S. from the California Institute of Technology, and an M.S. and Ph.D. from Stanford University, all in electrical engineering.

**Board Committee Memberships** Chairman of the Nominating Committee since May 18, 2010. Member of the Compensation Committee since August 1, 2005.

**Qualifications & Attributes** Dr. Yu has first-hand managerial experience in large, multinational corporations as well as private venture capital investment companies. Dr. Yu's extensive experience in semiconductor companies enables him to provide invaluable insight regarding the industry in which the Company operates.

Continuing Class III Director:

John Kibarian, Ph.D.

Age 48

Director Since; Class 1992; Class III

**Business Experience and Education** Dr. Kibarian is one of our founders and has served as our President since November 1991 and our Chief Executive Officer since July 2000. Dr. Kibarian received a B.S. in Electrical Engineering, an M.S. E.C.E. and a Ph.D. E.C.E. from Carnegie Mellon University.

**Board Committee Memberships** Member of the Strategic Committee since October 23, 2008.

**Qualifications & Attributes** Being the leader of the Company since its founding, Dr. Kibarian brings to our Board an extraordinary understanding of our Company's business, history and organization. Dr. Kibarian's training and education as an engineer, together with his day-to-day leadership and intimate knowledge of our business and operations, helps the Board in developing and executing the Company's long-term strategy.

Vote Required

If a quorum is present at the Annual Meeting, the nominees receiving the highest number of affirmative votes will be elected as Class II directors for the three-year term following the Annual Meeting. Unless marked otherwise, proxies received will be voted FOR the election of each of the two nominees. If additional people are nominated for election

as directors after the date of this proxy statement, the proxy holders intend to vote all proxies received by them in a way that will ensure that the nominees listed above are elected.

Recommendation of the Board

THE BOARD RECOMMENDS THAT OUR STOCKHOLDERS VOTE FOR THE ELECTION OF THE CLASS II  
DIRECTOR NOMINEES INDICATED ABOVE.

MEETINGS OF THE BOARD OF DIRECTORS AND ATTENDANCE

Board Meetings in 2011	6
Board Committees	Audit and Corporate Governance Compensation Nominating Special Option Strategic
Total Committee Meetings in 2011	14 (the number of meetings held by each committee is set forth below)

Director Attendance in 2011 Each incumbent Board member attended 75% or more of the meetings of the Board and the committees on which he served, held during the period for which he was a director or committee member. At our 2011 annual meeting of stockholders, all directors were present either in person or by telephone and are expected to attend the 2012 Annual Meeting, unless an emergency or unavoidable conflict prevents them from doing so.

BOARD COMMITTEES

The following table provides additional information regarding the committees of our Board of Directors during fiscal 2011:

Name of Committee and Members	Principal Functions of the Committee	Number of Meetings in Fiscal 2011
Audit and Corporate Governance Committee Mr. Heinrichs (Chair) Mr. Lanza Dr. Caulfield	<ul style="list-style-type: none"> <li>· Recommends the engagement of the independent registered public accounting firm.</li> <li>· Monitors the effectiveness of our internal and external audit efforts.</li> <li>· Monitors and assesses the effectiveness of our financial and accounting organization and the quality of our system of internal accounting controls.</li> <li>· Oversees all aspects of the Company's corporate governance functions on behalf of the Board and makes recommendations on corporate governance issues.</li> <li>· Committee charter posted at <a href="http://www.pdf.com/ir-governance">http://www.pdf.com/ir-governance</a>.</li> </ul>	12
Compensation Committee Dr. Caulfield (Chair) Mr. Heinrichs Dr. Yu	<ul style="list-style-type: none"> <li>· Establishes and administers our policies regarding annual executive salaries and cash incentives and long-term equity incentives.</li> <li>· Assists with the administration of our stock incentive and purchase plans.</li> <li>· Committee charter posted at <a href="http://www.pdf.com/ir-governance">http://www.pdf.com/ir-governance</a>.</li> </ul>	2
Nominating Committee Dr. Yu (Chair) Dr. Caulfield	<ul style="list-style-type: none"> <li>· Identifies, reviews and evaluates candidates to serve as directors.</li> <li>· Makes other recommendations to the Board regarding affairs related to the directors of the Company.</li> </ul>	-

Mr. Heinrichs	· Committee charter posted at <a href="http://www.pdf.com/ir-governance">http://www.pdf.com/ir-governance</a> .	
Special Option Committee1 Dr. Kibarian Ms. Leo2 (Confirming Role)	· Assisted the Compensation Committee by serving as administrator for our 2001 Stock Plan for the purposes of granting options to purchase up to 35,000 shares of common stock to new, non-executive employees and granting options to purchase up to 15,000 shares of common stock as merit increases for persons who are not executive officers.	-
Strategic Committee Dr. Kibarian Mr. Lanza Mr. Heinrichs	· Investigates and evaluates strategic alternatives with respect to the Company, including without limitation, possible strategic partnerships, partnering arrangements, joint ventures, licensing, merger, or other similar extraordinary transactions involving the Company and its subsidiaries.	-

In addition to the Board and committee meetings noted above, each of the Board and each committee also acted by unanimous written consent in the conduct of its business.

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1 Our Special Option Committee served until the expiration of our 2001 Stock Plan in 2010. The Board did not form a Special Option Committee since the expiration of the 2001 Stock Plan.

2 Ms. Leo resigned as our Executive Vice President, Chief Administration Officer and Acting Chief Financial Officer effective June 17, 2011.

## COMPENSATION COMMITTEE

As summarized above, and as more fully set forth in the charter to the Compensation Committee approved by the Company's Board of Directors, the Compensation Committee has the authority to determine the amount and form of compensation paid to the Company's executive officers, officers, employees, consultants and advisors and to review the performance of such persons in order to determine appropriate compensation, as well as to establish the Company's general compensation policies and practices and to administer plans and arrangements established pursuant to such policies and practices. The Committee will also periodically review and make recommendations to the Board as to compensation for the non-employee directors of the Board. We have included a more detailed discussion of the Company's executive compensation program, its objective and the process we undergo to set and review our compensation determinations starting on page 19 of this Proxy Statement. In addition, page 12 of this Proxy Statement includes the Compensation Committee's risk management review of the Company's compensation policies and practices in fiscal year 2011 under the heading "Risk Assessment of Compensation Policies". Each member of the Compensation Committee is an independent director under applicable NASDAQ listing standards, an "outside director" as defined in Section 162(m) of the Internal Revenue Code of 1986, as amended, and a "non-employee director" as defined in Rule 16b-3 under the Securities Exchange Act of 1934.

The Committee has exclusive authority to determine the amount and form of compensation paid to the Company's Chief Executive Officer, and to take such action, and to direct the Company to take such action, as is necessary and advisable to compensate the Chief Executive Officer in a manner consistent with its determinations. With respect to "executive officers" (as defined in Rule 3b-7 under the Exchange Act) and "officers" (as defined in Rule 16a-1(f) under the Exchange Act) of the Company, other than the Company's Chief Executive Officer, or Other Executive Officers, the Committee has authority to determine the amount and form of compensation paid to the Other Executive Officers, and to take such action, and to direct the Company to take such action, as is necessary and advisable to compensate the Other Executive Officers in a manner consistent with its determinations. Except as set forth below, the Compensation Committee retains and does not delegate any of its power to determine matters of executive and director compensation, although it may from time to time delegate its authority on the matters with regards to non-officer employees and consultants of the Company to our Chief Executive Officer and other appropriate Company supervisory personnel.

The Compensation Committee also has authority to select, engage, compensate and terminate compensation consultants, legal counsel and such other advisors as it deems necessary and advisable to assist the Compensation Committee in carrying out its responsibilities and functions as set forth herein. For example, in fiscal year 2011, the Compensation Committee engaged the services of Compensia, Inc. as its independent consultant to advise on our Named Executive Officers' compensation. As further detailed on page 22 of this Proxy Statement, the independent consultant provided services by assisting the Compensation Committee in determining the amount and form of executive compensation, evaluating the reasonableness and effectiveness of NE compensation levels and programs, and providing advice and recommendations on competitive market practices and specific compensation decisions for NEOs.

## NOMINATING COMMITTEE EVALUATION OF BOARD NOMINEES

The Nominating Committee identifies nominees by first evaluating the current members of the Board willing to continue in service. If any member of the Board does not wish to continue in service, if the Board decides not to re-nominate a member for re-election or if the Board decides to increase the size of the Board, the Nominating Committee identifies the desired skills and experience of a new nominee in light of the philosophy explained above. Current members of the Nominating Committee are polled for suggestions as to individuals meeting the philosophy of the Nominating Committee. To date, the Company has not engaged third parties to identify, evaluate or assist in identifying potential nominees, but the Company may in the future retain a third party search firm.

Once the Nominating Committee has identified a prospective nominee, the Nominating Committee makes an initial determination as to whether to conduct a full evaluation of the candidate. This initial determination is based on the information provided to the Nominating Committee concerning the prospective candidate, as well as the Nominating Committee's own knowledge of the prospective candidate, which may be supplemented by inquiries to the person making the recommendation or others. The preliminary determination is based primarily on the need for additional Board members to fill vacancies or expand the size of the Board and the likelihood that the prospective nominee can satisfy the evaluation factors described below. If the Nominating Committee determines, in consultation with other Board members as appropriate, that additional consideration is warranted, it may gather or request the third party search firm to gather additional information about the prospective nominee's background and experience. The Nominating Committee then evaluates the prospective nominee, taking into account the following:

- the independence of the proposed director within the meaning of the listing standards of The Nasdaq Stock Market;
- diversity of experience and background of the proposed director, including the need for financial, business, academic, public sector or other expertise on our Board of Directors or its committees; and
- current composition of the Board, the balance of management and independent directors.

In connection with this evaluation, the Nominating Committee determines whether to interview the prospective nominee and, if warranted, one or more members of the Nominating Committee and others, as appropriate, conduct interviews in person or by telephone. After completing this process, the Nominating Committee makes a recommendation to the full Board as to the persons who should be nominated by the Board, and the Board determines the nominees.

Stockholders may send any recommendations for director nominees or other communications to the Board or any individual director in accordance with Section 2.5 of the Bylaws at the following address:

Board of Directors (or Nominating Committee, or name of individual director)

PDF Solutions, Inc.  
Attention: Corporate Secretary  
333 West San Carlos Street, Suite 1000  
San Jose, California 95110

## DIRECTOR INDEPENDENCE

The Company has adopted standards for director independence in accordance with NASDAQ Listing Rules and SEC rules. An “independent director” means a person, other than an officer or employee of the Company or its subsidiaries, or any other individual having a relationship that, in the opinion of the Board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. To be considered independent, the Board must affirmatively determine that neither the director nor an immediate family member has had any direct or indirect material relationship with the Company within the last three years.

The Board considered relationships, transactions or arrangements with each of the directors, including relationships and transactions discussed in “Certain Relationships and Related Transactions,” in this Proxy Statement and concluded that none of the current non-employee directors has any relationships with the Company that would impair his independence. The Board has determined that each member of the Board, other than Dr. Kibarian and Dr. Michaels, is an independent director under applicable NASDAQ Listing Rules and SEC rules. Dr. Kibarian and Dr. Michaels did not meet the independence standards because they are employees of the Company.

The Board has determined that:

- all directors who serve on the Audit and Corporate Governance, Compensation, and Nominating Committees are independent under the NASDAQ Listing Rules and SEC rules; and
- all members of the Audit and Corporate Governance Committee meet the additional independence requirement and they do not directly or indirectly receive compensation from the Company other than their compensation as directors.

