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

Form 10-K

(Mark One)

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2007

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

000-31311
(Commission file number)

PDF SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**25-1701361**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
333 West San Carlos Street, Suite 700 San Jose, California	**95110**
(Address of Registrant's principal executive offices)	*(Zip Code)*

(408) 280-7900
(Registrant's telephone number, including area code)

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

Title of Class	**Name of Each Exchange on Which Registered**
Common Stock, $0.00015 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
None

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 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 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 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 in 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 ☐

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately $148,548,482 as of the last business day of the Registrant's most recently completed second quarter, based upon the closing sale price on the Nasdaq National Market reported for such date. Shares of Common Stock held by each officer and director and by each person who owns 10% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

There were 29,132,999 and 27,746,891 shares of the Registrant's Common Stock issued and outstanding, respectively, as of March 7, 2008.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates information by reference from the definitive Proxy Statement for our Annual Meeting of Stockholders to be held on May 22, 2008.

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PART I

This Annual Report on Form 10-K, particularly in Item 1 "Business" and Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations," includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements include, but are not limited to, statements concerning: expectations about the effectiveness of our business and technology strategies; expectations regarding previous and future acquisitions; current semiconductor industry trends; expectations of the success and market acceptance of our intellectual property and our solutions; expectations concerning recent completed acquisitions; expectations that our cash, cash equivalents and cash generated from operations will satisfy our business requirements for the next 12 months; and expectations of our future liquidity requirements. Our actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, risks and uncertainties discussed in this Form 10-K, especially those contained in Item 1A of this Form 10-K. The words "may," "will," "anticipate," "continue," "could," "projected," "expects," "believes," "intends," and "assumes," the negative of these terms and similar expressions are used to identify forward-looking statements. All forward-looking statements and information included herein is given as of the filing date of this Form 10-K with the Securities and Exchange Commission ("SEC") and based on information available to us at the time of this report and future events or circumstances could differ significantly from these forward-looking statements. Unless required by law, we undertake no obligation to update publicly any such forward-looking statements.

The following information should be read in conjunction with the Consolidated Financial Statements and notes thereto included in this Annual Report on Form 10-K. All references to fiscal year apply to our fiscal year which ends on December 31.

Item 1. ***Business***

Business Overview

We incorporated in 1992 and are a leading provider of infrastructure technologies and services to improve yield and optimize performance of integrated circuits. Our technologies and services enable semiconductor companies to improve profitability across the entire "process lifecycle," which is the term we have coined for the time from the design of an integrated circuit ("IC") through volume manufacturing of that IC. Our solutions enable this by improving our customer's time-to-market, increasing yield, and reducing total design and manufacturing costs. Our solutions combine proprietary software, physical intellectual property in the form of cell libraries for IC designs, test chips, an electrical wafer test system, proven methodologies, and professional services. We analyze yield loss mechanisms to identify, quantify, and correct the issues that cause yield loss. Our analysis drives IC design and manufacturing improvements to enable our customers to optimize the technology development process, to increase the initial yield when an IC design first enters a manufacturing line, to increase the rate at which yield improves, and to minimize excursions and process variability that cause yield loss throughout mass production. The result of successfully implementing our solutions is the creation of value that can be measured based on improvements to our customers' actual yield. Through our gainshare performance incentives component, we have aligned our financial interests with the yield and performance improvements realized by our customers, and we receive revenue based on this value. Our technologies and services have been sold to leading integrated device manufacturers, fabless semiconductor companies, and foundries.

The key benefits of our solutions to our customers are:

Faster Time to Market. Our solutions are designed to accelerate our customers' time-to-market and increase product profitability. Our solutions, which can predict and improve product yield even before IC product design is complete, transform the traditional design-to-silicon sequence into a primarily concurrent process, thereby shortening our customers' time-to-market. Systematically incorporating knowledge of the integration of the design and manufacturing processes into our software modules and physical intellectual property ("IP") enables our customers to introduce products with higher initial yields faster. Our solutions are designed to decrease design and process iterations and reduce our customers' up-front costs, and thus provide our customers with early-mover advantages such as increased market share and higher selling prices.

Faster Time to Volume. After achieving higher initial yields and faster time-to-market, our solutions are designed to enable our customers to isolate and eliminate remaining yield issues to achieve cost efficient volume manufacturing. Once a manufacturing process has been modeled using our solutions, our customers are able to diagnose problems and simulate potential corrections more quickly than using traditional methods. In addition, if process changes are required, improvements can be verified more quickly using our technology than using traditional methods. Our solutions thus enable our customers to quickly reach cost efficient volume, so that they are able to increase margins, improve their competitive position, and capture higher market share.

Increased Manufacturing Efficiencies. Our solutions for product design, product introduction, yield ramp, and process control are designed to allow our customers to achieve a higher yield at mass production and therefore a lower cost of goods sold. In addition, our solutions, which now also include fault detection and classification ("FDC") software, are designed to provide our customers with the ability to proactively monitor process health to avoid potential yield problems.

Our long-term business objective is to maximize IC yield by providing the industry standard in technologies and services for the Process Lifecycle. To achieve this objective, we intend to:

Extend Our Technology Leadership Position. We intend to extend our technology leadership position by leveraging our experienced engineering staff and codifying the knowledge that we acquire in our solution implementations. For example, we continue to expand and develop new technology that leverages our Characterization Vehicle® (CV®) methodology to embed test structures on product wafers; this provides valuable insight regarding product yield loss during mass production with minimal or no increase in test time and non-product wafers. In addition, we selectively acquire complementary businesses and technologies to increase the scope of our solutions. For example, in May 2007, we completed the acquisition of Fabbrix, Inc. ("Fabbrix"), a company with technology for creating physical IP building blocks for logic designers. This acquisition allows us to expand our Design-for-Manufacturability ("DFM") offerings by leveraging our proprietary characterization of our customers' processes and providing them with process-optimized physical IP libraries.

Leverage Our Gainshare Performance Incentives Business Model. We intend to continue expanding the gainshare performance incentives component of our customer contracts. We believe this approach allows us to form collaborative and longer-term relationships with our customers by aligning our financial success with that of our customers. Working closely with our customers on their core technologies that implement our solutions, with a common focus on their business results, provides direct and real-time feedback, through which we will continue to use to generate market-driven improvements that add even more value to our solutions and to our customers. Those customers that choose to adopt the gainshare performance incentives model succeed in improving their yield and performance while reducing costs. We believe that we will generate expanded relationships with these customers and new customer accounts based on these successes.

Focus on Key IC Product Segments. We intend to focus our solutions on high-volume, high-growth IC product segments such as system-on-a-chip, memory, CMOS image sensor, and high-performance central processing units. As a result, we will continue to expand our solutions for technology drivers such as high-k dielectrics, SOI, copper, and 300mm wafer fabs, which are all somewhat new and relatively complex manufacturing technologies. We believe that these product segments are particularly attractive because they include complex IC design and manufacturing processes where processed silicon is costly and yield is critical.

Expand Strategic Relationships. We intend to continue to extend and enhance our relationships with companies at various stages of the design-to-silicon process, such as manufacturing and test equipment vendors, electronic design automation vendors, silicon intellectual property providers, semiconductor foundries, and contract test and assembly houses. We believe that our integrated solution provides significant value because it is a comprehensive solution and thus, we will continue to pursue strategic relationships that expand the benefits of our CV® infrastructure, our Integrated Yield Ramp, and our DFM and process control solutions. We expect these relationships to also serve as sales channels and to increase industry awareness of our solutions.

Industry Background

Rapid technological innovation, with increasingly shorter product life cycles, now fuels the economic growth of the semiconductor industry. Previously, companies could afford to take months, or years in some cases, to integrate new IC designs with manufacturing processes. With longer product life cycles, IC companies historically ramped production slowly, produced at high volume once products gained market acceptance, and slowly reduced production volume when price and demand started to decrease near the end of the products' life cycles. Now, companies often need to be the first to market and the first to sell the most volume when a product is first introduced so that they have performance and pricing advantages over their competition, or else they lose market opportunity and revenue.

Increased IC complexity and compressed product lifecycles create significant challenges to achieve competitive initial yields and optimized performance. For example, it is not uncommon for an initial manufacturing run to yield only 20%, which means that 80% of the ICs produced are wasted. Yield improvement and performance optimization are critical drivers of IC companies' financial results because they typically lead to cost reduction and revenue generation concurrently, causing a leveraged effect on profitability.

Historically, yield loss resulted primarily from random contamination in the IC manufacturing process, for example from particles falling on the wafer during the manufacturing process. As the semiconductor industry has moved to 90-nanometer process technology and beyond, the primary drivers of yield loss with nanometer-era ICs has shifted from contamination to:

- systematic yield loss, or non-functioning ICs resulting from lack of compatibility between design and manufacturing processes; and
- performance yield loss, or functioning ICs that do not meet customer speed requirements.

Semiconductor manufacturers have traditionally addressed systematic yield loss and performance yield loss reactively and almost exclusively by implementing inefficient time consuming processes such as trial-and-error adjustments to the manufacturing process during volume production.

Disaggregation of the semiconductor industry has further complicated IC companies' ability to minimize systematic yield loss and performance yield loss. Historically, leading semiconductor companies designed, manufactured, and tested their ICs internally, thus retaining process-design integration knowledge. Today, the industry is more fragmented, comprised of separate organizations, as well as separate companies, that specialize in a particular phase of the IC design and manufacturing process. This has fragmented the knowledge related to the integration of IC design and manufacturing and resulted in great difficulty in making designs compatible with a manufacturing process prior to volume production.

Technology and Intellectual Property Protection

We have developed proprietary technologies for yield simulation, analysis, loss detection, and improvement. The foundation for many of our solutions is our CV infrastructure ("CV*i*") that enables our customers to characterize the manufacturing process, and establish fail-rate information needed to calibrate manufacturing yield models, prioritize yield improvement activities and speed-up process learning-cycles. Our CV*i* includes proprietary Characterization Vehicle® test chips, including designs of experiments and layout designs, and a proprietary and patented highly parallel electrical functional-test system, comprised of hardware and software designed to provide an order-of-magnitude reduction in the time required to test our Characterization Vehicle® test chips. In addition our technology embodies many algorithms, which we have developed over the course of many years, and which are implemented in our products including *data*POWER®, pdCV™, mæstria®, and pdBRIX™, among others. Further, our IP includes methodologies that our implementation teams use as guidelines to drive our customers' use of our CV® test chips and technologies, quantify the yield-loss associated with each process module and design block, simulate the impact of changes to the design and/or to the manufacturing process, and analyze the outcome of executing such changes. We continually enhance our core technologies through the codification of knowledge that we gain in our solution implementations.

Our future success and competitive position rely to some extent upon our ability to protect these proprietary technologies and IP and to prevent competitors from using our systems, methods, and technologies in their products. To accomplish this, we rely primarily on a combination of contractual provisions, confidentiality procedures, trade secrets, and patent, copyright, and trademark laws. We license our products and technologies pursuant to non-exclusive license agreements that impose restrictions on customers' use. In addition, we seek to avoid disclosure of our trade secrets, including requiring employees, customers, and others with access to our proprietary information to execute confidentiality agreements with us and restricting access to our source code. We also seek to protect our software, documentation, and other written materials under trade secret and copyright laws. As of December 31, 2007, we held 34 patents worldwide, including 26 U.S. patents, and we had 67 additional patent applications currently pending worldwide, including 39 pending in the United States. We intend to prepare additional patent applications for submission to the United States Patent and Trademark Office and various foreign patent offices. In the future, we may seek additional patent protection when we feel it is necessary. Characterization Vehicle®, Circuit Surfer®, CV®, *dataPOWER*®, mæstria®, Optissimo®, pdFasTest®, pDfx®, PDF Solutions®, Proxecco®, the PDF Solutions logo, Yield Ramp Simulator®, and YRS® are our registered trademarks, and Design-to-Silicon-Yield™, *dP*-bitMAP™, *dP*-Defect™, *dP*-Mining™, *dP*-probeMAP™, *dP*-shotMAP™, *dP*-SSA™, *dP*-VUE™, pdBRIX™, and pdCV™ are our unregistered trademarks.

Products and Services

Our solutions consist of integration engineering services, proprietary software, and other technologies designed to address our customers' specific manufacturing or design issues.

Services and Solutions

Manufacturing Process Solutions. The IC manufacturing process typically involves four sequential phases: research and development to establish unit manufacturing processes, such as units for the metal CMP or lithography processes; integration of these unit processes into functional modules, such as metal or contact modules; a yield ramp of lead products through the entire manufacturing line; and volume manufacturing of all products through the life of the process. We offer solutions targeted to each of these phases designed to accelerate the efficiency of yield learning by shortening the learning cycle, learning more per cycle, and reducing the number of silicon wafers required. Our targeted offerings include:

- *Process R&D:* Our process R&D solutions are designed to help customers increase the robustness of their manufacturing processes by characterizing and reducing the variability of unit processes and device performance with respect to layout characteristics within anticipated process design rules.
- *Process Integration and Yield Ramp:* Our process integration and yield ramp solutions are designed to enable our customers to more quickly ramp the yield of new products early in the manufacturing process by characterizing the process-design interactions within each key process module, simulating product yield loss by process module, and prioritizing quantitative yield improvement by design blocks in real products.

Volume Manufacturing Solutions. Our volume manufacturing solutions are designed to enable our customers to extend our yield ramp services through the life of the process by continuing to collect test data and equipment signals during production and improving yield while reducing the overhead of manufacturing separate test wafers. Optional software modules allow customers to perform rapid yield signature detection, characterization and diagnosis at all levels of map analysis from memory bits to wafers to final packaged parts with die identification traceability. Our process control software offering enables our customers to monitor and control process signals to detect and diagnose yield loss related to equipment performance.

Design-for-Manufacturability Solutions. Our DFM solutions are designed to enable our customers to optimize yields within the design cycle before a design is sent to the mask shop to more quickly and cost-effectively manufacture IC products. We target these solutions to customers' requirements by providing the following:

- *Logic DFM Solutions:* Logic DFM solutions include software, intellectual property, and services designed to make yield improvements by trading off density or performance, for example, in the logic portions of an

IC design. Our software helps designers optimize the yield of the logic portion by using process specific yield models, and technology files that include yield enhanced extensions to intellectual property design building block elements.

- *Circuit Level DFM Solutions:* Circuit level DFM solutions include software and services designed to anticipate the effects of process variability during analog/mixed signal/RF circuit design to optimize the manufacturability of each block given a pre-characterized manufacturing process.
- *Memory DFM Solutions:* Memory DFM solutions include software and services designed to optimize the memory redundancy and bit cell usage given a pre-characterized manufacturing process.
- *pdBRIX™ Physical IP Solutions:* pdBRIX™ physical IP solutions include software, IP and services for identifying and developing a set of large, regularly patterned physical IP building blocks that are tailored to a given manufacturing process and target product application. This solution includes mapping software for inserting these physical IP building blocks into a design flow.

Products

Our solutions incorporate the use of various elements of our software and other technologies depending on the customers' needs. Our software and other technologies include the following:

Characterization Vehicle® Infrastructure. Our test chip design engineers develop a design of experiments ("DOEs") to determine how IC design building blocks interact with the manufacturing process. Our CV software utilizes the DOE, as well as a library of building blocks that we know has potential yield and performance impact, to generate CV test chip layouts. Our CV *infrastructure* includes:

- *CV® Test Chips.* Our family of proprietary test chip products are run through the manufacturing process with intentional process modifications to explore the effects of potential process improvements given natural manufacturing variations. Our custom-designed CV test chips are optimized for our test hardware and analysis software and include DOEs tuned to each customer's process. Our full-reticle short-flow CV test chips provide a fast learning cycle for specific process modules and are fully integrated with third-party failure analysis and inspection tools for complete diagnosis to root cause. Our Scribe CV® products are inserted directly on customers' product wafers and collect data from product wafers about critical layers.
- *pdCV™ Analysis Software.* Our proprietary software accumulates data from our CV test chips, enabling models of the performance effects of process variations on these design building blocks to be generated for use with our Yield Ramp Simulator software.
- *pdFasTest® Electrical Wafer Test System.* Our proprietary system enables fast defect characterization of manufacturing processes. This automated system provides parallel functional testing, thus minimizing the time required to perform millions of electrical measurements to test our CV test chips.

Yield Ramp Simulator® (YRS®) Software. Our YRS software analyzes an IC design to compute its systematic and random yield loss. YRS software allows design attribute extraction and feature-based yield modeling. YRS software takes as input a layout that is typically in industry standard format and proprietary yield models generated by running our CV test chips. YRS software is designed to estimate the yield loss due to optical proximity effects, etch micro-loading, dishing in CMP, and other basic process issues.

Circuit Surfer® Software. Our Circuit Surfer software estimates the parametric performance yield and manufacturability of analog/mixed-signal/RF blocks in a design, such as RF transmission, PLLs/DLLs and logic critical paths. Using our Circuit Surfer software, a design engineer is able to estimate how manufacturing process variations will impact circuit performance and yield and then optimizes the circuit to reduce or eliminate the impact of those variations.

pDfx® Environment. Our pDfx environment, which is only offered to customers in a service format, improves the manufacturability of ICs by providing process-aware DFM. The environment incorporates our pDfx yield models with software tools previously incorporated into and subsequently distributed by commercial Electronic Design Automation ("EDA") tool providers to the IC Design community. These tools are either developed by PDF

or frequently in partnership with commercial EDA vendors. Incorporating our pDfx modeling capability into the design flow allows designers to optimize yield, performance, power, and area trade-offs within the design flow before the IC is released to manufacturing. In this manner, customers can further optimize designs for yield within their specific guidelines.

pdBRIX™ Platform. Our pdBRIX platform includes software for identifying and developing a set of physical IP building blocks that are tailored to a given manufacturing process and target product application. This platform also includes mapper software for inserting these physical IP building blocks into a traditional design flow.

dataPOWER® YMS Platform. Our *data*POWER YMS platform collects yield data, stores it in databases, and allows product engineers to identify and analyze production yield issues using proprietary yield analysis software tools. *data*POWER software contains powerful visualization and reporting tools that are flexible to address customers' requirements. Our YMS platform is designed to handle very large data sets, to efficiently improve productivity, yield and time-to-market at our customers' sites. Optional modules extend the base platform to enable defect analysis (*dP*-Defect™), memory analysis (*dP*-bitMAP™), spatial signature analysis (*dP*-SSA™), data-mining (*dP*-Mining™), optimization of die on the wafer (*dP*-shotMAP™), and probe-head optimization (*dP*-probeMAP™), and web-based access (*dP*-VUE™).

Mæstria® FDC Software. Our mæstria product provides fault detection and classification capabilities to rapidly identify sources of process variations and manufacturing excursions by monitoring equipment parameters through proprietary data collection and analysis features.

With the exception of *data*POWER, mæstria and pdBRIX, the primary distribution method for our software and technologies is through our manufacturing process solutions ("MPS") although, we have in the past and may in the future separately license these and other technologies. Though *data*POWER, mæstria and pdBRIX are primarily licensed separately, they may also be distributed within our Design-to-Silicon-Yield solutions.

Customers

Our current customers are primarily integrated device manufacturers ("IDM"), but also include fabless semiconductor design companies and foundries. Our customers' targeted product segments vary significantly, including microprocessors, memory, graphics, image sensor solutions, and communications. We believe that the adoption of our solutions by such companies for usage in a wide range of products validates the application of our Design-to-Silicon-Yield solutions to the broader semiconductor market.

Toshiba Corporation and International Business Machines Corporation represented 19% and 16%, respectively, of our total revenue for the year ended December 31, 2007. International Business Machines Corporation and Toshiba Corporation represented 25% and 12% respectively, of our total revenue for the year ended December 31, 2006. Texas Instruments, International Business Machines Corporation, Matsushita Electric Industrial Co., and Toshiba Corporation represented 15%, 13%, 11%, and 10%, respectively, of our total revenue for the year ended December 31, 2005. No other customer accounted for 10% or more of our revenue in years 2007, 2006, and 2005.

Sales and Marketing

Our sales strategy is to pursue targeted accounts through a combination of our direct sales force and strategic alliances. For sales in the United States, we rely on our direct sales team, which primarily operates out of our San Jose, California headquarters. In Japan, we use our direct sales team and, for FDC offerings, we use a local distributor, Yamatake Corporation. In Taiwan, we use J.I.T. International Co., Ltd. as a sales representative and in Korea we use a combination of direct sales and local sales representatives and distributors. We expect to continue to establish strategic alliances with vendors in the electronic design automation software, capital equipment for IC production, silicon intellectual property and mask-making software segments to create and take advantage of co-marketing opportunities. We believe that these relationships will also serve as sales channels for our Design-to-Silicon-Yield solutions and to increase industry awareness of our solutions.

In the year ended December 31, 2007, we derived 55% of total revenue from customers based in Asia compared to 50% and 55%, respectively, in the years ended December 31, 2006 and December 31, 2005. In the year ended December 31, 2007, 31% of our total revenue was derived from customers located in the United States as

compared to 39% and 35%, respectively, in the years ended December 31, 2006 and December 31, 2005. Additional discussion regarding the risks associated with international operations can be found under Item 1A, "Risk Factors".

See our "Notes to Consolidated Financial Statements", included under Part II, Item 8. "Financial Statements and Supplementary Data" for additional geographic information.

After we are engaged by a customer and early in the solution implementation, our engineers seek to establish relationships in the organization and gain an understanding of our customers' business issues. Our direct sales and solution implementation teams combine their efforts to deepen our customer relationships by expanding our penetration across the customer's products, processes and technologies. This close working relationship with the customer has the added benefit of helping us identify new product areas and technologies in which we should next focus our research and development efforts.

Research and Development

Our research and development focuses on developing and introducing new proprietary technologies, software products and enhancements to our existing solutions. We use a rapid-prototyping paradigm in the context of the customer engagement to achieve these goals.

We have made, and expect to continue to make, substantial investments in research and development. The complexity of our Design-to-Silicon-Yield technologies requires expertise in physical IC design and layout, transistor design and semiconductor physics, semiconductor process integration, numerical algorithms, statistics and software development. We believe that our team of engineers will continue to advance our market and technological leadership. We conduct in-house training for our engineers in the technical areas, as well as focusing on ways to enhance client service skills. At any given time, about one quarter of our research and development engineers are operating in the field, partnered with solution implementation engineers in a deliberate strategy to provide direct feedback between technology development and customer needs. Our research and development expenses were $36.1 million, $27.6 million, and $22.2 million in 2007, 2006, and 2005, respectively.

Competition

The semiconductor industry is highly competitive and driven by rapidly changing design and process technologies, evolving standards, short product life cycles, and decreasing prices. While the market for process-design integration technologies and services is in its early stages, it is quickly evolving and we expect market competition to continue to develop and increase. We believe the solution to address IC companies' needs requires a unified system of yield models, design analysis software, CV test chips, physical IP creation, process control software, and yield management software. Currently, we are the only provider of comprehensive commercial solutions for integrating design and manufacturing processes. We face indirect competition from internal groups at IC companies that use an incomplete set of components not optimized to accelerate process-design integration. Some providers of yield management software, inspection equipment, electronic design automation, or design IP may seek to broaden their product offerings and compete with us.

We face competition for some of the point applications of our solutions including some of those used by the internal groups at IC companies. Specifically there are several suppliers of yield management and/or prediction systems, such as KLA-Tencor, MKS Instruments, Inc. ("MKS") (through its acquisition of Yield Dynamics, Inc.), Ponte Solutions, Syntricity Inc., Synopsys, Inc. ("Synopsys"), and TIBCO Software Inc. (through its acquisition of Spotfire, Inc.), and process control software, such as Applied Materials, Inc. (through its acquisition of the software division of Brooks Automation, Inc.), Triant Holdings Inc., Straatum Processware Ltd., and MKS. ARM Ltd. and Virage Logic Corporation provide standard cells in the physical IP space, which could compete with our pdBRIX solution. In addition, Synopsys now appears to offer directly competing DFM, while other EDA suppliers provide alternative DFM solutions that may compete for the same budgetary funds.

We believe the principal factors affecting competition in our market include demonstrated results and reputation, strength of core technology, ability to create innovative technology, and ability to implement solutions for new technology and product generations. We believe that our solutions compete favorably with respect to these factors.

Employees

As of December 31, 2007, we had 382 employees, including 144 on client service teams, 147 in research and development, 33 in sales and marketing and 58 in general and administrative functions. 180 of these employees are located in San Jose/San Diego, California, 69 are located in France, 39 are located in China, 30 are located in Texas and other parts of the United States, 26 are located in Japan, 18 are located in Italy, 17 are located in Germany, 2 are located in Korea, and 1 employee is located in the Netherlands.

None of our employees is represented by a labor union or is subject to a collective bargaining agreement. We believe our relationship with our employees is good.

Executive Officers

The following table and notes set forth information about our current executive officers.

Name	Age	Position
John K. Kibarian, Ph.D.	43	Chief Executive Officer, President and Director
Keith A. Jones	37	Chief Financial Officer and Vice President, Finance
David A. Joseph	54	Chief Strategy Officer
Rebecca Baybrook, Ph.D.	56	Vice President, Human Resources
Cees Hartgring, Ph.D.	54	Vice President, Client Services and Sales
Andre Hawit	46	Vice President and General Manager, Yield Manufacturing Solutions
James Jensen	55	Vice President, Business Development
P. Steven Melman	53	Vice President, Investor Relations and Strategic Initiatives
Kimon Michaels, Ph.D.	41	Vice President, Design for Manufacturability

John K. Kibarian, Ph.D., one of our founders, has served as President since November 1991 and has served as our Chief Executive Officer since July 2000. Mr. Kibarian has served as a director since December 1992. Mr. Kibarian received a B.S. in Electrical Engineering, an M.S. E.C.E. and a Ph.D. E.C.E. from Carnegie Mellon University.

Keith A. Jones has served as Chief Financial Officer and Vice President, Finance since January 2006. Mr. Jones served as Director of Finance and SEC Compliance from July 2003 to December 2005. Prior to joining PDF, from September 2001 to July 2003, he served as Assistant Controller for Interwoven, Inc., a provider of enterprise content management solutions. From May 2000 to July 2001, he served as Controller for eTime Capital, Inc., a financial software applications company. From July 1994 to April 2000, he served in various positions at Deloitte & Touche LLP, most recently as an Audit Manager. Mr. Jones received a B.S. in Business Administration from California State University, Fresno and is a Certified Public Accountant.

David A. Joseph has served as Chief Strategy Officer since April 2003. Mr. Joseph served as Executive Vice President Sales, Marketing, and Business Development from August 2001 through March 2003, as Vice President, Products and Methods from July 1999 through August 2001 and as Vice President, Business Development from November 1998 through June 1999. Prior to joining PDF, from February 1978 to October 1998, Mr. Joseph served KLA-Tencor, a semiconductor manufacturing company, in various positions, including Japan Business Manager, Vice President Customer Satisfaction and General Manager of Yield Analysis Software. Mr. Joseph received a B.S. in Mathematical Science from Stanford University.

Rebecca Baybrook, Ph.D., has served as Vice President, Human Resources since May 2002. Prior to joining PDF, from September 2001 to April 2002, Ms. Baybrook served as Sr. Director, Human Resources for Vitria Technologies, an integrated software company. From October 1999 to July 2001 she served as Director, Human Resources for 3Com, a telecommunications company. From January 1986 to September 1999, Ms. Baybrook served as Assistant Vice President of Human Resources for Knight Ridder, Inc., a publishing company. Ms. Baybrook received a B.A. degree from Westmont College and a Ph.D. in Organizational Psychology from University of South Florida.

Cees Hartgring, Ph.D., has served as Vice President, Client Services and Sales since June 2007. Mr. Hartgring served as Vice President and General Manager, Manufacturing Process Solutions from January 2004 through May 2007, as Vice President, Worldwide Sales and Strategic Business Development from April 2003 through December 2003 and as Vice President of Sales from September 2002 through March 2003. Prior to joining PDF, from May 2000 to August 2001, Mr. Hartgring served as President and Chief Executive Officer of Trimedia Technologies, a Philips Semiconductor spinout. From August 1990 to April 2000, he held various executive positions at Philips Semiconductor, most recently as Vice President and General Manager of the Trimedia business unit. Mr. Hartgring has an undergraduate degree from the Technical University Delft and an M.S.E.E. and a Ph.D. in Electrical Engineering and Computer Science from the University of California at Berkeley.

Andre Hawit has served as Vice President and General Manager, Yield Manufacturing Solutions since January 2006. Mr. Hawit served as Vice President, Software Development from September 2003 through December 2005. Prior to joining PDF, Mr. Hawit was the founder of IDS Software Systems Inc. ("IDS"), a yield management systems software and solutions company. From October 1991 through August 2003, he held various positions within IDS including President and Chief Executive Officer, and most recently Chief Technology Officer. Mr. Hawit received a B.S. in Electronics and Computer Engineering from San Francisco State University and an M.B.A. from National University School of Business.

James Jensen has served as Vice President, Business Development since June 2007. Mr. Jensen served as Vice President, Engineering Services for Manufacturing Process Solutions from January 2006 through May 2007, as Co-Vice President, Client Services from November 2003 through December 2005 and as Director of Business Development, Integrated Yield Ramp Solutions, from March 2002 through October 2003. Prior to joining PDF, from July 1996 through February 2002, he served as General Manager of a semiconductor fabrication facility of Texas Instruments, a semiconductor products company. From November 1989 through June 1996, Mr. Jensen served as Fabrication Operations Director for Silicon Systems Inc., a semiconductor products company. Mr. Jensen received a B.S. in Physics from the University of Utah and an M.S. in Management from Purdue University.

P. Steven Melman has served as Vice President, Investor Relations and Strategic Initiatives since January 2006. Mr. Melman served as Chief Financial Officer and Vice President, Finance and Administration from July 1998 to December 2005. Prior to joining PDF, from April 1997 to June 1998, he served as Vice President, Finance and Administration with Animation Science Corporation, an animation company. From April 1995 to April 1997, he served as Vice President, Finance and Chief Financial Officer with Business Resource Group, a facilities management and commercial furnishings company. Mr. Melman received a B.S. in Business Administration from Boston University and is a Certified Public Accountant.

Kimon Michaels, Ph.D., one of our founders, has served as Vice President, Design for Manufacturability since June 2007. Mr. Michaels served as Vice President, Field Operations for Manufacturing Process Solutions from January 2006 through May 2007, and has been a Director since November 1995. From March 1993 through December 2005, he served in various vice presidential capacities. He also served as Chief Financial Officer from November 1995 to July 1998. Mr. Michaels received a B.S. in Electrical Engineering, an M.S. E.C.E. and a Ph.D. E.C.E. from Carnegie Mellon University.

Available Information

Our Internet website address is www.PDF.com. You may obtain, free of charge on our Internet website, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information we post is intended for reference purposes only; none of the information posted on our website is part of this report or incorporated by reference herein.

Item 1A. ***Risk Factors***

If semiconductor designers and manufacturers do not continue to adopt our Design-to-Silicon-Yield solutions, we may be unable to increase or maintain our revenue.

If semiconductor designers and manufacturers do not continue to adopt our Design-to-Silicon-Yield solutions, both as currently comprised and as we may offer them in the future, our revenue could decline. To be successful, we will need to continue to enter into agreements covering a larger number of IC products and processes with existing customers and new customers. We need to develop new customer relationships with companies that are integrated device manufacturers, fabless semiconductor companies, and foundries, as well as system manufacturers so that we can continue to implement our Design-to-Silicon-Yield solutions and experience greater market acceptance of our solutions. Factors that may limit adoption of our Design-to-Silicon-Yield solutions by semiconductor companies include:

- our customers' failure to achieve satisfactory yield improvements using our Design-to-Silicon-Yield solutions;
- a decrease in demand for semiconductors generally or the slowing of demand for deep submicron semiconductors;
- our inability to develop, market, or sell effective solutions that are outside of our traditional MPS logic focus;
- our existing and potential customers' delay in their adoption of the next process technology;
- the development in the industry of alternative methods to enhance the integration between the semiconductor design and manufacturing processes due to a rapidly evolving market and the emergence of new technologies;
- our existing and potential customers' reluctance to understand and accept our innovative gainshare performance incentives fee component; and
- our customers' concern about our ability to keep highly competitive information confidential.

We generate a large percentage of our total revenue from a limited number of customers, so the loss of any one of these customers could significantly reduce our revenue and results of operations below expectations.

Historically, we have had a small number of large customers for our core Design-to-Silicon-Yield solutions and we expect this to continue in the near term. In the year ended December 31, 2007, two customers accounted for 35% of our total net revenue, with Toshiba Corporation representing 19% and International Business Machines Corporation representing 16%. In the year ended December 31, 2006, two customers accounted for 37% of our total net revenue, with International Business Machines Corporation representing 25% and Toshiba Corporation representing 12%. We could lose a customer due to its decision not to engage us on future process nodes, its decision not to develop its own future process node, or as a result of industry consolidation. The loss of any of these customers or a decrease in the sales volumes of their products could significantly reduce our total revenue below expectations. In particular, such a loss could cause significant fluctuations in results of operations because our expenses are fixed in the short term and it takes us a long time to replace customers.

If integrated device manufacturers of logic integrated circuits reduce investment in new process technology as a result of a shift to a fabless manufacturing business model, the pool of potential logic customers for our yield ramp solutions will shrink and our results of operations may suffer.

Historically, the majority of our revenue from integrated yield ramps has been derived from IDM of logic IC. If IDMs decide to discontinue or significantly cut back their investment in the development of new process technology as a result of a shift to a model of outsourcing a larger proportion, or all, of the mass production of their ICs, there may be fewer IDMs that are potential customers for our solutions that integrate product designs with in-house manufacturing processes. As a result, the revenue we are able to generate from integrated yield ramps for logic ICs could fall below levels that are currently expected. Also, because our expenses are fixed in the short term and it takes

a long time for us to replace customers, such a reduction in revenue could cause significant fluctuations in results of operations.

If we do not effectively manage and support our operations and integrate recent and planned growth, our business strategy may fail.

We will need to continue to grow in all areas of operation and successfully integrate and support our existing and new employees into our operations, or we may be unable to implement our business strategy in the time frame we anticipate, if at all. We have in the past, and may in the future, experienced interruptions in our information systems on which our global operations depend. Further, physical damage to, failure of, or digital damage (such as significant viruses or worms) to, our information systems could disrupt and delay time-sensitive services or computing operations that we perform for our customers, which could negatively impact our business results and reputation. In addition, we will need to expand our intranet to support new data centers to enhance our research and development efforts. Our intranet is expensive to expand and must be highly secure due to the sensitive nature of our customers' information that we transmit. Building and managing the support necessary for our growth places significant demands on our management and resources. In addition, we may need to switch to a new accounting system in the near future, which could disrupt our business operations and distract management. These demands may divert these resources from the continued growth of our business and implementation of our business strategy. Further, we must adequately train our new personnel, especially our client service and technical support personnel, to effectively and accurately, respond to and support our customers. If we fail to do this, it could lead to dissatisfaction among our customers, which could slow our growth.

If we fail to protect our intellectual property rights, customers or potential competitors may be able to use our technologies to develop their own solutions which could weaken our competitive position, reduce our revenue, or increase our costs.

Our success depends largely on the proprietary nature of our technologies. We currently rely primarily on contractual, patent, copyright, trademark, and trade secret protection. Our pending patent applications may not result in issued patents, and even if issued, they may not be sufficiently broad to protect our proprietary technologies. Also, patent protection in foreign countries may be limited or unavailable where we need such protection. Litigation may be necessary from time to time to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. As a result of any such litigation, we could lose our proprietary rights and incur substantial unexpected operating costs. Litigation could also divert our resources, including our managerial and engineering resources.

Competition in the market for yield improvement solutions and increased integration between IC design and manufacturing may intensify in the future, which could impede our ability to grow or execute our strategy.

Competition in our market may intensify in the future, which could slow our ability to grow or execute our strategy and could lead to increased pricing pressure. Our current and potential customers may choose to develop their own solutions internally, particularly if we are slow in deploying our solutions. Many of these companies have the financial and technical capability to develop their own solutions. Also, competitors could establish non-domestic operations with a lower cost structure than our engineering organization, which, unless we also establish lower cost non-domestic operations, would give any such competitor's products a competitive advantage over our solutions. There may be other providers of commercial solutions for systematic IC yield and performance enhancement of which we are not aware. We currently face indirect competition from the internal groups at IC companies and some direct competition from providers of yield management or prediction software such as KLA-Tencor, MKS (through its acquisition of Yield Dynamics, Inc.), Ponte Solutions, Syntricity Inc., TIBCO Software Inc. (through its acquisition of Spotfire Inc.), and Synopsys, and process control software, such as Applied Materials, Inc., Triant Holdings Inc., Straatum Processware Ltd., and MKS. Further, ARM Ltd. and Virage Logic Corporation provide standard cells in the physical IP space, which could compete with our pdBRIX solution. Some providers of yield management software or inspection equipment may seek to broaden their product offerings and compete with us. For example, KLA-Tencor has announced adding the use of test structures to one of their

inspection product lines. In addition, we believe that the demand for solutions that address the need for better integration between the silicon design and manufacturing processes may encourage direct competitors to enter into our market. For example, large integrated organizations, such as IDMs, electronic design automation software providers, IC design service companies or semiconductor equipment vendors, may decide to spin-off a business unit that competes with us. Other potential competitors include fabrication facilities that may decide to offer solutions competitive with ours as part of their value proposition to their customers. In addition, Synopsys, Inc. now appears to offer directly competing DFM, while other EDA suppliers provide alternative DFM solutions that may compete for the same budgetary funds. If these potential competitors change the pricing environment or are able to attract industry partners or customers faster than we can, we may not be able to grow and execute our strategy as quickly or at all. In addition, customer preferences may shift away from our solutions as a result of the increase in competition.

We face operational and financial risks associated with international operations that could negatively impact our revenue.

We derive a majority of our revenue from international sales, principally from customers based in Asia. Revenue generated from customers in Asia accounted for 55% of total revenue in the year ended December 31, 2007 and 50% in the year ended December 31, 2006. We expect that a significant portion of our total future revenue will continue to be derived from companies based in Asia. In addition, we have expanded our non-U.S. operations recently and plan to continue such expansion by establishing overseas subsidiaries, offices, or contractor relationships in locations, and when, deemed appropriate by our management. The success of our business is subject to risks inherent in doing business internationally. These risks include:

- some of our key engineers and other personnel are foreign nationals and they may have difficulty gaining access to the United States and other countries in which our customers or our offices may be located and it may be difficult for us to recruit and retain qualified technical and managerial employees in foreign offices;
- greater difficulty in collecting account receivables resulting in longer collection periods;
- language and other cultural differences may inhibit our sales and marketing efforts and create internal communication problems among our U.S. and foreign research and development teams, increasing the difficulty of managing multiple, remote locations performing various development, quality assurance, and yield ramp analysis projects;
- compliance with, and unexpected changes in, a wide variety of foreign laws and regulatory environments with which we are not familiar, including, among other issues, with respect to protection of our intellectual property, and a wide variety of trade and export controls under domestic, foreign, and international law;
- currency risk due to the fact that expenses for our international offices are denominated in the local currency, including the Euro, while virtually all of our revenue is denominated in U.S. dollars;
- quarantine, private travel limitation, or business disruption in regions affecting our operations, stemming from actual, imminent or perceived outbreak of human pandemic or contagious disease;
- in the event a larger portion of our revenue becomes denominated in foreign currencies, we would be subject to a potentially significant exchange rate risk; and
- economic or political instability, including but not limited to armed conflict, terrorism, and the resulting disruption to economic activity and business operations.

In Japan, in particular, we face the following additional risks:

- a downturn in Asian economies which could limit our ability to retain existing customers and attract new ones in Asia; and
- if the U.S. dollar increases in value relative to the Japanese Yen, the cost of our solutions will be more expensive to existing and potential Japanese customers and therefore less competitive.

In the Middle East, we use a third-party service provider, whose operations are not located in a U.S. embargoed country, to provide certain software quality assurance and other services for certain of our software products. The

political uncertainty surrounding the region could disrupt our third-party service provider's operations and thus negatively affect the range of services we are able to provide.

Our earnings per share and other key operating results may be unusually high in a given quarter, thereby raising investors' expectations, and then unusually low in the next quarter, thereby disappointing investors, which could cause our stock price to drop.

Historically, our quarterly operating results have fluctuated. Our future quarterly operating results will likely fluctuate from time to time and may not meet the expectations of securities analysts and investors in some future period. The price of our common stock could decline due to such fluctuations. The following factors may cause significant fluctuations in our future quarterly operating results:

- the size and timing of sales volumes achieved by our customers' products;
- the loss of any of our large customers or an adverse change in any of our large customers' businesses;
- the size of improvements in our customers' yield and the timing of agreement as to those improvements;
- our long and variable sales cycle;
- changes in the mix of our revenue;
- changes in the level of our operating expenses needed to support our projected growth; and
- delays in completing solution implementations for our customers.

Revenue from our gainshare performance incentives is dependent on factors outside of our control, including the volume of integrated circuits that our customers are able to sell to their customers.

Our gainshare performance incentives fee component ties the profits of our customers to our own. Through this component, revenue for a particular product is largely determined by the volume of that product that our customer is able to sell to its customers, which is outside of our control. We have limited ability to predict the success or failure of our customers' IC products. Further, our customers may decide to implement changes to their manufacturing processes during the period that is covered by gainshare performance incentives component, which could negatively affect yield results; a decision which is beyond our control. In addition, we may commit a significant amount of time and resources to a customer who is ultimately unable to sell as many units as we had anticipated when contracting with them or who makes unplanned changes to their processes. Since we currently work on a small number of large projects, any product that does not achieve commercial viability or a significant increase in yield could significantly reduce our revenue and results of operations below expectations. In addition, if we work with two directly competitive products, volume in one may offset volume, and thus any of our related gainshare performance incentives, in the other product. Further, decreased demand for semiconductor products decreases the volume of products our customers are able to sell, which may adversely affect our gainshare performance incentives revenue.

Measurement of our gainshare performance incentives requires data collection and is subject to customer agreement, which can result in uncertainty and cause quarterly results to fluctuate.

We can only recognize revenue based on gainshare performance incentives once we have reached agreement with our customers on their level of yield performance improvements. Because measuring the amount of yield improvement is inherently complicated and dependent on our customers' internal information systems, there may be uncertainty as to some components of measurement. This could result in our recognition of less revenue than expected. In addition, any delay in measuring revenue attributable to our gainshare performance incentives could cause all of the associated revenue to be delayed until the next quarter. Since we currently have only a few large customers and we are relying on gainshare performance incentives as a significant component of our total revenue, any delay could significantly harm our quarterly results.

Changes in the structure of our customer contracts, including the mix between fixed and variable revenue and the mix of elements, can adversely affect the size and timing of our total revenue.

Our long-term success is largely dependent upon our ability to structure our future customer contracts to include a larger gainshare performance incentives component relative to the fixed fee component. We typically recognize the fixed fee component earlier than gainshare performance incentives component so if we are successful in increasing the gainshare performance incentives component of our customer contracts, we will experience an adverse impact on our operating results in the short term as we reduce the fixed fee component. Due to acquisitions and expanded business strategies, the mix of elements in some of our contracts has changed recently and the relative importance of the software component in some of our contracts has increased. We have experienced, and may in the future experience, delays in the expected recognition of revenue associated with generally accepted accounting principles regarding the timing of revenue recognition in multi-element software arrangements, including the effect of acceptance criteria as a result of the change in our contracts. If we fail to meet contractual acceptance criteria on time or at all, the total revenue we receive under a contract could be delayed or decline. In addition, by increasing the gainshare performance incentives or the software component, we may increase the variability or timing of recognition of our revenue, and therefore increase the risk that our total future revenue will be lower than expected and fluctuate significantly from period to period.

It typically takes us a long time to sell our unique solutions to new customers, which can result in uncertainty and delays in generating additional revenue.

Because our gainshare performance incentives business model is unique and our Design-to-Silicon-Yield solutions are unfamiliar to some new customers, our sales cycle is lengthy and requires a significant amount of our senior management's time and effort. Furthermore, we need to target those individuals within a customer's organization who have overall responsibility for the profitability of an IC. These individuals tend to be senior management or executive officers. We may face difficulty identifying and establishing contact with such individuals. Even after initial acceptance, due to the complexity of structuring the gainshare performance incentives component, the negotiation and documentation processes can be lengthy. It can take nine months or more to reach a signed contract with a customer. Unexpected delays in our sales cycle could cause our revenue to fall short of expectations.

We have a history of losses, we may incur losses in the future and we may be unable to maintain profitability.

We have experienced losses in the past and in the current fiscal year ended December 31, 2007. We may not achieve and thereafter maintain profitability if our revenue increases more slowly than we expect or not at all. In addition, virtually all of our operating expenses are fixed in the short term, so any shortfall in anticipated revenue in a given period could significantly reduce our operating results below expectations. Our accumulated deficit was $16.9 million as of December 31, 2007. We expect to continue to incur significant expenses in connection with:

- funding for research and development;
- expansion of our solution implementation teams;
- expansion of our sales and marketing efforts; and
- additional non-cash charges relating to amortization of intangibles and stock-based compensation.

As a result, we will need to significantly increase revenue to maintain profitability on a quarterly or annual basis. Any of these factors could cause our stock price to decline.

We may experience significant fluctuations in operating results due to the cyclical nature of the semiconductor industry.

Our revenue is highly dependent upon the overall condition of the semiconductor industry, especially in light of our gainshare performance incentives revenue component. The semiconductor industry is highly cyclical and subject to rapid technological change and has been subject to significant economic downturns at various times,

characterized by diminished product demand, accelerated erosion of average selling prices, and production overcapacity. The semiconductor industry also periodically experiences increased demand and production capacity constraints. As a result, we may experience significant fluctuations in operating results due to general semiconductor industry conditions and overall economic conditions.

We must continually attract and retain highly talented executives, engineers, and research and development personnel or we will be unable to expand our business as planned.

In order to stay competitive, we will need to continue to hire highly talented executives, engineers, and research and development personnel to support our planned growth. We have experienced, and we expect to continue to experience, delays and limitations in hiring and retaining highly skilled individuals with appropriate qualifications. We intend to continue to hire foreign nationals, particularly as we expand our operations internationally. We have had, and expect to continue to have, difficulty in obtaining visas permitting entry into the United States for several of our key personnel, which disrupts our ability to strategically locate our personnel. If we lose the services of any of our key executives or a significant number of our engineers, it could disrupt our ability to implement our business strategy. Competition for executives and qualified engineers can be intense, especially in Silicon Valley where we are principally based.

If our products, technologies, services, and integrated solutions fail to keep pace with the rapid technological changes in the semiconductor industry, we could lose customers and revenue.

