COMPUTER TASK GROUP INC
Form SC 13G/A
February 11, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 13G

(Rule 13d-102)

INFORMATION TO BE INCLUDED IN STATEMENTS FILED PURSUANT

TO RULES 13d-1(b)(c), AND (d) AND AMENDMENTS THERETO FILED

PURSUANT TO RULE 13d-2(b)

(Amendment No. 6)*

COMPUTER TASK GROUP, INC

(Name of Issuer)

COMMON STOCK

(Title of Class of Securities)

205477102

(CUSIP Number)

December 31, 2004

(Date of Event Which Requires Filing of this Statement)

Check the appropriate box to designate the Rule pursuant to which this Schedule is filed:

x Rule 13d-1(b)

¨ Rule 13d-1(c)

¨ Rule 13d-1(d)

* The remainder of this cover page shall be filled out for a reporting person s initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter disclosures provided in a prior cover page.

The information required on the remainder of this page shall not be deemed to be filed for the purpose of Section 18 of the Securities Exchange Act of 1934 (Act) or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, *see* the *Notes.*)

(Continued on following page(s))

1 NAMES OF REPORTING PERSONS

I.R.S. IDENTIFICATION NO. OF ABOVE PERSONS (ENTITIES ONLY):

Bank of America Corporation

56-0906609

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP*

(a) ¨

(b) ¨

3 SEC USE ONLY

4 CITIZENSHIP OR PLACE OF ORGANIZATION

Delaware

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	
	5 SOLE VOTING POWER 0
	6 SHARED VOTING POWER 2,149,841
	7 SOLE DISPOSITIVE POWER 0
	8 SHARED DISPOSITIVE POWER 2,192,641

9 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

2,192,641

10 CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES* ¨

11 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9)

10.51%

12 TYPE OF REPORTING PERSON*

HC

* **SEE INSTRUCTIONS BEFORE FILLING OUT!**

1 NAMES OF REPORTING PERSONS

I.R.S. IDENTIFICATION NO. OF ABOVE PERSONS (ENTITIES ONLY):

Fleet National Bank

04-2472499

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP*

(a) ¨

(b) ¨

3 SEC USE ONLY

4 CITIZENSHIP OR PLACE OF ORGANIZATION

United States

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	
	5 SOLE VOTING POWER 510,441
	6 SHARED VOTING POWER 1,637,900
	7 SOLE DISPOSITIVE POWER 547,241
	8 SHARED DISPOSITIVE POWER 1,643,900

9 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

2,191,141

10 CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES* ¨

11 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9)

10.5%

12 TYPE OF REPORTING PERSON*

BK

* **SEE INSTRUCTIONS BEFORE FILLING OUT!**

1 NAMES OF REPORTING PERSONS

I.R.S. IDENTIFICATION NO. OF ABOVE PERSONS (ENTITIES ONLY):

Columbia Management Group, Inc.

01-0547933

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP*

(a) ¨

(b) ¨

3 SEC USE ONLY

4 CITIZENSHIP OR PLACE OF ORGANIZATION

Delaware

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	
	5 SOLE VOTING POWER 0
	6 SHARED VOTING POWER 1,637,900
	7 SOLE DISPOSITIVE POWER 0
	8 SHARED DISPOSITIVE POWER 1,637,900

9 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

1,637,900

10 CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES* ¨

11 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9)

7.85%

12 TYPE OF REPORTING PERSON*

CO

* **SEE INSTRUCTIONS BEFORE FILLING OUT!**

1 NAMES OF REPORTING PERSONS

I.R.S. IDENTIFICATION NO. OF ABOVE PERSONS (ENTITIES ONLY):

Columbia Management Advisors, Inc.

93-1234220

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP*

(a) ¨

(b) ¨

3 SEC USE ONLY

4 CITIZENSHIP OR PLACE OF ORGANIZATION

Oregon

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	
	5 SOLE VOTING POWER 1,637,900
	6 SHARED VOTING POWER 0
	7 SOLE DISPOSITIVE POWER 1,637,900
	8 SHARED DISPOSITIVE POWER 0

9 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

1,637,900

10 CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES* ¨

11 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9)

7.85%

12 TYPE OF REPORTING PERSON*

CO

* **SEE INSTRUCTIONS BEFORE FILLING OUT!**

1 NAMES OF REPORTING PERSONS

I.R.S. IDENTIFICATION NO. OF ABOVE PERSONS (ENTITIES ONLY):

Bank of America, NA

86-0645265

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP*

(a) ¨

(b) ¨

3 SEC USE ONLY

4 CITIZENSHIP OR PLACE OF ORGANIZATION

United States

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	
5 SOLE VOTING POWER	0
6 SHARED VOTING POWER	1,500
7 SOLE DISPOSITIVE POWER	0
8 SHARED DISPOSITIVE POWER	1,500

9 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

1,500

10 CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES* ¨

11 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9)

0.01%

12 TYPE OF REPORTING PERSON*

BK

* **SEE INSTRUCTIONS BEFORE FILLING OUT!**

1 NAMES OF REPORTING PERSONS

I.R.S. IDENTIFICATION NO. OF ABOVE PERSONS (ENTITIES ONLY):

NB Holdings Corporation

56-1857749

2 CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP*

(a) ¨

(b) ¨

3 SEC USE ONLY

4 CITIZENSHIP OR PLACE OF ORGANIZATION

Delaware

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH	
	5 SOLE VOTING POWER 0
	6 SHARED VOTING POWER 1,500
	7 SOLE DISPOSITIVE POWER 0
	8 SHARED DISPOSITIVE POWER 1,500

9 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

1,500

10 CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES* ¨

11 PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9)

0.01%

12 TYPE OF REPORTING PERSON*

HC

* **SEE INSTRUCTIONS BEFORE FILLING OUT!**

Item 1 (a). Name of Issuer:

Computer Task Group, Inc.

Item 1 (b). Address of Issuer s Principal Executive Offices:

800 Delaware Avenue

Buffalo, NY 14209

Item 2 (a). Name of Person Filing:

Bank of America Corporation

Fleet National Bank

Columbia Management Group, Inc.

Columbia Management Advisors, Inc.

NB Holdings Corporation

Bank of America N.A.

Item 2 (b). Address of Principal Business Office or, if None, Residence:

Each Reporting Person has its or his principal business office at 100 North Tryon

Street, Floor 25, Bank of America Corporate Center, Charlotte, NC 28255.

Item 2 (c). Citizenship:

Bank of America Corporation	Delaware
Fleet National Bank	United States
Columbia Management Group, Inc.	Delaware
Columbia Management Advisors, Inc.	Oregon
NB Holdings Corporation	Delaware
Bank of America N.A.	United States

Item 2 (d). Title of Class of Securities:

Common Stock

Item 2 (e). CUSIP Number:

205477102

Item 3. If This Statement is Filed Pursuant to Rule 13d-1(b), or 13d-2(b) or (c), Check Whether the Person Filing is a:

(a) ¨ Broker or dealer registered under Section 15 of the Exchange Act.

(b) ¨ Bank as defined in Section 3(a)(6) of the Exchange Act.

(c) ¨ Insurance company as defined in Section 3(a)(19) of the Exchange Act.

(d) ¨ Investment company registered under Section 8 of the Investment Company Act.

(e) ¨ An investment adviser in accordance with Rule 13d-1(b)(1)(ii)(E).

(f) ¨ An employee benefit plan or endowment fund in accordance with Rule 13d-1(b)(1)(ii)(F).

(g) x A parent holding company or control person in accordance with Rule 13d-1(b)(1)(ii)(G).

(h) ¨ A savings association as defined in Section 3(b) of the Federal Deposit Insurance Act.

(i) ¨ A church plan that is excluded from the definition of an investment company under Section 3(c)(14) of the Investment Company Act.

(j) ¨ Group, in accordance with Rule 13d-1(b)(1)(ii)(J).

If this statement is filed pursuant to Rule 13d-1(c), check this box. ¨

Item 4. Ownership:

With respect to the beneficial ownership of the reporting person, see Items 5 through 11 of the cover pages to this Schedule 13G, which are incorporated herein by reference.

Item 5. Ownership of Five Percent or Less of a Class:

If this statement is being filed to report the fact that as of the date hereof the reporting person has ceased to be the beneficial owner of more than five percent of the class of securities, check the following ¨.

Item 6. Ownership of More than Five Percent on Behalf of Another Person:

Not applicable.

Item 7. Identification and Classification of the Subsidiary which Acquired the Security Being Reported on By the Parent Holding Company:

With respect to Subsidiary Identification and Classification, see Items 5 through 11 of the cover pages to this Schedule 13G, which are incorporated herein by reference.

Item 8. Identification and Classification of Members of the Group:

Not applicable.

Item 9. Notice of Dissolution of Group:

Not applicable.

Item 10. Certification:

By signing below each of the undersigned certifies that, to the best of such undersigned s knowledge and belief, the securities referred to above were not acquired and are not for the purpose of or with the effect of changing or influencing the control of the issuer of the securities and were not acquired and are not held in connection with or as a participant in any transaction having that purpose or effect.

SIGNATURE

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Dated: February 11, 2005

Bank of America Corporation

NB Holdings Corporation

Bank of America NA

Fleet National Bank

By: /s/ Charles F. Bowman

Charles F. Bowman
Senior Vice President

Columbia Management Group, Inc.

Columbia Management Advisors, Inc.

By: /s/ Keith Banks

Keith Banks
President

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We have technological core competencies in the design of integrated circuits to enable network-aware and content-aware processing using very large databases. Our products integrate in a single integrated circuit high performance processing, storage circuitry, control functionality and advanced I/O interfaces. Due to the highly specialized nature of our design process, we implement almost all portions of our product design without third party technology, with the exception of readily available intellectual property to implement standard functions, such as memory and timing control circuits.

We have assembled a research and development team with extensive expertise in the following areas:

Transistor-level Circuit Design. A common approach to application specific processor design is to use pre-defined logic functions. This approach is used extensively to shorten the development cycle by allowing an automated process for mapping a product s logical definition to its construction in silicon. In order to provide processors that feature high speed, low power dissipation and small form factors, we use a more

fundamental approach using transistor-level circuit design. With this highly-customized design flow, we are able to implement processing elements that are defined at the most fundamental transistor level and therefore provide higher levels of performance. We employ standard simulation tools that are commonly used in the transistor-level design of analog products. We complement these tools with unique and proprietary methods to meet the complex design requirements of our knowledge-based processors.

Full-custom Layout. In order to implement a transistor-level circuit design, we use a full-custom layout flow to define how circuits are constructed in silicon. This flow enables us to control transistor characteristics to optimize circuit design and minimize chip size. By minimizing chip size, we are able to reduce the cost of our knowledge-based processors. This flow also enables us to control the precise layout of transistors and the connections between them in order to reduce power dissipation. Minimizing the power dissipated by integrated circuits becomes increasingly important for networking systems, which are increasingly designed in small form factors.

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Advanced Design Architecture. By working closely with the engineering and design teams of our OEM customers, we utilize our design architecture skills to help ensure that our knowledge-based processors are deployed within their systems in a manner that best addresses their target applications. This product architecture task involves effective partitioning of our processors resources to multiple network decision processes, optimized timing to ensure efficient interfaces to other devices and determination of instruction sequences to allow for unique applications. We have acquired our advanced design architecture skills and application knowledge through close collaboration with networking OEMs during the development of successive generations of our products.

Device Physics. We possess a comprehensive understanding of device physics, which is important to the development of our knowledge-based processors. This understanding includes not only the desired transistor characteristics to be implemented but also the way in which process variations can affect the operation of an integrated circuit. To mitigate these effects, we utilize our extensive knowledge of device physics and skills in conjunction with standard tools to make circuit-level design modifications or manufacturing process changes to improve the performance of our products.

Software Product Code and Development Tools. Our knowledge-based processors are delivered to our OEM customers with a suite of supporting software that is intended to accelerate the integration of our solutions in their overall system environment. This product code includes database management software to assist in the initialization and management of records retained on our knowledge-based processors, as well as software used to communicate with our processor. In addition, we provide our OEM customers with emulation and modeling software for the design and verification of their software and hardware. We develop software packages using a team of engineers that possess advanced system knowledge and device modeling skills.

High-speed I/O Interface. Our products interface with high performance packet processors that utilize our knowledge-based processors to decide what action to take on an incoming packet of information. Due to the nature of this functional partitioning, a very high bandwidth connection is required between the packet processor and our knowledge-based processor. To meet the complex requirements of this interface, we develop custom high-speed I/O interfaces. We develop these circuits with advanced technology to support integrated circuit-to-integrated circuit communications.

Manufacturing

We design and develop our products and electronically transfer our proprietary designs to third party wafer foundries to manufacture our products. Wafers processed by these foundries are shipped to our subcontractors, where they are assembled into finished products and electronically tested before delivery to our customers. We believe that this manufacturing model significantly reduces our capital requirements and allows us to focus our resources on the design, development and marketing of our products.

Our principal wafer foundry is TSMC in Taiwan, and we also use UMC in Taiwan. We are actively involved with product development on next-generation processes, and are designing products on TSMC s 90-nanometer process geometries and higher. The latest generation of our products employs up to eight layers of copper interconnect and 300 millimeter wafer sizes.

Our products are designed to use industry standard packages and be tested using widely available automatic test equipment. We develop and control product test programs used by our subcontractors based on our product specifications. We currently rely on ASAT Holdings Limited in Hong Kong, Amkor Technology, Inc., Advanced Semiconductor Engineering, Inc. in Taiwan, King Yuan Electronics Co., Ltd. in Taiwan, ISE Labs, Inc. and Viko Test Lab in the U.S. to assemble and test our products. In February 2005, we established a representative office in Taiwan to employ local personnel to work directly with our Asian wafer manufacturers and assembly and test houses to facilitate manufacturing

operations.

We have designed and implemented an ISO9001-certified quality management system that provides the framework for continual improvement of our products, processes and customer service. We apply

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well-established design rules and practices for CMOS devices through standard design, layout and test processes. We also rely on in-depth simulation studies, testing and practical application testing to validate and verify our products. We emphasize a strong supplier quality management practice in which our manufacturing suppliers are pre-qualified by our operations and quality teams. To ensure consistent product quality, reliability and yield, we closely monitor the production cycle by reviewing electrical, parametric and manufacturing process data from each of our wafer foundries and assembly subcontractors. We currently do not have long-term supply contracts with any of our significant third party manufacturing service providers. We generally place purchase orders with these providers according to terms and conditions of sale which specify price and 30-day payment terms and which limit the providers liability.

