

QUICKLOGIC CORPORATION
Form 10-Q
November 06, 2009
Table of Contents

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 27, 2009

OR

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

For the Transition Period From _____ To _____

COMMISSION FILE NUMBER: 000-22671

QUICKLOGIC CORPORATION

(Exact name of registrant as specified in its charter)

Edgar Filing: QUICKLOGIC CORPORATION - Form 10-Q

DELAWARE
(State or other jurisdiction of
incorporation or organization)

77-0188504
(I.R.S. Employer
Identification No.)

1277 ORLEANS DRIVE SUNNYVALE, CA 94089

(Address of principal executive offices, including Zip Code)

(408) 990-4000

(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 Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller Reporting Company

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

As of November 5, 2009, the registrant had outstanding 30,437,658 shares of common stock, par value \$0.001.

Table of Contents

QUICKLOGIC CORPORATION

FORM 10-Q

September 27, 2009

| | Page |
|--|-------------|
| <u>Part I. Financial Information</u> | 3 |
| <u>Item 1. Financial Statements</u> | 3 |
| <u>Condensed Unaudited Consolidated Statements of Operations for the three and nine months ended September 27, 2009 and September 28, 2008</u> | 3 |
| <u>Condensed Unaudited Consolidated Balance Sheets as of September 27, 2009 and December 28, 2008</u> | 4 |
| <u>Condensed Unaudited Consolidated Statements of Cash Flows for the nine months ended September 27, 2009 and September 28, 2008</u> | 5 |
| <u>Condensed Unaudited Consolidated Statements of Comprehensive Loss for the three and nine months ended September 27, 2009 and September 28, 2008</u> | 6 |
| <u>Notes to Condensed Unaudited Consolidated Financial Statements</u> | 7 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 22 |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u> | 34 |
| <u>Item 4. Controls and Procedures</u> | 34 |
| <u>Part II. Other Information</u> | 35 |
| <u>Item 1. Legal Proceedings</u> | 35 |
| <u>Item 1A. Risk Factors</u> | 35 |
| <u>Item 6. Exhibits</u> | 47 |
| <u>Signatures</u> | 48 |

Table of Contents**PART I. Financial Information****Item 1. Financial Statements****QUICKLOGIC CORPORATION****CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

| | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2009 | September 28, 2008 | September 27, 2009 | September 28, 2008 |
| Revenue | \$ 3,332 | \$ 6,230 | \$ 10,795 | \$ 25,996 |
| Cost of revenue | 2,186 | 2,778 | 5,594 | 12,018 |
| Long-lived asset impairment | 150 | | 150 | 1,545 |
| Gross profit | 996 | 3,452 | 5,051 | 12,433 |
| Operating expenses: | | | | |
| Research and development | 1,400 | 1,354 | 4,889 | 6,785 |
| Selling, general and administrative | 2,525 | 2,666 | 7,877 | 10,956 |
| Long-lived asset impairment | | | | 468 |
| Restructuring costs | | | | 452 |
| Loss from operations | (2,929) | (568) | (7,715) | (6,228) |
| Write-down of investment in Tower Semiconductor Ltd. | | | | (417) |
| Interest expense | (31) | (59) | (78) | (202) |
| Interest income and other, net | (30) | (46) | (31) | 88 |
| Loss before income taxes | (2,990) | (673) | (7,824) | (6,759) |
| Provision for (benefit from) income taxes | 7 | (58) | (4) | (24) |
| Net loss | \$ (2,997) | \$ (615) | \$ (7,820) | \$ (6,735) |
| Net loss per share: | | | | |
| Basic | \$ (0.10) | \$ (0.02) | \$ (0.26) | \$ (0.23) |
| Diluted | \$ (0.10) | \$ (0.02) | \$ (0.26) | \$ (0.23) |
| Weighted average shares: | | | | |
| Basic | 30,322 | 29,772 | 30,104 | 29,589 |
| Diluted | 30,322 | 29,772 | 30,104 | 29,589 |

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

Table of Contents

QUICKLOGIC CORPORATION
CONDENSED UNAUDITED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value amount)

| | September 27, 2009 | December 28, 2008 |
|---|-----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 13,886 | \$ 19,376 |
| Short-term investment in Tower Semiconductor Ltd. | 823 | 116 |
| Accounts receivable, net of allowances for doubtful accounts of \$10 | 1,981 | 1,746 |
| Inventories | 1,844 | 1,900 |
| Other current assets | 612 | 833 |
| Total current assets | 19,146 | 23,971 |
| Property and equipment, net | 3,008 | 3,493 |
| Investment in Tower Semiconductor Ltd. | 414 | 59 |
| Other assets | 461 | 903 |
| TOTAL ASSETS | \$ 23,029 | \$ 28,426 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Revolving line of credit | \$ 2,000 | \$ 2,000 |
| Trade payables | 2,136 | 1,992 |
| Accrued liabilities | 1,114 | 1,537 |
| Deferred income on shipments to distributors | 7 | 282 |
| Deferred royalty revenue | 63 | |
| Current portion of capital lease obligations | 436 | 753 |
| Total current liabilities | 5,756 | 6,564 |
| Long-term liabilities: | | |
| Capital lease obligations, less current portion | 264 | |
| Total liabilities | 6,020 | 6,564 |
| Commitments and contingencies (see Notes 12 and 13) | | |
| Stockholders' equity: | | |
| Common stock, \$0.001 par value; 100,000 shares authorized; 30,378 and 29,909 shares issued and outstanding, respectively | 30 | 30 |
| Additional paid-in capital | 171,751 | 169,846 |
| Accumulated other comprehensive income | 1,062 | |
| Accumulated deficit | (155,834) | (148,014) |
| Total stockholders' equity | 17,009 | 21,862 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 23,029 | \$ 28,426 |

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

Table of Contents**QUICKLOGIC CORPORATION****CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

| | Nine Months Ended | |
|--|-----------------------|-----------------------|
| | September 27, 2009 | September 28, 2008 |
| Cash flows from operating activities: | | |
| Net loss | \$ (7,820) | \$ (6,735) |
| Adjustments to reconcile net loss to net cash provided by (used for) operating activities: | | |
| Depreciation and amortization | 1,347 | 1,717 |
| Stock-based compensation | 1,809 | 1,971 |
| Utilization of wafer credits from Tower Semiconductor Ltd. | 278 | 254 |
| Write-down of inventories | 467 | 1,331 |
| Long-lived asset impairment | 261 | 2,058 |
| Write-down of marketable securities | | 417 |
| Bad debt expense | | 44 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (235) | 311 |
| Inventories | (411) | 1,982 |
| Other assets | 337 | 725 |
| Trade payables | (76) | (2,697) |
| Accrued liabilities | (360) | (219) |
| Deferred income and royalty revenue | (275) | (708) |
| Net cash provided by (used for) operating activities | (4,678) | 451 |
| Cash flows from investing activities: | | |
| Capital expenditures for property and equipment | (89) | (541) |
| Net cash used for investing activities | (89) | (541) |
| Cash flows from financing activities: | | |
| Payment of debt and capital lease obligations | (6,819) | (4,074) |
| Proceeds from debt obligations | 6,000 | 2,000 |
| Proceeds from issuance of common stock | 96 | 129 |
| Net cash used for financing activities | (723) | (1,945) |
| Net decrease in cash and cash equivalents | (5,490) | (2,035) |
| Cash and cash equivalents at beginning of period | 19,376 | 20,868 |
| Cash and cash equivalents at end of period | \$ 13,886 | \$ 18,833 |
| Supplemental disclosures of cash flow information: | | |
| Interest paid | \$ 81 | \$ 210 |
| Income taxes paid | \$ | \$ 9 |
| Supplemental schedule of non-cash investing and financing activities: | | |
| Capital lease obligation to finance capital expenditures and related maintenance | \$ 513 | \$ |

Edgar Filing: QUICKLOGIC CORPORATION - Form 10-Q

| | | | |
|--|----|-----|----|
| Purchase of equipment included in accounts payable | \$ | 220 | \$ |
|--|----|-----|----|

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

Table of Contents**QUICKLOGIC CORPORATION****CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(in thousands)**

| | Three Months Ended | | Nine Months Ended | |
|--|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| | September 27, 2009 | September 28, 2008 | September 27, 2009 | September 28, 2008 |
| Net loss | \$ (2,997) | \$ (615) | \$ (7,820) | \$ (6,735) |
| Other comprehensive gain (loss), net of tax: | | | | |
| Unrealized gain (loss) on available-for-sale investments | 807 | (376) | 1,062 | (726) |
| Total comprehensive loss | \$ (2,190) | \$ (991) | \$ (6,758) | \$ (7,461) |

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

Table of Contents

QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 The Company and Basis of Presentation

QuickLogic Corporation, referenced herein as QuickLogic or the Company, was founded in 1988 and reincorporated in Delaware in 1999. The Company develops and markets low power programmable solutions that enable customers to add differentiated features and capabilities to their mobile, consumer and industrial products. The Company is a fabless semiconductor company that operates in a single industry segment where it designs, markets and supports Customer Specific Standard Products, or CSSPs, Field Programmable Gate Arrays, or FPGAs, application solutions, associated design software and programming hardware.

The accompanying interim consolidated financial statements are unaudited. In the opinion of management, these statements have been prepared in accordance with generally accepted accounting principles, or GAAP, and include all adjustments, consisting only of normal recurring adjustments, necessary to provide a fair statement of results for the interim periods presented. The Company recommends that these consolidated financial statements be read in conjunction with the Company's Form 10-K for the year ended December 28, 2008. Operating results for the three and nine months ended September 27, 2009 are not necessarily indicative of the results that may be expected for the full year.

QuickLogic's fiscal year ends on the Sunday closest to December 31. QuickLogic's fiscal third quarter for 2009 and 2008 ended Sunday, September 27, 2009 and September 28, 2008, respectively.

Subsequent events have been disclosed through November 5, 2009, the date of the issuance of these Condensed Unaudited Consolidated Financial Statements.

Liquidity

We have financed our operating losses and capital investments through sales of common stock, private equity investments, capital and operating leases, bank line of credit and cash flow from operations. As of September 27, 2009, our principal sources of liquidity consisted of our cash and cash equivalents of \$13.9 million, available credit under our revolving line of credit with Silicon Valley Bank of \$4.0 million, and our investment in Tower with a market value of approximately \$1.2 million.

The Company anticipates that its existing cash resources will fund operations, finance purchases of capital equipment and provide adequate working capital for the next twelve months. The Company's liquidity is affected by many factors including, among others, the level of revenue and gross profit as a result of the cyclicality of the semiconductor industry and the current global economic crisis, the conversion of design opportunities into revenue, market acceptance of existing and new products including CSSPs based on our ArcticLink® and PolarPro® solution platforms, fluctuations in revenue as a result of product end-of-life, fluctuations in revenue as a result of the stage in the product life cycle of its customers' products, costs of securing access to and availability of adequate manufacturing capacity, levels of inventories, wafer purchase commitments, customer credit terms, the amount and timing of research and development expenditures, the timing of new product introductions, production volumes, product quality, sales and marketing efforts, the value and liquidity of its investment portfolio, the amount and financing arrangements for purchases of capital equipment, changes in operating assets and liabilities, the ability to obtain or renew debt financing and to remain in compliance with the terms of existing credit facilities, the ability to raise funds from the sale of shares of Tower Semiconductor Ltd., or Tower, and equity in the Company, the issuance and exercise of stock options and participation in the Company's employee stock purchase plan, and other factors related to the uncertainties of the industry and global economics. Accordingly, there can be no assurance that events in the future will not require the Company to seek additional capital or, if so required, that such capital will be available on terms acceptable to the Company.

Principles of Consolidation

The consolidated financial statements include the accounts of QuickLogic Corporation and its wholly owned subsidiaries, QuickLogic International, Inc., QuickLogic Canada Company, QuickLogic Kabushiki Kaisha and QuickLogic Software (India) Private Ltd. The Company and its subsidiaries use the U.S. dollar as its functional currency. All intercompany accounts and transactions are eliminated in consolidation.

Table of Contents

QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Foreign Currency

The functional currency of the Company's non-U.S. operations is the U.S. dollar. Accordingly, all monetary assets and liabilities of these foreign operations are translated into U.S. dollars at current period-end exchange rates and non-monetary assets and related elements of expense are translated using historical rates of exchange. Income and expense elements are translated to U.S. dollars using average exchange rates in effect during the period. Gains and losses from the foreign currency transactions of these subsidiaries are recorded as interest income and other, net in the statement of operations.

Uses of Estimates

The preparation of these consolidated financial statements in conformity with generally accepted accounting principles, or GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates, particularly in relation to revenue recognition, the allowance for doubtful accounts, sales returns, valuation of investments, valuation of long-lived assets, valuation of inventories including identification of excess quantities, market value and obsolescence, measurement of stock-based compensation awards, accounting for income taxes and measuring accrued liabilities.

Concentration of Risk

The Company's accounts receivable are denominated in U.S. dollars and are derived primarily from sales to customers located in North America, Europe and Asia Pacific. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. See Note 11 for information regarding concentrations associated with accounts receivable. The Company's investment in Tower is subject to equity risk. See Note 4 for information regarding the Company's investment in Tower Semiconductor Ltd.

Note 2 Significant Accounting Policies

There have been no material changes in the Company's significant accounting policies for the third quarter of 2009 from its disclosure in the Annual Report on Form 10-K for the year ended December 28, 2008, except as described below. For a discussion of the significant accounting policies, please see the Annual Report on Form 10-K for the fiscal year ended December 28, 2008 filed with the Securities Exchange Commission, or SEC, on March 11, 2009.

Revenue Recognition

The Company supplies standard products which must be programmed before they can be used in an application. The Company's products may be programmed by the Company, distributors, end-customers or third parties. Once programmed, the Company's parts cannot be erased and, therefore, programmed parts are only useful to a specific customer.

The Company generally recognizes revenue as products are shipped if evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, collection of the resulting receivable is reasonably assured and product returns are reasonably estimable.

Revenue is recognized upon shipment of both programmed and unprogrammed parts to original equipment manufacturer, or OEM, customers, provided that legal title and risk of ownership have transferred. A significant portion of our sales is made through distributors. In the case of programmed parts and unprogrammed, end-of-life products, it is the Company's practice to agree upon the sales price with a distributor prior to shipment. Until the first quarter of 2009 in the case of unprogrammed, other than end-of-life parts, which may be used by multiple end-customers, the distribution agreements allowed for rights of return and post shipment price adjustments such as Ship from Stock and Debits, or SSDs. These rights of return and SSD provisions prevented us from being able to reasonably estimate the final price of the inventory to be sold and the amount of inventory that could be returned pursuant to these agreements. As a result, the price to the customer was not fixed or determinable at the time we delivered products to our distributors. Accordingly, product revenue from sales made through those distributors was deferred until the distributors shipped the product to the end-customers. Deferred income on shipments to distributors reflected the amount of

gross margin expected to be realized when distributors sell through these products purchased from the Company.