We must continually devote significant engineering resources to enable us to keep up with the rapidly evolving technologies and equipment used in the semiconductor design and manufacturing processes. These innovations are inherently complex and require long development cycles. Not only do we need the technical expertise to implement the changes necessary to keep our technologies current, we also rely heavily on the judgment of our advisors and management to anticipate future market trends. Our customers expect us to stay ahead of the technology curve and expect that our products, technologies, services, and integrated solutions will support any new design or manufacturing processes or materials as soon as they are deployed. If we are not able to timely predict industry changes, or if we are unable to modify our products, technologies, services, and integrated solutions on a timely basis, our existing solutions will be rendered obsolete and we may lose customers. If we do not keep pace with technology, our existing and potential customers may choose to develop their own solutions internally as an alternative to ours and we could lose market share, which could adversely affect our operating results.

We intend to pursue additional strategic relationships, which are necessary to maximize our growth, but could substantially divert management attention and resources.

In order to establish and maintain strategic relationships with industry leaders at each stage of the IC design and manufacturing processes, we may need to expend significant resources and will need to commit a significant amount of management's time and attention, with no guarantee of success. If we are unable to enter into strategic relationships with these companies, we will not be as effective at modeling existing technologies or at keeping ahead of the technology curve as new technologies are introduced. In the past, the absence of an established working relationship with key companies in the industry has meant that we have had to exclude the effect of their component parts from our modeling analysis, which reduces the overall effectiveness of our analysis and limits our ability to improve yield. We may be unable to establish key industry strategic relationships if any of the following occur:

- potential industry partners become concerned about our ability to protect their intellectual property;
- potential industry partners develop their own solutions to address the need for yield improvement;
- our potential competitors establish relationships with industry partners with which we seek to establish a relationship; or
- potential industry partners attempt to restrict our ability to enter into relationships with their competitors.

Our solution implementations may take longer than we anticipate, which could cause us to lose customers and may result in adjustments to our operating results.

Our solution implementations require a team of engineers to collaborate with our customers to address complex yield loss issues by using our software and other technologies. We must estimate the amount of time needed to complete an existing solution implementation in order to estimate when the engineers will be able to commence a new solution implementation. In addition, our accounting for solution implementation contracts, which generate fixed fees, sometimes require adjustments to profit and loss based on revised estimates during the performance of the contract. These adjustments may have a material effect on our results of operations in the period in which they are made. The estimates giving rise to these risks, which are inherent in fixed-price contracts, include the forecasting of costs and schedules, and contract revenues related to contract performance.

Key executive officers are critical to our business and we cannot guarantee that they will remain with us indefinitely.

Our future success will depend to a significant extent on the continued services of our key executive officers. If we lose the services of any of our key executive officers, it could slow execution of our business plan, hinder our product development processes and impair our sales efforts. Searching for replacements could divert our senior management's time and increase our operating expenses. In addition, our industry partners and customers could become concerned about our future operations, which could injure our reputation and cause our stock price to drop. We do not have long-term employment agreements with our executives and we do not maintain any key person life insurance policies on their lives.

Inadvertent disclosure of our customers' confidential information could result in costly litigation and cause us to lose existing and potential customers.

Our customers consider their product yield information and other confidential information, which we must gather in the course of our engagement with the customer, to be extremely competitively sensitive. If we inadvertently disclosed or were required to disclose this information, we would likely lose existing and potential customers and could be subject to costly litigation. In addition, to avoid potential disclosure of confidential information to competitors, some of our customers may, in the future, ask us not to work with key competitive products, which could limit our revenue opportunities.

Our technologies could infringe the intellectual property rights of others causing costly litigation and the loss of significant rights.

Significant litigation regarding intellectual property rights exists in the semiconductor industry. It is possible that a third party may claim that our technologies infringe their intellectual property rights or misappropriate their trade secrets. Any claim, even if without merit, could be time consuming to defend, result in costly litigation, or require us to enter into royalty or licensing agreements, which may not be available to us on acceptable terms, or at all. A successful claim of infringement against us in connection with the use of our technologies could adversely affect our business.

Defects in our proprietary technologies, hardware and software tools, and the cost of support to remedy any such defects could decrease our revenue and our competitive market share.

If the software, hardware, or proprietary technologies we provide to a customer contain defects that increase our customer's cost of goods sold and time-to-market, these defects could significantly decrease the market acceptance of our solutions. Further, the cost of support resources required to remedy any defects in our technologies, hardware, or software tools could exceed our expectations. Any actual or perceived defects with our software, hardware, or proprietary technologies may also hinder our ability to attract or retain industry partners or customers, leading to a decrease in our revenue. These defects are frequently found during the period following introduction of new software, hardware, or proprietary technologies or enhancements to existing software, hardware, or proprietary technologies. Our software, hardware, and proprietary technologies may contain errors not discovered until after customer implementation of the silicon design and manufacturing process recommended

by us. If our software, hardware, or proprietary technologies contain errors or defects, it could require us to expend significant resources to alleviate these problems, which could reduce margins and result in the diversion of technical and other resources from our other development efforts.

Failing to maintain the effectiveness of our internal control over financial reporting could cause the cost related to remediation to increase and could cause our stock price to decline.

In the future, our management may identify deficiencies regarding the design and effectiveness of our system of internal control over financial reporting that we engage in pursuant to Section 404 of the Sarbanes-Oxley Act ("Section 404") as part of our Form 10-K. Such deficiencies could include those arising from turnover of qualified personnel or arising as a result of acquisitions, which we may not be able to remediate in time to meet the continuing reporting deadlines imposed by Section 404 and the costs of which may harm our results of operations. In addition, if we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that our management can conclude on an ongoing basis that we have effective internal controls. We also may not be able to retain our independent registered public accounting firm with sufficient resources to attest to and report on our internal controls in a timely manner. Moreover, our registered public accounting firm may not agree with our management's future assessments and may deem our controls as ineffective if we are unable to remediate on a timely basis. If in the future we are unable to assert that we maintain effective internal controls, our investors could lose confidence in the accuracy and completeness of our financial reports that in turn could cause our stock price to decline.

We may not be able to expand our business and proprietary technologies if we do not consummate potential acquisitions or investments or successfully integrate them with our business.

To expand our proprietary technologies, we may acquire or make investments in complementary businesses, technologies, or products if appropriate opportunities arise. We may be unable to identify suitable acquisition or investment candidates at reasonable prices or on reasonable terms, or consummate future acquisitions or investments, each of which could slow our growth strategy. We may have difficulty integrating the acquired products, personnel or technologies of any acquisitions we might make. These difficulties could disrupt our ongoing business, distract our management and employees and increase our expenses.

We may not be able to raise necessary funds to support our growth or execute our strategy.

Unanticipated efforts to support more rapid expansion, develop or enhance Design-to-Silicon-Yield solutions, respond to competitive pressures or acquire complementary businesses or technologies could impact our future capital requirements and the adequacy of our available funds. In such event, we may need to raise additional funds through public or private financings, strategic relationships or other arrangements. We may not be able to raise any necessary funds on terms favorable to us, or at all.

Recent acquisitions may adversely affect our business by diverting management's attention, increasing our expenses or by being more difficult to integrate than expected.

Our success in realizing the strategic benefits, the timing of this realization, and growth opportunities to be gained from incorporating into PDF the operations of recently acquired businesses, including Si Automation S.A. ("SiA"), a French company, acquired in October 2006, and Fabbrix, acquired in May 2007, depend upon our ability to successfully integrate those businesses. The integration of acquired businesses is a complex, costly and time-consuming process. The difficulties of combining our existing operations associated with acquired businesses include:

- consolidating research and development operations;
- retaining key employees;
- incorporating acquired products and business technology into our existing product lines;
- coordinating effective sales and marketing functions;
- preserving research and development, marketing, customer and other important relationships; and
- minimizing the diversion of management's attention from ongoing business concerns.

If we were required to write down all or part of our goodwill, our net earnings and net worth could be materially adversely affected.

We had $65.2 million of goodwill recorded on our consolidated balance sheet as of December 31, 2007. Goodwill represents the excess of cost over the fair market value of net assets acquired in business combinations. If our market capitalization drops significantly below the amount of net equity recorded on our balance sheet, it would indicate a decline in the fair value of the Company and would require us to further evaluate whether our goodwill has been impaired. We also perform an annual review, at December 31, of our goodwill to determine if it has become impaired, in which case we would write down the impaired portion of our goodwill. If we were required to write down all or a significant part of our goodwill, our net earnings and net worth could be materially adversely affected.

Changes in effective tax rates could negatively affect our operating results.

We conduct our business globally, as a result, are subject to taxation in the United States and foreign countries. Our future tax rates could be affected by numerous factors, including changes in tax laws or the interpretation of such tax laws and changes in accounting policies. Our filings are subject to reviews or audit by the Internal Revenue Service and state, local and foreign taxing authorities. We cannot be sure that any final determination in an audit would not be materially different than the treatment reflected in our historical income tax provisions and accruals. If additional taxes are assessed as a result of an audit, there could be a significant negative effect on our income tax provision and net income in the period or periods for which that determination is made.

The uncertainty in the credit markets might impact the value of certain auction-rate securities we held at December 31, 2007 and we might have to record impairment charges in the future.

Credit concerns in the capital markets have significantly reduced our ability to liquidate auction-rate securities that we classify as available-for-sale securities on our balance sheet. As of December 31, 2007, we held auction-rate securities with a par value of $4.5 million. Auction-rate securities are variable rate debt instruments whose interest rates are reset through a “dutch” auction process at regular intervals, typically every 28 days. A portion of these securities are insured by third party bond insurers and are collateralized by student loans guaranteed by governmental agencies and private entities. Subsequent to December 31, 2007, the Company sold $3.0 million of auction rate securities at par during auctions. Since then, the liquidity of the remaining securities has been negatively impacted by the uncertainty in the credit markets and the exposure of these securities to the financial condition of bond insurance companies. In February and March 2008, the remaining $1.5 million in auction-rate securities we held failed to sell at auction due to an insufficient number of bidders. We will further review the value of these securities impairment. If we determine that these securities have been impaired, this will negatively affect our results from operations. In future periods, the estimated fair value of our auction-rate securities could decline further based on market conditions, which could result in additional impairment charges.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our principal executive offices are located in San Jose, California where we lease approximately 49,800 square feet under a lease that expires in August 2013. We lease 11,200 square feet of office and laboratory space in San Diego, California under a lease that expires in March 2008. We lease other sales offices and laboratory spaces in Pennsylvania, Texas, and New Hampshire in the United States. In addition, we have offices overseas in France, Germany, Italy, China, Japan, and Korea with an aggregate of square footage approximately 38,000 square feet under various leases that expire through 2013. We believe our existing facilities and those in negotiation are adequate to meet our current needs and are being utilized consistently with our past practice.

Item 3. ***Legal Proceedings***

We are not currently party to any material legal proceedings.

Item 4. ***Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of security holders during the fourth quarter of 2007.

PART II

Item 5. ***Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities***

Our common stock has traded on the Nasdaq National Market under the symbol "PDFS". As of February 25, 2008 we had approximately 248 stockholders of record and the closing price of our common stock was $5.25 per share as reported by the Nasdaq National Market. The number of stockholders of record does not include individuals whose stock is in nominee or "street name" accounts through brokers.

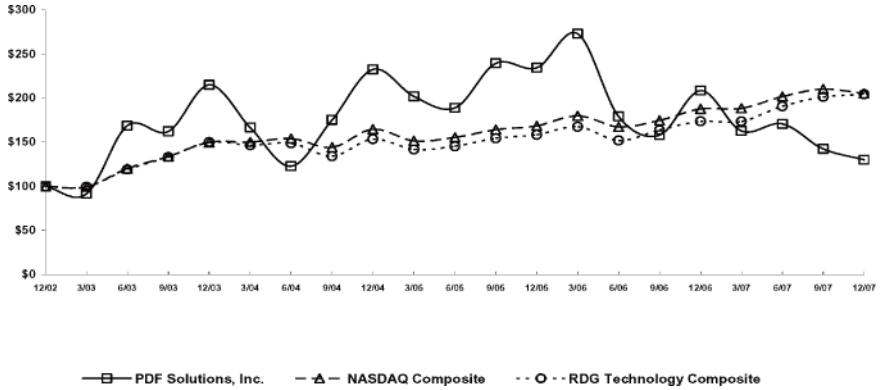
The following table sets forth for the periods indicated the high and low closing sale prices for our common stock as reported by the Nasdaq National Market:

2007	High	Low
First Quarter	$14.82	$10.00
Second Quarter	$12.16	$ 9.87
Third Quarter	$12.49	$ 9.36
Fourth Quarter	$10.22	$ 7.21

2006	High	Low
First Quarter	$19.85	$16.50
Second Quarter	$19.36	$11.00
Third Quarter	$13.35	$ 9.50
Fourth Quarter	$15.70	$10.79

The following graph compares the cumulative total stockholder return data for our stock since December 31, 2002 to the cumulative return over such period of (i) The Nasdaq Composite Index and (ii) the RDG Technology Composite Index. The graph assumes that $100 was invested on December 31, 2002. The graph further assumes that such amount was initially invested in the Common Stock of the Company at a per share price of $6.93 (closing price on December 31, 2002) and reinvestment of any dividends. This performance graph is not "soliciting material," is not deemed filed with the SEC and is not to be incorporated by reference in any filing by us under the Securities Act, or the Exchange Act, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

COMPARISON OF 5 YEARS CUMULATIVE TOTAL RETURNS*
Among PDF Solutions, Inc., The NASDAQ Composite Index
And The RDG Technology Composite Index



* $100 invested on 12/31/02 in stock or index-including reinvestment of dividends.

Fiscal year ending December 31.

The information under the heading "Equity Compensation Plan Information" in our definitive Proxy Statement (our "Proxy Statement") to be filed with the SEC in connection with our 2008 Annual Meeting of Stockholders is incorporated into Item 5 of this report by reference.

The table below sets forth the information with respect to purchases made by or on behalf of the Company or any "affiliated purchaser" (as the term is defined in Rule 10b-18(a)(3) under the Exchange Act) of our common stock during the fourth quarter of the year ended December 31, 2007:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(1)
Month #1 (October 1, 2007 through October 31, 2007)	—	—	—	$ 10,000,000
Month #2 (November 1, 2007 through November 30, 2007)	201,300	$ 7.57	201,300	$ 8,477,152
Month #3 (December 1, 2007 through December 31, 2007)	—	—	—	$ 8,477,152
Total	201,300	$ 7.57	201,300	

(1) On March 26. 2003, our Board of Directors approved a share repurchase program to purchase up to $10.0 million of our outstanding common stock. The program was completed in August 2007 with 987,808 shares repurchased at the average price of $10.12. On October 29, 2007, the Board of Directors approved a new program to repurchase up to an additional $10.0 million of the Company's common stock on the open market. The right of repurchase stock under this program will expire on October 29, 2010. As of December 31, 2007, 201,300 shares had been repurchased under this program and $8.5 million remained available for repurchases.

Dividend Policy

No cash dividends were declared or paid in 2007 or 2006. We currently intend to retain all available funds to finance future internal growth and product development and therefore do not anticipate paying any cash dividends on our common stock for the foreseeable future.

Item 6. ***Selected Financial Data.***

The following selected consolidated financial information has been derived from the audited consolidated financial statements. The information set forth below is not necessarily indicative of results of future operations and should be read in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes to those statements included therein and in Part IV of this Form 10-K.

	Year Ended December 31,				
	2007(3)	2006(2)	2005	2004	2003(1)
	(In thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenue:					
Design-to-silicon-yield solutions:					
Services	$63,731	$45,382	$52,719	$49,573	$28,060
Software licenses	6,645	10,774	9,319	4,971	7,569
Gainshare performance incentives	24,087	20,028	11,890	7,802	6,897
Total revenue	94,463	76,184	73,928	62,346	42,526
Cost of design-to-silicon-yield solutions:					
Direct costs of design-to-silicon-yield solutions:					
Services	32,279	27,418	24,319	21,811	14,734
Software licenses	191	209	293	83	23
Amortization of acquired technology	5,148	5,270	5,064	5,209	2,168
Total direct costs of design-to silicon-yield solutions	37,618	32,897	29,676	27,103	16,925
Gross margin	56,845	43,287	44,252	35,243	25,601
Operating expenses:					
Research and development	36,074	27,613	22,204	20,999	19,540
Selling, general and administrative	24,891	19,814	16,146	15,243	12,770
Amortization of other acquired intangible assets	3,422	1,459	940	1,406	547
Write-off of in-process research and development	—	800	—	—	800
Total operating expenses	64,387	49,686	39,290	37,648	33,657
Income (loss) from operations	(7,542)	(6,399)	4,962	(2,405)	(8,056)
Interest and other income, net	1,891	2,827	1,658	675	1,195
Income (loss) before taxes	(5,651)	(3,572)	6,620	(1,730)	(6,861)
Income tax provision (benefit)	(2,724)	(3,133)	96	(1,116)	(2,345)
Net income (loss)	$ (2,927)	$ (439)	$ 6,524	$ (614)	$ (4,516)
Net income (loss) per share:					
Basic	$ (0.10)	$ (0.02)	$ 0.25	$ (0.02)	$ (0.19)
Diluted	$ (0.10)	$ (0.02)	$ 0.24	$ (0.02)	$ (0.19)
Weighted average common shares:					
Basic	28,066	26,885	25,983	25,330	23,278
Diluted	28,066	26,885	27,473	25,330	23,278

Stock-based compensation expense included in these consolidated statements of operations was recorded under Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB No. 25") for the years 2003 through 2005 and under Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *Share-Based Payment* ("SFAS No. 123(R)") for the years 2006 through 2007.

For the years ended December 31, 2007 and December 31, 2006 the income tax provision includes income tax benefit from stock-based compensation.

	December 31,				
	2007(3)	2006(2)	2005	2004	2003(1)
			(In thousands)		
Consolidated Balance Sheets Data:					
Cash and cash equivalents	$ 35,315	$ 36,451	$ 60,506	$ 45,660	$ 39,110
Short-term investments	9,949	16,402	—	—	—
Working capital	72,456	66,586	68,534	51,312	42,613
Total assets	179,351	168,857	139,892	125,407	123,967
Total stockholders' equity	156,470	148,219	122,681	108,798	106,552

(1) In May 2003, we completed our acquisition of certain assets and liabilities of WaferYield, Inc., which related to wafer shot map optimization technology. The aggregate purchase price was $4.1 million, which included cash payments of $2.6 million and the recognition of $1.5 million in other liabilities associated with future payments that were contingent upon the attainment of certain revenue performance objectives.

In September 2003, we completed our acquisition of all the outstanding stock of IDS which developed and sold yield management software applications and services. The aggregate purchase price was $51.0 million which included the payment in cash of $23.0 million, the issuance of 2.0 million shares of PDF common stock valued at $25.0 million, the assumption of stock options valued at $1.7 million and acquisition costs of $1.3 million.

(2) In October 2006, we completed our acquisition of all the outstanding stock of SiA which developed and licensed fault detection and classification software applications and services. The aggregate purchase price of $36.6 million included the payment in cash of $25.5 million, the issuance of 699,298 shares of PDF common stock valued at $9.4 million and acquisition costs of $1.7 million.

(3) In May 2007, we completed our acquisition of all the outstanding stock of Fabbrix which developed DFM software applications. The aggregate purchase price of $6.2 million included the payment in cash of $2.7 million, the issuance of 271,531 shares of PDF common stock valued at $2.9 million and acquisition costs of $674,000.

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

Overview

Our technologies and services enable semiconductor companies to improve profitability across the entire "process lifecycle", which is the term we have coined for the time from the IC design through that IC's volume manufacturing. Our solutions improve profitability by improving a semiconductor company's time-to-market, increasing yield and reducing total design and manufacturing costs. Our solutions combine proprietary software, physical IP in the form of cell libraries for IC designs, test chips, an electrical electrical wafer test system, proven methodologies, and professional services. We analyze yield loss mechanisms to identify, quantify, and correct the issues that cause yield loss. This drives IC design and manufacturing improvements that enable our customers to optimize the technology development process, increase the initial yield when an IC design first enters a manufacturing line, increase the rate at which yield improves, and minimize excursions and process variability that cause yield loss throughout mass production.

The result of successfully implementing our solutions is the creation of value that can be measured based on improvements to our customers' actual yield. Through our gainshare performance incentives component, we have aligned our financial interests with the yield and performance improvements realized by our customers, and we

receive revenue based on this value. Our technologies and services have been sold to leading integrated device manufacturers, fabless semiconductor companies and foundries.

From our incorporation in 1992 through late 1995, we were primarily focused on research and development of our proprietary manufacturing process simulation and yield and performance modeling software. From late 1995 through late 1998, we continued to refine and sell our software, while expanding our offering to include yield and performance improvement consulting services. In late 1998, we began to sell our software and consulting services, together with our newly developed proprietary technologies, under the term Design-to-Silicon-Yield solutions, reflecting our current business model. In April 2000, we expanded our research and development team and gained additional technology by acquiring AISS. AISS now operates as PDF Solutions, GmbH, a German company, which continues to develop software and provide development services to the semiconductor industry. In July 2001, we completed the initial public offering of our common stock. In 2003, we enhanced our product and service offerings, including increased software applications, through the acquisitions of IDS and WaferYield. In 2006, we further complemented our technology offering by acquiring SiA and adding its FDC software capabilities to our integrated solution. In 2007, we added intellectual property building blocks for logic design technology to our solution portfolio by acquiring Fabbrix.

Industry Trend

Demand for consumer electronics and communications devices continues to drive technological innovation in the semiconductor industry as the need for products with greater performance, lower power consumption, reduced costs and smaller size continues to grow with each new product generation. In addition, advances in computing systems and mobile devices have fueled demand for higher capacity memory chips. To meet these demands, IC manufacturers and designers are constantly challenged to improve the overall performance of their ICs by designing and manufacturing ICs with more embedded applications to create greater functionality while lowering cost per transistor. As a result, both logic and memory manufacturers have migrated to more and more advanced manufacturing nodes, capable of integrating more devices with higher performance, higher density, and lower power. As this trend continues, companies will continually be challenged to improve process capabilities to optimally produce ICs with minimal random and systematic yield loss, which is driven by the lack of compatibility between the design and its respective manufacturing process. We believe that as volume production of deep submicron ICs continues to grow, the difficulties of integrating IC designs with their respective processes and ramping new manufacturing processes will create a greater need for products and services that address the yield loss and escalating cost issues the semiconductor industry is facing today and will face in the future.

Financial Highlights

The following were our financial highlights for the year ended December 31, 2007.

- Total revenue for the year ended December 31, 2007 was $94.5 million, an increase of 24% compared to the year ended December 31, 2006. Revenue from Design-to-Silicon-Yield solutions for the year ended December 31, 2007 increased to $70.4 million compared to $56.2 million for the year ended December 31, 2006. The increase, compared to the year ended December 31, 2006, was primarily the result of increases in services revenue of $18.3 million, partially offset by a decrease in revenue from software licenses of $4.1 million. The revenue derived from the gainshare performance incentives component for the year ended December 31, 2007 increased 20%, to $24.1 million from $20.0 million for the year ended December 31, 2006. Our gainshare performance incentives revenue may continue to fluctuate from quarter-to-quarter as a result of each customer's individual contractual performance measures for achieving gainshare performance incentives as well as each customer's production volumes in any given period.
- Net loss of $2.9 million was reported for the year ended December 31, 2007, compared to net loss of $439,000 for the year ended December 31, 2006. The increase in net loss was primarily attributable to increases in operating expenses and amortization of acquired intangible assets, both primarily the result of the acquisitions of SiA in October 2006 and Fabbrix in May 2007. Net loss for the year ended December 31, 2007 included $16.9 million in stock-based compensation, amortization of acquired intangible assets and the

write-off of acquired in-process research and development compared to $14.9 million for the year ended December 31, 2006.

- Net loss per basic and diluted share was $0.10 for the year ended December 31, 2007 compared to net loss per basic and diluted share of $0.02 for the year ended December 31, 2006.
- Cash, cash equivalents and short-term investments decreased $7.6 million to $45.3 million during the year ended December 31, 2007. Net cash provided by operating activities for the year ended December 31, 2007 totaled $1.4 million. Net cash used in investing activities for the year ended December 31, 2007 included $1.9 million as final payments for our acquisition of SiA, a $2.7 million payment for our acquisition of Fabbrix, and $2.2 million to purchase property and equipment. Net cash used in financing activities for the year ended December 31, 2007 totaled $3.7 million which primarily related to $6.0 million in purchase of treasury stock, partially offset by the exercise of employee stock options and purchases under the employee stock purchase plan of $2.9 million.

Acquisitions

On October 31, 2006, we completed our acquisition of all the outstanding capital stock of SiA, a privately held company based in Montpellier, France. SiA developed and licensed fault detection and classification software applications and provided services dedicated to the semiconductor industry that enable customers to rapidly identify sources of process variations and manufacturing excursions by monitoring equipment parameters through its proprietary data collection and analysis applications. The acquisition of SiA allowed us to provide our customers greater capabilities for managing product yield improvement as a result of these process control solutions and services. At the closing of the acquisition, SiA became our wholly owned subsidiary and its name was changed to PDF Solutions S.A., and then to PDF Solutions S.A.S. in 2007. The aggregate purchase price was $37.0 million which included the payment in cash of $25.5 million, the issuance of 699,298 shares of our common stock valued at $9.4 million, and acquisition costs of $2.2 million. Included in the acquisition costs above, $2.7 million in cash and approximately 119,000 shares of common stock were held in escrow as security against certain financial contingencies. The cash and shares held in escrow, less amounts deducted to satisfy contingencies, will be released upon the 18-month anniversary of the acquisition. Any remaining cash and shares held in escrow after satisfying contingencies will be released no later than the 36-month anniversary of the acquisition. In connection with the acquisition, we recorded $21.0 million in goodwill, including subsequent adjustments related to certain accruals and tax liabilities recognized in the acquisition and excluding the impact of changes in exchange rate. Goodwill reflects the excess of the purchase price paid over the identifiable assets assumed in the acquisition.

On May 24, 2007, we completed the acquisition of Fabbrix, a provider of silicon intellectual property designed to create highly manufacturable and area-efficient designs targeted for advanced technology nodes. With this acquisition, we have enhanced our strength in silicon characterization to enable a true co-optimization of the manufacturing fabric and the logic elements. Total cost for the acquisition was $6.2 million, which includes $2.7 million cash, 271,531 shares of our common stock valued at $2.9 million, and $674,000 in acquisition costs. Included in the acquisition costs above, approximately $405,000 in cash and 41,000 shares of common stock were held in escrow as security against certain financial contingencies. The cash and shares held in escrow, less amounts deducted to satisfy contingencies will be released no later than on the 18 month anniversary of the acquisition. The remaining amounts in cash and shares have been paid to the selling stockholders as of December 31, 2007. In connection with the acquisition, we recorded $2.2 million of goodwill and $7.8 million of identifiable intangible assets with a weighted average life of 5.4 years. The consolidated financial statements for the year ended December 31, 2007 include the results of Fabbrix since the date of acquisition.

Critical Accounting Policies

Financial Reporting Release No. 60 requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 1 of "Notes to Consolidated Financial Statements" includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. The following is a brief discussion of the more significant accounting policies and methods that we use.

General

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. Our preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We based our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. The most significant estimates and assumptions relate to revenue recognition, software development costs, recoverability of goodwill and acquired intangible assets, estimated useful lives of acquired intangibles and the realization of deferred tax assets. Actual amounts may differ from such estimates under different assumptions or conditions.

Revenue Recognition

We derive revenue from two sources: Design-to-Silicon-Yield Solutions, which includes Services and Software Licenses, and Gainshare Performance Incentives. We recognize revenue in accordance with the provisions of American Institute of Certified Public Accountants' Statement of Position ("SOP") No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* and SOP No. 97-2, *Software Revenue Recognition*, as amended.

Design-to-Silicon-Yield Solutions — Revenue that is derived from Design-to-Silicon-Yield solutions comes from services and software licenses. We recognize revenue for each element of Design-to-Silicon-Yield solutions as follows:

Services — We generate a significant portion of our Design-to-Silicon-Yield revenue from fixed-price solution implementation service contracts delivered over a specific period of time. These contracts require accurate estimation of the cost to perform obligations and the overall scope of each engagement. Revenue under contracts for solution implementation services is recognized as the services are performed using the cost-to-cost percentage of completion method of contract accounting. Losses on solution implementation contracts are recognized when determined. Revisions in profit estimates are reflected in the period in which the conditions that require the revisions become known and can be estimated. If we do not accurately estimate the resources required or the scope of work to be performed, or do not manage the projects properly within the planned period of time or satisfy our obligations under contracts, resulting contract margins could be materially different than those anticipated when the contract was executed. Any such reductions in contract margin could have a material negative impact on our operating results.

On occasion, we have licensed our software products as a component of our fixed price services contracts. In such instances, the software products are licensed to the customer over the specified term of the agreement with support and maintenance to be provided over the license term. Under these arrangements, where vendor-specific objective evidence of fair value ("VSOE") exists for the support and maintenance element, the support and maintenance revenue is recognized separately over the term of the supporting period. The remaining fee is recognized as the services are performed using the cost-to-cost percentage of completion method of contract accounting. VSOE for maintenance, in these instances, is generally established based upon a negotiated renewal rate. Under arrangements where software products are licensed as a component of its fixed-price service contract and where VSOE does not exist to allocate a portion of the total fixed-price to the undelivered elements, revenue is recognized for the total fixed-price as the lesser of either the percentage of completion method of contract accounting or ratably over the term of the agreement. Costs incurred under these arrangements are deferred and recognized in proportion to revenue recognized under these arrangements.

Revenue from related support and maintenance services is recognized ratably over the term of the support and maintenance contract, generally one year, while revenue from consulting, installation and training services is recognized as services are performed. When bundled with software licenses in multiple element arrangements, support and maintenance, consulting (other than for our fixed price solution implementations), installation, and training revenue is allocated to each element of a transaction based upon its fair value as determined by our VSOE. VSOE is generally established for maintenance based upon negotiated renewal rates

while VSOE for consulting, installation, and training is established based upon our customary pricing for such services when sold separately. When VSOE does not exist to allocate a portion of the total fee to the undelivered elements, revenue is recognized ratably over the term of the underlying element for which VSOE does not exist.

Software Licenses — We also license our software products separate from our services. In such cases revenue is recognized under the residual method when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the fee is fixed or determinable, (4) collectibility is probable, and (5) the arrangement does not require services that are essential to the functionality of the software. When arrangements include multiple elements such as support and maintenance, consulting (other than for our fixed price solution implementations), installation, and training, revenue is allocated to each element of a transaction based upon its fair value as determined by our VSOE and such services are recorded as services. VSOE is generally established for maintenance based upon negotiated renewal rates while VSOE for consulting, installation and training services is established based upon our customary pricing for such services when sold separately. When VSOE does not exist to allocate a portion of the total fee to the undelivered elements, revenue is recognized ratably over the term of the underlying element for which VSOE does not exist. No revenue has been recognized for software licenses with extended payment terms in excess of amounts due.

Gainshare Performance Incentives — When we enter into a contract to provide yield improvement services, the contract usually includes two components: (1) a fixed fee for performance by us of services delivered over a specific period of time; and (2) a gainshare performance incentives component where the customer may pay a variable fee, usually after the fixed fee period has ended. Revenue derived from gainshare performance incentives represents profit sharing and performance incentives earned based upon our customers reaching certain defined operational levels established in related solution implementation service contracts. Gainshare performance incentives periods are usually subsequent to the delivery of all contractual services and therefore have no cost to us. Due to the uncertainties surrounding attainment of such operational levels, we recognize gainshare performance incentives revenue (to the extent of completion of the related solution implementation contract) upon receipt of performance reports or other related information from our customers supporting the determination of amounts and probability of collection. Gainshare performance incentives revenue is dependent on many factors which are outside our control, including among others, continued production of the related ICs by our customers, sustained yield improvements by our customers and our ability to enter into new Design-to-Silicon-Yield solutions contracts containing provisions for gainshare performance incentives.

Software Development Costs

Costs for the development of new software products and substantial enhancements to existing software products are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized in accordance with SFAS No. 86, *Computer Software to be Sold, Leased or Otherwise Marketed*. Because we believe our current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no costs have been capitalized to date.

Goodwill and Acquired Intangible Assets

As of December 31, 2007, we had $65.2 million of goodwill and $12.8 million of intangible assets. In valuation of our goodwill and intangible assets, we must make assumptions regarding estimated future cash flows to be derived from the acquired assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets, which would have a material adverse effect on our operating results. We evaluate goodwill for impairment pursuant to the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*. We have selected December 31 as the date upon which to perform our annual testing for impairment. As of December 31, 2007, we completed our annual testing requirements and determined that the carrying value of goodwill had not been impaired.

We are currently amortizing our acquired intangible assets over estimated useful lives of one to seven years, which are based on the estimated period of benefit to be delivered from such assets. However, a decrease in the

estimated useful lives of such assets would cause additional amortization expense or an impairment of such asset in future periods.

Income Taxes

Realization of deferred tax assets is dependent on our ability to generate future taxable income and utilize tax planning strategies. We have recorded a deferred tax asset in the amount that is more likely than not to be realized based on current estimations and assumptions. We evaluate the valuation allowance on a quarterly basis. Any resulting changes to the valuation allowance will result in an adjustment to income in the period the determination is made.

In June, 2006, the Financial Accounting Standard Board ("FASB") issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109* ("FIN No. 48"), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. Additionally, the Interpretation provides guidance on measurement, de-recognition, classification, interest and penalties, accounting for interim periods, disclosure and transition. The Interpretation is effective for fiscal years beginning after December 15, 2006. We adopted the provisions of FIN No. 48 on January 1, 2007. See Note 9 to the consolidated financial statements for a further discussion on the income taxes.

Stock-Based Compensation

Effective January 1, 2006, we adopted the provisions of SFAS No. 123(R). The statement eliminates the ability to account for share-based compensation transactions using APB No. 25 and requires that the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements based on estimated fair values. SFAS No. 123(R) applies to all share-based payment transactions in which we acquire goods or services by issuing our shares, share options, or other equity instruments or by incurring liabilities based on the price of our shares or that require settlement by the issuance of equity instruments. We elected to use the modified prospective transition method upon adopting this statement and accordingly prior periods have not been restated to reflect the impact of SFAS No. 123(R). Under this transition method, stock-based compensation expense for the years ended December 31, 2006 and 2007 include compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provision of SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS No. 123"). Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). We recognize the compensation costs of options granted after January 1, 2006 on a straight-line basis over the vesting periods of the applicable stock purchase rights and stock options, generally four years. Prior to adoption of SFAS No. 123(R), we presented all tax benefits resulting from stock options as operating cash flow in our statement of cash flows. In accordance with SFAS No. l23(R), the cash flows resulting from excess tax benefits are classified as financing cash flows.

Prior to the adoption of SFAS No. 123(R), we accounted for stock-based compensation in accordance with APB No. 25, and complied with the disclosure provisions of SFAS No. 123 as amended by SFAS No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosures*. Deferred compensation recognized under APB No. 25 was amortized to expense using the graded vesting method. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB 107") regarding the SEC's interpretation of SFAS No. 123(R) and the valuation of share-based payments for public companies. We have applied the provisions of SAB 107 in its adoption of SFAS No. 123(R). In December 2007, the SEC issued Staff Accounting Bulletin No. 110 ("SAB 110") to amend the SEC's views discussed in SAB 107 regarding the use of the simplified method in developing an estimate of expected life of share options in accordance with SFAS No. 123(R). SAB 110 is effective for us beginning in the first quarter of fiscal year 2008. See Note 7 to the Consolidated Financial Statements for a further discussion on stock-based compensation.

Recent Accounting Pronouncements and Accounting Changes

See our Note 1, "Business and Significant Accounting Policies" of "Notes to Consolidated Financial Statements" included under Part IV, Item 15 of this Form 10-K for a description of recent accounting pronouncements and accounting changes, including the expected dates of adoption and estimated effects, if any, on our consolidated financial statements.

Results of Operations

The following table sets forth, for the years indicated, the percentage of total revenue represented by the line items reflected in our consolidated statements of operations:

	December 31, Years Ended		
	2007	2006	2005
Revenues:			
Design-to-silicon-yield solutions:			
Services	67%	60%	71%
Software licenses	7	14	13
Gainshare performance incentives	26	26	16
Total revenues	100%	100%	100%
Cost of design-to-silicon-yield solutions:			
Direct costs of design-to-silicon-yield solutions:			
Services	34	36	33
Software licenses	—	—	—
Amortization of acquired technology	6	7	7
Total cost of design-to silicon-yield solutions	40	43	40
Gross margin	60	57	60
Operating expenses:			
Research and development	38	37	30
Selling, general and administrative	26	26	22
Amortization of other acquired intangible assets	4	2	1
Write-off of in-process research and development	—	1	—
Total operating expenses	68	66	53
Income (loss) from operations	(8)	(9)	7
Interest and other income, net	2	4	2
Income (loss) before taxes	(6)	(5)	9
Income tax provision (benefit)	(3)	(4)	—
Net income (loss)	(3)%	(1)%	9%

Years Ended December 31, 2007 and 2006

Revenue	2007	2006	$ Change	% Change	2007 % of Revenue	2006 % of Revenue
			(In thousands, except for %'s)			
Design-to-silicon-yield solutions:						
Services	$63,731	$45,382	$18,349	40%	67%	60%
Software licenses	6,645	10,774	(4,129)	(38)	7	14
Gainshare performance incentives	24,087	20,028	4,059	20	26	26
Total	$94,463	$76,184	$18,279	24%	100%	100%

Design-to-Silicon-Yield Solutions. Design-to-Silicon-Yield solutions revenue is derived from services (including solution implementations, software support and maintenance, consulting, and training) and software licenses, provided during our customer yield improvement engagements and solution product sales.

Services. Services revenue increased $18.3 million for the year ended December 31, 2007 compared to the year ended December 31, 2006, primarily as a result of the acquisition of SiA in October 2006, and to a lesser extent due to an increase in fixed fee integrated solutions. Services revenue derived from the acquired business increased approximately $10.7 million for the year ended December 31, 2007 compared to the year ended December 31, 2006. Services revenues derived from our acquisition of SiA included $5.1 million in recognized revenue related to sales of licenses bundled with services for which VSOE did not exist for the year ended December 31, 2007 compared to $521,000 for the year ended December 31, 2006. Services revenue from fixed fee integrated solutions increased $7.1 million for the year ended December 31, 2007 compared to the year ended December 31, 2006 primarily due to new contracts signed during 2007. Our services revenue may fluctuate in the future and is dependent on a number of factors including our ability to obtain new customers at emerging technology nodes.

Software licenses. The decrease in software licenses revenue of $4.1 million for the year ended December 31, 2007 compared to the year ended December 31, 2006 was primarily due to weakness in attracting new customers in light of customer capital spending constraints. Software license revenue may fluctuate in the future and is dependent upon a number of factors including the semiconductor industry's acceptance of our products, our ability to attract new customers, further penetration of our current customer base and the degree to which we bundle software with services where there is no established VSOE for the undelivered services.

Gainshare Performance Incentives. Gainshare performance incentives revenue represents profit sharing and performance incentives earned based upon our customer reaching certain defined operational levels. Revenue derived from gainshare performance incentives increased $4.1 million for the year ended December 31, 2007 compared to the year ended December 31, 2006. The increase in revenue derived from gainshare performance incentives was primarily due to improved yields and volumes at our customers' sites. Our gainshare performance incentives revenue may continue to fluctuate from period to period. Gainshare performance incentives revenue is dependent on many factors that are outside our control, including among others, continued production of ICs by our customers, sustained yield improvements by our customers and our ability to enter into new Design-to-Silicon-Yield solutions contracts containing provisions for gainshare performance incentives.

Cost of Design-to-Silicon-Yield Solutions	2007	2006	$ Change	% Change	2007 % of Revenue	2006 % of Revenue
			(In thousands, except for %'s)			
Direct costs of design-to-silicon-yield solutions:						
Services	$32,279	$27,418	$4,861	18%	34%	36%
Software licenses	191	209	(18)	(9)	—	—
Amortization of acquired technology	5,148	5,270	(122)	(2)	6	7
Total	$37,618	$32,897	$4,721	14%	40%	43%

Direct Costs of Design-to-Silicon-Yield Solutions. Direct costs of Design-to-Silicon-Yield solutions consist of costs incurred to provide and support our services and costs recognized in connection with licensing our software.

Services. Services costs consist of material, labor, overhead costs, and stock-based compensation charges associated with our solution implementations. Costs include purchased materials, employee compensation and benefits, travel and facilities-related costs. Direct costs of Design-to-Silicon-Yield services increased $4.9 million for the year ended December 31, 2007 compared to the year ended December 31, 2006, primarily due to an increase of $2.0 million in expenses related to additional revenues driven by our acquisition of SiA in October 2006, and to an increase of $993,000 in costs associated with the deployment of our pdFasTest products at new engagements signed during the year ended December 31, 2007. If we do not accurately estimate the resources required or the scope of work to be performed, or we do not manage the projects properly within the planned period of time or satisfy our obligations under contracts, resulting contract margins could be materially different than those anticipated when the contract was executed. Any such reductions in contract margin could have a material negative impact on our operating results.

Software Licenses. Software license costs consist of costs associated with licensing third-party software sold in conjunction with our software products and expenses incurred to produce and distribute our product documentation. The direct costs of Design-to-Silicon-Yield solutions software licenses decreased $18,000 for the year ended December 31, 2007 as compared to the year ended December 31, 2006. We expect the cost of software licenses to fluctuate in the future as a result of royalties and license fees paid for third-party applications incorporated in our software products.

Amortization of Acquired Technology. Amortization of acquired technology consists of the amortization of intangibles acquired as a result of certain business combinations. For the year ended December 31, 2007, the amortization of acquired technology expense decreased $122,000 compared to the year ended December 31, 2006. Certain intangible assets became fully amortized during the fiscal year 2007 which resulted in a decrease of $1.9 million in amortization. The decrease was partially offset by an increase of $1.8 million in amortization of technology acquired from our acquisitions of SiA in October 2006 and Fabbrix in May 2007. We anticipate amortization of acquired technology to be $2.5 million in 2008, $2.5 million in 2009, $2.3 million in 2010, $1.3 million in 2011, and $536,000 in 2012.

Research and Development	2007	2006	$ Change	% Change	2007 % of Revenue	2006 % of Revenue
	(In thousands, except for %'s)					
Research and development	$36,074	$27,613	$8,461	31%	38%	37%

Research and Development. Research and development expenses consist primarily of personnel-related costs to support product development activities, including compensation and benefits, outside development services, travel, facilities cost allocations, and stock-based compensation charges. The increase in research and development expenses of $8.5 million for the year ended December 31, 2007 compared to the year ended December 31, 2006 was primarily the result of the acquisition of SiA in October 2006. Expenses in our French subsidiary increased approximately $6.0 million for the twelve months in fiscal year 2007 compared to the two months in fiscal year 2006. We anticipate our expenses in research and development will increase in absolute dollars as we continue to commit considerable resources in this area in the future.

Selling, General and Administrative	2007	2006	$ Change	% Change	2007 % of Revenue	2006 % of Revenue
	(In thousands, except for %'s)					
Selling, general and administrative	$24,891	$19,814	$5,077	26%	26%	26%

Selling, General and Administrative. Selling, general and administrative expenses consist primarily of compensation and benefits for sales, marketing and general and administrative personnel in addition to outside sales commissions, legal and accounting services, marketing communications, travel and facilities cost allocations, and stock-based compensation charges. The increase in selling, general and administrative expenses of $5.1 million for the year ended December 31, 2007 compared to the year ended December 31, 2006 was primarily due to increased

operating costs as a result of the acquisition of SiA in October 2006, and to a lesser extent to increases in outside sales commissions and legal expenses incurred as a result defending our intellectual property rights. Selling, general and administrative expenses incurred by our French subsidiary increased $3.1 million for the twelve months in fiscal year 2007 compared to the two months in fiscal year 2006. Outside sales commission increased $644,000 for the year ended December 31, 2007 compared to the year ended December 31, 2006 as a result of increases in revenue. We expect that selling, general and administrative expenses will increase in absolute dollars to support increased selling and administrative efforts in the future.

Amortization of Other Acquired Intangible Assets	2007	2006	$ Change	% Change	2007 % of Revenue	2006 % of Revenue
	(In thousands, except for %'s)					
Amortization of other acquired intangible assets	$3,422	$1,459	$1,963	135%	4%	2%

Amortization of Other Acquired Intangible Assets. Amortization of other acquired intangible assets consists of the amortization of intangibles acquired as a result of certain business combinations. Amortization of other acquired intangible assets for the year ended December 31, 2007 increased $2.0 million compared to the year ended December 31, 2006 as a result of the acquisition of SiA in October 2006. We anticipate amortization of these other acquired intangible assets to decrease in future periods as certain intangible assets became fully amortized during the fiscal year 2007. We anticipate amortization of other acquired intangible assets to be $776,000 in 2008, $776,000 in 2009, $713,000 in 2010, $575,000 in 2011, and $795,000 in 2012 and thereafter.

Write-off of In-Process Research and Development	2007	2006	$ Change	% Change	2007 % of Revenue	2006 % of Revenue
	(In thousands, except for %'s)					
Write-off of in-process research and development	$—	$800	$(800)	(100)%	—%	1%

Write-off of In-process Research and Development. Write-off of in-process research and development of $800,000 in the year ended December 31, 2006 was related to the acquisition of SiA and was associated with acquired technology that had not reached technological feasibility and for which there was no alternative future use. At December 31, 2006, the acquired technology was not being developed and did not have alternative future use. We determined the fair value of the acquired in-process technology by estimating the cash flows related to projects under development and the estimated revenues and operating profits related to those projects. The resulting estimated cash flows were discounted to their net present value. There was no such expense in 2007.

Interest and Other Income, Net	2007	2006	$ Change	% Change	2007 % of Revenue	2006 % of Revenue
	(In thousands, except for %'s)					
Interest and other income, net	$1,891	$2,827	$(936)	(33)%	2%	4%

Interest and Other Income, Net. The decrease in interest and other income, net of $936,000 for the year ended December 31, 2007 compared to the year ended December 31, 2006 was primarily due to lower average cash, cash equivalent, and short-term investments balance during the period. During fiscal year 2007, we spent $6.0 million to repurchase treasury stock, and made payments of $4.6 million in connection with those acquisitions. We also spent $2.2 million to purchase property and equipment. We anticipate interest and other income will fluctuate in future periods as a result of our projected use of cash.

Income Tax Provision (Benefit)	2007	2006	$ Change	% Change	2007 % of Revenue	2006 % of Revenue
	(In thousands, except for %'s)					
Income tax provision (benefit)	$(2,724)	$(3,133)	$ 409	(13)%	(3)%	(4)%

Income Tax Provision (Benefit). The decrease in the income tax benefit of $409,000 for the year ended December 31, 2007 compared to the year ended December 31, 2006 was primarily due to a decrease of $2.1 million in tax credits claimed, partially offset by the increase of $728,000 in statutory tax benefit for the year ended

December 31, 2007. In the year ended December 31, 2006, we performed a study that allowed us to claim additional research and development credits for prior years.

