NeuroMetrix, Inc.
Form 10-K
February 09, 2017

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2016

OR

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

For the transition period from to

Commission File Number 001-33351

NEUROMETRIX, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	04-3308180 (I.R.S. Employer Identification No.)
1000 Winter Street, Waltham, Massachusetts (Address of Principal Executive Offices)	02451 (Zip Code)

(781) 890-9989

(Registrant s Telephone Number, Including Area Code)

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

Title of each class	Name of exchange on which registered
Common Stock, $0.0001 par value per share	**The NASDAQ Stock Market LLC**
Preferred Stock Purchase Rights	**The NASDAQ Stock Market LLC**
Warrants to Purchase Common Stock	**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 o No x

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during

the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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. o

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

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

As of June 30, 2016, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $7,760,679 based on the closing sale price of the common stock as reported on the NASDAQ Capital Market on June 30, 2016.

As of February 1, 2017, there were 7,914,901 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents (or parts thereof) are incorporated by reference into the following parts of this Form 10-K: Certain information required by Part III of this Annual Report on Form 10-K is incorporated from the Registrant s Proxy Statement for the Annual Meeting of Stockholders to be held on May 2, 2017, or the 2017 Annual Meeting of Stockholders.

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NEUROMETRIX, INC.

ANNUAL REPORT ON FORM 10-K
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NEUROMETRIX , NC-STAT , OptiTherapy , ADVANCE , SENSUS , Quell , DPNCheck and NC-stat DP the subject of either a trademark registration or application for registration in the United States. Other brands, names and trademarks contained in this Annual Report on Form 10-K are the property of their respective owners.

All share amounts in this Annual Report on Form 10-K have been adjusted to reflect a 1-for-4 reverse stock split that was effected on December 1, 2015.

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PART I

The statements contained in this Annual Report on Form 10-K, including under the section titled Management s Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Annual Report, include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, including, without limitation, statements regarding our or our management s expectations, hopes, beliefs, intentions or strategies regarding the future, such as our estimates regarding anticipated operating losses, future revenues and projected expenses, our future liquidity and our expectations regarding our needs for and ability to raise additional capital; our ability to manage our expenses effectively and raise the funds needed to continue our business; our belief that there are unmet needs for the management of chronic pain and in the diagnosis and treatment of diabetic neuropathy; our expectations surrounding Quell and DPNCheck; our expected timing and our plans to develop and commercialize our products; our ability to meet our proposed timelines for the commercial availability of our products; our ability to obtain and maintain regulatory approval of our existing products and any future products we may develop; regulatory and legislative developments in the United States and foreign countries; the performance of our third-party manufacturers; our ability to obtain and maintain intellectual property protection for our products; the successful development of our sales and marketing capabilities; the size and growth of the potential markets for our products and our ability to serve those markets; our plan to make Quell more broadly available through retail distribution; our belief that there are significant opportunities to market Quell outside the United States; our estimate of our customer returns of our products; the rate and degree of market acceptance of any future products; our reliance on key scientific management or personnel; the payment and reimbursement methods used by private or government third party payers; and other factors discussed elsewhere in this Annual Report on Form 10-K or any document incorporated by reference herein or therein. The words believe, may, will, estimate, continue, anticipate, intend, expect, plan and similar expressio forward-looking statements, but the absence of these words does not mean that a statement is not forward-looking. The forward-looking statements contained in this Annual Report on Form 10-K are based on our current expectations and beliefs concerning future developments and their potential effects on us. There can be no assurance that future developments affecting us will be those that we have anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond our control) or other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements. These risks and uncertainties include, but are not limited to, those factors described in the section titled Risk Factors. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary from those projected in these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws. Unless the context otherwise requires, all references to we , us , the Company , or NeuroMetrix in this Annual Report on Form 10-K refer to NeuroMetrix, Inc.

ITEM 1. BUSINESS

Our Business An Overview

NeuroMetrix is a commercial stage, innovation driven healthcare company combining bioelectrical and digital medicine to address chronic health conditions including chronic pain, sleep disorders, and diabetes. Our business is fully integrated with in-house capabilities spanning product development, manufacturing, regulatory affairs and compliance, sales and marketing, and customer support. We derive revenues from the sale of medical devices and after-market consumable products and accessories. Our products are sold in the United States and selected overseas markets, and are cleared by the U.S. Food and Drug Administration, or FDA, and regulators in foreign jurisdictions

where appropriate. We have two principal product lines:

Wearable neuro-stimulation therapeutic devices
Point-of-care neuropathy diagnostic tests

Our core expertise in biomedical engineering has been refined over nearly two decades of designing, building and marketing medical devices that stimulate nerves and analyze nerve response for diagnostic and

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therapeutic purposes. We created the market for point-of-care nerve testing and were first to market with sophisticated, wearable technology for management of chronic pain. We also have an experienced management team and Board of Directors. Chronic pain is a significant public health problem. It is defined by the National Institutes of Health as any pain lasting more than 12 weeks in contrast to acute pain which is a normal bodily response to injury or trauma. Chronic pain conditions include painful diabetic neuropathy, or PDN, arthritis, fibromyalgia, sciatica, musculoskeletal pain, cancer pain and many others. Chronic pain may be triggered by an injury or there may be an ongoing cause such as disease or illness. There may also be no clear cause. Pain signals continue to be transmitted in the nervous system over extended periods of time often leading to other health problems. These can include fatigue, sleep disturbance, decreased appetite, and mood changes which cause difficulty in carrying out important activities and contributing to disability and despair. In general, chronic pain cannot be cured. Treatment of chronic pain is focused on reducing pain and improving function. The goal is effective pain management.

Chronic pain is widespread. It affects over 100 million adults in the United States and more than 1.5 billion people worldwide. The global market for pain management drugs and devices alone was valued at $35 billion in 2012. The estimated incremental impact of chronic pain on health care costs in the United States is over $250 billion per year and lost productivity is estimated to exceed $300 billion per year. Estimated out-of-pocket spending in the United States on chronic pain is $20 billion per year.

The most common approach to chronic pain is pain medication. This includes over-the-counter drugs (such as Advil and Motrin), and prescription drugs including anti-convulsants (such as Lyrica and Neurontin) and anti-depressants (such as Cymbalta and Elavil). Topical creams may also be used (such as Zostrix and Bengay). With severe pain, narcotic pain medications may be prescribed (such as codeine, fentanyl, morphine, and oxycodone). The approach to treatment is individualized, drug combinations may be employed, and the results are often hit or miss. Side effects and the potential for addiction are real and the risks are substantial.

Reflecting the difficulty in treating chronic pain, we believe that inadequate relief leads 25% to 50% of pain sufferers to turn to the over-the-counter market for supplements or alternatives to prescription pain medications. These include non-prescription medications, topical creams, lotions, electrical stimulators, dietary products, braces, sleeves, pads and other items. In total they account for over $4 billion in annual spending in the United States on pain relief products.

High frequency nerve stimulation is an established treatment for chronic pain supported by numerous clinical studies demonstrating efficacy. In simplified outline, the mechanism of action involves intensive nerve stimulation to activate the body s central pain inhibition system resulting in widespread analgesia, or pain relief. The nerve stimulation activates brainstem pain centers leading to the release of endogenous opioids that act primarily through the delta opioid receptor to reduce pain signal transmission through the central nervous system. This therapeutic approach is available through deep brain stimulation and through implantable spinal cord stimulation, both of which require surgery and have attendant risks. Non-invasive approaches to neuro-stimulation (transcutaneous electrical nerve stimulation, or TENS) have achieved limited efficacy in practice due to device limitations, ineffective dosing and low patient compliance.

Our Strategy

There are large and important unmet medical needs in chronic pain treatment. Prescription pain medications and over-the-counter therapies are often inadequate and can lead to other health issues. We believe that controlled, personalized, neuro-stimulation to suppress pain provides an important complement to pain medications. As a medical device company with unique experience in designing devices to manage and alter peripheral nerve function, we believe we are well positioned to make neuro-stimulation widely available to chronic pain sufferers. We have direct

experience with neuro-stimulation through our prescription SENSUS wearable pain management device which has been on the market for the past three and half years and Quell, our over-the-counter, or OTC, wearable device for pain relief which was launched in the second quarter of 2015 and builds upon the core SENSUS neuro-stimulation technology.

Our primary objective is revenue growth. We expect this to be led by the successful market adoption of Quell. We also expect an important contribution to revenue from DPNCheck, our rapid, accurate diagnostic test for diabetic peripheral neuropathy.

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Our key business strategies include:

Driving Commercial Adoption of Key Proprietary Products.

Quell, our OTC wearable device for pain relief, was made commercially available in the United States during the second quarter of 2015. Following commercial launch through the end of 2016, approximately 59,500 Quell devices plus electrodes and accessories were shipped to customers. Quell revenues for the years ended December 31, 2016 and 2015 were approximately $7.4 million and $2.1 million, respectively. Quell utilizes OptiTherapy, our proprietary non-invasive neuro-stimulation technology to provide relief from chronic intractable pain, such as nerve pain due to diabetes, fibromyalgia, arthritic pain, and lower back and leg pain. This advanced wearable device is lightweight and can be worn during the day while active, and at night while sleeping. It has been cleared by the FDA for treatment of chronic intractable pain without a doctor s prescription. Users of the device have the option of using their smartphones to control pain therapy and to track sleep and therapy parameters. Quell is distributed in North America via e-commerce, including the Company s website (*www.quellrelief.com*) and Amazon, via direct response television including QVC, via retail merchandisers including Target, CVS and Walgreens, and via health care professionals such as pain management physician practices and podiatry practices. Distribution is supported by television promotion to expand product awareness. We believe there are significant opportunities to market Quell outside of the United States, particularly in Western Europe, Japan and China. In November 2016, we received regulatory approval to market Quell in the European Union and we anticipate initiating marketing during 2017.

DPNCheck, our diagnostic test for peripheral neuropathies, was made commercially available in the fourth quarter of 2011. DPNCheck revenues for the years December 31, 2016 and 2015 were approximately $2.5 million and $2.3 million, respectively. Our US sales efforts focus on Medicare Advantage providers who assume financial responsibility and the associated risks for the health care costs of their patients. We believe that DPNCheck presents an attractive clinical case with early detection of neuropathy allowing for earlier clinical intervention to help mitigate the effects of neuropathy on both patient quality of life and cost of care. Also, the diagnosis and documentation of neuropathy provided by DPNCheck helps clarify the patient health profile which, in turn, may have a direct, positive effect on the Medicare Advantage premium received by the provider. We believe that attractive opportunities exist outside the United States including Japan where we launched DPNCheck with our distribution partner Omron Healthcare in the third quarter of 2014; in China where we received regulatory approval and initiated sales in the fourth quarter of 2016; and in Mexico where our distributor Scienta Farma received regulatory approval and initiated sales in the fourth quarter of 2015.

Maintaining a High Level of Research and Development Productivity Our research and development, or R&D, team successfully developed Quell, an FDA cleared, technologically sophisticated, smart phone integrated product with electrodes and other accessories. We believe that there are no comparable products on the market. Our R&D team is now charged with maintaining and expanding Quell s competitive technological advantage, addressing opportunities to reduce Quell cost of goods sold, and enhancing our intellectual property position, through continuing innovation. We expect innovation to take the form of device and software enhancements to improve the user experience, expanded smart phone applications, and new electrode features to optimize therapy. Technological innovation will continue to be one of our top priorities.

Our Business Model

Our products consist of a medical device used in conjunction with a consumable electrode or biosensor. Other accessories and consumables are also available to customers. Our goal for these devices is to build an installed base of active customer accounts and distributors that regularly order aftermarket products to meet their needs. We successfully implemented this model when we started our business with the NC-stat system and applied it to subsequent product generations including the ADVANCE system. Our recently developed products, Quell, SENSUS

and DPNCheck, conform to this model.

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Marketed Products

Quell

Quell is a wearable device for relief of chronic intractable pain, such as nerve pain due to diabetes and lower back problems. It incorporates our OptiTherapy technology, a collection of proprietary approaches designed to optimize the clinical efficacy of nerve stimulation. These include high power electrical stimulation hardware with precise control, algorithms that automatically determine therapeutic stimulation intensity and compensate for nerve desensitization, and automated detection of user sleep and appropriate adjustment of stimulation level. Quell is comprised of (1) an electronic device carried in a neoprene band that is worn on the upper calf and (2) an electrode that attaches to the device and is the interface between the device and the skin. The device is lightweight and can be worn during the day while active, and at night while sleeping. It has been cleared by the FDA for treatment of chronic intractable pain and is available OTC. Users of the device have the option of using their smartphones to control pain therapy and to track sleep and therapy parameters. The device was made commercially available in June 2015. In an independent post-market clinical study of Quell initiated by NeuroMetrix, 81% of subjects reported an improvement in management of their chronic pain and health, and 67% reported a reduction in their use of pain medications. To encourage persons with chronic pain to try Quell, we offer a 60-day trial period during which the product can be returned for a full refund. To date, product returns have averaged 25%. We estimate, over time, we will see product returns in the range of 20% to 25%, as indicated by the results of the post-market clinical study. The addressable market opportunity for Quell in the United States is estimated to be 19 million chronic pain sufferers. Quell is available via e-commerce on our product website (quellrelief.com) and on Amazon, via direct response television including QVC, via retail merchandisers including Target, CVS and Walgreens, and via select health care professionals. Distribution is supported by television promotion designed to expand product awareness. Following commercial launch through the fourth quarter of 2016 approximately 59,500 devices and accessories were shipped to customers with a total invoiced value of $13.7 million prior to the impact of product returns.

SENSUS

The SENSUS pain therapy device, the technological predecessor to Quell, is a prescription neuro-stimulation device based on TENS for relief of chronic, intractable pain. SENSUS, which was commercially launched in the first quarter of 2013, is a convenient and wearable device that offers physicians and their patients a non-narcotic pain relief option as a complement to medications. SENSUS is comprised of: (1) an electronic device with a strap that is worn on the upper calf and (2) an electrode which attaches to the device. We provide prescribing physicians with PC-based software that links to the device via a USB connection, thereby allowing them to download a record of the patient s use of the device. The SENSUS device and electrodes were cleared by the FDA for commercial distribution. When medically indicated and supported by proper documentation, TENS devices are generally reimbursed by Medicare and many commercial insurance companies under the DME benefit. SENSUS customers have purchased approximately 10,400 devices through December 31, 2016. We believe that the launch of Quell and contraction of the DME distribution channel due to Medicare competitive bidding will significantly reduce future opportunities for SENSUS sales. Accordingly, we believe SENSUS will have a limited impact on future revenues.

DPNCheck

DPNCheck is a fast, accurate, and quantitative nerve conduction test that is used to evaluate systemic neuropathies such as diabetic peripheral neuropathy, or DPN. It is designed to be used by primary care physicians, endocrinologists, podiatrists and other clinicians at the point-of-care to objectively detect, stage, and monitor DPN. The device measures nerve conduction velocity and response amplitude of the sural nerve, a nerve in the lower leg and ankle. These parameters are widely recognized as sensitive and specific biomarkers of DPN. DPNCheck is comprised of: (1)

an electronic hand-held device and (2) a single patient use biosensor. In addition, we provide users with PC-based software that links to the device via a USB connection. This PC software allows physicians to generate reports and manage their sural nerve conduction data.

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DPNCheck is a modified version of our previously marketed NC-stat nerve testing device that has the same clinical indications with respect to DPN. The modified device which costs less than the original device, has the same functionality with respect to sural nerve testing. More than 2.4 million patient studies have been performed using our NC-stat technology and there have been approximately 7.0 million nerve tests. It has been the subject of many published studies, including several studies specifically addressing the accuracy and clinical utility of the device in assessment of DPN. DPNCheck shipments commenced in late 2011 and approximately 3,400 devices have been placed with customers through December 31, 2016.

ADVANCE System

Our legacy neurodiagnostics business is based on the ADVANCE NCS/EMG System, or the ADVANCE System, which is a comprehensive platform for the performance of traditional nerve conduction studies. The ADVANCE System is comprised of: (1) the ADVANCE device and related modules, (2) various types of electrodes and needles, and (3) a communication hub that enables the physician s office to network their device to their personal computers and our servers for data archiving, report generation, and other network services. The ADVANCE System is most commonly used with proprietary nerve specific electrode arrays. These electrode arrays combine multiple individual electrodes and embedded microelectronic components into a single patient-use disposable unit. We currently market seven different nerve specific electrode arrays but do not actively market the ADVANCE device.

Historically, the ADVANCE System was marketed to a broad range of physician specialties including neurologists, orthopedic surgeons, primary care physicians, and endocrinologists, and utilized for a variety of different clinical indications including assessment of carpal tunnel syndrome, or CTS, low back and leg pain, and DPN. It is most commonly used in the assessment of CTS. Numerous papers have been published on the use of this technology in this clinical application. More than 2.4 million patient studies have been performed using our NC stat technology and there have been approximately 7.0 million nerve tests, including 1.3 million sural nerve tests. As of December 31, 2016, we had an installed base of approximately 400 active customers using our ADVANCE System.

The following chart summarizes our previously marketed products and currently marketed products.

Product	Time on Market		Technology	Primary Clinical Indications	No. Patients Tested/Treated
Quell	Q2 2015	present	Transcutaneous Electrical Nerve Stimulation	Relief for chronic, intractable pain	> 59,000
SENSUS	Q1 2013	present	Transcutaneous Electrical Nerve Stimulation	Relief for chronic, intractable pain	> 10,000
DPNCheck	Q4 2011	present	Nerve Conduction	Diagnosis and evaluation of peripheral neuropathies, such as DPN	> 595,000
ADVANCE	Q2 2008	present	Nerve Conduction	Diagnosis and evaluation of CTS, low back pain, peripheral neuropathies (including DPN)	> 1,850,000 (ADVANCE and NC-stat)
NC-stat	Q2 1999	Q3 2010	Nerve Conduction	Diagnosis and evaluation of CTS, low back pain, peripheral neuropathies	

(including DPN)

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Customers

Customers for our therapeutic products, Quell and SENSUS, include consumers, patients, retail merchandisers, health care professionals (physicians and clinics), and durable medical equipment (DME) suppliers in the United States. Customers for our diagnostic products, DPNCheck and ADVANCE, include physicians, clinics, hospitals, managed care organizations, and independent distributors in the United States and abroad. Through December 31, 2016, approximately 59,500 Quell devices have been shipped. SENSUS was launched in 2013 and is sold to DME suppliers who, in turn, distribute the product along with consumables directly to patients. SENSUS customers purchased approximately 10,400 devices since launch. DPNCheck shipments commenced in 2011 and approximately 3,400 devices had been placed with customers through December 31, 2016. These customers include managed care organizations, retail health businesses, endocrinologists, podiatrists and primary care physicians. As of December 31, 2016, we had an installed base of approximately 400 active customers using our ADVANCE System. These customers include primary care, internal medicine, orthopedic and hand surgeons, pain medicine physicians, neurologists, physical medicine and rehabilitation, or PM&R, physicians, and neurosurgeons. At December 31, 2016, two customers accounted for 41% of accounts receivable and no customers accounted for more than 10% of revenue.

Geographic Information

Substantially all of our assets, revenues, and expenses for 2016, 2015, and 2014 were located in or derived from operations in the United States. In addition, we have had sales through distributors in Europe, Asia, the Middle East and various regions. During 2016, 2015, and 2014, international revenues accounted for approximately 12%, 19%, and 19%, respectively, of our total revenues.

Sales, Marketing, and Distribution

Quell was launched in the second quarter of 2015. It is distributed in North America via e-commerce including the Company s website *www.quellrelief.com* and Amazon, via direct response television including QVC, via retail merchandisers including Target, CVS and Walgreens, and via health care professionals such as pain management physician practices and podiatry practices. Distribution is supported by television promotion designed to expand product awareness. We believe there are significant opportunities to market Quell outside of the United States, particularly in Western Europe, Japan and China. We have filed for regulatory approval to market Quell in the European Union and, assuming we receive such approval, we plan to initiate marketing during 2017. SENSUS is sold through a combination of national and regional DME suppliers whose sales representatives call on endocrinologists, podiatrists, and primary care physicians that are challenged with trying to manage chronic pain in their patients, including patients with painful diabetic neuropathy. The efforts of DME suppliers are coordinated from our corporate office.

Our U.S. sales efforts for DPNCheck focus on Medicare Advantage providers who assume financial responsibility and the associated risks for the health care costs of their patients. We believe that DPNCheck presents an attractive clinical case with early detection of neuropathy allowing for earlier clinical intervention to help mitigate the effects of neuropathy on both patient quality of life and cost of care. Also, the diagnosis and documentation of neuropathy provided by DPNCheck helps clarify the patient health profile which, in turn, may have a direct, positive effect on the Medicare Advantage premium received by the provider. We believe that attractive growth opportunities exist outside the United States, including Japan where DPNCheck is sold by our distribution partner Omron Healthcare; in China where we recently received regulatory approval and are working with Omron Healthcare toward commercial launch in late 2016; and in Mexico where our distributor Scienta Farma initiated sales in the fourth quarter of 2015.

Our installed base of ADVANCE accounts is supported by our customer service department. We are not actively pursuing new ADVANCE customers. Internationally, ADVANCE sales and account support is handled by our network of independent distributors.

Quell sales and marketing efforts are led by our Senior Vice President, Consumer. Sales and marketing support for DPNCheck, ADVANCE and SENSUS are provided by our Senior Vice President, Commercial Operations and other staff in our corporate office.

We invest in technical, clinical, and business practices training for our commercial employees including sales and marketing and customer service staff. Promotion and sales of medical devices are highly regulated

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not only by the FDA, but also by the U.S. Centers for Medicare and Medicaid Services, or CMS, and the Office of Inspector General, or OIG, and, outside the United States, by other international bodies, and are subject to federal and state fraud and abuse enforcement activities. See FDA and other Governmental Regulation below.

Manufacturing and Supply

We perform final assembly and servicing of our Quell, SENSUS and DPNCheck devices at our manufacturing facility in Massachusetts. The ADVANCE device, which is no longer in production, but for which we continue to sell accessories, was previously manufactured by an outside manufacturer and is now serviced by us. Outside suppliers provide us the subassemblies and components that we use in manufacturing Quell, SENSUS and DPNCheck, as well as our consumable biosensor/electrodes. We maintain alternative suppliers for some but not all of the subassemblies and key components and are expanding our list of alternative suppliers. Consumable biosensor/electrodes are manufactured to our specifications by single, long standing suppliers. In outsourcing, we target companies that meet FDA, International Organization for Standardization, or ISO, and other quality standards supported by internal policies and procedures. Supplier performance is maintained and managed through a corrective action program ensuring all product requirements are met or exceeded. Following the receipt of products or product components from our third-party manufacturers, we conduct the necessary inspection, final assembly, packaging, and labeling at our corporate headquarters facility. We believe these manufacturing relationships minimize our capital investment, provide us with manufacturing expertise, and help control costs.

Sunburst EMS, Inc. has been manufacturing devices and providing sub-assemblies to us since 2005. Sunburst currently manufactures subassemblies for Quell, DPNCheck and SENSUS at a facility in Massachusetts.

MC Assembly, Inc., a contract manufacturer, initiated manufacture during 2016 of sub-assemblies for Quell, at a facility in Massachusetts.

Johnson Medtech, LLC. or Johnson, has been manufacturing electrodes for us since 1999. In 2006 we entered into a manufacturing agreement with Johnson for the manufacture and supply of our requirements of nerve specific electrodes for resale in the United States. Under the agreement, Johnson agreed not to manufacture electrodes to be used to measure nerve conduction for any other company during the term of the agreement and, in some cases, for a period of one year thereafter. This agreement will continue indefinitely until terminated by either party upon not less than 18 months prior written notice to the other party. Johnson manufactures our electrodes at a facility in Massachusetts and also has the ability to perform certain manufacturing steps for our electrodes at a second site located in the United Kingdom.

Katecho, Inc., a full service original equipment manufacturer, or OEM, specializing in medical and cosmetic devices, manufactures biosensors for use with our DPNCheck device and electrodes for use with our SENSUS and Quell devices under normal commercial terms contained in our purchase orders. Katecho manufactures electrodes at its facility in Iowa.

We and our third-party manufacturers are registered with the FDA and subject to compliance with FDA quality system regulations. We are also ISO registered and undergo frequent quality system audits by European agencies. Our ADVANCE System and DPNCheck are cleared for marketing within the United States, Canada, and the European Union. DPNCheck is also cleared for marketing in Japan, China and Mexico. Our neuro-stimulation systems for chronic pain, Quell and SENSUS, are cleared for marketing in the United States and Canada. Our facility is subject to periodic inspections by regulatory authorities, and may undergo compliance inspections conducted by the FDA and corresponding state agencies. As a registered device manufacturer, we will undergo regularly scheduled FDA quality

system inspections. However, additional FDA inspections may occur if deemed necessary by the FDA.

Research and Development

We believe that we have research and development (R&D) capability that is unique to the industry with nearly two decades of experience in developing diagnostic and therapeutic devices involving the stimulation and measurement of nerve signals for clinical purposes. This group has extensive experience in neurophysiology, biomedical instrumentation, signal processing, biomedical sensors, and information systems.

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Our R&D team works closely with our marketing group and customers to design products that are focused on improving clinical outcomes. The team consists of ten people including two who hold M.D. degrees and three who hold Ph.D. degrees. It includes the extensive involvement of our founder and Chief Executive Officer who holds both M.D. and Ph.D. degrees and who also coordinates the clinical programs that we support.

R&D efforts currently encompass the following areas:

Quell Innovation. Quell utilizes our proprietary wearable intensive nerve stimulation (WINS) technology to provide relief from chronic pain which can encompass lower back problems, fibromyalgia, arthritis, painful diabetic neuropathy and others. Quell is unique among OTC neuro-stimulation products in its clinical indications, technology, personalization and digital health features. Our R&D efforts to date have provided us first-to-market competitive advantage. We anticipate that success will attract competition and that we must continually innovate to maintain a leadership position. Our product development strategy is focused on the annual delivery of new features that enhance usability and biometric tracking. These include form factor changes, electrode improvements and expanding digital health integration. We intend to strengthen our intellectual property position with the development of additional know-how and a growing body of patent applications.

Cost of Goods Sold (COGS) Improvement. We have identified specific opportunities to reduce Quell COGS, with both near-term and longer-term initiatives underway. Lower COGS would improve gross margins, thereby providing pricing flexibility, which may be necessary to expand Quell adoption. These COGS initiatives involve R&D support as well as investment in engineering design and equipment.

Support for DPNCheck. DPNCheck is our quantitative nerve conduction test for peripheral neuropathies including DPN. Its usage is growing in the Medicare Advantage market in the United States and in Japan, DPNCheck has received regulatory approval in China and Omron Healthcare initiated commercial launch in late 2016. The characteristics of new markets often require device modification for local acceptance which, in turn, involves our R&D team. We are collaborating with Omron Healthcare in Asia for DPNCheck and anticipate continuing engineering support requirements.

Support clinical studies for our wearable technology. Quell is an FDA-cleared Class 2 medical device. We expect that an expanding body of evidence from clinical studies will continue to build Quell credibility among health care professionals and support our marketing efforts. As an example, in 2015 we completed an independent post-market clinical study for Quell. Results were positive with 81% of subjects reporting an improvement in their chronic pain and overall health, and 67% reporting a reduction in their use of pain medications while using Quell. This was directly relevant to Quell marketing and reinforced the need to continue to build the clinical foundation for Quell. We have underway small-scale clinical studies to assess efficacy in key pain indications, reduction in prescription opioid use in cancer patients, and improvements in sleep, among others.

Research and development expenses were approximately $4.4 million, $3.9 million, and $4.1 million for 2016, 2015, and 2014, respectively.

Clinical Program

Our clinical program operates under the direction of our Chief Executive Officer. This may from time-to-time be comprised of internal, collaborative, and external clinical studies. Internal clinical studies are designed and implemented directly by us for the purposes of product design and early clinical validation. Collaborative studies are conducted together with leading researchers around the world to provide clinical validation and to explore the clinical utility of our products. External studies are entirely independent of us, although in many cases the researchers request unrestricted grants for financial and/or material support, such as for devices and consumables. External studies may examine the clinical performance and utility of our products or our products may be used as outcomes measures. We actively seek to publish our clinical study results in leading peer-reviewed journals while also encouraging our clinical

collaborators and clinical study grant recipients to do the same.

