CATALYST SEMICONDUCTOR INC
Form 10-Q
March 10, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended January 31, 2006

OR

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

For the transition period from to

0-21488

(Commission File Number)

CATALYST SEMICONDUCTOR, INC.

(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**77-0083129** (I.R.S. Employer Identification No.)
1250 Borregas Avenue **Sunnyvale, California** (Address of Registrant s principal executive offices)	**94089** (Zip Code)

(408) 542-1000

(Registrant s telephone number, including area code)

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

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

Large Accelerated filer o Accelerated filer ý Non-accelerated Filer o

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

The number of shares outstanding of the Registrant s Common Stock as of February 28, 2006 was 16,494,157 exclusive of 6,256,008 shares of treasury stock.

CATALYST SEMICONDUCTOR, INC.

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Part I. ***Financial Information***

Item 1. ***Financial Statements***

CATALYST SEMICONDUCTOR, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	January 31, 2006	April 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,213	$ 10,978
Short-term investments	21,736	22,815
Accounts receivable, net	10,512	9,966
Inventories	12,048	11,455
Other current assets	4,705	5,063
Total current assets	60,214	60,277
Property and equipment, net	5,710	5,582
Deferred tax assets	4,128	4,128
Other assets	63	74
Total assets	$ 70,115	$ 70,061
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 5,226	$ 5,755
Accounts payable related parties	41	314
Accrued expenses	3,889	4,245
Deferred gross profit on shipments to distributors	1,878	1,879
Total current liabilities	11,034	12,193
Commitments and contingencies (Note 8)		
Stockholders equity:		
Preferred stock, $.001 par value, 2,000 shares authorized; no shares issued and outstanding		
Common stock, $0.001 par value, 45,000 shares authorized; 22,750 shares issued and 16,680 shares outstanding at January 31, 2006 and 22,135 shares issued and 16,590 shares outstanding at April 30, 2005	23	22
Additional paid-in-capital	70,352	68,872
Treasury stock, 6,070 shares at January 31, 2006 and 5,545 shares at April 30, 2005	(24,752)	(22,169)
Retained earnings	13,490	11,203
Accumulated other comprehensive loss	(32)	(60)
Total stockholders equity	59,081	57,868
Total liabilities and stockholders equity	$ 70,115	$ 70,061

See accompanying notes to the unaudited condensed consolidated financial statements.

CATALYST SEMICONDUCTOR, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2006	**2005**	**2006**	**2005**
	(In thousands, except per share data)			

Net revenues	$ 14,423	$ 13,680	$ 46,030	$ 45,995
Cost of revenues	8,208	8,432	27,659	25,712
Gross profit	6,215	5,248	18,371	20,283
Operating expenses:				
Research and development	1,891	1,940	5,692	6,015
Selling, general and administrative	3,283	3,363	9,999	9,913
Income loss from operations	1,041	(55)	2,680	4,355
Interest income and other, net	362	212	841	505
Income before income taxes	1,403	157	3,521	4,860
Income tax provision	539	50	1,235	1,555
Net income	$ 864	$ 107	$ 2,286	$ 3,305
Net income per share:				
Basic	$ 0.05	$ 0.01	$ 0.14	$ 0.19
Diluted	$ 0.05	$ 0.01	$ 0.13	$ 0.17
Weighted average common shares outstanding:				
Basic	16,739	17,946	16,770	17,642
Diluted	18,090	19,761	18,174	19,662

See accompanying notes to the unaudited condensed consolidated financial statements.

CATALYST SEMICONDUCTOR, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Nine Months Ended January 31, 2006	Nine Months Ended January 31, 2005
Cash flows from operating activities:		
Net income	$ 2,286	$ 3,305
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property and equipment	1,389	1,178
Provision for excess and obsolete inventory	327	(97)
Loss on disposal of property and equipment		235
Tax benefits of options	522	709
Changes in assets and liabilities:		
Accounts receivable	(546)	4,278
Inventories	(920)	(4,845)
Other assets	369	119
Accounts payable (including related parties)	(802)	927
Accrued expenses	(356)	703
Deferred gross profit on shipments to distributors	(1)	(1,610)
Net cash provided by operating activities	2,268	4,902
Cash flows from investing activities:		
Purchases of short-term investments	(18,683)	(45,278)
Proceeds from sales and maturities of short-term investments	19,790	33,054
Acquisitions of property and equipment	(1,517)	(3,762)
Net cash used in investing activities	(410)	(15,986)
Cash flows from financing activities:		
Common stock issuances	960	580
Net proceeds from secondary public offering		7,986
Treasury stock purchases	(2,583)	(5,004)
Net cash provided (used) in financing activities	(1,623)	3,562
Net increase (decrease) in cash and cash equivalents	235	(7,522)
Cash and cash equivalents at beginning of the period	10,978	17,245
Cash and cash equivalents at end of the period	$ 11,213	$ 9,723

See accompanying notes to the unaudited condensed consolidated financial statements.

Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Note 1 Basis of Presentation

Catalyst Semiconductor, Inc. (the Company), was founded in October 1985, and designs, develops and markets a broad line of reprogrammable non-volatile memory and analog/mixed-signal products.

In the opinion of the management of the Company, the unaudited condensed consolidated interim financial statements included herein have been prepared on the same basis as the Company s April 30, 2005 audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary to fairly state the information set forth herein. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended April 30, 2005.

The Company s fiscal year is the 52 or 53-week period ending on the Sunday closest to April 30. In a 52 week year, each fiscal quarter consists of 13 weeks. Fiscal year 2005 was comprised of 52 weeks. Fiscal year 2006 will be comprised of 52 weeks. For ease of presentation, all periods are presented as if they ended on month end. All references to the quarter refer to the Company s fiscal quarter. The fiscal quarter covered by this report ended on January 29, 2006. For ease of presentation, the Company refers to the quarter as ending on the last date of the applicable month, or in this case, January 31, 2006.

Principles of Consolidation

The consolidated financial statements include the accounts of Catalyst Semiconductor, Inc. and its wholly owned subsidiaries, including its subsidiaries. Nippon Catalyst KK (NCKK), a sales organization in Yokohama, Japan and Catalyst Semiconductor Romania SRL (CSR), a product development center in Bucharest, Romania. All significant intercompany accounts and transactions are eliminated in consolidation.

Uses of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States (US GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Estimates in these financial statements include inventory valuation, deferral of gross profit on shipments of inventory not sold by distributors at the end of the period, reserves for stock rotation on sales to distributors, the original equipment manufacturers (OEMs) sales return reserve, actual warranty costs, allowances for doubtful accounts receivable and income taxes. Actual results could differ from those estimates.

Stock-Based Compensation

The Company has elected to measure employee stock-based compensation costs using the intrinsic value method prescribed by the Accounting Principles Board Opinion (ABP) No. 25, *Accounting for Stock Issued to Employees.* Accordingly, no compensation expense has been recorded for stock options granted with exercise prices greater than or equal to the fair value of the underlying common stock at the option grant date.

Pro forma information regarding net income and earnings is required by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation.* as amended by SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure.* SFAS No. 123 requires the disclosure of pro forma net income and earnings per share as if the Company had adopted the fair value method.

Stock-based compensation to employees under SFAS No. 123 is based on the fair value of the option, estimated using the Black-Scholes option pricing model on the date of grant. The related stock-based compensation expense is recognized over the vesting period. The following table summarizes the weighted-average assumptions used in the SFAS No. 123 calculation:

	Three Months Ended January 31, 2006		Three Months Ended January 31, 2005	
Expected term (in years)	5.3		4.0	
Risk-free interest rate	4.32	%	3.44	%
Volatility	63.60	%	66.00	%
Dividend yield	0.00	%	0.00	%

The following table illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation (in thousands, except per share amounts):

	Three Months Ended January 31, 2006	Three Months Ended January 31, 2005	Nine Months Ended January 31, 2006	Nine Months Ended January 31, 2005
	(In thousands, except per share amounts)			
Reported net income	$ 864	$ 107	$ 2,286	$ 3,305
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of tax	(492)	(444)	(1,549)	(1,556)
As adjusted net income (loss)	$ 372	$ (337)	$ 737	$ 1,749
As adjusted net income (loss) per share:				
Basic	$ 0.02	$ (0.02)	$ 0.05	$ 0.10
Diluted	$ 0.02	$ (0.02)	$ 0.04	$ 0.09
Reported net income (loss) per share:				
Basic	$ 0.05	$ 0.01	$ 0.14	$ 0.19
Diluted	$ 0.05	$ 0.01	$ 0.13	$ 0.17

During the periods presented the Company accounted for compensation cost related to employee stock options in accordance with the provisions of APB No. 25 and related interpretations. As such, compensation expense would be recorded on the date of grant only if the current market prices of the underlying stock exceeded the exercise price. The Company applies SFAS No. 123, which allows entities to continue to apply the provision of APB No. 25 and provide pro forma net income and pro forma earnings per share disclosures for employee stock option grants as if the fair value based method defined in SFAS No. 123 had been applied.

The accounting for stock-based compensation involves a number of estimates about the expected lives of stock options, interest rates, stock volatility and assumptions as well as the selection of a valuation model. The Company has elected to use the Black-Scholes option valuation model to value its stock-based compensation. A change in any of the estimates used in the model, or the selection of a different option pricing model, could have a material impact on the Company s pro forma net income (loss) disclosures in the periods presented and on its financial statements in future periods.

Note 2 Significant Accounting Policies

Cash and Cash Equivalents

All highly liquid investments purchased with an original maturity of three months or less are considered cash equivalents.

Short-term Investments

All of the Company s short-term investments are classified as available-for-sale. Investments in available-for-sale securities are reported at fair value with unrealized gains and losses, being recorded net of related tax, as a component of accumulated other comprehensive income (loss). Refer to Note 4 for details related to available-for-sale securities.

Accounts Receivable

The Company s accounts receivable are reported net of allowance for doubtful accounts. The Company estimates the collectibility of its accounts receivable at the end of each reporting period. The Company analyzes the aging of accounts receivable and bad debt history, payment history, customer concentration, customer credit worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. The Company maintains an allowance for doubtful accounts, which is created by recording a provision to selling, general and administrative expenses in the statement of income.

Fair Value of Financial Instruments

The Company measures its financial assets and liabilities in accordance with US GAAP. For financial instruments, including cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued expenses, the carrying amounts approximate fair value due to their short maturities.

Foreign Currency Translation

The Company uses the U.S. dollar as its functional currency. All of the Company s sales and a substantial majority of its costs are transacted in U.S. dollars. The Company purchases wafers from, and has test and assembly activities in, Asia and supports sales and marketing activities in various countries outside of the United States. Most of these costs are paid in U.S. dollars. Research and development personnel costs in Romania are tracked against the euro while all other activities are paid in Romanian leu. Foreign currency transaction gains and losses, resulting from remeasuring local currency to the U.S. dollar, are included in determining net income for the period. The foreign exchange gains and losses were not material for the periods presented.

