

Hanesbrands Inc.
Form 10-K
February 03, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2016

or

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

For the transition period from _____ to _____

Commission file number: 001-32891

Hanesbrands Inc.

(Exact name of registrant as specified in its charter)

Maryland 20-3552316

(State of incorporation) (I.R.S. employer identification no.)

1000 East Hanes Mill Road 27105

Winston-Salem, North Carolina (Address of principal executive office) (Zip code)

(336) 519-8080

(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value \$0.01 per share

Name of each exchange on which registered:

New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference into Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer

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

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

As of July 1, 2016, the aggregate market value of the registrant's common stock held by non-affiliates was approximately \$9,619,505,818 (based on the closing price of the common stock of \$25.60 per share on that date, as reported on the New York Stock Exchange and, for purposes of this computation only, the assumption that all of the registrant's directors and executive officers are affiliates and that beneficial holders of 5% or more of the outstanding common stock are not affiliates).

As of January 27, 2017, there were 378,721,050 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K incorporates by reference to portions of the registrant's proxy statement for its 2017 annual meeting of stockholders.

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains information that may constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”). Forward-looking statements include all statements that do not relate solely to historical or current facts, and can generally be identified by the use of words such as “may,” “believe,” “will,” “expect,” “project,” “estimate,” “intend,” “anticipate,” “plan,” “continue” or similar expressions. However, the absence of these words or similar expressions does not mean that a statement is not forward-looking. All statements regarding our intent, belief and current expectations about our strategic direction, prospects and future results are forward-looking statements. Management believes that these forward-looking statements are reasonable as and when made. However, caution should be taken not to place undue reliance on any such forward-looking statements because such statements speak only as of the date when made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. In addition, forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or projections. These risks and uncertainties include, but are not limited to, those described under “Risk Factors” and elsewhere in this report and those described from time to time in our future reports filed with the Securities and Exchange Commission (“SEC”).

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You can read our SEC filings over the Internet at the SEC’s website at www.sec.gov. To receive copies of public records not posted to the SEC’s website at prescribed rates, you may complete an online form at www.sec.gov, send a fax to (202) 772-9337 or submit a written request to the SEC, Office of FOIA/PA Operations, 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information.

We make available copies of materials we file with, or furnish to, the SEC free of charge at www.Hanes.com/investors (in the “Investors” section). By referring to our corporate website, www.Hanes.com/corporate, or any of our other websites, we do not incorporate any such website or its contents into this Annual Report on Form 10-K.

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PART I

Item 1. Business

Company Overview

Hanesbrands Inc. (collectively with its subsidiaries, “Hanesbrands,” “we,” “us,” “our” or the “Company”) is a socially responsible leading marketer of everyday basic innerwear and activewear apparel in the Americas, Europe, Australia and Asia/Pacific under some of the world’s strongest apparel brands, including Hanes, Champion, Maidenform, DIM, Bali, Playtex, Bonds, JMS/Just My Size, Nur Die/Nur Der, L’eggs, Lovable, Wonderbra, Flexees, Gear for Sports and Berlei.

We primarily sell bras, panties, shapewear, hosiery, men’s underwear, children’s underwear, socks, T-shirts and other activewear in the Americas, Europe, Australia and Asia. In the United States, Hanes sells more units of intimate apparel, male underwear and children’s underwear than any other brand. Unlike most apparel companies, Hanesbrands primarily operates its own manufacturing facilities. More than 70 percent of the apparel units that we sell are manufactured in our own plants or those of dedicated contractors.

We have a long history of innovation, product excellence and brand recognition. We revolutionized Tagless T-shirts and underwear, we invented the sports bra and we were the first to advertise a bra on national television (Playtex). We are now using our Innovate-to-Elevate strategy to integrate our brand superiority, industry-leading innovation and low-cost global supply chain to provide higher valued products while lowering production costs. Our Tagless apparel platform, ComfortFlex Fit bra platform, ComfortBlend fabric platform, temperature-control X-Temp fabric platform and FreshIQ advanced odor protection technology fabric platform incorporate big-idea innovation to span across brands, product categories, business segments, retailer and distribution channels and geographies.

Founded in 1901, we were organized as a Maryland corporation in 2005 and spun off from Sara Lee Corporation in 2006, at which time we became an independent, publicly-traded corporation. Since then, we have used strategic acquisitions to expand our brand portfolio. In October 2013, we acquired Maidenform Brands Inc., a global intimate apparel company, including the brands Maidenform and Flexees. We acquired another portfolio of strong brands including DIM, Nur Die/Nur Der, Lovable, Shock Absorber and Abanderado through the 2014 acquisition of DBA Lux Holding S.A. (“Hanes Europe Innerwear”), a leading marketer of intimate apparel, hosiery and underwear in Europe. In 2016 we continued our international expansion through the acquisitions of Champion Europe S.p.A. (“Champion Europe”), the owner of the trademark for the Champion brand in Europe, the Middle East and Africa, and Pacific Brands Limited (“Hanes Australasia”), a leading underwear and intimate apparel company in Australia with a portfolio of strong brands including Bonds, Sheridan and Berlei. We have also expanded our activewear portfolio through the acquisitions of GearCo, Inc. (“Gear for Sports”), a leading seller of licensed logo apparel in collegiate bookstores and other channels, and Knights Holdco, Inc. (“Knights Apparel”), a leading seller of licensed collegiate logo apparel primarily in the mass retail channel, in 2010 and 2015, respectively. We believe these acquisitions will create growth and cost savings opportunities and increased scale to serve retailers.

We take great pride in our strong reputation for ethical business practices and the success of our Hanes for Good corporate responsibility program for community and environmental improvement. Hanesbrands was a U.S. Environmental Protection Agency Energy Star Sustained Excellence Award winner every year from 2012-2016 and Partner of the Year winner in 2010 and 2011. We have significant goals for reducing our energy use, carbon emissions and water use and publicly report our progress. We are also a recognized leader for our community-building, philanthropy and workplace practices. More information about our Hanes for Good corporate responsibility initiatives may be found at www.HanesForGood.com.

Our fiscal year ends on the Saturday closest to December 31. All references to “2016”, “2015” and “2014” relate to the 52 week fiscal years ended on December 31, 2016 and January 2, 2016, and the 53 week fiscal year ended on January 3, 2015, respectively. A significant subsidiary of ours, Hanes Holdings Lux S.à.r.l. (formerly named DBA Lux Holding S.A.) (“Hanes Europe Innerwear”), had a 53 week fiscal year ended on January 2, 2016 as a result of aligning Hanes Europe Innerwear’s year end with ours in the year after acquisition. The difference in reporting one additional week of financial information for Hanes Europe Innerwear did not have a material impact on our financial condition, results of

operations or cash flows.

Our Brands

Our portfolio of leading brands is designed to address the needs and wants of various consumer segments across a broad range of basic apparel products. Each of our brands has a unique consumer positioning that distinguishes it from its competitors and guides its advertising and product development. We discuss some of our most important brands in more detail below.

Hanes is the largest and most widely recognized brand in our portfolio. Hanes is the number one selling apparel brand in the U.S. and is found in eight out of 10 U.S. households. The Hanes brand covers all of our product categories, including

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men's, women's and children's underwear, bras, socks, T-shirts, fleece, shapewear and sheer hosiery. Hanes stands for outstanding comfort, style and value.

Champion is our second-largest brand. For nearly 100 years, Champion has been outfitting athletes in authentic, high-quality athletic apparel, including high-performance sports bras, team uniforms and gym essentials like classic T-shirts, mesh shorts and fleece hoodies. Champion has also collaborated on premium apparel items through an exclusive collection with Todd Snyder, a limited edition men's apparel line for Urban Outfitters and custom specialty items for Supreme. In addition, we distribute a full line of men's, women's and children's C9 Champion products exclusively through Target Corporation ("Target") stores. In 2016, with the acquisitions of Champion Europe and the reacquisition of the rights to the Champion brand in Japan (the "Champion Japan Licensee"), we secured the rights to the Champion brand in Europe, the Middle East, Africa and Japan, creating a powerful global platform to drive Champion brand growth on every continent.

Our brand portfolio also includes a number of iconic intimate apparel brands. Maidenform is America's number one shapewear brand and has been trusted for modern, sensual style in bras, panties and shapewear since 1922. DIM is a flagship European brand and a market leader in women's underwear, hosiery and intimate apparel in France. Bali offers a range of bras, panties and shapewear sold in the department store channel and is the number one bra brand in department stores. Playtex is America's number one plus-size bra brand and is sold everywhere from mass merchandise retailers to department stores. Bonds is an iconic century-old brand that is the number one brand of men's underwear, women's underwear, children's underwear, babywear and socks in Australia.

In addition, we offer a variety of products under the following well-known brands: JMS/Just My Size, Nur Die/Nur Der, L'eggs, Sheridan, Lovable, Wonderbra, Gear for Sports and Berlei.

These brands serve to round out our product offerings, allowing us to give consumers a variety of options to meet their diverse needs.

Our Segments

Our operations are managed and reported in four operating segments, each of which is a reportable segment for financial reporting purposes: Innerwear, Activewear, Direct to Consumer and International. These segments are organized principally by product category, geographic location or distribution channel. Each segment has its own management that is responsible for the operations of the segment's businesses, but the segments share a common supply chain and media and marketing platforms.

The following table summarizes our operating segments by product category:

| Segment | Primary Products | Primary Brands |
|--------------------|---|--|
| | Men's underwear, women's panties, children's underwear and socks | Hanes, Champion, Maidenform, Bali, JMS/Just My Size, Polo Ralph Lauren* |
| Innerwear | Intimate apparel, such as bras and shapewear | Maidenform, Bali, Playtex, Hanes, JMS/Just My Size, Donna Karan,* DKNY* |
| | Hosiery | L'eggs, Hanes, Maidenform, JMS/Just My Size, Donna Karan,* DKNY* |
| Activewear | T-shirts, fleece, sport shirts, performance T-shirts and shorts, sports bras and thermals | Champion, Hanes, JMS/Just My Size, Hanes Beefy-T, Gear for Sports |
| Direct to Consumer | Activewear, men's underwear, children's underwear, intimate apparel, socks and hosiery | Hanes, Bali, Maidenform, Playtex, Champion, JMS/Just My Size, L'eggs |
| International | Activewear, men's underwear, women's panties, children's | DIM, Bonds, Champion, Hanes, Playtex, Nur Die/Nur Der, Sheridan, Lovable, Wonderbra, Maidenform, Shock Absorber, Abanderado, |

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underwear, intimate apparel,
socks and hosiery

Berlei, Zorba, Kendall,* Sol y Oro, Polo Ralph Lauren,* Fila,*
Bellinda, Donna Karan,* DKNY*

*Brand used under a license agreement.

Financial information regarding Hanesbrands' segments is included in Note, "Business Segment Information," to our financial statements included in this Annual Report on Form 10-K.

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Innerwear

The Innerwear segment focuses on core apparel products, such as intimate apparel, men's underwear, women's panties, children's underwear, socks and hosiery marketed under well-known brands that are trusted by consumers. We are the intimate apparel category leader in the United States with our Hanes, Maidenform, Bali, Playtex, JMS/Just My Size, L'eggs, Donna Karan and DKNY brands, and we are also the leading manufacturer and marketer of men's underwear and children's underwear in the United States under the Hanes, Champion and Polo Ralph Lauren brands and women's sheer hosiery under the L'eggs, Hanes, Maidenform, JMS/Just My Size, Donna Karan and DKNY brands. During 2016, net sales from our Innerwear segment were \$2.6 billion, representing approximately 43% of total net sales.

Activewear

We are a leader in the activewear market through our Champion, Hanes and JMS/Just My Size brands, where we sell products such as T-shirts and fleece to both retailers and wholesalers. In addition to activewear for men and women, Champion provides uniforms for athletic programs and includes an apparel program, C9 Champion, at Target stores. We also license our Champion name for footwear and sports accessories. In our branded printwear category, we supply our T-shirts, sport shirts and fleece products, including brands such as Hanes, Champion and Hanes Beefy-T, to customers, primarily wholesalers, who then resell to screen printers and embellishers. We sell licensed logo apparel in the mass retail channel and in collegiate bookstores and other channels under our Gear for Sports and Champion brands. We also sell licensed collegiate logo apparel primarily in the mass retail channel under our Knights Apparel brand. We also offer a range of quality, comfortable clothing for men, women and children marketed under the Hanes and JMS/Just My Size brands. The JMS/Just My Size brand offers casual apparel designed exclusively to meet the needs of plus-size women. During 2016, net sales from our Activewear segment were \$1.6 billion, representing approximately 26% of total net sales.

Direct to Consumer

Our Direct to Consumer operations include our domestic Company-operated outlet stores and website operations that sell our branded products directly to consumers in the United States. As of December 31, 2016, we had 252 outlet stores in the United States and operated websites under the Hanes, One Hanes Place, JMS/Just My Size and Champion names. During 2016, net sales from our Direct to Consumer segment were \$316 million, representing approximately 5% of total net sales.

International

Our International segment includes products that primarily span across the Innerwear and Activewear reportable segments and are primarily marketed under the DIM, Bonds, Champion, Hanes, Playtex, Nur Die/Nur Der, Sheridan, Lovable, Wonderbra, Maidenform, Shock Absorber, Abanderado, Berlei, Zorba, Kendall, Sol y Oro, Polo Ralph Lauren, Fila, Bellinda, Ritmo, Donna Karan and DKNY brands. Our Innerwear brands are market leaders across Australia and Western and Central Europe. In the intimate apparel category, we hold the number one market share in Spain and the number two market share in France, Italy and Australia. We are also the category leader in men's underwear in Australia, France and Spain, and in hosiery in France and Germany. During 2016, net sales from our International segment were \$1.5 billion, representing approximately 26% of total net sales and included sales in Europe, Australia, Asia, Latin America, Canada, the Middle East, Africa and the Caribbean. Our largest international markets are Europe, Australia, Japan, Canada, Mexico, and Brazil.

Customers and Distribution Channels

In 2016, approximately 74% of our net sales were to customers in the United States and approximately 26% were to customers outside the United States. Domestically, approximately 89% of our net sales were wholesale sales to retailers, 7% were direct to consumers and 4% were wholesale sales to wholesalers and third party embellishers. We have well-established relationships with some of the largest apparel retailers in the world. Our largest customers are Wal-Mart Stores, Inc. ("Wal-Mart") and Target, accounting for 20% and 15% respectively, of our total net sales in 2016. As is common in the basic apparel industry, we generally do not have purchase agreements that obligate our customers to purchase our products. However, the majority of our key customer relationships have been in place for 10 years or more. Wal-Mart and Target are our only customers with sales that exceed 10% of any individual segment's sales. In our Innerwear segment, Wal-Mart accounted for 34% of net sales and Target accounted for 17% of net sales

during 2016. In our Activewear segment, Target accounted for 28% of net sales and Wal-Mart accounted for 19% of net sales.

Sales to the mass merchant channel in the United States accounted for approximately 35% of our total net sales in 2016. We sell all of our product categories in this channel, including our Hanes, Champion, Playtex, Maidenform and JMS/Just My Size brands, as well as licensed logo apparel. Mass merchants feature high-volume, low-cost sales of basic apparel items along with a diverse variety of consumer goods products, such as grocery and drug products and other hard lines, and are characterized by large retailers, such as Wal-Mart and Target. Our largest mass merchant customer is Wal-Mart, which accounted for approximately 20% of our total net sales in 2016.

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Sales to the mid-tier and department stores channel in the United States accounted for approximately 10% of our total net sales in 2016. Mid-tier stores target a higher-income consumer than mass merchants, focus more of their sales on apparel items rather than other consumer goods such as grocery and drug products and are characterized by large retailers such as Kohl's, J.C. Penney Company, Inc. and Sears Holdings Corporation. We sell all of our product categories in this channel. Traditional department stores target higher-income consumers and carry more high-end, fashion conscious products than mid-tier stores or mass merchants and tend to operate in higher-income areas and commercial centers. Traditional department stores are characterized by large retailers such as Macy's, Inc. and Belk, Inc. We sell products in our intimate apparel, underwear, socks, hosiery and activewear categories through department stores.

Sales in our Direct to Consumer segment accounted for approximately 5% of our total net sales in 2016. We sell our branded products directly to consumers through our 252 domestic outlet stores, as well as our websites operating under the Hanes, One Hanes Place, JMS/Just My Size and Champion names. Our outlet stores are value-based, offering the consumer a savings of 25% to 40% off suggested retail prices, and sell first-quality, excess, post-season, obsolete and slightly imperfect products. Our websites, supported by emails, address the growing e-commerce channel that characterizes today's 24/7 retail environment. Our websites recorded 36.8 million user sessions in 2016, with 6.8 million consumers receiving our emails.

Sales in our International segment represented approximately 26% of our total net sales in 2016, and included sales in Europe, Australia, Asia, Latin America and Canada. We also have offices in each of these markets, as well as the Philippines, Thailand, Argentina, South Africa and Central America. Internationally, the majority of our net sales were wholesale sales to retailers. For more information about our sales on a geographic basis, see Note, "Geographic Area Information," to our financial statements.

Sales in other channels in the United States represented approximately 24% of our total net sales in 2016. We sell T-shirts, golf and sport shirts and fleece sweatshirts to wholesalers and third party embellishers primarily under our Hanes, Champion and Hanes Beefy-T brands. We also sell a significant range of our underwear, activewear and socks products under the Champion brand to wholesale clubs, such as Costco Wholesale Corporation, and sporting goods stores, such as DICK'S Sporting Goods. We also sell products that span across the Innerwear and Activewear reportable segments in the e-commerce environment through our owned e-commerce websites and through pure play e-commerce sites, such as Amazon. We sell primarily legwear and underwear products under the Hanes and L'eggs brands to food, drug and variety stores. We also sell licensed logo apparel in collegiate bookstores. We sell products that span across our Innerwear and Activewear segments to the U.S. military for sale to servicemen and servicewomen and through discount retailers, such as the Dollar General Corporation.