Competition

The markets for our products are highly competitive. We believe that the principal bases of competition are:

- processing speed;
- power dissipation;
- capacity of the knowledge database that can be processed;
- advanced product features allowing OEM and system customer product differentiation;
- price;
- product availability and reliability;
- customer support and responsiveness;
- timeliness of new product introductions; and
- credibility of supplier to design and manufacture product.

We believe that we compete favorably with respect to each of the bases identified above. However, some of our larger competitors have greater financial resources and a longer track record as a semiconductor supplier than we do. We anticipate that the market for our products will be subject to rapid technological change. As we enter new markets and pursue additional applications for our products, we expect to face competition from a larger number of competitors. Within our target market, we primarily compete with certain divisions of Integrated Device Technology, Inc. and Renesas Technology, Corp. In the new Layer 7 target market, we believe that Tarari, Inc. and Sensory Networks, Inc are principal competitors of ours. We expect to face competition in the future from our current competitors, other manufacturers and designers of semiconductors, including large integrated device manufacturers, and innovative start-up semiconductor design companies.

Intellectual Property

Our success and future growth will depend, in part, on our ability to protect our intellectual property. We rely primarily on patent, copyright, trademark and trade secret laws to protect our intellectual property. We also attempt to protect our trade secrets and other proprietary information through agreements with our customers, suppliers, employees and consultants and through security protection of our computer network and physical premises. However, these measures may not provide meaningful protection for our intellectual property. While our patents and other intellectual property rights are important, we believe that our technical expertise and ability to introduce new products in a timely manner will also be important factors in maintaining our competitive position.

As of February 21, 2006, we held 140 issued U.S. patents, 7 issued foreign patents, and numerous patent applications pending in the U.S and abroad. We may not receive any additional patents as a result of these applications or future applications. Nonetheless, we continue to pursue the filing of additional patent applications. Any rights granted under any of our existing or future patents may not provide meaningful protection or any commercial advantage to us.

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Many participants in the semiconductor industry have a significant number of patents and have frequently demonstrated a willingness to commence litigation based on allegations of patent and other intellectual property infringement. From time to time, we have received, and expect to continue to receive, notices of claims of infringement or misappropriation of other parties proprietary rights. In the event any such claims result in legal actions, we cannot assure you that we will prevail in these actions, or that other actions alleging infringement by us of third party intellectual property rights, misappropriation or misuse by us of third party trade secrets, or invalidity or unenforceability of our patents will not be asserted against us or that any assertions of infringement, misappropriation, misuse, invalidity or unenforceability will not materially and adversely affect our business, financial condition and results of operations.

We intend to protect our rights vigorously, but there can be no assurance that our efforts will be successful. Thus, despite our precautions, a third party may copy or otherwise obtain and use our products, services or technology without authorization, develop similar technology independently or design around our patents. In addition, effective patent, copyright, trademark and trade secret protection may be unavailable or limited in certain foreign countries. Moreover, we often incorporate the intellectual property of third parties into our designs, which is subject to certain obligations with respect to the non-use and non-disclosure of such intellectual property. We cannot assure you that the steps we have taken to prevent infringement, misappropriation or misuse of our intellectual property or the intellectual property of third parties will be successful. Furthermore, enforcement of our intellectual property rights may divert the efforts and attention of our management team and may be costly to us.

Agreement with Micron Technology

Under a license and technology transfer agreement with Micron Technology, Inc., or Micron, as amended in May 2003, we have granted Micron a non-transferable, non-exclusive limited license that gives Micron the right to arrange for the manufacture of one of our NL5000GLQ products at our designated wafer foundry and to sell worldwide the product supplied by that foundry. Micron has paid us license and design fees totaling $4.6 million through December 31, 2005, and under the agreement must pay us additional design fees of up to approximately $0.7 million under specified circumstances, including achievement of particular milestones. Micron must pay us royalties under specified circumstances. The agreement expires in December 2006, and Micron s license rights will survive termination of the agreement, subject to payment of all required fees and royalties and compliance with other continuing obligations of Micron under the agreement. To date, Micron has not exercised its license rights under the agreement, and we do not expect Micron to do so in the foreseeable future.

The license and technology transfer agreement further provides that Micron may design specified versions of our NL5000GLQ products or other products compliant to the LA-1 interface, a high-speed interface based on the LA-1 standard defined by the Networking Processing Forum. In the event Micron develops these products, we would have the option to receive a non-transferable, non-exclusive limited license that would allow us to have these Micron products manufactured for us at Micron s facility with the additional right to sell them worldwide. Further, if we were to exercise these license rights, we would be required to pay design fees and royalties to Micron. Under specified conditions, Micron s design rights and our related license rights will survive termination of the agreement, subject to payment of all required fees and royalties and compliance with other continuing obligations of both parties under the agreement. To date, Micron has not exercised its design rights under the agreement, and we do not expect Micron to do so in the foreseeable future.

Employees

As of December 31, 2005, we had 110 full-time employees, including 67 in research and development, 21 in operations, 13 in sales and marketing and 9 in general and administrative. None of our employees are covered by collective bargaining agreements. We believe our relations with our employees are good.

Available Information

Our Web site address is www.netlogicmicro.com. The information in our Web site is not incorporated by reference into this report. Through a link on the Investor Relations section of our Web site, we make available

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our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after they are filed with, or furnished to, the Securities and Exchange Commission.

ITEM 1A. RISK FACTORS.

If any of the following risks actually occur, our business, results of operations and financial condition could suffer significantly.

We expect to derive most of our revenue from sales of our knowledge-based processors, and, if the demand for these products does not grow, we may not achieve our growth and strategic objectives.

Our knowledge-based processors are used primarily in networking systems, including routers, switches, network access equipment and networked storage devices. We derive a substantial portion of our total revenue from sales of our knowledge-based processors in the networking market and expect to continue to derive a substantial portion of our total revenue from this market for the foreseeable future. Sales of our knowledge-based processors accounted for 93%, 86% and 43% of our total revenue during the year ended December 31, 2005, 2004 and 2003, respectively. We believe our future business and financial success depends on continued market acceptance and increasing sales of our knowledge-based processors. In order to meet our growth and strategic objectives, networking original equipment manufacturers, or OEMs, must continue to incorporate our products into their systems as their preferred means of enabling network-aware processing of IP packets, and the demand for their systems must grow as well. Thus, our future success depends in large part on factors outside our control, and sales of our knowledge-based processors may not meet our revenue growth and strategic objectives.

Because we rely on a small number of customers for a significant portion of our total revenue, the loss of, or a significant reduction in, orders for our products from these customers would negatively affect our total revenue and business.

To date, we have been dependent upon orders for sales of knowledge-based processors to a limited number of customers, and, in particular, Cisco, for most of our total revenue. During the year ended December 31, 2005, 2004 and 2003, Cisco and its contract manufacturers accounted for 74%, 73% and 34% of our total revenue, respectively. We expect that our future financial performance will continue to depend in large part upon our relationship with Cisco and several other networking OEMs.

We cannot assure you that existing or potential customers will not develop their own solutions, purchase competitive products or acquire companies that use alternative methods to enable network-aware processing in their systems. We do not have long-term purchase commitments from any of our OEM customers or their contract manufacturers. Although we recently entered into master purchase agreements with Cisco and one of its foreign affiliates, these agreements do not include any long-term purchase commitments. Cisco and our other customers do business with us currently only on the basis of short-term purchase orders (subject, in the case of Cisco, to the terms of the master purchase agreements), which often are cancelable prior to shipment. The loss of orders for our knowledge-based processors for Cisco products or products of other major users of our knowledge-based processors would have a significant negative impact on our business.

We face additional risks to our business success and financial condition because of our dependence on a small number of customers for sales of our products.

Our dependence on a small number of customers, especially Cisco and its contract manufacturers, for most of our revenue in the foreseeable future creates additional risks for our business, including the following:

- we may face increased pressure to reduce the average selling prices of our knowledge-based processors;

- we may find it difficult to pass through increases in our manufacturing and other direct costs;

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the reputation of our knowledge-based processors in the marketplace may be affected adversely if Cisco or other networking OEMs that represent a significant percentage of our sales of knowledge-based processors reduce or cease their use of our products; and

we may face problems in collecting a substantial portion of our accounts receivable if any of these companies faces financial difficulties or dispute payments.

We have a history of net losses, may incur significant net losses in the future and may not be able to sustain profitability.

Although we reported net income of $16.4 million during the year ended December 31, 2005, we reported net losses in years prior to fiscal 2005. At December 31, 2005, we had an accumulated deficit of approximately $82.7 million. To sustain profitability, we will have to continue to generate greater total revenue and control costs and expenses. We cannot assure you that we will be able to generate greater total revenue, or limit our costs and expenses, sufficiently to sustain profitability on a quarterly or annual basis.

Our limited history of sales of our knowledge-based processors makes it difficult to evaluate our prospects.

Although our first knowledge-based processor was introduced in the second quarter of 2002, we did not have significant sales of these products until the third quarter of 2003. We cannot provide assurance that sales of our knowledge-based processors will increase substantially in the future. Due to our limited historical sales data and the high concentration of our sales with a small number of networking OEMs, our ability to predict future sales and operating results for our products is limited, and, accordingly, prior quarterly or annual results may not be an indication of our future revenue growth or financial results.

Because we sell our products on a purchase order basis and rely on estimated forecasts of our customers needs, inaccurate forecasts could adversely affect our business.

We sell our products pursuant to individual purchase orders (subject, in the case of Cisco, to the terms of a master purchase agreement), and not pursuant to long-term purchase commitments. Therefore, we rely on estimated demand forecasts, based upon input from our customers, to determine how much product to manufacture. Because our sales are based on purchase orders, our customers may cancel, delay or otherwise modify their purchase commitments with little or no consequence to them and with little or no notice to us. For these reasons, we generally have limited visibility regarding our customers product needs. We cannot provide assurance as to the quantities or timing required by our customers for our products. We cannot assure you that we will not experience subsequent substantial warranty claims or that warranty claims will not result in cancellation of existing orders or reluctance of customers to place future orders. In addition, the product design cycle for networking OEMs is lengthy, and it may be difficult for us to accurately anticipate when they will commence commercial shipments of products that include our knowledge-based processors. Whether in response to changes affecting the industry or a customer s specific business pressures, any cancellation, delay or other modification in our customers orders could significantly reduce our revenue, cause our operating results to fluctuate from period to period and make it more difficult for us to predict our revenue. In the event of a cancellation or reduction of an order, we may not have enough time to reduce operating expenses to minimize the effect of the lost revenue on our business, and we may purchase too much inventory and spend more capital than expected.

As a result of acquiring Cypress Semiconductor s Network Search Engine Products on February 15, 2006, we began selling some of the acquired products through a distributor previously used by Cypress. The distributor has sole authority to accept returns from end customers in the ordinary course of business. Because we recognize revenue when the distributor sells product to end customers, returns from end customers to our distributor reduce our reported sales. We have no direct control over our distributor s policies or practices on accepting customer returns and

may have no forewarning of significant customer returns. Consequently, large returns could have an unexpected material adverse impact on our sales.

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We do not expect to sustain our recent revenue growth rate.

We have recently experienced significant revenue growth. Specifically, our total revenue increased 253% from $13.5 million in 2003 to $47.8 million during the year ended December 31, 2004 and by 71% from 2004 to $81.8 million for the year ended December 31, 2005. We do not expect similar revenue growth rates in future periods. Accordingly, you should not rely on the results of any prior quarterly or annual periods as an indication of the future rate of our revenue growth or our future financial results.

We are dependent on contract manufacturers for a significant portion of our revenue.

Many of our OEM customers, including Cisco, use third party contract manufacturers to manufacture their networking systems. These contract manufacturers represented 79%, 78% and 38% of our total revenue for the year ended December 31, 2005, 2004 and 2003, respectively. Contract manufacturers purchase our products directly from us on behalf of networking OEMs. Although we work with our OEM customers in the design and development phases of their systems, these OEM customers are gradually giving contract manufacturers more authority in product purchasing decisions. As a result, we depend on a concentrated group of contract manufacturers for a substantial portion of our revenue. If we cannot compete effectively for the business of these contract manufacturers or if any of the contract manufacturers, which work with our OEM customers, experience financial or other difficulties in their businesses, our revenue and our business could be adversely affected. In particular, if one of our OEM customer s contract manufacturers becomes subject to bankruptcy proceedings, neither we nor our OEM customer may be able to obtain any of our products held by the contract manufacturer. In addition, we may not be able to recover any payments owed to us by the contract manufacturer for products already delivered or recover the products held in the contract manufacturer s inventory when the bankruptcy proceeding is initiated. If we are unable to deliver our products to our OEM customers in a timely manner, our business would be adversely affected.

The average selling prices of our products may decline, which could reduce our revenue and gross margin.

The average selling prices of our products are expected to decline over the course of their commercial lives, principally due to the supply of competing products, reduction in demand from customers, pressure from customers to reduce prices and product cycle changes. In addition, under our master purchase agreements with Cisco, we agreed to provide to Cisco all price decreases that we achieve, and granted to Cisco the right (under limited circumstances) to purchase our knowledge-based processors directly from our manufacturers (subject to payments to us, net of specified costs). Declining average selling prices will adversely affect our future operating results. To maintain acceptable operating results, we will need to develop and introduce new products and product enhancements on a timely basis and continue to reduce our costs. If we are unable to offset any reductions in our average selling prices by increasing our sales volumes and achieving corresponding production cost reductions, or if we fail to develop and introduce new products and enhancements on a timely basis, our revenue and operating results will suffer.

We rely on third parties for the manufacture of our products, and a significant increase in wafer pricing or our failure to secure sufficient capacity could limit our growth and adversely affect our operating results.

As a fabless semiconductor company, we rely on third-party wafer foundries to manufacture our products. We currently do not have long-term supply contracts with either of our wafer foundries, Taiwan Semiconductor Manufacturing Co., Ltd., or TSMC, and United Microelectronics Corporation, or UMC. Neither TSMC nor UMC is obligated to perform services or supply products to us for any specific period, in any specific quantities or at any specific price, except as may be provided in a particular purchase order. As a result, there are numerous risks associated with our reliance on these wafer foundries, including the possibilities that TSMC or UMC may give higher priority to their other customers or that our

relationships with either wafer foundry may deteriorate. We cannot assure you that TSMC and UMC will continue to provide us with our products at acceptable yields or in

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sufficient quantities, for reasonable costs and on a timely basis to meet our customers needs. A failure to ensure the timely fabrication of our products could cause us to lose customers and could have a material adverse effect on our operating results.