Years Ended December 31, 2006 and 2005

Revenue	2006	2005	$ Change	% Change	2006 % of Revenue	2005 % of Revenue
			(In thousands, except for %'s)			
Design-to-silicon-yield solutions:						
Services	$45,382	$52,719	$(7,337)	(14)%	60%	71%
Software licenses	10,774	9,319	1,455	16	14	13
Gainshare performance incentives	20,028	11,890	8,138	68	26	16
Total	$76,184	$73,928	$ 2,256	3%	100%	100%

Design-to-Silicon-Yield Solutions. Design-to-Silicon-Yield solutions revenue is derived from services (including solution implementations, software support and maintenance and training) and software licenses, provided during our customer yield improvement engagements and solution product sales.

Services. The decrease in services revenue of $7.3 million for the year ended December 31, 2006 compared to the year ended December 31, 2005 was primarily attributable to decreases in fixed fee services revenue which was partially offset by an increase in software related services revenue. Fixed fee service revenue decreased $10.6 million due to a slower booking rate for new integrated solution engagements in late 2005, which would have contributed to revenue in 2006, and in the first half of 2006, and to the late timing of new contracts signed in the second half of 2006. Software related services revenue increased $3.3 million due to greater adoption of our software applications by new and existing customers.

Software licenses. The increase in software licenses revenue of $1.5 million for the year ended December 31, 2006 compared to the year ended December 31, 2005 was due to greater adoption of our software applications by new and existing customers and the addition of new software offerings as a result of the acquisition of SiA in October 2006.

Gainshare Performance Incentives. Gainshare performance incentives revenue represents profit sharing and performance incentives earned based upon our customer reaching certain defined operational levels. Revenue derived from gainshare performance incentives increased approximately $8.1 million for the year ended December 31, 2006 compared to the year ended December 31, 2005. The increase in revenue derived from gainshare performance incentives experienced for the year ended December 31, 2006 was primarily due to a greater number of wafer starts at our customers' sites, as well as a greater number of engagements contributing to gainshare performance incentives at newer technology nodes.

Cost of Design-to-Silicon-Yield Solutions	2006	2005	$ Change	% Change	2006 % of Revenue	2005 % of Revenue
			(In thousands, except for %'s)			
Direct costs of design-to-silicon-yield solutions:						
Services	$27,418	$24,319	$3,099	13%	36%	33%
Software licenses	209	293	(84)	(29)	—	—
Amortization of acquired technology	5,270	5,064	206	4	7	7
Total	$32,897	$29,676	$3,221	11%	43%	40%

Direct Costs of Design-to-Silicon-Yield Solutions. Direct costs of Design-to-Silicon-Yield solutions consist of costs incurred to provide and support our services and costs recognized in connection with licensing our software.

Services. The increase in direct costs of Design-to-Silicon-Yield services of $3.1 million for the year ended December 31, 2006 compared to the year ended December 31, 2005 was primarily attributable to the

increase of $2.1 million in stock-based compensation expense under SFAS No. 123(R), and the increase of $974,000 in the distribution of expanded pdFasTest products. Our labor costs remained relatively unchanged for the year ended December 31, 2006 as compared to the year ended December 31, 2005, despite the decrease in revenues, primarily a result of a decrease in the utilization rate of our labor resources.

Software Licenses. The decrease in direct costs of Design-to-Silicon-Yield solutions software licenses of $84,000 for the year ended December 31, 2006 compared to the year ended December 31, 2005 was primarily attributable to a decrease in license fees and royalties incurred associated with third party software licenses sold in conjunction with our software.

Amortization of Acquired Technology. The increase in the amortization of acquired technology expense of $206,000 for the year ended December 31, 2006 compared to the year ended December 31, 2005 was primarily attributable to the amortization of technology acquired from our acquisition of SiA in October 2006.

Research and Development	2006	2005	$ Change	% Change	2006 % of Revenue	2005 % of Revenue
			(In thousands, except for %'s)			
Research and development	$27,613	$22,204	$5,409	24%	37%	30%

Research and Development. The increase in research and development expenses of $5.4 million for the year ended December 31, 2006 compared to the year ended December 31, 2005 was primarily due to the increase of $2.1 million in stock-based compensation expense recognized since the adoption of SFAS No. 123(R), the increase of $1.3 million in personnel-related expenses, and additional operating costs of $908,000 associated with the acquisition of SiA in October 2006.

Selling, General and Administrative	2006	2005	$ Change	% Change	2006 % of Revenue	2005 % of Revenue
			(In thousands, except for %'s)			
Selling, general and administrative	$19,814	$16,146	$3,668	23%	26%	22%

Selling, General and Administrative. The increase in selling, general and administrative expenses of $3.7 million for the year ended December 31, 2006 compared to the year ended December 31, 2005 was primarily due to the increase of $3.0 million in stock-based compensation expense recognized since the adoption of SFAS No. 123(R).

Amortization of Other Acquired Intangible Assets	2006	2005	$ Change	% Change	2006 % of Revenue	2005 % of Revenue
			(In thousands, except for %'s)			
Amortization of other acquired intangible assets	$1,459	$940	$ 519	55%	2%	1%

Amortization of Other Acquired Intangible Assets. Amortization of other acquired intangible assets increased $519,000 for the year ended December 31, 2006 compared to the year ended December 31, 2005, as a result of the acquisition of SiA in October 2006.

Write-off of In-Process Research and Development	2006	2005	$ Change	% Change	2006 % of Revenue	2005 % of Revenue
			(In thousands, except for %'s)			
Write-off of in-process research and development	$800	$ —	$ 800	N/A	1%	—

Write-off of In-process Research and Development. Write-off of in-process research and development of $800,000 in the year ended December 31, 2006 was related to the acquisition of SiA and was associated with acquired technology that had not reached technological feasibility and for which there was no alternative future use. At December 31, 2006, the acquired technology was not being developed and did not have alternative future use. We determined the fair value of the acquired in-process technology by estimating the cash flows related to projects

under development and the estimated revenues and operating profits related to those projects. The resulting estimated cash flows were discounted to their net present value. There was no such expense in 2005.

Interest and Other Income, Net	2006	2005	$ Change	% Change	2006 % of Revenue	2005 % of Revenue
			(In thousands, except for %'s)			
Interest and other income, net	$2,827	$1,658	$1,169	71%	4%	2%

Interest and Other Income, Net. The increase in interest and other income, net of $1.2 million for the year ended December 31, 2006 compared to the year ended December 31, 2005 was primarily the result of investing in marketable securities that earned higher interest rates whereas there were no such investments in year 2005.

Income Tax Provision (Benefit)	2006	2005	$ Change	% Change	2006 % of Revenue	2005 % of Revenue
			(In thousands, except for %'s)			
Income tax provision (benefit)	$(3,133)	$96	$(3,229)	(3,364)%	(4)%	—

Income Tax Provision (Benefit). The decrease in the income tax provision of $3.2 million for the year ended December 31, 2006 compared to the year ended December 31, 2005 was primarily due to the benefit of increased research and development tax credits claimed for the current and certain prior years as a result of a study performed during the period and to the decrease in operating income for the year ended December 31, 2006.

Liquidity and Capital Resources

Operating Activities

Operating cash flows consist of net loss adjusted for certain non-cash items and changes in assets and liabilities. Net cash provided by operating activities was $1.4 million for fiscal year 2007 compared to $2.6 million for the fiscal year 2006. The decrease in operating cash flows is primarily due to a higher net loss, an increase in accounts receivable and a decrease in deferred revenue, which was partially offset by changes in accrued compensation and related benefits and tax payable. Amortization of acquired intangible assets increased $1.9 million for fiscal year 2007 compared to fiscal year 2006.

The increase in accounts receivable was due to increased revenue as well as the timing of billing schedules specified in the contract agreements related to both design-to-silicon-yield solutions and gainshare performance incentives. The decrease in deferred revenue was primarily due to the timing of bundled software and services deals that were recognized ratably over their service period, primarily during 2007. The increase in accrued compensation and related benefits was primarily due to the increase in discretionary compensation. The increase in taxes payable was primarily due to the increase of FIN No. 48 liabilities.

Investing Activities

Investing cash flows consist of proceed from investment maturities and sales, offset by payments for investments acquired, payments for businesses acquired, and capital expenditures. Net cash provided by investing activities was $203,000 for the year ended December 31, 2007 compared to $35.2 million cash used in investing activities for the year ended December 31, 2006. In fiscal year 2007, our investing activities included net proceeds of $7.0 million from short-term investments, payments of $4.6 million associated with the acquisitions, and payments of $2.2 million to purchase property and equipment. In fiscal year 2006, our investing activities included net purchases of short-term investments of $14.1 million, the purchase of SiA of $18.7 million net of cash acquired, and the purchase of property and equipment of $2.4 million. As of December 31, 2007, we had not invested in derivative securities.

Financing Activities

Financing cash flows consist primarily of payments for purchase of treasury stock and proceeds from sales of shares through employee equity incentive plans. Net cash used in financing activities was $3.7 million for fiscal

year 2007 compared to $8.2 million cash provided by financing activities for 2006. We repurchased 638,587 shares of common stock for $6.0 million in fiscal year 2007. We did not repurchase any of our common stock in fiscal year 2006. Proceeds from exercise of stock options and employee stock purchase plan were $2.9 million in fiscal year 2007 compared to $7.8 million in fiscal year 2006. We also paid off $416,000 in promissory notes assumed with the acquisition of Fabbrix in May 2007.

Liquidity

As of December 31, 2007, our working capital was $72.5 million, compared with $66.6 million as of December 31, 2006. Cash and cash equivalents, and short-term investments as of December 31, 2007 were $45.3 million compared to $52.9 million as of December 31, 2006, a decrease of $7.6 million. Decreases in cash and short-term investments were primarily attributable to the stock repurchases, payments associated with acquisitions, purchase of property and equipment, and partially offset by proceeds from the exercise of stock options and issuance of common stock under our equity plan and by cash provided by operating activities. We expect to experience growth in our overall expenses, in order to execute our business plan. As a result, we anticipate that our overall expenses, as well as planned capital expenditures, may constitute a material use of our cash resources. In addition, we may use cash resources to repurchase common stock, fund potential investments in, or acquisitions of complementary products, technologies or businesses. We believe that our existing cash resources and anticipated funds from operations will satisfy our cash requirements to fund our operating activities, capital expenditures and other obligations for at least the next twelve months. However, in the event that during such period, or thereafter, we are not successful in generating sufficient cash flows from operations we may need to raise additional capital through private or public financings, strategic relationships or other arrangements, which may not be available to us on acceptable terms or at all.

The credit markets have been volatile and have experienced a shortage on overall liquidity. We believe we have sufficient liquidity under cash provided by operations. If the global credit market continue to deteriorate, our investment portfolio may be impacted and we could determine that some of our investments are impaired which could adversely impact our financial results.

At December 31, 2007, our short-term investments included $4.5 million in auction-rate securities, which are variable rate debt instruments whose interest rates are reset through a “dutch” auction process at regular intervals, typically every 28 days. See Item 7A. “Quantitative and Qualitative Disclosures About Market Risk” in Part II and Note 3 to “Notes to Consolidated Financial Statements” in Part IV in this Form 10-K for further discussion.

Off-Balance Sheet Arrangements

We have not entered into any derivative contracts and do not have any off-balance sheet arrangements, investments in special purpose entities or undisclosed borrowings or debt, other than operating leases on our facilities. As of December 31, 2007, other than Euro denominated receivables, we had no foreign currency contracts outstanding.

We indemnify certain customers from third-party claims of intellectual property infringement relating to the use of our products. Historically, costs related to these guarantees of indemnification have not been significant. We are unable to estimate the maximum potential impact of these guarantees on our future results of operations.

Contractual Obligations

The following table summarizes our known contractual obligations (in thousands):

	Payments Due by Period					
Contractual Obligations	**2008**	**2009-2010**	**2011-2012**	**Thereafter**	**Other**	**Total**
Debt principal(1)	$ 307	$ 759	$ 117	$ —	$ —	$ 1,183
Debt interest	27	32	5	—	—	64
Capital lease obligations (including interest)	107	50	2	—	—	159
Operating lease obligations	1,719	4,607	4,240	1,523	—	12,089
Unrecognized tax benefits(2)	—	—	—	—	5,581	5,581
Total	$2,160	$ 5,448	$ 4,364	$ 1,523	$5,581	$19,076

(1) Amount represents the repayment of an interest free loan of €550,000 and a €400,000 euros loan with a variable interest rate based on the EURIBOR plus 160 basis points.

(2) Due to the inherent uncertainty of the tax positions, it is not practicable to assign this liability to any particular years in the table.

Operating lease amounts include minimum rental payments under our operating leases for our office facilities, as well as limited computer, office equipment, and vehicles that we utilize under lease agreements. These agreements expire at various dates through 2013. Capital lease amounts include $14,000 of imputed interest. Capital leases were contracted to purchase computer, software, office equipment, and vehicles in our French subsidiary.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

The following discusses our exposure to market risk related to changes in interest rates and foreign currency exchange rates. We do not currently own any equity investments, nor do we expect to own any in the foreseeable future. This discussion contains forward-looking statements that are subject to risks and uncertainties. Actual results could vary materially as a result of a number of factors.

Interest Rate Risk. As of December 31, 2007, we had cash and cash equivalents and short term investments of $45.3 million. Cash and cash equivalents consisted of cash, highly liquid money market instruments and commercial paper with maturities of 90 days or less. Short-term investments consisted of debt securities with maturities of more than three months but less than twelve months. Because of the short maturities of those instruments, a sudden change in market interest rates would not have a material impact on the fair value of the portfolio. We would not expect our operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest on our portfolio. A hypothetical increase in market interest rates of 100 basis points from the market rates in effect at December 31, 2007 would cause the fair value of these investments to decrease by an immaterial amount which would not have significantly impacted our financial position or results of operations. Declines in interest rates over time will result in lower interest income and interest expense.

At December 31, 2007, our short-term investments included $4.5 million in auction-rate securities, which are variable rate debt instruments whose interest rates are reset through a “dutch” auction process at regular intervals, typically every 28 days. Approximately $3.3 million of auction-rate securities were backed by pools of student loans guaranteed by governmental agencies and private entities, and all were rated AAA/Aaa as of December 31, 2007. Subsequent to December 31, 2007, we successfully reset $1.5 million and sold $3.0 million of auction rate securities at par during auctions. Since then, the liquidity and fair value of the remaining securities has been negatively impacted by the uncertainty in the credit markets and the exposure of these securities to the financial condition of bond insurance companies. In February and March 2008, the remaining auction-rate securities, with a fair value of $1.5 million as of December 31, 2007, failed to sell at auction, and as a result, their interest rate was reset to the maximum LIBOR + 150 basis points. We do not believe that the liquidity crisis currently affecting

auction-rate securities will materially affect our overall liquidity. We believe that our current balance of cash, cash equivalents, and short-term investments (excluding auction-rate securities) and cash flows generated by our operations is sufficient to meet our operating needs. We will review the investment in these securities further to determine whether they were other-than-temporarily impaired during the three months ending March 31, 2008. If we deem the securities to be impaired, an impairment charge will be recorded.

Foreign Currency and Exchange Risk. Certain of our sales contracts with our German subsidiary and our French subsidiary are denominated in US Dollars. Therefore, a portion of our revenue is subject to foreign currency risks. For example, the effect of an immediate 10% adverse change in exchange rates on foreign denominated receivables as of December 31, 2007 would result in a loss of approximately $77,000. To date, we have not entered into any hedging contracts, although we may do so in the future. We intend to monitor our foreign currency exposure. Future exchange rate fluctuations may have a material negative impact on our business.

Item 8. ***Financial Statements and Supplementary Data***

The consolidated financial statements and supplementary data required by this Item 8 are listed in Item 15(a)(1) of this Form 10-K.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

Item 9A. ***Controls and Procedures***

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Our Chief Executive Officer and our Chief Financial Officer, after evaluating the effectiveness of our "disclosure controls and procedures" (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act as of the end of the period covered by this Form 10-K, have concluded that our disclosure controls and procedures are effective and designed to ensure that information required to be disclosed by us in the reports we file and submit under the Exchange Act is (i) recorded, processed, summarized and reported within the timeframes specified in the rules and forms of the SEC, and (ii) is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control — Integrated Framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2007.

The effectiveness of our internal control over financial reporting as of December 31, 2007 has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report, which is included herein.

Changes in Internal Control

There were no changes in the our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 of the Exchange Act that occurred during the our fourth fiscal quarter of 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
PDF Solutions, Inc.
San Jose, California

We have audited the internal control over financial reporting of PDF Solutions, Inc. and subsidiaries (collectively, the "Company") as of December 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2007, of the Company and our report dated March 17, 2008, expressed an unqualified opinion on those financial statements and financial statement schedule and included an explanatory paragraph regarding the adoption of Financial Accounting Standards Board Interpretation No. 48 *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109*, Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment,* and Emerging Issues Task Force Issue No. 06-02, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43.*

/s/ DELOITTE & TOUCHE LLP

San Jose, California
March 17, 2008

Item 9B. ***Other Information.***

None.

PART III

Pursuant to Paragraph (3) of the General Instructions to Form 10-K, the information required by Part III of this Form 10-K is incorporated by reference from our Proxy Statement. The Proxy Statement is expected to be filed within 120 days of December 31, 2007.

Item 10. ***Directors and Executive Officers of the Registrant.***

Information with respect to our directors appears in our Proxy Statement under "Proposal No. 1 — Election of Directors — Nominees for the Board of Directors" and is incorporated herein by reference. Information with respect to our executive officers appears in Part I, Item 1 — "Executive Officers" of this Form 10-K.

Information with respect to compliance with Section 16(a) of the Exchange Act, appears in our Proxy Statement under "Section 16 Beneficial Ownership Reporting Compliance" and is incorporated herein by reference.

Our Board of Directors has adopted a Code of Ethics ("Code of Ethics") which is applicable to our Chief Executive Officer, our Chief Financial Officer and employees of the Company. Our Code of Ethics is available on our website at www.pdf.com, on the investor relations page. You may also request a copy of our Code of Ethics in writing by sending your request to PDF Solutions, Inc., Attention: Investor Relations, 333 W. San Carlos Street, San Jose, California 95110. If we make any substantive amendments to the Code of Ethics or grant any waiver, including any implicit waiver, from a provision of the Code of Ethics to our Chief Executive Officer or Chief Financial Officer, we will disclose the nature of such amendment or waiver on our website or in a current report on Form 8-K.

Item 11. ***Executive Compensation.***

The information required by this item is incorporated herein by reference to the section entitled "Compensation of Executive Officers and Other Matters — Executive Compensation" in our Proxy Statement.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.***

The information required by this item is incorporated herein by reference to the section entitled "Security Ownership of Certain Beneficial Owners and Management" in our Proxy Statement.

Item 13. ***Certain Relationships and Related Transactions.***

The information required by this item is incorporated herein by reference to the section entitled "Certain Relationships and Related Transactions" in our Proxy Statement.

Item 14. ***Principal Accounting Fees and Services.***

Information with respect to Principal Accountant Fees and Services is incorporated by reference from our Proxy Statement.

Non-Audit Services Provided by Independent Registered Public Accounting Firm

During 2007, our independent registered public accounting firm, Deloitte & Touche LLP, performed certain services that were approved by the Audit Committee of our Board of Directors as follows:

- International tax planning and tax compliance services.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules.***

(a) The following documents are filed as part of this report:

(1) Consolidated Financial Statements and Report of Independent Registered Public Accounting Firm

See Index to Consolidated Financial Statements.

(2) Schedule II Valuation and Qualifying Account

See the Report of Independent Registered Public Accounting Firm and Schedule II.

(3) Exhibits

The exhibits listed in the accompanying Index to Exhibits are filed or incorporated by reference as part of this Annual Report on Form 10-K.

PDF SOLUTIONS, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
PDF Solutions, Inc.
San Jose, California

We have audited the accompanying consolidated balance sheets of PDF Solutions, Inc. and subsidiaries (collectively, the "Company") as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedule listed in Item 15(a)(2). These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements (1) effective January 1, 2006, the Company changed its method of accounting for stock-based compensation in accordance with guidance provided in Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payments,* (2) effective January 1, 2007, the Company changed its method of accounting for its sabbatical program in accordance with guidance provided by Emerging Issues Task Force Issue No. 06-02, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43,* and (3) effective January 1, 2007, the Company changed its method of measuring and recognizing tax benefits associated with uncertain tax positions in accordance with Financial Accounting Standards Board Interpretation No. 48 *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109*.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2007, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 17, 2008, expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

San Jose, California
March 17, 2008

PDF SOLUTIONS, INC.

CONSOLIDATED BALANCE SHEETS

	December 31,	
	2007	2006
	(In thousands, except par values)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 35,315	$ 36,451
Short-term investments	9,949	16,402
Accounts receivable, net of allowances of $254 in 2007 and $294 in 2006	38,526	27,575
Prepaid expenses and other current assets	3,354	2,796
Deferred tax assets	1,676	2,581
Total current assets	88,820	85,805
Property and equipment, net	3,621	3,916
Goodwill	65,170	60,034
Intangible assets, net	12,818	13,605
Deferred tax assets and other assets	8,922	5,497
Total assets	$179,351	$168,857
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 421	$ 302
Accounts payable	3,469	3,182
Accrued compensation and related benefits	5,950	3,325
Other accrued liabilities	2,604	3,843
Taxes payable	208	4,767
Deferred revenues	3,159	3,705
Billings in excess of recognized revenue	553	95
Total current liabilities	16,364	19,219
Long-term debt	907	1,198
Long-term taxes payable	5,581	—
Other liabilities	29	221
Total liabilities	22,881	20,638
Commitments and contingencies (Notes 6 and 11)		
Stockholders' equity:		
Preferred stock, $0.00015 par value, 5,000 shares authorized, no shares issued and outstanding	—	—
Common stock, $0.00015 par value, 70,000 shares authorized: shares issued 29,122 in 2007 and 28,498 in 2006; shares outstanding 27,933 in 2007 and 27,948 in 2006	4	4
Additional paid-in capital	181,566	167,323
Treasury stock at cost, 1,190 shares in 2007 and 551 shares in 2006	(11,524)	(5,549)
Accumulated deficit	(16,892)	(13,890)
Accumulated other comprehensive income	3,316	331
Total stockholders' equity	156,470	148,219
Total liabilities and stockholders' equity	$179,351	$168,857

See notes to consolidated financial statements.

PDF SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2007	2006	2005
		(In thousands, except per share amounts)	
Revenues:			
Design-to-silicon-yield solutions:			
Services	$63,731	$45,382	$52,719
Software licenses	6,645	10,774	9,319
Gainshare performance incentives	24,087	20,028	11,890
Total revenues	94,463	76,184	73,928
Cost of design-to-silicon-yield solutions:			
Direct costs of design-to-silicon-yield solutions:			
Services	32,279(1)	27,418(1)	24,319
Software licenses	191	209	293
Amortization of acquired technology	5,148	5,270	5,064
Total cost of design-to-silicon-yield solutions	37,618	32,897	29,676
Gross margin	56,845	43,287	44,252
Operating expenses:			
Research and development	36,074(1)	27,613(1)	22,204
Selling, general and administrative	24,891(1)	19,814(1)	16,146
Amortization of other acquired intangible assets	3,422	1,459	940
Write-off of in-process research and development	—	800	—
Total operating expenses	64,387	49,686	39,290
Income (loss) from operations	(7,542)	(6,399)	4,962
Interest and other income, net	1,891	2,827	1,658
Income (loss) before taxes	(5,651)	(3,572)	6,620
Income tax provision (benefit)	(2,724)(2)	(3,133)(2)	96
Net income (loss)	$ (2,927)	$ (439)	$ 6,524
Net income (loss) per share:			
Basic	$ (0.10)	$ (0.02)	$ 0.25
Diluted	$ (0.10)	$ (0.02)	$ 0.24
Weighted average common shares:			
Basic	28,066	26,885	25,983
Diluted	28,066	26,885	27,473

See notes to consolidated financial statements.

(1) Costs and expenses for the year ended December 31, 2007 and December 31, 2006 include SFAS No. 123(R) stock-based compensation expense. See Notes 1 and 7 to the consolidated financial statements for additional information.

(2) Tax benefit includes income tax benefit from stock-based compensation.

PDF SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deferred Stock-Based Compensation	Treasury Stock Shares	Treasury Stock Amount	Notes Receivable from Stockholders	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
					(In thousands)					
Balances, January 1, 2005	25,645	$ 4	$ 134,191	$ (148)	506	$ (4,806)	$ (550)	$ (19,975)	$ 82	$ 108,798
Exercise of options	669		5,952							5,952
Issuance of common stock in connection with employee stock purchase plan	164		1,592							1,592
Stock-based compensation expense				114						114
Reversal of stock-based compensation for terminated employees			(23)	7						(16)
Acceleration of employee stock options			8							8
Acquisition of treasury stock in exchange for stockholder note receivable	(45)				45	(743)	550			(193)
Net income								6,524		
Cumulative translation adjustment									(98)	
Comprehensive loss										6,426
Balances, December 31, 2005	26,433	4	141,720	(27)	551	(5,549)	—	(13,451)	(16)	122,681
Exercise of options	639		6,021							6,021
Issuance of common stock in connection with employee stock purchase plan	177		1,752							1,752
Issuance of common stock in connection with acquisition	699		9,362							9,362
Reversal of deferred stock-based compensation expense			(27)	27						—
Stock-based compensation expense			7,351							7,351
Tax benefit related to stock-based compensation expense			1,144							1,144
Net loss								(439)		
Cumulative translation adjustment									347	
Comprehensive loss										(92)
Balances, December 31, 2006	27,948	4	167,323	—	551	(5,549)	—	(13,890)	331	148,219
Exercise of options	182		1,442							1,442
Issuance of common stock in connection with employee stock purchase plan	170		1,490							1,490
Issuance of common stock in connection with acquisition	272		2,874							2,874
Purchases of treasury stock	(639)				639	(5,975)				(5,975)
Stock-based compensation expense			8,229							8,229
Tax benefit related to stock-based compensation expense			208							208
Net loss								(2,927)		
Cumulative translation adjustment, net of tax effect									2,982	
Unrealized gain on investments									3	
Comprehensive loss										58
Cumulative effect from adoption of FIN No. 48								771		771
Cumulative effect from adoption of EITF No. 06-2, net of tax effect								(846)		(846)
Balances, December 31, 2007	27,933	$ 4	$ 181,566	$ —	1,190	$ (11,524)	$ —	$ (16,892)	$ 3,316	$ 156,470

See notes to consolidated financial statements.

PDF SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2007	2006	2005
	(In thousands)		
Operating activities:			
Net income (loss)	$ (2,927)	$ (439)	$ 6,524
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	2,070	2,103	2,235
Stock-based compensation expense	8,229	7,351	106
Loss on disposal of property, plant and equipment	—	61	—
Amortization of acquired intangible assets	8,637	6,729	6,004
Tax benefit related to stock-based compensation expense	208	1,144	—
Excess tax benefit from stock-based compensation expense	(44)	(463)	—
Write-off of in-process research and development	—	800	—
Deferred taxes	(5,494)	(6,864)	(1,900)
Changes in operating assets and liabilities, net of effect of acquisition:			
Accounts receivable, net of allowances	(10,951)	(3,648)	(6,104)
Prepaid expenses and other assets	(510)	(67)	475
Accounts payable	59	391	783
Accrued compensation and related benefits	1,182	(2,402)	1,713
Other accrued liabilities	(794)	(1,582)	(1,124)
Taxes payable	1,793	(184)	1,664
Deferred revenues	(546)	1,206	(624)
Billings in excess of recognized revenue	458	(1,509)	23
Net cash provided by operating activities	1,370	2,627	9,775
Investing activities:			
Purchases of available-for-sale securities	(26,803)	(45,823)	—
Maturities and sales of available-for-sale securities	33,818	31,700	—
Purchases of property and equipment	(2,226)	(2,433)	(2,320)
Business acquired in purchase transactions, net of cash acquired	(4,586)	(18,658)	—
Net cash provided by (used in) investing activities	203	(35,214)	(2,320)
Financing activities:			
Exercise of stock options	1,442	6,021	5,952
Proceeds from employee stock purchase plan	1,490	1,752	1,592
Purchases of treasury stock	(5,975)	—	—
Principal payments on long-term obligations	(324)	(23)	(55)
Principal payments on notes to stockholders	(416)	—	—
Excess tax benefit from stock-based compensation expense	44	463	—
Net cash provided by (used in) financing activities	(3,739)	8,213	7,489
Effect of exchange rate changes on cash and cash equivalents	1,030	319	(98)
Net increase (decrease) in cash and cash equivalents	(1,136)	(24,055)	14,846
Cash and cash equivalents, beginning of period	36,451	60,506	45,660
Cash and cash equivalents, end of period	$ 35,315	$ 36,451	$60,506
Non-cash investing and financing activities:			
Repurchase of common stock through cancellation of notes receivable	$ —	$ —	$ 743
Purchase price adjustments	$ 9	$ 923	$ —
Reversal of deferred stock compensation	$ —	$ 27	$ —
Purchase of property and equipment on account	$ 38	$ 28	$ 22
Stock issued for acquisitions	$ 2,874	$ 9,362	$ —
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Taxes	$ 634	$ 2,808	$ 241
Interest	$ 48	$ 5	$ 4

See notes to consolidated financial statements.

PDF SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2007, 2006, and 2005

1. Business and Significant Accounting Policies

PDF Solutions, Inc. (the "Company" or "PDF"), provides infrastructure technologies and services to improve yield and optimize performance of integrated circuits. The Company's approach includes manufacturing simulation and analysis, combined with yield improvement methodologies to increase product yield and performance.

Basis of Presentation — The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries after the elimination of all significant intercompany balances and transactions.

The Company has chosen to replace the term "Integrated Solutions", under the caption Design-to-Silicon Solutions in its consolidated statements of operations, with the term "Services", and replace the term "Gain Share" with "Gainshare Performance Incentives", to better describe the arrangements provided to its customers.

Significant Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. A significant portion of the Company's revenues requires estimates in regards to total costs which may be incurred and revenues earned. Actual results could differ from these estimates.

Certain Significant Risks and Uncertainties — The Company operates in the dynamic semiconductor and software industries, and accordingly, can be affected by a variety of factors. For example, management of the Company believes that changes in any of the following areas could have a significant negative effect on the Company in terms of its future financial position, results of operations and cash flows: regulatory changes; fundamental changes in the technology underlying software technologies; market acceptance of the Company's solutions; development of sales channels; litigation or other claims against the Company; the hiring, training and retention of key employees; successful and timely completion of development efforts; integration of newly acquired companies; and new product introductions by competitors.

Concentration of Credit Risk — Financial instruments that potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company maintains its cash and cash equivalents with what it considers high credit quality financial institutions.

The Company primarily sells its technologies and services to companies in Japan, Europe and North America. If the financial condition or operations of the Company's customers deteriorate the risks of collection could increase substantially. As of December 31, 2007, three customers accounted for 53% of the Company's gross accounts receivable and two customers accounted for 35% of the Company's total revenue for 2007. As of December 31, 2006, four customers accounted for 52% of the Company's gross accounts receivable and two customers accounted for 37% of the Company's total revenue for 2006. As of December 31, 2005, two customers accounted for 43% of the Company's gross accounts receivable and four customers accounted for 49% of the Company's total revenue for 2005. The Company does not require collateral or other security to support accounts receivable. To reduce credit risk, management performs ongoing credit evaluations of its customers' financial condition. The Company maintains allowances for potential credit losses.

Cash Equivalents — The Company considers all highly liquid investments with an original maturity of 90 days or fewer or remaining maturity of 90 days or fewer when acquired to be cash equivalents.

Accounts Receivable — Accounts receivable includes amounts that are unbilled at the end of the period. Unbilled accounts receivable are determined on an individual contract basis and were approximately $12.1 million and $7.8 million at December 31, 2007 and 2006, respectively.

Property and Equipment — Property and equipment are stated at cost and are depreciated or amortized using the straight-line method over the estimated useful lives of the related asset as follows:

Computer and equipment	3 years
Software	3 years
Furniture, fixtures, and equipment	5-7 years
Leasehold improvements	Shorter of estimated useful life or term of lease
Assets acquired under capital lease	Shorter of estimated useful life or term of lease

Goodwill and Intangible Assets — In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets* ("SFAS No. 142"), goodwill is generated when the consideration paid for an acquisition exceeds its fair value of net tangible assets acquired. Acquired intangible assets are amortized over their useful lives unless these lives are determined to be indefinite.

The following table provides information relating to the intangible assets and goodwill contained within the Company's consolidated balance sheets as of December 31, 2007 and December 31, 2006 (in thousands):

	Amortization Period (Years)	December 31, 2006 Net Carrying Amount	Acquisitions	Purchase Price Adjustments	Amortization	Foreign Currency Translation	December 31, 2007 Net Carrying Amount
Goodwill	N/A	$ 60,034	$ 2,155	$ 6	$ —	$ 2,975	$ 65,170
Acquired identifiable intangibles:							
Acquired technology	4-5	$ 7,901	$ 6,430	$ —	$ (5,147)	—	$ 9,184
Brand name	4	822	—	—	(461)	—	361
Customer relationships and backlog	1-6	4,362	—	—	(2,550)	—	1,812
Patent and applications	7	—	1,400	—	(117)	—	1,283
Other acquired intangibles	4	520	—	—	(362)	20	178
Total		$ 13,605	$ 7,830	$ —	$ (8,637)	$ 20	$ 12,818

	Amortization Period (Years)	December 31, 2005 Net Carrying Amount	Acquisitions	Purchase Price Adjustments	Amortization	Foreign Currency Translation	December 31, 2006 Net Carrying Amount
Goodwill	N/A	$ 39,886	$ 21,071	$ (923)	$ —	$ —	$ 60,034
Acquired identifiable intangibles:							
Acquired technology	4	$ 8,221	$ 4,950	$ —	$ (5,270)	—	$ 7,901
Brand name	4	833	510	—	(521)	—	822
Customer relationships and backlog	1-6	—	4,860	—	(498)	—	4,362
Other acquired intangibles	4	733	255	—	(477)	9	520
Total		$ 9,787	$ 10,575	$ —	$ (6,766)	$ 9	$ 13,605

In accordance with SFAS No. 142 goodwill is measured and tested for impairment on an annual basis and more frequently in certain circumstances. Accordingly, the Company has selected December 31, as the date to perform the annual testing requirements. The Company completed its annual testing requirements for 2007 and determined that the carrying value of goodwill had not been impaired.

In 2006, the Company recorded a non-cash adjustment of $923,000 relating to the reduction of a valuation allowance established for deferred tax assets that were assumed in connection with the Company's acquisition of IDS Software Inc. in 2003. Such adjustment resulted in a decrease in goodwill.

In 2007, the Company recorded adjustments to goodwill of $6,000 due to additional transaction costs incurred, partially offset by the revision in fair value of certain deferred tax assets and the billing of a pre-acquisition license sale in connection with the acquisitions of Si Automation S.A. ("SiA") and Fabbrix, Inc. ("Fabbrix"). The Company also recorded an adjustment of $3.0 million related to the effect of changes in exchange rates associated with recorded goodwill.

The Company expects that annual amortization of acquired identifiable intangible assets to be as follows (in thousands):

Year Ending December 31,	Amount
2008	3,299
2009	3,299
2010	3,030
2011	1,861
2012	1,048
Thereafter	281
Total	$12,818

Long-lived Assets — The Company's long-lived assets, excluding goodwill, consist of property and equipment and other acquired intangibles. The Company periodically reviews its long-lived assets for impairment in accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets.* For assets to be held and used, the Company initiates its review whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset group may not be recoverable. Recoverability of an asset group is measured by comparison of its carrying amount to the expected future undiscounted cash flows (without interest charges) that the asset group is expected to generate. If it is determined that an asset group is not recoverable, an impairment loss is recorded in the amount by which the carrying amount of the asset group exceeds its fair value.

The Company concluded in 2007 and 2006 that there were no events or changes in circumstances that would indicate that the carrying amounts of long-lived assets were impaired.

Revenue Recognition — The Company derives revenue from two sources: Design-to-Silicon-Yield Solutions, which includes Services and Software Licenses, and Gainshare Performance Incentives. The Company recognizes revenue in accordance with the provisions of American Institute of Certified Public Accountants Statement of Position ("SOP") No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* and SOP No. 97-2, *Software Revenue Recognition,* as amended.

Design-to-Silicon-Yield Solutions — Revenue that is derived from Design-to-Silicon-Yield solutions comes from services and software licenses. The Company recognizes revenue for each element of Design-to-Silicon-Yield solutions as follows:

Services — The Company generates a significant portion of its Design-to-Silicon-Yield revenue from fixed-price solution implementation service contracts delivered over a specific period of time. These contracts require accurate estimation of the cost to perform obligations and the overall scope of each engagement. Revenue under contracts for solution implementation services is recognized as the services are performed using the cost-to-cost percentage of completion method of contract accounting. Losses on solution implementation contracts are recognized when determined. Revisions in profit estimates are reflected in the period in which the conditions that require the revisions become known and can be estimated.

On occasion, the Company has licensed its software products as a component of its fixed-price services contracts. In such instances, the software products are licensed to the customer over the specified term of the agreement with support and maintenance to be provided over the license term. Under these arrangements, where vendor-specific objective evidence of fair value ("VSOE") exists for the support and maintenance element, the support and maintenance revenue is recognized separately over the term of the supporting period. The remaining fee is recognized as the services are performed using the cost-to-cost percentage of completion method of contract accounting. VSOE for maintenance, in these instances, is generally established based upon a negotiated renewal rate. Under arrangements where software products are licensed as a component of its fixed-price service contract and where VSOE does not exist to allocate a portion of the total fixed-price to the undelivered elements, revenue is recognized for the total fixed-price as the lesser of either the percentage of completion method of contract accounting or ratably over the term of the agreement. Costs incurred under these arrangements are deferred and recognized in proportion to revenue recognized under these arrangements.

Revenue from related support and maintenance services is recognized ratably over the term of the support and maintenance contract, generally one year, while revenue from consulting, installation and training services is recognized as the services are performed. When bundled with software licenses in multiple element arrangements, support and maintenance, consulting (other than for our fixed-price solution implementations), installation, and training revenue is allocated to each element of a transaction based upon its fair value as determined by the Company's VSOE. VSOE is generally established for maintenance based upon negotiated renewal rates while VSOE for consulting, installation, and training is established based upon the Company's customary pricing for such services when sold separately. When VSOE does not exist to allocate a portion of the total fee to the undelivered elements, revenue is recognized ratably over the term of the underlying element for which VSOE does not exist.

Software Licenses — The Company also licenses its software products separately from its integrated solution implementations. In such cases revenue is recognized under the residual method when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the fee is fixed or determinable, (4) collectibility is probable, and (5) the arrangement does not require services that are essential to the functionality of the software. When arrangements include multiple elements such as support and maintenance, consulting (other than for our fixed price solution implementations), installation, and training, revenue is allocated to each element of a transaction based upon its fair value as determined by the Company's VSOE and such services are recorded as services. VSOE is generally established for maintenance based upon negotiated renewal rates while VSOE for consulting, installation and training services is established based upon the Company's customary pricing for such services when sold separately. When VSOE does not exist to allocate a portion of the total fee to the undelivered elements, revenue is recognized ratably over the term of the underlying element for which VSOE does not exist, and such revenue is recorded as services. No revenue has been recognized for software licenses with extended payment terms in excess of amounts due. During the year ended December 31, 2006, the Company entered into a barter transaction with another software company. As the fair value of the software licenses exchanged could not be reliably estimated, the Company did not record any revenue nor cost for the transaction.

Gainshare Performance Incentives — When the Company enters into a contract to provide yield improvement services, the contract usually includes two components: (1) a fixed fee for performance by the Company of services delivered over a specific period of time; and (2) a gainshare performance incentives component where the customer may pay a variable fee, usually after the fixed fee period has ended. Revenue derived from gainshare performance incentives represents profit sharing and performance incentives earned based upon the Company's customers reaching certain defined operational levels established in related solution implementation services contracts. Gainshare performance incentives periods are usually subsequent to the delivery of all contractual services and therefore have no cost to the Company. Due to the uncertainties surrounding attainment of such operational levels, the Company recognizes gainshare performance incentives revenue (to the extent of completion of the related

solution implementation contract) upon receipt of performance reports or other related information from the customer supporting the determination of amounts and probability of collection.

Software Development Costs — Costs for the development of new software products and substantial enhancements to existing software products are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized in accordance with SFAS No. 86, *Computer Software to be Sold, Leased or Otherwise Marketed.* Because the Company believes its current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no costs have been capitalized to date.

Research and Development — Research and development expenses are charged to operations as incurred.

Stock-Based Compensation — Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS No. 123(R)"). The statement eliminates the ability to account for share-based compensation transactions using Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB No. 25") and requires that the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements based on estimated fair values. SFAS No. 123(R) applies to all share-based payment transactions in which the Company acquires goods or services by issuing its shares, share options, or other equity instruments or by incurring liabilities based on the price of the Company's shares or that require settlement by the issuance of equity instruments. The Company elected to use the modified prospective transition method upon adopting this statement and accordingly prior periods have not been restated to reflect the impact of SFAS No. 123(R). Under this transition method, stock-based compensation expense during fiscal 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provision of SFAS No. 123. Stock-based compensation expense during fiscal 2006 also includes expense for all stock-based compensation awards granted after January 1, 2006 based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). The Company recognizes the compensation costs of options granted after January 1, 2006 on a straight-line basis over the vesting periods of the applicable stock purchase rights and stock options, generally four years. Prior to the adoption of SFAS No. 123(R), the Company accounted for stock-based compensation in accordance with APB No. 25, and complied with the disclosure provisions of SFAS No. 123 as amended by SFAS No. 148, *"Accounting for Stock-Based Compensation — Transition and Disclosures"*. Deferred compensation recognized under APB No. 25 was amortized to expense using the graded vesting method. Prior to adoption of SFAS No. 123(R), the Company presented all tax benefits resulting from stock options as operating cash flow in its statement of cash flows. In accordance with SFAS No. l23(R), the cash flows resulting from excess tax benefits for awards accounted under SFAS No. 123(R) are classified as financing cash flows.

In March 2005, the Securities and Exchange Commission (the "SEC") issued Staff Accounting Bulletin No. 107 ("SAB 107") regarding the SEC's interpretation of SFAS No. 123(R) and the valuation of share-based payments for public companies. The Company has applied the provisions of SAB 107 in its adoption of SFAS No. 123(R). In December 2007, the SEC issued Staff Accounting Bulletin No. 110 ("SAB 110") to amend the SEC's views discussed in SAB 107 regarding the use of the simplified method in developing an estimate of expected life of share options in accordance with SFAS No. 123(R). SAB 110 is effective for the Company beginning in the first quarter of fiscal year 2008. In the fourth quarter of fiscal 2007, the Company had enough historical data to determine its expected life. See Note 7 to the Consolidated Financial Statements for a further discussion on stock-based compensation.

Income Taxes — The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*, ("SFAS No. 109"). In determining taxable income for financial statement reporting purposes, certain estimates and judgments must be made. These estimates and judgments are applied in the calculation of certain tax liabilities and in the determination of the recoverability of deferred tax assets, which arise from temporary differences between the recognition of assets and liabilities for tax and financial statement reporting purposes. The

realization of deferred tax assets is dependent on the Company's ability to generate future taxable income and utilize tax planning strategies. The deferred tax asset amount recorded is more likely than not to be realized based on current estimations and assumptions. The valuation allowance is evaluated on a quarterly basis. Any resulting changes to the valuation allowance will result in an adjustment to income in the period the determination is made.

In June, 2006, the Financial Accounting Standard Board ("FASB") issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109* ("FIN No. 48"), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. Additionally, the Interpretation provides guidance on measurement, de-recognition, classification, interest and penalties, accounting for interim periods, disclosure and transition. The Interpretation is effective for fiscal years beginning after December 15, 2006. The Company adopted the provisions of FIN No. 48 on January 1, 2007. See Note 9 to the consolidated financial statements for a further discussion on the income taxes.

Foreign Currency Translation — The functional currency of the Company's foreign subsidiaries is the local currency for the respective subsidiary. The assets and liabilities are translated at the period-end exchange rate, and statements of operations are translated at the average exchange rate during the year. Gains and losses resulting from foreign currency translations are included as a component of other comprehensive income (loss). Gains and losses resulting from foreign currency transactions are included in the consolidated statement of operations.

Comprehensive Income (Loss) — SFAS No. 130, *Reporting Comprehensive Income,* requires that an enterprise report, by major components and as a single total, the change in its net assets during the period from nonowner sources. Comprehensive income (loss) is presented within the statement of stockholders' equity. Accumulated other comprehensive income (loss) at December 31, 2007 and 2006 is comprised of (in thousands):

	Balance at December 31,	
	2007	2006
Unrealized gain on short-term investments	$ 3	$ —
Foreign currency translation adjustments	3,313	331
Accumulated other comprehensive income	$ 3,316	$ 331

Fair Value of Financial Instruments — The carrying amounts of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, approximate fair value because of their short maturities. The carrying amount of debt approximates fair value because of the immaterial difference between the effective and actual interest rates.

Recent Accounting Pronouncements — In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement,* ("SFAS No. 157"), which establishes a framework for measuring fair value and expands disclosures about fair value measurements. Additionally, the pronouncement provides guidance on definition, measurement, methodology and use of assumptions and inputs in determining fair value. In February 2008, the FASB issued FASB Staff Position ("FSP") 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* ("FSP 157-1") and FSP 157-2, *Effective Date of FASB Statement No. 157* ("FSP 157-2"). FSP 157-1 removes certain leasing transactions from the scope of SFAS No. 157. FSP 157-2 delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. SFAS No. 157 for financial assets and financial liabilities is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of SFAS No. 157 on its financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115*, ("SFAS No. 159"). SFAS No. 159 permits companies to choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. Entities choosing the fair value option would be required to recognize subsequent changes in the fair value of those instruments and other items directly in earnings. This standard also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 159 on its financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ("SFAS No. 141R"). SFAS No. 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS No. 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141R is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008, and will be adopted by the Company in the first quarter of fiscal 2009. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 141R on its financial statements.

Other Accounting Changes — Effective January 1, 2007, the Company adopted the provisions of the FASB's Emerging Issues Task Force ("EITF") No. 06-2, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43* ("EITF No. 06-2"). Prior to the issuance of EITF No. 06-2 the Company accounted for sabbatical expense under SFAS No. 43, by expensing the cost of compensated absences for sabbatical programs as incurred. EITF No. 06-2 requires companies to accrue the cost of such compensated absences over the requisite service period. The Task Force allows the use of one of two specified methodologies for adopting the change in accounting principle: i) a cumulative-effect adjustment to retained earnings at the beginning of the year of adoption; or ii) retrospective application to all prior periods. The Company elected to use the cumulative-effect adjustment to the beginning balance of retained earnings resulting in an additional liability of $1.4 million, an additional deferred tax asset of $587,000, and an increase in the accumulated deficit of $846,000. Under this transition method, prior periods were not restated and accrued expenses as of December 31, 2007 include accrued sabbatical expense for all employees who are eligible for sabbatical leave.

