

AUGUST TECHNOLOGY CORP
Form DEF 14A
March 11, 2004

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

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant o

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Check the appropriate box:

- ☐ Preliminary Proxy Statement
- ☐ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- ☒ Definitive Proxy Statement
- ☐ Definitive Additional Materials
- ☐ Soliciting Material Pursuant to §240.14a-12

August Technology Corporation

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- ☒ No fee required.
- ☐ Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.
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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

to be held

April 28, 2004

TO THE SHAREHOLDERS OF AUGUST TECHNOLOGY CORPORATION:

The 2004 Annual Meeting of Shareholders (the "Annual Meeting") of August Technology Corporation (the "Company") will be held at the Company's world headquarters at 4900 West 78th Street, Bloomington, Minnesota at 3:30 p.m. on Wednesday, April 28, 2004, for the following purposes:

1. To set the number of members of the Board of Directors at five (5).
2. To elect two (2) Class I Directors.
3. To approve the Company's Amended and Restated 1997 Stock Incentive Plan.
4. To ratify the appointment of KPMG LLP as the Company's independent auditors.

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5.

To take action on any other business that may properly come before the meeting or any adjournment thereof.

Accompanying this Notice of Annual Meeting is a Proxy Statement, form of Proxy and the Company's 2003 Annual Report.

Only shareholders of record as shown on the books of the Company at the close of business on March 4, 2004 will be entitled to vote at the Annual Meeting or any adjournment thereof. Each shareholder is entitled to one vote per share on all matters to be voted on at the Annual Meeting.

You are cordially invited to attend the Annual Meeting. Whether or not you plan to attend the Annual Meeting, please sign, date and mail the enclosed form of Proxy in the return envelope provided as soon as possible. Your cooperation in promptly signing and returning your Proxy will help avoid further solicitation expense to the Company.

BY ORDER OF THE BOARD OF DIRECTORS

March 18, 2004
Bloomington, Minnesota

Jeff L. O'Dell
Chairman and Chief Executive Officer

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AUGUST TECHNOLOGY CORPORATION

PROXY STATEMENT FOR ANNUAL MEETING OF SHAREHOLDERS to be held April 28, 2004

The accompanying Proxy is solicited by the Board of Directors of August Technology Corporation (the "Company") for use at the Annual Meeting of Shareholders (the "Annual Meeting") of the Company to be held on April 28, 2004, at the location and for the purposes set forth in the Notice of Annual Meeting of Shareholders, and at any adjournments thereof.

The cost of soliciting proxies, including the preparation, assembly and mailing of the proxies and soliciting material, as well as the cost of forwarding such material to the beneficial owners of the Company's Common Stock, will be borne by the Company. Directors and Executive Officers of the Company may, without compensation other than their regular remuneration, solicit proxies personally or by telephone. Directors is defined as current members of the Board of Directors, and Executive Officers is defined as all Board elected officers. The Company has retained The Proxy Advisory Group of Strategic Stock Surveillance, LLC to assist the Company in the solicitation of proxies for a fee of \$8,500 plus customary out-of-pocket expenses.

Any shareholder giving a Proxy may revoke it any time prior to its use at the Annual Meeting by giving written notice of such revocation to the Secretary or other Board-elected officer of the Company or by filing a later-dated written Proxy with a Board-elected officer of the Company. Personal attendance at the Annual Meeting is not, by itself, sufficient to revoke a Proxy unless written notice of the revocation or a later-dated Proxy is delivered to a Board-elected officer of the Company before the Proxy to be revoked or superseded is used at the Annual Meeting. Proxies will be voted as specified by the shareholders.

The presence at the Annual Meeting in person or by proxy of the holders of a majority of the outstanding shares of the Company's Common Stock entitled to vote shall constitute a quorum for the transaction of business. If a broker returns a "non-vote" proxy, indicating a lack of voting instructions by the beneficial holder and a lack of discretionary authority on the part of the broker to vote on a particular matter, then the shares covered by such non-vote shall be deemed present at the meeting for purposes of determining a quorum but shall not be deemed to be represented at the Annual Meeting for purposes of calculating the vote with respect to such matter. If a shareholder abstains from voting as to

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any matter, then the shares held by such shareholder shall be deemed present at the Annual Meeting for purposes of determining a quorum and for purposes of calculating the vote with respect to such matter, but shall not be deemed to have been voted in favor of such matter. An abstention as to any proposal will, therefore, have the same effect as a vote against the proposal. Proxies which are signed but which lack any such specification will be voted in favor of the proposals set forth in the Notice of Meeting and in favor of the number and slate of directors proposed by the Board of Directors and listed herein.

The mailing address of the principal executive office of the Company is 4900 West 78th Street, Bloomington, Minnesota 55435. The Company expects that this Proxy Statement, the related Proxy and Notice of Meeting will first be mailed to shareholders on approximately March 18, 2004.

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OUTSTANDING SHARES AND VOTING RIGHTS

The Board of Directors of the Company has fixed the close of business on March 4, 2004 (the "Record Date") as the record date for determining shareholders entitled to vote at the Annual Meeting. Persons who were not shareholders on the Record Date will not be allowed to vote at the Annual Meeting. At the close of business on the Record Date, 17,671,930 shares of the Company's Common Stock were issued and outstanding. The Common Stock is the only outstanding class of capital stock of the Company. Each share of Common Stock is entitled to one vote on each matter to be voted upon at the Annual Meeting. Holders of Common Stock are not entitled to cumulative voting rights.

PRINCIPAL SHAREHOLDERS AND MANAGEMENT SHAREHOLDINGS

The following table presents the number of shares of the Company's Common Stock owned on March 4, 2004 by all persons who are beneficial owners of more than five percent of the Company's Common Stock, the Company's directors and nominees, the Executive Officers identified in the Summary Compensation Table included elsewhere in this Proxy Statement and all current directors and Executive Officers as a group.

Name of Beneficial Owner	Number of Shares Beneficially Owned(1)(2)	Of Shares Beneficially Owned, Amount that May be Acquired Within 60 Days by Option Exercise	Percent of Outstanding Shares(2)
Jeff L. O'Dell(3)	1,183,286	10,500	6.7
D. Mayson Brooks	33,282	31,451	*
David L. Klenk	112,550	112,550	*
Scott A. Gabbard	38,517	38,517	*
Stanley D. Piekos	31,632	31,632	*
James A. Bernards(4)	96,296	29,796	*
Roger E. Gower	37,296	37,296	*
Michael W. Wright	44,526	44,526	*
Linda Whitman	25,854	25,854	*
U.S. Bancorp(5)	1,198,576		6.8
All current directors and Executive Officers as a group (11 persons)(4)	1,680,075	428,958	9.3

*
Less than one percent.

(1)
Unless otherwise indicated, each person named or included in the group has sole power to vote and sole power to direct the disposition of all shares listed as beneficially owned.

(2)

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Amounts include shares, which are not currently outstanding but are deemed beneficially owned because of the right to acquire them pursuant to options exercisable either currently or within 60 days after March 4, 2004. Pursuant to SEC rules, shares deemed beneficially owned by virtue of an individual's right to acquire them are also treated as outstanding when calculating the percent of the class owned by such individual and when determining the percent owned by any group in which the individual is included.

(3)

The address for Jeff L. O'Dell is c/o August Technology Corporation, 4900 West 78th Street, Bloomington, Minnesota 55435. Pursuant to an agreement with U.S. Bancorp Asset Management, Inc. as investment adviser, Mr. O'Dell has granted sole voting authority and shared dispositive authority to U.S. Bancorp with respect to 1,172,786 of the shares beneficially owned by Mr. O'Dell. See note (5).

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(4)

Includes 50,000 shares held by Dougherty Summit Opportunity Fund I (the "Dougherty Fund"). Mr. Bernards is the President of BS Cap, LLC which does business as Brightstone Capital, which manages the Dougherty Fund; provided, however, pursuant to an agreement, Mr. Bernards has no control over the voting or disposition of the shares held by the Dougherty Fund.

(5)

Includes 1,172,786 shares beneficially owned by Jeff L. O'Dell. U.S. Bancorp, as agent, and U.S. Bancorp Asset Management, Inc., as investment advisor under a service agreement, have sole voting power over all of the shares and shared dispositive power over 1,196,076 of the shares and no dispositive power over 2,500 of the shares.

ELECTION OF DIRECTORS (Proposals #1 and #2)

The Bylaws of the Company provide that the number of directors shall be the number set by the shareholders, which shall be not less than three (3) nor more than nine (9). The Board of Directors recommends that the number of directors be set at five (5), the number of directors currently on the Board.

The Bylaws provide for the election of three classes of directors with terms staggered so as to require the election of only one class of directors each year. Only directors who are members of Class I will be elected at the Annual Meeting. The Governance and Nominating Committee of the Board of Directors nominates Jeff L. O'Dell and Michael W. Wright for reelection as Class I directors of the Company. If elected, Mr. O'Dell and Mr. Wright will each serve a three year term as Class I directors and until their successors are duly elected and qualified. The Class II and Class III directors will continue serving until 2005 and 2006, respectively.

The Bylaws under Section 3.2 provide that between annual meetings of the shareholders the Board of Directors may increase the authorized number of directors to no more than nine (9). Although the Governance and Nominating Committee is not actively seeking additional Board members, the Committee may nominate additional directors if candidates meeting the committee's criteria become available. As a result, new candidates may be presented to the Board under the terms of the Bylaws for election. The Bylaws require that if the number of directors is changed that any increase shall be apportioned by the Board of Directors among the classes so as to maintain, as nearly as possible, an equal number of directors in each class; thus, should a first director be added, such director will be seated in Class II. The Bylaws further require that if the number of directors is changed, any increase that makes it impossible to maintain an equal number of directors in each class, the director causing the increase shall be allocated to the class with the longest term; thus should a second director be added, such director will be seated in Class I.

In the absence of other instruction, the Proxies will be voted for each of the Class I nominees. If, prior to the Annual Meeting, it should become known that either Mr. O'Dell or Mr. Wright will be unable to serve as a director after the Annual Meeting by reason of death, incapacity or other unexpected occurrence, the Proxies may be voted for such substitute nominee as selected by the Board of Directors. Alternatively, the Proxies may, at the Board's discretion, be voted for such fewer number of nominees as results from such death, incapacity or other unexpected occurrence. The Board of Directors has no reason to believe that either Mr. O'Dell or Mr. Wright will be unable to serve.

Under applicable Minnesota law, the election of each of the Class I nominees requires the affirmative vote of the holders of a majority of the voting power of the shares represented in person or by proxy at the Annual Meeting with authority to vote on such matter, provided that such majority must be greater than 25% of the Company's outstanding shares.

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Following is current information about the Class I nominees and all other current directors of the Company whose terms will continue.

Name	Age	Position with the Company	Class/ Term Expires	Director Since
Jeff L. O'Dell	42	Chief Executive Officer and Director	I-2004	1994
Michael W. Wright	57	Director	I-2004	2000
Linda Whitman	55	Director	II-2005	2002
James A. Bernards	57	Director	III-2006	1998
Roger E. Gower	63	Director	III-2006	1998

Jeff L. O'Dell co-founded the Company in 1992 and has served as its Chief Executive Officer since 1992 and Chairman of the Board since 1994, and also served as its President from 1992 to 2001. From August 1987 to August 1992, Mr. O'Dell was Director of Sales and Marketing for MicroVision Corporation, which develops and manufactures robotic and inspection systems. From February 1985 to August 1987, Mr. O'Dell was a Field Applications Engineer for Cognex Corporation, which designs, develops and markets machine vision systems that are used to automate a wide range of manufacturing processes. From March 1984 to February 1985, Mr. O'Dell served as a Systems Analyst for Control Data Corporation.

Michael W. Wright has been Chief Operating Officer of Entegris, Inc., a supplier to semiconductor manufacturers, since May of 2002. Prior to that time, beginning in January of 2001, Mr. Wright was President of the microelectronics group of Entegris, Inc. Prior to that time, beginning in 1998, he was Senior Vice President of Corporate Marketing of Entegris, Inc. From 1996 to 1998, Mr. Wright was Vice President and General Manager of Integrated Solutions, Inc., a lithography supplier. From 1995 to 1996, he was Director of International Design Corporation. Mr. Wright is also the founder of Wright Williams and Kelly, and a graduate of the U.S. Navy Nuclear Power Program.

Linda Whitman has been Chief Executive Officer of MinuteClinic, Inc., a medical services company, since May of 2002. Prior to that, Ms. Whitman was President of Ceridian Performance Partners from 1996 to 2000, and Vice President of Ceridian's Business Integration from 1995 to 1996. From 1980 to 1995, Ms. Whitman held various positions at Honeywell including Vice President of Consumer Business Group; Director of Home Systems; Director of Marketing for HVAC Commercial Controls; Director of Customer Service, Traffic and Distribution; Director of Information Technology; International Market Manager; and Strategic Marketing Manager. Since 1999, Ms. Whitman has served on the Ninth District Federal Reserve Bank Board. She currently also serves as a director of two other public companies, Health Fitness Corporation and MTS Systems Corporation, as well as for several private companies.

