GSI TECHNOLOGY INC
Form 10-Q
November 13, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2007 or

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

For the transition period from to

Commission File Number 000-33387

GSI Technology, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**77-0398779**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

2360 Owen Street

Santa Clara, California 95054

(Address of principal executive offices, zip code)

(408) 980-8388

(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 filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act). Large accelerated filer o Accelerated filer o Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

The number of shares of the registrant s common stock outstanding as of October 31, 2007: 27,615,815.

GSI TECHNOLOGY, INC.

FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2007		March 31, 2007	
	(In thousands, except share and per share amounts)			
ASSETS				
Cash and cash equivalents	$	8,194	$	4,275
Restricted cash				1,000
Short-term investments		39,093		4,000
Accounts receivable, net		6,503		6,397
Inventories		17,506		24,209
Prepaid expenses and other current assets		1,991		3,205
Deferred income taxes		1,116		1,084
Total current assets		74,403		44,170
Property and equipment, net		4,780		4,745
Other assets		1,066		995
Total assets	$	80,249	$	49,910
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS EQUITY				
Accounts payable	$	2,671	$	4,864
Accrued expenses and other liabilities		1,357		2,603
Deferred revenue		4,058		3,704
Total current liabilities		8,086		11,171
Income taxes payable		306		
Total liabilities		8,392		11,171
Commitments and contingencies (Notes 7 and 13)				
Redeemable convertible preferred stock: $0.001 par value Authorized: 15,120,168 shares Issued and outstanding: 0 and 15,120,168 shares, respectively Liquidation preference: $0 and $9,007, respectively				9,007
Stockholders equity:				
Preferred stock: $0.001 par value Authorized: 5,000,000 shares Issued and outstanding: none				
Common stock: $0.001 par value Authorized: 150,000,000 shares Issued and outstanding: 27,615,815 and 6,343,411 shares, respectively		28		6
Additional paid-in capital		47,334		7,542
Accumulated other comprehensive income		8		
Retained earnings		24,487		22,184
Total stockholders equity		71,857		29,732

Total liabilities, redeemable convertible preferred stock and stockholders equity	$	80,249	$	49,910

The accompanying notes are an integral part of these condensed consolidated financial statements.

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Six Months Ended September 30, 2007	Six Months Ended September 30, 2006
	(In thousands, except per share amounts)		(In thousands, except per share amounts)	
Net revenues	$ 12,672	$ 14,956	$ 23,977	$ 28,929
Cost of revenues	8,084	9,047	14,970	17,442
Gross profit	4,588	5,909	9,007	11,487
Operating expenses:				
Research and development	1,087	1,157	2,219	2,444
Selling, general and administrative	2,121	1,382	4,308	2,700
Total operating expenses	3,208	2,539	6,527	5,144
Income from operations	1,380	3,370	2,480	6,343
Interest income, net	425	218	837	396
Other income (expense), net	48	(16)	101	(9)
Income before income taxes	1,853	3,572	3,418	6,730
Provision for income taxes	604	1,185	1,115	2,233
Net income	$ 1,249	$ 2,387	$ 2,303	$ 4,497
Basic and diluted net income per share available to common stockholders:				
Basic	$ 0.05	$ 0.35	$ 0.08	$ 0.65
Diluted	$ 0.04	$ 0.10	$ 0.08	$ 0.20
Weighted average shares used in per share calculations:				
Basic	27,616	6,250	27,376	6,216
Diluted	28,673	22,954	28,785	22,841

The accompanying notes are an integral part of these condensed consolidated financial statements.