The independent directors meet regularly in executive sessions without the presence of the non-independent directors or members of the Company’s management, and in any event, not less than twice per year during regularly scheduled Board meeting days and from time to time as they deem necessary or appropriate.

## BOARD LEADERSHIP STRUCTURE AND ROLE IN RISK OVERSIGHT

### Board Leadership Structure

The Board has determined that the positions of Chairman of the Board and Chief Executive Officer should be held by different persons. In addition, the Board believes that the Chairman should not be an employee. Since April 2004, our Chairman has been Lucio L. Lanza. The Chairman of the Board is responsible for coordinating the Board's activities, including the scheduling of meetings of the full Board, scheduling executive sessions of the non-employee directors and setting relevant items on the agenda (in consultation with the Chief Executive Officer as necessary or appropriate). The Board believes this leadership structure has enhanced the Board's oversight of, and independence from, Company management, the ability of the Board to carry out its roles and responsibilities on behalf of our stockholders, and our overall corporate governance compared to a combined Chairman/Chief Executive Officer leadership structure.

### Board Role in Risk Oversight

The Board of Directors plays a significant role in providing oversight of the Company's management of risk. Senior management has responsibility for the management of risk and reports to the Board regularly with respect to its ongoing enterprise risk management efforts. Because responsibility for the oversight of elements of the Company's enterprise risk management extends to various committees of the Board, the Board has determined that it, rather than any one of its committees, should retain the primary oversight role for risk management. In exercising its oversight of risk management, the Board has delegated to the Audit and Corporate Governance Committee primary responsibility for the oversight of risk related to the Company's financial statements and processes and responsibility for the oversight of risk related to the Company's corporate governance practices. The Board has also determined that the Company's internal audit function should report directly to the Audit and Corporate Governance Committee. The Board has delegated to the Compensation Committee primary responsibility for the oversight of risk related to (1) the Company's compensation policies and practices and (2) administering the Company's equity compensation plan(s). Each committee reports regularly to the Board with respect to such committee's particular risk oversight responsibilities.

## RISK ASSESSMENT OF COMPENSATION POLICIES

The Compensation Committee, with the assistance of management, conducted a risk assessment of the Company's compensation policies and practices in fiscal year 2011 and concluded that they do not motivate imprudent risk taking. In this regard, the Company notes that:

- the Company's annual incentive compensation is based on balanced performance metrics that promote disciplined progress towards Company goals;
- the Company does not offer significant short-term incentives that might drive high-risk investments at the expense of long-term Company value;
- the Company's long-term incentives do not drive high-risk investments at the expense of long-term Company value;
- the Company's compensation programs are weighted towards cash, and the equity component does not promote unnecessary risk taking; and
-



the Company's compensation is capped at reasonable and sustainable levels, as determined by a review of the Company's economic position and prospects, as well as the compensation offered by comparable companies.

The Company's compensation policies and practices were evaluated to ensure that they do not foster risk taking above the level of risk associated with the Company's business model. Based on this assessment, the Board concluded that it has a balanced pay and performance program that does not promote excessive risk taking.

#### CORPORATE GOVERNANCE POLICES

The Company provides information on its website about its corporate governance policies, including the Company's Code of Ethics, which applies to all employees, officers and directors, including the Company's principal executive officer and principal financial officer, and charters for the three standing committees of the Board (Audit and Corporate Governance, Compensation, and Nominating). These materials can be found at [www.pdf.com](http://www.pdf.com) under the "Governance" link on the "Investor" tab. The Company's website address provided is not intended to function as a hyperlink, and the information on the Company's website is not, and should not be considered, part of this Proxy statement and is not incorporated by reference herein.

Investors may also request free printed copies of the Code of Ethics and committee charters by sending inquiries to us at PDF Solutions, Inc., Attention: Investor Relations, 333 West San Carlos Street, Suite 1000, San Jose, California 95110.

The Company's policies and practices reflect corporate governance initiatives that are compliant with NASDAQ continued listing requirements and the corporate governance requirements of the Sarbanes-Oxley Act of 2002, including:

- a majority of the Board are independent as defined in the NASDAQ Listing Rule 5605(a)(2);
- all members of the standing committees of the Board (the Audit and Corporate Governance Committee, the Compensation Committee and the Nominating Committee) are independent as the term is defined under the NASDAQ Listing Rules;
- the independent members of the Board meet at least twice per year in execution sessions without the presence of management;
- the Company has an ethics hotline available to all employees, and the Company's Audit and Corporate Governance Committee has procedures for the anonymous submission of employee complaints on accounting, internal controls, auditing or other related matters; and
- the Company has adopted a Code of Ethics that applies to all of its employees, including its principal executive officer and all members of its finance department, including the principal financial officer and principal accounting officer, as well as to members of the Board.

#### Stockholders Communications

Our Board welcomes all communications from our stockholders. Stockholders may send communications to the Board or any director of the Board in particular, at the following address: PDF Solutions, Inc., Attention: Investor Relations, 333 West San Carlos Street, Suite 1000, San Jose, California 95110. Any correspondence addressed to the Board or to any one of our directors of the Board sent in care of our corporate offices is reviewed by our Investor Relations department and presented to the Board at its regular meetings.

PROPOSAL NO. 2: RATIFICATION OF APPOINTMENT OF  
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit and Corporate Governance Committee has appointed PricewaterhouseCoopers LLP (“PwC”) as our independent registered public accounting firm for the fiscal year ending December 31, 2012. In the event that ratification of this selection of auditors is not approved by a majority of the shares of common stock voting at the Annual Meeting in person or by proxy, the Audit and Corporate Governance Committee will have the responsibility of selecting the Company’s auditors.

Even if the selection is ratified, the Audit and Corporate Governance Committee in its discretion may select a different registered public accounting firm at any time to be the independent registered public accounting firm for the fiscal year ending December 31, 2012 if it determines that such a change would be in the best interests of the Company and our stockholders.

A representative of PwC is expected to be present at the Annual Meeting. This representative will have an opportunity to make a statement and will be available to respond to questions.

Principal Accountant Fees and Services

The table below shows the fees billed to us for the last two fiscal years by PricewaterhouseCoopers LLP, the Company’s independent registered accounting firm since November 10, 2009. PwC is the accounting firm that delivered an opinion for the audit of the Company’s financial statements for the two most recently completed fiscal years.

Fee Category	Fiscal 2011 Fees	Fiscal 2010 Fees
Audit Fees (1)	\$ 1,200,400	804,000
Audit-Related Fees	-	6,000(2)
Tax Fees	-	-
All Other Fees	-	55,000(3)
Total Fees	\$ 1,200,400	865,000

- (1) Represents the aggregate fees for professional services rendered in connection with the annual audit of financial statements and internal controls over financial reporting. \$1,084,500 of the amount shown under “Fiscal 2011 Fees” has been billed as of April 30, 2012.
- (2) Represents aggregate fees billed in 2010 for professional services rendered in connection with delivering consent for the Company’s S-8 filing.
- (3) Represents aggregate fees billed in such year for consulting services rendered in connection with our early adoption of EITF08-1.

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

The Audit and Corporate Governance Committee's policy is to pre-approve all audit and permissible non-audit services provided by PwC. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular

service or category of services and is generally subject to an initial estimated budget. PwC and Company management are required to periodically report to the Audit and Corporate Governance Committee regarding the extent of services provided by PwC in accordance with this pre-approval, and the fees performed to date. The Audit and Corporate Governance Committee may also pre-approve particular services on a case-by-case basis.

All services provided by PwC during the fiscal years ended December 31, 2010 and 2011 were approved by the Audit and Corporate Governance Committee in accordance with our pre-approval policy and applicable SEC regulations.

Recommendation of the Board

THE BOARD RECOMMENDS THAT OUR STOCKHOLDERS VOTE FOR THE RATIFICATION OF PRICEWATERHOUSECOOPERS LLP AS OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE YEAR ENDING DECEMBER 31, 2012.

### PROPOSAL NO. 3: ADVISORY APPROVAL OF OUR NAMED EXECUTIVE OFFICERS' COMPENSATION

At our 2011 annual meeting, a majority of our stockholders recommended that an advisory resolution with respect to the Company's compensation program of our Named Executive Officers be presented to the Company's stockholders every year. Our Board of Directors adopted the stockholders' recommendation for the frequency of the "say-on-pay" vote, and accordingly, we are requesting your advisory approval of the compensation of our Named Executive Officers as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the narrative discussion set forth on pages 19 to 32 of this Proxy Statement.

As more fully described in this Proxy Statement under the heading "Compensation Discussion and Analysis," the Company's executive officer compensation program is designed to attract and retain the caliber of officers needed to ensure the Company's continued growth and profitability, to align incentives with the Company's fiscal performance, to reward officers' individual performance against objectives that achieve the Company's strategy and the creation of long term value for stockholders and to provide a balanced approach to compensation that properly aligns incentives with Company performance and stockholder value and does not promote inappropriate risk taking. Accordingly, the compensation of our Named Executive Officers is based in large part upon the financial achievement of the Company.

We believe we utilize a well-proportioned mix of security-oriented compensation, retention benefits and at-risk compensation which produces both short-term and long-term performance incentives and rewards.

The Compensation Committee and the Board of Directors believe that the design of our executive compensation program, and hence the compensation awarded to our Named Executive Officers under the current program, fulfills the objectives set forth above.

We encourage you to carefully review the "Compensation Discussion and Analysis" of this Proxy Statement for additional details on our executive compensation, including PDF's compensation philosophy and objectives, as well as the processes our Compensation Committee used to determine the structure and amounts of the compensation of our Named Executive Officers in fiscal year 2011.

We are asking you to indicate your support for the compensation of our Named Executive Officers as described in this Proxy Statement. This vote is not intended to address any specific item of compensation, but rather the overall compensation of our Named Executive Officers and the philosophy, policies and practices described in this Proxy Statement. Accordingly, we are asking our stockholders to vote FOR the following resolution at the Annual Meeting:

"RESOLVED, that the Company's stockholders approve, on an advisory basis, the 2011 compensation of the Named Executive Officers, as disclosed in the Company's Proxy Statement for the 2012 Annual Meeting of Stockholders pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the Compensation Discussion and Analysis, the Summary Compensation Table and the other related tables and disclosure."

The results of your approval are advisory, which means the outcome of this proposal is not binding on the Company, our Board of Directors or the Compensation Committee of the Board of Directors.

#### Required Vote

So long as a quorum is present (in person or by proxy) at the Annual Meeting, a majority of the votes cast at the Annual Meeting is required to approve this proposal. Unless otherwise instructed, the proxy holders will vote the proxies they receive FOR the advisory approval of the Company's compensation of our Named Executive Officers, as disclosed in this proxy statement.

Recommendation of the Board

THE BOARD RECOMMENDS THAT OUR STOCKHOLDERS VOTE FOR THE ADVISORY APPROVAL OF THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS.