Recognition of Revenues

The Company generally recognizes revenues as products are shipped if evidence of an arrangement exists, the customer has taken title to the products, services, if any, have been rendered, the sales price is fixed or determinable, collection of the resulting receivable is reasonably assured and product returns are reasonably estimable.

The Company markets and sells products directly through its sales force and sales representatives to original equipment manufacturers (OEM) and indirectly through distributors and resellers. Revenues are recognized upon delivery to OEMs and resellers who have no product return rights and no price protection rights. Reserves for estimated returns and allowances are provided against net revenues at the time of recognition of revenues. The Company also sells products to certain distributors under agreements which allow certain rights to return the product and provides for price protection rights. These agreements generally permit the distributor to return up to 10%, by value, of the total products they purchased from the Company every six months. As a result of the above, the Company defers recognition of revenues until the time the distributor sells the product to an end-customer. Upon shipment to a distributor, the Company records an account receivable from the distributor, relieves inventory for the cost of the product shipped, and records the gross profit, which equals revenues less the cost of revenues, on the consolidated balance sheet as deferred gross profit on shipments to distributors until such time as the inventory is resold by the distributor to their end-customers.

Inventories

Inventory is stated at the lower of standard cost or net realizable value. Standard cost approximates actual cost on a first-in, first-out basis. The Company periodically reviews its inventory for slow moving or obsolete items and writes down the related products to estimated net realizable value. Once established, inventory write downs are not reversed until the related inventory has been sold or physically scrapped.

Shipping and Handling Costs

The Company charges inbound freight shipments within the supply chain and associated handling costs to the cost of revenues on its consolidated statements of income. The Company charges outbound freight shipments and associated handling costs to selling, general and administrative on its consolidated statements of income. Such outbound freight costs aggregated to $171,000 and $92,000 for the three months ended January, 2006 and 2005, respectively and to $457,000 and $405,000 for the nine months ended January 31, 2006 and 2005, respectively.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets. Furniture, office equipment and engineering/test equipment are depreciated over five years with the exception of mask sets which are depreciated over two years. Computer hardware is depreciated over three years. Computer software is depreciated over three or five years. Buildings are generally depreciated over 30 years. Amortization of leasehold improvements is computed on a straight-line basis and amortized over the shorter of the remaining lease term or the estimated useful lives of the assets.

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and cash equivalents, short-term investments and accounts receivable. Cash and cash equivalents and short-term investments are maintained with high quality financial institutions. The Company s accounts receivable are denominated in

U.S. dollars and are derived from sales to customers located principally in North America, Europe and Asia. The Company performs ongoing credit evaluations of its customers and generally does not require collateral.

As of January 31, 2006, two customers accounted for 10% or more of the Company s gross accounts receivable. These two customers each accounted for 16% and 10% of gross accounts receivable, respectively. As of April 30, 2005, one customer accounted for 12% of gross accounts receivable.

Concentration of Other Risks

The semiconductor industry is characterized by rapid technological change, competitive pricing pressures and cyclical market patterns. The Company s financial results are affected by a wide variety of factors, including general economic conditions worldwide, economic conditions specific to the semiconductor industry, the timely implementation of new manufacturing process technologies and the ability to safeguard patents and intellectual property in a rapidly evolving market. In addition, the semiconductor market has historically been cyclical and subject to significant economic downturns at various times. As a result, the Company may experience significant period to period fluctuations in operating results due to the factors mentioned above or other factors.

Advertising Costs

Costs related to advertising and related promotional expenditures are charged to selling, general and administrative on the Company s consolidated statements of income. Such advertising and related promotional expenditures were less than $50,000 in each of the three months ended January 31, 2006 and 2005 and less than $75,000 in each of the nine months ended January 31, 2006 and 2005.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) includes all changes in stockholders equity during a period from non-owner sources. Accumulated other comprehensive income (loss) for the Company is comprised of unrealized gains (losses) on securities available-for-sale, net of tax.

Segment Reporting

The Company reports in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS No. 131). SFAS No. 131 requires the management approach in identifying reportable segments. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of the company s reportable segments. Based on its operating structure and management reporting, the Company has concluded it has one reporting segment: the semiconductor segment.

Reclassifications

Certain prior year balances have been reclassified to conform to current year presentation. These reclassifications had no impact on total assets, income from operations or net income.

New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) SFAS No. 123 (revised 2004), *Share-Based Payment,* or SFAS No. 123(R). SFAS No. 123(R) eliminates the alternative of applying the intrinsic value measurement provisions of Accounting Principals Board (APB) Opinion No. 25, or APB 25, to stock compensation awards issued to employees. The new standard requires enterprises to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the date of grant. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, usually the vesting period.

The pro forma effects on net income and earnings per share as if the Company had applied the fair value recognition provisions of original SFAS No. 123 on stock compensation awards (rather than applying the intrinsic value measurement provisions of APB 25) are in the Notes to Consolidated Financial Statements (see Note 1). Although the pro forma effects of applying original SFAS No. 123 may be indicative of the effects of adopting SFAS No. 123(R), the provisions of these two statements differ in some important respects. The actual effects of adopting SFAS No. 123(R) will be dependent on numerous factors including, but not limited to, the valuation model chosen by the Company to value stock-based awards;

the assumed award forfeiture rate; the accounting policies adopted concerning the method of recognizing the fair value of awards over the requisite service period; and the transition method chosen for adopting SFAS No. 123(R). Adoption of this accounting standard will have a material adverse impact on its consolidated financial statements. SFAS No. 123(R) will be effective for the Company s fiscal quarter ending July 31, 2006.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an Amendment of ARB No. 43, Chapter 4. The amendments made by SFAS No. 151 are intended to improve financial reporting by clarifying that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognized as current-period charges and by requiring the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred after June 15, 2005. The adoption of SFAS No. 151 did not have a material impact on the Company s condensed consolidated financial statements.

On December 21, 2004, the FASB issued Staff Position No. FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004.* The American Jobs Creation Act introduces a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FSP FAS 109-2 provides accounting and disclosure guidance for the repatriation provision. The Company may elect to apply this provision to qualifying earnings repatriations in fiscal 2006. The Company plans to evaluate the effects of the repatriation provision and in particular of the limitation of the deduction to certain qualifying expenses incurred in the United States. The adoption of FSP FAS 109-2 is not expected to have a material effect on the Company s consolidated financial position, results of operations or cash flows.

On May 30, 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections,* a replacement of APB Opinion No. 20 and FASB Statement No. 3, which changes the requirements for the accounting and reporting of a change in accounting principle effective for fiscal years beginning after December 15, 2005. SFAS No. 154 applies to all voluntary changes in accounting principle as well as to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 eliminates the requirement in APB Opinion No. 20, *Accounting Changes,* to include the cumulative effect of changes in accounting principle in the income statement in the period of change. Instead, to enhance the comparability of prior period financial statements, SFAS No. 154 requires that changes in accounting principle be retrospectively applied. Under retrospective application, the new accounting principle is applied as of the beginning of the first period presented as if that principle had always been used. Under SFAS No. 154, a change in reporting entity is also retrospectively applied as of the beginning of the first period presented. A change in accounting estimate continues to be accounted for in the period of change and future periods if necessary. The Company is currently assessing the impact of adopting SFAS No. 154 and believes the new standard will not have a material impact on its financial statements.

Note 3 Net Income Per Share

Basic net income per share is computed by dividing net income available to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period. Diluted net income per share is computed using the weighted number of common and potentially dilutive common shares outstanding during the period under the treasury stock method. In computing diluted net income per share, the average stock price for the period is used in determining the number of shares assumed to be purchased from the exercise of stock options. A reconciliation of the basic and diluted per share computations for the three months ended January 31, 2006 and January 31, 2005 is as follows (in thousands, except per share data):

	Three Months Ended January 31,					
	2006			2005		
	Net Income	**Shares**	**Per Share**	**Net Income**	**Shares**	**Per Share**

						Amount						**Amount**
Basic	$	864		16,739	$	0.05	$	107		17,946	$	0.01
Effect of stock options				1,351						1,815		
Diluted	$	864		18,090	$	0.05	$	107		19,761	$	0.01

Options to purchase 2,041,000 shares of common stock at a weighted average exercise price of $6.52 per share outstanding during the three months ended January 31, 2006 and options to purchase 2,023,000 shares of common stock at a weighted average exercise price of $6.78 per share outstanding during the three months ended January 31, 2005 were not included in the computation of diluted income per share because their option price was greater than the average fair market value for the period.

A reconciliation of the basic and diluted per share computations for the nine months ended January 31, 2006 and January 31, 2005 is as follows (in thousands, except per share data):

	Nine Months Ended January 31,					
	2006			2005		
	Net Income	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
Basic	$ 2,286	16,770	$ 0.14	$ 3,305	17,642	$ 0.19
Effect of stock options		1,404	(0.01)		2,020	(0.02)
Diluted	$ 2,286	18,174	$ 0.13	$ 3,305	19,662	$ 0.17

Options to purchase 2,219,000 shares of common stock at a weighted average exercise price of $6.43 per share outstanding during the nine months ended January 31, 2006 and options to purchase 1,666,000 shares of common stock at a weighted average exercise price of $6.89 per share outstanding during the nine months ended January 31, 2005 were not included in the computation of diluted income per share because their option price was greater than the average fair market value for the period.

Note 4 Balance Sheet Components

	January 31, 2006			
	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Market Value
	(In thousands)			
Investments available-for-sale:				
U.S. government debt securities with maturities less than one year	$ 20,767	$	$ (36)	$ 20,731
U.S. government debt securities with maturities over one year	1,014		(9)	1,005
Total investments available-for-sale	$ 21,781	$	$ (45)	$ 21,736

	April 30, 2005			
	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Market Value
	(In thousands)			
Investments available-for-sale:				

U.S. government debt securities with maturities less than one year	$ 20,901	$	$ (88)	$ 20,813
U.S. government debt securities with maturities over one year	2,008		(6)	2,002
Total investments available-for-sale	$ 22,909	$	$ (94)	$ 22,815

The net unrealized gains (losses) as of January 31, 2006 and April 30, 2005 are recorded in accumulated other comprehensive loss, net of related tax of $13,000 and $34,000, respectively.

The financial instruments in short-term investments are highly liquid and can be converted to cash and cash equivalents without restriction and, accordingly, are classified as current assets in the accompanying consolidated balance sheets (in thousands).