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During the third quarter of 2015 we completed an external study managed by Ipsos-Vantis of our wearable technology for chronic pain among subjects with several diseases accompanied by chronic pain. The results indicated a statistically significant improvement in chronic pain and a reduction in use of pain medications. The encouraging results have led us to planning further studies during 2016 and beyond with the goal of expanding the clinical foundation for our wearable technology for chronic pain. We initiated Quell clinical studies in 2016 related to chemotherapy-induced peripheral neuropathy (University of Rochester School of Medicine), opioid reduction and pain relief in patients with cancer (Scripps Translational Science Institute), and chronic low back pain (Brigham and Women s Hospital).

Competition

We believe there is no direct competition to our wearable neuro-stimulation devices, Quell and SENSUS, for the treatment of chronic pain. The most common approach to chronic pain is pain medication. This includes over-the-counter drugs (such as Advil and Motrin), and prescription drugs including anti-convulsants (such as Lyrica and Neurontin) and anti-depressants (such as Cymbalta and Elavil). Topical creams may also be used (such as Zostrix and Bengay). With severe pain, narcotic pain medications may be prescribed (such as codeine, fentanyl, morphine, and oxycodone). The approach to treatment is individualized, drug combinations may be employed, and the results are often hit or miss. Side effects and the potential for addiction are real and the risks are substantial.

Reflecting the difficulty in treating chronic pain, inadequate relief leads many pain sufferers to turn to the over-the-counter market for supplements or alternatives to prescription pain medications. These include non-prescription medications, topical creams, lotions, electrical stimulators, dietary products, braces, sleeves, pads and other items. In total they account for over $4 billion in annual spending in the United States on pain relief products.

High frequency nerve stimulation is an established treatment for chronic pain supported by numerous clinical studies demonstrating efficacy. In simplified outline, the mechanism of action involves intensive nerve stimulation to activate the body s central pain inhibition system resulting in widespread analgesia, or pain relief. The nerve stimulation activates brainstem pain centers leading to the release of endogenous opioids that act primarily through the delta opioid receptor to reduce pain signal transmission through the central nervous system. This therapeutic approach is available through deep brain stimulation and through implantable spinal cord stimulation; however, both require surgery and have attendant risks. Non-invasive approaches to neuro-stimulation (transcutaneous electrical nerve stimulation, or TENS) have achieved limited efficacy in practice due to device limitations, ineffective dosing and low patient compliance. We believe that Quell and SENSUS clinical and market claims covering chronic pain and sleep, technical characteristics of high power and automation, and the digital health integration characteristics (Quell), place our products in a unique neuro-stimulation category. There are numerous manufacturers of transcutaneous electrical nerve stimulation devices including widely marketed over-the-counter TENS such as Sanofi s IcyHot SmartRelief, Omron PM3030 and Aleve Direct Therapy.

We believe that DPNCheck is currently the only objective and standardized test for DPN widely available at the point-of-care. The American Diabetes Association, or ADA, and other organizations recommend at least annual evaluation of all people with diabetes for DPN. Due to cost and availability, this screen is typically performed with a simple (5.07/10g) monofilament. This subjective method identifies late stage neuropathy where intervention is generally limited to foot care. Experts in the field have indicated that there is an unmet need for a practical, objective, and sensitive test for diabetic neuropathy that can be widely deployed in the regular care of all people with diabetes. Monofilaments (5.07/10g) are a commodity sold by a number of medical supply companies.

There are several companies that sell neurodiagnostic devices that compete with our ADVANCE System. These companies include Cadwell Laboratories, Inc. and Natus Medical Incorporated. Natus Medical Incorporated has substantially greater financial resources than we do. Natus Medical Incorporated and Cadwell Laboratories, Inc. have established reputations as having effective worldwide distribution channels for medical instruments to neurologists and PM&R physicians.

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Intellectual Property

We rely on a combination of patents, trademarks, copyrights, trade secrets, and other intellectual property laws, nondisclosure agreements and other measures to protect our proprietary technology, intellectual property rights, and know-how. We hold issued utility patents covering a number of important aspects of our Quell, SENSUS, DPNCheck and ADVANCE products. We believe that in order to have a competitive advantage, we must develop and maintain the proprietary aspects of our technologies. We also require our employees, consultants and advisors, whom we expect to work on our products, to agree to disclose and assign to us all inventions conceived, developed using our property, or which relate to our business. Despite any measures taken to protect our intellectual property, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary.

Patents

As of December 31, 2016, we had 43 issued U.S. patents, three issued foreign patents, and 36 patent applications, including 19 U.S. applications, and 17 foreign applications. Our wearable therapeutic products have two issued U.S. utility patent and three issued design patents plus 31 utility and design patent applications. For our DPNCheck diagnostic device, five utility patents were issued that cover the core technology and there are seven additional utility patent applications.

With regard to our legacy neurodiagnostic products, our issued design patents began to expire in 2015, and our issued utility patents begin to expire in 2017. In particular, seven of our issued U.S. utility patents covering various aspects of the legacy neurodiagnostic products will expire on the same date in 2017. Although the patent protection for material aspects of these products covered by the claims of the patents will be lost at that time, we have additional patents and patent applications directed to other novel inventions that will have patent terms extending beyond 2017.

The medical device industry is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. Patent litigation can involve complex factual and legal questions, and its outcome is uncertain. Any claim relating to infringement of patents that is successfully asserted against us may require us to pay substantial damages. Even if we were to prevail, any litigation could be costly and time-consuming and would divert the attention of our management and key personnel from our business operations. Our success will also depend in part on our not infringing patents issued to others, including our competitors and potential competitors. If our products are found to infringe the patents of others, our development, manufacture, and sale of these potential products could be severely restricted or prohibited. In addition, our competitors may independently develop similar technologies. Because of the importance of our patent portfolio to our business, we may lose market share to our competitors if we fail to protect our intellectual property rights.

A patent infringement suit brought against us may force us or any strategic partners or licensees to stop or delay developing, manufacturing, or selling potential products that are claimed to infringe a third-party s intellectual property, unless that party grants us rights to use its intellectual property. In such cases, we may be required to obtain licenses to patents or proprietary rights of others in order to continue to commercialize our products. However, we may not be able to obtain any licenses required under any patents or proprietary rights of third parties on acceptable terms, or at all. Even if we were able to obtain rights to the third-party s intellectual property, these rights may be non-exclusive, thereby giving our competitors access to the same intellectual property. Ultimately, we may be unable to commercialize some of our potential products or may have to cease some of our business operations as a result of patent infringement claims, which could severely harm our business.

Trademarks

We hold domestic registrations for the trademarks NEUROMETRIX, Quell, OptiTherapy, DPNCheck, SENSUS, and NC-stat. We use a trademark for ADVANCE, and Wearable Pain Relief Technology. We hold certain foreign registrations for the marks NEUROMETRIX, Quell, OptiTherapy, NC-stat, and SENSUS.

Third-Party Reimbursement

Procedures performed with our neurodiagnostic medical devices including ADVANCE and DPNCheck may be paid for by third-party payers, including government health programs, such as Medicare, and private

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insurance and managed care organizations. The 2016 Physicians Fee Schedule published by CMS includes CPT 95905 for nerve conduction studies performed with pre-configured electrode arrays such as are used with the DPNCheck device and the ADVANCE System.

We believe that physicians are generally receiving reimbursement under CPT 95905 from Medicare for nerve conduction studies performed for carpal tunnel syndrome using pre-configured electrode arrays that meet the medical necessity requirements in their local Medicare region but that commercial insurers are generally not providing reimbursement. Reimbursement by third-party payers is an important element of success for medical device companies. We do not foresee a significant near-term improvement in reimbursement for procedures performed with ADVANCE and DPNCheck.

In the United States, some insured individuals are receiving their medical care through managed care programs which monitor and often require pre-approval of the services that a member will receive. Some managed care programs are paying their providers on a per capita basis a predetermined annual payment per member which puts the providers at financial risk for the services provided to their members. This is generally the case under Medicare Advantage where contracting insurers receive a monthly capitated fee from CMS to provide all necessary medical care to participating members. These capitated fees are adjusted under CMS s risk-adjustment model which uses health status indicators, or risk scores, to ensure the adequacy of payment. Members with higher risk codes generally require more healthcare resources than those with lower risk codes. In turn, the insurer fully absorbs the risk of patient health care costs. Insurers may share a portion of the risk with provider organizations such as independent practice associations (IPAs) with whom they contract to provide medical services to their members. Proper assessment of each member s health status and accurate coding helps to assure that insurers receive capitation fees consistent with the cost of treating these members. Nerve conduction testing can provide valuable, early identification of neuropathy leading to clinical interventions that can reduce health care costs. Also, these tests provide valuable input regarding each member s health risk status which can result in more appropriate capitated payments from CMS. We believe that the clinical and economic proposition for DPNCheck is attractive to Medicare Advantage insurers and risk bearing provider organizations. We are focusing our sales effort for DPNCheck on the Medicare Advantage managed care market segment.

We believe that the SENSUS pain management therapeutic system is considered a durable medical equipment (DME) benefit and is reimbursed for chronic pain by Medicare and many commercial insurers under HCPCS code EO730 for the device and under HCPCS code A4595 for the consumable electrodes. These pre-existing codes apply to DME benefits employing transcutaneous electrical nerve stimulation equipment. We expect that Quell will generally not be reimbursed by third party payers in the near future.

We believe that the overall escalating cost of medical products and services has led to, and will continue to lead to, increased pressures on the healthcare industry to reduce the costs of products and services.

Our success in selling DPNCheck, SENSUS and ADVANCE will depend upon, among other things, our customers receiving, and our potential customers expectation that they will receive sufficient reimbursement or patient capitated premium adjustments from third-party payers for procedures or therapies using these products. See Risk Factors, *If health care providers are unable to obtain sufficient reimbursement or other financial incentives from third-party health care payers related to the use of our products other than Quell, their adoption and our future product sales will be materially adversely affected.*

FDA and Other Governmental Regulation

FDA Regulation

Our products are medical devices subject to extensive regulation by the FDA under the Federal Food, Drug, and Cosmetic Act, or FDCA, and the regulations promulgated thereunder, as well as by other regulatory bodies in the United States and abroad. The FDA classifies medical devices into one of three classes on the basis of the amount of risk associated with the medical device and the controls deemed necessary to reasonably ensure their safety and effectiveness:

Class I, requiring general controls, including labeling, device listing, reporting and, for some products, adherence to good manufacturing practices through the FDA s quality system regulations and pre-market notification;

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Class II, requiring general controls and special controls, which may include performance standards and post-market surveillance; and
Class III, requiring general controls and pre-market approval, or PMA, which may include post-approval conditions and post-market surveillance.

Before being introduced into the market, our products must obtain market clearance or approval through the 510(k) pre-market notification process, the *de novo* review process or the PMA process, unless they qualify for an exemption from these processes. See Risk Factors, *We are subject to extensive regulation by the FDA which could restrict the sales and marketing of the Quell, SENSUS and DPNCheck devices and the ADVANCE System, as well as other products for which we may seek FDA clearance or approval, and could cause us to incur significant costs.*

510(k) Pre-Market Notification Process

To obtain 510(k) clearance, we must submit a pre-market notification demonstrating that the proposed device is substantially equivalent to a legally marketed Class I or II medical device or to a Class III device marketed prior to May 28, 1976 for which the FDA has not required the submission of a PMA application. In some cases, we may be required to perform clinical trials to support a claim of substantial equivalence. If clinical trials are required, we must submit an application for an investigational device exemption, or IDE, which must be cleared by the FDA prior to the start of a clinical investigation, unless the device and clinical investigation are considered non-significant risk by the FDA or are exempt from the IDE requirements. It generally takes three months from the date of the pre-market notification submission to obtain a final 510(k) decision, but it can be significantly longer.

After a medical device receives 510(k) clearance, any modification that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, requires the submission of a new 510(k) clearance or could require *de novo* classification or PMA. The FDA allows each company to make this determination, but the FDA can review the decision. If the FDA disagrees with a company s decision not to seek FDA authorization, the FDA may require the company to seek 510(k) clearance or PMA. The FDA also can require the company to cease marketing and/or recall the medical device in question until its regulatory status is resolved.

De Novo Review Process

If a previously unclassified new medical device does not qualify for the 510(k) pre-market notification process because there is no predicate device to which it is substantially equivalent, and if the device may be adequately regulated through general controls or special controls, the device may be eligible for *de novo* classification through what is called the *de novo* review process. In order to use the de novo review process, a company must receive a letter from the FDA stating that, because the device has been found not substantially equivalent to a legally marketed Class I or II medical device or to a Class III device marketed prior to May 28, 1976 for which the FDA has not required the submission of a PMA application, it has been placed into Class III. After receiving this letter, the company, within 30 days, must submit to the FDA a request for a risk based down classification of the device from Class III to Class I or II based on the device s moderate or low risk profile which meets the definition of a Class I or Class II medical device. The FDA then has 60 days in which to decide whether to down classify the device. If the FDA agrees that a lower classification is warranted, it will issue a new regulation describing the device type and, for a Class II device, publish a Special Controls guidance document. The Special Controls guidance document specifies the scope of the device type and the recommendations for submission of subsequent devices for the same intended use. If a product is classified as Class II through the *de novo* review process, then that device may serve as a predicate device for subsequent 510(k) pre-market notifications.

PMA Process

If a medical device does not qualify for the 510(k) pre-market notification process and is not eligible for clearance through the *de novo* review process, a company must submit a PMA application. The PMA requires more extensive pre-filing testing than is required in the 510(k) and is more costly, lengthy and uncertain. The FDA will decide within 45 days of receiving a PMA whether it is sufficiently complete to permit a substantive review and if the PMA is complete, the FDA will notify the applicant that the PMA has been filed. The PMA

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process can take one to three years or longer, from the time the PMA application is filed with the FDA. The PMA process requires the company to prove that the medical device is safe and effective for its intended purpose. A PMA typically includes extensive pre-clinical and clinical trial data, and information about the device, its design, manufacture, labeling and components. Before approving a PMA, the FDA generally also performs an on-site inspection of manufacturing facilities for the product to ensure compliance with the FDA s quality system regulation, or QSR.

If FDA approves the PMA, the approved indications may be more limited than those originally sought. In addition, FDA s approval order may include post-approval conditions that the FDA believes necessary to ensure the safety and effectiveness of the device, including, among other things, restrictions on labeling, promotion, sale and distribution and post-market study requirements. Failure to comply with the post-approval conditions can result in adverse enforcement or administrative actions, including the withdrawal of the approval. Approval of a new PMA application or a PMA supplement may be required in the event of modifications to the device, including to its labeling, intended use or indication, or its manufacturing process that affect safety and effectiveness.

Post-Approval Obligations

After a device is placed on the market, numerous regulatory requirements continue to apply. These include:

the FDA s QSR, which requires manufacturers, including third-party manufacturers, to follow stringent design, testing, control, documentation and other good manufacturing practice and quality assurance procedures during all aspects of the manufacturing process;
labeling regulations and FDA prohibitions against the promotion of products for uncleared or unapproved uses (known as off-label uses), as well as requirements to provide adequate information on both risks and benefits;
medical device reporting regulations, which require that manufacturers report to FDA any device that may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if the malfunction were to recur;
correction and removal reporting regulations, which require that manufacturers report to the FDA field corrections and device recalls or removals if undertaken to reduce a risk to health posed by the device or to remedy a violation of the FDCA caused by the device which may present a risk to health;
post-market surveillance regulations, which apply to Class II or III devices if the FDA has issued a post-market surveillance order and the failure of the device would be reasonably likely to have serious adverse health consequences, the device is expected to have significant use in the pediatric population, the device is intended to be implanted in the human body for more than one year, or the device is intended to be used to support or sustain life and to be used outside a user facility;
regular and for cause inspections by FDA to review a manufacturer s facilities and their compliance with applicable FDA requirements; and
the FDA s recall authority, whereby it can ask, or order, device manufacturers to recall from the market a product that is in violation of applicable laws and regulations.

Regulatory Approvals and Clearances

The ADVANCE System received 510(k) clearance as a Class II medical device in April 2008 for its intended use by physicians to perform nerve conduction studies and needle electromyography procedures.

The NC-stat System is also a Class II medical device and has been the subject of several 510(k) clearances, the most recent in July 2006 (K060584). The NC-stat System is cleared for use to stimulate and measure neuromuscular signals that are useful in diagnosing and evaluating systemic and entrapment neuropathies. We believe our NC-stat DPNCheck, or DPNCheck, device is a technical modification to the 510(k) cleared NC-stat device and has the same

intended use, and therefore does not raise safety or effectiveness questions. Under the FDA s published guidance on 510(k) requirements for modified devices, we do not believe that a 510(k) submission is required for DPNCheck.

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As transcutaneous electrical nerve stimulators, the SENSUS and Quell pain therapy devices are Class II medical devices which received 510(k) clearance from the FDA in August 2012 and July 2014, respectively. In November 2012, the FDA provided 510(k) clearance for the disposable electrode used in conjunction with the SENSUS device, and in July 2013, the FDA provided 510(k) clearance for the use of SENSUS during sleep. The intended use of the SENSUS pain management therapeutic system is the symptomatic relief and management of chronic pain. In July 2014, our Quell device received 510(k) clearance for over-the-counter use and in November 2014, our Quell disposable electrode received 510(k) clearance for over-the-counter use. In January 2016, a number of new features were added to Quell and received 510(k) clearance, most notably use with an optional mobile app that contains several convenience features. The intended use of the Quell pain management therapeutic system is the symptomatic relief and management of chronic pain. The Quell device may also be used during nighttime sleep.

Manufacturing Facilities

Our facility, and the facilities utilized by Sunburst and MC Assemblies, Inc., our contract sub-assembly manufacturers, have each been inspected by FDA in the past, and observations were noted. There were no findings that involved a significant violation of regulatory requirements. The responses to these observations have been accepted by the FDA and we believe that we and our contract manufacturers are in substantial compliance with the QSR. We expect that our facility and our subcontract facilities will be inspected again as required by the FDA. If the FDA finds significant violations, we could be subject to fines, recalls, requirements to halt manufacturing, or other administrative or judicial sanctions.

U.S. Anti-Kickback and False Claims Laws

In the United States, the federal Anti-Kickback Statute, as well as numerous state anti-kickback laws, prohibit the offer, payment, solicitation or receipt of kickbacks, bribes or other remuneration, whether direct or indirect, overt or covert, in cash or in kind, intended, among other things, to induce the purchase or recommendation of healthcare products and services. While the federal law applies only to products and services for which payment may be made by a federal healthcare program, the state laws may apply regardless of whether any public healthcare funds are involved. Violations of these laws can lead to severe civil and criminal penalties, including exclusion from participation in federal healthcare programs. These laws are potentially applicable to manufacturers of medical devices, such as us, and to hospitals, physicians and other potential purchasers of our products.

Also, the federal False Claims Act, as well as many state false claims statutes, provides civil and criminal penalties for presenting, or causing to be presented, to third-party payers for reimbursement, claims that are false or fraudulent, or which are for items or services that were not provided as claimed. Under the federal False Claims Act, in addition to actions initiated by federal law enforcement authorities, the statute authorizes qui tam actions to be brought on behalf of the federal government by a private party in certain circumstances and, if successful, that private party can share in any monetary recovery. Any challenge by federal or state enforcement officials or others under these laws, could have a material adverse effect on our business, financial condition, and results of operations.

Legacy Neurodiagnostics Business

We were founded in 1996 as a science-based health care company. Our focus had been the development of innovative products for the detection, diagnosis, and monitoring of peripheral nerve and spinal cord disorders, such as those associated with carpal tunnel syndrome, lumbosacral disc disease and spinal stenosis, and diabetes. Our NC-stat System for the performance of nerve conduction studies at the point-of-care was commercially launched in 1999. The second generation NC-stat was released in 2002. In 2008, we brought to market the more sophisticated ADVANCE

System for nerve conduction testing and performance of invasive needle electromyography. These systems were general purpose with broad application in evaluating and diagnosing nerve disorders. Numerous studies demonstrating the clinical accuracy and utility of these devices have been conducted and published in high quality peer-reviewed journals. Furthermore, these devices have been used in FDA sanctioned clinical trials for pharmacological agents and large scale epidemiological studies sponsored by the NIH, Center for Disease Control, or CDC, and other governmental agencies. The products have been cleared by the FDA, field tested for over a decade and highly regarded for their ease of use, accuracy and reproducibility of results.

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Following launch of NC-stat in 1999, we experienced rapid revenue growth, which led to our initial public offering in 2004. The health market, particularly the physician office segment, embraced the opportunity to perform nerve conduction tests which previously had always required referral to specialists. Point-of-care nerve testing was seen to provide a combination of improved patient care and patient convenience. The success of point-of-care nerve testing, a market which we created, was met with resistance in some sectors of the medical community, particularly by neurologists and physical medicine and rehabilitation physicians, both of which had traditionally provided nerve testing services. As a consequence of successful lobbying by these specialists, physicians using our technology experienced increased denials of coverage by third party payers resulting in their discontinuing usage and our difficulty in accruing new customer accounts. In late 2009 CMS included in the Physician Fee Schedule a new Category I CPT Code, CPT 95905, for nerve conduction studies performed using preconfigured electrode such as those employed with our products. During 2010 most Medicare fiscal intermediaries assumed coverage for CPT 95905 for at least some clinical indications; however, the health care environment was such that we were unable to secure broad coverage among private payers, which was essential to the success of our ADVANCE System product. This experience was reflected in our revenues for the legacy Neurodiagnostics business, which peaked in 2006 at $55.3 million. We reported revenue for our legacy Neurodiagnostics business of $2.0 million, $2.3 million and $2.8 million in 2016, 2015 and 2014, respectively. We currently manage this business to optimize cash flow.

Employees

As of December 31, 2016, we had a total of 44 full time employees. Of these employees, ten were in research and development, 15 in sales and marketing, ten in production/distribution, and nine in general and administrative services. One employee holds both M.D. and Ph.D. degrees, one employee holds an M.D. degree and two additional employees hold Ph.D. degrees. Our employees are not represented by a labor union and are not subject to a collective bargaining agreement. We have never experienced a work stoppage. We believe that we have good relations with our employees.

Available Information

Access to our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these reports filed with or furnished to the Securities and Exchange Commission, or SEC, may be obtained through the Investor Relations section of our website at *www.neurometrix.com/investor* as soon as reasonably practical after we electronically file or furnish these reports. We do not charge for access to and viewing of these reports. Information on our Investor Relations page and on our website is not part of this Annual Report on Form 10-K or any of our other securities filings unless specifically incorporated herein by reference. In addition, the public may read and copy any materials that we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Also, our filings with the SEC may be accessed through the SEC s website at *www.sec.gov.* All statements made in any of our securities filings, including all forward-looking statements or information, are made as of the date of the document in which the statement is included, and we do not assume or undertake any obligation to update any of those statements or documents unless we are required to do so by law.

Corporate Information

NeuroMetrix was founded in June 1996 by our President and Chief Executive Officer, Shai N. Gozani, M.D., Ph.D. We originally were incorporated in Massachusetts in 1996, and we reincorporated in Delaware in 2001. Our principal offices are located at 1000 Winter Street, Waltham, Massachusetts 02451.

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ITEM 1A. Risk Factors

You should carefully consider the following risks and all other information contained in this Annual Report on Form 10-K and our other public filings before making any investment decisions with respect to our securities. If any of the following risks occurs, our business, prospects, reputation, results of operations, or financial condition could be harmed. In that case, the trading price of our securities could decline, and our stockholders could lose all or part of their investment. This Annual Report also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of specific factors, including the risks described below and elsewhere in this Annual Report on Form 10-K.

We have incurred significant operating losses since inception and cannot assure you that we will achieve profitability.

We have incurred significant cumulative net losses since our inception. Our net losses for the years ended December 31, 2016, 2015, and 2014, were approximately $14.9 million, $9.2 million, and $7.8 million, respectively. At December 31, 2016, we had an accumulated deficit of $178.5 million. The extent of our future operating income or losses is highly uncertain, and we cannot assure you that we will be able to achieve or maintain profitability.

Our future capital needs are uncertain and our independent auditor has expressed substantial doubt about our ability to continue as a going concern. Our ability to continue as a going concern is dependent on our ability to raise additional capital and our operations could be curtailed if we are unable to obtain the required additional funding when needed. We may not be able to do so when necessary, and/or the terms of any financings may not be advantageous to us.

We held cash and cash equivalents of $3.9 million as of December 31, 2016. We believe that these resources, cash proceeds from a $7 million equity offering, the first tranche of which closed on January 5, 2017, and the cash to be generated from future product sales will be sufficient to meet our projected operating requirements into the fourth quarter of 2017. However, the amount of our future product sales is difficult to predict and actual sales may not be in line with our forecasts.

Our financial statements have been prepared assuming that we will continue as a going concern which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. We expect to incur further losses as we aim to successfully commercialize Quell and DPNCheck and the operations of our business and will be dependent on funding our operations through additional public or private financing, collaborative arrangements with strategic partners, or through additional credit lines or other debt financing sources to increase the funds available to fund operations. These circumstances raise substantial doubt about our ability to continue as a going concern. As a result of this uncertainty and the substantial doubt about our ability to continue as a going concern as of December 31, 2016, the report of our independent registered public accounting firm in this Annual Report on Form 10-K for the year ended December 31, 2016 includes a going concern explanatory paragraph. Management s plans include increasing

revenue through the commercialization of Quell and DPNCheck. However, no assurance can be given at this time as to whether we will be able to achieve these objectives. Our financial statements do not include any adjustment relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should we be unable to continue as a going concern.

We continue to face significant challenges and uncertainties and, as a result, our available capital resources may be consumed more rapidly than currently expected due to (a) decreases in sales of our products and the uncertainty of future revenues from new products; (b) changes we may make to the business that affect ongoing operating expenses; (c) changes we may make in our business strategy; (d) regulatory developments affecting our existing products and delays in the FDA approval process for products under development; (e) changes in our research and development spending plans; and (f) other items affecting our forecasted level of expenditures and use of cash resources. Accordingly, we will need to raise additional funds to support our future operating and capital needs for the fourth quarter of 2017 and beyond. We may attempt to obtain additional funding through public or private financing, collaborative arrangements with strategic partners, or through additional credit lines or other debt financing sources to increase the funds available to fund operations. However, we may not be able to secure such financing in a timely manner or on favorable

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terms, if at all. Furthermore, if we issue equity or debt securities to raise additional funds, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences and privileges senior to those of our existing stockholders. If we raise additional funds through collaboration, licensing or other similar arrangements, it may be necessary to relinquish valuable rights to our potential products or proprietary technologies, or grant licenses on terms that are not favorable to us. Without additional funds, we may be forced to delay, scale back or eliminate some of our sales and marketing efforts, research and development activities, or other operations and potentially delay product development in an effort to provide sufficient funds to continue our operations. If any of these events occurs, our ability to achieve our development and commercialization goals would be adversely affected.

We are focused on commercialization of Quell, our over-the-counter, or OTC, wearable device for chronic pain. We cannot assure you that we will be successful in this field or that our current commercial product for peripheral neuropathy, DPNCheck, or the product candidates or product enhancements in our development pipeline, will be successful.

We are focused on the commercialization of Quell, our OTC wearable device for pain relief. Quell is based on our prescription product for pain relief, SENSUS. Quell has been on the market since June 2015 and we have shipped approximately 59,500 Quell devices since then. Additionally, DPNCheck, which was launched in 2011, is a quantitative nerve conduction test for systemic neuropathies, such as DPN. We also have other product candidates and product enhancements in our development pipeline. Our future prospects are closely tied to our success with Quell and DPNCheck, which, in turn, depend upon market acceptance and growth in future revenues. We cannot assure you that our commercialization strategy will be successful. If our strategy is not successful, it could materially affect our revenues and results of operations.