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## SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth the beneficial ownership, as of June 11, 2012, of (i) each person known to us to be the beneficial holder of more than 5% of our outstanding common stock, (ii) each director and each director nominee, (iii) each Named Executive Officer identified in the Summary Compensation Table on page 27 of this Proxy Statement, and (iv) all executive officers and directors as a group. Except as otherwise indicated, the address for each person listed as a director or executive officer is c/o PDF Solutions, Inc., 333 West San Carlos Street, Suite 1000, San Jose, California 95110. The Company has relied upon information provided to the Company by its directors and Named Executive Officers and copies of documents sent to the Company that have been filed with the SEC by others for purposes of determining the number of shares each person beneficially owns. Beneficial ownership is determined in accordance with the rules and regulations of the SEC and generally includes those persons who have voting or investment power with respect to the securities. Except as otherwise indicated, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all shares of the Company's common stock beneficially owned by them.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership (1)	Percent of Class (1)(2)
<b>5% Stockholders:</b>		
T. Rowe Price Associates, Inc. 100 E. Pratt Street Baltimore, Maryland 21202 (3)	2,639,801	9.2
Samjo Capital LLC 1325 Avenue of the Americas, 26th Floor New York, New York 10019 (4)	2,225,700	7.8
Burnham Asset Management Corporation 1325 Avenue of the Americas, 26th Floor New York, New York 10019 (5)	3,277,403	11.4
Concept Capital Markets, LLC 1010 Franklin Avenue Garden City, NY 11530 (6)	3,686,653	12.9
John K. Kibarian (7)	2,567,474	9.0
Kimon W. Michaels (8)	1,521,819	5.3
<b>Directors and Named Executive Officers:</b>		
John K. Kibarian (7)	2,567,474	9.0
Gregory C. Walker	-	*
Michael Shahbazian (9)	10,966	*
Joy Leo	18,991	*
Kimon W. Michaels (8)	1,521,819	5.3
Cornelis (Cees) Hartgring (10)	298,257	1.0
Lucio L. Lanza (11)	636,287	2.2
R. Stephen Heinrichs (12)	176,015	*
Albert Y.C. Yu (13)	28,125	*
Thomas Caulfield (14)	52,027	*
All directors and executive officers as a group (10 persons) (15)	5,309,961	18.5

\* Less than 1%.

- (1) Beneficial ownership is determined in accordance with SEC rules. In computing the number of shares beneficially owned by a person, we have included shares for which the named person has sole or shared power over voting or investment decisions. The number of shares beneficially owned also includes ownership of which the named person has the right to acquire, through conversion, option and warrant exercise or otherwise, within 60 days after June 11, 2012.
- (2) Percentage of beneficial ownership is based on 28,644,840 shares outstanding as of June 11, 2012. For each named person, the percentage ownership includes beneficial ownership which the person has the right to acquire within 60 days after June 11, 2012, as described in Footnote 1. However, such beneficial ownership shall not be deemed outstanding with respect to the calculation of ownership percentage for any other person.
- (3) Based solely on the Schedule 13G Amendment No. 8 filed on February 13, 2012 (the "T. Rowe Price 13G Amendment"). These securities are owned by various individual and institutional investors including T. Rowe Price Associates, Inc. (which owns 2,639,801 shares, representing 9.3% of the shares outstanding as of filing of the T. Rowe Price 13G Amendment), of which T. Rowe Price Associates, Inc. (Price Associates) serves as investment adviser with power to direct investments and/or sole power to vote the securities. For purposes of the reporting requirements of the Securities Exchange Act of 1934, Price Associates is deemed to be a beneficial owner of such securities; however, Price Associates expressly disclaims that it is, in fact, the beneficial owner of such securities.



- (4) Based solely on the Schedule 13G Amendment No. 1 that was jointly filed on February 6, 2012 by Samjo Capital LLC (“Samjo Capital”), Samjo Management LLC (“Samjo Management”) and Andrew Wiener. The Schedule 13G indicates that: (i) Samjo Capital, Samjo Management and Mr. Wiener share voting power and dispositive power over 2,221,000 shares; and, (ii) Mr. Weiner has sole voting power and dispositive power over 4,700 shares.
- (5) Based solely on the Form 13F-HR filed by Burnham Asset Management Corporation on February 14, 2012.
- (6) Based solely on the Form 13F-HR/A filed by Concept Capital Markets, LLC on May 14, 2012.
- (7) Includes 80,000 shares issuable upon the exercise of stock options fully vested as of June 11, 2012.
- (8) Includes 22,540 shares issuable to Mr. Michaels upon the exercise of stock options vested as of June 11, 2012 and 2,271 shares issuable upon the exercise of stock options that will vest within 60 days after June 11, 2012. Excludes 89,318 shares held by Mr. Michaels' spouse as separate property.
- (9) Consists of 10,966 shares of restricted stock units that are fully vested as of June 11, 2012.
- (10) Includes 234,784 shares issuable upon the exercise of stock options vested as of June 11, 2012 and 3,136 shares issuable upon the exercise of stock options that will vest within 60 days after June 11, 2012.
- (11) Includes 317,497 shares issuable upon the exercise of stock options vested as of June 11, 2012 and 5,937 shares issuable upon the exercise of stock options that will vest within 60 days after June 11, 2012. Includes 121,720 shares owned by Lanza techVentures, an early stage venture capital and investment firm of which Mr. Lanza is the managing director.
- (12) Includes 165,859 shares issuable upon the exercise of stock options vested as of June 11, 2012 and 3,438 shares issuable upon the exercise of stock options that will vest within 60 days after June 11, 2012.
- (13) Includes 8,749 shares issuable upon the exercise of stock options vested as of June 11, 2012 and 2,710 shares issuable upon the exercise of stock options that will vest within 60 days after June 11, 2012.
- (14) Includes 31,039 shares issuable upon the exercise of stock options vested as of June 11, 2012 and 2,708 shares issuable upon the exercise of stock options that will vest within 60 days after June 11, 2012.
- (15) Consists of 5,309,961 shares held by our directors and executive officers, as a group, of which 860,468 shares are issuable upon the exercise of stock options vested as of June 11, 2012 and 20,200 shares are issuable upon the exercise of stock options that

will vest within 60 days after June 11, 2012.

## CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

### Limitation of Liability and Indemnification Matters

As permitted by the Delaware General Corporation Law, we have included a provision in our amended and restated certificate of incorporation to eliminate the personal liability of our officers and directors for monetary damages for breach or alleged breach of their fiduciary duties as officers or directors, other than in cases of fraud or other willful misconduct.

In addition, our Bylaws provide that we are required to indemnify our officers and directors even when indemnification would otherwise be discretionary, and we are required to advance expenses to our officers and directors as incurred in connection with proceedings against them for which they may be indemnified. We have entered into indemnification agreements with our officers and directors containing provisions that are in some respects broader than the specific indemnification provisions contained in the Delaware general corporation law. The indemnification agreements require us to indemnify our officers and directors against liabilities that may arise by reason of their status or service as officers and directors other than for liabilities arising from willful misconduct of a culpable nature, to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified, and to obtain our directors' and officers' insurance if available on reasonable terms. We have filed our forms of indemnification agreement on the SEC's website at [www.sec.gov](http://www.sec.gov). We have obtained directors' and officers' liability insurance in amounts comparable to other companies of our size and in our industry.

### Other Transactions

We have granted options to some of our officers and directors. Please see "Executive Compensation" and "Director Compensation" in this proxy statement. We have also entered into acceleration agreements with certain of our officers and directors. Please see "Potential Payments Upon Termination or Change-in-Control" and "Director Compensation" in this proxy statement.

### Review, Approval or Ratification of Transactions with Related Persons

Related party transactions have the potential to create actual or perceived conflicts of interest between the Company and its directors, its officers, its employees, and members of their respective families. While we do not maintain a written policy with respect to the identification, review, approval or ratification of transactions with related persons, the Company's Code of Ethics prohibits conflicts of interest between an employee and the Company and requires an employee to report any such potential conflict to our compliance officer. In addition, each officer and director is expected to identify to the Secretary, by means of an annual director questionnaire, any transactions between the Company and any person or entity with which the director may have a relationship that is engaged or about to be engaged in a transaction with the Company.

## SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our directors, our executive officers and persons who own more than 10% of the common stock (collectively, the "Reporting Persons") to file initial reports of ownership and changes in ownership of our common stock. Reporting Persons are required by SEC regulations to furnish us with copies of all Section 16(a) reports they file. During the fiscal year ended December 31, 2011, one Form 4 filing for Mr. Lucio Lanza, one of our directors, was not timely filed in connection with restricted stock and stock options granted to him on May 27, 2011 as compensation for Board membership. Based on our review of copies of the reports on the Section 16(a) forms received filed by us with respect to the fiscal year ended December 31, 2011 and the written representations received from the reporting persons that no other reports were required, we believe that, except as indicated in the foregoing sentence, all Reporting Persons complied with all applicable filing requirements under Section 16(a) of the Exchange Act.

## EQUITY COMPENSATION PLAN INFORMATION

The following table provides information as of December 31, 2011 about our common stock that may be issued upon the exercise of options, warrants and rights under all of our existing equity compensation plans.

Plan Category	Number of Securities to be issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding Securities Reflected in Column (a)) (c)	
Equity Compensation Plans Approved by Stockholders (1)	3,668,559	\$5.78	5,710,932	(2)(3)
Equity Compensation Plans Not Approved by Stockholders	204,266	(4) \$8.31	388,919	(4)
<b>Total</b>	<b>3,872,825</b>		<b>6,099,851</b>	

(1) In 2001, the Company terminated its 1996 Stock Option Plan and 1997 Stock Plan with respect to future option grants, and adopted its 2001 Stock Plan. As of December 31, 2011, no option rights were outstanding under the 1996 Stock Option and 1997 Stock Plans. The 2001 Stock Plan expired in 2011. For a description of these plans, see Note 8 to our Consolidated Financial Statements in the Form 10-K filed with SEC on March 23, 2011. In the 2011, the Company adopted 2011 Stock Incentive Plan. For a description of the 2011 Plan, see Note 8 to our Consolidated Financial Statements in the Form 10-K filed with SEC on March 15, 2012.

(2) Includes 4,625,986 shares available for issuance pursuant to options and stock purchase rights under the 2001 Stock Plan, awarded prior to its expiration on June 12, 2011 and not cancelled or otherwise terminated through December 31, 2011. Other than in connection with outstanding awards, no shares

remain available for issuance pursuant to 2001 Stock Plan.

- (3) Includes 1,084,946 shares available for issuance under the 2001 Employee Stock Purchase Plan (as amended the "ESPP"). The ESPP, designed to comply with Internal Revenue Code Section 423, includes an "evergreen" feature which provides for an automatic annual increase in the number of shares available under the plan on the first day of each of our fiscal years, equal to the lesser of 675,000 shares, 2% of our outstanding common stock on the last day of the immediately preceding fiscal year, or such amount as is determined by our Board. At the annual meeting of stockholders on May 18, 2010, our stockholders approved an amendment to the ESPP to extend it through May 17, 2020.
- (4) Consists of the Stock Option/Stock Issuance Plan that was assumed by us upon the acquisition of IDS Software Systems, Inc. Stock options granted under the plan generally vest with respect to 25% of the shares subject to the option one year after the date of grant and then 1/48 of the shares subject to the option each month thereafter. Options generally expire 10 years after the grant date. The vesting for certain options is accelerated upon a change in control.

## EXECUTIVE COMPENSATION

### Introduction

This Compensation Discussion and Analysis (the “CD&A”) describes and analyzes the compensation program for: (a) the person who served as our principal executive officer during the fiscal year ended December 31, 2011; (b) the people who served as our principal financial officer during the fiscal year ended December 31, 2011; and, (c) our two other executive officers who were serving as executive officers on December 31, 2011. Collectively, these were our “Named Executive Officers” or “NEOs” for 2011:

- John K. Kibarian, Ph.D., our Chief Executive Officer and President;
- Gregory C. Walker, our Vice President, Finance, and Chief Financial Officer;
- Michael Shahbazian, our former Interim Chief Financial Officer, Vice President, Finance;
- Joy E. Leo, our former Executive Vice President, Chief Administration Officer and Acting Chief Financial Officer;
- Cornelis (Cees) Hartgring, our Vice President, Client Services and Sales; and
- Kimon Michaels, Ph.D., our Vice President, Products and Solutions.