James A. Bernards is currently President of Facilitation, Inc., a business consulting services company, and President of BS Cap, LLC doing business as Brightstone Capital, a venture capital fund manager. Mr. Bernards was co-founder and President of the accounting firm of Stirtz, Bernards & Co. from May 1981 to June 1993. He currently serves as a Director of three public companies, Health Fitness Corporation, Entegris, Inc., and FSI International, Inc., and several private companies.

Roger E. Gower has been Chairman of the Board, President, Chief Executive Officer and Director of Micro Component Technology, Inc. since April 1995. Prior to that time, Mr. Gower was employed by Datamedia Corporation of Nashua, New Hampshire, a network and PC security software development company, where he served as President and Chief Executive Officer since 1991. Prior to 1991, he was President and Chief Executive Officer of Intelledix, Inc., a Corvallis, Oregon-based manufacturer of robotic and automation systems for the semiconductor and disk drive manufacturing industries.

Code of Ethics and Business Conduct

Effective February 7, 2003, the Company adopted a Code of Ethics and Business Conduct, and, in addition, a Code of Ethics for Financial Executives. The Code of Ethics and Business Conduct sets forth the Company's general principles with detailed explanations and responsibilities associated therewith. A copy of the Company's Code of Ethics was attached as an exhibit to the Company's 2002 Annual Report on Form 10-K.

Majority of Independent Directors; Committees of Independent Directors

The Board of Directors has determined that James A. Bernards, Roger E. Gower and Linda Whitman and Michael W. Wright, constituting a majority of the Board of Directors, are independent directors in accordance with rules of the National Association of Securities Dealers, Inc. ("NASD") since none of them are believed to have any relationships that, in the opinion of the Board of Directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. Jeff L. O'Dell is precluded from being considered independent by NASD rules since he currently serves as an executive officer of the Company.

Each member of the Company's Audit Committee, Compensation Committee and Governance and Nominating Committee has been determined, in the opinion of the Board of Directors, to be independent in accordance with NASD rules.

Board and Committee Meetings

During the year ended December 31, 2003, the Board of Directors held five (5) regularly scheduled meetings, and four (4) special meetings. Each director attended at least 75% of the aggregate of the total number of meetings of the Board of Directors and all committees of the Board on which he/she served. The Board of Directors has three standing committees, an Audit Committee, a Compensation Committee, and a Governance and Nominating Committee.

The Audit Committee recommends to the Board of Directors the selection of independent accountants and reviews the activities and reports of the independent accountants as well as the internal accounting controls of the Company. The Audit Committee is comprised of Roger E. Gower, James A. Bernards and Michael W. Wright all of whom are non-employee independent members of the Board. During 2003, the Audit Committee held five (5) meetings.

The Compensation Committee recommends the compensation for Executive Officers and other members of the senior leadership team of the Company. The Compensation Committee is comprised of James A. Bernards, Roger E. Gower and Linda Whitman. During 2003, the Compensation Committee held five (5) meetings.

The Governance and Nominating Committee was created in February 2003, the Committee is comprised of James A. Bernards, Roger E. Gower, Linda Whitman and Michael W. Wright. In accordance with its written charter adopted by the Board of Directors, the Governance and Nominating Committee assists the Board of Directors with fulfilling its responsibility regarding any matters relating to corporate governance including selection of candidates for the Company's Board of Directors. During 2003, the Governance and Nominating Committee held four (4) meetings.

Compensation of Directors

Pursuant to the Company's 1998 Board of Directors Compensation Plan as amended July 29, 2003 (the "1998 Compensation Plan"), the Board or a committee has broad power to award directors compensation in the form of options or cash payments. Effective July 1, 2003, the Board of Directors amended the 1998 Compensation Plan to provide for the grant of an option to purchase 20,000 shares of the Company's Common Stock to a new director upon election to the Board of Directors, which

option is exercisable to the extent of one-third of the shares immediately and on each of the first two anniversary dates. Each director receives an option to purchase 6,500 shares of the Company's Common Stock upon completion of each year of service, which option is exercisable immediately. In addition, non-employee directors receive a \$1,000 fee (the "Attendance Fee") for attendance in person or by teleconference at each regularly scheduled Board meeting and a \$500 fee for attendance in person or by teleconference at each regularly scheduled committee meeting. Non-employee directors chairing any Board or Committee meeting receive an additional \$500 for that meeting. For up to four special board or committee meetings each year, non-employee directors receive a fee of \$500 for attendance. Further, each director receives a \$500 stipend per month (the "Guidance Fee") for providing guidance to the Company on an as needed basis.

Report of Audit Committee

The Board of Directors maintains an Audit Committee comprised of three of the Company's independent directors, namely Roger E. Gower, James A. Bernards, and Michael W. Wright. The Board of Directors and the Audit Committee believe that the Audit Committee's member composition during 2003 and currently satisfies the rule of the NASD that governs audit committees, Rule 4310(c)(26)(B)(i), including the requirement that audit committee members all be "independent directors" as that term is defined by NASD Rule 4200(a)(15).

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In accordance with its written charter adopted by the Board of Directors, the Audit Committee assists the Board of Directors with fulfilling its oversight responsibility regarding the quality and integrity of the accounting, auditing and financial reporting practices of the Company. In discharging its oversight responsibilities regarding the audit process, the Audit Committee:

- (1) reviewed and discussed the audited financial statements with management;
- (2) discussed with the independent auditors the material required to be discussed by Statement on Auditing Standards No. 61; and
- (3) reviewed the written disclosures and the letter from the independent auditors required by the Independence Standards Board's Standard No.1, and discussed with the independent auditors any relationships that may impact their objectivity and independence.

On February 23, 2004, the Board of Directors amended the written charter of the Audit Committee. The amended charter is attached to this Proxy Statement as Appendix A. Under its amended written charter, the Audit Committee's primary duties and responsibilities are to:

- (1) Serve as an independent and objective party to monitor the Company's financial reporting process and internal control system.
- (2) Coordinate, review, and appraise the audit efforts of the Company's independent accountants.
- (3) Communicate directly with the independent accountants, the financial and senior management, and the Board of Directors regarding the matters related to the Committee's responsibilities and duties.

The Committee must include at least three independent directors. All Committee members shall have a working familiarity with basic finance and accounting practices and shall be able to read and understand financial statements at the time of their appointment to the Committee. In addition, at least one member of the Committee shall be an audit committee "financial expert." The Company has determined that James A. Bernards qualifies as a "financial expert" as that term is defined in applicable regulations of the Securities and Exchange Commission and The Nasdaq Stock Market, Inc.

Based upon the review and discussions referred to above, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Company's Annual

Report on Form 10-K for the fiscal year ended December 31, 2003, as filed with the Securities and Exchange Commission.

Members of the Audit Committee
Roger E. Gower, Chair
James A. Bernards
Michael W. Wright

Compensation Committee Report on Executive Compensation

Compensation Committee Interlocks and Insider Participation. The Compensation Committee of the Board of Directors of the Company is composed of three of the Company's independent directors, namely James A. Bernards, Roger E. Gower and Linda Whitman. None of the members of the Committee is or ever has been an employee or officer of the Company.

Overview and Philosophy. In accordance with its written charter adopted by the Board of Directors, the Compensation Committee assists the Board of Directors with fulfilling its responsibility regarding compensation and benefits. The purpose of the Committee is to review and make recommendations to the Board regarding all forms of compensation and benefits to be provided to the Executive Officers and other members of the senior leadership team of the Company and its Board, as well as to give oversight to bonus plans, incentives, and benefit plans

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for all employees and consultants. The Board has delegated to the Compensation Committee the full authority to approve stock option grants for all employees except Executive Officers. The Compensation Committee has delegated to Board-elected officers its authority to approve new hire stock options for new hires that are not Executive Officers and have a base salary of less than \$90,000 where the grants fit within a defined matrix, the highest level of which allows for a grant of no more than 3,500 options.

The Compensation Committee's executive compensation policies are designed to enhance the financial performance of the Company, and thus shareholder value, by aligning the financial interests of the Company's Executive Officers with those of the Company's shareholders. Compensation of the Company's Executive Officers is comprised of four parts: base salary, annual incentive bonuses, fringe benefits and long-term incentives in the form of stock options.

The Compensation Committee strives to reward the Company's Executive Officers by focusing compensation on performance of the Company. This is accomplished by reviewing an executive compensation study of comparable, publicly held, high technology companies prior to the start of each year. The Company has moved from a philosophy of structuring base pay below market medians to one of structuring base pay at or near the 50th percentile market of the market, and providing for above market incentive opportunities if the Company's performance meets or exceeds its targets. Effective June 1, 2003, the Company had an Annual Incentive Plan (the "AIP"), as described under "Bonuses" below based on achievement of key financial and strategic objectives and reviewed by an independent compensation consultant. For 2004, an AIP has been established based on key financial and strategic objectives set by senior management and approved by the Board of Directors. In addition, long-term incentives are based on stock performance through stock options under the Company's 1997 Stock Incentive Plan (the "1997 Incentive Plan"). The Compensation Committee believes that stock ownership by the Company's Executive Officers is beneficial in aligning management's and shareholders' interests in the enhancement of shareholder value. Overall, the Compensation Committee believes this philosophy and structure relating to base salaries, annual incentives and long-term incentives are in the best interests of the Company's shareholders.

Base Salaries. The Compensation Committee completed its annual review of the Executive Compensation Study and concluded that the base salaries of most of the Executive Officers were comparable or slightly below the base salaries for Executive Officers of comparable, publicly held high

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technology companies. The two exceptions to this were the CEO position held by Jeff L. O'Dell and the COO/President position held by David L. Klenk. A plan was conceptually approved that would move those two positions closer to the 50th percentile over a two-year period. For all Executive Officers, base pay increases were approved, but implementation of the increases was delayed until such time as the Company returned to profitability. The Company reported profitability for the third quarter ended September 30, 2003. The Compensation Committee then approved implementation of the 2003 increases for Executive Officers effective November 1, 2003.

The Compensation Committee again reviewed an updated Executive Compensation Study in December 2003, and found that the Executive Officer base pay levels remained at or below the base salaries of Executive Officers of comparable, publicly held high technology companies. Moderate base pay increases were approved for this group, to be implemented January 1, 2004. The CEO position and President/COO positions were approved for increases that completed the two year plan to move the level to one near the 50th percentile of the market for comparable positions in comparable companies.

Bonuses. Effective June 1, 2003, the Board of Directors implemented an Annual Incentive Plan for members of the management team consisting of target incentive awards directly linked to achievement of key corporate financial and strategic objectives and individual goals and objectives. All Executive Officers were measured entirely by achievement of the corporate financial objectives that included revenue growth compared to the semiconductor capital equipment industry, new product revenues, profitability during the second half of 2003 and improved cash flow.

Stock Options and Other Incentives. The Company's stock option program is the Company's long-term incentive plan for Executive Officers and key employees. The objectives of the program are to align the Executive Officer and shareholder long-term interests by creating a strong and direct link between executive pay and shareholder return and to enable executives to develop and maintain a significant, long-term ownership position in the Company's Common Stock.

The Company's 1997 Stock Incentive Plan authorizes the Compensation Committee to award stock options to Executive Officers and other employees. Stock options are generally granted at hiring and from time to time thereafter for exceptional performance, with an option price equal to the fair market value of the Company's Common Stock on the date of grant and vesting periods from immediately to five years. The amount of stock options awarded is generally a function of the recipient's salary and position in the Company. The Company has not granted a significant number of stock options to Jeff L. O'Dell because he owns a significant number of shares of the Company's Common Stock and so

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already has an interest aligned with shareholders. Awards are intended to be competitive with other companies of comparable size and complexity, although the Compensation Committee has not conducted any thorough comparative analysis.

Benefits. The Company provides medical and other insurance benefits to its Executive Officers which are generally available to all Company employees. The Company has a 401(k) plan in which all qualified employees, including the Executive Officers, may participate. The amounts of perquisites allowed to Executive Officers, as determined in accordance with rules of the Securities and Exchange Commission, did not exceed 10% of salary in 2003.

Chief Executive Officer Compensation. Jeff L. O'Dell served as the Company's Chief Executive Officer in 2003. His compensation was determined in accordance with the policies described above as applicable to all Executive Officers. His base salary was increased from \$185,000 in 2000 to \$203,000 at the beginning of 2001 but thereafter reduced by ten percent to \$182,000 in the first quarter of 2001 as part of the Company's cost reductions in light of the industry downturn. Mr. O'Dell's salary was returned on January 1, 2002 to \$203,000; however, no other increases were implemented for 2002 due to the continuing industry downturn. The Board of Directors approved 2002 increases, including an increase for Mr. O'Dell to \$222,500, if and when industry conditions improve. On January 1, 2003,

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Mr. O'Dell's salary was increased to the 2002 level of \$222,500 although no 2003 increase was implemented. The 2003 increase was implemented on November 1, 2003 after the company returned to profitability, increasing the base salary from \$222,500 to \$245,000. The 2004 Base Salary has been increased to \$295,000 effective January 1, 2004. Mr. O'Dell received a bonus of \$134,943 in 2000, \$35,000 in 2001, none in 2002 due to industry conditions, and \$121,938 for 2003.