Our future success could be adversely affected by a number of factors, including:

inability to create market demand for Quell through online marketing efforts, direct response television and other retail channels;

manufacturing issues with Quell or our other products;

inability to increase adoption of DPNCheck within the Medicare Advantage market;

unfavorable market response to DPNCheck in Japan and other Asia markets;

unfavorable changes to current Medicare, Medicare Advantage and commercial payer payment policies;

changes to payor policies under the Patient Protection and Affordable Care Act;

unfavorable experiences by patients and physicians using Quell and our other products; and,

physicians reluctance to alter their existing practices and adopt the use of our devices.

If we are unable to expand exposure and penetrate the market for Quell and/or DPNCheck, our ability to increase our revenues will be limited and our business prospects will be adversely affected.

Our current and future revenue is dependent upon commercial acceptance of Quell by the market. The failure of such acceptance will materially and adversely affect our operations.

We are focused on commercialization of Quell, our over-the-counter, or OTC, wearable device for chronic pain. We

We anticipate that as revenue from our legacy neurodiagnostics business, the ADVANCE System, continues to decrease, we will continue to rely heavily on revenue from sales of Quell, our OTC wearable device. As a result, we will continue to incur operating losses until such time as sales of Quell and other products or product candidates reach a mature level and we are able to generate sufficient revenue from their sale to meet our operating expenses. There can be no assurance that customers will adopt our technology and products, or that prospective customers will agree to pay for our products. In the event that we are not able to significantly increase the number of customers that purchase our products, or if we are unable to charge the necessary prices, our financial condition and results of operations will be materially and adversely affected.

Our current and future revenue is dependent upon commercialacceptance of Quell by the market. The failure of suc

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If health care providers are unable to obtain sufficient reimbursement or other financial incentives from third-party health care payers related to the use of our products other than Quell, their adoption and our future product sales will be materially adversely affected.

Widespread adoption of our SENSUS and DPNCheck products by the medical community is unlikely to occur without a financial incentive from third-party payers for the use of these products. If health care providers are unable to obtain adequate reimbursement for procedures performed using these products, if managed care organizations do not receive improved capitated payments due to more accurate patient risk assessment using our products, and if DME suppliers are not adequately reimbursed for supplying our therapeutic products, we may be unable to sell our products at levels that are sufficient to allow us to achieve and maintain profitability, and our business would suffer significantly. Additionally, even if these products and procedures are adequately reimbursed by third-party payers today, adverse changes in payers future policies toward payment would harm our ability to market and sell our products. Third-party payers include those governmental programs such as Medicare and Medicaid, private health insurers, workers compensation programs and other organizations.

Future regulatory action by CMS or other governmental agencies or negative clinical results may diminish reimbursement payments to physicians for performing procedures using our products. Medicaid reimbursement differs from state to state, and some state Medicaid programs may not cover the procedures performed with our products or pay physicians an adequate amount for performing those procedures, if at all. Additionally, some private payers do not follow the Medicare guidelines and may reimburse for only a portion of these procedures or not at all. We are unable to predict what changes will be made in the reimbursement methods used by private or governmental third-party payers. Importantly, we cannot predict the effects that implementation of the Patient Protection and Affordable Care Act, or potential repeal and replacement of that legislation, will have on CMS, commercial insurers, health care providers, and ultimately on our business.

Healthcare reform legislation could adversely affect our future revenues.

Our future revenues from SENSUS will be impacted by the CMS Durable Medical Equipment, Prosthetics, Orthotics and Supplies (DMEPOS) Competitive Bidding Program. Under this program, Medicare will no longer reimburse suppliers for certain products and services, including transcutaneous electrical nerve stimulation (TENS), based on the Medicare fee schedule amount. Instead CMS will provide reimbursement for those products and services based on a competitive bidding process. Our SENSUS pain management system is presently classified within TENS. The DMEPOS Competitive Bidding Program will likely require us to sell SENSUS devices and related consumables subject to Medicare reimbursement at significantly lower prices which would have a material adverse effect on SENSUS profitability. In those regions of the country where DMEPOS Competitive Bidding was implemented in January 2014, low Medicare pricing is restricting our ability to sell SENSUS. As the DMEPOS program is expanded to other regions, a similar effect will likely be seen.

We are subject to extensive regulation by the FDA which could restrict the sales and marketing of the Quell, SENSUS and DPNCheck devices and the ADVANCE System as well as other products for which we may seek FDA clearance or approval, and could cause us to incur significant costs.

We sell medical devices that are subject to extensive regulation in the United States by the FDA with regard to manufacturing, labeling, sale, promotion, distribution, shipping and ongoing monitoring and follow-up. Before a new medical device, or a new use of or claim for an existing product, can be marketed in the United States, it must first be cleared or approved by the FDA. Medical devices may be marketed only for the indications for which they are approved or cleared. The regulatory review process can be expensive and lengthy. The FDA s process for granting 510(k) clearance typically takes approximately three to six months, but it can be significantly longer. The process for obtaining a pre-market approval, or PMA, is much more costly and onerous. By law, the time period designated for the FDA s review of a PMA is 180 days; however, this time is often extended and it is not uncommon for the PMA review process to take three years or longer from the time the application is filed with the FDA.

The FDA may remove our devices from the market or enjoin them from commercial distribution if safety or effectiveness problems develop. Further, we may not be able to obtain additional 510(k) clearances or

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pre-market approvals for new products or for modifications to, or additional indications for, our existing products in a timely fashion, or at all. Delays in obtaining future clearances or approvals would adversely affect our ability to introduce new or enhanced products in a timely manner, which in turn would harm our revenue and future profitability. We have made modifications to our devices in the past and may make additional modifications in the future that we believe do not or will not require additional clearances or approvals. If the FDA disagrees, and requires new clearances or approvals for the modifications, we may be required to recall and to stop marketing the modified devices. If any of these events occurs or if the FDA takes other enforcement actions, we may not be able to provide our customers with the products they require on a timely basis, our reputation could be harmed, and we could lose customers and suffer reduced revenues and increased costs.

We also are subject to numerous post-marketing regulatory requirements, including the FDA s quality system regulations, which relate to the design, manufacture, packaging, labeling, storage, installation and servicing of our products, labeling regulations, medical device reporting regulations and correction and removal reporting regulations. Our failure or the failure by any manufacturer of our products to comply with applicable regulatory requirements could result in enforcement action by the FDA. FDA enforcement actions relating to post-marketing regulatory requirements or other issues, may include any of the following:

warning letters, untitled letters, fines, injunctions, product seizures, consent decrees and civil penalties;
requiring repair, replacement, refunds, customer notifications or recall of our products;
imposing operating restrictions, suspension or shutdown of production;
refusing our requests for 510(k) clearance or PMA approval of new products, new intended uses, or modifications to existing products;
requesting voluntary rescission of 510(k) clearances or withdrawing PMA approvals that have already been granted; and
criminal prosecution.

If any of these events were to occur, they could harm our reputation, our ability to generate revenues and our profitability.

Also, from time to time, legislation is introduced into Congress that could significantly change the statutory provisions governing the approval, manufacturing and marketing of medical devices. FDA regulations and guidance are often revised or reinterpreted by the agency in ways that may significantly affect our business and our products. It is impossible to predict whether legislative changes will be enacted, or FDA regulations, guidance or interpretations changed, and what the impact of such changes, if any, may be. The FDA has publicly stated that it is reevaluating its longstanding 510(k) review program. It is not clear when, or if, the program will be modified and what effect the modified review process will have on our ability to bring our products to market.

We depend on several single source manufacturers to produce components of our products. Any material adverse changes in our relationships with these manufacturers could prevent us from delivering products to our customers in a timely manner and may adversely impact our future revenues or costs.

We rely on third-party manufacturers to manufacture components of our Quell, DPNCheck and SENSUS systems, and to fully manufacture electrodes for the ADVANCE system. In the event that our manufacturers cease to manufacture sufficient quantities of our products or components in a timely manner and on terms acceptable to us, we would be

forced to locate alternate manufacturers. Additionally, if our manufacturers experience a failure in their production process, are unable to obtain sufficient quantities of the components necessary to manufacture our products or otherwise fail to meet our quality requirements, we may be forced to delay the manufacture and sale of our products or locate an alternative manufacturer. We may be unable to locate suitable alternative manufacturers for our products or components for which the manufacturing process is relatively specialized, on terms acceptable to us, or at all. We have a manufacturing and supply agreement with Johnson Medtech, LLC. for the manufacture of the ADVANCE electrodes for nerve conduction testing.

We depend on several single source manufacturers to produce components of our products. Any material adverse

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Katecho, Inc. manufactures biosensors for use with our DPNCheck devices and manufactures electrodes for Quell and SENSUS, and Sunburst EMS, Inc. manufactures electronic boards and other components of our Quell, DPNCheck and SENSUS products which we assemble at our Massachusetts facility to produce completed devices. Moreover, other than Katecho, Inc., we do not have long-standing relationships with our manufacturers and may not be able to convince suppliers to continue to make components available to us unless there is demand for such components from their other customers. As a result, there is a risk that certain components could be discontinued and no longer available to us.

We have experienced transient inventory shortages on new products, including Quell, during the initial production ramp-up phase. If any materially adverse changes in our relationships with the manufacturers of our products occur, our ability to supply our customers will be severely limited until we are able to engage an alternate manufacturer or, if applicable, resolve any quality issues with our existing manufacturer. This situation could prevent us from delivering products to our customers in a timely manner, lead to decreased sales or increased costs, or harm our reputation with our customers.

If our manufacturers are unable to supply us with an adequate supply of product components as we expand our markets, we could lose customers, our potential future growth could be limited and our business could be harmed.

In order for us to successfully expand our business within the United States and internationally, our contract manufacturers must be able to provide us with substantial quantities of components of our products in compliance with regulatory requirements, in accordance with agreed upon specifications, at acceptable cost and on a timely basis. Our potential future growth could strain the ability of our manufacturers to deliver products and obtain materials and components in sufficient quantities. Manufacturers often experience difficulties in scaling up production, including problems with production yields and quality control and assurance. If we are unable to obtain sufficient quantities of high quality products to meet customer demand on a timely basis, we could lose customers, our growth may be limited and our business could be harmed.

If we or our manufacturers fail to comply with the FDA s quality system regulation, the manufacturing and distribution of our products could be interrupted, and our product sales and operating results could suffer.

We and our contract manufacturers are required to comply with the FDA s quality system regulation, or QSR, which is a complex regulation that governs the procedures and documentation of the design, testing, production, control, quality assurance, labeling, packaging, sterilization, storage and shipping of our devices. The FDA enforces the QSR through periodic inspections. We cannot assure you that our facilities or the facilities of the manufacturers of our products would pass any future inspection. If our facilities or any of the facilities of the manufacturers of our products fail an inspection, the manufacturing or distribution of our products could be interrupted and our operations disrupted. Failure to take adequate and timely corrective action in response to an adverse inspection could result in a suspension or shutdown of our packaging and labeling operations and the operations of the manufacturers of our products or a recall of our products, or other administrative or judicial sanctions. If any of these events occurs, we may not be able

to provide our customers with the quantity of products they require on a timely basis, our reputation could be harmed, and we could lose customers and suffer reduced revenues and increased costs.

Our products may be subject to recalls, even after receiving FDA clearance or approval, which would harm our reputation, business and financial results.

We are subject to the medical device reporting regulations, which require us to report to the FDA if our products may have caused or contributed to a death or serious injury, or have malfunctioned in a way that would likely cause or contribute to a death or serious injury if the malfunction were to occur. We are also subject to the correction and removal reporting regulations, which require us to report to the FDA any field corrections and device recalls or removals that we undertake to reduce a risk to health posed by the device or to remedy a violation of the Federal Food, Drug and Cosmetic Act, or FDCA, caused by the device which may present a risk to health. In addition, the FDA and similar governmental agencies in other countries have the authority to require the recall of our products if there is a reasonable probability that the products would cause serious adverse health consequences or death. A government-mandated or voluntary recall by us could

If we or our manufacturers fail to comply with the FDA s qualitysystem regulation, the manufacturing and distributio

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occur as a result of manufacturing defects, labeling deficiencies, packaging defects or other failures to comply with applicable regulations. Any recall would divert management attention and financial resources and harm our reputation with customers and could have a material adverse effect on our financial condition and results of operations.

The success of our business depends upon our ability to advance our pipeline products to commercialization.

We commenced commercialization of Quell in June 2015. We have additional product candidates and enhancements of our existing products in our R&D pipeline. We expect that advancing our pipeline products will require significant time and resources. We may not be successful in our commercialization efforts for any of the product candidates or product enhancements currently in our pipeline and we may not be successful in developing, acquiring, or in-licensing additional product candidates, to the extent we decide to do so. If we are not successful advancing new products through our development pipeline, the regulatory process and commercial launch, our business, financial condition, and results of operations will be adversely affected.

Our ability to achieve profitability depends in part on maintaining or increasing our gross margins on product sales which we may not be able to achieve.

A number of factors may adversely impact our gross margins on product sales and services, including:

lower than expected manufacturing yields of high cost components leading to increased manufacturing costs;
low production volume which will result in high levels of overhead cost per unit of production;
the timing of revenue recognition and revenue deferrals;
increased material or labor costs;
increased service or warranty costs or the failure to reduce service or warranty costs;
increased price competition;
variation in the margins across products in a particular period; and
how well we execute on our strategic and operating plans.

If we are unable to maintain or increase our gross margins on product sales, our results of operations could be adversely impacted, we may not achieve profitability and our stock price could decline.

The patent rights we rely upon to protect the intellectual property underlying our products may not be adequate, which could enable third parties to use our technology and would harm our ability to compete in the market.

Our success will depend in part on our ability to develop or acquire commercially valuable patent rights and to protect these rights adequately. The risks and uncertainties that we face with respect to our patents and other related rights include the following:

the pending patent applications we have filed or to which we have exclusive rights may not result in issued patents or may take longer than we expect to result in issued patents;

the claims of any patents that are issued may not provide meaningful protection;
we may not be able to develop additional proprietary technologies that are patentable;
other parties may challenge patents, patent claims or patent applications licensed or issued to us; and
other companies may design around technologies we have patented, licensed or developed.

Our issued and filed patents for our wearable therapeutic products are recent. With regard to our legacy neurodiagnostic products, our issued design patents began to expire in 2015, and our issued utility patents begin to expire in 2017. Although the patent protection for material aspects of these products covered by the claims of the patents will be lost at that time, we have additional patents and patent applications directed to

The patent rights we rely upon to protect the intellectualproperty underlying our products may not be adequate, whi

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other novel inventions that will have patent terms extending beyond 2017. We may not be able to protect our patent rights effectively in some foreign countries. For a variety of reasons, we may decide not to file for patent protection in the United States or in particular foreign countries. Our patent rights underlying our products may not be adequate, and our competitors or customers may design around our proprietary technologies or independently develop similar or alternative technologies or products that are equal or superior to our technology and products without infringing on any of our patent rights. In addition, the patents licensed or issued to us may not provide a competitive advantage. If any of these events were to occur, our ability to compete in the market would be harmed.

Other rights and measures we have taken to protect our intellectual property may not be adequate, which would harm our ability to compete in the market.

In addition to patents, we rely on a combination of trade secrets, copyright and trademark laws, confidentiality, nondisclosure and assignment of invention agreements and other contractual provisions and technical measures to protect our intellectual property rights. We rely on trade secrets to protect the technology and algorithms we use in our customer data processing and warehousing information system. While we currently require employees, consultants and other third parties to enter into confidentiality, non-disclosure or assignment of invention agreements or a combination thereof where appropriate, any of the following could still occur:

the agreements may be breached or not enforced in a particular jurisdiction;
we may have inadequate remedies for any breach;
trade secrets and other proprietary information could be disclosed to our competitors; or
others may independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets or disclose such technologies.

If, for any of the above reasons, our intellectual property is disclosed or misappropriated, it would harm our ability to protect our rights and our competitive position.

We may need to initiate lawsuits to protect or enforce our patents and other intellectual property rights, which could be expensive and, if we lose, could cause us to lose some of our intellectual property rights, which would harm our ability to compete in the market.

We rely on patents to protect a portion of our intellectual property and our competitive position. Patent law relating to the scope of claims in the technology fields in which we operate is still evolving and, consequently, patent positions in the medical device industry are generally uncertain. In order to protect or enforce our patent rights, we may initiate patent litigation against third parties, such as infringement suits or interference proceedings. Litigation may be necessary to:

assert claims of infringement;
enforce our patents;
protect our trade secrets or know-how; or
determine the enforceability, scope and validity of the proprietary rights of others.

Any lawsuits that we initiate could be expensive, take significant time and divert management s attention from other business concerns. Litigation also puts our patents at risk of being invalidated or interpreted narrowly and our patent applications at risk of not issuing. Additionally, we may provoke third parties to assert claims against us. We may not prevail in any lawsuits that we initiate and the damages or other remedies awarded, if any, may not be commercially valuable. The occurrence of any of these events could harm our business, our ability to compete in the market or our reputation.

Claims that our products infringe on the proprietary rights of others could adversely affect our ability to sell our products and increase our costs.

Substantial litigation over intellectual property rights exists in the medical device industry. We expect that our products could be increasingly subject to third-party infringement claims as the number of competitors

We may need to initiate lawsuits to protect or enforce ourpatents and other intellectual property rights, which could

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grows and the functionality of products and technology in different industry segments overlap. Third parties may currently have, or may eventually be issued, patents on which our products or technologies may infringe. Any of these third parties might make a claim of infringement against us. Any litigation regardless of its impact would likely result in the expenditure of significant financial resources and the diversion of management s time and resources. In addition, litigation in which we are accused of infringement may cause negative publicity, adversely impact prospective customers, cause product shipment delays or require us to develop non-infringing technology, make substantial payments to third parties, or enter into royalty or license agreements, which may not be available on acceptable terms, or at all. If a successful claim of infringement were made against us and we could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, our revenues may decrease substantially and we could be exposed to significant liability.

We are subject to federal and state laws prohibiting kickbacks and false or fraudulent claims, which, if violated, could subject us to substantial penalties. Additionally, any challenge to or investigation into our practices under these laws could cause adverse publicity and be costly to respond to, and thus could harm our business.

A federal law commonly known as the federal anti-kickback law, and several similar state laws, prohibit the payment of any remuneration that is intended to induce physicians or others either to refer patients or to acquire or arrange for or recommend the acquisition of health care products or services. These laws constrain a medical device company s sales, marketing and other promotional activities by limiting the kinds of business relationships and financial arrangements, including sales programs we may have with hospitals, physicians or other potential purchasers of medical devices. Other federal and state laws generally prohibit individuals or entities from knowingly presenting, or causing to be presented, claims for payment to Medicare, Medicaid or other third-party payers that are false or fraudulent, or for items or services that were not provided as claimed. From time to time, we may provide coding and billing information as product support to purchasers of our products. Anti-kickback and false claims laws prescribe civil and criminal penalties for noncompliance, which can be quite substantial including exclusion from participation in federal health care programs. A number of states have enacted laws that require pharmaceutical and medical device companies to monitor and report payments, gifts and other remuneration made to physicians and other health care professionals and health care organizations. Some state statutes, such as the one in Massachusetts, impose an outright ban on gifts to physicians. These laws are often referred to as gift ban or aggregate spend laws and carry substantial fines if they are violated. Similar legislation, known as the Physician Payments Sunshine Act, was enacted by Congress during 2014. In the event that we are found to have violated these laws or determine to settle a claim that we have done so, our business may be materially adversely affected as a result of any payments required to be made, restrictions on our future operations or actions required to be taken, damage to our business reputation or adverse publicity in connection with such a finding or settlement or other adverse effects relating thereto. Additionally, even an unsuccessful challenge or investigation into our practices could cause adverse publicity, and be costly to respond to, and thus could harm our business and results of operations.

If we are found to have violated laws protecting the confidentiality of patient health information, we could be subject to civil or criminal penalties, which could increase our liabilities,

Claims that our products infringe on the proprietary rights ofothers could adversely affect our ability to sell our produ

damage our reputation and harm our business.

There are a number of federal and state laws protecting the confidentiality of individually identifiable patient health information, including patient records, and restricting the use and disclosure of that protected information. In particular, the U.S. Department of Health and Human Services promulgated patient privacy rules under the Health Insurance Portability and Accountability Act of 1996, or HIPAA. These privacy rules protect medical records and other personal health information by limiting their use and disclosure, giving individuals the right to access, amend and seek accounting of their own health information and limiting most use and disclosures of health information to the minimum amount reasonably necessary to accomplish the intended purpose. We do not believe that we are subject to the HIPAA rules. However, if we are found to be in violation of the privacy rules under HIPAA, we could be subject to civil or criminal penalties, which could increase our liabilities and harm our reputation or our business.

If we are found to have violated laws protecting theconfidentiality of patient health information, we could be subjectt

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The use of our products could result in product liability claims that could be expensive, damage our reputation and harm our business.

Our business exposes us to an inherent risk of potential product liability claims related to the manufacturing, marketing and sale of medical devices. The medical device industry historically has been litigious, and we face financial exposure to product liability claims if the use of our products were to cause or contribute to injury or death. Our products may be susceptible to claims of injury because their use involves the electric stimulation of a patient s nerves. Although we maintain product liability insurance for our products and other commercial insurance, the coverage limits of these policies may not be adequate to cover future claims. As sales and use of our products increase, we may be unable to maintain sufficient product liability or other commercial insurance on acceptable terms or at reasonable costs, and this insurance may not provide us with adequate coverage against potential liabilities. A successful claim brought against us in excess of, or outside of, our insurance coverage could have a material adverse effect on our financial condition and results of operations. A product liability claim, regardless of its merit or eventual outcome, could result in substantial costs to us, a substantial diversion of management attention and adverse publicity. A product liability claim could also harm our reputation and result in a decline in revenues and an increase in expenses.

Our products are complex in design, and defects may not be discovered prior to shipment to customers, which could result in warranty obligations or product liability or other claims, reducing our revenues and increasing our costs and liabilities.

We depend upon third parties for the manufacture of our products or components. Our products, particularly our electrodes, require a significant degree of technical expertise to produce. If these manufacturers fail to produce our products to specification, or if the manufacturers use defective materials or workmanship in the manufacturing process, the reliability and performance of our products will be compromised.

If our products contain defects that cannot be repaired quickly, easily and inexpensively, we may experience:

loss of customer orders and delay in order fulfillment;
damage to our brand reputation;
increased cost of our warranty program due to product repair or replacement;
inability to attract new customers;
diversion of resources from our manufacturing and research and development departments into our service department; and
legal action.

The occurrence of any one or more of the foregoing could harm our reputation and materially reduce our revenues and increase our costs and liabilities.

If we lose any of our officers or key employees, our management and technical expertise could be weakened

significantly.

Our success largely depends on the skills, experience, and efforts of our executive officers, including Shai N. Gozani, M.D., Ph.D., our founder, Chairman, President and Chief Executive Officer, Thomas T. Higgins, our Senior Vice President and Chief Financial Officer; and Francis X. McGillin, our Senior Vice President and Chief Commercial Officer. We do not maintain key person life insurance policies covering any of our employees. The loss of any of our executive officers could weaken our management and technical expertise significantly and harm our business.

If we are unable to recruit, hire and retain skilled and experienced personnel, our ability to manage and expand our business will be harmed, which would impair our future revenues and profitability.

We are a small company with 44 employees as of December 31, 2016, and our ability to retain our skilled labor force and our success in attracting and hiring new skilled employees will be a critical factor in determining our future performance. We may not be able to meet our future hiring needs or retain existing

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personnel, particularly given the challenges faced by our business. We will face challenges and risks in hiring, training, managing and retaining engineering and sales and marketing employees. Failure to attract and retain personnel, particularly technical and sales and marketing personnel would materially harm our ability to compete effectively and grow our business.

Failure to develop or enter into relationships to sell products other than our existing products or enhance our existing products could have an adverse effect on our business prospects.

Our future business and financial success will depend, in part, on our ability to effectively market our products, such as Quell and DPNCheck, and enhance these products in response to customer demand. Developing new products and upgrades to existing and future products imposes burdens on our research and development department and our management. This process is costly, and we cannot assure you that we will be able to successfully develop new products or enhance our current products. We also may not be able to enter into relationships with other companies to sell additional products. In addition, as we develop the market for our products, future competitors may develop desirable product features earlier than we do which could make our competitors products less expensive or more effective than our products and could render our products obsolete or unmarketable. If our product development efforts are unsuccessful, we will have incurred significant costs without recognizing the expected benefits and our business prospects may suffer.

If we are unable to develop new products or enhance existing products, we may be unable to attract or retain customers.

Our success depends on the successful development, regulatory clearance or approval (if required), introduction and commercialization of new generations of products, treatment systems, and enhancements to and/or simplification of existing products. Quell and DPNCheck must keep pace with, among other things, the products of our competitors. We are making significant investments in long-term growth initiatives. Such initiatives require significant capital commitments, involvement of senior management and other investments on our part, which we may be unable to recover. Our timeline for the development of new products or enhancements may not be achieved and price and profitability targets may not prove feasible. Commercialization of new products may prove challenging, and we may be required to invest more time and money than expected to successfully introduce them. Once introduced, new products may adversely impact orders and sales of our existing products, or make them less desirable or even obsolete. Compliance with regulations, competitive alternatives, and shifting market preferences may also impact the successful implementation of new products or enhancements.

Our ability to successfully develop and introduce new products and product enhancements, and the revenues and costs associated with these efforts, may be affected by our ability to:

properly identify customer needs;
prove feasibility of new products in a timely manner;
educate physicians about the use of new products and procedures;
comply with internal quality assurance systems and processes timely and efficiently;
limit the timing and cost of obtaining required regulatory approvals or clearances;

If we are unable to recruit, hire and retain skilled andexperienced personnel, our ability to manage and exp and ourb

accurately predict and control costs associated with inventory overruns caused by phase-in of new products and phase-out of old products;

price new products competitively;

manufacture and deliver our products in sufficient volumes on time, and accurately predict and control costs associated with manufacture of the products; and

meet our product development plan and launch timelines.

Even if customers accept new products or product enhancements, the revenues from these products may not be sufficient to offset the significant costs associated with making them available to customers.

If we are unable to develop new products or enhance existingproducts, we may be unable to attract or retain custor

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Failure to successfully develop, obtain regulatory approval or clearance for, manufacture or introduce new products or to complete these processes in a timely and efficient manner could result in delays that could affect our ability to attract and retain customers, or could cause customers to delay or cancel orders, causing our backlog, revenues and operating results to suffer.

We currently compete, and may in the future need to compete, against other medical device and consumer companies with greater resources, more established distribution channels and other competitive advantages, and the success of these competitors may harm our ability to generate revenues.

We currently do, and in the future may need to, compete directly and indirectly with a number of other companies that may have competitive advantages over us. Our diagnostic devices for nerve testing compete with companies that sell traditional nerve conduction study and electromyography equipment including Cadwell Laboratories, Inc. and Natus Medical Incorporated. These companies enjoy significant competitive advantages, including:

greater resources for product development, sales and marketing;
more established distribution networks;
greater name recognition;
more established relationships with health care professionals, customers and third-party payers; and
additional lines of products and the ability to offer rebates or bundle products to offer discounts or incentives.

As we develop the market for wearable technology for chronic pain, we will likely be faced with competition from other companies that decide and are able to enter the market, as well as competition from other forms of treatment for chronic pain. Some or all of our future competitors in the diagnostic nerve testing market and the consumer market for pain relief may enjoy competitive advantages such as those described above. If we are unable to compete effectively against existing and future competitors, our sales will decline and our business will be harmed.

Security breaches and other disruptions could compromise our information and expose us to liability, which could cause our business and reputation to suffer.

In the ordinary course of our business, we collect and store sensitive data in our data centers, on our networks, including intellectual property, our proprietary business information, and that of our customers, suppliers and business partners, and personally identifiable information of our employees. The secure processing, maintenance and transmission of this information is critical to our operations. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, disrupt our operations, damage our reputation, and cause a loss of confidence in our products and services, which could have a material adverse effect on our business, financial condition, results of operations or cash flows.

If future clinical studies or other articles are published, or physician associations or other organizations announce positions that are unfavorable to our products, our sales efforts and revenues may be negatively affected.