Manufacturing, Sourcing and Distribution

During 2016, approximately 72% of units sold were from finished goods manufactured through a combination of facilities we own and operate and facilities owned and operated by third party contractors who perform some of the steps in the manufacturing process for us, such as cutting and/or sewing. We sourced the remainder of our finished goods from third party manufacturers who supply us with finished products based on our designs. In making decisions about the location of manufacturing operations and third party sources of supply, we consider a number of factors, including labor, local operating costs, quality, regional infrastructure, applicable quotas and duties and freight costs. We believe that our balanced approach to product supply, which relies on a combination of owned, contracted and sourced manufacturing located across different geographic regions, increases the efficiency of our operations, reduces product costs and offers customers a reliable source of supply.

Finished Goods That Are Manufactured by Hanesbrands

The manufacturing process for the finished goods that we manufacture begins with raw materials we obtain from suppliers. The principal raw materials in our product categories are cotton and synthetics. Cotton and synthetic materials are typically spun into yarn, which is then knitted into cotton, synthetic and blended fabrics. We source all of our yarn requirements from large-scale domestic and international suppliers. To a lesser extent, we purchase fabric from several domestic and international suppliers in conjunction with scheduled production. In addition to cotton yarn and cotton-based textiles, we use thread, narrow elastic and trim for product identification, buttons, zippers, snaps and

lace. These fabrics are cut and sewn into finished products, either by us or by third party contractors. We currently operate 52 manufacturing facilities. Most of our cutting and sewing operations are strategically located in Asia, Central America and the Caribbean Basin. Alternate sources of these materials and services are readily available.

Finished Goods That Are Manufactured by Third Parties

In addition to our manufacturing capabilities, we also source finished goods we design from third-party manufacturers, also referred to as “turnkey products.” Many of these turnkey products are sourced from international suppliers by our strategic sourcing hubs in Asia.

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All contracted and sourced manufacturing must meet our high quality standards. Further, all contractors and third-party manufacturers must be preaudited and adhere to our strict supplier and business practices guidelines. These requirements provide strict standards that, among other things, cover hours of work, age of workers, health and safety conditions and conformity with local laws and Hanesbrands' standards. Each new supplier must be inspected and agree to comprehensive compliance terms prior to performance of any production on our behalf. We audit compliance with these standards and maintain strict compliance performance records. In addition to our audit procedures, many of our suppliers are certified by the Worldwide Responsible Accredited Production, or "WRAP," program. WRAP uses third-party, independent audit firms and requires factory-by-factory certification. We are also a fully accredited participating company in the Fair Labor Association.

Distribution

As of December 31, 2016, we distributed our products from 44 distribution centers. These facilities include 15 facilities located in the United States and 29 facilities located outside the United States in regions primarily where we sell our products. We internally manage and operate 32 of these facilities, and we use third party logistics providers who operate the other 12 facilities on our behalf. International distribution operations use a combination of third party logistics providers, as well as owned and operated distribution operations, to distribute goods to our various international markets.

Inventory

Effective inventory management is key to our success. Because our customers generally do not purchase our products under long-term supply contracts, but rather on a purchase order basis, effective inventory management requires close coordination with the customer base. We seek to ensure that products are available to meet customer demands while effectively managing inventory levels. We employ various types of inventory management techniques that include collaborative forecasting and planning, supplier-managed inventory, key event management and various forms of replenishment management processes. Our supplier-managed inventory initiative is intended to shift raw material ownership and management to our suppliers until consumption, freeing up cash and improving response time. We have demand management planners in our customer management group who work closely with customers to develop demand forecasts that are passed to the supply chain. We also have professionals within the customer management group who coordinate daily with our larger customers to help ensure that our customers' planned inventory levels are in fact available at their individual retail outlets. Additionally, within our supply chain organization we have dedicated professionals who translate the demand forecast into our inventory strategy and specific production plans. These individuals work closely with our customer management team to balance inventory investment/exposure with customer service targets.

Seasonality and Other Factors

Our operating results are subject to some variability due to seasonality and other factors. For instance, we generally have higher sales during the back-to-school and holiday shopping seasons and during periods of cooler weather, which benefits certain product categories such as fleece. Our diverse range of product offerings, however, provides some mitigation to the impact of seasonal changes in demand for certain items. Sales levels in any period are also impacted by customers' decisions to increase or decrease their inventory levels in response to anticipated consumer demand. Our customers may cancel orders, change delivery schedules or change the mix of products ordered with minimal notice to us. Media, advertising and promotion expenses may vary from period to period during a fiscal year depending on the timing of our advertising campaigns for retail selling seasons and product introductions.

Product Innovation and Marketing

A significant component of our margin-enhancing Innovate-to-Elevate strategy is our strong product research and development and innovation capabilities. From 2014 to 2016, we spent nearly \$196 million on design, research and product development, including the development of new and improved products.

We use a disciplined, consumer-driven approach to direct our product innovation and marketing efforts. We seek to identify relevant consumer insights and long-term megatrends that will impact our product categories over the next five to 10 years. We focus our innovation efforts on big-idea platforms that span brands, product categories, business segments, distribution channels and geographies. In addition, we concentrate on margin accretive product innovations

where we can leverage our supply chain in order to drive further economies of scale. Examples of our product innovation platforms include:

Tagless: Over a decade ago, we launched Hanes Tagless Tees that deliver superior softness without the itch and irritation of a tag. In 2012, our consumer-driven innovation process led us to expand this platform to the male underwear bottom category where research indicated that itchy tags were the number two consumer complaint. The Tagless platform also taps into the power of our supply chain, generating significant cost savings and allowing us to expand gross margins.

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ComfortBlend: ComfortBlend, our fabric innovation that combines cotton and synthetic yarns for products that are softer, shrink less and dry faster, is an outgrowth of the performance fabric megatrend. In developing ComfortBlend, we worked through each step of the big idea process, testing the concept, the product and the advertising. We introduced Hanes men’s ComfortBlend underwear in 2012 with exceptional results and have now expanded this platform to socks, children’s underwear and panties.

ComfortFlex Fit: Our ComfortFlex Fit platform is another example of our consumer-driven innovation process, where research indicated the two most significant consumer complaints in the bra category were that the consumer could not find the right size and that the consumer could not find a comfortable bra. ComfortFlex Fit effectively addresses both concerns by combining a simplified shopping system that eliminates the complicated cup-and-band combinations of traditional bra sizing systems with a more comfortable, flexible fit. We have successfully leveraged the ComfortFlex Fit platform across our Hanes, Champion, Bali, Playtex and JMS/Just My Size brands where it is driving incremental purchases in a category where consumers typically buy only a little over three bras per year.

| | |
|--|-------------------------------|
| <ul style="list-style-type: none"> • X-Temp: 2004 \$ 2,192 | <p>\$ 509,875(15) 450,000</p> |
| <p>X-Temp brings a new level of technology and comfort to basic apparel. Hanes and Champion X-Temp garments are designed to keep consumers cooler and drier by increasing the rate of evaporation when body temperature rises and reducing the rate of evaporation as body temperature cools. The X-Temp platform was successfully introduced in Hanes men’s</p> | |

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underwear
and men's
socks in
2013 and
expanded to
women's
socks,
panties,
bras,
legweD>

| | | | | | | |
|---|------|------------|----------------|---------------|----------------|---------|
| Steven G. Chambers President SpeechWorks Solutions Business Unit(16) | 2006 | \$ 265,625 | \$ 83,410(17) | \$ 14,067(18) | \$ 771,927(19) | 100,000 |
| | 2005 | \$ 250,000 | \$ 75,900(20) | \$ 4,650(21) | \$ 49,988(22) | 150,000 |
| | 2004 | \$ 170,833 | \$ 42,065(23) | | \$ 526,350(24) | 200,000 |
| Peter Hauser Sr. Vice President and General Manager, International Operations(25) | 2006 | \$ 215,011 | \$ 204,976(26) | \$ 20,373(27) | \$ 697,425(28) | 100,000 |
| | 2005 | \$ 246,525 | \$ 275,700(26) | \$ 2,894(27) | | 100,000 |
| John D. Shagoury President PABU(30) | 2006 | \$ 265,625 | \$ 113,470(31) | \$ 16,354(32) | \$ 821,920(33) | 100,000 |
| | 2005 | \$ 250,000 | \$ 62,675(34) | \$ 11,428(35) | | 100,000 |
| | 2004 | \$ 136,378 | \$ 11,312(36) | | \$ 499,898(37) | 400,000 |

(1) This column shows the market value of restricted stock awards on the date of grant. The aggregate holdings and market value of restricted stock held on September 30, 2006 by the individuals listed in this table are:

| Executive Officer | Shares of Restricted Stock | Value of Restricted Stock |
|--------------------------|---------------------------------------|--------------------------------------|
| Paul A. Ricci | 735,445 | \$ 6,007,850 |
| James R. Arnold, Jr. | 89,343 | 729,843 |
| Steven G. Chambers | 146,302 | 1,195,167 |
| Peter Hauser | 100,061 | 817,398 |
| John D. Shagoury | 141,677 | 1,157,359 |

(2) Unless otherwise noted, represents Company matching contributions made under its 401(k) plan.

(3) In view of the reduced bonuses payable to employees for the first half of Fiscal 2006, Mr. Ricci requested that this bonus be eliminated. The Compensation Committee accepted this proposal and Mr. Ricci returned the bonus to the Company.

(4) Represents taxable benefits relating to an auto lease in the amount of \$7,861, reimbursement for attorney's fees relating to Mr. Ricci's employment contract entered into on August 11, 2006 of \$12,636, reimbursement for financial and tax planning services of \$28,554 (of which \$9,500 was for tax planning for the 2005 calendar year that was reimbursed in fiscal 2006), personal assistant in the amount of \$25,911.04 and reimbursement for income taxes payable on perquisites in the amount \$3,896.

(5) Mr. Ricci received 735,445 shares of restricted stock which shall vest on August 11, 2009, provided that the vesting of 50% of such shares shall accelerate upon the achievement of certain performance objectives

established by the Board of Directors for the Company's 2007 fiscal year and the vesting of the remaining 50%

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of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2008 fiscal year. Mr. Ricci received a restricted stock unit award for 33,633 shares pursuant to the 2006 Company Bonus Incentive Program. This award vested on March 15, 2006.

- (6) Represents allowance paid for living expenses in the amount of \$40,125, taxable benefit relating to an auto lease in the amount of \$5,644, personal assistance in the amount of \$13,181 and reimbursement for income taxes payable on perquisites in the amount \$3,220.00.
- (7) Mr. Ricci received a restricted stock award for 14,555 shares pursuant to the 2005 Company Bonus Incentive Program on December 15, 2005. This award vested on April 15, 2006.
- (8) Represents allowance paid for living expenses.
- (9) On August 11, 2003, Mr. Ricci received a restricted stock award for 300,000 shares. This restricted stock award vests in equal installments over three years, 1/3 on each anniversary date of grant. Mr. Ricci also received an additional restricted stock award for 5,291 shares pursuant to the 2003 Company Bonus Incentive Program on February 24, 2004. These restricted stock awards are currently vested.
- (10) Mr. Arnold joined the Company on September 29, 2004 as the Company's Senior Vice President and Chief Financial Officer.
- (11) Represents taxable benefits relating to an auto lease of \$5,183, reimbursement for financial and tax planning services of \$4,000, reimbursement for income taxes payable on perquisites in the amount \$1,813.
- (12) On May 2, 2006, Mr. Arnold received a restricted stock unit award for 6,005 shares. This restricted stock award vests on May 2, 2007 if Mr. Arnold achieves certain performance goals. If performance goals are not achieved, this award will not vest. On December 15, 2006, Mr. Arnold received an additional restricted stock unit award for 8,616 shares pursuant to the 2006 Company Bonus Incentive Program. This award vested on March 15, 2006.
- (13) Represents reimbursement for taxable relocation expenses in the amount of \$9,200 and taxable benefits relating to an auto lease in the amount of \$3,000.
- (14) Mr. Arnold received a restricted stock award for 3,904 shares pursuant to the 2005 Company Bonus Incentive Program on December 15, 2005. This award vested on April 15, 2006.
- (15) On September 30, 2004, Mr. Arnold received a restricted stock award for 125,000 shares. This restricted stock award has a 3-year cliff vesting, which vests 100% on September 30, 2007. The vesting of the restricted stock award may accelerate 1/3 each year upon the achievement of certain enumerated Company goals.
- (16) Mr. Chambers became an officer of the Company in April 2004 and assumed the position of President SpeechWorks Solutions Business Unit.
- (17) Represents commission payments pursuant to achievements under Mr. Chambers' Sales Incentive Plan in the amount of \$49,660, and payments pursuant to the Company's Bonus Incentive Plan in the amount of \$33,750.
- (18) Represents taxable benefits relating to an auto lease of \$6,103, reimbursement for financial and tax planning services of \$5,000, and reimbursement for income taxes payable on perquisites in the amount \$2,964.

- (19) Mr. Chambers received 75,000 restricted stock units which are scheduled to vest on February 15, 2009, provided that the vesting of 50% of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2007 fiscal year and the vesting of the remaining 50% of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2008 fiscal year. Mr. Chambers received an additional restricted stock unit award for 6,235 shares pursuant to the 2006 Company Bonus Incentive Program. This award vested on March 15, 2006.
- (20) Represents commission payments pursuant to achievements under Mr. Chambers' Sales Incentive Plan in the amount of \$51,900 and payments pursuant to the Company's Bonus Incentive Plan in the amount of \$24,000.
- (21) Represents taxable benefits relating to an auto lease.
- (22) On November 1, 2004 Mr. Chambers received a restricted stock grant for 12,500 shares, which vested in full on December 31, 2004.
- (23) Represents commission payments pursuant to achievements under Mr. Chambers' Sales Incentive Plan.

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- (24) On February 24, 2004, Mr. Chambers received a restricted stock award for 74,074 shares. This restricted stock award has 3-year cliff vesting, which vests 100% on February 24, 2007. The vesting of the restricted stock award may accelerate 1/3 each year upon the achievement of certain enumerated Company Goals. Mr. Chambers also received a restricted stock award for 25,619 shares on March 25, 2003 as part of his employment with SpeechWorks International, Inc. which was subsequently assumed by the Company on August 11, 2003 in connection with the SpeechWorks acquisition. This restricted stock award will vest 100% on March 25, 2007. The value of this award, on the date the award was assumed by the Company, was \$100,426. Mr. Chambers also received an additional restricted stock award for 1,058 shares that was awarded pursuant to the 2003 Company Bonus Incentive Program on February 24, 2004. This restricted stock award is currently vested. The value of this award on the date of grant was \$5,998.
- (25) Mr. Hauser became an executive officer in March 2005. Mr. Hauser is a resident of Switzerland. Where necessary, the amounts in the Summary Compensation Table have been converted from euros to United States dollars at an exchange rate of U.S. \$1.2058 per euro.
- (26) Represents commission payments pursuant to achievements under Mr. Hauser's Sales Incentive Plan.
- (27) Represents allowance paid to Mr. Hauser on a monthly basis for payment of miscellaneous expenses.
- (28) Mr. Hauser received 75,000 restricted stock units which are scheduled to vest on February 15, 2009, provided that the vesting of 50% of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2007 fiscal year and the vesting of the remaining 50% of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2008 fiscal year.
- (29) Represents a pension allowance made to Mr. Hauser.
- (30) Mr. Shagoury became an officer of the Company in May 2004 and assumed the position of President Productivity Applications Business Unit.
- (31) Represents commission payments pursuant to achievements under Mr. Shagoury's Sales Incentive Plan in the amount of \$65,970, a \$25,000 bonus awarded for performance, and payments pursuant to the Company's Bonus Incentive Plan in the amount of \$22,500.
- (32) Represents payments made to Mr. Shagoury for use towards an automobile lease in the amount of \$13,500, reimbursement for tax preparation services in the amount of \$1,690 and reimbursement for income taxes payable on perquisites in the amount \$1,164.
- (33) Mr. Shagoury received 2 grants of restricted stock units during fiscal 2006. One grant was made on February 15, 2006 for 75,000 restricted stock units which shall vest on February 15, 2009, provided that the vesting of 50% of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2007 fiscal year and the vesting of the remaining 50% of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2008 fiscal year. An additional grant was made on May 2, 2006 for 4,003 restricted stock units which shall vest on May 2, 2007 if Mr. Shagoury achieves certain performance goals. If performance goals are not achieved, this award will not vest. Mr. Shagoury received an additional restricted stock unit award for 6,235 shares pursuant to the 2006 Company Bonus Incentive Program. This award will be vested on March 15, 2006.

- (34) Represents commission payments pursuant to achievements under Mr. Shagoury's Sales Incentive Plan in the amount of \$47,675 and payments pursuant to the Company's Bonus Incentive Plan in the amount of \$15,000.
- (35) Represents payments made to Mr. Shagoury for use towards an automobile lease in the amount of \$8,438, reimbursement for tax preparation services in the amount of \$2,271 and reimbursement for income taxes payable on perquisites in the amount \$719.
- (36) Represents commission payments pursuant to achievements under Mr. Shagoury's Sales Incentive Plan.
- (37) On May 14, 2004, Mr. Shagoury received a restricted stock award for 101,626 shares. This restricted stock award has 3-year cliff vesting, which vests 100% on May 14, 2007. The vesting of the restricted stock award may accelerate 1/3 each year upon the achievement of certain enumerated Company goals.