	January 31, 2006	April 30, 2005
	(In thousands)	
Accounts receivable:		
Accounts receivable	$ 10,650	$ 10,104
Less: Allowance for doubtful accounts	(138)	(138)
	$ 10,512	$ 9,966

The Company did not have any bad debts written off to the allowance for doubtful accounts in the three months or nine months ended January 31, 2006 and 2005.

	January 31, 2006	April 30, 2005
	(In thousands)	
Inventories:		
Work-in-process	$ 7,399	$ 7,450
Finished goods	4,649	4,005
	$ 12,048	$ 11,455
Property and equipment, net:		
Building	$ 1,946	$ 2,000
Engineering and test equipment	2,010	1,781
Computer software	658	824
Mask sets	623	407
Computer hardware	178	176
Land	165	165
Leasehold improvements	45	119
Furniture and office equipment	66	82
Vehicles	19	28
	$ 5,710	$ 5,582

	January 31, 2006	April 30, 2005
	(In thousands	
Accrued expenses:		
Accrued employee compensation	$ 988	$ 1,671
Accrued income taxes	1,764	1,075
Other	1,137	1,499
	$ 3,889	$ 4,245

Note 5 Income Taxes

The provision for income taxes was $539,000, or 38.4% of income before taxes, for the three months ended January 31, 2006. The provision for income taxes was $50,000, or 31.8% of income before taxes, for the three months ended January 31, 2005. The income tax rate provision for the three months ended January 31, 2006 was higher than the income tax rate provision for the three months ended January 31, 2005 primarily due to additional taxes associated with the revaluation of state deferred tax assets and the filing of federal and state tax returns for the previous fiscal year.

The provision for income taxes was $1.2 million or 35.1% of income before taxes, for the nine months ended January 31, 2006. The provision for income taxes was $1.6 million, or 32.0% of income before taxes, for the nine months ended January 31, 2005. The income tax rate provision for the nine months ended January 31, 2006 was higher than the income tax rate provision for the nine months ended January 31, 2005 primarily due to reduced tax benefits associated with federal research credits.

Note 6 Stockholders Equity

Common and Preferred Stock

The Company completed a secondary public offering of its common stock in July 2004. The Company sold 1,450,000 common shares at $6.00 per share. Proceeds to the Company, net of underwriting discounts and commissions and related offering expenses of $714,000 were approximately $8.0 million. In connection with this transaction, Elex N.V., a related party, and other selling stockholders sold 2,850,000 and 300,000 common shares, respectively, at $6.00 per share. In aggregate, 4,600,000 common shares were sold.

Note 7 Segment Reporting

The Company operates in one business segment, the semiconductor segment. Sales transactions are denominated in U.S. dollars.

Net revenues by product group were as follows (in thousands):

	Three Months Ended January 31, 2006	Three Months Ended January 31, 2005	Nine Months Ended January 31, 2006	Nine Months Ended January 31, 2005
EEPROM	$ 11,971	$ 11,705	$ 39,008	$ 39,555
Flash	1,329	1,248	3,587	4,402
Analog/mixed-signal	1,123	727	3,435	2,038
Total net revenues	$ 14,423	$ 13,680	$ 46,030	$ 45,995

Net revenues by geography were as follows (in thousands):

	Three Months Ended January 31, 2006	Three Months Ended January 31, 2005	Nine Months Ended January 31, 2006	Nine Months Ended January 31, 2005
United States	$ 1,707	$ 1,424	$ 5,321	$ 5,854
Hong Kong/China	4,212	3,032	13,506	11,483
Japan	1,928	2,109	6,478	8,213
Europe	1,822	1,879	5,244	6,042
South Korea	1,603	1,832	4,795	4,853
Taiwan	2,138	2,262	6,431	6,294
Other Far East	907	575	3,894	1,702
Other Americas	106	567	361	1,554
Total net revenues	$ 14,423	$ 13,680	$ 46,030	$ 45,995

For the three months ended January 31, 2006, Avnet, an international distributor, represented 15.1% of the Company s net revenues. For the three months ended January 31, 2005, Memec, an international distributor, represented 10.2% of the Company s net revenues.

For the nine months ended January 31, 2006, Avnet, an international distributor, represented 14% of the Company s net revenues. For the nine months ended January 31, 2005, no customer represented 10% or more of the Company s net revenues.

Property and equipment, net, geographical breakdown was as follows (in thousands):

	January 31, 2006		April 30, 2005	
United States	$	1,700	$	1,771
Romania		2,285		2,429
Thailand		1,221		1,169
Japan		466		181
Other		38		32
Total property and equipment, net	$	5,710	$	5,582

Note 8 Commitments and Contingencies

Purchase Commitments

Purchase commitments for open purchase orders at January 31, 2006 for which goods and services had not been received were approximately $4.9 million as compared to approximately $3.9 million at April 30, 2005.

Contingencies

In the normal course of business, the Company periodically receives notification of threats of legal action in relation to claims of patent infringement by the Company. Currently there are no such active actions.

In November 2002, the FASB issued FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). The Company applies the disclosure provisions of FIN 45 to its agreements that contain guarantee or indemnification clauses. FIN 45 requires that a liability be recorded in the guarantor s balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a reconciliation of changes in the entity s product warranty liabilities. These disclosure provisions expand those required by SFAS No. 5, *Accounting for Contingencies,* by requiring that guarantors disclose certain types of guarantees, even if the likelihood of requiring the guarantor s performance is remote. The following is a description of significant arrangements through which the Company is a guarantor:

Indemnification Obligations

The Company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in the context of contracts entered into by the Company, under which the Company customarily agrees to hold the other party harmless against losses arising from a breach of representations and covenants related to such matters as title to assets sold and certain intellectual property rights. Generally, payment by the Company is conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the Company to challenge the other party s claims. Further, the Company s obligations under these agreements may be limited in terms of time and/or amount, and in some instances, the Company may have recourse against third parties for certain payments made by it under these agreements.

It is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of the Company s obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material effect on its business, financial condition, cash flows or results of operations. The Company believes that if it were to incur a loss in any of these matters, such loss should not have a material effect on its business, financial condition, cash flows or results of operations.

Product Warranties

The Company estimates its product warranty costs based on historical warranty claim experience and applies this estimate to the revenue stream for products under warranty. Included in the Company s sales returns reserves are estimated return exposures associated with product warranties. Estimated future costs for warranties applicable to revenues recognized in the current period are charged to the Company s cost of revenues. The warranty accrual is reviewed quarterly to verify that it properly reflects the remaining obligations based on the anticipated expenditures over the balance of the obligation period. Adjustments are made when actual claim experience differs from estimates. Warranty costs were less than $25,000 for each of the three months ended January 31, 2006 and 2005 and less than $75,000 for each of the nine months ended January 31, 2006 and 2005.

Note 9 Related Party Transactions

Elex N.V.

During the fourth quarter of fiscal 2000, the Company began taking delivery of wafers fabricated at X-FAB Texas, Inc. (X-FAB) a wholly owned subsidiary of Elex N.V. (Elex), a Belgian holding company. Roland Duchâtelet, the Chairman and Chief Executive Officer of Elex, serves as a member of the Company s Board of Directors. Elex initially became a related party in 1998 through the purchase of 5.5 million restricted shares of the Company s common stock. The wafers provided by X-FAB include most of the Company s analog/mixed-signal products and supplement some of the same EEPROM designs fabricated at various other foundries the Company utilizes. Other than purchase orders currently open with X-FAB, there is no purchasing agreement in place with X-FAB.

During the nine months ended January 31, 2006 and 2005, the Company purchased $1.7 million and $1.5 million of wafers, respectively, from X-FAB. As of January 31, 2006 and April 30, 2005, the total amount owed X-FAB by the

Company was $41,000 and $314,000, respectively. As of January 31, 2006, Elex holds 728,700 shares or 4.4% of the outstanding shares of the Company.

Note 10 Other Comprehensive Income

The components of other comprehensive income, net of tax, are presented in the following table (in thousands):

	Three Months Ended January 31, 2006	Three Months Ended January 31, 2005	Nine Months Ended January 31, 2006	Nine Months Ended January 31, 2005
Reported net income	$ 864	$ 107	$ 2,286	$ 3,305
Other comprehensive income:				
Unrealized gain (loss) on available-for-sale investments, net of related tax	5	(5)	28	(41)
Total comprehensive income	$ 869	$ 102	$ 2,314	$ 3,264

Note 11 Subsequent Event

The Company entered into an agreement to purchase land and a building to serve as its principal facility effective on February 3, 2006. Under the agreement, the Company agreed to pay $3.7 million in cash for the property at 2975 Stender Way, Santa Clara, California. The transaction is expected to close on or about March 16, 2006.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 which involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors that include, but are not limited to, the risks discussed in Factors Affecting Future Results. These forward-looking statements include, but are not limited to: the statements relating to product pricing trends; the statements relating to the increasing portion of our net revenues from analog/mixed-signal products; the statements relating to the sufficiency of our cash resources and cash flows to fund our operating and capital requirements and the risks associated with seeking additional financing; and the statements relating to our efforts to increase our die supply and decrease our unit costs, and the statements regarding our future sales outside the United States, among others. These forward-looking statements are based on current expectations and entail various risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties are set forth below under Factors Affecting Future Operating Results.

Overview

We design, develop and market a broad line of reprogrammable non-volatile memory products and analog/mixed-signal products. Our products are used by manufacturers of electronic products in a wide range of consumer, computing, communications, industrial and automotive applications. We generally target high volume markets for our cost effective, high quality products. We have been a committed long-term supplier of memory products which may include periods of tight manufacturing capacity and cyclical market downturns.

The market for our non-volatile memory is highly competitive and market participants have relatively weak pricing power. Average selling prices of our non-volatile memory products have declined over time and prices are sensitive to conditions in our OEM customers target markets. For example, in fiscal 2005 and continuing into fiscal 2006, we experienced a downward trend in average selling prices for our non-volatile memory products due to market competition, product availability and manufacturing capacity. In response to that trend, we are working with our major foundry to migrate the majority of our memory products from 0.8 micron geometries to 0.35 micron geometries in order to increase our die supply and decrease our per unit costs.

We are leveraging our extensive experience in high volume, reprogrammable memory products to develop complementary analog/mixed-signal products that offer our customers a more complete system solution. In fiscal 2003, we strengthened and expanded the expertise of our research and development team by establishing our own development center in Bucharest, Romania and by hiring additional engineers in Bucharest, Romania. In fiscal 2005, we purchased a new building in Bucharest for our Romanian product development team. We continue to make substantial investments in research and development to advance our non-volatile memory products, as well as develop broader solutions with our line of analog/mixed-signal products.

Sales of our analog/mixed-signal products continue to increase, reaching 7.5% of net revenues in the nine months ended January 31, 2006 as compared to 4.4% of net revenues in the similar period in the prior year. We expect net revenues from analog/mixed-signal products to increase in the future.