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended September 30, 2007	Six Months Ended September 30, 2006
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 2,303	$ 4,497
Adjustments to reconcile net income to net cash provided by operating activities:		
Allowance for sales returns and doubtful accounts	57	(37)
Provision for excess and obsolete inventories	45	325
Depreciation and amortization	556	421
Stock-based compensation	761	218
Deferred income taxes	(103)	
Amortization of bond premium on investments	163	
Changes in assets and liabilities:		
Accounts receivable	(163)	(1,984)
Inventory	6,658	(4,057)
Prepaid expenses and other assets	634	(313)
Accounts payable	(2,134)	(171)
Accrued expenses and other liabilities	221	457
Deferred revenue	354	723
Net cash provided by operating activities	9,352	79
Cash flows from investing activities:		
Decrease in restricted cash	1,000	
Purchase of short-term investments	(39,748)	(8,000)
Proceeds from sales and maturities of short-term investments	4,500	6,000
Purchases of property and equipment	(1,812)	(79)
Net cash used in investing activities	(36,060)	(2,079)
Cash flows from financing activities:		
Initial public offering costs paid during the period	(739)	
Proceeds from initial public offering, net of underwriting discount	31,361	35
Proceeds from issuance of common stock upon option exercises	5	
Net cash provided by financing activities	30,627	35
Net increase (decrease) in cash and cash equivalents	3,919	(1,965)
Cash and cash equivalents at beginning of the period	4,275	11,505
Cash and cash equivalents at end of the period	$ 8,194	$ 9,540
Non-cash financing activities:		
Purchases of property and equipment through accounts payable and accruals	$ 121	$
Supplemental cash flow information:		
Cash paid for income taxes	$ 1,253	$ 1,964
Cash paid for interest	$	$ 8

The accompanying notes are an integral part of these condensed consolidated financial statements.

GSI TECHNOLOGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of GSI Technology, Inc. and its subsidiaries (GSI or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, the interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. These interim financial statements contain all adjustments (which consist of only normal, recurring adjustments) that are, in the opinion of management, necessary to state fairly the interim financial information included therein. The Company believes that the disclosures are adequate to make the information not misleading. However, these financial statements should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2007.

The consolidated results of operations for the three and six months ended September 30, 2007 are not necessarily indicative of the results to be expected for the entire fiscal year.

Significant accounting policies

The Company s significant accounting policies are disclosed in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2007. The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48) as of the first day of the first quarter of fiscal 2008. The Company has not otherwise materially changed its significant accounting policies.

Income taxes

FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return (including a decision whether to file or not to file a return in a particular jurisdiction). Under the Interpretation, the financial statements will reflect expected future tax consequences of such positions presuming the taxing authorities full knowledge of the position and all relevant facts, but without considering time values. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation process, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement. The Company adopted this standard in the first quarter of fiscal 2008 and the impact of the adoption of FIN 48 is disclosed in Note 5.

Recent accounting pronouncements

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* which permits entities to choose to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the effect that the adoption of SFAS 159 will have on its consolidated financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* SFAS No. 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. The changes to current practice resulting from the application of this Statement relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. The Company will be required to adopt the provisions of SFAS

No. 157 beginning with its fiscal quarter ending June 30, 2008. The Company is currently evaluating the impact of the adoption of SFAS No. 157, but we do not currently believe its adoption will have a material impact on our consolidated financial position, results of operations or cash flows.

NOTE 2 NET INCOME PER COMMON SHARE

The Company applies the provisions of EITF Issue No. 03-6, *Participating Securities and the Two Class Method under FASB Statement 128* (EITF No. 03-6), which established standards regarding the computation of earnings per share by companies with participating securities or multiple classes of common stock. The Company s Series A through E redeemable convertible preferred stock, which were converted into common stock immediately prior to the closing of the initial public offering of the Company s common stock, were participating securities due to their participation rights related to cash dividends declared by the Company.

Basic net income available to common stockholders per share is computed by dividing the net income available to common stockholders by the weighted-average common shares outstanding for the three months and six months ended September 30, 2007 and 2006, respectively. The net income available to common stockholders is calculated by deducting dividends allocable to the Company s redeemable convertible preferred stock from net income to determine the net income available to common stockholders.

Diluted net income available to common stockholders per share is computed giving effect to all potentially dilutive common stock, including options and common stock subject to repurchase using the treasury stock method, and all convertible securities using the if-converted method to the extent they are dilutive.