Table of Contents**Change in Control and Employment Agreements**

Mr. Ricci serves as our Chief Executive Officer and Chairman of the Board. We entered into an amended and restated employment agreement with Mr. Ricci effective August 11, 2006. Pursuant to the new agreement, effective October 1, 2006, Mr. Ricci received an annual base salary of \$575,000, with an annual bonus opportunity of up to 100% of his base salary. Mr. Ricci also received the following equity-based compensation awards: (i) a grant of 750,000 shares of restricted stock which shall vest on August 11, 2009 (735,445 of the shares of restricted stock were issued on August 11, 2006 and 14,555 of the shares of restricted stock were issued on October 1, 2006), provided that the vesting of 50% of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2007 fiscal year and the vesting of the remaining 50% of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2008 fiscal year and (ii) a grant of 1,000,000 stock options which shall be scheduled to vest in three equal annual installments on each anniversary of the grant date. In addition, Mr. Ricci is entitled to receive an additional grant of 250,000 shares of restricted stock if (x) the vesting of the shares of restricted stock described above is accelerated based upon the achievement of the fiscal 2007 and fiscal 2008 performance objectives or (y) the closing price of the Company's common stock on the Nasdaq Global Market exceeds \$18 per share for a period of ninety consecutive days. If issued, the additional grant of shares of restricted stock shall be scheduled to vest on August 11, 2009. The grants of equity-based compensation pursuant to the terms of the employment agreement are intended to serve as Mr. Ricci's equity-based compensation for the three-year term of the agreement, provided, however the compensation committee reserves the right to make additional grants of equity-based compensation to Mr. Ricci if deemed appropriate by the committee.

Upon any termination of Mr. Ricci's employment by the Company, other than for cause, death or disability, or by Mr. Ricci for good reason, Mr. Ricci shall be entitled to continued payment of 1.5 times his base salary as then in effect and payment of 100% of his target bonus as then in effect for a period of eighteen months following termination; provided, however, if such termination occurs within 12 months of a change in control of the Company, Mr. Ricci shall be entitled to continued payment of 2.0 times his base salary as then in effect and payment of 100% of his target bonus as then in effect for a period of twenty-four months following termination. In addition, upon any termination of Mr. Ricci's employment by the Company, other than for cause, death or disability, or by Mr. Ricci for good reason, (i) the vesting of all equity-based compensation awards issued to Mr. Ricci prior to August 11, 2006 shall accelerate and be fully vested as of the termination date and (ii) equity-based compensation awards issued on or after August 11, 2006 shall continue to vest during the severance period and any unvested options or awards at the termination of the severance period will be forfeited, provided, however, if such termination occurs within 12 months of a change in control of the Company, the vesting of 100% of Mr. Ricci's stock options and restricted stock shall accelerate upon the termination event. Following termination of Mr. Ricci's employment, Mr. Ricci shall be entitled to exercise all stock options granted prior to August 11, 2006 for the life of the stock option, and all stock options granted on or after August 11, 2006 for the lesser of (i) the life of the stock option or (ii) two years following the termination date. If Mr. Ricci's employment is terminated due to his death or disability, Mr. Ricci (or his legal heirs or designees) shall be entitled to receive his base salary through the termination date and all equity-based compensation awards issued to Mr. Ricci shall accelerate and be fully vested as of the termination date. Mr. Ricci is also entitled to continuation of certain Company benefits following termination of employment, depending on the circumstances surrounding such termination. Mr. Ricci has agreed not to compete with the Company or solicit the Company's employees or customers during the period in which he is receiving severance payments from the Company.

The agreement also provides for reimbursement to Mr. Ricci for excise tax payments which may be due pursuant to Section 4999 of the Internal Revenue Code of 1986, as amended (the Code), if payments to Mr. Ricci are deemed parachute payments within the meaning of Section 280G of the Code, subject to a maximum amount of \$4,000,000. The Company has also agreed to provide an enhanced executive medical program and will reimburse up to \$15,000 of

services provided under the program annually. The Company has also agreed to reimburse Mr. Ricci up to \$15,000 per year for post-retirement medical coverage for a 10 year period. Mr. Ricci will only receive this benefit in the event that (i) Mr. Ricci's employment is terminated within twelve months following a change in control of the Company or (ii) Mr. Ricci retires from active employment with the Company after the age

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of fifty-five. The Company has also agreed to reimburse Mr. Ricci for up to \$10,000 of tax and financial planning services and to provide a \$15,000 car allowance to Mr. Ricci.

Mr. Arnold serves as our Chief Financial Officer. As part of Mr. Arnold's September 2004 offer letter, in the event Mr. Arnold's employment is terminated without cause and provided he executes our standard severance agreement, Mr. Arnold will receive a severance package of six months base salary, six months paid health insurance under COBRA, and a budget of \$60,000 for relocation expenses. If Mr. Arnold's employment is terminated without cause within six months following a change of control, Mr. Arnold will receive a severance package of twelve months base salary and twelve months paid health insurance under COBRA, plus immediate acceleration of all of his unvested stock options or restricted stock.

Ms. McCann serves as our Senior Vice President of Research and Development. Under the terms of a letter addressed to Ms. McCann on February 17, 2003, in the event there is a change in control and Ms. McCann's employment is terminated within 6 months following the change in control, all of her unvested stock options and restricted stock will become fully vested as of the effective date of the termination of her employment. In addition, under the terms of our standard severance benefits for officers, if Ms. McCann's employment is terminated without cause, Ms. McCann will receive a severance package of six months base salary and six months paid health insurance under COBRA, provided, however, if such termination occurs in connection with a change of control, Ms. McCann will receive a severance package of twelve months base salary and twelve months paid health insurance under COBRA.

Mr. Chambers serves as President of our SpeechWorks® Solutions Business Unit. As part of Mr. Chambers August 2003 offer letter, in the event Mr. Chambers' employment is terminated for any reason other than cause, Mr. Chambers will be eligible to receive a severance package that is equal to the greater of the severance provided under the Senior Management severance plan in place at the time of his termination or six months base salary. In the event there is a change in control and Mr. Chambers' employment is terminated within 6 months following the change in control, all of his unvested stock options and restricted stock will become fully vested as of the effective date of the termination of his employment. In addition, under the terms of our standard severance benefits for officers, if Mr. Chambers' employment is terminated without cause, Mr. Chambers will receive a severance package of six months base salary and six months paid health insurance under COBRA, provided, however, if such termination occurs in connection with a change of control, Mr. Chambers will receive a severance package of twelve months base salary and twelve months paid health insurance under COBRA.

Mr. Shagoury serves as President of our Productivity Applications Business Unit. As part of Mr. Shagoury's March 2004 offer letter, in the event Mr. Shagoury's employment is terminated without cause, and provided he executes a standard severance agreement, Mr. Shagoury will receive a severance package of six months base salary plus six months of paid health insurance under COBRA. In the event there is a change in control and Mr. Shagoury's employment is terminated within 12 months following the change in control, he will receive a severance package of twelve months base salary, twelve months of paid health insurance under COBRA and all of his unvested stock options and restricted stock will become fully vested as of the effective date of the termination of his employment.

Mr. Hauser serves as our Senior Vice President & General Manager, International Operations. As part of Mr. Hauser's election as an executive officer, in the event there is a change in control and Mr. Hauser's employment is terminated within 6 months following the change in control, all of his unvested stock options and restricted stock will become fully vested as of the effective date of the termination of his employment. In addition, pursuant to the terms of his employment agreement, Mr. Hauser is also entitled to severance equal to twelve months base salary and bonus in the event his employment is terminated without cause.

Mr. Hunt serves as our Senior Vice President, Worldwide Sales. As part of Mr. Hunt's September 2006 offer letter, in the event Mr. Hunt's employment is terminated without cause and provided he executes our standard severance

agreement, Mr. Hunt will receive a severance package of twelve months base salary, twelve months paid health insurance under COBRA. If Mr. Hunt's employment is terminated without cause within twelve months following a change of control, Mr. Hunt will receive a severance package of twelve months base salary and twelve months paid health insurance under COBRA, plus immediate acceleration of all of his unvested stock options or restricted stock. In addition, if there is a change of control transaction and there is a significant reduction in Mr. Hunt's duties, position, reporting status or responsibilities during the twelve month period following the change

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of control transaction, Mr. Hunt will have the right to the same change of control benefits, as outlined above, provided he remains with the company for the full one-year period following the change of control, executes our standard severance agreement and gives notice of his intent to terminate employment within 30 days of the end of the 12 month period following the change of control transaction.

Recent Option Grants

The following table sets forth certain information regarding options granted during the fiscal year ended September 30, 2006 to the Named Executive Officers.

| Name | Securities Underlying Options Granted(#) | Percent of Total Options Granted to Employees in Fiscal Year(%) ⁽¹⁾ | Exercise or Base Price (\$/Share) | Expiration Date | Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term ⁽²⁾ | |
|----------------------|--|--|-----------------------------------|-----------------|---|--------------|
| | | | | | 5% | 10% |
| Paul A. Ricci | 1,000,000 ⁽³⁾ | 30.2% | \$ 7.57 | 8/11/2013 | \$ 3,081,750 | \$ 7,181,788 |
| James R. Arnold, Jr. | | | | | | |
| Steven G. Chambers | 100,000 ⁽³⁾ | 3.0% | \$ 9.30 | 2/15/2013 | \$ 378,603 | \$ 882,307 |
| Peter Hauser | 100,000 ⁽⁴⁾ | 3.0% | \$ 9.30 | 2/15/2011 | \$ 256,942 | \$ 567,774 |
| John D. Shagoury | 100,000 ⁽³⁾ | 3.0% | \$ 9.30 | 2/15/2013 | \$ 378,603 | \$ 882,307 |

- (1) Based on options to purchase an aggregate of 3,312,064 shares of the Company's Common Stock granted to employees during the fiscal year ended September 30, 2006.
- (2) Amounts represent hypothetical gains that could be achieved for the respective options if exercised at the end of the option term. These gains are based on assumed rates of stock appreciation of five percent (5%) and ten percent (10%) compounded annually from the date the respective options were granted to their expiration date and are not presented to forecast possible future appreciation, if any, in the price of the Company's Common Stock. The gains shown are net of the option exercise price, but do not include deductions for taxes or other expenses associated with the exercise of the options or the sale of the underlying shares of the Company's Common Stock. The actual gains, if any, on the stock option exercises will depend on the future performance of the Company's Common Stock, the optionee's continued employment through applicable vesting periods and the date on which the options are exercised.
- (3) These options have a seven year term, and vest in equal installments on an annual basis over a 3 year period.
- (4) These options have a five year term and vest in equal installments on an annual basis over a 3 year period.

Aggregate Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values⁽¹⁾

The following table shows the number of shares of Common Stock represented by outstanding stock options held by each of the Named Executive Officers as of September 30, 2006.

| | Shares Acquired on Exercise | Value Realized | Number of Securities Underlying Unexercised Options at 09/30/06 | | Value of Unexercised In-The-Money Options at 09/30/06 | |
|-------------------------|--------------------------------------|-------------------|---|---------------|---|---------------|
| | | | Exercisable | Unexercisable | Exercisable | Unexercisable |
| Paul A. Ricci | 400,000 | \$ 3,751,923 | 3,036,554 | 1,375,000 | \$ 14,999,742 | \$ 2,242,500 |
| James R. Arnold, Jr. | 75,000 | \$ 485,490 | 200,000 | 275,000 | \$ 807,500 | \$ 1,114,250 |
| Steven G. Chambers | 75,000 | \$ 434,250 | 384,374 | 240,626 | \$ 1,308,518 | \$ 505,482 |
| Peter Hauser | 187,500 | \$ 1,304,610 | 140,624 | 171,876 | \$ 471,163 | \$ 281,837 |
| John D. Shagoury | 100,000 | \$ 539,850 | 191,666 | 308,334 | \$ 678,247 | \$ 749,753 |

(1) Based on a per share price of \$8.17, the closing price of the Company's Common Stock as reported by NASDAQ on September 29, 2006, the last trading day of the fiscal year, less the exercise price. The actual value of unexercised options fluctuates with stock market activity.

Table of Contents**Equity Compensation Plan Information**

As of September 30, 2006, there were 23,404,137 shares subject to issuance upon exercise of outstanding options or awards under all of our equity compensation plans referred to in the table below, at a weighted average exercise price of \$4.80, and with a weighted average remaining life of 5.66 years. As of September 30, 2006 there were 5,131,476 shares available for issuance under those plans.

The following table provides information as of September 30, 2006 with respect to the shares of Common Stock that may be issued under existing equity compensation plans.

| | (a) Number of Securities to be Issued Upon Exercise of Options | (b) Weighted Average Exercise Price of Outstanding Options | (c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) |
|--|--|--|---|
| Equity compensation plans approved by shareholders(1) | 8,334,020(2) | \$ 6.08 | 4,290,317(3) |
| Equity compensation plans not approved by shareholders(4)(5) | 8,414,777(6)(7) | \$ 4.15 | 1,851,989 |
| Total equity compensation plans | 16,748,797 | \$ 5.11 | 6,142,306 |

(1) Consists of our 1995 Directors' Stock Option Plan, 1993 Incentive Stock Option Plan, 1995 Employee Stock Purchase Plan, 1997 Employee Stock Option Plan, 1998 Stock Option Plan and 2000 Stock Plan.

(2) Excludes securities to be issued upon vesting of restricted stock units. As of September 30, 2006, 2,705,554 shares of the Company's Common Stock were issuable upon vesting of the restricted stock units.

(3) Includes 1,010,830 shares of the Company's Common Stock available for future issuance under the 1995 Employee Stock Purchase Plan.

(4) Includes a stand-alone stock option grant to Paul Ricci described more fully below, our 2000 Nonstatutory Stock Option Plan and our 2003 Stock Plan (formerly the SpeechWorks International, Inc. 2000 Employee, Director and Consultant Stock Plan).

- (5) Excludes options assumed by the Company in the Caere acquisition and the acquisition of the former Nuance Communications, Inc. As of September 30, 2006, a total of 257,434 shares of the Company's Common Stock were issuable upon exercise of the assumed options. The weighted average exercise price of the outstanding assumed options is \$3.47 per share and they have an average weighted life remaining of 1.5 years. All outstanding assumed options from the Caere acquisition are fully vested and exercisable. 3,017,398 of the 3,647,852 options assumed in connection with the acquisition of the former Nuance Communications, Inc. were exercisable as of September 30, 2006. No additional options may be granted under the assumed options or their related plans. The weighted average exercise price of the outstanding assumed options in the Nuance acquisition is \$3.48 per share and have an average weighted life remaining of 6.4 years.
- (6) Excludes securities to be issued upon vesting of restricted stock units. As of September 30, 2006, 44,500 shares of the Company's Common Stock were issuable upon vesting of restricted stock units.
- (7) Includes a stand-alone stock option to purchase 1,500,000 shares of the Company's Common Stock granted to Paul Ricci at a per share exercise price of \$1.3438 on August 17, 2000. This option, which was issued in connection with the hiring of Mr. Ricci, is fully vested and exercisable. In the event of termination of employment, Mr. Ricci will have the remaining term of the option to exercise any unexercised options.

Description of Plans Not Adopted by Stockholders

2000 Nonstatutory Stock Option Plan (the NSO Plan)

In August 2000, the Board of Directors approved our NSO Plan. The NSO Plan has not been approved by our stockholders. The NSO Plan, which has been amended from time to time, provides for the grant of nonstatutory stock

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options to employees and consultants. A total of 10,150,000 shares of Common Stock have been reserved for issuance under the NSO Plan. Of this amount, as of September 30, 2006, options with respect to 5,089,650 shares were outstanding, and 543,172 shares were available for future grants. All of the outstanding options were granted with an exercise price at or above fair market value, ranging from \$0.66 to \$11.81 per share with an average per share exercise price of \$4.68. Vesting schedules of the options range from 2 to 4 years, and they have a maximum term of 10 years. All future options will be issued at or above fair market value with a maximum option term of 7 years.

Nuance 2003 Stock Plan (formerly the SpeechWorks International, Inc. 2000 Employee, Director and Consultant Stock Plan) (the 2003 Plan)

In August 2003, in connection with the SpeechWorks acquisition, the Company assumed the 2003 Plan. The 2003 Plan provides for the grant of nonstatutory stock options or stock purchase rights to employees and consultants that were not employed by the Company prior to the time of the acquisition. A total of 4,402,011 shares of Common Stock have been reserved for issuance under the 2003 Plan. Of this amount, as of September 30, 2006, options with respect to 1,821,627 shares were outstanding, stock purchase units with respect to 44,500 shares were outstanding, and 1,308,817 shares were available for future grants. All outstanding options were granted with an exercise price at or above fair market value, ranging from \$3.46 to \$12.41 per share with an average per share price of \$4.95. Vesting schedules of the options range from 3 to 4 years, and have a maximum term of 10 years. All future options will be issued at or above fair market value with a maximum option term of 7 years.