Table of Contents

QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the fourth quarter of 2008, the Company renegotiated the majority of its agreements with its distributors. Under the new agreements, post shipment price adjustments such as SSDs have been eliminated and parts held by distributors may only be returned for quality reasons under the Company's standard warranty policy. Revenue is recognized upon shipment of both programmed and unprogrammed parts to distributors if persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, collection of the resulting receivable is reasonably assured and risk of loss has been transferred. As of the end of the first quarter of 2009, all of the Company's distributors had signed the new agreements.

New Accounting Pronouncements

In June 2009, the FASB issued the FASB Accounting Standards Codification (Codification). The Codification became the single source for all authoritative GAAP recognized by the FASB to be applied for financial statements issued for periods ending after September 15, 2009. The Codification did not change GAAP and did not have an effect on our financial position, results of operations or liquidity.

Note 3 Net Loss Per Share

Basic net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share was computed using the weighted average number of common shares outstanding during the period plus potentially dilutive common shares outstanding during the period under the treasury stock method. In computing diluted net loss 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.

For the first nine months of 2009 and 2008, 9.5 million and 7.3 million shares, respectively, associated with equity awards outstanding and the estimated number of shares to be purchased under the current offering period of the 2009 Employee Stock Purchase Plan were not included in the calculation of diluted net loss per share, as they were considered antidilutive due to the net loss the Company experienced during these periods.

Note 4 Investment in Tower Semiconductor Ltd.

On December 12, 2000, the Company entered into several agreements with Tower, as amended, under which the Company agreed to make a strategic investment in Tower of up to \$25 million as part of Tower's plan to build and equip a new wafer fabrication facility. During 2001 and 2002, the Company paid a total of \$21.3 million to Tower to fulfill its investment requirements under the agreement. In partial consideration for the investment, the Company received 1,757,368 Tower ordinary shares with an original cost of \$16.6 million. The Company sold approximately 413,000 of the Tower ordinary shares in fiscal 2003.

During 2008 the Company wrote down the value of its investment in Tower shares by \$1.4 million due to an other than temporary decline in market value, resulting in a carrying value of \$0.13 per share for the period ended December 28, 2008. This determination included factors such as market value and the period of time that the market had been below the carrying value of the shares.

As of September 27, 2009, the Company held 1,344,543 available-for-sale Tower ordinary shares with an unrealized gain of \$1.1 million recorded in accumulated other comprehensive income on the balance sheet, representing the difference between the carrying value per share and \$0.92 per share, their market value on the last trading day of the reporting period. The fair value of the Company's marketable securities as of September 27, 2009 was determined based on Level 1 inputs as described in Note 7. The Company plans to continue to hold 450,000 of the Tower ordinary shares in order to receive preferred product pricing under the agreements with Tower and has recorded these shares as a long-term investment on the balance sheets. The remaining 894,543 shares are classified as a short-term investment on the balance sheets.

During the years of 2001 and 2002, the Company also received \$4.7 million in prepaid wafer credits in partial consideration for the investment. During 2008, the Company assessed the value of its Tower wafer credit and incurred a long-lived asset impairment of \$1.3 million. In the third quarter of 2009, the Company assessed the value of its Tower wafer credit and incurred a long-lived asset impairment of \$150,000. As of September 27, 2009, the prepaid wafer credits balance was \$419,000. The Company has guaranteed capacity at Tower through at least 2010.

Table of Contents**QUICKLOGIC CORPORATION****NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

These credits are recorded within long-term other assets on the balance sheets and can be applied toward wafer purchases from Tower at 15% of the value of purchases made through 2010.

Note 5 Balance Sheet Components

| | September 27, 2009 | December 28, 2008 |
|---|-----------------------|----------------------|
| | (in thousands) | |
| Inventories: | | |
| Raw materials | \$ 8 | \$ 75 |
| Work-in-process | 1,604 | 1,579 |
| Finished goods | 232 | 246 |
| | \$ 1,844 | \$ 1,900 |
| Other current assets: | | |
| Prepaid expenses | \$ 468 | \$ 743 |
| Other | 144 | 90 |
| | \$ 612 | \$ 833 |
| Property and equipment: | | |
| Equipment | \$ 12,229 | \$ 13,881 |
| Software | 8,451 | 8,030 |
| Furniture and fixtures | 780 | 840 |
| Leasehold improvements | 800 | 800 |
| | 22,260 | 23,551 |
| Accumulated depreciation and amortization | (19,252) | (20,058) |
| | \$ 3,008 | \$ 3,493 |
| Other assets: | | |
| Prepaid wafer credits | \$ 419 | \$ 846 |
| Other | 42 | 57 |
| | \$ 461 | \$ 903 |
| Accrued liabilities: | | |
| Employee related accruals | \$ 847 | \$ 1,047 |
| Other | 267 | 490 |
| | \$ 1,114 | \$ 1,537 |

Table of Contents**QUICKLOGIC CORPORATION****NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 6 Obligations**

| | September 27, 2009 | December 28, 2008 |
|---|-----------------------|----------------------|
| | (in thousands) | |
| Debt and capital lease obligations: | | |
| Revolving line of credit | \$ 2,000 | \$ 2,000 |
| Capital leases | 700 | 753 |
| | 2,700 | 2,753 |
| Current portion of debt and capital lease obligations | (2,436) | (2,753) |
| | \$ 264 | \$ |

Revolving Line of Credit

In September 2009, the Company amended its Second Amended and Restated Loan and Security Agreement with Silicon Valley Bank. Terms of the amended agreement require the Company to maintain a tangible net worth of at least \$11 million and unrestricted cash or cash equivalent balance at all times in an amount of at least \$8 million. In August 2008, the Company amended its Second Amended and Restated Loan and Security Agreement with Silicon Valley Bank. Terms of the amended agreement include a \$6.0 million revolving line of credit available through June 2010, as long as the Company is in compliance with the loan covenants. Upon each advance, the Company can elect a variable interest rate, which is the greater of six percent or the prime rate plus one percent, or a fixed rate which is LIBOR plus 3.50%.

For the three months and nine months ended September 27, 2009, the Company repaid \$2.0 million and \$6.0 million, respectively, of revolving debt and borrowed \$2.0 million and \$6.0 million, respectively, of revolving debt with a variable interest rate of 4.0% as of September 27, 2009.

The bank has a first priority security interest in substantially all of the Company's tangible and intangible assets to secure any outstanding amounts under the agreement. Under the terms of the agreement, except as noted above, the Company must maintain a minimum tangible net worth and adjusted quick ratio. The agreement also has certain restrictions including, among others, on the incurrence of other indebtedness, the maintenance of depository accounts, the disposition of assets, mergers, acquisitions, investments, the granting of liens and the payment of dividends. The Company was in compliance with the financial covenants of the agreement as of the end of the current reporting period.

Capital Leases

In 2007, the Company leased design software and related maintenance under a two year capital lease at an imputed interest rate of 7.1% per annum. Terms of the agreement require the Company to make quarterly payments of approximately \$190,000 through November 2009. The Company recorded a capital asset of \$1.2 million and prepaid maintenance of \$256,000 that is being amortized over the term of the agreement and a capital lease obligation of \$1.4 million. As of September 27, 2009, \$187,000 was outstanding under the capital lease, all of which was classified as a current liability.

In January 2009, the Company leased design software tools and related maintenance under a three-year capital lease at an imputed interest rate of 5.75% per annum. Terms of the agreement require the Company to make semi-annual payments of approximately \$138,000 through August 2011, for a total of approximately \$825,000 over the three years period. As of September 27, 2009, \$513,000 was outstanding under the capital lease, of which \$249,000 was classified as a current liability.

Table of Contents**QUICKLOGIC CORPORATION****NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 7 Fair Value Measurements**

The guidance for the fair value option for financial assets and financial liabilities provides companies the irrevocable option to measure many financial assets and liabilities at fair value with changes in fair value recognized in earnings. The Company has not elected to measure any financial assets or liabilities at fair value that were not previously required to be measured at fair value. The Company adopted the authoritative guidance with respect to the Company's non-financial assets and liabilities on December 29, 2008, and the adoption did not have an effect on its consolidated financial statements.

The authoritative guidance specifies a hierarchy of valuation techniques based upon whether the inputs to those valuation techniques reflect assumptions other market participants would use based upon market data obtained from independent sources (observable inputs) or reflect the company's own assumption of market participant valuation (unobservable inputs). The fair value hierarchy consists of the following three levels:

Level 1 Inputs are quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable and market-corroborated inputs which are derived principally from or corroborated by observable market data.

Level 3 Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable. The following table presents the Company's financial assets that are measured at fair value on a recurring basis as of September 27, 2009 consistent with the fair value hierarchy provisions of the authoritative guidance (in thousands):

| | As of September 27, 2009 | | | | As of December 28, 2008 | | | |
|--|--------------------------|-----------|---------|---------|-------------------------|-----------|---------|---------|
| | Total | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | | | | | |
| Money market funds ⁽¹⁾ | \$ 10,268 | \$ 10,268 | \$ | \$ | \$ 14,794 | \$ 14,794 | \$ | \$ |
| Investment in Tower Semiconductor Ltd. | 1,237 | 1,237 | | | 175 | 175 | | |
| Total assets | \$ 11,505 | \$ 11,505 | \$ | \$ | \$ 14,969 | \$ 14,969 | \$ | \$ |

⁽¹⁾ Money market funds are presented as a part of cash and cash equivalents on the accompanying consolidated balance sheets as of September 27, 2009 and December 28, 2008.

As of September 27, 2009, there is no material difference between the fair value and the carrying amount of the debt outstanding under the Company's line of credit and capital leasing arrangements.

Note 8 Employee Stock Plans*1989 Stock Option Plan*

Edgar Filing: QUICKLOGIC CORPORATION - Form 10-Q

The 1989 Stock Option Plan, or 1989 Plan, provided for the issuance of incentive and nonqualified options for the purchase of up to 4.6 million shares of common stock. Options granted under the 1989 Plan have a term of up to ten years, and typically vest at a rate of 25% of the total grant per year over a four year period. In September 1999, the Company adopted the 1999 Stock Plan and no further stock option grants were made under the 1989 Plan.

1999 Stock Plan

The 1999 Stock Plan, or 1999 Plan, provided for the issuance of incentive and nonqualified options, restricted stock units and restricted stock. Equity awards granted under the 1999 Plan have a term of up to ten years. Options typically vest at a rate of 25% one year after the vesting commencement date, and one forty-eighth for each month of service thereafter. In March 2009, the Board adopted the 2009 Stock Plan which was approved by the Company's stockholders on April 22, 2009. Effective April 22, 2009, no further stock options may be granted under the 1999 Plan.

Table of Contents**QUICKLOGIC CORPORATION****NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****2009 Stock Plan***

The 2009 Stock Plan, or 2009 Plan, was adopted by the Board of Directors in March 2009 and approved by the Company's stockholders on April 22, 2009. As of September 27, 2009, approximately 2.6 million shares were reserved for issuance under the 2009 Plan. Equity awards that are cancelled, forfeited or repurchased under the 1999 Plan also become available for grant under the 2009 Plan, up to a maximum of an additional 7,500,000 shares. Equity awards granted under the 2009 Plan have a term of up to ten years. Options typically vest at a rate of 25% one year after the vesting commencement date, and one forty-eighth for each month of service thereafter. The Company may implement different vesting schedules in the future with respect to any new equity awards.

Employee Stock Purchase Plan

The 1999 Employee Stock Purchase Plan, or 1999 ESPP, was adopted by the Board of Directors in August 1999 and was approved by the Company's stockholders in September 1999. The 1999 ESPP was replaced by the 2009 Employee Stock Purchase Plan described below and the last purchase under the 1999 ESPP was made on May 15, 2009.

The 2009 Employee Stock Purchase Plan, or 2009 ESPP, was adopted by the Board of Directors in March 2009 and approved by the Company's stockholders in April 2009. The Company has reserved 2.3 million shares for issuance under the 2009 ESPP. The 2009 ESPP provides for six month offering periods. Participants purchase shares through payroll deductions of up to 20% of an employee's total compensation (maximum of 20,000 shares per offering period). The 2009 ESPP permits the Board of Directors to determine, prior to each offering period, whether participants purchase shares at: (i) 85% of the fair market value of the common stock at the end of the offering period; or (ii) 85% of the lower of the fair market value of the common stock at the beginning or the end of an offering period. The Board of Directors has determined that, until further notice, future offering periods will be made at 85% of the lower of the fair market value of the common stock at the beginning or the end of an offering period.

Note 9 Stock-Based Compensation

Stock-based compensation expense is recognized in the Company's consolidated statements of operations and includes: (i) compensation expense for stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated and re-measured upon modification in accordance with the pro forma provisions of the authoritative guidance, and (ii) compensation expense for the stock-based compensation awards granted or modified subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of the amended authoritative guidance. The impact of the amended authoritative guidance on the Company's consolidated financial statements for the third quarter and first nine months of 2009 and 2008 was as follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------|---------------------------|----------------------|--------------------------|----------------------|
| | September 27, | September 28, | September 27, | September 28, |
| | 2009 | 2008 | 2009 | 2008 |
| Cost of revenue | \$ 110 | \$ 49 | \$ 232 | \$ 220 |
| Research and development | 213 | 89 | 439 | 443 |
| Selling, general and administrative | 535 | 251 | 1,138 | 1,308 |
| Total costs and expenses | \$ 858 | \$ 389 | \$ 1,809 | \$ 1,971 |

The amount of stock-based compensation included in inventories as of September 27, 2009 and December 28, 2008 was not significant.

Table of Contents**QUICKLOGIC CORPORATION****NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Valuation Assumptions**

The following weighted average assumptions are included in the estimated fair value calculations for stock option grants:

| | Three Months Ended | | Nine Months Ended | |
|-------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2009 | September 28, 2008 | September 27, 2009 | September 28, 2008 |
| Expected term (years) | 4.47 | 5.00 | 5.14 | 5.62 |
| Risk-free interest rate | 2.19% | 3.11% | 1.97% | 2.92% |
| Expected volatility | 48.67% | 50.68% | 50.99% | 52.68% |
| Expected dividend | | | | |

The weighted average estimated fair value for options granted during the third quarter of 2009 and 2008 was \$0.66 and \$0.74 per option, respectively. The weighted average estimated fair value for options granted during the first nine months of 2009 and 2008 was \$0.74 and \$1.38 per option, respectively. As of September 27, 2009, the fair value of unvested stock options, net of expected forfeitures, was approximately \$3.6 million. This unrecognized stock-based compensation expense is expected to be recorded over a weighted average period of 2.73 years.