The following table sets forth the computation of basic and diluted net income attributable to common stockholders per share:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2007	2006	2007	2006
	(In thousands, except per share amounts)		(In thousands, except per share amounts)	
Numerators:				
Net income	$ 1,249	$ 2,387	$ 2,303	$ 4,497
Net income allocated to participating redeemable convertible preferred stockholders		225	5	450
Net income available to common stockholders Basic	$ 1,249	$ 2,162	$ 2,298	$ 4,047
Net income allocated to participating redeemable convertible preferred stockholders		225	5	450
Net income available to common stockholders Diluted	$ 1,249	$ 2,387	$ 2,303	$ 4,497
Denominators:				
Weighted average common shares outstanding	27,616	6,250	27,376	6,216
Weighted average shares Basic	27,616	6,250	27,376	6,216
Dilutive effect of employee stock options	1,057	1,584	1,245	1,505
		15,120	164	15,120

Dilutive effect of redeemable convertible preferred shares				
Weighted average shares Dilutive	28,673	22,954	28,785	22,841
Net income per common share Basic	$ 0.05	$ 0.35	$ 0.08	$ 0.65
Net income per common share Diluted	$ 0.04	$ 0.10	$ 0.08	$ 0.20

The following outstanding redeemable convertible preferred stock and common stock options determined on a weighted average basis were excluded from the computation of diluted net income per share as they had an anti-dilutive effect:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Redeemable convertible preferred stock			1	
Stock options	2,543	197	2,168	939
	2,543	197	2,169	939

NOTE 3 BALANCE SHEET DETAIL

The following table summarizes the Company s available-for-sale investments:

	September 30, 2007			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Short-term investments				
Auction rate securities	$ 12,625	$	$	$ 12,625
State and municipal obligations	25,460	8		25,468
Certificates of deposit	1,000			1,000
Total short-term investments	$ 39,085	$ 8	$	$ 39,093

	March 31, 2007			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Short-term investments				
Auction rate securities	$ 4,000	$	$	$ 4,000
Total short-term investments	$ 4,000	$	$	$ 4,000

At March 31, 2007, restricted cash consisted of certificates of deposit totaling $1,000,000 held with a financial institution as collateral for the Company s line of credit. On May 9, 2007, the line of credit was not renewed and this cash is no longer restricted.

The Company classifies its short-term investments as available for sale as they are intended to be available for use in current operations.

	September 30, 2007	March 31, 2007
	(In thousands)	
Inventories:		
Work-in-progress	$ 8,157	$ 14,009
Finished goods	7,972	8,893
Inventory at distributors	1,377	1,307
	$ 17,506	$ 24,209

	September 30, 2007	March 31, 2007
	(In thousands)	
Accounts receivable, net:		
Accounts receivable	$ 6,668	$ 6,505
Less: Allowances for sales returns and doubtful accounts	(165)	(108)
	$ 6,503	$ 6,397

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		September 30, 2007		March 31, 2007
		(In thousands)		
Prepaid expenses and other current assets:				
Prepaid tooling and masks	$	619	$	1,073
Prepaid initial public offering costs				1,197
Other prepaid expenses		1,372		935
	$	1,991	$	3,205
Property and equipment, net:				
Computer and other equipment	$	8,149	$	8,078
Software		2,872		2,353
Furniture and fixtures		228		228
Leasehold improvements		286		286
		11,535		10,945
Less: Accumulated depreciation and amortization		(6,755)		(6,200)
	$	4,780	$	4,745

Depreciation and amortization expense was $289,000 and $210,000, respectively, for the three months ended September 30, 2007 and 2006 and $556,000 and $421,000, respectively, for the six months ended September 30, 2007 and 2006.