Members of the Compensation Committee

James A. Bernards, Chair
Roger E. Gower
Linda Whitman

Governance and Nominating Committee Report

The Governance and Nominating Committee of the Board of Directors of the Company was created on February 7, 2003 and is composed of all non-employee independent members of the Board of Directors, namely James A. Bernards, Roger E. Gower, Linda Whitman, and Michael W. Wright. In accordance with its written charter adopted by the Board of Directors, the Governance and Nominating Committee assists the Board of Directors with fulfilling its responsibility regarding any matters relating to corporate governance including selection of candidates for the Company's Board of Directors. Its duties shall include oversight of the following: Principles of Corporate Governance by which the Company and the Board shall be governed; the codes of ethical conduct and legal compliance by which the Company and its directors, Executive Officers, employees and agents will be governed; policies for evaluation of the Board and the chairperson; policies for election and reelection of Board members; and policies for succession planning for the Chief Executive Officer and Board members. In addition, the Committee is responsible for annually reviewing the composition of the Board against a matrix of skills and characteristics focused on the governance and business needs and requirements of the Company, nominating and screening of Board member candidates, evaluating the performance of the Board and its members, and terminating memberships of Board members in accordance with corporate policy for cause or other appropriate reasons.

The Governance and Nominating Committee has evaluated the Company's board with reference to a profile matrix of desirable skills and experience. Based on this evaluation and the attributes on the existing members of the Board, the Governance and Nominating Committee believes that additional candidates for director should have international business experience, a general technology background or education and experience with company operations or organization development. Experience as a Chief Executive Officer or Chief Financial Officer of a public company, particularly in the micro-electronic industry would be advantageous. The Committee retains the right to modify these criteria as it deems appropriate. The committee's process for identifying and evaluating nominees is as follows: In the case of incumbent directors whose terms of office are set to expire, the committee reviews such directors' overall service to the Company during their term, including the number of meetings attended, level of participation, quality of performance, and any transactions of such directors with the Company during their term. In the case of new director candidates, the committee first determines whether the nominee is independent for Nasdaq purposes. The committee then uses its network of contacts to compile a list of potential candidates meeting the Company's minimum qualifications. The Company may also engage, if it deems appropriate, a professional search firm to assist the committee in identifying director candidates. The committee then meets to discuss and consider each potential candidates' qualifications and chooses a candidate by majority vote.

The Governance and Nominating Committee will consider all bona fide director candidates recommended by shareholders provided the procedures set forth below are followed in submitting recommendations. The committee does not intend to alter in any respect the manner in which it

evaluates candidates, including the criteria set forth above, based on whether the candidate was recommended by a shareholder or not.

Shareholders who wish to recommend one or more directors must provide written recommendation to the Governance and Nominating Committee of the Company. Notice of a recommendation must include the shareholder's name, address, the class and number of shares owned; the name, age, business address, residence address and current principal occupation, five year employment history with employer names and a description of the employer's business of the nominee, the number of shares beneficially owned by the nominee, whether such nominee can read and understand basic financial statements and board memberships, if any. The recommendation must be accompanied by a written consent of the nominee to stand for election if nominated by the Board of Directors and to serve if elected by the shareholders. The Company may require any nominee to furnish additional information that may be needed to determine the eligibility of the nominee.

A copy of the Governance and Nominating Committee Charter can be found on the Company's website at www.augusttech.com.

Members of the Governance and Nominating Committee

James A. Bernards
Roger E. Gower
Linda Whitman
Michael W. Wright

Manner of Shareholder Communication with the Board of Directors

The Board provides a process for shareholders to send communications to the Board or any of the Directors. Shareholders may send written communications to the Board or any of the Directors c/o Investor Relations, August Technology Corporation, 4900 West 78th Street, Bloomington, Minnesota. All communications will be compiled by investor relations personnel of the Company and submitted to the Board or the individual Directors on a periodic basis.

Policy Regarding Director Attendance at Annual Meetings

On February 23, 2004, the Board adopted a policy providing that the Directors who are up for election at the Annual Meeting should attend the Annual Meeting if reasonably possible. One of the Company's directors attended the Company's 2003 Annual Meeting.

EXECUTIVE COMPENSATION

Summary Compensation Table

The following table sets forth information with respect to compensation paid in each of the last three years ended December 31, 2003 for services provided by the Company's Chief Executive Officer and the next four most highly compensated Executive Officers based on total annual salary and bonus paid or accrued during 2003.

Name and Principal Position	Year	Annual Compensation		Long-Term Compensation	All Other Compensation \$(5)
		Salary (\$)	Bonus \$(1)	Securities Underlying Options (#)	
Jeff L. O'Dell	2003	225,812	121,938		4,547
Chief Executive Officer; Chairman of the Board	2002	203,000		10,000	4,136
	2001	182,000	35,000	7,250	4,625
D. Mayson Brooks Vice President, Global Sales and Field Operations	2003	183,077	48,446	6,251(2)	4,555
	2002	168,000	10,000	56,500	4,165
	2001	133,000	17,500	37,500(3)	3,961

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		Annual Compensation		Long-Term Compensation	
David L. Klenk President and Chief Operating Officer	2003	183,327	43,998	22,154(2)	5,157
	2002	140,000		15,000	4,729
	2001	128,000	25,000	22,750(3)	4,405
Scott A. Gabbard Chief Accounting Officer and Vice President, Finance	2003	150,000	41,850	4,610(2)	4,521
	2002	125,000	20,000	77,461	4,199
	2001	102,000	5,000	12,500(3)	3,446
Stanley D. Piekos Chief Financial Officer(4)	2003	144,327	34,638	135,632(2)	912

- (1) Amounts represent cash bonuses earned for the indicated years.
- (2) Includes options granted to D. Mayson Brooks, David L. Klenk, Scott A. Gabbard and Stanley D. Piekos in 2004 for their performance in 2003.
- (3) Includes options granted to D. Mayson Brooks, David L. Klenk and Scott A. Gabbard in 2002 for their performance in 2001.
- (4) Stanley D. Piekos joined August Technology in April 2003.
- (5) The amounts only include Company contributions under the Company's 401(k) Plan.

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Option Grants in 2003

The following table sets forth for each of the Executive Officers named in the Summary Compensation Table the stock options granted during 2003.

Name	Number of Securities Underlying Options Granted (#)	Individual Grants			Potential Realized Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (6)	
		% of Total Options Granted to Employees in 2003	Exercise Price/Share \$(4)(5)	Expiration Date	5% (\$)	10% (\$)
Jeff L. O'Dell						
D. Mayson Brooks						
David L. Klenk	15,000(1)	3.6	18.50	10/24/2010	112,970	263,269
Scott A. Gabbard						
Stanley D. Piekos	120,000(2)(3)	29.0	4.36	4/07/2010	212,995	496,369
	10,000(1)	2.4	18.50	10/24/2010	75,314	175,513

- (1) The stock options have a seven-year term and vest at a rate of 20% per year commencing on the option grant date.
- (2) The stock options have a seven-year term and vest at a rate of 20% per year commencing on the first anniversary of the option grant date.

- (3) The stock option grants consist of incentive stock option (ISO) and non-qualified stock option (NQSO) grants. The vesting, exercise price and terms of the ISO and NQSO grants are identical.
- (4) The stock options were granted at an exercise price equal to the fair market value of the Company's Common Stock, as determined by the closing price reported on the NASDAQ Stock Market on the date of grant.
- (5) The stock option exercise price may be paid in shares of Common Stock previously owned by the Executive Officer or in cash, unless the Board or one of its committees, in its sole discretion, rejects the optionee's election to pay in stock.
- (6) The hypothetical potential appreciation shown in these columns reflects the required calculations at annual rates of 5% and 10% set by the Securities and Exchange Commission and therefore is not intended to represent either historical appreciation or anticipated future appreciation of the Company's Common Stock price.

Aggregated Option Exercises in 2003 and Year-End Option Values

The following table provides information related to options exercised by the named Executive Officers during 2003 and the number and value of options held on December 31, 2003. The Company does not have any outstanding stock appreciation rights.

Name	Shares Acquired on Exercise (#)	Value Realized \$(1)	Number of Unexercised Options at Exercisable December 31, 2003 (#)		Value of Unexercised In-the-Money Options at December 31, 2003 \$(1)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Jeff L. O'Dell			10,500	9,000	126,463	99,480
D. Mayson Brooks	17,465	246,269	70,535	77,250	819,342	812,257
David L. Klenk	31,500	486,150	150,396	40,000	2,222,500	345,990
Scott A. Gabbard	13,200	162,919	56,407	39,815	620,012	411,177
Stanley D. Piekos			2,000	128,000	200	1,709,600

- (1) Market value of underlying securities at exercise date or year-end, as the case may be, minus the exercise price.

Employment Agreements and Severance Arrangements

The Company has entered into executive employment agreements with all of its Executive Officers including each of the following: Jeff L. O'Dell, D. Mayson Brooks, and David L. Klenk effective March 1, 2002, Scott A. Gabbard effective May 9, 2002, and Stanley D. Piekos effective April 7, 2003 (each referred to as a Key Executive below). These agreements supersede all prior agreements. Pursuant to these agreements, each Key Executive has a set annual base salary that may be adjusted by the Chief Executive Officer or Board of Directors, which base salary is currently \$295,000 for Mr. O'Dell, \$210,000 for Mr. Brooks, \$215,000 for Mr. Klenk, \$160,000 for Mr. Gabbard and \$205,000 for Mr. Piekos. The agreements set forth that the employment of each Key Executive may be terminated by mutual written agreement, by either party with thirty days written notice, by the Company for cause as defined therein, or by death of the Key Executive. In the event the Company terminates the Key Executive's employment without cause, mutual agreement or death, the Key Executive is entitled to severance equal to a standard severance period, except where change in control provisions are met whereby the severance is equal to a change in control severance period. All of the agreements are identical in nature except for the specific terms set forth in the exhibit to the respective employment agreements defining employee title, manager, base salary, severance period, change in control severance, and other special provisions. The standard severance period is twelve months of base salary, and the change in control severance is eighteen months of base salary.

Stock Performance Chart

The following graph compares the quarterly percentage change in the cumulative total shareholder return for the Company's Common Stock during the fiscal year ended December 31, 2003 with the cumulative total return on the NASDAQ U.S. Index and the Philadelphia SOX Index. The comparison assumes \$100 was invested on June 14, 2000 (the date that the Company's stock began to be publicly traded) in the Company's Common Stock and in each of the foregoing indices and assumes reinvestment of dividends. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

Based solely on its review of the copies of forms received by it, or written representations from certain reporting persons that no Forms 5 were required for those persons, the Company believes that, during 2003, all Executive Officers, directors and greater than ten-percent beneficial owners complied with applicable filing requirements pursuant to Section 16(a) of the Securities Exchange Act of 1934; provided, however, that, in 2004, the Company did not timely file a Form 4 for each of Linda Whitman, Roger E. Gower, James A. Bernards and Michael W. Wright, our outside directors, to report an option grant.

(Proposal #3)

Amendment

On February 4, 2004, the Board amended the 1997 Stock Option Plan to increase the shares reserved under the plan from 3,050,000 to 4,250,000 shares and added restricted stock awards, performance awards, and stock appreciation rights to the incentives available under the plan (the "Amendment"). The Amendment also gives the Board the ability to permit transfers of non-statutory stock options to members of the optionee's immediate family, trusts whose beneficiaries are members of the optionee's immediate family, and partnerships in which such family members are the only partners. The plan is now known as the 1997 Stock Incentive Plan (the "1997 Plan"). As of March 4, 2004, the Company had outstanding incentive and nonqualified options for the purchase of an aggregate of 1,615,790 shares of the Company's Common Stock with an average exercise price of \$9.18 per share. Options to purchase 1,201,199 shares under the 1997 Plan have been exercised as of March 4, 2004. The increase in the number of shares is necessary to provide sufficient shares for future option grants, restricted stock awards, performance share awards, and stock appreciation rights. The Amendment provides, however, that no more than 50% of the maximum number of shares reserved for issuance under the 1997 Plan shall be issued or reserved for issuance (or issued and reserved) pursuant to restricted stock awards, performance awards, and stock appreciation rights. The Board believes that granting these stock incentives to employees and directors is an effective means to promote the future growth and development of the Company. Such incentives, among other things, increase employees' and directors' proprietary interest in the Company's success and enable the Company to attract and retain qualified personnel. The Board therefore recommends that all shareholders vote in favor of the Amendment.

Summary of 1997 Stock Incentive Plan

A general description of the basic features of the 1997 Plan is presented below, but such description is qualified in its entirety by reference to the full text of the 1997 Plan, a copy of which may be obtained without charge upon written request to Scott A. Gabbard, the Company's Chief Accounting Officer and Vice President, Finance.

Purpose. The purpose of the 1997 Plan is to advance the interests of the Company and its shareholders by enabling the Company to attract and retain competent employees and directors, by providing an incentive to such individuals through equity participation in the Company and by rewarding such individuals who contribute to the Company's achievement of its long-term economic objectives.

Term. Options and awards may be granted pursuant to the 1997 Plan until July 30, 2007, which is ten (10) years from the date the 1997 Plan was originally adopted by the Board of Directors.

