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	**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,		Nine Months Ended January 31,	
	2006	2005	2006	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,		Nine Months Ended January 31,	
	2006	2005	2006	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,		Nine Months Ended January 31,	
	2006	2005	2006	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,		Nine Months Ended January 31,	
	2006	2005	2006	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&