		September 30, 2007		March 31, 2007
		(In thousands)		
Other Assets:				
Non-current deferred income taxes	$	970	$	901
Deposits		96		94
	$	1,066	$	995

		September 30, 2007		March 31, 2007
		(In thousands)		
Accrued expenses and other liabilities:				
Accrued compensation	$	446	$	373
Accrued professional fees		171		100
Accrued commissions		282		340
Accrued royalties		46		20
Accrued income taxes		93		227
Accrued equipment and software costs				1,161
Other accrued expenses		319		382
	$	1,357	$	2,603

NOTE 4 RELATED PARTY TRANSACTIONS

HolyStone Enterprises Co. Ltd., its subsidiaries, and its Chief Executive Officer, together held approximately 11% of the outstanding shares of the Company s common stock at September 30, 2007. Holystone s Chief Executive Officer was a director of the Company through August 28, 2007. The Company recorded net revenues of $217,000 and $839,000, respectively, from HolyStone Enterprises Co. Ltd. during the three months ended September 30, 2007 and 2006 and $516,000 and $1,177,000, respectively, for the six months ended September 30, 2007 and 2006.

The Company had a receivable balance of $202,000 and $1,155,000 from HolyStone Enterprises Co. Ltd. at September 30, 2007 and March 31, 2007, respectively.

NOTE 5 INCOME TAXES

Effective April 1, 2007, the Company adopted the provisions of FIN 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*. FIN 48 utilizes a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes.*

The adoption of FIN 48 did not have a material effect on the Company s consolidated results of operations or financial position. The total amount of gross unrecognized tax benefits as of the date of adoption was $303,000 of which $276,000, if recognized, would affect the Company s effective tax rate. The Company historically classified unrecognized tax benefits in current taxes payable. As a result of adoption of FIN 48, $284,000 of unrecognized tax benefits were classified to long-term income taxes payable. Interest and penalties related to uncertain tax positions accrued as of the date of adoption of FIN 48 were approximately $45,000. The current portion of the Company s unrecognized tax benefits at September 30, 2007 was $20,000 which is expected to be resolved in the next twelve months. The long term portion at September 30, 2007 was $306,000, of which the timing of the resolution is uncertain.

The Company s policy is to include interest and penalties related to unrecognized tax benefits within the provision for income taxes in the Condensed Consolidated Statements of Operations. This policy did not change as a result of the implementation of FIN 48.

The Company is subject to taxation in the US and various state and foreign jurisdictions. The fiscal years 2004 to 2007 remain open to examination by the federal and most state tax authorities.

The Company s effective income tax rate was approximately 32.6% for the three and six months ended September 30, 2007 and the effective income tax rate was approximately 33.2% for the three and six months ended September 30, 2006. Primary differences between the effective income tax rate and the applicable statutory U.S. income tax rate in each period are tax credits, foreign tax rate differentials and tax free interest income offset by stock-based compensation expense.

NOTE 6 BORROWINGS

At March 31, 2007, the Company had a line of credit with Mega International Commercial Bank Co., Ltd., which expired on May 9, 2007. The line of credit was not renewed.

NOTE 7 COMMITMENTS AND CONTINGENCIES

Indemnification obligations

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

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

Product warranties

The Company warrants its products to be free of defects generally for a period of three years. The Company estimates its warranty costs based on historical warranty claim experience and includes such costs in cost of revenues. Warranty costs were not significant for the three months and six months ended September 30, 2007 and 2006.

Legal proceedings

From time to time, the Company may be involved in litigation relating to claims arising out of day-to-day operations. See Note 13 for a description of certain litigation.

NOTE 8 REDEEMABLE CONVERTIBLE PREFERRED STOCK

Redeemable convertible preferred stock at March 31, 2007 consisted of the following:

	Shares Issued and Outstanding	Liquidation Amount
	(In thousands, except share data)	
Series A	4,350,000	$ 870
Series B	7,260,000	2,722
Series C	253,500	254
Series D	3,136,668	4,705
Series E	120,000	456
	15,120,168	$ 9,007

On April 3, 2007, all shares of redeemable convertible preferred stock were converted into common stock immediately prior to the closing of the initial public offering of the Company s common stock.