Ms. Leo resigned as our Executive Vice President, Chief Administration Officer and Acting Chief Financial Officer effective on June 17, 2011 as initially reported in a Current Report on Form 8-K filed by us on May 31, 2011 and updated in a Current Report on Form 8-K filed by us on June 20, 2011.

Mr. Shahbazian was appointed by the Board on June 17, 2011 on a temporary basis to serve as Interim Chief Financial Officer and Vice President, Finance until a replacement Chief Financial Officer was appointed. Mr. Shahbazian’s temporary employment as Interim Chief Financial Officer and Vice President, Finance terminated as of December 1, 2011.

This CD&A contains forward-looking statements that are based on our current plans, considerations, expectations, and determinations regarding future compensation programs. The actual compensation programs that we adopt in the future may differ materially from currently planned programs as summarized in this discussion.

### Compensation Governance

We endeavor to maintain good governance standards in our executive compensation program, as reflected by the following policies and practices that were in effect in 2011:

- **CEO Compensation.** In part due to his request, since 2002 through the end of fiscal 2011, Dr. Kibarian has not received an increase to his \$250,000 base salary. Also in response to his request, as well as a desire to conserve equity for other purposes, including to grant equity to other employees, Dr. Kibarian, has not received an annual discretionary cash bonus since 2002 and has not received an equity award since 2003. As a significant stockholder, Dr. Kibarian’s interests are already strongly aligned with the interests of our other stockholders.
- **Independence.** The Compensation Committee of our Board of Directors develops, reviews and approves each element of executive compensation. The Compensation Committee is comprised solely of independent directors. Additionally, pursuant to its Charter, the Compensation Committee has the authority to engage a compensation consultant and other advisers as it deems appropriate or necessary to support it in fulfilling its responsibilities.
  - **No Perquisites.** We do not provide perquisites or other personal benefits to our executives officers.
  -

**No Tax Gross-Ups.** We do not provide tax gross-ups or other tax reimbursement payments to our executive officers.

- **Severance and Change in Control Agreements.** Except in the case of Ms. Leo and Mr. Walker, we have not entered into any agreement with our NEOs in connection with the commencement of, or during, their employment with us that provides for severance payments or other special benefits upon their future termination of their employment or any payments or other special benefits in the event of a termination of employment in connection with a change of control of the Company.
- **Exclusive Decision-Making Power.** The Compensation Committee retains and does not delegate any of its exclusive power to determine all matters of executive compensation and benefits, although our Chief Executive Officer and the Company's Human Resources department periodically present compensation and benefit recommendations to the Compensation Committee. The Compensation Committee considers, but independently evaluates whether or not to accept, management's recommendations with respect to NEO compensation.
- **Periodic Review.** The Compensation Committee, in connection with management, regularly reviews our executive compensation policies and practices and program, including the mix of elements within our executive compensation program and the allocation between short-term and long-term compensation and cash and non-cash compensation, to ensure that our executive officers are compensated in a manner that is consistent with competitive market practice and sound corporate governance principles, and that rewards them for performance tied to the Company's primary business objective of delivering sustained high-performance to our customers and stockholders.
- **Risk Mitigation.** The Compensation Committee regularly considers how the primary elements of our executive compensation program could encourage or mitigate excessive risk-taking, and has structured our program to mitigate risk by rewarding performance tied to several reasonable business objectives, and avoiding incentives that could encourage inappropriate risk-taking by our NEOs.

## Executive Compensation Objectives

The design and operation of our executive compensation program reflect the following objectives, established by our Compensation Committee, with a strong emphasis on tying NEO pay to Company performance:

- to emphasize performance-based compensation that is progressively weighted with seniority level;
  - to align our NEOs' interest with long-term stockholder value;
  - to attract and retain talented leadership; and
- to maintain an executive compensation program that encourages our NEOs to adhere to high ethical standards.

## Elements of Our Executive Compensation Program

### Performance-Based Awards

In 2011, we adopted a pay-for-performance component for our executive compensation program, such that 50% of each NEO's total target annual equity awards (we refer to this portion of the total annual awards as the "Executive Performance Awards") was subject to the Company's achievement of revenue and performance profitability metric triggers as follows:

- 50% of the Executive Performance Awards was to be granted to an NEO only if the Company's revenue growth rate (year-over-year) for the fiscal year equals or exceeds the annual revenue growth rate of worldwide electronic design automation (EDA) industry, as reported by EDAC.
- 50% of the Executive Performance Awards was to be granted to an NEO only if the Company's annual profitability for the fiscal year exceeds 7%. As used in the 2011 compensation program, profitability meant the Company's non-GAAP, pre-tax net income, which excludes stock based compensation, amortization of acquired intangibles and restructuring charges, which we call EBITAR.

The Company intends to award Executive Performance Awards, if any, in May of each year, based on achievement of the applicable performance goals for the prior fiscal year. Since Executive Performance Awards are granted based on performance against the goals for the prior year, they will be 25% vested upon issuance. However, the remaining 75% of the Executive Performance Award will be subject to further service-based vesting such that they shall vest in equal installments on each annual anniversary of the grant date for the following 3 years.

The other elements of our executive compensation program, the specific philosophy behind each element, the basis for the Compensation Committee's decisions regarding each element, and the objectives of our program that each element fulfills, are described below.

Element	Philosophy Statement	Basis for Compensation Decisions; Pay-for-Performance Criteria	Reward Long-term Performance	Attract & Retain	Align to Stockholder Value	Adhere to High-Ethical Standards
Base Salary	We provide a base salary to our NEOs as a significant element of their overall compensation to recruit and retain competitive experienced	Base salaries are initially established through arms-length negotiations at the time an NEO is hired, taking into account the NEO's qualifications, experience, prior salary, and competitive salary information based on market data obtained		X		X

executives. from both Radford High-Tech Executive Surveys and publicly-available proxy data from peer companies.

Annual Discretionary Cash Incentive Bonus	We provide an annual incentive cash bonus, payable in the sole discretion of the Compensation Committee, to reward our NEOs for individual and Company performance.	After the end of each year, the Compensation Committee reviews the Company's performance and the individual NEO's performance for the preceding fiscal year taking into consideration such factors as leadership qualities, business responsibilities, career with the Company, current compensation arrangements, and long-term potential to enhance stockholder value. As noted below, commencing with the annual discretionary cash incentive bonus that may be paid in 2013 for 2012 performance, 50% of each such bonus will also be subject to the Company's achievement of the performance goals noted below, provided that the Compensation Committee has reserved the sole discretion to determine the amount and whether any annual discretionary cash incentive bonus will be paid to any NEO.	X	X	X	X
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Element	Philosophy Statement	Basis for Compensation Decisions; Pay-for-Performance Criteria	Reward Long-term Performance	Attract & Retain	Align to Stockholder Value	Adhere to High-Ethical Standards
Annual Discretionary Long-Term Equity Incentive Awards	We provide annual discretionary long-term equity incentive awards, which may consist of a mix of stock options and restricted stock awards proxy data from peer companies. As noted above, with 50% of the total target equity vesting based on award will be subject to the continued service of our stockholders.	The Compensation Committee considers an NEO's relative job scope, the value of such NEO's outstanding long-term equity incentive awards, individual and Company performance history, prior contributions to the Company, the size of prior restricted stock or awards, and competitive market data based on publicly-available proxy data from peer companies. As noted above, with 50% of the total target equity vesting based on award will be subject to the continued service of our stockholders.	X	X	X	X
Stock Options	We grant stock options to our NEOs with exercise prices based on the fair market value of the Company's common stock on the date of grant, which ties the value of the stock option directly to our future financial performance, to provide further incentives to our NEOs to increase the value of our common stock and to create	The Compensation Committee considers the same general criteria as described above for long-term equity incentive awards.	X	X	X	X

retention incentives.

<p>Restricted Stock or Stock Unit Awards</p>	<p>We grant Restricted Stock to reduce potential dilution to our stockholders, and to provide strong equity-based retention incentives to our NEOs.</p>	<p>The Compensation Committee considers the same criteria as described above for long-term equity incentive awards.</p>	<p>X</p>	<p>X</p>	<p>X</p>	<p>X</p>
<p>Health and Welfare Benefits Retirement Benefits</p>	<p>We provide industry-standard programs to provide for the health, welfare and retirement planning of our NEOs, including life insurance equal to the lesser of \$200,000 or twice base salary.</p>	<p>The Compensation Committee has determined that our NEOs may participate on the same terms in the same programs that are available to all employees.</p>	<p>X</p>			

#### 2011 Compensation Decision-Making Process and Results

##### Process

Generally, around the first quarter of each fiscal year, the Compensation Committee reviews the previous year's performance of each of our NEOs and the Company's performance. Our Compensation Committee relies upon the judgment of its members in making compensation decisions, reviewing the performance of the Company and carefully evaluating each NEO's performance during the year against leadership qualities, operational performance, business responsibilities, career with the Company, current compensation arrangements, and long-term potential to enhance stockholder value. Also, while the Compensation Committee may consider competitive market compensation paid by other companies, as further described below, in assessing the reasonableness of compensation, the Compensation Committee does not attempt to achieve and maintain a certain target percentile within a peer group or otherwise rely entirely on that data to determine NEO compensation. Instead, the Compensation Committee maintains the flexibility in its assessment and decision-making process to respond to and adjust for the evolving business environment. The Compensation Committee strives to achieve an appropriate mix between equity incentive awards and cash payments to meet the objectives of our executive compensation program and may consider such data in its compensation decisions, however no particular apportionment goal is set.

We believe the most important indicator of whether our compensation objectives are being met is our ability to motivate our NEOs to deliver superior performance (as well as their actual ability to do so) and to retain them to continue their careers with the Company on a cost-effective basis. The Compensation Committee discusses our Chief Executive Officer's compensation package with him, but makes decisions with respect to his compensation without him present. Our Compensation Committee reports to our Board of Directors on the major items covered at each Compensation Committee meeting.

The Compensation Committee believes our executive compensation programs are effectively designed and working well in alignment with the interests of our stockholders and are instrumental to achieving our business strategy. As has been the case in the past, the Compensation Committee will consider any stockholder concerns and feedback on its executive compensation programs that it receives. We held our first advisory stockholder vote on executive compensation on November 16, 2011. Over 98% of the shares that voted approved our executive compensation program as described in last year's proxy statement. The Compensation Committee considered this overwhelming support from our stockholders on our executive compensation program when making executive compensation decisions in fiscal year 2012 and continued to apply the same effective principles and philosophy it has used in fiscal year 2011 executive compensation decisions. Further, consistent with the results of our stockholder vote regarding the frequency of future advisory votes on executive compensation which was also held on November 16, 2011, the Company will hold an advisory vote on the compensation of our NEOs every year (including at the 2012 Annual Meeting, as provided in this Proxy Statement) until the next required vote on the frequency of advisory votes on the compensation of NEOs,

#### Role of Compensation Committee Consultant

The Compensation Committee is authorized to retain the services of compensation consultants and other advisors from time to time, as it sees fit, in connection with its oversight of, and decisions related to, the Company's executive compensation program.