RELATED PARTY TRANSACTIONS

On May 5, 2005, we entered into a Securities Purchase Agreement (the Securities Purchase Agreement) by and among the Company, Warburg Pincus Private Equity VIII, L.P. and certain of its affiliated funds (collectively, Warburg Pincus) pursuant to which Warburg Pincus agreed to purchase and we agreed to sell 3,537,736 shares of our common stock and warrants to purchase 863,236 shares of our common stock for an aggregate purchase price of \$15.1 million. The warrants have an exercise price of \$5.00 per share and a term of four years. On May 9, 2005, the sale of the shares and the warrants pursuant to the Securities Purchase Agreement was completed. We also entered into a Stock Purchase Agreement (the Stock Purchase Agreement) by and among the Company and Warburg Pincus pursuant to which Warburg Pincus agreed to purchase and we agreed to sell 14,150,943 shares of our common stock and warrants to purchase 3,177,570 shares of our common stock for an aggregate purchase price of \$60.0 million. The warrants have an exercise price of \$5.00 per share and a term of four years. On September 15, 2005, the sale of the shares and the warrants pursuant to the Stock Purchase Agreement was completed. The net proceeds from these two fiscal 2005 financings were \$73.9 million. In connection with the financings, we granted Warburg Pincus registration rights giving Warburg Pincus the right to request that we use commercially reasonable efforts to register some or all of the shares of common stock issued to Warburg Pincus under both the Securities Purchase Agreement and Stock Purchase Agreement, including shares of common stock underlying the warrants.

In connection with the foregoing transactions, we and Warburg Pincus entered into an Amended and Restated Stockholders Agreement dated May 5, 2005 (the Amended and Restated Stockholders Agreement), which amended and restated the previous Stockholders Agreement dated March 19, 2004. The Amended and Restated Stockholders Agreement provides Warburg Pincus with the opportunity to designate two directors to the Board, until the later of (i) the date that Warburg Pincus shall cease to beneficially own at least 25,000,000 shares of our voting stock, or (ii) the date that Warburg Pincus' s percentage beneficial ownership of our voting stock is less than the quotient of (x) two divided by (y) the then authorized number of directors of the Company. Messrs. Janeway and Harris, who are each members of the Board, are the designees of Warburg Pincus.

During the fiscal year ended September 30, 2006, the law firm of Wilson Sonsini Goodrich & Rosati, Professional Corporation, acted as primary outside corporate and securities counsel to the Company. Ms. Martin, a member of our

Board of Directors, is a member, and is currently the head of the business law and tax services departments, of Wilson Sonsini Goodrich & Rosati. Aggregate fees and costs billed to us for services performed during the fiscal year ended September 30, 2006 by Wilson Sonsini Goodrich & Rosati were approximately \$2,242,480, which is less than one percent (1%) of Wilson Sonsini Goodrich & Rosati's revenue for the year ended January 31, 2007.

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COMPENSATION COMMITTEE REPORT ON COMPENSATION

The Company's executive compensation program is administered by the Compensation Committee of the Board of Directors. During the fiscal year ended September 30, 2006, the Compensation Committee consisted of Messrs. Robert J. Frankenberg and John C. Freker, Jr., each of whom is independent within the meaning of the listing standards of the NASDAQ Stock Market. No member of the Compensation Committee during this fiscal year ended September 30, 2006 was an employee of the Company or any of its subsidiaries.

Compensation Strategy

Generally, the Company's 2006 executive compensation programs consisted of a base salary program, a performance-based cash bonus program and a long-term incentive plan consisting of nonqualified stock options and restricted stock awards. A large part of executive compensation is at-risk and tied to individual and Company performance. The Compensation Committee's executive compensation policy has the following objectives:

to align the interests of the Company's executives and other key employees with those of the Company's stockholders, employees, and customers;

to link executive compensation to the Company's performance;

to target base salaries at about the 50th percentile and total annual cash incentive at about the 75th percentile for each executive as compared to his or her industry-specific peers; and

to offer significant levels of at-risk compensation in the form of stock options and restricted stock awards so that the long-term rewards available to the Company's executive officers will have a direct correlation to stockholder value.

Factors Considered in Establishing Compensation Packages

Several of the more important factors that were considered in establishing the components of each executive officer's compensation package are summarized below. Additional factors were also taken into account to a lesser degree.

Base Salary. The Compensation Committee reviews recommendations and sets the salary levels of executive officers at the beginning of each calendar year. This review is based on the duties and responsibilities that the Company expects each executive to discharge during the current year and upon the executive's performance during the previous year. The Company performs external market comparisons, relative to industry-specific peers, based on individual job responsibility. The Compensation Committee reviews companies whose employee size and annual revenue are similar to that of the Company.

Bonuses. The 2006 Bonus Program for the executive officers consisted of cash (the Cash Component) and equity in the form of restricted stock (the Equity Component).

The Cash Component included a bonus tied to certain corporate objectives. The bonus amount was a percentage of the executive's base salary. The bonus program is an annual program paid out twice annually, with the exception of Messrs. Chambers and Shagoury who have 50% of their variable compensation as well as Mr. Hauser, who has 100% of his variable compensation, tied to a sales incentive plan which pays for achievements quarterly. Achievements made by Messrs. Hauser, Chambers and Shagoury under the sales incentive plans is included in Bonus column in the Summary Compensation Table. Mr. Hauser's sales incentive plan achievements are in lieu of participation in the Cash Component of the Company's 2006 Bonus Program. It

was determined by the Compensation Committee that certain achievements have been accomplished under the Company bonus program and payouts in accordance with this program are included in the Bonus column in the Summary Compensation Table. A portion of the 2nd half of the Executive's bonus's were paid out in the form of restricted stock and are included in the Long-Term Incentive-Restricted Stock Awards column in the Summary Compensation Table.

The Equity Component took the form of restricted stock. All executive officers, with the exception of Mr. Arnold, were issued restricted stock with a 3-year cliff vesting schedule. All of the restricted stock

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awards had an acceleration feature pursuant to which fifty percent of the unvested shares would accelerate upon the achievement of corporate objectives for Fiscal 2007 and the remaining fifty percent of the unvested shares would accelerate upon the achievement of corporate objectives for Fiscal 2008. The value of the restricted stock issued to each of the Named Executive Officers is included in the Long-Term Incentive-Restricted Stock Awards column in the Summary Compensation Table.

Additional restricted stock grants were issued to Messrs. Arnold and Shagoury. Both of the restricted stock awards were issued as performance grants that would only vest if certain performance goals are achieved by May 2, 2007. If goals were not achieved, the grants would be cancelled. The value of these restricted stock grants issued is included in the Long-Term Incentive-Restricted Stock Awards column in the Summary Compensation Table.

Other Bonus Payments. The Compensation Committee also approved a special 2006 Recognition Incentive Bonus Program pursuant to which each eligible employee, including the executive officers (other than Messrs. Chambers, Hauser and Shagoury, received a special incentive cash bonus on April 15, 2006 equal to the total bonus paid to such employee for the second half of fiscal 2005 pursuant to the Company's Fiscal 2005 Company Bonus Program, provided such employee remained employed by the Company on that date. In addition, the Compensation Committee approved a special one time bonus payment to Mr. Shagoury in the amount of \$25,000.

In view of the reduced bonuses payable to employees for the first half of Fiscal 2006, Mr. Ricci requested that his bonus due pursuant to the 2006 Recognition Incentive Bonus Program be eliminated. The Compensation Committee accepted this proposal.

Options. The Compensation Committee periodically approves grants of stock options to each of the Company's executive officers under the Company's stock option plans. The grants are designed to give executive officers the opportunity to build a meaningful stake in the Company, with the objective of aligning executive officers' long-range interests with those of the stockholders and encouraging the achievement of superior results over time. Each grant generally allows the officer to acquire shares of the Company's Common Stock at a fixed price per share (the fair market value on the grant date) over a specified period of time (up to 7 years), thus providing a return to the executive officer only if the market price of the shares appreciates over the option term. The Committee approved the issuance of grants to certain Named Executive Officers during the fiscal year ended September 30, 2006. Please see Recent Option Grants table for details of options granted during the fiscal year ended September 30, 2006.

Compensation of the Chief Executive Officer

The Company entered into a new employment agreement with Mr. Ricci effective August 11, 2006. Pursuant to the new agreement, effective October 1, 2006, Mr. Ricci received an annual base salary of \$575,000, with an annual bonus opportunity of up to 100% of his base salary. Mr. Ricci also received the following equity-based compensation awards: (i) a grant of 750,000 shares of restricted stock which shall vest on August 11, 2009 (735,445 of the shares of restricted stock were issued on August 11, 2006 and 14,555 of the shares of restricted stock were issued on October 1, 2006), provided that the vesting of 50% of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2007 fiscal year and the vesting of the remaining 50% of such shares shall accelerate upon the achievement of certain performance objectives established by the Board of Directors for the Company's 2008 fiscal year and (ii) a grant of 1,000,000 stock options which shall be scheduled to vest in three equal annual installments on each anniversary of the grant date. In addition, Mr. Ricci is entitled to receive an additional grant of 250,000 shares of restricted stock if (x) the vesting of the shares of restricted stock described above is accelerated based upon the achievement of the fiscal 2007 and fiscal 2008 performance objectives or (y) the closing price of the Company's common stock on the Nasdaq Global Market exceeds \$18 per share for a

period of ninety consecutive days. If issued, the additional grant of shares of restricted stock shall be scheduled to vest on August 11, 2009. The grants of equity-based compensation pursuant to the terms of the employment agreement are intended to serve as Mr. Ricci's equity-based compensation for the three-year term of the agreement, provided, however the Compensation Committee reserves the right to make additional grants of equity-based compensation to Mr. Ricci if deemed appropriate by the committee. Other terms of

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Mr. Ricci's employment agreement, particularly with respect to benefits upon a termination of his employment, are more fully set forth under the heading "Change in Control and Employee Agreements."

The Compensation Committee has considered the potential impact of Section 162(m) of the Internal Revenue Code adopted under the Federal Revenue Reconciliation Act of 1993. This section precludes a public corporation from taking a tax deduction for individual compensation in excess of \$1 million for its chief executive officer or any of its four other highest-paid officers. This section also provides for certain exemptions to this limitation, specifically compensation that is performance based within the meaning of Section 162(m). It is the Company's policy to qualify, to the extent reasonable, compensation paid to executive for deductibility under Section 162(m). However, the Compensation Committee may from time to time approve compensation that is not deductible under this Section.

Robert J. Frankenberg

John C. Freker, Jr.

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PROPOSAL 2

APPROVAL OF THE AMENDED AND RESTATED 2000 STOCK PLAN

The stockholders are being asked to approve the Company's amended and restated 2000 Stock Plan (the "2000 Plan"). The 2000 Plan, as amended, will enable the Company to continue to use the 2000 Plan to assist in recruiting, motivating and retaining talented employees to help achieve the Company's business goals.

The 2000 Plan, as amended, increases the number of shares of Common Stock authorized for issuance under the 2000 Plan from 16,250,000 shares to 22,750,000 shares, an increase of 6,500,000 shares. It does not differ in any other material respects from the current version of the 2000 Plan.

Awards granted under the 2000 Plan may be designed to qualify as performance-based compensation within the meaning of Section 162(m) of the Internal Revenue Code, as amended (the "Code"). Pursuant to Section 162(m) of the Code, the Company generally may not deduct for federal income tax purposes compensation paid to the Chief Executive Officer or the four other most highly-paid employees to the extent that any of these persons receive more than \$1 million in compensation in any single year. However, if the compensation qualifies as performance-based for Section 162(m) purposes, the Company may deduct for federal income tax purposes the compensation paid, even if such compensation exceeds \$1 million in a single year.

In February 2007, the Board of Directors approved the change described above, subject to approval from the Company's stockholders at the Annual Meeting. If the stockholders approve the 2000 Plan, it will replace the current version of the 2000 Plan. Otherwise, the current version of the 2000 Plan will remain in effect. The Company's named executive officers and directors have an interest in this proposal.

We believe strongly that the approval of the amended 2000 Plan is essential to the Company's continued success. The Company's employees are its most valuable assets. Stock options and other awards such as those provided under the 2000 Plan are vital to the Company's ability to attract and retain outstanding and highly skilled individuals in the extremely competitive labor markets in which the Company must compete. Such awards also are crucial to our ability to motivate employees to achieve the Company's goals. While the Company does not have any specific plans or commitments to issue stock options or awards under the 2000 Plan at this time, for the reasons stated above and to ensure the Company can continue to grant stock awards to key employees of the Company at levels determined appropriate by the Board and the Compensation Committee of the Board, the stockholders are being asked to approve the 2000 Plan, as amended.

Description of the 2000 Plan

The essential features of the 2000 Plan are outlined below. The following summary of the principal provisions of the 2000 Plan as proposed to be amended and restated is qualified in its entirety by reference to the full text of the 2000 Plan, which is included as [Annex A](#) hereto.

General

The purpose of the 2000 Plan is to attract and retain the best available personnel for positions of substantial responsibility with the Company, to provide additional incentive to the employees, directors and consultants of the Company and employees and consultants of its parent and subsidiary companies and to promote the success of the Company's business. The 2000 Plan authorizes the Board of Directors or one or more of its committees to grant stock options, restricted stock units, rights to purchase restricted stock and stock appreciation rights (each an "Award").

Administration

The 2000 Plan may generally be administered by the Board or a committee appointed by the Board (as applicable, the Administrator). The Administrator may make any determinations deemed necessary or advisable for the 2000 Plan. To the extent that the Administrator determines it to be desirable to qualify Awards granted hereunder as performance-based compensation within the meaning of Section 162(m) of the Code, the Plan shall

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be administered by a Committee of two or more outside directors within the meaning of Section 162(m) of the Code (to enable the Company to receive a federal tax deduction for certain compensation paid under the Plan).

Number of Shares of Common Stock Available Under the Incentive Plan

Assuming stockholders approve this proposal, a total of 22,750,000 shares of Common Stock will have been reserved for issuance under the 2000 Plan. As of December 31, 2006, 2,188,553 shares of Common Stock were available for issuance under the 2000 Plan. Assuming stockholders approve this Plan, the shares available under this Plan would increase to 8,688,553 shares.

If any outstanding Award for any reason expires or is terminated or canceled without having been exercised or settled in full, or if shares acquired pursuant to an Award subject to forfeiture or repurchase are forfeited or repurchased by the Company, the shares allocable to the terminated portion of such Award or such forfeited or repurchased shares shall again be available for grant under the 2000 Plan. Shares shall not be deemed to have been granted pursuant to the 2000 Plan (a) with respect to any portion of an Award that is settled in cash or (b) to the extent such shares are withheld in satisfaction of tax withholding obligations. Upon payment in shares pursuant to the exercise of a stock appreciation right, the number of shares available for grant under the 2000 Plan shall be reduced only by the number of shares actually issued in such payment. If the exercise price of an option is paid by tender to the Company of shares underlying the option, the number of shares available for grant under the 2000 Plan shall be reduced by the net number of shares for which the option is exercised.

Eligibility

Nonstatutory stock options, stock purchase rights (i.e., awards of restricted stock), restricted stock units and stock appreciation rights may be granted under the 2000 Plan to employees, directors and consultants of the Company and employees and consultants of any parent or subsidiary of the Company. Incentive stock options may be granted only to employees. The Administrator, in its discretion, selects the employees, directors and consultants to whom Awards may be granted, the time or times at which such Awards will be granted, and the exercise price and number of shares subject to each such grant; provided, however, the exercise price of a stock option and a stock appreciation right may not be less than 100% of the fair market value of the Common Stock on the date such Award is granted.

Limitations

Section 162(m) of the Code places limits on the deductibility for federal income tax purposes of compensation paid to certain executive officers of the Company. In order to preserve the Company's ability to deduct the compensation income associated with certain Awards granted to such persons, the 2000 Plan provides that no service provider may be granted, in any fiscal year of the Company, options or stock appreciation rights to purchase more than 1,000,000 shares of Common Stock or 750,000 restricted stock awards or restricted stock units. Notwithstanding the limit on grants of options or stock appreciation rights, however, in connection with such individual's initial employment with the Company, he or she may be granted options or stock appreciation rights to purchase up to an additional 1,000,000 shares of Common Stock or up to an additional 750,000 restricted stock awards or restricted stock units.

Terms and Conditions of Options

Each option is evidenced by a stock option agreement between the Company and the optionee, and is subject to the following terms and conditions:

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

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The Company's by-laws provide that it may not reduce the exercise price of any stock option, including stock appreciation right, outstanding or to be granted in the future under the 2000 Plan; cancel options in exchange for the re-grant of options at a lower exercise price (including entering into any 6 month and 1 day cancellation and re-grant scheme), whether or not the cancelled options are returned to the available pool for grant; replace underwater options with restricted stock in an exchange, buy-back or other scheme; or replace any options with new options having a lower exercise price or accelerated vesting schedule in an exchange, buy-back or other scheme.

(b) *Exercise of Option; Form of Consideration.* The Administrator determines when options become exercisable, and may in its discretion, accelerate the vesting of any outstanding option in connection with the termination of a participant's employment with the Company. The means of payment for shares issued upon exercise of an option is specified in each option agreement. The 2000 Plan permits payment to be made by cash, check, other shares of Common Stock of the Company (with some restrictions), cashless exercises, any other form of consideration permitted by applicable law, or any combination thereof.

(c) *Term of Option.* No stock option or stock appreciation right granted under the 2000 Plan may have a term greater than seven years after the date of grant. In the case of an incentive stock option granted to a 10% shareholder, the term of the option may be no more than five (5) years from the date of grant. No option may be exercised after the expiration of its term.

(d) *Termination of Service.* The Administrator determines the length of the post-termination exercise period of a stock option. In the absence of a time specified in a participant's Award agreement, a participant may exercise the option within three months of such termination, to the extent that the option is vested on the date of termination, (but in no event later than the expiration of the term of such option as set forth in the option agreement), unless such participant's service relationship terminates due to the participant's death or disability, in which case the participant or the participant's estate or the person who acquires the right to exercise the option by bequest or inheritance may exercise the option, to the extent the option was vested on the date of termination, within 12 months from the date of such termination.