Stock-Based Compensation Award Activity

The following table summarizes the shares available for grant under the 2009 Plan for the first nine months of 2009:

| | Shares Available for Grant (in thousands) |
|-------------------------------|---|
| Balance at December 28, 2008 | 8,313 |
| Authorized | 2,500 |
| Options granted | (2,105) |
| Options forfeited or expired | (6,862) |
| RSUs granted | (362) |
| RSUs forfeited or expired | 605 |
| Balance at September 27, 2009 | 2,089 |

Table of Contents

QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Options

The following table summarizes stock options outstanding and stock option activity under the 1989 Plan, the 1999 Plan and the 2009 Plan, and the related weighted average exercise price, for the first nine months of 2009:

| | Number of Shares (in thousands) | Weighted Average Exercise Price | Weighted Average Remaining Term (in years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---------------------------------------|---|---|
| Balance outstanding at December 28, 2008 | 7,367 | \$ 4.13 | | |
| Granted | 2,105 | 1.60 | | |
| Forfeited or cancelled | (538) | 3.13 | | |
| Exercised | | | | |
| Balance outstanding at September 27, 2009 | 8,934 | \$ 3.59 | 6.28 | \$ 836 |
| Exercisable at September 27, 2009 | 4,898 | \$ 5.03 | 4.04 | \$ 23 |
| Vested and expected to vest at September 27, 2009 | 8,934 | \$ 3.59 | 6.28 | \$ 836 |

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value, based on the Company's closing stock price of \$1.57 as of the end of the Company's current reporting period, which would have been received by the option holders had all option holders exercised their options as of that date.

There were no stock option exercises during the first nine months of 2009. The total intrinsic value of options exercised during the first nine months of 2008 was \$42,000. Total cash received from employees as a result of employee stock option exercises during the first nine months of 2008 was approximately \$117,000. The Company settles employee stock option exercises with newly issued common shares. In connection with these exercises, there was no tax benefit realized by the Company due to its current loss position.

Table of Contents**QUICKLOGIC CORPORATION****NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Restricted Stock Awards and Restricted Stock Units***

The Company began issuing restricted stock awards, or RSAs in the second quarter of 2007 and restricted stock units, or RSUs, in the third quarter of 2007 under the 1999 Plan. RSAs entitle the holder to purchase shares of common stock at par value during a short period of time, and purchased shares are held in escrow until they vest. RSUs entitle the holder to receive, at no cost, one common share for each restricted stock unit as it vests. During the third quarter of 2009, the Company granted RSUs in lieu of cash compensation that vest in two tranches over a four month period. Total stock-based compensation related to RSUs was \$295,000 for the third quarter of 2009. The Company withheld shares in settlement of employee tax withholding obligations upon the vesting of restricted stock units. A summary of the Company's RSA and RSU activity and related information are as follows:

| | RSAs and RSUs Outstanding | |
|---------------------------------|--|---|
| | Number of Shares (in thousands) | Weighted Average Grant Date Fair Value |
| Nonvested at December 28, 2008 | 654 | \$ 3.35 |
| Granted | 362 | 1.20 |
| Vested | (197) | 1.20 |
| Forfeited | (605) | 3.55 |
| Nonvested at September 27, 2009 | 214 | \$ 1.13 |

As of September 27, 2009, the fair value of unvested RSUs, net of expected forfeitures, was approximately \$148,000. This unrecognized stock-based compensation expense is expected to be recorded over a weighted average period of 1.3 months.

Employee Stock Purchase Plan

Under the 2009 ESPP, the Company issued 343,491 shares at a price of \$0.55 per share during the nine months ended September 27, 2009. As of September 27, 2009, 2,300,000 shares under the 2009 ESPP remained available for issuance. For the three and nine months ended September 27, 2009, the Company recorded compensation expense related to the ESPP of \$71,000 and \$198,000, respectively.

The fair value of rights issued pursuant to the Company's ESPP was estimated on the commencement date of each offering period using the following weighted average assumptions:

| | Three Months Ended | | Nine Months Ended | |
|-------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| | September 27, 2009 | September 28, 2008 | September 27, 2009 | September 28, 2008 |
| Expected term (months) | 6.00 | 6.00 | 6.00 | 6.00 |
| Risk-free interest rate | 0.29% | 3.56% | 0.29% | 3.56% |
| Expected volatility | 126.98% | 49.57% | 126.98% | 49.57% |
| Expected dividend | | | | |

As of September 27, 2009, the unrecognized stock-based compensation expense relating to the Company's ESPP was \$38,000 and is expected to be recognized over a weighted average period of approximately 1.5 months.

Table of Contents**QUICKLOGIC CORPORATION****NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 10 Income Taxes**

In the third quarter of 2009 and 2008, the Company recorded income tax expense of \$7,000 and income tax benefit of \$58,000, respectively, which consisted primarily of income taxes on foreign operations offset by the monetization of prior year federal research credits. In the first nine months of 2009 and 2008, the Company recorded an income tax benefit of \$4,000 and \$24,000, respectively, which consisted primarily of income taxes on foreign operations offset by the monetization of prior year federal research credits.

Due to the uncertainties surrounding the realization of the deferred tax assets resulting from the Company's accumulated deficit and net tax losses in previous years, the Company has provided a full valuation allowance against the associated deferred tax assets. The Company will continue to assess the realizability of the deferred tax assets in future periods.

The Company had approximately \$73,000 and \$66,000 of unrecognized tax benefits at September 27, 2009 and December 28, 2008, respectively. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 27, 2009, the Company had approximately \$13,000 of accrued interest and penalties related to uncertain tax positions.

The Company is no longer subject to U.S. federal, state and non-U.S. income tax audits by taxing authorities for fiscal years through 1992. The Company estimates that any unrecognized tax benefit will not change significantly within the next twelve months.

Note 11 Information Concerning Product Lines, Geographic Information and Revenue Concentration

The Company identifies its business segments based on business activities, management responsibility and geographic location. For all periods presented, the Company operated in a single business segment.

The following is a breakdown of revenue by product line (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2009 | September 28, 2008 | September 27, 2009 | September 28, 2008 |
| <i>Revenue by product line⁽¹⁾:</i> | | | | |
| New products | \$ 1,363 | \$ 1,422 | \$ 2,837 | \$ 6,584 |
| Mature products | 1,908 | 4,619 | 7,393 | 13,533 |
| End-of-life products | 61 | 189 | 565 | 5,879 |
| Total revenue | \$ 3,332 | \$ 6,230 | \$ 10,795 | \$ 25,996 |

⁽¹⁾ For all periods presented: New products represent products introduced since 2005, and include ArcticLink, PolarPro II, PolarPro, Eclipse II and QuickPCI[®] II products. Mature products include pASIC[®] 3, QuickRAM[®], Eclipse, QuickDSP and QuickFC products, as well as royalty revenue, programming hardware and software. End-of-life products include pASIC 1, pASIC 2, V3, QuickMIPS and QuickPCI products.

Table of Contents**QUICKLOGIC CORPORATION****NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following is a breakdown of revenue by shipment destination (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2009 | September 28, 2008 | September 27, 2009 | September 28, 2008 |
| <i>Revenue by geography:</i> | | | | |
| United States | \$ 1,455 | \$ 1,955 | \$ 4,910 | \$ 9,646 |
| Europe | 650 | 878 | 2,211 | 4,024 |
| Taiwan | 9 | 1,306 | 20 | 5,282 |
| Japan | 219 | 703 | 1,034 | 2,261 |
| China | 782 | 711 | 1,455 | 2,888 |
| Rest of North America | 125 | 87 | 453 | 642 |
| Rest of Asia Pacific | 92 | 590 | 712 | 1,253 |
| Total revenue | \$ 3,332 | \$ 6,230 | \$ 10,795 | \$ 25,996 |

The following distributors and customers accounted for 10% or more of the Company's revenue for the periods presented:

| | Three Months Ended | | Nine Months Ended | |
|---------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2009 | September 28, 2008 | September 27, 2009 | September 28, 2008 |
| Distributor A | 25% | 13% | 25% | 14% |
| Distributor B | 15% | 11% | 16% | 13% |
| Distributor D | 13% | 11% | * | * |
| Customer A | * | 13% | * | 17% |
| Customer B | * | 28% | 11% | 18% |
| Customer C | 12% | * | * | * |

* Represents less than 10% of revenue for the period presented.

The following distributors and customers accounted for 10% or more of the Company's accounts receivable as of the dates presented:

| | September 27, 2009 | December 28, 2008 |
|---------------|-----------------------|----------------------|
| Customer A | *% | 10% |
| Distributor A | 29% | 20% |
| Distributor C | 15% | 16% |
| Distributor D | 15% | 12% |

* Represents less than 10% of accounts receivable as of the date presented.

As of September 27, 2009, less than 10% of the Company's long-lived assets, including property and equipment and other assets, were located outside the United States.

Table of Contents**QUICKLOGIC CORPORATION****NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 12 Commitments and Contingencies**

Certain of the Company's wafer manufacturers require the Company to forecast wafer starts several months in advance. The Company is committed to take delivery of and pay for a portion of forecasted wafer volume. As of September 27, 2009 and December 28, 2008, the Company had \$2.1 million and \$4.8 million, respectively, of outstanding commitments for the purchase of wafer inventory.

The Company leases, with an option to renew, its primary facility under a non-cancelable operating lease that expires in 2012. In addition, the Company rents development facilities in Canada and India as well as sales offices in Europe and Asia. Total rent expense for the third quarter of 2009 and 2008 was approximately \$145,000 and \$130,000, respectively, and rent expense for the first nine months of 2009 and 2008 was approximately \$435,000 and \$490,000, respectively.

Future minimum lease commitments under the Company's operating leases, excluding property taxes and insurance are as follows:

| <u>Fiscal Years</u> | Operating Leases (in thousands) |
|---------------------|--|
| Rest of 2009 | \$ 152 |
| 2010 | 429 |
| 2011 | 396 |
| 2012 | 396 |
| 2013 and thereafter | |
| | \$ 1,373 |

Table of Contents

QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 13 Litigation

Initial Public Offering Securities Litigation

On October 26, 2001, a putative securities class action was filed in the U.S. District Court for the Southern District of New York against certain investment banks that underwrote QuickLogic's initial public offering, QuickLogic and some of QuickLogic's officers and directors. The complaint alleges excessive and undisclosed commissions in connection with the allocation of shares of common stock in QuickLogic's initial and secondary public offerings and artificially high prices through tie-in arrangements which required the underwriters' customers to buy shares in the aftermarket at pre-determined prices in violation of the federal securities laws. Plaintiffs seek an unspecified amount of damages on behalf of persons who purchased QuickLogic's stock pursuant to the registration statements between October 14, 1999 and December 6, 2000. Various plaintiffs have filed similar actions asserting virtually identical allegations against over 300 other public companies, their underwriters, and their officers and directors arising out of each company's public offering. These actions, including the action against QuickLogic, have been coordinated for pretrial purposes and captioned *In re Initial Public Offering Securities Litigation, 21 MC 92*, or IPO Securities Litigation.

In June 2004, a stipulation of settlement and release of claims against the issuer defendants, including QuickLogic, was submitted to the court for approval. On August 31, 2005, the Court preliminarily approved the settlement. In December 2006, the appellate Court overturned the certification of classes in the six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceedings. Because class certification was a condition of the settlement, it was unlikely that the settlement would receive final Court approval. On June 25, 2007, the Court entered an order terminating the proposed settlement based upon a stipulation among the parties to the settlement. Plaintiffs have filed amended master allegations and amended complaints, in the six test cases. On March 26, 2008, the Court denied the defendants' motion to dismiss the amended complaints.

On October 5, 2009, the Court issued an opinion and order granting final approval of the settlement, plan of allocation and class certification. Under the terms of the settlement, the insurers are responsible for paying the full amount of settlement share allocated to the Company, and the Company bears no financial liability. The Company, as well as the officer and director defendants who were previously dismissed from the action pursuant to tolling agreements, have received complete dismissals from the case. Certain objectors are seeking to appeal from this order.

Patent Infringement Litigation

On August 31, 2009, Xpoint Technologies, Inc., served the Company with a complaint for patent infringement. The complaint was filed in the U.S. District Court for the District of Delaware against the Company and a number of other defendant companies in the mobile phone market. The complaint alleges wrongful manufacturing, using, selling or offering to sell of products that infringe patent number 5,913,028 (the '028 Patent) pertaining to a direct data-delivery system and method for program-controlled, direct transfer of data along a bus or data pathway between peer input/output devices in a data-processing apparatus or network. Plaintiff seeks a preliminary and permanent injunction enjoining Defendants from further infringement of the claims of the patent, an unspecified amount of damages to compensate for Defendants' infringement and treble damages based on Defendants' copying and willful infringement of the '028 Patent. On September 21, 2009, Plaintiff served the Company with an Amended Complaint for Patent Infringement. The Company believes it has meritorious defenses and intends to defend the action vigorously.

No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies and, accordingly, the Company has not recorded a liability.

From time to time, the Company is involved in legal actions arising in the ordinary course of business, including but not limited to intellectual property infringement and collection matters. Absolute assurance cannot be given that third party assertions will be resolved without costly litigation in a manner that is not adverse to the Company's financial position, results of operations or cash flows or without requiring royalty or other payments in the future which may adversely impact gross profit.

Table of Contents

QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 14 Restructuring Charges

In April 2008, the Company decided to outsource certain development functions that were previously performed in-house. This reorganization resulted in a headcount reduction of approximately 13% of employees worldwide. In June 2008, the Company announced the completion of its CSSP focused operational realignment which included an additional 17% reduction in headcount worldwide, resulting in a total reduction in worldwide headcount of approximately 30%. The purpose of the operational realignment was to lower fixed costs in order to conserve cash, to reduce the Company's break-even revenue level and enable a quicker return to profitability, to provide optimal profitability scaling with revenue growth and to provide greater headroom for discretionary costs to enable new product revenue growth. Our restructuring liabilities are included in the Accrued Liabilities line item in our consolidated balance sheets as of September 27, 2009 and December 28, 2008, and the remaining balance of \$51,000 is expected to be paid by the end of fiscal year 2009.

Note 15 Subsequent Events

In October 2009, the Company extended a software license and maintenance agreement under a two-year capital lease at an imputed interest rate of 5.75% per annum. Terms of the agreement require the Company to make quarterly payments of approximately \$38,000 through November 2011, for a total of \$300,000 over the two years period.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as information contained in Risk Factors in Part II, Item 1A and elsewhere in this Quarterly Report on Form 10-Q, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend that these forward-looking statements be subject to the safe harbors created by those provisions. Forward-looking statements are generally written in the future tense and/or are preceded by words such as will, may, should, forecast, could, expect, suggest, believe, anticipate, intend, plan, or other similar words. Forward-looking statements include statements regarding (1) the conversion of our design opportunities into revenue, (2) our revenue levels, including the commercial success of our Customer Specific Standard Products, or CSSPs, and new products, and the effect of our end-of-life products, (3) our liquidity, (4) our gross profit and factors that affect gross profit, (5) our level of operating expenses, (6) our research and development efforts, (7) our partners and suppliers and (8) industry trends. The following discussion should be read in conjunction with the attached condensed unaudited consolidated financial statements and notes thereto, and with our audited consolidated financial statements and notes thereto for the fiscal year ended December 28, 2008, found in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 11, 2009.