If either wafer foundry, and in particular TSMC, ceases to provide us with required production capacity with respect to our products, we cannot assure you that we will be able to obtain manufacturing capacity from other wafer foundries on commercially reasonable terms or that these arrangements, if established, will result in the successful manufacturing of our products. These arrangements might require us to share our technology and might be subject to unilateral termination by the wafer foundries. Even if such capacity is available from another manufacturer, we would need to convert the production of our integrated circuits to a new fabrication process and qualify the other manufacturer, which process could take nine months or longer. Furthermore, we may not be able to identify or qualify manufacturing sources that would be able to produce wafers with acceptable manufacturing yields.

We also rely on third parties for other products and services, including the assembly and testing of our products, and any failure by third parties to provide the tools and services we require could limit our growth and adversely affect our future operating results.

All of our products are assembled and tested by third-party vendors and require the use of high performance assembly and test equipment. In addition, in connection with the design of our products, we use software tools, which we obtain from third party software vendors, for simulation, layout and other design purposes. Our reliance on independent assembly, testing, software and other vendors involves a number of risks, including reduced control over delivery schedules, quality assurance and costs. We currently do not have long-term supply contracts with all of these third party vendors. As a result, most of these third party vendors are not obligated to provide products or perform services to us for any specific period, in any specific quantities or at any specific price, except as may be provided in a particular purchase order. The inability of these third party vendors to deliver high performance products or services of acceptable quality and in a timely manner, could lengthen our design cycle, result in the loss of our customers and reduce our revenue.

Our costs may increase substantially if the wafer foundries, assembly and test vendors that supply and test our products do not achieve satisfactory product yields, reliability or quality.

The wafer fabrication process is an extremely complicated process where the slightest changes in the design, specifications or materials can result in material decreases in manufacturing yields or even the suspension of production. From time to time, we and our wafer foundries have experienced, and are likely to continue to experience manufacturing defects and reduced manufacturing yields related to errors or problems in our wafer foundries manufacturing processes or the interrelationship of their processes with our designs. In some cases, our wafer foundries may not be able to detect these defects early in the fabrication process or determine the cause of such defects in a timely manner, which may affect the quality or reliability of our products. We may incur substantial research and development expense for prototype or development stage products as we qualify the products for production.

Generally, in pricing our knowledge-based processors, we assume that manufacturing, assembly and test yields will continue to increase, even as the complexity of our products increases. Once our products are initially qualified with our wafer foundries, minimum acceptable yields are established. We are responsible for the costs of the wafers if the actual yield is above the minimum. If actual yields are below the minimum, we are not required to purchase the wafers. The minimum acceptable yields for our new products are generally lower at first and increase as we achieve full production. Whether as a result of a design defect or manufacturing, assembly or test error, unacceptably low product yields or other product manufacturing, assembly or test problems could substantially increase the overall production time and costs and adversely impact our operating results on sales of our products. Product yield losses will increase our costs and reduce our gross margin. In addition to significantly harming our operating results and cash flow, poor yields may delay shipment of our products and harm our relationships with existing and potential customers.

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To be successful we must continue to develop and have manufactured for us, innovative products to meet the evolving requirements of networking OEMs.

To remain competitive, we devote substantial resources to research and development, both to improve our existing knowledge-based processor technology and to develop new technology. We also seek to improve the manufacturing processes for our knowledge-based processors, including the use of smaller process geometries, which we believe is important for our products to serve our OEM customers requirements for increased network-aware processing. Our failure to migrate our knowledge-based processors to logic processes at smaller process geometries could substantially reduce the future competitiveness of our products. In addition, from time to time, we may have to redesign some of our knowledge-based processors or modify the manufacturing process for them. We cannot give you any assurance that we will be able to improve our existing knowledge-based processor technology or develop and integrate new technology into our products. Even if we design better knowledge-based processors, we may encounter problems during the manufacturing or assembly process, including reduced manufacturing yields, production delays and increased expenses, all of which could adversely affect our business and results of operations.

In addition, given the highly complex nature of these products, even the slightest change or adjustment to our integrated circuit designs could require substantial resources to implement them. We may not be able to make these changes or adjustments to our knowledge-based processors or correct any errors or defects arising from their implementation. Failure to make these changes or adjustments or correct these errors or defects during the product development stages, or any resulting delays, could severely harm our existing and potential customer relationships and could likely increase our development costs, adversely affecting our operating results. If these changes, adjustments, errors or defects are not identified or requested until after commercial production has begun or after products have been delivered to customers, we may be required to re-test existing inventory, replace products already shipped or re-design the products, all of which would likely result in significant time delays and additional costs and expenses. For example, we accelerated production of our knowledge-based processors to meet the schedule demands of Cisco in the fall of 2003. As a result of certain design issues, these production runs had relatively low production yields, which resulted in related costs and expenses of approximately $11.4 million in 2003 including $9.8 million in adverse purchase commitments, $1.0 million in warranty accruals and a $0.6 million write down of inventory.

We have sustained substantial losses from low production yields in the past and may incur such losses in the future.

Designing and manufacturing integrated circuits is a difficult, complex and costly process. Once research and development has been completed and the foundry begins to produce commercial volumes of the new integrated circuit, products still may contain errors or defects that could adversely affect product quality and reliability. We have experienced low yields and have incurred substantial research and development expenses in the design and initial production phases of all of our legacy network search engine products and knowledge-based processors during the past three years. For example, after the introduction of our first knowledge-based processor, we shipped a substantial quantity of these knowledge-based processors to Cisco in 2003, which processors met our yield objectives and passed the qualification and testing procedures that Cisco and we had applied to them. Subsequently, Cisco began to apply more rigorous testing on their networking systems that identified certain situations in which our products failed to perform to specification. As a result, Cisco returned these products to us under the terms of our standard warranty, and we replaced them with processors that passed more stringent testing procedures. The more stringent testing resulted in unusually low production yields which increased our per unit cost to an amount in excess of selling price. As a result of these events, we reduced the carrying value of our inventory at December 31, 2003 by $7.0 million to properly record them at their estimated market value. In addition, we established reserves to cover expected future losses on non- cancelable commitments to purchase wafers from our foundries as we estimated that the cost of these wafers and the additional expenses required to package and test the finished products would exceed the price at which the final products could be sold by approximately $3.4 million. The reserves were recorded in the third and fourth quarters

of 2003. Although the previously identified errors have not appeared in tests of Cisco networking systems replacement parts, and some of the products that we have written down may be reclassified as good parts and resold, we cannot assure you that this error or other material problems will not occur in knowledge-based processors that we have shipped previously or may ship in the future. Moreover, we cannot be certain that other low yield problems with similar or even greater consequences will not arise in the future.

If we fail to retain key personnel and hire additional personnel, our business and growth could be negatively affected.

Our business has been dependent to a significant degree upon the services of a small number of executive officers and technical employees. We generally do not have non-competition agreements or term employment agreements with any of our executive officers, whom we generally employ at will. We do not maintain key-man life insurance on the lives of any of our key personnel. The loss of any of these individuals could negatively impact our technology development efforts and our ability to service our existing customers and obtain new customers.

Our future growth will also depend, in part, upon our ability to recruit and retain other qualified managers, engineers and sales and marketing personnel. There is intense competition for these individuals in our industry, and we cannot assure you that we will be successful in recruiting and retaining these individuals. If we are unable to recruit and retain these individuals, our technology development and sales and marketing efforts could be negatively impacted.

If we fail to maintain competitive stock option packages for our employees, or if our stock price declines materially for a protracted period of time, we might have difficulty retaining our employees and our business may be harmed.

In today s competitive technology industry, employment decisions of highly skilled personnel are influenced by stock option packages, which offer incentives above traditional compensation only where there is a consistent, long-term upward trend over time of a company s stock price. If our stock price declines due to market conditions, investors perceptions of the technology industry or managerial or performance problems we have, our stock option incentives may lose value to key employees, and we may lose these employees or be forced to grant additional options to retain them. This in turn could result in:

- immediate and substantial dilution to investors resulting from the grant of additional options necessary to retain employees; and

- potential compensation charges against the company, which could negatively impact our operating results.

Our earnings will be adversely affected by the new stock option accounting rule and we may be forced to change our employee compensation and benefits practices.

Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), Share-Based Payment , which requires us to measure all employee stock-based compensation awards using a fair value method and record such expense in its financial statements. In addition, SFAS No. 123(R) requires additional accounting related to the income tax effects and additional disclosure regarding the cash flow effects resulting from share-based payment arrangements. Under SFAS No. 123(R), our stock-based compensation expenses will be higher and our net income will be reduced or net losses will be increased compared to our past accounting. As a consequence, we may consider reducing future stock option grants which could make it harder for us to retain existing employees and attract qualified candidates.

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A failure to successfully address the potential difficulties associated with international business could reduce our growth, increase our operating costs and negatively impact our business.

We conduct a significant amount of our business with companies that operate primarily outside of the United States, and intend to increase sales to companies operating outside of the United States. For example, our customers based outside the United States accounted for 33% of our total revenue during the year ended December 31, 2005, and for 7% of our total revenue during the year ended December 31, 2004. Not only are many of our customers located abroad, but our two wafer foundries are based in Taiwan, and we outsource the assembly and some of the testing of our products to companies based in Taiwan and Hong Kong. We face a variety of challenges in doing business internationally, including:

- foreign currency exchange fluctuations;
- unanticipated changes in local regulations;
- potentially adverse tax consequences, such as withholding taxes;
- timing and availability of export and import licenses;
- political and economic instability;
- reduced or limited protection of our intellectual property;
- protectionist laws and business practices that favor local competition; and
- additional financial risks, such as potentially longer and more difficult collection periods.

Because we anticipate that we will continue to rely heavily on foreign companies for our future growth, the occurrence of any of the circumstances identified above could significantly increase our operating costs, delay the timing of our revenue and harm our business and financial condition.

We must design our processors to meet the needs of our OEM customers and convince them to use our products, or our revenue will be adversely affected.

In general, our OEM customers design our processors into their products during the early stages of their development after an in-depth technical evaluation of both our and our competitors products. These design wins are critical to the success of our business. In competing for design wins, if a competitor s product is already designed into the product offering of a potential customer, it becomes very difficult for us to sell our products to that customer. Changing suppliers involves additional cost, time, effort and risk for the customer. In addition, our products must comply with the continually evolving specifications of networking OEMs. Our ability to compete in the future will depend, in large part, on our ability to comply with these specifications. As a result, we expect to invest significant time and effort and to incur significant expense to design our

products to ensure compliance with relevant specifications. Even if a networking OEM designs our knowledge-based processors into its systems, we cannot assure you that its systems will be commercially successful or that we will receive significant revenue from sales of knowledge-based processors for those systems.

Factors that negatively affect the businesses of the networking OEMs that use or could use our knowledge-based processors could negatively impact our total revenue.

The timing and amount of our revenue depend on the ability of the networking OEMs who use our knowledge-based processors to market, produce and ship systems incorporating our technology. Factors that negatively affect a significant customer or group of customers could negatively affect our results of operations and financial condition. Many issues beyond our control influence the success of the networking OEMs that use our products, including, for example, the highly competitive environment in which they operate, the strength of the markets for their products, their engineering capabilities, their ability or inability to obtain other components from other suppliers, the compatibility of any of their other components with our products, and their financial and other resources. Likewise, we have no control over their product development or pricing strategies, which

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directly affect sales of their products and, in turn, our revenue. A decline in sales of our OEM customers systems that use our knowledge-based processors would reduce our revenue. In addition, seasonal and other fluctuations in demand for their products could cause our operating results to fluctuate, which could cause our stock price to fall.

We have a lengthy sales cycle, which may result in significant expenses that do not generate significant revenue or delayed revenue generation from our selling efforts and limits our ability to forecast our revenue.

Based on our limited sales history for our knowledge-based processors, we have limited visibility on the length of the sales cycle for our knowledge-based processors. However, we expect that our product sales cycle, which results in our knowledge-based processors being designed into our customers products, could take up to 24 months. It can take an additional nine months to reach volume production of these products. A number of factors can contribute to the length of the sales cycle, including technical evaluations of our products by networking OEMs, the design process required to integrate our products into our OEM customers products and the timing of networking OEMs new product announcements. In anticipation of product orders, we may incur substantial costs before the sales cycle is complete and before we receive any customer payments. As a result, in the event that a sale is not completed or is cancelled or delayed, we may have incurred substantial expenses, making it more difficult for us to become profitable or otherwise negatively impacting our financial results. Furthermore, because of our lengthy sales cycle, our receipt of revenue from our selling efforts may be substantially delayed, our ability to forecast our future revenue may be more limited and our revenue may fluctuate significantly from quarter to quarter.

Our operating results could be adversely affected if we have to satisfy product warranty or liability claims.

If our products are defective or malfunction, we could be subject to product warranty or product liability claims, such as the return of our products under warranty sold to Cisco in the third and fourth quarters of 2003 and the first quarter of 2004. These returns resulted in warranty and related charges to our financial statements of approximately $1.0 million in the fourth quarter of 2003. Further, in connection with the master purchase agreements that we recently entered into with Cisco, we agreed to extended product warranties for the benefit of Cisco. Specifically, we agreed to general three-year warranties and, in the case of epidemic failures, to five-year warranties. While we have insurance for product liability claims for matters other than product warranty, we may not have sufficient insurance coverage for all of the claims that may be asserted against us. In addition, under the Cisco agreements, we have agreed to indemnify Cisco for costs incurred in rectifying epidemic failures, up to the greater of (on a per claim basis) 25% of all amounts paid to us by Cisco during the preceding 12 months or $9.0 million, plus replacement costs. If we are required to make payments under this indemnity, our operating results may be adversely affected. Moreover, these claims in the future, regardless of their outcome, could adversely affect our business.

Our revenue and operating results may fluctuate significantly from period to period, on a quarterly or annual basis, causing volatility in our stock price.

Our total revenue and operating results have fluctuated from quarter to quarter in the past and are expected to continue to do so in the future. As a result, you should not rely on quarter to quarter comparisons of our operating results as an indication of our future performance. Fluctuations in our total revenue and operating results could negatively affect the trading price of our stock. In addition, our total revenue and results of operations may, in the future, be below the expectations of analysts and investors, which could cause our stock price to decline. Factors that are likely to cause our revenue and operating results to fluctuate include, for example, the periodic costs associated with the generation of mask sets for new products and product improvements and the risk factors discussed throughout this section, as well as under the section of this prospectus identified as Management s Discuss and Analysis of Financial Condition and Results of Operations.

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We have grown rapidly, and a failure to manage any continued growth could reduce our potential revenue and could negatively impact our future operating results.

In order to successfully implement our overall growth strategies, we will need to carefully and efficiently manage our planned expansion. Among other things, this will require us to continue to:

- improve our existing knowledge-based processor technology and develop new processor technologies;
- implement and manage new marketing and distribution channels to penetrate different and broader markets for our products;
- manage an increasing number of complex relationships with our customers, wafer foundries and other third parties;
- monitor and improve our operating systems, procedures and financial controls on a timely basis;
- retain existing, and hire additional, key management and technical personnel; and
- expand, train and manage our workforce and, in particular, our development, sales, marketing and support organizations.

