

QUICKLOGIC CORPORATION  
Form 10-Q  
November 06, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**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 28, 2008

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

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**QUICKLOGIC CORPORATION**

(Exact name of registrant as specified in its charter)

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**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 is a large accelerated filer, an accelerated filer, 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

Smaller reporting Company

(Do not check if a 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 3, 2008, 29,782,785 shares of the registrant's common stock were outstanding.

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## QUICKLOGIC CORPORATION

## FORM 10-Q

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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 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
Revenue	\$ 6,230	\$ 9,025	\$ 25,996	\$ 23,672
Cost of revenue	2,778	4,314	12,018	13,690
Long-lived asset impairment			1,545	
Gross profit	3,452	4,711	12,433	9,982
Operating expenses:				
Research and development	1,354	2,342	6,785	6,968
Selling, general and administrative	2,666	3,953	10,956	12,933
Long-lived asset impairment			468	
Restructuring costs			452	
Loss from operations	(568)	(1,584)	(6,228)	(9,919)
Write-down of investment in Tower Semiconductor Ltd.			(417)	
Interest expense	(59)	(69)	(202)	(226)
Interest income and other, net	(46)	189	88	752
Loss before income taxes	(673)	(1,464)	(6,759)	(9,393)
Provision for (benefit from) income taxes	(58)	29	(24)	71
Net loss	\$ (615)	\$ (1,493)	\$ (6,735)	\$ (9,464)
Net loss per share:				
Basic	\$ (0.02)	\$ (0.05)	\$ (0.23)	\$ (0.33)
Diluted	\$ (0.02)	\$ (0.05)	\$ (0.23)	\$ (0.33)
Weighted average shares:				
Basic and diluted	29,772	29,116	29,589	28,966

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

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**QUICKLOGIC CORPORATION**  
**CONDENSED UNAUDITED CONSOLIDATED BALANCE SHEETS**

(in thousands, except par value amount)

	September 28, 2008	December 30, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 18,833	\$ 20,868
Short-term investment in Tower Semiconductor Ltd.	519	1,279
Accounts receivable, net	2,279	2,634
Inventories	2,457	5,770
Other current assets	919	1,607
Total current assets	25,007	32,158
Property and equipment, net	4,013	5,877
Investment in Tower Semiconductor Ltd.	261	644
Other assets	1,027	2,745
<b>TOTAL ASSETS</b>	<b>\$ 30,308</b>	<b>\$ 41,424</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Revolving line of credit	\$ 2,000	\$
Trade payables	1,453	4,207
Accrued liabilities	2,009	2,228
Deferred revenue less cost of revenue	239	516
Deferred royalty revenue		431
Current portion of debt and capital lease obligations	764	2,497
Total current liabilities	6,465	9,879
Long-term liabilities:		
Debt and capital lease obligations, less current portion	186	2,527
Total liabilities	6,651	12,406
Commitments and contingencies (see Note 15) and litigation (see Note 16)		
Stockholders' equity:		
Common stock, \$0.001 par value; 100,000 shares authorized; 29,783 and 29,390 shares issued and outstanding, respectively	30	29
Additional paid-in capital	169,397	167,298
Accumulated other comprehensive income (loss)	(376)	350
Accumulated deficit	(145,394)	(138,659)
Total stockholders' equity	23,657	29,018
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 30,308</b>	<b>\$ 41,424</b>

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.



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## QUICKLOGIC CORPORATION

## CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended	
	September 28, 2008	September 30, 2007
Cash flows from operating activities:		
Net loss	\$ (6,735)	\$ (9,464)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	1,717	2,292
Gain on sale of equipment		(95)
Write-off of long-lived assets	45	7
Stock-based compensation	1,971	1,261
Decrease in wafer credits from Tower Semiconductor Ltd.	254	681
Write-down of inventories	1,331	3,533
Long-lived asset impairment	2,013	
Write-down of marketable securities	417	
Bad debt expense	44	163
Changes in assets and liabilities:		
Accounts receivable	311	93
Inventories	1,982	693
Other assets	725	714
Trade payables	(2,697)	(1,965)
Accrued liabilities	(219)	182
Deferred income and royalty revenue	(708)	(405)
Net cash provided by (used for) operating activities	451	(2,310)
Cash flows from investing activities:		
Capital expenditures for property and equipment	(541)	(1,021)
Proceeds from sale of equipment		95
Net cash used for investing activities	(541)	(926)
Cash flows from financing activities:		
Payment of debt and capital lease obligations	(4,074)	(1,896)
Proceeds from debt obligations		442
Proceeds from issuance of common stock	129	915
Proceeds from revolving line of credit	2,000	
Net cash used for financing activities	(1,945)	(539)
Net decrease in cash and cash equivalents	(2,035)	(3,775)
Cash and cash equivalents at beginning of period	20,868	24,621
Cash and cash equivalents at end of period	\$ 18,833	\$ 20,846
Supplemental disclosures of cash flow information:		
Interest paid	\$ 210	\$ 245
Income taxes paid	\$ 9	\$ 132

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.





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**QUICKLOGIC CORPORATION**  
**CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

(in thousands)

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
Net loss	\$ (615)	\$ (1,493)	\$ (6,735)	\$ (9,464)
Other comprehensive loss, net of tax:				
Unrealized gain (loss) on available-for-sale investments	(376)	484	(726)	108
Total comprehensive loss	\$ (991)	\$ (1,009)	\$ (7,461)	\$ (9,356)

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

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**QUICKLOGIC CORPORATION**

**NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 The Company and Basis of Presentation**

QuickLogic Corporation ( 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 features 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 ( CSSPs ), Field Programmable Gate Arrays ( 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 ( 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 Annual Report on Form 10-K for the year ended December 30, 2007. Operating results for the three and nine months ended September 28, 2008 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 2008 and 2007 ended Sunday, September 28, 2008 and September 30, 2007, respectively.

*Liquidity*

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, the conversion of design opportunities into revenue, market acceptance of existing and new products including CSSPs based on our ArcticLink and PolarPr® 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. ( 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.

*Uses of Estimates*

The preparation of these consolidated financial statements in conformity with 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, fair value measurements of financial assets and liabilities, accounting for income taxes and estimating accrued liabilities.

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**QUICKLOGIC CORPORATION**

**NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2 Significant Accounting Policies**

There have been no material changes in the Company's significant accounting policies for the nine months ended September 28, 2008 from its disclosure in the Annual Report on Form 10-K for the year ended December 30, 2007, 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 30, 2007 filed with the Securities Exchange Commission ( SEC ) on March 11, 2008.

*Long-Lived Assets*

The Company reviews the recoverability of its long-lived assets, such as property and equipment, prepaid wafer credits and investments, annually and when events or changes in circumstances occur that indicate that the carrying value of the asset or asset group may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows, undiscounted and without interest charges, of the related operations. If these cash flows are less than the carrying value of the asset or asset group, an impairment loss is recognized for the difference between the estimated fair value and the carrying value, and the carrying value of the related assets is reduced by this difference. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets. The Company recorded \$2.0 million of long-lived asset impairment charges in the second quarter of 2008. See Note 12.

*Fair Value*

Effective December 31, 2007, the Company adopted the provisions of SFAS No. 157, *Fair Value Measurements*, ( SFAS 157 ) and SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, ( SFAS 159 ). SFAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. See Note 8.

*Recently Issued Accounting Pronouncements*

In October 2008, the Financial Accounting Standards Board ( FASB ) issued FSP No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, FSP No. 157-3 clarifies the application of SFAS No. 157, which the Company adopted as of December 31, 2007, in cases where a market is not active. The Company has considered FSB No. 157-3 in its determination of estimated fair values as of September 28, 2008, and the impact was not significant.

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In May 2008, FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, ( SFAS 162 ). This standard reorganizes the GAAP hierarchy in order to improve financial reporting by providing a consistent framework for determining what accounting principles should be used when preparing U.S. GAAP financial statements. SFAS 162 shall be effective 60 days after the SEC's approval of the Public Company Accounting Oversight Board's amendments to Interim Auditing Standard, AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The Company is currently evaluating the impact SFAS 162 will have on its consolidated financial statements.

In April 2008, FASB issued FASB Staff Position ( FSP ) SFAS No. 142-3, *Determination of the Useful Life of Intangible Assets*, ( FSP FAS 142-3 ). FSP FAS 142-3 amends the list of factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under SFAS No. 142, *Goodwill and Other Intangible Assets*, ( SFAS 142 ). The intent of FSP FAS 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141, *Business Combinations*. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. The Company is currently evaluating the impact FSP FAS 142-3 will have on its consolidated financial statements.

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**QUICKLOGIC CORPORATION**

**NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**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 is 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 third quarter and first nine months of 2008 and 2007, approximately 7.3 million and 7.8 million shares, respectively, associated with stock-based awards outstanding and the estimated number of shares to be purchased under the offering period of the ESPP 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 this period.

**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 a portion of the Tower ordinary shares in fiscal year 2003.

During the second quarter of 2008, the Company wrote down the value of its investment in Tower shares by \$417,000 due to an other than temporary decline in market value, to a carrying value of \$0.86 per share. This determination included factors such as market value and the period of time that the market value had been below the carrying value. The Company also wrote down the Tower shares in periods prior to 2006 as a result of other than temporary declines in their market value. During the third quarter of 2008, the market value of Tower ordinary shares declined to \$0.58 per share, and the resulting \$376,000 reduction in value of the Company's investment in Tower was reflected in accumulated other comprehensive loss on the unaudited consolidated balance sheet. The market value of Tower ordinary shares was \$0.22 per share on October 31, 2008. If the value per share remains below \$0.86 at the end of our fiscal fourth quarter, we may incur a charge for the other than temporary decline in market value since June 28, 2008.

Pursuant to SFAS 157, the fair value of the Company's marketable securities as of September 28, 2008 was determined based on Level 1 inputs as described in Note 8. As of September 28, 2008, the Company held 1,344,543 available-for-sale Tower ordinary shares. 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 unaudited consolidated balance sheets. The remaining 894,543 shares are classified as a short-term investment on the unaudited consolidated balance sheets.