Our business is less capital intensive than traditional semiconductor companies since we outsource to third parties the manufacturing, assembling and most of the testing of our products. We strive to maintain long-term relationships with our suppliers to ensure stability in our supply of products at a competitive cost. Additionally, in an effort to alleviate any potential wafer capacity constraints, we maintain a supply of wafers in a die bank for selected products.

We market and sell our products directly through our sales force and sales representatives to OEMs and indirectly through distributors and resellers who sell to their end customers. Indirect sales were a majority of our total sales in fiscal 2005 though the third quarter of fiscal 2006. Our total customer base, including OEMs and end-customers of our distributors and resellers, is relatively diverse and during the nine months ended January 31, 2006 consisted of more than 4,000 customers. We have approximately 38 active distributors and resellers.

In the nine months ended January 31, 2006, one customer accounted for more than 14% of our net revenues.

Our sales are initiated by purchase orders received from our customers and are typically shipped within a few weeks of receiving the order. Since industry practice allows customers to reschedule or cancel orders on relatively short notice, we do not use backlog to forecast our future net revenues. Common industry practices, such as cancellations of customer orders, distributor price protection and distributor stock rotation rights, all industry standards, could result in the loss of future net revenues without allowing us sufficient time to reduce our inventory and operating expenses.

Sales to customers outside the United States comprised the majority of our net revenues in recent periods. This increasing non-United States growth in net revenues was consistent with industry trends of outsourcing of the manufacturing process, particularly to companies who manufacture in Asia. Substantially all sales of our products are denominated in U.S. dollars, minimizing the effects of currency fluctuations.

Description of Operating Accounts

Net Revenues. Net revenues consist of product sales, net of returns and allowances.

Gross Profit. Gross profit is net revenues less cost of revenues and is affected by a number of factors, including competitive pricing, product mix, foundry pricing, the cost of test and assembly services and manufacturing yields. Cost of revenues consists primarily of costs of manufacturing, assembly and testing of our products as well as compensation and associated costs related to manufacturing support, inbound freight shipments and quality assurance personnel. It also can include, on occasion, adjustments to inventory valuations based on demand and average selling prices expected in future periods.

Research and Development. Research and development expense consists primarily of compensation and associated costs for engineering, technical and support personnel, contract engineering services, depreciation of equipment and cost of wafers and mask sets used to evaluate new products and new versions of current products.

Selling, General and Administrative. Selling, general and administrative expense consists primarily of compensation and associated costs for sales, marketing and administrative personnel, commissions, promotional activities, outbound freight shipments, professional fees and director and officer insurance.

Critical Accounting Estimates

The preparation of our condensed consolidated financial statements and related disclosures in conformity with US GAAP requires us to make estimates and judgments that affect the amounts reported in our financial statements and accompanying notes. We evaluate our estimates and judgments based on historical experience and apply them on a consistent basis. We believe that such consistent application results in financial statements and accompanying notes that fairly represent our financial condition, operating results and cash flows for all periods presented. However, any factual errors or errors in these estimates and judgments may have a material impact on our financial conditions, operating results and cash flows.

Recognition of Revenues

We generally recognize revenues as products are shipped if all of the following criteria are met:

- we have evidence that a sales arrangement exists;
- our customer has taken title to the products;
- we have delivered the products and performed the services, if any;
- the sales price is fixed or determinable;
- we believe that collection of the resulting receivable is reasonably assured; and
- we can reasonably estimate product returns.

We sell our products directly through our sales force and sales representatives to OEMs and indirectly through distributors and resellers who sell to their end customers. We recognize revenues upon delivery to OEM customers and resellers who have no product return rights and no price protection rights. We deem that delivery occurs when legal title and the risk of loss transfers to the customer. Delivery is generally defined by the customers shipping terms, as stated in the related purchase order. If the customers purchase orders do not define the shipping terms, the shipping terms will be Ex-Works as defined in our invoice. We record an estimated allowance for returns from OEM customers and resellers, based on a percentage of our revenues. This estimate is based on historical averages.

We sell to some of our distributors under agreements which provide for product return and price protection rights. These agreements generally permit the distributor to return up to 10% by value of the total products that the distributor has purchased from us in specified six-month periods. We defer recognition of revenues until such time as the distributor resells the product to their end customer, at which time the sales price becomes fixed. On a monthly basis, we receive point of sales and ending inventory information from each distributor. Using this information, we determine the amount of revenues to recognize. For distributors who have product return rights, we also record an inventory reserve to address the cost of products we anticipate that we will not be able to resell after their return by the distributors. For distributors who have price protection rights, distributors may take the associated credits immediately and in general, we process the credits one or two months after the credit is taken by the distributor. We record a reserve to cover the estimated liability of those unprocessed credits. We re-evaluate our revenue recognition policies periodically and no less often than annually.

We defer the recognition of revenue for certain resellers who have no product return rights and no price protection rights. In accordance with our policy, we will generally defer the recognition of revenue for certain resellers based on their high dollar volume of purchases.

Inventory Valuation

We value our inventory at the lower of standard cost or net realizable value. Standard cost approximates actual cost on a first-in, first-out basis. We routinely evaluate the value and quantities of our inventory in light of the current market conditions and market trends and we record reserves for quantities in excess of demand, cost in excess of market value and product age. Our analysis may take into consideration historical usage, expected demand, anticipated sales price, new product development schedules, the effect new products might have on the sales of existing products, product age, customer design activity, customer concentration and other factors. Our forecasts for our inventory usage may differ from actual inventory use. The lives of our products are usually long and obsolescence has not been a significant factor historically in the valuation of our inventories.

We reduce the value of our inventory by analyzing on-hand quantities and open purchase orders which are in excess of demand equal to the cost of inventory that exceeds expected demand for approximately the next 12 to 15 months. We make judgments in establishing these reserves and do not establish reserves if we believe we can sell the excess inventory. If market conditions are less favorable than those we estimate, we may be required to write down inventory. If we overestimate the future selling prices, we will incur additional losses when the inventory is sold for a lower price or when we establish additional write downs to cover the even lower estimated sales price. Once written down, we establish a new cost basis and accordingly we do not reverse inventory provisions until the associated inventory has been sold or physically scrapped.

Allowance for Doubtful Accounts

We estimate the collectibility of our accounts receivable at the end of each reporting period. We analyze the aging of accounts receivable and bad debt history, payment history, customer concentration, customer credit worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. We maintain an allowance for doubtful accounts, which is created by charges to selling, general and administrative expense. Our accounts receivable balance was $10.5 million, net of allowance for doubtful accounts of $138,000 as of January 31, 2006.

Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our current tax exposure and assessing temporary differences resulting from differing treatment of items, such as deferred revenues, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included on our balance sheet on a net basis. We then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we establish a valuation allowance or increase this allowance in a period; we will include an additional tax provision in the statement of income.

We reassess and may adjust the estimated tax rate quarterly. We apply the current tax rate to our year-to-date income and our tax provision and related accrual is adjusted accordingly. Our effective income tax rate was 35.1% and 32.0% for the nine months ended January 31, 2006 and 2005, respectively.

We make significant judgments in determining our provision for income taxes, our deferred tax assets and any valuation allowance recorded against our net deferred tax asset. As of January 31, 2006, our gross deferred tax assets, consisting primarily of net operating loss carryforwards, tax credit carryforwards and nondeductible reserves and accruals, were valued at $8.3 million and our valuation allowance was zero.

We have concluded that all of our deferred tax assets will be realizable, based on available objective evidence and our history of income before taxes.

Results of Operations

The following table sets forth the results of our operations as a percentage of net revenues for the periods indicated:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2006	2005	2006	2005
Net revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	56.9	61.6	60.1	55.9
Gross profit	43.1	38.4	39.9	44.1
Operating expenses:				
Research and development	13.1	14.2	12.4	13.1
Selling, general and administrative	22.8	24.6	21.7	21.5
Income (loss) from operations	7.2	(0.4)	5.8	9.5
Interest income and other, net	2.5	1.5	1.8	1.1
Income before income taxes	9.7	1.1	7.6	10.6
Income tax provision	3.7	0.3	2.7	3.4
Net income	6.0%	0.8%	4.9%	7.2%

Comparison of the three months ended January 31, 2006 and January 31, 2005

The following table sets forth net revenues (in thousands) and percentage of net revenues by product group:

	Three Months Ended January 31,					
	2006			2005		
EEPROM	$	11,971	83.0%	$	11,705	85.6%
Flash		1,329	9.2		1,248	9.1
Analog/mixed-signal		1,123	7.8		727	5.3
Net revenues	$	14,423	100.0%	$	13,680	100.0%

Net Revenues. Our net revenues increased approximately $743,000 or 5.4%, to $14.4 million for the three months ended January 31, 2006 from $13.7 million for three months ended January 31, 2005. The increase in net revenues was primarily due to improved market demand resulting in a 17% increase in unit volume sold to end customers.

Sales to customers outside the United States represented approximately 88.2% of net revenues for the three months ended January 31, 2006 as compared to 89.6% of net revenues for the three months ended January 31, 2005.

Gross Profit. Gross profit increased $967,000 or 18.4%, to $6.2 million for the three months ended January 31, 2006 from $5.2 million for three months ended January 31, 2005. The increase in gross profit was primarily due to improved market demand resulting in increase in overall unit volume, decreased test and assembly costs and improved factory throughput, resulting in increased absorption of operational expenses for the three months ended January 31, 2006. This increase was offset by declining overall average selling prices due to increasing market competition and product mix. The net provision recorded for excess and obsolete inventory was $82,000 in the three months ended January 31, 2006 compared to a $59,000 reduction in the net provision recorded in the three months ended January 31, 2005.

Research and Development. Research and development expense decreased $49,000, or 2.5%, to $1.9 million for the three months ended January 31, 2006 from $1.9 million for the three months ended January 31, 2005. The decrease in research and development expense was primarily attributable to a $77,000 decrease in wafer fabrication and test and assembly costs incurred in the research and development efforts.

Selling, General and Administrative. Selling, general and administrative expense decreased $80,000, or 2.4%, to $3.3 million for the three months ended January 31, 2006 from $3.4 million for the three months ended January 31, 2005. The decrease was primarily attributable to a decrease in fees paid primarily to consultants related to compliance with Section 404 of the Sarbanes-Oxley Act of 2002 and the past implementation of our enterprise resource planning, or ERP, system in fiscal 2005. These decreases were offset by an $86,000 increase in freight costs to end customers as a result of higher net revenue and unit volume for the three months ended January 31, 2005.