(e) *Nontransferability of Options.* Unless otherwise determined by the Administrator, options granted under the 2000 Plan are not transferable other than by will or the laws of descent and distribution, and may be exercised during the optionee's lifetime only by the optionee.

(f) *Other Provisions.* The stock option agreement may contain other terms, provisions and conditions not inconsistent with the 2000 Plan as may be determined by the Administrator.

Stock Purchase Rights

In the case of stock purchase rights, (i.e. rights to acquire restricted stock), unless the Administrator determines otherwise, the Award agreement will grant the Company a repurchase option exercisable upon the termination of the participant's service with the Company for any reason (including death or disability). The purchase price for shares repurchased pursuant to the restricted stock purchase agreement will generally be the original price paid by the purchaser and may be paid by cancellation of any indebtedness of the purchaser to the Company. The repurchase option will lapse at a rate determined by the Administrator including, if the Administrator has determined it is desirable for the stock purchase right to qualify as performance-based compensation for purposes of Section 162(m) of the Internal Revenue Code, the repurchase option will lapse based on the achievement of performance goals. The Administrator will determine the number of shares granted pursuant to a stock purchase right, but as discussed above, the Administrator will not be permitted to grant restricted stock and restricted stock units in excess of the limits described above.

Restricted Stock Units

The Administrator may grant restricted stock units under the 2000 Plan. Each restricted stock unit award will be evidenced by an Award agreement that will specify the period of restriction, the number of shares granted and all other terms and conditions as the Administrator may determine in its sole discretion, including, without limitation whatever conditions to vesting it determines to be appropriate. For example, the Administrator may set restrictions

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based on the achievement of specific performance goals. The Administrator will determine the number of shares granted pursuant to a restricted stock unit award, but as discussed above, the Administrator will not be permitted to grant restricted stock and restricted stock units in excess of the Restricted Stock Limit.

Stock Appreciation Rights

The Administrator may grant stock appreciation rights either alone or in tandem with stock options. A stock appreciation right is the right to receive the appreciation in fair market value of Common Stock between the exercise date and the date of grant. The Company can pay the appreciation in either cash or shares of Common Stock. The Administrator will determine the exercise price of a stock appreciation right, which will be no less than 100% of the fair market value of the Common Stock on the date of grant, and the term of each stock appreciation right, which will not be greater than seven (7) years from the date of grant. Stock appreciation rights will become exercisable at the times and on the terms established by the Administrator, subject to the terms of the 2000 Plan. The Administrator will determine the number of shares granted to a service provider pursuant to a stock appreciation right, but as discussed above, the Administrator will not be permitted to grant to a service provider, in any fiscal year of the Company, more than 1,000,000 shares of Common Stock for issuance pursuant to awards of stock appreciation rights. Notwithstanding this limit, however, in connection with such individual's initial employment with the Company, he or she may be granted stock appreciation rights to purchase up to an additional 1,000,000 shares of Common Stock.

After termination of service with the Company, a participant will be able to exercise the vested portion of his or her stock appreciation right for the period of time stated in the Award agreement. If no such period of time is stated in a participant's Award agreement, a participant will generally be able to exercise his or her stock appreciation right for (i) three months following his or her termination for reasons other than death or disability, and (ii) one year following his or her termination due to death or disability. In no event will a stock appreciation right be exercised later than the expiration of its term.

Performance Goals

As discussed above, under Section 162(m) of the Internal Revenue Code, the annual compensation paid to the Chief Executive Officer and to each of its four other most highly-paid executive officers may not be deductible to the extent it exceeds \$1 million. However, we are able to preserve the deductibility of compensation in excess of \$1 million if the conditions of Section 162(m) are met. These conditions include stockholder approval of the 2000 Plan, setting limits on the number of Awards that any individual may receive, and for Awards other than options, establishing performance criteria that must be met before the Award actually will vest or be paid.

The 2000 Plan permits us to pay compensation that qualifies as performance-based under Section 162(m). Thus, the Administrator (in its discretion) may make performance goals applicable to a participant with respect to Administrator's discretion, one or more of the following performance goals may apply: annual revenue, cash position, controllable profits, customer satisfaction MBOs, earnings per share, individual objectives, net income, new orders, operating cash flow, operating income, return on assets, return on equity, return on sales, and total shareholder return. Any criteria used may be measured, as applicable, in absolute terms or in relative terms (including passage of time and/or against another company or companies), on a per-share basis, against the performance of the Company as a whole or any segment of the Company, and on a pre-tax or after-tax basis.

Adjustments upon Changes in Capitalization

In the event that the stock of the Company changes by reason of any stock split, reverse stock split, stock dividend, combination, reclassification or other similar change in the capital structure of the Company effected without the receipt of consideration, appropriate adjustments will be made in the number and class of shares of Common Stock

subject to the 2000 Plan, the number of shares of Common Stock that may be issued pursuant to Awards of restricted stock and restricted stock units, the maximum number of shares of Common Stock that may be issued to service providers in any fiscal year pursuant to Awards, the number and class of shares of stock subject to any outstanding Award, and the exercise price of any such outstanding Award.

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In the event of a liquidation or dissolution, any unexercised Award will terminate. The Administrator may, in its sole discretion, provide that each participant will have the right to exercise all or any part of the Award, including shares as to which the Award would not otherwise be exercisable.

In connection with any merger of the Company with or into another corporation or the sale of all or substantially all of the assets of the Company, each outstanding Award will be assumed or an equivalent Award substituted by the successor corporation. If the successor corporation refuses to assume an Award or to substitute a substantially equivalent Award, the participant will have the right to exercise his or her option and stock appreciation right as to all of the shares subject to the Award, all restrictions on restricted stock will lapse, and all performance goals or other vesting requirements for restricted stock units will be deemed achieved, and all other terms and conditions met. In such event, the Administrator will notify the participant that the Award is fully exercisable for fifteen (15) days from the date of such notice and that the Award terminates upon expiration of such period.

Amendment and Termination of the Plan

The Board may amend, alter, suspend or terminate the 2000 Plan, or any part thereof, at any time and for any reason. However, the Company will obtain stockholder approval for any amendment to the 2000 Plan to the extent the Board determines it necessary and desirable to comply with applicable law. No such action by the Board or stockholders may alter or impair any Award previously granted under the 2000 Plan without the written consent of the participant. Unless terminated earlier, the 2000 Plan will terminate ten years from the date the 2000 Plan was originally adopted by the Board.

Plan Benefits

The amount and timing of Awards granted under the 2000 Plan are determined in the sole discretion of the Administrator and therefore cannot be determined in advance. The benefits or amounts that were received by, or allocated to, the Chief Executive Officer, the other Named Executive Officers, all current executive officers as a group, the current Directors of the Company who are not executive officers as a group, and all employees, including all current officers who are not executive officers, as a group under the 2000 Plan for the fiscal year ended September 30, 2006 are set forth in the table below:

| Name and Position | Number of Options Granted | Average Per Share Exercise Price | Number of Shares of Restricted Stock Granted | Dollar Value of Shares of Restricted Stock Granted |
|--------------------------------------|----------------------------------|---|---|---|
| Paul A. Ricci | 1,000,000 | \$ 7.57 | 750,000 | \$ 5,662,195 |
| James R. Arnold, Jr. | | | 9,909 | \$ 100,642 |
| Steven G. Chambers | 100,000 | \$ 9.30 | 75,000 | \$ 697,425 |
| Peter Hauser | 100,000 | \$ 9.30 | 75,000 | \$ 697,425 |
| John D. Shagoury | 100,000 | \$ 9.30 | 79,003 | \$ 747,418 |
| Executive Group | 1,400,000 | \$ 8.06 | 1,071,340 | \$ 8,675,022 |
| Non-Executive Director Group | | | | |
| Non-Executive Officer Employee Group | 1,816,964 | \$ 9.06 | 2,132,528 | \$ 19,489,166 |

The future benefits or amounts that would be received under the 2000 Stock Plan by executive officers and other employees are discretionary and are therefore not determinable at this time. In addition, the benefits or amounts which would have been received by or allocated to such persons for the last completed fiscal year if the 2000 Stock Plan, as amended, had been in effect cannot be determined.

Federal Income Tax Consequences

Incentive Stock Options. An optionee who is granted an incentive stock option does not recognize taxable income at the time the option is granted or upon its exercise, although the exercise is an adjustment item for alternative minimum tax purposes and may subject the optionee to the alternative minimum tax. Upon a disposition of the shares more than two years after grant of the option and one year after exercise of the option, any gain or loss

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is treated as long-term capital gain or loss. If these holding periods are not satisfied, the optionee recognizes ordinary income at the time of disposition equal to the difference between the exercise price and the lower of (i) the fair market value of the shares at the date of the option exercise or (ii) the sale price of the shares. Any gain or loss recognized on such a premature disposition of the shares in excess of the amount treated as ordinary income is treated as long-term or short-term capital gain or loss, depending on the holding period. Unless limited by Section 162(m), the Company is generally entitled to a deduction in the same amount as the ordinary income recognized by the optionee.

Nonstatutory Stock Options. An optionee does not recognize any taxable income at the time he or she is granted a nonstatutory stock option. Upon exercise, the optionee recognizes taxable income generally measured by the excess of the then fair market value of the shares over the exercise price. Any taxable income recognized in connection with an option exercise by an employee of the Company is subject to tax withholding by the Company. Unless limited by Section 162(m), the Company is generally entitled to a deduction in the same amount as the ordinary income recognized by the optionee. Upon a disposition of such shares by the optionee, any difference between the sale price and the optionee's exercise price, to the extent not recognized as taxable income as provided above, is treated as long-term or short-term capital gain or loss, depending on the holding period.

Stock Purchase Rights (i.e., Restricted Stock) and Restricted Stock Units. A participant generally will not have taxable income at the time an award of restricted stock and restricted stock units is granted. Instead, he or she will recognize ordinary income in the first taxable year in which his or her interest in the shares underlying the Award becomes either (i) freely transferable or (ii) no longer subject to substantial risk of forfeiture. However, a holder of a restricted stock award may elect to recognize income at the time he or she receives the award in an amount equal to the fair market value of the shares underlying the Award (less any amount paid for the shares) on the date the Award is granted.

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

Tax Effect for the Company. The Company generally will be entitled to a tax deduction in connection with an Award under the 2000 Plan in an amount equal to the ordinary income realized by a participant and at the time the participant recognizes such income (for example, the exercise of a nonqualified stock option). Special rules limit the deductibility of compensation paid to the Company's Chief Executive Officer and to each of its four most highly-paid executive officers. Under Section 162(m) of the Internal Revenue Code, the annual compensation paid to any of these specified executives will be deductible only to the extent that it does not exceed \$1,000,000. However, the Company can preserve the deductibility of certain compensation in excess of \$1,000,000 if the conditions of Section 162(m) are met. These conditions include stockholder approval of the 2000 Plan and setting limits on the number of Awards that any individual may receive. The 2000 Plan has been designed to permit the Administrator to grant Awards that qualify as performance-based for purposes of satisfying the conditions of Section 162(m), thereby permitting the Company to continue to receive a federal income tax deduction in connection with such Awards.

THE FOREGOING IS ONLY A SUMMARY OF THE EFFECT OF FEDERAL INCOME TAXATION UPON PARTICIPANTS AND THE COMPANY WITH RESPECT TO THE GRANT AND EXERCISE OF AWARDS UNDER THE 2000 PLAN. IT DOES NOT PURPORT TO BE COMPLETE, AND DOES NOT DISCUSS THE TAX CONSEQUENCES OF A SERVICE PROVIDER'S DEATH OR THE PROVISIONS OF THE INCOME TAX LAWS OF ANY MUNICIPALITY, STATE OR FOREIGN COUNTRY IN WHICH THE SERVICE PROVIDER MAY RESIDE.

Vote Required; Recommendation of the Board

The affirmative vote of a majority of shares of the Company's Common Stock present at the Annual Meeting in person or by proxy and entitled to vote is required to approve the 2000 Plan, as amended. Unless marked to the contrary, proxies received will be voted FOR approval of the 2000 Plan, as amended.

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**THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR
THE APPROVAL OF THE 2000 PLAN, AS AMENDED.**

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PROPOSAL 3

**AMENDMENT OF OUR CERTIFICATE OF INCORPORATION TO
INCREASE THE NUMBER OF AUTHORIZED SHARES OF COMMON STOCK**

The Board of Directors has adopted an amendment to the Company's Amended and Restated Certificate of Incorporation to increase the number of shares of Common Stock par value \$0.001 the Company is authorized to issue from 280,000,000 shares of Common Stock to 560,000,000 shares. As of December 31, 2006, of the 280,000,000 shares of Common Stock the Company is currently authorized to issue, 172,348,961 shares of Common Stock were outstanding, 29,257,684 shares of Common Stock were reserved for issuance under the Company's stock-based compensation plans, and 8,060,339 shares of Common Stock were reserved for issuance upon exercise of other outstanding warrants and convertible securities. The Company is also authorized to issue up to 40,000,000 shares of preferred stock, par value \$0.001 per share. The Company has designated 100,000 shares as Series A Preferred Stock, none of which are issued and outstanding, and 15,000,000 as Series B Preferred Stock, 3,562,238 of which are issued and outstanding.

The purpose of the amendment is to allow the Company to have a sufficient number of shares of authorized and unissued Common Stock which can be issued in connection with such corporate purposes as may, from time to time, be considered advisable by the Board. Having such shares available for issuance in the future will give the Company greater flexibility and will allow such shares to be issued as determined by the Board without the expense and delay of a special stockholder's meeting to approve such additional authorized Common Stock. Such corporate purposes could include, without limitation; the issuance of shares in connection with stock splits or stock dividends, the issuance of shares upon exercise of options granted under the Company's various stock option plans or in connection with other employee benefit plans, the issuance of shares in connection with equity financings and the issuance of shares in connection with acquisitions.

The increase in authorized common stock will not have an immediate effect on the rights of existing stockholders. However, the Board will have the authority to issue authorized Common Stock without requiring future stockholder approval of such issuances, except as may be required by the Certificate of Incorporation and applicable laws and regulations. To the extent that the additional authorized shares are issued in the future, they will decrease the existing stockholders' percentage equity ownership and, depending upon the price at which they are issued as compared to the price paid by existing stockholders for their shares, could be dilutive to the Company's existing stockholders. The holders of Common Stock have no preemptive rights to subscribe for or purchase any additional shares of Common Stock that may be issued in the future.

The increase in the authorized number of shares of Common Stock and the subsequent issuance of such shares could have the effect of delaying or preventing a change in control of the Company without further action by the stockholders. Shares of authorized and unissued Common Stock could (within the limits imposed by applicable law) be issued in one or more transactions that would make a change in control of the Company more difficult, and therefore less likely. Any such issuance of additional stock could have the effect of diluting the earnings per share and book value per share of outstanding shares of common stock, and such additional shares could be used to dilute the stock ownership or voting right of a person seeking to obtain control of the Company. The Board is not aware of any attempt to take control of the Company and has not presented this proposal with the intention that the increase in authorized shares of common stock be used as a type of antitakeover device.

Vote Required; Recommendation of the Board

The affirmative vote of a majority of the Company's outstanding shares of Common Stock is required for approval of this proposal. Unless marked to the contrary, proxies received will be voted **FOR** the amendment of the Company's

Amended and Restated Certificate of Incorporation.

**THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT THE STOCKHOLDERS
VOTE FOR THE AMENDMENT OF OUR AMENDED AND RESTATED CERTIFICATE
OF INCORPORATION TO INCREASE THE AUTHORIZED SHARES.**

Table of Contents**PROPOSAL NUMBER 4****RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITORS**

In January 2007, the Audit Committee approved the retention of BDO Seidman, LLP (BDO) as the Company s independent registered public accounting firm for the fiscal period ended September 30, 2007. A representative of BDO is expected to be present at the Annual Meeting to make a statement if he or she desires to do so, and such representative is expected to be available to respond to appropriate questions.

The stockholders are asked to ratify the appointment of BDO as independent registered public accounting firm for the Company for the fiscal year ending September 30, 2007. BDO was engaged as the Company s independent registered public accounting firm by the Audit Committee on October 24, 2004 and has audited the Company s financial statements for the nine months ended September 30, 2004 and fiscal years ended September 30, 2005 and 2006. BDO was engaged following the resignation of PricewaterhouseCoopers LLP (PwC) as the independent registered public accounting firm for the Company on September 8, 2004.

During the Company s fiscal year ended September 30, 2006, (i) there were no disagreements with BDO on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to BDO s satisfaction, would have caused BDO to make reference thereto in their reports on the financial statements for such year and (ii) there were no reportable events as such term is defined in Item 304(a)(1)(v) of Regulation S-K.

PwC s reports on the Company s consolidated financial statements for the year ended December 31, 2003 did not contain any adverse opinion, or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles.

During the Company s fiscal year ended December 31, 2003 and through September 8, 2004, (i) there were no disagreements with PwC on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to PwC s satisfaction, would have caused PwC to make reference thereto in their reports on the financial statements for such years and (ii) there were no reportable events as such term is defined in Item 304(a)(1)(v) of Regulation S-K.

During the Company s two most recent fiscal years and the period from the end of the most recent fiscal year to the date of BDO s engagement, neither the Company nor anyone acting on its behalf consulted with BDO with respect to any subject matter or reportable event set forth in Item 304(a)(2) of Regulation S-K.