Administration. The 1997 Plan shall be administered by the Board of Directors. The Board grants the options and awards, setting the terms of such options and awards; provided, however, that the Board has granted authority to two Board elected officers, who, acting together, may grant options and awards for the purchase of up to 3,500 shares to certain new employees, not including any Executive Officers. The 1997 Plan permits the Board to appoint a committee (the "Committee") to administer the 1997 Plan, all of the members of which must be "non-employee directors" under Rule 16b-3 of the Act, and the Board may appoint a committee in the future. The Board has granted the Compensation Committee the authority to grant options to employees who are not Executive Officers. The 1997 Plan gives broad powers to the committee to administer and interpret the 1997 Plan, including the authority to select the individuals to be granted options and awards and to prescribe the particular form and conditions of each option granted. Notwithstanding any other provision of the 1997 Plan, neither the

Board nor the Committee may reduce the exercise price of any outstanding award without the affirmative vote of the holders of a majority of the voting power of all outstanding shares entitled to vote.

Eligibility. All employees of the Company or any subsidiary are eligible to receive incentive stock options pursuant to the 1997 Option Plan. All employees, Executive Officers and directors of and consultants and advisors to the Company or any subsidiary are eligible to receive non-statutory stock options, restricted stock awards, stock appreciation rights, and performance awards. As of March 4, 2004, the Company had approximately 194 employees, of whom seven are Executive Officers, and four directors who are not employees.

Options. When an option is granted under the 1997 Option Plan, the Board, at its discretion, specifies the option price and the number of shares of Common Stock which may be purchased upon exercise of the option. The exercise price of an incentive stock option may not be less than 100% of the fair market value of the Company's Common Stock, as that term is defined in the 1997 Option Plan, or 110% of the fair market value of the Company's Common Stock if the employee owns, directly or indirectly, more than 10% of the total combined voting power of all classes of stock of the Company, any Subsidiary or any parent corporation of the Company (within the meaning of Section 424(e) of the Code). The exercise price of a non-statutory stock option may not be less than the fair market value on the date of grant. The period during which an

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option may be exercised and whether the option will be exercisable immediately, in stages, or otherwise is set by the Board. An incentive stock option may not be exercisable more than ten years from the date of grant. Optionees may pay for shares upon exercise of options with cash, certified check or Common Stock of the Company valued at the stock's then "fair market value" as defined in the 1997 Plan.

Generally, under the form of incentive option agreement which is currently being used for options granted under the 1997 Plan, if the optionee's affiliation with the Company terminates before expiration of the option for reasons other than death, disability, the optionee has a right to exercise the option for 90 days after termination of such affiliation or until the option's original expiration date, whichever is earlier. The current form of non-statutory option agreement used for options granted to the directors provides that, if the optionee's directorship with the Company terminates before expiration of the option, the optionee has a right to exercise the option until the option's original expiration date, whichever is earlier. If the termination is because of death or disability, the option typically is exercisable until its original stated expiration. Some of the previous option agreements with employees and directors terminate immediately or in 30 days or 12 months after termination of optionee's affiliation with the Company. The Board may impose additional or alternative conditions and restrictions on the incentive or non-statutory stock options granted under the 1997 Plan; however, each incentive option must contain such limitations and restrictions upon its exercise as are necessary to ensure that the option will be an incentive stock option as defined under the Internal Revenue Code.

Restricted Stock Awards. The Board is also authorized to grant awards of restricted stock. Each restricted stock award granted under the Plan shall be for a number of shares as determined by the Board or the Committee, and the Board or the Committee, in its discretion, may also establish continued employment, vesting or other conditions that must be satisfied for the restrictions on the transferability of the shares and the risks of forfeiture to lapse.

Performance Awards. The Board is also authorized to grant performance awards. Performance awards shall consist of shares of Common Stock of the Company or other awards denominated in shares of Common Stock that may be earned or become vested in whole or in part if the Company achieves certain goals established by the Board or the Committee over a specified period.

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Stock Appreciation Rights. The Board is also authorized to grant stock appreciation rights. A stock appreciation right may be granted independent of or in tandem with a previously or contemporaneously granted stock option, as determined by the Board or the Committee. Generally, upon the exercise of a stock appreciation right, the recipient will receive cash, shares of Common Stock or some combination of cash and shares having a value equal to the excess of (i) the fair market value of a specified number of shares of the Company's Common Stock on the date of exercise, over (ii) a specified exercise price. Unless otherwise determined by the Board or the Committee, the specified exercise price shall not be less than 100% of the fair market value of the stock on the date of grant of the stock appreciation right. The Committee will determine the term of the stock appreciation right and how it will become exercisable. If a Stock Appreciation Right is granted in tandem with an Option, the Stock Appreciation Agreement shall set forth the extent to which the exercise of all or a portion of the Stock Appreciation Right shall cancel a corresponding portion of the Option, and the extent to which the exercise of all or a portion of the Option shall cancel a corresponding portion of the Stock Appreciation Right.

Transferability. Options, restricted stock awards, performance awards, and stock appreciation rights granted under the 1997 Plan are nontransferable during the lifetime of the optionee, except that the Committee has discretion to permit optionees to transfer any or all non-statutory options to any member of the optionee's immediate family, to one or more trusts whose beneficiaries are members of such optionee's immediate family, or to partnerships in which such family members are the only partners.

Change of Control. In the event of an acquisition of the Company through the sale of substantially all of the Company's assets and the consequent discontinuance of its business or through a merger, consolidation, exchange, reorganization, reclassification, extraordinary dividend, divestiture or liquidation of the Company, the Board may, in its sole discretion and in accordance with the provisions contained in the plan, provide for the acceleration, continuation, termination, or cancellation of any option or award granted pursuant to the 1997 Plan or for the distribution of stock or cash as provided in the 1997 Plan.

Amendment. The Board of Directors may from time to time suspend or discontinue the 1997 Plan or revise or amend it in any respect; provided, however, that no such revision or amendment may impair the terms and conditions of any outstanding option to the material detriment of the optionee without the consent of the optionee, except as authorized in the event of a change of control of the Company. The 1997 Plan may not be amended in any manner that will cause incentive stock options to fail to meet the requirements of Code Section 422, and may not be amended, without the approval of the shareholders, in any manner that will: (i) increase the number of shares subject to the 1997 Plan except as provided in the case of stock splits, consolidations, stock dividends or similar events; (ii) change the designation of the class of employees eligible to receive options; or (iii) materially increase the benefits accruing to optionees under the 1997 Plan.

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The Board of Directors will equitably adjust the maximum number of shares of Common Stock reserved for issuance under the 1997 Plan, the number of shares covered by each outstanding option and the option price per share in the event of stock splits or consolidations, stock dividends or other transactions in which the Company receives no consideration. Generally, the Board of Directors may also provide for the protection of optionees in the event of a merger, liquidation or reorganization of the Company.

Federal Income Tax Consequences of the Plan.

Options. Under present law, an optionee will not realize any taxable income on the date a non-statutory stock option is granted to the optionee pursuant to the 1997 Plan. Upon exercise of the non-statutory stock option, however, the optionee will realize, in the year of exercise, ordinary income to the extent of the difference between the option price and the fair market value of the Company's

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Common Stock on the date of exercise. Upon the sale of the shares, any resulting gain or loss will be treated as capital gain or loss. The Company will be entitled to a tax deduction in its fiscal year in which non-statutory stock options are exercised, equal to the amount of compensation required to be included as ordinary income by those optionees exercising such options.

Incentive stock options granted pursuant to the 1997 Plan are intended to qualify for favorable tax treatment to the optionee under Code Section 422. Under Code Section 422, an employee realizes no taxable income when the incentive stock option is granted. If the employee has been an employee of the Company or any subsidiary at all times from the date of grant until three months before the date of exercise, the employee will realize no taxable income when the option is exercised. If the employee does not dispose of shares acquired upon exercise for a period of two years from the granting of the incentive stock option and one year after receipt of the shares, the employee may sell the shares and report any gain as capital gain. The Company will not be entitled to a tax deduction in connection with either the grant or exercise of an incentive stock option. If the employee should dispose of the shares prior to the expiration of the two-year or one-year periods described above, the employee will be deemed to have received compensation taxable as ordinary income in the year of the early sale in an amount equal to the lesser of (i) the difference between the fair market value of the Company's Common Stock on the date of exercise and the option price of the shares, or (ii) the difference between the sale price of the shares and the option price of shares. In the event of such an early sale, the Company will be entitled to a tax deduction equal to the amount recognized by the employee as ordinary income. The foregoing discussion ignores the impact of the alternative minimum tax, which may particularly be applicable to the year in which an incentive stock option is exercised.

Restricted Stock Awards. Generally, no income is taxable to the recipient of a restricted stock award in the year that the award is granted. Instead, the recipient will recognize compensation taxable as ordinary income equal to the fair market value of the shares in the year in which the transfer restrictions lapse. Alternatively, if a recipient makes a "Section 83(b)" election, the recipient will, in the year that the restricted stock award is granted, recognize compensation taxable as ordinary income equal to the fair market value of the shares on the date of the award. The Company normally will receive a deduction equal to the amount of compensation the recipient is required to recognize as ordinary taxable income, and must comply with applicable tax withholding requirements.

Performance Awards. A recipient of performance awards will recognize compensation taxable as ordinary income equal to the value of the shares of Common Stock or the cash received, as the case may be, in the year that the recipient receives payment. The Company normally will receive a deduction equal to the amount of compensation the recipient is required to recognize as ordinary taxable income, and must comply with applicable tax withholding requirements.

Stock Appreciation Rights. Generally, a recipient of a stock appreciation right will recognize compensation taxable as ordinary income equal to the value of the shares of Common Stock or the cash received in the year that the stock appreciation right is exercised. The Company normally will receive a deduction equal to the amount of compensation the recipient is required to recognize as ordinary taxable income, and must comply with applicable tax withholding requirements.

Plan Benefits. Because future grants of stock options are subject to the discretion of the Board, the future benefits under the 1997 Plan cannot be determined at this time. The table below shows the

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total number of shares underlying stock options that have been granted under the 1997 Plan as of March 4, 2004 to the named Executive Officers and the groups set forth.

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Name and Position/Group	Shares of Common Stock Underlying Options Received(1)
Jeff L. O'Dell Chief Executive Officer and Chairman	19,500
D. Mayson Brooks Vice President, Global Sales and Field Operations	235,022
David L. Klenk President and Chief Operating Officer	289,050
Scott A. Gabbard Chief Accounting Officer and Vice President, Finance	118,132
Stanley D. Piekos Chief Financial Officer	135,632
Current Executive Officers as a Group (7 persons)	963,405
Current Directors who are not Executive Officers as a Group (4 persons)	216,403
Current Employees who are not Executive Officers or Directors as a Group (187 persons)	1,225,384

(1)

Includes options granted which are currently outstanding or have been exercised.

Vote Required. The Board of Directors recommends that the shareholders approve the Amended and Restated 1997 Plan which increases the number of shares reserved for issuance under the 1997 Plan from 3,050,000 to 4,250,000 and adds restricted stock awards, performance awards, and stock appreciation rights to the incentives available under the plan. Under applicable Minnesota law, approval of the amendment to the 1997 Plan requires the affirmative vote of the holders of a majority of the voting power of the shares represented in person or by proxy at the Annual Meeting with authority to vote on such matter, provided that such majority must be greater than 25% of the Company's outstanding shares.

Equity Compensation Plan Information

The following table provides information about shares of the Company's Common Stock that may be issued under the Company's equity compensation plans, as of December 31, 2003:

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders(1)	1,799,630	\$ 7.43	612,161(2)
Equity compensation plans not approved by security holders			
Total	1,799,630	\$ 7.43	612,161

(1)

Includes options under the August Technology 1997 Stock Option Plan

(2)

Includes 249,598 shares available for issuance under the August Technology 2000 Employee Stock Purchase Plan

RATIFICATION OF INDEPENDENT AUDITORS
(Proposal #4)

The Audit Committee of the Board of Directors has appointed KPMG LLP as the Company's independent auditors to audit its consolidated financial statements for the 2004 fiscal year. KPMG LLP served as independent auditors for the Company for the year ended December 31, 2003 and has been selected to act as the Company's independent auditors for the current year ending December 31, 2004. Although the Company is not required to seek shareholder approval of this appointment, the Board of Directors believes it to be sound and prudent corporate governance to do so. If the appointment is not ratified, the Audit Committee will investigate the reasons for shareholders' rejections and will reconsider the appointment.

Representatives of KPMG LLP are expected to be present at the Annual Meeting and will be given an opportunity to make a statement regarding financial and accounting matters of the Company, if they so desire, and will be available to respond to appropriate questions from the Company's shareholders.

The following table presents fees paid by the Company for professional services rendered by KPMG LLP for the years ended December 31, 2003 and 2002. Certain amounts for 2002 have been reclassified to conform to the 2003 presentation.

Fee Category	Years ended December 31,	
	2003	2002
Audit Fees	\$ 203,000	\$ 110,000
Audit Related Fees	14,500	22,950
Tax Fees	28,800	16,120
All Other Fees		9,000
	<u>\$ 246,300</u>	<u>\$ 158,070</u>

out-of-pocket expenses incurred by non-employee directors in attending Board and committee meetings.