We may not be able to adequately manage our growth or meet the foregoing objectives. A failure to do so could jeopardize our future revenue and cause our stock price to decline.

Our ability to execute our business plan and grow our business will be heavily dependent on our management team s ability to work effectively together. We may incur additional costs as we effect this integration while also satisfying the enhanced financial management requirements that will be imposed on us as we manage our growth and become a public company.

The cyclical nature of the semiconductor industry and the networking markets could adversely affect our operating results and our business.

We expect our business to be subject to the cyclicality of the semiconductor industry, especially the market for communications integrated circuits. Historically, there have been significant downturns in this industry segment, characterized by reduced demand for integrated circuits and accelerated erosion of average selling prices. At times, these downturns have lasted for prolonged periods of time. Furthermore, from time to time, the semiconductor industry also has experienced periods of increased demand and production constraints, in which event we may not be able to have our products produced in sufficient quantities, if at all, to satisfy our customers needs. It is likely that the communications integrated circuit business will experience similar downturns in the future and that, during such times, our business could be affected adversely. It is also likely that the semiconductor industry will experience periods of strong demand. We may have difficulty in obtaining enough product to sell to our customers or may face substantial increases in the wafer prices charged by our foundries.

In addition, the networking industry from time to time has experienced and may experience a pronounced downturn. To respond to a downturn, many networking service providers may be required to slow their research and development activities, cancel or delay new product developments, reduce their workforces and inventories and take a cautious approach to acquiring new equipment and technologies from networking OEMs, which would have a significant negative impact on our business. In the future, a downturn in the networking industry may cause our operating results to fluctuate significantly from year to year, which also may tend to increase the volatility of the price of our common stock.

We may not be able to protect and enforce our intellectual property rights, which could impair our ability to compete and reduce the value of our technology.

Our success and future revenue growth depend, in part, on our ability to protect our intellectual property. We rely primarily on patent, copyright, trademark and trade secret laws, as well as confidentiality procedures, to protect our proprietary technologies and processes. However, these measures may not provide meaningful protection for our intellectual property.

We cannot assure you that any patents will issue from any of our pending applications. Any rights granted under any of our existing or future patents may not provide meaningful protection or any commercial advantage to us. For example, such patents could be challenged or circumvented by our competitors or declared invalid or unenforceable in judicial or administrative proceedings. The failure of any patents to adequately protect our technology would make it easier for our competitors to offer similar products. We do not have foreign patents or pending applications corresponding to many of our U.S. patents and patent applications, including in some foreign countries where our products are sold or may be sold in the future. Even if foreign patents are granted, effective enforcement in foreign countries may not be available.

With respect to our other proprietary rights, it may be possible for third parties to copy or otherwise obtain and use our proprietary technology or marks without authorization or to develop similar technology independently. Monitoring unauthorized use of our proprietary technology or marks is difficult and costly, and we cannot be certain that the steps we have taken will prevent misappropriation or unauthorized use of our technology or marks. In addition, effective patent, copyright, trademark and trade secret protection may not be available or may be limited in certain foreign countries. Many companies based in the U.S. have encountered substantial infringement problems in foreign countries, including countries in which we sell products. Our failure to effectively protect our intellectual property could reduce the value of our technology and could harm our business, financial condition and operating results.

Furthermore, we have in the past and may in the future initiate claims or litigation against third parties to determine the validity and scope of proprietary rights of others. In addition, we may in the future initiate litigation to enforce our intellectual property rights or the rights of our customers or to protect our trade secrets. Litigation by us could result in significant expense and divert the efforts of our technical and management personnel and could materially and adversely affect our business, whether or not such litigation results in a determination favorable to us.

Any claim that our products or our proprietary technology infringe third party intellectual property rights could increase our costs of operation and distract management and could result in expensive settlement costs.

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights or positions, which have resulted in often protracted and expensive litigation. From time to time, we are involved in litigation relating to intellectual property rights. In addition, we have received notices from time to time that claim we have infringed upon or misappropriated intellectual property rights owned by others. We typically respond when appropriate and as advised by legal counsel. We cannot assure you that parties will not pursue litigation with respect to those allegations. We may, in the future, receive similar notices, any of which could lead to litigation against us. For example, parties may initiate litigation based on allegations that we have infringed their intellectual property rights or misappropriated or misused their trade secrets or may seek to invalidate or otherwise render unenforceable one or more of our patents. Litigation against us can result in significant expense and divert the efforts of our management, technical, marketing and other personnel, whether or not the litigation results in a determination adverse to us. We cannot assure you that we will be able to prevail or settle any such claims or that we will be able to do so at a reasonable cost. In the event of an adverse result in any such litigation, we could be required to pay substantial damages for past infringement and royalties for any future use of the technology. In addition, we may be required to cease the sale of certain products, recall certain products from the market, redesign certain products offered for sale or under development or cease the use of certain marks or names. We cannot assure you that we will be able to successfully redesign our products or do so at a reasonable cost. Additionally, we have in the past sought and may in the future seek to obtain a license to a third party s intellectual rights and have granted and may in the future grant a license to certain of our intellectual property rights to a third party in connection with a cross-license agreement or a settlement of claims or actions asserted against us. However, we cannot assure you that we would be able to obtain a license on commercially reasonable terms, or at all.

Our customers could also become the target of litigation relating to the patent and other intellectual property rights of others. This could trigger technical support and indemnification obligations in some of our license or

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customer agreements. These obligations could result in substantial expenses, including the payment by us of costs and damages related to claims of patent infringement. In addition to the time and expense required for us to provide support or indemnification to our customers, any such litigation could disrupt the businesses of our customers, which in turn could hurt our relations with our customers and cause the sale of our products to decrease. We cannot assure you that claims for indemnification will not be made or that if made, such claims would not have a material adverse effect on our business, operating results or financial condition. We do not have any insurance coverage for intellectual property infringement claims for which we may be obligated to provide indemnification. If we are obligated to pay damages in excess of, or otherwise outside of, our insurance coverage, or if we have to settle these claims, our operating results could be adversely affected.

If we are unable to compete effectively, our revenue and market share may be reduced.

Our business is extremely competitive, especially during the design-in phase of networking OEMs design cycles. We compete with the enterprise and networking divisions of large semiconductor manufacturers, such as IDT and Renesas Technology, Corp., which have more established reputations, more diverse customer bases and greater financial and other resources than we do. In addition, our OEM customers may design their own integrated circuits to address their needs for network-aware processing. As we develop new applications for our knowledge-based processors and expand into new markets, we expect to face even greater competition. Our present and future competitors may be able to better anticipate customer and industry demands and to respond more quickly and efficiently to those demands, such as with product offerings, financial discounts or other incentives. Furthermore, our OEM customers may be able develop or acquire integrated circuits that satisfy their needs faster or most cost effectively than we can. We cannot assure you that we will be able to compete effectively against these and our other competitors. If we do not compete effectively, our revenue and market share may decline.

Any acquisitions we make, such as our recent acquisition of NSE products and business from Cypress Semiconductor, could disrupt our business, and harm our financial condition and dilute our stockholders.

In the future, we may consider opportunities to acquire other businesses or technologies that would complement our current offerings, expand the breadth of our markets or enhance our technical capabilities. Acquisitions, like our recent purchase of assets and intellectual property associated with Cypress Semiconductor s standard NSE products, present a significant number of potential challenges that could, if not met, disrupt our business operations, increase our operating costs, reduce the value to us of the acquired company or business, including:

- integration of the acquired employees, operations, technologies and products with our existing business and products;
- focusing management s time and attention on our existing core business;
- retention of business relationships with suppliers and customers of the acquired company;
- entering markets in which we may lack prior experience;
- retention of key employees of the acquired company or business;
- amortization of intangible assets, write-offs, stock-based compensation and other charges relating to the acquired business and our acquisition costs; and

dilution to our existing stockholders from the issuance of additional shares of common stock in connection with an acquisition that fails to increase the value of our company.

We cannot provide assurances, however, that this acquisition or future acquisitions that we might make will achieve our business objectives or increase our value or the price of our common stock.

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Our success may depend on our ability to comply with new or evolving industry standards applicable to our products or our business.

Our ability to compete in the future may depend on our ability to ensure that our products comply with evolving industry standards affecting the networking equipment and other markets in which we compete. In addition, from time to time, new industry standards may emerge which could render our products incompatible with the products of our customers or suppliers. In order to ensure compliance with the relevant standards, we may be required to devote significant time, capital and other resources to modify or redesign our existing products or to develop new products. We cannot assure you that we will be able to develop products which comply with prevailing standards. If we are unable to develop these products in a timely manner, we may miss significant business opportunities, and our revenue and operating results could suffer.

If an earthquake or other natural disaster disrupts the operations of our third party wafer foundries or other vendors located in high risk regions, we could experience significant delays in the production or shipment of our products.

TSMC and UMC, which manufacture our products, along with most of our vendors who handle the assembly and testing of our products, are located in Asia. The risk of an earthquake in the Pacific Rim region is significant due to the proximity of major earthquake fault lines. In September 1999, a major earthquake in Taiwan affected the facilities of several of these third party vendors, as well as other providers of these services. As a result of this earthquake, these vendors suffered power outages and disruptions that impaired their production capacity. In March 2002 and September 2003, additional earthquakes occurred in Taiwan. The occurrence of additional earthquakes or other natural disasters could result in the disruption of the wafer foundry or assembly and test capacity of the third parties that supply these services to us. We may not be able to obtain alternate capacity on favorable terms, if at all.

Our stock price could drop, and there could be significantly less trading activity in our stock, if securities or industry analysts downgrade our stock or do not publish research or reports about our business.

Our stock price and the trading market for our stock are likely to be affected significantly by the research and reports concerning our company and our business which are published by industry and securities analysts. We do not have any influence or control over these analysts, their reports or their recommendations. Our stock price and the trading market for our stock could be negatively affected if any analyst downgrades our stock, publishes a report which is critical of our business, or discontinues coverage of us.

Our common stock has experienced substantial price volatility.

Our common stock has experienced substantial price volatility. Such volatility may occur in the future, particularly because of quarter-to-quarter variations in our actual or anticipated financial results, or the reported financial results of other semiconductor companies or our customers. Stock price volatility may also result from product announcements by us or our competitors, or from changes in perceptions about the various types of products we manufacture and sell. In addition, our stock price may fluctuate due to price and volume fluctuations in the stock market, especially in the technology sector.

A limited number of stockholders will have the ability to influence the outcome of director elections and other matters requiring stockholder approval.

Our executive officers, directors and entities affiliated with them will, in the aggregate, beneficially own a significant portion of our outstanding common stock. These stockholders acting together will have the ability to exert substantial influence over all matters requiring the approval of our stockholders, including the election and removal of directors and any proposed acquisition, consolidation or sale of all or substantially all of our assets. In addition, they could dictate the management of our business and affairs. This concentration of ownership could

have the effect of delaying, deferring or preventing a change in control, or impeding an acquisition, consolidation, takeover or other business combination, which might otherwise involve the payment of a premium for your shares of our common stock.

Provisions of our certificate of incorporation and bylaws, Delaware law and customer agreements might delay or prevent a change of control transaction and depress the market price of our stock.

Various provisions of our certificate of incorporation and bylaws might have the effect of making it more difficult for a third party to acquire, or discouraging a third party from attempting to acquire, control of us. These provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock. Certain of these provisions eliminate cumulative voting in the election of directors, limit the right of stockholders to call special meetings and establish specific procedures for director nominations by stockholders and the submission of other proposals for consideration at stockholder meetings.

We are also subject to provisions of Delaware law which could delay or make more difficult a merger, tender offer or proxy contest involving us. In particular, Section 203 of the Delaware General Corporation Law prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years unless specific conditions are met. Any of these provisions could have the effect of delaying, deferring or preventing a change in control, including, without limitation, discouraging a proxy contest or making more difficult the acquisition of a substantial block of our common stock.

Our board of directors might issue up to 50,000,000 shares of preferred stock without stockholder approval on such terms as the board might determine. The rights of the holders of common stock will be subject to, and might be adversely affected by, the rights of the holders of any preferred stock that might be issued in the future.

Under our master purchase agreements with Cisco, in the event of, among other things, the transfer of at least 50% of our voting control to a Cisco competitor that generates less than 50% of its annual sales from integrated circuit products, Cisco may exercise its rights to purchase our knowledge-based processors directly from our manufacturers, subject to payments to us. This provision may discourage or complicate attempts by some third parties to acquire us.

The price of our stock could decrease as a result of shares being sold in the market, including sales by directors, officers and other significant stockholders.

Sales of a substantial number of shares of common stock in the public market could adversely affect the prevailing market price of our common stock from time to time. The number of shares of our common stock available for sale in the public market is limited by restrictions under the Securities Act of 1933, as amended, but taking into account sales of stock made in accordance with the provisions of Rules 144(k), 144 and 701, substantially all the shares of our common stock currently outstanding are eligible for sale in the public market. We believe that as of January 31, 2006, approximately 5.1 million shares (including currently exercisable options) are held by our directors and officers.

As of February 28, 2006, the majority of our executive officers have entered into plans for selling a portion of their shares of common stock in the manner described under Rule 10b5-1 of the Securities Exchange Act of 1934. Each plan is non-discretionary and is administered by an independent brokerage firm. Each plan provide for aggregate sales of between 12,000 and 120,000 shares pursuant to limit orders at specified prices. The duration of each plan is through December 31, 2006. Pursuant to these plans, these executive officers may sell up to approximately

490,000 shares of common stock combined during 2006. Sales of the shares are further subject to the volume restrictions set forth in SEC Rule 144(e). Each plan provides for termination upon the completion of the specified trading program, the instruction of the stockholder, or the occurrence of other specified events, whichever is earliest. All of the shares are sold through broker-dealers in ordinary market transactions. In addition, subject to compliance with applicable securities laws, each of these executive officers may sell shares of common stock outside of these plans. Pre-designated trading under these plans may cause unexpected declines in the market price of our common stock.

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Our stockholder rights plan could prevent stockholders from receiving a premium over the market price for their shares from a potential acquirer.

We adopted a stockholder rights plan that generally entitles our stockholders to rights to acquire additional shares of our common stock when a third party acquires 15.0% of our common stock or commences or announces its intent to commence a tender offer for at least 15.0% of our common stock, other than for certain stockholders that were stockholders prior to our initial public offering as to whom this threshold is 20.0%. This plan could delay, deter or prevent an investor from acquiring us in a transaction that could otherwise result in stockholders receiving a premium over the market price for their shares of common stock.