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NOTE 9 COMMON STOCK

The Company s Certificate of Incorporation, as amended, authorizes the Company to issue 150,000,000 shares of $0.001 par value common stock. The Company s initial public offering of common stock closed on April 3, 2007. The Company issued 6,131,111 shares of common stock at an initial public offering price of $5.50, for an aggregate offering price of $33.7 million. Net proceeds to the Company after an underwriting discount of $2.4 million and offering expenses of $1.3 million were $30.0 million.

NOTE 10 STOCK OPTION PLANS

As of September 30, 2007, 2,736,614 shares of common stock were available for grant under the Company s 2007 Equity Incentive Plan.

The following table summarizes the Company s stock option activities for the six months ended September 30, 2007:

	Number of Options Outstanding	Weighted Average Remaining Contractual Life (Years)		Weighted Average Exercise Price		Intrinsic Value
Options outstanding as of March 31, 2007	4,312,419		$	3.57		
Granted	264,186		$	4.01		
Exercised	(21,125)		$	0.25	$	86,441
Forfeited	(24,175)		$	5.32		
Options outstanding as of September 30, 2007	4,531,305	5.58	$	3.60	$	1,995,134
Options exercisable as of September 30, 2007	3,139,219	4.08	$	2.94	$	1,995,134
Options vested and expected to vest	4,397,329	5.48	$	3.55	$	1,995,134

The weighted average fair value of options granted during the three months ended September 30, 2007 and 2006 was $1.44 and $3.25, respectively, and for the six months ended September 30, 2007 and 2006 was $1.58 and $3.25, respectively.

Options outstanding by exercise price at September 30, 2007 were as follows:

	Options Outstanding			Options Exercisable	
Exercise Price	**Number Outstanding**	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Life (Years)**	**Number Vested and Exercisable**	**Weighted Average Exercise Price**
$ 0.04-0.15	460,500	$ 0.14	1.51	460,500	$ 0.14
$ 2.00	777,927	$ 2.00	2.52	777,927	$ 2.00
$ 2.10	679,717	$ 2.10	5.79	679,717	$ 2.10
$ 3.50-4.00	467,914	$ 3.74	6.36	259,902	$ 3.79
$ 4.20-4.70	262,398	$ 4.33	8.87	45,700	$ 4.51
$ 5.40	673,880	$ 5.40	3.62	673,880	$ 5.40
$ 5.50	999,769	$ 5.50	9.13	187,793	$ 5.50
$ 5.75	155,200	$ 5.75	8.93	38,800	$ 5.75
$ 6.00	20,000	$ 6.00	6.50	15,000	$ 6.00
$ 6.70	34,000	$ 6.70	9.28		
	4,531,305			3,139,219	

Stock-based compensation

The following table summarizes stock-based compensation expense by line item in the Condensed Consolidated Statements of Operations, all relating to stock options:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Cost of revenues	$ 70	$ 19	$ 155	$ 41
Research and development	122	48	250	96
Selling, general and administrative	182	45	356	81
Total	$ 374	$ 112	$ 761	$ 218

As stock-based compensation expense recognized in the Condensed Consolidated Statement of Operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures in accordance with the provisions of SFAS 123R. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company recognized related income tax benefits of $37,000 and $3,000, respectively, for the three months ended September 30, 2007 and 2006 and $67,000 and $5,000, respectively, for the six months ended September 30, 2007 and 2006. There were no windfall tax benefits realized from exercised stock options during either period. Compensation cost capitalized within inventory at September 30, 2007 was insignificant. As of September 30, 2007, the Company s total unrecognized compensation cost was $2.4 million, which will be recognized over the weighted average period of 2.15 years. The Company calculated the fair value of each option grant in the periods presented using the Black-Scholes option pricing model and the following weighted average assumptions:

	Three Months Ended September 30, 2007	Six Months Ended September 30,	
		2007	2006
Risk-free interest rate	4.46%	4.46 4.76%	4.86%
Expected life (in years)	4.00	4.00	4.00
Volatility	41.6%	41.6 43.8%	71.2%
Dividend yield	0%	0%	0%

There were no options granted in the three months ended June 30, 2006.