Effective January 1, 2007, the Company adopted the provisions of FIN No. 48, which provides a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. Unrecognized tax benefits represent tax positions for which reserves have been established. As a result of the implementation of FIN No. 48, the Company recognized a $771,000 decrease in net liabilities for unrecognized tax benefits. This was accounted for as an adjustment to the beginning balance of the accumulated deficit on the balance sheet. As the Company does not anticipate recognizing these tax benefits over the next twelve months, it has reclassified these liabilities as long-term. Prior to the adoption of FIN No. 48, the Company recorded its tax exposure as current liabilities.

2. Acquisitions

Fabbrix, Inc.

On May 24, 2007, the Company completed the acquisition of Fabbrix, a provider of silicon intellectual property designed to create highly manufacturable and area-efficient designs targeted for advanced technology nodes. With this acquisition, the Company has enhanced its strength in silicon characterization to enable a true co-optimization of the manufacturing fabric and the logic elements. Total cost for the acquisition was $6.2 million, which includes $2.7 million cash, 271,531 shares of the Company's common stock valued at $2.9 million, and $607,000 in acquisition costs. Included in the acquisition costs above, $405,000 in cash and approximately 41,000 shares of common stock were held in escrow as security against certain financial contingencies. The cash

and shares held in escrow, less amounts deducted to satisfy contingencies will be released no later than on the 18 month anniversary of the acquisition. The fair value of the Company's common stock was determined based on the average closing price per share of the Company's common stock over a 5-day period beginning two trading days before and ending two trading days after the terms were announced (May 23, 2007). The acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, *Business Combinations* ("SFAS No. 141"), and accordingly the Company's consolidated financial statements from May 24, 2007 include the impact of the acquisition.

In addition to the initial cash and stock consideration, up to $14.0 million in earnout consideration will be paid to the selling stockholders if qualifying orders, received during the first twelve months following the closing date, are recognized as revenue during the forty-eight months following the closing date. Earnout consideration will consist of a combination of fifty percent of such amount as a cash payment and fifty percent of such amount as shares of PDF's common stock. As the contingent consideration is based on future earnings, and was not determinable nor estimable at the date of acquisition, the additional consideration would be recorded only when it becomes determinable. Since the acquisition, the estimable qualifying revenue has not met the threshold, and no additional consideration has been recorded as of December 31, 2007.

The allocation of the purchase price for this acquisition, as of the date of the acquisition, is as follows (in thousands, except amortization period):

Allocation of Purchase Price	Amortization Period (Years)	Amount
Fair value of tangible assets (including cash of $62,000)		$ 406
Fair value of intangible assets:		
Developed technology	5	6,430
Patent and applications	7	1,400
Goodwill	N/A	2,155
Total assets acquired		10,391
Deferred tax liability		(3,210)
Notes to stockholders		(416)
Accrued liabilities		(364)
Accounts payable		(219)
Total liabilities assumed		(4,209)
Total consideration, net		$ 6,182

The acquisition was accounted for as a purchase transaction, and accordingly, the assets and liabilities of Fabbrix were recorded at their estimated fair values at the date of the acquisition. With the exception of the goodwill, the identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives, which vary from 5 to 7 years, with a weighted average life of 5.4 years. As of December 31, 2007, the Company recorded an adjustment of $70,000, primarily related to actual transaction costs, resulting in an increase to goodwill.

The acquisition of Fabbrix was structured as a tax-free acquisition. Therefore, the difference between the recognized fair values of the acquired net assets and their historical tax base are not deductible for tax purposes. A deferred tax liability has been recognized for the difference between the assigned fair values of intangible assets for book purposes and the tax basis of such assets.

As of December 31, 2007, the Company has repaid $416,000 of promissory notes due to Fabbrix stockholders and has made payments of $2.7 million that were previously accrued as part of the acquisition of Fabbrix.

Si Automation S.A.

On October 31, 2006, the Company completed its acquisition of all the outstanding capital stock of SiA, a privately held company based in Montpellier, France. SiA developed and licensed fault detection and classification software applications and services dedicated to the semiconductor industry that enables customers to rapidly identify sources of process variations and manufacturing excursions by monitoring equipment parameters through its proprietary data collection and analysis applications. The acquisition of SiA will allow the Company's customers greater capabilities for managing product yield improvement as a result of these process control solutions and services. At the closing of the acquisition, SiA became the Company's wholly owned subsidiary and its name was changed to PDF Solutions S.A., and then to PDF Solutions S.A.S. in 2007. The aggregate purchase price was $36.6 million which included the payment in cash of $25.5 million, the issuance of 699,298 shares of our common stock valued at $9.4 million, and acquisition costs of $1.7 million. Included in the acquisition costs above, $2.7 million in cash and approximately 119,000 shares of common stock were held in escrow as security against certain financial contingencies. The cash and shares held in escrow, less amounts deducted to satisfy contingencies, will be released upon the 18-month anniversary of the acquisition. Any remaining cash and shares held in escrow after satisfying contingencies will be released no later than the 36-month anniversary of the acquisition. The fair value of the Company's common stock was determined based on the average closing price per share of the Company's common stock over a 5-day period beginning two trading days before and ending two trading days after the terms were announced (October 25, 2006). The acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, and accordingly the Company's consolidated financial statements from October 31, 2006 include the impact of the acquisition.

The allocation of the purchase price for this acquisition, as of the date of the acquisition, is as follows (in thousands, except amortization period):

Allocation of Purchase Price	Amortization Period (Years)	Amount
Fair value of tangible assets		$11,496
Fair value of intangible assets:		
Brand name	4	510
Contract backlog	1	2,610
Customer relationships	6	2,250
Core technology	4	4,950
Other	4	255
In-process research and development	N/A	800
Goodwill	N/A	21,071
Total assets acquired		43,942
Deferred tax liability		(3,440)
Bank debt and capital leases		(1,486)
Accrued liabilities		(1,104)
Accounts payable		(1,058)
Deferred revenue under maintenance obligations		(218)
Total liabilities assumed		(7,306)
Total consideration, net		$36,636

The acquisition was accounted for as a purchase transaction, and accordingly, the assets and liabilities of SiA were recorded at their estimated fair values at the date of the acquisition. With the exception of the goodwill and

acquired in-process research and development ("IPR&D"), the identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives, which vary from 1 to 6 years, with a weighted average life of 3.7 years. The acquired IPR&D technology was immediately expensed because technological feasibility had not been established and no future alternative use exists. In assessing SiA's IPR&D projects, the key characteristics of the products under development were considered as well as future prospects, the rate at which technology changes, product life cycles, and the projects' stages of development. The IPR&D technology write-off is included as a component of operating expenses in the consolidated statement of operations. The fair value of IPR&D, as well as the fair value of the identifiable intangible assets, was determined, in part, using established valuation techniques.

The acquisition of SiA was structured as a taxable acquisition. Therefore, the difference between the recognized fair values of the acquired net assets and their historical tax base are deductible for tax purposes. A deferred tax liability has been recognized for the difference between the assigned fair values of intangible assets (other than goodwill) for book purposes and the tax basis of such assets.

During the year ended December 31, 2007, the Company recorded an adjustment of $126,000 related to the final billing of a license sale that occurred prior to acquisition, and an adjustment of $332,000 related to a revision in the fair value of acquired deferred tax assets, both resulting in a reduction of goodwill. The Company also recorded an adjustment of $393,000 related to additional transaction costs, which resulted in an increase in goodwill.

As of December 31, 2007, the Company has made final net payments of $1.9 million that were previously accrued as part of the acquisitions of SiA.

The following unaudited pro forma consolidated financial data represents the combined results of operations as if SiA and Fabbrix had been combined with the Company at the beginning of the respective periods. This pro forma financial data includes the straight line amortization of intangibles over their respective estimated useful lives and excludes the write-off of IPR&D (in thousands, except per share data):

	Year Ended December 31,	
	2007	2006
Revenue	$94,463	$81,462
Net loss	$ (4,077)	$ (5,422)
Pro forma net loss per share — basic and diluted	$ (0.14)	$ (0.20)
Number of shares used to compute pro forma net loss per share — basic and diluted	28,179	27,740

These results do not purport to be indicative of what would have occurred had the acquisition been made as of the beginning of the respective periods or the results of operations which may occur in future periods.

3. Investments

The following tables summarize the Company's investments (in thousands):

	December 31, 2007			
	Amortized Cost	Unrealized Holding Gains	Unrealized Holding Losses	Market Value
Commercial paper	$ 12,500	$ 3	$ —	$ 12,503
Auction rate securities	4,450	—	—	4,450
Agency discount notes	1,543	—	—	1,543
	$ 18,493	$ 3	$ —	$ 18,496
Included in cash and cash equivalents				$ 8,547
Included in short-term investments				9,949
Total				$ 18,496

	December 31, 2006			
	Amortized Cost	Unrealized Holding Gains	Unrealized Holding Losses	Market Value
Commercial paper	$ 13,307	$ 1	$ —	$ 13,308
Auction rate securities	5,050	—	—	5,050
Corporate bonds and notes	1,984	—	(1)	1,983
	$ 20,341	$ 1	$ (1)	$ 20,341
Included in cash and cash equivalents				$ 3,939
Included in short-term investments				16,402
Total				$ 20,341

As of December 31, 2007 and 2006 all securities held by the Company had a maturity of one year or less.

The primary objective of the Company's cash equivalent and short-term investment activities is to preserve capital and maintain liquidity while generating appropriate returns. The Company's investment policy allows for only high-credit-quality securities. The value and liquidity of these securities are affected by market interest rates generally, as well as the ability of the issuer to make principal and interest payments when due and the normal functioning of the markets in which these securities are traded. There were no material impairments of short-term investments or cash equivalents in the periods presented.

At December 31, 2007, the Company's short-term investments included $4.5 million in auction-rate securities, which are variable rate debt instruments whose interest rates are reset through a "dutch" auction process at regular intervals, typically every 28 days. Approximately $3.3 million of auction-rate securities were backed by pools of student loans guaranteed by governmental agencies and private entities, and all were rated AAA/Aaa as of December 31, 2007. Subsequent to December 31, 2007, the Company successfully reset $1.5 million and sold $3.0 million of auction rate securities at par during auctions. Since then, the liquidity and fair value of the remaining securities has been negatively impacted by the uncertainty in the credit markets and the exposure of these securities to the financial condition of bond insurance companies. In February and March 2008, the remaining auction-rate securities, with a fair value of $1.5 million as of December 31, 2007, failed to sell at auction, and as a result, their interest rate was reset to the maximum LIBOR + 150 basis points. The Company does not believe that the liquidity crisis currently affecting auction-rate securities will materially affect its overall liquidity. The Company believes

that its current balance of cash, cash equivalents, and short-term investments (excluding auction-rate securities) and cash flows generated by its operations is sufficient to meet its operating needs. The Company will review the investment in these securities further to determine whether they were other-than-temporarily impaired during the three months ending March 31, 2008. If the Company deems the securities to be impaired, an impairment charge will be recorded.

4. Property and Equipment

Property and equipment consist of (in thousands):

	December 31,	
	2007	2006
Computer equipment	$ 11,890	$ 10,714
Software	3,299	3,133
Furniture, fixtures, and equipment	1,437	1,254
Vehicles	36	60
Leasehold improvements	558	523
	17,220	15,684
Accumulated depreciation and amortization	(13,599)	(11,768)
	$ 3,621	$ 3,916

The Company leases office equipment, computer hardware, vehicles and computer software under capital leases as defined in *SFAS No. 13, Accounting for Leases.* The following is an analysis of the leased property (included in table above) under capital leases by major classes (in thousands):

	December 31, 2007	December 31, 2006
Computer and office equipment	$ 205	$ 424
Vehicles	36	60
Software	44	47
	285	531
Accumulated depreciation and amortization	(172)	(287)
	$ 113	$ 244

5. Other Accrued Liabilities

Other accrued liabilities consist of (in thousands):

	December 31,	
	2007	2006
Amounts due to SiA shareholders	$ —	$1,879
Other accrued expenses	2,604	1,964
Total other accrued expenses	$2,604	$3,843

6. Commitments and Contingencies

Leases — The Company leases administrative and sales offices and certain equipment under noncancelable operating leases which contain various renewal options and require payment of common area costs, taxes and

utilities, when applicable. These operating leases expire at various times through 2013. Rent expense was $3.1 million, $2.8 million, and $2.6 million in 2007, 2006, and 2005, respectively.

Future minimum lease payments under noncancelable operating leases at December 31, 2007 are as follows (in thousands):

Year Ended December 31,	
2008	$ 1,719
2009	2,430
2010	2,177
2011	2,196
2012	2,045
Thereafter	1,522
Total future minimum lease payments	$12,089

Future minimum lease payments under capital leases are as follows as of December 31, 2007 (in thousands):

Year Ended December 31,	
2008	$107
2009	40
2010	10
2011	2
2012	—
Net minimum lease payments	159
Less: amount representing interest	(14)
Present value of future minimum lease payments	$145

Debt — During 2004 and 2005, the former SiA entered into two separate debt agreements with a government-backed agency in France. Such obligations were assumed by the Company at the time of acquisition. In 2004 SiA obtained a €550,000 loan to cover research and development expenses. The loan does not carry interest and its repayment is conditioned on meeting certain revenue targets. The Company met those targets both in 2006 and 2007, and as such, will reimburse the entire loan in four payments through 2010. SiA also entered into a long-term debt agreement in 2005 for a total amount of €400,000. The debt carries a variable interest rate based on the three month average EURIBOR plus 160 basis points. As of December 31, 2007, such rate was 6.46%. The debt is reimbursable in 20 equal principal quarterly installments from January 2007 through October 2011. Neither debt agreements carry any financial covenant.

Future minimum debt payments under the current debt agreements are as follows (in thousands):

Year Ended December 31,	Principal	Interest
2008	$ 307	$ 27
2009	350	20
2010	409	12
2011	117	5
Total future minimum debt payments	$ 1,183	$ 64

Indemnifications — The Company generally provides a warranty to its customers that its software will perform substantially in accordance with documented specifications typically for a period of 90 days following

delivery of its products. The Company also indemnifies certain customers from third-party claims of intellectual property infringement relating to the use of its products. Historically, costs related to these guarantees have not been significant. The Company is unable to estimate the maximum potential impact of these guarantees on its future results of operations.

Indemnification of Officers and Directors — As permitted by the Delaware general corporation law, the Company has included a provision in its certificate of incorporation to eliminate the personal liability of its officers and directors for monetary damages for breach or alleged breach of their fiduciary duties as officers or directors, other than in cases of fraud or other willful misconduct.

In addition, the Bylaws of the Company provide that the Company is required to indemnify its officers and directors even when indemnification would otherwise be discretionary, and the Company is required to advance expenses to its officers and directors as incurred in connection with proceedings against them for which they may be indemnified. The Company has entered into indemnification agreements with its officers and directors containing provisions that are in some respects broader than the specific indemnification provisions contained in the Delaware general corporation law. The indemnification agreements require the Company to indemnify its officers and directors against liabilities that may arise by reason of their status or service as officers and directors other than for liabilities arising from willful misconduct of a culpable nature, to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified, and to obtain directors' and officers' insurance if available on reasonable terms. The Company has obtained directors' and officers' liability insurance in amounts comparable to other companies of the Company's size and in the Company's industry. Since a maximum obligation of the Company is not explicitly stated in the Company's Bylaws or in its indemnification agreements and will depend on the facts and circumstances that arise out of any future claims, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, the Company has not made payments related to these obligations, and the estimated fair value for these obligations is zero on the consolidated balance sheet as of December 31, 2007.

7. Stockholders' Equity

Effective January 1, 2006 the Company adopted SFAS No. 123(R). Stock-based compensation expenses before taxes related to the Company's employee stock purchase plan and stock-option plans were allocated as follows (in thousands):

	Year Ended December 31, 2007(1)	Year Ended December 31, 2006(1)	Year Ended December 31, 2005(2)
Cost of design-to-silicon yield solutions	$ 2,170	$ 2,115	$ —
Research and development	2,619	2,229	98
Selling, general and administrative	3,440	3,007	8
Stock based compensation expense before income taxes	$ 8,229	$ 7,351	$ 106

(1) Stock-based compensation expense computed under SFAS No. 123(R)

(2) Stock-based compensation expense computed under APB No. 25

Prior to January 1, 2006, the Company accounted for stock-based compensation in accordance with the provisions of APB No. 25 and complied with the disclosure only provisions of SFAS No. 123 as amended by SFAS No. 148, and accordingly, no expense computed under SFAS No. 123 had been recognized for options granted to employees under the various stock plans. Deferred compensation recognized under APB No. 25 was amortized to expense over the vesting period, usually four years, using the graded vesting method. For SFAS No. 123 as amended by SFAS No. 148 disclosure purposes, the Company amortized deferred stock-based compensation on

the graded vesting method over the vesting periods of the applicable stock purchase rights and stock options, generally four years. The graded vesting method provided for vesting of portions of the overall awards at interim dates and resulted in greater vesting in earlier years than the straight-line method. Had compensation expense been determined for employee awards based on the fair value at the grant date for the awards, consistent with the provisions of SFAS No. 123, the Company's pro forma net loss per share for the year ended December 31, 2005 would have been as follows (in thousands, except per share data):

	Year Ended December 31, 2005
Net income as reported:	$ 6,524
Add: stock-based employee compensation expense included in reported net income under APB No. 25	106
Deduct: total stock based employee compensation determined under fair value based method for all awards, net of related tax effects	(7,153)
Pro forma net loss	$ (523)
Basic net income (loss) per share:	
As reported	$ 0.25
Pro forma	$ (0.02)
Diluted net income (loss) per share:	
As reported	$ 0.24
Pro forma	$ (0.02)

Upon its adoption of the fair value recognition provisions of SFAS No. 123(R), the Company elected to use the modified prospective transition method, and accordingly, prior periods have not been restated to reflect the impact of SFAS No. 123(R). Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Under the modified prospective transition method, stock-based compensation expense recognized in the Company's consolidated statement of operations for the years ended December 31, 2006 and December 31, 2007 included compensation expense for share-based payment awards granted prior to, but not yet vested as of December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 123, and compensation expense for the share-based payment awards granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). In conjunction with the adoption of SFAS No. 123(R), the Company changed its method of attributing the value of stock-based compensation to expense from the graded vesting method to the straight-line method. Compensation expense for all share-based payment awards granted on or prior to December 31, 2005 will continue to be recognized using the graded vesting method while compensation expense for all share-based payment awards granted subsequent to December 31, 2005 is recognized using the straight-line method. As stock-based compensation expense recognized in the consolidated statements of operations for the years ended December 31, 2006 and December 31, 2007 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's pro forma information required under SFAS No. 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred. The Company estimated the forfeiture rate based on its employee turnover history over the last two fiscal years.

The Company has elected to use the Black-Scholes-Merton option-pricing model, which incorporates various assumptions including volatility, expected life and interest rates. The expected volatility is based on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected

life of the Company's stock options. The expected life of an award is based on historical experience and on the terms and conditions of the stock awards granted to employees. The interest rate assumption is based upon observed Treasury yield curve rates appropriate for the expected life of the Company's stock options.

The fair value of options granted was estimated on the date of grant with the following weighted average assumptions:

	Stock Plans			Employee Stock Purchase Plan		
	2007	2006	2005	2007	2006	2005
Expected life (in years)	5.9	5.7	5.5	0.74	0.95	0.79
Volatility	57.9%	60.4%	55.3%	55.5%	50.3%	39%
Risk-free interest rate	4.21%	4.60%	4.15%	5.11%	4.08%	2.66%
Expected dividend	—	—	—	—	—	—

On December 31, 2007, the Company has in effect the following stock-based compensation plans:

Stock Plans — During 2001, the Company terminated the 1996 and 1997 Stock Plans as to future option grants, and adopted the 2001 Stock Plan. Under the 2001 Stock Plan, on January 1 of each year, starting with year 2002, the number of shares in the reserve will increase by the lesser of (1) 3,000,000 shares, (2) 5% of the outstanding common stock on the last day of the immediately preceding year, or (3) the number of shares determined by the board of directors. Under the 2001 Stock Plan, the Company may grant options to purchase shares of common stock to employees, directors and consultants at prices not less than the fair market value at the date of grant for incentive stock options and not less than 85% of fair market value for nonstatutory stock options. These options generally expire ten years from the date of grant and become vested and exercisable ratably over a four-year period. Certain option grants under the 1996 and 1997 Stock Plans provide for the immediate exercise by the optionee with the resulting shares issued subject to a right of repurchase by the Company which lapses based on the original vesting provisions.

As of December 31, 2007 the Company has authorized 10,218,539 shares of common stock for issuance and exercise of options, of which 638,629 shares are available for grant.

At December 31, 2007 there were no outstanding options that had been granted outside of the Plans.

PDF SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Additional information with respect to options under the Plans, including options granted outside the Plans, is as follows:

	Outstanding Options		Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in 000's)
	Number of Options	Weighted Average Exercise Price per Share		
Outstanding, January 1, 2005 (2,368,598 shares vested and exercisable at a weighted average exercise price of $10.00 per share)	4,952,282	$ 9.72		
Granted (weighted average fair value of $7.75 per share)	1,625,205	14.39		
Exercised	(669,175)	8.89		
Canceled	(215,888)	9.83		
Expired	(18,379)	14.33		
Outstanding, December 31, 2005 (2,877,674 shares vested and exercisable at a weighted average exercise price of $10.15 per share)	5,674,045	11.13		
Granted (weighted average fair value of $8.35 per share)	1,947,400	14.25		
Exercised	(638,610)	9.43		
Canceled	(300,034)	13.33		
Expired	(18,707)	11.44		
Outstanding, December 31, 2006 (3,419,259 shares vested and exercisable at a weighted average exercise price of $10.64 per share)	6,664,094	12.11		
Granted (weighted average fair value of $5.47 per share)	2,077,878	9.50		
Exercised	(182,090)	7.92		
Canceled	(256,234)	14.15		
Expired	(288,728)	13.23		
Outstanding, December 31, 2007	8,014,920	11.42	7.41	2,661
Vested and expected to vest	7,414,409	11.45	7.26	2,628
Exercisable, December 31, 2007	4,240,561	$ 11.28	5.96	$ 2,487

The aggregate intrinsic value in the table above represents the total pretax intrinsic value based on the Company's closing stock price of $9.01 as of December 31, 2007, which would have been received by the option holders had all option holders exercised their options as of that date.

The total intrinsic value of options exercised during the twelve months ended December 31, 2007 was $672,000, determined as of the date of option exercise.

PDF SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

As of December 31, 2007, there was $17.9 million of total unrecognized compensation cost net of forfeitures related to nonvested stock options. That cost is expected to be recognized over a weighted average period of 3.0 years. The total fair value of shares vested during the year ended December 31, 2007 was $9.6 million. Additional information regarding options outstanding as of December 31, 2007 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price per Share	Number Vested and Exercisable	Weighted Average Exercise Price per Share
$0.15 - $0.15	3,332	0.5	$ 0.15	3,332	$ 0.15
$0.53 - $0.53	333	2.0	0.53	333	0.53
$1.13 - $1.13	26,836	4.2	1.13	26,836	1.13
$1.88 - $1.88	16,666	2.4	1.88	16,666	1.88
$3.78 - $5.40	197,895	4.6	5.16	197,895	5.16
$6.00 - $9.00	2,073,402	8.3	8.27	678,037	7.00
$9.01 - $13.35	2,707,202	6.4	11.05	1,885,873	11.11
$13.60 - $19.00	2,989,254	7.8	14.52	1,431,589	14.70
$0.15 - $19.00	8,014,920	7.4	11.42	4,240,561	11.28

Nonvested shares (restricted stock units) as of December 31, 2007 and changes during the twelve months ended December 31, 2007 were as follows:

	Shares	Weighted Average Measurement Date Fair Value
Nonvested, January 1, 2007	—	$ —
Granted	133,000	9.01
Vested	—	—
Forfeited	—	—
Nonvested, December 31, 2007	133,000	$ 9.01

As of December 31, 2007, there was $1.0 million of total unrecognized compensation cost related to restricted stock. That cost is expected to be recognized over a weighted average period of 6.4 years. The total compensation expense related to shares expected to vest during year ended December 31, 2007 was $181,000.

Employee Stock Purchase Plan — In July 2001, the Company adopted an Employee Stock Purchase Plan, ("Purchase Plan") under which eligible employees can contribute up to 10% of their compensation, as defined in the Purchase Plan, towards the purchase of shares of PDF common stock at a price of 85% of the lower of the fair market value at the beginning of the offering period or the end of each six-month offering period. Under the Purchase Plan, on January 1 of each year, starting with 2002, the number of shares reserved for issuance will automatically increase by the lesser of (1) 675,000 shares, (2) 2% of the Company's outstanding common stock on the last day of the immediately preceding year, or (3) the number of shares determined by the board of directors. As of December 31, 2007, 2,288,059 shares of the Company's common stock have been reserved for issuance under the Purchase Plan. During years 2007, 2006, and 2005, 170,189, 175,977 and 163,823 were issued at a weighted average price of $8.75, $9.95, and $9.72 per share, respectively and at December 31, 2007, 1,079,684 shares were available for future issuance under the Purchase Plan. The weighted average estimated fair value of shares granted under the Purchase Plan during 2007, 2006, and 2005 was $4.09, $4.10, and $3.15, respectively.

Common Stock Options — During 2003, in connection with stock options granted and assumed through the Company's acquisition of IDS, it recorded deferred stock-based compensation of $920,000, which reflects the intrinsic value of the unvested stock options assumed as of the acquisition date. Deferred compensation associated with such options was amortized over the remaining vesting periods of the applicable options and the remaining balance of $27,000 was reversed upon the adoption of SFAF No. 123(R).

Amortization of employee and non-employee stock-based compensation totaled $106,000 in 2005.

Stock Repurchase Program — In February 2003, the Board of Directors approved a program to repurchase up to $10.0 million of the Company's common stock in the open market. During the year ended December 31, 2005, the Company repurchased 44,942 shares of common stock from a Director of the Company at the closing price on the date of repurchase, which was $16.52 per share, in exchange for the repayment of a stockholder note receivable in the amount of approximately $743,000 consisting of the principal amount of the note and accrued interest. During the year ended December 31, 2006 the Company did not repurchase any shares of the Company's common stock. During the year ended December 31, 2007 the Company repurchased 638,587 shares of common stock at a weighted average price of $9.36 per share for a total cost of $6.0 million. As of December 31, 2007, the Company has repurchased an aggregate of 1,189,108 shares at a weighted average price of $9.69 per share for a total cost of $11.5 million since the inception of the program. Under this authorization, the Company may continue to make additional stock repurchases from time to time, depending on market conditions, stock price and other factors. At December 31, 2007, $8.5 million remained available under the program to repurchase additional shares.

8. Net Income (Loss) Per Share

Basic net income (loss) per share excludes dilution and is computed by dividing net income (loss) attributable to common stockholders by the weighted average common shares outstanding for the period (excluding shares subject to repurchase). Diluted net income (loss) per share reflects the weighted average common shares outstanding plus the potential effect of dilutive securities which are convertible into common shares (using the treasury stock method), except in cases in which the effect would be anti-dilutive. The following is a reconciliation of the numerators and denominators used in computing basic and diluted net income (loss) per share (in thousands except per share data):

	Year Ended December 31,		
	2007	2006	2005
Net income (loss)	$ (2,927)	$ (439)	$ 6,524
Denominator:			
Weighted average common shares outstanding	28,066	26,885	25,986
Weighted average common shares outstanding subject to repurchase	—	—	(3)
Denominator for basic calculation, weighted average shares	28,066	26,885	25,983
Dilutive common equivalent shares:			
Weighted average common shares outstanding subject to repurchase	—	—	3
Effect of dilutive securities	—	—	1,487
Denominator for diluted calculation, weighted average shares	28,066	26,885	27,473
Net income (loss) per share — basic	$ (0.10)	$ (0.02)	$ 0.25
Net income (loss) per share — diluted	$ (0.10)	$ (0.02)	$ 0.24

Note: potential shares of common stock, that would be antidilutive during periods in which the Company reported a net loss, are excluded from the calculation of diluted earnings per share.

The following table sets forth potential shares of common stock that are not included in the diluted net income (loss) per share calculation above because to do so would be anti-dilutive for the periods indicated (in thousands):

	Year Ended December 31,		
	2007	2006	2005
Outstanding options	8,015	6,664	451

9. Income Taxes

	Year Ended December 31,		
	2007	2006 (In thousands)	2005
U.S.			
Current	$ (1,470)	$ 631	$ 1,678
Deferred	(1,744)	(4,050)	(1,882)
Foreign			
Current	260	204	168
Withholding	758	335	150
Deferred	(528)	(253)	(18)
Total provision (benefit)	$ (2,724)	$ (3,133)	$ 96

During 2007, 2006 and 2005, respectively, income (loss) before taxes from U.S. operations was ($14.2) million, ($3.2) million and $6.2 million, respectively, and income (loss) before taxes from foreign operations was $8.6 million, ($393,000) and $405,000, respectively. The amounts of income (loss) before taxes for year 2007 included $6.4 million intercompany sale of intangibles by a foreign subsidiary to PDF Solutions, Inc.

The amount of income tax recorded differs from the amount using the statutory federal income tax rate (35%) for the following reasons (in thousands):

	Year Ended December 31,		
	2007	2006	2005
Federal statutory tax provision (benefit)	$ (1,978)	$ (1,250)	$ 2,317
State tax expense	(615)	(632)	(151)
Stock compensation expense	1,537	1,697	(1,322)
Write-off of in-process research and development	—	280	—
Meals and entertainment	57	18	22
Tax credits	(1,512)	(3,633)	(701)
Foreign tax, net	22	477	101
Other	(235)	(90)	(170)
Total	$ (2,724)	$ (3,133)	$ 96

In addition, as of December 31, 2007, the Company had federal and state research and experimental and other tax credit carry forwards of $4.5 million and $6.8 million, respectively. The federal credits begin to expire in 2022, while the state credits have no expiration. The extent to which the federal and state credit carry forwards can be used to offset future tax liabilities, respectively, may be limited, depending on the extent of ownership changes within any three-year period as provided in the Tax Reform Act of 1986 and the California Conformity Act of 1987.

Undistributed earnings of the Company's foreign subsidiaries of $9.6 million are considered to be indefinitely reinvested, except for those of the Company's French subsidiary since May 1, 2007 and accordingly, no provision for federal and state income taxes has been provided thereon.

Deferred income taxes reflect the tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, as well as net operating loss and tax credit carry forwards.

The components of the net deferred tax assets (liability) are comprised of (in thousands):

	Year Ended December 31,	
	2007	2006
Net operating loss carry forward	$ 251	$ 1,162
Research and development and other credit carry forward	8,824	7,559
Accruals deductible in different periods	3,223	1,917
Stock-based compensation	2,186	717
Deferred tax assets	14,484	11,355
Deferred tax liabilities — intangible assets	(4,350)	(3,780)
Total	$10,134	$ 7,575

The Company adopted the provisions of FIN No. 48 at the beginning of fiscal 2007. FIN No. 48 provides a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns.

Unrecognized tax benefits represent tax positions for which reserves have been established. The cumulative effect of adopting FIN No. 48 on January 1, 2007 is recognized as a change in accounting principle, recorded as an adjustment to the opening balance of accumulated deficit on the adoption date. As a result of the implementation of FIN No. 48, the Company recognized a decrease of $771,000 in accumulated deficit. The decrease of $771,000 in accumulated deficit reflects an increase of $468,000 from the amount previously disclosed in the Company's quarterly financial statements to correct an error in the original computation of the cumulative effect of the adoption of FIN No. 48.

Upon adoption of FIN No. 48, the Company has reclassified these liabilities as long-term. Prior to the adoption of FIN No. 48, the Company recorded its tax exposure as current liabilities. However, the Company's historical policy of including interest and penalties related to unrecognized tax benefits within the Company's income tax provision (benefit) remained unchanged. As of December 31, 2007, the Company had $566,000 accrued for payment of interest and penalties related to unrecognized tax benefits ($348,000 as of the adoption date of FIN No. 48). The Company recognized $218,000 of interest and penalties related to unrecognized tax benefits in its provision for income taxes for the year ended December 31, 2007.

The Company's total amounts of unrecognized tax benefits as of January 1, 2007 (adoption date) was $6.3 million, of which $3.4 million, if recognized, would affect the Company's effective tax rate. As of December 31, 2007, the Company's total amount of unrecognized tax benefits was $7.9 million, of which $4.1 million, if recognized, would affect the Company's effective tax rate. The Company has recognized a net amount of $5.6 million in long-term tax payable for unrecognized tax benefits in its consolidated balance sheets. The Company does not expect the change in unrecognized tax benefits over the next twelve months to materially impact its results of operations and financial position.

The Company conducts business globally and, as a result, files numerous consolidated and separate income tax returns in the U.S. federal, various state and foreign jurisdictions. The Company is currently under audit by the German tax authority for the years 2002 through 2004, however, the audit has not been completed as of

December 31, 2007. Because the Company used some of the tax attributes carried forward from previous years to tax years that are still open, statutes of limitation remain open for all tax years to the extent of the attributes carried forward into tax year 2001 for federal tax purposes and tax year 2002 for California tax purposes. With few exceptions, the Company is no longer subject to income tax examinations in its major foreign subsidiaries' jurisdictions for years before 2003.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	December 31, 2007
Gross unrecognized tax benefits at January 1, 2007	$ 6,259
Increases in tax positions for prior years	58
Increases in tax positions for current year	1,613
Lapse in statute of limitations	(70)
Gross unrecognized tax benefits at December 31, 2007	7,860

10. Customer and Geographic Information

The Company has adopted the disclosure requirements of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information,* which establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or group, in deciding how to allocate resources and in assessing performance.

The Company's chief operating decision maker, the chief executive officer, reviews discrete financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance. Accordingly the Company considers itself to be in one operating segment, specifically the licensing and implementation of yield improvement solutions for integrated circuit manufacturers

The Company had revenues from individual customers in excess of 10% of total revenues as follows:

	Year Ended December 31,		
Customer	2007	2006	2005
A	19%	12%	10%
B	16%	25%	13%
C	4%	4%	11%
D	—%	1%	15%

The Company had accounts receivable from individual customers in excess of 10% of gross accounts receivable as follows:

	December 31,	
Customer	2007	2006
A	27%	12%
B	15%	18%
E	11%	10%
F	6%	12%

Revenue from customers by geographic area is as follows (in thousands):

	Year Ended December 31,					
	2007		2006		2005	
	Revenues	Percentage of Revenues	Revenues	Percentage of Revenues	Revenues	Percentage of Revenues
Asia	$51,466	55%	$38,129	50%	$40,982	55%
United States	29,682	31	29,850	39	25,610	35
Europe	13,315	14	8,205	11	7,336	10
Total	$94,463	100%	$76,184	100%	$73,928	100%

As of December 31, 2007 and 2006, long-lived assets related to PDF SAS (formerly SiA), located in France, totaled $446,000 and $583,000, respectively. As of December 31, 2007 and 2006, long-lived assets related to PDF Solutions GmbH (formerly AISS), located in Germany, totaled $92,000 and $216,000, respectively. The majority of the Company's remaining long-lived assets are in the United States.

11. Litigation

The Company is not currently party to any material legal proceedings.

12. Employee Benefit Plan

During 1999, the Company established a 401(k) tax-deferred savings plan, whereby eligible employees may contribute up to 15% of their eligible compensation with a maximum amount subject to IRS guidelines in any calendar year. Company contributions to this plan are discretionary; no such Company contributions have been made since the inception of this plan.

13. Related Party Transactions

Immediately prior to the merger with Fabbrix (the "Merger"), Mr. Lucio L. Lanza, a director and Chairman of the Board of the Company, served as President, Chief Executive Officer and Chairman of the Board of Fabbrix. Mr. Lanza also held shares of capital stock of Fabbrix, both individually and through his venture capital firm, Lanza techVentures. In connection with the Merger, Mr. Lanza received $353,000 in cash and 35,722 shares of the Company's common stock in exchange for his Fabbrix shares, and will be eligible to receive up to an additional $2.1 million worth of earnout consideration. Lanza techVentures received $1.2 million in cash and 121,720 shares of the Company's common stock at the closing of the Fabbrix acquisition (the "Closing") in exchange for its Fabbrix shares, and will be eligible to receive up to an additional $5.4 million worth of earnout consideration. In addition, out of the merger consideration, Lanza techVentures received $416,000 in cash as repayment of certain bridge loans previously made to Fabbrix. To consider a transaction with Fabbrix, the Company's Board established a special committee consisting exclusively of independent directors (the "Special Committee"). The Special Committee reviewed, evaluated and directed the negotiation of the transaction and the Merger Agreement and recommended to the Company's Board that the Company enter into the Merger Agreement. Mr. Lanza did not participate on behalf of the Company in any actions with respect to the transaction and the Merger Agreement, and did not participate in any deliberations or other activities of the Special Committee.

In view of the Nasdaq independent director rules and other applicable requirements, the Company's Board has determined that Mr. Lanza is no longer independent under those rules and therefore, Mr. Lanza has resigned from the Audit, Compensation, and Nominating and Corporate Governance Committees of the Company's Board effective at the Closing. Mr. Lanza continues to serve as Chairman of the Company's Board. The Company has replaced Mr. Lanza with other independent Board Members to fill the vacancies on the Company's Audit, Compensation, and Nominating and Corporate Governance. The Company's Board has also appointed a Lead Independent Director.

Andrzej Strojwas, the Company's Chief Technologist was a stockholder of Fabbrix immediately prior to the Merger. In connection with the Merger, Mr. Strojwas received $53,000 in cash and 5,402 shares of the Company's common stock, and will be eligible to receive up to an additional $311,000 worth of earnout consideration.

14. Selected Quarterly Financial Data (Unaudited)

	Year Ended December 31, 2007			
	Q1	Q2	Q3	Q4
	(In thousands, except for per share amounts)			
Total revenue	$22,142	$23,698	$24,068	$24,555
Gross profit	$12,800	$14,979	$14,637	$14,429
Total operating expenses	$15,227	$16,473	$15,782	$16,905
Net income (loss)	$ (2,355)	$ (701)	$ (939)	$ 1,068
Net income (loss) per share:				
Basic	$ (0.08)	$ (0.02)	$ (0.03)	$ 0.04
Diluted	$ (0.08)	$ (0.02)	$ (0.03)	$ 0.04

	Year Ended December 31, 2006			
	Q1	Q2	Q3	Q4
	(In thousands, except for per share amounts)			
Total revenue	$19,857	$18,010	$19,364	$18,953
Gross profit	$12,151	$10,070	$11,306	$ 9,760
Total operating expenses	$11,447	$11,972	$11,679	$14,588
Net income	$ 268	$ (847)	$ 570	$ (430)
Net income (loss) per share:				
Basic	$ 0.01	$ (0.03)	$ 0.02	$ (0.02)
Diluted	$ 0.01	$ (0.03)	$ 0.02	$ (0.02)

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PDF SOLUTIONS, INC.

By: /s/ John K. Kibarian
John K. Kibarian
President and Chief Executive Officer

By: /s/ Keith A. Jones
Keith A. Jones
Chief Financial Officer and Vice President, Finance

Date: March 17, 2008

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints John K. Kibarian and Keith A. Jones, jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his or her substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title
/s/ JOHN K. KIBARIAN John K. Kibarian	Director, President and Chief Executive Officer (Principal Executive Officer)
/s/ KEITH A. JONES Keith A. Jones	Chief Financial Officer and Vice President, Finance (Principal Financial and Accounting Officer)
/s/ KIMON MICHAELS Kimon Michaels	Director, Vice President, Design for Manufacturability
/s/ LUCIO L. LANZA Lucio L. Lanza	Chairman of the Board of Directors
/s/ R. STEPHEN HEINRICHS R. Stephen Heinrichs	Director, Lead Independent Director
/s/ SUSAN BILLAT Susan Billat	Director
/s/ TOM CAULFIELD Tom Caulfield	Director
/s/ ALBERT Y. C. YU Albert Y. C. Yu	Director

SCHEDULE II

PDF SOLUTIONS, INC.

VALUATION AND QUALIFYING ACCOUNT
Years Ended December 31, 2007, 2006, and 2005

	Balance at Beginning of Period	Charged to Costs and Expenses	Balance Assumed in Acquisition	Deductions/ Write-offs of Accounts	Balance at End of Period
Allowance for doubtful accounts					
2007	$ 294	$ —	$ —	$ 40	$ 254
2006	$ 254	$ —	$ 40	$ —	$ 294
2005	$ 254	$ —	$ —	$ —	$ 254

INDEX TO EXHIBITS

Exhibit Number	Description
2.01	Amended and Restated Agreement and Plan of Reorganization, dated September 2, 2003, by and among PDF Solutions, Inc., IDS Software Acquisition Corp., PDF Solutions, LLC and IDS Software Systems Inc.(5)
3.01	Third Amended and Restated Certificate of Incorporation of PDF Solutions, Inc.(1)
3.02	Amended and Restated Bylaws of PDF Solutions, Inc.(9)
4.01	Specimen Stock Certificate.(2)
4.02	Second Amended and Restated Rights Agreement dated July 6, 2001.(1)
10.01	Form of Indemnification Agreement between PDF Solutions, Inc. and each of its Officers and Directors.(1)(H)
10.02	1996 Stock Option Plan and related agreements.(1)*
10.03	1997 Stock Plan and related agreements.(1)*
10.04	2001 Stock Plan and related agreements.(8)*
10.05	2001 Employee Stock Purchase Plan.(1)*
10.06	2001 Stock Option/Stock Issuance Plan.(7)*
10.07	Lease Agreement between PDF Solutions, Inc. and Metropolitan Life Insurance Company dated April 1, 1996.(1)
10.08	Offer letter to P. Steven Melman dated July 9, 1998.(1)*
10.09	Offer letter to Cornelius D. Hartgring dated August 29, 2002.(3)*
10.10	Amendment to Lease Agreement between PDF Solutions, Inc. and Metropolitan Life Insurance Company dated as of March 19, 2003.(4)
10.11	Office Lease between PDF Solutions, Inc. and 15015 Avenue of Science Associates LLC dated as of April 1, 2003.(4)
10.12	Andre Hawit Employment Offer letter agreement dated September 24, 2003 by and between PDF Solutions Inc. and Andre Hawit.(6)*
10.13	Indemnity Agreement with Kevin MacLean, incorporated by reference to the Registrant's standard form of Indemnification Agreement.(9)
10.14	Indemnity Agreement with Albert Y. C. Yu, incorporated by reference to the Registrant's standard form of Indemnification Agreement.(9)
10.15	Indemnity Agreement with R. Stephen Heinrichs, incorporated by reference to the Registrant's standard form of Indemnification Agreement.(9)
10.16	Offer letter to Keith A. Jones dated October 10, 2005.(10)*
10.17	Lease Agreement between PDF Solutions, Inc. and Legacy Partners I Riverpark I, LLC, dated June 29, 2007.
21.01	Subsidiaries of Registrant.
23.01	Consent of Independent Registered Public Accounting Firm.
24.01	Power of Attorney (see Signature Page).
31.01	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.02	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Incorporated by reference to PDF's Registration Statement on Form S-1, as amended (File No. 333-43192).
(2) Incorporated by reference to PDF's Report on Form 10-Q filed September 6, 2001 (File No. 000-31311).
(3) Incorporated by reference to PDF's Report on Form 10-K filed March 26, 2003 (File No. 000-31311).
(4) Incorporated by reference to PDF's Report Form 10-Q filed May 14, 2003 (File No. 000-31311).
(5) Incorporated by reference to Exhibit 2.1 to PDF's Current Report on Form 8-K filed on September 25, 2003.
(6) Incorporated by reference to PDF's report on Form 10-Q filed November 14, 2003 (File No. 000-31311).
(7) Incorporated by reference to PDF's Registration Statement on Form S-8 (File No. 333-109809).
(8) Incorporated by reference to PDF's Definitive Proxy Statement filed April 15, 2004 (File No. 000-31311).
(9) Incorporated by reference to PDF's Report on Form 10-Q filed August 9, 2005 (File No. 000-31311).
(10) Incorporated by reference to Exhibit 10.1 to PDF's Current Report on Form 8-K filed on December 19, 2005.
(H) Portions of this Exhibit have been omitted pursuant to a request for confidential treatment.
* Indicates management contract or compensatory plan or arrangement.

EXHIBIT 10.17

RIVERPARK TOWER

OFFICE LEASE

LEGACY PARTNERS I RIVERPARK I, LLC,
a Delaware limited liability company

as Landlord,

and

PDF SOLUTIONS, INC.,
a Delaware corporation

as Tenant

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SUMMARY OF BASIC LEASE INFORMATION

This Summary of Basic Lease Information ("**Summary**") is hereby incorporated into and made a part of the attached Office Lease. Each reference in the Office Lease to any term of this Summary shall have the meaning as set forth in this Summary for such term. In the event of a conflict between the terms of this Summary and the Office Lease, the terms of the Office Lease shall prevail. Any capitalized terms used herein and not otherwise defined herein shall have the meaning as set forth in the Office Lease.

TERMS OF LEASE (References are to the Office Lease)	**DESCRIPTION**
1. Date:	June 29, 2007
2. Landlord:	LEGACY PARTNERS I RIVERPARK I, LLC, a Delaware limited liability company
3. Address of Landlord (Section 24.19):	Legacy Partners I Riverpark I, LLC c/o Legacy Partners Commercial, Inc. 4000 East Third Avenue, Suite 600 Foster City, California 94404-4805 Attention: Regional Vice President
4. Tenant:	PDF SOLUTIONS, INC., a Delaware corporation
5. Address of Tenant (Section 24.19):	PDF Solutions, Inc. 333 West San Carlos Street, Suite 700 San Jose, California 95110 Attention: Chief Financial Officer
6. Premises (Article 1):	
6.1 Premises:	A total of 49,789 rentable square feet of space consisting of the following, which are more particularly set forth in Exhibit A attached hereto: (i) 19,670 rentable square feet of space located on the fifth (5th) floor of the Building (as defined below) and designated as Suite 500; (ii) 19,670 rentable square feet of space located on the seventh (7th) floor of the Building and designated as Suite 700; (iii) 8,948 rentable square feet of space located on the tenth (10th) floor of the Building and designated as Suite 1000; and (iv) 1,501 rentable square feet of space located on the tenth (10th) floor of the Building and designated as Suite 1080.
6.2 Building:	The Premises are located in the building whose address is 333 West San Carlos Street, San Jose, California.
7. Term (Article 2):	
7.1 Lease Term:	Sixty-eight (68) months.
7.2 Lease Commencement Date:	February 1, 2008.
7.3 Lease Expiration Date:	The last day of the sixty-eighth (68th) month following the Lease Commencement Date.