The Compensation Committee retained the services of Compensia, Inc. as an independent compensation consultant for fiscal year 2011 and Compensia served the Company at the discretion of the Compensation Committee. The services provided by Compensia included:

- Assisting in the selection of our peer group companies and applicable benchmarks;
- Providing compensation survey data to benchmark NEO compensation;
- Helping the Compensation Committee interpret compensation data;
- Advising on the reasonableness and effectiveness of our NEO compensation levels and programs; and
- Assisting in the review of NEO compensation disclosure in the Proxy Statement filed by us for the 2011 annual meeting of stockholders.

Compensia did not provide any other services to our Company in fiscal 2011.

#### Use of Competitive Data

To assess the competitiveness of our executive compensation program and compensation levels, the Compensation Committee instructed Compensia to first assist with identifying an appropriate group of peer companies and then to examine the executive compensation practices of this peer group.

As a result of this process, in connection with the fiscal year 2011 NEO compensation decisions, our Compensation Committee considered compensation data from a select group of 23 peer companies, each of which: (1) were business

or labor market competitors in the semiconductor intellectual property or electronic design automation industries or were small fabless or semiconductor capital equipment manufacturers; and (2) generated revenues between \$50 million and \$250 million. This peer group was comprised of the following companies:

Advanced Analogic Technologies	GSI Technology	Pericom Semiconductor
AXT	Mattson Technology	PLX Technology
BTU International	MaxLinear	QuickLogic
Cascade Microtech	MEMSIC	Ramtron International
CEVA	Mindspeed Technologies	Rudolph Technologies
Exar	MIPS Technologies	Supertex
FormFactor	Nanometrics	Transwitch
FSI International		Vitesse Semiconductor

Our Compensation Committee believes that peer group comparisons provide a useful framework to measure the competitiveness of our compensation practices. The Compensation Committee understands that no two companies are exactly alike, and it maintains the discretion to set levels of NEO compensation above or below levels paid by our peers based upon factors such as individual performance, an NEO's level of experience and responsibilities, individual discussions with the NEO, and our compensation budget. The Compensation Committee intends to review our peer group at least annually and make adjustments to its composition as necessary.

#### Base Salaries

Our NEOs' base salaries are reviewed annually and adjusted in the discretion of the Compensation Committee based on factors such as an NEO's promotion or other significant change in responsibilities or sustained individual and Company performance. In 2011, the Compensation Committee considered the competitive market data and advice provided by Compensia described above.

Due to market conditions and Company performance in 2010, the Compensation Committee decided not to increase the base salary of any NEO during 2011. The base salary paid to each NEO for 2011 is set forth in the "Summary Compensation Table" below.

#### Annual Discretionary Incentive Bonuses

After the end of 2010, the Compensation Committee reviewed the Company's performance and each NEO's performance for 2010 using factors such as leadership qualities, business responsibilities, career with the Company, current compensation arrangements, and long-term potential to enhance stockholder value. No pre-established formula is followed by the Compensation Committee for determining whether and the extent to which any NEO may receive a bonus for any fiscal year or any other period. Specifically, with respect to 2010 performance, the Compensation Committee did not prospectively establish individual or Company-wide qualitative or quantitative performance measures or related target levels that were required to be achieved for the NEOs to receive a bonus. In 2011, the Compensation Committee considered the competitive market data and advice provided by Compensia described above.

Due to market conditions and Company performance in 2010, the Compensation Committee decided not to award any annual discretionary incentive bonuses in 2011, other than in connection with the offer of initial employment made to Mr. Walker. In November 2011 as part of his employment offer, the Compensation Committee awarded Mr. Walker a fixed bonus in the total amount of \$100,000 for his first year of service with the Company, which amount is being paid ratably over such period. The amount of this bonus paid to Mr. Walker in 2011 is set forth in the "Summary Compensation Table" below.

#### Annual Discretionary Long-Term Equity Incentive Awards

In determining whether annual equity incentive awards will be granted to our NEOs and the size of any such equity incentive awards, the Compensation Committee considers a number of factors, including, but not limited to, the relative job scope of the executive officer, the value of his or her existing long-term equity incentive awards, his or her individual, and the Company's, performance history, prior contributions to the Company, the size of prior equity incentive awards, and competitive market data as described above. Based upon some or all of these factors, the Compensation Committee determines the size of the long-term equity incentives at levels it considers appropriate to create a meaningful opportunity for reward predicated on the creation of long-term stockholder value.

Due to market conditions and Company performance in 2010, the Compensation Committee decided not to award any annual equity incentive awards in 2011, other than in connection with Mr. Hartgring's individual performance with respect to increased business activity during 2010, and the offer of temporary employment to Mr. Shahbazian and the offer of initial employment to Mr. Walker. In May 2011, Mr. Hartgring was awarded 6,750 shares of restricted stock units and 20,250 stock options. In June 2011, as part of his employment offer, the Compensation Committee awarded Mr. Shahbazian 9,000 restricted stock units. This award vested in three equal portions during the term of his temporary employment. In November 2011 as part of his employment offer, the Compensation Committee awarded Mr. Walker a stock option for 180,000 shares. 25% of the total shares subject to this option vest on the first anniversary of the grant date and 1/48th of the total shares vest on the grant date day of each month thereafter until fully vested. The equity incentive awards granted to Mr. Hartgring, Mr. Walker and Mr. Shahbazian in 2011 are set forth in the "Grants of Plan-Based Awards For Fiscal Year 2011" table below.

#### Compensation of Dr. Kibarian

Our Chief Executive Officer and President, Dr. Kibarian, is also a co-founder of the Company. The "Stock Ownership of Certain Beneficial Owners and Management" table below sets forth his total percentage ownership of the Company's common stock as of June 15, 2012. Given his significant equity stake, Dr. Kibarian's interests are strongly aligned with our other stockholders and, accordingly, he has a powerful incentive to manage the Company from the perspective of an owner. As such, Dr. Kibarian has requested that, instead of using the limited shares available for issuance under the Company's stock plans to further increase his ownership interest, the Compensation Committee use

such shares for awards to other employees of the Company, in the Compensation Committee's sole discretion and judgment, to further the Company's ability to provide appropriate incentives aimed at motivating and retaining such employees and the creation of further long-term stockholder value. Also, for similar reasons, Dr. Kibarian has requested that he not receive an annual discretionary cash bonus. Despite very positive factors for Dr. Kibarian based on 2010 performance and during fiscal 2011, including increased leadership of the executive team and the Company and long-term potential to enhance stockholder value as evidenced by his key role in closing significant business deals for the Company during the year, the Compensation Committee honored this request and did not award Dr. Kibarian either a long-term equity incentive award or a cash bonus during fiscal year 2011.

#### Severance and Change of Control Arrangements

The Company's 2011 Stock Incentive Plan (the "2011 Plan") provides that in the event of a change in control, outstanding awards shall be subject to the applicable agreement of merger or reorganization and that such agreement may provide, without limitation, for the assumption of outstanding awards by the surviving corporation or its parent, for their continuation by the Company (if the Company is a surviving corporation), for accelerated vesting or for their cancellation with or without consideration. Additionally, under the 2011 Plan, the administrator may determine, at the time of grant of an award or thereafter, that such award shall become vested and exercisable, in full or in part, in the event that the Company is party to a change in control and a 2011 Plan participant is terminated within a set time following such change in control.

The employment agreement entered into between the Company and Ms. Leo effective July 9, 2008 provided that any outstanding stock options and restricted stock units held by Ms. Leo at the time of a change of control of the Company would immediately become fully vested and, if applicable, exercisable upon such event. In addition, pursuant to Ms. Leo's employment agreement, she was entitled to the following benefits if the Company terminated her employment at any time without "Cause" or "Disability" or if she resigned for "Good Reason" (as such terms are defined in the employment agreement): (i) Ms. Leo's then outstanding stock options and restricted stock would immediately vest and if applicable, become exercisable as if Ms. Leo continued in service with the Company for an additional 12 months, (ii) 12 months of her then current base salary, (iii) a pro-rated portion of Ms. Leo's annual target bonus that the Company determines was earned as of the termination date, and (iii) up to 12 months of COBRA premium payments. Additional details regarding the amounts of the severance payments and benefits that would have been payable to Ms. Leo had she terminated for "Good Reason" on December 31, 2011, as well as the severance payments and benefits actually paid to her in connection with her resignation for "Good Reason" on June 17, 2011, are discussed in the section of this Proxy Statement titled "Potential Payments Upon Termination or Change-in-Control."

The employment agreement entered into between the Company and Mr. Walker effective November 1, 2011 provided that, if the Company undergoes a change of control during the first 12 months of Mr. Walker's employment and, within the 12 months following the change of control, Mr. Walker's employment is terminated without "Cause" or if he resigns for "Good Reason" (as such terms are defined in the employment agreement), and, provided Mr. Walker's termination or resignation was a "separation from service" within the meaning of Internal Revenue Code Section 409A, then Mr. Walker would be entitled to the following benefits: (i) 50% of Mr. Walker's then outstanding stock options and restricted stock would immediately become fully vested, and if applicable, exercisable, (ii) 12 months of his then current base salary, (iii) 100% of an amount equal to the annual target bonus paid to Mr. Walker for the year prior to the year in which his termination occurred, and (iii) up to 12 months of COBRA premium payments. If the Company undergoes a change of control following the first 12 months of Mr. Walker's employment and, within the 12 months following the change of control, Mr. Walker's employment is terminated without "Cause" or if he resigns for "Good Reason" then Mr. Walker's then outstanding stock options and restricted stock would immediately vest, and if applicable, become exercisable, as if Mr. Walker provided an additional 2 years of service to the Company.

In addition, pursuant to Mr. Walker's employment agreement, he is entitled to certain severance payments and benefits if the Company terminated his employment at any time without "Cause" or "Disability" (as such terms are defined in the employment agreement). In this case, Mr. Walker would be entitled to the following benefits: (i) Mr. Walker's then outstanding stock options and restricted stock would immediately vest, and if applicable, become exercisable, as if Mr. Walker provided an additional 6 months of service, (ii) 6 months of his then current base salary, (iii) 50% of an amount equal to the annual target bonus paid to Mr. Walker for the year prior to the year in which his termination occurred, and (iii) up to 6 months of COBRA premium payments.

Additional details regarding the severance payments and benefits that would have been payable to Mr. Walker had he terminated under each of the scenarios set forth above on December 31, 2011 are discussed in the section of this Proxy Statement titled "Potential Payments Upon Termination or Change-in-Control."

#### Share Ownership Guidelines

Each NEO is required to own shares of our common stock as follows:

- Our CEO must own shares equal to six (6) times such executive's annual base salary.
- All NEOs other than our CEO must own shares equal to two (2) times such executive's annual base salary.

NEOs appointed after October 6, 2011 (the date the change was adopted by our Compensation Committee and Board), which includes Mr. Walker, who was appointed on November 2, 2011, will have five years from the date of hire or appointment to attain such ownership levels. Our other NEOs will have five years from October 6, 2011 to attain such ownership levels. For purposes of these guidelines, a NEO's share ownership includes all shares of the Company's common stock owned by such NEO outright or held in trust for such executive and his or her immediate family, but not a NEO's unvested or unexercised equity (i.e. unvested restricted stock units or outstanding stock options). The value of the shares will be measured as the greater of the then current market price or the closing price of the Company's common stock on the acquisition date.