The Company also received \$4.7 million in prepaid wafer credits in partial consideration for the investment. As of September 28, 2008, the prepaid wafer credit balance was \$951,000 and these credits were recorded within long-term other assets on the unaudited consolidated balance sheets. Tower has guaranteed the Company capacity at Tower through at least 2010 and the credits can be applied toward wafer purchases from Tower at 15% of the value of purchases made through 2010.

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## QUICKLOGIC CORPORATION

## NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 5 Balance Sheet Components

	September 28, 2008	December 30, 2007
	(in thousands)	
Inventories:		
Raw materials	\$ 75	\$ 199
Work-in-process	2,052	4,714
Finished goods	330	857
	\$ 2,457	\$ 5,770
Other current assets:		
Prepaid expenses	\$ 747	\$ 1,371
Other	172	236
	\$ 919	\$ 1,607
Property and equipment:		
Equipment	\$ 13,893	\$ 14,979
Software	8,072	9,303
Furniture and fixtures	840	823
Leasehold improvements	800	803
	23,605	25,908
Accumulated depreciation and amortization	(19,592)	(20,031)
	\$ 4,013	\$ 5,877
Other assets:		
Prepaid wafer credits	\$ 951	\$ 2,551
Other	76	194
	\$ 1,027	\$ 2,745
Accrued liabilities:		
Employee related accruals	\$ 1,284	\$ 1,452
Other	725	776
	\$ 2,009	\$ 2,228



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## QUICKLOGIC CORPORATION

## NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Note 6 Obligations**

	September 28, 2008	December 30, 2007
	(in thousands)	
Debt and capital lease obligations:		
Revolving line of credit	\$ 2,000	\$
Notes payable to bank		3,278
Capital leases	950	1,746
	2,950	5,024
Current portion of debt and capital lease obligations	(2,764)	(2,497)
	\$ 186	\$ 2,527

*Revolving Line of Credit and Notes Payable to Bank*

Effective 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. 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%. During the third quarter of 2008, the Company repaid notes payable of \$2,514,000 and borrowed \$2,000,000 of revolving debt through a prime rate plus one percent advance under its revolving line of credit (6% as of September 28, 2008).

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.

At September 28, 2008, the prime rate under the credit facility was 5.00%. As of September 28, 2008 and December 30, 2007, zero and \$1.8 million, respectively, of amounts outstanding under the equipment line of credit were classified as long-term obligations.

*Capital Leases*

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In December 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, prepaid maintenance of \$256,000 and a capital lease obligation of \$1.4 million. In the second quarter of 2008, the Company decided to outsource its physical silicon design activity. As a result of this decision, the Company determined that a portion of the capital asset was unutilized. As a result, the Company recorded a long-lived asset impairment of \$468,000 for the unutilized portion. See Note 12. As of September 28, 2008, \$901,000 was outstanding under the capital lease, \$186,000 of which was classified as a long-term obligation.

In the fourth quarter of 2006, the Company entered into a capital lease obligation in the amount of \$77,000 to finance design software. The capital lease obligation has an imputed interest rate of 9.25% per annum and is being repaid in annual amounts of \$28,000 through January 2009. As of September 28, 2008, \$49,000 was outstanding under the capital lease, zero of which was classified as a long-term obligation.

In January 2006, the Company leased design software tools and related maintenance under a three year capital lease at an imputed interest rate of 9.0% per annum. Terms of the agreement required the Company to make semi-annual payments of approximately \$148,000 through July 2008. The Company recorded a capital asset of \$633,000, prepaid maintenance of \$158,000 and a capital lease obligation of \$791,000. There was no outstanding balance under the capital lease as of September 28, 2008.

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**QUICKLOGIC CORPORATION**

**NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 7 Deferred Royalty Revenue**

In October 2000, the Company entered into a technology license and wafer supply agreement with Aeroflex Incorporated ( Aeroflex ). Under the terms of the agreement, the Company received \$750,000 of prepaid royalties. In addition, Aeroflex receives a prepaid royalty credit for a portion of the amounts paid for wafers purchased from the Company under the agreement. Prepaid royalties are recognized as revenue when Aeroflex reports the sale of products incorporating the licensed technology. As of September 28, 2008 and December 30, 2007, the Company had classified as a current liability zero and \$431,000, respectively, of deferred royalty revenue under this agreement. The Company recognized \$420,000 and \$520,000 of royalty revenue under the agreement in the first nine months of 2008 and 2007, respectively.

**Note 8 Fair Value Measurements**

In September 2006, the FASB issued SFAS 157. SFAS 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 SFAS 157 relate to the definition of fair value, the methods used to measure fair value and expanded disclosures about fair value measurements. In February 2008, the FASB issued FSP FAS No. 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Its Related Interpretive Accounting Pronouncements That Address Leasing Transactions*, ( FSP FAS 157-1 ) and FASB FSP FAS No. 157-2, *Effective Date of FASB Statement No.157*, ( FSP FAS 157-2 ). FSP FAS 157-1 removes leasing from the scope of SFAS 157. FSP FAS 157-2 delays the effective date of SFAS 157 from 2008 to 2009 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis in the consolidated financial statements.

Effective December 31, 2007, the Company adopted the provisions of SFAS 157 as amended by FSP FAS 157-1 and FSP FAS 157-2. The adoption of this standard in fiscal 2008 was limited to financial assets and liabilities. The adoption of SFAS 157 did not have a material effect on the Company's financial condition or results of operations. The Company is in the process of evaluating the impact of this standard with respect to the Company's nonfinancial assets and liabilities and the effect it will have on its consolidated financial statements.

SFAS 157 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.

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- 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 the end of the third quarter of 2008 consistent with the fair value hierarchy provisions of SFAS 157 (in thousands):

	Total		Level 1		Level 2		Level 3
<b>Assets:</b>							
Cash equivalents	\$ 16,256	\$	16,256	\$		\$	
Investment in Tower Semiconductor Ltd.	780		780				
Total assets	\$ 17,036	\$	17,036	\$		\$	

As of the end of the third quarter of 2008, the Company did not have any financial liabilities that are subject to the provisions of SFAS 157.

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**QUICKLOGIC CORPORATION**

**NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In February 2007, the FASB issued SFAS 159. SFAS 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007, although earlier adoption is permitted. Effective December 31, 2007, the Company adopted the provisions of SFAS 159. The adoption of SFAS 159 did not have an effect on the Company's financial condition or results of operations as it did not elect the fair value option.

**Note 9 Employee Stock Plans**

*1989 Stock Option Plan*

The 1989 Stock Option Plan (the 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 (the 1999 Plan) was adopted by the Board of Directors in August 1999 and was approved by the Company's stockholders in September 1999. As of September 28, 2008, approximately 16.3 million shares were reserved for issuance under the 1999 Plan. In addition, each January an annual increase is added to the 1999 Plan equal to the lesser of (i) 5,000,000 shares, (ii) 5% of the Company's outstanding shares on such date, or (iii) a lesser amount determined by the Board of Directors. Equity awards that are cancelled, forfeited or repurchased under the 1989 Plan also become available for grant under the 1999 Plan. 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. The Company has implemented a different vesting schedule in the past and 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 (ESPP) was adopted by the Board of Directors in August 1999 and was approved by the Company's stockholders in September 1999. As of September 28, 2008, approximately 7.2 million shares were reserved for issuance under the ESPP. In addition, each August an annual increase is added to the ESPP equal to the lesser of (i) 1,500,000 shares, (ii) 4% of the Company's outstanding shares on such date, or (iii) a lesser amount determined by the Board of Directors.

The ESPP, as amended, 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 amended 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.

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## QUICKLOGIC CORPORATION

## NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Note 10 Stock-Based Compensation**

The impact of SFAS 123(R) on the Company's consolidated financial statements for the third quarter and first nine months of 2008 and 2007 was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
Cost of revenue	\$ 49	\$ 67	\$ 220	\$ 176
Research and development	89	94	443	273
Selling, general and administrative	251	291	1,308	812
Total costs and expenses	\$ 389	\$ 452	\$ 1,971	\$ 1,261

The amount of stock-based compensation included in inventories as of September 28, 2008 and December 30, 2007 was not material.

*Valuation Assumptions*

SFAS 123(R) requires companies to estimate the fair value of stock-based compensation awards. The fair value of stock-based compensation awards is measured at the grant date and re-measured upon modification, as appropriate. The Company uses the Black-Scholes option pricing model to estimate the fair value of stock options and rights to purchase shares under the Company's ESPP, consistent with the provisions of SFAS 123(R). Using Black-Scholes requires the Company to develop highly subjective assumptions including the expected term of awards, expected volatility of its stock, expected risk-free interest rate and expected dividend rate over the term of the award. The Company's expected term of awards assumption is based primarily on its historical experience with similar grants. The Company's expected stock price volatility assumption for both stock options and ESPP shares is based on the historical volatility of the Company's stock, using the daily average of the opening and closing prices and measured using historical data appropriate for the expected life. The risk-free interest rate assumption approximates the risk-free interest rate of a Treasury Constant Maturity bond with a maturity approximately equal to the expected term of the stock option or ESPP shares. This fair value is expensed over the requisite service period of the award. The fair value of restricted stock awards (RSAs) and restricted stock units (RSUs) is based on the closing price of the Company's common stock on the date of grant. Equity compensation awards which vest with service are expensed using the straight-line attribution method over the requisite service period. RSU awards which are expected to vest based on the achievement of a performance goal are expensed over the estimated vesting period.

In addition to the assumptions used in Black-Scholes, SFAS 123(R) requires that the Company recognize expense for awards ultimately expected to vest; therefore we are required to develop an estimate of the number of awards expected to be forfeited prior to vesting (forfeiture rate). The forfeiture rate is estimated based on historical pre-vest cancellation experience and is applied to all share-based awards.

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

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
Expected term (years)	5.00	5.07	5.62	5.09
Risk-free interest rate	3.11%	4.51%	2.92%	4.62%
Expected volatility	50.68%	80.00%	52.68%	80.00%
Expected dividend				



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**QUICKLOGIC CORPORATION**

**NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The methodologies for determining the above values were as follows:

- *Expected term:* The expected term represents the period that the Company's stock-based awards are expected to be outstanding and is estimated based on historical experience.
- *Risk-free interest rate:* The risk-free interest rate assumption is based upon the risk-free rate of a Treasury Constant Maturity bond with a maturity appropriate for the expected term of the Company's employee stock options.
- *Expected volatility:* The expected volatility is based on historical volatility of the Company's common stock.
- *Expected dividend:* The expected dividend assumption is based on the Company's intent not to issue a dividend under its dividend policy.