We may need to obtain financing in order to fund our growth strategy.

We believe that we have or will have access to capital sufficient to satisfy our working capital requirements for at least the next 12 months. After that time, it may be necessary for us to raise additional funds to support our growth. We cannot assure you that we will be able to obtain financing when needed or that, if available to us, the terms will be acceptable to us. If we issue equity securities in any financing, the new securities may have rights and preferences senior to our shares of common stock, and the ownership interest in us of our current stockholders will be proportionately reduced. If we issued debt securities, they will rank senior to all equity securities. If we are unable to raise additional capital, we may not be able to implement our growth strategy, and our business could be harmed significantly.

Changes in laws and regulations that affect the governance of public companies have increased our operating expenses and will continue to do so.

Changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and the listing requirements for The Nasdaq National Market have imposed new duties on us and on our executives, directors, attorneys and independent accountants. In order to comply with these rules, we have hired and expect to hire additional personnel and use additional outside legal, accounting and advisory services, which have increased and are likely to continue increasing our operating expenses. In particular, we expect to incur additional administrative expenses as we continue to comply with Section 404 of the Sarbanes-Oxley Act, which requires management to report on, and our Independent Registered Public Accounting Firm to attest to, our internal controls. For example, we expect to incur significant expenses in connection with the implementation, documentation and testing of our existing and possibly newly implemented control systems. Management time associated with these compliance efforts necessarily reduces time available for other operating activities, which could adversely affect operating results. If we are unable to achieve full and timely compliance with these regulatory requirements, we could be required to incur additional costs, expend additional management time on remedial efforts and make related public disclosures that could adversely affect our stock price and result in securities litigation.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following table provides the names, ages and offices of each of our executive officers as of February 28, 2006:

Name	Age	Position
Ronald Jankov	47	Director, Chief Executive Officer and President
Don Witmer	52	Vice President and Chief Financial Officer

Dimitrios Dimitrelis	48	Vice President of Engineering
Ibrahim Korgav	57	Senior Vice President of Manufacturing and Business Operations
Varadarajan Srinivasan	55	Vice President of Product Development and Chief Technical Officer
Marcia Zander	43	Senior Vice President of Worldwide Sales
Roland Cortes	41	Senior Director of Legal Affairs and IP Management and Secretary

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Ronald Jankov has served as our President, Chief Executive Officer and as a member of our board of directors since April 2000. From September 1995 to September 1999, Mr. Jankov was Vice President of Sales and then Vice President and General Manager for the Multimedia Division of NeoMagic Corporation, a provider of semiconductors for handheld systems. Prior to that time, Mr. Jankov was Vice President of Cyrix Corporation, a microprocessor company, and held various engineering, sales and management positions at other semiconductor companies, including LSI Logic Corp. and Texas Instruments.

Donald Witmer has served as our Vice President of Finance and Chief Financial Officer since January 2004. From September 2001 to December 2003, Mr. Witmer was the chairman of the board and Chief Executive Officer of Home Director, Inc., a home networking company. From December 1999 to September 2001, Mr. Witmer was the chairman of the board and Chief Executive Officer of Digital Interiors, Inc., a home networking company that was acquired by Home Director in October 2000. From June 1997 to December 1999, Mr. Witmer was the President and Chief Executive Officer of Amazing Smart Card Technologies, Inc., a smart card solutions company. In addition, Mr. Witmer has served previously as Chief Financial Officer of each of Catalyst Semiconductor, Inc. and DeltaPoint, Inc. and as an accountant with PricewaterhouseCoopers LLP.

Dimitrios Dimitrelis has served as our Vice President of Engineering since July 2002. From July 1999 to March 2002, Mr. Dimitrelis was Director of Engineering for Vitesse Semiconductor Corp., a communications integrated circuit company, where he was primarily responsible for the development of a 10G network processor. From May 1998 to June 1999, Mr. Dimitrelis was Director of ASIC Development for XaQti Corporation, a manufacturer of digital network processors, which was acquired by Vitesse Semiconductor Corp.

Ibrahim Korgav has served as our Senior Vice President of Manufacturing and Business Operations since March 2002. From April 2001 to March 2002, Mr. Korgav was a member of the venture capital firm Global Catalyst Partners, during which time he consulted with several semiconductor companies. From April 2000 to March 2001, Mr. Korgav was Senior Vice President of Manufacturing Operations for Zaffire Inc., an optical transport systems company. From June 1994 to March 2000, Mr. Korgav was Vice President of Manufacturing Operations for NeoMagic Corporation.

Varadarajan Srinivasan has served as our Vice President of Product Development since March 1996, as our Chief Technical Officer since August 2000. From January 1989 to March 1996, Mr. Srinivasan was a director of Design Engineering for Quality Semiconductor, Inc., working with SRAMs and logic products.

Marcia Zander has served as our Senior Vice President of Worldwide Sales since January 2006 and Vice President of Sales since July 1999. From July 1987 to July 1999, Ms. Zander held various sales and sales management positions, including General Sales Manager, with QuadRep, Inc., a manufacturer s representative firm, who represented large semiconductor and other electronic component companies. From June 1984 to June 1987, Ms. Zander worked in sales and sales management for AVX Corporation and Corning Electronics.

Roland Cortes has served as our Secretary since May 2004, as our Senior Director of Legal Affairs and IP Management since July 2002, and as our Director of Legal Affairs and IP Management since April 1999. From December 1995 to April 1999, Mr. Cortes was an intellectual property attorney with Blakely, Sokoloff, Taylor & Zafman LLP.

ITEM 2. PROPERTIES.

Our main executive, administrative and technical offices occupy approximately 31,600 square feet in Mountain View, California, under a lease that expires in July 2011. We also lease approximately 13,000 square feet in Bangalore, India under a lease that expires in April 2007. We believe that these facilities are adequate for our current needs and that suitable additional or substitute space will be available as needed to accommodate foreseeable expansion of our operations.

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ITEM 3. LEGAL PROCEEDINGS.

We are not involved in any legal proceedings that management believes will have a material adverse effect our business, results of operations, financial position or cash flows.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq National Market under the symbol NETL . Public trading commenced on July 9, 2004. Prior to that, there was no public market for our common stock. The following table sets forth, for the periods indicated, the intra-day high and low per share sale prices of our common stock, as reported by the Nasdaq National Market on its consolidated transaction reporting system.

	High	Low
Fiscal 2005:		
Fourth quarter	$ 28.11	$ 17.93
Third quarter	$ 22.64	$ 16.02
Second quarter	$ 18.32	$ 11.08
First quarter	$ 15.00	$ 8.55
Fiscal 2004:		
Fourth quarter	$ 11.35	$ 5.92
Third quarter (from July 9, 2004)	$ 12.50	$ 6.40

As of February 10, 2006, there were approximately 219 holders of record (not including beneficial holders of stock held in street names) of our common stock.

Dividend Policy

We have not declared or paid cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future. We expect to retain future earnings, if any, to fund the development and growth of our business. Our board of directors will determine future dividends, if any.

Recent Sales of Unregistered Securities

During the fiscal year ended December 31, 2005, we issued and sold the following unregistered securities. None of these sales involved an underwriter, finder or other agent or the payment of any selling commission to any person.

1. We issued to one investor an aggregate of 3,332 shares of our common stock upon exercise of a warrant previously issued. The exercise price for the warrant was $5.00 per share, and the exercise resulted in aggregate proceeds to us of $16,660. These shares were issued in reliance on Section 3(a)(9) of the Securities Act or Regulation D promulgated under the Securities Act.

The sales of the above securities were deemed to be exempt from registration under the Securities Act in reliance on the basis noted above. The purchasers of securities in each such transaction represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution of the securities, and appropriate legends were affixed to the share certificates and instruments issued in such transactions.

Use of Proceeds from Registered Securities

The Securities and Exchange Commission declared our first registration statement, filed on Form S-1 under the Securities Act of 1933 (File No. 333-114549) relating to our initial public offering of common stock, effective on July 8, 2004. We realized approximately $39.2 million after offering expenses.

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As of the date of this report, we used the net proceeds of the offering as follows:

- We used $10.5 million to repay existing debt under our credit lines with Silicon Valley Bank;
- We used $7.6 million to repay the convertible promissory notes we issued and sold in March 2004; and
- We invested the remaining net proceeds in short-term, interest-bearing instruments, pending their use to fund working capital and other general corporate purposes, including capital expenditures and research and development.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

We are furnishing the following information with respect to purchases made by us or on our behalf or on behalf of any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934) of shares of our common stock during each of the three months ended December 31, 2005:

Period	(a) Total Number of Shares (or Units) Purchased [(1)]	(b) Average Price Paid per Share (or Unit) [(1)]	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs [(2)]	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs [(2)]
Month #1 (October 1-31)	1,029	$ 2.00		
Month #2 (November 1-30)				
Month #3 (December 1-31)				
Total	1,029	$ 2.00		

(1) We repurchased these shares from the individuals upon their termination of employment or service with us pursuant to our right to repurchase unvested shares at the original exercise price in accordance with our 2000 Stock Plan and the stock option agreements with the individuals.

(2) We did not have any publicly announced plans or programs to purchase our common stock during 2005.

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ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data are qualified by reference to, and should be read in conjunction with, Management s Discussion and Analysis of Financial Condition and Results of Operations and the Financial Statements and related Notes included in Item 8 of this report, which discusses factors affecting the comparability of such financial data. The selected balance sheet data as of December 31, 2005 and 2004 and selected statements of operations data for the years ended December 31, 2005, 2004 and 2003 are derived from our audited financial statements included elsewhere in this report. The selected balance sheet data as of December 31, 2003, 2002 and 2001 and the selected statements of operations data for the years ended December 31, 2002, 2001 and 2000 were derived from audited financial statements not included in this report. Our historical results are not necessarily indicative of our future results.

Statement of Operations Data:	Year Ended December 31,				
	2001	2002	2003	2004	2005
	(in thousands, except per share data)				
Revenue:					
Product revenue	$ 1,634	$ 2,592	$ 10,015	$ 46,705	$ 81,759
License and engineering service revenue	378	303	3,520	1,128	
Total revenue	2,012	2,895	13,535	47,833	81,759
Cost of revenue:					
Product revenue	1,031	1,634	20,310	26,664	33,415
License and engineering service revenue	108	89	5		
Total cost of revenue	1,139	1,723	20,315	26,664	33,415
Gross margin	873	1,172	(6,780)	21,169	48,344
Operating expenses:					
Research and development	11,641	17,133	18,312	17,259	21,125
Selling, general and administrative	4,965	4,184	4,405	6,587	9,929
Stock-based compensation		4	2,675	5,511	1,821
Total operating expenses	16,606	21,321	25,392	29,357	32,875
Loss from operations	(15,733)	(20,149)	(32,172)	(8,188)	15,469
Interest expense	(178)	(481)	(166)	(4,076)	(203)
Interest income	566	759	466	382	1,568
Other income (expense), net	17	(48)	(88)	(149)	(16)
Net income (loss) before income taxes	(15,328)	(19,919)	(31,960)	(12,031)	16,818
Provision for income taxes					379
Net income (loss)	(15,328)	(19,919)	(31,960)	(12,031)	16,439
Net income (loss) per common share basic	$ (8.10)	$ (7.49)	$ (11.01)	$ (1.17)	$ 0.93

Net income (loss) per common share diluted	$ (8.10)	$ (7.49)	$ (11.01)	$ (1.17)	$ 0.87
Shares used for calculation basic	1,892	2,658	2,903	10,318	17,725
Shares used for calculation diluted	1,892	2,658	2,903	10,318	18,992

	December 31,				
	2001	**2002**	**2003**	**2004**	**2005**
			(in thousands)		
Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 26,169	$ 39,690	$ 16,150	$ 41,411	$ 65,788
Working capital	23,991	35,233	6,896	45,283	65,164
Total assets	31,585	44,815	31,844	59,454	85,529
Debt	3,221	1,471	10,396	1,317	687
Redeemable convertible preferred stock	58,591	91,600	91,600		
Stockholders equity (deficit)	(34,146)	(53,733)	(82,351)	48,102	68,658

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Forward-looking Statements

This report 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, which include, without limitation, statements about the market for our technology, our strategy and competition. Such statements are based upon current expectations that involve risks and uncertainties. Any statements contained herein that are not statements of historical fact may be deemed forward-looking statements. For example, the words believes , anticipates , plans , expects , intends and similar expressions are intended to identify forward-looking statements. Our actual results and the timing of certain events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a discrepancy include, but are not limited to, those discussed in Overview , Results of Operations, Liquidity and Capital Resources and Risks Factors below. All forward-looking statements in this document are based on information available to us as of the date hereof and we assume no obligation to update any such forward-looking statements. The following discussion should be read in conjunction with our condensed financial statements and the accompanying notes contained in this quarterly report. Unless expressly stated or the context otherwise requires, the terms we , our , us and NetLogic Microsystems refer to NetLogic Microsystems, Inc.

ACQUISITION OF CYPRESS SEMICONDUCTOR S NETWORK SEARCH ENGINE PRODUCTS

On February 15, 2006, we completed the acquisition of Cypress Semiconductor Corporation s (Cypress) Network Search Engine products pursuant to an Agreement for the Purchase and Sale of Assets entered into on January 25, 2006, as amended. Upon closing the transaction, we acquired assets relating to Cypress network search engine (NSE) business, including all intellectual property related primarily to the acquired NSE business (including all intellectual property related to the Sahasra algorithmic technology), the NSE70K and Ayama product families and all inventory and fixed assets for those product families. We did not acquire any of Cypress TCAM1, TCAM2, TCAM2-CR, TurboCAM or Toy Cam products and inventory.

We paid Cypress approximately $50 million in shares of common stock in connection with the closing of the transaction. We may pay an additional $10 million in cash and up to approximately $10 million in shares of common stock upon achieving specific revenue objectives as outlined in the agreement.

The Sahasra algorithmic technology complements our Layer 7 processing initiative and is a beneficial building block in driving towards low-cost Layer 7 applications acceleration and security processing solutions. In addition, the NSE70000, Ayama 10000 and Ayama 20000 expand our customer base and product offerings in the high-volume, entry-level Layer 2/3 switch market. We expect this acquisition to have a significant impact on our consolidated financial position, results of operations and cash flows. We expect our revenue, cost of revenue and operating expenses to increase in the future as a result of this acquisition. The discussions in this section of the Annual Report on Form 10-K, as well as the financial statements contained herein, does not reflect the impact of the acquisition.