#### Prohibition against Certain Equity Transactions

Our Insider Trading and Disclosure Policy prohibits our NEOs from engaging in "short" sales and hedging transactions which could reasonably cause them to have interests adverse to our stockholders. "Short" sales, which are sales of shares of common stock by a person that does not own the shares at the time of the sale, evidence an expectation that the value of the shares will decline. Our NEOs are also prohibited from entering into hedging transactions if our

compliance officer determines that such transaction would violate our Insider Trading and Disclosure Policy.

#### Other Considerations

In determining the Named Executive Officers' compensation, the Compensation Committee also considers, among other factors, the possible income tax consequences to the Company and to the NEOs. However, to maintain maximum flexibility in designing an effective Named Executive Officers' compensation program, the Compensation Committee retains the flexibility to design compensation plans and arrangements that may not be deductible for federal income tax purposes. For example, our Compensation Committee considers the provisions of Section 162(m) of the Code that restrict deductibility for federal income tax purposes of executive compensation paid to our chief executive officer and each of our three other most-highly-compensated executive officers holding office at the end of any year (other than our chief financial officer), to the extent such compensation exceeds \$1 million for any of such executive officers in any year and does not qualify for an exception to such limitation. The members of our Compensation Committee qualify as outside directors for purposes of exempting executive compensation from the limits on deductibility under Section 162(m) as "performance-based compensation". However, the Compensation Committee believes that our interests are best served in certain circumstances by providing compensation that does not qualify as performance-based compensation under Section 162(m) and, accordingly, has granted such compensation which may be subject to the \$1 million annual limit on deductibility, including base salary, annual cash bonuses and stock options.

In addition to Section 162(m), Sections 280G and 4999 of the Code provide that executive officers, persons who hold significant equity interests and certain other highly-compensated service providers may be subject to an excise tax if they receive payments or benefits in connection with a change in control of the Company that exceeds certain prescribed limits, and that the Company (or a successor) may forfeit a deduction on the amounts subject to this additional tax. Further, Section 409A of the Code imposes certain additional taxes on service providers who enter into certain deferred compensation arrangements that do not comply with the requirements of Section 409A. We have not agreed to pay any NEO a "gross-up" or other reimbursement payment for any tax liability that he or she might owe as a result of the application of Sections 280G, 4999 or 409A.



We follow Financial Accounting Standard Board Accounting Standards Codification Topic 718 (“ASC Topic 718”) for our stock-based compensation awards. ASC Topic 718 ASC requires companies to measure the compensation expense for all share-based payment awards made to employees and directors, including stock options and restricted stock awards, based on the grant date “fair value” of these awards. This calculation is performed for accounting purposes and reported in the compensation tables below, even though our executive officers may never realize any value from their awards. ASC Topic 718 also requires companies to recognize the compensation cost of their stock-based compensation awards in their income statements over the period that an executive officer is required to render service in exchange for the option or other award.

The Compensation Committee also considers the accounting consequences to the Company of different compensation decisions and the impact of certain arrangements on stockholder dilution. However, neither of these factors by themselves will compel a particular compensation decision.

#### Looking Forward – 2012 Executive Compensation

In connection with its annual assessment of the Company’s compensation policies and practices, on April 26, 2012, the Compensation Committee adopted the Pay for Performance Compensation Program. The purpose of the Pay for Performance Compensation Program is to provide a mechanism for the Compensation Committee to implement and administer the annual pay-for-performance component of our executive compensation program, to drive performance of the Company and its affiliates and operating units, and to align, motivate and reward eligible employees by making a portion of their equity and cash compensation dependent on the achievement of certain performance goals related to such Company performance.

Equity awards and cash bonuses awarded pursuant to the Pay for Performance Compensation Program will be based on the attainment of performance goals, which may include corporate and strategic business objectives, a participant’s individual performance and contribution to the Company, and/or any other factor deemed appropriate by the Compensation Committee. The Compensation Committee will establish the performance period or periods for the Pay for Performance Compensation Program (which will typically be the Company’s fiscal year, but may include, without limitation, multiple fiscal years or any other period longer than one fiscal year or shorter than one fiscal year), the performance goals for each performance period and, in the Compensation Committee’s sole discretion, the target equity award and/or cash bonus amount for each participant. Performance goals and target amounts may be established, and once established, may be modified, by the Compensation Committee at any time, as determined appropriate in the Compensation Committee’s sole discretion. Corporate objectives may include one or more objective measurable performance factors, including, but not limited to, the following: (i) operating income; (ii) earnings before income taxes, depreciation, amortization and restructuring (“EBITDAR”); (iii) earnings; (iv) cash flow; (v) market share; (vi) sales or revenue; (vii) expenses; (viii) cost of goods sold; (ix) profit/loss or profit margin; (x) working capital; (xi) return on equity or assets; (xii) debt or debt-to-equity; (xiii) accounts receivable; (xiv) writeoffs; (xv) cash; (xvi) assets; (xvii) liquidity; (xviii) operations; (xvix) product development; (xx) regulatory activity; (xxi) management; (xxii) human resources; (xxiii) corporate governance; (xxiv) information technology; (xxv) business development; (xxvi) strategic alliances, licensing and partnering; (xxvii) mergers and acquisitions or divestitures; and/or (xxviii) financings, each with respect to the Company and/or one or more of its affiliates or operating units. The Compensation Committee has reserved the right, in its sole discretion, to increase, reduce or eliminate the amount of an equity award or cash bonus otherwise payable to a participant with respect to any performance period. No equity award will be approved and no cash bonus will be payable with respect to any performance period until the applicable results have been verified by the Compensation Committee and the Compensation Committee otherwise determines that the underlying terms and conditions of the program have been satisfied.

The Compensation Committee then revised the pay-for-performance component of our executive compensation program as it will apply to 2012 compensation as follows:

- Increase Portion of NEO Compensation Tied to Performance. In addition to 50% of each NEO's total target annual equity awards being subject to the achievement of revenue and profitability triggers, 50% of each NEO's annual discretionary cash incentive bonus will also be subject to the achievement of such performance triggers. We call this 50% of each of the equity awards and incentive cash bonus that is at risk, collectively the "Performance Compensation."
- Use Internal Revenue Measures. Instead of judging the Company's performance based on the growth of EDA Industry, which includes many dissimilar companies and results, the Compensation Committee decided it was a better measure of results to consider whether the Company's revenue growth for the fiscal year equals or exceeds the Company's internal revenue plan. Accordingly, 50% of each NEO's Performance Compensation will be tied to this measure.
- Use GAAP and Non-GAPP Profitability Triggers. Instead of judging the Company's profitability performance based solely on a non-GAAP measure, the Compensation Committee decided it was a better measure of profitability results to equally consider whether the Company's non-GAAP, pre-tax net income, excluding stock-based compensation, depreciation, amortization of acquired intangibles and restructuring charges, which we call EBITDAR, and the Company's GAAP earnings per share each equaled or exceeded certain thresholds. Accordingly, 12.5% of each NEO's Performance Compensation will be tied to the EBITDAR measure and 12.5% of each NEO's Performance Compensation will be tied to the GAAP earnings per share measure.

## COMPENSATION COMMITTEE REPORT

The Compensation Committee has reviewed and discussed the Company's Compensation Discussion and Analysis contained in this proxy statement, or the CD&A, with management. Based on this review and discussion, the Compensation Committee recommended to the Board that the CD&A be included in this proxy statement.

### THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS OF PDF SOLUTIONS, INC.:

Thomas Caulfield, DES, Chair  
Albert Y.C. Yu, Ph.D.  
R. Stephen Heinrichs

The information contained in the Compensation Committee Report shall not be deemed to be "soliciting material," to be "filed" with the SEC, or to be subject to Regulation 14A or Regulation 14C (other than as provided in Item 407 of Regulation S-K) or to the liabilities of Section 18 of the Securities Exchange Act of 1934 and, notwithstanding anything to the contrary set forth in any of the Company's filings under the Securities Act of 1933 or the Securities Exchange Act of 1934 that might incorporate future filings, including this Proxy Statement, in whole or in part, the Compensation Committee Report shall not be deemed to be incorporated by reference into any such filings with the SEC except to the extent that the Company specifically incorporates it by reference into a document filed under the Securities Act of 1933 or the Securities Exchange Act of 1934.

## COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Compensation Committee of the Board of Directors currently consists of Thomas Caulfield, DES (Chair), Albert Y.C. Yu, Ph.D. and R. Stephen Heinrichs. No member of the Compensation Committee or executive officer of the Company is, or has been, an officer of the Company, or has a relationship that would constitute an interlocking relationship with executive officers or directors of another entity.

## SUMMARY COMPENSATION TABLE

The following table presents the compensation paid to and earned by our Named Executive Officers in the year ended December 31, 2011.

Name & Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)(1)	Option Awards (\$)(1)	All Other Compensation (\$)(2)	Total (\$)
John K. Kibarian Chief Executive Officer, President and Director	2011	250,000	-	-	-	200	250,200
	2010	250,000	-	-	-	200	250,200
	2009	250,000	-	-	-	200	250,200
Gregory C. Walker Chief Financial Officer, Vice President, Finance (3)	2011	44,000	16,700(4)	-	546,100	40	606,840
	2010	-	-	-	-	-	-
	2009	-	-	-	-	-	-
Michael Shahbazian Former Interim Chief Financial Officer, and Vice President, Finance (5)	2011	129,000	-	50,700	-	7,600 (6)	187,300
	2010	-	-	-	-	-	-
	2009	-	-	-	-	-	-
Joy E. Leo Former Executive Vice President, Chief Administration Officer and Acting Chief Financial Officer (7)	2011	125,800	-	-	-	160,100(8)	285,900
	2010	270,000	-	-	-	200	270,200
	2009	270,000	89,400(9)	-	98,600	200	458,200
Cornelis (Cees) Hartgring Vice President, Client Services and Sales	2011	240,000	-	41,900	64,800	200	346,900
	2010	240,000	-	-	-	200	240,200
	2009	240,000	-	-	51,700	200	291,900
Kimon W. Michaels Vice President, Products	2011	210,000	-	-	-	200	210,200
	2010	210,000	-	-	-	200	210,200
	2009	210,000	-	135,600	-	200	345,800

and Solutions and  
Director

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- (1) The amounts reported in these columns reflect the aggregate grant date fair value for financial statement reporting purposes for stock options and restricted stock unit awards granted in that fiscal year as determined in accordance with the Financial Accounting Standards Board Accounting Standards Codification Topic 718, or FASB ASC Topic 718. These amounts reflect our accounting expense for these awards and do not represent the actual economic value that may be realized by the Named Executive Officers. There can be no assurance that these amounts will ever be realized. For information on the assumptions used in valuing these awards, refer to the Note to the consolidated financial statements contained in the Company's Annual Report on Form 10-K for the fiscal year in which the award was granted titled "Stockholder's Equity".
- (2) Unless indicated otherwise, the amounts reported represent the dollar value of premiums for term life insurance paid by us on behalf of each Named Executive Officer during the fiscal years ended December 31, 2009, 2010 and 2011. There is no cash surrender value under these life insurance policies.
- (3) Mr. Walker was appointed our Vice President, Finance and Chief Financial Officer on November 10, 2011.
- (4) This amount represents the portion of the first-year bonus that the Company agreed to pay to Mr. Walker in connection with his hire, which bonus is to be paid to Mr. Walker on a semi-monthly basis over the first 12 months of his employment with the Company.
- (5) Mr. Shahbazian was appointed as our Vice President Finance and Interim Chief Financial Officer on June 17, 2011 and served through December 1, 2011.
- (6) This amount includes amounts received by Mr. Shahbazian for accrued paid time off paid at the time of termination of employment
- (7) Ms. Leo resigned as our Executive Vice President, Chief Administration Officer and Acting Chief Financial Officer effective June 17, 2011.
- (8) This amount includes the portion of then current base salary paid to Ms. Leo and the premiums for COBRA coverage paid by the Company provided as severance in connection with the termination of Ms. Leo's employment pursuant to Ms. Leo's employment offer, as well as amounts received for accrued paid time off at the time of termination of employment.
- (9) This amount represents a retention bonus agreed to through arms-length negotiation at the time Ms. Leo was hired and set forth in the offer letter between Ms. Leo and the Company effective as of July 9, 2008. In agreeing to pay this retention bonus, the Company took into account Ms. Leo's qualifications, experience, prior salary, and competitive salary information for companies that are comparable to ours.