The weighted average estimated fair value for options granted during third quarter of 2008 and 2007 was \$0.74 and \$2.35 per option, respectively. The weighted average estimated fair value for options granted during the first nine months of 2008 and 2007 was \$1.38 and \$2.10 per option, respectively. As of the end of the third quarter of 2008, 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 approximately 2.6 years.

*Stock-Based Compensation Award Activity*

The following table summarizes the shares available for grant under the 1989 Plan and the 1999 Plan for the first nine months of 2008:

	<b>Shares Available for Grant (in thousands)</b>
Balance at December 30, 2007	6,588
Authorized	1,470
Options granted	(248)

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Options forfeited or expired	1,195
RSAs granted	(8)
RSUs granted	(339)
RSUs withheld for employee tax withholdings	109
RSUs forfeited or expired	353
Balance at September 28, 2008	9,120

*Stock Options*

The following table summarizes stock options outstanding and stock option activity under the 1989 Plan and the 1999 Plan, and the related weighted average exercise price, for the first nine months of 2008:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Term (in years)	Aggregate Intrinsic Value (in thousands)
Balance outstanding at December 30, 2007	7,594	\$ 4.72		
Granted	248	2.72		
Forfeited or expired	(1,195)	4.24		
Exercised	(69)	1.57		
Balance outstanding at September 28, 2008	6,578	\$ 4.76	5.45	\$
Exercisable at September 28, 2008	4,792	\$ 5.22	4.22	\$
Vested and expected to vest at September 28, 2008	6,106	\$ 4.86	5.20	\$

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

The aggregate intrinsic value in the table above represents the total pretax intrinsic value based on the Company's closing stock price of \$1.03 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.

The total intrinsic value of options exercised during the third quarter of 2008 and 2007 was \$7,000 and \$55,000, respectively. The total intrinsic value of options exercised during the first nine months of 2008 and 2007 was \$42,000 and \$345,000 respectively.

*Restricted Stock Awards and Restricted Stock Units*

The Company began issuing RSAs and RSUs in 2007. 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. A summary of the Company's RSA and RSU activity and related information for the first nine months of 2008 follows:

	<b>Number of Shares (in thousands)</b>	<b>RSAs and RSUs Outstanding Weighted Average Grant Date Fair Value</b>	
Nonvested at December 30, 2007	937	\$	3.60
Granted, net of shares withheld for employee tax withholdings	238		2.14
Vested	(186)		2.01
Forfeited	(353)		3.57
Nonvested at September 28, 2008	636	\$	3.55

As of the end of the third quarter of 2008, the unrecognized stock-based compensation expense related to outstanding performance based RSUs, which are not currently expected to vest, was \$2.3 million. The Company will recognize this expense to the extent it determines these performance based RSUs are likely to vest.

*Employee Stock Purchase Plan*

The offering period ending May 14, 2007 commenced on January 24, 2007, once the Company had completed its stock option review and was current with its filings as required by the SEC and Nasdaq. Offering periods beginning May 15, 2007 or later are standard six month offering periods. Employees participating in these offering periods purchase common stock at 85% of the lower of the fair market value of the common stock at the beginning or the end of the offering period.

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The weighted average estimated fair value, as defined by SFAS 123(R), of rights issued pursuant to the Company's ESPP during the third quarter of 2008 and 2007 was \$0.53 and \$0.90 per right, respectively. The weighted average estimated fair value, as defined by SFAS 123(R) of rights issued during the first nine months of 2008 and 2007 was \$0.53 and \$0.88 per right, respectively. For the first nine months of 2008, 139,000 shares of common stock were purchased under the ESPP at \$1.65 per share.

The following weighted average assumptions are included in the estimated fair value calculations for rights to purchase stock under the ESPP as of the grant date:

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
Expected term (months)	6.00	6.00	6.00	5.10
Risk-free interest rate	3.56%	5.00%	3.56%	5.00%
Expected volatility	49.57%	55.00%	49.57%	55.00%
Expected dividend				

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**QUICKLOGIC CORPORATION**

**NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The methodologies for determining the above values were as follows:

- *Expected term:* The expected term represents the length of the purchase period contained in the ESPP.
- *Risk-free interest rate:* The risk-free interest rate assumption is based upon the risk-free rate of a Treasury Constant Maturity bond with a maturity appropriate for the term of the purchase period.
- *Expected volatility:* The expected volatility is based on historical volatility of the Company's common stock for the term of the purchase period.
- *Expected dividend:* The expected dividend assumption is based on the Company's intent not to issue a dividend under its dividend policy.

As of the end of the third quarter of 2008, the unrecognized stock-based compensation expense relating to the Company's ESPP was \$13,000 and is expected to be recognized over a weighted average period of approximately 1.5 months.

**Note 11 Income Taxes**

In the third quarter of 2008, the Company recorded an income tax benefit of \$58,000 which consisted primarily of a domestic tax benefit from refundable tax credits netted with income taxes on foreign operations. In the third quarter of 2007, the Company recorded income tax expense of \$29,000 which consisted primarily of income taxes on foreign operations. In the first nine months of 2008, the Company recorded an income tax benefit of \$24,000 which consisted primarily of a domestic tax benefit from refundable tax credits netted with income taxes on foreign operations. In the first nine months of 2007, the Company recorded income tax expense of \$71,000 which consisted primarily of income taxes on foreign operations.

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 \$64,000 and \$78,000 of unrecognized tax benefits at September 28, 2008 and December 30, 2007, respectively. The total amount of unrecognized tax benefits that would affect our effective tax rate, if recognized, is approximately \$64,000 as of September 28, 2008. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 28, 2008, the Company had approximately \$7,000 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 12 Long-Lived Asset Impairment**

The Company reviews the recoverability of its long-lived assets annually and when events or changes in circumstances occur that indicate that the carrying value of the asset or asset group may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the asset or asset group from expected future pre-tax cash flows, undiscounted and without interest charges, of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets.

The Company did not incur long-lived asset impairment charges in the third quarter of 2008. During the second quarter of 2008, the Company recorded \$2.0 million of long-lived asset impairment charges to cost of revenue for Tower prepaid wafer credits and certain assets used in production and to operating expenses for EDA software licenses. The Company evaluated the revenue potential of its products based on discussions with customers, review of actual sales levels and analysis of current and future design opportunities. Based on this evaluation, the Company determined that the future revenue outlook for products fabricated at Tower was lower than previously expected. Accordingly, the Company performed an impairment analysis on the prepaid wafer credits associated with these products. Factors considered in this analysis included the Company's sales forecast of products to be manufactured at Tower, the timing and quantity of planned wafer purchases and general economic conditions.

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## QUICKLOGIC CORPORATION

## NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A preliminary assessment, based on undiscounted cash flows, indicated that these assets were impaired. In order to determine the fair value of these assets, which are non-transferrable, the Company performed a probability-weighted assessment of expected wafer credit utilization and related cash flows, discounted using a risk-free interest rate. Based on this assessment, the Company recorded a long-lived asset impairment charge of \$1.3 million to cost of revenue and reduced the carrying value of the prepaid wafer credits during the second quarter of 2008.

The Company determined that equipment used in the production of a particular silicon device was impaired based on sales expectations for this device. As a result, the Company recorded a long-lived asset impairment charge of \$199,000 to cost of revenue for these assets, and reduced the carrying value of the associated assets during the second quarter of 2008.

During the second quarter of 2008 the Company decided to outsource its physical silicon design activity while retaining core competencies in-house. See Note 14. As a result of this decision, the Company determined that it had unutilized EDA licenses, recorded a long-lived asset impairment charge of \$468,000 within operating expenses and reduced the carrying value of the related assets during the second quarter of 2008.

**Note 13 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 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
<i>Revenue by product line(1):</i>				
New products	\$ 1,422	\$ 1,620	\$ 6,584	\$ 2,837
Mature products	4,619	4,536	13,533	12,418
End-of-life products	189	2,869	5,879	8,417
Total revenue	\$ 6,230	\$ 9,025	\$ 25,996	\$ 23,672

- (1) For all periods presented: New products include ArcticLink, PolarPro, Eclipse II and QuickPCII 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.

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

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
<i>Revenue by geography:</i>				
United States	\$ 1,955	\$ 4,133	\$ 9,646	\$ 11,031
Europe	878	1,961	4,024	4,507
Taiwan	1,306	794	5,282	2,152
Japan	703	805	2,261	1,394
China	711	433	2,888	1,234
Rest of North America	87	386	642	2,638
Rest of Asia Pacific	590	513	1,253	716
Total revenue	\$ 6,230	\$ 9,025	\$ 25,996	\$ 23,672



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## QUICKLOGIC CORPORATION

## NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
Distributor A	13%	24%	14%	22%
Distributor B	11%	16%	13%	17%
Customer A OEM	13%	*	17%	11%
Customer B OEM	28%	*	18%	*

\* 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 28, 2008	December 30, 2007
Distributor A	*	31%
Customer A OEM	22%	22%
Customer C OEM	13%	*
Customer D OEM	11%	*
Customer E OEM	10%	*

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

As of September 28, 2008, less than 10% of the Company's long-lived assets, including property and equipment and other assets, were located outside of the United States.

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**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. The Company has retained its core competencies and does not expect this change to have a material impact on its product introduction schedules for 2008. This reorganization resulted in a headcount reduction of approximately 13% of employees worldwide. On June 3, 2008, the Company announced the completion of its CSSP focused operational realignment which included a 17% reduction in headcount worldwide, resulting in a total reduction in worldwide headcount of approximately 30%. The purpose of the operational realignment is 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. In connection with this decision, the Company recorded a \$452,000 restructuring charge for employee severance benefits in the second quarter of 2008. During the second and third quarter of 2008, the Company paid \$150,000 and \$195,000 of these benefits, respectively. As of September 28, 2008, the Company has \$107,000 of restructuring costs recorded as accrued liabilities on the unaudited consolidated balance sheet and anticipates that final payments will be made by the end of the first quarter in 2009.

**Note 15 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 28, 2008 and December 30, 2007, the Company had \$2.4 million and \$4.3 million, respectively, of outstanding commitments for the purchase of wafer inventory.