Overview

QuickLogic Corporation was founded in 1988 and reincorporated in Delaware in 1999. We develop and market low power customizable semiconductor solutions that enable customers to add differentiated features and capabilities to their mobile, prosumer (derived from the term professional consumer), consumer and industrial products. We are a fabless semiconductor company that operates in a single industry segment where we design, market and support primarily Customer Specific Standard Products, or CSSPs, and, secondarily, Field Programmable Gate Arrays, or FPGAs, associated design software and programming hardware. Our CSSPs are customized semiconductor building blocks created from our new solution platforms including ArcticLink[®] II, ArcticLink, PolarPro[®] II, PolarPro, Eclipse II and QuickPCI[®] II (all of which fall into our new product category); our mature product family includes pASIC[®] 3, QuickRAM[®], Eclipse, and EclipsePlus, as well as royalty revenue, programming hardware and design software; our end-of-life product family includes pASIC 1, pASIC 2, V3, QuickMIPS, QuickPCI and QuickFC.

We are marketing CSSPs to Original Equipment Manufacturers, or OEMs, and Original Design Manufactures, or ODMs, offering differentiated mobile products. Our target mobile markets include:

Cellular including multimedia and smartphones;

Computing including Mobile Internet Devices, or MIDs, Netbooks, Smartbooks, Ultra Mobile PCs, or UMPCs, industrial personal digital assistants, or PDAs, handheld point-of-sales, or POS, terminals and broadband 3G data cards, USB secure authenticated data cards; and

Consumer Electronics including portable media players, or PMPs, personal navigation devices, or PNDs, and wireless hard disk drives or wireless storage devices.

In addition to working directly with our customers, we partner with other companies with expertise in certain technologies to develop additional intellectual property, reference platforms and system software to provide application solutions. We also work with mobile processor manufacturers and companies that supply storage, networking or graphics components for embedded systems. The depth of these relationships varies depending on the partner and the dynamics of the end market being targeted, but is typically a co-marketing program that includes joint account calls, promotional activities and/or engineering collaboration and developments, such as reference designs.

During the third quarter of 2009, we received from our manufacturing partners the latest in our family of VEE-enabled solution platforms - ArcticLink II, VX2 and VX4. The engineering validation was completed for the VX2 platform, and the Company subsequently released engineering samples for lead customers. The VX4 is in the final stages of engineering validation and we expect to release engineering samples during the fourth quarter of 2009. The VX family embeds the second generation Visual Enhancement Engine, or VEE, Proven System Block (PSB), which improves the user's video viewing experience while extending system battery life by allowing reduction in the power used by a mobile device's single biggest consumer of power, the backlight. The VX4 platform also embeds the Qualcomm developed MDDI serial interface for ease of connection with their mobile processors. The VX2 platform

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

also embeds an LCD Controller and optional CellularRAM frame buffer for storing display content. By embedding the frame buffer, the mobile processor can be powered down more frequently, saving previous energy and extending battery life. Both the VX2 and VX4 embed a programmable fabric for integrating additional PSBs that can reduce BOM cost, reduce PCB space, and can optimize system power consumption.

Although the semiconductor industry as a whole has seen a dramatic decline in 2009 with modest growth predicted in 2010, consumer products remain a strong driver for semiconductor sales. We believe that the target mobile markets for our CSSPs continue to provide growth potential. Trends in the rapidly growing sub-segments of the consumer market in which we participate include:

Mobile, Handheld Devices: In 2008, more than 1.2 billion cellular phones, ranging from multimedia to ultra low cost phones, were sold (according to iSuppli, a market intelligence company). More importantly, iSuppli predicts that the Smartphone segment of the overall cellular phone segment will increase 62% over the next three years, from 219 million units in 2008 to 356 million units, by the end of 2011. In fact, the Smartphone segment is predicted to be one of the higher growth segments during the current economic downturn.

Netbook/Smartbook Category: iSuppli predicts shipments of wirelessly-enabled netbooks will more than triple by 2012, rising to 36.3 million units, up from 10.3 million in 2008. This segment is largely driven by the desire for a consumer platform that combines the mobile computing and internet experience of notebooks with the day-long battery life of multimedia and smartphones. During the third quarter, we announced the availability of a CSSP containing our Visual Enhancement Engine, or VEE, technology tailored to Intel Atom-based netbooks that enabled reduced display backlight, delivering longer battery life to the consumer. Also in the third quarter of 2009, we announced a series of new Proven System Blocks targeted at augmenting the functionality of ARM-based processors in smartbooks including an I2C master controller, a pulse width modulator (PWM), a PS2 controller, and a low-power matrix keyboard controller. These new PSBs will be used by QuickLogic to deliver CSSPs for smartbooks.

USB-Based Broadband Data Card: Consumer demand for USB based broadband data cards are expected to reach nearly 40 million units in 2009, according to the market research firm ABI Research. These data cards enable consumers to connect their notebook, netbook, smartbook or PC to the cellular network as a broadband Internet connection. During the third quarter of 2009, QuickLogic announced the selection of a CSSP, based on the ArcticLink solution platform, for the Icera Espresso[®] 300 3G soft modem platform. Icera is a leader in software-defined wireless chipsets and is the only company to deliver software-based cellular modems for broadband data cards, USB sticks, and mobile internet devices. Icera's first reference design uses a wafer-level chip scale, or WLCSP, version of the ArcticLink solution platform to compliment its second-generation baseband chip design. Demonstrating a breadth of functionality and price points, Icera's next generation reference design uses a WLCSP version of the PolarPro II solution platform.

Underlying industry trends affecting the large market for mobile devices include the use of platforms to enable rapid product proliferation, the need for high bandwidth solutions enabling mobile Internet and streaming video, miniaturization and the need to increase battery life. Another important trend is shrinking product life cycles, which drives a need for faster, lower risk product development. There is intense pressure on the total product cost of these devices, including per unit component costs and non-recurring development costs. As more people experience the advantages of a mobile lifestyle at home, they demand the same advantages in their professional lives, and while they are on the go, or mobile. Therefore, we believe that these trends toward mobile, handheld products which have a small form factor and maximize battery life will also be evident in other segments such as industrial, medical and military.

Critical Accounting Estimates

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our consolidated financial statements. The SEC has defined critical accounting policies as those that are most important to the portrayal of our financial condition and results of operations and require us to make our most difficult and subjective

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, our critical policies include revenue recognition, valuation of inventories including identification of excess quantities and product obsolescence, allowance for doubtful accounts, valuation of investments, valuation of long-lived assets, measurement of stock-based compensation, accounting for income taxes, fair value measurements of financial assets and liabilities, and measuring accrued liabilities. We believe that we apply judgments and estimates in a consistent manner and that such consistent application results in consolidated financial statements and accompanying notes that fairly represent all periods presented. However, any factual errors or errors in these judgments and estimates may have a material impact on our statements of operations and financial condition. For a discussion of critical accounting policies and estimates, please see Item 7 in our Annual Report on Form 10-K for the fiscal year ended December 28, 2008 filed with the SEC on March 11, 2009.

Results of Operations

The following table sets forth the percentage of revenue for certain items in our statements of operations for the periods indicated:

| | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2009 | September 28, 2008 | September 27, 2009 | September 28, 2008 |
| Revenue | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of revenue ⁽¹⁾ | 65.6 | 44.6 | 51.8 | 46.2 |
| Long-lived asset impairment | 4.5 | | 1.4 | 6.0 |
| Gross profit | 29.9 | 55.4 | 46.8 | 47.8 |
| Operating expenses: | | | | |
| Research and development | 42.0 | 21.7 | 45.2 | 26.1 |
| Selling, general and administrative | 75.8 | 42.8 | 73.0 | 42.2 |
| Long-lived asset impairment | | | | 1.8 |
| Restructuring costs | | | | 1.7 |
| Loss from operations | (87.9) | (9.1) | (71.4) | (24.0) |
| Write-down of investment in Tower Semiconductor Ltd. | | | | (1.6) |
| Interest expense | (0.9) | (1.0) | (0.7) | (0.8) |
| Interest income and other, net | (0.9) | (0.7) | (0.3) | 0.4 |
| Loss before income taxes | (89.7) | (10.8) | (72.4) | (26.0) |
| Provision for (benefit from) income taxes | (0.2) | 0.9 | | 0.1 |
| Net loss | (89.9)% | (9.9)% | (72.4)% | (25.9)% |

⁽¹⁾ The third quarter of 2009 and 2008 includes \$231,000 and \$203,000, respectively, of costs for the write-down of inventories and related charges, which represents 7.0% and 3.3% of revenue, respectively. The first nine months of 2009 and 2008 includes \$467,000 and \$1.3 million, respectively, of costs for the write-down of inventories and related charges, which represents 4.0% and 5.1% of revenue, respectively.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****Three Months Ended September 27, 2009 and September 28, 2008****Revenue**

The table below sets forth the changes in revenue for the three months ended September 28, 2008 as compared to the three months ended September 27 2009 (in thousands, except percentage data):

| | Three Months Ended | | September 28, 2008 | | Year-Over-Year Change | |
|----------------------|--------------------|---------------------|--------------------|---------------------|-----------------------|-------|
| | September 27, 2009 | | September 28, 2008 | | | |
| | Amount | % of Total Revenues | Amount | % of Total Revenues | | |
| New products | \$ 1,363 | 41% | \$ 1,422 | 23% | \$ (59) | (4)% |
| Mature products | 1,908 | 57 | 4,619 | 74 | (2,711) | (59) |
| End-of-life products | 61 | 2 | 189 | 3 | (128) | (68) |
| Total revenue | \$ 3,332 | 100% | \$ 6,230 | 100% | \$ (2,898) | (47)% |

For all periods presented, new products represent products introduced since 2005, and include ArcticLink, PolarPro, Eclipse II and QuickPCI II products; mature products include pASIC 3, QuickRAM, Eclipse, QuickDSP and QuickFC products, as well as royalty revenue, programming hardware and design software; end-of-life products include pASIC 1, pASIC 2, V3, QuickMIPS and QuickPCI products.

The decline in revenue was due to declines in both our mature and new product lines. The decline in new product revenue was caused by the expected end of life by the manufacturer of a product family of a personal navigation device, or PND, and by delays in new product production ramp-up with several major customers. The decline in mature product revenue primarily resulted from the general economic slowdown, which caused lower customer demand for pASIC 3 and QuickRAM products. One of our U.S. customers, purchasing primarily pASIC 3 devices, accounted for 4% and 28% of total revenue in the third quarters of 2009 and 2008, respectively.

In order to grow our revenue from its current level, we are dependent upon increased revenue from our existing new products; especially revenue from CSSPs designed using our ArcticLink, ArcticLink II, PolarPro and PolarPro II solution platforms and the development of additional new products and CSSPs.

We continue to seek to expand our revenue, including the pursuit of high volume sales opportunities in the consumer market segment, by providing CSSPs incorporating intellectual property such as boot from managed NAND or industry standard interfaces such as USB 2.0 OTG, SDIO and integrated drive electronics, or IDE, PS2, I2C, SPI, PWM and keyboard controllers. Our industry is characterized by intense price competition and by lower margins as order volumes increase. While winning large volume sales opportunities will increase our revenue, we believe these opportunities may decrease our gross profit as a percentage of revenue.

Gross Profit

The table below sets forth the changes in gross profit for the three months ended September 28, 2008 as compared to the three months ended September 27, 2009 (in thousands, except percentage data):

| | Three Months Ended | | September 28, 2008 | | Year-Over-Year Change | |
|-----------------------------|--------------------|---------------------|--------------------|---------------------|-----------------------|--------|
| | September 27, 2009 | | September 28, 2008 | | | |
| | Amount | % of Total Revenues | Amount | % of Total Revenues | | |
| Revenue | \$ 3,332 | 100% | \$ 6,230 | 100% | \$ (2,898) | (47)% |
| Cost of revenue | 2,186 | 66 | 2,778 | 45 | (592) | (21) |
| Long-lived asset impairment | 150 | 5 | | | 150 | (100)% |

Edgar Filing: QUICKLOGIC CORPORATION - Form 10-Q

| | | | | | | |
|--------------|--------|-----|----------|-----|------------|-------|
| Gross Profit | \$ 996 | 29% | \$ 3,452 | 55% | \$ (2,456) | (71)% |
|--------------|--------|-----|----------|-----|------------|-------|

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

The decline in gross profit was mainly due to the decline in revenue and the long-lived asset impairment charges of \$150,000 in the third quarter of 2009 as compared to the third quarter of 2008. The sale of previously reserved inventories contributed \$98,000, or 2.9% of revenue, to gross profit in the third quarter of 2009 and \$57,000, or 0.9% of revenue, in the third quarter of 2008.

Our semiconductor products have historically had a long product life cycle and obsolescence has not been a significant factor in the valuation of inventories. However, as we pursue opportunities in the mobile market and continue to develop new CSSPs and products, we believe our product life cycle will be shorter and increase the potential for obsolescence. We also regularly review the cost of inventories against estimated market value and record a lower of cost or market reserve for inventories that have a cost in excess of estimated market value, which could have a material impact on our gross margin and inventory balances based on additional write-downs to net realizable value or a benefit from inventories previously written down.

Operating Expenses

The table below sets forth the changes in operating expenses for the three months ended September 28, 2008 as compared to the three months ended September 27 2009 (in thousands, except percentage data):

| | Three Months Ended | | September 28, 2008 | | Year-Over-Year Change | |
|---------------------------------|--------------------|---------------------|--------------------|---------------------|-----------------------|-------------|
| | September 27, 2009 | | September 28, 2008 | | | |
| | Amount | % of Total Revenues | Amount | % of Total Revenues | | |
| R&D expense | \$ 1,400 | 42% | \$ 1,354 | 22% | \$ 46 | 3% |
| SG&A expense | 2,525 | 76 | 2,666 | 43 | (141) | (5) |
| Total operating expenses | \$ 3,925 | 118% | \$ 4,020 | 65% | \$ (95) | (2)% |

Research and Development

Our research and development expenses consist primarily of personnel, overhead and other costs associated with engineering process improvements, programmable logic design, ASSP design and software development. The decrease in R&D expenses results primarily from measures undertaken in the third quarter of 2008 to change certain development activities to an on-demand, outsourced model from an in-house, fixed cost model. As a result of this decision, our research and development staffing in Toronto, Canada was reduced during the third quarter of 2008. The \$46,000 decrease in R&D expenses in the third quarter of 2009 as compared to the third quarter of 2008 is attributable primarily to a \$129,000 or 25% decrease in compensation expenses due to reduced headcount; a \$94,000 or 24% decrease in expense allocations to R&D such as facilities and other corporate costs; offset by an increase of \$101,000 or 142% in outside services, and \$124,000 or 139% increase in stock based compensation expenses. The increase in stock based compensation expenses were due to the issuance of RSUs to employees in lieu of 10% of their cash compensation.