## GRANTS OF PLAN-BASED AWARDS FOR FISCAL YEAR 2011

The following table shows grants of restricted stock units and stock option awards made to our Named Executive Officers during the fiscal year ended December 31, 2011.

Name	Grant Date	All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards (\$/Sh)	Grant Date Fair Value of Stock and Option Awards (\$) (1)
Gregory C. Walker	11/16/2011	-	180,000	6.09	546,100
Michael Shahbazian	06/10/2011	9,000	-	-	50,700
Cornelis (Cees)					
Hartgring	5/27/2011	-	20,250	6.21	64,800
	5/27/2011	6,750	-	-	41,900

- (1) The amounts in this column reflects the aggregate grant date fair value for financial statement reporting purposes for stock options and restricted stock units granted in that fiscal year as determined in accordance with the FASB ASC Topic 718.

## OUTSTANDING EQUITY AWARDS AS OF DECEMBER 31, 2011

The following table presents the outstanding equity awards of each of our Named Executive Officers as of December 31, 2011.

Name	Grant Date	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable (1)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)
John K. Kibarian	4/21/2003	6,668	-	6.39	04/20/2013	-	-
	4/21/2003	73,332	-	6.39	04/20/2013	-	-
Gregory C. Walker	11/16/2011	-	180,000	6.09	11/15/2021		
Cornelis (Cees)	09/03/2002	74,072	-	5.40	09/02/2012	-	-
Hartgring	09/03/2002	60,867	-	5.40	09/02/2012	-	-
	11/07/2007	80,000	-	8.92	11/06/2017	-	-
	10/29/2009	18,958	16,042	3.62	10/28/2019	-	-
	05/27/2011	2,953	17,297	6.21	05/26/2021		

	08/18/2008	-	-	-	-	2,977 (2)	20,800
	05/27/2011	-	-	-	-	5,907 (3)	41,200
Kimon Michaels	08/18/2008	-	-	-	-	2,381 (2)	16,600

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- (1) 25% of the total shares subject to the original option vested on the first anniversary of the grant and 1/48th of the total shares subject to the original option vested and will vest on the grant date day of each month thereafter until fully vested.
- (2) 12.5% of the total original award vested on May 15, 2009 and vested or will vest every six months thereafter until fully vested.
- (3) 12.5% of the total original award vested on November 27, 2011 and vested or will vest every six months thereafter until fully vested.



## OPTION EXERCISES AND STOCK VESTED IN THE FISCAL YEAR 2011

The following table presents the stock options exercised by our Named Executive Officers and restricted stock units held by our Named Executive Officers that vested in 2011.

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$) (1)
John K. Kibarian	-	-	-	-
Gregory C. Walker	-	-	-	-
Michael Shahbazian	-	-	9,000	48,700
Joy E. Leo	326,040	65,100	-	-
Cornelis (Cees) Hartgring	-	-	6,596	40,500
Kimon W. Michaels	-	-	22,620	128,100

- (1) The values of the vested awards were determined based on the number of shares that vested multiplied by the per share closing sale price on the NASDAQ Global Market reported for the applicable vesting date.

## Pension Benefits

We did not sponsor any defined benefit pension or other actuarial plan for the Named Executive Officers during 2011.

## Non-qualified Deferred Compensation

We did not maintain any non-qualified defined contribution or other deferred compensation plans or arrangements for the Named Executive Officers during 2011.

## Potential Payments Upon Termination or Change-in-Control

## Potential Payments Upon Termination of Employment

Except as described below for Ms. Leo and Mr. Walker, we have not entered into agreements with our NEOs that provide for severance or other special benefits upon any termination of our NEOs' employment.

Pursuant to the employment agreement with Ms. Leo effective July 9, 2008, if the Company terminated her employment at any time without "Cause" or "Disability" or if she resigned for "Good Reason" (as such terms are defined in the employment agreement, which was filed with the Company's Form 10-Q for the fiscal quarter ended June 30, 2008), and provided that Ms. Leo's termination or resignation was a "separation from service" within the meaning of Internal Revenue Code Section 409A, Ms. Leo would have been entitled to all of the following:

vesting acceleration with respect to her outstanding and unvested stock options and/or restricted stock units for an additional 12 months after the effective date of her termination;

- 12 months of her then-current annual base salary, paid in accordance with the Company's standard payroll procedures over a 12-month period following the termination date;
- a percentage of her annual incentive target bonus, which would have been determined by pro rating the percentage of the target bonus that the Company determined was earned as of the effective date of her separation, had such target bonus been payable at such time; and
- the Company's payment of the premiums for Ms. Leo's COBRA coverage from the last date on which she received health care coverage as a Company employee until the earlier of: (1) the date that is 12 months following the effective date of her separation; or (2) the date Ms. Leo becomes covered under another employer's health coverage plan.

The following table presents the estimated value and payments that (1) Ms. Leo would have received in the hypothetical event that she resigned for Good Reason, as of the last business day of fiscal year 2011 (i.e. December 31, 2011), and the hypothetical termination was a “separation from service” within the meaning of Internal Revenue Code Section 409A, and what (2) Ms. Leo received at the time of her resignation from the Company for Good Reason, which resignation was effective on June 17, 2011.

Executive Benefits and Payments Upon Termination of Employment	Value of the Hypothetical Benefit and Payment Amount (\$)	Value of the Benefit and Payment Amount Received at the Time of Resignation (\$)
Vesting acceleration of outstanding and unvested stock options	287,600(1)	85,400(2)
Vesting acceleration of outstanding and unvested restricted stock units (3)	-	-
Twelve months of annual base salary	270,000	270,000
A percentage of target bonus	216,000(4)	-
Premiums for COBRA coverage	7,200	6,800
Total	780,800	362,200

(1) The value of outstanding stock options were calculated based on Black-Scholes methodology using the closing price on December 31, 2011 (\$6.97), volatility (62.8%), risk free rate of return (0.81%), no dividends and expected term of 4.6 years.

(2) The value of outstanding stock options were calculated based on Black-Scholes methodology using the closing price on June 17, 2011 (\$5.55), volatility (37.97%), risk free rate of return (0.03%), no dividends and expected term of 0.25 years.

(3) Ms. Leo did not have any restricted stock units as of December 31, 2011 or at the time of her resignation.

(4) Amount is calculated based on the maximum potential annual incentive target bonus, which was 80% of Ms. Leo's base salary.

In the event the Company terminates Mr. Walker's employment at any time without Cause or Disability, then subject to meeting certain criteria, he will be entitled to all of the following:

- (i) vesting acceleration of his then outstanding and unvested stock options and restricted stock as if he had provided continuous service to the Company for an additional 6 months after his separation date;
- (ii) 6 months of his then-current annual base salary, paid in accordance with the Company's standard payroll procedures over a 6-month period;
- (iii) a payment equal to 50% of the annual target bonus paid for the immediately preceding performance period; and,

- (iv) the Company's payment of the premiums for COBRA coverage from the last date on which he receives health care coverage as a Company employee until the earlier of:
- (1) the date that is 6 months following the separation date; or
  - (2) the date Mr. Walker becomes covered under another employer's health coverage plan.

The following table presents the estimated value and payments that Mr. Walker would have received had the following events occurred as of the last business day of fiscal year 2011 (i.e. December 31, 2011) (1) termination of his employment without Cause or a Resignation for Good Reason with the Company immediately following a Change of Control; and (2) termination of his employment without Cause or Disability.

Executive Benefits and Payments upon Termination of Employment	Value of the Hypothetical Benefit and Payment Amount (change of control) (\$)	Value of the Hypothetical Benefit and Payment Amount (termination at any time without cause or disability) (\$)
Vesting acceleration of outstanding and unvested stock options	339,900(1)	-
Vesting acceleration of outstanding and unvested restricted stock units	-	-
Base salary	315,000	157,500
A percentage of target bonus	220,500(2)	110,300
Premiums for COBRA coverage	11,700	11,700
<b>Total</b>	<b>887,100</b>	<b>279,500</b>

(1) The value of outstanding stock options were calculated based on Black-Scholes methodology using the closing price on 12/30/2011 (\$6.97), volatility (62.8%), risk free rate of return (0.81%), no dividends and expected term of 4.6 years.

(2) Amount is calculated based on the maximum potential annual incentive target bonus, which was 70% of Mr. Walker's base salary.

## Potential Payments Upon Change-in-Control

Pursuant to the employment agreement with Mr. Walker, in the event that the Company undergoes a “Change in Control” during the first 12 months of his employment and if, at any time over the next 12 months after consummation of such Change of Control, his employment is terminated without “Cause” or he resigns with “Good Reason” (as such terms are defined in the employment agreement) and, provided Mr. Walker’s termination or resignation was a “separation from service” within the meaning of Internal Revenue Code Section 409A, then he will be entitled to all of the following:

- (i) vesting acceleration with respect to 50% of then outstanding and unvested stock options and restricted stock;
- (ii) 12 months of then-current annual base salary, paid in accordance with the Company's standard payroll procedures over a 12-month period;
- (iii) a payment equal to 100% of the annual target bonus paid for the immediately preceding performance period; and
- (iv) the Company's payment of the premiums for COBRA coverage from the last date on which he receives health care coverage as a Company employee until the earlier of: (1) the date that is 12 months following the separation date; or (2) the date Mr. Walker becomes covered under another employer's health coverage plan.

The Company’s 2011 Plan provides that in the event of a change in control, outstanding awards shall be subject to the applicable agreement of merger or reorganization and that such agreement may provide, without limitation, for the assumption of outstanding awards by the surviving corporation or its parent, for their continuation by the Company (if the Company is a surviving corporation), for accelerated vesting or for their cancellation with or without consideration. Additionally, under the 2011 Plan, the administrator may determine, at the time of grant of an award or thereafter, that such award shall become vested and exercisable, in full or in part, in the event that the Company is party to a change in control and a 2011 Plan participant is terminated in connection with or within a set time following such change in control.

The following table presents the estimated value that our Named Executive Officers would have realized in the hypothetical event a change in control of the Company had occurred on the last business day of 2011 (i.e. December 31, 2011) and outstanding stock options and restricted stock units held by them were not assumed or continued by the acquiring company.

Name	Value of Accelerated Rights (\$)
John K. Kibarian	-
Gregory C. Walker	339,900(1)
Michael Shahbazian	-
Joy E. Leo	-
Cornelis (Cees) Hartgring	61,900(2)
Kimon W. Michaels	16,600(2)

- (1) Consists of options. The value of outstanding stock options were calculated based on Black-Scholes methodology using the closing price on December 31, 2011 (\$6.97), volatility 62.8%, risk free rate of return 0.81%, no dividends and expected term of 4.6 years.
- (2) Consists of restricted stock units. The value was determined by multiplying the number of unvested shares subject to the restricted stock unit award as of December 31, 2011 by the closing market price of the Company's common stock on December 31, 2011 (\$6.97 per share).