Net Interest Income and Other. We earned net interest income of $362,000 for the three months ended January 31, 2006 compared to net interest income of $212,000 for the three months ended January 31, 2005. Our rate of return on our average balance of cash, cash equivalents and short-term investments was approximately 3.7% for the three months ended January 31, 2006 and approximately 2.0% for the three months ended January 31, 2005. The increase in net interest income was primarily attributable to the higher rates of return.

Income Tax Provision. The provision for income taxes was $539,000 or 38.4% of income before taxes, for the three months ended January 31, 2006. The provision for income taxes was $50,000, or 31.8% of income before taxes, for the three months ended January 31, 2005. The income tax rates are impacted by the level of tax credits when compared to pretax income and the current estimate of the level of income subject to California taxation.

Comparison of the nine months ended January 31, 2006 and January 31, 2005

The following table sets forth net revenues (in thousands) and percentage of net revenues by product group:

	Nine Months Ended January 31,					
	2006			2005		
EEPROM	$	39,008	84.7%	$	39,555	86.0%
Flash		3,587	7.8		4,402	9.6
Analog/mixed-signal		3,435	7.5		2,038	4.4
Net revenues	$	46,030	100.0%	$	45,995	100.0%

Net Revenues. Our net revenues were flat at approximately $46.0 million for both the nine months ended January 31, 2006 and the nine months ended January 31, 2005. While we experienced an improved market demand resulting in a 14% increase in unit volume sold to end customers in the more recent period, net revenues were flat because the increase was off-set by increased market competition resulting in a decline in overall average selling prices.

Sales to customers outside the United States represented approximately 88.4% of net revenues for the nine months ended January 31, 2006 as compared to 87.3% of net revenues for the nine months ended January 31, 2005.

Gross Profit. Gross profit decreased $1.9 million, or 9.4%, to $18.4 million for the nine months ended January 31, 2006 from $20.3 million for the nine months ended January 31, 2005. The decrease in gross profit was primarily due to increased market competition resulting in a decline in overall average selling prices. The decrease in gross profit was offset by improved factory throughput, greater market demand and increased overall unit volume resulting in increased absorption of operational expenses for the nine months ended January 31, 2005. The net provision for excess and obsolete inventory recorded in the first nine months ended January 31, 2006 was $327,000 compared to a $97,000 reduction in the net provision recorded in the nine month period ended January 31, 2005.

Research and Development. Research and development expense decreased $323,000, or 5.4%, to $5.7 million for the nine months ended January 31, 2006 from $6.0 million for the nine months ended January 31, 2005. The decrease in research and development expense was primarily attributable to a $217,000 decrease in employee incentive compensation, a $78,000 decrease in wafer fabrication and test and assembly costs and a $59,000 decrease in occupancy costs for our research and development activities.

Selling, General and Administrative. Selling, general and administrative expense increased $86,000, or 1%, to $10.0 million for the nine months ended January 31, 2006 from $9.9 million for the nine months ended January 31, 2005. Selling general and administrative remained relatively flat between the two periods. The increase in selling general and administrative expense between periods was impacted by a decrease in insurance expense of $83,000 offset by an increase in depreciation expense of $85,000 and an increase in consulting fees of $83,000 for consulting work performed for Section 404 compliance.

Net Interest Income and Other. We earned net interest and other income of $841,000 for the nine months ended January 31, 2006, as compared to net interest income of $505,000 for the nine months ended January 31, 2005. Our rate of return on our average balance of cash, cash equivalents and short-term investments was approximately 3.2% for the nine months ended January 31, 2006 and approximately 1.6% for the nine months ended January 31, 2005. The increase in net interest income was primarily attributable to the higher rates of return.

Income Tax Provision. The provision for income taxes was $1.2 million, or 35.1% of income before taxes, for the nine months ended January 31, 2006. The provision for income taxes was $1.6 million, or 32.0% of income before taxes, for the nine months ended January 31, 2005. The income tax rate provision for the nine months ended January 31, 2006 is higher than the income tax rate provision for the nine months ended January 31, 2005 primarily due to reduced tax benefits associated with federal research credits. Although extension of the federal tax credit provision is expected during 2006, the federal tax law authorizing such credits expired in December 2005. As a result, we cannot reflect the benefit of credits until the related laws are enacted.

Liquidity and Capital Resources

At January 31, 2006, we had cash, cash equivalents and short-term investments of $32.9 million compared to $33.8 million at April 30, 2005. During the nine months ended January 31, 2006, we repurchased 524,759 shares of our common stock for approximately $2.6 million. Additionally, employees exercised stock options to generate $960,000 during the nine months ended January 31, 2006. We invest our excess cash in short-term financial instruments to generate interest income. These instruments are U.S. government debt securities, the majority of which have maturities that are less than one year. They are highly liquid and can be converted to cash at any time.

Historically, our primary source of cash has been provided through operations and the issuance of our common stock. Our historical uses of cash have primarily been for operating activities as well as capital expenditures. Supplemental information pertaining to our historical sources and uses of cash is presented as follows and should be read in conjunction with our Unaudited Condensed Consolidated Statements of Cash Flows and notes thereto:

	Nine Months Ended January 31,	
	2006	**2005**
	(In thousands)	
Net cash provided by operating activities	$ 2,268	$ 4,902
Net cash proceeds from sales and (purchases) of short-term investments	1,107	(12,224)
Acquisition of property and equipment	(1,517)	(3,762)
Net proceeds from secondary public offering		7,986
Treasury stock purchases	$ (2,583)	$ (5,004)

Net Cash from Operating Activities

In the nine months ended January 31, 2006, we had operating cash flows of $2.3 million which was primarily due to net income of $2.3 million, adjusted for depreciation and amortization of $1.4 million. Non-cash items included a net increase in inventory reserves of $327,000 and a tax benefit of $522,000 related to the exercise of employee stock options. Cash used by operating activities included an increase in gross inventory of $920,000 due to faster delivery times from our suppliers, a decrease in accounts payable of $802,000 related to a decrease in inventory purchases near the end of the quarter and an increase in accounts receivable of $546,000 related to the timing of recording sales relative to the prior year

In the nine months ended January 31, 2005, we had operating cash flows of $4.9 million which was primarily due to net income of $3.3 million, adjusted for depreciation and amortization of $1.2 million. Non-cash items included a net decrease in accounts receivable of $4.3 million related to our decrease in sales. Cash used by operating activities included a decrease of our deferred gross profit on shipments to distributors of $1.6 million and an increase of our inventories of $4.8 million.

Net Cash from Investing Activities

In the nine months ended January 31, 2006, investing activities used $410,000, primarily related to the proceeds from the sales and maturities of our short-term investments of $19.8 million and purchases of short-term investments of $18.7 million. We purchased $1.5 million of property and equipment, mostly production mask sets and test equipment.

In the nine months ended January 31, 2005, investing activities of $16 million, primarily related to purchases of short-term investments of $45.3 million and sales of short-term investments of $33.1 million. Our acquisitions of property and equipment of $3.8 million were for our new building for our R&D operation in Romania for $2.1 million and investments in our ERP system and production equipment of $1.7 million.

Net Cash from Financing Activities

In the nine months ended January 31, 2006, net cash used in our financing activities was $1.6 million, consisting primarily of $2.6 million used to repurchase an aggregate of 524,759 shares of our common stock on the open market during the nine months ended January 31, 2006, partially offset by proceeds of $960,000 from the sale of common stock through the exercise of stock options.

In the nine months ended January 31, 2005, net cash provided by our financing activities was $3.6 million, consisting primarily of the net proceeds of $8.0 million the Company received from our secondary offering of 1.4 million shares in July 2004, and by proceeds of $580,000 from the sale of common stock through the exercise of stock options which were offset by the repurchase of 955,000 shares of our common stock for $5 million.

Common Stock Repurchase Plans

In September 2001, our board of directors authorized a program for the open market repurchase of shares of our common stock. Under the program, as subsequently amended, we were authorized to purchase up to an aggregate of 3,500,000 shares, which included the most recent authorization in February 2005 for an additional 500,000 shares. As of July 31, 2005, we had purchased the maximum number of shares authorized under the program.

In September 2005 the board of directors authorized a new stock repurchase program under which the Company may repurchase up to 1.0 million shares of its common stock. The purpose of these share repurchase programs was to reduce the long-term potential dilution in earnings per share that might result from issuances under our stock option plans and to take advantage of the relatively low price of our common stock. The following table summarizes the activity of the open market repurchase programs for the stated periods and does not include our repurchases of shares from Elex N.V.:

	Nine Months Ended January 31, 2006	Nine Months Ended January 31, 2005
Shares repurchased in open market	524,759	955,000
Total cost of shares	$ 2,582,969	$ 5,004,000
Average cost per share	$ 4.92	$ 5.24

Contractual Obligations and Commercial Commitments

The following table summarizes our contractual obligations as of January 31, 2006 and the effects these obligations and commitments are expected to have on our liquidity and cash flows in future periods (in thousands):

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	4-5 Years	More Than 5 Years
Contractual cash obligations					
Operating leases(1)	$ 292	$ 285	$ 7	$	$
Wafer purchases	4,387	4,387			
Other purchase commitments	501	501			
Total contractual cash obligations	$ 5,180	$ 5,173	$ 7	$	$

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(1) Our primary facility lease is our business office in Sunnyvale, California. This lease expires in 2006 and will not be extended. On February 3, 2006, we entered into an agreement to purchase land and a building in Santa Clara, California for $3.7 million which will serve as our principal facility. The purchase of the land and building will be

funded by cash and the proceeds from sales of short term investments.

Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities of financial partnerships, such as entities often referred to as structured finance or special purpose entities, or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of January 31, 2006, we were not involved in any SPE transactions.

Warranties

We provide one year warranties on our products. Warranty costs may include costs to rescreen, rework or scrap returned products.

Future Liquidity

We believe that our current cash, cash equivalents and available-for-sale securities will be sufficient to meet our anticipated operating and capital requirements for at least the next 12 months. We have no current plans, nor are we currently negotiating, to obtain additional financing. Our long-term plan is to finance our core business operations with cash we generate from operations. However, from time to time we may raise additional capital through a variety of sources, including the public equity market, private financings, collaborative arrangements and debt. The additional capital we raise could be used for working capital purposes, to fund our research and development activities or our capital expenditures or to acquire complementary businesses or technologies. If we raise additional capital through the issuance of equity or securities convertible into equity, our stockholders may experience dilution. Those securities may have rights, preferences or privileges senior to those of the holders of the common stock. Additional financing may not be available to us on favorable terms, if at all. If we are unable to obtain financing, or to obtain it on acceptable terms, we may be unable to successfully support our business requirements.

New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) SFAS No. 123 (revised 2004), *Share-Based Payment,* or SFAS No. 123(R). SFAS No. 123(R) eliminates the alternative of applying the intrinsic value measurement provisions of Accounting Principals Board (APB) Opinion No. 25, or APB 25, to stock compensation awards issued to employees. The new standard requires enterprises to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the date of grant. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, usually the vesting period.