Future clinical studies or other articles regarding our existing products or any competing products may be published that either support a claim, or are perceived to support a claim, that a competitor s product is more accurate or effective than our products or that our products are not as accurate or effective as we claim or previous clinical studies have concluded. Additionally, physician associations or other organizations that may be viewed as authoritative or have an economic interest in nerve conduction studies and in related electrodiagnostic procedures or other procedures that may be performed using our products or in neurostimulation therapies using our devices could endorse products or methods that compete with our products or otherwise announce positions that are unfavorable to our products. Any of these events may negatively affect our sales efforts and result in decreased revenues.

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As we expand into foreign markets, we will be affected by new business risks that may adversely impact our financial condition or results of operations.

Foreign markets represented approximately 12% and 19% of our revenues in 2016 and 2015, respectively. We are working to expand market penetration, particularly in Asia. Any such expansion will subject us to the possibility of new business risks, including:

failure to fulfill foreign regulatory requirements, if applicable, to market our products;
availability of, and changes in, reimbursement within prevailing foreign health care payment systems;
adapting to the differing business practices and laws in foreign countries;
difficulties in managing foreign relationships and operations, including any relationships that we establish with foreign distributors or sales or marketing agents;
limited protection for intellectual property rights in some countries;
difficulty in collecting accounts receivable and longer collection periods;
costs of enforcing contractual obligations in foreign jurisdictions;
recessions in economies outside of the United States;
political instability and unexpected changes in diplomatic and trade relationships;
currency exchange rate fluctuations; and
potentially adverse tax consequences.

If we are successful in introducing our products into foreign markets, we will be affected by these additional business risks, which may adversely impact our financial condition or results of operations. In addition, expansion into foreign markets imposes additional burdens on our executive and administrative personnel, research and sales departments, and general managerial resources. Our efforts to introduce our products into foreign markets may not be successful, in which case we may have expended significant resources without realizing the expected benefit.

Our loan and security agreement with a bank, which we refer to as our credit facility, contains financial and operating restrictions that may limit our access to credit. If we fail to comply with covenants in the credit facility, we may be required to repay any indebtedness thereunder, which may have an adverse effect on our liquidity.

Although we have not borrowed any funds under the credit facility, provisions in the credit facility impose restrictions on our ability to, among other things:

incur additional indebtedness;
create liens;
replace certain of our executive officers;
enter into transactions with affiliates;
transfer assets;
pay dividends or make distributions on, or repurchase, our capital stock; and
merge or consolidate.

In addition, we are required to meet certain financial covenants customary with this type of credit facility, including maintaining a minimum specified tangible net worth. The credit facility also contains other customary covenants, which we may not be able to comply with in the future. Our failure to comply with these covenants may result in the declaration of an event of default and could cause us to be unable to borrow under the credit facility. In addition to preventing additional borrowings under the credit facility, an event of default, if not cured or waived, may result in the acceleration of the maturity of indebtedness outstanding

Our loan and security agreement with a bank, which we refer toas our credit facility, contains financial and operating

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under the credit facility at the time of the default, which would require us to pay all amounts outstanding. If an event of default occurs, we may not be able to cure it within any applicable cure period, if at all. If the maturity of our indebtedness is accelerated, we may not have sufficient funds available for repayment or we may not have the ability to borrow or obtain sufficient funds to replace the accelerated indebtedness on terms acceptable to us, or at all. We have not borrowed any funds under this agreement; however, as of December 31, 2016, $896,571 of the amounts available under the agreement are restricted to support letters of credit issued in favor of our landlords and a materials component supplier.

If we sell additional shares, our stock price may decline as a result of the dilution which will occur to existing stockholders.

Until we are profitable, we will need significant additional funds to develop our business and sustain our operations. We sold shares of convertible preferred stock and warrants in January 2017, June 2016 and December 2015, and any additional sales of shares of our common stock or other securities exercisable into our common stock are likely to have a dilutive effect on our then existing stockholders. Resales of newly issued shares in the open market could also have the effect of lowering our stock price, thereby increasing the number of shares we may need to issue in the future to raise the same dollar amount and consequently further diluting our outstanding shares.

The perceived risk associated with the possible sale of a large number of shares could cause some of our stockholders to sell their stock, thus causing the price of our stock to decline. In addition, actual or anticipated downward pressure on our stock price due to actual or anticipated issuances or sales of stock could cause some institutions or individuals to engage in short sales of our common stock, which may itself cause the price of our stock to decline.

If our stock price declines, we may be unable to raise additional capital. A sustained inability to raise capital could force us to go out of business. Significant declines in the price of our common stock could also impair our ability to attract and retain qualified employees, reduce the liquidity of our common stock and result in the delisting of our common stock from The NASDAQ Stock Market LLC, or NASDAQ.

The trading price of our common stock has been volatile and is likely to be volatile in the future.

The trading price of our common stock has been highly volatile. For the five year period ended December 31, 2016, our stock price has fluctuated from a low of $0.60 to a high of $37.92, as adjusted for stock splits. The market price for our common stock will be affected by a number of factors, including:

the denial or delay of regulatory clearances or approvals for our products under development or receipt of regulatory approval of competing products;
our ability to accomplish clinical, regulatory and other product development and commercialization milestones and to do so in accordance with our timing estimates;
changes in policies affecting third-party coverage and reimbursement in the United States and other countries;
changes in government regulations and standards affecting the medical device industry and our products;
ability of our products to achieve market success;
the performance of third-party contract manufacturers and component suppliers;
actual or anticipated variations in our results of operations or those of our competitors;
announcements of new products, technological innovations or product advancements by us or our competitors;
developments with respect to patents and other intellectual property rights;

sales of common stock or other securities by us or our stockholders in the future;
additions or departures of key scientific or management personnel;

The trading price of our common stock has been volatile and islikely to be volatile in the future. 61

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disputes or other developments relating to proprietary rights, including patents, litigation matters and our ability to obtain patent protection for our technologies;

trading volume of our common stock;

changes in earnings estimates or recommendations by securities analysts, failure to obtain or maintain analyst coverage of our common stock or our failure to achieve analyst earnings estimates;

public statements by analysts or clinicians regarding their perceptions of our clinical results or the effectiveness of our products;

decreases in market valuations of medical device companies; and

general market conditions and other factors unrelated to our operating performance or the operating performance of our competitors.

The stock prices of many companies in the medical device industry have experienced wide fluctuations that have often been unrelated to the operating performance of these companies. Periods of volatility in the market price of a company s securities can result in securities class action litigation against a company. If class action litigation is initiated against us, we may incur substantial costs and our management s attention may be diverted from our operations, which could significantly harm our business.

If we fail to continue to meet all applicable NASDAQ Capital Market requirements and The NASDAQ Stock Market determines to delist our common stock, the delisting could adversely affect the market liquidity of our common stock, impair the value of your investment and harm our business.

Our common stock is currently listed on the NASDAQ Capital Market. In order to maintain that listing, we must satisfy minimum financial and other requirements. On February 2, 2017, we received a notice from the Listing Qualifications Department of the NASDAQ Stock Market indicating that, for the last 30 consecutive business days, the bid price for our common stock had closed below the minimum $1.00 per share required for continued inclusion on The NASDAQ Capital Market under NASDAQ Listing Rule 5550(a)(2). The notification letter states that pursuant to NASDAQ Listing Rule 5810(c)(3)(A) the Company will be afforded 180 calendar days, or until August 1, 2017, to regain compliance with the minimum bid price requirement. In order to regain compliance, shares of the Company s common stock must maintain a minimum bid closing price of at least $1.00 per share for a minimum of ten consecutive business days. If we do not regain compliance by August 1, 2017, NASDAQ will provide written notification to us that our common stock will be delisted. At that time, we may appeal NASDAQ s delisting determination to a NASDAQ Listing Qualifications Panel. Alternatively, we may be eligible for an additional 180 day grace period if we satisfy all of the requirements, other than the minimum bid price requirement, for listing on The NASDAQ Capital Market set forth in NASDAQ Listing Rule 5505.

While we intend to engage in efforts to regain compliance, and thus maintain our listing, there can be no assurance that we will be able to regain compliance during the applicable time periods set forth above. If we fail to continue to meet all applicable NASDAQ Capital Market requirements in the future and NASDAQ determines to delist our common stock, the delisting could substantially decrease trading in our common stock and adversely affect the market liquidity of our common stock; adversely affect our ability to obtain financing on acceptable terms, if at all, for the continuation of our operations; and harm our business. Additionally, the market price of our common stock may decline further and stockholders may lose some or all of their investment. The closing bid price of our common stock on the NASDAQ Capital Market was $0.68 on February 3, 2017.

The low trading volume of our common stock may adversely affect the price of our shares.

Although our common stock is listed on The NASDAQ Capital Market, our common stock has experienced low trading volume. The 50 day average trading volume through December 31, 2016 as reported by NASDAQ was approximately 184,000 shares. Limited trading volume may subject our common stock to greater price volatility and may make it difficult for investors to sell shares at a price that is attractive to them.

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Anti-takeover provisions in our organizational documents and Delaware law, and the shareholder rights plan that we previously adopted in 2007, may discourage or prevent a change of control, even if an acquisition would be beneficial to our stockholders, which could affect our stock price adversely and prevent attempts by our stockholders to replace or remove our current management.

Our certificate of incorporation and bylaws contain provisions that could delay or prevent a change of control of our company or changes in our Board of Directors that our stockholders might consider favorable. Some of these provisions:

authorize the issuance of preferred stock which can be created and issued by the Board of Directors without prior stockholder approval, with rights senior to those of our common stock;

provide for a classified Board of Directors, with each director serving a staggered three-year term;

prohibit our stockholders from filling board vacancies, calling special stockholder meetings, or taking action by written consent;

provide for the removal of a director only with cause and by the affirmative vote of the holders of 75% or more of the shares then entitled to vote at an election of our directors; and

require advance written notice of stockholder proposals and director nominations.

We have also adopted a shareholder rights plan that could make it more difficult for a third party to acquire, or could discourage a third party from acquiring, us or a large block of our common stock. A third party that acquires 15% or more of our common stock could suffer substantial dilution of its ownership interest under the terms of the shareholder rights plan through the issuance of common stock to all stockholders other than the acquiring person.

In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law, which may prohibit certain business combinations with stockholders owning 15% or more of our outstanding voting stock. These and other provisions in our certificate of incorporation, bylaws and Delaware law could make it more difficult for stockholders or potential acquirers to obtain control of our Board of Directors or initiate actions that are opposed by our then-current Board of Directors, including a merger, tender offer, or proxy contest involving our company. Any delay or prevention of a change of control transaction or changes in our Board of Directors could cause the market price of our common stock to decline.

We do not intend to pay cash dividends.

We have never declared or paid cash dividends on our capital stock. We currently intend to retain all available funds and any future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. In addition, the terms of our credit facility precludes us from paying any dividends. As a result, capital appreciation, if any, of our common stock will be our stockholders sole source of potential gain for the foreseeable future.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our headquarters and engineering activities are located in an approximately 12,000 square foot leased facility in Waltham, Massachusetts and our manufacturing and fulfillment activities are located in a 6,000 square foot leased facility in Woburn, Massachusetts. We believe these facilities will be adequate for our needs during the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

While we are not currently a party to any material legal proceedings, we could become subject to legal proceedings in the ordinary course of business. We do not expect any such potential items to have a significant impact on our financial position.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is traded on the NASDAQ Capital Market under the symbol NURO . The price range per share reflected in the table below is the high and low sales prices of our common stock as reported by NASDAQ (rounded to the nearest penny) for the periods presented and has been adjusted to reflect a 1-for-4 reverse stock split of our common stock completed on December 1, 2015.

	Years ended December 31,			
	2016		2015	
	High	Low	High	Low
First quarter	$ 2.35	$ 1.35	$ 8.20	$ 6.40
Second quarter	2.36	1.51	6.80	3.37
Third quarter	1.80	1.36	4.96	2.84
Fourth quarter	1.60	0.60	3.72	1.88

Stockholders

On February 1, 2017, there were approximately 56 stockholders of record of our common stock. This number does not include stockholders for whom shares were held in a nominee or street name. On February 1, 2017, the last reported sale price per share of our common stock on the NASDAQ Capital Market was $0.68.

Dividends

We have never declared or paid any cash dividends on our common stock. We currently intend to retain future earnings, if any, to finance the expansion and growth of our business and do not expect to pay any cash dividends in the foreseeable future. Payment of future cash dividends, if any, will be at the discretion of our board of directors after taking into account various factors, including our financial condition, operating results, current and anticipated cash needs, and plans for expansion. Additionally, the credit facility restricts our ability to pay dividends.

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ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data are derived from our audited financial statements, which have been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm. The selected financial data below should be read in conjunction with Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, Item 7A, Quantitative and Qualitative Disclosures About Market Risk and our financial statements and related notes for the years ended 2016, 2015, and 2014 appearing elsewhere in this Annual Report on Form 10-K:

	Years Ended December 31,				
	2016	2015	2014	2013	2012
	(In thousands, except share and per share data)				
Statement of Operations Data:					
Revenues	$12,028	$7,300	$5,513	$5,279	$7,575
Cost of revenues	7,113	3,951	2,569	2,194	3,589
Gross profit	4,915	3,349	2,944	3,085	3,986
Operating expenses:					
Research and development	4,394	3,895	4,076	3,438	3,546
Sales and marketing	10,856	7,233	2,913	2,780	5,727
General and administrative	4,873	5,497	4,725	4,225	4,735
Total operating expenses	20,123	16,625	11,714	10,443	14,008
Loss from operations	(15,208)	(13,276)	(8,770)	(7,358)	(10,022)
Interest and other income	19	5	5	5	14
Warrants offering costs			(51)	(376)	
Changes in fair value of warrant liability	276	4,084	1,050	(290)	
Net loss	$(14,913)	$(9,187)	$(7,766)	$(8,019)	$(10,008)
Net loss per common share applicable to common stockholders, basic and diluted	$(7.28)	$(7.75)	$(6.15)	$(12.28)	$(20.86)

Note: Net loss per common share applicable to common stockholders has been adjusted to reflect our 1-for-4 reverse stock split effected December 2015.

	As of December 31,				
	2016	2015	2014	2013	2012
	(in thousands)				
Balance Sheet Data:					
Cash and cash equivalents	$ 3,949	$ 12,463	$ 9,222	$ 9,196	$ 8,699
Working capital	4,268	11,956	8,392	8,919	8,567
Total assets	8,284	16,100	11,402	10,797	10,877
Total liabilities	3,323	3,537	8,015	3,602	2,077
Total stockholders equity	4,961	12,563	3,387	7,195	8,800

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of our financial condition and results of operations in conjunction with our selected financial data, our financial statements, and the accompanying notes to those financial statements included elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. For a description of factors that may cause our actual results to differ materially from those anticipated in these forward-looking statements, please refer to the section titled Risk Factors , contained in Item 1A of this Annual Report on Form 10-K.

Overview

NeuroMetrix is a commercial stage, innovation driven healthcare company combining bioelectrical and digital medicine to address chronic health conditions including chronic pain, sleep disorders, and diabetes. Our business is fully integrated with in-house capabilities spanning product development, manufacturing, regulatory affairs and compliance, sales and marketing, and customer support. We derive revenues from the sale of medical devices and after-market consumable products and accessories. Our products are sold in the United States and selected overseas markets, and are cleared by the U.S. Food and Drug Administration, or FDA, and regulators in foreign jurisdictions where appropriate. We have two principal product lines:

Wearable neuro-stimulation therapeutic devices
Point-of-care neuropathy diagnostic tests

Our core expertise in biomedical engineering has been refined over nearly two decades of designing, building and marketing medical devices that stimulate nerves and analyze nerve response for diagnostic and therapeutic purposes. We created the market for point-of-care nerve testing and were first to market with sophisticated, wearable technology for management of chronic pain. We also have an experienced management team and Board of Directors.

Chronic pain is a significant public health problem. It is defined by the National Institutes of Health as any pain lasting more than 12 weeks in contrast to acute pain which is a normal bodily response to injury or trauma. Chronic pain conditions include painful diabetic neuropathy, or PDN, arthritis, fibromyalgia, sciatica, musculoskeletal pain, cancer pain and many others. Chronic pain may be triggered by an injury or there may be an ongoing cause such as disease or illness. There may also be no clear cause. Pain signals continue to be transmitted in the nervous system over extended periods of time often leading to other health problems. These can include fatigue, sleep disturbance, decreased appetite, and mood changes which cause difficulty in carrying out important activities and contributing to disability and despair. In general, chronic pain cannot be cured. Treatment of chronic pain is focused on reducing pain and improving function. The goal is effective pain management.

Chronic pain is widespread. It affects over 100 million adults in the United States and more than 1.5 billion people worldwide. The global market for pain management drugs and devices alone was valued at $35 billion in 2012. The estimated incremental impact of chronic pain on health care costs in the United States is over $250 billion per year and lost productivity is estimated to exceed $300 billion per year. Estimated out-of-pocket spending in the United States on chronic pain is $20 billion per year.

The most common approach to chronic pain is pain medication. This includes over-the-counter drugs (such as Advil and Motrin), and prescription drugs including anti-convulsants (such as Lyrica and Neurontin) and anti-depressants (such as Cymbalta and Elavil). Topical creams may also be used (such as Zostrix and Bengay). With severe pain,

narcotic pain medications may be prescribed (such as codeine, fentanyl, morphine, and oxycodone). The approach to treatment is individualized, drug combinations may be employed, and the results are often hit or miss. Side effects and the potential for addiction are real and the risks are substantial.

Reflecting the difficulty in treating chronic pain, we believe that inadequate relief leads 25% to 50% of pain sufferers to turn to the over-the-counter market for supplements or alternatives to prescription pain medications. These include non-prescription medications, topical creams, lotions, electrical stimulators, dietary products, braces, sleeves, pads and other items. In total they account for over $4 billion in annual spending in the United States on pain relief products.

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High frequency nerve stimulation is an established treatment for chronic pain supported by numerous clinical studies demonstrating efficacy. In simplified outline, the mechanism of action involves intensive nerve stimulation to activate the body s central pain inhibition system resulting in widespread analgesia, or pain relief. The nerve stimulation activates brainstem pain centers leading to the release of endogenous opioids that act primarily through the delta opioid receptor to reduce pain signal transmission through the central nervous system. This therapeutic approach is available through deep brain stimulation and through implantable spinal cord stimulation, both of which require surgery and have attendant risks. Non-invasive approaches to neuro-stimulation (transcutaneous electrical nerve stimulation, or TENS) have achieved limited efficacy in practice due to device limitations, ineffective dosing and low patient compliance.

Quell, our OTC wearable device for pain relief, was unveiled at the January 2015 Consumer Electronics Show (CES) and made commercially available in the United States during the second quarter of 2015. Following commercial launch through the end of 2016, approximately 59,500 Quell devices plus electrodes and accessories were shipped to consumers with a total invoiced value of $13.7 million prior to the impact of product returns. Quell utilizes OptiTherapy ™, our proprietary non-invasive neuro-stimulation technology to provide relief from chronic intractable pain, such as nerve pain due to diabetes, fibromyalgia, arthritic pain, and lower back and leg pain. This advanced wearable device is lightweight and can be worn during the day while active, and at night while sleeping. It has been cleared by the FDA for treatment of chronic intractable pain without a doctor s prescription. Users of the device have the option of using their smartphones to control pain therapy and to track sleep and therapy parameters. Quell is distributed in North America via e-commerce, including the Company s website (*www.quellrelief.com*) and Amazon, via direct response television including QVC, via retail merchandisers including Target, CVS and Walgreens, and via health care professionals such as pain management physician practices and podiatry practices. Distribution is supported by television promotion to expand product awareness. We believe there are significant opportunities to market Quell outside of the United States, particularly in Western Europe, Japan and China. In November 2016, we received regulatory approval to market Quell in the European Union and we anticipate initiating marketing during 2017.

DPNCheck, our diagnostic test for peripheral neuropathies, was made commercially available in the fourth quarter of 2011. DPNCheck revenues for 2016, 2015, and 2014 were approximately $2.5 million, $2.3 million, and $1.8 million, respectively. Our U.S. sales efforts focus on Medicare Advantage providers who assume financial responsibility and the associated risks for the health care costs of their patients. We believe that DPNCheck presents an attractive clinical case with early detection of neuropathy allowing for earlier clinical intervention to help mitigate the effects of neuropathy on both patient quality of life and cost of care. Also, the diagnosis and documentation of neuropathy provided by DPNCheck helps clarify the patient health profile which, in turn, may have a direct, positive effect on the Medicare Advantage premium received by the provider. We believe that attractive opportunities exist outside the United States, including Japan where we launched DPNCheck with our distribution partner Omron Healthcare in the third quarter of 2014; in China where we received regulatory approval and launched DPNCheck with our distribution partner Omron Healthcare in the fourth quarter of 2016; and in Mexico where our distributor Scienta Farma received regulatory approval and initiated sales in the fourth quarter of 2015.

Our products consist of a medical device used in conjunction with a consumable electrode or biosensor. Other accessories and consumables are also available to customers. Our goal for these devices is to build an installed base of active customer accounts and distributors that regularly order aftermarket products to meet their needs. We successfully implemented this model when we started our business with the NC-stat system and applied it to subsequent product generations including ADVANCE. Our recent products, Quell, SENSUS and DPNCheck, conform to this model. Other products in our development pipeline are based on the device plus consumables business model.

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Results of Operations

Comparison of Years Ended December 31, 2016 and December 31, 2015

Revenues

The following table summarizes our revenues:

	Years Ended December 31,			
	2016	2015	Change	% Change
	(in thousands)			
Revenues	$ 12,027.5	$ 7,299.8	$ 4,727.7	64.8 %

Revenues include sales from Quell, DPNCheck and our legacy neurodiagnostic products. Quell was made commercially available during the second quarter of 2015 and sales of DPNCheck launched in the fourth quarter of 2011. During 2016 total revenues increased by $4.7 million, or 65%, from 2015.

Quell revenues were $7.4 million and $2.1 million in 2016 and 2015, respectively. This increase of approximately $5.3 million was the largest contributor to overall revenue growth.

During 2016, 45,726 Quell devices and 52,658 electrode reorder packages with a total invoiced value of approximately $10.6 million were shipped to Quell customers. In the comparative period of 2015, we shipped 13,796 Quell devices and 14,906 electrode reorder packages with a total invoiced value of approximately $3.1 million. Quell revenues are recorded at the point of shipment or, where distributors have a contractual right to return unsold merchandise, when Quell is sold through to the ultimate customer. In both cases, revenues are recorded net of a provision for product returns under our right-of-return policy.

In 2016, DPNCheck revenue of approximately $2.5 million reflected sales of 630 DPNCheck devices plus 188,925 biosensors. This compared with approximately $2.3 million in revenue in 2015 reflecting sales of 703 DPNCheck devices and 159,000 biosensors.

ADVANCE neurodiagnostic products contributed approximately $2.0 million in revenue for 2016, as compared to approximately $2.3 million in 2015. SENSUS, our prescription wearable device for chronic pain had revenues of approximately $0.1 million and $0.6 million in 2016 and 2015, respectively.

Cost of Revenues and Gross Margin

The following table summarizes our cost of revenues and gross margin:

	Years Ended December 31,			
	2016	2015	Change	% Change
	(in thousands)			

Cost of revenues	$ 7,113.0	$ 3,950.7	$ 3,162.3	80.0 %
Gross profit	$ 4,914.5	$ 3,349.1	$ 1,565.4	46.7 %

Our cost of revenues increased to $7.1 million in 2016, compared to $4.0 million in 2015, primarily due to the increase in orders and shipment volumes during the comparable periods. Gross margin decreased to 40.9% in 2016 compared to 45.9% in 2015. The contraction in gross margin conforms to the early stages of our plan for building a business with a high level of recurring revenue from an installed product base of medical devices. It reflects two factors: growing Quell sales which are heavily weighted toward lower margin devices rather than higher margin electrodes, and operating costs of our new manufacturing facility. As we build our installed base of Quell users we expect growth in recurring electrode sales at higher margins. Also, we expect continued growth in Quell sales to improve manufacturing cost absorption, contributing to future margin gains.

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Operating Expenses

The following table summarizes our operating expenses:

	Years Ended December 31,			
	2016	2015	Change	% Change
	(in thousands)			
Operating expenses:				
Research and development	$ 4,394.4	$ 3,894.8	$ 499.6	12.8 %
Sales and marketing	10,855.4	7,233.0	3,622.4	50.1 %
General and administrative	4,872.7	5,497.5	(624.8)	(11.4)%
Total operating expenses	$ 20,122.5	$ 16,625.3	$ 3,497.2	21.0 %

Research and Development

Research and development expenses for 2016 and 2015 were $4.4 million and $3.9 million, respectively. The increase of $0.5 million primarily increased spending of $0.4 million in consulting fees to develop the next product generation of Quell and increased spending of $0.2 million related to clinical studies.

Sales and Marketing

Sales and marketing expenses increased to $10.9 million in 2016 from $7.2 million in 2015. The $3.6 million increase in spending was primarily attributable to Quell which was launched in the second quarter of 2015. Spending to build product awareness was responsible for the majority of the increase with approximately $3.7 million attributable to TV advertising, on-line advertising and paid search.

General and Administrative

General and administrative expenses decreased by $0.6 million to $4.9 million in 2016 compared to $5.5 million in the prior year. Personnel costs decreased by $0.4 million during 2016, primarily due to lower incentive compensation and stock based compensation. In addition, scientific advisory board fees decreased by $0.2 million.

Interest Income

Interest income was approximately $19,100 and $5,200 during 2016 and 2015, respectively. Interest income was earned from investments in cash equivalents.

Change in fair value of warrant liability

The change in fair value of warrant liability was $0.3 million in 2016 in comparison with $4.1 million for 2015. The larger 2015 change in valuation reflects the combined effects of a lower base of outstanding warrants, a lower stock price and shorter remaining warrant life. Also, in the May 2015 financing (See Liquidity and Capital Resources) we redeemed $0.9 million in outstanding warrants.

Net loss per common share applicable to common stockholders, basic and diluted

The net loss per common share applicable to common stockholders, basic and diluted, was $7.28 and $7.75 for 2016 and 2015, respectively.

Net loss per common share applicable to common stockholders in 2016 of $7.28 reflected a deemed dividend attributable to preferred stockholders of $19.8 million, or $4.15 per share, related to our June 2016 equity offering; and our 2016 net loss reported in our Statement of Operations of $14.9 million, or $3.12 per share. Per share amounts are calculated using 4,777,037 weighted average shares outstanding as of December 31, 2016.

Net loss per common share applicable to common stockholders in 2015 of $7.75 included a deemed dividend attributable to preferred stockholders of $4.1 million, or $1.52 per share, related to our May 2015 equity offering; a deemed dividend attributable to preferred stockholders of $8.3 million, or $3.06 per share, related to our December 2015 equity offering; and a return of capital to common shareholders and related embedded beneficial conversion of $0.6 million, or $0.22 per share, related to our December 2015 equity offering; and our 2015 net loss reported in our Statement of Operations of $9.2 million, or $3.38 per share. Per share amounts are calculated using 2,719,285 weighted average number of shares outstanding as of December 31, 2015.

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Comparison of Years Ended December 31, 2015 and December 31, 2014

Revenues

The following table summarizes our revenues:

	Years Ended December 31,			
	2015	2014	Change	% Change
	(in thousands)			
Revenues	$ 7,299.8	$ 5,512.8	$ 1,787.0	32.4 %

Revenues include sales from Quell, DPNCheck and our legacy products. Quell was made commercially available during the second quarter of 2015 and sales of DPNCheck launched in the fourth quarter of 2011. During 2015 total revenues increased by $1.8 million, or 32.4%, from 2014.

Quell revenues were approximately $2.1 million and zero in 2015 and 2014, respectively. This increase of approximately $2.1 million was the largest contributor to overall revenue growth.

In 2015 DPNCheck revenue of approximately $2.3 million reflected sales of 703 DPNCheck devices plus 159,000 biosensors. This compared with approximately $1.8 million in revenue in 2014 reflecting sales of 677 DPNCheck devices and 109,525 biosensors.

ADVANCE neurodiagnostic products contributed approximately $2.3 million in revenue for 2015, as compared to approximately $2.8 million in 2014. SENSUS, our prescription wearable device for chronic pain had revenues of approximately $0.6 million and $0.9 million in 2015 and 2014, respectively.