Our principal administrative, sales, marketing, research and development and final testing facility is located in a building of approximately 42,600 square feet in Sunnyvale, California. During the third quarter of 2008, we extended the lease for this facility until December 2012. We have sublet approximately 8,000 square feet of this facility through March 2009. Our research and development facility in Toronto, Canada, consisting of approximately 8,400 square feet, is leased through February 2010. We lease a 4,500 square foot facility in Bangalore, India for the purpose of software development. This facility is leased through November 2009. We also lease office space in Hong Kong, China; Taipei, Taiwan; and London, England. We believe that our existing facilities are adequate for our current needs. Total rent expense, net of sublease income, for the third quarter of 2008 and 2007 was approximately \$130,000 and \$225,000, respectively, and rent expense for the first nine months of 2008 and 2007 was approximately \$490,000 and \$665,000, respectively.

**Note 16 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

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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*. 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, which the defendants in those cases have opposed. On March 26, 2008, the Court denied the defendants motion to dismiss the amended complaints. If a settlement does not occur and litigation against QuickLogic continues, the Company intends to defend the case vigorously.

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**QUICKLOGIC CORPORATION**

**NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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.

**Note 17 Shelf Registration Statement**

On July 12, 2005, the Company filed a shelf registration statement on Form S-3, which was declared effective on July 26, 2005 by the SEC. Under the shelf registration statement, the Company has the ability to raise up to \$30.0 million, in one or more transactions, by selling common stock, preferred stock, depositary shares, or warrants. The Company has not raised any funds in connection with this filing. Under the Securities Offering Reform of 2005, the Company may offer and sell securities registered under this shelf registration statement through November 30, 2008.

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**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 breakeven revenue level and factors that affect gross profit and the breakeven revenue level, (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 30, 2007, found in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 11, 2008 and with our condensed unaudited consolidated financial statements and notes thereto for the quarters ended March 30, 2008 and June 29, 2008 found in our Quarterly Reports on Form 10-Q filed with the SEC on May 8, 2008 and August 7, 2008, respectively.*

*The forward-looking statements contained in this Quarterly Report involve a number of risks and uncertainties, many of which are outside of our control. Factors that could cause actual results to differ materially from projected results include, but are not limited to, risks associated with (1) the conversion of CSSP design opportunities into revenue, (2) the adverse affects of the current financial crisis (3) the commercial and technical success of our CSSPs and new products such as ArcticLink and PolarPro®, (4) our ability to accurately estimate quarterly revenue, (5) the liquidity required to support our future operating and capital requirements, (6) our dependence upon single suppliers to fabricate and assemble our products, (7) our dependence on our relationship with Tower, and (8) our successful introduction of products and CSSPs incorporating emerging technologies or standards. Although we believe that the assumptions underlying the forward-looking statements contained in this Quarterly Report are reasonable, any of the assumptions could be inaccurate, and therefore there can be no assurance that such statements will be accurate. The risks, uncertainties and assumptions referred to above that could cause our results to differ materially from the results expressed or implied by such forward-looking statements include, but are not limited to, those discussed under the heading Risk Factors in Part II, Item 1A hereto and the risks, uncertainties and assumptions discussed from time to time in our other public filings and public announcements. All forward-looking statements included in this document are based on information available to us as of the date hereof. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that the results or conditions described in such statements or our objectives and plans will be achieved. Furthermore, past performance in operations and share price is not necessarily indicative of future performance. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

**Overview**

We are a fabless semiconductor company that operates in a single industry segment where we design, market and support CSSPs, Field Programmable Gate Arrays, or FPGAs, application solutions, associated design software and programming hardware. Our new product family includes ArcticLink, PolarPro, Eclipse II and QuickPCI® II; our mature product family includes pASIC® 3, QuickRAM®, Eclipse, QuickDSP and QuickFC, as well as royalty revenue, programming hardware and design software; our end-of-life product family includes pASIC 1, pASIC 2, V3, QuickMIPS and QuickPCI. We develop CSSPs using our ArcticLink and PolarPro solution platforms.

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Customer Specific Standard Products, or CSSPs, are customer specific complete solutions that include our silicon solution platform, proven system blocks, custom logic and software drivers. Our ArcticLink and PolarPro solution platforms are standard silicon products and must be programmed to be effective in a system. Our proven system blocks range from intellectual property, or IP, which improves video images to IP which implements commonly used mobile system interfaces, such as secure digital input output, or SDIO, or universal serial bus 2.0 on-the-go, or USB 2.0 OTG. We provide complete solutions by selecting the appropriate solution platform and

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

proven system blocks, providing custom logic, integrating logic, programming the device and providing software drivers required for the customers' application.

CSSPs, which we pioneered and introduced in the first quarter of 2007, are developed for specific low power application markets that have similar differentiated IP, intelligent data processing or connectivity requirements. Target customers value CSSPs for the ability to provide a range of products from a single platform and the flexibility to address specific product requirements. Market leading original equipment manufacturers, or OEMs, and original design manufacturers, or ODMs, seek to develop product platforms from which several products can be introduced. For example, multimedia phone companies may plan to introduce products offering mobile TV, WiMAX, Bluetooth 2.1 and USB 2.0 OTG. These customers value our ability to provide a range of products from a single platform design by incorporating different features in the programmable fabric of our solution platforms. Other customers value the flexibility of programmable fabric to address specific product requirements. By providing customized solutions for these customers we increase their ability to meet the time-to-market and time-in-market pressures associated with their markets. In addition to CSSPs, we sell products to industrial, military and other customers who do their own selection and integration of IP cores and add software drivers to their application. We market FPGAs, IP cores and software drivers to these customers, who value the low power consumption, reduced development risk through the use of proven IP cores, fast time-to-market, high IP security, instant-on and reliability of our devices.

This range of offerings allows customers to acquire a solution tailored for their needs. Mobile product OEMs and ODMs tend to prefer a complete solution, and purchase CSSPs. Other customers with proprietary IP requirements choose to purchase our FPGAs or ArcticLink solution platforms and utilize our IP cores as appropriate. Whether a customer uses our CSSPs as a complete solution, or proven IP cores with our FPGAs, we believe our solutions and products enable system manufacturers to improve their time-to-market, lower total system power consumption, reduce their development risk and total cost of ownership, and add features or performance to their embedded applications.

Our CSSPs and the rest of our product offerings are based on our patented ViaLink® metal-to-metal programmable technology. ViaLink is the foundation of our competitive advantage in providing energy efficient devices and solutions that deliver the high performance, high reliability, IP security and instant-on features that our customers value. Our ViaLink technology allows us to create devices smaller than competitors' products on comparable technology, thereby minimizing silicon area and cost. In addition, our ViaLink technology has lower electrical resistance and capacitance than other programmable technologies and therefore supports higher signal speed and low power consumption. Our architecture uses our ViaLink technology to maximize interconnects at every routing wire intersection, which allows more paths between logic cells. As a result, system designers are able to use our devices with smaller gate counts to implement their designs than if they had used competing FPGAs. The abundance of interconnect resources also provides an efficient connection between the Application Specific Standard Product, or ASSP, and the FPGA portions of CSSPs.

We believe that the underlying attributes of our ViaLink technology, including low power consumption, high reliability, design security and design efficiency, enable us to deliver differentiated silicon solutions to our customers.

Our CSSPs provide:

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- *Complete Flexible Solutions* we partner with customers to bring their differentiated products to market quickly and to adapt these products to meet changing market conditions;
- *Platform Design Capability* we partner with customers to develop a range of solutions from a single hardware platform, enabling these manufacturers to bring several products to market quickly and cost effectively through the use of our programmable fabric;
- *Reduced Design Expense and Risk* we provide proven system blocks addressing a range of video, network, storage and custom logic requirements, along with software drivers, thereby reducing the time and cost of product development;



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

- *Small Form Factor* we manufacture single chip solutions in packages as small as 5x5 millimeters, wafer level, chip scale packaging, or WLCSP, and known good die;
- *Energy Efficiency* our ViaLink technology is the lowest power consumption full featured programmable logic technology on the market today, allowing the time-to-market and time-in-market advantages of programmable logic for differentiated mobile products;
- *Low Total Cost of Ownership* CSSPs reduce time-to-market and lower the risk and expense associated with new product development. In platform designs these savings are leveraged over several products. The flexible nature of CSSPs enables new features in existing designs, which can be used to extend time-in-market and delay the cost of new product development. In addition, CSSPs often reduce bill of materials, or BOM, costs by combining the function of several ASSPs into one cost effective device; a simplified BOM also leads to lower printed circuit board, or PCB, costs;
- *Instant-on* our products are live at power up because ViaLink based products require no configuration bit stream;
- *High Reliability* ViaLink based products do not rely on a SRAM cell that is susceptible to alpha particles, or brownouts, to define and maintain their functionality; and
- *Unmatched IP Security* our ViaLink technology makes it virtually impossible to clone or reverse engineer designs implemented in our programmable fabric.

We offer a range of CSSPs built on our PolarPro and ArcticLink solutions platforms. Our PolarPro architecture provides low power consumption and a cost effective device for pure digital applications. CSSPs developed using our PolarPro solution implement proven system blocks and custom logic in programmable fabric. Based on our engineering analysis of portable media player applications, we believe designers using PolarPro can extend battery life by as much as four times as compared to a standard product implementation, setting a new standard for low power consumption through the use of programmable logic.

We started shipping CSSPs based on our ArcticLink architecture in 2007. ArcticLink solution platforms combine mixed signal physical layers, hard-wired logic and programmable fabric on one device. Mixed signal capability supports the trend toward serial connectivity in mobile applications, where designers benefit from lower pin counts, simplified PCB layout, lower cost PCB interconnect and reduced signal noise. Adding hard-wired IP enables us to deliver more logic per die area, while the programmable fabric allows us to provide CSSPs that can be rapidly customized to differentiate products, add features and reduce system development costs. Market leading companies seek to develop product platforms from which several products can be introduced. This combination of mixed signal physical layer, hard-wired logic and programmable fabric enables us to deliver low cost, small form factor solutions that can be customized for a particular customer or market requirements.