Director Compensation Table 2017

The following table sets forth information with respect to the compensation earned by our non-employee directors during the fiscal year ended December 31, 2017. Mr. Wolchko did not receive compensation for service on the Board of Directors, and the compensation paid to Mr. Wolchko as an employee of the Company is set forth under the heading Compensation of Executive Officers Summary Compensation Table below.

Name	Fees Earned or Paid in Cash (\$)	Option Awards (\$)	All Other Compensation (\$)	Total (\$)
William H. Rastetter, Ph.D. (Chairman)(2)	\$ 89,500	\$ 87,188	\$	\$ 176,688
	\$ 38,500	\$ 87,188	\$	\$ 125,688

Years ended
December 31,

John D. Mendlein, Ph.D., J.D.(3)				
Timothy P. Coughlin(4)	\$ 55,000	\$ 87,188	\$	\$ 142,188
Mark J. Enyedy(5)	\$ 52,500	\$ 87,188	\$	\$ 139,688
Amir Nashat, Sc.D.(6)	\$ 38,500	\$ 87,188	\$	\$ 125,688
Robert S. Epstein, M.D., M.S.(7)	\$ 40,000	\$ 87,188	\$	\$ 127,188

- (1) In accordance with SEC rules, this column reflects the aggregate grant date fair value of the option awards granted during 2017, computed in accordance with Financial Accounting Standard Board Accounting Standards Codification Topic 718 for stock-based compensation transactions (ASC 718). Such aggregate grant date fair values do not take into account any estimated forfeitures related to service-vesting conditions. Assumptions used in the calculation of these amounts will be included in the notes to our consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 when filed in March 2018. These amounts do not reflect the actual economic value that may be realized by the directors upon the vesting of the stock options, the exercise of the stock options or the sale of the common stock underlying such stock options.
- (2) Dr. Rastetter held stock options to purchase an aggregate of 98,461 shares of common stock as of December 31, 2017.

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- (3) Dr. Mendlein held stock options to purchase an aggregate of 130,023 shares of common stock as of December 31, 2017.
- (4) Mr. Coughlin held stock options to purchase an aggregate of 93,076 shares of common stock as of December 31, 2017.
- (5) Mr. Enyedy held stock options to purchase an aggregate of 100,769 shares of common stock as of December 31, 2017.
- (6) Dr. Nashat held stock options to purchase an aggregate of 70,000 shares of common stock as of December 31, 2017.
- (7) Dr. Epstein held stock options to purchase an aggregate of 90,000 shares of common stock as of December 31, 2017.

Required Vote

The nominees for Class II director receiving the highest number of affirmative votes of all the votes properly cast shall be elected as director to serve until the 2021 Annual Meeting of Stockholders or until their successors have been duly elected and qualified.

Recommendation of the Board of Directors

The Board of Directors recommends that the stockholders vote FOR the election of the two nominees for Class II director listed above.

Table of Contents**PROPOSAL 2****RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Audit Committee has appointed Ernst & Young LLP as the Company's independent registered public accounting firm for 2018. Representatives of Ernst & Young LLP will attend the Annual Meeting and will have the opportunity to make a statement if they desire to do so. They will also be available to respond to appropriate questions.

The Company's organizational documents do not require that the stockholders ratify the selection of Ernst & Young LLP as the Company's independent registered public accounting firm, and stockholder ratification is not binding on the Company, the Board or the Audit Committee. The Company requests such ratification, however, as a matter of good corporate practice. Our Board, including our Audit Committee, values the opinions of our stockholders and, to the extent there is any significant vote against the ratification of the selection of Ernst & Young LLP as disclosed in this Proxy Statement, we will consider our stockholders' concerns and evaluate what actions may be appropriate to address those concerns, although the Audit Committee, in its discretion, may still retain Ernst & Young LLP.

The following table shows information about fees billed to the Company by Ernst & Young LLP for the fiscal years ended December 31, 2017 and 2016:

Fees billed by Ernst & Young LLP	2017	2016
Audit Fees(1)	\$ 464,676	\$ 345,828
Audit Related Fees		
Tax Fees	\$ 53,022	\$ 41,365
All Other Fees		
Total	\$ 517,698	\$ 387,193

- (1) Includes fees associated with the annual audit of our financial statements, the reviews of our interim financial statements and the issuance of consent and comfort letters in connection with registration statements.

Audit Committee Pre-Approval Policies

The Audit Committee is directly responsible for the appointment, retention and termination, and for determining the compensation, of the Company's independent registered public accounting firm. The Audit Committee shall pre-approve all auditing services and the terms thereof and non-audit services (other than non-audit services prohibited under Section 10A(g) of the Exchange Act or the applicable rules of the SEC or the Public Company Accounting Oversight Board), except that pre-approval is not required for the provision of non-audit services if the de minimis provisions of Section 10A(i)(1)(B) of the Exchange Act are satisfied. The Audit Committee may delegate to the chairperson of the Audit Committee the authority to grant pre-approvals for audit and non-audit services, provided such approvals are presented to the Audit Committee at its next scheduled meeting. All services provided by Ernst & Young LLP during fiscal year 2017 were pre-approved by the Audit Committee in accordance with the pre-approval policy described above, and all audit-related fees, tax fees and other fees during the fiscal year 2017 were approved by the Audit Committee.

Required Vote

The ratification of the selection of Ernst & Young LLP requires the affirmative vote of a majority of the votes cast on the proposal at the Annual Meeting.

Recommendation of the Board of Directors

The Board of Directors recommends that the stockholders vote FOR the ratification of the appointment of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2018.

Table of Contents**EXECUTIVE OFFICERS**

The names of the executive officers of the Company, their ages as of March 1, 2018, and certain other information about them are set forth below (unless set forth elsewhere in this Proxy Statement).

Name	Age	Position
J. Scott Wolchko	47	President, Chief Executive Officer and Director
Daniel D. Shoemaker, Ph.D.	50	Chief Scientific Officer
Stewart Abbot, Ph.D.	51	Chief Development Officer
Cindy R. Tahl, J.D.	45	General Counsel and Corporate Secretary
Chris M. Storgard, M.D.	52	Chief Medical Officer

The biographies of our executive officers, other than Mr. Wolchko, whose biography is set forth above, appear below.

Daniel D. Shoemaker, Ph.D. has served as our Chief Scientific Officer since May 2015 and oversees our discovery and preclinical research efforts. He previously served as our Chief Research Officer from January 2015 to May 2015, and as our Chief Technology officer from February 2009 to January 2015. From 2003 to 2009, Dr. Shoemaker was Chief Scientific Officer of ICxBiosystems, a biotechnology firm that develops advanced detection technologies for use in biodefense, cancer and prenatal diagnostics. From 1998 to 2003, Dr. Shoemaker held several positions at Merck Research Laboratories, including Director of Target Discovery, Senior Director at Rosetta Inpharmatics and research fellow in the Department of Molecular Neurosciences, where his main focus was on target identification and biomarker discovery. Dr. Shoemaker received his Ph.D. in biochemistry from Stanford University and his B.S. in biochemistry from the University of California, Santa Barbara.

Stewart Abbot, Ph.D., has served as our Chief Development Officer since October 2015. Prior to that, Dr. Abbot served as our Vice President of Translational Research from July 2015. Previously, Dr. Abbot was Executive Director of Integrative Research at Celgene Cellular Therapeutics (CCT) from January 2013 to July 2015, where he led research activities for CCT that encompassed technology and product scouting, alliance identification and business development activities, including initiation of engineered T cell programs. He was Executive Director of Research at CCT from January 2010 to January 2013, and Senior Director of Research at CCT from June 2007 to December 2010. In these roles, Dr. Abbot led a group that developed novel therapeutic candidates based on hematopoietic stem cells and human placenta-derived cells and initiated clinical trials for placental cells. Prior to CCT, Dr. Abbot led General Electric's Molecular and Cellular Biology research laboratory at its Global Research Center in Albany, NY. Dr. Abbot received his Ph.D. in pathology from the University of London, his M.Sc. in biomedical engineering from the University of Strathclyde, and his B.Sc. in biological sciences from the University of Edinburgh.

Cindy R. Tahl, J.D., has served as our General Counsel and Corporate Secretary since October 2015. She previously served as our Vice President, IP and Senior Corporate Counsel since December 2013. From 2009 to 2013, Ms. Tahl served as our Senior Director, Intellectual Property and Corporate Counsel. From 2007 to 2009, Ms. Tahl was a technology transactions attorney at the law firm of Wilson Sonsini Goodrich and Rosati, P.C, and from 2004 to 2007 practiced intellectual property law in the New York office of Kenyon & Kenyon, LLP. Ms. Tahl received her J.D. from Boston College Law School and her B.S. in biology from the University of California, San Diego.

Chris M. Storgard, M.D., has served as our Chief Medical Officer since May 2016, and is leading the company's clinical development efforts. Prior to that, Dr. Storgard was the Vice President, Clinical Research and Development at Ardea Biosciences, a biotechnology company and a member of the AstraZeneca group, from August 2013 to July 2016, where he led the global clinical development of ZURAMPIC® to successful U.S. and European regulatory

approvals. Dr. Storgard served as an Executive Director of Ardea Biosciences from August 2011 to August 2013, where he was responsible for the oversight and delivery of two global Phase 3 registration

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trials. Before joining Ardea, he held senior positions in drug development and medical affairs at Prometheus Laboratories, Biogen Idec, and Amgen, where he focused on biologic and small molecule development programs within the inflammation and oncology teams. Dr. Storgard received his M.D. and B.Sc. from the University of Saskatchewan.

Table of Contents**COMPENSATION OF EXECUTIVE OFFICERS****Summary Compensation Table**

The following table presents information regarding the total compensation earned by each individual who served as our chief executive officer at any time during the fiscal year ended December 31, 2017 and our two other most highly compensated executive officers who were serving as executive officers as of December 31, 2017. We refer to these officers in this Proxy Statement as our named executive officers. The following table also sets forth information regarding total compensation awarded to, earned by and paid to each of our named executive officers during the fiscal year ending December 31, 2016.

Name and Principal

Position as of December 31, 2017	Year	Salary (\$)	Stock Awards (\$)	Option Awards \$(1)	Non-Equity Incentive Plan	All Other	Total (\$)
					Compensation \$(2)	Compensation (\$)	
J. Scott Wolchko, President, Chief Executive Officer and Director	2017	480,000		668,789	156,000		1,304,789
	2016	425,000		558,744	138,125		1,121,869
Christopher Storgard, M.D, Chief Medical Officer(3)	2017	385,000		365,604	87,588		838,192
Daniel D. Shoemaker, Ph.D., Chief Scientific Officer	2017	352,500		365,604	80,194		798,298
	2016	340,000		295,800	77,350		713,150

- (1) In accordance with SEC rules, this column reflects the aggregate grant date fair value of option awards granted during 2017 and 2016, computed in accordance with ASC 718. Such aggregate grant date fair values do not take into account any estimated forfeitures related to service-vesting conditions. Assumptions used in the calculation of these amounts will be included in the notes to our consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, to be filed in March 2018. These amounts do not reflect the actual economic value that may be realized by the named executive officer upon the vesting of the stock options the exercise of the stock options or the sale of the common stock underlying such stock options.
- (2) The amounts in this column represent the annual incentive compensation paid for performance during 2017 and 2016. The amounts of these awards were determined based upon the achievement of performance metrics related to the Company's 2017 and 2016 corporate objectives, including objectives pertaining to the Company's advancement of its clinical and preclinical programs and achievement of its corporate development and financing initiatives.
- (3) Dr. Storgard was not a named executive officer for the fiscal year ended December 31, 2016, but is a named executive officer for the fiscal year ended December 31, 2017.

Bonuses. In January 2015, the Board of Directors adopted the Company's Amended and Restated Senior Executive Incentive Bonus Plan (the "Bonus Plan"), which applies to certain key executives (the "Executives"), that are recommended by the Compensation Committee and selected by the Board of Directors. The Bonus Plan provides for bonus payments based upon the attainment of performance targets established by the Compensation Committee and related to scientific, operational and financial metrics with respect to the Company or any of its subsidiaries (the "Performance Goals"), which may include, among others, revenue; expense levels; business development and financing milestones; total shareholder return; earnings before interest, taxes, depreciation and amortization; net income (loss)

(either before or after interest, taxes, depreciation and/or amortization); changes in the market price of the Company's common stock; economic value-added; sales or revenue, developmental, clinical or regulatory milestones; acquisitions or strategic transactions; operating income (loss); cash flow (including, but not limited to, operating cash flow and free cash flow); return on capital, assets, equity, or investment; stockholder returns; return on sales; gross or net profit levels; productivity; expense efficiency; margins; operating efficiency; customer satisfaction; clinical trial results; publications; reimbursement decisions; working capital; earnings (loss) per share of the Company's common stock; sales or market shares; number of customers or units of products sold; and operating income and/or net annual recurring revenue, any of which may

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be (i) measured in absolute terms or compared to any incremental increase, (ii) measured in terms of growth, (iii) compared to another company or companies or to results of a peer group, (iv) measured against the market as a whole and/or as compared to applicable market indices and/or (v) measured on a pre-tax or post-tax basis (if applicable). Further, any Performance Goals may be used to measure the performance of the Company as a whole or a business unit or other segment of the Company, or one or more product lines or specific markets. Any bonuses paid under the Bonus Plan will be based upon objectively determinable bonus formulas that tie such bonuses to one or more performance targets relating to the Performance Goals. The bonus formulas will be adopted in each performance period by the Compensation Committee and communicated to each Executive. No bonuses will be paid under the Bonus Plan unless and until the Compensation Committee makes a determination with respect to the attainment of the performance objectives. Notwithstanding the foregoing, the Compensation Committee may adjust bonuses payable under the Bonus Plan based on achievement of individual performance goals or pay bonuses (including, without limitation, discretionary bonuses) to Executives under the Bonus Plan based upon such other terms and conditions as the Compensation Committee may in its discretion determine. The bonuses payable under the Bonus Plan may be paid in equity or cash.