8. Base Rent (Article 3):

Months	Annual Base Rent	Monthly Installment of Base Rent	Monthly Rental Rate per Rentable Square Foot
1* - 20	$1,762,530.60	$146,877.55	$ 2.95
21 - 32	$1,816,302.70	$151,358.56	$ 3.04
33 - 44	$1,870,074.80	$155,839.57	$ 3.13
45 - 56	$1,923,846.90	$160,320.58	$ 3.22

TERMS OF LEASE
(References are to the Office Lease) **DESCRIPTION**

Months	Annual Base Rent	Monthly Installment of Base Rent	Monthly Rental Rate per Rentable Square Foot
57 - 68	$1,983.593.70	$165,299.48	$ 3.32

* Base Rent for the first (1st) eight (8) months of the initial Lease Term shall be abated, pursuant to the terms of Article 3 of the Lease.

9. Additional Rent (Article 4):

9.1 Expense Base Year:	Calendar year 2008.
9.2 Tax Expense Base Year:	Calendar year 2008.
9.3 Utilities Base Year:	Calendar year 2008.
9.4 Tenant's Share of Operating Expenses, Tax Expenses and Utilities Costs:	16.93% (49,789 rentable square feet within the Premises/294,097 rentable square feet within the Building).
10. Security Deposit (Article 20):	$166,391.96, pursuant to the terms of Article 20 of the Lease.
11. Parking (Article 23):	Initially, three (3) parking passes for unassigned parking spaces for every 1,000 rentable square feet of the Premises, for a total of one hundred forty-nine (49) unassigned parking passes; provided, however, upon written notice to Tenant, Tenant's parking passes hereunder shall be reduced to 2.4 parking passes for unassigned parking spaces for every 1,000 rentable square feet of the Premises, for a total of one hundred nineteen (119) parking passes for unassigned parking spaces. Landlord will deliver notice of this reduction in Tenant's parking passes as necessary to comply with applicable regulations relating to available parking for the Building, including in connection with the anticipated completion of an adjacent office building.
12. Brokers (Section 24.25):	None.
13. Tenant Improvement Allowance (Exhibit B):	$248,945.00 (calculated at the rate of $5.00 per rentable square foot of the Premises), pursuant to the terms of Exhibit B.

OFFICE LEASE

This Office Lease, which includes the preceding Summary and the exhibits attached hereto and incorporated herein by this reference (the Office Lease, the Summary and the exhibits to be known sometimes collectively hereafter as the "**Lease**"), dated as of the date set forth in Section 1 of the Summary, is made by and between LEGACY PARTNERS I RIVERPARK I, LLC, a Delaware limited liability company ("**Landlord**"), and PDF SOLUTIONS, INC., a Delaware corporation ("**Tenant**").

ARTICLE 1

REAL PROPERTY, BUILDING AND PREMISES

1.1 Real Property, Building and Premises.

1.1.1 Premises. Upon and subject to the terms, covenants and conditions hereinafter set forth in this Lease, Landlord hereby leases to Tenant and Tenant hereby leases from Landlord the premises set forth in Section 6.1 of the Summary (the "**Premises**"), which Premises are located in the Building defined in Section 6.2 of the Summary constructed on the Real Property. The outline of the floor plan of the Premises is set forth in Exhibit A attached hereto.

1.1.2 Building and Real Property/Project. The Building is part of that certain office building project ("**Project**") constructed on the Real Property (as defined below) known as "RiverPark Tower". The term "**Real Property**," as used in this Lease, shall mean, collectively, (i) the Building, (ii) any outside plaza areas, walkways, driveways, courtyards, public and private streets, transportation facilitation areas and other improvements and facilities now or hereafter constructed surrounding and/or servicing the Building, including the existing parking structure constructed by or for Landlord within the Project and located adjacent to the Building and any other parking structures and/or facilities now or hereafter constructed by or for Landlord within the Project and servicing the Building and any other buildings which may be subsequently constructed within the Project (collectively, the "**Parking Facilities**"), which are designated from time to time by Landlord as common areas (or parking facilities, as the case may be) appurtenant to or servicing the Building and any such other buildings; (iii) any additional buildings, improvements, facilities, parking areas and structures and common areas which Landlord (and/or any common area association formed by Landlord or Landlord's assignee for the Project) may add thereto from time to time within or as part of the Project; and (iv) the land upon which any of the foregoing are situated. The site plan depicting the current configuration of the Real Property is set forth in Exhibit A-1 attached hereto. Notwithstanding the foregoing or anything contained in this Lease to the contrary, (1) Landlord has no obligation to expand or otherwise make any improvements within the Project, including, without limitation, any of the outside plaza areas, walkways, driveways, courtyards, public and private streets, transportation facilitation areas and other improvements and facilities which may be depicted on Exhibit A-1 attached hereto (as the same may be modified by Landlord from time to time without notice to Tenant), other than Landlord's obligations (if any) specifically set forth in the Tenant Work Letter, and (2) Landlord shall have the right from time to time to include or exclude any improvements or facilities within the Project, at Landlord's sole election, as more particularly set forth in Section 1.1.3 below.

1.1.3 Tenant's and Landlord's Rights. Tenant is hereby granted the right to the nonexclusive use of the common corridors and hallways, stairwells, elevators, restrooms and other public or common areas located within the Building, and the non-exclusive use of the areas located on the Real Property designated by Landlord from time to time as common areas for the Building; provided, however, that (i) Tenant's use thereof shall be subject to (A) the provisions of any covenants, conditions and restrictions regarding the use thereof now or hereafter recorded against the Real Property, and (B) such reasonable, non-discriminatory rules, regulations and restrictions as Landlord may make from time to time (which shall be provided in writing to Tenant), and (ii) Tenant may not go on the roof of Building without Landlord's prior consent (which may be withheld in Landlord's sole and absolute discretion) and without otherwise being accompanied by a representative of Landlord. Landlord reserves the right from time to time to use any of the common areas of the Real Property, and the roof, risers and conduits of the Building for telecommunications and/or any other purposes, and to do any of the following: (1) make any changes, additions, improvements, repairs and/or replacements in or to the Real Property or any portion or elements thereof, including, without limitation, (x) changes in the location, size, shape and number of driveways, entrances, loading and unloading areas, ingress, egress, direction of traffic, landscaped areas, walkways, public and private streets, plazas, courtyards, transportation facilitation areas and common areas, parking spaces, parking structures and parking areas, and (y) expanding or decreasing the size of the Real Property and any common areas and other elements thereof, including adding or deleting buildings thereon and therefrom; (2) close temporarily any of the common areas while engaged in making repairs, improvements or alterations to the Real Property; (3) form a common area association or associations under covenants, conditions and restrictions to own, manage, operate, maintain, repair and/or replace all or any portion of the landscaping, driveways, walkways, parking areas, public and private streets, plazas, courtyards, transportation facilitation areas and/or other common areas located outside of the Building and, subject to Article 4 below, include the common area assessments, fees and taxes charged by the association(s) and the cost of maintaining, managing, administering and operating the association(s), in Operating Expenses or Tax Expenses; and (4) perform such other acts and make such other changes with respect to the Real Property as Landlord may, in the exercise of good faith business judgment, deem to be appropriate.

1.2 Condition of Premises. Except as expressly set forth in this Lease and in the Tenant Work Letter attached hereto as Exhibit B, Landlord shall not be obligated to provide or pay for any improvement, remodeling or refurbishment work or services related to the improvement, remodeling or refurbishment of the Premises, and Tenant shall accept the Premises in its "**AS IS**" condition on the Lease Commencement Date.

1.3 Rentable Square Feet. The rentable square feet for the Premises are approximately as set forth in Section 6.1 of the Summary. For purposes hereof, the "**rentable square feet**" of the Premises and the Building shall be calculated by Landlord pursuant to the Standard Method for Measuring Floor Area in Office Buildings, ANSI Z65.1-1996 ("**BOMA**"), as modified for the Building pursuant to Landlord's standard rentable area measurements for the Building, to include, among other calculations, a portion of the common areas and service areas of the Building. The rentable square feet of the Premises and the rentable square feet of the Building are subject to verification from time to time by Landlord's planner/designer and such verification shall be made in accordance with the provisions of this Section 1.3. Tenant's architect may consult with Landlord's planner/designer regarding such verification, except to the extent it relates to the rentable square feet of the Building; provided, however, the determination of Landlord's planner/designer shall be conclusive and binding upon the parties. In the event that Landlord's planner/designer determines that the rentable square footage amounts shall be different from those set forth in this Lease, all amounts, percentages and figures appearing or referred to in this Lease based upon such incorrect rentable square feet (including, without limitation, the amount of the Base Rent and Tenant's Share) shall be modified in accordance with such determination. If such determination is made, it will be confirmed in writing by Landlord to Tenant.

ARTICLE 2

LEASE TERM

The terms and provisions of this Lease shall be effective as of the date of this Lease except for the provisions of this Lease relating to the payment of Rent. The term of this Lease (the "**Lease Term**") shall be as set forth in Section 7.1 of the Summary and shall commence on the date (the "**Lease Commencement Date**") set forth in Section 7.2 of the Summary (subject, however, to the terms of the Tenant Work Letter), and shall terminate on the date (the "**Lease Expiration Date**") set forth in Section 7.3 of the Summary, unless this Lease is sooner terminated as hereinafter provided. For purposes of this Lease, the term "**Lease Year**" shall mean each consecutive twelve (12) month period during the Lease Term, provided that the last Lease Year shall end on the Lease Expiration Date.

ARTICLE 3

BASE RENT

3.1 Base Rent. Tenant shall pay, without notice or demand, to Landlord or Landlord's agent at the management office of the Project, or at such other place as Landlord may from time to time designate in writing, in currency or a check for currency which, at the time of payment, is legal tender for private or public debts in the United States of America, base rent ("**Base Rent**") as set forth in Section 8 of the Summary, payable in equal monthly installments as set forth in Section 8 of the Summary in advance on or before the first day of each and every month during the Lease Term, without any setoff or deduction whatsoever. The Base Rent for the first full month of the Lease Term shall be paid at the time of Tenant's execution of this Lease. If any rental payment date (including the Lease Commencement Date) falls on a day of the month other than the first day of such month or if any rental payment is for a period which is shorter than one month, then the rental for any such fractional month shall be a proportionate amount of a full calendar month's rental based on the proportion that the number of days in such fractional month bears to the number of days in the calendar month during which such fractional month occurs. All other payments or adjustments required to be made under the terms of this Lease that require proration on a time basis shall be prorated on the same basis.

3.2 Rent Abatement. Notwithstanding anything to the contrary contained herein and provided that Tenant faithfully performs all of the terms and conditions of this Lease, and no default by Tenant occurs hereunder, Landlord hereby agrees that Tenant shall not be required to pay monthly Base Rent for the first (1st) eight (8) months of the initial Lease Term (the "**Abatement Period**"). During the Abatement Period, Tenant shall still be responsible for the payment of all of its other monetary obligations under this Lease. In the event of a default by Tenant under the terms of this Lease that results in termination of this Lease in accordance with the provisions of Article 19 hereof, then as a part of the recovery set forth in Article 19 of this Lease, Landlord shall be entitled to the recovery of the monthly Base Rent that was abated under the provisions of this Article 3.

ARTICLE 4

ADDITIONAL RENT

4.1 Additional Rent. In addition to paying the Base Rent specified in Article 3 of this Lease, Tenant shall pay as additional rent the sum of the following: (i) Tenant's Share (as such term is defined below) of the annual Operating Expenses allocated to the Building (pursuant to Section 4.3.4 below) which are in excess of the amount of Operating Expenses allocated to the Building and applicable to the Expense Base Year; plus (ii) Tenant's Share of the annual Tax Expenses allocated to the Building (pursuant to Section 4.3.4 below) which are in excess of the amount of Tax Expenses allocated to the Building and applicable to the Tax Expense Base Year; plus (iii) Tenant's Share of the annual Utilities Costs allocated to the Building (pursuant to Section 4.3.4 below) which are in excess of the amount of Utilities Costs allocated to the Building and applicable to the Utilities Base Year. Such additional rent, together with any and all other amounts payable by Tenant to Landlord pursuant to the terms of this Lease (including, without limitation, pursuant to Article 6), shall be hereinafter collectively referred to as the "**Additional Rent**." The Base Rent and Additional Rent are herein collectively referred to as the "**Rent**." All amounts due under this Article 4 as Additional Rent shall be payable for the same periods and in the same manner, time and place as the Base Rent. Without limitation on other obligations of Tenant which shall survive the expiration of the Lease Term, the obligations of Tenant to pay the Additional Rent provided for in this Article 4 shall survive the expiration of the

Lease Term for a period of three (3) years, but in no event shall Tenant be obligated to pay Additional Rent for periods other than during the Lease Term.

4.2 Definitions. As used in this Article 4, the following terms shall have the meanings hereinafter set forth:

4.2.1 "**Calendar Year**" shall mean each calendar year in which any portion of the Lease Term falls, through and including the calendar year in which the Lease Term expires.

4.2.2 "**Expense Base Year**" shall mean the year set forth in Section 9.1 of the Summary.

4.2.3 "**Expense Year**" shall mean each Calendar Year, provided that Landlord, upon notice to Tenant, may change the Expense Year from time to time to any other twelve (12) consecutive-month period, and, in the event of any such change, Tenant's Share of Operating Expenses, Tax Expenses and Utilities Costs shall be equitably adjusted for any Expense Year involved in any such change.

4.2.4 "**Operating Expenses**" shall mean all expenses, costs and amounts of every kind and nature which Landlord shall pay during any Expense Year because of or in connection with the ownership, management, maintenance, repair, replacement, restoration or operation of the Real Property, including, without limitation, any amounts paid for: (i) the cost of operating, maintaining, repairing, renovating and managing the utility systems, mechanical systems, sanitary and storm drainage systems, any elevator systems and all other "Systems and Equipment" (as defined in Section 4.2.5 of this Lease), and the cost of supplies and equipment and maintenance and service contracts in connection therewith; (ii) the cost of licenses, certificates, permits and inspections, and the cost of contesting the validity or applicability of any governmental enactments which may affect Operating Expenses, and the costs incurred in connection with implementation and operation (by Landlord or any common area association(s) formed for the Project) of any transportation system management program or similar program; (iii) the cost of insurance carried by Landlord, in such amounts as Landlord may reasonably determine or as may be required by any mortgagees or the lessor of any underlying or ground lease affecting the Real Property; (iv) the cost of landscaping, relamping, supplies, tools, equipment and materials, and all fees, charges and other costs (including consulting fees, legal fees and accounting fees) incurred in connection with the management, operation, repair and maintenance of the Real Property; (v) the cost of parking area repair, restoration, and maintenance; (vi) any equipment rental agreements or management agreements (including the cost of any management fee and the fair rental value of any office space provided thereunder); (vii) wages, salaries and other compensation and benefits of all persons engaged in the operation, management, maintenance or security of the Real Property, and employer's Social Security taxes, unemployment taxes or insurance, and any other taxes which may be levied on such wages, salaries, compensation and benefits; (viii) payments under any easement, license, operating agreement, declaration, restrictive covenant, underlying or ground lease (excluding rent), or instrument pertaining to the sharing of costs by the Real Property; (ix) the cost of janitorial service, alarm and security service, if any, window cleaning, trash removal, replacement of wall and floor coverings, ceiling tiles and fixtures in lobbies, corridors, restrooms and other common or public areas or facilities, maintenance and replacement of curbs and walkways, repair to roofs and re-roofing; (x) amortization (including interest on the unamortized cost) of the cost of acquiring or the rental expense of personal property used in the maintenance, operation and repair of the Real Property; and (xi) the cost of any capital improvements or other costs (I) which are intended as a labor-saving device or to effect other economies in the operation or maintenance of the Real Property, (II) made to the Real Property or any portion thereof after the Lease Commencement Date that are required under any governmental law or regulation, or (III) which are reasonably determined by Landlord to be in the best interests of the Real Property; provided, however, that if any such cost described in (I), (II) or (III) above, is a capital expenditure, such cost shall be amortized (including interest on the unamortized cost) over its useful life as Landlord shall reasonably determine. If Landlord is not furnishing any particular work or service (the cost of which, if performed by Landlord, would be included in Operating Expenses) to a tenant who has undertaken to perform such work or service in lieu of the performance thereof by Landlord, Operating Expenses shall be deemed to be increased by an amount equal to the additional Operating Expenses which would reasonably have been incurred during such period by Landlord if it had at its own expense furnished such work or service to such tenant. If the Building (and during the period of time when any other office buildings are fully constructed and ready for occupancy and are included by Landlord within the Project) is less than ninety-five percent (95%) occupied during all or a portion of any Expense Year (including the Expense Base Year), Landlord shall make an appropriate adjustment to the variable components of Operating Expenses for such year or applicable portion thereof, employing sound accounting and management principles, to determine the amount of Operating Expenses that would have been paid had the Building (and during the period of time when any other office buildings are fully constructed and ready for occupancy and are included by Landlord within the Project) been ninety-five percent (95%) occupied; and the amount so determined shall be deemed to have been the amount of Operating Expenses for such year, or applicable portion thereof.

Subject to the provisions of Section 4.3.4 below, Landlord shall have the right, from time to time, to equitably allocate some or all of the Operating Expenses (and/or Tax Expenses and Utilities Costs) among different tenants of the Project and/or different buildings of the Real Property as and when such different buildings are constructed and added to (and/or excluded from) the Real Property or otherwise (the "**Cost Pools**"). Such Cost Pools may include, without limitation, the office space tenants and retail space tenants of the Real Property or of a building or buildings in the Real Property. Such Cost Pools may also include an allocation of certain Operating Expenses (and/or Tax Expenses and Utilities Costs) within or under covenants, conditions and restrictions affecting the Real Property. In addition, Landlord shall have the right from time to time, in its reasonable discretion, to include or exclude existing or future buildings in the Project for purposes of determining Operating Expenses, Tax Expenses and Utilities Costs and/or the provision of various services and amenities thereto, including allocation of Operating Expenses, Tax Expenses and Utilities Costs in any such Cost Pools. With reference to the foregoing, it is acknowledged that expenses which are generally allocated throughout the Project, shall be allocated to Tenant based

upon Tenant's equitable share of the Project. Such calculations and the fair and equitable share allocated to Tenant will be subject to adjustment in accordance with industry standards and to reflect the current occupancy and use of the Project from time to time.

Notwithstanding anything to the contrary set forth in this Article 4, when calculating Operating Expenses for the Expense Base Year, Operating Expenses shall exclude market-wide labor-rate increases due to extraordinary circumstances, including, but not limited to, boycotts and strikes, and costs relating to capital improvements or expenditures.

Notwithstanding the foregoing, Operating Expenses shall not, however, include: (A) costs of leasing commissions, attorneys' fees and other costs and expenses incurred in connection with negotiations or disputes with present or prospective tenants or other occupants of the Real Property; (B) costs (including permit, license and inspection costs) incurred in renovating or otherwise improving, decorating or redecorating rentable space for other tenants or vacant rentable space; (C) costs incurred due to the violation by Landlord of the terms and conditions of any lease of space in the Real Property; (D) costs of overhead or profit increment paid to Landlord or to subsidiaries or affiliates of Landlord for services in or in connection with the Real Property to the extent the same exceeds the costs of overhead and profit increment included in the costs of such services which could be obtained from third parties on a competitive basis; (E) except as otherwise specifically provided in this Section 4.2.4, costs of interest on debt or amortization on any mortgages, and rent payable under any ground lease of the Real Property; (F) Utilities Costs; and (G) Tax Expenses.

4.2.5 **Systems and Equipment**" shall mean any plant, machinery, transformers, duct work, cable, wires, and other equipment, facilities, and systems designed to supply heat, ventilation, air conditioning and humidity or any other services or utilities, or comprising or serving as any component or portion of the electrical, gas, steam, plumbing, sprinkler, communications, alarm, security, or fire/life safety systems or equipment, or any other mechanical, electrical, electronic, computer or other systems or equipment which serve the Building and/or any other building in the Project in whole or in part.

4.2.6 "**Tax Expense Base Year**" shall mean the year set forth in Section 9.2 of the Summary.

4.2.7 "**Tax Expenses**" shall mean all federal, state, county, or local governmental or municipal taxes, fees, assessments, charges or other impositions of every kind and nature, whether general, special, ordinary or extraordinary, (including, without limitation, real estate taxes, general and special assessments, transit assessments, fees and taxes, child care subsidies, fees and/or assessments, job training subsidies, fees and/or assessments, open space fees and/or assessments, housing subsidies and/or housing fund fees or assessments, public art fees and/or assessments, leasehold taxes or taxes based upon the receipt of rent, including gross receipts or sales taxes applicable to the receipt of rent, personal property taxes imposed upon the fixtures, machinery, equipment, apparatus, systems and equipment, appurtenances, furniture and other personal property used in connection with the Real Property), which Landlord shall pay during any Expense Year because of or in connection with the ownership, leasing and operation of the Real Property or Landlord's interest therein. For purposes of this Lease, Tax Expenses shall be calculated as if the tenant improvements in the Building were fully constructed and the Real Property, the Building and all tenant improvements in the Building were fully assessed for real estate tax purposes.

4.2.7.1 Tax Expenses shall include, without limitation:

(i) Any tax on Landlord's rent, right to rent or other income from the Real Property or as against Landlord's business of leasing any of the Real Property;

(ii) Any assessment, tax, fee, levy or charge in addition to, or in substitution, partially or totally, of any assessment, tax, fee, levy or charge previously included within the definition of real property tax, it being acknowledged by Tenant and Landlord that Proposition 13 was adopted by the voters of the State of California in the June 1978 election ("**Proposition 13**") and that assessments, taxes, fees, levies and charges may be imposed by governmental agencies for such services as fire protection, street, sidewalk and road maintenance, refuse removal and for other governmental services formerly provided without charge to property owners or occupants. It is the intention of Tenant and Landlord that all such new and increased assessments, taxes, fees, levies, and charges and all similar assessments, taxes, fees, levies and charges be included within the definition of Tax Expenses for purposes of this Lease;

(iii) Any assessment, tax, fee, levy, or charge allocable to or measured by the area of the Premises or the rent payable hereunder, including, without limitation, any gross income tax upon or with respect to the possession, leasing, operating, management, maintenance, alteration, repair, use or occupancy by Tenant of the Premises, or any portion thereof;

(iv) Any assessment, tax, fee, levy or charge, upon this transaction or any document to which Tenant is a party, creating or transferring an interest or an estate in the Premises; and

(v) Any reasonable expenses incurred by Landlord in attempting to protest, reduce or minimize Tax Expenses.

4.2.7.2 In no event shall Tax Expenses for any Expense Year be less than the Tax Expenses for the Tax Expense Base Year.

4.2.7.3 Notwithstanding anything to the contrary contained in this Section 4.2.7, there shall be excluded from Tax Expenses (i) all excess profits taxes, franchise taxes, gift taxes, capital stock taxes,

inheritance and succession taxes, estate taxes, federal and state net income taxes, and other taxes to the extent applicable to Landlord's net income (as opposed to rents, receipts or income attributable to operations at the Real Property), (ii) any items included as Operating Expenses, and (iii) any items paid by Tenant under Section 4.4 of this Lease.

4.2.8 "**Tenant's Share**" shall mean the percentage set forth in Section 9.4 of the Summary. Tenant's Share was calculated by dividing the number of rentable square feet of the Premises by the total rentable square feet in the Building (as set forth in Section 9.4 of the Summary), and stating such amount as a percentage. Landlord shall have the right from time to time to redetermine the rentable square feet of the Premises and/or Building, and Tenant's Share shall be appropriately adjusted to reflect any such redetermination. If Tenant's Share is adjusted pursuant to the foregoing, as to the Expense Year in which such adjustment occurs, Tenant's Share for such year shall be determined on the basis of the number of days during such Expense Year that each such Tenant's Share was in effect.

4.2.9 "**Utilities Base Year**" shall mean the year set forth in Section 9.3 of the Summary.

4.2.10 "**Utilities Costs**" shall mean all actual charges for utilities for the Building and the Project which Landlord shall pay during any Expense Year, including, but not limited to, the costs of water, sewer and electricity, and the costs of HVAC and other utilities (but excluding those charges for which tenants directly reimburse Landlord or otherwise pay directly to the utility company) as well as related fees, assessments and surcharges. Utilities Costs shall be calculated assuming the Building (and during the period of time when any other office buildings are fully constructed and ready for occupancy and are included by Landlord within the Project, such other office buildings), are at least ninety-five percent (95%) occupied. If, during all or any part of any Expense Year, Landlord shall not provide any utilities (the cost of which, if provided by Landlord, would be included in Utilities Costs) to a tenant (including Tenant) who has undertaken to provide the same instead of Landlord, Utilities Costs shall be deemed to be increased by an amount equal to the additional Utilities Costs which would reasonably have been incurred during such period by Landlord if Landlord had at its own expense provided such utilities to such tenant. Utilities Costs shall include any costs of utilities which are allocated to the Real Property under any declaration, restrictive covenant, or other instrument pertaining to the sharing of costs by the Real Property or any portion thereof, including any covenants, conditions or restrictions now or hereafter recorded against or affecting the Real Property. For purposes of determining Utilities Costs incurred for the Utilities Base Year, Utilities Costs for the Utilities Base Year shall not include any one time special charges, costs or fees or extraordinary charges or costs incurred in the Utilities Base Year only, including those attributable to boycotts, embargoes, strikes or other shortages of services or fuel. In addition, if in any Expense Year subsequent to the Utilities Base Year, the amount of Utilities Costs decreases due to a reduction in the cost of providing utilities to the Real Property for any reason, including without limitation, because of deregulation of the utility industry and/or reduction in rates achieved in contracts with utilities providers, then for purposes of the Expense Year in which such decrease in Utilities Costs occurred and all subsequent Expense Years, the Utilities Costs for the Utilities Base Year shall be decreased by an amount equal to such decrease.

4.3 Calculation and Payment of Additional Rent.

4.3.1 Calculation of Excess. If for any Expense Year ending or commencing within the Lease Term, (i) Tenant's Share of Operating Expenses allocated to the Building pursuant to Section 4.3.4 below for such Expense Year exceeds Tenant's Share of Operating Expenses allocated to the Building for the Expense Base Year and/or (ii) Tenant's Share of Tax Expenses allocated to the Building pursuant to Section 4.3.4 below for such Expense Year exceeds Tenant's Share of Tax Expenses allocated to the Building for the Tax Expense Base Year, and/or (iii) Tenant's Share of Utilities Costs allocated to the Building pursuant to Section 4.3.4 below for such Expense Year exceeds Tenant's Share of Utilities Costs allocated to the Building for the Utilities Base Year, then Tenant shall pay to Landlord, in the manner set forth in Section 4.3.2, below, and as Additional Rent, an amount equal to such excess (the "**Excess**").

4.3.2 Statement of Actual Operating Expenses, Tax Expenses and Utilities Costs and Payment by Tenant. Landlord shall endeavor to give to Tenant on or before the first day of May following the end of each Expense Year, a statement (the "**Statement**") which shall state the Operating Expenses, Tax Expenses and Utilities Costs incurred or accrued for such preceding Expense Year, and which shall indicate the amount, if any, of any Excess. Upon receipt of the Statement for each Expense Year ending during the Lease Term, if an Excess is present, Tenant shall pay, with its next installment of Base Rent due, the full amount of the Excess for such Expense Year, less the amounts, if any, paid during such Expense Year as "Estimated Excess," as that term is defined in Section 4.3.3 of this Lease. The failure of Landlord to timely furnish the Statement for any Expense Year shall not prejudice Landlord from enforcing its rights under this Article 4. Even though the Lease Term has expired and Tenant has vacated the Premises, when the final determination is made of Tenant's Share of the Operating Expenses, Tax Expenses and Utilities Costs for the Expense Year in which this Lease terminates, if an Excess is present, Tenant shall immediately pay to Landlord an amount as calculated pursuant to the provisions of Section 4.3.1 of this Lease. The provisions of this Section 4.3.2 shall survive the expiration or earlier termination of the Lease Term.

4.3.3 Statement of Estimated Operating Expenses, Tax Expenses and Utilities Costs. In addition, Landlord shall endeavor to give Tenant a yearly expense estimate statement (the "**Estimate Statement**") which shall set forth Landlord's reasonable estimate (the "**Estimate**") of what the total amount of Operating Expenses, Tax Expenses and Utilities Costs allocated to the Building pursuant to Section 4.3.4 below for the then-current Expense Year shall be and the estimated Excess (the "**Estimated Excess**") as calculated by comparing (i) Tenant's Share of Operating Expenses allocated to the Building, which shall be based upon the Estimate, to Tenant's Share of Operating Expenses allocated to the Building for the Expense Base Year, (ii) Tenant's Share of Tax Expenses allocated to the Building, which shall be based upon the Estimate, to Tenant's Share of Tax Expenses

allocated to the Building for the Tax Expense Base Year, and (iii) Tenant's Share of Utilities Costs allocated to the Building, which shall be based upon the Estimate, to Tenant's Share of Utilities Costs allocated to the Building for the Utilities Base Year. The failure of Landlord to timely furnish the Estimate Statement for any Expense Year shall not preclude Landlord from enforcing its rights to collect any Estimated Excess under this Article 4. If pursuant to the Estimate Statement an Estimated Excess is calculated for the then-current Expense Year, Tenant shall pay, with its next installment of Base Rent due, a fraction of the Estimated Excess for the then-current Expense Year (reduced by any amounts paid pursuant to the last sentence of this Section 4.3.3). Such fraction shall have as its numerator the number of months which have elapsed in such current Expense Year to the month of such payment, both months inclusive, and shall have twelve (12) as its denominator. Until a new Estimate Statement is furnished, Tenant shall pay monthly, with the monthly Base Rent installments, an amount equal to one-twelfth (1/12) of the total Estimated Excess set forth in the previous Estimate Statement delivered by Landlord to Tenant.

4.3.4 Allocation of Operating Expenses, Tax Expenses and Utilities Costs to Building. The parties acknowledge that the Building may in the future be part of a multi-office building project consisting of the Building and such other buildings as Landlord may elect to construct and include as part of the Real Property from time to time (collectively, the "**Other Buildings**"), and that certain of the costs and expenses incurred in connection with the Real Property (*i.e.*, the Operating Expenses, Tax Expenses and Utilities Costs) shall be shared among the Building and/or such Other Buildings, while certain other costs and expenses which are solely attributable to the Building and such Other Buildings, as applicable, shall be allocated directly to the Building and the Other Buildings, respectively. Accordingly, as set forth in Sections 4.1 and 4.2 above, Operating Expenses, Tax Expenses and Utilities Costs are determined annually for the Real Property as a whole, and a portion of the Operating Expenses, Tax Expenses and Utilities Costs, which portion shall be determined by Landlord on an equitable basis, shall be allocated to the Building (as opposed to the tenants of the Other Buildings), and such portion so allocated shall be the amount of Operating Expenses, Tax Expenses and Utilities Costs payable with respect to the Building upon which Tenant's Share shall be calculated. Such portion of the Operating Expenses, Tax Expenses and Utilities Costs allocated to the Building shall include all Operating Expenses, Tax Expenses and Utilities Costs which are attributable solely to the Building, and an equitable portion of the Operating Expenses, Tax Expenses and Utilities Costs attributable to the Real Property as a whole (but not any portion of the Operating Expenses, Tax Expenses and Utilities Costs which are attributable solely to Other Buildings or utilities of the Other Buildings that are separately metered). As an example of such allocation with respect to Tax Expenses and Utilities Costs, it is anticipated that Landlord may receive separate tax bills which separately assess the improvements component of Tax Expenses for each building in the Project and/or Landlord may receive separate utilities bills from the utilities companies identifying the Utilities Costs for certain of the utilities costs directly incurred by each such building (as measured by separate meters installed for each such building), and such separately assessed Tax Expenses and separately metered Utilities Costs shall be calculated for and allocated separately to each such applicable building. In addition, in the event Landlord elects, at its sole option, to subdivide certain common area portions of the Real Property such as landscaping, public and private streets, driveways, walkways, courtyards, plazas, transportation facilitation areas, accessways and/or parking areas into a separate parcel or parcels of land (and/or separately convey all or any of such parcels to a common area association to own, operate and/or maintain same), the Operating Expenses, Tax Expenses and Utilities Costs for such common area parcels of land may be aggregated and then reasonably allocated by Landlord to the Building and such Other Buildings on an equitable basis as Landlord (and/or any applicable covenants, conditions and restrictions for any such common area association) shall provide from time to time.

4.4 Taxes and Other Charges for Which Tenant Is Directly Responsible. Tenant shall reimburse Landlord upon demand for any and all taxes or assessments required to be paid by Landlord (except to the extent included in Tax Expenses by Landlord), excluding state, local and federal personal or corporate income taxes measured by the net income of Landlord from all sources and estate and inheritance taxes, whether or not now customary or within the contemplation of the parties hereto, when:

4.4.1 said taxes are measured by or reasonably attributable to the cost or value of Tenant's equipment, furniture, fixtures and other personal property located in the Premises, or by the cost or value of any leasehold improvements made in or to the Premises by or for Tenant, to the extent the cost or value of such leasehold improvements exceeds the cost or value of a building standard build-out as determined by Landlord regardless of whether title to such improvements shall be vested in Tenant or Landlord;

4.4.2 said taxes are assessed upon or with respect to the possession, leasing, operation, management, maintenance, alteration, repair, use or occupancy by Tenant of the Premises or any portion of the Real Property (including the Parking Facilities); or

4.4.3 said taxes are assessed upon this transaction or any document to which Tenant is a party creating or transferring an interest or an estate in the Premises.

4.5 Late Charges. If any installment of Rent or any other sum due from Tenant shall not be received by Landlord or Landlord's designee by the due date therefor, then Tenant shall pay to Landlord a late charge equal to ten percent (10%) of the amount due plus reasonable attorneys' fees incurred by Landlord by reason of Tenant's failure to pay Rent and/or other charges when due hereunder. The late charge shall be deemed Additional Rent and the right to require it shall be in addition to all of Landlord's other rights and remedies hereunder, at law and/or in equity and shall not be construed as liquidated damages or as limiting Landlord's remedies in any manner. In addition to the late charge described above, any Rent or other amounts owing hereunder which are not paid by the date that they are due shall thereafter bear interest until paid at a rate (the "**Interest Rate**") equal to the lesser of (i) the "Prime Rate" or "Reference Rate" announced from time to time by the Bank of America (or such reasonable comparable national banking institution as selected by Landlord in the event Bank of America ceases to exist or publish a Prime Rate or Reference Rate), plus four percent (4%), or (ii) the highest rate permitted by applicable law.

ARTICLE 5

USE OF PREMISES

Tenant shall use the Premises solely for general office purposes consistent with the character of the Building as a first-class office building, and Tenant shall not use or permit the Premises to be used for any other purpose or purposes whatsoever. Tenant further covenants and agrees that it shall not use, or suffer or permit any person or persons to use, the Premises or any part thereof for any use or purpose contrary to the provisions of Exhibit D, attached hereto, or in violation of the laws of the United States of America, the state in which the Real Property is located, or the ordinances, regulations or requirements of the local municipal or county governing body or other lawful authorities having jurisdiction over the Real Property. Tenant shall comply with all recorded covenants, conditions, and restrictions, and the provisions of all ground or underlying leases, now or hereafter affecting the Real Property. Tenant shall not use or allow another person or entity to use any part of the Premises for the storage, use, treatment, manufacture or sale of "Hazardous Material," as that term is defined below. As used herein, the term "**Hazardous Material**" means any hazardous or toxic substance, material or waste which is or becomes regulated by any local governmental authority, the state in which the Real Property is located or the United States Government.

ARTICLE 6

SERVICES AND UTILITIES

6.1 Standard Tenant Services. Landlord shall provide the following services on all days during the Lease Term, unless otherwise stated below.

6.1.1 Subject to reasonable changes implemented by Landlord and to all governmental rules, regulations and guidelines applicable thereto, Landlord shall provide heating and air conditioning when necessary for normal comfort for normal office use in the Premises, from Monday through Friday, during the period from 7:00 a.m. to 6:00 p.m., except for the date of observation of New Year's Day, Presidents' Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, Christmas Day and other locally or nationally recognized holidays as designated by Landlord (collectively, the "**Holidays**`").

6.1.2 Landlord shall provide adequate electrical wiring and facilities and power for normal general office use for Building standard lighting and standard office equipment, as determined by Landlord. Landlord shall designate the electricity utility provider from time to time.

6.1.3 As part of Operating Expenses or Utilities Costs (as determined by Landlord), Landlord shall replace lamps, starters and ballasts for Building standard lighting fixtures within the Premises. In addition, Tenant shall bear the cost of replacement of lamps, starters and ballasts for non-Building standard lighting fixtures within the Premises.

6.1.4 Landlord shall provide city water from the regular Building outlets for drinking, lavatory and toilet purposes.

6.1.5 Landlord shall provide janitorial services five (5) days per week, except the date of observation of the Holidays, in and about the Premises and window washing services in a manner consistent with other comparable buildings in the vicinity of the Project.

6.1.6 Landlord shall provide nonexclusive automatic passenger elevator service at all times.

6.1.7 Landlord shall provide nonexclusive freight elevator service subject to scheduling by Landlord.

6.2 Overstandard Tenant Use. Tenant shall not, without Landlord's prior written consent, use heat-generating machines, machines other than normal fractional horsepower office machines, or equipment or lighting other than Building standard lights in the Premises, which may affect the temperature otherwise maintained by the air conditioning system or increase the need for water normally furnished for the Premises by Landlord pursuant to the terms of Section 6.1 of this Lease. If such consent is given, Landlord shall have the right to install supplementary air conditioning equipment or systems in the Premises, including supplementary or additional metering devices, and the cost thereof, including the cost of installation, operation and maintenance, increased wear and tear on existing equipment and other similar charges, shall be paid by Tenant to Landlord upon billing by Landlord. If Tenant uses water or heat or air conditioning in excess of that supplied by Landlord pursuant to Section 6.1 of this Lease, or if Tenant's consumption of electricity shall exceed two (2) watts connected load per rentable square foot of the Premises, calculated on an monthly basis for the hours described in Section 6.1.1 above, Tenant shall pay to Landlord, within ten (10) days after billing and as additional rent, the cost of such excess consumption, the cost of the installation, operation, and maintenance of equipment which is installed in order to supply such excess consumption, and the cost of the increased wear and tear on existing equipment caused by such excess consumption; and Landlord may install devices to separately meter any increased use, and in such event Tenant shall pay, as additional rent, the increased cost directly to Landlord, within ten (10) days after demand, including the cost of such additional metering devices. If Tenant desires to use heat, ventilation or air conditioning during hours other than those for which Landlord is obligated to supply such utilities pursuant to the terms of Section 6.1 of this Lease, (i) Tenant shall give Landlord such prior notice, as Landlord shall from time to time establish as appropriate, of Tenant's desired use, (ii) Landlord shall supply such utilities to Tenant at such hourly cost to Tenant as Landlord shall from time to time establish, and (iii) Tenant shall pay such cost within ten (10) days

after billing, as additional rent. Landlord confirms that after-hours heating and air-conditioning is available to the Premises at the current cost of $35.00 per hour. The rate for after-hours heating and air-conditioning to the Premises is subject to change based upon changes in Landlord's cost to provide such services.

6.3 Separate Metering. Notwithstanding the foregoing provisions of this Section 6 to the contrary, Landlord shall have the right to cause some or all of the electricity, water and/or other utilities to be separately metered for the Premises, and Tenant shall pay for the cost of all such utilities so separately metered, or which are billed directly to Tenant, within ten (10) days after invoice, in which event Utilities Costs for the Utilities Base Year and each Expense Year shall be equitably reduced to exclude all such utilities provided to Tenant and other tenants in the Building.

6.4 Interruption of Use. Tenant agrees that Landlord shall not be liable for damages, by abatement of Rent or otherwise, for failure to furnish or delay in furnishing any service (including telephone and telecommunication services), or for any diminution in the quality or quantity thereof, when such failure or delay or diminution is occasioned, in whole or in part, by repairs, replacements, or improvements, by any strike, lockout or other labor trouble, by inability to secure electricity, gas, water, or other fuel at the Building or Real Property after reasonable effort to do so, by any accident or casualty whatsoever, by act or default of Tenant or other parties, or by any other cause beyond Landlord's reasonable control; and such failures or delays or diminution shall never be deemed to constitute an eviction or disturbance of Tenant's use and possession of the Premises or relieve Tenant from paying Rent or performing any of its obligations under this Lease. Furthermore, Landlord shall not be liable under any circumstances for a loss of, or injury to, property or for injury to, or interference with, Tenant's business, including, without limitation, loss of profits, however occurring, through or in connection with or incidental to a failure to furnish any of the services or utilities as set forth in this Article 6.

6.5 Additional Services. Landlord shall also have the exclusive right, but not the obligation, to provide any additional services which may be required by Tenant, including, without limitation, locksmithing, lamp replacement, additional janitorial service, and additional repairs and maintenance, provided that Tenant shall pay to Landlord upon billing, the sum of all costs to Landlord of such additional services plus an administration fee. Charges for any utilities or service for which Tenant is required to pay from time to time hereunder, shall be deemed Additional Rent hereunder and shall be billed on a monthly basis.

ARTICLE 7

REPAIRS

7.1 Tenant's Repairs. Subject to Landlord's repair obligations in Sections 7.2 and 11.1 below, Tenant shall, at Tenant's own expense, keep the Premises, including all improvements, fixtures and furnishings therein, in good order, repair and condition at all times during the Lease Term, which repair obligations shall include, without limitation, the obligation to promptly and adequately repair all damage to the Premises and replace or repair all damaged or broken fixtures and appurtenances; provided however, that, at Landlord's option, or if Tenant fails to make such repairs, Landlord may, but need not, make such repairs and replacements, and Tenant shall pay Landlord the cost thereof, including a percentage of the cost thereof (to be uniformly established for the Building) sufficient to reimburse Landlord for all overhead, general conditions, fees and other costs or expenses arising from Landlord's involvement with such repairs and replacements forthwith upon being billed for same.

7.2 Landlord's Repairs. Anything contained in Section 7.1 above to the contrary notwithstanding, and subject to Articles 11 and 12 of this Lease, Landlord shall repair and maintain the structural portions of the Building, including the basic plumbing, heating, ventilating, air conditioning and electrical systems serving the Building and not located in the Premises; provided, however, if such maintenance and repairs are caused in part or in whole by the act, neglect, fault of or omission of any duty by Tenant, its agents, servants, employees or invitees, Tenant shall pay to Landlord as additional rent, the reasonable cost of such maintenance and repairs. Landlord shall not be liable for any failure to make any such repairs, or to perform any maintenance. There shall be no abatement of rent and no liability of Landlord by reason of any injury to or interference with Tenant's business arising from the making of any repairs, alterations or improvements in or to any portion of the Real Property, Building or the Premises or in or to fixtures, appurtenances and equipment therein. Tenant hereby waives and releases its right to make repairs at Landlord's expense under Sections 1941 and 1942 of the California Civil Code; or under any similar law, statute, or ordinance now or hereafter in effect.

ARTICLE 8

ADDITIONS AND ALTERATIONS

8.1 Landlord's Consent to Alterations. Tenant may not make any improvements, alterations, additions or changes to the Premises (collectively, the "**Alterations**") without first procuring the prior written consent of Landlord to such Alterations, which consent shall be requested by Tenant not less than thirty (30) days prior to the commencement thereof, and which consent shall not be unreasonably withheld by Landlord; provided, however, Landlord may withhold its consent in its sole and absolute discretion with respect to any Alterations which may affect the structural components of the Building or the Systems and Equipment or which can be seen from outside the Premises. Tenant shall pay for all overhead, general conditions, fees and other costs and expenses of the Alterations, and shall pay to Landlord a Landlord supervision fee of ten percent (10%) of the cost of the Alterations. The construction of the initial improvements to the Premises shall be governed by the terms of the Tenant Work Letter and not the terms of this Article 8.

8.2 Manner of Construction. Landlord may impose, as a condition of its consent to all Alterations or repairs of the Premises or about the Premises, such requirements as Landlord in its reasonable discretion may deem desirable, including, but not limited to, the requirement that Tenant utilize for such purposes only contractors, materials, mechanics and materialmen approved by Landlord; provided, however, Landlord may impose such requirements as Landlord may determine, in its sole and absolute discretion, with respect to any work affecting the structural components of the Building or Systems and Equipment (including designating specific contractors to perform such work). Tenant shall construct such Alterations and perform such repairs in conformance with any and all applicable rules and regulations of any federal, state, county or municipal code or ordinance and pursuant to a valid building permit, issued by the city in which the Real Property is located, and in conformance with Landlord's construction rules and regulations. Landlord's approval of the plans, specifications and working drawings for Tenant's Alterations shall create no responsibility or liability on the part of Landlord for their completeness, design sufficiency, or compliance with all laws, rules and regulations of governmental agencies or authorities. All work with respect to any Alterations must be done in a good and workmanlike manner and diligently prosecuted to completion to the end that the Premises shall at all times be a complete unit except during the period of work. In performing the work of any such Alterations, Tenant shall have the work performed in such manner as not to obstruct access to the Building or Real Property or the common areas for any other tenant of the Real Property, and as not to obstruct the business of Landlord or other tenants of the Real Property, or interfere with the labor force working at the Real Property. If Tenant makes any Alterations, Tenant agrees to carry "Builder's All Risk" insurance in an amount approved by Landlord covering the construction of such Alterations, and such other insurance as Landlord may require, it being understood and agreed that all of such Alterations shall be insured by Tenant pursuant to Article 10 of this Lease immediately upon completion thereof. In addition, Landlord may, in its discretion, require Tenant to obtain a lien and completion bond or some alternate form of security satisfactory to Landlord in an amount sufficient to ensure the lien-free completion of such Alterations and naming Landlord as a co-obligee. Upon completion of any Alterations, Tenant shall (i) cause a Notice of Completion to be recorded in the office of the Recorder of the county in which the Real Property is located in accordance with Section 3093 of the Civil Code of the State of California or any successor statute, (ii) deliver to the management office of the Real Property a reproducible copy of the "as built" drawings of the Alterations, and (iii) deliver to Landlord evidence of payment, contractors' affidavits and full and final waivers of all liens for labor, services or materials.

8.3 Landlord's Property. All Alterations, improvements, fixtures and/or equipment which may be installed or placed in or about the Premises, and all signs installed in, on or about the Premises, from time to time, shall be at the sole cost of Tenant and shall be and become the property of Landlord. Furthermore, Landlord may require that Tenant remove any improvement or Alteration upon the expiration or early termination of the Lease Term, and repair any damage to the Premises and Building caused by such removal. If Tenant fails to complete such removal and/or to repair any damage caused by the removal of any Alterations, Landlord may do so and may charge the cost thereof to Tenant.