Selling, General and Administrative Expense

Our selling, general and administrative expenses consist primarily of personnel and related overhead costs for sales, marketing, finance, administration, human resources and general management. The \$141,000 decrease in SG&A expenses in the third quarter of 2009 as compared to the third quarter of 2008 resulted from our effort to realign resources with our expected revenue outlook and was primarily due to a \$323,000 or 24% decrease in cash compensation expenses as a result of headcount reductions; a \$113,000 or 17% decrease in outside services such as consulting, temporary help and legal, a \$125,000 or 31% decrease in expense allocation, offset by \$283,000 or 113% increase in stock based compensation expenses. The increase in stock based compensation expenses were due to the issuance of RSUs to employees in lieu of 10% of their cash compensation.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)*****Interest and Other Income (Expense), net***

The table below sets forth the changes in Interest and Other Income (Expense), net, from the three months ended September 28, 2008 as compared to the three months ended September 27, 2009:

| | Three Months Ended | |
|--------------------------------|-------------------------------|-------------------------------|
| | September 27, 2009 | September 28, 2008 |
| | (in thousands) | |
| Interest expense | (31) | (59) |
| Interest income and other, net | (30) | (46) |
| | \$ (61) | \$ (105) |

The decrease in interest expense is due primarily to the reduction of our average debt obligation to \$2.9 million in the third quarter of 2009 from \$3.4 million in the third quarter of 2008. The decrease in interest income is due primarily to the drop in investment yields between the third quarter of 2008 and the third quarter of 2009.

We conduct a portion of our research and development activities in Canada and India and we have sales and marketing activities in various countries outside of the United States. Most of these international expenses are incurred in local currency. Foreign currency transaction gains and losses are included in interest income and other, net, as they occur. We do not use derivative financial instruments to hedge our exposure to fluctuations in foreign currency and, therefore, our results of operations are and will continue to be susceptible to fluctuations in foreign exchange gains or losses.

Provision for (Benefit from) Income Taxes

| | Three Months Ended | |
|--------------------------------|-------------------------------|-------------------------------|
| | September 27, 2009 | September 28, 2008 |
| | (in thousands) | |
| Income tax provision (benefit) | \$ 7 | \$ (58) |

The income tax provision (benefit) for the third quarters of 2009 and 2008 are primarily for our foreign operations which are cost-plus entities offset by the monetization of prior year federal research credits. As of the end of the third quarter of 2009, our ability to utilize our income tax loss carryforwards in future periods is uncertain and, accordingly, we recorded a full valuation allowance against the related US tax benefit. We will continue to assess the realizability of deferred tax assets in future periods.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****Nine Months Ended September 27, 2009 and September 28, 2008****Revenue**

The table below sets forth the changes in revenue for the nine months ended September 28, 2008 as compared to the nine months ended September 27, 2009 (in thousands, except percentage data):

| | Nine Months Ended | | | | Year-Over-Year Change | |
|----------------------|--------------------|---------------------|--------------------|---------------------|-----------------------|-------|
| | September 27, 2009 | | September 28, 2008 | | | |
| | Amount | % of Total Revenues | Amount | % of Total Revenues | | |
| New products | \$ 2,837 | 26% | \$ 6,584 | 25% | \$ (3,747) | (57)% |
| Mature products | 7,393 | 68 | 13,533 | 52 | (6,140) | (45) |
| End-of-life products | 565 | 6 | 5,879 | 23 | (5,314) | (90) |
| Total revenue | \$ 10,795 | 100% | \$ 25,996 | 100% | \$ (15,201) | (58)% |

For all periods presented, new products represent products introduced since 2005, and include ArcticLink, PolarPro, Eclipse II and QuickPCI II products; mature products include pASIC 3, QuickRAM, Eclipse, QuickDSP and QuickFC products, as well as royalty revenue, programming hardware and design software; end-of-life products include pASIC 1, pASIC 2, V3, QuickMIPS and QuickPCI products.

The decline in revenue was due to declines in both our mature and new product lines. The decline in new product revenue was caused by the expected end of life of a product family of a personal navigation device, or PND, manufacturer and by delays in new product production ramp-up with several major customers. The decline in mature product revenue primarily resulted from the general economic slowdown, which caused lower customer demand for pASIC 3 and QuickRAM products. One of our U.S. customers, purchasing primarily pASIC 3 devices, accounted for 11% and 18% of total revenue in the first nine months of 2009 and 2008, respectively.

Gross Profit

The table below sets forth the changes in gross profit for the nine months ended September 28, 2008 as compared to the nine months ended September 27, 2009 (in thousands, except percentage data):

| | Nine Months Ended | | | | Year-Over-Year Change | |
|-----------------------------|--------------------|---------------------|--------------------|---------------------|-----------------------|-------|
| | September 27, 2009 | | September 28, 2008 | | | |
| | Amount | % of Total Revenues | Amount | % of Total Revenues | | |
| Revenue | \$ 10,795 | 100% | \$ 25,996 | 100% | \$ (15,201) | (58)% |
| Cost of revenue | 5,594 | 52 | 12,018 | 46 | (6,424) | (53) |
| Long-lived asset impairment | 150 | 2 | 1,545 | 6 | (1,395) | (90)% |
| Gross Profit | \$ 5,051 | 46% | \$ 12,433 | 48% | \$ (7,382) | (59)% |

The decline in gross profit was mainly due to the decline in revenue in the first nine months of 2009 as compared to the first nine months of 2008. The gross profit decline during the first nine months of 2009 was partially offset by the decrease in long-lived asset impairment charge in the first nine months of 2009 as compared to the first nine months of 2008; a change in product mix towards mature products which carry higher gross margins than new products; a reduction of excess and obsolescence provisions in the first nine months of 2009 as compared to the first nine months of 2008; and a change to favorable purchase price variances in the first nine months of 2009 from unfavorable purchase price variances in the first nine months of 2008. The sale of previously reserved inventories contributed \$312,000, or 2.9% of revenue, to gross profit in the first nine months of 2009 and \$441,000, or 1.7% of revenue, in the first nine months of 2008.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****Operating Expenses**

The table below sets forth the changes in operating expenses for the nine months ended September 28, 2008 as compared to the nine months ended September 27, 2009 (in thousands, except percentage data):

| | Nine Months Ended | | | | Year-Over-Year Change | |
|---------------------------------|--------------------|---------------------|--------------------|---------------------|-----------------------|--------------|
| | September 27, 2009 | | September 28, 2008 | | | |
| | Amount | % of Total Revenues | Amount | % of Total Revenues | | |
| R&D expense | \$ 4,889 | 45% | \$ 6,785 | 26% | \$ (1,896) | (28)% |
| SG&A expense | 7,877 | 73 | 10,956 | 42 | (3,079) | (28) |
| Long-lived asset impairment | | | 468 | 2 | (468) | (100) |
| Restructuring costs | | | 452 | 2 | (452) | (100) |
| Total operating expenses | \$ 12,766 | 118% | \$ 18,661 | 72% | \$ (5,895) | (32)% |

Research and Development

Our research and development expenses consist primarily of personnel, overhead and other costs associated with engineering process improvements, programmable logic design, ASSP design and software development. The decrease in R&D expenses results primarily from measures undertaken in the second quarter of 2008 to change certain development activities to an on-demand, outsourced model from an in-house, fixed cost model. As a result of this decision, our research and development staffing in Toronto, Canada was reduced during the second quarter of 2008. The \$1.9 million decrease in R&D expenses in the first nine months of 2009 as compared to the first nine months of 2008 is attributable primarily to a \$1.3 million or 51% decrease in compensation expenses due to reduced headcount; a \$705,000 or 42% decrease in expense allocations to R&D such as facilities and other corporate costs.

Selling, General and Administrative Expense

Our selling, general and administrative expenses consist primarily of personnel and related overhead costs for sales, marketing, finance, administration, human resources and general management. The \$3.1 million decrease in SG&A expenses in the first nine months of 2009 as compared to the first nine months of 2008 resulted from our effort to realign resources with our expected revenue outlook and was primarily due to a \$1.4 million or 27% decrease in cash compensation expenses as a result of headcount reductions; a \$1.3 million or 45% decrease in outside services such as consulting, temporary help and legal, and a \$253,000 or 18% decrease in occupancy costs including rent, utilities and insurance expenses, and a \$225,000 or 32% decrease in travel and entertainment expenses.

Long-Lived Assets Impairment

In the first nine months of 2008, we recorded a \$468,000 long-lived asset impairment charge to operating expenses as a result of our decision to outsource design implementation activity, which resulted in unutilized EDA software licenses. There were no long-lived asset impairment charges in the first nine months of 2009.

Restructuring Costs

In the first nine months of 2008, we reduced our worldwide headcount by approximately 30% in order to: lower fixed cost; enable a lower break-even revenue level and optimal profitability scaling with revenue growth; provide greater headroom for discretionary costs, resulting in the ability to pursue new product market opportunities; conserve cash by reducing operating expenses; and enable a quicker return to profitability. In connection with this decision, we recorded a \$452,000 restructuring charge for employee severance benefits in the first nine months of 2008; the remaining benefits of \$51,000 are expected to be paid by the end of fiscal 2009. There were no additional restructuring charges incurred in the third quarter of 2009.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)*****Interest and Other Income (Expense), net***

The table below sets forth the changes in Interest and Other Income (Expense), net, for the nine months ended September 28, 2008 as compared to the nine months ended September 27, 2009:

| | Nine Months Ended | |
|--|-----------------------|-----------------------|
| | September 27, 2009 | September 28, 2008 |
| | (in thousands) | |
| Write-down of investment in Tower Semiconductor Ltd. | \$ | \$ (417) |
| Interest expense | (78) | (202) |
| Interest income and other, net | (31) | 88 |
| | \$ (109) | \$ (531) |

In the first nine months of 2008, we determined that our investment in Tower had suffered a decline in value that was determined to be other than temporary. This determination included factors such as market value and the period of time that the market value has been below the carrying value. Accordingly, we recorded a write-down of \$417,000 in the first nine months of 2008 based on the quoted market price of the stock on the last day of the reporting period. There were no write-downs of marketable securities in the first nine months of 2009.

The decrease in interest expense is due primarily to the reduction of our average debt obligation to \$2.9 million in the first nine months of 2009 from \$3.6 million in the first nine months of 2008. The decrease in interest income is due primarily to the drop in investment yields between the first nine months of 2008 and the first nine months of 2009.

Benefit from Income Taxes

| | Nine Months Ended | |
|--------------------|-----------------------|-----------------------|
| | September 27, 2009 | September 28, 2008 |
| | (in thousands) | |
| Income tax benefit | \$ 4 | \$ 24 |

The income tax benefit for the nine months of 2009 and 2008 are primarily for our foreign operations which are cost-plus entities offset by the monetization of prior year federal research credits. As of the end of the nine months of 2009, our ability to utilize our income tax loss carryforwards in future periods is uncertain and, accordingly, we recorded a full valuation allowance against the related US tax benefit. We will continue to assess the realizability of deferred tax assets in future periods.

Liquidity and Capital Resources

We have financed our operating losses and capital investments through sales of common stock, private equity investments, capital and operating leases, bank line of credit and cash flow from operations. As of September 27, 2009, our principal sources of liquidity consisted of our cash and cash equivalents of \$13.9 million, available credit under our revolving line of credit with Silicon Valley Bank of \$4.0 million, and our investment in Tower with a market value of approximately \$1.2 million. As of September 27, 2009, there is no material difference between the fair value and the carrying amount of the debt outstanding under the Company's line of credit and capital leasing arrangements. The borrowing under the Company's line of credit is subject to maintaining a tangible net worth of at least \$11 million, unrestricted cash or cash equivalent balance of at least \$8 million and a quick ratio of 2 to 1.

Most of our cash and cash equivalents were invested in a US Treasury money market fund rated AAAM/Aaa. Our interest-bearing debt consisted of \$2.0 million of revolving debt outstanding from Silicon Valley Bank and \$0.7 million outstanding under capital leases (see Note 6 of the Condensed Unaudited Consolidated Financial Statements). The term of the revolving debt

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

facility runs until June 2010. Upon each advance, the Company can elect a variable interest rate, which is the greater of six percent or the prime rate plus one percent, or a fixed rate which is the LIBOR plus 3.50%. We were in compliance with all loan covenants as of the end of the current reporting period. Our investment in Tower had a market value of approximately \$1.2 million as of September 27, 2009. We intend to hold 450,000 of these shares, valued at \$414,000 as of the end of the third quarter of 2009 in order to obtain preferred wafer pricing from Tower.

Net cash from operating activities

Net cash used for operating activities was \$4.7 million in the first nine months of 2009. The cash used for operating activities resulted primarily from a net loss of \$7.8 million, which included \$4.2 million of non-cash charges. These non-cash charges included stock-based compensation of \$1.8 million, depreciation and amortization of \$1.3 million, a write-down of inventory of \$467,000 and utilization of wafer credits of \$278,000. In addition, changes in working capital accounts in the first nine months of 2009 accounted for used cash of \$402,000 which consisted of a decrease in current assets of \$309,000 partially offset by a decrease in current liabilities of \$711,000 in the first nine months of 2009. The decrease in current assets resulted from a decrease in inventory of \$411,000 and a decrease in prepaid expenses of \$275,000. The decrease in current liabilities resulted primarily from a decrease in deferred income on shipments to distributors of \$275,000, and a decrease in accrued liabilities of \$360,000.

Net cash provided by operating activities was \$451,000 in the first nine months of 2008. The Company's net loss of \$6.7 million, excluding non-cash charges of \$7.8 million, provided \$1.1 million of cash flow. This was reduced by \$606,000 for changes in working capital accounts. The non-cash charges included \$2.0 million of long-lived asset impairment, stock-based compensation of \$2.0 million, depreciation and amortization of \$1.7 million, write-down of inventories of \$1.3 million, write-down of marketable securities of \$417,000 and decrease in wafer credits of \$254,000. Changes in working capital accounts used cash as a result of a decrease in accounts payable of \$2.7 million due to timing of expenditures and purchases of inventories and a decrease in deferred income and royalty revenue of \$708,000. These cash uses were partially offset by a decrease in inventories of \$2.0 million, a decrease in other assets of \$725,000 and a decrease in accounts receivable of \$311,000.

Net cash from investing activities

Net cash used for investing activities for the first nine months of 2009 and 2008 was \$89,000 and \$541,000, respectively, as a result of capital expenditures made primarily to acquire software used in the development and production of our products and solutions. Capital expenditures, which are largely driven by the development of new products and manufacturing levels, are projected to be approximately \$300,000 during the rest of fiscal year 2009.