Audit Fees During Fiscal Years 2006 and 2005

The following table sets forth the approximate aggregate fees paid by the Company to BDO Seidman, LLP during the fiscal years ended September 30, 2006 and September 30, 2005.

| | 2006 | 2005 |
|-----------------------|--------------|--------------|
| Audit Fees(1) | \$ 3,292,675 | \$ 2,690,425 |
| Audit Related Fees(2) | \$ 1,564,870 | \$ 352,176 |
| Tax Fees(3) | \$ 23,945 | \$ 3,120 |
| All Other Fees | \$ | \$ |

Total Fees \$ 4,881,490 \$ 3,045,721

- (1) *Audit Fees.* This category represents fees billed for professional services rendered by the principal accountant for the audits of the registrant's annual financial statements and internal controls over financial reporting, and review of the interim financial statements included in the registrant's quarterly reports on Form 10-Q, and statutory audits and other SEC filings.
- (2) *Audit Related Fees.* This category represents fees billed for assurance and related services by the principal accountant that are reasonably related to the performance of the audit or review of registrant's financial statements, primarily accounting consultations and audits of significant acquirees.

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- (3) *Tax Fees.* This category represents fees billed for professional services rendered by the principal accountant for tax compliance, advice and planning, primarily for tax compliance.

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

The Sarbanes-Oxley Act of 2002 and the auditor independence rules of the U.S. Securities and Exchange Commission require all independent registered public accounting firms that audit issuers to obtain pre-approval from their respective audit committees in order to provide professional services without impairing independence. As such, the Company's Audit Committee has a policy and has established procedures by which it pre-approves all audit and other permitted professional services to be provided by the Company's independent registered public accounting firm.

The pre-approval procedures of the Company include execution by the Chief Financial Officer and Audit Committee Chairperson, on behalf of the Company and the entire Audit Committee, of an audit and quarterly review engagement letter and pre-approval listing of other permitted professional services anticipated to be rendered during the foreseeable future. Additionally, from time to time, the Company may desire additional permitted professional services for which specific pre-approval is obtained from the Audit Committee Chairman, acting on behalf of the Company and entire Audit Committee, before provision of such services commences. In doing this, the Company and Audit Committee have established a procedure whereby a BDO Seidman, LLP representative, in conjunction with the Chief Financial Officer or Chief Accounting Officer, contacts the Audit Committee Chairman and obtains pre-approval for such services on behalf of the entire Audit Committee, to be followed by a written engagement letter, as appropriate, confirming such arrangements between BDO Seidman, LLP and the Company. In addition, on a periodic (at least quarterly) basis, the entire Audit Committee is provided with a summary of all pre-approved services to date for its review. During the fiscal year ended September 30, 2006, all services provided by the Company's independent registered public accounting firm were pre-approved by the Audit Committee in accordance with this policy.

Although ratification by stockholders is not required by law, the Board is submitting the selection of BDO for ratification as a matter of good corporate governance. Should the stockholders fail to ratify the appointment of BDO as independent registered public accounting firm the Audit Committee will reconsider whether or not to retain BDO. Even if the selection is ratified, the Audit Committee may appoint new independent registered public accounting firm at any time during the year if they believe that such a change would be in the best interests of the Company and its stockholders.

Recommendation of the Board

Unless marked to the contrary, proxies received will be voted FOR approval of the ratification of the appointment of BDO as independent registered public accounting firm for the Company for the fiscal year ending September 30, 2007.

**THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR
RATIFICATION OF APPOINTMENT OF BDO AS THE COMPANY'S
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM.**

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AUDIT COMMITTEE REPORT

The Audit Committee of the Board of Directors is responsible for providing an independent, objective review of the Company's accounting functions and internal controls. During the fiscal year ended September 30, 2006, the Audit Committee was comprised of Messrs. Frankenberg, Finch and Myers, each of whom is independent within the meaning of the listing standards of the NASDAQ Stock Market, and was governed by a written charter first adopted and approved by the Board of Directors in June 2001, and as amended and restated on April 29, 2003 and February 24, 2004. A copy of the Company's Amended and Restated Audit Committee Charter is available on the Company's Website at <http://www.nuance.com/company/governance>. The Audit Committee met 11 times during the fiscal year ended September 30, 2006.

In connection with the Company's audited financial statements for the fiscal year ended September 30, 2005, the Audit Committee (1) reviewed and discussed the audited financial statements with management, (2) discussed with the independent registered public accounting firm the matters required to be discussed by Statement on Auditing Standards No. 61, and (3) received the written disclosures and the letter from the independent registered public accounting firm required by Independence Standards Board Standard No. 1 and discussed with the independent registered public accounting firm the independent auditors' independence.

The Audit Committee has considered and determined that the provision of the services other than audit services referenced above is compatible with maintenance of the auditor's independence. Based upon these reviews and discussions, the Audit Committee recommended to the Board of Directors, and the Board of Directors approved, that the Company's audited financial statements be included in the Company's Annual Report on Form 10-K/A for the fiscal year ended September 30, 2006 for filing with the Securities and Exchange Commission.

Robert J. Frankenberg, Chairman
Mark B. Myers
Robert M. Finch

Table of Contents**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth certain information with respect to the beneficial ownership of the Company's Common Stock as of December 31, 2006, as to (1) each person (or group of affiliated persons) who is known by us to own beneficially more than 5% of the Company's Common Stock; (2) each of our directors; (3) each executive officer named in the Summary Compensation Table; and (4) all directors and executive officers of the Company as a group.

Beneficial ownership is determined in accordance with SEC rules and includes voting or investment power with respect to securities. All shares of Common Stock subject to options exercisable within 60 days of December 31, 2006 are deemed to be outstanding and beneficially owned by the persons holding those options for the purpose of computing the number of shares beneficially owned and the percentage ownership of that person. They are not, however, deemed to be outstanding and beneficially owned for the purpose of computing the percentage ownership of any other person.

Subject to the paragraph above, percentage ownership of outstanding shares is based on 172,348,961 shares of Common Stock outstanding as of December 31, 2006.

| Name and Address of Beneficial Owner(1) | Number Owned | Percent of Outstanding Shares |
|--|---------------------|--------------------------------------|
| Warburg Pincus(2) 466 Lexington Avenue New York, NY 10017 Franklin Resources, Inc. One Franklin Parkway San Mateo, CA 94403 | 42,277,057 | 23.1% |
| Paul A. Ricci(3) | 9,073,191 | 5.3% |
| Charles W. Berger(4) | 4,075,840 | 2.3% |
| Robert M. Finch(5) | 1,253,220 | * |
| Robert J. Frankenberg(6) | 88,582 | * |
| John C. Freker(7) | 252,675 | * |
| Jeffrey A. Harris(8) | 99,411 | * |
| William H. Janeway(9) | 42,289,557 | 23.1% |
| Katharine A. Martin(10) | 42,332,057 | 23.1% |
| Mark B. Myers(11) | 146,000 | * |
| Philip J. Quigley(12) | 145,000 | * |
| Robert G. Teresi(13) | 152,079 | * |
| James R. Arnold, Jr.(14) | 281,757 | * |
| Steven G. Chambers(15) | 399,434 | * |
| John D. Shagoury(16) | 544,500 | * |
| All directors and executive officers as a group (16 persons)(17) | 458,260 | * |
| | 51,630,257 | 28.5% |

* Less than 1%.

(1)

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Unless otherwise indicated, the address for the following stockholders is c/o Nuance Communications, Inc., One Wayside Drive, Burlington, Massachusetts 01803.

- (2) The stockholder is Warburg Pincus Private Equity VIII, L.P., including two affiliated partnerships (WP VIII). Warburg Pincus Partners LLC (WP Partners LLC), a direct subsidiary of Warburg Pincus & Co. (WP), is the sole general partner of WP VIII. WP VIII is managed by Warburg Pincus LLC (WP LLC). Includes four warrants that were exercisable, within sixty days of December 31, 2006, for up to 525,732, 2,500,000, 863,236 and 3,177,570 shares of our common stock, respectively, and 3,562,238 shares of non-voting Series B Preferred Stock. The shares that underlie the warrants and the Series B shares have not been

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converted into our common stock and are factored into the calculation of Warburg Pincus' beneficial ownership only for the purposes of this table. Charles R. Kaye and Joseph P. Landy are Managing General Partners of WP and Managing Members of WP LLC and may be deemed to control the Warburg Pincus entities. Messrs. Kaye and Landy disclaim beneficial ownership of all shares held by the Warburg Pincus entities.

- (3) Includes options to acquire 2,964,054 shares of Common Stock that are exercisable within 60 days of December 31, 2006. Includes 750,000 unvested shares of restricted stock and 33,633 unvested restricted stock units. Mr. Ricci does not have voting rights with respect to the shares underlying the restricted stock units.
- (4) Includes options to acquire 1,179,877 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006.
- (5) Includes options to acquire 67,500 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006.
- (6) Includes options to acquire 210,854 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006.
- (7) Includes options to acquire 67,500 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006.
- (8) Mr. Harris, a director of the Company, is a general partner of WP and a Managing Director and member of WP LLC. All shares indicated as owned by Mr. Harris other than 12,500 shares are included because of his affiliation with the Warburg Pincus entities. Mr. Harris disclaims beneficial ownership of all shares held by the Warburg Pincus entities. Includes four warrants that, as of January 15, 2007, were exercisable for up to 525,732, 2,500,000, 863,236 and 3,177,570 shares of our common stock, respectively, and 3,562,238 shares of non-voting Series B Preferred Stock. The shares that underlie the warrants and the Series B shares have not been converted into our common stock and are factored into the calculation of Mr. Harris' beneficial ownership only for the purposes of this table. Mr. Harris may be deemed to have a pecuniary interest in these shares. Also includes options to acquire 12,500 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006.
- (9) Mr. Janeway, a director of the Company, is a general partner of WP and a Vice Chairman and member of WP LLC. All shares indicated as owned by Mr. Janeway other than 55,000 shares are included because of his affiliation with the Warburg Pincus entities. Mr. Janeway disclaims beneficial ownership of all shares held by the Warburg Pincus entities. Includes four warrants that, as of January 15, 2007, were exercisable for up to 525,732, 2,500,000, 863,236 and 3,177,570 shares of our common stock, respectively, and 3,562,238 shares of non-voting Series B Preferred Stock. The shares that underlie the warrants and the Series B shares have not been converted into our common stock and are factored into the calculation of Mr. Janeway's beneficial ownership only for the purposes of this table. Mr. Janeway may be deemed to have a pecuniary interest in these shares. Also includes options to acquire 55,000 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006.
- (10) Includes options to acquire 145,000 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006.
- (11) Represents options to acquire shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006.

- (12) Includes options to acquire 146,689 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006.
- (13) Includes options to acquire 140,000 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006. 141,757 shares are held indirectly in a Trust.
- (14) Includes options to acquire 263,541 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006 and 97,959 unvested restricted stock units. Mr. Arnold does not have voting rights with respect to the shares underlying the restricted stock units.
- (15) Includes options to acquire 363,750 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006, 71,302 unvested shares of restricted stock and 81,235 unvested restricted stock units. Mr. Chambers does not have voting rights with respect to the shares underlying the restricted stock units.

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- (16) Includes options to acquire 283,333 shares of the Company's Common Stock that are exercisable within 60 days of December 31, 2006, 62,674 unvested shares of restricted stock and 85,238 unvested restricted stock units. Mr. Shagoury does not have voting rights with respect to the shares underlying the restricted stock units.
- (17) Includes options to acquire 6,606,848 shares of the our common stock that are exercisable within 60 days of December 31, 2006, 932,921 unvested shares of restricted stock and 388,858 unvested restricted stock units. Also includes, as outlined in footnotes 8 and 9 above, four warrants that as of December 31, 2006 were exercisable for up to 525,732, 2,500,000, 863,236, and 3,177,570 shares of our common stock, respectively, and 3,562,238 shares of non-voting Series B Preferred Stock. The shares that underlie the warrants and the Series B shares have not been converted into the Company's Common Stock and are factored into the calculation of beneficial ownership only for the purposes of this table.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and the rules of the Securities and Exchange Commission (the Commission) thereunder require the Company's executive officers, directors and certain stockholders to file reports of ownership and changes in ownership of the Company's Common Stock with the Commission. Based solely on a review of the copies of such reports furnished to the Company and representations that no other reports were required during the fiscal year ended September 30, 2006, the Company believes that all directors, executive officers and beneficial owners of more than 10% of the Company's Common Stock complied with all filing requirements applicable to them during the fiscal year ended September 30, 2006, except for inadvertent late filings by Messrs. Ricci, Arnold and Hebert and Ms. McCann. Messrs. Ricci and Arnold and Ms. McCann were late to report shares of restricted stock granted to them on December 15, 2005. Mr. Hebert was late to report shares of restricted stock granted to him on May 1, 2006.

Table of Contents**PERFORMANCE GRAPH**

The following performance graph compares the Company's cumulative total return on its Common Stock for a 69-month period ended September 30, 2006 with the cumulative total return of the Russell 2000, and the S&P Information Technology indices assuming \$100 was invested in the Company's Common Stock and each of the indices on December 31, 2000. The measurement periods shown in the performance graph below correspond to the Company's fiscal years ended December 31, 2001, 2002, 2003 and September 30, 2004, 2005 and 2006. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

Comparison of 5 Year Cumulative Total Return*
Among Nuance Communications, Inc., The Russell 2000 Index
and The S&P Information Technology Index

| | Cumulative Total Return | | | | | |
|-----------------------------|-------------------------|--------|--------|--------|--------|--------|
| | 9/01 | 9/02 | 9/03 | 9/04 | 9/05 | 9/06 |
| Nuance Communications, Inc. | 100.00 | 234.04 | 297.87 | 289.36 | 378.01 | 579.43 |
| Russell 2000 | 100.00 | 90.70 | 123.80 | 147.04 | 173.44 | 190.65 |
| S&P Information Technology | 100.00 | 68.95 | 110.00 | 112.16 | 127.24 | 131.39 |

* \$100 invested on 9/30/2001 in stock or index-including reinvestment of dividends.

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OTHER MATTERS

Other Matters. Management knows of no business or nominations that will be presented for consideration at the Annual Meeting other than as stated in the Notice of Meeting. If, however, other matters are properly brought before the meeting, it is the intention of the persons named in the accompanying form of proxy to vote the shares represented thereby on such matters in accordance with their best judgment.

Not Soliciting Materials. The information contained in this Proxy Statement under the captions Report of the Audit Committee , Compensation Committee Report on Compensation and Performance Graph shall not be deemed to be soliciting material or to be filed with the Securities and Exchange Commission, nor will such information be incorporated by reference into any future filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the Company specifically incorporates it by reference in such filing.

By Order of the Board of Directors,

Jo-Anne Sinclair
Secretary

Burlington, Massachusetts
February , 2007

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ANNEX A

**NUANCE COMMUNICATIONS, INC.
(FORMERLY KNOWN AS SCANSOFT, INC.)**

**2000 STOCK PLAN
(As proposed to be amended at the 2007 Annual Meeting of Stockholders)**

1. *Purposes of the Plan.* The purposes of this Plan are:

- to attract and retain the best available personnel for positions of substantial responsibility,
- to provide additional incentive to Employees, Directors and Consultants, and
- to promote the success of the Company's business.

The Plan permits the grant of Incentive Stock Options, Nonstatutory Stock Options, Stock Purchase Rights, Stock Appreciation Rights, and Restricted Stock Units.

2. *Definitions.* As used herein, the following definitions shall apply:

- (a) *Administrator* means the Board or any of its Committees as shall be administering the Plan, in accordance with Section 4 of the Plan.
- (b) *Affiliated SAR* means an SAR that is granted in connection with a related Option, and which automatically will be deemed to be exercised at the same time that the related Option is exercised.
- (c) *Applicable Laws* means the requirements relating to the administration of equity-based awards under U.S. state corporate laws, U.S. federal and state securities laws, the Code, any stock exchange or quotation system on which the Common Stock is listed or quoted and the applicable laws of any foreign country or jurisdiction where Awards are, or will be, granted under the Plan.
- (d) *Annual Revenue* means the Company's or a business unit's net sales for the Fiscal Year, determined in accordance with generally accepted accounting principles; provided, however, that prior to the Fiscal Year, the Committee shall determine whether any significant item(s) shall be excluded or included from the calculation of Annual Revenue with respect to one or more Participants.
- (e) *Award* means, individually or collectively, a grant under the Plan of Options, Stock Purchase Rights, Stock Appreciation Rights, and Restricted Stock Units.
- (f) *Award Agreement* means the written or electronic agreement setting forth the terms and provisions applicable to each Award granted under the Plan. The Award Agreement is subject to the terms and conditions of the Plan.
- (g) *Board* means the Board of Directors of the Company.
- (h) *Cash Position* means the Company's level of cash and cash equivalents.
- (i) *Code* means the Internal Revenue Code of 1986, as amended. Any reference to a section of the Code herein will be a reference to any successor or amended section of the Code.

- (j) *Committee* means a committee of Directors appointed by the Board in accordance with Section 4 of the Plan.
- (k) *Common Stock* means the common stock of the Company.
- (l) *Company* means Nuance Communications, Inc. (formerly known as ScanSoft, Inc.) a Delaware corporation. With respect to the definitions of the Performance Goals, the Committee may determine that *Company* means Nuance Communications, Inc. and its consolidated subsidiaries.
- (m) *Consultant* means any person, including an advisor, engaged by the Company or a Parent or Subsidiary to render services to such entity.

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(n) *Controllable Profits* means as to any Plan Year, a business unit's Annual Revenue minus (a) cost of sales, (b) research, development, and engineering expense, (c) marketing and sales expense, (d) general and administrative expense, (e) extended receivables expense, and (f) shipping requirement deviation expense.