The pro forma effects on net income and earnings per share as if the Company had applied the fair value recognition provisions of original SFAS No. 123 on stock compensation awards (rather than applying the intrinsic value measurement provisions of APB 25) are in the Notes to Consolidated Financial Statements (see Note 1). Although the pro forma effects of applying original SFAS No. 123 may be indicative of the effects of adopting SFAS No. 123(R), the provisions of these two statements differ in some important respects. The actual effects of adopting SFAS No. 123(R) will be dependent on numerous factors including, but not limited to, the valuation model chosen by the Company to value stock-based awards; the assumed award forfeiture rate; the accounting policies adopted concerning the method of recognizing the fair value of awards over the requisite service period; and the transition method chosen for adopting SFAS No. 123(R). Adoption of this accounting standard will have a material adverse impact on its consolidated financial statements. SFAS No. 123(R) will be effective for the Company s fiscal quarter ending July 31, 2006.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an Amendment of ARB No. 43, Chapter 4. The amendments made by SFAS No. 151 are intended to improve financial reporting by clarifying that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognized as current-period charges and by requiring the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred after June 15, 2005. The adoption of SFAS No. 151 did not have a material impact on the Company s condensed consolidated financial statements.

On December 21, 2004, the FASB issued Staff Position No. FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004.* The American Jobs Creation Act introduces a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FSP FAS 109-2 provides accounting and disclosure guidance for the repatriation provision. The Company may elect to apply this provision to qualifying earnings repatriations in fiscal 2006. The Company plans to evaluate the effects of the repatriation provision and in particular of the limitation of the deduction to certain qualifying expenses incurred in the United States. The adoption of FSP FAS 109-2 is not expected to have a material effect on the Company s consolidated financial position, results of operations or cash flows

On May 30, 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections,* a replacement of APB Opinion No. 20 and FASB Statement No. 3, which changes the requirements for the accounting and reporting of a change in accounting principle effective for fiscal years beginning after December 15, 2005. SFAS No. 154 applies to all voluntary changes in accounting principle as well as to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 eliminates the requirement in APB Opinion No. 20, *Accounting Changes,* to include the cumulative effect of changes in accounting principle in the income statement in the period of change. Instead, to enhance the comparability of prior period financial statements, SFAS No. 154 requires that changes in accounting principle be retrospectively applied. Under retrospective application, the new accounting principle is applied as of the beginning of the first period presented as if that principle had always been used. Under SFAS No. 154, a change in reporting entity is also retrospectively applied as of the beginning of the first period presented. A change in accounting estimate continues to be accounted for in the period of change and future periods if necessary. The Company is currently assessing the impact of adopting SFAS No. 154 and believes the new standard will not have a material impact on its financial statements.

Item 3. ***Quantitative and Qualitative Disclosures about Market Risk***

Interest Rate Risk. We do not use derivative financial instruments in our investment portfolio. Our investment portfolio is generally comprised of U.S. government debt securities and cash deposits. Our policy is to place these investments in instruments that meet high credit quality standards and have maturities of less than two years with an overall average maturity of less than one year. These securities are subject to interest rate risk and could decline in value if interest rates fluctuate. Due to the short duration of the securities in which we invest and the conservative nature of our investment portfolio, a 10% move in interest rates would have an immaterial effect on our financial position, results of operations and cash flows.

Foreign Currency Exchange Rate Risk. A significant majority of our sales, manufacturing costs, and research and development and marketing expenses are transacted in U.S. dollars. Accordingly, our net profitability is not currently subject directly to material foreign exchange rate fluctuations. Gains and losses from such fluctuations have not been material to us to date.

Item 4. ***Controls and Procedures***

Evaluation of disclosure controls and procedures. Our management, with the participation of our chief executive officer and our chief financial officer, conducted an evaluation as of January 31, 2006 of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e)). Based on that evaluation, our chief executive officer and our chief financial officer concluded that the disclosure controls and procedures were effective as of January 31, 2006 in ensuring that all material information required to be disclosed in the reports we file and submit under the Securities and Exchange Act of 1934 has been made known to them on a timely basis and that such information has been properly recorded, processed, summarized and reported, as required.

Changes in internal controls. During the three months ended October 31, 2005, we implemented a new supply chain management, or SCM, system designed to provide additional operational and financial reporting functionality by allowing users to monitor inventory and business activities at a greater level of detail and with increased timeliness. During the three months ended January 31, 2006, we completed the SCM system implementation.

PART II

OTHER INFORMATION

Item 1. ***Legal Proceedings***

We are not a party to any legal proceedings as of the date of this report.

Item 1A. Risk Factors

The following lists some, but not all, of the risks and uncertainties which may have a material and adverse effect on our business, financial condition or results of operations. The risks and uncertainties set out below are not the only risks and uncertainties we face.

Risks related to our business

Our quarterly operating results may fluctuate due to many factors and are difficult to forecast, which may cause the trading price of our common stock to decline substantially.

Our operating results have historically been and in the future may be adversely affected or otherwise fluctuate due to factors such as:

fluctuations in customer demand for the electronic devices into which our products are incorporated;

volatility in supply and demand affecting semiconductor prices generally, such as an increase in the supply of competitive products and a significant decline in average selling prices;

establishment of additional inventory reserves if sales of our inventory fall below our expected sales, or the anticipated selling prices of our products fall below the amounts paid to produce and sell certain parts;

changes in our product mix including product category, density, package type, lead content, or voltage;

inadequate visibility of future demand for our products;

timing of new product introductions and orders for our products;

increases in expenses associated with new product introductions and promotions, process changes and/or expansion of our sales channels;

increases in wafer prices due to increased market demand and other factors;

increases in prices charged by our suppliers due to increased costs, decreased competition and other factors;

fluctuations in manufacturing yields;

gains or losses of significant OEM customers or indirect channel sellers, such as distributors or resellers; and

general economic conditions.

Our net revenues and operating results are difficult to forecast. We base our expense levels, in significant part, on our expectations of future net revenues and our expenses are therefore relatively fixed in the short term. If our net revenues fall below our forecasts, our operating results are likely to be disproportionately adversely affected because our costs are relatively fixed in the short term.

We may never realize a material portion of our net revenues from our analog/mixed-signal products, despite our expenditure of a disproportionate amount of our research and development and marketing resources on these products.

Analog/mixed-signal products accounted for 7.5% and 4.4% of net revenues for the nine months ended January 31, 2006 and January 31, 2005, respectively. We believe that the growth in our analog/mixed-signal product revenues has been limited due to the extended product design cycles and production lead times, and a sales force that has limited experience selling these products. Despite limited product acceptance to date, we continue to invest in and devote research and development and marketing resources to analog/mixed-signal products with the expectation that our standard analog/mixed-signal products will be accepted by many of our current customers and that we will eventually qualify and sell custom analog/mixed-signal products. Competition is intense as we have initially offered a limited range of products while our more established competitors are offering a much broader array of analog/mixed-signal products. If we are unable to realize more revenues from these products, our total revenues may not grow. In addition, if we devote a disproportionate amount of our research and development resources to analog/mixed-signal products, our development of new non-volatile memory products may suffer and operating results may be harmed.

We may be unable in the future to obtain sufficient quantities of wafers from our current foundry suppliers to fulfill customer demand.

We currently purchase a majority of our production wafers from two foundries. To address our wafer supply concerns, we plan to continue expanding our foundry capability at our primary supplier by qualifying our products in multiple fabrication plants owned by the supplier and to expand our foundry capacity with other suppliers. As the need arises, from time to time, we may pursue additional wafer sources. However, we cannot be certain that these efforts will provide us with access to adequate capacity in the future at costs which will enable us to remain profitable. Even if such capacity is available from another manufacturer, the qualification process and time required to make the foundry fully operational for us could take many months or longer and be subject to other factors described below and the prices could be materially higher. Our business, financial condition and results of operations could be materially adversely affected by:

- the loss of any of our current foundries as a supplier;

- our inability to obtain additional capacity at our current foundry suppliers;

our inability to qualify our current foundry suppliers for additional products;

our inability to locate and qualify other wafer manufacturers for desired foundry capacity; or

any other problems foundries may have causing a significant interruption in our supply of semiconductor wafers.

We will be required to expense share-based payments to our employees, and our financial statements will have a significant material adverse charge.

We will be required to expense stock options and other share-based payments to employees and directors, which will require us to record a significant charge to earnings. On December 16, 2004, the FASB issued SFAS No. 123(R), Share-Based Payment, which is a revision of SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. Pro forma disclosure of the income statement effects of share-based payments will no longer an alternative. SFAS No. 123(R), as amended, is effective for all stock-based awards granted in the fiscal years beginning after June 15, 2006. In addition, companies must also recognize compensation expense related to any awards that are not fully vested as of the effective date. Compensation expense for the unvested awards will be measured based on the fair value of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS No. 123. Our pro forma stock compensation expense was $1.5 million for the nine months ended January 31, 2006. Adoption of this accounting standard will have a material adverse impact on our consolidated financial statements. We are currently evaluating our stock-based compensation programs to determine what our alternatives may be to reduce this charge in the future. If we choose not to issue stock options at the levels we have in the past, we believe we may face a more difficult time in attracting and retaining employees.

We depend on a small number of suppliers for the supply of wafers and we may be unable to meet customer demand due to our inability to obtain wafers.

We do not manufacture or process the semiconductor wafers used for our products. In 1985, we began a relationship with our principal foundry supplier. Since 1987, that foundry has supplied wafers to us and has been our principal foundry source. In fiscal 2000, an additional foundry began to provide products to us. We primarily use our principal foundry supplier for fabricating our memory products and our other foundry supplier for fabricating our analog/mixed-signal products. We do not presently have a wafer supply agreement with our foundry suppliers and instead purchase wafers on a purchase order and acceptance basis. Our reliance on these independent foundries involves a number of risks, including:

inadequate wafer supplies to meet our production needs;

increased prices charged by these independent foundries;

reduced control over delivery schedules, manufacturing yields and costs; and

any other circumstances causing a significant interruption in our supply of semiconductor wafers.

We may forecast the future demand for our products incorrectly and produce excess or insufficient inventories of particular products, which may adversely affect our results of operations.

Since we must order products and build inventory substantially in advance of product shipments, we may forecast incorrectly and produce excess or insufficient inventories of particular products. The ability of our customers to reschedule or cancel orders without significant penalty could adversely affect our liquidity, as we may be unable to adjust our purchases from our wafer suppliers to match any customer changes and cancellations. As part of our business strategy, we maintain a substantial inventory of sorted wafers in a die bank but limit our investment in finished goods. We may have adequate wafer inventory to meet customer needs but may be unable to finish the manufacturing process prior to the delivery date specified by the customer. Demand for our products is volatile and customers often place orders with short lead times. Our inventory may not be reduced by sufficient demand of customer orders and in the future we may produce excess quantities of our products.