For 2017, bonuses under the Bonus Plan were paid in cash and determined based upon the achievement of performance metrics related to the Company's corporate objectives, including objectives pertaining to the Company's advancement of its clinical and preclinical programs and achievement of its corporate development and financing initiatives.

Equity Incentive Compensation. We generally grant stock options to our employees, including our named executive officers, in connection with their initial employment with us. We also have historically granted stock options on an annual basis as part of annual performance reviews of our employees. From time to time, we have also granted, and may continue to grant, restricted stock unit awards to our employees, including our named executive officers, in connection with their initial employment with us or as part of annual performance reviews. We did not grant any restricted stock units to our named executive officers in 2017.

Outstanding Equity Awards at Fiscal Year-End

The following table sets forth certain information with respect to outstanding equity awards as of December 31, 2017 with respect to our named executive officers. The equity awards are subject to certain acceleration of vesting provisions as provided (i) in the case of Mr. Wolchko, in his employment agreement, as described in Compensation of Executive Officers' Employment Arrangement with Our Named Executive Officers, below, and (ii) in the case of the other named executive officers, in the Company's Severance and Change in Control

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Policy (the Severance and CIC Policy), as described in Compensation of Executive Officers Executive Severance and Change in Control Policy, below.

Name	Option Awards Equity Incentive Plan Awards:				Stock Awards		
	Number of Securities underlying Unexercised Options (#)	Number of Securities underlying Unexercised Options (#)	Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of shares or units of stock that have not vested (#)	Market value of shares or units of stock that have not vested \$(1)
J. Scott Wolchko, President, Chief Executive Officer and Director	27,935(2)			1.63	2/9/2022		
	26,400(2)			1.63	2/9/2022		
	9,846(2)			7.87	8/12/2023		
	85,000(3)			6.62	1/9/2024		
	51,041(4)	18,959(4)		4.84	1/5/2025		
						43,125(5)	263,494
	94,800(6)	94,800(6)		2.70	1/12/2026		
	36,800(7)		73,600(7)	2.70	1/12/2026		
	57,291(8)	192,709(8)		2.73	1/4/2027		
Christopher Storgard, M.D, Chief Medical Officer	79,162(9)	120,838(9)		1.54	5/16/2026		
	34,375(8)	115,625(8)		2.73	1/4/2027		
Daniel D. Shoemaker, Ph.D., Chief Scientific Officer	31,784(2)			1.63	2/9/2022		
	19,200(2)			1.63	2/9/2022		
	20,294(2)			1.37	7/24/2022		
	9,846(2)			7.87	8/12/2023		
	85,000(3)			6.62	1/9/2024		
						33,000(5)	201,630
	51,041(4)	18,959(4)		4.84	1/5/2025		
	71,300(10)	77,500(10)		2.90	1/8/2026		
	34,375(8)	115,625(8)		2.73	1/4/2027		

- (1) This amount reflects the closing market price of a share of our common stock of \$6.11 as of December 29, 2017, multiplied by the amount shown in the column Stock Awards Number of shares or units of stock that have not vested.
- (2) All outstanding options were fully vested. The options were issued pursuant to the 2007 Equity Incentive Plan (the 2017 Plan).

- (3) All outstanding options were fully vested. The options were issued pursuant to the 2013 Plan.
- (4) The shares underlying the options vest in equal monthly installments over four years from January 5, 2015 through January 5, 2019. The options were issued pursuant to the 2013 Plan.
- (5) The restricted stock units will vest on October 12, 2019. This grant was subject to accelerated vesting upon a change of control of the Company and in the event of certain terminations of employment following a change of control of the Company, as provided in the applicable restricted stock unit award agreement, which has been superseded by the accelerated vesting terms under (i) for Mr. Wolchko, his employment agreement and (ii) for Dr. Shoemaker, the Severance and CIC Policy. The restricted stock units were issued pursuant to the 2013 Plan.
- (6) The shares underlying the options vest in equal monthly installments over four years from January 1, 2016 through January 1, 2020. The options were issued pursuant to the 2013 Plan.
- (7) 1/3 of the shares underlying the options vest upon the Company's achievement of certain performance goals by December 31, 2017, September 30, 2018 and December 31, 2018. The options were issued pursuant to the 2013 Plan.

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- (8) The shares underlying the options vest in equal monthly installments over four years from January 4, 2017 through January 4, 2021. The options were issued pursuant to the 2013 Plan.
- (9) The shares underlying this option vest in equal monthly installments over four years from May 16, 2016 through May 16, 2020. The options were issued pursuant to the Company's Inducement Equity Plan (the "Inducement Plan").
- (10) The shares underlying the options vest in equal monthly installments over four years from January 8, 2016 through January 8, 2020. The options were issued pursuant to the 2013 Plan.

401(k) Savings Plan and Other Benefits

We have established a 401(k) plan to allow our employees to save on a tax-favorable basis for their retirement. We do not match any contributions made by any employees, including our named executive officers, pursuant to the plan. We also pay, on behalf of our employees, a portion of the premiums for health, life and disability insurance.

Employment and Severance Arrangements

We consider it essential to the best interests of our stockholders to foster the continuous employment of our key management personnel. In this regard, we recognize that the possibility of a change in control may exist and that the uncertainty and questions that it may raise among management could result in the departure or distraction of management personnel to the detriment of the Company and our stockholders. In order to reinforce and encourage the continued attention and dedication of certain key members of management, we have entered into written employment agreements with certain of our named executive officers that, while at-will, contain certain change in control and severance provisions. We have also adopted a severance and change in control policy for our employees, including our named executive officers, except for our Chief Executive Officer. A summary of such provisions is below.

Employment Arrangements with Our Named Executive Officers

J. Scott Wolchko

Mr. Wolchko commenced employment with us on September 17, 2007, and, in connection with his appointment as our President and CEO, we entered into a new employment agreement with Mr. Wolchko (the "Original CEO Employment Agreement"). The Original CEO Agreement was amended and restated in its entirety by a new employment agreement that Mr. Wolchko entered into with us on January 14, 2018, effective January 1, 2018 (the "CEO Employment Agreement"). The CEO Employment Agreement sets forth Mr. Wolchko's current annual base salary, annual incentive compensation and his eligibility to participate in our benefit plans generally. Pursuant to the CEO Employment Agreement, Mr. Wolchko is eligible to receive annual incentive compensation, for which the target annual incentive compensation will be 50% of his then-current annual base salary, as determined by the Board of Directors or the Compensation Committee.

Payments Provided upon a Change of Control or Termination for Good Reason or Without Cause

Mr. Wolchko's employment is at-will. Upon any termination of his employment, Mr. Wolchko will be entitled to receive (A) the amount of his accrued but unpaid salary and unpaid expense reimbursements and any accrued but unused vacation as of the date of termination, (B) any vested benefits Mr. Wolchko may have under any employee benefit plan, which shall be paid in accordance with the terms of such employee benefit plans, as of the date of termination, and (C) any earned but unpaid incentive compensation from the prior calendar year (clauses (A) through (C) collectively, the "Accrued Benefits"). Pursuant to the CEO Employment Agreement, in the event that Mr. Wolchko's employment is terminated by the Company without Cause (other than due to death or disability) or by Mr. Wolchko for Good Reason (as such terms are defined below), in each case outside of the "Sale Event Period" (as defined below),

subject to his execution of a nonrevocable separation agreement and

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release, Mr. Wolchko will be entitled to, in addition to the Accrued Benefits, (i) a lump sum cash payment equal to the sum of twelve (12) months of Mr. Wolchko's then-current base salary and his annual target incentive compensation for the year of termination, (ii) full acceleration of vesting of all outstanding equity awards containing performance-based vesting conditions, if such performance-based vesting conditions have been satisfied as of the date of termination, (iii) for all outstanding equity awards containing time-based vesting conditions, twelve (12) months of accelerated vesting; provided, however, that for any equity awards that include both a performance-based vesting condition (including the achievement of a specified stock price or market capitalization) and a time-based vesting condition, or any equity awards that vest solely upon the achievement of a performance-based vesting condition, no acceleration of vesting will be provided unless the applicable performance-based vesting condition has been satisfied as of the date of Mr. Wolchko's termination, and any acceleration provided shall be subject to clause (ii) of this paragraph, and (iv) payment of the premiums for Mr. Wolchko's and his family's participation in the Company's group health care plans, subject to Mr. Wolchko's copayment amount, for up to eighteen (18) months after such termination.

Pursuant to the CEO Employment Agreement, in the event that Mr. Wolchko's employment is terminated by the Company without Cause (other than due to death or disability) or by Mr. Wolchko for Good Reason, in each case within the period beginning three months prior to and ending eighteen (18) months following a Sale Event (as such term is defined below) (the Sale Event Period), subject to his execution of a nonrevocable separation agreement and release, Mr. Wolchko is entitled to, in addition to the Accrued Benefits, (i) a lump sum cash payment equal to the sum of eighteen (18) months of Mr. Wolchko's then-current base salary (or base salary in effect immediately prior to the Sale Event, if higher) and one and a half (1.5) times his annual target incentive compensation for the year of termination, (ii) full acceleration of vesting of all outstanding equity awards; provided, that for any equity awards that include both a performance-based vesting condition (including the achievement of a specified stock price or market capitalization) and a time-based vesting condition, or any equity awards that vest solely upon the achievement of a performance-based vesting condition, no acceleration of vesting will be provided unless the applicable performance-based vesting condition has been satisfied as of the date of Mr. Wolchko's termination, and (iii) payment of the premiums for Mr. Wolchko's and his family's participation in the Company's group health care plans, subject to Mr. Wolchko's copayment amount, for up to eighteen (18) months after such termination.

The payments and benefits provided to Mr. Wolchko under the CEO Employment Agreements in connection with a change of control may not be eligible for federal income tax deduction for the Company pursuant to Section 280G of the Internal Revenue Code of 1986. These payments and benefits may also be subject to an excise tax under Section 4999 of the Internal Revenue Code of 1986. If the payments or benefits payable to Mr. Wolchko in connection with a change of control would be subject to the excise tax imposed under Section 4999 of the Internal Revenue Code of 1986, then those payments or benefits will be reduced if such reduction would result in a higher net after-tax benefit to him.

Under the CEO Employment Agreement, the terms below are generally defined as follows:

Cause means, (i) conduct by the employee constituting a material act of misconduct in connection with the performance of the employee's duties, including, without limitation, misappropriation of funds or property of the Company or any of its subsidiaries or affiliates other than the occasional, customary and *de minimis* use of Company property for personal purposes; (ii) the commission by the employee of (A) any felony; or (B) a misdemeanor involving moral turpitude, deceit, dishonesty or fraud; (iii) any conduct by the employee that would reasonably be expected to result in material injury or reputational harm to the Company or any of its subsidiaries and affiliates if the employee were retained in the employee's position; (iv) continued material and substantial non-performance by the employee of the employee's material responsibilities hereunder (other than by reason of the employee's physical or mental illness, incapacity or disability) which has continued for more than thirty (30) days following written notice of such non-performance from the Board of Directors; (v) a material and substantial breach by the employee of any of

the employee's confidentiality, noncompetition, nonsolicitation or other similar restrictive covenant obligations to the Company; (vi) a material and substantial

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violation by the employee of any of the Company's written employment policies; or (vii) failure to cooperate with a bona fide internal investigation by or on behalf of the Board or an authorized committee thereof or an investigation by regulatory or law enforcement authorities, after being instructed by the Company to cooperate, or the willful destruction or failure to preserve documents or other materials known to be relevant to such investigation or the inducement of others to fail to cooperate or to produce documents or other materials in connection with such investigation.

Sale Event means (i) the sale of all or substantially all of the assets of the Company on a consolidated basis to an unrelated person or entity, (ii) a merger, reorganization or consolidation pursuant to which the holders of the Company's outstanding voting power and outstanding stock immediately prior to such transaction do not own a

majority of the outstanding voting power and outstanding stock or other equity interests of the resulting or successor entity (or its ultimate parent, if applicable) immediately upon completion of such transaction, (iii) the sale of all of the common stock of the Company to an unrelated person, entity or group thereof acting in concert, or (iv) any other transaction in which the owners of the Company's outstanding voting power immediately prior to such transaction do not own at least a majority of the outstanding voting power of the Company or any successor entity immediately upon completion of the transaction other than as a result of the acquisition of securities directly from the Company.