Overview

We are a semiconductor company that designs, develops and markets high performance knowledge-based processors for a variety of advanced Internet, corporate and other networking systems, such as routers, switches, network security appliances, network access equipment and

networked storage devices. Knowledge-based processors are integrated circuits that employ an advanced processor architecture and a large knowledge database containing information on the network, as well as applications and content that run on the network to make complex decisions about individual packets of information traveling through the network. Our knowledge-based processors significantly enhance the ability of networking original equipment manufacturers, or OEMs, to supply network service providers with systems offering more advanced functionality for the Internet, such as voice transmission over the Internet, or VoIP, unified threat management, or UTM, virtual private networks, or VPNs, and streaming video and audio.

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Our knowledge-based processors incorporate advanced technologies that enable rapid processing, such as a superscalar architecture, which uses parallel-processing techniques, and deep pipelining, which segments processing tasks into smaller sub-tasks, for higher decision throughput. These technologies enable networking systems to perform a broad range of network-aware and content-aware processing functions, such as application-based routing, UTM network security, intrusion detection and prevention, virus inspection, access control for network security, prioritization of traffic flow to maintain quality of service, or QoS, and statistical measurement of Internet traffic for transaction billing.

In January 2006, we announced the launch of our NETL7 family of Layer 7 knowledge-based processors. The first product in the NETL7 family is the NLS1000 content processor that accelerates pattern and signature recognition tasks for enterprise and carrier-class networks, and is used to perform 10 Gigabits per second wire-speed content inspection of packets traveling through the network. The NLS1000 content processor extends the processing capabilities of our knowledge-based processors into the packet payload, thereby enabling the design and deployment of next-generation networking systems that can make packet processing decisions based on an awareness of the packet content. Typical applications for the NLS1000 content processor include Layer 7 application switches and routers, unified threat management appliances, intrusion detection and prevention systems and anti-virus gateways. The NETL7 family of Layer 7 knowledge-based processors are expected to expand our customer base in the communications, networking, security appliance, software provider and computing markets.

Since the second half of 2003, we have experienced significant revenue growth caused by a rapid rise in new customer orders for our knowledge-based processors. Our total revenue increased 253% from $13.5 million in 2003 to $47.8 million during the year ended December 31, 2004 and by 71% from 2004 to $81.8 million for the year ended December 31, 2005. While our total revenue for the year ended December 31, 2004 and 2003 included non-recurring license fees of approximately $1.1 million and 3.5 million, respectively, related to our license agreement with Micron Technology, Inc., we had no such revenue during the year ended December 31, 2005. We do not expect similar revenue growth rates in future periods, nor do we expect to receive any significant revenues from non-recurring engineering services.

As a fabless semiconductor company, our business model is less capital intensive than other businesses because we rely on third parties to manufacture, assemble, and test our products. In general, we do not anticipate making significant capital expenditures. In transitioning from a design and development company to volume production as a fabless semiconductor company, we required significant funds for our ramp up in production to support increased sales of our knowledge-based processors. In the future, as we launch new products or expand our operations, we may require additional funds to procure product mask sets, order elevated quantities of wafers from our foundry partners, perform qualification testing and assemble and test those products.

We employ a direct sales force as well as a sales representative network to sell our products. The majority of our revenue comes from customers headquartered in the United States. All revenue to date has been denominated in U.S. dollars.

Our product sales cycles can take up to 24 months to complete and volume production can take an additional six months to be achieved, if at all. Cancellations of customer orders or changes in product specifications might result in the loss of anticipated sales without allowing us sufficient time to reduce our inventory or operating expenses. Our recent rapid revenue growth makes it difficult for us to assess the impact of seasonal factors on our business.

We recognize revenue at the time of shipment to our customers or our international stocking sales representatives. Our revenue consists primarily of sales of our knowledge-based processors to networking OEMs and contract manufacturers. Initial sales of our products for a new design are usually made directly to networking OEMs. Once a design enters production, a networking OEM often outsources its manufacturing to contract manufacturers that purchase products directly from us.

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Since we purchase all wafers from suppliers with fabrication facilities and outsource the assembly and testing to third party vendors, a significant portion of our costs of revenue consists of payments to our third party vendors. We do not have long-term agreements with any of our suppliers and rely upon them to fulfill our orders.

Research and development expenses consist primarily of compensation and related costs for personnel as well as costs related to new and existing product development, depreciation, software maintenance and facilities costs. All research and development costs are expensed in the period incurred. In order for us to remain competitive, we believe a significant portion of our operating expenses will continue to be related to research and development efforts. We also believe research and development headcount will increase in the future, and that research and development costs will increase in absolute dollars but decline as a percentage of revenue.

Selling expenses consist primarily of compensation and related costs for sales and marketing personnel, marketing programs, travel, facilities overhead and bonuses and commissions for independent sales representatives. General and administrative expenses consist primarily of compensation and related costs for finance and accounting, patent and corporate legal expenses, and facilities overhead.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the U.S. requires management to make fair and reasonable estimates and assumptions that affect reported amounts of assets, liabilities and operating expenses during the period reported. The following accounting policies require management to make estimates and assumptions. These estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the period that they are determined to be necessary. If actual results differ significantly from management s estimates, our financial statements could be materially impacted. Our estimates are guided by observing the following critical accounting policies.

Revenue Recognition. One of the criteria for revenue recognition is that the collectability of the resulting receivable is reasonably assured. Determination of this criterion is based on management s judgments regarding the collectability of those fees. The recent growth and the establishment of new or more significant customer relationships mean that management does not have a substantial history of making these judgments. To date, our customers consist primarily of large, well-established publicly traded companies. Should our customer base change to include smaller, less-established companies, and collectability of accounts receivable from these customers be uncertain, revenue recognition for a reporting period may be negatively affected. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

Inventory Valuation and Adverse Purchase Commitments. We value our inventories at the lower of cost or market. We record inventory reserves for estimated obsolescence or unmarketable inventories based upon assumptions about future demand and market conditions. These estimates are generally based on a 12-month forecast prepared by management. If our inventory on hand is in excess of our forecast, the excess amounts are written off. If actual market conditions are less favorable than those expected by management, additional inventory reserves may be required. The carrying value of inventory and the determination of possible adverse purchase commitments are dependent on our estimate of the yield that will be achieved, or the percent of good products identified when the product is tested. A small change in yield could result in a significant adjustment and have a significant impact on our financial position and results of operations.

During the year ended December 31, 2003, we recorded charges to cost of revenue of $10.4 million as a result of a low expected yield on work-in-process inventories on hand and on order with our vendors that resulted in the estimated cost of finished product exceeding its estimated market value. The estimated cost was based on actual yield experience and estimated costs to test and package our products. These estimates

were based on historical costs of similar products. The charge reduced the carrying value of our inventory to record them at their estimated market value and established reserves to cover expected future losses and adverse purchase

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commitments. Since then our production yields have improved, but we may experience lower than expected yields in the future, primarily upon the introduction of new products.

Warranty Accrual. Our products are subject to warranty and we provide for the estimated future costs of replacement upon shipment of the product in the accompanying statements of operations. Our warranty accrual is estimated based on historical claims compared to historical revenue and assumes that we have to replace products subject to a claim. For new products, we use our historical percentage for the appropriate class of product. Should actual product failure rates differ from our estimates, revisions to the estimated warranty liability would be required. During the fourth quarter of 2003, we recorded a charge of $1.0 million for the expected costs of replacing product that was returned in early 2004. This level of warranty claims was much higher than what we experienced prior to 2004. We have subsequently implemented more stringent testing procedures to reduce the level of warranty claims when compared to the volume shipped. In the future, as we continue to introduce new products, warranty expenses may increase.

Allowance for Doubtful Accounts. In order to determine the collectability of our accounts receivable, we continually assess factors such as previous customer transactions and the credit-worthiness of the customer. To date, our accounts receivable write-offs have been immaterial. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of certain customers to make required payments. In general, such allowances are established for accounts aged over 90 days from the invoice date, unless specific circumstances indicate that the balance is collectible. If the financial conditions of our customers were to deteriorate, additional allowances may be required.

Accounting for Income Taxes. We account for income taxes under the provisions of Statement of Financial Accounting Standards (SFAS) No. 109 Accounting for Income Taxes. In applying SFAS 109, we are required to estimate our current tax exposure together with assessing temporary differences resulting from differing treatments of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. Significant management judgment is required to assess the likelihood that our deferred tax assets will be recovered from future taxable income. We have established a full valuation allowance against our deferred tax assets due to uncertainties regarding our ability to realize these assets. These uncertainties relate primarily to the level of our historical losses and the absence of objective evidence supporting the future realization of these assets. In the event we were to determine that it is more likely than not that we are able to realize our deferred tax assets in the future, an adjustment to the valuation allowance would increase income in the period such determination is made.

Stock-based Compensation. We account for stock-based employee compensation arrangements in accordance with provisions of Accounting Principals Board, or APB, Opinion No. 25, Accounting for Stock Issued to Employees, and Financial Accounting Standards Board, or FASB, Interpretation, or FIN No 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans, and comply with the disclosure provisions of SFAS No. 123, Accounting for Stock-Based Compensation and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Under APB Opinion No. 25, compensation cost is recognized based on the difference, if any, on the date of grant between the fair value of our stock and the amount an employee must pay to acquire the stock. SFAS No. 123 defines a fair value based method of accounting for an employee stock option or similar equity investment. In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment, which replaces SFAS No. 123 and supersedes APB Opinion No. 25. We have adopted SFAS No. 123(R) effective January 1, 2006. We plan to use the modified-prospective method of recognition of compensation expense related to share-based payments and use the Black-Scholes option pricing model to estimate the fair value of stock-based compensation awards. The adoption of SFAS No. 123(R) s fair value method is expected to have a material adverse impact on our results of operations, although it is not expected to have a material impact on our overall financial position. The balance of unearned stock-based compensation to be included in the period 2006 through 2009 related to share-based awards unvested at December 31, 2005, as previously calculated under the disclosure-only requirements of SFAS 123, is approximately $13.0 million, of which approximately $7.4 million is expected to be recorded as expense in 2006.

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We awarded a limited number of stock options and warrants to non-employees. We account for non-cash stock-based expense issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force Pronouncement No. 96-18, Accounting for Equity Investments That Are Issued to Non-Employees for Acquiring, or in Conjunction with Selling, Goods or Services. For these options and warrants, we recognize the stock-based expense over the service period of the underlying awards, based on an estimate of their fair value on the vesting dates using the Black-Scholes option-pricing model.

Results of Operations

Comparison of Year Ended December 31, 2005 to Year Ended December 31, 2004

Revenue, cost of revenue and gross profit

The table below sets forth the fluctuations in revenue, cost of revenue and gross profit data for the years ended December 31, 2005 and 2004 (in thousands, except percentage data):

	Year ended December 31, 2005	Percentage of Revenue	Year ended December 31, 2004	Percentage of Revenue	Year-to-Year Increase (Decrease)	Increase (Decrease) Percentage
Revenue:						
Product revenue	$ 81,759	100.0%	$ 46,705	97.6%	$ 35,054	75.1%
License and engineering service revenue		0.0%	1,128	2.4%	(1,128)	-100.0%
Total revenue	81,759	100.0%	47,833	100.0%	33,926	70.9%
Cost of revenue:						
Cost of product revenue	33,415	40.9%	26,664	55.7%	6,751	25.3%
Cost of license and engineering service revenue		0.0%				0.0%
Total cost of revenue	33,415	40.9%	26,664	55.7%	6,751	25.3%
Gross profit	$ 48,344	59.1%	$ 21,169	44.3%	$ 27,175	128.4%

Revenue. The increase in total revenue during the year ended December 31, 2005 resulted from the growth in sales of our knowledge-based processors. During the year ended December 31, 2005, the units of knowledge-based processor shipments increased more than 138% compared to that of the year ended December 31, 2004. Revenue from sales to one of Cisco Systems, Inc. s contract manufacturers, Solectron, represented 69% of total revenue for the years ended December 31, 2005 and December 31, 2004.

Cost of Revenue. The cost of revenue increased to $33.4 million for the year ended December 31, 2005 primarily due to the increased unit shipments of knowledge-based processors.

Gross Profit /Gross Margin. Gross margin increased to 59.1% during the year ended December 31, 2005 from 44.3% during the year ended December 31, 2004. The improvement in gross margin in 2005 was primarily due to the continued improvements in our production yields for the knowledge-based processor products. Version 4 of our knowledge-based processors, which was introduced earlier in 2005, produces a higher number of die per wafer as compared to that of the previous version and contributed to the lower overall production costs. Further, gross margin was favorably impacted during the first quarter of 2005 by $1.0 million from the sale of products that had been fully reserved in prior periods and accordingly had no associated cost of revenue. This amount represented approximately 2.1% of the gross margin during the year ended December 31, 2005.

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Operating expenses

The table below sets forth operating expense data for the years ended December 31, 2005 and 2004 (in thousands, except percentage data):

	Year ended December 31, 2005	Percentage of Revenue	Year ended December 31, 2004	Percentage of Revenue	Year-to-Year Increase (Decrease)	Increase (Decrease) Percentage
Operating expenses:						
Research and development	$ 21,125	25.8%	$ 17,259	36.1%	$ 3,866	22.4%
Selling, general and administrative	9,929	12.2%	6,587	13.8%	3,342	50.7%
Stock-based compensation	1,821	2.2%	5,511	11.5%	(3,690)	-67.0%
Total operating expenses	$ 32,875	40.2%	$ 29,357	61.4%	$ 3,518	12.0%

Research and Development Expenses. Research and development expenses increased during the year ended December 31, 2005, as compared to the year ended December 31, 2004, primarily due to increases in product development and qualification expenses of $0.7 million, payroll related expenses of $0.9 million and consulting expenses of $1.0 million as we continued to invest in the development of the next generation knowledge-based processor products as well as new non-knowledge-based processor products. In addition, depreciation expense and software maintenance expense increased by $0.4 million and $0.2 million, respectively, during the year ended December 31, 2005 as we purchased software licenses to support our research and development efforts. During the year ended December 31, 2005, we also incurred $0.3 million of expenses associated with our new design center in Bangalore, India, which consisted primarily of payroll related costs for 19 engineers. The remainder of the increase in research and development expenses was caused by individually minor items.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased during the year ended December 31, 2005, as compared to the year ended December 31, 2004, primarily due to increases in directors and officers insurance premium of $0.2 million, payroll related costs of $1.3 million, accounting and consulting expenses of $0.8 million, investor relations expense of $0.2 million, sales commission of $0.3 million and state and local taxes of $0.4 million. The increases in directors and officers insurance premium and investor relations expenses occured subsequent to our initial public offering in July 2004. The increase in payroll related costs was due to increased headcount to support our growing operations and the accrual of management bonuses pursuant to an incentive bonus plan, which was adopted for fiscal 2005. The increase in accounting and consulting expenses primarily related to our on-going effort to document, evaluate and test our system of internal control over financial reporting as we prepare to comply with Section 404 of the Sarbanes-Oxley Act of 2002. The increase in commission expense was the result of a significant sales increase during the year ended December 31, 2005. The increase in state and local taxes was primarily due to the increased business activities in the states where we conduct business. The increases in expenses were offset by the release of the allowance for bad debt of $0.4 million as we continue to improve cash collections. The remainder of the fluctuation in selling, general and administrative expenses was caused by individually minor items.