It is our policy to fully write down all inventories that we do not expect to be sold in a reasonable period of time. During recent fiscal years, as a result of changes in estimated demand for our various products, we have taken charges for write down of inventories for certain products, primarily our EEPROM products. For example, we recorded inventory write-down charges of $2.7 million in fiscal 2003, which were offset by a benefit of $3.1 million relating to products that were written off in prior years and sold during fiscal 2003. In subsequent years, we recorded additional inventory write-down charges of substantially smaller magnitude, which were similarly reduced by the benefit relating to the sales of products that were written off in prior years. We may suffer reductions in values of our inventories in the future and we may be unable to liquidate our inventory at acceptable prices. To the extent we have excess inventories of particular products, our operating results could be adversely affected by charges to cost of revenues that we would be required to recognize due to significant reductions in demand for our products or rapid declines in the market value of our inventory, resulting in inventory write downs or other related factors.

We may be unable to fulfill all our customers orders according to the schedule originally requested due to the constraints in our wafer supply and processing time from die bank to finished goods, which could result in reduced revenues or higher expenses.

Due to the lead time constraints in our wafer supply, foundry activities and other manufacturing processes, from time to time we have been unable to fulfill all our customers orders on the schedule originally requested. Although we attempt to anticipate pending orders and maintain an adequate supply of wafers and communicate to our customers delivery dates that we believe we can reasonably expect to meet, our customers may not accept the alternative delivery date or may cancel their outstanding orders. Reductions in orders received or cancellation of outstanding orders would result in lower net revenues and reduced operating results, excess inventories and increased inventory reserves. We may also be required to pay substantially higher per wafer prices to replenish our die bank, which could harm our gross margins. If we were requested to pay rush charges to our manufacturing or foundry suppliers to meet a customer s requested delivery date, our expenses would increase and possibly harm our operating results.

We rely on distributors and resellers for a substantial portion of our net revenues and if our relationships with one or more of those distributors or resellers were to terminate, our operating results may be harmed.

We market and distribute our products primarily through independent distributors and resellers, which typically offer competing products. These distribution channels have been characterized by rapid change, including consolidations and financial difficulties.

Distributors and resellers have accounted for a significant portion of our net revenues in the past. For the nine months ended January 31, 2006, sales to Avnet, an international distributor, represented 14% of our net revenues. For the nine months ended January 31, 2005, no customer represented 10% or more of our net revenues.

In addition, we have experienced and may continue to experience lower margins on sales to distributors and resellers as a result of volume pricing arrangements. We also do not typically enter into long-term arrangements with our distributors and resellers and we cannot be certain as to future order levels from our distributors and resellers. When we do enter into long-term arrangements, the contracts are generally terminable at the convenience of either party and it may be difficult to replace that source of revenues in the short-term upon cancellation.

Our business depends on these third parties to sell our products. As a result, our operating results and financial condition could be materially adversely affected by the loss of one or more of our current distributors or resellers, additional volume pricing arrangements, order cancellations, delay in shipment by one of our distributors or resellers or the failure of our distributors or sellers to successfully sell our products.

We face risks from failures in our manufacturing processes and the processes of our foundries and vendors.

The fabrication of semiconductors, particularly EEPROM products, is a highly complex and precise process. Most of our products are currently manufactured by two outside foundries and a number of other vendors participate in assembling, testing and other processing of our products. During manufacturing, each wafer is processed to provide numerous EEPROM, flash or analog/mixed-signal devices. We may reject or be unable to sell a substantial percentage of wafers or the components on a given wafer because of:

- minute impurities;

- difficulties in the fabrication process, such as failure of special equipment, operator error or power outages;

defects in the masks used to imprint circuits on a wafer;

nonconforming electrical and/or optical performance;

breakage of wafers; or

other factors.

We refer to the proportion of final components that have been processed, assembled and tested relative to the gross number of components that could be constructed from the raw materials as our manufacturing yield. We have in the past experienced lower than expected manufacturing yields, which have delayed product shipments and negatively impacted our results of operations. We may experience difficulty maintaining acceptable manufacturing yields in the future.

In addition, the maintenance of our outsourced fabrication, manufacturing and assembly model is subject to risks, including:

the demands of managing and coordinating workflow between geographically separate production facilities;

disruption of production in one facility as a result of a slowdown or shutdown in another facility; and

higher operating costs from managing geographically separate manufacturing facilities.

We depend on certain vendors for foundry services, materials, test and assembly services. We maintain stringent policies regarding qualification of these vendors. However, if these vendors processes vary in reliability or quality, they could negatively affect our products and our results of operations.

We rely on third party subcontractors to sort, assemble, test and ship our products to customers, which reduces our control over quality, delivery schedules and capacity.

We outsource all or a portion of the production planning, assembly, test and finish work of our products, as well as our inventory management function to subcontractors who are primarily located in Thailand and the Philippines. We do not have long-term contractual arrangements with these subcontractors. Our reliance on third parties subjects us to risks such as reduced control over delivery schedules and quality, a potential lack of adequate capacity during periods when demand is high and potential increases in product costs due to factors outside our control such as capacity shortages and pricing changes. Our outsourcing model could lead to delays in product deliveries, lost sales and increased costs which could harm our relationships with OEM customers and indirect sales channels and result in lower operating results. Because we utilize the services of a group of assembly and test providers, this makes our operation highly complex, requiring a high degree of diligence in managing the costs of production and overall logistics of our manufacturing operations.

International sales comprise a significant portion of our product sales, which exposes us to foreign political and economic risks.

For the nine months ended January 31, 2006 and January 31, 2005, sales outside the United States comprised 89.6% and 87.3% of our net revenues, respectively. The increase in percentage of international revenues in fiscal 2006 was primarily attributable to the continuing outsourcing of electronic systems manufacturing, primarily to Asia. We expect that sales outside of the United States will continue to represent a significant portion of our net revenues in the future. However, our international operations may be adversely affected by the following factors:

- greater fluctuations in demand for our products due to the increased sensitivity to pricing changes in certain markets, particularly Asia;
- longer payment cycles;
- fluctuations in exchange rates;
- imposition of government controls;
- difficulties in staffing international operations;

political, socioeconomic and financial instability, such as the military actions in Afghanistan and Iraq;

trade restrictions;

the impact of communicable diseases, such as severe acute respiratory syndrome; and

changes in regulatory requirements.

Our business is also subject to other risks because of our design center in Romania and our relationships with foreign subcontractors including, but not limited to, foreign government regulations and political and financial unrest which may cause disruptions or delays in shipments to our customers or access to our inventories. We do not currently hedge against any foreign currency exchange rate risks.

Corporate governance regulations have recently increased our costs and may further increase our costs.

Changes in laws and regulations affecting public companies, including the provision of the Sarbanes-Oxley Act of 2002, have imposed new requirements on us and on our officers, directors, attorneys and independent accountants. In order to comply with these new rules, we have added internal resources and have utilized additional outside legal, accounting and advisory services, which have increased and are likely to continue increasing our operating expenses. In particular, we expect to incur additional administrative expenses as we maintain compliance with Section 404 of the Sarbanes-Oxley Act, which requires management to report on, and our Independent Registered Public Accounting Firm to attest to, our internal control over financial reporting. In addition, if we undergo significant modifications to our structure through personnel or system changes, acquisitions, or otherwise, it may be increasingly difficult to maintain compliance with the existing and evolving corporate governance regulations. We may also face challenges with our review and reporting of the effectiveness of internal control over financial reporting due to changes in materiality thresholds, interpretive literature and other procedures in future reviews.

We may face increased management costs and other risks due to the establishment of our product development group in Romania.

In January 2003, we formed a wholly owned subsidiary in Romania to provide engineering services for current products and the development of potential new products. In August 2004, we purchased a building in Bucharest for use by our Romanian engineering group at a cost of $2.1 million. We have no prior experience in establishing or operating engineering services outside of our headquarters in Sunnyvale, California. Our expansion of engineering design operations to remotely situated offices presents a number of substantial risks that could increase our operating expenses and adversely affect our operating results, financial condition and ability to deliver our products and grow our business, including:

difficulties in staffing and managing foreign operations, in particular attracting and retaining personnel qualified to provide high quality engineering services;

difficulties in coordinating our engineering operations in Romania with those in California;

diversion of management attention;

political and economic instability, which may have an adverse impact on foreign exchange rates of the Romanian leu relative to the U.S. dollar and could impair our ability to conduct our business in Romania;

difficulties in maintaining uniform standards, controls, procedures and policies with our Romanian subsidiary relative to those of our other locations, including product development management and financial consolidation;

difficulties in owning and operating real property in Romania; and

inadequacy of the local infrastructure to support our needs.

Our ability to operate successfully depends upon the continued service of certain key employees and the continued ability to attract and retain additional highly qualified personnel.

Our ability to operate successfully will depend, to a large extent, upon the continued service of certain key employees and the continued ability to attract and retain additional highly qualified personnel. Competition for these personnel, particularly for highly skilled design, process and test engineers, is intense and we may not be able to retain these personnel or attract other highly qualified personnel. Our business, financial condition and results of operations could be materially adversely affected by the loss of or failure to attract and retain highly qualified personnel.

Our low-density flash memory products may become obsolete.

A substantial portion of our net revenues have been and continue to be derived from sales of low density flash memory products. Flash memory products represented 7.8% and 9.5% of our net revenues for the nine months ended January 31, 2006 and 2005, respectively. In general, the market for flash memory products has been characterized by competing technologies, migration of demand to larger memory sizes and intense overall competition. Other flash memory vendors continue to design, develop and sell flash memory devices with larger memory in reaction to changes in market demand. This transition to larger flash memory sizes is resulting in a limited and shrinking market for the low density flash memory products that we currently offer. We have decided not to develop any of the higher density flash memory devices due to the extreme competition in the medium and high density flash memory market and the considerable costs of development associated with it. Due to these and other factors, we are likely to experience declining net revenues from our low-density flash memory products, which could harm our operating results.

Risks Related to Our Industry and Competition

Competition in our markets may lead to reduced average selling prices of our products, reduced sales of our products or gross margins.

The non-volatile memory market is competitive and has been characterized by rapid price erosion, manufacturing capacity constraints and limited product availability. Average selling prices in the non-volatile memory market generally, and for our products in particular, have fluctuated significantly over the life of each product and, over the long term, the average selling price of each product has tended to decline. Declines in average selling prices for our products, if not offset by reductions in the cost of producing those products or by sales of new products with higher gross margins, would decrease our overall gross margins, could cause a negative adjustment to the value of our inventories and could materially and adversely affect our operating results.