Net cash from financing activities

Net cash used for financing activities was \$723,000 for the first nine months of 2009, resulting from scheduled payments under the terms of our debt and capital lease obligations, partially offset by \$96,000 in proceeds related to the issuance of common shares to employees under our equity plans. During the first nine months of 2009, we repaid \$6.0 million of revolving debt and borrowed \$6.0 million of revolving debt with a variable interest rate of 4.0%.

Net cash used for financing activities was \$1.9 million for the first nine months of 2008, resulting from payments of \$4.1 million under the terms of our debt and capital lease obligations, partially offset by \$2.0 million in proceeds from the revolving line of credit and \$129,000 in proceeds related to the issuance of common shares to employees under our equity plans.

We require substantial cash to fund our business. However, we believe that our existing cash resources will be sufficient to fund operations and capital expenditures, and provide adequate working capital for at least the next twelve months. After the next twelve months, our cash requirements will depend on many factors, including our level of revenue and gross profit, the market acceptance of our existing and new products, the levels at which we maintain inventories and accounts receivable, costs of securing access to adequate manufacturing capacity, new product development efforts, capital expenditures and the level of our operating expenses.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****Contractual Obligations and Commercial Commitments**

The following table summarizes our contractual obligations and commercial commitments as of September 27, 2009 and the effect such obligations and commitments are expected to have on our liquidity and cash flows in future fiscal periods (in thousands):

| | Total | Payments Due by Period | | |
|---|--------------|------------------------|------------|----------------------|
| | | Less than 1 Year | 1-3 Years | More than 3 Years |
| <i>Contractual cash obligations:</i> | | | | |
| Operating leases | \$ 1,373 | \$ 482 | \$ 792 | \$ 99 |
| Wafer purchases ⁽¹⁾ | 2,144 | 2,144 | | |
| Other purchase commitments | 1,558 | 1,458 | 100 | |
| <i>Total contractual cash obligations</i> | <i>5,075</i> | <i>4,084</i> | <i>892</i> | <i>99</i> |
| <i>Other commercial commitments⁽²⁾:</i> | | | | |
| Revolving line of credit | 2,000 | 2,000 | | |
| Capital lease obligations | 983 | 540 | 443 | |
| <i>Total commercial commitments</i> | <i>2,983</i> | <i>2,540</i> | <i>443</i> | |
| Total contractual obligations and commercial commitments ⁽³⁾ | \$ 8,058 | \$ 6,624 | \$ 1,335 | \$ 99 |

(1) Certain of our wafer manufacturers require us to forecast wafer starts several months in advance. We are committed to take delivery of and pay for a portion of forecasted wafer volume. Wafer purchase commitments of \$2.1 million include both firm purchase commitments and a portion of our forecasted wafer starts as of September 27, 2009.

(2) Other commercial commitments are included as liabilities on our balance sheets as of September 27, 2009.

(3) Does not include unrecognized tax benefits of \$73,000 as of September 27, 2009. See Note 10 of the Condensed Unaudited Consolidated Financial Statements.

Concentration of Suppliers

We depend on a limited number of contract manufacturers, subcontractors, and suppliers for wafer fabrication, assembly, programming and test of our devices, and for the supply of programming equipment, and these services are typically provided by one supplier for each of our devices. We generally purchase these single or limited source services through standard purchase orders or under our agreement with Tower. Because we rely on independent subcontractors to perform these services, we cannot directly control product delivery schedules, costs or quality levels. Our future success also depends on the financial viability of our independent subcontractors. These subcontract manufacturers produce products for other companies and we must place orders in advance of expected delivery. As a result, we have only a limited ability to react to fluctuations in demand for our products, which could cause us to have an excess or a shortage of inventories of a particular product, and our ability to respond to changes in demand is limited by these suppliers' ability to provide products with the quantity, quality, cost and timeliness that we require. The decision not to provide these services to us or the inability to supply these services to us, such as in the case of a natural or financial disaster, would have a significant impact on our business. Increased demand from other companies could result in these subcontract manufacturers allocating available capacity to customers that are larger or have long-term supply contracts in place and we may be unable to obtain adequate foundry and other capacity at acceptable prices, or we may experience delays or interruption in supply. Additionally, volatility of economic, market, social and political conditions in countries where these suppliers operate may be unpredictable and could result in a reduction in product revenue or increase our cost of revenue and could adversely affect our business, financial condition and results of operations.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Off-Balance Sheet Arrangements

We do not maintain any off-balance sheet partnerships, arrangements or other relationships with unconsolidated entities or others, often referred to as structured finance or special purpose entities, which are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Recently Issued Accounting Pronouncements

See Note 2 of the Condensed Unaudited Consolidated Financial Statements for a description of recent accounting pronouncements, including the respective dates of adoption and effects on results of operations and financial condition.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio and variable rate debt. We do not use derivative financial instruments to manage our interest rate risk. We ensure the safety and preservation of invested funds by limiting default, market risk and reinvestment risk. Our investment portfolio is generally comprised of investments that meet high credit quality standards and have active secondary and resale markets. Since these securities are subject to interest rate risk, they could decline in value if interest rates fluctuate or if the liquidity of the investment portfolio were to change. Due to the short duration and conservative nature of our investment portfolio, we do not anticipate any material loss with respect to our investment portfolio. A 10% move in interest rates as of the end of the third quarter of 2009 would have an immaterial effect on our financial position, results of operations and cash flows.

Foreign Currency Exchange Rate Risk

All of our sales and cost of manufacturing are transacted in U.S. dollars. We conduct a portion of our research and development activities in Canada and India and have sales and marketing offices in several locations outside of the United States. We use the U.S. dollar as our functional currency. Most of the costs incurred at these international locations are in local currency. If these local currencies strengthen against the U.S. dollar, our payroll and other local expenses will be higher than we currently anticipate. Since our sales are transacted in U.S. dollars, this negative impact on expenses would not be offset by any positive effect on revenue. Operating expenses denominated in foreign currencies were approximately 18% and 26% of total operating expenses for the first nine months of 2009 and 2008, respectively. A currency exchange rate fluctuation of 10% would have caused our operating expenses to change by approximately \$230,000 in the first nine months of 2009.

Equity Price Risk

Our exposure to equity price risk for changes in market value relates primarily to our investment in Tower Semiconductor Ltd., or Tower. Tower's ordinary shares trade on the Nasdaq Global Market under the symbol TSEM. Since these securities are publicly traded on the open market, they are subject to market fluctuations. Temporary market fluctuations are reflected by increasing or decreasing the presented value of the related securities and recording accumulated other comprehensive income (loss) in the equity section of the balance sheet. An other than temporary decline in market value is reflected by decreasing the carrying value of the related securities and recording a charge to operating expenses in the income statement. We wrote down the value of the Tower shares due to an other than temporary decline in their market value by \$15.1 million between 2001 and December 28, 2008. The determination that the decline in market value was other than temporary included factors such as the then current market value and the period of time that the market value had been below the carrying value in each of the respective periods.

There have been no changes since the end of the last fiscal year, in the risk exposures described above or the management of such exposures and there are no expected changes going forward.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in the reports we file or submit pursuant to the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management, with the participation of the Chief Executive Officer and Chief Financial Officer, has performed an evaluation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 27, 2009, our disclosure controls and procedures were effective.

Table of Contents

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

See Note 13 of the Condensed Unaudited Consolidated Financial Statements for a description of legal proceedings.

Item 1A. Risk Factors

This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in our filings made with SEC. Because of the following risk factors, as well as other variables affecting our operating results, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

Risk Factors

Our CSSP design opportunities may not result in the revenue we expect

We have transitioned from being a broad-based supplier of FPGA devices to being a supplier of CSSPs primarily to the mobile market. We have developed a significant pipeline of design opportunities for CSSPs in our target markets, have brought multiple 3G broadband data card opportunities to revenue, and we are focused on converting additional design opportunities into revenue. Revenue contributions from new mobile products will be important over the next two to four quarters in order to grow our business, achieve profitability and maintain or increase our cash and cash equivalent balances. Mobile product life cycles are short and we must replace revenue lost at the end of each product life cycle with sales from new design wins. In addition, we expect revenue from the rest of our business to continue to decline due to the stage of our customers' product life cycles.

The generation of revenue from mobile market design opportunities is influenced by a number of factors, such as our ability to supply solutions that meet customers' cost targets and performance requirements, the value and price of our solutions relative to competing solutions, our customers' decisions whether to produce in volume the products utilizing our solution, the timing of our customers' product introduction dates, the market success of our customers' products and general economic conditions. If these design opportunities result in revenue that is later or significantly lower than we expect, our results of operations and financial condition will be adversely affected.

We may not have the liquidity to support our future operations and capital requirements

As a result of current revenue and operating expense levels, changes in working capital and interest and debt payments, we will need to generate significantly higher revenue to generate positive cash flow. In addition, our new products such as our ArcticLink and PolarPro solution platforms and products currently under development, have been generating lower gross margin as a percentage of revenue than the rest of our historical business due to the markets that we have targeted and the larger order quantities associated with these applications. Whether we can achieve cash flow levels sufficient to support our operations cannot be accurately predicted, and our investment portfolio is subject to a degree of interest rate and liquidity risk. Unless such cash flow levels are achieved and our investment portfolio remains liquid and its capital is preserved, we may need to borrow additional funds or sell debt or equity securities, or some combination thereof, to provide funding for our operations. Such additional funding source may not be available on commercially reasonable terms, or at all. If adequate funds are not available when needed, our financial condition and operating results would be materially and adversely affected and we may not be able to operate our business without significant changes in our operations, or at all.

Table of Contents

If we fail to successfully develop, introduce and sell CSSPs and new products, or if our CSSP design opportunities do not generate the revenue we expect, we may be unable to compete effectively in the future

The market for differentiated mobile devices is highly competitive and dynamic, with short end market product life cycles and rapid obsolescence of existing products. To compete successfully, we must obtain access to advanced fabrication capacity and dedicate significant resources to specify, design, develop, manufacture and sell new or enhanced CSSPs that provide increasingly higher levels of performance, low power consumption, new features, reliability and/or cost savings to our customers. Due to the short product life cycle of these devices our revenue is subject to fluctuation in a short period of time and our ability to grow our business depends on accelerating our design win activity. We often make significant investments in CSSP and silicon platform development, selling and marketing, long before we generate revenue, if any, from our efforts. The markets we are targeting typically have higher volumes and greater price pressure than our traditional business. In addition, we quote opportunities in anticipation of future cost reductions and may aggressively price products to gain market share. In order to react quickly to opportunities or to obtain favorable wafer prices, we make significant investments in and commitments to purchase inventories and capital equipment before we have firm commitments from customers. Our gross margin and valuation of inventories may be affected by these strategies if, for instance, we generate significant revenue before we are able to reduce our costs or if an opportunity priced to gain market share becomes significant to our quarterly revenue.

We expect our business growth to be driven by CSSPs, and CSSP revenue growth needs to be strong enough to achieve profitability while offsetting expected declines in other parts of our business. The gross margin associated with our CSSPs and new products is generally lower than the gross margin of our mature and end-of-life products, due primarily to the price sensitive nature of the higher volume mobile consumer opportunities that we are pursuing with CSSPs. If our mature product revenue were to decline more quickly than expected, it could have a significant effect on our results of operations and cash flows. Because the product life cycle of mobile products is short, we must replace revenue at the end of a product life cycle with sales from new design opportunities. In addition, sales of our mature product family could decline if competitors replace us in these design opportunities. While we expect revenue and gross profit growth from CSSPs will offset the expected decline in revenue and gross profit from our mature products and the effect of short mobile product life cycles, there is no assurance whether or when this will occur. In order to grow our revenue from its current level, we are dependent upon increased revenue from our existing products, especially CSSPs based on our ArcticLink and PolarPro solution platforms, and the development of CSSPs, additional new products and solutions.

If (i) we are unable to design, produce and sell new CSSPs that meet design specifications, address customer requirements and generate sufficient revenue and gross profit; (ii) market demand for our CSSPs and other products fails to materialize; (iii) we are unable to obtain adequate capacity on a timely basis; (iv) we are unable to develop CSSPs or solutions in a timely manner; or (v) our customers do not successfully introduce products incorporating our devices, our revenue and gross margin will be materially harmed, our liquidity and cash flows will be materially affected, we may be required to write-off related inventories and long-lived assets or there may be other adverse effects on our business or the price of our common stock.

Our business could be adversely affected by the current financial crisis

The downturn in general worldwide economic conditions may continue to cause a reduction in the consumption of the products that use our devices, cause the cancellation of or delay our customers' introduction of new products using our devices, disrupt supply chains and affect the financial health of our customers or suppliers. As such, the financial crisis may continue to adversely impact our customer and supplier relationships, revenue level, product prices, the value of our inventories and long-lived assets, reserves for excess and obsolete inventory, production capability, collectability of accounts receivable, access to inventory or equipment at suppliers and liquidity, which may materially harm our business. Additionally, our ability to access the capital markets may be severely restricted at a time when we would like, or need to do so, which could have an impact on our flexibility to pursue additional expansion opportunities and maintain our desired level of revenue growth in the future.

Table of Contents

We may be unable to accurately estimate quarterly revenue, which could adversely affect the trading price of our stock

Due to our relatively long product delivery cycle and the inability of our customers in the rapidly evolving mobile market to confirm product requirements on a timely basis, we may have low visibility to product demand in any given quarter. If our customers cannot provide us with accurate delivery lead times, we may not be able to deliver product to our customers in a timely fashion. Furthermore, our ability to respond to increased demand is limited to inventories on hand or on order, the capacity available at our contract manufacturers and our capacity to program products to customer specifications. If we fail to accurately estimate customer demand, record revenue, or if our available capacity is less than needed to meet customer demand, our results of operations could be harmed and our stock price could materially fluctuate.

We have a limited number of significant customers and limited visibility into the long-term demand for our products from these customers

A few end-customers can represent a significant portion of our total revenue in a given reporting period and the likelihood of this occurring will increase in the future as we target market leading manufacturers of high volume mobile applications. As in the past, future demand from these customers may fluctuate significantly from quarter to quarter. These customers typically order products with short requested delivery lead times, and do not provide a commitment to purchase product past the period covered by purchase orders, which may be rescheduled or cancelled. In addition, our manufacturing lead times are longer than the delivery lead times requested by these customers, and we make significant purchases of inventory and capital expenditures in anticipation of future demand. If revenue from any significant customer were to decline substantially, we may be unable to offset this decline with increased revenue and gross margin from other customers and we may purchase excess inventories. These factors could severely harm our business.

In addition, we may make a significant investment in long-lived assets for the production of our products based upon historical and expected demand. If demand for our products or gross margin generated from our products does not meet our expectations or if we are unable to collect amounts due from significant customers, we may be required to write-off inventories, provide for uncollectible accounts receivable or incur charges against long-lived assets, which would materially harm our business.