Good Reason means that the employee has complied with the appropriate notice process following the occurrence of any of the following events: (i) a material diminution in the employee's responsibilities, authorities, powers, functions or duties; (ii) a material reduction in the employee's then-current base salary or target annual incentive compensation, except for across-the-board reductions based on the Company's financial performance similarly affecting all or substantially all senior management employees of the Company; or (iii) the relocation of the employee's principal place of business to a place that is more than twenty-five (25) miles from the employee's current location of employment as of the effective date of the employment agreement. Notwithstanding the foregoing, none of the following shall be considered good reason: (x) the mere occurrence of a Sale Event; (y) any change in the identity of the surviving corporation in the event of a Sale Event; or (z) any change in the status of the surviving corporation after a Sale Event as a public or private Company.

Christopher Storgard, M.D.

Dr. Storgard is a party to an at-will employment offer letter with us, dated April 27, 2016 (the **Storgard Offer Letter**). The Storgard Offer Letter sets forth Dr. Storgard's initial annual base salary, initial annual incentive compensation, initial option grant and his eligibility to participate in our benefit plans generally. Pursuant to the Storgard Offer Letter and the Bonus Plan, Dr. Storgard is eligible to receive annual incentive compensation at a target percentage of 35% of his then-current annual base salary, as determined by the Board of Directors or the Compensation Committee.

Payments Provided upon a Change of Control or Termination for Good Reason or Without Cause

Dr. Storgard is entitled to certain severance payments and other benefits under the Severance and CIC Policy described below.

Daniel D. Shoemaker, Ph.D.

Dr. Shoemaker is a party to an at-will employment offer letter with us, dated February 11, 2009 (the **Shoemaker Offer Letter**). The Shoemaker Offer Letter sets forth Dr. Shoemaker's initial annual base salary, initial annual incentive compensation and his eligibility to participate in our benefit plans generally. Pursuant to the Shoemaker Offer Letter and the Bonus Plan, Dr. Shoemaker is eligible to receive annual incentive compensation, for which the initial target

annual incentive compensation will be 35% of his then-current annual base salary, as determined by the Board of Directors or the Compensation Committee.

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Payments Provided upon a Change of Control or Termination for Good Reason or Without Cause

Pursuant to the Shoemaker Offer Letter, Dr. Shoemaker was entitled to certain severance benefits in the event of certain terminations of employment following a change in control, which have been superseded by the severance payments and other benefits under the Severance and CIC Policy described below.

Executive Severance and Change in Control Policy

On January 14, 2018, the Compensation Committee adopted the Severance and CIC Policy, in which all of our named executive officers, except for Mr. Wolchko, participate.

Under the Severance and CIC Policy, if a participant is terminated by the Company without Cause (as defined below) or resigns for Good Reason (as defined below), in each case, following the first anniversary of the participant's first day of employment with the Company, then the participant will be entitled to the following benefits, subject to his or her execution of a nonrevocable release: (i) for all outstanding equity awards containing time-based vesting conditions, nine (9) months of accelerated vesting; provided, however, that for any equity awards that include both a performance-based vesting condition (including the achievement of a specified stock price or market capitalization) and a time-based vesting condition, or any equity awards that vest solely upon the achievement of a performance-based vesting condition, no acceleration of vesting will be provided unless the applicable performance-based vesting condition has been satisfied as of the date of the participant's termination; (ii) a lump sum cash payment equal to nine (9) months of the participant's then-current base salary; and (iii) payment of the employer portion of group health care benefits under COBRA for up to nine (9) months.

In addition, if a participant is terminated by the Company without Cause or resigns for Good Reason, in each case within the period beginning three (3) months prior to and ending twelve (12) months following a Sale Event (as defined in the 2013 Plan), then, in lieu of the benefits described above, such participant will be entitled to the following benefits, subject to his or her execution of a nonrevocable release: (i) for all outstanding equity awards containing time-based vesting conditions, full acceleration of vesting; provided, however, that for any equity awards that include both a performance-based vesting condition (including the achievement of a specified stock price or market capitalization) and a time-based vesting condition, or any equity awards that vest solely upon the achievement of a performance-based vesting condition, no acceleration of vesting will be provided unless the applicable performance-based vesting condition has been satisfied as of the date of the participant's termination; (ii) a lump sum cash payment equal to twelve (12) months of the participant's then-current base salary; (iii) one (1) times the participant's annual target incentive compensation for the year of termination; and (iv) payment of the employer portion of group health care benefits under COBRA for up to twelve (12) months.

The payments and benefits provided a participant under the Severance and CIC Policy may not be eligible for federal income tax deduction for the Company pursuant to Section 280G of the Internal Revenue Code of 1986. These payments and benefits may also be subject to an excise tax under Section 4999 of the Internal Revenue Code of 1986. If the payments or benefits payable to a participant would be subject to the excise tax imposed under Section 4999 of the Internal Revenue Code of 1986, then those payments or benefits will be reduced to the extent necessary so that no portion of such payments or benefits will be subject to such excise tax or loss of tax deduction for the Company.

Participants who are party to an agreement or an arrangement with the Company that provides greater benefits in the aggregate than set forth in the Severance and CIC Policy are not eligible to receive any payments or benefits under the Severance and CIC Policy.

Under the Severance and CIC Policy, the terms above are generally defined as follows:

Cause means (i) the participant's dishonest statements or acts with respect to the Company or any affiliate of the Company, or any current or prospective customers, suppliers, vendors or other third parties with which such

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entity does business; (ii) the participant's commission of (A) a felony or (B) any misdemeanor involving moral turpitude, deceit, dishonesty or fraud; (iii) any conduct by the participant that would reasonably be expected to result in material injury or reputational harm to the Company or any of its subsidiaries and affiliates if the participant were retained in the participant's position; (iv) the participant's failure to perform his or her assigned duties and responsibilities to the reasonable satisfaction of the Company which failure continues, in the reasonable judgment of the Company, after written notice given to the participant by the Company; (v) the participant's gross negligence, willful misconduct or insubordination with respect to the Company or any affiliate of the Company; or (vi) the participant's material violation of any provision of any agreement(s) between the participant and the Company relating to noncompetition, nonsolicitation, nondisclosure and/or assignment of inventions.

Good Reason means (i) a material diminution in the participant's responsibilities, authority or duties; (ii) a material diminution in the participant's base compensation except for across-the-board compensation reductions similarly affecting all or substantially all similarly situated service providers of the Company; or (iii) a change of more than twenty-five (25) miles in the geographic location at which the participant provides services to the Company, in each case so long as the participant provides at least sixty (60) days' notice to the Company following the initial occurrence of any such event, the Company fails to cure such event within thirty (30) days thereafter and the participant terminates his or her employment within thirty (30) days after the end of such cure period.

Securities Authorized for Issuance under Equity Compensation Plans

The table below sets forth information regarding our equity compensation plans in effect as of December 31, 2017:

Plan Category	Equity Compensation Plan Information		
	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights (a)(3)	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plan (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by security holders: 2007 Plan, 2013 Plan and 2013 Employee Stock Purchase Plan (the 2013 ESPP)(1)	5,058,043	\$ 3.57	4,301,112(4)
Equity compensation plans not approved by security holders(2):	400,000	\$ 2.89	100,000
Total	5,458,043		4,401,112

(1)

The number of shares of stock available for issuance under the 2013 Plan will be automatically increased each January 1, beginning on January 1, 2014, by 4% of the outstanding number of shares of the Company's common stock on the immediately preceding December 31 or such lesser number as determined by the compensation committee of the Company's Board of Directors.

- (2) Represents 200,000 shares subject to an outstanding option granted to Dr. Storgard and 200,000 shares subject to an outstanding option granted to a non-named executive officer pursuant to the Inducement Plan and 100,000 shares remaining available for future issuance pursuant to the Inducement Plan.
- (3) Excludes 212,625 shares subject to RSUs outstanding as of December 31, 2017 that were issued under the 2013 Plan.
- (4) This number includes 729,000 shares that are available for issuance under the 2013 ESPP and zero shares subject to purchase during the current purchase period. To date, the Company has not issued any shares pursuant to the 2013 ESPP.

Table of Contents**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Other than the compensation agreements and other arrangements described under Compensation of Executive Officers and the transactions described below, since the beginning of the fiscal year ended December 31, 2017, there has not been and there is not currently proposed, any transaction or series of similar transactions to which we were, or will be, a party in which the amount involved exceeded, or will exceed, \$120,000 and in which any director, executive officer, holder of five percent or more of any class of our capital stock or any member of the immediate family of, or entities affiliated with, any of the foregoing persons, had, or will have, a direct or indirect material interest.

Public Offering

The following table summarizes the participation in our December 2017 public offering of our common stock by our directors, entities affiliated with our directors, or holders of five percent or more of our voting securities:

Name of Investor	Shares of Common Stock	Aggregate Purchase Price Paid
Entities affiliated with Redmile Group, LLC	5,236,904	\$ 21,994,996.80

Indemnification Agreements

We have entered into indemnification agreements with or have contractual obligations to provide indemnification to each of our directors and intend to enter into such agreements with certain of our executive officers. These agreements require us, among other things, to indemnify these individuals for certain expenses (including attorneys' fees), judgments, fines and settlement amounts reasonably incurred by such person in any action or proceeding, including any action by or in our right, on account of any services undertaken by such person on behalf of the Company or that person's status as a member of our Board of Directors to the maximum extent allowed under Delaware law.

Restricted Stock and Stock Option Awards

For information regarding stock option awards and other equity incentive awards granted to our named executive officers and directors, see Election of Directors Director Compensation and Compensation of Executive Officers.

Procedures for Approval of Related Person Transactions

The Audit Committee conducts an appropriate review of all related party transactions for potential conflict of interest situations on an ongoing basis, and the approval of the Audit Committee is required for all such transactions. The Audit Committee follows the policies and procedures set forth in our Related Person Transaction Policy in order to facilitate such review. The Related Person Transaction Policy is written.

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

The following table sets forth information with respect to the beneficial ownership of shares of our common stock by (i) each director, (ii) each named executive officer, (iii) all directors and executive officers as a group, and (iv) each person who we know beneficially owns more than 5% of our common stock as of January 30, 2018.

Beneficial ownership is determined in accordance with the rules of the SEC. These rules generally attribute beneficial ownership of securities to persons who possess sole or shared voting power or investment power with respect to those securities and include shares of common stock issuable upon the exercise of stock options that are immediately exercisable or exercisable within 60 days after January 30, 2018, but excludes unvested stock options. Except as otherwise indicated, all of the shares reflected in the table are shares of common stock and all persons listed below have sole voting and investment power with respect to the shares beneficially owned by them, subject to applicable community property laws. The information is not necessarily indicative of beneficial ownership for any other purpose.

In computing the number of shares of common stock beneficially owned by a person and the percentage ownership of that person, we deemed outstanding shares of common stock subject to options or warrants held by that person that are currently exercisable or exercisable within 60 days of January 30, 2018, as well as common stock issuable upon the vesting and settlement of restricted stock unit awards held by that person. We did not deem these shares outstanding, however, for the purpose of computing the percentage ownership of any other person. Shares beneficially owned include restricted shares of common stock acquired upon any early exercise of stock options granted under our 2007 Plan.

Percentage ownership calculations for beneficial ownership for each person or entity are based on 52,722,060 shares of our common stock outstanding as of January 30, 2018 and, except as set forth in footnote (4) below, do not take into account 14,097,745 shares of common stock issuable upon conversion of all 2,819,549 Preferred Shares outstanding on such date.

Name and Address of Beneficial Owner(1)	Number of Class A Convertible Preferred Convertible, Restricted Stock Units Vesting or Stock Options Exercisable Within 60 Days of January 30,			Total	Percentage of Common Stock
	Number of Shares Beneficially Owned and underlying unvested Restricted Stock Units as of January 30, 2018				
5% or Greater Stockholders:					
Entities affiliated with Redmile Group, LLC(2)	6,655,962			6,655,962	12.62%
FMR LLC(3)	7,861,643			7,861,643	14.91%
Entities affiliated with Franklin Advisers, Inc.(4)	6,035,779			6,035,779	11.45%

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All 5% Stockholders as a group	20,553,384		20,553,384	38.98%
Named Executive Officers and Directors:				
J. Scott Wolchko(5)	124,881	435,463	560,344	1.05%
William H. Rastetter, Ph.D.(6).	577,632	45,000	622,632	1.18%
John D. Mendlein, Ph.D.(7)	156,774	76,562	233,336	*
Timothy P. Coughlin(8)	56,390	68,076	124,466	*
Mark Enyedy		75,769	75,769	*
Robert S. Epstein		65,000	65,000	*
Amir Nashat, Sc.D.(9).	2,473,186	45,000	2,518,186	4.77%
Christopher Storgard, M.D.(10)	51,683	143,160	194,843	*
Daniel D. Shoemaker, Ph.D.(11)	90,591	353,640	444,231	*
Stewart Abbot, Ph.D.(12)	43,863	221,057	264,920	*
All executive officers and directors as a group (11 persons)(13)	3,620,418	1,766,769	5,387,187	9.89%

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* Represents beneficial ownership of less than 1% of the shares of common stock.