8.4 Wi-Fi Network. Without limiting the generality of the foregoing, in the event Tenant desires to install wireless intranet, Internet and communications network ("**Wi-Fi Network**") in the Premises for the use by Tenant and its employees, then the same shall be subject to the provisions of this Section 8.4 (in addition to the other provisions of this Article 8). In the event Landlord consents to Tenant's installation of such Wi-Fi Network, Tenant shall, in accordance with Article 15 below, remove the Wi-Fi Network from the Premises prior to the termination of the Lease. Tenant shall use the Wi-Fi Network so as not to cause any interference to other tenants in the Building or to other tenants at the Real Property or with any other tenant's communication equipment, and not to damage the Real Property or interfere with the normal operation of the Real Property and Tenant hereby agrees to indemnify, defend and hold Landlord harmless from and against any and all claims, costs, damages, expenses and liabilities (including attorneys' fees) arising out of Tenant's failure to comply with the provisions of this Section 8.4, except to the extent same is caused by the gross negligence or willful misconduct of Landlord and which is not covered by the insurance carried by Tenant under this Lease (or which would not be covered by the insurance required to be carried by Tenant under this Lease). Should any interference occur, Tenant shall take all necessary steps as soon as reasonably possible and no later than three (3) calendar days following such occurrence to correct such interference. If such interference continues after such three (3) day period, Tenant shall immediately cease operating such Wi-Fi Network until such interference is corrected or remedied to Landlord's satisfaction. Tenant acknowledges that Landlord has granted and/or may grant telecommunication rights to other tenants and occupants of the Building and Real Property and to telecommunication service providers and in no event shall Landlord be liable to Tenant for any interference of the same with such Wi-Fi Network. Landlord makes no representation that the Wi-Fi Network will be able to receive or transmit communication signals without interference or disturbance. Tenant shall (i) be solely responsible for any damage caused as a result of the Wi-Fi Network, (ii) promptly pay any tax, license or permit fees charged pursuant to any laws or regulations in connection with the installation, maintenance or use of the Wi-Fi Network and comply with all precautions and safeguards recommended by all governmental authorities, (iii) pay for all necessary repairs, replacements to or maintenance of the Wi-Fi Network, and (iv) be responsible for any modifications, additions or repairs to the Building or Real Property, including without limitation, Building or Real Property systems or infrastructure, which are required by reason of the installation, operation or removal of Tenant's Wi-Fi Network. Should Landlord be required to retain professionals to research any interference issues that may arise and confirm Tenant's compliance with the terms of this Section 8.4, Tenant shall reimburse Landlord for the costs incurred by Landlord in connection with Landlord's retention of such professionals, the research of such interference issues and confirmation of Tenant's compliance with the terms of this Section 8.4 within twenty (20) days after the date Landlord submits to Tenant an invoice for such costs, which costs shall not exceed One Thousand Dollars ($1,000.00) in the aggregate per year (the "**Reimbursement Cap**"); provided, however, that to the extent that it is determined that Tenant has failed to perform its obligations under this Section 8.4, the Reimbursement Cap shall not apply, and Tenant shall be responsible for reimbursing Landlord for all costs Landlord incurs in connection with Landlord's retention of such professionals, the research of such interference issues and confirmation of Tenant's compliance with the terms of this Section 8.4. This reimbursement obligation is in addition to, and not in lieu of, any rights or remedies Landlord may have in the event of a breach or default by Tenant under this Lease.

8.5 Supplemental HVAC Equipment. Tenant shall be entitled to the continued use and maintenance of the existing supplemental HVAC equipment located within the computer room of the Premises, as more particularly set forth on Exhibit E attached hereto (collectively, the "**Supplemental HVAC Equipment**"). Tenant's continued use and maintenance of the Supplemental HVAC Equipment shall continue to be at Tenant's sole cost and expense and shall remain in the current locations, previously approved by Landlord pursuant to the Existing Lease (defined in Section 24.31 below). The Supplemental HVAC Units shall be separately metered at Tenant's sole cost and expense (including condensor water and electricity, as applicable), and all costs and utility charges relating to the operation, maintenance and repair of such Supplemental HVAC Equipment shall be paid for by Tenant. If Tenant elects to install any additional supplemental HVAC equipment pursuant to the terms of this Article 8, Tenant shall install and operate the additional supplemental HVAC equipment in compliance with applicable law and shall at all times maintain the Supplemental HVAC Equipment, including any additional supplemental HVAC equipment, in good condition and repair. If Tenant desires to relocate the Supplemental HVAC Equipment, Tenant shall obtain Landlord's prior written approval of the new locations, and any costs incurred due to the relocation shall be Tenant's sole responsibility. Upon the expiration or earlier termination of this Lease, Tenant shall surrender the Supplemental HVAC Equipment to Landlord in good condition, normal wear and tear excepted, or, at Landlord's option, Tenant shall remove the Supplemental HVAC Equipment and repair any damage to the Premises and/or the Building caused by such removal.

ARTICLE 9

COVENANT AGAINST LIENS

Tenant has no authority or power to cause or permit any lien or encumbrance of any kind whatsoever, whether created by act of Tenant, operation of law or otherwise, to attach to or be placed upon the Real Property, Building or Premises, and any and all liens and encumbrances created by Tenant shall attach to Tenant's interest only. Landlord shall have the right at all times to post and keep posted on the Premises any notice which it deems necessary for protection from such liens. Tenant covenants and agrees not to suffer or permit any lien of mechanics or materialmen or others to be placed against the Real Property, the Building or the Premises with respect to work or services claimed to have been performed for or materials claimed to have been furnished to Tenant or the Premises, and, in case of any such lien attaching or notice of any lien, Tenant covenants and agrees to cause it to be immediately released and removed of record. Notwithstanding anything to the contrary set forth in this Lease, if any such lien is not released and removed on or before the date notice of such lien is delivered by Landlord to Tenant, Landlord, at its sole option, may immediately take all action necessary to release and remove such lien, without any duty to investigate the validity thereof, and all sums, costs and expenses, including reasonable attorneys' fees and costs, incurred by Landlord in connection with such lien shall be deemed Additional Rent under this Lease and shall immediately be due and payable by Tenant.

ARTICLE 10

INDEMNIFICATION AND INSURANCE

10.1 Indemnification and Waiver. Tenant hereby assumes all risk of damage to property and injury to persons, in, on, or about the Premises from any cause whatsoever and agrees that Landlord, and its partners and subpartners, and their respective officers, agents, property managers, servants, employees, and independent contractors (collectively, "**Landlord Parties**") shall not be liable for, and are hereby released from any responsibility for, any damage to property or injury to persons or resulting from the loss of use thereof, which damage or injury is sustained by Tenant or by other persons claiming through Tenant. Tenant shall indemnify, defend, protect, and hold harmless the Landlord Parties from any and all loss, cost, damage, expense and liability (including without limitation court costs and reasonable attorneys' fees) incurred in connection with or arising from any cause in, on or about the Premises (including, without limitation, Tenant's installation, placement and removal of Alterations, improvements, fixtures and/or equipment in, on or about the Premises), and any acts, omissions or negligence of Tenant or of any person claiming by, through or under Tenant, or of the contractors, agents, servants, employees, licensees or invitees of Tenant or any such person, in, on or about the Premises, the Building and Real Property; provided, however, that the terms of the foregoing indemnity shall not apply to the gross negligence or willful misconduct of Landlord. The provisions of this Section 10.1 shall survive the expiration or sooner termination of this Lease.

10.2 Tenant's Compliance with Landlord's Fire and Casualty Insurance. Tenant shall, at Tenant's expense, comply as to the Premises with all insurance company requirements pertaining to the use of the Premises. If Tenant's conduct or use of the Premises causes any increase in the premium for such insurance policies, then Tenant shall reimburse Landlord for any such increase. Tenant, at Tenant's expense, shall comply with all rules, orders, regulations or requirements of the American Insurance Association (formerly the National Board of Fire Underwriters) and with any similar body.

10.3 Tenant's Insurance. Tenant shall maintain the following coverages in the following amounts.

10.3.1 Commercial General Liability Insurance covering the insured against claims of bodily injury, personal injury and property damage arising out of Tenant's operations, assumed liabilities or use of the Premises, including a Broad Form Commercial General Liability endorsement covering the insuring provisions of this Lease and the performance by Tenant of the indemnity agreements set forth in Section 10.1 of this Lease, (and with owned and non-owned automobile liability coverage, and liquor liability coverage in the event alcoholic beverages are served on the Premises) for limits of liability not less than:

Bodily Injury and Property Damage Liability	$5,000,000 each occurrence $5,000,000 annual aggregate
Personal Injury Liability	$5,000,000 each occurrence $5,000,000 annual aggregate 0% Insured's participation

10.3.2 Physical Damage Insurance covering (i) all office furniture, trade fixtures, office equipment, merchandise and all other items of Tenant's property on the Premises installed by, for, or at the expense of Tenant, (ii) the Tenant Improvements, including any Tenant Improvements which Landlord permits to be installed above the ceiling of the Premises or below the floor of the Premises, and (iii) all other improvements, alterations and additions to the Premises, including any improvements, alterations or additions installed at Tenant's request above the ceiling of the Premises or below the floor of the Premises. Such insurance shall be written on a "physical loss or damage" basis under a "special form" policy, for the full replacement cost value new without deduction for depreciation of the covered items and in amounts that meet any co-insurance clauses of the policies of insurance and shall include a vandalism and malicious mischief endorsement, sprinkler leakage coverage and earthquake sprinkler leakage coverage.

10.3.3 Workers' compensation insurance as required by law.

10.3.4 Loss-of-income, business interruption and extra-expense insurance in such amounts as will reimburse Tenant for direct and indirect loss of earnings attributable to all perils commonly insured against by prudent tenants or attributable to prevention of loss of access to the Premises or to the Building as a result of such perils.

10.3.5 Tenant shall carry comprehensive automobile liability insurance having a combined single limit of not less than Two Million Dollars ($2,000,000.00) per occurrence and insuring Tenant against liability for claims arising out of ownership, maintenance or use of any owned, hired or non-owned automobiles.

10.3.6 The minimum limits of policies of insurance required of Tenant under this Lease shall in no event limit the liability of Tenant under this Lease. Such insurance shall: (i) name Landlord, and any other party it so specifies, as an additional insured; (ii) specifically cover the liability assumed by Tenant under this Lease, including, but not limited to, Tenant's obligations under Section 10.1 of this Lease; (iii) be issued by an insurance company having a rating of not less than A-X in Best's Insurance Guide or which is otherwise acceptable to Landlord and licensed to do business in the state in which the Real Property is located; (iv) be primary insurance as to all claims thereunder and provide that any insurance carried by Landlord is excess and is non-contributing with any insurance requirement of Tenant; (v) provide that said insurance shall not be canceled or coverage changed unless thirty (30) days' prior written notice shall have been given to Landlord and any mortgagee or ground or underlying lessor of Landlord; (vi) contain a cross-liability endorsement or severability of interest clause acceptable to Landlord; and (vii) with respect to the insurance required in Sections 10.3.1 and 10.3.2 above, have deductible amounts not exceeding Five Thousand Dollars ($5,000.00). Tenant shall deliver said policy or policies or certificates thereof to Landlord on or before the Lease Commencement Date and at least thirty (30) days before the expiration dates thereof. If Tenant shall fail to procure such insurance, or to deliver such policies or certificate, within such time periods, Landlord may, at its option, in addition to all of its other rights and remedies under this Lease, and without regard to any notice and cure periods set forth in Section 19.1, procure such policies for the account of Tenant, and the cost thereof shall be paid to Landlord as Additional Rent within ten (10) days after delivery of bills therefor.

10.4 Subrogation. Landlord and Tenant agree to have their respective insurance companies issuing property damage insurance waive any rights of subrogation that such companies may have against Landlord or Tenant, as the case may be, so long as the insurance carried by Landlord and Tenant, respectively, is not invalidated thereby. As long as such waivers of subrogation are contained in their respective insurance policies, Landlord and Tenant hereby waive any right that either may have against the other on account of any loss or damage to their respective property to the extent such loss or damage is insurable under policies of insurance for fire and all risk coverage, theft, public liability, or other similar insurance.

10.5 Additional Insurance Obligations. Tenant shall carry and maintain during the entire Lease Term, at Tenant's sole cost and expense, increased amounts of the insurance required to be carried by Tenant pursuant to this Article 10, and such other reasonable types of insurance coverage and in such reasonable amounts covering the Premises and Tenant's operations therein, as may be reasonably requested by Landlord.

ARTICLE 11

DAMAGE AND DESTRUCTION

11.1 Repair of Damage to Premises by Landlord. Tenant shall promptly notify Landlord of any damage to the Premises resulting from fire or any other casualty. If the Premises or any common areas of the Building or Real Property serving or providing access to the Premises shall be damaged by fire or other casualty, Landlord shall promptly and diligently, subject to reasonable delays for insurance adjustment or other matters beyond Landlord's reasonable control, and subject to all other terms of this Article 11, restore the base, shell, and core of the Premises and such common areas. Such restoration shall be to substantially the same condition of the

base, shell, and core of the Premises and common areas prior to the casualty, except for modifications required by zoning and building codes and other laws or by the holder of a mortgage on the Real Property, or the lessor of a ground or underlying lease with respect to the Real Property and/or the Building, or any other modifications to the common areas deemed desirable by Landlord, provided access to the Premises and any common restrooms serving the Premises shall not be materially impaired. Notwithstanding any other provision of this Lease, upon the occurrence of any damage to the Premises, Tenant shall assign to Landlord (or to any party designated by Landlord) all insurance proceeds payable to Tenant under Tenant's insurance required under Section 10.3 of this Lease, and Landlord shall repair any injury or damage to the tenant improvements and alterations installed in the Premises and shall return such tenant improvements and alterations to their original condition; provided that if the cost of such repair by Landlord exceeds the amount of insurance proceeds received by Landlord from Tenant's insurance carrier, as assigned by Tenant, the cost of such repairs shall be paid by Tenant to Landlord prior to Landlord's repair of the damage. In connection with such repairs and replacements, Tenant shall, prior to the commencement of construction, submit to Landlord, for Landlord's review and approval, all plans, specifications and working drawings relating thereto, and Landlord shall select the contractors to perform such improvement work. Landlord shall not be liable for any inconvenience or annoyance to Tenant or its visitors, or injury to Tenant's business resulting in any way from such damage or the repair thereof; provided however, that if such fire or other casualty shall have damaged the Premises or common areas necessary to Tenant's occupancy, and if such damage is not the result of the negligence or willful misconduct of Tenant or Tenant's employees, contractors, licensees, or invitees, Landlord shall allow Tenant a proportionate abatement of Base Rent and Tenant's Share of Operating Expenses, Tax Expenses and Utilities Costs to the extent Landlord is reimbursed from the proceeds of rental interruption insurance purchased by Landlord as part of Operating Expenses, during the time and to the extent the Premises are unfit for occupancy for the purposes permitted under this Lease, and not occupied by Tenant as a result thereof.

11.2 Landlord's Option to Repair. Notwithstanding the terms of Section 11.1 of this Lease, Landlord may elect not to rebuild and/or restore the Premises, the Building and/or any other portion of the Real Property and instead terminate this Lease by notifying Tenant in writing of such termination within sixty (60) days after the date of damage, such notice to include a termination date giving Tenant ninety (90) days to vacate the Premises, but Landlord may so elect only if the Building shall be damaged by fire or other casualty or cause, whether or not the Premises are affected, and one or more of the following conditions is present: (i) repairs cannot reasonably be completed within one hundred twenty (120) days of the date of damage (when such repairs are made without the payment of overtime or other premiums); (ii) the holder of any mortgage on the Real Property or ground or underlying lessor with respect to the Real Property and/or the Building shall require that the insurance proceeds or any portion thereof be used to retire the mortgage debt, or shall terminate the ground or underlying lease, as the case may be; or (iii) the damage is not fully covered, except for deductible amounts, by Landlord's insurance policies. In addition, if the Premises or the Building is destroyed or damaged to any substantial extent during the last twelve (12) months of the Lease Term, then notwithstanding anything contained in this Article 11, Landlord shall have the option to terminate this Lease by giving written notice to Tenant of the exercise of such option within thirty (30) days after such damage or destruction, in which event this Lease shall cease and terminate as of the date of such notice. Upon any such termination of this Lease pursuant to this Section 11.2, Tenant shall pay the Base Rent and Additional Rent, properly apportioned up to such date of termination, and both parties hereto shall thereafter be freed and discharged of all further obligations hereunder, except as provided for in provisions of this Lease which by their terms survive the expiration or earlier termination of the Lease Term.

11.3 Waiver of Statutory Provisions. The provisions of this Lease, including this Article 11, constitute an express agreement between Landlord and Tenant with respect to any and all damage to, or destruction of, all or any part of the Premises, the Building or any other portion of the Real Property, and any statute or regulation of the state in which the Real Property is located, including, without limitation, Sections 1932(2) and 1933(4) of the California Civil Code, with respect to any rights or obligations concerning damage or destruction in the absence of an express agreement between the parties, and any other statute or regulation, now or hereafter in effect, shall have no application to this Lease or any damage or destruction to all or any part of the Premises, the Building or any other portion of the Real Property.

ARTICLE 12

CONDEMNATION

12.1 Permanent Taking. If the whole or any part of the Premises, Building or Real Property shall be taken by power of eminent domain or condemned by any competent authority for any public or quasi-public use or purpose, or if any adjacent property or street shall be so taken or condemned, or reconfigured or vacated by such authority in such manner as to require the use, reconstruction or remodeling of any part of the Premises, Building or Real Property, or if Landlord shall grant a deed or other instrument in lieu of such taking by eminent domain or condemnation, Landlord shall have the option to terminate this Lease upon one hundred eighty (180) days' notice, provided such notice is given no later than ninety (90) days after the date of such taking, condemnation, reconfiguration, vacation, deed or other instrument. If more than twenty-five percent (25%) of the rentable square feet of the Premises is taken, or if access to the Premises is substantially impaired, by power of eminent domain or condemned by any competent authority for any public or quasi-public use or purpose, then Tenant shall have the option to terminate this Lease upon one hundred eighty (180) days' notice, provided such notice is given no later than ninety (90) days after the date of such taking. Landlord shall be entitled to receive the entire award or payment in connection therewith, except that Tenant shall have the right to file any separate claim available to Tenant for any taking of Tenant's personal property and fixtures belonging to Tenant and removable by Tenant upon expiration of the Lease Term pursuant to the terms of this Lease, and for moving expenses and any other compensatory damages, so long as such claim does not diminish the award available to Landlord, its ground lessor with respect to the Real Property or its mortgagee, and such claim is payable separately to Tenant. All Rent shall be apportioned as of the date of such termination, or the date of such taking, whichever shall first occur. If any part of the Premises shall be

taken by power of eminent domain or condemned by any competent authority for any public or quasi-public use or purpose, and this Lease is not terminated, the Base Rent and Tenant's Share of Operating Expenses, Tax Expenses and Utilities Costs shall be proportionately abated. Tenant hereby waives any and all rights it might otherwise have pursuant to Section 1265.130 of The California Code of Civil Procedure.

12.2 Temporary Taking. Notwithstanding anything to the contrary contained in this Article 12, in the event of a temporary taking of all or any portion of the Premises by power of eminent domain or condemned by any competent authority for any public or quasi-public use or purpose for a period of one hundred and eighty (180) days or less, then this Lease shall not terminate but the Base Rent and Tenant's Share of Operating Expenses, Tax Expenses and Utilities Costs shall be abated for the period of such taking in proportion to the ratio that the amount of rentable square feet of the Premises taken bears to the total rentable square feet of the Premises. Landlord shall be entitled to receive the entire award made in connection with any such temporary taking.

ARTICLE 13

COVENANT OF QUIET ENJOYMENT

Landlord covenants that Tenant, on paying the Rent, charges for services and other payments herein reserved and on keeping, observing and performing all the other terms, covenants, conditions, provisions and agreements herein contained on the part of Tenant to be kept, observed and performed, shall, during the Lease Term, peaceably and quietly have, hold and enjoy the Premises subject to the terms, covenants, conditions, provisions and agreements hereof without interference by any persons lawfully claiming by or through Landlord. The foregoing covenant is in lieu of any other covenant express or implied.

ARTICLE 14

ASSIGNMENT AND SUBLETTING

14.1 Transfers. Tenant shall not, without the prior written consent of Landlord, assign, mortgage, pledge, hypothecate, encumber, or permit any lien to attach to, or otherwise transfer, this Lease or any interest hereunder, permit any assignment or other such foregoing transfer of this Lease or any interest hereunder by operation of law, sublet the Premises or any part thereof, or permit the use of the Premises by any persons other than Tenant and its employees (all of the foregoing are hereinafter sometimes referred to collectively as "**Transfers**" and any person to whom any Transfer is made or sought to be made is hereinafter sometimes referred to as a "**Transferee**"). If Tenant shall desire Landlord's consent to any Transfer, Tenant shall notify Landlord in writing, which notice (the "**Transfer Notice**") shall include (i) the proposed effective date of the Transfer, which shall not be less than thirty (30) days nor more than one hundred eighty (180) days after the date of delivery of the Transfer Notice, (ii) a description of the portion of the Premises to be transferred (the "**Subject Space**"), (iii) all of the terms of the proposed Transfer, the name and address of the proposed Transferee, and a copy of all existing and/or proposed documentation pertaining to the proposed Transfer, including all existing operative documents to be executed to evidence such Transfer or the agreements incidental or related to such Transfer, (iv) current financial statements of the proposed Transferee certified by an officer, partner or owner thereof, and (v) such other information as Landlord may reasonably require. Any Transfer made without Landlord's prior written consent shall, at Landlord's option, be null, void and of no effect, and shall, at Landlord's option, constitute a default by Tenant under this Lease. Whether or not Landlord shall grant consent, within thirty (30) days after written request by Landlord, Tenant shall pay to Landlord Two Thousand Five Hundred Dollars ($2,500.00) to reimburse Landlord for its review and processing fees, and Tenant shall also reimburse Landlord for any reasonable legal fees incurred by Landlord in connection with Tenant's proposed Transfer.

14.2 Landlord's Consent. Landlord shall not unreasonably withhold its consent to any proposed Transfer of the Subject Space to the Transferee on the terms specified in the Transfer Notice. The parties hereby agree that it shall be reasonable under this Lease and under any applicable law for Landlord to withhold consent to any proposed Transfer where one or more of the following apply, without limitation as to other reasonable grounds for withholding consent:

14.2.1 The Transferee is of a character or reputation or engaged in a business which is not consistent with the quality of the Building or Real Property;

14.2.2 The Transferee intends to use the Subject Space for purposes which are not permitted under this Lease;

14.2.3 The Transferee is either a governmental agency or instrumentality thereof;

14.2.4 The Transfer will result in more than a reasonable and safe number of occupants per floor within the Subject Space;

14.2.5 The Transferee is not a party of reasonable financial worth and/or financial stability in light of the responsibilities involved under the Lease on the date consent is requested;

14.2.6 The proposed Transfer would cause Landlord to be in violation of another lease or agreement to which Landlord is a party, or would give an occupant of the Real Property a right to cancel its lease;

14.2.7 The terms of the proposed Transfer will allow the Transferee to exercise a right of renewal, right of expansion, right of first offer, or other similar right held by Tenant (or will allow the Transferee to occupy space leased by Tenant pursuant to any such right); or

14.2.8 Either the proposed Transferee, or any person or entity which directly or indirectly, controls, is controlled by, or is under common control with, the proposed Transferee, (i) occupies space in the Project at the time of the request for consent, (ii) is negotiating with Landlord to lease space in the Project at such time, or (iii) has negotiated with Landlord during the twelve (12)-month period immediately preceding the Transfer Notice.

If Landlord consents to any Transfer pursuant to the terms of this Section 14.2 (and does not exercise any recapture rights Landlord may have under Section 14.4 of this Lease), Tenant may within six (6) months after Landlord's consent, but not later than the expiration of said six-month period, enter into such Transfer of the Premises or portion thereof, upon substantially the same terms and conditions as are set forth in the Transfer Notice furnished by Tenant to Landlord pursuant to Section 14.1 of this Lease, provided that if there are any changes in the terms and conditions from those specified in the Transfer Notice (i) such that Landlord would initially have been entitled to refuse its consent to such Transfer under this Section 14.2, or (ii) which would cause the proposed Transfer to be more favorable to the Transferee than the terms set forth in Tenant's original Transfer Notice, Tenant shall again submit the Transfer to Landlord for its approval and other action under this Article 14 (including Landlord's right of recapture, if any, under Section 14.4 of this Lease).

14.3 Transfer Premium. If Landlord consents to a Transfer, as a condition thereto which the parties hereby agree is reasonable, Tenant shall pay to Landlord fifty percent (50%) of any "Transfer Premium," as that term is defined in this Section 14.3, received by Tenant from such Transferee. "**Transfer Premium**" shall mean all rent, additional rent or other consideration payable by such Transferee in excess of the Rent and Additional Rent payable by Tenant under this Lease on a per rentable square foot basis if less than all of the Premises is transferred, after deducting the reasonable expenses incurred by Tenant for (i) any reasonable changes, alterations and improvements to the Premises in connection with the Transfer (but only to the extent approved by Landlord), and (ii) any reasonable brokerage commissions in connection with the Transfer (collectively, the "**Subleasing Costs**"). "Transfer Premium" shall also include, but not be limited to, key money and bonus money paid by Transferee to Tenant in connection with such Transfer, and any payment in excess of fair market value for services rendered by Tenant to Transferee or for assets, fixtures, inventory, equipment, or furniture transferred by Tenant to Transferee in connection with such Transfer.

14.4 Landlord's Option as to Subject Space. Notwithstanding anything to the contrary contained in this Article 14, Landlord shall have the option, by giving written notice to Tenant within thirty (30) days after receipt of any Transfer Notice, to recapture the Subject Space. Such recapture notice shall cancel and terminate this Lease with respect to the Subject Space as of the date stated in the Transfer Notice as the effective date of the proposed Transfer until the last day of the term of the Transfer as set forth in the Transfer Notice. If this Lease shall be canceled with respect to less than the entire Premises, the Rent reserved herein shall be prorated on the basis of the number of rentable square feet retained by Tenant in proportion to the number of rentable square feet contained in the Premises, and this Lease as so amended shall continue thereafter in full force and effect, and upon request of either party, the parties shall execute written confirmation of the same. If Landlord declines, or fails to elect in a timely manner to recapture the Subject Space under this Section 14.4, then, provided Landlord has consented to the proposed Transfer, Tenant shall be entitled to proceed to transfer the Subject Space to the proposed Transferee, subject to provisions of the last paragraph of Section 14.2 of this Lease.

14.5 Effect of Transfer. If Landlord consents to a Transfer, (i) the terms and conditions of this Lease shall in no way be deemed to have been waived or modified, (ii) such consent shall not be deemed consent to any further Transfer by either Tenant or a Transferee, (iii) Tenant shall deliver to Landlord, promptly after execution, an original executed copy of all documentation pertaining to the Transfer in form reasonably acceptable to Landlord, and (iv) no Transfer relating to this Lease or agreement entered into with respect thereto, whether with or without Landlord's consent, shall relieve Tenant or any guarantor of the Lease from liability under this Lease. Landlord or its authorized representatives shall have the right at all reasonable times to audit the books, records and papers of Tenant relating to any Transfer, and shall have the right to make copies thereof. If the Transfer Premium respecting any Transfer shall be found understated, Tenant shall, within thirty (30) days after demand, pay the deficiency and Landlord's costs of such audit.

14.6 Additional Transfers. For purposes of this Lease, the term "**Transfer**" shall also include (i) if Tenant is a partnership, the withdrawal or change, voluntary, involuntary or by operation of law, of fifty percent (50%) or more of the partners, or transfer of twenty-five percent or more of partnership interests, within a twelve (12)-month period, or the dissolution of the partnership without immediate reconstitution thereof, and (ii) if Tenant is a closely held corporation (i.e., whose stock is not publicly held and not traded through an exchange or over the counter), (A) the dissolution, merger, consolidation or other reorganization of Tenant, (B) the sale or other transfer of more than an aggregate of fifty percent (50%) of the voting shares of Tenant (other than to immediate family members by reason of gift or death), within a twelve (12)-month period, or (C) the sale, mortgage, hypothecation or pledge of more than an aggregate of fifty percent (50%) of the value of the unencumbered assets of Tenant within a twelve (12) month period.

ARTICLE 15

SURRENDER; OWNERSHIP AND REMOVAL OF TRADE FIXTURES

15.1 Surrender of Premises. No act or thing done by Landlord or any agent or employee of Landlord during the Lease Term shall be deemed to constitute an acceptance by Landlord of a surrender of the Premises unless such intent is specifically acknowledged in a writing signed by Landlord. The delivery of keys to the Premises to Landlord or any agent or employee of Landlord shall not constitute a surrender of the Premises or effect a termination of this Lease, whether or not the keys are thereafter retained by Landlord, and notwithstanding such delivery Tenant shall be entitled to the return of such keys at any reasonable time upon request until this Lease shall have been properly terminated. The voluntary or other surrender of this Lease by Tenant, whether accepted by Landlord or not, or a mutual termination hereof, shall not work a merger, and at the option of Landlord shall operate as an assignment to Landlord of all subleases or subtenancies affecting the Premises.

15.2 Removal of Tenant Property by Tenant. Upon the expiration of the Lease Term, or upon any earlier termination of this Lease, Tenant shall, subject to the provisions of this Article 15, quit and surrender possession of the Premises to Landlord in as good order and condition as when Tenant took possession and as thereafter improved by Landlord and/or Tenant, reasonable wear and tear and repairs which are specifically made the responsibility of Landlord hereunder excepted. Upon such expiration or termination, Tenant shall, without expense to Landlord, remove or cause to be removed from the Premises all telephone, data, and other cabling and wiring (including any cabling and wiring associated with the Wi-Fi Network, if any) installed or caused to be installed by Tenant (including any cabling and wiring, installed above the ceiling of the Premises or below the floor of the Premises), all debris and rubbish, and such items of furniture, equipment, free-standing cabinet work, and other articles of personal property owned by Tenant or installed or placed by Tenant at its expense in the Premises, and such similar articles of any other persons claiming under Tenant, as Landlord may, in its sole discretion, require to be removed, and Tenant shall repair at its own expense all damage to the Premises and Building resulting from such removal.

ARTICLE 16

HOLDING OVER

If Tenant holds over after the expiration of the Lease Term hereof, with or without the express or implied consent of Landlord, such tenancy shall be from month-to-month only, and shall not constitute a renewal hereof or an extension for any further term, and in such case Base Rent shall be payable at a monthly rate equal to two hundred percent (200%) of the greater of (i) the Base Rent applicable during the last rental period of the Lease Term under this Lease, and (ii) the fair market rental rate of the Premises as of the commencement of such holdover period. Such month-to-month tenancy shall be subject to every other term, covenant and agreement contained herein. Landlord hereby expressly reserves the right to require Tenant to surrender possession of the Premises to Landlord as provided in this Lease upon the expiration or other termination of this Lease. The provisions of this Article 16 shall not be deemed to limit or constitute a waiver of any other rights or remedies of Landlord provided herein or at law. If Tenant fails to surrender the Premises upon the termination or expiration of this Lease, in addition to any other liabilities to Landlord accruing therefrom, Tenant shall protect, defend, indemnify and hold Landlord harmless from all loss, costs (including reasonable attorneys' fees) and liability resulting from such failure, including, without limiting the generality of the foregoing, any claims made by any succeeding tenant founded upon such failure to surrender, and any lost profits to Landlord resulting therefrom.

ARTICLE 17

ESTOPPEL CERTIFICATES

Within ten (10) days following a request in writing by Landlord, Tenant shall execute and deliver to Landlord an estoppel certificate, which, as submitted by Landlord, shall be in the form as may be required by any prospective mortgagee or purchaser of the Real Property (or any portion thereof), indicating therein any exceptions thereto that may exist at that time, and shall also contain any other information reasonably requested by Landlord or Landlord's mortgagee or prospective mortgagee. Tenant shall execute and deliver whatever other instruments may be reasonably required for such purposes. Failure of Tenant to timely execute and deliver such estoppel certificate or other instruments shall constitute an acceptance of the Premises and an acknowledgment by Tenant that statements included in the estoppel certificate are true and correct, without exception. Failure by Tenant to so deliver such estoppel certificate shall be a material default of the provisions of this Lease. In addition, Tenant shall be liable to Landlord, and shall indemnify Landlord from and against any loss, cost, damage or expense, incidental, consequential, or otherwise, including attorneys' fees, arising or accruing directly or indirectly, from any failure of Tenant to execute or deliver to Landlord any such estoppel certificate.

ARTICLE 18

SUBORDINATION

This Lease is subject and subordinate to all present and future ground or underlying leases of the Real Property and to the lien of any mortgages or trust deeds, now or hereafter in force against the Real Property, if any, and to all renewals, extensions, modifications, consolidations and replacements thereof, and to all advances made or hereafter to be made upon the security of such mortgages or trust deeds, unless the holders of such mortgages or trust deeds, or the lessors under such ground lease or underlying leases, require in writing that this Lease be superior thereto. Tenant covenants and agrees in the event any proceedings are brought for the foreclosure of any such

mortgage, or if any ground or underlying lease is terminated, to attorn, without any deductions or set-offs whatsoever, to the purchaser upon any such foreclosure sale, or to the lessor of such ground or underlying lease, as the case may be, if so requested to do so by such purchaser or lessor, and to recognize such purchaser or lessor as the lessor under this Lease. Tenant shall, within five (5) days of request by Landlord, execute such further instruments or assurances as Landlord may reasonably deem necessary to evidence or confirm the subordination or superiority of this Lease to any such mortgages, trust deeds, ground leases or underlying leases. Tenant hereby irrevocably authorizes Landlord to execute and deliver in the name of Tenant any such instrument or instruments if Tenant fails to do so, provided that such authorization shall in no way relieve Tenant from the obligation of executing such instruments of subordination or superiority. Tenant waives the provisions of any current or future statute, rule or law which may give or purport to give Tenant any right or election to terminate or otherwise adversely affect this Lease and the obligations of the Tenant hereunder in the event of any foreclosure proceeding or sale.

ARTICLE 19

TENANT'S DEFAULTS; LANDLORD'S REMEDIES

19.1 Events of Default by Tenant. All covenants and agreements to be kept or performed by Tenant under this Lease shall be performed by Tenant at Tenant's sole cost and expense and without any reduction of Rent. The occurrence of any of the following shall constitute a default of this Lease by Tenant:

19.1.1 Any failure by Tenant to pay any Rent or any other charge required to be paid under this Lease, or any part thereof, when due; or

19.1.2 Any failure by Tenant to observe or perform any other provision, covenant or condition of this Lease to be observed or performed by Tenant where such failure continues for fifteen (15) days after written notice thereof from Landlord to Tenant; provided however, that any such notice shall be in lieu of, and not in addition to, any notice required under California Code of Civil Procedure Section 1161 or any similar or successor law; and provided further that if the nature of such default is such that the same cannot reasonably be cured within a fifteen (15)-day period, Tenant shall not be deemed to be in default if it diligently commences such cure within such period and thereafter diligently proceeds to rectify and cure said default as soon as possible; or

19.1.3 Abandonment or vacation of the Premises by Tenant. Abandonment is herein defined to include, but is not limited to, any absence by Tenant from the Premises for three (3) business days or longer while in default of any provision of this Lease.

19.2 Landlord's Remedies Upon Default. Upon the occurrence of any such default by Tenant, Landlord shall have, in addition to any other remedies available to Landlord at law or in equity, the option to pursue any one or more of the following remedies, each and all of which shall be cumulative and nonexclusive, without any notice or demand whatsoever.

19.2.1 Terminate this Lease, in which event Tenant shall immediately surrender the Premises to Landlord, and if Tenant fails to do so, Landlord may, without prejudice to any other remedy which it may have for possession or arrearages in rent, enter upon and take possession of the Premises and expel or remove Tenant and any other person who may be occupying the Premises or any part thereof, without being liable for prosecution or any claim or damages therefor; and Landlord may recover from Tenant the following:

(i) The worth at the time of award of any unpaid rent which has been earned at the time of such termination; plus

(ii) The worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus

(iii) The worth at the time of award of the amount by which the unpaid rent for the balance of the Lease Term after the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus

(iv) Any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, specifically including but not limited to, brokerage commissions and advertising expenses incurred, expenses of remodeling the Premises or any portion thereof for a new tenant, whether for the same or a different use, and any special concessions made to obtain a new tenant; and

(v) At Landlord's election, such other amounts in addition to or in lieu of the foregoing as may be permitted from time to time by applicable law.

The term "**rent**" as used in this Section 19.2 shall be deemed to be and to mean all sums of every nature required to be paid by Tenant pursuant to the terms of this Lease, whether to Landlord or to others. As used in Sections 19.2.1(i) and (ii), above, the "worth at the time of award" shall be computed by allowing interest at the Interest Rate set forth in Section 4.5 of this Lease. As used in Section 19.2.1(iii) above, the "worth at the time of award" shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus one percent (1%).

19.2.2 Landlord shall have the remedy described in California Civil Code Section 1951.4 (lessor may continue lease in effect after lessee's breach and abandonment and recover rent as it becomes due, if lessee has the right to sublet or assign, subject only to reasonable limitations). Accordingly, if Landlord does not elect to terminate this Lease on account of any default by Tenant, Landlord may, from time to time, without terminating this Lease, enforce all of its rights and remedies under this Lease, including the right to recover all rent as it becomes due.

19.2.3 Landlord may, but shall not be obligated to, make any such payment or perform or otherwise cure any such obligation, provision, covenant or condition on Tenant's part to be observed or performed (and may enter the Premises for such purposes). In the event of Tenant's failure to perform any of its obligations or covenants under this Lease, and such failure to perform poses a material risk of injury or harm to persons or damage to or loss of property, then Landlord shall have the right to cure or otherwise perform such covenant or obligation at any time after such failure to perform by Tenant, whether or not any such notice or cure period set forth in Section 19.1 above has expired. Any such actions undertaken by Landlord pursuant to the foregoing provisions of this Section 19.2.3 shall not be deemed a waiver of Landlord's rights and remedies as a result of Tenant's failure to perform and shall not release Tenant from any of its obligations under this Lease.

19.3 Payment by Tenant. Tenant shall pay to Landlord, within fifteen (15) days after delivery by Landlord to Tenant of statements therefor: (i) sums equal to expenditures reasonably made and obligations incurred by Landlord in connection with Landlord's performance or cure of any of Tenant's obligations pursuant to the provisions of Section 19.2.3 above; and (ii) sums equal to all expenditures made and obligations incurred by Landlord in collecting or attempting to collect the Rent or in enforcing or attempting to enforce any rights of Landlord under this Lease or pursuant to law, including, without limitation, all legal fees and other amounts so expended. Tenant's obligations under this Section 19.3 shall survive the expiration or sooner termination of the Lease Term.

19.4 Sublessees of Tenant. Whether or not Landlord elects to terminate this Lease on account of any default by Tenant, as set forth in this Article 19, Landlord shall have the right to terminate any and all subleases, licenses, concessions or other consensual arrangements for possession entered into by Tenant and affecting the Premises or may, in Landlord's sole discretion, succeed to Tenant's interest in such subleases, licenses, concessions or arrangements. In the event of Landlord's election to succeed to Tenant's interest in any such subleases, licenses, concessions or arrangements, Tenant shall, as of the date of notice by Landlord of such election, have no further right to or interest in the rent or other consideration receivable thereunder.

19.5 Waiver of Default. No waiver by Landlord of any violation or breach by Tenant of any of the terms, provisions and covenants herein contained shall be deemed or construed to constitute a waiver of any other or later violation or breach by Tenant of the same or any other of the terms, provisions, and covenants herein contained. Forbearance by Landlord in enforcement of one or more of the remedies herein provided upon a default by Tenant shall not be deemed or construed to constitute a waiver of such default. The acceptance of any Rent hereunder by Landlord following the occurrence of any default, whether or not known to Landlord, shall not be deemed a waiver of any such default, except only a default in the payment of the Rent so accepted.

19.6 Efforts to Relet. For the purposes of this Article 19, Tenant's right to possession shall not be deemed to have been terminated by efforts of Landlord to relet the Premises, by its acts of maintenance or preservation with respect to the Premises, or by appointment of a receiver to protect Landlord's interests hereunder. The foregoing enumeration is not exhaustive, but merely illustrative of acts which may be performed by Landlord without terminating Tenant's right to possession.

ARTICLE 20

SECURITY DEPOSIT

Landlord is currently holding an existing security deposit as security under the Existing Lease (defined in Section 24.31), which is currently in the amount of $166,391.96 (the "**Existing Security Deposit**"). Tenant hereby grants to Landlord a security interest in the Existing Security Deposit, as security for the faithful performance by Tenant of all the terms, covenants, and conditions of this Lease to be kept and performed by Tenant during the Lease Term, as well as the Existing Lease. Tenant hereby agrees that upon the expiration or termination of the Existing Lease, Landlord may continue to hold any unapplied portion of the Existing Security Deposit under this Lease, notwithstanding anything to the contrary set forth in the Existing Lease. It is understood and agreed that, if and to the extent that the Existing Security Deposit is less than $166,391.96, Tenant shall immediately deposit cash with Landlord, such that the security deposit hereunder shall total $166,391.96 (the "**Security Deposit**"). If Tenant defaults with respect to any provisions of this Lease, including, but not limited to, the provisions relating to the payment of Rent, Landlord may, but shall not be required to, use, apply or retain all or any part of the Security Deposit for the payment of any Rent or any other sum in default, or for the payment of any amount that Landlord may spend or become obligated to spend by reason of Tenant's default, or to compensate Landlord for any other loss or damage that Landlord may suffer by reason of Tenant's default. If any portion of the Security Deposit is so used or applied, Tenant shall, within five (5) days after written demand therefor, deposit cash with Landlord in an amount sufficient to restore the Security Deposit to its original amount, and Tenant's failure to do so shall be a default under this Lease. If Tenant shall fully and faithfully perform every provision of this Lease to be performed by it, the Security Deposit, or any balance thereof, shall be returned to Tenant, or, at Landlord's option, to the last assignee of Tenant's interest hereunder, within sixty (60) days following the expiration of the Lease Term. Tenant shall not be entitled to any interest on the Security Deposit. Tenant hereby waives the provisions of Section 1950.7 of the California Civil Code, and all other provisions of law, now or hereafter in force, which provide that Landlord may claim from a security deposit only those sums reasonably necessary to remedy defaults in the payment of rent, to

repair damage caused by Tenant or to clean the Premises, it being agreed that Landlord may, in addition, claim those sums reasonably necessary to compensate Landlord for any other loss or damage, foreseeable or unforeseeable, caused by the act or omission of Tenant or any officer, employee, agent or invitee of Tenant.

ARTICLE 21

COMPLIANCE WITH LAW

Tenant shall not do anything or suffer anything to be done in or about the Premises which will in any way conflict with any law, statute, ordinance or other governmental rule, regulation or requirement now in force or which may hereafter be enacted or promulgated. At its sole cost and expense, Tenant shall promptly comply with all such governmental measures, other than the making of structural changes or changes to the Building's life safety system (collectively the "**Excluded Changes**") except to the extent such Excluded Changes are required due to Tenant's alterations to or manner of use of the Premises. In addition, Tenant shall fully comply with all present or future programs intended to manage parking, transportation or traffic in and around the Real Property, and in connection therewith, Tenant shall take responsible action for the transportation planning and management of all employees located at the Premises by working directly with Landlord, any governmental transportation management organization or any other transportation-related committees or entities. The judgment of any court of competent jurisdiction or the admission of Tenant in any judicial action, regardless of whether Landlord is a party thereto, that Tenant has violated any of said governmental measures, shall be conclusive of that fact as between Landlord and Tenant.

ARTICLE 22

ENTRY BY LANDLORD

Landlord reserves the right at all reasonable times and upon reasonable notice to Tenant to enter the Premises to: (i) inspect them; (ii) show the Premises to prospective purchasers, mortgagees or tenants, or to the ground or underlying lessors; (iii) to post notices of nonresponsibility; or (iv) alter, improve or repair the Premises or the Building if necessary to comply with current building codes or other applicable laws, or for structural alterations, repairs or improvements to the Building, or as Landlord may otherwise reasonably desire or deem necessary. Notwithstanding anything to the contrary contained in this Article 22, Landlord may enter the Premises at any time, without notice to Tenant, in emergency situations and/or to perform janitorial or other services required of Landlord pursuant to this Lease. Any such entries shall be without the abatement of Rent and shall include the right to take such reasonable steps as required to accomplish the stated purposes. Tenant hereby waives any claims for damages or for any injuries or inconvenience to or interference with Tenant's business, lost profits, any loss of occupancy or quiet enjoyment of the Premises, and any other loss occasioned thereby. For each of the above purposes, Landlord shall at all times have a key with which to unlock all the doors in the Premises, excluding Tenant's vaults, safes and special security areas designated in advance by Tenant. In an emergency, Landlord shall have the right to enter without notice and use any means that Landlord may deem proper to open the doors in and to the Premises. Any entry into the Premises in the manner hereinbefore described shall not be deemed to be a forcible or unlawful entry into, or a detainer of, the Premises, or an actual or constructive eviction of Tenant from any portion of the Premises.

ARTICLE 23

TENANT PARKING

Tenant shall rent throughout the Lease Term the number of parking passes set forth in Section 11 of the Summary, located in those portions of the Parking Facilities as may be designated by Landlord from time to time. Tenant shall pay to Landlord for the use of such parking passes, on a monthly basis, the prevailing rate charged from time to time by Landlord or Landlord's parking operator for parking passes in the Parking Facilities where such parking passes are located, which rates are currently $120.00 per unreserved parking pass per month, and $190.00 per reserved parking pass per month. Tenant's continued right to use the parking passes is conditioned upon Tenant abiding by all rules and regulations which are prescribed from time to time for the orderly operation and use of the Parking Facilities and upon Tenant's cooperation in seeing that Tenant's employees and visitors also comply with such rules and regulations. In addition, Landlord may assign any parking spaces and/or make all or a portion of such spaces reserved or institute an attendant-assisted tandem parking program and/or valet parking program if Landlord determines in its sole discretion that such is necessary or desirable for orderly and efficient parking. Landlord specifically reserves the right, from time to time, to change the size, configuration, design, layout, location and all other aspects of the Parking Facilities, and Tenant acknowledges and agrees that Landlord, from time to time, may, without incurring any liability to Tenant and without any abatement of Rent under this Lease temporarily close-off or restrict access to the Parking Facilities, or temporarily relocate Tenant's parking spaces to other parking structures and/or surface parking areas within a reasonable distance from the Parking Facilities, for purposes of permitting or facilitating any such construction, alteration or improvements or to accommodate or facilitate renovation, alteration, construction or other modification of other improvements or structures located on the Real Property. Landlord may delegate its responsibilities hereunder to a parking operator in which case such parking operator shall have all the rights of control attributed hereby to Landlord. The parking rates charged by Landlord for Tenant's parking passes shall be exclusive of any parking tax or other charges imposed by governmental authorities in connection with the use of such parking, which taxes and/or charges shall be paid directly by Tenant or the parking users, or, if directly imposed against Landlord, Tenant shall reimburse Landlord for all such taxes and/or charges within ten (10) days after Tenant's receipt of the invoice from Landlord. The parking passes provided to Tenant pursuant to this Article 23 are provided solely for use by Tenant's own personnel and such passes may not be transferred, assigned, subleased or otherwise alienated by Tenant without Landlord's prior approval.