NOTE 11 COMPREHENSIVE INCOME

The Company s comprehensive income for the three months and six months ended September 30, 2007 and 2006, respectively, was as follows:

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Six Months Ended September 30, 2007	Six Months Ended September 30, 2006
	(In thousands)		(In thousands)	
Net income	$ 1,249	$ 2,387	$ 2,303	$ 4,497
Unrealized gain on marketable securities, net	35		8	
Comprehensive income	$ 1,284	$ 2,387	$ 2,311	$ 4,497

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NOTE 12 SEGMENT AND GEOGRAPHIC INFORMATION

The Company has adopted Statement of Financial Accounting Standards No. 131, *Disclosure about Segments of an Enterprise and Related Information.* Based on its operating management and financial reporting structure, the Company has determined that it has one reportable business segment: the design, development and sale of integrated circuits.

The following is a summary of net revenue by geographic area based on the location to which product is shipped:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
United States	$ 5,908	$ 7,196	$ 11,891	$ 14,336
China	1,900	1,530	3,396	3,019
Malaysia	2,605	3,149	4,352	5,932
Rest of the world	2,259	3,081	4,338	5,642
	$ 12,672	$ 14,956	$ 23,977	$ 28,929

All sales are denominated in United States dollars.

NOTE 13 LITIGATION

On October 23, 2006, the Company was served with a civil antitrust complaint filed by Reclaim Center, Inc. and other plaintiffs in the United States District Court for the Northern District of California against the Company and a number of other semiconductor companies. The complaint was filed on behalf of a purported class of indirect purchasers of SRAM products throughout the United States. The complaint alleges that the defendants conspired to raise the price of SRAM in violation of Section 1 of the Sherman Act, the California Cartwright Act, and several other state antitrust, unfair competition and consumer protection statutes. Shortly thereafter, a number of similar complaints were filed by other plaintiffs in various jurisdictions on behalf of purported classes of both direct and indirect purchasers. The Company has been served in some but not all of these subsequent actions. Many of these cases have been transferred by the Judicial Panel on Multidistrict Litigation to the Northern District of California. The Company has also been named in similar class action lawsuits in the Superior Court of Ontario, Canada and the Supreme Court of British Columbia, Canada. On July 23, 2007, the Company entered into agreements with the lead plaintiffs for the direct and indirect classes in the U.S. cases under which the Company was voluntarily dismissed from the litigation in exchange for a tolling of the statute of limitations. The plaintiffs have the right to terminate the tolling agreement and reassert their claims against the Company in the future. The tolling agreement does not involve the lawsuits in Canada, which remain pending. The Company believes that it has meritorious defenses to the allegations in the complaints, including the complaints that remain pending in Canada, and the Company intends to defend these lawsuits vigorously. However, the litigation is in the preliminary stage, and the litigation process is inherently uncertain. Given the early stage of these cases, the Company cannot predict their outcome or provide an estimate of any possible losses, therefore no amounts have been accrued for this litigation as of September 30, 2007. Antitrust litigation is particularly complex and can extend for a protracted time which can substantially increase the cost of such litigation. The defense of these lawsuits is also expected to divert the efforts and attention of some of the Company s key management and technical personnel. As a result, the Company s defense of this litigation, regardless of its eventual outcome, will likely be costly and time consuming. Should the outcome of the litigation be adverse to the Company, it could be required to pay significant monetary damages which could adversely affect the Company s business, financial condition, operating results or cash flows.

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

This Quarterly Report on Form 10-Q, and in particular the following Management s Discussion and Analysis of Financial Condition and Results of Operations, includes 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 (the Exchange Act). These forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as anticipates, believes, expects, intends, may, will, and other similar expressions. In addition, any statements which refer to expectations, projections, or other characterizations of future events, or circumstances, are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth in this report under Risk Factors, those described elsewhere in this report, and those described in our other reports filed with the Securities and Exchange Commission (SEC). We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to update these forward-looking statements after the filing of this report. You are urged to review carefully and consider our various disclosures in this report and in our other reports publicly disclosed or filed with the SEC that attempt to advise you of the risks and factors that may affect our business.