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We are marketing CSSPs to OEMs and ODMs offering differentiated mobile products. Our target mobile markets include:

- *Cellular* including multimedia and smartphones;
- *Consumer Electronics* including personal media players, or PMPs, personal navigation devices, or PNDs, and wireless hard disk drives or wireless storage devices; and
- *Computing* including ultra mobile PCs, or UMPCs, mobile internet devices, or MIDS, industrial personal digital assistants, or PDAs, handheld point-of-sales, or POS, terminals and broadband data cards.

Examples of how existing and potential customers benefit from CSSPs are:

- *Multimedia Phones* we have been marketing our recently announced Visual Enhancement Engine, or VEE , a proven system block built upon an IP core we licensed, to enable improved video image, color, contrast and resolution with longer battery life;
- *Smartphones* our solutions enable the simultaneous display of video on the handset and an external display;

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

- *Personal Navigation Devices* our solutions allow the incorporation of the latest storage technology, managed NAND, and access to the latest high capacity SD cards and SDIO based peripherals;
- *Portable Media Players* our solutions allow a processor to access and efficiently control a micro hard disk drive;
- *Wireless Hard Disk Drives* our solutions allow for the intelligent transfer of data, which improves the data transfer rate, virtually eliminates the CPU cycles associated with data transfer and improves battery life;
- *Handheld POS Terminals* our solutions enable high speed connectivity to Wi-Fi and BlueTooth chipsets as well as storage connectivity; and
- *Cellular Data Cards* our solutions provide the lowest power interface between a cellular radio and a laptop card slot.

Our CSSPs and new products are also being designed into applications in our traditional markets, such as data communications, instrumentation and test, and military-aerospace, where customers value the low power consumption, instant-on, IP security, reliability and fast time-to-market of our products.

In addition to working directly with our customers, we partner with other technology companies to develop additional intellectual property, reference platforms and system software to provide application solutions. We partner with companies that are experts in certain technologies. For instance, we licensed elements of our VEE technology from Apical Limited, a U.K. company that markets enhanced video image capability to companies such as Nikon, Olympus and Sony Ericsson. We also work with processor manufacturers, such as Marvell Technology Group Ltd., 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, such as reference designs.

We sell programmed and unprogrammed products through distributors and directly to OEMs. We recognize revenue at the time of shipment of products directly to system manufacturers. However, we have historically sold a significant portion of our products through distributors who earn a negotiated margin on the sale of our products and who have stock rotation and price protection privileges. We defer recognition of income from sales of unprogrammed products to these distributors, other than end-of-life products, until after they have sold our products to systems manufacturers. During the third quarter of 2008, we changed our standard distribution agreement from a sell-through to a sell-in model and began to enter into new agreements with our distributors. Under these agreements all products are sold to the distributor at fixed prices without return or price adjustment privileges. We expect to complete the process of moving all of our distributors to the new agreement by the first quarter of 2009. We recognize revenue on programmed products and certain unprogrammed products, for which the price is fixed or determinable and there are no return privileges, at the time of shipment to our distributors. During the first nine months of 2008 and 2007,

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approximately 70% and 60%, respectively, of the units shipped to our distributors were programmed by us and, accordingly, are not returnable. The percentage of sales derived through distributors was 50% and 60% during the first nine months of 2008 and 2007, respectively.

Two distributors, Avnet, Inc. and Future Electronics, accounted for 14% and 13% of revenue in the first nine months of 2008. These distributors accounted for 22% and 17% of revenue in the first nine months of 2007. We anticipate that a limited number of distributors will continue to account for a significant portion of our revenue and that individual distributors could account for a larger portion of our revenue.

Our international sales were 63% and 53% of our revenue in the first nine months of 2008 and 2007, respectively. We expect that revenue from sales to international customers will continue to represent a significant portion of our revenue. All of our sales originate in the United States and are denominated in U.S. dollars.

We outsource the wafer manufacturing, assembly and testing of all of our products. We currently rely upon Taiwan Semiconductor Manufacturing Company Ltd., or TSMC, Tower, Kawasaki Microelectronics, Inc. and Samsung Semiconductor, Inc. to manufacture our products, and we rely upon Amkor Technology, Inc. and Unisem

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

(M) Berhad to assemble, test and program our products. Our wafer suppliers' lead times are often as long as three months and sometimes longer. In addition, Tower requires us to provide them with a monthly wafer start forecast. Under the terms of our agreement with Tower, our ability to increase or decrease our wafer forecast is limited and we are committed to take delivery of and pay for a minimum portion of the forecasted wafer volume. Our long manufacturing cycle times are at odds with our customers' desire for short delivery lead times and, as a result, we typically purchase wafers based on our internal forecasts of customer demand.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****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 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue (1)	44.6	47.8	46.2	57.8
Long-lived asset impairment			6.0	
Gross profit	55.4	52.2	47.8	42.2
Operating expenses:				
Research and development	21.7	26.0	26.1	29.4
Selling, general and administrative	42.8	43.7	42.2	54.7
Long-lived asset impairment			1.8	
Restructuring costs			1.7	
Loss from operations	(9.1)	(17.5)	(24.0)	(41.9)
Write-down of marketable securities			(1.6)	
Interest expense	(1.0)	(0.8)	(0.8)	(1.0)
Interest income and other, net	(0.7)	2.1	0.4	3.2
Loss before income taxes	(10.8)	(16.2)	(26.0)	(39.7)
Provision for (benefit from) income taxes	(0.9)	0.3	(0.1)	0.3
Net loss	(9.9)%	(16.5)%	(25.9)%	(40.0)%

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
Revenue by product line (2) (in thousands):				
New products	\$ 1,422	\$ 1,620	\$ 6,584	\$ 2,837
Mature products	4,619	4,536	13,533	12,418
End-of-life products	189	2,869	5,879	8,417
Total revenue	\$ 6,230	\$ 9,025	\$ 25,996	\$ 23,672

(1) The third quarter of 2008 and 2007 includes \$203,000 and \$309,000 of costs for the write-down of inventories and related charges, which represents 3.3% and 3.4% of revenue, respectively. The first nine months of 2008 and 2007 includes \$1.3 million and \$3.5 million of costs for the write-down of inventories and related charges, which represents 5.1% and 14.9% of revenue, respectively.

(2) For all periods presented: New products 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.

Three Months Ended September 28, 2008 and September 30, 2007

*Revenue.* Our revenue for the third quarter of 2008 was \$6.2 million, representing a decline of approximately \$2.8 million, or 31.0%, from revenue of \$9.0 million in the third quarter of 2007. The decline in revenue is primarily due to a decrease in demand for end-of-life products, which declined by \$2.7 million compared with the third quarter of 2007. New product revenue declined by \$200,000 compared with the third quarter of 2007; lower demand for Eclipse II products was partially offset by higher demand for PolarPro and ArcticLink products. Our mature product revenue increased by \$80,000 compared with the third quarter of 2007. A PND manufacturer contributed 13% and 5% of total revenue in the third quarter of 2008 and 2007, respectively. A worldwide customer purchasing primarily pASIC 3 devices contributed 28% and 9% of total revenue in the third quarter of 2008 and 2007, respectively.

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

Our revenue for the third quarter of 2008 was 28.7% lower sequentially, decreasing by approximately \$2.5 million to \$6.2 million from \$8.7 million in the second quarter of 2008. This sequential revenue decline was primarily due to an anticipated \$1.4 million decline in end-of-life product revenue. New product revenue also decreased by \$1.1 million sequentially due to an anticipated \$1.1 million decrease in demand from a large PND OEM customer. This decrease in demand resulted from the late stage of their product life cycle. End-of-life products contributed \$189,000 of revenue in the third quarter. Revenue from these products is expected to fluctuate and contribute less than 10% of total quarterly revenue.

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 VEE and boot from managed NAND, or industry standard interfaces such as USB 2.0 OTG, SDIO and integrated drive electronics, or IDE. 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.* Gross profit was \$3.5 million and \$4.7 million in the third quarter of 2008 and 2007, respectively, which represented 55.4% and 52.2% of revenue for those periods. The \$1.3 million decline in gross profit was primarily due to lower revenue and product mix, which decreased gross profit by \$1.4 million, offset by \$100,000 of lower charges for the write-down of inventories.

*Research and Development Expense.* Research and development expense was \$1.4 million and \$2.3 million in the third quarter of 2008 and 2007, respectively, which represented 21.7% and 26.0% of revenue for those periods. The decrease of approximately \$1.0 million was primarily due to savings associated with the operational realignment that we undertook in the second quarter of 2008. This change reduced cash compensation costs by \$500,000 and depreciation by \$90,000 compared with the third quarter of 2007. In addition, project expenses were \$160,000 lower compared with the third quarter of 2007 due primarily to a delay in the start of a new project.

In the second quarter of 2008, we implemented a plan to outsource certain development functions that were previously performed in-house. Moving certain development activities to an on-demand, outsourced model from an in-house, fixed cost model resulted in a reduction in our research and development staffing in Toronto, Canada. We also reduced other development expenses in the second quarter as we realigned resources throughout the Company with our expected revenue outlook. We retained our core competencies and do not expect this change to have a material adverse impact on our product introduction schedules for the remainder of 2008. We believe this realignment of resources will lower our development expense per project, lower fixed costs, reduce our cash consumption and lower our break-even revenue level, enable a more rapid return to profitability and profit scalability, and allow room for discretionary spending in response to market demands. Our project expenses, which typically include the purchase of intellectual property, prototype costs and outsourced research and development activity, were less than \$100,000 in the third quarter of 2008. We believe that investments in product and intellectual property development, including project expenses, are essential for us to remain competitive in the markets we serve. We expect that our development efforts will allow us to expand our product and solution offerings, increase our revenue and provide additional value to our customers and stockholders.



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*Selling, General and Administrative Expense.* Selling, general and administrative expense was \$2.7 million and \$4.0 million for the third quarter of 2008 and 2007, respectively, which represented 42.8% and 43.7% of revenue for those periods. The decrease of approximately \$1.3 million in selling, general and administrative expense was primarily due to a \$600,000 decrease in cash compensation expenses and a \$700,000 decrease in outside service expenses such as consulting, temporary help, sales commissions, and legal expenses.

*Interest Expense.* Interest expense of \$59,000 in the third quarter of 2008 was flat compared with \$69,000 in the third quarter of 2007.

*Interest Income and Other, Net.* Interest income and other, net decreased to \$46,000 of expense for the third quarter of 2008 as compared to \$189,000 of income for the third quarter of 2007. The \$235,000 decrease in interest income and other, net is primarily due to decreased interest income received as a result of lower average cash balances and interest rates and foreign exchange losses.