We compete with major domestic and international semiconductor companies, many of which have substantially greater financial, technical, marketing, distribution and other resources. We may not be able to compete successfully in the future. Our more mature products, such as serial and parallel EEPROM devices, compete on the basis of price, product availability and customer service. Principal competitors for our EEPROM products currently include Atmel, STMicroelectronics and Microchip Technology. Principal competitors for our low density flash products include Silicon Storage Technology and Integrated Silicon Solution. Principal competitors for our analog/mixed-signal products include Fairchild Semiconductor, Intersil, Linear Technology, Maxim Integrated Products, National Semiconductor and Texas Instruments.

The semiconductor industry is highly cyclical in nature, which may cause our operating results to fluctuate.

We operate in a highly cyclical industry that has been subject to significant economic downturns often in connection with, or in anticipation of, maturing product cycles and declines in general economic conditions. These types of downturns have occurred numerous times in the past, most recently, in calendar 2005. During such downturns, we experience reduced product demand and production overcapacity which result in competitive pricing pressures leading to accelerated erosion of average selling prices and reduced gross margins. These downturns may occur for extended periods. Accordingly, we may experience substantial period-to-period fluctuations in operating results.

Our continued success depends in large part on the continued growth of various electronics industries that use semiconductors. We attempt to identify changes in market conditions as soon as possible; however, market dynamics make our prediction of and timely reaction to such events difficult. Our business could be harmed in the future by additional cyclical downturns in the semiconductor industry or by slower growth by any of the markets served by our end customers products.

If our products fail to keep pace with the rapid changes in the semiconductor industry, we could lose customers and revenues.

The markets for our products are characterized by rapidly changing customer demand, over or under utilization of manufacturing capacity and price fluctuations. To compete successfully, we must introduce new products in a timely manner at competitive price, quality and performance levels. In particular, our future success will depend on our ability to develop and implement new design and process technologies which enable us to reduce product costs. Our business, financial condition and results of operations could be materially adversely affected by delays in developing new products, achievement of volume production and market acceptance of new products, successful completion of technology transitions of our existing products to new process geometries or foundries with acceptable yields and reliability.

Risks Related to Our Intellectual Property

Our business may be harmed if we fail to protect our proprietary technology.

We rely on a combination of patents, trademarks, copyrights, trade secret laws, confidentiality procedures and licensing arrangements to protect our intellectual property rights. We currently have patents granted and pending in the United States and intend to seek further United States and international patents on our technology. We cannot be certain that patents will be issued from any of our pending applications, that patents will be issued in all countries where our products can be sold or that any issued patents will be of sufficient scope or strength to provide meaningful protection or any commercial advantage. Our competitors may also be able to design around our patents. The laws of some countries in which our products are or may be developed, manufactured or sold, may not protect our products or intellectual property rights to the same extent as do the laws of the United States, increasing the possibility of piracy of our technology and products. Although we intend to vigorously defend our intellectual property rights, we may not be able to prevent misappropriation of our technology. Our competitors may also independently develop technologies that are substantially equivalent or superior to our technology.

Our ability to produce our products may suffer if someone claims we infringe on their intellectual property.

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights or positions, which have resulted in significant and often protracted and expensive litigation. In addition, it is typical for companies in the industry to receive notices from time to time that allege infringement of patents or other intellectual property rights. We may receive other notices or become a party to other proceedings alleging our infringement of patents or intellectual property rights in the future. If it is necessary or desirable, we may seek licenses under such patents or other intellectual property rights. However, we cannot be certain that licenses will be offered or that we would find the terms of licenses that are offered acceptable or commercially reasonable. Our failure to obtain a license from a third party for technology used by us could cause us to incur substantial liabilities and to suspend the manufacture of the affected products. Furthermore, we may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Litigation by or against us could result in significant expense and divert the efforts of our technical personnel and management, whether or not the litigation results in a favorable resolution. In the event of an adverse result in any litigation, we could be required to:

- pay substantial damages;
- pay amounts to indemnify our customers;

- stop the manufacture and sale of the infringing products;
- expend significant resources to develop non-infringing technology;
- discontinue the use of certain processes; or
- obtain licenses to the technology.

We may be unsuccessful in developing non-infringing products or negotiating licenses with reasonable terms, or at all. These problems might not be resolved in time to avoid harming our results of operations. If any third party makes a successful claim against our customers or us and a license is not made available to us on commercially reasonable terms, our business could be harmed.

We may be subject to damages resulting from claims that we have wrongfully used the alleged trade secrets of our employees former employers.

Many of our employees were previously employed at other companies, including our competitors or potential competitors. Although we have no current or pending claims against us, we may be subject to claims that we have relied on information that these employees have inadvertently, or otherwise, disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. If we fail in defending such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights or personnel. A loss of key research personnel or their work product could hamper or prevent our ability to develop new products, which could severely harm our business. Even if we are successful, litigation could result in substantial costs and be a distraction to management.

We may not be able to expand our proprietary technology if we do not acquire rights to use key technologies, consummate potential acquisitions or investments or successfully integrate them with our business.

To expand our proprietary technologies, we may acquire or make investments in complementary businesses, technologies or products if appropriate opportunities arise. We may be unable to identify suitable acquisition or investment candidates at reasonable prices or on reasonable terms or consummate transactions with such candidates, the failure of which could slow our growth. We may also have difficulty in acquiring licenses to use proprietary technologies of third parties to expand our product lines. We may have difficulty integrating the acquired products, personnel or technologies of any acquisition we might make. These difficulties could disrupt our ongoing business, limit our future growth, distract our management and employees and increase our expenses.

Risks Related to Our Stock

Our stock is subject to substantial price and volume fluctuations due to a number of factors, many of which are beyond our control, and those fluctuations may prevent our stockholders from reselling our common stock at a profit.

The trading price of our common stock has in the past been and could in the future be subject to significant fluctuations in response to:

- quarterly variations in our results of operations;
- announcements of technological innovations or new products by us, our customers or competitors;
- our failure to achieve the operating results anticipated by analysts or investors;

sales or the perception in the market of possible sales of a large number of shares of our common stock by our directors, officers, employees or principal stockholders;

international political, socioeconomic and financial instability, including instability associated with military action in Afghanistan and Iraq or other conflicts;

releases or reports by or changes in security analysts recommendations; and

developments or disputes concerning patents or proprietary rights or other events.

For example, during the 12 months ended January 31, 2006, the trading price of our common stock on the Nasdaq National Market has ranged from a high of $5.44 to a low of $4.13. If our net revenues and results of operations are below the expectations of investors, significant fluctuations in the market price of our common stock could occur. In addition, the securities markets have, from time to time, experienced significant price and volume fluctuations, which have particularly affected the market prices for high technology companies and often are unrelated and disproportionate to the operating performance of particular companies. These broad market fluctuations, as well as general economic, political and market conditions, may negatively affect the market price of our common stock.

Our charter documents, Delaware law and our stockholder rights plan contain provisions that may inhibit potential acquisition bids, which may adversely affect the market price of our common stock, discourage merger offers or prevent changes in our management.

Our board of directors has the authority to issue up to 2,000,000 shares of preferred stock and to determine the rights, preferences, privileges and restrictions, including voting rights, of the shares without any further vote or action by our stockholders. If we issue any of these shares of preferred stock in the future, the rights of shareholders of our common stock may be negatively affected. If we issue preferred stock, a change of control of our company could be delayed, deferred or prevented. We have no current plans to issue shares of preferred stock.

Section 203 of the Delaware General Corporation Law restricts certain business combinations with any interested stockholder as defined by that statute. In addition, our certificate of incorporation and bylaws contain certain other provisions that may have the effect of delaying, deferring or preventing a change of control. These provisions include:

the classification of our board so that only a portion of our directors are elected each year and each director serves a three year term;

the elimination of actions by written consent of stockholders; and

the establishment of an advance notice procedure for stockholder proposals and director nominations to be acted upon at annual meetings of the stockholders.

In 1996, our board of directors adopted a stockholder rights plan with an initial term of ten years. Under this plan, we issued a dividend of one right for each share of our common stock. Each right initially entitles stockholders to purchase one one-thousandth of a share of our preferred stock for $18.00. However, the rights are not immediately exercisable. If a person or group acquires, or announces a tender or exchange offer that would result in the acquisition of 15% of our common stock, unless the rights are redeemed by us for $0.01 per right, the rights will become exercisable by all rights holders, except the acquiring person or group, for shares of our common stock or the stock of the third party acquirer having a value of twice the right s then-current exercise price.

These provisions are designed to encourage potential acquirers to negotiate with our board of directors and give our board of directors an opportunity to consider various alternatives to increase stockholder value. These provisions are also intended to discourage certain tactics that may be used in proxy contests. However, the potential issuance of preferred stock, our charter and bylaw provisions, the restrictions in Section 203 of the Delaware General Corporation Law and our stockholder rights plan could discourage potential acquisition proposals and could delay or prevent a change in control, which may adversely affect the market price of our stock. These provisions and plans may also have the effect of preventing changes in our management or board of directors.

We may be the subject of securities class action litigation due to future stock price volatility.

In the past, when the market price of a stock has been volatile, holders of that stock have often initiated securities class action litigation against the company that issued the stock. If any of our stockholders brought a lawsuit against us, we could incur substantial costs defending the lawsuit. The lawsuit could also divert the time and attention of our management.

Item 1. ***Legal Proceedings***

We are not a party to any legal proceedings as of the date of this report.

Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

Period	Total Number of Shares Purchased	Average Price Paid per Share		Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans
October 31, 2005 November, 2005		$			710,556
November, 2005 December, 2005	75,092	$	4.95	75,092	635,464
December, 2005 January, 2006	105,499	$	4.99	105,499	529,965
Total	180,591	$	4.97	180,591	

(1) In September 2005, the board of directors authorized a new stock repurchase program under which the Company may repurchase up to 1.0 million shares of its common stock. Prior to September 2005, the board of directors authorized the repurchase of 3.5 million shares. Through January 31, 2006, the Company has repurchased 3,970,035 shares under the board of director s authorized repurchase plans. See the section entitled Common Stock Repurchase Plans in Item 2 of this Quarterly Report on Form 10-Q for further information on this program.

Item 6. ***Exhibits***

Exhibit Number	Description
10.97(1)	Offer Letter with Scott Brown dated August 18, 2005
31.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference to Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission on October 11, 2006.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: March 10, 2006	By: /s/ GELU VOICU Gelu Voicu *President,Chief Executive Officer and Director*
Date: March 10, 2006	By: /s/ THOMAS E. GAY III Thomas E. Gay III *Vice President of Finance and Administration* *and Chief Financial Officer*

INDEX TO EXHIBITS

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