ARTICLE 24

MISCELLANEOUS PROVISIONS

24.1 Terms; Captions. The necessary grammatical changes required to make the provisions hereof apply either to corporations or partnerships or individuals, men or women, as the case may require, shall in all cases be assumed as though in each case fully expressed. The captions of Articles and Sections are for convenience only and shall not be deemed to limit, construe, affect or alter the meaning of such Articles and Sections.

24.2 Binding Effect. Each of the provisions of this Lease shall extend to and shall, as the case may require, bind or inure to the benefit not only of Landlord and of Tenant, but also of their respective successors or assigns, provided this clause shall not permit any assignment by Tenant contrary to the provisions of Article 14 of this Lease.

24.3 No Waiver. No waiver of any provision of this Lease shall be implied by any failure of a party to enforce any remedy on account of the violation of such provision, even if such violation shall continue or be repeated subsequently, any waiver by a party of any provision of this Lease may only be in writing, and no express waiver shall affect any provision other than the one specified in such waiver and that one only for the time and in the manner specifically stated. No receipt of monies by Landlord from Tenant after the termination of this Lease shall in any way alter the length of the Lease Term or of Tenant's right of possession hereunder or after the giving of any notice shall reinstate, continue or extend the Lease Term or affect any notice given Tenant prior to the receipt of such monies, it being agreed that after the service of notice or the commencement of a suit or after final judgment for possession of the Premises, Landlord may receive and collect any Rent due, and the payment of said Rent shall not waive or affect said notice, suit or judgment.

24.4 Modification of Lease; Financials. Should any current or prospective mortgagee or ground lessor for the Real Property require a modification or modifications of this Lease, which modification or modifications will not cause an increased cost or expense to Tenant or in any other way materially and adversely change the rights and obligations of Tenant hereunder, then and in such event, Tenant agrees that this Lease may be so modified and agrees to execute whatever documents are required therefor and deliver the same to Landlord within ten (10) days following the request therefor. Should Landlord or any such current or prospective mortgagee or ground lessor require execution of a short form of Lease for recording, containing, among other customary provisions, the names of the parties, a description of the Premises and the Lease Term, Tenant agrees to execute such short form of Lease and to deliver the same to Landlord within ten (10) days following the request therefor. In addition, upon request from time to time, Tenant agrees to provide to Landlord, within ten (10) days of written request, current financial statements for Tenant, dated no earlier than one (1) year prior to such request, certified as accurate by Tenant or, if available, audited financial statements prepared by an independent certified public accountant with copies of the auditor's statement. If any Guaranty is executed in connection with this Lease, Tenant also agrees to deliver to Landlord, within ten (10) days of written request, current financial statements of the Guarantor in a form consistent with the above criteria. All such financial statements will be delivered to Landlord and any such lender or purchaser in confidence and shall only be used for purposes of evaluating the financial strength of Tenant or of Guarantor, as applicable.

24.5 Transfer of Landlord's Interest. Tenant acknowledges that Landlord has the right to transfer all or any portion of its interest in the Real Property, the Building and/or in this Lease, and Tenant agrees that in the event of any such transfer, Landlord shall automatically be released from all liability under this Lease and Tenant agrees to look solely to such transferee for the performance of Landlord's obligations hereunder after the date of transfer. The liability of any transferee of Landlord shall be limited to the interest of such transferee in the Real Property and such transferee shall be without personal liability under this Lease, and Tenant hereby expressly waives and releases such personal liability on behalf of itself and all persons claiming by, through or under Tenant. Tenant further acknowledges that Landlord may assign its interest in this Lease to a mortgage lender as additional security and agrees that such an assignment shall not release Landlord from its obligations hereunder and that Tenant shall continue to look to Landlord for the performance of its obligations hereunder.

24.6 Prohibition Against Recording. Except as provided in Section 24.4 of this Lease, neither this Lease, nor any memorandum, affidavit or other writing with respect thereto, shall be recorded by Tenant or by anyone acting through, under or on behalf of Tenant, and the recording thereof in violation of this provision shall make this Lease null and void at Landlord's election.

24.7 Landlord's Title; Air Rights. Landlord's title is and always shall be paramount to the title of Tenant. Nothing herein contained shall empower Tenant to do any act which can, shall or may encumber the title of Landlord. No rights to any view or to light or air over any property, whether belonging to Landlord or any other person, are granted to Tenant by this Lease.

24.8 Tenant's Signs. Landlord shall provide space on the Building directory on the ground floor lobby of the Building for a listing identifying Tenant's name and suite number. Landlord shall also install near the entry door to the Leased Premises signage identifying Tenant's name. All such permitted signage shall use Building standard materials and lettering. Landlord shall pay for the cost of the initial installation of such permitted signage, and Tenant shall pay for the cost of any changes thereto. Except for such identification signs, Tenant may not install any signs on the exterior or roof of the Building or the common areas of the Building or the Real Property. Any signs, window coverings, or blinds (even if the same are located behind the Landlord approved window coverings for the Building), or other items visible from the exterior of the Premises or Building are subject to the prior approval of Landlord, in its sole and absolute discretion.

24.9 Relationship of Parties. Nothing contained in this Lease shall be deemed or construed by the parties hereto or by any third party to create the relationship of principal and agent, partnership, joint venturer or any association between Landlord and Tenant, it being expressly understood and agreed that neither the method of computation of Rent nor any act of the parties hereto shall be deemed to create any relationship between Landlord and Tenant other than the relationship of landlord and tenant.

24.10 Application of Payments. Landlord shall have the right to apply payments received from Tenant pursuant to this Lease, regardless of Tenant's designation of such payments, to satisfy any obligations of Tenant hereunder, in such order and amounts as Landlord, in its sole discretion, may elect.

24.11 Time of Essence. Time is of the essence of this Lease and each of its provisions.

24.12 Partial Invalidity. If any term, provision or condition contained in this Lease shall, to any extent, be invalid or unenforceable, the remainder of this Lease, or the application of such term, provision or condition to persons or circumstances other than those with respect to which it is invalid or unenforceable, shall not be affected thereby, and each and every other term, provision and condition of this Lease shall be valid and enforceable to the fullest extent possible permitted by law.

24.13 No Warranty. In executing and delivering this Lease, Tenant has not relied on any representation, including, but not limited to, any representation whatsoever as to the amount of any item comprising Additional Rent or the amount of the Additional Rent in the aggregate or that Landlord is furnishing the same services to other tenants, at all, on the same level or on the same basis, or any warranty or any statement of Landlord which is not set forth herein or in one or more of the Exhibits attached hereto.

24.14 Landlord Exculpation. It is expressly understood and agreed that notwithstanding anything in this Lease to the contrary, and notwithstanding any applicable law to the contrary, the liability of Landlord and the Landlord Parties hereunder (including any successor landlord) and any recourse by Tenant against Landlord or the Landlord Parties shall be limited solely and exclusively to an amount which is equal to the interest of Landlord in the Real Property, and neither Landlord, nor any of the Landlord Parties shall have any personal liability therefor, and Tenant hereby expressly waives and releases such personal liability on behalf of itself and all persons claiming by, through or under Tenant.

24.15 Entire Agreement. It is understood and acknowledged that there are no oral agreements between the parties hereto affecting this Lease and this Lease supersedes and cancels any and all previous negotiations, arrangements, brochures, agreements and understandings, if any, between the parties hereto or displayed by Landlord to Tenant with respect to the subject matter thereof, and none thereof shall be used to interpret or construe this Lease. This Lease and any side letter or separate agreement executed by Landlord and Tenant in connection with this Lease and dated of even date herewith contain all of the terms, covenants, conditions, warranties and agreements of the parties relating in any manner to the rental, use and occupancy of the Premises, shall be considered to be the only agreement between the parties hereto and their representatives and agents, and none of the terms, covenants, conditions or provisions of this Lease can be modified, deleted or added to except in writing signed by the parties hereto. All negotiations and oral agreements acceptable to both parties have been merged into and are included herein. There are no other representations or warranties between the parties, and all reliance with respect to representations is based totally upon the representations and agreements contained in this Lease.

24.16 Right to Lease. Landlord reserves the absolute right to effect such other tenancies in the Building and/or in any other building and/or any other portion of the Real Property as Landlord in the exercise of its sole business judgment shall determine to best promote the interests of the Real Property. Tenant does not rely on the fact, nor does Landlord represent, that any specific tenant or type or number of tenants shall, during the Lease Term, occupy any space in the Building or Real Property.

24.17 Force Majeure. Any prevention, delay or stoppage due to strikes, lockouts, labor disputes, acts of God, inability to obtain services, labor, or materials or reasonable substitutes therefor, governmental actions, civil commotions, fire or other casualty, and other causes beyond the reasonable control of the party obligated to perform, except with respect to the obligations imposed with regard to Rent and other charges to be paid by Tenant pursuant to this Lease and except with respect to Tenant's obligations under the Tenant Work Letter (collectively, the "**Force Majeure**"), notwithstanding anything to the contrary contained in this Lease, shall excuse the performance of such party for a period equal to any such prevention, delay or stoppage and, therefore, if this Lease specifies a time period for performance of an obligation of either party, that time period shall be extended by the period of any delay in such party's performance caused by a Force Majeure.

24.18 Waiver of Redemption by Tenant. Tenant hereby waives for Tenant and for all those claiming under Tenant all right now or hereafter existing to redeem by order or judgment of any court or by any legal process or writ, Tenant's right of occupancy of the Premises after any termination of this Lease.

24.19 Notices. All notices, demands, statements or communications (collectively, "**Notices**") given or required to be given by either party to the other hereunder shall be in writing, shall be sent by United States certified or registered mail, postage prepaid, return receipt requested, or delivered personally (i) to Tenant at the appropriate address set forth in Section 5 of the Summary, or to such other place as Tenant may from time to time designate in a Notice to Landlord; or (ii) to Landlord at the addresses set forth in Section 3 of the Summary, or to such other firm or to such other place as Landlord may from time to time designate in a Notice to Tenant. Any Notice will be deemed given on the date it is mailed as provided in this Section 24.19 or upon the date personal delivery is made. If Tenant is notified of the identity and address of Landlord's mortgagee or ground or underlying lessor, Tenant shall give to such mortgagee or ground or underlying lessor written notice of any default by Landlord under the terms of

this Lease by registered or certified mail, and such mortgagee or ground or underlying lessor shall be given a reasonable opportunity to cure such default prior to Tenant's exercising any remedy available to Tenant.

24.20 Joint and Several. If there is more than one Tenant, the obligations imposed upon Tenant under this Lease shall be joint and several.

24.21 Authority. If Tenant is a corporation or partnership, each individual executing this Lease on behalf of Tenant hereby represents and warrants that Tenant is a duly formed and existing entity qualified to do business in the state in which the Real Property is located and that Tenant has full right and authority to execute and deliver this Lease and that each person signing on behalf of Tenant is authorized to do so. Tenant confirms that it is not in violation of any executive order or similar governmental regulation or law, which prohibits terrorism or transactions with suspected or confirmed terrorists or terrorist entities or with persons or organizations that are associated with, or that provide any form of support to, terrorists. Tenant further confirms that it will comply throughout the Term of this Lease, with all governmental laws, rules or regulations governing transactions or business dealings with any suspected or confirmed terrorists or terrorist entities, as identified from time to time by the U.S. Treasury Department's Office of Foreign Assets Control or any other applicable governmental entity.

24.22 Jury Trial; Attorneys' Fees. IF EITHER PARTY COMMENCES LITIGATION AGAINST THE OTHER FOR THE SPECIFIC PERFORMANCE OF THIS LEASE, FOR DAMAGES FOR THE BREACH HEREOF OR OTHERWISE FOR ENFORCEMENT OF ANY REMEDY HEREUNDER, THE PARTIES HERETO AGREE TO AND HEREBY DO WAIVE ANY RIGHT TO A TRIAL BY JURY. In the event of any such commencement of litigation, the prevailing party shall be entitled to recover from the other party such costs and reasonable attorneys' fees as may have been incurred, including any and all costs incurred in enforcing, perfecting and executing such judgment.

24.23 Governing Law. This Lease shall be construed and enforced in accordance with the laws of the state in which the Real Property is located.

24.24 Submission of Lease. Submission of this instrument for examination or signature by Tenant does not constitute a reservation of or an option for lease, and it is not effective as a lease or otherwise until execution and delivery by both Landlord and Tenant.

24.25 Brokers. Landlord and Tenant hereby warrant to each other that they have had no dealings with any real estate broker or agent in connection with the negotiation of this Lease, excepting only the real estate brokers or agents specified in Section 12 of the Summary (the "**Brokers**"), and that they know of no other real estate broker or agent who is entitled to a commission in connection with this Lease. Each party agrees to indemnify and defend the other party against and hold the other party harmless from any and all claims, demands, losses, liabilities, lawsuits, judgments, and costs and expenses (including without limitation reasonable attorneys' fees) with respect to any leasing commission or equivalent compensation alleged to be owing on account of the indemnifying party's dealings with any real estate broker or agent other than the Brokers.

24.26 Independent Covenants. This Lease shall be construed as though the covenants herein between Landlord and Tenant are independent and not dependent and Tenant hereby expressly waives the benefit of any statute to the contrary and agrees that if Landlord fails to perform its obligations set forth herein, Tenant shall not be entitled to make any repairs or perform any acts hereunder at Landlord's expense or to any setoff of the Rent or other amounts owing hereunder against Landlord; provided, however, that the foregoing shall in no way impair the right of Tenant to commence a separate action against Landlord for any violation by Landlord of the provisions hereof so long as notice is first given to Landlord and any holder of a mortgage or deed of trust covering the Building, Real Property or any portion thereof, of whose address Tenant has theretofore been notified, and an opportunity is granted to Landlord and such holder to correct such violations as provided above.

24.27 Building Name and Signage. Landlord shall have the right at any time to change the name(s) of the Building and Real Property and to install, affix and maintain any and all signs on the exterior and on the interior of the Building and any portion of the Real Property as Landlord may, in Landlord's sole discretion, desire. Tenant shall not use the names of the Building or Real Property or use pictures or illustrations of the Building or Real Property in advertising or other publicity, without the prior written consent of Landlord.

24.28 Confidentiality. Tenant acknowledges that the content of this Lease and any related documents are confidential information. Tenant shall keep such confidential information strictly confidential and shall not disclose such confidential information to any person or entity other than Tenant's financial, legal, and space planning consultants.

24.29 Landlord's Construction. It is specifically understood and agreed that Landlord has no obligation and has made no promises to alter, remodel, improve, renovate, repair or decorate the Premises, Building, Real Property, or any part thereof and that no representations or warranties respecting the condition of the Premises, the Building or the Real Property have been made by Landlord to Tenant, except as specifically set forth in this Lease. Tenant acknowledges that prior to and during the Lease Term, Landlord (and/or any common area association) will be completing construction and/or demolition work pertaining to various portions of the Building, Premises, and/or Real Property, including without limitation the Parking Facilities, landscaping and tenant improvements for premises for other tenants and, at Landlord's sole election, such other buildings, parking facilities, improvements, landscaping and other facilities within or as part of the Project as Landlord (and/or such common area association) shall from time to time desire (collectively, the "**Construction**"). In connection with such Construction, Landlord may, among other things, erect scaffolding or other necessary structures in the Building, limit or eliminate access to portions of the Real Property, including portions of the common areas, or perform work in the Building and/or Real

Property, which work may create noise, dust or leave debris in the Building and/or Real Property. Tenant hereby agrees that such Construction and Landlord's actions in connection with such Construction shall in no way constitute a constructive eviction of Tenant nor entitle Tenant to any abatement of Rent. Landlord shall have no responsibility or for any reason be liable to Tenant for any direct or indirect injury to or interference with Tenant's business arising from such Construction, nor shall Tenant be entitled to any compensation or damages from Landlord for loss of the use of the whole or any part of the Premises or of Tenant's personal property or improvements resulting from such Construction or Landlord's actions in connection with such Construction, or for any inconvenience or annoyance occasioned by such Construction or Landlord's actions in connection with such Construction.

24.30 Substitution of Other Premises. With respect only to portions of the Premises which do not constitute a full floor of the Building ("**Partial Floor Premises**"), Landlord shall have the right to move such Partial Floor Premises to other space in the Project which is (i) contiguous to the Premises (subject to availability as determined by Landlord), and (ii) comparable in size (subject to availability as determined by Landlord) to the Partial Floor Premises, and all terms hereof shall apply to the new space with equal force. In such event, Landlord shall give Tenant prior notice of Landlord's election to so relocate Tenant, and shall move Tenant's effects to the new space at Landlord's sole cost and expense at such time and in such manner as to inconvenience Tenant as little as reasonably practicable. The new space shall be delivered to Tenant with improvements substantially similar to those improvements existing in the Premises at the time of Landlord's notification to Tenant of the relocation. Simultaneously with such relocation of the Partial Floor Premises, the parties shall immediately execute an amendment to this Lease stating the relocation of the Partial Floor Premises. In the event Tenant is relocated to new space pursuant to this Section 24.30, Landlord shall be responsible for all reasonable costs associated with the relocation (*i.e.*, re-printing costs for stationery and business cards, and telecommunication re-wiring and connectivity in the new space), subject to Landlord's prior approval of such costs before they are incurred. In no event will the Partial Floor Premises be relocated to space below the sixth (6th) floor of the Building.

24.31 Termination of Existing Lease. Tenant currently occupies the Premises pursuant to that certain Office Lease dated as of April 1, 1996, as amended by that certain Amendment to Office Lease dated as of February 10, 1997, that certain Second Amendment to Office Lease dated as of July 11, 1997, that certain Third Amendment to Office Lease dated as of August 17, 1999, that certain Amendment to Lease dated as of August 9, 2002, that certain Fourth Amendment to Office Lease (Amending the Seventh Floor Lease) and Second Amendment to Lease (Amending the Fifth Floor Lease) dated as of March 19, 2003, that certain Fifth Amendment to Office Lease dated as of October 27, 2003, that certain Sixth Amendment to Office Lease dated as of November 18, 2004, and that certain Seventh Amendment to Office Lease dated as of April ___, 2006, by and between Landlord and Tenant (collectively, as amended, the "**Existing Lease**"). Prior to the Lease Commencement Date, Tenant shall continue to occupy the Premises and perform all its obligations under each of the terms and conditions of the Existing Lease, it being acknowledged that the term thereof expires January 31, 2008. Upon the Lease Commencement Date, the Existing Lease shall terminate for all purposes, except that Tenant shall be responsible for any liabilities or obligations which specifically survive the termination of the Existing Lease in accordance with its terms. This Lease shall govern with respect to Tenant's occupancy of the Premises from and after the Lease Commencement Date.

Fitness Facility. Subject to the terms of this Section 24.32, Landlord agrees to maintain an exercise room in the Building in a manner consistent with the exercise room currently existing at the Building and used by tenants and occupants of the Building (such exercise room or reasonable replacement thereof, the "**Exercise Room**"). The Exercise Room will be for the non-exclusive use by Landlord, Tenant and other permitted users, including other tenants and occupants of the Building and Tenant and its invitees may use such facility at no cost to Tenant in accordance with this Section 24.32 and such reasonable rules and regulations as Landlord may from time to time promulgate. Tenant agrees that (i) it will instruct all of its officers, agents, employees, guests, and invitees that use of the Exercise Room is at their own risk; and (ii) Landlord shall not be liable for any injuries or damages resulting from use of the Exercise Room. Landlord reserves the right to refuse access to such Exercise Room in the event of any breach or violation of Landlord's rules and regulations concerning use of the Exercise Room, or any other default under the terms of the Lease. All users of the Exercise Room shall sign a release, waiver and indemnification in form acceptable to Landlord prior to admittance to the Exercise Room. Notwithstanding the foregoing, Landlord shall not be required to continue to maintain the Exercise Room if (a) the maintenance or operation of the Exercise Room in its current manner of operation does not comply with laws, rules or regulations, (b) Landlord's insurers or lenders prohibit the operation of the Exercise Room, or (c) Landlord determines, using Landlord's commercially reasonable judgment, that maintaining the Exercise Room is cost prohibitive or results in an unreasonable operating expense, presents an unreasonable danger or hazard to the tenants or occupants of the Building.

(SIGNATURES ON NEXT PAGE)

IN WITNESS WHEREOF, Landlord and Tenant have caused this Lease to be executed the day and date first above written.

"**Landlord**":

LEGACY PARTNERS I RIVERPARK I, LLC,
a Delaware limited liability company, as Owner

By: Legacy Partners Commercial, L.P.,
a California limited partnership,
as Property Manager and Agent for Owner

By: Legacy Partners Commercial, Inc., General Partner

By: _____
Debra Smith
Its: Executive Vice President

"**Tenant**":

PDF SOLUTIONS, INC.,
a Delaware corporation

By: _____
Name: _____
Its: _____

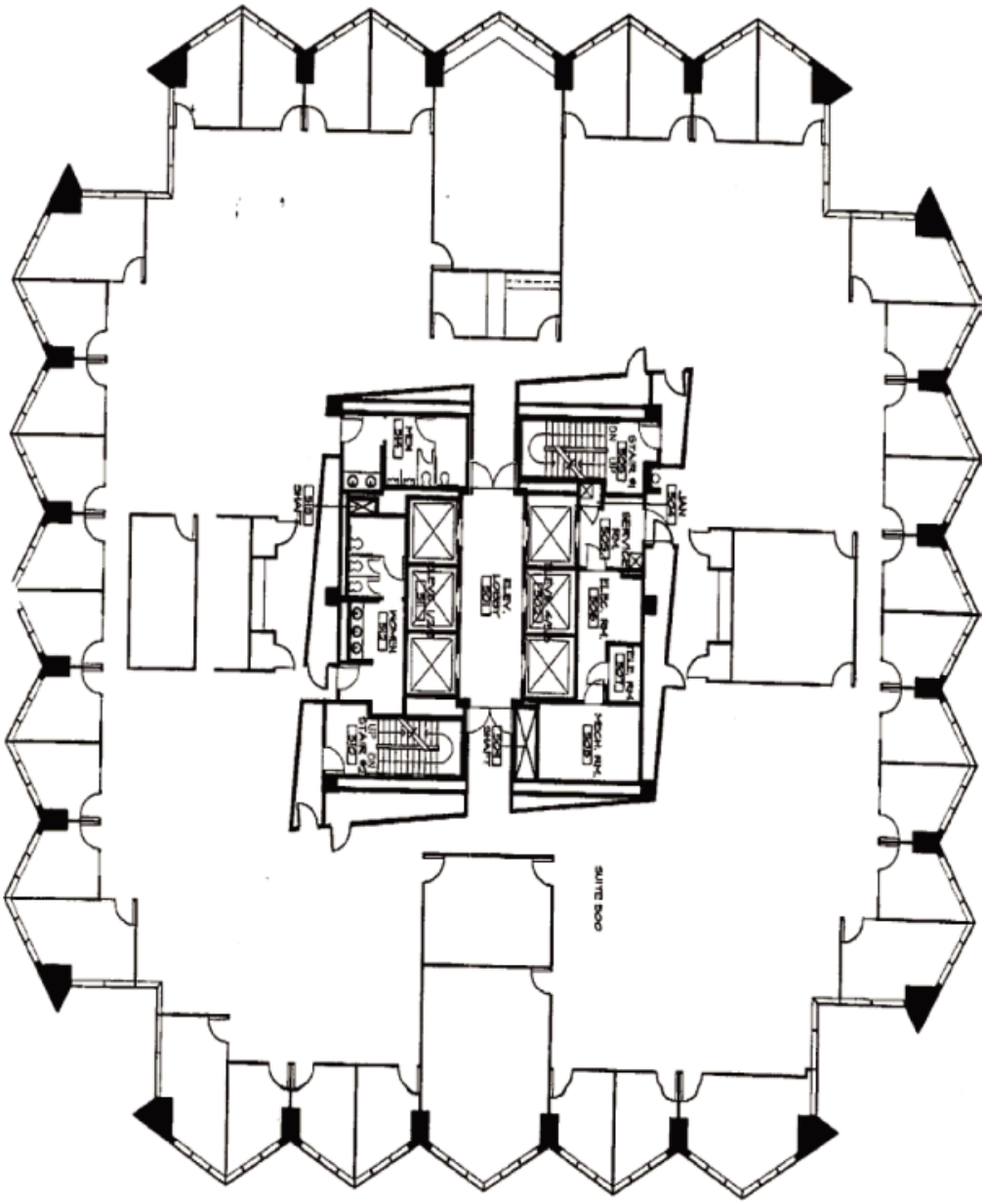
By: _____
Name: _____
Its: _____

*** If Tenant is a CORPORATION, the authorized officers must sign on behalf of the corporation and indicate the capacity in which they are signing. The Lease must be executed by the president or vice president and the secretary or assistant secretary, unless the bylaws or a resolution of the board of directors shall otherwise provide, in which event, the bylaws or a certified copy of the resolution, as the case may be, must be attached to this Lease.

EXHIBIT A

OUTLINE OF FLOOR PLAN OF PREMISES

SUITE 500

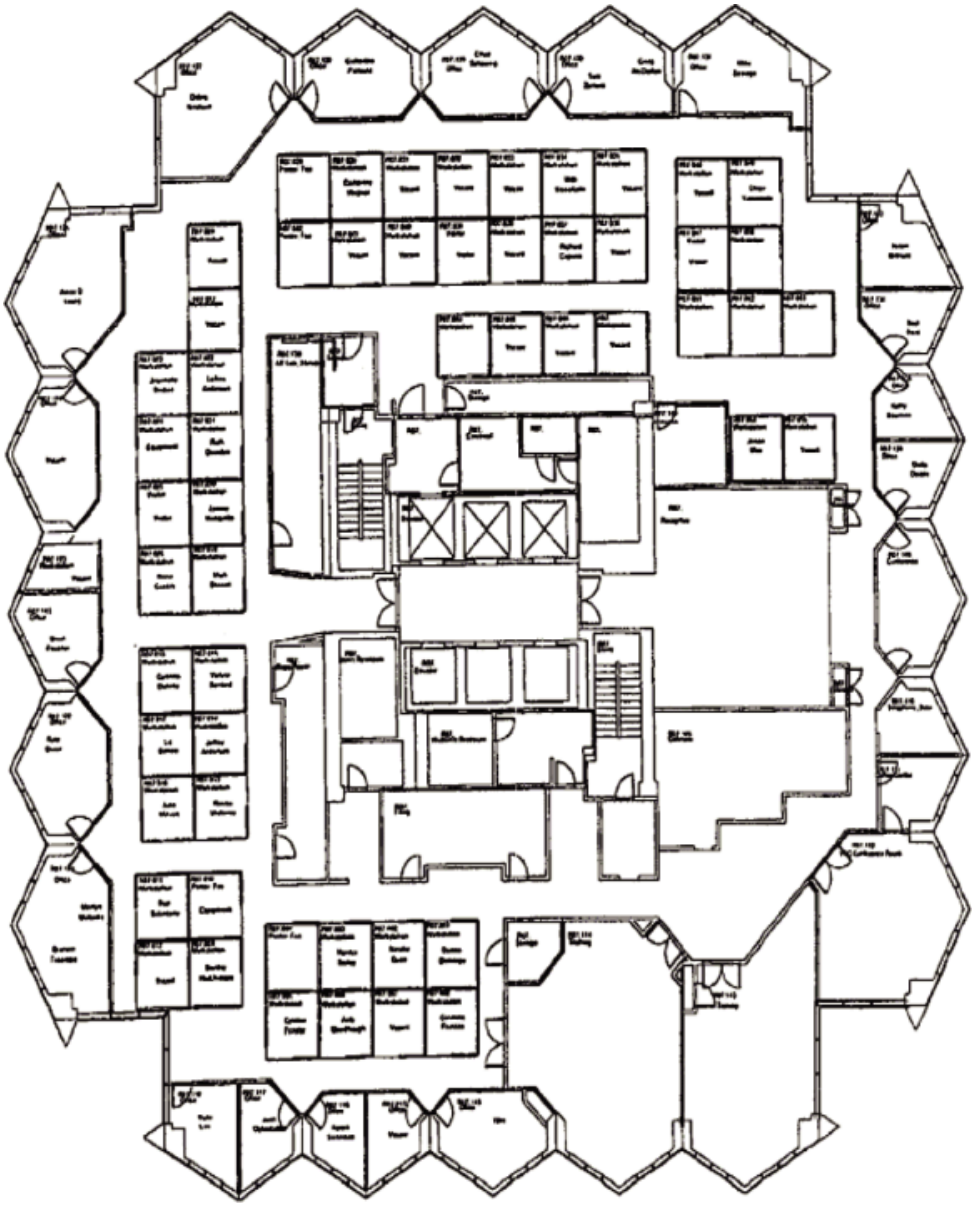


SUITE 500

TENANT'S INITIALS HERE:_____

OUTLINE OF FLOOR PLAN OF PREMISES

SUITE 700



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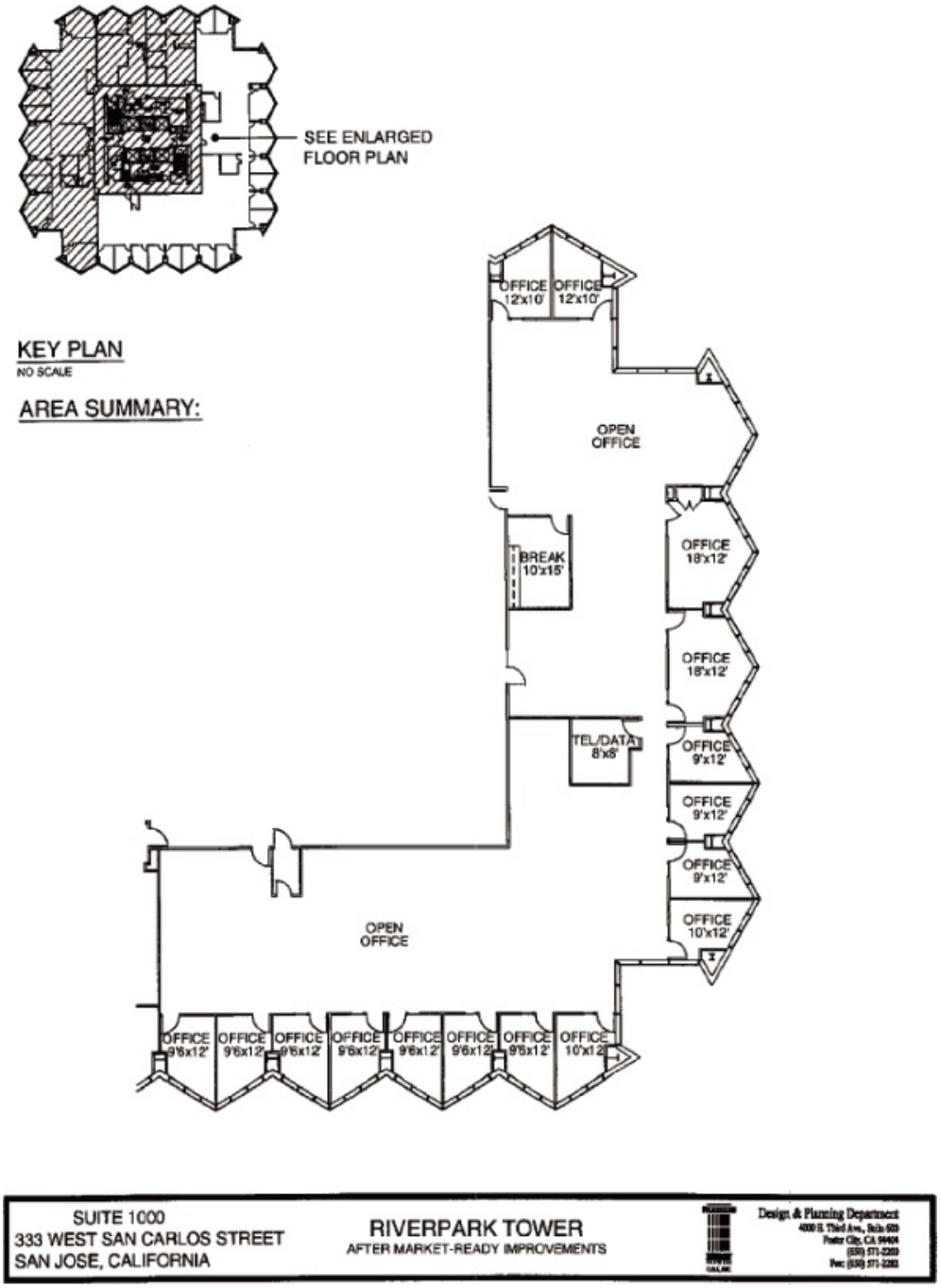
OUTLINE OF FLOOR PLAN OF PREMISES

SUITE 1000



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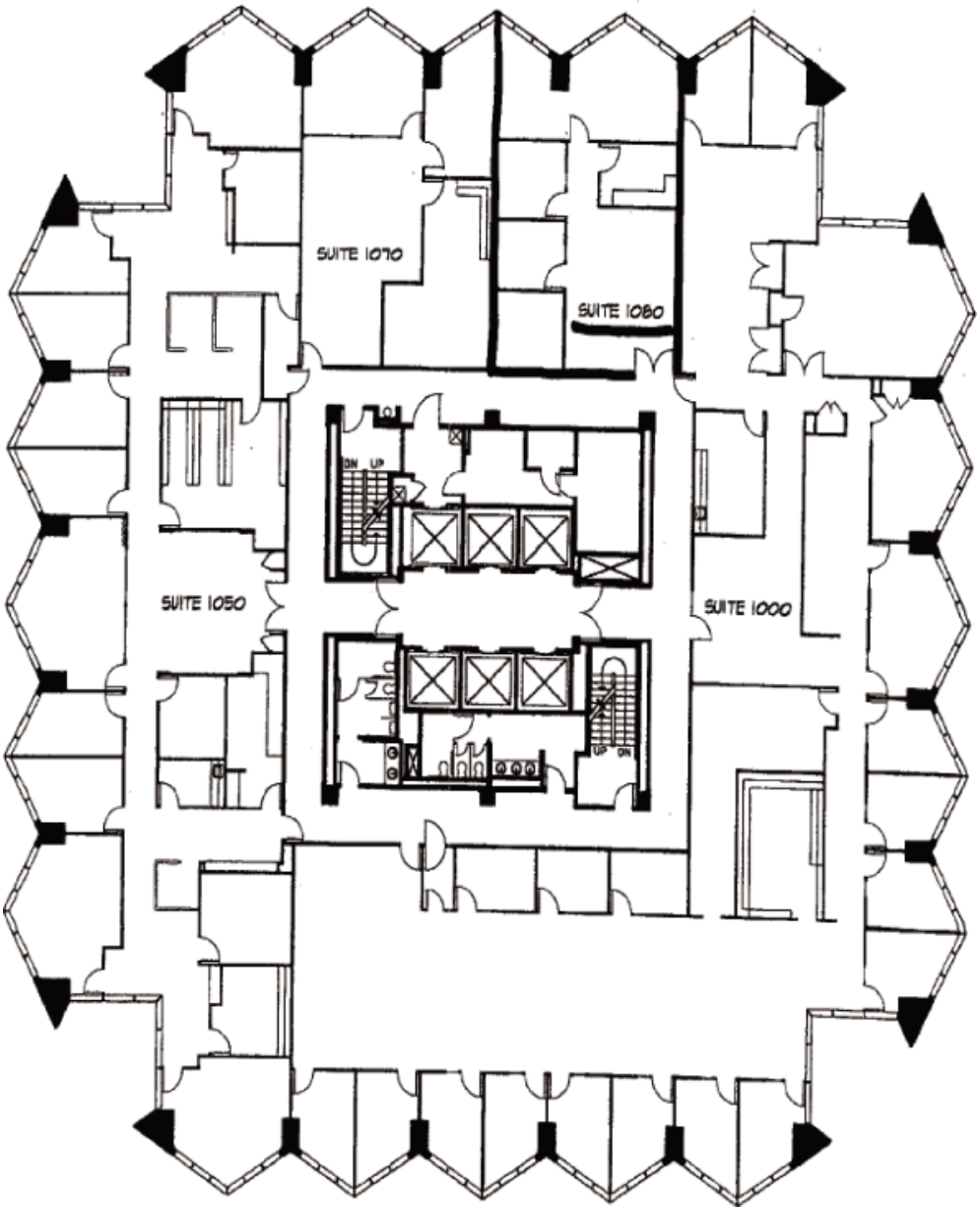
OUTLINE OF FLOOR PLAN OF PREMISES

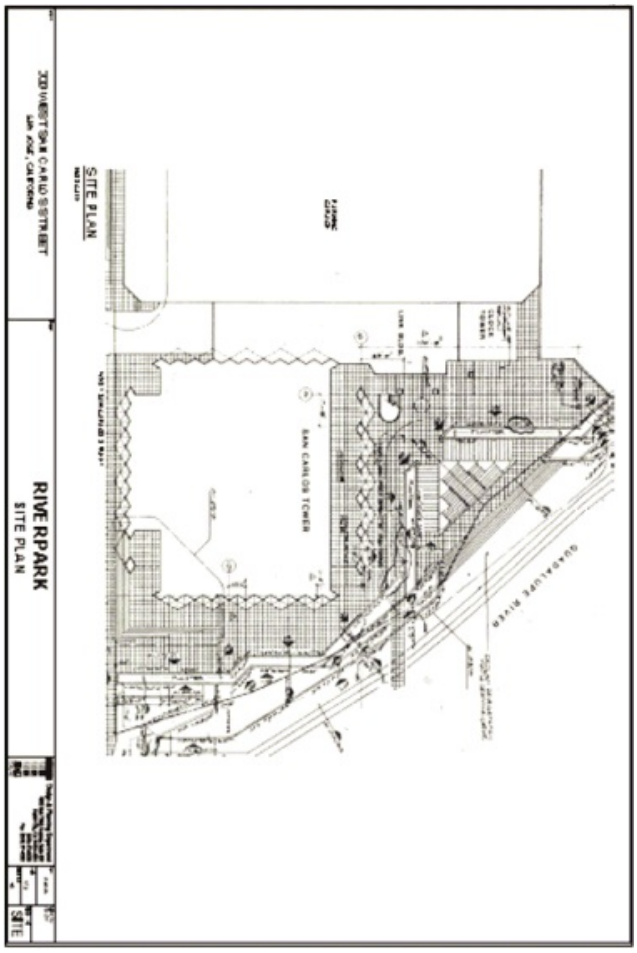
SUITE 1080



TENANT'S INITIALS HERE:_____

EXHIBIT A-1

SITE PLAN OF REAL PROPERTY



TENANT'S INITIALS HERE:_____

EXHIBIT B

TENANT WORK LETTER

This Tenant Work Letter ("**Tenant Work Letter**") shall set forth the terms and conditions relating to the construction of the Premises. All references in this Tenant Work Letter to the "**Lease**" shall mean the relevant portions of the Lease to which this Tenant Work Letter is attached as Exhibit B.

SECTION 1

BASE, SHELL AND CORE

Tenant hereby accepts the base, shell and core (i) of the Premises and (ii) of the floor(s) of the Building on which the Premises are located (collectively, the "**Base, Shell and Core**"), in its current "**AS-IS**" condition existing as of the date of the Lease and the Lease Commencement Date. Except for the Tenant Improvement Allowance set forth below, Landlord shall not be obligated to make or pay for any alterations or improvements to the Premises, the Building, the Project or the Real Property.

SECTION 2

TENANT IMPROVEMENTS

2.1 Tenant Improvement Allowance. Tenant shall be entitled to a one-time tenant improvement allowance (the "**Tenant Improvement Allowance**") in the amount of up to, but not exceeding $5.00 per rentable square foot of the Premises (i.e., up to $248,945.00 based on 49,789 rentable square feet of the Premises), for the costs relating to the initial design and construction of Tenant's improvements which are permanently affixed to the Premises (the "**Tenant Improvements**"); provided, however, that Landlord shall have no obligation to disburse all or any portion of the Tenant Improvement Allowance to Tenant unless Tenant makes a request for disbursement pursuant to the terms and conditions of Section 2.2 below prior to that date which is eighteen (18) months after the Lease Commencement Date. In no event shall Landlord be obligated to make disbursements pursuant to this Tenant Work Letter in a total amount which exceeds the Tenant Improvement Allowance. Tenant shall not be entitled to receive any cash payment or credit against Rent or otherwise for any unused portion of the Tenant Improvement Allowance which is not used to pay for the Tenant Improvement Allowance Items (as such term is defined below).

2.2 Disbursement of the Tenant Improvement Allowance.

2.2.1 Tenant Improvement Allowance Items. Except as otherwise set forth in this Tenant Work Letter, the Tenant Improvement Allowance shall be disbursed by Landlord only for the following items and costs (collectively, the "**Tenant Improvement Allowance Items**"):

2.2.1.1 payment of the fees of the "Architect" and the "Engineers," as those terms are defined in Section 3.1 of this Tenant Work Letter, and payment of the fees incurred by, and the cost of documents and materials supplied by, Landlord and Landlord's consultants in connection with the preparation and review of the "Construction Drawings," as that term is defined in Section 3.1 of this Tenant Work Letter;

2.2.1.2 the payment of plan check, permit and license fees relating to construction of the Tenant Improvements;

2.2.1.3 the cost of construction of the Tenant Improvements, including, without limitation, contractors' fees and general conditions, testing and inspection costs, costs of utilities, trash removal, parking and hoists, and the costs of after-hours freight elevator usage.

2.2.1.4 the cost of any changes in the Base, Shell and Core work when such changes are required by the Construction Drawings (including if such changes are due to the fact that such work is prepared on an unoccupied basis), such cost to include all direct architectural and/or engineering fees and expenses incurred in connection therewith;

2.2.1.5 the cost of any changes to the Construction Drawings or Tenant Improvements required by applicable laws ;

2.2.1.6 sales and use taxes and Title 24 fees;

2.2.1.7 amounts owed to Landlord pursuant to Section 4.2.2.2 of this Tenant Work Letter; and

2.2.1.8 all other costs to be expended by Landlord in connection with the construction of the Tenant Improvements, including the costs for paint and carpet.

2.2.2 Disbursement of Tenant Improvement Allowance. Subject to Section 2.1 above, during the construction of the Tenant Improvements, Landlord shall make monthly disbursements of the Tenant Improvement Allowance for Tenant Improvement Allowance Items for the benefit of Tenant and shall authorize the release of monies for the benefit of Tenant as follows:

2.2.2.1 Disbursements. In order to obtain disbursement of the Tenant Improvement Allowance (which Tenant may request in one or more disbursements), Tenant shall deliver to Landlord a request for disbursement, including evidence of payment of the "Contractor", as that term is defined in Section 4.1 below, together with a schedule of the work represented by such payment; (ii) evidence of payment of invoices to any of "Tenant's Agents," as that term is defined in Section 4.1.2 below, for labor rendered and materials delivered to the Premises; (iii) executed mechanic's lien releases from all of Tenant's Agents which shall comply with the appropriate provisions, as reasonably determined by Landlord, of California Civil Code Section 3262(d); and (iv) all other information reasonably requested by Landlord. Tenant's request for payment shall be deemed Tenant's acceptance and approval of the work furnished and/or the materials supplied as set forth in Tenant's payment request. Within thirty (30) days following Tenant's submission of the foregoing, Landlord shall disburse to Tenant by check the amount of the Tenant Improvement Allowance expended by Tenant for Tenant Improvement Allowance Items (not to exceed the available balance of the Tenant Improvement Allowance), provided that Landlord does not dispute any request for payment based on non-compliance of any work with the "Approved Working Drawings", as that term is defined in Section 3.4 below, or due to any substandard work, or for any other reason. Further, to the extent a ten percent (10%) retention (the aggregate amount of such retentions to be known as the "**Final Retention**") has not been taken into account in connection with payments made by Tenant to Contractor, Landlord's disbursement of the Tenant Improvement Allowance shall take into account such Final Retention, which will be disbursed pursuant to the terms of Section 2.2.2.2 below. Landlord's payment of such amounts shall not be deemed Landlord's approval or acceptance of the work furnished or materials supplied as set forth in Tenant's payment request.

2.2.2.2 Final Retention. Tenant confirms that it will only pay the Final Retention to Contractor following the completion of construction of the Premises, provided that (i) Tenant has obtained and delivered to Landlord properly executed mechanics lien releases in compliance with both California Civil Code Section 3262(d)(2) and either Section 3262(d)(3) or Section 3262(d)(4), and (ii) Landlord has determined that no substandard work exists which adversely affects the mechanical, electrical, plumbing, heating, ventilating and air conditioning, life-safety or other systems of the Building, the curtain wall of the Building, the structure or exterior appearance of the Building, or any other tenant's use of such other tenant's leased premises in the Building. Landlord will only disburse available funds from the Tenant Improvement Allowance for the Final Retention once the terms of this Section 2.2.2.2 are satisfied.

2.2.2.3 Other Terms. Landlord shall only be obligated to make disbursements from the Tenant Improvement Allowance to the extent costs are incurred by Tenant for Tenant Improvement Allowance Items.

2.2.3 Specifications for Building Standard Components. Landlord has established specifications (the "**Specifications**") for the Building standard components to be used in the construction of the Tenant Improvements in the Premises which Specifications have been received by Tenant, and which Specifications are attached hereto as Schedule 1. Unless otherwise agreed to by Landlord, the Tenant Improvements shall comply with the Specifications. Landlord may make changes to the Specifications from time to time.

SECTION 3

CONSTRUCTION DRAWINGS

3.1 Selection of Architect/Construction Drawings. Tenant shall retain the architect/space planner (the "**Architect**") approved by Landlord, which approval shall not be unreasonably withheld, to prepare the Construction Drawings. Tenant shall retain the engineering consultants designated by Landlord (the "**Engineers**") to prepare all plans and engineering working drawings relating to the structural, mechanical, electrical, plumbing, HVAC, lifesafety, and sprinkler work in the Premises. The plans and drawings to be prepared by Architect and the Engineers hereunder shall be known collectively as the "**Construction Drawings**." All Construction Drawings shall comply with the drawing format and specifications reasonably determined by Landlord, and shall be subject to Landlord's approval. Tenant and Architect shall verify, in the field, the dimensions and conditions as shown on the relevant portions of the base building plans, and Tenant and Architect shall be solely responsible for the same, and Landlord shall have no responsibility in connection therewith. Landlord's review of the Construction Drawings as set forth in this Section 3, shall be for its sole purpose and shall not imply Landlord's review of the same, or obligate Landlord to review the same, for quality, design, Code compliance or other like matters. Accordingly, notwithstanding that any Construction Drawings are reviewed by Landlord or its space planner, architect, engineers and consultants, and notwithstanding any advice or assistance which may be rendered to Tenant by Landlord or Landlord's space planner, architect, engineers, and consultants, Landlord shall have no liability whatsoever in connection therewith and shall not be responsible for any omissions or errors contained in the Construction Drawings.