Cost of Revenues and Gross Margin

The following table summarizes our cost of revenues and gross margin:

	Years Ended December 31,			
	2015	2014	Change	% Change
	(in thousands)			
Cost of revenues	$ 3,950.7	$ 2,568.6	$ 1,382.1	53.8 %
Gross profit	$ 3,349.1	$ 2,944.2	$ 404.9	13.8

Our cost of revenues increased to $4.0 million in 2015, compared to $2.6 million in 2014, primarily due to the increase in orders and shipment volumes during the comparable periods. Gross margin decreased to 45.9% in 2015 compared to 53.4% in 2014. The contraction in gross margin conforms to the early stages of our plan for building a business with a high level of recurring revenue from an installed product base of medical devices. It reflects two factors: growing Quell sales which are heavily weighted toward lower margin devices rather than higher margin electrodes, and operating costs of our new manufacturing facility. As we build our installed base of Quell users we expect growth in recurring electrode sales at higher margins. Also, we expect continued growth in Quell sales to

improve manufacturing cost absorption, contributing to future margin gains.

Operating Expenses

The following table summarizes our operating expenses:

	Years Ended December 31,			
	2015	2014	Change	% Change
	(in thousands)			
Operating expenses:				
Research and development	$ 3,894.8	$ 4,076.0	$ (181.2)	(4.4)%
Sales and marketing	7,233.0	2,913.1	4,319.9	148.3
General and administrative	5,497.5	4,725.1	772.4	16.3
Total operating expenses	$ 16,625.3	$ 11,714.2	$ 4,911.1	41.9

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Research and Development

Research and development expenses for 2015 and 2014 were $3.9 million and $4.1 million, respectively. The decrease of $0.2 million primarily reflects decreased spending of $0.5 million in personnel costs, partially offset by increased spending of $0.3 million in consulting fees to develop Quell for launch in June 2015 and in transitioning the engineering focus to Quell enhancements and eventually the next product generation.

Sales and Marketing

Sales and marketing expenses increased to $7.2 million in 2015 from $2.9 million in 2014. The increase of $4.3 million included incremental expenses to build product awareness was responsible for the majority of the increase with approximately $1.9 million attributable to TV advertising, on-line advertising and paid search. An increase in personnel costs of $1.7 million and travel and expense of $0.3 million as compared to the same period last year is attributed to the addition of 14 new employees hired specifically to support the commercialization of Quell, which included a new marketing team, a field sales force, and expansion of the customer care function.

General and Administrative

General and administrative expenses increased by $0.8 million to $5.5 million in 2015 compared to $4.7 million in the prior year. This increase reflected $0.3 million in incremental temporary staffing and consulting services and recruiting fees of $0.1 million related to staff turnover in accounting and information technology as well as costs related to relocating the company s corporate offices and production to new facilities in the first quarter of 2015.

Interest Income

Interest income was approximately $5,200 and $4,600 during 2015 and 2014, respectively. Interest income was earned from investments in cash equivalents.

Change in fair value of warrant liability

The change in fair value of warrant liability of $4.1 million for 2015 reflects the combined effects of a lower base of outstanding warrants for valuation purposes plus a lower stock price and a shorter remaining life of the remaining warrants. In connection with the May 2015 financing (see Liquidity and Capital Resources), we redeemed $0.9 million in outstanding warrants. The change in the fair value of the warrant liability in the year ended December 31, 2014 was $1.1 million.

Net loss per common share applicable to common stockholders, basic and diluted

The net loss per common share applicable to common stockholders, basic and diluted, was $7.75 and $6.15 for 2015 and 2014, respectively.

Net loss per common share applicable to common stockholders in 2015 of $7.75 included a deemed dividend attributable to preferred stockholders of $4.1 million, or $1.52 per share, related to our May 2015 equity offering; a deemed dividend attributable to preferred stockholders of $8.3 million, or $3.06 per share, related to our December 2015 equity offering; and a return of capital to common shareholders and related embedded beneficial conversion of $0.6 million, or $0.22 per share, related to our December 2015 equity offering; and our 2015 net loss reported in our Statement of Operations of $9.2 million, or $3.38 per share. Per share amounts are calculated using 2,719,285 weighted average number of shares outstanding as of December 31, 2015.

Net loss per common share applicable to common stockholders in 2014 of $6.15 included a deemed dividend attributable to preferred stockholders of $3.0 million, or $1.70 per share, related to our 2014 equity offering; and our 2014 net loss reported in our Statement of Operations of $7.8 million, or $4.45 per share. Per share amounts are calculated using 1,743,494 weighted average number of shares outstanding at December 31, 2014.

Liquidity and Capital Resources

Our principal source of liquidity is our cash and cash equivalents. As of December 31, 2016, cash and cash equivalents totaled $3.9 million. Our ability to generate revenue to fund our operations will largely depend on the success of our wearable therapeutic products for chronic pain and our diagnostic products for

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neuropathy. A low level of market interest in Quell or DPNCheck, an accelerated decline in our neurodiagnostics consumables sales, or unanticipated increases in our operating costs would have an adverse effect on our liquidity and cash generated from operations. The following table sets forth information relating to our cash and cash equivalents:

	December 31, 2016	December 31, 2015	Change	% Change
	(in thousands)			
Cash and cash equivalents	$ 3,949.1	$ 12,462.9	$ (8,513.8)	(68.3)%

During 2016 our cash and cash equivalents decreased by $8.5 million reflecting the net proceeds provided by our 2016 equity offering, offset by $15.1 million of net cash used in operations and $0.1 million used in investing activities.

In June 2016, we completed a private equity offering providing for the issuance of (i) 21,300 shares of Series D convertible preferred stock at a price of $1,000 per share, and (ii) warrants to purchase up to 11,800,554 shares of our common stock, at an exercise price of $1.69 per share. The offering resulted in approximately $6.7 million in net proceeds after deducting placement agent fees and expenses and the redemption of 13,800 shares of previously issued Series C convertible preferred stock.

On December 28, 2016, we entered into a $7 million private equity offering providing for the issuance of (i) 7,000 shares of Series E convertible preferred stock at a price of $1,000 per share, and (ii) warrants to purchase 10 million shares of our common stock, at an initial exercise price of $0.92 per share. The equity offering is designed to be funded in two tranches: an initial tranche of $4.0 million, which closed on January 5, 2017 contributing net proceeds of approximately $3.6 million after fees and expenses, and a second tranche, subject to shareholder approval, of $3.0 million and is expected to close late in the first quarter of 2017.

In order to supplement our access to capital, we are party to an amended Loan and Security Agreement, most recently amended on December 29, 2016, with a bank which provides us with a credit facility in the amount of $2.5 million on a revolving basis. The amended credit facility expires on January 15, 2018. Amounts borrowed under the credit facility will bear interest equal to the prime rate plus 0.5%. Any borrowings under the credit facility will be collateralized by our cash, accounts receivable, inventory, and equipment. The credit facility includes traditional lending and reporting covenants. These include certain financial covenants applicable to liquidity that are to be maintained by us. As of December 31, 2016, we were in compliance with these covenants and had not borrowed any funds under the credit facility. However, $896,571 of the amount under the Credit Facility is restricted to support letters of credit issued in favor of our facilities landlords and a materials component supplier. Consequently, the amount available for borrowing under the credit facility as of December 31, 2016 was approximately $1.6 million.

In managing working capital, we focus on two important financial measurements as presented below:

	Years Ended December 31,	
	2016	2015
Days sales outstanding (days)	23	34
Inventory turnover rate (times per year)	6.1	4.5

Customer payment terms generally vary from payment-on-order for Quell e-commerce sales to 30 days from invoice date. Both days sales outstanding and inventory turnover improved during 2016.

The following sets forth information relating to sources and uses of our cash:

	Years Ended December 31,		
	2016	2015	2014
	(in thousands)		
Net cash used in operating activities	$ (15,080.3)	$ (13,099.9)	$ (7,678.5)
Net cash used in investing activities	(100.5)	(594.6)	(227.3)
Net cash provided by financing activities	6,667.0	16,935.3	7,932.0

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Our operating activities used $15.1 million for the year ended December 31, 2016 primarily attributable to our net loss of $14.9 million. This loss included non-cash credits of approximately $0.3 million for revaluing outstanding warrants at fair value. In addition, operating activities included increases in prepaid expenses and other assets of $0.8 million, partially offset by increases in deferred revenue of $0.4 million.

During the year ended December 31, 2016, our investing activities reflected $0.1 million spent for the acquisition of fixed assets, primarily related to production system upgrades.

We held cash and cash equivalents of $3.9 million as of December 31, 2016. On January 5, 2017 we received net proceeds of $3.6 million upon closing the first tranche of the equity offering described above and expect net proceeds of $2.7 million in March 2017 from the second tranche of the equity offering, subject to shareholder approval. We believe that these resources and the cash to be generated from expected product sales will be sufficient to meet our projected operating requirements into the fourth quarter of 2017. We continue to face significant challenges and uncertainties and, as a result, our available capital resources may be consumed more rapidly than currently expected due to (a) decreases in sales of our products; (b) changes we may make to the business that affect ongoing operating expenses; (c) changes we may make in our business strategy; (d) regulatory developments affecting our existing products; (e) changes we may make in our research and development spending plans; and (f) other items affecting our forecasted level of expenditures and use of cash resources. Accordingly, we will need to raise additional funds to support our operating and capital needs in the fourth quarter of 2017 and beyond. These factors raise substantial doubt about our ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. We will attempt to obtain additional funding through public or private financing, collaborative arrangements with strategic partners, or through additional credit lines or other debt financing sources. However, we may not be able to secure such financing in a timely manner or on favorable terms, if at all. We filed a shelf registration statement on Form S-3 with the SEC covering shares of our common stock and other securities for sale, giving us the opportunity to raise funding when needed or otherwise considered appropriate at prices and on terms to be determined at the time of any such offerings. However, pursuant to the instructions to Form S-3, we only have the ability to sell shares under the shelf registration statement, during any 12-month period, in an amount less than or equal to one-third of the aggregate market value of our common stock held by non-affiliates. If we raise additional funds by issuing equity or debt securities, either through the sale of securities pursuant to a registration statement or by other means, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences and privileges senior to those of our existing stockholders. If we raise additional funds through collaboration, licensing or other similar arrangements, it may be necessary to relinquish valuable rights to our potential products or proprietary technologies, or grant licenses on terms that are not favorable to us. Without additional funds, we may be forced to delay, scale back or eliminate some of our sales and marketing efforts, research and development activities, or other operations and potentially delay product development in an effort to provide sufficient funds to continue our operations. If any of these events occurs, our ability to achieve our development and commercialization goals would be adversely affected.

Our common stock is quoted on the NASDAQ Capital Market under the symbol NURO. One of the requirements for continued listing on the NASDAQ Capital Market is maintenance of a minimum closing bid price of $1.00. The closing bid price of our common stock on the NASDAQ Global Market was $0.68 on February 3, 2017.

On February 2, 2017, we received a notice from the Listing Qualifications Department of the NASDAQ Stock Market indicating that, for the last 30 consecutive business days, the bid price for our common stock had closed below the minimum $1.00 per share required for continued inclusion on The NASDAQ Capital Market under NASDAQ Listing Rule 5550(a)(2). The notification letter states that pursuant to NASDAQ Listing Rule 5810(c)(3)(A) the Company will be afforded 180 calendar days, or until August 1, 2017, to regain compliance with the minimum bid price requirement. In order to regain compliance, shares of the Company s common stock must maintain a minimum bid

closing price of at least $1.00 per share for a minimum of ten consecutive business days. If we do not regain compliance by August 1, 2017, NASDAQ will provide written notification to us that our common stock will be delisted. At that time, we may appeal NASDAQ s delisting determination to a NASDAQ Listing Qualifications Panel. Alternatively, we may be eligible for an additional 180 day grace period if we satisfy all of the requirements, other than the minimum

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bid price requirement, for listing on The NASDAQ Capital Market set forth in NASDAQ Listing Rule 5505. The notification letter has no effect at this time on the listing of our common stock on NASDAQ Capital Market.

The Company intends to actively monitor the bid price for its common stock between now and August 1, 2017 while continuing to demonstrate commercial and strategic progress with its Quell wearable technology for chronic pain. The Company believes that this may improve investor confidence and increase the market valuation of its common stock.

At December 31, 2016, we had federal and state net operating loss carryforwards (NOL) of $132.9 million and $43.2 million, respectively, as well as federal and state tax credits of $1.4 million and $1.1 million, respectively, which may be available to reduce future taxable income and the related taxes thereon. The federal NOLs begin to expire in 2019 and the state NOLs begin to expire in 2017. The federal and state research and development credits both begin to expire in 2018. A full valuation allowance has been provided against our NOL carryforwards and research and development credit carryforwards and, if an adjustment is required, this adjustment would be offset by an adjustment to the valuation allowance. Thus, there would be no impact to the balance sheet or statement of operations if an adjustment were required.

Off-Balance Sheet Arrangements, Contractual Obligations, and Contingent Liabilities and Commitments

As of December 31, 2016, we did not have any off-balance sheet financing arrangements.

The following table summarizes our principal contractual obligations as of December 31, 2016 and the effects such obligations are expected to have on our liquidity and cash flows in future periods.

		Payments due in			
Contractual Obligations	Total	Less than 1 year	1 3 years	3 5 years	More than 5 years
Operating lease obligations	$ 2,664,686	$ 530,674	$ 1,089,663	$ 962,787	$ 81,562
Purchase order obligations	1,699,823	1,699,823			
Total contractual obligations	$ 4,364,509	$ 2,230,497	$ 1,089,663	$ 962,787	$ 81,562

Critical Accounting Policies and Estimates

Our financial statements are based on the selection and application of generally accepted accounting principles, which require us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and the accompanying notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ significantly from those estimates, and any such differences may be material to our financial statements. We believe that the policies set forth below may involve a higher degree of judgment and complexity in their application than our other accounting policies and represent the critical accounting policies used in the preparation of our financial statements. If different assumptions or conditions were to prevail, the results could be materially different from our reported results. Our significant accounting policies are presented within Note 2 to our Financial Statements.

Revenue Recognition and Accounts Receivable

We recognize revenue when the following criteria have been met: persuasive evidence of an arrangement exists, delivery has occurred and risk of loss has passed, the seller s price to the buyer is fixed or determinable, and collection

is reasonably assured. Revenues associated with our medical devices and consumables, including single use nerve specific electrodes and other accessories are generally recognized upon shipment, assuming all other revenue criteria have been met.

Revenue recognition involves judgments, including assessments of expected returns and expected customer relationship periods. We analyze various factors, including a review of specific transactions, its historical product returns, average customer relationship periods, customer usage, customer balances, and market and economic conditions. Changes in judgments or estimates on these factors could materially impact the timing and amount of revenues and costs recognized. Should market or economic conditions deteriorate, our actual return or bad debt experience could exceed its estimate. Certain product sales are made with a 30-day or 60-day right of return. Where we can reasonably estimate future returns, we recognize revenues

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upon shipment and record as a reduction of revenue a provision for estimated returns. Where we cannot reasonably estimate future returns, we defer revenues until we gain sufficient experience to estimate returns or until the right of return lapses.

Trade accounts receivable are recorded at the invoiced amount and do not bear interest.

Accounts receivable are recorded net of the allowance for doubtful accounts receivable. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable. We review our allowance for doubtful accounts and determine the allowance based on an analysis of customer past payment history, product usage activity, and recent communications between us and the customer. Individual customer balances which are past due and over 90 days outstanding are reviewed individually for collectability. Account balances are written-off against the allowance when we feel it is probable the receivable will not be recovered. We do not have any off-balance sheet credit exposure related to our customers.

Inventories

Inventories, consisting primarily of finished goods and purchased components, are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. We write down inventory to its net realizable value for excess or obsolete inventory. Finished goods inventories owned by us, but stored in third party warehouses prior to order fulfillment, are disclosed separately as finished goods on consignment. The realizable value of inventories is based upon the types and levels of inventories held, forecasted demand, pricing, competition, and changes in technology. Our consumables have an eighteen to twenty-four month shelf life. Should current market and economic conditions deteriorate, our actual recoveries could be less than our estimates.

Recently Issued or Adopted Accounting Pronouncements

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases (Topic 842)* (ASU 2016-02). ASU 2016-02 requires that lessees will need to recognize virtually all of their leases on the balance sheet, by recording a right-of-use asset and lease liability. The provisions of this guidance are effective for annual periods beginning after December 31, 2018, and for interim periods therein. The Company is in the process of evaluating the new standard and assessing the impact, if any, ASU 2016-02 will have on the Company s financial statements.

In May 2014, the FASB and the International Accounting Standards Board (IASB) jointly issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), a comprehensive new revenue recognition standard that will supersede nearly all existing revenue recognition guidance. The objective of ASU 2014-09 is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers*, which delayed the effective date of the new standard from January 1, 2017 to January 1, 2018. An entity can elect to adopt ASU 2014-09 using one of two methods, either full retrospective adoption to each prior reporting period, or recognizing the cumulative effect of adoption at the date of initial application. In March 2016, the FASB issued ASU No. 2016-08, *Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*, which clarifies the implementation guidance on principal versus agent considerations. The Company is in the process of evaluating the new standard and assessing the impact, if any, ASU 2014-09 will have on the Company s financial statements and which adoption method will be used.

ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk

We do not use derivative financial instruments in our investment portfolio and have no foreign exchange contracts. Our financial instruments consist of cash anid #000000"> **Medical Life**

Insurance, Vacation ($)		**Benefits Death Benefits ($)**	**Disability and of Share-based**	**Continued Vesting**		**Base Salary ($)**	**Bonus ($)**	**Paid**
Name (a)	**(b) ($)**	**(c)**	**(d)**	**Compensation ($)**	**Total ($)**			
Keh-Shew Lu								
686,000	-	13,192	4,666	3,118	1,227,150	**1,934,127**		
Carl C. Wertz								
340,000	-	10,462	6,368	2,744	48,862	**408,435**		
Joseph Liu								
496,000	-	19,077	5,278	2,404	72,344	**595,103**		
Mark A. King								
430,000	-	16,538	9,490	2,995	63,630	**522,654**		
Richard D. White								
-	-	-	-	-	-	-		

(a) For purposes of determining this amount, the executive would receive his current base salary during the LOA and the one-year following the LOA. For the LOA, the base salary will be paid over the year, in accordance with the Company s payroll practices. Payment of the base salary for the one year following the LOA will be paid in a lump sum.

(b) Any bonus amount would be prorated based on days employed in 2009 and calculated using actual 2009 results per the performance criteria in accordance with the Company s executive bonus plan.

(c) Reflects the estimated lump sum value of premiums to be paid on behalf of the executive under the medical benefit plans during the LOA.

(d) Reflects the estimated lump sum value of cost of coverage for life insurance, disability, and death benefits to be paid on behalf of the executive during the LOA. Does not include a $700,000 benefit for each NEO employed in the U.S. paid by the Company s life insurance policy upon death.

Does not include the following short- and long-term disability payments for two years paid by disability insurance policies:

Name	Amount ($)
Keh-Shew Lu	167,500
Carl C. Wertz	117,492
Joseph Liu	156,488
Mark A. King	139,989
Richard D. White	-

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(3) Represents the value of the accelerated vesting of the following shares underlying options, RSAs and RSUs assuming a change in control occurs on December 31, 2008:

Name	Options	RSA/RSU	Total Shares
Keh-Shew Lu	253,313	202,500	455,813
Carl C. Wertz	32,250	8,063	40,313
Joseph Liu	62,375	11,938	74,313
Mark A. King	57,625	10,500	68,125
Richard D.White	33,750	8,863	42,613

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COMPENSATION OF DIRECTORS

The following table sets forth the compensation paid to each director who is not a NEO for service in 2008.

Name (a)	Fees Earned or Paid in Cash ($) (b)	Stock Awards ($) (1)(2) (c)	Option Awards ($) (1)(2) (d)	Non-Equity Incentive Plan Compensation ($) (e)	Changes in Pension Value and Nonqualified Deferred Compensation Earnings ($) (f)	All Other Compensation ($) (g)	Total ($) (h)
Raymond Soong	80,000	446,082	314,017	-	-	-	840,099
C.H Chen	80,000	572,295	51,945	-	-	-	704,241
Michael R. Giordano	100,000	122,934	120,532	-	-	-	343,465
John M. Stich	90,000	116,673	101,500	-	-	-	308,174
Shing Mao	80,000	104,152	82,469	-	-	-	266,621
L.P. Hsu	90,000	49,893	-	-	-	-	139,893

(1) These amounts reflect the value determined by the Company for accounting purposes for these awards and do not reflect whether each director has actually realized benefit from the awards. The value of the equity awards in column (c) and (d) is calculated in accordance with the amount

recognized for financial statement reporting purposes for the fiscal year ended December 31, 2008 in accordance with SFAS 123(R). Pursuant to SEC rules, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. Amounts reported for stock awards include RSUs and are calculated by multiplying the number of shares subject to the award by the closing price of the Company s Common Stock on the grant date and then dividing by the vesting period. Amounts reported for stock options are determined using the Black-Scholes option-pricing model. This model was developed to

estimate the fair value of traded options, which have different characteristics than employee stock options, and changes to the subjective assumptions used in the model can result in materially different fair value estimates. See Note 17 to the Company s audited financial statements for the fiscal year ended December 31, 2008, included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 26, 2009, for a further discussion of the relevant valuation assumptions used in calculating grant date fair value pursuant to SFAS 123(R).

(Footnotes continued on following page.)

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(Footnotes continued from previous page.)

(2) Under the Company s 2008 director compensation plan, each non-employee director listed in the table above was granted an award of 4,300 RSUs on May 29, 2008, except Mr. Raymond Soong, Chairman of the Board, and Mr. C.H. Chen, Vice Chairman of the Board, who were granted an award of 21,500 and 14,700, respectively, on May 29, 2008. Each of these awards to the Company s non-employee directors, except Mr. Soong and Mr. Chen, had a grant date fair value of $120,185. Awards to Mr. Soong and Mr. Chen had grant date fair values of $600,925 and $410,865, respectively. The following table details the amounts in column (c) and (d) of the previous table and represents the SFAS 123(R) expense in 2008 for each of the equity awards:

Name	2008 RSUs ($)	2007 RSUs ($)	2006 RSUs ($)	2005 RSAs ($)	Total Stock Awards ($) (c)	2008 Stock Options ($)	2007 Stock Options ($)	2006 Stock Options ($)	2005 Stock Options ($)	Total Option Awards ($) (d)
Raymond Soong	87,635	166,455	191,993	-	**446,082**	-	-	-	314,017	**314,017**
C.H Chen	59,918	110,970	141,908	259,500	**572,295**	-	-	-	51,945	**51,945**
Michael R. Giordano	17,527	32,366	73,041	-	**122,934**	-	-	-	120,532	**120,532**
John M. Stich	17,527	32,366	66,780	-	**116,673**	-	-	-	101,500	**101,500**
Shing Mao	17,527	32,366	54,259	-	**104,152**	-	-	-	82,469	**82,469**
L.P. Hsu	17,527	32,366	-	-	**49,893**	-	-	-	-	-

The table below shows the aggregate number of shares underlying outstanding restricted stock units/awards held by non-employee directors as of December 31, 2008:

Name	Restricted Stock Units/Awards (in shares)
Raymond Soong	59,000
C.H Chen	85,950
Michael R. Giordano	14,801
John M. Stich	14,238
Shing Mao	13,113
L.P. Hsu	8,238

The table below shows the aggregate number of shares underlying outstanding stock options held by non-employee directors as of December 31, 2008:

Name	Options (in shares)
Raymond Soong	761,063
C.H Chen	320,625
Michael R. Giordano	133,875
John M. Stich	113,625
Shing Mao	223,875
L.P. Hsu	-

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Beginning June 2007, each non-employee director of the Company receives a quarterly retainer of $20,000, the Chairman of the Audit Committee receives an additional $5,000 quarterly retainer and all other members of the Audit Committee receive an additional $2,500 quarterly retainer.

In addition, the following annual awards, which vest in four equal annual installments commencing on the first anniversary of the date of grant, of shares of Common Stock are granted to each non-employee director:

Chairman of the Board: 21,500 shares

Vice Chairman: 14,700 shares

All other directors: 4,300 shares.

The Board may modify such compensation in the future.

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COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

During fiscal 2008, the Compensation Committee consisted of three directors, Raymond Soong (Chairman), L.P. Hsu, and Shing Mao. During 2008, no executive officer of the Company served on the compensation committee (or equivalent) of the Board of another entity whose executive officer(s) served on the Company s Compensation Committee or Board.

Report of the Audit Committee of the Board to Stockholders

The Report of the Audit Committee of the Board shall not be deemed incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under the Securities Act of 1933 or under the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates this information by reference, and shall not otherwise be deemed filed under such Acts.

AUDIT COMMITTEE REPORT

The Board maintains an Audit Committee comprised of three of the Company s directors, Michael R. Giordano (Chairman), John M. Stich and L.P. Hsu. Each member of the Audit Committee meets the independence and experience requirements of the Nasdaq Stock Market and the independence requirements of the SEC. Mr. Giordano qualifies as an audit committee financial expert as defined under the rules of the SEC. The Audit Committee assists the Board in monitoring the accounting, auditing and financial reporting practices of the Company.

Management is responsible for the preparation of the Company s financial statements and financial reporting process, including its system of internal controls. In fulfilling its oversight responsibilities, the Audit Committee:

Reviewed and discussed with management the audited financial statements contained in the Company s Annual Report on Form 10-K for fiscal 2008; and

Obtained from management their representation that the Company s financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

The independent registered public accounting firm is responsible for performing an audit of the Company s financial statements in accordance with the auditing standards generally accepted in the United States and expressing an opinion on whether the Company s financial statements present fairly, in all material respects, the Company s financial position and results of operations for the periods presented and conform with accounting principles generally accepted in the United States. In fulfilling its oversight responsibilities, the Audit Committee:

Discussed with the independent registered public accounting firm the matters required to be discussed by Statement on Auditing Standards No. 61, as amended (Communication with Audit Committees); and

Received and discussed with the independent registered public accounting firm the written disclosures and the letter from the independent registered public accounting firm required by the Public Company Accounting Oversight Board as currently in effect (Independence Discussions with Audit Committees), and reviewed and discussed with the independent registered public accounting firm whether the rendering of the non-audit services provided by them to the Company during fiscal 2008 was compatible with their independence.

The Audit Committee operates under a written charter, which was adopted by the Board and is assessed annually for adequacy by the Audit Committee. In 2008, the charter was revised. The revised charter is attached to this Proxy Statement as Appendix A. The Audit Committee held six meetings during fiscal 2008, and took action by written consent on four occasions.

In performing its functions, the Audit Committee acts only in an oversight capacity. It is not the responsibility of the Audit Committee to determine that the Company s financial statements are complete and accurate, are presented in accordance with accounting principles generally accepted in the United States or present fairly the results of operations of the Company for the periods presented or that the Company maintains appropriate internal controls. Nor is it the duty of the Audit Committee to determine that the audit of the Company s financial statements has been carried out in accordance with generally accepted auditing standards or that the Company s auditors are independent.

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Based upon the reviews and discussions described above, and the report of the independent registered public accounting firm, the Audit Committee has recommended to the Board, and the Board has approved, that the audited financial statements be included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2008 for filing with the Securities and Exchange Commission. The Audit Committee also has recommended, and the Board also has approved, the selection of Moss Adams LLP as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2009.

Dated: April 1, 2009 THE AUDIT COMMITTEE

Michael R. Giordano, Chairman
L.P. Hsu
John M. Stich

Code of Ethics

The Company has adopted a Code of Ethics applicable to the principal executive officer, principal financial officer, principal accounting officer, or persons performing similar functions of the Company. The Code of Ethics is available on the Company s Investor Relations website at investor.diodes.com under the Corporate Governance section of the web site. The direct link to the Code of Ethics is media.corporateir.net/media_files/irol/62/62202/Codeofethics1a.pdf. We intend to disclose future amendments to, or waivers from, certain provisions of the Code of Ethics applicable to senior financial executives on our website within four business days following the date of such amendment or waiver.