(o) *Customer Satisfaction MBOs* means as to any Participant for any Plan Year, the objective and measurable individual goals set by a management by objectives process and approved by the Committee, which goals relate to the satisfaction of external or internal customer requirements(p) .

(p) *Director* means a member of the Board.

(q) *Disability* means total and permanent disability as defined in Section 22(e)(3) of the Code.

(r) *Earnings Per Share* means as to any Fiscal Year, the Company's or a business unit's Net Income, divided by a weighted average number of common shares outstanding and dilutive common equivalent shares deemed outstanding, determined in accordance with generally accepted accounting principles.

(s) *Employee* means any person, including Officers and Directors, employed by the Company or any Parent or Subsidiary of the Company. Neither service as a Director nor payment of a director's fee by the Company shall be sufficient to constitute employment by the Company.

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

(u) *Fair Market Value* means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the Nasdaq National Market or The Nasdaq SmallCap Market of The Nasdaq Stock Market, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system on the day of determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, the Fair Market Value of a Share of Common Stock shall be the mean between the high bid and low asked prices for the Common Stock on the last market trading day on the day of determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable; or

(iii) In the absence of an established market for the Common Stock, the Fair Market Value shall be determined in good faith by the Administrator.

(v) *Fiscal Year* means the fiscal year of the Company.

(w) *Freestanding SAR* means an SAR that is granted independent of any Option.

(x) *Incentive Stock Option* means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder.

(y) *Individual Objectives* means as to a Participant, the objective and measurable goals set by a management by objectives process and approved by the Committee (in its discretion).

(z) *Net Income* means as to any Fiscal Year, the income after taxes of the Company for the Fiscal Year determined in accordance with generally accepted accounting principles, provided that prior to the Fiscal Year, the Committee shall determine whether any significant item(s) shall be included or excluded from the calculation of Net Income with respect to one or more Participants.

(aa) *New Orders* means as to any Plan Year, the firm orders for a system, product, part, or service that are being recorded for the first time as defined in the Company's order Recognition Policy.

(bb) *Nonstatutory Stock Option* means an Option that by its terms does not qualify or is not intended to qualify as an Incentive Stock Option.

(cc) *Officer* means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

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(dd) *Operating Cash Flow* means the Company's or a business unit's sum of Net Income plus depreciation and amortization less capital expenditures plus changes in working capital comprised of accounts receivable, inventories, other current assets, trade accounts payable, accrued expenses, product warranty, advance payments from customers and long-term accrued expenses, determined in accordance with generally acceptable accounting principles.

(ee) *Operating Income* means the Company's or a business unit's income from operations but excluding any unusual items, determined in accordance with generally accepted accounting principles.

(ff) *Option* means a stock option granted pursuant to the Plan.

(gg) *Optionee* means the holder of an outstanding Option or Stock Purchase Right granted under the Plan.

(hh) *Optioned Stock* means the Shares subject to an Award.

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

(jj) *Participant* means the holder of an outstanding Award, which shall include an Optionee.

(kk) *Performance Goals* means the goal(s) (or combined goal(s)) determined by the Committee (in its discretion) to be applicable to a Participant with respect to an Award. As determined by the Committee, the Performance Goals applicable to an Award may provide for a targeted level or levels of achievement using one or more of the following measures: (a) Annual Revenue, (b) Cash Position, (c) Controllable Profits, (d) Customer Satisfaction MBOs, (e) Earnings Per Share, (f) Individual Objectives, (g) Net Income, (h) New Orders, (i) Operating Cash Flow, (j) Operating Income, (k) Return on Assets, (l) Return on Equity, (m) Return on Sales, and (n) Total Shareholder Return. The Performance Goals may differ from Participant to Participant and from Award to Award.

(ll) *Plan* means this 2000 Stock Plan, as amended and restated.

(mm) *Restricted Stock* means Shares acquired pursuant to a grant of Stock Purchase Rights under Section 9 of the Plan or pursuant to the early exercise of an Option.

(nn) *Restricted Stock Purchase Agreement* means a written agreement between the Company and the Participant evidencing the terms and restrictions applying to stock purchased under a Stock Purchase Right. The Restricted Stock Purchase Agreement is subject to the terms and conditions of the Plan and the Notice of Grant.

(oo) *Restricted Stock Unit* means an Award granted to a Participant pursuant to Section 11.

(pp) *Return on Assets* means the percentage equal to the Company's or a business unit's Operating Income before incentive compensation, divided by average net Company or business unit, as applicable, assets, determined in accordance with generally accepted accounting principles.

(qq) *Return on Equity* means the percentage equal to the Company's Net Income divided by average stockholder's equity, determined in accordance with generally accepted accounting principles.

(rr) *Return on Sales* means the percentage equal to the Company's or a business unit's Operating Income before incentive compensation, divided by the Company's or the business unit's, as applicable, revenue, determined in accordance with generally accepted accounting principles.

(ss) *Rule 16b-3* means Rule 16b-3 of the Exchange Act or any successor to Rule 16b-3, as in effect when discretion is being exercised with respect to the Plan.

(tt) *Section 16(b)* means Section 16(b) of the Exchange Act.

(uu) *Service Provider* means an Employee, Director or Consultant.

(vv) *Share* means a share of the Common Stock, as adjusted in accordance with Section 14 of the Plan.

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(ww) *Stock Appreciation Right* or *SAR* means an Award, granted alone or in connection with an Option, which pursuant to Section 10 is designated as an SAR.

(xx) *Stock Purchase Right* means the right to purchase Shares pursuant to Section 9 of the Plan.

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

(zz) *Tandem SAR* means an SAR that is granted in connection with a related Option, the exercise of which will require forfeiture of the right to purchase an equal number of Shares under the related Option (and when a Share is purchased under the Option, the SAR will be canceled to the same extent).

(aaa) *Total Shareholder Return* means the total return (change in share price plus reinvestment of any dividends) of a Share.

3. *Stock Subject to the Plan.* Subject to the provisions of Section 14 of the Plan, the maximum aggregate number of Shares that may be issued under the Plan is 22,750,000 Shares (the *Plan Maximum*). If any outstanding Award for any reason expires or is terminated or canceled without having been exercised or settled in full, or if Shares acquired pursuant to an Award subject to forfeiture or repurchase are forfeited or repurchased by the Company, the Shares allocable to the terminated portion of such Award or such forfeited or repurchased Shares shall again be available for grant under the Plan. Shares shall not be deemed to have been granted pursuant to the Plan (a) with respect to any portion of an Award that is settled in cash or (b) to the extent such Shares are withheld in satisfaction of tax withholding obligations. Upon payment in Shares pursuant to the exercise of a Stock Appreciation Right, the number of Shares available for grant under the Plan shall be reduced only by the number of Shares actually issued in such payment. If the exercise price of an Option is paid by tender to the Company of Shares underlying the Option, the number of Shares available for grant under the Plan shall be reduced by the net number of Shares for which the Option is exercised. The Shares may be authorized, but unissued, or reacquired Common Stock.

4. *Administration of the Plan.*

(a) *Procedure.*

(i) *Multiple Administrative Bodies.* Different Committees with respect to different groups of Service Providers may administer the Plan.

(ii) *Section 162(m).* To the extent that the Administrator determines it to be desirable to qualify Awards granted hereunder as performance-based compensation within the meaning of Section 162(m) of the Code, the Plan shall be administered by a Committee of two or more outside directors within the meaning of Section 162(m) of the Code. For purposes of qualifying grants of Awards as performance-based compensation under Section 162(m) of the Code, the Committee, in its discretion, may set restrictions based upon the achievement of Performance Goals. The Performance Goals shall be set by the Committee on or before the latest date permissible to enable the Awards to qualify as performance-based compensation under Section 162(m) of the Code. In granting Awards which are intended to qualify under Section 162(m) of the Code, the Committee shall follow any procedures determined by it from time to time to be necessary or appropriate to ensure qualification of the Awards under Section 162(m) of the Code (e.g., in determining the Performance Goals).

(iii) *Rule 16b-3.* To the extent desirable to qualify transactions hereunder as exempt under Rule 16b-3, the transactions contemplated hereunder shall be structured to satisfy the requirements for exemption under Rule 16b-3.

(iv) *Other Administration.* Other than as provided above, the Plan shall be administered by (A) the Board or (B) a Committee, which committee shall be constituted to satisfy Applicable Laws.

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(b) *Powers of the Administrator.* Subject to the provisions of the Plan, and in the case of a Committee, subject to the specific duties delegated by the Board to such Committee, the Administrator shall have the authority, in its discretion:

(i) to determine the Fair Market Value;

(ii) to select the Service Providers to whom Awards may be granted hereunder;

(iii) to determine the number of Shares to be covered by each Award granted hereunder;

(iv) to approve forms of agreement for use under the Plan;

(v) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any Award granted hereunder. Such terms and conditions include, but are not limited to, the exercise price, the time or times when Awards may be exercised (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions in connection with the termination of a Participant's status as a Service Provider, and any restriction or limitation regarding any Award or the Shares relating thereto, based in each case on such factors as the Administrator, in its sole discretion, shall determine;

(vi) to construe and interpret the terms of the Plan and awards granted pursuant to the Plan;

(vii) to prescribe, amend and rescind rules and regulations relating to the Plan, including rules and regulations relating to sub-plans established for the purpose of qualifying for preferred tax treatment under foreign tax laws;

(viii) to modify or amend each Award (subject to Section 17(c) of the Plan), including the discretionary authority to extend the post-termination exercisability period of Awards longer than is otherwise provided for in the Plan;

(ix) to allow Participants to satisfy withholding tax obligations by electing to have the Company withhold from the Shares to be issued upon exercise of an Award that number of Shares having a Fair Market Value equal to the minimum amount required to be withheld. The Fair Market Value of the Shares to be withheld shall be determined on the date that the amount of tax to be withheld is to be determined. All elections by a Participant to have Shares withheld for this purpose shall be made in such form and under such conditions as the Administrator may deem necessary or advisable;

(x) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Award previously granted by the Administrator;

(xi) to allow a Participant to defer the receipt of payment of cash or the delivery of Shares that would otherwise be due to such Participant under an Award; or

(xii) to make all other determinations deemed necessary or advisable for administering the Plan.

(c) *Effect of Administrator's Decision.* The Administrator's decisions, determinations and interpretations shall be final and binding on all Participants and any other holders of Awards.

5. *Eligibility.* Nonstatutory Stock Options, Stock Purchase Rights, Stock Appreciation Rights, and Restricted Stock Units may be granted to Service Providers. Incentive Stock Options may be granted only to Employees.

6. *Limitations.*

(a) Each Option shall be designated in the Award Agreement as either an Incentive Stock Option or a Nonstatutory Stock Option. However, notwithstanding such designation, to the extent that the aggregate Fair Market Value of the Shares with respect to which Incentive Stock Options are exercisable for the first time by the Participant during any calendar year (under all plans of the Company and any Parent or Subsidiary) exceeds \$100,000, such Options shall be treated as Nonstatutory Stock Options. For purposes of this Section 6(a), Incentive Stock Options shall be taken into account in the order in which they were granted. The Fair Market Value of the Shares shall be determined as of the time the Option with respect to such Shares is granted.

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(b) The following limitations shall apply to grants of Options and Stock Appreciation Rights:

(i) No Service Provider shall be granted, in any Fiscal Year, Options or Stock Appreciation Rights covering more than 1,000,000 Shares.

(ii) In connection with his or her initial service, a Service Provider may be granted Options or Stock Appreciation Rights covering up to an additional 1,000,000 Shares, which shall not count against the limit set forth in subsection (i) above.

(iii) The foregoing limitations shall be adjusted proportionately in connection with any change in the Company's capitalization as described in Section 14.

(iv) If an Option or Stock Appreciation Right is cancelled in the same fiscal year of the Company in which it was granted (other than in connection with a transaction described in Section 14), the cancelled Option or Stock Appreciation Right will be counted against the limits set forth in subsections (i) and (ii) above. For this purpose, if the exercise price of an Option or Stock Appreciation Right is reduced, the transaction will be treated as a cancellation of the Option or Stock Appreciation Right and the grant of a new Option or Stock Appreciation Right.

(c) The exercise price of any Option or SAR outstanding or to be granted in the future under the Plan shall not be reduced or cancelled and re-granted at a lower exercise price (including pursuant to any 6 month and 1 day cancellation and re-grant scheme), regardless of whether or not the Shares subject to the cancelled Options or SARs are put back into the available pool for grant. In addition, the Administrator shall not replace underwater Options or SARs with restricted stock in an exchange, buy-back or other scheme. Moreover, the Administrator shall not replace any Options or SARs with new options or stock appreciation rights having a lower exercise price or accelerated vesting schedule in an exchange, buy-back or other scheme.

7. *Term of Plan.* Subject to Section 20 of the Plan, the Plan shall become effective upon its adoption by the Board. It shall continue in effect for a term of ten (10) years unless terminated earlier under Section 17 of the Plan.

8. *Stock Options*

(a) *Term of Option.* The term of each Option shall be stated in the Award Agreement, but in no event shall the term of an Option be more than seven (7) years from the date of grant. Moreover, in the case of an Incentive Stock Option granted to a Participant who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or any Parent or Subsidiary, the term of the Incentive Stock Option shall be five (5) years from the date of grant or such shorter term as may be provided in the Award Agreement.

(b) *Option Exercise Price and Consideration.*

(i) *Exercise Price.* The per Share exercise price for the Shares to be issued pursuant to the exercise of an Option shall be no less than 100% of the Fair Market Value per Share on the date of grant. In the case of an Incentive Stock Option granted to an Employee who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the per Share exercise price shall be no less than 110% of the Fair Market Value per Share on the date of grant.

(ii) *Waiting Period and Exercise Dates.* At the time an Option is granted, the Administrator shall fix the period within which the Option may be exercised and shall determine any conditions that must be satisfied before the Option may be

exercised.

(iii) *Form of Consideration.* The Administrator shall determine the acceptable form of consideration for exercising an Option, including the method of payment. In the case of an Incentive Stock Option, the Administrator shall determine the acceptable form of consideration at the time of grant. Such consideration may consist entirely of:

(1) cash;

(2) check;

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(3) other Shares which (A) in the case of Shares acquired upon exercise of an option, have been owned by the Participant for more than six months on the date of surrender, and (B) have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option shall be exercised;

(4) consideration received by the Company under a cashless exercise program implemented by the Company in connection with the Plan;

(5) a reduction in the amount of any Company liability to the Participant, including any liability attributable to the Participant's participation in any Company-sponsored deferred compensation program or arrangement;

(6) any combination of the foregoing methods of payment; or

(7) such other consideration and method of payment for the issuance of Shares to the extent permitted by Applicable Laws.

(c) Exercise of Option.

(i) Procedure for Exercise; Rights as a Stockholder. Any Option granted hereunder shall be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Administrator and set forth in the Award Agreement. An Option may not be exercised for a fraction of a Share.

(1) An Option shall be deemed exercised when the Company receives: (i) written or electronic notice of exercise (in such form as the Administrator may specify from time to time) from the person entitled to exercise the Option, and (ii) full payment for the Shares with respect to which the Option is exercised (together with any applicable withholding taxes). Full payment may consist of any consideration and method of payment authorized by the Administrator and permitted by the Award Agreement and the Plan. Shares issued upon exercise of an Option shall be issued in the name of the Participant or, if requested by the Participant, in the name of the Participant and his or her spouse. Until the Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. The Company shall issue (or cause to be issued) such Shares promptly after the Option is exercised. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Shares are issued, except as provided in Section 14 of the Plan.

(2) Exercising an Option in any manner shall decrease the number of Shares thereafter available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

(ii) Termination of Relationship as a Service Provider. If a Participant ceases to be a Service Provider, other than upon the Participant's death or Disability, the Participant may exercise his or her Option within such period of time as is specified in the Award Agreement to the extent that the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Award Agreement). In the absence of a specified time in the Award Agreement, the Option shall remain exercisable for three (3) months following the Participant's termination. If, on the date of termination, the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination, the Participant does not exercise his or her Option within the time specified by the Administrator, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(iii) *Disability of Participant.* If a Participant ceases to be a Service Provider as a result of the Participant's Disability, the Participant may exercise his or her Option within such period of time as is specified in the Award Agreement to the extent the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Award Agreement). In the absence of a specified time in the Award Agreement, the Option shall remain exercisable for twelve (12) months following the Participant's termination. If, on the date of termination, the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination,

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the Participant does not exercise his or her Option within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(iv) *Death of Participant.* If a Participant dies while a Service Provider, the Option may be exercised following the Participant's death within such period of time as is specified in the Award Agreement (but in no event may the Option be exercised later than the expiration of the term of such Option as set forth in the Award Agreement), by the Participant's estate or by a person who acquires the right to exercise the Option by bequest or inheritance, but only to the extent that the Option is vested on the date of death. In the absence of a specified time in the Award Agreement, the Option shall remain exercisable for twelve (12) months following the Participant's termination. If, at the time of death, the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall immediately revert to the Plan. The Option may be exercised by the executor or administrator of the Participant's estate or, if none, by the person(s) entitled to exercise the Option under the Participant's will or the laws of descent or distribution. If the Option is not so exercised within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(v) *Buyout Provisions.* The Administrator may at any time offer to buy out for a payment in cash or Shares an Option previously granted based on such terms and conditions as the Administrator shall establish and communicate to the Participant at the time that such offer is made.