*Provision for Income Taxes.* For the third quarter of 2008 and 2007, we incurred a loss before income taxes of \$673,000 and \$1.5 million, respectively. We recorded a benefit from income taxes of \$58,000 in the third quarter

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

of 2008 due primarily to a domestic tax benefit from refundable tax credits netted with income taxes on foreign operations. We recorded a provision for income taxes of \$29,000 for the third quarter of 2007 which consisted primarily of income taxes on foreign operations. 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 tax benefit. We will continue to assess the realizability of deferred tax assets in future periods.

*Stock-Based Compensation.* For the third quarter of 2008 and 2007, stock-based compensation totaled \$389,000 and \$452,000, respectively, and was included in the statements of operations as follows (in thousands):

	<b>Three Months Ended</b>	
	<b>September 28, 2008</b>	<b>September 30, 2007</b>
Cost of revenue	\$ 49	\$ 67
Research and development	89	94
Selling, general and administrative	251	291
Total	\$ 389	\$ 452

The amount of stock-based compensation included in inventories at the end of the third quarter of 2008 and 2007 was not material.

**Nine Months Ended September 28, 2008 and September 30, 2007**

*Revenue.* Our revenue for the first nine months of 2008 was \$26.0 million, representing an increase of \$2.3 million, or 9.8%, from revenue of \$23.7 million in the first nine months of 2007. Revenue from new products increased \$3.7 million, or 132%, due to \$4.1 million of higher demand in Asia from a PND manufacturer that purchases CSSPs based on our PolarPro solution platform. Mature product revenue increased \$1.1 million compared with the first nine months of 2007 due primarily to higher demand for pASIC 3 products. Revenue from end-of-life products declined by \$2.5 million compared with 2007 due to the timing of end of life purchases.

*Gross Profit.* Gross profit was \$12.4 million and \$10.0 million in the first nine months of 2008 and 2007, respectively, which represented 47.8% and 42.2% of revenue for those periods. The \$2.5 million increase in gross profit was primarily due to \$2.2 million of lower charges for inventory reserves, \$1.1 million due to higher revenue and product mix, and \$1.1 million for lower unabsorbed overhead costs, partially offset by a \$1.5 million long-lived asset impairment charge associated with the write-down of prepaid wafer credits and certain assets used in production and by higher purchase price variances. During the first nine months of 2008, the Company recorded inventory related charges totaling \$1.3 million, or 5.1% of revenue, primarily for excess quantities due to a reduction in expected

demand for inventories on hand, and cost of revenue was reduced by \$440,000, or 1.7% of revenue, through the sale of inventories that were previously written down.

*Research and Development Expense.* Research and development expense was \$6.8 million and \$7.0 million for the first nine months of 2008 and 2007, respectively, which represented 26.1% and 29.4% of revenue for those periods. The decrease of \$180,000 was primarily due to \$520,000 of lower cash compensation costs, partially offset by \$280,000 of higher project related expenses.

*Selling, General and Administrative Expense.* Selling, general and administrative expense was \$11.0 million and \$12.9 million for the first nine months of 2008 and 2007, respectively, which represented 42.2% and 54.7% of revenue for those periods. The \$2.0 million decrease in selling, general and administrative expense was primarily due to \$1.2 million of lower expense for outside services including legal, recruiting, consulting and temporary help, \$1.0 million of lower cash compensation expense and lower depreciation expense of \$220,000, partially offset by \$470,000 of higher stock based compensation expense.

*Long-Lived Asset Impairment.* In the second quarter 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.

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

*Restructuring Costs.* In the second quarter of 2008, we reduced our worldwide headcount by approximately 30% in order to lower fixed costs; enable a lower break-even revenue level and optimal profitability scaling with revenue growth and provide greater headroom for discretionary costs, resulting in improved agility to pursue CSSP and new product market opportunities and conservation of cash by reducing operating expenses, and enabling a quicker return to profitability. In connection with this decision, we recorded a \$452,000 restructuring charge for employee severance benefits; these benefits are expected to be paid by the end of the first quarter of 2009.

*Write-down of Marketable Securities.* In the second quarter of 2008, we determined that our investment in Tower had suffered a decline in value that was 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 second quarter of 2008 based on the quoted market price of the stock on the last day of the reporting period. As a result of this write-down, the carrying value of the Tower ordinary shares was \$0.86 per share as of the end of the second quarter of 2008. The market value of Tower ordinary shares declined to \$0.58 per share as of September 28, 2008, and the market value was \$0.22 per share on October 31, 2008. If the value per share remains below \$0.86 at the end of our fiscal fourth quarter, we may incur a charge for the other than temporary decline in market value since June 28, 2008.

*Interest Expense.* Interest expense decreased to \$202,000 for the first nine months of 2008 as compared to \$226,000 for the first nine months of 2007. This \$24,000 decline was primarily due to lower interest rates.

*Interest Income and Other, Net.* Interest income and other, net decreased to \$88,000 of income for the first nine months of 2008 as compared to \$752,000 of income for the first nine months of 2007. The \$664,000 decrease in interest income and other, net is primarily due to decreased interest income resulting from lower average cash balances and lower interest rates.

*Provision for Income Taxes.* For the first nine months of 2008 and 2007, we incurred a loss before income taxes of \$6.8 million and \$9.4 million, respectively. We recorded a benefit from income taxes of \$24,000 in the first nine months of 2008 due primarily to a domestic tax benefit from refundable tax credits netted with income taxes on foreign operations. We recorded a provision for income taxes of \$71,000 for the first nine months of 2007, which consisted primarily of income taxes on foreign operations.

*Stock-Based Compensation.* For the first nine months of 2008 and 2007, stock-based compensation totaled \$2.0 million and \$1.3 million, respectively, and was included in the statements of operations as follows (in thousands):

	Nine Months Ended	
	September 28, 2008	September 30, 2007
Cost of revenue	\$ 220	\$ 176
Research and development	443	273
Selling, general and administrative	1,308	812
Total	\$ 1,971	\$ 1,261

The increase in stock-based compensation was primarily due to the issuance of fully vested restricted stock units, or RSUs, in lieu of cash compensation in the second quarter of 2008. Total stock-based compensation related to fully vested RSUs was \$570,000 for the first nine months of 2008.

### 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 lines of credit and cash flow from operations. As of September 28, 2008, our principal sources of liquidity consisted of our cash and cash equivalents of \$18.8 million, available credit under our revolving line of credit with Silicon Valley Bank of approximately \$4.0 million, and our investment in Tower with a market value of approximately \$780,000. We intend to hold 450,000 shares in Tower, valued at \$261,000 as of the end of the third quarter of 2008, in order to obtain preferred wafer pricing from Tower. Pursuant

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

to SFAS 157, the fair value of our cash equivalents and marketable securities as of September 28, 2008 was determined based on Level 1 inputs as described in Note 8 to our consolidated financial statements.

As of September 28, 2008, our interest-bearing debt consisted of \$2.0 million of revolving debt outstanding from Silicon Valley Bank and \$950,000 outstanding under capital leases. The term of the revolving debt facility runs until June 2010. Our accumulated deficit was \$145.4 million as of September 28, 2008. Capital expenditures, which are largely driven by the development of new products and manufacturing activity, could be up to \$1.2 million in the next twelve months.

On August 13, 2008, we entered into a Fourth Amendment to Second Amended Restated Loan and Security Agreement (the Agreement) with Silicon Valley Bank. The amended facility includes a \$6.0 million revolving line of credit that is available until June 2010. Advances under the line of credit may be either prime rate plus one percent advances, which accrue interest at a variable interest rate of the prime rate plus one percent, or fixed rate advances, which earn interest at LIBOR plus 3.5%. Prime rate plus one percent advances may be prepaid without penalty, and the Company pays interest at a rate of 0.25% for the unused portion of its line of credit. As of September 28, 2008, the Company has \$2.0 million of prime rate plus one percent advances under the line of credit, which are classified as a short term liability on the balance sheets. The bank has a first priority security interest on substantially all of our tangible and intangible assets to secure any outstanding amounts under the agreement. Under the terms of the agreement, we must maintain a minimum tangible net worth and an adjusted quick ratio. The agreement also has certain restrictions including, among others, the incurrence of other indebtedness, the maintenance of depository accounts, the disposition of assets, mergers, acquisitions, the granting of liens and the payment of dividends. We were in compliance with all loan covenants as of the end of the current reporting period.

During the third quarter of 2008, the Company repaid notes payable of \$2.5 million and, as noted above, borrowed \$2.0 million of revolving debt through a prime rate plus one percent advance under its revolving line of credit. At June 29, 2008, the prior line of credit terms included a \$5.0 million revolving line of credit, \$870,000 of borrowing capacity under an equipment line of credit that could be drawn through July 31, 2008, and a waiver of the tangible net worth covenant through July 31, 2008. In July 2008, the Company entered into a third amendment to the loan and security agreement to extend the available draw date and waive the tangible net worth covenant through August 31, 2008.

*Net cash from operating activities*

Operating activities provided \$451,000 of cash and used \$2.3 million of cash in the first nine months of 2008 and 2007, respectively. The primary reason for the \$2.8 improvement in cash flow from operations was a \$2.7 million reduction in our net loss. The adjustments to reconcile net loss to net cash provided by (used for) operating activities totaled \$7.8 million in both the first nine months of 2008 and 2007. Changes in working capital used cash of \$606,000 and \$688,000 in the first nine months of 2008 and 2007, respectively.

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

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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 used for operating activities was \$2.3 million for the first nine months of 2007. The cash used for operating activities resulted primarily from a net loss of \$9.5 million, which included \$7.8 million of non-cash charges including write-down of inventories of \$3.5 million, depreciation and amortization of \$2.3 million, stock-based compensation of \$1.3 million, and a decrease in wafer credits of \$681,000 and bad debt reserves of \$163,000. In addition, changes in working capital accounts used cash in the amount of \$688,000 primarily as a result of a \$2.0 million decrease in accounts payable due to timing of expenditures and purchases of inventories and a \$405,000 decrease in deferred income and royalty revenue due primarily to royalty revenue recognized under the Aeroflex

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

agreement. These uses of cash were partially offset by a \$714,000 decrease in other assets and \$693,000 decrease in inventories.