Certain Relationships and Related Transactions

Policy Regarding Related Person Transactions

The Audit Committee has adopted a written policy (the Policy) to review any transaction (a related person transaction) in which the Company was, or is to be, a participant and in which any director, executive officer, nominee for director or beneficial owner of more than 5% of the outstanding shares of Common Stock of the Company, or any immediate family member of any such person, has a direct or indirect material interest. The Policy requires the following:

the Audit Committee shall review any proposed agreement or arrangement relating to a related person transaction or series of related person transactions, and any proposed amendment to any such agreement or arrangement;

the Audit Committee shall establish standards for determining whether the transactions covered by such proposed agreement or arrangement are on terms no less favorable to the Company than could be obtained from an unrelated third party (fair to the Company);

before the Company enters into any such proposed agreement or arrangement, and at least annually thereafter, the Company s internal audit department shall report to the Audit Committee whether the transactions covered by such agreement or arrangement are fair to the Company under the standards established by the Audit Committee;

the Audit Committee shall make all reasonable efforts (taking into account the cost thereof to the Company) to cancel or to renegotiate any such agreement or arrangement which is not so determined to be fair to the Company; and

the Company will disclose any related person transactions required to be disclosed by the rules promulgated by the SEC, in the manner so required.

Relationships and Transactions

The Audit Committee of our Board reviews all related party transactions for potential conflict of interest situations on an ongoing basis, in accordance with such procedures as the Audit Committee may adopt from time to time. We believe that all related party transactions are on terms no less favorable to us than could be obtained from unaffiliated third parties.

We conduct business with one related party company: LSC. LSC is our largest stockholder and is a member of the Lite-On Group of companies. C.H. Chen, our former President and Chief Executive Officer and current Vice Chairman of our Board, is also Vice Chairman of LSC. Mr. Chen is the Vice Chairman of Dynacard Corporation, a board member of Lite-On Technology Corporation, the Chairman of Co-Tech Copper Foil Corporation, and a board member of Actron Technology

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Corporation, each of which is a member or an affiliate of the Lite-On Group. M.K. Lu, a member of our Board until May 2007, was President of LSC. In addition, Raymond Soong, the Chairman of our Board, is the Chairman of the Board of LSC, Liteon-IT Corp., and Lite-On Technology Corporation, a significant shareholder of LSC, and also serves on the Board of Actron Technology Corporation and Co-Tech Copper Foil Corporation, both of which are affiliates of the Lite-On Group.

We also conduct business with one significant company, Keylink International (B.V.I) Inc., and its subsidiaries and affiliates (Keylink). Keylink is our 5% joint venture partner in our Shanghai manufacturing facilities.

In connection with our 2005 follow-on public offering, LSC sold 1.7 million shares (split adjusted), reducing its holdings of our Common Stock to approximately 8.7 million shares. We did not receive any of the proceeds from LSC s sale of our Common Stock, but LSC shared in the offering expenses. During 2008, LSC further sold 0.3 million shares, reducing its holdings of our Common Stock to 8.4 million shares (approximately 20.2% of our outstanding Common Stock as of December 31, 2008).

We sold products to LSC totaling 6.5%, 6.2% and 3.5% of total sales for the years ended December 31, 2006, 2007 and 2008, respectively, making LSC our largest customer. Also for the years ended December 31, 2006, 2007 and 2008, 13.0%, 11.3% and 9.6%, respectively, of our net sales were from discrete semiconductor products purchased from LSC for subsequent sale by us, making LSC our largest outside supplier. We also rent warehouse space in Hong Kong from a member of the Lite-On Group, which also provides us with warehousing services at that location. For 2006, 2007 and 2008, we reimbursed this entity in aggregate amounts of $0.5 million, $0.5 million and $0.7 million, respectively, for these services. We believe such transactions are on terms no less favorable to us than could be obtained from unaffiliated third parties. See Part I, Item 1A of the Company s Annual Report on Form 10-K Risk Factor *We receive a significant portion of our net sales from a single customer. In addition, this customer is also our largest external supplier and is a related party. The loss of this customer or supplier could harm our business and results of operations.*

We sell products to, and purchase inventory from, companies owned by Keylink. We sold products to companies owned by Keylink totaling 0.4%, 0.6% and 0.8% of total sales for the years ended December 31, 2006, 2007 and 2008, respectively. Also for the years ended December 31, 2006, 2007 and 2008, 2.3%, 1.5% and 1.3%, respectively, of our net sales were from discrete semiconductor products purchased from companies owned by Keylink. In addition, we lease our Shanghai manufacturing facilities from, and subcontract a portion of their manufacturing process (metal plating and environmental services) to, Keylink, and also pay a consulting fee to a Keylink affiliated company. The aggregate amounts for these services for the years ended December 31, 2006, 2007 and 2008 were $7.9 million, $9.4 million and $10.5 million, respectively. We believe such transactions are on terms no less favorable to us than could be obtained from unaffiliated third parties.

We acquired our wafer foundry, FabTech, Inc., from LSC in December 2000 for approximately $6.0 million cash plus $19.0 million in assumed debt (the debt was due primarily to LSC). In addition, in 2006, we acquired 99.81% of Anachip Corp., a Taiwanese fabless analog IC company located in the Hsinchu Science Park in Taiwan. The selling shareholders included LSC (which owned approximately 60% of Anachip s outstanding capital stock), and two Taiwanese venture capital firms (together owning approximately 20% of Anachip s stock), as well as current and former Anachip Corp. employees, among others.

When we acquired Anachip Corp., we entered into a wafer purchase agreement between Anachip Corp. and LSC, pursuant to which LSC would sell to Anachip Corp., according to Anachip Corp. s requirements, during the three year period ending on December 31, 2008. Anachip Corp. purchased the wafers on terms (including purchase price, delivery schedule, and payment terms) no less favorable to Anachip Corp. than those terms on which Anachip Corp. purchased such wafers from LSC at the time of the acquisition; provided, however, that the purchase price was the lower of the current price or the most favorable customer pricing. If the price of raw wafers increased by more than 20% within any six-month period, Anachip Corp. and LSC would renegotiate in good faith the price of wafers to reflect the cost increase. Although this contract was not renewed, Anachip Corp. continues to purchase wafers from LSC.

Dr. Shing Mao, a director of the Company, retired in 2000 as Chairman of the Board of Lite-On USA, Inc., a wholly-owned subsidiary of Taiwan Lite-On, a Lite-On Group company, which merged with Lite-On Technology

Corporation in 2002. Dr. Mao was also a director of LSC from 1989 to 2000.

Lu-Pao Hsu, elected to our Board in May 2007, was an independent director for Lite-On Technology Corporation from 2004 to 2006, and now serves as a consultant to Lite-On Technology Corporation.

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Michael Giordano, a director of the Company, is a Senior Vice President-Investments with UBS Financial Services, Inc. From time to time, Mr. Giordano and his son, James Giordano, provide brokerage services to directors, executive officers and employees of the Company at customary rates and terms. In 2008, Michael Giordano and James Giordano together received less than $15,000 in commissions as a result of these services.

Notwithstanding such relationships and transactions, the Board has determined that each of Messrs. Soong, Stich, Mao, Hsu and Giordano is independent under the rules of the Nasdaq Stock Market and the SEC.

COMPLIANCE WITH SECTION 16(a) OF THE SECURITIES EXCHANGE ACT OF 1934

Under Section 16(a) of the Exchange Act, the Company s directors, executive officers and any persons holding ten percent or more of the Common Stock are required to report their ownership of Common Stock and any changes in that ownership to the SEC and to furnish the Company with copies of such reports.

Specific due dates for these reports have been established and the Company is required to report any failure to file on a timely basis. Based solely upon review of copies of reports filed with the SEC during the most recent fiscal year ended December 31, 2008 and during the prior fiscal year ended December 31, 2007, a number of reports and transactions failed to file on a timely basis. Based solely upon a review of the Forms 3, 4 and 5 filed by the Company s directors and executive officers, the Company identified the following reporting persons and the number of untimely reported transactions (stated in parentheses): Mr. Edmund Tang (1) during fiscal 2007; and Mr. C.H. Chen (2), Mr. Edmund Tang (3), Ms. Julie Holland (2), Mr. T.J. Lee (2) and Mr. Colin Greene (1) during fiscal 2008.

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PROPOSAL TWO
AMENDMENT OF 2001 OMNIBUS EQUITY INCENTIVE PLAN

General

At the Meeting the stockholders will be asked to approve an amendment to the Company s 2001 Incentive Plan. The proposed amendment was approved by the Board on April 1, 2009, subject to the stockholders approval.

Under the 2001 Incentive Plan, employees, non-employee directors and consultants of the Company and its subsidiaries are eligible to receive shares of Common Stock of the Company or other securities or benefits with a value derived from the value of the Common Stock of the Company. The purpose of the 2001 Incentive Plan is to enable the Company to attract, retain and motivate employees, non-employee directors and consultants by providing for or increasing their proprietary interests in the Company and, thereby, further align their interests with those of the Company s stockholders.

Purpose and Effect of the Amendment

The stockholders will be asked at the Meeting to consider and vote upon a proposal to amend the 2001 Incentive Plan to:

Increase the number of shares of Common Stock that may be issued pursuant to awards granted thereunder by 5,000,000 shares.

Extend the term of the 2001 Incentive Plan until May 28, 2019.

Provide that the gross number of shares of Common Stock subject to awards shall be used for purposes of (i) computing the total number of shares of Common Stock available for awards under the 2001 Incentive Plan, (ii) computing the total number of shares of Common Stock to be made available for awards under the 2001 Incentive Plan after any such awards are forfeited, terminated, expire unexercised, settled or paid in cash in lieu of stock or exchanged for other awards, (iii) computing the number of shares used to settle a stock appreciation right upon exercise, and (iv) computing the number of shares issued in a cashless exercise of a stock option.

Provide that a Change in Control shall have occurred in the event the Company ceases to be an independent publicly owned corporation or a sale or other disposition is completed for all or substantially all the assets of the Company. Currently, a Change in Control shall have occurred if the stockholders of the Company approved an agreement providing such a transaction.

Provide that a stock appreciation right shall accrue in value from the date of grant over a maximum of a ten year time period.

Provide that the maximum amount payable for any calendar year pursuant to a performance unit grant under the 2001 Incentive Plan shall be $5,000,000. Currently, such limit is $4,000,000.

The foregoing summary of the proposed amendment to the 2001 Incentive Plan is qualified in its entirety by a copy of the amended plan attached to this Proxy Statement as Appendix B.

THE BOARD RECOMMENDS A VOTE FOR THE PROPOSED AMENDMENT OF THE 2001 OMNIBUS EQUITY INCENTIVE PLAN

Option Grants and Exercises

As of the Record Date, 2,052,303 shares have been issued pursuant to awards granted under the 2001 Incentive Plan, 3,844,275 shares were subject to awards outstanding under the 2001 Incentive Plan, and 6,792,753 shares were available for issuance under awards that may be granted under the 2001 Incentive Plan. For information concerning the grant of awards during fiscal 2008 to the Named Executive Officers, the exercise of stock options, RSUs or RSAs during fiscal 2008 by the Name Executive Officers, and unexercised stock options, RSUs and RSAs held by the Named Executive Officers as of

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December 31, 2008, see EXECUTIVE COMPENSATION Grants of Plan-Based Awards, EXECUTIVE COMPENSATION Option Exercises and Stock Vested and EXECUTIVE COMPENSATION Outstanding Equity Awards at Fiscal Year-End.

Vote Required

The affirmative vote of a majority of the outstanding shares of Common Stock present, in person or by proxy, and entitled to vote on the amendment at the Meeting is required to approve the amendment. Abstentions will be included in the number of votes cast on the amendment and, accordingly, will have the effect of a vote AGAINST the amendment. However, broker non-votes will not be included in the number of shares counted as being present for the purposes of voting on the amendment and, accordingly, will have the effect of reducing the number of affirmative votes required to approve the amendment).

Summary of the 2001 Incentive Plan

The following summary of the 2001 Incentive Plan does not purport to be a complete description of the Plan and is qualified in its entirety by reference to its full text, a copy of which is attached to this Proxy Statement as Appendix B.

General. The purpose of the 2001 Incentive Plan is to encourage ownership in the Company by key personnel whose long-term employment is considered essential to the Company s continued progress and, thereby, align participants and stockholders interests. Stock options and stock awards, including stock units and cash awards, may be granted under the 2001 Incentive Plan. Options granted under the 2001 Incentive Plan may be either incentive stock options, as defined in Section 422 of the IRCode, or non-qualified stock options.

Administration. The 2001 Incentive Plan is administered by the Compensation Committee. Subject to the provisions of the 2001 Incentive Plan, the Compensation Committee has a wide degree of flexibility in determining the terms and conditions of awards and the number of shares to be issued pursuant thereto, including conditioning the receipt or vesting of awards upon the achievement by the Company of specified performance criteria. The expenses of administering the 2001 Incentive Plan are borne by the Company.

Shares Subject to the Plan. As of the Record Date, 2,052,303 have been issued pursuant to awards granted under the 2001 Incentive Plan, 3,844,275 shares were subject to awards outstanding under the 2001 Incentive Plan, and 6,792,753 shares were available for issuance under awards that may be granted in the future. Each share of Common Stock subject to issuance under any award, other than options or stock appreciation rights, shall be counted against the maximum number of shares of Common Stock that may be issued under the 2001 Incentive Plan as 1.52 shares. To the extent a stock appreciation right is settled for shares of Common Stock, the number of shares used for determining the benefit under such stock appreciation right shall be counted against the maximum number of shares of Common Stock that may be issued under the 2001 Incentive Plan, regardless of the number of shares used to settle the stock appreciation right upon such exercise. To the extent a stock option is exercised on a cashless (or net) basis, the number of shares of Common Stock issued upon exercise, plus the number of shares retained by the Company, shall be counted against the maximum number of shares of Common Stock that may be issued under the 2001 Incentive Plan.

Terms of Awards. The 2001 Incentive Plan authorizes the Compensation Committee to enter into any type of arrangement with an eligible recipient that, by its terms, involves or might involve the issuance of Common Stock or any other security or benefit with a value derived from the value of Common Stock. Awards are not restricted to any specified form or structure and may include, without limitation, sales or bonuses of stock, restricted stock, stock options, reload options, stock appreciation rights, phantom stock, dividend equivalents, performance units or performance shares. An award may consist of one such security or benefit or two or more of them in tandem or in the alternative.

Stock options and stock appreciation rights may not be repriced without the approval of the stockholders. In addition, the exercise price per share of Common Stock purchasable under a stock option may not be less than 100% of the fair market value of the Common Stock on the date of grant of such stock option.

An award granted under the 2001 Incentive Plan may include a provision accelerating the receipt of benefits upon the occurrence of specified events, such as a change of control of the Company or a dissolution, liquidation, merger, reclassification, sale of substantially all of the property and assets of the Company or other significant

corporate transactions. The Compensation Committee may grant options that either are intended to be incentive stock options as defined under Section 422 of the IRCode, or are not intended to be incentive options (non-qualified stock options). Incentive stock options may be granted only to employees.

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No incentive stock option may be granted under the 2001 Incentive Plan to any person who, at the time of the grant, owns (or is deemed to own) stock possessing more than ten percent (10%) of the total combined voting power of the Company or any affiliate of the Company, unless the option exercise price is at least one hundred and ten percent (110%) of the fair market value of the stock subject to the option on the date of the grant and the term of the option does not exceed five years from the date of the grant. In addition, the aggregate fair market value, determined at the time of the grant, of the shares of Common Stock with respect to which incentive stock options are exercisable for the first time by an optionee during any calendar year (under all such plans of the Company and its subsidiaries) may not exceed $100,000. As a result of the enactment of Section 162(m) of the IRCode, and to provide the Compensation Committee flexibility in structuring awards, the 2001 Incentive Plan states that in the case of stock options and stock appreciation rights, no person may receive in any year a stock option to purchase more than 100,000 shares or a stock appreciation right measured by more than 100,000 shares.

If awards granted under the 2001 Incentive Plan expire, are canceled or otherwise terminate without being exercised, the Common Stock not purchased pursuant to the award again becomes available for issuance under the 2001 Incentive Plan. Awards may not be granted under the 2001 Incentive Plan on or after the tenth anniversary of the adoption of the 2001 Incentive Plan.

Eligibility. All employees and consultants of the Company and all non-employee directors of the Company will be eligible to participate in the 2001 Incentive Plan. As of December 31, 2008, there were approximately 3,067 employees of the Company, including eleven current executive officers and six non-employee directors of the Company who would be eligible to participate in the 2001 Incentive Plan.

Payment of Exercise Price. An award may permit the recipient to pay all or part of the purchase price of the shares or other property issuable pursuant thereto, or to pay all or part of such recipient s tax withholding obligation with respect to such issuance, by (i) delivering previously owned shares of capital stock of the Company or other property or (ii) reducing the amount of shares or other property otherwise issuable pursuant to the award (i.e., a net exercise), the terms and conditions of which will be determined by the Compensation Committee. The exercise price and any withholding taxes are payable in cash by consultants and non-employee directors, although the Compensation Committee at its discretion may permit such payment by delivery of shares of Common Stock, or by delivery of broker instructions authorizing a loan secured by the shares acquired upon exercise or payment of proceeds from the sale of such shares.

Amendment. Subject to limitations imposed by law, the Board may amend or terminate the 2001 Incentive Plan at any time and in any manner. However, no such amendment or termination may deprive the recipient of any award previously granted under the 2001 Incentive Plan or any rights thereunder without the recipient s consent.

Section 16(b). Pursuant to Section 16(b) of the Exchange Act, directors, certain officers and 10% stockholders of the Company are generally liable to the Company for repayment of any short-swing profits realized from any non-exempt purchase and sale of Common Stock occurring within a six-month period. Rule 16b-3, promulgated under the Exchange Act, provides an exemption from Section 16(b) liability for certain transactions by an officer or director pursuant to an employee benefit plan that complies with such rule. Specifically, the grant of an option under an employee benefit plan that complies with Rule 16b-3 will not be deemed a purchase of a security for purposes of Section 16(b). The 2001 Incentive Plan is designed to comply with Rule 16b-3.

Term. Awards may not be granted under the 2001 Incentive Plan on or after the tenth anniversary of the adoption of the 2001 Incentive Plan. Although any award that was duly granted on or prior to such date may thereafter be exercised or settled in accordance with its terms, no shares of Common Stock may be issued pursuant to any award on or after the twentieth anniversary of the adoption of the 2001 Incentive Plan.

Performance Goals. The business criteria on which performance goals are based under the 2001 Incentive Plan will be determined on a case-by-case basis, except that with respect to stock options and stock appreciation rights compensation is based on increases in the value of the Common Stock after the date of grant of award. Similarly, the maximum amount of compensation that could be paid to any participant or the formula used to calculate the amount of compensation to be paid to the participant if a performance goal is obtained will be determined on a case-by-case basis, except that in the case of stock options the maximum possible compensation will be calculated as the difference between the exercise price of the option and the fair market value of the Common Stock on the date of option

exercise, times the maximum number of shares for which grants may be made to any participant. The Compensation Committee may use any one or more of the following performance criteria: (i) cash flow, (ii) earnings (including gross margin, earnings before interest and taxes, earnings before taxes, and net earnings), (iii) earnings per share, (iv) growth in earnings or earnings per share, (v) stock price, (vi) return on equity or average stockholders equity, (vii) total stockholder return, (viii) return on capital, (ix) return on assets or net assets, (x) return on investment, (xi) revenue, (xii) income or net income, (xiii) operating

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income or net operating income, (xiv) operating profit or net operating profit, (xv) operating margin, (xvi) return on operating revenue, (xvii) market share, (xviii) contract awards or backlog, (xix) overhead or other expense reduction, (xx) growth in stockholder value relative to the moving average of the S&P 500 Index or a peer group index, (xxi) credit rating, (xxii) strategic plan development and implementation, (xxiii) improvement in workforce diversity or productivity, (xxiv) EBITDA, and (xxv) any other similar criteria.

Adjustments. If there is any change in the stock subject to the 2001 Incentive Plan or subject to any award made under the 2001 Incentive Plan (through merger, consolidation, reorganization, re-capitalization, stock dividend, dividend in kind, stock split, liquidating dividend, combination or exchange of shares, change in corporate structure or otherwise), the 2001 Incentive Plan and shares outstanding thereunder will be appropriately adjusted as to the class and the maximum number of shares subject to the 2001 Incentive Plan and the class, number of shares and price per share of stock subject to such outstanding options as determined by the Compensation Committee to be fair and equitable to the holders, the Company and the stockholders. In addition, the Compensation Committee may also make adjustments in the number of shares covered by, and the price or other value of any outstanding awards under the 2001 Incentive Plan in the event of a spin off or other distribution (other than normal cash dividends) of Company assets to stockholders.

Section 162(m) Limitations. Section 162(m) of the IRCode generally disallows a tax deduction to public companies for compensation in excess of $1 million paid to the Company s Chief Executive Officer or any of the four other most highly compensated officers. Certain performance-based compensation is specifically exempt from the deduction limit if it otherwise meets the requirements of Section 162(m). One of the requirements for equity compensation plans is that there must be a limit to the number of shares granted to any one individual under the plan. Accordingly, the 2001 Incentive Plan provides that no employee may be granted more than 100,000 shares in any calendar year.

Federal Income Tax Consequences

Incentive Stock Options. An optionee who is granted an incentive stock option does not recognize taxable income at the time the option is granted or upon its exercise, although the exercise is an adjustment item for alternative minimum tax purposes and may subject the optionee to the alternative minimum tax. Upon a disposition of the shares more than two years after grant of the option and one year after exercise of the option, the optionee will recognize long-term capital gain or loss equal to the difference between the sale price and the exercise price. If the holding periods are not satisfied, then: (1) if the sale price exceeds the exercise price, the optionee will recognize capital gain equal to the excess, if any, of the sale price over the fair market value of the shares on the date of exercise and will recognize ordinary income equal to the difference, if any, between the lesser of the sale price or the fair market value of the shares on the exercise date and the exercise price; or (2) if the sale price is less than the exercise price, the optionee will recognize a capital loss equal to the difference between the exercise price and the sale price. Unless limited by Section 162(m) of the IRCode, the Company is entitled to a deduction in the same amount as and at the time the optionee recognizes ordinary income.

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

Stock Awards. Stock awards will generally be taxed in the same manner as non-qualified stock options. However, a restricted stock award is subject to a substantial risk of forfeiture within the meaning of Section 83 of the IRCode to the extent the award will be forfeited in the event that the employee ceases to provide services to the Company. As a result of this substantial risk of forfeiture, the employee will not recognize ordinary income at the time of award. Instead, the employee will recognize ordinary income on the dates when the stock is no longer subject to a substantial risk of forfeiture, or when the stock becomes transferable, if earlier. The employee s ordinary income is

measured as the difference between the amount paid for the stock, if any, and the fair market value of the stock on the date the stock is no longer subject to forfeiture.

The employee may accelerate his or her recognition of ordinary income, if any, and begin his or her capital gains holding period by timely filing (i.e., within thirty days of the award) an election pursuant to Section 83(b) of the IRCode. In such event, the ordinary income recognized, if any, is measured as the difference between the amount paid for the stock, if any, and the fair market value of the stock on the date of award, and the capital gain holding period commences on such

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date. The ordinary income recognized by an employee will be subject to tax withholding by the Company. Unless limited by Section 162(m) of the IRCode, the Company is entitled to a deduction in the same amount as and at the time the employee recognizes ordinary income.

Stock Appreciation Rights. An awardee does not recognize any taxable income at the time a stock appreciation right is granted. Upon exercise, the awardee recognizes taxable income generally measured by the excess of the then fair market value of the shares over the exercise price.

The foregoing is only a summary of the effect of U.S. federal income taxation upon recipients and the Company with respect to the grant and exercise of awards under the 2001 Incentive Plan. It does not purport to be complete and does not discuss the tax consequences arising in the context of the employee s death or the income tax laws of any municipality, state or foreign country in which the employee s income or gain may be taxable.

The Board unanimously recommends that you vote FOR the proposed amendment of the 2001 Omnibus Equity Incentive Plan.

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PROPOSAL THREE
RATIFICATION OF THE APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The firm of Moss Adams LLP has been the Company s independent registered public accounting firm since 1993 and has been selected by the Board, upon the recommendation of the Audit Committee, to serve as its independent registered public accounting firm for the fiscal year ending December 31, 2009. Professional services rendered by Moss Adams LLP for 2008 consisted of an audit of the Company s annual financial statements (including services incurred with rendering an opinion under Section 404 of the Sarbanes-Oxley Act of 2002) and review of quarterly financial statements, consultation on interim financial statements, services related to filings with the SEC, meetings with the Company s Audit Committee and consultation on various matters relating to accounting and financial reporting. All professional services rendered by Moss Adams LLP during 2008 were furnished at customary rates and terms. Representatives of Moss Adams LLP are expected to be present at the Meeting and will have the opportunity to make a statement, if they so desire, and respond to appropriate questions from stockholders.

Audit Fees, Tax Fees, and All Other Fees

For the fiscal years ended December 31, 2007 and 2008, fees for the services provided by Moss Adams LLP were approximately as follows:

Description	2007	2008
Audit Fees, including fees for professional services necessary to perform an audit or review in accordance with the standards of the Public Company Accounting Oversight Board, including services rendered for the audit of the Company s financial statements (including services incurred with rendering an opinion under Section 404 of the Sarbanes-Oxley Act of 2002) included in the Annual Report on Form 10-K and review of financial statements included in the Quarterly Reports on Form 10-Q, and including the Zetex acquisition.	$702,000	$913,000
Tax-related Fees, professional services for income tax return preparation, tax advice (including Zetex acquisition accounting, and tax planning).	$96,000	$118,000
All Other Fees, not included in above.	$31,000	$6,000
Total	**$829,000**	**$1,037,000**

The Audit Committee administers the Company s engagement of Moss Adams LLP and pre-approves all audit and permissible non-audit services on a case-by-case basis. In approving non-audit services, the Audit Committee considers whether the engagement could compromise the independence of Moss Adams LLP, and whether for reasons of efficiency or convenience it is in the best interest of the Company to engage its independent registered public accounting firm to perform the services.

Moss Adams LLP has advised the Company that neither the firm, nor any member of the firm, has any financial interest, direct or indirect, in any capacity in the Company or its subsidiaries. The Audit Committee, in reliance on the independent registered public accounting firm, determined that the provision of these services is compatible with maintaining the independence of Moss Adams LLP.

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Prior to engagement, the Audit Committee pre-approves all independent registered public accounting firm services. The fees are budgeted and the Audit Committee requires the independent registered public accounting firm and management to report actual fees versus the budget periodically throughout the year by category of service. During the year, circumstances may arise when it may become necessary to engage the independent registered public accounting firm for additional services not contemplated in the original pre-approval categories. In those instances, the Audit Committee requires specific pre-approval before engaging the independent registered public accounting firm.

The Audit Committee may delegate pre-approval authority to one or more of its members. The member to whom such authority is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next scheduled meeting.

Although this appointment is not required to be submitted to a vote of stockholders, the Audit Committee believes it is appropriate as a matter of policy to request that the stockholders ratify the appointment. If the stockholders do not ratify the appointment, which requires the affirmative vote of a majority of the outstanding shares of Common Stock present, in person or by proxy, and entitled to vote at the Meeting, the Board will consider the selection of another independent registered public accounting firm.

The Board unanimously recommends that you vote FOR the ratification of appointment of Moss Adams LLP as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2009.

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PROPOSALS OF STOCKHOLDERS AND STOCKHOLDER NOMINATIONS FOR 2010 ANNUAL MEETING

Under certain circumstances, stockholders are entitled to present proposals at stockholder meetings. Currently, the 2010 annual meeting of stockholders is expected to be held on or about May 27, 2010.