- (1) Unless otherwise indicated, the address for each beneficial owner is c/o Fate Therapeutics, Inc., 3535 General Atomics Court, Suite 200, San Diego, CA 92121.
- (2) Based on Schedule 13G/A filed December 19, 2017, Redmile Group, LLC (Redmile) beneficial ownership includes 6,655,962 shares of common stock and 14,097,745 shares of common stock issuable upon conversion of 2,819,549 outstanding shares of Class A Convertible Preferred Stock (for which the terms of the Class A Convertible Preferred Stock provide that the holder is limited in the number of shares it may convert into such that it will not own in excess of 9.99% of the then outstanding shares of common stock) owned by certain investment limited partnerships, pooled investment vehicle(s), separately managed accounts, etc. for which Redmile serves as the general partner and/or investment manager. If Redmile elects pursuant to the CoD to increase the percentage of shares of common stock that it, together with its affiliates, may beneficially own to cover the maximum number of shares of common stock issuable upon conversion of all outstanding shares of Class A Convertible Preferred Stock held by Redmile, then Redmile would beneficially own an aggregate of 20,753,707 shares of common stock, representing a beneficial ownership percentage of 31.06%. Redmile, as the general partner and/or investment manager to the limited partnerships, pooled investment vehicle(s), separately managed accounts, etc. and Jeremy Green, as the majority managing member and owner of Redmile, may therefore be deemed to beneficially own the shares owned by such investment limited partnerships, pooled investment vehicle(s), separately managed accounts, etc., insofar as they may be deemed to have the power to direct the voting or disposition of those shares. Each of Redmile and Jeremy Green disclaims beneficial ownership as to the shares, except to the extent of his or its pecuniary interests therein. The mailing address of the beneficial owners is One Letterman Drive, Bldg D, Ste D3-300, San Francisco, CA 94129.
- (3) Based on Schedule 13G/A filed on February 13, 2018 and includes an aggregate of 2,805,659 shares of common stock held by Select Biotechnology Portfolio. Abigail P. Johnson and FMR LLC, through its control of Fidelity Management & Research Company, and the funds each has sole power to dispose of the 7,861,643 shares owned by the funds. Abigail P. Johnson is a Director, the Chairman and the Chief Executive Officer of FMR LLC. Members of the family of Abigail P. Johnson are the predominant owners of FMR LLC and may be deemed to form a controlling group with respect to FMR LLC. Neither FMR LLC nor Abigail P. Johnson has the sole power to vote or direct the voting of the shares owned directly by the various investment companies registered under the Investment Company Act (Fidelity Funds) advised by Fidelity Management & Research Company, a wholly owned subsidiary of FMR LLC, which power resides with the Fidelity Funds Boards of Trustees. Fidelity Management & Research Company carries out the voting of the shares under written guidelines established by the Fidelity Funds Boards of Trustees. The mailing address of the beneficial owner is 245 Summer Street, Boston, MA 02210.
- (4) Includes (i) 3,662,002 shares of common stock held by Franklin Templeton Investment Fund Franklin Biotechnology Discovery Fund and (ii) 2,373,777 shares of common stock held by Franklin Strategic Series Franklin Biotechnology Discovery Fund. Franklin Advisers, Inc., or FAV, an indirectly wholly owned subsidiary of a publicly traded company, Franklin Resources, Inc., or FRI, may be deemed to be the beneficial owner of these securities for purposes of Rule 13d-3 under the Exchange Act in its capacity as the investment adviser to Franklin Strategic Series - Franklin Biotechnology Discovery Fund and Franklin Templeton Investment Funds Franklin Biotechnology Discovery Fund pursuant to investment management contracts that grant investment and/or voting power to FAV. When an investment management contract (including a sub-advisory agreement) delegates to FAV investment discretion or voting power over the securities held in the investment advisory accounts that are subject to that agreement, FRI treats FAV as having sole investment discretion or voting authority, as the case may be, unless the agreement specifies otherwise. Accordingly, FAV reports for purposes of Section 13(d) of the Exchange Act that it has sole investment discretion and voting authority over the securities covered by any such investment management agreement, unless otherwise specifically noted. The mailing address of the beneficial owners is One Franklin Parkway, San Mateo, CA 94403.
- (5)

Consists of 435,463 shares of common stock issuable pursuant to stock options exercisable within 60 days of January 30, 2018.

- (6) Consists of (i) 459,272 shares of common stock held by The Investment 2002 Trust dated November 11, 2001 (the Investment Trust), (ii) 118,360 shares of common stock held by The Rastetter Family Trust, dated September 2, 2010 (the Rastetter Family Trust), and (iii) options to purchase 45,000 shares of common stock that are exercisable within 60 days of January 30, 2018 held by Dr. Rastetter. William Rastetter is the sole trustee of the Investment Trust and has sole dispositive power over the shares held by this entity. William Rastetter and Marisa Gard Rastetter, as co-trustees of the Rastetter Family Trust, share dispositive power over the shares held by this entity.
- (7) Consists of 76,562 shares of common stock issuable pursuant to stock options exercisable within 60 days of January 30, 2018.
- (8) Consists of 56,390 shares of common stock owned of record by Timothy P. Coughlin & Holly Coughlin as TTEEs of Coughlin Family Trust u/a DTD 12/07/2006, which is affiliated with Mr. Coughlin, and options to purchase 68,076 shares of common stock that are exercisable within 60 days of January 30, 2018.

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- (9) Based on Schedule 13D filed on October 11, 2013 by entities affiliated with Polaris Venture Partners V, L.P. (Polaris Ventures) and consists of: (i) an aggregate of 2,386,464 shares of common stock held by Polaris Ventures, (ii) an aggregate of 46,511 shares of common stock held by Polaris Venture Partners Entrepreneurs Fund V, L.P. (Polaris Entrepreneurs Fund), (iii) an aggregate of 16,347 shares of common stock held by Polaris Venture Partners Founders Fund V, L.P. (Polaris Founders Fund) and (iv) an aggregate of 23,864 shares of common stock held by Polaris Venture Partners Special Founders Fund V, L.P. (Polaris Special Founders Fund). Polaris Venture Management Co. V, L.L.C. (PVM V) is the general partner of each Polaris Ventures, Polaris Entrepreneurs Fund, Polaris Founders Fund and Polaris Special Founders Fund (collectively, the Polaris Funds). PVM V may be deemed to have sole power to vote and dispose of the shares held by the Polaris Funds. Each of Jonathan Flint and Terrance McGuire (collectively, the Managing Members) are the managing members of PVM V and may be deemed to share voting and dispositive power with respect to the shares held by the Polaris Funds. Dr. Nashat, a member of the Issuer s Board of Directors, has a membership interest in PVM V and may be deemed to share voting and dispositive powers with respect to the shares held by the Polaris Fund by virtue of his relationship to PVMV V, the Managing Members and Dr. Nashat disclaim beneficial ownership of all of the shares owned by the Polaris Funds, except to the extent of their respective and proportionate pecuniary interests therein. The address of the Polaris Funds is One Marina Park Drive, 10th Floor, Boston, Massachusetts 02210.
- (10) Consists of 14,090 shares of common stock owned of record by Chris M. Storgard, 37,593 shares of common stock held by The Storgard Family Trust, June 28, 2012, which is affiliated with Dr. Storgard, and options to purchase 143,160 shares of common stock that are exercisable within 60 days of January 30, 2018.
- (11) Consists of 353,640 shares of common stock issuable pursuant to stock options exercisable within 60 days of January 30, 2018.
- (12) Consists of 221,057 shares of common stock issuable pursuant to stock options exercisable within 60 days of January 30, 2018.
- (13) Includes the number of shares beneficially owned by the executive officers and directors listed in the above table, as well as (i) 45,418 shares of common stock owned of record by Cindy R. Tahl, our General Counsel and Corporate Secretary, and (ii) options to purchase 238,042 shares of common stock that are exercisable within 60 days of January 30, 2018 held by Ms. Tahl.

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SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our officers and directors, and persons who own more than 10% of a registered class of our equity securities, to file reports of ownership and changes in ownership (Forms 3, 4 and 5) with the SEC. Officers, directors and greater than 10% stockholders are required to furnish us with copies of all such forms which they file.

To our knowledge, based solely on our review of such reports or written representations from certain reporting persons, we believe that all of the filing requirements applicable to our officers, directors, greater than 10% beneficial owners and other persons subject to Section 16 of the Exchange Act were complied with during the year ended December 31, 2017.

The following Audit Committee Report is not considered proxy solicitation material and is not deemed filed with the Securities and Exchange Commission. Notwithstanding anything to the contrary set forth in any of the Company's filings made under the Securities Act of 1933 or the Exchange Act that might incorporate filings made by the Company under those statutes, the Audit Committee Report shall not be incorporated by reference into any prior filings or into any future filings made by the Company under those statutes.

AUDIT COMMITTEE REPORT

The Audit Committee of the Board of Directors has furnished this report concerning the independent audit of the Company's financial statements. Each member of the Audit Committee meets the enhanced independence standards established by the Sarbanes-Oxley Act of 2002 and rulemaking of the Securities and Exchange Commission (the "SEC") and the NASDAQ Stock Market regulations. A copy of the Audit Committee Charter is available on the Company's website at <http://www.fatetherapeutics.com>.

The Audit Committee's responsibilities include assisting the Board of Directors regarding the oversight of the integrity of the Company's financial statements, the Company's compliance with legal and regulatory requirements, the independent registered public accounting firm's qualifications and independence, and the performance of the Company's internal audit function and the independent registered public accounting firm.

In fulfilling its oversight responsibilities, the Audit Committee reviewed and discussed the Company's financial statements for the fiscal year ended December 31, 2017 with the Company's management and Ernst & Young LLP. In addition, the Audit Committee has discussed with Ernst & Young LLP, with and without management present, their evaluation of the Company's internal accounting controls and overall quality of the Company's financial reporting. The Audit Committee also discussed with Ernst & Young LLP the matters required to be discussed by Statement on Auditing Standards No. 114 (formerly SAS 61), as amended (AICPA, *Professional Standards*, Vol. 1 AU section 380), as adopted by the Public Company Accounting Oversight Board in Rule 3200T. The Audit Committee also received the written disclosures and the letter from Ernst & Young LLP required by the Public Company Accounting Oversight Board Rule 3526 and the Audit Committee discussed the independence of Ernst & Young LLP with that firm.

Based on the Audit Committee's review and discussions noted above, the Audit Committee recommended to the Board of Directors, and the Board of Directors approved, that the audited financial statements be included in the Company's Annual Report for the fiscal year ended December 31, 2017.

The Audit Committee and the Board of Directors have recommended the selection of Ernst & Young LLP as the Company's independent registered public accounting firm for the year ending December 31, 2018.

AUDIT COMMITTEE

TIMOTHY P. COUGHLIN, CHAIRMAN

MARK J. ENYEDY

WILLIAM H. RASTETTER, PH.D.

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HOUSEHOLDING OF PROXY MATERIALS

We have made available a procedure approved by the SEC known as householding. This procedure allows multiple stockholders residing at the same address the convenience of receiving a single copy of our Notice, Annual Report on Form 10-K and proxy materials, as applicable. This allows us to save money by reducing the number of documents we must print and mail, and helps protect the environment as well.

Householding is available to both registered stockholders (i.e., those stockholders with certificates registered in their name) and street name holders (i.e., those stockholders who hold their shares through a brokerage).

Registered Stockholders

If you are a registered stockholder and would like to consent to a mailing of proxy materials and other stockholder information only to one account in your household, as identified by you, we will deliver or mail a single copy of our Annual Report and proxy materials for all registered stockholders residing at the same address. Your consent will be perpetual unless you revoke it, which you may do at any time by contacting the Householding Department of American Stock Transfer & Trust Company, LLC (AST), at One Embarcadero Center, Suite 530, San Francisco, CA 94111.

Registered stockholders who have not consented to householding will continue to receive copies of Annual Reports and proxy materials for each registered stockholder residing at the same address. As a registered stockholder, you may elect to participate in householding and receive only a single copy of Annual Reports or proxy statements for all registered stockholders residing at the same address by contacting AST as outlined above.

Street Name Holders

Stockholders who hold their shares through a brokerage may elect to participate in householding or revoke their consent to participate in householding by contacting their respective brokers.

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OTHER MATTERS

We are not aware of any matters that may come before the meeting other than those referred to in the Notice. If any other matter shall properly come before the Annual Meeting, however, the persons named in the accompanying proxy intend to vote all proxies in accordance with their best judgment.

Accompanying this Proxy Statement is our Annual Report. Copies of our Annual Report are available free of charge on our website at www.fatetherapeutics.com or you can request a copy free of charge by calling Investor Relations at (858) 875-1800 or sending an e-mail request to Investor Relations by accessing our website (www.fatetherapeutics.com), selecting the Investors & Media tab and then selecting Contact Us. Please include your contact information with the request.

By Order of the Board of Directors

Fate Therapeutics, Inc.

Sincerely,

/s/ J. Scott Wolchko

J. Scott Wolchko

President and Chief Executive Officer

San Diego, California

March 16, 2018

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