*Net cash from investing activities*

Net cash used for investing activities for the first nine months of 2008 and 2007 was \$541,000 and \$926,000, respectively, as a result of capital expenditures made primarily to acquire equipment and software used in the development and production of our products and solutions.

*Net cash from financing activities*

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.

Net cash used for financing activities was \$539,000 for the first nine months of 2007, resulting from scheduled payments of \$1.9 million under the terms of our debt and capital lease obligations, partially offset by \$915,000 in proceeds related to the issuance of common shares to employees under our equity plans and \$442,000 in proceeds from borrowings under our equipment line of credit.

We require substantial cash to fund our business, particularly to finance our operations, to acquire property and equipment, for the repayment of debt and for working capital requirements. Our future liquidity will depend on many factors such as these, as well as our level of revenue and gross profit, market acceptance of our existing and new products, the decline in revenue under end-of-life programs, wafer purchase commitments, the amount and timing of research and development expenditures, the timing of new product introductions, production volumes, the quality of our products, sales and marketing efforts, the capital preservation and liquidity of our investment portfolio, our ability to obtain debt financing and to remain in compliance with the terms of our credit facilities, our ability to raise funds from the sale of Tower shares and equity in the Company, the exercise of employee stock options and participation in our employee stock purchase plan, and other factors related to the uncertainties of the industry and global economics. However, we believe that our existing cash resources will be sufficient to fund operations, capital expenditures of up to \$1.2 million, and provide adequate working capital for at least the next twelve months. As our liquidity is affected by many factors as mentioned above and as discussed in our Risk Factors section, there can be no assurance that we will not seek additional capital during the next twelve months or that such capital will be available on terms acceptable to us.



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 28, 2008 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	\$ 1,920	\$ 587	\$ 838	\$ 495
Wafer purchases (1)	2,435	2,435		
Other purchase commitments	979	979		
<i>Total contractual cash obligations</i>	<i>5,334</i>	<i>4,001</i>	<i>838</i>	<i>495</i>
<i>Other commercial commitments (2):</i>				
Revolving line of credit	2,000	2,000		
Capital lease obligations	950	764	186	
<i>Total commercial commitments</i>	<i>2,950</i>	<i>2,764</i>	<i>186</i>	
Total contractual obligations and commercial commitments (3)	\$ 8,284	\$ 6,765	\$ 1,024	\$ 495

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- (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 \$2.4 million include both firm purchase commitments and a portion of our forecasted wafer starts as of September 28, 2008.
- (2) Other commercial commitments are included as liabilities on our balance sheet as of September 28, 2008.
- (3) Does not include unrecognized tax benefits of \$64,000 as of September 28, 2008.

**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**

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In October 2008, the Financial Accounting Standards Board, or ( FASB ), issued FSP No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* , FSP No. 157-3 clarifies the application of SFAS No. 157, which we adopted as of December 31, 2007, in cases where a market is not active. We considered FSB No. 157-3 in the determination of estimated fair values as of September 28, 2008, and the impact was not significant.

In May 2008, FASB issued Statement of Financial Accounting Standards, or SFAS, No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, or SFAS 162. This standard reorganizes the GAAP hierarchy in order to improve financial reporting by providing a consistent framework for determining what accounting principles should be used when preparing U.S. GAAP financial statements. SFAS 162 shall be effective 60 days after the SEC s approval of the Public Company Accounting Oversight Board s amendments to Interim Auditing Standard, AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. We are currently evaluating the impact SFAS 162 will have on our consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position, or FSP, SFAS No. 142-3, *Determination of the Useful Life of Intangible Assets*, or FSP FAS 142-3. FSP FAS 142-3 amends the list of factors an entity should consider in

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

developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under SFAS No. 142, *Goodwill and Other Intangible Assets*, or SFAS 142. The intent of FSP FAS 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141, *Business Combinations*. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. We are currently evaluating the impact FSP FAS 142-3 will have on our consolidated financial statements.

**Critical Accounting Policies and 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 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 including sales returns and allowances, valuation of inventories including identification of excess quantities, market value 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 estimating 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 30, 2007 filed with the SEC on March 11, 2008.

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**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 are adverse to principal loss and 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. At September 28, 2008, our portfolio of investments was classified as Level 1 under SFAS 157 (see Note 8 to our consolidated financial statements). 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 September 28, 2008 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 26% and 24% of total operating expenses for the first nine months 2008 and 2007, respectively. A majority of these foreign expenses were incurred in Canada. A currency exchange rate fluctuation of 10% would have caused our operating expenses to change by approximately \$540,000, or 2.9%, in the first nine months of 2008.

**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. At September 28, 2008, our Tower investment was classified as Level 1 under SFAS 157 (see Note 8 to our consolidated financial statements). 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 net loss before income taxes 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 \$417,000 in the second quarter of 2008 and by \$13.7 million between 2001 and 2005. 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. At June 29, 2008, the market value of our Tower investment was \$0.86 per share, or \$1.2 million. As of September 28, 2008, the market value of our Tower investment had declined to \$0.58 per share; and the resulting \$376,000 reduction in value was recorded as accumulated other comprehensive loss on the balance sheet. A market value fluctuation of 10% would have a \$78,000 impact on accumulated other comprehensive loss as of September 28, 2008. At October 31, 2008, the market value of Tower ordinary shares was \$0.22 per share. If the value of Tower ordinary shares remains below \$0.86 per share at December 28, 2008, we may record a charge to our statement of operations for the decline in value since June 28, 2008.

**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

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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 28, 2008, our disclosure controls and procedures were effective.

**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**

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*. 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, which the defendants in those cases have opposed. On March 26, 2008, the Court denied the defendants' motion to dismiss the amended complaints. If a settlement does not occur and litigation against QuickLogic continues, we intend to defend the case vigorously.

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

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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 our financial position, results of operations or cash flows or without requiring royalty or other payments in the future which may adversely impact gross profit.

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**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 Item 1A of our 2007 Annual Report on Form 10-K filed with the SEC on March 11, 2008 and our quarterly reports on Form 10-Q for the periods ended March 30, 2008 and June 29, 2008, filed with the SEC on May 8, 2008 and August 7, 2008, respectively. 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 are transitioning to becoming a supplier of CSSPs that addresses the mobile market from being a broad-based supplier of FPGA devices. We have developed a significant pipeline of design opportunities for CSSPs in our target markets, and we are focused on converting these 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, obtain profitability and maintain or increase our cash position. Mobile product life cycles are short, and we must replace revenue lost at the end of these product life cycles with sales from new design wins. In addition, we expect revenue from the rest of our business 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.

*Our business may be adversely affected by the current financial crisis*

Recently general worldwide economic conditions have experienced a downturn due to the credit conditions impacted by the subprime-mortgage turmoil and other factors, slower economic activity, concerns about inflation and deflation, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions, a rise in unemployment, lower investment valuations and liquidity concerns. The current financial crisis may cause a reduction in the consumption of the products that use our devices, cause cancellation or delay of 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 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.



*If we fail to successfully develop, introduce and sell CSSPs and new products, we may be unable to compete effectively in the future*

We have focused the development and marketing of our CSSPs to address the needs of OEMs and ODMs that offer differentiated mobile products such as personal navigation devices, multimedia phones, portable media players, data cards and wireless hard disk drives. These are new customers and markets for us and we currently have a small customer base for CSSPs. While we believe that this business will provide long-term revenue growth for our Company, there is no assurance when this will occur.

The market for these mobile devices is highly competitive and dynamic, with short product life cycles and rapid obsolescence of existing products. To compete successfully, we must efficiently create CSSPs from our existing silicon platforms to meet the needs of customers in our sales pipeline. In addition, we must obtain access to advanced fabrication capacity and dedicate significant resources to specify, design, develop, manufacture and sell new or enhanced silicon platforms and 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

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platform development, selling and marketing long before we generate revenue, if any, from these efforts. These markets typically have higher volumes and greater price pressure than our traditional business; 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 business before we are able to reduce our costs or if an opportunity priced to gain market share becomes significant to our quarterly revenue.

In the second quarter of 2008, we realigned our operating model in order to reduce our fixed costs, lower our breakeven revenue level, increase our profit scalability with growth beyond breakeven and improve our agility. As a result of the operational realignment, which included a significant reduction in staffing, we lowered our non-GAAP breakeven revenue level to approximately \$8.5 million per quarter in light of our expected revenue mix, gross margin and operating expenses. Our revenue in the third quarter of 2008 was \$6.2 million, consisting of \$1.4 million in new product revenue, including CSSPs, \$4.6 million in mature product revenue and \$189,000 in end-of-life product 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 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 we are unable to design, produce and sell new CSSPs that meet design specifications, address customer requirements and generate sufficient revenue and gross profit; if market demand for our CSSPs and other products fails to materialize; if we are unable to obtain adequate capacity on a timely basis; if we are unable to develop CSSPs or solutions in a timely manner; or if 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.

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

We offer our customers a short delivery lead time and a significant portion of our shipments during a quarter are ordered by customers in that quarter. In addition, our customers may cancel orders with little or no penalty. As a result, we often have low visibility to revenue in the current quarter and our revenue levels can change significantly in a short period of time. 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. In addition, a portion of our revenue is deferred until our distributors ship unprogrammed parts to end customers. Therefore, we are highly dependent on the accuracy and timeliness of resale and inventory reports from our distributors. Inaccurate distributor resale or inventory reports, as well as unanticipated changes in distributor levels of inventory, could contribute to our difficulty in predicting and reporting our quarterly revenue and results of operations. If we fail to accurately estimate customer demand, if there is a deterioration in the demand for or supply of our products, if we fail to adequately 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 may not have the liquidity to support our future operations and capital requirements*

At September 28, 2008, our cash and cash equivalents balance was \$18.8 million and our interest-bearing debt consisted of \$2.0 million outstanding from Silicon Valley Bank and \$950,000 outstanding under capital leases.

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In August 2008, we amended our credit facility with Silicon Valley Bank and at September 28, 2008, we had \$4.0 million available to borrow under our revolving credit facility and outstanding revolving debt of \$2.0 million.