3.2 Final Space Plan. Tenant shall supply Landlord with four (4) copies signed by Tenant of its final space plan for the Premises before any architectural working drawings or engineering drawings have been commenced. The final space plan (the "**Final Space Plan**") shall include a layout and designation of all offices, rooms and other partitioning, their intended use, and equipment to be contained therein. Landlord may request clarification or more specific drawings for special use items not included in the Final Space Plan. Landlord shall advise Tenant within five (5) business days after Landlord's receipt of the Final Space Plan for the Premises if the same is unsatisfactory or incomplete in any respect. If Tenant is so advised, Tenant shall promptly (i) cause the Final Space Plan to be revised to correct any deficiencies or other matters Landlord may reasonably require, and (ii) deliver such revised Final Space Plan to Landlord.

3.3 Final Working Drawings. After the Final Space Plan has been approved by Landlord and Tenant, Tenant shall promptly cause the Architect and the Engineers to complete the architectural and engineering drawings for the Premises, and cause the Architect to compile a fully coordinated set of architectural, structural, mechanical, electrical and plumbing working drawings in a form which is complete to allow subcontractors to bid on the work and to obtain all applicable permits for the Tenant Improvements (collectively, the "**Final Working Drawings**"), and shall submit the same to Landlord for Landlord's approval. Tenant shall supply Landlord with four (4) copies signed by Tenant of such Final Working Drawings. Landlord shall advise Tenant within five (5) business days after Landlord's receipt of the Final Working Drawings for the Premises if the same is unsatisfactory or incomplete in any respect. If Tenant is so advised, Tenant shall promptly (i) revise the Final Working Drawings in accordance with such review and any disapproval of Landlord in connection therewith, and (ii) deliver such revised Final Working Drawings to Landlord.

3.4 Approved Working Drawings. The Final Working Drawings shall be approved by Landlord (the "**Approved Working Drawings**") prior to the commencement of construction of the Premises by Tenant. After approval by Landlord of the Final Working Drawings, Tenant shall promptly submit the same to the appropriate governmental authorities for all applicable building permits. Tenant hereby agrees that neither Landlord nor Landlord's consultants shall be responsible for obtaining any building permit or certificate of occupancy for the Premises and that obtaining the same shall be Tenant's responsibility; provided, however, that Landlord shall cooperate with Tenant in executing permit applications and performing other ministerial acts reasonably necessary to enable Tenant to obtain any such permit or certificate of occupancy. No changes, modifications or alterations in the Approved Working Drawings may be made without the prior written consent of Landlord, which consent shall not be unreasonably withheld; provided that Landlord may withhold its consent, in its sole discretion, to any change in the Approved Working Drawings, if such change would result in an Over-Allowance Cap (as defined below).

SECTION 4

CONSTRUCTION OF THE TENANT IMPROVEMENTS

4.1 Tenant's Selection of Contractor and Tenant's Agents.

4.1.4 The Contractor. A general contractor shall be retained by Tenant to construct the Tenant Improvements. Such general contractor ("**Contractor**") shall be selected by Tenant from a list of general contractors supplied by Landlord, and Tenant shall deliver to Landlord notice of its selection of the Contractor upon such selection.

4.1.2 Tenant's Agents. All subcontractors, laborers, materialmen, and suppliers used by Tenant (such subcontractors, laborers, materialmen, and suppliers, and the Contractor to be known collectively as "**Tenant's Agents**") must be approved in writing by Landlord, which approval shall not be unreasonably withheld or delayed; provided that, in any event, Tenant must contract with Landlord's base building subcontractors for any mechanical, electrical, plumbing, life safety, structural, heating, ventilation, and air-conditioning work in the Premises. If requested by Landlord, Tenant's Agents shall all be union labor in compliance with the master labor agreements existing between trade unions and the local chapter of the Associated General Contractors of America.

4.2 Construction of Tenant Improvements by Tenant's Agents.

4.2.1 Construction Contract; Cost Budget. Prior to Tenant's execution of the construction contract and general conditions with Contractor (the "**Contract**"), Tenant shall submit the Contract to Landlord for its approval, which approval shall not be unreasonably withheld or delayed. Prior to the commencement of the construction of the Tenant Improvements, and after Tenant has accepted all bids for the Tenant Improvements, Tenant shall provide Landlord with a written detailed cost breakdown (the "**Final Costs Statement**"), by trade, of the final costs to be incurred, or which have been incurred, as set forth more particularly in Section 2.2.1.1 through 2.2.1.8 above, in connection with the design and construction of the Tenant Improvements to be performed by or at the direction of Tenant or the Contractor (which costs form a basis for the amount of the Contract, if any (the "**Final Costs**"). Prior to the commencement of construction of the Tenant Improvements, Tenant shall supply Landlord with cash in an amount (the "**Over-Allowance Amount**") by which the Final Costs exceed the Tenant Improvement Allowance (less any portion thereof already disbursed by Landlord, or in the process of being disbursed by Landlord, on or before the commencement of construction of the Tenant Improvements). The Over-Allowance Amount shall be disbursed by Landlord prior to the disbursement of any of the then remaining portion of the Tenant Improvement Allowance, and such disbursement shall be pursuant to the same procedure as the Tenant Improvement Allowance. In the event that, after the Final Costs have been delivered by Landlord to Tenant, the costs relating to the design and construction of the Tenant Improvements shall change, any additional costs necessary to such design and construction in excess of the Final Costs shall, to the extent they exceed the remaining balance of the Tenant Improvement Allowance, be paid by Tenant to Landlord immediately as an addition to the Over-Allowance Amount and, in any event, prior to the commencement of the construction of such changes, or, at Landlord's option, Tenant shall make payments for such additional costs out of its own funds, but Tenant shall continue to provide Landlord with the documents described in Sections 2.2.2.1(i), (ii), (iii) and (iv) above, for Landlord's approval, prior to Tenant paying such costs. Notwithstanding anything above to the contrary, if upon Tenant's delivery of the Final Costs Statement to Landlord, the Over-Allowance Amount is determined to be greater than an amount equal to twenty-five percent (25%) of the Tenant Improvement Allowance (the "**Over-Allowance Cap**"), then Landlord, in Landlord's sole discretion, shall have the right to require that Tenant revise the Approved Working Drawings and/or any other Construction Drawings (and resubmit the same to Landlord for Landlord's approval) to reduce the Over-Allowance Amount to an amount less than the Over-Allowance Cap and Landlord may refuse to disburse any portion of the Tenant Improvement Allowance and/or approve any changes to the

Construction Drawings, until such revisions to the Approved Working Drawings and/or any other Construction Drawings are made by Tenant and approved by Landlord.

4.2.2 Tenant's Agents.

4.2.2.1 Landlord's General Conditions for Tenant's Agents and Tenant Improvement Work. Tenant's and Tenant's Agents' construction of the Tenant Improvements shall comply with the following: (i) the Tenant Improvements shall be constructed in strict accordance with the Approved Working Drawings; (ii) Tenant and Tenant's Agents shall not, in any way, interfere with, obstruct, or delay, the work of Landlord's base building contractor and subcontractors with respect to the Base, Shell and Core or any other work in the Building or Real Property; (iii) Tenant's Agents shall submit schedules of all work relating to the Tenant's Improvements to Contractor and Contractor shall, within five (5) business days of receipt thereof, inform Tenant's Agents of any changes which are necessary thereto, and Tenant's Agents shall adhere to such corrected schedule; and (iv) Tenant shall abide by all rules made by Landlord's Building contractor or Landlord's Building manager with respect to the use of freight, loading dock and service elevators, storage of materials, coordination of work with the contractors of other tenants, and any other matter in connection with this Tenant Work Letter, including, without limitation, the construction of the Tenant Improvements.

4.2.2.2 Construction Fee. Tenant shall not be obligated to pay a logistical coordination or construction fee to Landlord in connection with portions of the Tenant Improvements which do not require the issuance of a building permit by the applicable governmental agencies. With respect to any portions of the Tenant Improvements which require the issuance of a building permit, Tenant agrees to reimburse Landlord for its actual costs incurred in connection with Landlord's review and approval of plans and specifications for such portions of the Tenant Improvements.

4.2.2.3 Indemnity. Tenant's indemnity of Landlord as set forth in the Lease shall also apply with respect to any and all costs, losses, damages, injuries and liabilities related in any way to any act or omission of Tenant or Tenant's Agents, or anyone directly or indirectly employed by any of them, or in connection with Tenant's non-payment of any amount arising out of the Tenant Improvements and/or Tenant's disapproval of all or any portion of any request for payment. Such indemnity by Tenant, as set forth in the Lease, shall also apply with respect to any and all costs, losses, damages, injuries and liabilities related in any way to Landlord's performance of any ministerial acts reasonably necessary (i) to permit Tenant to complete the Tenant Improvements, and (ii) to enable Tenant to obtain any building permit or certificate of occupancy for the Premises.

4.2.2.4 Insurance Requirements.

4.2.2.4.1 General Coverages. All of Tenant's Agents shall carry worker's compensation insurance covering all of their respective employees, and shall also carry public liability insurance, including property damage, all with limits, in form and with companies as are required to be carried by Tenant as set forth in the Lease.

4.2.2.4.2 Special Coverages. Tenant shall carry "Builder's All Risk" insurance in an amount approved by Landlord covering the construction of the Tenant Improvements, and such other insurance as Landlord may require, it being understood and agreed that the Tenant Improvements shall be insured by Tenant pursuant to the Lease immediately upon completion thereof. Such insurance shall be in amounts and shall include such extended coverage endorsements as may be reasonably required by Landlord, and in form and with companies as are required to be carried by Tenant as set forth in the Lease.

4.2.2.4.3 General Terms. Certificates for all insurance carried pursuant to this Section 4.2.2.4 shall be delivered to Landlord before the commencement of construction of the Tenant Improvements and before the Contractor's equipment is moved onto the site. All such policies of insurance must contain a provision that the company writing said policy will give Landlord thirty (30) days prior written notice of any cancellation or lapse of the effective date or any reduction in the amounts of such insurance. In the event that the Tenant Improvements are damaged by any cause during the course of the construction thereof, Tenant shall immediately repair the same at Tenant's sole cost and expense. All policies carried under this Section 4.2.2.4 shall insure Landlord and Tenant, as their interests may appear, as well as Contractor and Tenant's Agents, and shall name as additional insureds Landlord's Property Manager, Landlord's Asset Manager, and all mortgagees and ground lessors of the Building. All insurance, except Workers' Compensation, maintained by Tenant's Agents shall preclude subrogation claims by the insurer against anyone insured thereunder. Such insurance shall provide that it is primary insurance as respects the owner and that any other insurance maintained by owner is excess and noncontributing with the insurance required hereunder. The requirements for the foregoing insurance shall not derogate from the provisions for indemnification of Landlord by Tenant under Section 4.2.2.3 of this Tenant Work Letter.

4.2.3 Governmental Compliance. The Tenant Improvements shall comply in all respects with the following: (i) the Code and other state, federal, city or quasi-governmental laws, codes, ordinances and regulations, as each may apply according to the rulings of the controlling public official, agent or other person; (ii) applicable standards of the American Insurance Association (formerly, the National Board of Fire Underwriters) and the National Electrical Code; and (iii) building material manufacturer's specifications.

4.2.4 Inspection by Landlord. Landlord shall have the right to inspect the Tenant Improvements at all times, provided however, that Landlord's failure to inspect the Tenant Improvements shall in no event constitute a waiver of any of Landlord's rights hereunder nor shall Landlord's inspection of the Tenant Improvements constitute Landlord's approval of the same. Should Landlord disapprove any portion of the Tenant

Improvements, Landlord shall notify Tenant in writing of such disapproval and shall specify the items disapproved. Any defects or deviations in, and/or disapproval by Landlord of, the Tenant Improvements shall be rectified by Tenant at no expense to Landlord, provided however, that in the event Landlord determines that a defect or deviation exists or disapproves of any matter in connection with any portion of the Tenant Improvements and such defect, deviation or matter might adversely affect the mechanical, electrical, plumbing, heating, ventilating and air conditioning or life-safety systems of the Building, the structure or exterior appearance of the Building or any other tenant's use of such other tenant's leased premises, Landlord may, take such action as Landlord deems necessary, at Tenant's expense and without incurring any liability on Landlord's part, to correct any such defect, deviation and/or matter, including, without limitation, causing the cessation of performance of the construction of the Tenant Improvements until such time as the defect, deviation and/or matter is corrected to Landlord's satisfaction.

4.2.5 Meetings. Commencing upon the execution of the Lease, Tenant shall hold weekly meetings at a reasonable time, with the Architect and the Contractor regarding the progress of the preparation of Construction Drawings and the construction of the Tenant Improvements, which meetings shall be held at a location designated by Landlord, and Landlord and/or its agents shall receive prior notice of, and shall have the right to attend, all such meetings, and, upon Landlord's request, certain of Tenant's Agents shall attend such meetings. In addition, minutes shall be taken at all such meetings, a copy of which minutes shall be promptly delivered to Landlord. One such meeting each month shall include the review of Contractor's current request for payment.

4.3 Notice of Completion; Copy of "As Built" Plans. Within ten (10) days after completion of construction of the Tenant Improvements, Tenant shall cause a Notice of Completion to be recorded in the office of the Recorder of the County in which the Building is located in accordance with Section 3093 of the Civil Code of the State of California or any successor statute, and shall furnish a copy thereof to Landlord upon such recordation. If Tenant fails to do so, Landlord may execute and file the same on behalf of Tenant as Tenant's agent for such purpose, at Tenant's sole cost and expense. At the conclusion of construction, (i) Tenant shall cause the Architect and Contractor (A) to update the Approved Working Drawings as necessary to reflect all changes made to the Approved Working Drawings during the course of construction, (B) to certify to the best of their knowledge that the "record-set" of as-built drawings are true and correct, which certification shall survive the expiration or termination of the Lease, (C) to deliver to Landlord two (2) sets of sepias of such as-built drawings within ninety (90) days following issuance of a certificate of occupancy for the Premises, and (D) to deliver to Landlord a computer disk containing the Approved Working Drawings in AutoCAD format, and (ii) Tenant shall deliver to Landlord a copy of all warranties, guaranties, and operating manuals and information relating to the improvements, equipment, and systems in the Premises.

4.4 Coordination by Tenant's Agents with Landlord. Upon Tenant's delivery of the Contract to Landlord under Section 4.2.1 of this Tenant Work Letter, Tenant shall furnish Landlord with a schedule setting forth the projected date of the completion of the Tenant Improvements and showing the critical time deadlines for each phase, item or trade relating to the construction of the Tenant Improvements.

SECTION 5

MISCELLANEOUS

5.1 Tenant's Representative. Tenant has designated Steve Melman as its sole representative with respect to the matters set forth in this Tenant Work Letter, who shall have full authority and responsibility to act on behalf of the Tenant as required in this Tenant Work Letter.

5.2 Landlord's Representative. Landlord has designated Elva Guitron as its sole representative with respect to the matters set forth in this Tenant Work Letter, who, until further notice to Tenant, shall have full authority and responsibility to act on behalf of the Landlord as required in this Tenant Work Letter.

5.3 Time of the Essence in This Tenant Work Letter. Unless otherwise indicated, all references herein to a "number of days" shall mean and refer to calendar days. If any item requiring approval is timely disapproved by Landlord, the procedure for preparation of the document and approval thereof shall be repeated until the document is approved by Landlord.

5.4 Tenant's Lease Default. Notwithstanding any provision to the contrary contained in the Lease, if an event of default by Tenant of this Tenant Work Letter or the Lease has occurred at any time on or before the substantial completion of the Premises, then (i) in addition to all other rights and remedies granted to Landlord pursuant to the Lease, at law and/or in equity, Landlord shall have the right to withhold payment of all or any portion of the Tenant Improvement Allowance and/or Landlord may cause Contractor to cease the construction of the Premises (in which case, Tenant shall be responsible for any delay in the substantial completion of the Premises caused by such work stoppage), and (ii) all other obligations of Landlord under the terms of this Tenant Work Letter shall be forgiven until such time as such default is cured pursuant to the terms of the Lease (in which case, Tenant shall be responsible for any delay in the substantial completion of the Premises caused by such inaction by Landlord). In addition, if the Lease is terminated prior to the Lease Commencement Date, for any reason due to a default by Tenant as described in Section 19.1 of the Lease or under this Tenant Work Letter, in addition to any other remedies available to Landlord under the Lease, at law and/or in equity, Tenant shall pay to Landlord, as Additional Rent under the Lease, within five (5) days of receipt of a statement therefor, any and all costs (if any) incurred by Landlord (including any portion of the Tenant Improvement Allowance disbursed by Landlord) and not reimbursed or otherwise paid by Tenant through the date of such termination in connection with the Tenant Improvements to the extent planned, installed and/or constructed as of such date of termination, including, but not limited to, any costs related to the removal of all or any portion of the Tenant Improvements and restoration costs related thereto.

SCHEDULE 1 TO EXHIBIT B

BUILDING STANDARD SPECIFICATIONS

PARTITIONS

A. DEMISING PARTITION AND CORRIDOR WALLS

1. 3-5/8" (or match existing)- 20 gauge metal studs — 24" on center maximum from floor to ceiling grid. (Provide backing for cabinet as required)
2. 5/8" Type 'X' gypsum wallboard one layer each side of studs, fire taped only.
3. Height from floor to ceiling grid.
4. Seismic bracing per code.
5. Two rows of continuous acoustical sealant - bottom tracks. R-11 batt type fiberglass insulation between studs

Note:

- All partitions to be paint finished on smooth surfaces GA-214, level 5 smoothness.
- One hour rated walls where required based on occupancy group.
- All interior 1-hour corridors to be tunnel construction in compliance with UBC requirements for one-hour fire rated assembly.

B. TYPICAL INTERIOR PARTITION (Non rated)

1. 3-5/8" (or match existing) — 25 gauge metal studs — 24" on center maximum. (provide backing for wall mounted cabinetry or equipment as required).
2. 5/8" Type 'X' gypsum wallboard one layer each side of studs.
3. Height from floor to ceiling grid — approximately 9'-0" or 10'-0" based on structure cost at all floors; regular ceiling tiles must be scribed
4. Seismic bracing per code.
5. All exterior corners with corner beads. All exposed edges finished with metal trim.

Note:

- All partitions to be paint finished on smooth surfaces GA-214, level 5 smoothness.
- Partitions must connect to building mullions or walls. Mechanical fasteners to mullions shall not be allowed.

C. PERIMETER DRYWALL (at office areas)

1. 2-1/2" — 25 gauge metal studs 24" on center to 6" above suspended ceiling (or as required by Title-24 for full height envelope, refer to demising wall specification
2. 5/8" Type 'X' gypsum wallboard one layer on one side.
3. Height — floor slab to 6" above ceiling grid.
4. All exterior corners with corner beads.

Note:

- All partitions to be paint finished on smooth surfaces GA-214, level 5 smoothness.

D. COLUMN FURRING

1. 5/8" Type 'X' gypsum wallboard, one layer on 2 1/2" – 25 gauge metal studs, UNO.
2. Height — floor slab to 2" above ceiling grid.
3. All exterior corners with corner beads.

Note:

- All partitions to be paint finished on smooth surfaces GA-214, level 5 smoothness.

E. INSULATION

1. Insulation at all perimeter walls and roof per specifications

2. All common area walls including corridor, conference, copy rooms and lunch room to receive R-11 within partition cavity and four feet on either side of partition over ceiling at demising wall (if not full height)

F. FIRE BLOCKING

1. 2-1/2" 20 Gauge metal studs.
2. 5/8" gypsum wallboard one layer on one side.
3. Height-from top of suspended ceiling to structure above as required by code.
4. Locate as required by code for the proposed tenant space plans.

G. PAINTING

1. All gypsum board walls to receive a prime coat (hi-build PVA sealer) and two (2) coats to cover of 'carefree' eggshell finish paint or equal.
2. Semi-gloss paint at all kitchens, break rooms, restrooms and server/copy rooms.

DOORS, FRAMES AND HARDWARE

Note: all doors and hardware within existing buildings to match U.O.N.

A. INTERIOR TENANT DOOR ASSEMBLY (non-rated doors within office suites)

1. Interior doors: shall be 3'0" wide x full height x 1 3/4" blind end" flush doors (unless otherwise specified), solid core, pre-finished with plain sliced select white maple, book-match with clear sealer. **All** doors shall be 20 minute fire rated.
2. (existing condition) Doors shall be pre-finished and match existing core doors in finish, material and appearance. Finish all edges. 5" top blocking at doors w/closers.
3. Interior Tenant doorframes to be prefinished rated Western Integrated frames with factory finish; Color: Satin Aluminum
4. Corridor doorframes to Suites to be: Satin Aluminum
5. Hardware:

(a) Interior Tenant Door

QTY	SUBTYPE	ITEM DESCRIPTION
4	Butts(2 pair per door)	Hager
1	Latchset	Schlage "L" Series Mortise
1	Lockset	Schlage "L" Series Mortise
1	Door Stop	Glynn Johnson FB13, floor dome
1	Closer	LCN #4111(where required)

(b) Suite Entry Doors-Fire rated as required by occupancy and code requirements.

QTY	SUBTYPE	ITEM DESCRIPTION
8	Hinges (4 pair per door)	Hager
1	Lockset	Schlage "L" Mortise
1	Auto Flush Bolt	942 626 DCI
1	Dust Proof Strike	80 626 DCI
2	Door Stops	Glynn Johnson FB13, floor dome
1	Closer	LCN #4111(where required)

B. INTERIOR GLAZING

1. (a) 1/4" thick clear tempered glass in non-rated, prefinished frames by Western Integrated frames with aluminum trim. Frame to be factory finished; Color: Satin Aluminum

   (b)1/4 thick clear tempered glass in non-rated, M-121 glass stops; Color: Satin Aluminum
2. 1/4" thick tempered safety glass where required per code.
3. Return gypsum board into opening at both sides, provide metal corner bead all around opening. Finish to match wall.
2. Provide two 20 Ga. metal studs fastened at 12" O.C. back-to-back at jambs and head (minimum) as per detail. Provide seismic brace per code.

Note:

- All office doors to have 2'-0" wide by full height (inside window frame to inside window frame) sidelights where possible. At areas where less than 2'-0" is available, provide maximum. Sidelight frames to be integral with doorframes.

SUSPENDED ACOUSTICAL CEILING

Note: Tenant ceiling height at 9'-0" (installed at top of top exterior window mullion)

1. Grid: **USG Donn Fineline DXFF** Narrow 9/16" face with 1/8" reveal. Finish: White Matte with white reveal, Suspension System with wire suspension and seismic bracing per code. Wall angle: M9
2. Tile: USG 2'x2'x 3/4" Millennia Tegular White.
3. Seismic bracing per code.
4. Seismic wires for lighting and electrical to be provided by acoustical ceiling contractor.

WINDOW COVERINGS

1. Exterior Window covering – horizontal: 1" mini-blinds as manufactured by Levelor, series: Riviera Dustguard.
2. Blinds to be sized to fit inside window module. Fasten to top horizontal mullions only.
3. Vertical blinds to be installed with building shell but costs allocated to tenant improvement allowance.

FIRE SPRINKLER SYSTEM

1. A pre-zoned sprinkler will be provided in all areas. Head locations will be determined by a pre-zoned master layout. Modification of sprinkler locations and piping, due to specific tenant layout, will be at tenant's cost. Semi-recessed pendent sprinkler heads with white escutcheon. Sprinkler to be centered in tile.
2. Fire Sprinkler coverage light hazard, .33 gpm / 3,000 SF in shell and modified per improvement.
4. Gyp Board Ceilings: Fully recessed with cap at gypsum board ceiling. Reliable Model F4FR Concealed automatic sprinkler with 1/2" - 1 1/2" adjustment — White

SIGNAGE

Refer to Landlord

CABINETRY

1. 6'-0" linear feet of upper and lower millwork allowable by building standard.
6. Plastic laminate horizontal and vertical surfaces.
7. Horizontal and Verticals: See individual options under finishes for plastic laminate specifications
3. Cabinetry Construction: Designation, APA C-D plugged with exterior glue, 3/4" thick or 3/4" high pressure particle board. Min. density 45 PSF, U.N.O.
4. Cabinetry: Plastic laminate finish, countertops and splashes shall be constructed in accordance with WIC manual of Millwork, "Custom" grade.
5. Hardware:
   a. Hinges: Self-closing type, fully concealed when the doors are closed.
   Shall have independent vertical, horizontal and depth adjustment.
   Shall be steel with nickel-plated finish. Hinges shall be one of the following products:

      Brass America, Inc. Nos. 1200/1201
      Julius Blum, Inc. No.91.650

Stanley Hardware Nos. 1511-2/1511-9x or equal.

6. Pulls: 4” X 5/16” diameter wire pulls, brushed chrome finish. U.N.O.

7. Adjustable Shelf Supports to be hole & pin type, Hafele 282.24.710 5MM steel pin.
8. Drawers: Provide heavy-duty 3/4 extension drawer slides.
9. Mutes: Clear vinyl dot.
10. Fasteners and Anchorages: Provide nails, screws, or other anchoring devices of type, size material and finish suitable for intended use and required to provide secure
11. Casework:
    a. Drawer Boxes: Provide sub-front and applied finish fronts securely fastened, with square corners and self-edges. Provide drawers with metal studs.
    b. Doors: Flush overlay type with square corners, and self edged. Do not notch door, cabinet ends or dividers to receive hinges.
    c. Shelves: 3/4" thick for spans up to 35" and 1" thick for spans over 35" up to 48" and adjustable to 1" centers. Do not recess metal shelf standards into end panels; notch shelving to clear standards.

TENANT SUITE FINISH MATERIALS

A. PAINT

Field Color: Kelly Moore # 20 Western Acoustic (accent colors within open areas may be used at designer's discretion approved by Ownership)

B. FINISH STANDARD

Carpet:	Shaw Contract Group: 'Java' or 'Ripple' Installation: Direct Glue Down
Rubber Base:	Johnsonite tight lock wall base #11 Canvas 2 1/2" cove base at resilient flooring, 2 1/2" straight base at carpet (rolled goods only). Rubber transition strip between carpet and resilient flooring, Color to match base
VCT#1:	Armstrong 'Stonetex Vinyl Composite Tile, Color #52139 Limestone Beige or #52128 Desert Dust , 12" x 12" x 1/8"
Plastic Lam.:	Formica #756-58 Natural Maple (base cabinet vertical surfaces)
Plastic Lam.:	Formica #7022-58 Natural Canvas (horizontal surfaces & upper cabinets)

HEATING, VENTILATION AND AIR CONDITIONING

Furnish and install all materials and equipment necessary to provide complete and usable air conditioning systems in tenant spaces including, but not necessarily limited to, the following:

A. Requirements shall be in accordance with title 24 and all other applicable codes.

B. CEILING DIFFUSER SPECIFICATION

a. Ceiling diffusers shall have perforated face with frame style compatible with the type of ceiling used. Surface mounted diffusers shall have gaskets to prevent leakage. Diffuser faceplate shall have concealed hinges and latches. Face plates shall be easily removable from the frame.

b. Diffusers shall be modular core and shall have curved, adjustable blades and shall be capable of delivering 1-way,2-way,3-way or 360 degree horizontal ceiling pattern and be adjustable to obtain a down air pattern. Diffuser must have high anti-smudge characteristics with center aspiration.

c. Material shall be steel. Finish shall be Standard White baked enamel.

d. Supply diffusers shall be Titus modular core PMC perforated face-size 24"x24" for lay-in ceiling tile.

e. Return/Exhaust diffusers shall be Kruger

f. Perforated ceiling diffusers shall be tested in accordance with Air Diffusion Council (ADC) code 10602R4. Sound data for diffusers shall be calculated in accordance with International Standard ISO 3741 Comparison Method.

g. The following manufactures shall be considered equal, providing corresponding models meet specific requirements. Equivalent substituted equipment named herein shall be submitted for the Architect's review. Submit alternate selections at a time of bid listing major equipment.

h. Manual dampers in all drops.

ITEM	MANUFACTURER
AIR FILTERS	Kruger
MIXING BOXES	Kruger
GRILLES	Kruger

C. THERMOSTATS

Thermostats shall be provided for each zone. Honeywell Pneumatic, Model TP970A, 2004

Direct Acting, Range 60° to 90°, Color White

D. SUBMITTALS

For Non-Standard Material Lists/Product Data: Within 5-7 days of contract award, and prior to ordering any materials or equipment, submit for Owner's review complete material list including catalogue data of material and products for work in this section.

Note: Install BTU meters for any condenser water usage at tenant cost.

ELECTRICAL

1. GENERAL

a. All work, material or equipment shall comply with the codes, ordinance and regulations of the local government having jurisdiction, including Title 24 and any participating government agencies having jurisdiction.

b. 110V duplex outlet in demising or interior partitions only, as Manufactured by Leviton or equal. Color: White

c. Maximum eight outlets per 20 amps 3 phase 4-wire circuit, spacing to meet code requirements. Minimum 2 per: office(1 quad with drop for voice/data and 1 duplex on opposite wall), conference room, reception, 2 dedicated over cabinet at break room; junction boxes above ceiling for large open area with furniture partitions.

d. Contractors to inspect electric room and base building Electrical drawings to include all necessary metering, connections and additional equipment, i.e., panels and transformers, if needed. Base building provides one (1) power panel and one (1) lighting panel per electrical room.

e. Note: Install electric meter for any above-standard electrical usage at Tenant Cost.

2. RACEWAYS

a. Conduit shall be rigid galvanized steel(RGS), electrical metallic tubing (EMT), metal clad (MC) cable, polyvinyl, chloride (PVC), and flexible or liquid tight flexible conduit.

b. Type 'AC' and 'NM' cable are not acceptable.

c. Support per seismic zone 4 requirements.

3. WIRING DEVICES

a. Receptacles, toggle switches and coverplates shall be white (dedicated- gray) – Leviton. Mount so that the center of the receptacles is no less than 15" AFF.

b. Maximum eight (8) outlets per 20 amp 3 phase 4-wire circuit. Spacing to meet code requirements. Amounts to be two duplex outlets per small and three for large private office, storage room and conference room. One dedicated outlet per copy room; one dedicated 20-amp outlet per telephone panel and one 20-amp circuit per 200 square foot of open area for workstations.

c. All workstation hardwire connections to be building power to be supplied by tenant.

d. Transformers to be a minimum of 20% or over required capacity shall be K-=rated dry type.

e. Contractors to inspect electric room and base building electrical drawings to include all necessary metering and connections.

f. No aluminum wiring is acceptable. AC and NM cable is not to be used.

g. Provide separate neutrals for each circuit. Use stranded wire for each circuit. Use copper conductors only, no exception.

h. Switch assembly to be Leviton.

i. Motion sensors as required by lighting management system and by Title 24.

4. TELEPHONE / DATA OUTLETS

a. One (1) single box to house phone/data jack with pull string from outlet box to area above T-bar ceiling with cover plate per office; Two (2) boxes to house phone/data jack with pull string from outlet box to area above T-bar ceiling with cover plate per large open area. Cover plate finish required: white, supplied by tenant's Telcom contractor. Mount so that the center of the receptacles is no less than 15" AFF.

b. One (1) 6' wide by 4' high plywood backboard installed as telephone backboard, brace and secure to wall. Painted to match wall color. Provide one duplex 20 amp dedicated outlet for phone service per above electrical specification. Provide 2" conduit from floor main phone room to six inches (6") below ceiling at telephone backboard.

c. Cable service installation for phone and data outlets by tenant's telephone/data vendors at tenant's cost. Additional outlets and cover plates to be provided by tenant's vendors at tenant's cost. In speculative office suites, contractor to provide and install blank cover plates.

d. Telephone panel boards to be located within tenant space and to be surface mounted.

5. TRANSFORMERS

a. Transformers shall be UL listed and suitable for the application- NEMA 1 or 3 R.

b. Transformers shall be 480V (primary) – 20by/120V (secondary), rated for 80 C rise above an ambient temperature of 40 C.

c. Support for seismic zone 4 requirements.

d. Acceptable manufacturers shall be General Electric, Cutler-Hammer, Siemens, Square D, or Westinghouse.

6. PANEL BOARDS

a. Panel boards shall be UL listed and suitable for the application- NEMA 1 or 3R.

b. All circuit breakers shall be molded case, bolt-on type.

c. Support per seismic zone 4 requirements.

d. Acceptable manufactures shall be General Electric, Cutler-Hammer, Siemens, Square D, or Westinghouse.

7. LIGHT FIXTURES

a. Light fixtures shall be 24"x 48"x 3" Parabolic Diffuser with three 32 Watt T8 lamps per fixture size, 1-electronic ballasts. Fixtures shall be Lightolier DPA-2T18-L-S-332-UNV03-18-29187-000M 277 V with modular wiring and (1) electronic ballast (Advance Ballast #VEL-3P32-SC). Fixtures shall match existing in suite with modular wiring and (1) electronic ballast (verify for 2 or 3 lamp fixture requirement based on energy efficiency requirement with approximately 50 F.C. at desk height).

b. Support per seismic zone 4 requirements.

c. Quantities and locations per plans.

8. LIGHT CONTROL/SWITCHING

Wall occupancy sensors – Mytec #LP-2-DC

9. EXIT SIGNS

a. Edge lite with recessed ceiling mount, floating green letters on a clear panel with LED Technology, by Dualite or equivalent.

b. Quantities and locations per exiting and lighting plans.

c. Single or double face and directional arrows per lighting plans.

MISCELLANEOUS

1. **FIRE CAULKING**

   a. General Contractor is responsible for all fire caulking required by any and all work done during the process of construction.

2. **PLUMBING**

   a. Shall comply with all local codes and handicapped code requirements. Fixture shall be: Manufacturer Elkay, 'Hospitality sin" #BPSR-2317 – stainless steel, two faucet holes, or equivalent. Faucet: single lever post mount bar faucet by 'Elkay' #LK-4122 or equivalent.

   b. Plumbing bid shall include 5 gallon minimum hot water heater, or insta-hot with mixer valve including all connections, located within tenant's suite.

EXHIBIT C

(Intentionally Omitted)

EXHIBIT D

RULES AND REGULATIONS

Tenant shall faithfully observe and comply with the following Rules and Regulations. Landlord shall not be responsible to Tenant for the nonperformance of any of said Rules and Regulations by or otherwise with respect to the acts or omissions of any other tenants or occupants of the Building or Real Property.

1. Tenant shall not alter any lock or install any new or additional locks or bolts on any doors or windows of the Premises without obtaining Landlord's prior written consent. Tenant shall bear the cost of any lock changes or repairs required by Tenant. Two keys will be furnished by Landlord for the Premises, and any additional keys required by Tenant must be obtained from Landlord at a reasonable cost to be established by Landlord.

2. All doors opening to public corridors shall be kept closed at all times except for normal ingress and egress to the Premises, unless electrical hold backs have been installed.

3. Landlord reserves the right to close and keep locked all entrance and exit doors of the Building during such hours as are customary for comparable buildings in the vicinity of the Building. Tenant, its employees and agents must be sure that the doors to the Building are securely closed and locked when leaving the Premises if it is after the normal hours of business for the Building. Any tenant, its employees, agents or any other persons entering or leaving the Building at any time when it is so locked, or any time when it is considered to be after normal business hours for the Building, may be required to sign the Building register when so doing. After-hours access by Tenant's authorized employees may be provided by card-key access or other procedures adopted by Landlord from time to time; Tenant shall pay for the costs of all access cards provided to Tenant's employees and all replacements thereof for lost, stolen or damaged cards. Access to the Building and/or Real Property may be refused unless the person seeking access has proper identification or has a previously arranged pass for such access. Landlord and its agents shall in no case be liable for damages for any error with regard to the admission to or exclusion from the Building and/or Real Property of any person. In case of invasion, mob, riot, public excitement, or other commotion, Landlord reserves the right to prevent access to the Building and/or Real Property during the continuance of same by any means it deems appropriate for the safety and protection of life and property.

4. Landlord shall have the right to prescribe the weight, size and position of all safes and other heavy property brought into the Building. Safes and other heavy objects shall, if considered necessary by Landlord, stand on supports of such thickness as is necessary to properly distribute the weight. Landlord will not be responsible for loss of or damage to any such safe or property in any case. All damage done to any part of the Building, its contents, occupants or visitors by moving or maintaining any such safe or other property shall be the sole responsibility of Tenant and any expense of said damage or injury shall be borne by Tenant.

5. No furniture, freight, packages, supplies, equipment or merchandise will be brought into or removed from the Building or carried up or down in the elevators, except upon prior notice to Landlord, and in such manner, in such specific elevator, and between such hours as shall be designated by Landlord. Tenant shall provide Landlord with not less than 24 hours prior notice of the need to utilize an elevator for any such purpose, so as to provide Landlord with a reasonable period to schedule such use and to install such padding or take such other actions or prescribe such procedures as are appropriate to protect against damage to the elevators or other parts of the Building.

6. Landlord shall have the right to control and operate the public portions of the Building and Real Property, the public facilities, the heating and air conditioning, and any other facilities furnished for the common use of tenants, in such manner as is customary for comparable buildings in the vicinity of the Building.

7. The requirements of Tenant will be attended to only upon application at the management office of the Real Property or at such office location designated by Landlord. Employees of Landlord shall not perform any work or do anything outside their regular duties unless under special instructions from Landlord.

8. Tenant shall not disturb, solicit, or canvass any occupant of the Building or Real Property and shall cooperate with Landlord or Landlord's agents to prevent same.

9. The toilet rooms, urinals, wash bowls and other apparatus shall not be used for any purpose other than that for which they were constructed, and no foreign substance of any kind whatsoever shall be thrown therein. The expense of any breakage, stoppage or damage resulting from the violation of this rule shall be borne by the tenant who, or whose employees or agents, shall have caused it.

10. Tenant shall not overload the floor of the Premises. Tenant shall not mark, drive nails or screws, or drill into the partitions, woodwork or plaster or in any way deface the Premises or any part thereof without Landlord's consent first had and obtained; provided, however, Landlord's prior consent shall not be required with respect to Tenant's placement of pictures and other normal office wall hangings on the interior walls of the Premises (but at the end of the Term, Tenant shall repair any holes and other damage to the Premises resulting therefrom).

11. Except for vending machines intended for the sole use of Tenant's employees and invitees, no vending machine or machines of any description other than fractional horsepower office machines shall be installed, maintained or operated upon the Premises without the written consent of Landlord.

12. Tenant shall not use any method of heating or air conditioning other than that which may be supplied by Landlord, without the prior written consent of Landlord.

13. Tenant shall not use or keep in or on the Premises, the Building or Real Property any kerosene, gasoline or other inflammable or combustible fluid or material. Tenant shall not use, keep or permit to be used or kept, any foul or noxious gas or substance in or on the Premises, or permit or allow the Premises to be occupied or used in a manner offensive or objectionable to Landlord or other occupants of the Building or Real Property by reason of noise, odors, or vibrations, or interfere in any way with other tenants or those having business therewith.

14. Tenant shall not bring into or keep within the Real Property, the Building or the Premises any animals, birds, bicycles or other vehicles.

15. No cooking shall be done or permitted by Tenant on the Premises, nor shall the Premises be used for the storage of merchandise, for lodging or for any improper, objectionable or immoral purposes. Notwithstanding the foregoing, Underwriters' laboratory-approved equipment and microwave ovens may be used in the Premises for heating food and brewing coffee, tea, hot chocolate and similar beverages, provided that such use is in accordance with all applicable federal, state and city laws, codes, ordinances, rules and regulations, and does not cause odors which are objectionable to Landlord and other tenants.

16. Landlord will approve where and how telephone and telegraph wires are to be introduced to the Premises. No boring or cutting for wires shall be allowed without the consent of Landlord. The location of telephone, call boxes and other office equipment affixed to the Premises shall be subject to the approval of Landlord.

17. Landlord reserves the right to exclude or expel from the Building and/or Real Property any person who, in the judgment of Landlord, is intoxicated or under the influence of liquor or drugs, or who shall in any manner do any act in violation of any of these Rules and Regulations.

18. Tenant, its employees and agents shall not loiter in the entrances or corridors, nor in any way obstruct the sidewalks, lobby, halls, stairways or elevators, and shall use the same only as a means of ingress and egress for the Premises.

19. Tenant shall not waste electricity, water or air conditioning and agrees to cooperate fully with Landlord to ensure the most effective operation of the Building's heating and air conditioning system, and shall refrain from attempting to adjust any controls.

20. Tenant shall store all its trash and garbage within the interior of the Premises. No material shall be placed in the trash boxes or receptacles if such material is of such nature that it may not be disposed of in the ordinary and customary manner of removing and disposing of trash and garbage in the city in which the Real Property is located without violation of any law or ordinance governing such disposal. All trash, garbage and refuse disposal shall be made only through entry-ways and elevators provided for such purposes at such times as Landlord shall designate.

21. Tenant shall comply with all safety, fire protection and evacuation procedures and regulations established by Landlord or any governmental agency.

22. Tenant shall assume any and all responsibility for protecting the Premises from theft, robbery and pilferage, which includes keeping doors locked and other means of entry to the Premises closed, when the Premises are not occupied.

23. No awnings or other projection shall be attached to the outside walls of the Building without the prior written consent of Landlord. No curtains, blinds, shades or screens shall be attached to or hung in, or used in connection with, any window or door of the Premises without the prior written consent of Landlord. The sashes, sash doors, skylights, windows, and doors that reflect or admit light and air into the halls, passageways or other public places in the Building shall not be covered or obstructed by Tenant, nor shall any bottles, parcels or other articles be placed on the windowsills. All electrical ceiling fixtures hung in offices or spaces along the perimeter of the Building must be fluorescent and/or of a quality, type, design and bulb color approved by Landlord.

24. The washing and/or detailing of or, the installation of windshields, radios, telephones in or general work on, automobiles shall not be allowed on the Real Property.

25. Food vendors shall be allowed in the Building upon receipt of a written request from the Tenant. The food vendor shall service only the tenants that have a written request on file in the management office of the Real Property. Under no circumstance shall the food vendor display their products in a public or common area including corridors and elevator lobbies. Any failure to comply with this rule shall result in immediate permanent withdrawal of the vendor from the Building.

26. Tenant must comply with requests by the Landlord concerning the informing of their employees of items of importance to the Landlord.

27. Tenant shall comply with any non-smoking ordinance adopted by any applicable governmental authority, and neither Tenant nor any of its contractors, agents, employees, invitees or visitors shall smoke in the Premises, in the Building or in any other portion of the Real Property which is not designated as an area in which smoking is permitted.

28. Landlord may waive any one or more of these Rules and Regulations for the benefit of any particular tenant or tenants, but no such waiver by Landlord shall be construed as a waiver of such Rules and

Regulations in favor of any other tenant or tenants, nor prevent Landlord from thereafter enforcing any such Rules or Regulations against any or all tenants of the Building and/or Real Property. Landlord reserves the right at any time to change or rescind any one or more of these Rules and Regulations, or to make such other and further reasonable Rules and Regulations as in Landlord's judgment may from time to time be necessary for the management, safety, care and cleanliness of the Premises, Building and Real Property, and for the preservation of good order therein, as well as for the convenience of other occupants and tenants therein. Landlord shall not be responsible to Tenant or to any other person for the nonobservance of the Rules and Regulations by another tenant or other person. Tenant shall be deemed to have read these Rules and Regulations and to have agreed to abide by them as a condition of its occupancy of the Premises.

EXHIBIT E

SUPPLEMENTAL HVAC EQUIPMENT

For purposes of this Lease, the "Supplemental HVAC Equipment" consists of the following:

The existing equipment mounted on the Building's roof adjacent to the penthouse at column 7 between columns D and E, and which is described as follows:

- one (1) Liebert Model DSC Dyrcooler and one (1) associated pump
- one (1) Liebert Model DDC Dyrcooler and two (2) associated pumps
- the existing associated devices, wiring and piping which extends from such roof equipment down to the eighth (8th) floor mechanical room, and the existing electrical connections and controls for such equipment

EXHIBIT 21.01

Subsidiaries of Registrant

Name of Entity	Jurisdiction of Incorporation or Organization
PDF Solutions GmbH	Germany
PDF Solutions KK	Japan
PDF Solutions S.A.S.	France
PDF Solutions Semiconductor Technology (Shanghai) Co. Ltd.	China
PDF Solutions Semiconductor Technology (Korea) Limited	Korea

EXHIBIT 23.01

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-66758, 333-102509, 333-109809, 333-112728, 333-133332, 333-141660, and 333-149281 on Form S-8 and Registration Statement Nos. 333-140268 and 333-143989 on Form S-3 of our reports dated March 17, 2008, relating to the consolidated financial statements and financial statement schedule of PDF Solutions, Inc. and subsidiaries (collectively, the "Company") (which report expresses an unqualified opinion and includes an explanatory paragraph regarding the adoption of Financial Accounting Standards Board Interpretation No. 48 *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment,* and Emerging Issues Task Force Issue No. 06-02, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43*), and the effectiveness of the Company's internal control over financial reporting, appearing in this Annual Report on Form 10-K of the Company for the year ended December 31, 2007.

/s/ DELOITTE & TOUCHE LLP

San Jose, California
March 17, 2008

EXHIBIT 31.01

CERTIFICATIONS

I, John K. Kibarian, certify that:

1. I have reviewed this annual report on Form 10-K of PDF Solutions, Inc.;

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

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

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

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

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

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

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

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

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

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

/s/ JOHN K. KIBARIAN

John K. Kibarian
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 17, 2008

EXHIBIT 31.02

CERTIFICATIONS

I, Keith Jones, certify that:

1. I have reviewed this annual report on Form 10-K of PDF Solutions, Inc.;

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

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

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

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

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

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

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

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

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

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

/s/ KEITH JONES

Keith Jones
Chief Financial Officer and Vice President, Finance
(Principal Financial Officer)

Date: March 17, 2008

EXHIBIT 32.01

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of PDF Solutions, Inc. (the "Company") on Form 10-K for the year ended December 31, 2007 as filed with the Securities and Exchange Commission on March 17, 2008 (the "Report"), I, John K. Kibarian, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ JOHN K. KIBARIAN

John K. Kibarian
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 17, 2008

EXHIBIT 32.02

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of PDF Solutions, Inc. (the "Company") on Form 10-K for the year ended December 31, 2007 as filed with the Securities and Exchange Commission on March 17, 2008 (the "Report"), I, Keith Jones, Chief Financial Officer and Vice President, Finance of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ KEITH JONES

Keith Jones
Chief Financial Officer and Vice President, Finance
(Principal Financial Officer)

Date: March 17, 2008