Stock-based compensation. Stock-based compensation expense represents amortization of deferred stock-based compensation that was recorded in connection with the pre-IPO grants of stock options with exercise prices below the fair value of our common stock. Stock-based compensation expense is based on the difference between the exercise price of the option grants and the fair value of our common stock at the time of such grants, which is amortized over the vesting period of the related options.

Effective January 1, 2006, we adopted SFAS No.123(R). We plan to use the modified-prospective method of recognition of compensation expense related to share-based payments and use the Black-Scholes option

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pricing model to estimate the fair value of stock-based compensation awards. The balance of unearned stock-based compensation to be included in operating expenses in the period 2006 through 2009 related to share-based awards unvested at December 31, 2005, as previously calculated under the disclosure-only requirements of SFAS 123, is approximately $13.0 million, of which approximately $7.4 million is expected to be recorded as expense in 2006. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. To the extent that we grant additional equity securities to employees or assume unvested securities in connection with any acquisitions, our operating expenses will be increased by the additional unearned compensation resulting from those additional grants or acquisitions. We anticipate we will grant additional employee stock options and restricted stock units in 2006 as part of our regular equity compensation program. The value of these grants is not included in the amount above, and the impact of these grants cannot be predicted at this time because it will depend on the number of share-based payments granted as part of our compensation program and the then current fair values.

Other items

The table below sets forth other data for the years ended December 31, 2005 and 2004 (in thousands, except percentage data):

	Year ended December 31, 2005	Percentage of Revenue	Year ended December 31, 2004	Percentage of Revenue	Year-to-Year Change	Change Percentage
Other income (expense), net:						
Interest income	1,568	1.9%	382	0.8%	$ 1,186	310.47%
Interest expense	(203)	-0.2%	(4,076)	-8.5%	3,873	-95.02%
Other income (expense), net	(16)	0.0%	(149)	-0.3%	133	-89.26%
Total interest and other income (expense), net	$ 1,349	1.7%	$ (3,843)	-8.0%	$ 5,192	-135.10%

Interest and Other Income (Expenses), net. The net interest and other income of $1.3 million generated during the year ended December 31, 2005 was due to a higher average cash and investment balance during the period and higher market yields for our chosen investments. The higher average cash and investment balance during the year ended December 31, 2005 as compared to the year ended December 31, 2004 was primarily due to the cash generated from operating activities, which totaled $25.9 million during fiscal 2005. The higher interest expense during the year ended December 31, 2004 resulted primarily from the accelerated amortization of beneficial conversion feature and warrants that were originally recorded in connection with the issuance of promissory notes in March 2004. The promissory notes were repaid in full in July 2004, and accordingly, the remaining value of beneficial conversion feature at the time of repayment was entirely charged to interest expense. During the year ended December 31, 2004, amortization of beneficial conversion feature and warrant fair values totaled $2.5 million. Interest expense for the year ended December 31, 2004 also included the amounts associated with the outstanding balance under the lines of credit. All outstanding amounts under the lines of credit and convertible promissory notes were paid off in July 2004 and our credit lines expired in October 2005.

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Comparison of Year Ended December 31, 2004 to Year Ended December 31, 2003

Revenue, cost of revenue and gross profit

The table below sets forth the fluctuations in revenue, cost of revenue and gross profit data for the years ended December 31, 2004 and 2003 (in thousands, except percentage data):

	Year ended December 31, 2004	Percentage of Revenue	Year ended December 31, 2003	Percentage of Revenue	Year-to-Year Increase (Decrease)	Increase (Decrease) Percentage
Revenue:						
Product revenue	$ 46,705	97.6%	$ 10,015	74.0%	$ 36,690	366.4%
License and engineering service revenue	1,128	2.4%	3,520	26.0%	(2,392)	-68.0%
Total revenue	47,833	100.0%	13,535	100.0%	34,298	253.4%
Cost of revenue:						
Cost of product revenue	26,664	55.7%	20,310	150.1%	6,354	31.3%
Cost of license and engineering service revenue			5	0.0%	(5)	-100.0%
Total cost of revenue	26,664	55.7%	20,315	150.1%	6,349	31.3%
Gross profit (loss)	$ 21,169	44.3%	$ (6,780)	-50.1%	$ 27,949	412.2%

Revenue. The increase in total revenue during the year ended December 31, 2004 resulted from the growth in sales of our knowledge-based processors. During the year ended December 31, 2004, the units of knowledge-based processor shipments increased more than 600% compared to that of the year ended December 31, 2003. Revenue from sales to one of Cisco Systems, Inc. s contract manufacturers, Solectron, represented 69% of total revenue for the year ended December 31, 2004 compared to 27% during the year ended December 31, 2003.

Cost of Revenue. The cost of revenue increased to $26.7 million for the year ended December 31, 2004 primarily due to the increased unit shipments of knowledge-based processors. During the second half of the year ended December 31, 2004, we reassessed the warranty accrual requirements based on our most recent warranty expense data as our manufacturing yield improved to projected levels. As a result of this reassessment, we released approximately $0.3 million of warranty accrual to cost of sales during the third quarter of fiscal 2004. We also recorded a provision for excess and obsolete inventory reserve of $0.6 million during the year ended December 31, 2004 as we determined that a portion of inventory related to our previous generation products was unsalable. The cost of revenue for the year ended December 31, 2003 was adversely affected by the low manufacturing yield of our products due to Cisco s applying more rigorous testing on their networking systems that identified certain situation in which our products failed to perform to specification. As a result, Cisco returned a portion of those products under the terms of our standard warranty. We recorded charges of approximately $11.4 million in order to write down the carrying value of our inventory to market and establish reserves for warranty and adverse purchase commitments, which resulted in the negative gross margin. To improve yield, we modified the design of our knowledge-based processors. To date, the products incorporating the design modification have met and continue to meet Cisco s testing and qualification requirements and our production yields have improved to projected levels.

Gross Profit /Gross Margin. Gross margin increased to 44.3% during the year ended December 31, 2004 from (50.1)% during the year ended December 31, 2003. Excluding the charges related to Cisco returns of $11.4 million described above, gross margin for the year ended December 31, 2003 would have been 34.1%. The improvement in gross margin from 2003 to 2004, excluding the effect of Cisco returns in 2003, was primarily due to the sales growth of knowledge-based processors, which have a higher average selling price than other products, and continued improvements in production yields for these products. Further, gross margin in 2004 was favorably impacted by the sale of $0.8 million of products that had been fully reserved in prior periods and accordingly had no associated costs of revenue.

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Operating expenses

The table below sets forth operating expense data for the years ended December 31, 2004 and 2003 (in thousands, except percentage data):

	Year ended December 31, 2004	Percentage of Revenue	Year ended December 31, 2003	Percentage of Revenue	Year-to-Year Increase (Decrease)	Increase (Decrease) Percentage
Operating expenses:						
Research and development	$ 17,259	36.1%	$ 18,312	135.3%	$ (1,053)	-5.8%
Selling, general and administrative	6,587	13.8%	4,405	32.5%	2,182	49.5%
Stock-based compensation	5,511	11.5%	2,675	19.8%	2,836	106.0%
Total operating expenses	$ 29,357	61.4%	$ 25,392	187.6%	$ 3,965	15.6%

Research and Development Expenses. Research and development expenses decreased during the year ended December 31, 2004 primarily due to decreases in product development and qualification expenses of $1.8 million and depreciation expense of $0.7 million. During the year ended December 31, 2003, product development and qualification expenses were significantly higher as we began to ramp up the production of knowledge-based processor products. The decrease in depreciation expense was primarily due to some of our software design tools being fully depreciated prior to 2004. The decreases in product development and qualification expenses and depreciation expense were offset by the increases in consulting fees of $0.4 million, common expense allocation of $0.4 million and mask expenses of $0.2 million. The remainder of the change in research and development expenses was caused by individually minor items.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased during the year ended December 31, 2004 primarily due to the increases in payroll related expenses of $0.4 million, directors and officers insurance premium of $0.4 million, audit and legal fees of $0.6 million, consulting fees of $0.3 million, commission expense of $0.2 million and trade show expenses of $0.1 million. The increase in payroll related expenses was caused by the increase in headcount to support our growing operations. The increase in commission expense was due to the increase in sales of our knowledge-based processors in 2004. The increases in consulting and trade show expenses were due to the increased sales and marketing activities to promote our knowledge-based processors. The remainder of the change in selling, general and administrative expenses resulted from individually minor items.

Stock-based compensation Expense. The increase in stock-based compensation amortization was primarily due to grants of stock options prior to our initial public offering with exercise prices below the fair value of our common stock. Stock-based compensation expense is based on the difference between the exercise price of the option grants and the fair value of our common stock at the time of such grants.

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Other items

The table below sets forth other data for the years ended December 31, 2004 and 2003 (in thousands, except percentage data):

	Year ended December 31, 2004	Percentage of Revenue	Year ended December 31, 2003	Percentage of Revenue	Year-to-Year Change	Change Percentage
Other income (expense), net:						
Interest income	382	0.8%	$ 466	3.4%	$ (84)	-18.0%
Interest expense	(4,076)	-8.5%	(166)	-1.2%	(3,910)	-2355.4%
Other income (expense), net	(149)	-0.3%	(88)	-0.7%	(61)	-69.3%
Total interest and other income (expense), net	$ (3,843)	-8.0%	$ 212	1.5%	$ (4,055)	-1912.7%

Interest and Other Income (Expense), net. The significant increase in interest and other income (expense), net during the year ended December 31, 2004 was primarily due to the amortization of beneficial conversion feature and fair value of warrants that were originally recorded in connection with the issuance of promissory notes in March 2004. Both the beneficial conversion feature and fair value of warrants of $2.5 million and $1.0 million, respectively, were originally being amortized over the term of the promissory notes. However, the promissory notes were repaid in full in July 2004, at which time the remaining value of beneficial conversion feature and warrants were charged entirely to interest expense.

Liquidity and Capital Resources

At December 31, 2005, our principal sources of liquidity were our cash and cash equivalents which totaled $65.8 million.

Our line of credit for $14.5 million with Silicon Valley Bank expired on October 2, 2005, and was not renewed as management determined that our currently available liquid resources were adequate for our operational needs for the foreseeable future.

The table below (in thousands) sets forth the key components of cash flow for the years ended December 31, 2005, 2004 and 2003:

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Net cash provided by (used in) operating activities	$ 25,925	$ (9,658)	$ (25,795)
Net cash provided by (used in) investing activities	$ (1,635)	$ 6,814	$ (7,523)

Net cash provided by financing activities	$	77	$	31,100	$	8,592

Cash Flows during the Year ended December 31, 2005

During the year ended December 31, 2005, our operating activities generated net cash of $25.9 million. For cash provided by operating activities, our primary source was net income of $16.4 million, adjusted for non-cash items of $4.0 million primarily related to depreciation, amortization of deferred stock-based compensation and provision for inventory reserves. The provision for inventory reserves of $3.5 million was primarily related to the write-off of approximately $2.0 million of inventory during the second quarter of 2005. The inventory write-off was related to specific inventory that we mutually agreed with our foundry partner did not meet specifications. This write-off did not impact our cash flows during the year ended December 31, 2005 as we received wafer credits from the foundry partner for the same amount. Cash was also generated from increases in accounts payable and accrued liabilities of $2.8 million and $3.2 million, respectively. The decrease in accounts receivable

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resulted from our continued effort to improve cash collections. The increases in accounts payable and accruals were primarily due to the growth of our overall operations and the timing of vendor invoice payments. The primary use of cash for operating activities during the year ended December 31, 2005 was for inventory, which increased as we ramped up our production volume in order to meet our customers increasing demand for knowledge-based processors.

Our investing activities used cash of $1.6 million during the year ended December 31, 2005. Cash was primarily used to purchase research and development design tools and computer equipment to support our growing operations. We expect to make capital expenditures of approximately $3.1 million fiscal 2006. These capital expenditures will be used primarily to support product development activities. We expect to use our cash and cash equivalents to fund these purchases.

Our financing activities provided net cash of $0.1 million for the year ended December 31, 2005. The primary sources of cash were the proceeds from exercises of stock options and repayment of stockholder notes received, which were offset by repayment of capital lease obligations.

Cash Flows during the Year ended December 31, 2004

During the year ended December 31, 2004, our operating activities used net cash of $9.7 million. Cash used in operating activities consisted of a net loss of $12.0 million adjusted for non-cash items primarily related to depreciation, amortization of stock-based compensation and interest expense, which included the amortization and write-off of discount related to the issuance of promissory notes. The primary use of cash for operating activities during the year ended December 31, 2004 was for our inventory, which increased as we ramped up our production volume in order to meet our customers increasing demand for our knowledge-based processors. In addition, the significant growth in our product sales in 2004 increased accounts receivable and lowered our operating cash flows. Cash was also used to reduce our accrued liabilities as we settled our product warranty obligations during the period and used a portion of our initial public offering proceeds to reduce our overall liability balance. Other uses of cash for operating activities included an increase in prepaid and other assets due to the payment of a directors and officers insurance premium in connection with our initial public offering, and a decrease in deferred revenue as we completed our obligation under the agreement with Micron. Cash used for activities related to inventory, accounts receivable, accrued liabilities, prepaid and other assets and deferred revenue was offset by an increase in accounts payable due to the growth in our operations.

Our investing activities provided net cash of $6.8 million during the year ended December 31, 2004. Cash was provided by the sale of short-term investments and the reduction in restricted cash as our amended line of credit agreement with a bank no longer required a restricted cash deposit. Cash provided by the sale of short-term investments and the reduction in restricted cash was offset by the acquisition of property and equipment totaling $1.2 million. The property and equipment expenditures were primarily for purchases of computer equipment and research and development design tools to support our growing operations. We expect to make capital expenditures of approximately $2.9 million during fiscal 2005. These capital expenditures will be used primarily to support product development activities. We will use our cash and cash equivalents to fund these purchases.

Our financing activities provided net cash of $31.1 million for the year ended December 31, 2004. The primary source of cash was the net proceeds received in connection with our initial public offering of $39.3 million. The other sources of cash included the issuance of convertible promissory notes, repayment of stockholder notes received, proceeds from exercises of stock options and warrants and borrowings under the line of credit. Cash provided by these activities was offset by repayment of convertible promissory notes, repayment of the outstanding balance under the working capital line and the payments for capital lease obligations.