## DIRECTOR COMPENSATION

Directors who are also employees of the Company are not compensated for serving on our Board of Directors. Information regarding the compensation otherwise received by our directors, who are also executive officers, is provided above. The Compensation Committee of the Board reviews director compensation periodically and recommends changes to the Board, when it deems them appropriate. The following table describes the cash and equity components of director compensation program:

Compensation Element	Director Compensation Program
Annual cash retainer	\$36,000 for each non-employee director (1)
Annual equity award	Option to purchase 11,250 shares and 3,750 restricted stock units for each non-employee director (2)
Additional annual cash retainer and equity award for Chairman of the Board	\$30,000 plus an option to purchase 15,000 shares and 5,000 restricted stock units (1)(2)
Additional annual cash retainer for Audit and Corporate Governance Committee	\$12,000 (chair); \$6,000 (member) (1)
Additional annual cash retainer for Compensation Committee	\$10,000 (chair); \$4,000 (member) (1)
Additional annual cash retainer for Nominating Committee	\$5,000 (chair); \$2,000 (member) (1)
Additional cash fees for Strategic Committee meetings	\$1,000 per in-person meeting and \$500 for telephone participation
New Director equity award (one-time)	Option to purchase 17,650 shares and 5,750 restricted stock units (3)

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- (1) All cash retainers are paid in four equal quarterly installments at the beginning of each calendar quarter.
- (2) These stock options and restricted stock units are targeted to be awarded on or around May 15th of each year. Under the director compensation program, options granted in 2012 and thereafter will vest with respect to 1/4th of the total shares subject to the option on the grant date and 1/48th of the total shares monthly after the grant date until fully vested; and (b) restricted stock unit awards will be subject to the performance criteria for the fiscal year prior to the year of grant and thereafter and will vest with respect to 1/4th of the total shares on the grant date and 1/4th of the total units subject to such award every anniversary of the grant date thereafter until fully vested.

- (3) These stock option grants are awarded at the time a new director is appointed or elected to the Board. These stock options will vest with respect to 1/48th of the total shares subject to the option on the grant date and each month thereafter until fully vested, and restricted stock unit awards will vest with respect to 1/8th of the total shares subject to such award every 6 months after the grant date until fully vested.

#### Performance-Based Awards

Annual equity awards made to non-employee directors in 2012 and thereafter will be subject to the achievement of the following revenue and performance profitability metric triggers for the Company:

- With respect to fiscal year 2011, (1) 50% of each non-employee director's annual restricted stock unit awards will be granted to such director in 2012 only if the Company's revenue growth rate (year-over-year) for the prior fiscal year equals or exceeds the annual revenue growth rate (for the same period) of the EDA industry; and (2) 50% of each director's annual restricted stock unit awards will be granted to such director only if the Company's annual EBITAR for the prior fiscal year exceeds 7%.
- With respect to fiscal year 2012 and thereafter, (1) 25% of each director's annual total equity awards will be granted to such director in 2013 and thereafter only if the Company's annual revenue growth rate equals or exceeds the Company's internal plan; (2) 12.5% of each director's annual total equity awards will be granted to such director only if the Company's non-GAAP, pre-tax net income, excluding stock-based compensation, depreciation, amortization of acquired intangibles and restructuring charges, which we call EBITDAR, for the prior fiscal year equals or exceeds certain thresholds; and (3) 12.5% of each director's annual total equity awards will be granted to such director only if the Company's GAAP earnings per share for the prior fiscal year equals or exceeds certain thresholds.

The Company intends to grant annual equity awards to directors in May of each year, with those related to performance, if any, based on achievement of the applicable performance goals for the prior fiscal year. Since the annual awards related to performance are granted based on performance against the goals for the prior year, they will be 25% vested upon issuance. However, the remaining 75% of the annual awards related to performance will be subject to further service-based vesting such that they shall vest in equal installments on each annual anniversary of the grant date for the following 3 years.



## Share Ownership Guidelines

Each non-employee director is required to own shares of our common stock having value equal to at least three times the non-employee director's regular cash Board retainer. Non-employee directors will have five years from the date of election or appointment to attain such ownership levels (or from May 27, 2011 (the date of adoption of the program) for the current non-employee directors). For purposes of these guidelines, a non-employee director's share ownership includes all shares of the Company's common stock owned by such non-employee director outright or held in trust for the non-employee director and his or her immediate family, but not a non-employee director's unvested or unexercised equity (i.e. unvested restricted stock or stock unit awards or outstanding stock options). The value of shares shall be measured as the greater of the then current market price or the closing price of the Company's common stock on the acquisition date.

## Allocation of Awards Between Employees and Directors

Starting in 2012, total options and restricted stock or stock unit awards grants to non-employee directors shall not exceed 8% of total annual option and restricted stock or stock unit awards annual grants to employees and consultants (including grants to executives). If the above grants to the non-employee directors set forth in the director compensation program would otherwise exceed such limit, then all non-employee director grants shall automatically be adjusted down by an equal percentage to comply with this limitation.

Our non-employee directors received the following compensation during the fiscal year ended December 31, 2011:

## DIRECTOR COMPENSATION TABLE

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$) (1)	Total(\$)
Thomas Caulfield, DES	54,000	23,300	36,000	113,300
R. Stephen Heinrichs	54,000	23,300	36,000	113,300
Albert Y.C. Yu, Ph.D	45,000	23,300	36,000	104,300
Lucio Lanza	72,000	54,400	84,000	210,400

(1) The amounts reported in this column reflect the aggregate grant date fair value for financial statement reporting purposes for the stock options granted in 2011 as determined in accordance with the FASB ASC Topic 718. These amounts reflect our accounting expense for these awards and do not represent the actual value that may be realized by our non-employee directors. For information on the assumptions used in valuing these stock option grants, refer to the Note to the consolidated financial statements contained in the Company's Annual Report on Form 10-K for 2011 titled "Stockholder's Equity." The number of outstanding stock options held by each non-employee director at the end of 2011 were: Dr. Caulfield (53,750); Mr. Heinrichs (194,195); Mr. Lanza (373,750); and Dr. Yu (41,095). The outstanding and unvested restricted stock units held by each non-employee director at the end of 2011 were: Dr. Caulfield (5,961); Mr. Heinrichs (3,282); Mr. Lanza (7,657); and Dr. Yu (5,792).

On November 17, 2005, we entered into acceleration agreements (each, an "Acceleration Agreement") with each of Mr. Lanza, Dr. Yu and Mr. Heinrichs pursuant to which all of the stock options to purchase shares of the Company's common stock that have been granted or will be granted to each of the aforementioned directors will become vested

and exercisable in full in the event of a change in control of the Company. Each of the acceleration agreements will generally remain in effect until terminated by the Company or, if earlier, the date a director ceases to provide services to the Company.

#### AUDIT AND CORPORATE GOVERNANCE COMMITTEE REPORT

The Audit and Corporate Governance Committee of our Board is composed of three independent directors and operates under a written charter adopted by the Board of Directors. The members of the Audit and Corporate Governance Committee are Mr. Heinrichs (Chair), Dr. Caulfield, and Mr. Lanza. Each of the members of the Audit and Corporate Governance Committee is independent as defined by the NASDAQ Listing Rules. In addition and based on the background, education, qualification and attributes summarized in this Proxy Statement, our Board has determined that Mr. Heinrichs qualifies as an “audit committee financial expert” as defined by SEC rules.

Our Board has adopted a written charter for the Audit and Corporate Governance Committee which governs the Audit and Corporate Governance Committee’s functions and responsibilities. This charter was amended and restated on July 23, 2003, again on January 26, 2005, in light of the Sarbanes-Oxley Act of 2002 and new SEC and FINRA rules, and again on February 3, 2009 in conjunction with the renaming of the committee and the adoption of a revised charter for the committee on April 23, 2009 to reflect its corporate governance-related duties. The Audit and Corporate Governance Committee reviews and reassesses the adequacy of this charter at least once per year and makes recommendations to the Board regarding changes or amendments the Audit and Corporate Governance Committee deems appropriate.

The Audit and Corporate Governance Committee, subject to stockholder ratification, appoints the accounting firm to be engaged as the Company’s independent registered public accounting firm. The independent registered public accounting firm is responsible for performing an independent audit of the Company’s consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States), or PCAOB, and to issue a report thereon. Management is responsible for our internal controls and the financial reporting process. The Audit and Corporate Governance Committee is responsible for monitoring, overseeing and assessing the effectiveness of these processes.

The Audit and Corporate Governance Committee held 12 meetings during the fiscal year ended December 31, 2011. The meetings were designed to facilitate and encourage communication between the Audit and Corporate Governance Committee, management and our independent registered public accounting firm PricewaterhouseCoopers LLP. Management represented to the Audit and Corporate Governance Committee that our consolidated financial statements were prepared in accordance with GAAP. The Audit and Corporate Governance Committee reviewed and discussed the audited consolidated financial statements for the fiscal year ended December 31, 2011 with management and the independent registered public accounting firm.

The Audit and Corporate Governance Committee discussed with the independent registered public accounting firm the adequacy of the Company's internal control system, financial reporting procedures and the matters required to be discussed by the statement on Auditing Standards No. 62, as amended (AICPA, professional Standards, vol. 1, AU section 380) as adopted by the Public Company Accounting Oversight Board in Rule 3200T.

The Audit and Corporate Governance Committee has received and reviewed the written disclosures and the letter from the independent registered public accounting firm, PricewaterhouseCoopers LLP as required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant's communications with the audit committee concerning independence. Additionally, the Audit and Corporate Governance Committee has discussed with PricewaterhouseCoopers LLP the issue of its independence from PDF Solutions, Inc.

Based on its review of the audited consolidated financial statements and the various discussions noted above, the Audit and Corporate Governance Committee recommended to the Board that the audited consolidated financial statements be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

THE AUDIT AND CORPORATE  
GOVERNANCE COMMITTEE OF THE  
BOARD OF  
DIRECTORS OF PDF SOLUTIONS, INC.:

R. Stephen Heinrichs, Chair  
Thomas Caulfield, DES  
Lucio L. Lanza

The information contained in the Audit and Corporate Governance Committee Report shall not be deemed to be "soliciting material," to be "filed" with the SEC, or to be subject to Regulation 14A or Regulation 14C (other than as provided in Item 407 of Regulation S-K) or to the liabilities of Section 18 of the Securities Exchange Act of 1934 and, notwithstanding anything to the contrary set forth in any of the Company's filings under the Securities Act of 1933 or the Securities Exchange Act of 1934 that might incorporate future filings, including this proxy statement, in whole or in part, the Audit and Corporate Governance Committee Report shall not be deemed to be incorporated by reference into any such filings with the SEC except to the extent that the Company specifically incorporates it by reference into a document filed under the Securities Act of 1933 or the Securities Exchange Act of 1934.

OTHER MATTERS

The Board knows of no other business that will be presented to the Annual Meeting. If any other business is properly brought before the Annual Meeting, the enclosed proxy will be voted in respect thereof as the proxy holders deem advisable.

It is important that the enclosed proxies be returned promptly and that your shares be represented at the Annual Meeting. Stockholders are urged to mark, date, execute and promptly return the enclosed proxy card in the enclosed envelope or access the proxy materials online, indicate your choices and submit them on the Internet.

By Order of the Board of Directors,

PETER COHN  
Secretary

San Jose, California  
June 26, 2012