Overview

We are a fabless semiconductor company that designs, develops and markets Very Fast static random access memories, or SRAMs, primarily for the networking and telecommunications markets. We are subject to the highly cyclical nature of the semiconductor industry, which has experienced significant fluctuations, often in connection with fluctuations in demand for the products in which semiconductor devices are used. Beginning in fiscal 2001, the networking and telecommunications markets experienced an extended period of severe contraction, during which our operating results sharply declined. Between fiscal 2004 and fiscal 2006, demand for networking and telecommunications equipment recovered. During the first three quarters of fiscal 2007, demand for such equipment accelerated and, as a result, our operating results improved. In the fourth quarter of fiscal 2007 and the first quarter of fiscal 2008, revenues again declined due, in part, to the implementation of a lean manufacturing program by our largest customer, Cisco Systems.

Revenues. Our revenues are derived primarily from sales of our Very Fast SRAM products. Sales to networking and telecommunications OEMs accounted for 70% to 80% of our net revenues during our last three fiscal years. We also sell our products to OEMs that manufacture products for defense applications such as radar and guidance systems, for professional audio applications such as sound mixing systems, for test and measurement applications such as high-speed testers, for automotive applications such as smart cruise control and voice recognition systems, and for medical applications such as ultrasound and CAT scan equipment.

We sell our products through our direct sales force, international and domestic sales representatives and distributors. Revenues from product sales, except for sales to distributors, are generally recognized upon shipment, net of sales returns and allowances. Sales to consignment warehouses, who purchase products from us for use by contract manufacturers, are recorded upon delivery to the contract manufacturer. Sales to distributors are recorded as deferred revenues for financial reporting purposes and recognized as revenues when the products are resold by the distributors to the OEM.

Cisco Systems, our largest OEM customer, purchases our products primarily through its consignment warehouse, SMART Modular Technologies, and also purchases some products through its contract manufacturers and directly from us. Historically, purchases by Cisco Systems have fluctuated from period to period. Based on information provided to us by Cisco Systems consignment warehouse and contract manufacturers, purchases by Cisco Systems represented approximately 30%, 28% and 34% of our net revenues in fiscal 2007, 2006 and 2005, respectively. Purchases by Cisco Systems consignment warehouse and contract manufacturers were 29% of our net revenues for each of the three months ended September 30, 2007 and 2006, and 28% and 30% for the six months ended September 30, 2007 and 2006, respectively. During the quarter ended March 31, 2007, Cisco Systems announced the implementation of a lean manufacturing program under which it reduced the levels of inventory carried by it and by its contract manufacturers. The transition to this new program resulted in reductions in purchases of our products by Cisco Systems contract manufacturers during the quarter ended March 31, 2007, as they drew down existing inventories. This transition continued to impact our revenues in the quarter ended June 30, 2007. Purchases by Cisco Systems contract manufacturers increased in the quarter ended September 30, 2007 compared to the prior two quarters, but were still less than the levels achieved in each of the three quarters ended December 31, 2006.

Cost of Revenues. Our cost of revenues consists primarily of wafer fabrication costs, wafer sort, assembly, test and burn-in expenses, the amortized cost of production mask sets, stock-based compensation and the cost of materials and overhead from operations. All of our wafer manufacturing and assembly operations, and most of our product testing operations, are outsourced. Accordingly, most of our cost of revenues consists of payments to Taiwan Semiconductor Manufacturing Company, or TSMC, our independent wafer foundry, and to our independent assembly and test houses. Cost of revenues also includes expenses related to supply chain management, quality assurance, and final product testing and documentation control activities conducted at our headquarters in Santa Clara, California and our branch operations in Taiwan.

Gross Profit. Our gross profit margins vary among our products and are generally greater on our higher density products and, within a particular density, greater on our higher speed and industrial temperature products. We expect that our overall gross margins will fluctuate from period to period as a result of shifts in product mix, changes in average selling prices and our ability to control our cost of revenues, including costs associated with outsourced wafer fabrication and product assembly and testing.