SEC rules provide that any stockholder proposal to be included in the proxy statement for the Company s 2010 annual meeting must be received by the Secretary of the Company at the Company s office at 15660 North Dallas Parkway, Suite 850, Dallas, Texas 75248 prior to December 18, 2009, in a form that complies with applicable regulations. If the date of the 2010 annual meeting is advanced or delayed more than 30 days from the date of the 2009 annual meeting, stockholder proposals intended to be included in the proxy statement for the 2010 annual meeting must be received by us within a reasonable time before the Company begins to print and mail the proxy statement for the 2010 annual meeting. Upon any determination that the date of the 2010 annual meeting will be advanced or delayed by more than 30 days from the date of the 2009 annual meeting, the Company will disclose the change in the earliest practicable Quarterly Report on Form 10-Q.

SEC rules also govern a company s ability to use discretionary proxy authority with respect to stockholder proposals that were not submitted by the stockholders in time to be included in the proxy statement. In the event a stockholder proposal is not submitted to the Company prior to March 3, 2010, the proxies solicited by the Board for the 2010 annual meeting of stockholders will confer authority on the proxyholders to vote the shares in accordance with the recommendations of the Board if the proposal is presented at the 2010 annual meeting of stockholders without any discussion of the proposal in the proxy statement for such meeting. If the date of the 2010 annual meeting is advanced or delayed more than 30 days from the date of the 2009 annual meeting, then the stockholder proposal must not have been submitted to the Company within a reasonable time before the Company mails the proxy statement for the 2010 annual meeting.

Stockholders may nominate candidates for the Board at an annual meeting. Stockholders who wish to request that the Governance Committee consider a candidate for the 2010 annual meeting should submit information about the candidate to the Governance Committee a reasonable time before the Company begins to print and mail the proxy statement for the 2010 annual meeting. The requesting stockholder should provide sufficient biographical information about the proposed candidate to satisfy the requirements of the Securities and Exchange Commission for inclusion in the proxy statement and to permit the Governance Committee to evaluate the proposed candidate in light of the criteria described under the caption Nominating Procedures and Criteria. The request should also provide the full name, address and telephone number of the requesting stockholder and sufficient information to verify that the requesting stockholder is eligible to vote at the 2010 annual meeting. Additional information and certifications by the requesting stockholder and the proposed candidate may be required before the Governance Committee can make its evaluation.

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ANNUAL REPORT AND FORM 10-K

The Company s annual report to stockholders for the year ended December 31, 2008 accompanies or has preceded this Proxy Statement. The annual report contains consolidated financial statements of the Company and its subsidiaries and the report thereon of Moss Adams LLP, the Company s independent registered public accounting firm, for the calendar years ended December 31, 2006, 2007 and 2008.

STOCKHOLDERS MAY OBTAIN, WITHOUT CHARGE, A COPY OF THE COMPANY S ANNUAL REPORT ON FORM 10-K, INCLUDING FINANCIAL STATEMENTS REQUIRED TO BE FILED WITH THE SEC PURSUANT TO THE EXCHANGE ACT, FOR THE YEAR ENDED DECEMBER 31, 2008 BY WRITING TO THE COMPANY; ATTN: INVESTOR RELATIONS, 15660 NORTH DALLAS PARKWAY, SUITE 850, DALLAS, TEXAS 75248, OR EMAIL THE REQUEST TO DIODES-FIN@DIODES.COM. THE INFORMATION IS ALSO AVAILABLE ON THE COMPANY S WEBSITE AT WWW.DIODES.COM AND THE SEC S WEBSITE AT WWW.SEC.GOV.

Dated at Dallas, Texas, this 17th day of April, 2009.

By Order of the Board of Directors,
DIODES INCORPORATED

/s/ Carl C. Wertz

Carl C. Wertz,
Secretary

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Appendix A
AUDIT COMMITTEE CHARTER
(As Amended February 6, 2009)

The Audit Committee is appointed by the Board to assist the Board in monitoring (1) the integrity of the financial statements of the Company, (2) the compliance by the Company with legal and regulatory requirements and (3) the independence and performance of the Company s internal and external auditors.

The members of the Audit Committee shall meet the independence and audit committee policy of the Nasdaq Stock Exchange and the Securities and Exchange Commission. The members of the Audit Committee shall be appointed by the Board.

The Audit Committee shall have the authority to retain special legal, accounting or other consultants to advise the Committee. The Audit Committee may request any officer or employee of the Company or the Company s outside counsel or independent auditor to attend a meeting of the Committee or to meet with any members of, or consultants to, the Committee.

The Audit Committee shall make regular reports to the Board.

The Audit Committee shall:

1. Review and reassess the adequacy of this Charter annually and recommend any proposed changes to the Board for approval.

2. Review the annual audited financial statements with management, including major issues regarding accounting and auditing principles and practices as well as the adequacy of internal controls that could significantly affect the Company s financial statements.

3. Review an analysis prepared by management and the independent auditor of significant financial reporting issues and judgments made in connection with the preparation of the Company s financial statements.

4. Review with management and the independent auditor the Company s annual and quarterly financial statements prior to the filing of its Form 10-K and 10-Q.

5. Meet periodically with management to review the Company s major financial risk exposures and the steps management has taken to monitor and control such exposures.

6. Review major changes to the Company s auditing and accounting principles and practices as suggested by the independent auditor, internal auditors or management.

7. Recommend to the Board the appointment of the independent auditor, which firm is ultimately accountable to the Audit Committee and the Board.

8. Has the authority and responsibility for appointment, compensation, retention, and oversight of the work of independent auditors, including resolution of disagreements between management and the auditors regarding financial reporting.

9. Pre-approve all audit and permitted non-audit services to be performed by the independent auditors.

10. Receive periodic reports from the independent auditor regarding the auditor s independence consistent with Independence Standards Board Standard 1, discuss such reports with the auditor, and if so determined by the Audit Committee, take or recommend that the Board take appropriate action to oversee the independence of the auditor.

11.

Evaluate together with the Board the performance of the independent auditor and, if so determined by the Audit Committee, recommend that the Board replace the independent auditor.

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12. Appoint and replace~~Review the appointment and replacement of~~ the senior internal auditing executive.

13. Review any significant reports to management prepared by the internal auditing department and management s responses.

14. Meet with the independent auditor prior to the audit to review the planning and staffing of the audit.

15. Obtain from the independent auditor assurance that Section 10A of the Securities Exchange Act of 1934 has not been implicated.

16. Obtain reports from management, the Company s senior internal auditing executive and the independent auditor that the Company s subsidiary/foreign affiliated entities are in conformity with applicable legal requirements and the Company s code of conduct.

17. Discuss with the independent auditor the matters required to be discussed by Statement on Auditing Standards No. 61 and the requirement of Section 204 of Sarbanes-Oxley Act of 2002 relating to the conduct of the audit before the reports issuance of auditors.

18. Review with the independent auditor any problems or difficulties the auditor may have encountered and any management letter provided by the auditor and the Company s response to that letter. Such review should include:
    a. Any difficulties encountered in the course of the audit work, including any restrictions on the scope of activities or access to required information.

    b. Any changes required in the planned scope of the audit.

    c. The responsibilities, budget and staffing of the internal audit department, if any.
19. Supervise preparation of the report required by the rules of the Securities and Exchange Commission to be included in the Company s annual proxy statement.

20. Advise the Board from time to time with respect to the Company s policies and procedures regarding compliance with applicable laws and regulations and with the Company s code of conduct.

21. Meet with the Company s legal counsel to review legal matters that may have a material impact on the financial statements, the Company s compliance policies and any material reports or inquiries received from regulators or governmental agencies.

22. Meet at least annually with the Chief Financial Officer, the senior internal auditing executive and the independent auditor in separate executive sessions.

23. Conduct an appropriate review of all related party transactions for potential conflict of interest situations on an ongoing basis, all in accordance with such procedures as the Audit Committee may adopt from time to time.

24. Establish procedures, under confidential and anonymous submission, for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting control or auditing matters.

25.

While the Audit Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Audit Committee to plan or conduct audits or to determine that the Company s financial statements are complete and accurate and are in accordance with generally accepted accounting principles. This is the responsibility of management and the independent auditor.

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Appendix B
DIODES INCORPORATED
2001 OMNIBUS EQUITY INCENTIVE PLAN
(As Amended May 28, 2009~~December 22, 2008~~)

Diodes Incorporated, a Delaware corporation (the Company), by action of its Board of Directors, hereby adopt the Diodes Incorporated 2001 Omnibus Equity Incentive Plan (the Plan) with the following provisions:

1. Purpose

The purpose of the Plan is to promote and advance the interests of the Company and its stockholders by enabling the Company and its Subsidiaries to attract, retain and motivate officers, directors, employees and independent contractors by providing for performance-based benefits, and to strengthen the mutuality of interests between such persons and the Company s stockholders. The Plan is designed to meet this intent by offering performance-based stock and cash incentives and other equity-based incentive awards, thereby providing a proprietary interest in pursuing the long-term growth, profitability and financial success of the Company.

2. Definitions

For purposes of this Plan, the following terms shall have the meanings set forth below:

Affiliate shall mean any parent or subsidiary (as defined in Sections 424(e) and (f) of the Code) of the Company.

Award means an award or grant made to a Participant under Sections 6 through 10, inclusive, of the Plan.

Board means the Board of Directors of the Company.

Change in Control means the occurrence of any one (or more) of the following events:

(i) Any person, including a group as defined in Section 13(d)(3) of the Exchange Act, becomes the beneficial owner of stock of the Company with respect to which twenty-five percent (25%) or more of the total number of votes for the election of the Board may be cast;

(ii) As a result of, or in connection with, any cash tender offer, exchange offer, merger or other business combination, sale of assets or contested election, or combination of the foregoing, persons who were directors of the Company just prior to such event shall cease to constitute a majority of the Board;

(iii) ~~The stockholders of the Company shall approve an agreement providing either for a transaction in which t~~The Company ~~will~~ ceases to be an independent publicly owned corporation or ~~for~~ a sale or other disposition is completed for ~~of~~ all or substantially all the assets of the Company; or

(iv) A tender offer or exchange offer is made for the shares of the Common Stock (other than one made by the Company) and the shares of the Common Stock are acquired thereunder.

Notwithstanding the foregoing, the formation of a holding company for the Company in which the stockholdings of the holding company after its formation are substantially the same as for the Company prior to the holding company formation does not constitute a Change in Control for purposes of this Plan.

Code means the Internal Revenue Code of 1986, as amended and in effect from time to time, or any successor thereto, together with rules, regulations and authoritative interpretations promulgated thereunder.

Committee means the committee of the Board that is provided for in Section 3 of the Plan.

Common Stock means the common stock of the Company or any security of the Company issued in

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substitution, exchange or lieu thereof.

Company means Diodes Incorporated, a Delaware corporation.

Consultant means any natural person who performs bona fide services for the Company or an Affiliate as a consultant or advisor, excluding Employees and Non-Employee Directors.

Date of Grant means the date the Committee (or the Board, as the case may be) takes formal action designating that a Participant shall receive an Award, notwithstanding the date the Participant accepts the Award, the date the Company and the Participant enter into a written agreement with respect to the Award, or any other date.

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

Employee means any individual who is a common-law employee of the Company or an Affiliate.

Exchange Act means the Securities Exchange Act of 1934, as amended and in effect from time to time, or any successor thereto.

Fair Market Value means on any given date, the closing price for the Common Stock on such date, or, if the Common Stock was not traded on such date, on the next preceding day on which the Common Stock was traded, determined in accordance with the following rules:

(i) If the Common Stock is admitted to trading or listing on a national securities exchange registered under the Exchange Act, the closing price for any day shall be the last reported sale price, or in the case no such reported sale takes place on such date, the average of the last reported bid and ask prices, in either case on the principal national securities exchange on which the Common Stock is admitted to trading or listed;

(ii) If not listed or admitted to trading on any national securities exchange, the last sale price of the Common Stock on the National Association of Securities Dealers Automated Quotation National Market System (NMS) or, in the case no such reported sale takes place, the average of the closing bid and ask prices on such date;

(iii) If not quoted on the NMS, the average of the closing bid and ask prices of the Common Stock on the National Association of Securities Dealers Automated Quotation System (NASDAQ) or any comparable system; or

(iv) If the Common Stock is not listed on NASDAQ or any comparable system, the closing bid and ask prices as furnished by any member of the National Association of Securities Dealers, Inc., selected from time to time by the Committee for that purpose.

Incentive Stock Option means any Stock Option granted pursuant to the provisions of Section 6 of the Plan that is intended to be and is specifically designated as an incentive stock option within the meaning of Section 422 of the Code.

Non-Employee Director means a non-Employee member of the Board.

Non-Qualified Stock Option means any Stock Option granted pursuant to the provisions of Section 6 of the Plan that is not an Incentive Stock Option.

Optioned Stock means the shares of Common Stock that are subject to a Stock Option.

Participant means an Employee, Non-Employee Director, or Consultant of the Company or a Subsidiary who is granted an Award under the Plan.

Performance Award means an Award granted pursuant to the provisions of Section 9 of the Plan, the vesting of which is contingent on the attainment of specified performance criteria.

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Performance Share Grant means an Award of units representing shares of Common Stock granted pursuant to the provisions of Section 9 of the Plan.

Performance Unit Grant means an Award of monetary units granted pursuant to the provisions of Section 9 of the Plan.

Plan means this Diodes Incorporated 2001 Omnibus Equity Incentive Plan, as set forth herein and as it may be hereafter amended and from time to time in effect.

Qualified Note means a recourse note, with a fixed market rate of interest, that may, at the discretion of the Committee, be secured by the Optioned Stock or otherwise.

Restricted Award means an Award granted pursuant to the provisions of Section 8 of the Plan.

Restricted Stock Grant means an Award of shares of Common Stock granted pursuant to the provisions of Section 8 of the Plan.

Restricted Unit Grant means an Award of units representing shares of Common Stock granted pursuant to the provisions of Section 8 of the Plan.

Service means the performance of services for the Company (or any Affiliate) by an Employee, Non-Employee Director, or Consultant, as determined by the Committee in its sole discretion. Service shall not be considered interrupted in the case of (i) any leave of absence approved by the Company or (ii) transfers between locations of the Company or between the Company and any Affiliate, or any successor. A leave of absence approved by the Company shall include sick leave, military leave, or any other personal leave approved by an authorized representative of the Company. For purposes of Incentive Stock Options, no such leave may exceed 90 days, unless reemployment upon expiration of such leave is guaranteed by statute or contract, including Company policies. If reemployment upon expiration of a leave of absence approved by the Company is not so guaranteed, on the 91st day of such leave any Incentive Stock Option held by the Optionee shall cease to be treated as an Incentive Stock Option and shall be treated for tax purposes as a Non-Qualified Stock Option.

Stock Appreciation Right means an Award to benefit from the appreciation of Common Stock granted pursuant to the provisions of Section 7 of the Plan.

Stock Option means an Award to purchase shares of Common Stock granted pursuant to the provisions of Section 6 of the Plan.

Subsidiary means any corporation or entity which is a subsidiary of the Company within the meaning of Section 424(f) of the Code.

Ten Percent Stockholder means a person who owns stock (after taking into account the constructive ownership rules of Section 424(d) of the Code) possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company (or any Affiliate).

Termination Date means the date on which a Participant s Service terminates, as determined by the Committee in its sole discretion.

3. Administration.

(a) The Plan shall be administered by a committee appointed by the Board. The Committee shall be comprised solely of not less than two persons who are outside directors within the meaning of Section 162(m)(4)(C) of the Code and non-employee directors within the meaning of Rule 16b-3 of the Exchange Act. Members of the Committee shall serve at the pleasure of the Board and the Board may from time to time remove members from, or add members to, the Committee. No person who is not an outside director within the meaning of Section 162(m)(4)(C) of the Code and a non-employee director within the meaning of Rule 16b-3 of the Exchange Act may serve on the Committee. Appointment to the Committee of any person who is not an outside director and a non-employee director shall automatically be null and void, and any person on the Committee who ceases to be an outside director

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and a non-employee director shall automatically and without further action cease to be a member of the Committee.

(b) A majority of the members of the Committee shall constitute a quorum for the transaction of business. Action approved in writing by a majority of the members of the Committee then serving shall be as effective as if the action had been taken by unanimous vote at a meeting duly called and held.

(c) The Committee is authorized to construe and interpret the Plan, to promulgate, amend, and rescind rules and procedures relating to the implementation of the Plan, and to make all other determinations necessary or advisable for the administration of the Plan. Any determination, decision, or action of the Committee in connection with the construction, interpretation, administration, or application of the Plan shall be binding upon all Participants and any person claiming under or through any Participant. Although the Committee is anticipated to make certain Awards that constitute performance-based compensation within the meaning of Section 162(m)(4)(C) of the Code, the Committee is also expressly authorized to make Awards that do not constitute performance-based compensation within the meaning of that provision. By way of example, and not by way of limitation, the Committee, in its sole and absolute discretion, may issue an Award that is not based on a performance goal, as set forth in (i) below, but is based solely on continued service to the Company.

(d) The Committee may employ or retain persons other than members of the Committee to assist the Committee to carry out its responsibilities under such conditions and limitations as it may prescribe, except that the Committee may not delegate its authority with regard to selection for participation of and the granting of Awards to persons subject to Section 16 of the Exchange Act or with regard to any of its duties under Section 162(m) of the Code necessary for awards under this Plan to qualify as performance-based compensation for purposes of Section 162(m)(4)(C) of the Code.

(e) The Committee is expressly authorized to make such modifications to the Plan as are necessary to effectuate the intent of the Plan as a result of any changes in the income tax, accounting, or securities law treatment of Participants and the Plan.

(f) The Company shall effect the granting of Awards under the Plan in accordance with the determinations made by the Committee, by execution of instruments in writing in such form as approved by the Committee.

(g) The Committee may not increase an Award once granted, although it may grant additional Awards to the same Participant.

(h) The Committee shall keep the Board informed as to its actions and make available to the Board its books and records. Although the Committee has the authority to establish and administer the Plan, the Board reserves the right at any time to abolish the Committee and administer the Plan itself.

(i) In the case of an Award that is intended to qualify as performance-based compensation for purposes of Code Section 162(m)(4)(C), the Committee shall establish in writing at the time of making the Award the business criterion or criteria that must be satisfied for payment pursuant to the Award and the amount payable upon satisfaction of those standards. Those standards are also referred to herein as performance goals. Such criterion or criteria shall be established prior to the Participant rendering the services to which they relate and while the outcome is substantially uncertain or at such other time permitted under Treasury Regulations Section 1.162-27(e)(2). In carrying out these duties, the Committee shall use objective written standards for establishing both the performance goal and the amount of compensation such that a third party with knowledge of the relevant facts would be able to determine whether and to what extent the goal has been

satisfied and the amount of compensation payable. The Committee shall provide a copy of the document setting forth such standards to the affected Participant and shall retain such written material in its permanent books and records.

(j) In the case of remuneration that is intended to qualify as performance-based compensation for purposes of Code Section 162(m)(4)(C), other than Performance Awards granted pursuant to Section 9 of the Plan, the Committee and the Board shall disclose to the stockholders of the Company the material terms under which such remuneration is to be paid under the Plan, and shall seek approval of the stockholders by a majority vote in a separate stockholder vote before payment of such remuneration. For these purposes, the material terms include the individuals (or class of individuals) eligible to receive such

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compensation, a description of the business criterion or criteria on which the performance goal is based, either the maximum amount of the compensation to be paid thereunder or the formula used to calculate the amount of compensation if the performance goal is attained, and such other terms as required under Code Section 162(m)(4)(C) and the Treasury Regulations thereunder determined from time to time. The foregoing actions shall be undertaken in conformity with the rules of Code Section 162(m)(4)(C)(ii) and Treasury Regulations promulgated thereunder. Such remuneration shall not be payable under this Plan in the absence of such an approving stockholder vote. In the case of remuneration that is not intended to qualify as performance-based compensation under Code Section 162(m)(4)(C), the Committee and the Board shall make such disclosures to and seek such approval from the stockholders of the Company as they reasonably determine are required by law.

(k) To the extent required under Code Section 162(m)(4)(C), before any payment of remuneration under this Plan, the Committee must certify in writing that the performance goals and any other material terms of the Award were in fact satisfied. Such certification shall be kept with the permanent books and records of the Committee, and the Committee shall provide the affected Participant with a copy of such certification.

(l) The Committee shall use its good faith best efforts to comply with the requirements of Section 162(m)(4)(C) of the Code for Awards that are intended to qualify under that section as performance-based compensation, but shall have no liability to the Company or any recipient in the event one or more Awards do not so qualify.

4. Duration of and Common Stock Subject to the Plan.

(a) **Term.** The Plan shall become effective as of June 11, 2001, the date of its adoption by the Board, subject to ratification by the stockholders of the Company within twelve (12) months after the effective date. In the event that the stockholders of the Company do not ratify the Plan within twelve (12) months after the effective date, any Awards granted pursuant to the Plan shall be rescinded automatically. Unless sooner terminated by the Board, the Plan shall continue until May 28, 2019~~June 11, 2011, one day prior to the tenth (10th) anniversary of the Plan's effective date~~, when it shall terminate and no Awards may be granted under the Plan thereafter. The termination of the Plan shall not affect the Awards that are outstanding on the termination date.

(b) **Shares of Common Stock Subject to the Plan.** The maximum total number of shares of Common Stock with respect to which aggregate stock Awards may be granted under the Plan shall be ten~~five~~ million eight hundred eighty-three thousand two hundred seventeen (10,883,217~~5,883,217~~). Notwithstanding the foregoing, the maximum number of shares of Common Stock which may be issued pursuant to Incentive Stock Options under this Plan may not exceed ten~~five~~ million eight hundred eighty-three thousand two hundred seventeen (10,883,217~~5,883,217~~).

(i) All of the amounts stated in this Paragraph (b) are subject to adjustment as provided in Section 15 below.

(ii) For the purpose of computing the total number of shares of Common Stock available for Awards under the Plan, there shall be counted against the foregoing limitations the gross number of shares of Common Stock subject to issuance upon exercise or used for payment or settlement of Awards, subject to clauses (iv), (v) and (vi) of this Paragraph (b).

(iii) If any Awards are forfeited, terminated, expire unexercised, settled or paid in cash in lieu of stock or exchanged for other Awards, the gross number of shares of Common Stock which were theretofore subject to such Awards shall again be available for Awards under the Plan to the extent of such

forfeiture or expiration of such Awards.

(iv) Each share of Common Stock subject to issuance under any award, other than options or Stock Appreciation Rights, shall be counted against the foregoing limitations as 1.52 shares.

(v) To the extent a Stock Appreciation Right is settled for shares of Common Stock, the gross number of shares used for determining the benefit under such Stock Appreciation Right, to the extent exercised, shall be counted against the foregoing limitations, regardless of the number of

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shares used to settle the Stock Appreciation Right upon such exercise.

(vi) To the extent a Stock Option is exercised on a cashless basis, the gross number of shares of Common Stock issued upon such exercise, plus the number of shares of Common Stock retained by the Company, shall be counted against the foregoing limitations.

(c) **Source of Common Stock.** Common Stock which may be issued under the Plan may be either authorized and unissued stock or issued stock which have been reacquired by the Company. No fractional shares of Common Stock shall be issued under the Plan.

5. Eligibility Incentive Stock Options may only be granted to Employees of the Company or a Subsidiary. Employees, Non-Employee Directors, and Consultants of the Company or a Subsidiary are eligible to receive Non-Qualified Stock Options, Stock Appreciation Rights, Restricted Awards, Performance Awards and other Awards under the Plan.

6. Stock Options Stock options granted under the Plan may be in the form of Incentive Stock Options or Non-Qualified Stock Options (collectively referred to as Stock Options). Stock Options shall be subject to the terms and conditions set forth below. Each written Stock Option agreement shall contain such additional terms and conditions, not inconsistent with the express provisions of the Plan, as the Committee shall deem desirable.

(a) **Grant**. Stock Options shall be granted under the Plan on such terms and conditions not inconsistent with the provisions of the Plan and pursuant to written agreements with the Participant in such form as the Committee may from time to time approve in its sole and absolute discretion. The terms of individual Stock Option agreements need not be identical. Each Stock Option agreement shall state specifically whether it is intended to be an Incentive Stock Option agreement or a Non-Qualified Stock Option agreement. Stock Options may be granted alone or in addition to other Awards under the Plan. No person may be granted (in any calendar year) options to purchase more than one-hundred thousand (100,000) shares of Common Stock (subject to adjustment pursuant to Section 15 below). The foregoing sentence is an annual limitation on grants and not a cumulative limitation.

(b) **Exercise Price**. Except as otherwise provided for in Paragraph (f) below, the exercise price per share of Common Stock purchasable under a Stock Option shall be determined by the Committee at the time of grant; provided, however, that the exercise price per share may not be less than one hundred percent (100%) of the Fair Market Value of the Common Stock on the Date of Grant of such Stock Option.

(c) **Option Term**. The term of each Stock Option shall be fixed by the Committee. However, the term of any Stock Option shall not exceed ten (10) years after the Date of Grant of such Stock Option.

(d) **Exercisability**. A Stock Option shall be exercisable at such time or times and subject to such terms and conditions as shall be determined by the Committee at the Date of Grant and set forth in the written Stock Option agreement. A written Stock Option agreement may, if permitted pursuant to its terms, become exercisable in full upon the occurrence of events selected by the Committee that are beyond the control of the Participant (including, but not limited to, a Change in Control).

(e) **Method of Exercise**. A Stock Option may be exercised, in whole or in part, by giving written notice of exercise to the Committee specifying the number of shares of Common Stock to be purchased. Such notice shall be accompanied by payment in full of the exercise price (i) in cash or (ii) if acceptable to the Committee, in shares of Common Stock or a Qualified Note. The Committee may also permit Participants, either on a selective or aggregate basis, to simultaneously exercise Stock Options and sell the shares of

Common Stock thereby acquired, pursuant to a brokerage or similar arrangement, approved in advance by the Committee, and use the proceeds from such sale as payment of part or all of the exercise price of such shares; provided, however, that such payment of the exercise price would not cause the Company to recognize compensation expense for financial reporting purposes. The Committee may also permit a cashless exercise, subject to any conditions or limitations that the Committee may establish.

(f) **Special Rules for Incentive Stock Options**. The terms specified below shall be applicable to all Incentive Stock Options. Stock Options which are specifically designated as Non-Qualified Stock

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Options when issued under the Plan shall not be subject to the terms of this Paragraph.

(i) Ten Percent Stockholder. If any Employee to whom an Incentive Stock Option is granted is a Ten Percent Stockholder, then the exercise price of the Incentive Stock Option shall not be less than one hundred and ten percent (110%) of the Fair Market Value of the Common Stock on the Date of Grant of such Incentive Stock Option, and the term of the Incentive Stock Option shall not exceed five (5) years measured from the Date of Grant of such option.

(ii) Dollar Limitation. In the case of an Incentive Stock Option, the aggregate Fair Market Value of the Optioned Stock (determined as of the Date of Grant of each Stock Option) with respect to Stock Options granted to any Employee under the Plan (or any other option plan of the Company or any Affiliate) that may for the first time become exercisable as Incentive Stock Options during any one calendar year shall not exceed the sum of one hundred thousand dollars ($100,000). To the extent the Employee holds two or more such Stock Options which become exercisable for the first time in the same calendar year, the foregoing limitation on the exercisability of such Stock Options as Incentive Stock Options shall be applied on the basis of the order in which such Stock Options are granted. Any Stock Options in excess of such limitation shall automatically be treated as Non-Qualified Stock Options.

(g) Without the approval of the stockholders of the Company, Stock Options and Stock Appreciation Rights granted under the Plan will not be repriced, replaced or regranted through cancellation, or by lowering the exercise price of a previously granted Award.

7. Stock Appreciation Rights The grant of Stock Appreciation Rights under the Plan shall be subject to the following terms and conditions. Furthermore, the Stock Appreciation Rights shall contain such additional terms and conditions, not inconsistent with the express terms of the Plan, as the Committee shall deem desirable. The terms of each Stock Appreciation Right granted shall be set forth in a written agreement between the Company and the Participant receiving such grant. The terms of such agreements need not be identical.