9. Stock Purchase Rights.

(a) *Rights to Purchase.* Stock Purchase Rights may be issued either alone, in addition to, or in tandem with other Awards granted under the Plan and/or cash awards made outside of the Plan. After the Administrator determines that it will offer Stock Purchase Rights under the Plan, it shall advise the offeree in writing or electronically, of the terms, conditions and restrictions related to the offer, including the number of Shares that the offeree shall be entitled to purchase (subject to the limits set forth in Section 3), the price to be paid, and the time within which the offeree must accept such offer. The offer shall be accepted by execution of a Restricted Stock Purchase Agreement in the form determined by the Administrator. The following limitations shall apply to grants of Stock Purchase Rights:

(i) No Service Provider shall be granted, in any Fiscal Year, Stock Purchase Rights covering more than 750,000 Shares.

(ii) The foregoing limitation shall be adjusted proportionately in connection with any change in the Company's capitalization as described in Section 14.

(iii) If a Stock Purchase Right is cancelled in the same fiscal year of the Company in which it was granted (other than in connection with a transaction described in Section 14), the cancelled Stock Purchase Right will be counted against the limit set forth in subsection (i) above.

(b) *Repurchase Option.* Unless the Administrator determines otherwise, the Restricted Stock Purchase Agreement shall grant the Company a repurchase option exercisable upon the voluntary or involuntary termination of the purchaser's service with the Company for any reason (including death or Disability). The purchase price for Shares repurchased pursuant to the Restricted Stock Purchase Agreement shall be the original price paid by the purchaser and may be paid by cancellation of any indebtedness of the purchaser to the Company. The repurchase option shall lapse at a rate determined by the Administrator.

(c) *Other Provisions.* The Restricted Stock Purchase Agreement shall contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Administrator in its sole discretion.

(d) *Rights as a Stockholder.* Once the Stock Purchase Right is exercised, the purchaser shall have the rights equivalent to those of a stockholder, and shall be a stockholder when his or her purchase is entered upon the records of the duly authorized transfer agent of the Company. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Stock Purchase Right is exercised, except as provided in Section 14 of the Plan.

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10. Stock Appreciation Rights

(a) *Grant of SARs.* Subject to the terms and conditions of the Plan, an SAR may be granted to Service Providers at any time and from time to time as will be determined by the Administrator, in its sole discretion. The Administrator may grant Affiliated SARs, Freestanding SARs, Tandem SARs, or any combination thereof.

(b) *Number of Shares.* The Administrator will have complete discretion to determine the number of SARs granted to any Service Provider.

(c) *Exercise Price and Other Terms.* The Administrator, subject to the provisions of the Plan, will determine the terms and conditions of SARs granted under the Plan; provided, that, the exercise price of an SAR is at least 100% of the Fair Market Value of the Shares subject to the SAR; provided, further, the exercise price of Tandem or Affiliated SARs will equal the exercise price of the related Option.

(d) *Exercise of Tandem SARs.* Tandem SARs may be exercised for all or part of the Shares subject to the related Option upon the surrender of the right to exercise the equivalent portion of the related Option. A Tandem SAR may be exercised only with respect to the Shares for which its related Option is then exercisable. With respect to a Tandem SAR granted in connection with an Incentive Stock Option: (i) the Tandem SAR will expire no later than the expiration of the underlying Incentive Stock Option; (ii) the value of the payout with respect to the Tandem SAR will be for no more than one hundred percent (100%) of the difference between the exercise price of the underlying Incentive Stock Option and the Fair Market Value of the Shares subject to the underlying Incentive Stock Option at the time the Tandem SAR is exercised; and (iii) the Tandem SAR will be exercisable only when the Fair Market Value of the Shares subject to the Incentive Stock Option exceeds the Exercise Price of the Incentive Stock Option.

(e) *Exercise of Affiliated SARs.* An Affiliated SAR will be deemed to be exercised upon the exercise of the related Option. The deemed exercise of an Affiliated SAR will not necessitate a reduction in the number of Shares subject to the related Option.

(f) *Exercise of Freestanding SARs.* Freestanding SARs will be exercisable on such terms and conditions as the Administrator, in its sole discretion, will determine.

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

(h) *Expiration of SARs.* An SAR granted under the Plan will expire upon the date determined by the Administrator, in its sole discretion, and set forth in the Award Agreement. Notwithstanding the foregoing, the rules of Section 8(c) also will apply to SARs.

(i) *Payment of SAR Amount.* Upon exercise of an SAR, a Participant will be entitled to receive payment from the Company in an amount determined by multiplying:

(i) The difference between the Fair Market Value of a Share on the date of exercise over the exercise price; times

(ii) The number of Shares with respect to which the SAR is exercised.

At the discretion of the Administrator, the payment upon SAR exercise may be in cash, in Shares of equivalent value, or in some combination thereof.

11. *Restricted Stock Units.*

(a) *Grant of Restricted Stock Units.* Restricted Stock Units may be granted to Service Providers at any time and from time to time, as will be determined by the Administrator, in its sole discretion. The Administrator will have complete discretion in determining the number of Restricted Stock Units granted to each Participant, subject to the limits set forth in Section 3 of the Plan. The following limitations shall apply to grants of Restricted Stock Units:

(i) No Service Provider shall be granted, in any Fiscal Year, Restricted Stock Units covering more than 750,000 Shares.

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(ii) The foregoing limitation shall be adjusted proportionately in connection with any change in the Company's capitalization as described in Section 14.

(iii) If a Restricted Stock Unit is cancelled in the same fiscal year of the Company in which it was granted (other than in connection with a transaction described in Section 14), the cancelled Restricted Stock Unit will be counted against the limit set forth in subsection (i) above.

(b) *Value of Restricted Stock Units.* Each Restricted Stock Unit will have an initial value that is established by the Administrator on or before the date of grant.

(c) *Performance Objectives and Other Terms.* The Administrator will set performance objectives or other vesting provisions (including, without limitation, continued status as a Service Provider) in its discretion which, depending on the extent to which they are met, will determine the number or value of Restricted Stock Units that will be paid out to the Service Providers. The time period during which the performance objectives or other vesting provisions must be met will be called the Performance Period. Each award of Restricted Stock Units will be evidenced by an Award Agreement that will specify the Performance Period, and such other terms and conditions as the Administrator, in its sole discretion, will determine. The Administrator may set performance objectives based upon the achievement of Company-wide, divisional, or individual goals, applicable federal or state securities laws, or any other basis determined by the Administrator in its discretion.

(d) *Earning of Restricted Stock Units.* After the applicable Performance Period has ended, the holder of Restricted Stock Units will be entitled to receive a payout of the number of Restricted Stock Units earned by the Participant over the Performance Period, to be determined as a function of the extent to which the corresponding performance objectives or other vesting provisions have been achieved. After the grant of a Restricted Stock Unit, the Administrator, in its sole discretion, may reduce or waive any performance objectives or other vesting provisions for such Restricted Stock Unit.

(e) *Form and Timing of Payment of Restricted Stock Units.* Payment of earned Restricted Stock Units will be made as soon as practicable after the expiration of the applicable Performance Period. The Administrator, in its sole discretion, may pay earned Restricted Stock Units in the form of cash, in Shares (which have an aggregate Fair Market Value equal to the value of the earned Restricted Stock Units at the close of the applicable Performance Period) or in a combination thereof.

(f) *Cancellation of Restricted Stock Units.* On the date set forth in the Award Agreement, all unearned or unvested Restricted Stock Units will be forfeited to the Company, and again will be available for grant under the Plan.

12. *Leaves of Absence.* Unless the Administrator provides otherwise, vesting of Awards granted hereunder will be suspended during any unpaid leave of absence. A Service Provider will not cease to be an Employee in the case of (i) any leave of absence approved by the Company or (ii) transfers between locations of the Company or between the Company, its Parent, or any Subsidiary. For purposes of Incentive Stock Options, no such leave may exceed ninety (90) days, unless reemployment upon expiration of such leave is guaranteed by statute or contract. If reemployment upon expiration of a leave of absence approved by the Company is not so guaranteed, then three months following the 91st day of such leave any Incentive Stock Option held by the Participant will cease to be treated as an Incentive Stock Option and will be treated for tax purposes as a Nonstatutory Stock Option.

13. *Non-Transferability of Awards.* Unless determined otherwise by the Administrator, an Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Participant, only by the Participant. If the

Administrator makes an Award transferable, such Award shall contain such additional terms and conditions as the Administrator deems appropriate.

14. *Adjustments Upon Changes in Capitalization, Dissolution, Merger or Asset Sale.*

(a) *Changes in Capitalization.* Subject to any required action by the stockholders of the Company, the number and class of Shares that may be delivered under the Plan and/or the number, class, and price of Shares covered by each outstanding Award, and the numerical Share limits in Sections 3, 6, 9 and 11 of the Plan, shall be proportionately adjusted for any increase or decrease in the number of issued Shares resulting from a stock split,

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reverse stock split, stock dividend, combination or reclassification of the Shares, or any other increase or decrease in the number of issued Shares effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been effected without receipt of consideration. Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Shares subject to an Award.

(b) *Dissolution or Liquidation.* In the event of the proposed dissolution or liquidation of the Company, the Administrator shall notify each Participant as soon as practicable prior to the effective date of such proposed transaction. The Administrator in its discretion may provide for a Participant to have the right to exercise his or her Award until ten (10) days prior to such transaction as to all of the Optioned Stock covered thereby, including Shares as to which the Award would not otherwise be exercisable. In addition, the Administrator may provide that any Company repurchase option applicable to any Shares purchased upon exercise of an Award shall lapse as to all such Shares, provided the proposed dissolution or liquidation takes place at the time and in the manner contemplated. To the extent it has not been previously exercised, an Award will terminate immediately prior to the consummation of such proposed action.

(c) *Merger or Asset Sale.* In the event of a merger of the Company with or into another corporation, or the sale of substantially all of the assets of the Company, each outstanding Award shall be assumed or an equivalent option or right substituted by the successor corporation or a Parent or Subsidiary of the successor corporation. In the event that the successor corporation refuses to assume or substitute for the Award, the Participant will fully vest in and have the right to exercise all of his or her outstanding Options and Stock Appreciation Rights, including Shares as to which such Awards would not otherwise be vested or exercisable, all restrictions on Restricted Stock will lapse, and, with respect to Restricted Stock Units, all Performance Goals or other vesting criteria will be deemed achieved at target levels and all other terms and conditions met. In addition, if an Option or Stock Appreciation Right becomes fully vested and exercisable in lieu of assumption or substitution in the event of a merger or sale of assets, the Administrator will notify the Participant in writing or electronically that the Option or Stock Appreciation Right will be fully vested and exercisable for a period of 15 days from the date of such notice, and the Option or Stock Appreciation Right will terminate upon the expiration of such period.

For the purposes of this paragraph, the Award shall be considered assumed if, following the merger or sale of assets, the Award confers the right to purchase or receive, for each Share subject to the Award immediately prior to the merger or sale of assets, the consideration (whether stock, cash, or other securities or property) or, in the case of a Stock Appreciation Right upon the exercise of which the Administrator determines to pay cash or a Restricted Stock Unit which the Administrator can determine to pay in cash, the fair market value of the consideration received in the merger or sale of assets by holders of Common Stock for each Share held on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the merger or sale of assets is not solely common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of an Option or Stock Appreciation Right or upon the payout of a Restricted Stock Unit, for each Share subject to such Award (or in the case of Restricted Stock Units, the number of implied shares determined by dividing the value of the Restricted Stock Units by the per Share consideration received by holders of Common Stock in the merger or sale of assets), to be solely common stock of the successor corporation or its Parent equal in fair market value to the per Share consideration received by holders of Common Stock in the merger or sale of assets.

Notwithstanding anything in this Section 14(c) to the contrary, an Award that vests, is earned or paid-out upon the satisfaction of one or more Performance Goals will not be considered assumed if the Company or its successor

modifies any of such Performance Goals without the Participant's consent; provided, however, a modification to such Performance Goals only to reflect the successor corporation's corporate structure post-merger or post-sale of assets will not be deemed to invalidate an otherwise valid Award assumption.

15. *No Effect on Employment or Service.* Neither the Plan nor any Award will confer upon a Participant any right with respect to continuing the Participant's relationship as a Service Provider with the Company, nor will they

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interfere in any way with the Participant's right or the Company's right to terminate such relationship at any time, with or without cause, to the extent permitted by Applicable Laws.

16. *Date of Grant.* The date of grant of an Award shall be, for all purposes, the date on which the Administrator makes the determination granting such Award, or such other later date as is determined by the Administrator. Notice of the determination shall be provided to each Participant within a reasonable time after the date of such grant.

17. *Amendment and Termination of the Plan.*

(a) *Amendment and Termination.* The Board may at any time amend, alter, suspend or terminate the Plan.

(b) *Stockholder Approval.* The Company shall obtain stockholder approval of any Plan amendment to the extent necessary and desirable to comply with Applicable Laws.

(c) *Effect of Amendment or Termination.* No amendment, alteration, suspension or termination of the Plan shall impair the rights of any Participant, unless mutually agreed otherwise between the Participant and the Administrator, which agreement must be in writing and signed by the Participant and the Company. Termination of the Plan shall not affect the Administrator's ability to exercise the powers granted to it hereunder with respect to Awards granted under the Plan prior to the date of such termination.

18. *Conditions Upon Issuance of Shares.*

(a) *Legal Compliance.* Shares shall not be issued pursuant to the exercise of an Award unless the exercise of such Award and the issuance and delivery of such Shares shall comply with Applicable Laws and shall be further subject to the approval of counsel for the Company with respect to such compliance.

(b) *Investment Representations.* As a condition to the exercise of an Award, the Company may require the person exercising such Award to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required.

19. *Inability to Obtain Authority.* The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

20. *Stockholder Approval.* The Plan shall be subject to approval by the stockholders of the Company within twelve (12) months after the date the Plan is adopted. Such stockholder approval shall be obtained in the manner and to the degree required under Applicable Laws.

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DETACH PROXY CARD HERE

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

**FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON
MARCH 22, 2007**

The undersigned stockholder of Nuance Communications, Inc., a Delaware corporation (the Company), hereby acknowledges receipt of the Notice of Annual Meeting of Stockholders and accompanying Proxy Statement, each dated February 1, 2007, and hereby appoints Paul A. Ricci and James R. Arnold, Jr., or one of them, proxies and attorneys-in-fact, each with full power of substitution, to represent the undersigned at the Annual Meeting of Stockholders of Nuance Communications, Inc. to be held on March 22, 2007 at 9:00 a.m., local time, at Company's corporate headquarters, 1 Wayside Road, Burlington, Massachusetts, 01803 and at any adjournment thereof, and to vote all shares of Common Stock of the Company held of record by the undersigned on January 22, 2007 as hereinafter specified upon the proposals listed, and with discretionary authority upon such other matters as may properly come before the meeting.

**IN ORDER TO ASSURE YOUR REPRESENTATION AT THE ANNUAL MEETING OF
STOCKHOLDERS, PLEASE MARK, SIGN, DATE AND RETURN THIS PROXY CARD PROMPTLY IN
THE ENCLOSED ENVELOPE.**

**THIS PROXY WHEN PROPERLY EXECUTED WILL BE VOTED IN THE MANNER DIRECTED
HEREIN. IF NO SPECIFICATION IS MADE, THIS PROXY WILL BE VOTED FOR THE PROPOSALS
LISTED AND AS SAID PROXIES DEEM ADVISABLE ON SUCH OTHER MATTERS AS MAY
PROPERLY COME BEFORE THE MEETING OR MAY OTHERWISE BE ALLOWED TO BE
CONSIDERED AT THE MEETING. THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A
VOTE FOR THE PROPOSALS.**

PLEASE SIGN AND DATE ON REVERSE SIDE

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DETACH PROXY CARD

1. ELECTION OF DIRECTORS **FOR** all nominees listed below (except as indicated) **WITHHOLD AUTHORITY** to vote for all nominees listed below **EXCEPTIONS** Director

Nominees: Charles W. Berger, Robert J. Frankenberg, Jeffrey A. Harris, William H. Janeway, Katharine A. Martin, Mark B. Myers, Philip J. Quigley, Paul A. Ricci, Robert G. Teresi

(INSTRUCTIONS: To withhold authority to vote for any individual nominee, mark the Exceptions box and write that nominee's name on the space below.)

EXCEPTIONS:

- | | |
|--|--|
| <p><input type="radio"/> FOR <input type="radio"/> AGAINST <input type="radio"/> ABSTAIN</p> <p><input type="radio"/> FOR <input type="radio"/> AGAINST <input type="radio"/> ABSTAIN</p> <p><input type="radio"/> FOR <input type="radio"/> AGAINST <input type="radio"/> ABSTAIN</p> <p><input type="radio"/> MARK HERE FOR ADDRESS CHANGE AND NOTE BELOW</p> | <p>2. To approve the amended and restated 2000 Stock Plan.</p> <p>3. To approve the amendment to the Company's Amended and Restated Certificate of Incorporation.</p> <p>4. To ratify the appointment of BDO Seidman, LLP as the Company's independent registered public accounting firm for the fiscal year ending September 30, 2007.</p> <p>I (WE) WILL <input type="radio"/> WILL NOT <input type="radio"/> ATTEND THE MEETING IN PERSON.</p> <p>Please sign exactly as your name appears hereon. When shares are registered in the names of two or more persons, whether as joint tenants, as community property or otherwise, both or all of such persons should sign. When signing as attorney, executor, administrator, trustee, guardian or another fiduciary capacity, please give full title as such. If a corporation, please sign in full corporate name by President or other authorized person. If a partnership, please sign in partnership name by authorized person.</p> <p>Date: ____</p> |
|--|--|

Signature:

Date: ____

Signature:

**Please Detach Here
You Must Detach This Portion of the Proxy Card**

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Before Returning it in the Enclosed Envelope

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