Research and Development Expenses. Research and development expenses consist primarily of salaries and related expenses for design engineers and other technical personnel, the cost of developing prototypes, stock-based compensation and fees paid to consultants. We charge all research and development expenses to operations as incurred. We charge mask costs used in production to costs of revenues over a 12-month period. However, we charge costs related to pre-production mask sets, which are not used in production, to research and development expenses at the time they are incurred. These charges often arise as we transition to new process technologies and, accordingly, can cause research and development expenses to fluctuate on a quarterly basis. We believe that continued investment in research and development is critical to our long-term success, and we expect to continue to devote significant resources to product development activities. Accordingly, we expect that our research and development expenses will increase in future periods, although such expenses as a percentage of net revenues may fluctuate.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of commissions paid to independent sales representatives, salaries, stock-based compensation and related expenses for personnel engaged in sales, marketing, administrative, finance and human resources activities, professional fees, costs associated with the promotion of our products and other corporate expenses. We expect that our sales and marketing expenses will increase in absolute dollars in future periods as we continue to grow and expand our sales force but that, to the extent our revenues increase in future periods, these expenses will generally decline as a percentage of net revenues. We also expect that, in support of our continued growth and our operations as a public company, general and administrative expenses will continue to increase in absolute dollars for the foreseeable future but will fluctuate as a percentage of net revenues.

Results of Operations

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

	Three Months Ended September 30,		**Six Months Ended September 30,**	
	2007	**2006**	**2007**	**2006**
Net revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	63.8	60.5	62.4	60.3
Gross profit	36.2	39.5	37.6	39.7
Operating expenses:				
Research and development	8.6	7.7	9.2	8.5
Selling, general and administrative	16.7	9.2	18.0	9.3
Total operating expenses	25.3	16.9	27.2	17.8
Income from operations	10.9	22.6	10.4	21.9
Interest and other income (expense), net	3.7	1.3	3.9	1.3
Income before income taxes	14.6	23.9	14.3	23.2
Provision for income taxes	4.7	7.9	4.7	7.7
Net income	9.9%	16.0%	9.6%	15.5%

Net Revenues. Net revenues decreased by 15.3% from $15.0 million in the three months ended September 30, 2006 to $12.7 million in the three months ended September 30, 2007. Net revenues decreased by 17.1% from $28.9 million in the six months ended September 30, 2006 to $24.0 million in the six months ended September 30, 2007. These reductions in net revenues were principally due to overall weakness in the telecommunications segment of the network equipment market resulting in decreased orders from our distributors as they, and a number of our OEM customers who buy from them, adjusted their purchasing based on their own inventory levels. In addition, direct and indirect sales to Cisco Systems, our largest customer, were down approximately 24% in the six months ended September 30, 2007 compared to the six months ended September 30, 2006 due, in part, to the continued impact of the implementation of its lean manufacturing program, described above. During the current six month period, Cisco Systems contract manufacturers further curtailed their purchases of our products as they continued to work against their existing inventories. Although sales for Cisco Systems related business increased in the quarter ending September 30, 2007 compared to the quarter ended June 30, 2007, they were still less than the levels achieved in each of the three quarters ended December 31, 2006.

Cost of Revenues. Cost of revenues decreased by 10.6% from $9.0 million in the three months ended September 30, 2006 to $8.1 million in the three months ended September 30, 2007 and by 14.2% from $17.4 million in the six months ended September 30, 2006 to $15.0 million in the six months ended September 30, 2007. These decreases were due to the decreases in net revenues. Cost of revenues included stock-based compensation of $70,000 and $19,000, respectively, for the three months ended September 30, 2007 and 2006 and $155,000 and $41,000, respectively, for six months ended September 30, 2007 and 2006.

Gross Profit. Gross profit decreased by 22.4% from $5.9 million in the three months ended September 30, 2006