(a) **Stock Appreciation Rights.** A Stock Appreciation Right is an Award determined by the Committee entitling a Participant to receive an amount equal to the excess of the Fair Market Value of a share of Common Stock on a fixed date, which shall be the date concluding a measuring period set by the Committee upon granting the Stock Appreciation Right, over the Fair Market Value of a share of Common Stock on the Date of Grant of the Stock Appreciation Right, multiplied by the number of shares of Common Stock subject to the Stock Appreciation Right. No Stock Appreciation Rights granted in any calendar year to any person may be measured by an amount of shares of Common Stock in excess of one hundred thousand (100,000) shares, subject to adjustment under Section 15 below. The foregoing sentence is an annual limitation on grants and not a cumulative limitation.

(b) **Grant.** A Stock Appreciation Right may be granted in addition to or completely independent of any other Award under the Plan. Upon grant of a Stock Appreciation Right, the Committee shall select and inform the Participant regarding the number of shares of Common Stock subject to the Stock Appreciation Right and the date that constitutes the close of the measuring period.

(c) **Measuring Period.** A Stock Appreciation Right shall accrue in value from the Date of Grant over a maximum of a 10 (ten) year time period established by the Committee. In the written Stock Appreciation Right agreement, the Committee may also provide (but is not required to provide) that a Stock Appreciation Right shall be automatically payable on one or more specified dates prior to the normal end of the measuring period upon the occurrence of events selected by the Committee (including, but not limited to, a Change in Control) that are beyond the control of the Participant. The Committee may provide (but is not required to

provide) in the Stock Appreciation Right agreement that in the case of a cash payment such acceleration in payment shall also be subject to discounting of the payment to reasonably reflect the time value of money using any reasonable discount rate selected by the Committee in accordance with Treasury Regulations under Code Section 162(m).

(d) **Form of Payment.** Payment pursuant to a Stock Appreciation Right may be made (i) in cash, (ii) in shares of Common Stock, or (iii) in any combination of the above, as the Committee shall determine in its sole and absolute discretion. The Committee may elect to make this determination either at the time the

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Stock Appreciation Right is granted, at the time of payment or at any time in between such dates. However, any Stock Appreciation Right paid upon or subsequent to the occurrence of a Change in Control shall be paid in cash.

8. Restricted Awards Restricted Awards granted under the Plan may be in the form of either Restricted Stock Grants or Restricted Unit Grants. Restricted Awards shall be subject to the following terms and conditions. Furthermore, the Restricted Awards shall be pursuant to a written agreement executed both by the Company and the Participant, which agreement shall contain such additional terms and conditions, not inconsistent with the express provisions of the Plan, as the Committee shall deem desirable in its sole and absolute discretion. The terms of such written agreements need not be identical.

(a) **Restricted Stock Grants.** A Restricted Stock Grant is an Award of shares of Common Stock transferred to a Participant subject to such terms and conditions as the Committee deems appropriate, as set forth in Paragraph (d) below.

(b) **Restricted Unit Grants.** A Restricted Unit Grant is an Award of units (with each unit having a value equivalent to one share of Common Stock) granted to a Participant subject to such terms and conditions as the Committee deems appropriate, including, without limitation, the requirement that the Participant forfeit all or a portion of such units upon termination of Service for specified reasons within a specified period of time, and restrictions on the sale, assignment, transfer or other disposition of such units.

(c) **Grants of Awards.** Restricted Awards may be granted under the Plan in such form and on such terms and conditions as the Committee may from time to time approve. Restricted Awards may be granted alone or in addition to other Awards under the Plan. Subject to the terms of the Plan, the Committee shall determine the number of Restricted Awards to be granted to a Participant and the Committee may impose different terms and conditions (including performance goals) on any particular Restricted Award made to any Participant. Each Participant receiving a Restricted Stock Grant shall be issued a stock certificate in respect of such shares of Common Stock. Such certificate shall be registered in the name of such Participant, shall be accompanied by a stock power duly executed by such Participant, and shall bear an appropriate legend referring to the terms, conditions and restrictions applicable to such Award. The certificate evidencing the shares shall be held in custody by the Company until the restrictions imposed thereon shall have lapsed or been removed. No person may be granted (in any calendar year) Restricted Awards that are intended to constitute performance-based compensation within the meaning of Section 162(m)(4)(C) of the Code, totaling or measured by more than one-hundred thousand (100,000) shares of Common Stock (subject to adjustment pursuant to Section 15 below). The foregoing sentence is an annual limitation on grants and not a cumulative limitation.

(d) **Restriction Period.** Restricted Awards shall provide that in order for a Participant to vest in such Awards, the Participant must continuously provide Services, subject to relief for specified reasons, for such period as the Committee may designate at the time of the Award (Restriction Period). If the Committee so provides in the written agreement with the Participant, a Restricted Award may also be subject to satisfaction of such performance goals as are set forth in such agreement. During the Restriction Period, a Participant may not sell, assign, transfer, pledge, encumber, or otherwise dispose of shares of Common Stock received under a Restricted Stock Grant. The Committee, in its sole discretion, may provide for the lapse of restrictions during the Restriction Period upon the occurrence of events selected by the Committee that are beyond the control of the Participant (including, but not limited to, a Change in Control). The Committee may provide (but is not required to provide) in the written agreement with the recipient that in the case of a cash payment such acceleration in payment shall also be subject to discounting of the payment to reasonably reflect the time value of money using any reasonable discount rate selected by the Committee in accordance with

Treasury Regulations under Code Section 162(m). Upon expiration of the applicable Restriction Period (or lapse of restrictions during the Restriction Period where the restrictions lapse in installments or by action of the Committee), the Participant shall be entitled to receive his or her Restricted Award or portion thereof, as the case may be.

(e) **Payment of Awards.** A Participant who receives a Restricted Stock Grant shall be paid solely by release of the restricted stock at the termination of the Restriction Period (whether in one payment, in installments or otherwise). A Participant shall be entitled to receive payment for a Restricted Unit Grant (or portion thereof) in an amount equal to the aggregate Fair Market Value of the shares of Common Stock covered by such Award upon the expiration of the applicable Restriction Period. Payment in settlement of a

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Restricted Unit Grant shall be made as soon as practicable but in no event later than sixty (60) days following the conclusion of the specified Restriction Period (i) in cash, (ii) in shares of Common Stock, or (iii) in any combination of the above, as the Committee shall determine in its sole and absolute discretion. The Committee may elect to make this determination either at the time the Award is granted, at the time of payment or at any time in between such dates.

(f) **Rights as a Stockholder.** A Participant shall have, with respect to the shares of Common Stock received under a Restricted Stock Grant, all of the rights of a stockholder of the Company, including the right to vote the stock, and the right to receive any cash dividends. Such cash dividends shall be withheld, however, until their release upon lapse of the restrictions under the Restricted Award. Stock dividends issued with respect to the shares covered by a Restricted Stock Grant shall be treated as additional shares under the Restricted Stock Grant and shall be subject to the same restrictions and other terms and conditions that apply to shares under the Restricted Stock Grant with respect to which the dividends are issued.

9. Performance Awards Performance Awards granted under the Plan may be in the form of either Performance Share Grants or Performance Unit Grants. Performance Awards shall be subject to the terms and conditions set forth below. Furthermore, the Performance Awards shall be subject to written agreements, which shall contain such additional terms and conditions, not inconsistent with the express provisions of the Plan, as the Committee shall deem desirable in its sole and absolute discretion. Such agreements need not be identical.

(a) **Performance Share Grants.** A Performance Share Grant is an Award of units (with each unit equivalent in value to one share of Common Stock) granted to a Participant subject to such terms and conditions as the Committee deems appropriate, including, without limitation, the requirement that the Participant forfeit such units (or a portion of such units) in the event certain performance criteria are not met within a designated period of time.

(b) **Performance Unit Grants.** A Performance Unit Grant is an Award of units (with each unit representing such monetary amount as designated by the Committee) granted to a Participant subject to such terms and conditions as the Committee deems appropriate, including, without limitation, the requirement that the Participant forfeit such units (or a portion of such units) in the event certain performance criteria are not met within a designated period of time.

(c) **Grants of Awards.** Performance Awards shall be granted under the Plan pursuant to written agreements with the Participant in such form as the Committee may from time to time approve. Performance Awards may be granted alone or in addition to other Awards under the Plan. Subject to the terms of the Plan, the Committee shall determine the number of Performance Awards to be granted to a Participant and the Committee may impose different terms and conditions on any particular Performance Award made to any Participant. No Performance Share Grants granted in any calendar year to any one person may be measured by more than one-hundred thousand (100,000) shares of Common Stock (subject to adjustment pursuant to Section 15 below). The maximum amount payable for any calendar year pursuant to a Performance Unit Grant shall not exceed $5,000,000~~4,000,000~~. The preceding two sentences are annual limitation on grants and a not cumulative limitation.

(d) **Performance Goals and Performance Periods.** Performance Awards shall provide that, in order for a Participant to vest in such Awards, the Company must achieve certain performance goals (Performance Goals) over a designated performance period selected by the Committee (Performance Period). The Performance Goals and Performance Period shall be established by the Committee, in its sole and absolute discretion. The Committee shall establish Performance Goals for each Performance Period before the commencement of the Performance Period and while the outcome is substantially uncertain or at such other

time permitted under Treasury Regulations Section 1.162-27(e)(2). The Committee shall also establish a schedule or schedules for such Performance Period setting forth the portion of the Performance Award which will be earned or forfeited based on the degree of achievement of the Performance Goals actually achieved or exceeded. In setting Performance Goals, the Committee may use any one or more of the following performance criteria, applied to either the Company as a whole or to a business unit, Affiliate, or business segment, either individually, alternatively, or in any combination, and measured either annually or cumulatively over a period of years, on an absolute basis or relative to a pre-established target, to previous years results or to a designated comparison group, in each case as specified by the

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Committee in the Award: (i) cash flow, (ii) earnings (including gross margin, earnings before interest and taxes, earnings before taxes, and net earnings), (iii) earnings per share, (iv) growth in earnings or earnings per share, (v) stock price, (vi) return on equity or average shareholders equity, (vii) total shareholder return, (viii) return on capital, (ix) return on assets or net assets, (x) return on investment, (xi) revenue, (xii) income or net income, (xiii) operating income or net operating income, (xiv) operating profit or net operating profit, (xv) operating margin, (xvi) return on operating revenue, (xvii) market share, (xviii) contract awards or backlog, (xix) overhead or other expense reduction, (xx) growth in shareholder value relative to the moving average of the S&P 500 Index or a peer group index, (xxi) credit rating, (xxii) strategic plan development and implementation, (xxiii) improvement in workforce diversity, (xxiv) EBITDA, and (xxv) any other similar criteria.

(e) **Payment of Awards.** In the case of a Performance Share Grant, the Participant shall be entitled to receive payment for each unit earned in an amount equal to the aggregate Fair Market Value of the shares of Common Stock covered by such Award as of the end of the Performance Period. In the case of a Performance Unit Grant, the Participant shall be entitled to receive payment for each unit earned in an amount equal to the dollar value of each unit times the number of units earned. The Committee, pursuant to the written agreement with the Participant, may make such Performance Awards payable in whole or in part upon the occurrence of events selected by the Committee that are beyond the control of the Participant (including, but not limited to, a Change in Control). The Committee may provide (but is not required to provide) in the written agreement with the recipient that, in the case of a cash payment, acceleration in payment of a Performance Award shall also be subject to discounting to reasonably reflect the time value of money using any reasonable discount rate selected by the Committee in accordance with Treasury Regulations under Code Section 162(m). Payment in settlement of a Performance Award shall be made as soon as practicable but in no event later than sixty (60) days following the conclusion of the Performance Period (i) in cash, (ii) in shares of Common Stock, or (iii) in any combination of the above, as the Committee may determine in its sole and absolute discretion. The Committee may elect to make this determination either at the time the Award is granted, at the time of payment, or at any time in between such dates.

10. Other Stock-Based and Combination Awards.

(a) The Committee may grant other Awards under the Plan pursuant to which Common Stock is or may in the future be acquired, or Awards denominated in stock units, including ones valued using measures other than market value. Such other stock-based grants may be granted either alone or in addition to any other type of Award granted under the Plan. To the extent that an Award is intended to constitute performance-based compensation within the meaning of Section 162(m)(4)(C) of the Code, such Award shall be subject to Paragraph (d) of Section 9 of the Plan. No stock-based Award granted in any calendar year to any one person, to the extent such Award is intended to satisfy the requirements for performance-based compensation under Section 162(m) of the Code, may be denominated by more than one-hundred thousand (100,000) shares of Common Stock.

(b) The Committee may also grant Awards under the Plan in combination with other Awards or in exchange of Awards, or in combination with or as alternatives to grants or rights under any other employee plan of the Company, including the plan of any acquired entity.

(c) Subject to the provisions of the Plan, the Committee shall have authority to determine the individuals to whom and the time or times at which the Awards shall be made, the number of shares of Common Stock to be granted or covered pursuant to such Awards, and any and all other conditions and/or terms of the Awards.

11.

Deferral Elections. The Committee may permit a Participant to elect to defer his or her receipt of the payment of cash or the delivery of shares of Common Stock that would otherwise be due to such Participant by virtue of the exercise, earn out or vesting of an Award made under the Plan. If any such election is permitted, the Committee shall establish rules and procedures for such payment deferrals, including the possible (a) payment or crediting of reasonable interest on such deferred amounts credited in cash, and (b) the payment or crediting of dividend equivalents in respect of deferrals credited in units of Common Stock. The Company and the Committee shall not be responsible to any person in the event that the payment deferral does not result in deferral of income for tax purposes. Notwithstanding any part of the foregoing to the contrary, it is the Company s intent that all Awards granted under this Plan, and any payment deferral permitted under this Plan, shall not cause an imposition of the additional taxes provided

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for in Section 409A(a)(1)(B) of the Code.

12. **Dividend Equivalents**Awards of Stock Options, Stock Appreciation Rights, Restricted Unit Grants, Performance Share Grants, and other stock-based Awards may, in the sole and absolute discretion of the Committee, earn dividend equivalents. In respect of any such Award which is outstanding on a dividend record date for Common Stock, the Participant may be credited with an amount equal to the amount of cash or stock dividends that would have been paid on the shares of Common Stock covered by such Award had such shares been issued and outstanding on such dividend record date. The Committee shall establish such rules and procedures governing the crediting of dividend equivalents, including the timing, form of payment, and payment contingencies of such dividend equivalents, as it deems appropriate or necessary.

13. **Termination of Service**The terms and conditions under which an Award may be exercised after a Participant s termination of Service shall be determined by the Committee and reflected in the written agreement with the Participant concerning the Award.

14. **Non-Transferability of Awards**No Award under the Plan, and no rights or interest therein, shall be assignable or transferable by a Participant except by will or the laws of descent and distribution. Subject to the foregoing, during the lifetime of a Participant, Awards are exercisable only by, and payments in settlement of Awards will be payable only to, the Participant or his or her legal representative if the Participant is Disabled.

15. **Adjustments Upon Changes in Capitalization, Etc.**

(a) The existence of the Plan and the Awards granted hereunder shall not affect or restrict in any way the right or power of the Board or the stockholders of the Company to make or authorize any adjustment, recapitalization, reorganization or other change in the Company s capital structure or its business, any merger or consolidation of the Company, any issue of bonds, debentures, preferred or prior preference stocks ahead of or affecting the Common Stock or the rights thereof, the dissolution or liquidation of the Company, or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding.

(b) (i) The maximum aggregate total number of shares of Common Stock for which Awards in respect thereof may be granted, the number and kind of Shares covered by each outstanding Award, the maximum number of shares of Common Stock that may be sold or awarded to any Participant, and the price per share (but not the total price) subject to each outstanding Award shall be proportionally adjusted to prevent dilution or enlargement of rights under the Plan for any change in the outstanding Common Stock subject to the Plan, or subject to any Award, resulting from any stock splits, combination or exchange of shares of Common Stock, consolidation, spin-off or recapitalization of shares of Common Stock or any capital adjustment or transaction similar to the foregoing or any distribution to holders of Common Stock other than regular cash dividends. (ii) The Committee shall make such adjustment in such manner as it may deem equitable and appropriate, subject to compliance with applicable laws. Any determination, substitution or adjustment made by the Committee under this Section shall be conclusive and binding on all persons. Except as expressly provided herein, neither the Company s issuance of shares of stock of any class or securities convertible into shares of stock of any class, nor the conversion of any convertible securities of the Company, shall be treated as a transaction requiring any substitution or adjustment under this Section.

(c) The Committee may also make such adjustments in the number of shares covered by, and the price or other value of any outstanding Awards in the event of a spin-off or other distribution (other than normal cash dividends) of Company assets to stockholders.

16. Change in Control.

(a) Except as otherwise provided for in Paragraph (b) below, in the event of a Change in Control, and except as otherwise provided in Award agreements:

(i) All Stock Options and Stock Appreciation Rights then outstanding shall become fully exercisable as of the date of the Change in Control (and shall terminate at such time as specified in the

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Award agreement);

(ii) All restrictions and conditions of all Restricted Stock Grants and Restricted Unit Grants then outstanding shall be deemed satisfied as of the date of the Change in Control; and

(iii) All Performance Share Grants and Performance Unit Grants shall be deemed to have been fully earned as of the date of the Change in Control.

Any payment in settlement of Stock Appreciation Rights in (i) or Awards discussed in (ii) and (iii) above, shall be made on the date of the Change in Control; provided, however, that if making such payments would result in the imposition of taxes under Code Section 409A, then the payments shall instead be made on the originally schedules date(s) set forth in the Award Agreements.

(b) In the event that any payment under this Plan (alone or in conjunction with other payments) would otherwise constitute an excess parachute payment under Section 280G of the Code (in the sole judgment of the Committee), such payment shall be reduced or eliminated to the extent the Committee determines necessary to avoid deduction disallowance under Section 280G of the Code or the imposition of excise tax under Section 4999 of the Code. The Committee may consult with a Participant regarding the application of Section 280G and/or Section 4999 to payments otherwise due to such Participant under the Plan, but the judgment of the Committee as to applicability of those provisions, the degree to which a payment must be reduced to avoid those provisions, and which Awards shall be reduced, is final.

17. Amendment and Termination.

Without further approval of the stockholders, the Board may at any time terminate the Plan, or may amend it from time to time in such respects as the Board may deem advisable. However, the Board may not, without approval of the stockholders, make any amendment which would (a) increase the aggregate number of shares of Common Stock which may be issued under the Plan (except for adjustments pursuant to Section 15 above), (b) materially modify the requirements as to eligibility for participation in the Plan, or (c) materially increase the benefits accruing to Participants under the Plan. Notwithstanding the above, the Board may amend the Plan to take into account changes in applicable securities laws, federal income tax laws and other applicable laws. Further, should the provisions of Rule 16b-3, or any successor rule, under the Exchange Act be amended, the Board may amend the Plan in accordance with any modifications to that rule without the need for stockholder approval. Notwithstanding the foregoing, the Plan may not be amended more than once every six months other than to comply with the changes in the Code.

18. Miscellaneous Matters.

(a) **Tax Withholding.**

(i) The Company s obligation to deliver Common Stock and/or pay any amount under the Plan shall be subject to the satisfaction of all applicable federal, state, local, and foreign tax withholding requirements.

(ii) The Committee may, in its discretion, provide the Participants or their successors with the right to use previously vested Common Stock in satisfaction of all or part of the taxes incurred by such Participants in connection with the Plan; provided, however, that this form of payment shall be limited to the withholding amount calculated using the minimum statutory rates. Such right may be provided to any such holder in either or both of the following formats.

1. Stock Withholding: The election to have the Company withhold, from the Common Stock otherwise issuable under the Plan, a portion of the Common Stock with an aggregate Fair Market Value equal to the taxes

calculated using the minimum statutory rates.

2. Stock Delivery: The election to deliver to the Company, at the time the taxes are required to be withheld, one or more shares of Common Stock previously acquired by the Participant or his or her successor with an aggregate Fair Market Value equal to the taxes calculated using the minimum statutory rates.

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(b) **Not an Employment or Service Contract.** Neither the adoption of the Plan nor the granting of any Award shall confer upon any Participant any right to continue in the Service of the Company or an Affiliate, as the case may be, nor shall it interfere in any way with the right of the Company or an Affiliate to terminate the Services of any of its Employees, Non-Employee Directors, or Consultants at any time, with or without cause.

(c) **Unfunded Plan.** The Plan shall be unfunded and the Company shall not be required to segregate any assets that may at any time be represented by Awards under the Plan. Any liability of the Company to any person with respect to any Award under the Plan shall be based solely upon any written contractual obligations that may be effected pursuant to the Plan. No such obligation of the Company shall be deemed to be secured by any pledge of, or other encumbrance on, any property of the Company.

(d) **Annulment of Awards.** The grant of any Award under the Plan payable in cash is provisional until cash is paid in settlement thereof. The grant of any Award payable in Common Stock is provisional until the Participant becomes entitled to the certificate in settlement thereof. Payment under any Awards granted pursuant to the Plan is wholly contingent upon stockholder approval of the Plan. Where approval for an Award sought pursuant to Section 162(m)(4)(C)(ii) is not granted by the Company s stockholders, the Award shall be annulled automatically. In the event the Service of a Participant is terminated for cause (as defined below), any Award which is provisional shall be annulled as of the date of such termination for cause. For purposes of the Plan, the term terminated for cause means any discharge because of personal dishonesty, willful misconduct, breach of fiduciary duty involving personal profit, continuing intentional or habitual failure to perform stated duties, violation of any law (other than minor traffic violations or similar misdemeanor offenses not involving moral turpitude), or material breach of any provision of an employment or independent contractor agreement with the Company.

(e) **Other Company Benefit and Compensation Programs.** Payments and other benefits received by a Participant under an Award made pursuant to the Plan shall not be deemed a part of a Participant s regular, recurring compensation for purposes of the termination indemnity or severance pay law of any state. Furthermore, such benefits shall not be included in, nor have any effect on, the determination of benefits under any other employee benefit plan or similar arrangement provided by the Company or a Subsidiary unless expressly so provided by such other plan or arrangement, or except where the Committee expressly determines that inclusion of an Award or portion of an Award should be included. Awards under the Plan may be made in combination with or in addition to, or as alternatives to, grants, awards or payments under any other Company or Subsidiary plans. The Company or any Subsidiary may adopt such other compensation programs and additional compensation arrangements (in addition to this Plan) as it deems necessary to attract, retain, and motivate officers, directors, employees or independent contractors for their service with the Company and its Subsidiaries.

(f) **Securities Law Restrictions.** No shares of Common Stock shall be issued under the Plan unless counsel for the Company shall be satisfied that such issuance will be in compliance with applicable federal and state securities laws. Certificates for shares of Common Stock delivered under the Plan may be subject to such stock-transfer orders and other restrictions as the Committee may deem advisable under the rules, regulations, and other requirements of the Securities and Exchange Commission, any stock exchange upon which the Common Stock is then listed, and any applicable federal or state securities law. The Committee may cause a legend or legends to be put on any such certificates to make appropriate reference to such restrictions.

(g) **Award Agreement.** Each Participant receiving an Award under the Plan shall enter into a written agreement with the Company in a form specified by the Committee agreeing to the terms and conditions of the Award

and such related matters as the Committee shall, in its sole and absolute discretion, determine.

(h) **Costs of Plan.** The costs and expenses of administering the Plan shall be borne by the Company.

(i) **Governing Law.** The Plan and all actions taken thereunder shall be governed by and construed in accordance with the laws of the State of Delaware.

(j) **Code Section 409A.** Notwithstanding anything in the Plan to the contrary, the Plan and Awards granted hereunder are intended to comply with the requirements of Code Section 409A and shall be interpreted in a manner consistent with such intention. If, upon a Participant s separation from service within the

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meaning of Code Section 409A, the Participant is then a specified employee (as defined in Code Section 409A), the Company shall defer payment of nonqualified deferred compensation subject to Code Section 409A payable as a result of and within six (6) months following such separation from service under this Plan and/or applicable Award Agreement until the earlier of (i) ten (10) days after the Company receives notification of the Participant s death, or (ii) the first business day of the seventh month following the Participant s separation from service. Any such delayed payments shall be made without interest.

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MEETING MAP AND DRIVING DIRECTIONS

Dallas/Addison Marriott Quorum by the Galleria
14901 Dallas Parkway
Dallas, Texas 75254
972-661-2800

Airports

Dallas/Fort Worth DFW

Hotel direction: 14 miles E
Driving Directions: Use North Exit and follow I-635 East 14 miles to Dallas Tollway North.
Exit at Belt Line Road and make U-turn. Hotel is on the right.

Dallas/Love Field DAL

Hotel direction: 10 miles NE
Driving Directions: Take Mockingbird Lane East to Dallas Tollway North.
Exit Belt Line Road. Make a U-turn. Hotel is on the right.

Dallas/Addison ADS

Hotel direction: 2 miles S
Driving Directions: Take Addison Road south to Belt Line Road.
Take Belt Line Road East to Dallas Parkway.
Take Dallas Parkway South for 1 block. Hotel is on the right.

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DIODES INCORPORATED
15660 NORTH DALLAS PARKWAY
SUITE 850
DALLAS, TEXAS 75248

VOTE BY INTERNET - www.proxyvote.com
Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS
If you would like to reduce the costs incurred by our company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years.

VOTE BY PHONE - 1-800-690-6903
Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL
Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

M13283-P72191 KEEP THIS PORTION FOR YOUR RECORDS
DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

DIODES INCORPORATED	**For All**	**Withhold All**	**For All Except**	To withhold authority to vote for any individual nominee(s), mark For All Except
	o	o	o	

The Board of Directors recommends that you vote FOR the following.

and write the number(s) of the nominee(s) on the line below.

_____
_____

1. Election of Directors

Nominees:
01) C.H. Chen
02) Michael R. Giordano
03) L.P. Hsu
04) Keh-Shew Lu
05) Shing Mao
06) Raymond Soong
07) John M. Stich

	For	Against	Abstain
The Board of Directors recommends that you vote FOR the following proposals.			
2. To approve various proposed amendments of the 2001 Omnibus Equity Incentive Plan, including the extension of the term of the plan until May 28, 2019 and the increase by 5,000,000 in the number of shares of Common Stock which may be subject to awards granted thereunder.	o	o	o
3. To ratify the appointment of Moss Adams LLP as the Company s independent registered public accounting firm for the year ending December 31, 2009.	o	o	o

Such other business as may properly come before the meeting or any adjournment thereof.

For address changes and/or comments, please check this box and write them on the back where indicated. o

	Yes	No
Please indicate if you plan to attend this meeting.	o	o

Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor, administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership, by authorized officer.

Signature [PLEASE SIGN WITHIN BOX] Date

Signature (Joint Owners) Date

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Meeting Map and Driving Directions

Dallas/Fort Worth - DFW

Hotel direction: 14 miles E.

Driving Directions: Use North Exit and follow I-635 East 14 miles to Dallas Tollway North.

Exit at Belt Line Road and make a U-turn. Hotel is on the right.

Dallas/Love Field - DAL

Hotel direction: 10 miles NE.

Driving Directions: Take Mockingbird Lane East to Dallas Tollway North.

Exit Belt Line Road. Make a U-turn. Hotel is on the right.

Dallas/Addison - ADS

Hotel direction: 2 miles S.

Driving Directions: Take Addison Road south to Belt Line Road.

Take Belt Line Road East to Dallas Parkway.

Take Dallas Parkway South for 1 block. Hotel is on the right.

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting:

The Notice and Proxy Statement and Annual Report are available at www.proxyvote.com.

M13284-P72191

DIODES INCORPORATED

Annual Meeting of Stockholders May 28, 2009

This Proxy Is Solicited by the Board of Directors

The undersigned stockholder(s) of Diodes Incorporated (the Company) hereby nominate(s), constitute(s) and appoint(s) Keh-Shew Lu and Carl C. Wertz, the attorneys, agents and proxies of the undersigned, with full power of substitution, to vote all stock of the Company which the undersigned is/are entitled to vote at the annual meeting of stockholders of the Company (the Meeting) to be held on Thursday, May 28, 2009, at the Dallas/Addison Marriott Quorum by the Galleria, located at 14901 Dallas Parkway, Dallas, Texas 75254, at 10:00 a.m. (Central time), and any adjournments thereof, as fully and with the same force and effect as the undersigned might or could do if personally thereat.

Address Changes/Comments:

(If you noted any Address Changes/Comments above, please mark corresponding box on the reverse side.)

Continued and to be signed on reverse side