At September 28, 2008, we held 1,344,543 Tower ordinary shares, valued at approximately \$780,000 based upon the market closing price of \$0.58 per share at the end of the reporting period. The market value of Tower ordinary shares was \$0.22 per share on October 31, 2008. If the value per share remains below \$0.86 at the end of our fiscal fourth quarter, we may incur a charge for the other than temporary decline in market value since June 28, 2008. Our ability to continue to obtain preferred pricing from Tower is tied to our ownership of at least 450,000 of these Tower shares.

While our primary investment object is the preservation of cash and our portfolio is comprised of securities with active secondary and resale markets, any investment is subject to a degree of interest rate and liquidity risk. Capital expenditures, which are largely driven by development activities and the introduction and initial manufacturing of new products, could total \$1.2 million in the next twelve months. At the end of the third quarter of 2008, we had commitments to purchase \$2.4 million of wafer inventory.

As a result of potential investments, expected revenue and operating expense levels, changes in working capital and interest and debt payments, we will need to generate significantly higher revenue and gross profit, especially from our ArcticLink and PolarPro solution platforms and products currently under development, to generate positive cash flow. In addition, our new products have been generating lower gross margin as a percentage of revenue than the rest of our historical business due to the competitive and cost-sensitive markets that we have targeted and the larger order quantities associated with these applications. Based on our current expectations for revenue, gross profit and expense levels, we have sufficient liquidity for the next twelve months. These expectations may be adversely effected by a recession. Whether we can achieve cash flow levels sufficient to support our operations cannot be accurately predicted. Unless such cash flow levels are achieved and our investment portfolio remains liquid and its capital is preserved, we may have to borrow additional funds or sell debt or equity securities, or some combination thereof, to provide funding for our operations. 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.

***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. We sell programmers to customers that are supplied by a single source. Programming capacity at our subcontractors is also dependent on our investment in sufficient programming hardware to meet fluctuating demand. Our relationship with our suppliers could change as a result of a merger or acquisition or due to a supplier's financial condition. 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. We have announced an end-of-life for several products, due primarily to certain suppliers' decisions to stop manufacturing these products, and the loss of this revenue has significantly harmed our business.

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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. 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

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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 misstate our inventories, incorrectly record gross profit, 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.

***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, preferred 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 or generate adequate cash flow, the value of our investment in Tower may decline significantly or 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 sole manufacturer of our new products, CSSP silicon platforms and other new silicon platforms currently under development.

At the end of the third quarter of 2008 we have \$950,000 of prepaid wafer credits reported as other assets on our balance sheet, and we hold 1.3 million tower ordinary shares with a value \$0.58 per share. 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. 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. We wrote down the Tower shares to their fair market value of \$0.86 per share, or \$1.2 million, in the second quarter of 2008 due to an other than temporary decline in their market value. The value of Tower ordinary shares was \$0.58 per share at the end of our third fiscal quarter and was \$0.22 per share as of October 31, 2008. If the value per share remains below \$0.86 per share at the end of our fiscal fourth quarter, we may incur a charge for the other than temporary decline in market value since June 28, 2008.

***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 to design and develop silicon solution platforms such as ArcticLink and PolarPro and proven system blocks, such as our VEE technology, 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.

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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 effective manner, we may be unable to generate significant revenue from our sales pipeline or 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.

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***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 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.

***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 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. In the first nine months of 2008, we wrote down approximately \$1.3 million of inventories due primarily to changes in forecasted demand. Our failure to adequately forecast demand for our products could materially harm our business.



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Our distributors or customers may cancel purchase orders at any time with little or no penalty. Contractually, our distributors are generally permitted to return unprogrammed products worth up to 10%, by value, of the products they purchase from us. If our distributors or customers cancel or defer significant purchase orders or return our products, our accounts receivable collections would decrease and inventories would increase, which would materially harm our business.

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***We are expending substantial time and effort to develop solutions with partners that depend on the availability and success of technology owned by the partner***

Our approach to developing solutions for potential customers involves: (1) embedded processors developed by companies such as Marvell Semiconductor, Inc.; (2) peripheral devices developed by other parties such as micro hard disk drives, Wi-Fi devices and NAND flash memory; (3) proprietary intellectual property such as key elements of our VEE technology; and (4) specific industry standards such as USB 2.0 OTG, Serial 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 develop and integrate a competing 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.

***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. While our recent operational realignment has reduced our fixed costs, it has increased our need to retain qualified personnel. Hiring and retaining qualified sales, technical and financial personnel is 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.

***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.

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

We incurred significant losses in 2007, 2006 and certain years prior to 2005. Our accumulated deficit as of September 28, 2008 was \$145.4 million. Although we recorded net income of \$2.4 million in 2005, we recorded a net loss of \$6.7 million in the first nine months of 2008, and we may not return to profitability in any future periods.

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*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:

- the effect of end-of-life programs;
- a significant change in sales to, or the collectability of accounts receivable from, our largest customers;
- successful development and market acceptance of our products and solutions;
- our ability to accurately forecast product volumes and mix, and to respond to rapid changes in customer demand;
- changes in sales volume or expected sales volume, product mix, average selling prices or production variances that affect gross profit;
- our ability to adjust our product features, manufacturing capacity and costs in response to economic and competitive pressures;
- our reliance on subcontract manufacturers for product capacity, yield and quality;
- our competitors' product portfolio and product pricing policies;

- timely implementation of efficient manufacturing technologies;
- errors in applying or changes in accounting and corporate governance rules;
- the issuance of equity compensation awards or changes in the terms of our stock plan or employee stock purchase plan;
- mergers or acquisitions;
- the impact of import and export laws and regulations;
- 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;
- our ability to obtain capital, debt financing and insurance on commercially reasonable terms; and
- the impact of restructuring activities.

During the second quarter of 2008 we realigned our resources to be consistent with our CSSP business model and incurred restructuring costs. The intent of the realignment is to lower our fixed costs, reduce spending, provide a faster return to profitability, enable us to scale profits with revenue growth and provide the room to make discretionary expenditures in response to market opportunities. The realignment includes outsourcing some development functions to lower our per project development expense. The restructuring costs adversely affected our second quarter financial performance. The restructuring costs recorded in the second quarter of 2008 are only an estimate of charges and actual amounts may differ. While we believe the realignment enables us to accomplish our business objectives, the realignment could be disruptive to our business and cause actual results to differ from our expected results.

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 have been widely out of balance. An industry wide semiconductor oversupply could result in severe downward pricing pressure from

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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.

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.

*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 Taiwan, South Korea, the Philippines, China and Israel. We expect to manufacture a majority of our new products and the products that we currently have under development in Israel and to assemble these products in South Korea or China. As a result, these manufacturing operations and new product introductions are subject to risks of political instability, including the risk of conflict between Taiwan and the People's Republic of China, between South Korea and North Korea, and conflicts involving Israel.

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 marketing and 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:

- managing foreign distributors and suppliers;
- collecting amounts due;
- staffing and managing foreign offices;
- political and economic instability;
- foreign currency exchange fluctuations;

- changes in tax laws, import and export regulations, tariffs and freight rates;
- timing and availability of export licenses;
- supplying products that meet local environmental regulations; and
- 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.

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*Our CSSPs face competition from suppliers of ASSPs such as Cypress Semiconductor Corporation, suppliers of integrated application processors such as Texas Instruments Inc., and suppliers of ASICs such as LSI Logic Corporation*

We face competition from companies that offer ASSPs, such as Cypress Semiconductor and Oxford Semiconductor. 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. Some manufacturers of integrated application processors, such as Texas Instruments, 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 Logic supply Application Specific Integrated Circuits, or ASICs, which may be purchased for a lower unit price at higher volumes and typically have greater logic capacity, additional features and higher performance than our products, but have larger development risk, longer time to market and often charge NRE fees for development. Our inability to successfully compete in any of the following areas could materially harm our business:

- the development of new products, CSSPs and advanced manufacturing technologies;
- the quality, power characteristics, performance characteristics, price and availability of devices, programming hardware and software development tools;
- the ability to engage with companies that provide synergistic products and services;
- the incorporation of industry standards in our products and solutions;
- the diversity of product offerings available to customers; or
- the quality and cost effectiveness of design, development, manufacturing and marketing efforts.

*Many system manufacturers may be unwilling to switch to our products because of their familiarity with the products offered by our direct competitors, such as Xilinx, Inc. and Altera Corporation, which compete with us in the sale of FPGAs*

Companies that compete with our mature product family and end-of-life product family, and certain CSSP and new product opportunities, include suppliers of complex programmable logic devices and field programmable gate arrays, such as Xilinx, Inc., Altera Corporation, Actel Corporation and Lattice Semiconductor Corporation. Xilinx and Altera together have a majority share of the programmable logic market. Many system manufacturers may be unwilling or unable to switch to our products due to their familiarity with competitors' products or other inhibiting factors.



The semiconductor industry is intensely competitive and characterized by:

- erosion of selling prices over product lives;
- rapid technological change;
- short product life cycles; and
- strong domestic and foreign competition.

If we are not able to compete successfully in this environment, our business will be materially harmed.

Many of the companies that compete with CSSPs and our new product, mature and end-of-life families have substantially greater financial, technical, manufacturing, marketing, sales, distribution, name recognition and other resources than we do. In addition, many of our competitors have well established relationships with our current and potential customers and have extensive knowledge of system applications. In the past, we have lost potential customers to competitors for various reasons, including, but not limited to, re-programmability and lower price.

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***We 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 significant portion of our products. We typically have only a few distributors and a single representative serving each geographic market and, in the future, we may have a single distributor covering a geographic market. 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.

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, due for instance to their financial health or the liquidity of their investments, our financial results may be materially harmed.

***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 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.

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

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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.

*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.

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*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. Our Common Stock has at times traded below \$1.00 during the fiscal fourth quarter of 2008. 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. The Nasdaq Stock Market suspended the minimum closing bid requirements until January 2009.

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. Our stock is thinly traded and the decisions by significant shareholders to acquire or dispose of our stock can have a material impact on stock price. 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 are promulgated by, and are subject to the interpretation of the 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.

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*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

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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.

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.



*The Company, our directors and management have in the past 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.
10.20	Second Amendment to Lease Agreement between NetApp, Inc. and the registrant effective September 25, 2008.
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.

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(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.

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**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/ CARL M. MILLS

Carl M. Mills

*Chief Financial Officer*

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

Date: November 6, 2008

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