Our future results depend on our relationship with Tower

We have invested approximately \$21.3 million in Tower. In return for our investment, we received equity, prepaid wafer credits, favorable wafer pricing and committed production capacity in Tower's foundry facility. We believe that Tower's long-term operation of this fabrication facility depends on its ability to attract sufficient customer demand, to obtain additional financing, to increase capacity, to obtain the release of grants and approvals for changes in grant programs from the Israeli government's Investment Center and its ability to remain in compliance with the terms of its grant and credit agreements. The current political uncertainty and security situation in the Middle East where Tower's fabrication facility is located, the cyclical nature of the market for foundry manufacturing services, Tower's financial condition, or other factors may adversely impact Tower's business prospects and may discourage future investments in Tower from outside sources. If Tower is unable to obtain adequate financing and increase production output in a timely manner, the value of our investment in Tower may possibly become worthless, our wafer credit from Tower may decline in value or possibly become worthless, and we would have to identify and qualify a substitute supplier to manufacture our products. This could require significant development time, cause product shipment delays, impair long-lived assets and the value of our wafer credits, damage our liquidity and severely harm our business. In addition, Tower is the primary manufacturer of our new products.

The value of our investment in Tower and its corresponding wafer credits may also be adversely affected by a deterioration of conditions in the market for foundry manufacturing services, the market for semiconductor products, Tower's financial health and Tower's ability to remain in compliance with Nasdaq listing standards. As of September 27, 2009, we held 1,344,543 available for sale Tower ordinary shares. Tower's shares from time to time have been trading below \$1.00 during the past 52 weeks, if Tower does not remain in compliance with Nasdaq listing standards, or if Tower's financial position is determined to be significantly impaired, the liquidity of our investment and our ability to utilize the remaining prepaid wafer credits may be adversely affected.

Table of Contents

We depend upon third parties to fabricate, assemble, test and program our products, and they may discontinue manufacturing our products, fail to give our products priority, be unable to successfully manufacture our products to meet performance, volume or cost targets, or inaccurately report inventories to us

We contract with third parties to fabricate, assemble, test and program our devices. Our devices are generally fabricated, assembled and programmed by single suppliers, and the loss of a supplier, transfer of manufacturing to a new location, expiration of a supply agreement or the inability of our suppliers to manufacture our products to meet volume, performance and cost targets could have a material adverse effect on our business. Our relationship with our suppliers could change as a result of a merger or acquisition. If for any reason these suppliers or any other vendor becomes unable or unwilling to continue to provide services of acceptable quality, at acceptable costs and in a timely manner, our ability to operate our business or deliver our products to our customers could be severely impaired. We would have to identify and qualify substitute suppliers, which could be time consuming, difficult and result in unforeseen operational problems, or we could announce an end-of-life program for these products. Alternate suppliers might not be available to fabricate, assemble, test and program our devices or, if available, might be unwilling or unable to offer services on acceptable terms.

In addition, if competition for wafer manufacturing capacity increases, if we need to migrate to more advanced wafer manufacturing technology, or if competition for assembly services increases, we may be required to pay or invest significant amounts to secure access to this capacity. For example, between 2001 and 2002 we invested \$21.3 million in equity and prepaid wafer credits to obtain guaranteed wafer fabrication capacity at Tower Semiconductor until at least 2010. The number of companies that provide these services is limited and some of them have limited operating histories and financial resources. In the event our current suppliers refuse or are unable to continue to provide these services to us, or if we are unable to secure sufficient capacity from our current suppliers on commercially reasonable terms, we may be unable to procure services from alternate suppliers in a timely manner, if at all. Moreover, our reliance on a limited number of suppliers subjects us to reduced control over delivery schedules, quality assurance and costs. This lack of control may cause unforeseen product shortages or may increase our cost to manufacture and test our products, which would adversely affect our operating results and cash flows.

We record a majority of our inventory transactions based on information from our subcontractors. If we do not receive prompt and accurate information from our suppliers, we could be unable to meet our delivery commitments to customers or commit to manufacturing inventories that are not required to meet customer delivery commitments, which could materially harm our business.

We will be unable to compete effectively if we fail to anticipate product opportunities based upon emerging technologies and standards or fail to develop products and solutions that incorporate these technologies and standards in a timely manner

We spend significant time and money designing and developing silicon solution platforms such as ArcticLink and PolarPro and proven system blocks, such as our VEE, USB and IDE, or emerging technologies, such as low power programmable logic, advanced process technology or small form factor packaging. We intend to develop additional products and solutions and to adopt new technologies in the future. If system manufacturers adopt alternative standards or technologies, if an industry standard or emerging technology that we have targeted fails to achieve broad market acceptance, if customers choose low power offerings from our competitors, or if we are unable to bring the technologies or solutions to market in a timely and cost-effective manner, we may be unable to generate significant revenue from our research and development efforts. As a result, our business would be materially harmed and we may be required to write-off related inventories and long-lived assets.

Our customers may cancel or change their product plans after we have expended substantial time and resources in the design of their products

Our customers often evaluate our products for six months or more before designing them into their systems, and they may not commence volume shipments for up to an additional six to twelve months, if at all. During this lengthy sales cycle, our potential customers may cancel or change their product plans. Customers may also discontinue products incorporating our devices at any time or they may choose to replace our products with lower cost semiconductors. In addition, we are working with leading customers in our target markets to define our future products. If customers cancel, reduce or delay product orders from us or choose not to release products that incorporate our devices after we have spent substantial time and resources developing products or assisting customers with their product design, our revenue levels may be less than anticipated and our business could be materially harmed.

Table of Contents

If we fail to adequately forecast demand for our products, we may incur product shortages or excess product inventories

Our agreements with certain suppliers require us to provide forecasts of our anticipated manufacturing orders, and place binding manufacturing commitments in advance of receiving purchase orders from our customers. We are limited in our ability to increase or decrease our forecasts under such agreements. Other manufacturers supply us with product on a purchase order basis. The allocation of capacity is determined solely by our suppliers over which we have no direct control. Additionally, we may place orders with our suppliers in advance of customer orders to allow us to quickly respond to changing customer demand or to obtain favorable product costs. Furthermore, we provide our suppliers with equipment which is used to program our products to customer specifications. The programming equipment is manufactured to our specifications and has significant order lead times. These factors may result in product shortages or excess product inventories. Obtaining additional supply in the face of product, programming equipment or capacity shortages may be costly, or not possible, especially in the short term since most of our products and programming equipment are supplied by a single supplier. Our failure to adequately forecast demand for our products could materially harm our business.

Our approach to developing solutions for potential customers involves: (i) embedded processors developed by other companies; (ii) peripheral devices developed by other parties such as micro hard disk drives, Wi-Fi devices and Managed NAND flash memory; (iii) proprietary intellectual property such as key elements of our VEE technology; and (iv) specific industry standards such as USB 2.0 OTG, Secure Digital High Capacity, or SDHC, IDE and SDIO. We have entered into informal partnerships with other parties that involve the development of solutions that interface with their devices or standards. These informal partnerships also may involve joint marketing campaigns and sales calls. If our solutions are not incorporated into customer products, if our partners discontinue production of or integrate our solution into their product offerings, or if the informal partnerships do not grow as expected or if they are significantly reduced or terminated by acquisition or other means, our revenue and gross margin will be materially harmed and we may be required to write-off related inventories and long-lived assets. Fluctuations in our manufacturing processes, yields and quality, especially for new products, may increase our costs.

Difficulties encountered during the complex semiconductor manufacturing process can render a substantial percentage of semiconductor devices nonfunctional. New manufacturing techniques or fluctuations in the manufacturing process may change the performance distribution and yield of our products. We have, in the past, experienced manufacturing runs that have contained substantially reduced or no functioning devices, or that generated devices with below normal performance characteristics. Our reliance on third party suppliers may extend the period of time required to analyze and correct these problems. Once corrected, our customers may be required to redesign or requalify their products. As a result, we may incur substantially higher manufacturing costs, shortages of inventories or reduced customer demand.

Yield fluctuations frequently occur in connection with the manufacture of newly introduced products, with changes in product architecture, with manufacturing at new facilities, on new fabrication processes or in conjunction with new backend manufacturing processes. Newly introduced solutions and products, such as our CSSPs and ArcticLink and PolarPro solution platforms, are often more complex and more difficult to produce, increasing the risk of manufacturing related defects. New manufacturing facilities or processes are often more complex and take a period of time to achieve expected quality levels and manufacturing efficiencies. While we test our products, including our software development tools, they may still contain errors or defects that are found after we have commenced commercial production. Undetected errors or defects may also result from new manufacturing processes or when new intellectual property is incorporated into our products. If our products or software development tools contain undetected or unresolved defects, we may lose market share, experience delays in or loss of market acceptance, reserve or scrap inventories or be required to issue a product recall. In addition, we would be at risk of product liability litigation if defects in our products were discovered. Although we attempt to limit our liability to end users through disclaimers of special, consequential and indirect damages and similar provisions, we cannot assure you that such limitations of liability will be legally enforceable.

Table of Contents

We have a history of losses and cannot assure you that we will again be profitable in the future

We incurred significant losses to date. Our accumulated deficit as of September 27, 2009 was \$156.0 million. We recorded a net loss of \$9.4 million in 2008, \$11.1 million in 2007, and \$9.2 million in 2006, and we may not return to profitability in any future periods.

Our future operating results are likely to fluctuate and therefore may fail to meet expectations, which could cause our stock price to decline

Our operating results have varied widely in the past and are likely to do so in the future. In addition, our past operating results may not be an indicator of future operating results. Our future operating results will depend on many factors and may fail to meet our expectations for a number of reasons, including those set forth in these risk factors. Any failure to meet expectations could cause our stock price to significantly fluctuate or decline.

Factors that could cause our operating results to fluctuate include: (i) successful development and market acceptance of our products and solutions; (ii) our ability to accurately forecast product volumes and mix, and to respond to rapid changes in customer demand; (iii) changes in sales volume or expected sales volume, product mix, average selling prices or production variances that affect gross profit; (iv) the effect of end-of-life programs; (v) a significant change in sales to, or the collectability of accounts receivable from, our largest customers; (vi) our ability to adjust our product features, manufacturing capacity and costs in response to economic and competitive pressures; (vii) our reliance on subcontract manufacturers for product capacity, yield and quality; (viii) our competitors' product portfolio and product pricing policies; (ix) timely implementation of efficient manufacturing technologies; (x) errors in applying or changes in accounting and corporate governance rules; (xi) the issuance of equity compensation awards or changes in the terms of our stock plan or employee stock purchase plan; (xii) mergers or acquisitions; (xiii) the impact of import and export laws and regulations; (xiv) the cyclical nature of the semiconductor industry and general economic, market, political and social conditions in the countries where we sell our products and the related effect on our customers, distributors and suppliers; and (xv) our ability to obtain capital, debt financing and insurance on commercially reasonable terms. Although certain of these factors are out of our immediate control, unless we can anticipate and be prepared with contingency plans that respond to these factors, our business may be materially harmed.

We may encounter periods of industry wide semiconductor oversupply, resulting in pricing pressure, as well as undersupply, resulting in a risk that we could be unable to fulfill our customers' requirements. The semiconductor industry has historically been characterized by wide fluctuations in the demand for, and supply of, its products. These fluctuations have resulted in circumstances when supply of and demand for semiconductors has been widely out of balance. An industry wide semiconductor oversupply could result in severe downward pricing pressure from customers. In a market with undersupply of manufacturing capacity, we would have to compete with larger foundry and assembly customers for limited manufacturing resources. In such an environment, we may be unable to have our products manufactured in a timely manner, at a cost that generates adequate gross profit or in sufficient quantities. Since we outsource all of our manufacturing and generally have a single source of wafer supply, test, assembly and programming for our products, we are particularly vulnerable to such supply shortages and capacity limitations. As a result, we may be unable to fulfill orders and may lose customers. Any future industry wide oversupply or undersupply of semiconductors could materially harm our business.

We may be unable to successfully grow our business if we fail to compete effectively with others to attract and retain key personnel

We believe our future success depends upon our ability to attract and retain highly competent personnel. Our employees are at-will and not subject to employment contracts. Hiring and retaining qualified sales, technical and financial personnel are difficult due to the limited number of qualified professionals, economic conditions and the size of our company. Competition for these types of employees is intense. In addition, new hires frequently require extensive training before they achieve desired levels of productivity. Failure to attract, hire, train and retain personnel could materially harm our business.

Table of Contents

Problems associated with international business operations could affect our ability to manufacture and sell our products

Most of our products are manufactured outside of the United States at manufacturing facilities operated by our suppliers in Asia, South Asia and the Middle East regions. As a result, these manufacturing operations and new product introductions are subject to risks of political instability.

A significant portion of our total revenue comes from sales to customers located outside the United States. We anticipate that sales to customers located outside the United States will continue to represent a significant portion of our total revenue in future periods. In addition, most of our domestic customers sell their products outside of North America, thereby indirectly exposing us to risks associated with foreign commerce and economic instability. In addition to overseas sales offices, we have significant research and development activities in Canada and India.

Accordingly, our operations and revenue are subject to a number of risks associated with foreign commerce, including the following: (i) staffing and managing foreign offices; (ii) managing foreign distributors; (iii) collecting amounts due; (iv) political and economic instability; (v) foreign currency exchange fluctuations; (vi) changes in tax laws, import and export regulations, tariffs and freight rates; (vii) timing and availability of export licenses; (viii) supplying products that meet local environmental regulations; and (ix) inadequate protection of intellectual property rights.

In the past, we have denominated sales of our products to foreign countries exclusively in U.S. dollars. As a result, any increase in the value of the U.S. dollar relative to the local currency of a foreign country will increase the price of our products in that country so that our products become relatively more expensive to customers in their local currency. As a result, sales of our products in that foreign country may decline. If the local currency of a foreign country in which we conduct business strengthens against the U.S. dollar, our payroll and other local expenses will be higher, and since sales are transacted in U.S. dollars, would not be offset by any increase in revenue. To the extent any such risks materialize, our business could be materially harmed.

In addition, we incur costs in foreign countries that may be difficult to reduce quickly because of employee related laws and practices in those foreign countries.

Our CSSPs face competition from suppliers of ASSPs, suppliers of integrated application processors, and suppliers of ASICs

We face competition from companies that offer ASSPs such as Cypress Semiconductor and Alcor Micro Corporation. While it is difficult to provide a unique solution through the use of ASSPs, they generally are cost effective standard products and have short lead times. In certain design opportunities, ASSPs can be combined to achieve system design objectives. Manufacturers of integrated application processors often integrate new features when they introduce new products. A system designer could elect the use of an integrated processor that includes the features offered in our CSSPs. Companies such as LSI Corporation supply ASICs, which may be purchased for a lower price at higher volumes and typically have greater logic capacity, additional features and higher performance than our products. Our inability to successfully compete in any of the following areas could materially harm our business: (i) the development of new products, CSSPs and advanced manufacturing technologies; (ii) the quality, power characteristics, performance characteristics, price and availability of devices, programming hardware and software development tools; (iii) the ability to engage with companies that provide synergistic products and services; (iv) the incorporation of industry standards in our products and solutions; (v) the diversity of product offerings available to customers; or (vi) the quality and cost effectiveness of design, development, manufacturing and marketing efforts.

We may depend upon third party distributors and independent sales representatives to market and sell our products, and they may discontinue sale of our products, fail to give our products priority or be unable to successfully market, sell and support our products

We contract with third party distributors and independent sales representatives to market and sell a portion of our products in certain geographies. Although we have contracts with our distributors and representatives, our agreements with them may be terminated on short notice by either party and, if terminated, we may be unable to recruit additional or replacement distributors or representatives. As a result, our future performance will depend in part on our ability to retain our existing distributors and representatives and to attract new distributors and representatives that will be able to effectively market, sell and support our products and solutions. The loss of one or more of our principal distributors or representatives, or our inability to attract new distributors or representatives, could materially harm our business.

Table of Contents

Many of our distributors and representatives, including our principal distributors and representatives, market and sell products for other companies. Many of these products may compete directly or indirectly with our products and solutions. Also, we generally are not one of the principal suppliers of products to our distributors or representatives. If our distributors or representatives give higher priority or greater attention to the products of other companies, including products that compete with our products and solutions, our business would be materially harmed.

Individual distributors and OEMs often represent a significant portion of our accounts receivable. If we are unable to collect funds due from these distributors and customers, our financial results may be materially harmed.

Restrictive covenants in the indentures and agreements governing our current and future indebtedness could restrict our operating flexibility

The indentures and agreements governing our existing debt, and debt we may incur in the future, contain, or may contain, affirmative and negative covenants that materially limit our ability to take certain actions, including our ability to incur debt, pay dividends and repurchase stock, make certain investments and other payments, enter into certain mergers and consolidations, engage in sale leaseback transactions and encumber and dispose of assets. In addition, our future debt agreements may contain financial covenants and ratios.

The breach of any of these covenants by us or the failure by us to meet any of these ratios or conditions could result in a default under any or all of such indebtedness. If a default occurs under any such indebtedness, all of the outstanding obligations thereunder could become immediately due and payable, which could result in a default under our other outstanding debt and could lead to an acceleration of obligations related to other outstanding debt. The existence of such a default or event of default could also preclude us from borrowing funds under our revolving credit facilities. Our ability to comply with the provisions of the indentures, credit facilities and other agreements governing our outstanding debt and indebtedness we may incur in the future can be affected by events beyond our control and a default under any debt instrument, if not cured or waived, could have a material adverse effect on us.

We may be unable to adequately protect our intellectual property rights and may face significant expenses as a result of future litigation

Protection of intellectual property rights is crucial to our business, since that is how we keep others from copying the innovations that are central to our existing and future products. From time to time, we receive letters alleging patent infringement or inviting us to license other parties patents. We evaluate these requests on a case-by-case basis. These situations may lead to litigation if we reject the offer to obtain the license.

In the past, we have been and we are currently involved in litigation relating to our alleged infringement of third party patents or other intellectual property rights. This type of litigation is expensive and consumes large amounts of management time and attention. Additionally, matters that we initially consider not material to our business could become costly. In addition, if the letters we sometimes receive alleging patent infringement or other similar matters result in litigation that we lose, a court could order us to pay substantial damages and/or royalties, and prohibit us from making, using, selling or importing essential technologies. For these and other reasons, this type of litigation could materially harm our business.

Although we may seek to obtain a license under a third party's intellectual property rights in order to bring an end to certain claims or actions asserted against us, we may not be able to obtain such a license on reasonable terms, or at all. We have entered into technology license agreements with third parties which give those parties the right to use patents and other technology developed by us and which give us the right to use patents and other technology developed by them. We anticipate that we will continue to enter into these kinds of licensing arrangements in the future; however, it is possible that desirable licenses will not be available to us on commercially reasonable terms. If we lose existing licenses to key technology, or are unable to enter into new licenses that we deem important, our business could be materially harmed.

Table of Contents

Because it is critical to our success that we continue to prevent competitors from copying our innovations, we intend to continue to seek patent and trade secret protection for our products. The process of seeking patent protection can be long and expensive, and we cannot be certain that any currently pending or future applications will actually result in issued patents or that, even if patents are issued, they will be of sufficient scope or strength to provide meaningful protection or any commercial advantage to us. Furthermore, others may develop technologies that are similar or superior to our technology or design around the patents we own. We also rely on trade secret protection for our technology, in part through confidentiality agreements with our employees, consultants and other third parties. However, these parties may breach these agreements and we may not have adequate remedies for any breach. In any case, others may come to know about or determine our trade secrets through a variety of methods. In addition, the laws of certain territories in which we develop, manufacture or sell our products may not protect our intellectual property rights to the same extent as the laws of the United States.

We may engage in manufacturing, distribution or technology agreements that involve numerous risks, including the use of cash, diversion of resources and significant write-offs

We have entered into and, in the future, intend to enter into agreements that involve numerous risks, including the use of significant amounts of our cash; diversion of resources from other development projects or market opportunities; our ability to incorporate licensed technology in our products and solutions; our ability to introduce related products in a cost effective and timely manner; our ability to collect amounts due under these contracts; and market acceptance of related products and solutions. If we fail to recover the cost of these or other assets from the cash flow generated by the related products, our assets will become impaired and our financial results would be harmed.

Our business is subject to the risks of earthquakes, other catastrophic events and business interruptions for which we may maintain limited insurance

Our operations and the operations of our suppliers are vulnerable to interruption by fire, earthquake, power loss, flood, terrorist acts and other catastrophic events beyond our control. In particular, our headquarters are located near earthquake fault lines in the San Francisco Bay Area. In addition, we rely on sole suppliers to manufacture our products and would not be able to qualify an alternate supplier of our products for several quarters. Our suppliers often hold significant quantities of our inventories which, in the event of a disaster, could be destroyed. In addition, our business processes and systems are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering. Any catastrophic event, such as an earthquake or other natural disaster, the failure of our computer systems, war or acts of terrorism, could significantly impair our ability to maintain our records, pay our suppliers, or design, manufacture or ship our products. The occurrence of any of these events could also affect our customers, distributors and suppliers and produce similar disruptive effects upon their business. If there is an earthquake or other catastrophic event near our headquarters, our customers' facilities, our distributors' facilities or our suppliers' facilities, our business could be seriously harmed.

We do not have a detailed disaster recovery plan. In addition, we do not maintain sufficient business interruption and other insurance policies to compensate us for all losses that may occur. Any losses or damages incurred by us as a result of a catastrophic event or any other significant uninsured loss could have a material adverse effect on our business.

Our principal stockholders have significant voting power and may vote for actions that may not be in the best interests of our other stockholders

Our officers, directors and principal stockholders together control a significant portion of our outstanding common stock. As a result, these stockholders, if they act together, will be able to significantly influence our operations, affairs and all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. This concentration of ownership may have the effect of delaying or preventing a change in control and might affect the market price of our common stock. This concentration of ownership may not be in the best interest of our other stockholders.

Table of Contents

Our Shareholder Rights Plan, Certificate of Incorporation, Bylaws and Delaware law contain provisions that could discourage a takeover that is beneficial to stockholders

Our Shareholder Rights Plan as well as provisions of our Certificate of Incorporation, our Bylaws and Delaware law could make it difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders.

Our Common Stock may become ineligible for listing on the Nasdaq Global Market or alternatively the NASDAQ Capital Market if it does not trade at or above \$1.00, which would materially adversely affect the liquidity and price of our Common Stock

We are listed on the Nasdaq Global Market. Our continued listing is contingent on meeting specific quantitative standards, including a minimum closing bid price of \$1.00. At times during the fiscal fourth quarter of 2008 and the first fiscal quarter of 2009, our Common Stock was below \$1.00. In the event that our stock fails to maintain a minimum closing bid price of at least \$1.00 for 30 consecutive business days, we may receive a deficiency notice from the Listing Qualifications Department of the Nasdaq Stock Market. If we receive a deficiency notice, our stock will have to achieve a minimum closing bid price of at least \$1.00 for at least 10 consecutive business days within 180 calendar days, or else we may be delisted from the Nasdaq Global Market. Should we be delisted from the NASDAQ Global Market, we may be eligible for listing on the Nasdaq Capital Market, subject to meeting specific quantitative standards, including maintaining a minimum closing bid price of \$1.00, and would have to achieve that within the 180 calendar days of initial listing on the Nasdaq Capital Market.

If our Common Stock becomes ineligible for listing on either the Nasdaq Global Market or the Nasdaq Capital Market, and is thereafter traded only on the over-the-counter market, our stockholders' abilities to purchase and sell our Common Stock could be less orderly and efficient and more costly. Furthermore, a delisting of our Common Stock could have a materially adverse impact on our business operations by damaging our general business reputation, impairing our ability to obtain additional capital, reducing the incentives that equity ownership is intended to provide to our employees, and causing a loss of confidence by investors, suppliers and employees. As a result of the negative impact on the liquidity of our Common Stock and on our business, a delisting would also likely decrease the market price of our Common Stock and increase the volatility of our stock price.

The market price of our common stock may fluctuate significantly and could lead to securities litigation

Stock prices for many companies in the technology and emerging growth sectors have experienced wide fluctuations that have often been unrelated to the operating performance of such companies. In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. In the future, we may be the subject of similar litigation. Securities litigation could result in substantial costs and divert management's attention.

Changes to existing accounting pronouncements or taxation rules or practices may cause adverse revenue fluctuations, affect our reported financial results or how we conduct our business

Generally accepted accounting principles, or GAAP, are promulgated by, and are subject to the interpretation of the Financial Accounting Standards Board, or FASB, and the SEC. New accounting pronouncements or taxation rules and varying interpretations of accounting pronouncements or taxation practices have occurred and may occur in the future. Any future changes in accounting pronouncements or taxation rules or practices may have a significant effect on how we report our results and may even affect our reporting of transactions completed before the change is effective. In addition, a review of existing or prior accounting practices may result in a change in previously reported amounts. This change to existing rules, future changes, if any, or the questioning of current practices may adversely affect our reported financial results, our ability to remain listed on the Nasdaq Global Market, or the way we conduct our business and subject us to regulatory inquiries or litigation.

Table of Contents

Compliance with regulations related to corporate governance and public disclosure may result in additional expenses

Federal securities laws, rules and regulations, as well as Nasdaq rules and regulations, require companies to maintain extensive corporate governance measures, impose comprehensive reporting and disclosure requirements, set strict independence and financial expertise standards for audit and other committee members and impose civil and criminal penalties for companies and their chief executive officers, chief financial officers and directors for securities law violations. These laws, rules and regulations have increased and will continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices, which could harm our results of operations and divert management's attention from business operations. We are committed to maintaining high standards of corporate governance and public disclosure. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may be harmed and the market price of our common stock could be affected.

While we believe that we currently have adequate internal control procedures in place, we are still exposed to potential risks from legislation requiring companies to evaluate controls under Section 404 of the Sarbanes-Oxley Act of 2002

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

As of December 2008, we have evaluated our internal control systems in order to allow management to report on our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. We performed the system and process evaluation and testing required in an effort to comply with the management certification of Section 404. While we believe that our internal control procedures are adequate and we intend to continue to fully comply with the requirements relating to internal control and all other aspects of Section 404, our controls necessary for continued compliance with the Sarbanes-Oxley Act may not operate effectively at all times and may result in a material control disclosure. The identification of a material weakness in internal control over financial reporting, if any, could indicate a lack of proper controls to generate accurate consolidated financial statements. Furthermore, we cannot be certain as to the outcome of future evaluations, testing and remediation actions or the impact of the same on our operations. If we are not able to remain in compliance with the requirements of Section 404, we might be subject to sanctions or investigation by regulatory authorities, such as the SEC or the Nasdaq Global Market. Any such action could adversely affect our financial results and the market price of our common stock.

We have implemented import and export control procedures to comply with United States regulations but we are still exposed to potential risks from import and export activity

Our products, solutions, technology and software are subject to import and export control laws and regulations which, in some instances, may impose restrictions on business activities, or otherwise require licenses or other authorizations from agencies such as the U.S. Department of State, U.S. Department of Commerce and U.S. Department of the Treasury. These restrictions may impact deliveries to customers or limit development and manufacturing alternatives. We have import and export licensing and compliance procedures in place for purposes of conducting our business consistent with U.S. and applicable international laws and regulations, and we periodically review these procedures to maintain compliance with the requirements relating to import and export regulations. If we are not able to remain in compliance with import and export regulations, we might be subject to investigation, sanctions or penalties by regulatory authorities. Such penalties can include civil, criminal or administrative remedies such as loss of export privileges. We cannot be certain as to the outcome of an evaluation, investigation, inquiry or other action or the impact of these items on our operations. Any such action could adversely affect our financial results and the market price of our common stock.

Table of Contents

The Company, our directors and management have been named parties to lawsuits and may be subject to future litigation, which could result in an unfavorable outcome and have a material adverse effect on our business, financial condition, results of operations, cash flows and the trading price for our securities

The Company and certain of our directors and officers are named in a lawsuit relating to the initial public offering laddering litigation. We may become the subject of other private or government actions in the future. Litigation may be time consuming, expensive and disruptive to normal business operations and the outcome of litigation is difficult to predict. Any expenses associated with litigation or the outcome relating to any such actions could have a material adverse effect on our business, financial condition, results of operations, cash flows and the trading price for our securities.

Table of Contents

Item 6. Exhibits

a. Exhibits

The following Exhibits are filed with this report:

| Exhibit | |
|--------------------|--|
| Number | Description |
| 3.1 ⁽¹⁾ | Amended and Restated Certificate of Incorporation of Registrant. |
| 3.2 ⁽²⁾ | Bylaws of Registrant. |
| 31.1 | CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | CEO and CFO Certifications 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 the Company's Registration Statement on Form S-1 declared effective October 14, 1999 (Commission File No. 333-28833).

⁽²⁾ Incorporated by reference to the Company's Current Report on Form 8-K (Item 5.03) filed May 2, 2005.

Table of Contents

Signatures

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

QUICKLOGIC CORPORATION

/s/ Ralph S. Marimon

Ralph S. Marimon
Vice President, Finance and Chief Financial Officer

*(as Principal Accounting and Financial Officer and on behalf of the
Registrant)*

Date: November 6, 2009

Table of Contents

EXHIBIT INDEX

Exhibit

| Number | Description |
|--------------------|--|
| 3.1 ⁽¹⁾ | Amended and Restated Certificate of Incorporation of Registrant. |
| 3.2 ⁽²⁾ | Bylaws of Registrant. |
| 31.1 | CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | CEO and CFO Certifications 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 the Company's Registration Statement on Form S-1 declared effective October 14, 1999 (Commission File No. 333-28833).

⁽²⁾ Incorporated by reference to the Company's Current Report on Form 8-K (Item 5.03) filed May 2, 2005.