Cash Flows during the Year ended December 31, 2003

Cash used in operating activities during the year ended December 31, 2003 was $25.8 million. Our reported net loss of $32.0 million in 2003 was offset by non-cash charges of approximately $15.6 million primarily due to

stock-based compensation. Cash used in operations during 2003 included an increase in accounts receivable of $3.7 million resulting from product sales late in 2003. We reduced our cash utilization during the year in part through an increase in accrued liabilities of $7.1 million, which primarily related to unfavorable purchase commitments and warranty charges for the cost of replacement parts. We also increased inventories during this period by $12.7 million as we began ramping production of our knowledge-based processors for Cisco, but this increase in gross inventories was significantly offset by a $10.4 million provision for inventory and adverse purchase commitments.

Cash used in investing activities was $7.5 million for the year ended December 31, 2003. During 2003, we used $5.0 million in cash related to bank financings as the cash was reclassified as restricted cash, $1.3 million in purchases of property and equipment and a net increase of $1.2 million in short-term investments.

Cash provided by financing activities was $8.6 million in 2003. During 2003, we received proceeds of approximately $9.9 million from bank financings. We repaid bank debt totaling $1.4 million.

Capital Resources

We believe that our existing cash and cash equivalents balance of $65.8 million will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including the amount of revenue we generate, the timing and extent of spending to support product development efforts, the expansion of sales and marketing activities, the timing of introductions of new products, the costs to ensure access to adequate manufacturing capacity, and the continuing market acceptance of our products. However, if we do not meet our plan, we could be required, or might elect, to seek additional funding through public or private equity or debt financing and additional funds may not be available on terms acceptable to us or at all. We also might decide to raise additional capital at such times and upon such terms as management considers favorable and in the interests of our company.

Contractual Obligations

As of December 31, 2005, our principal commitments consisted of operating and capital lease payments, which are summarized below (in thousands):

	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Operating lease obligations	$ 4,077	$ 707	$ 1,459	$ 1,911	$
Capital lease obligations	687	360	327		
Wafer purchases	5,693	5,693			
Total	$ 10,457	$ 6,760	$ 1,786	$ 1,911	$

In addition to the enforceable and legally binding obligations quantified in the table above, we have other obligations for goods and services entered into in the normal course of business. These obligations, however, either are not enforceable or legally binding or are subject to change

based on our business decisions.

Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 31, 2005, we were not involved in any unconsolidated SPE transactions.

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Indemnities, Commitments and Guarantees

In the normal course of business, we have made certain indemnities, commitments and guarantees under which we may be required to make payments in relation to certain transactions. These include agreements to indemnify our customers with respect to liabilities associated with the infringement of other parties technology based upon our products, obligation to indemnify our lessors under facility lease agreements, and obligation to indemnify our directors and officers to the maximum extent permitted under the laws of the state of Delaware. The duration of such indemnification obligations, commitments and guarantees varies and, in certain cases, is indefinite. We have not recorded any liability for any such indemnification obligations, commitments and guarantees in the accompanying balance sheets. We do, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is probable.

Under master purchase agreements signed with Cisco in November 2005, we have agreed to indemnify Cisco for costs incurred in rectifying epidemic failures, up to the greater of (on a per claim basis) 25% of all amounts paid to us by Cisco during the preceding 12 months or $9.0 million, plus replacement costs. If we are required to make payments under the indemnity, our operating results may be adversely affected.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment. SFAS No. 123(R) would require us to measure all employee stock-based compensation awards using a fair value method and record such expense in our financial statements. In addition, the adoption of SFAS No. 123(R) will require additional accounting related to the income tax effects and additional disclosure regarding the cash flow effects resulting from share-based payment arrangements. We have adopted SFAS No. 123(R) effective January 1, 2006. We plan to use the modified-prospective method of recognition of compensation expense related to share-based payments and use the Black-Scholes option pricing model to estimate the fair value of stock-based compensation awards. The adoption of SFAS No. 123(R) will have a material adverse impact on our results of operations. The balance of unearned stock-based compensation to be included in the period 2006 through 2009 related to share-based awards unvested at December 31, 2005, as previously calculated under the disclosure-only requirements of SFAS 123, is approximately $13.0 million, of which approximately $7.4 million is expected to be recorded as expense in 2006.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4 . SFAS No. 151 clarifies that abnormal inventory costs such as costs of idle facilities, excess freight and handling costs, and wasted materials (spoilage) are required to be recognized as current period charges. The provisions of SFAS No.151 is effective for us beginning in the first quarter of fiscal 2006. The adoption of SFAS No. 151 is not expected to have a material impact on our financial position, results of operations and cash flows.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The primary objective of our investment activities is to preserve principal while maximizing the income we receive from our investments without significantly increasing the risk of loss. Some of the investment securities permitted under our cash management policy may be subject to market risk for changes in interest rates. To mitigate this risk, we plan to maintain a portfolio of cash equivalent and short-term investments in a variety of securities which may include money market funds, government debt issued by the United States of America, state debt, certificates of deposit and investment grade corporate debt. Presently, we are exposed to minimal market risks associated with interest rate changes. We manage the sensitivity of our results of operations to these risks by maintaining investment grade short-term investments. Our cash management policy does not allow us to purchase or hold derivative or commodity instruments or other financial instruments for trading purposes. Additionally, our policy stipulates that we periodically monitor our investments for adverse material holdings related to the underlying financial solvency of the issuer. As of December 31, 2005, our investments consisted of money market funds and U.S. government securities. Our results

of operations and financial condition would not be significantly impacted by either a 10% increase or decrease in interest rates due mainly to the short-term nature of our investment portfolio.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

NETLOGIC MICROSYSTEMS, INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

NetLogic Microsystems, Inc.:

We have completed an integrated audit of NetLogic Microsystems, Inc. s 2005 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005 and audits of its 2004 and 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of NetLogic Microsystems, Inc. and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal control over financial reporting

Also, in our opinion, management s assessment, included in Management s Report on Internal Control Over Financial Reporting, appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control Integrated Framework* issued by the COSO. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

San Jose, California

February 28, 2006

NETLOGIC MICROSYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

	December 31, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 65,788	$ 41,411
Accounts receivable, net	5,972	5,873
Inventory	8,822	7,759
Prepaid expenses and other current assets	832	1,408
Total current assets	81,414	56,451
Property and equipment, net	4,012	2,953
Other assets	103	50
Total assets	$ 85,529	$ 59,454
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 8,458	$ 5,690
Accrued liabilities	7,434	4,164
Capital lease obligations, current	360	1,314
Total current liabilities	16,252	11,168
Capital lease obligations, long-term	327	3
Other liabilities	294	181
Total liabilities	16,873	11,352
Commitments and contingencies (Note 10)		
Stockholders equity:		
Common stock; 200,000 shares authorized at December 31, 2005 and December 31, 2004; 18,075 and 17,581 shares issued and outstanding at December 31, 2005 and 2004	180	176
Additional paid-in capital	152,379	150,771
Notes receivable from stockholders	(44)	(434)
Deferred stock-based compensation	(1,114)	(3,227)
Accumulated deficit	(82,745)	(99,184)
Total stockholders equity	68,656	48,102
Total liabilities and stockholders equity	$ 85,529	$ 59,454

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

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NETLOGIC MICROSYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT FOR PER SHARE AMOUNTS)

	Year Ended December 31,		
	2005	**2004**	**2003**
Revenue:			
Product revenue	$ 81,759	$ 46,705	$ 10,015
License and engineering service revenue		1,128	3,520
Total revenue	81,759	47,833	13,535
Cost of revenue:			
Cost of product revenue (1)	33,415	26,664	20,310
Cost of license and engineering revenue			5
Total cost of revenue	33,415	26,664	20,315
Gross profit (loss)	48,344	21,169	(6,780)
Operating expenses:			
Research and development	21,125	17,259	18,312
Selling, general and administrative	9,929	6,587	4,405
Stock-based compensation (2)	1,821	5,511	2,675
Total operating expenses	32,875	29,357	25,392
Income (loss) from operations	15,469	(8,188)	(32,172)
Interest income	1,568	382	466
Interest expense	(203)	(4,076)	(166)
Other expense, net	(16)	(149)	(88)
Income (loss) before income taxes	$ 16,818	$ (12,031)	$ (31,960)
Provision for income taxes	379	$	$
Net income (loss)	$ 16,439	$ (12,031)	$ (31,960)
Net gain (loss) per common share Basic	$ 0.93	$ (1.17)	$ (11.01)
Net gain (loss) per common share Diluted	$ 0.87	$ (1.17)	$ (11.01)
Shares used in calculation Basic	17,725	10,318	2,903

Shares used in calculation Diluted	18,992	10,318	2,903

(1) Stock-based compensation included in cost of product revenue	$ 76	$ 168	$ 111
(2) Components of stock-based compensation excluded from operating expenses:			
Research and development	$ 814	$ 2,166	$ 1,487
Selling, general and administrative	1,007	3,345	1,188
Total	$ 1,821	$ 5,511	$ 2,675

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

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NETLOGIC MICROSYSTEMS, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY (DEFICIT) AND COMPREHENSIVE INCOME (LOSS)

(IN THOUSANDS)

	Common Stock		Additional Paid-In	Notes Receivable from	Deferred Stock-based	Accumulated	Total Stockholders Equity
	Shares	Amount	Capital	Stockholders	Compensation	Deficit	(Deficit)
Balance at December 31, 2002	3,684	37	3,427	(2,004)		(55,193)	(53,733)
Repurchase of restricted Common Stock	(122)	(1)	(175)	118			(58)
Repayment of stockholders notes				266			266
Issuance of Common Stock for cash and services	76		149				149
Issuance of warrants in conjunction with financing lines of credits			199				199
Deferred stock-based compensation, net of reversal			7,086		(7,086)		
Amortization of deferred stock-based compensation					2,786		2,786
Net loss and comprehensive loss						(31,960)	(31,960)
Balance at December 31, 2003	3,638	36	10,686	(1,620)	(4,300)	(87,153)	(82,351)
Issuance of common stock in connection with initial public offering, net of expenses of $2,442	3,737	38	39,224				39,262
Issuance of common stock in connection with conversion of redeemable preferred stock	9,640	96	91,504				91,600
Repurchase of Restricted Common Stock	(14)		(23)	23			
Repayment of stockholders notes				1,163			1,163
Beneficial conversion feature on notes payable			2,466				2,466
Issurance of warrants in connection with line of credit			220				220
Issuance of warrants in connection with notes payable			981				981
Issuance of Common Stock upon exercise of warrants	127	1	238				239
Issuance of Common Stock for cash and services	453	5	869				874
Deferred stock-based compensation, net of reversal due to terminations			4,606		(4,606)		
Amortization of deferred stock-based compensation					5,679		5,679
Net loss and comprehensive loss						(12,031)	(12,031)
Balance at December 31, 2004	17,581	176	150,771	(434)	(3,227)	(99,184)	48,102
Issuance of stock under stock compensation plans	495	4	1,834				1,838
Issuance of stock for warrant exercise	2						
Additional deferred compensation for below-market option grants			192		(192)		
Amortization of deferred stock-based compensation					1,897		1,897
Reversal of deferred stock-based compensation due to terminations			(408)		408		
Repurchase of Common Stock	(3)		(10)				(10)
Repayment of notes receivable				390			390
Net income and comprehensive income						16,439	16,439
Balance at December 31, 2005	18,075	$ 180	$ 152,379	$ (44)	$ (1,114)	$ (82,745)	$ 68,656

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

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NETLOGIC MICROSYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

	Year Ended December 31,		
	2005	**2004**	**2003**
Cash flows from operating activities:			
Net (income) loss	$ 16,439	$ (12,031)	$ (31,960)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	2,062	1,607	2,234
Issuance of stock options for services		11	32
Amortization of deferred stock-based compensation	1,897	5,679	2,786
Non-cash stock-based compensation charge	19		
Non-cash interest expense	204	3,634	90
Provision for (recovery of) doubtful accounts	(225)	192	80
Provision for inventory reserves and adverse purchase commitments	3,473		10,421
Changes in current assets and liabilities:			
Accounts receivable	126	(2,003)	(3,734)
Inventories	(4,536)	(4,175)	(12,696)
Prepaid expenses and other assets	323	(409)	(211)
Accounts payable	2,768	2,109	110
Accrued liabilities	3,272	(3,953)	7,103
Deferred revenue		(500)	(50)
Other long-term liabilities	113	181	
Net cash provided by (used in) operating activities	25,935	(9,658)	(25,795)
Cash flows from investing activities:			
Purchase of property and equipment	(1,635)	(1,181)	(1,337)
Purchase of short-term investments			(3,423)
Sales and maturities of short-term investments		2,995	2,237
Restricted cash		5,000	(5,000)
Net cash (used in) provided by investing activities	(1,635)	6,814	(7,523)
Cash flows from financing activities:			
Proceeds from initial public offering, net		39,262	
Proceeds from issuance of convertible promissory notes and warrants		7,650	
Repayment of convertible promissory notes		(7,650)	
Principal payments on capital lease obligations	(2,122)	(517)	(311)
Repurchase of restricted Common Stock for cash	(10)		(58)
Proceeds from issuance of Common Stock	1,819	1,102	149
Proceeds from payment of notes receivable from stockholders	390	1,163	266
Proceeds from notes payable and lines of credit		27,039	9,910
Repayment of notes payable and lines of credit		(36,949)	(1,364)
Net cash provided by financing activities	77	31,100	8,592
Net increase (decrease) in cash and cash equivalents	24,377	28,256	(24,726)
Cash and cash equivalents at beginning of year	41,411	13,155	37,881

Cash and cash equivalents at end of year	$ 65,788	$ 41,411	$ 13,155
Supplemental disclosure of cash flow information:			
Cash paid for interest	$ 1	$ 277	$ 76
Supplemental disclosure of non-cash investing and financing activities:			
Conversion of Redeemable Convertible Preferred stock into Common Stock in connection with the initial public offering	$	$ 91,600	$
Acquisition of property and equipment under capital leases	$ 1,490	$ 1,348	$ 249
Repurchase of restricted Common Stock through cancellation of stockholders notes	$	$ 23	$ 118
Issuance of warrants in connection with notes payable and line of credit	$	$ 1,201	$ 199
Beneficial conversion feature of convertible promissory notes	$	$ 2,466	$
Issuance of warrants in connection with convertible promissory notes	$	$ 979	$

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

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005

NOTE 1 THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Company

We are a fabless semiconductor company that designs, develops and markets high performance knowledge-based processors for a variety of advanced Internet, corporate and other networking systems, such as routers, switches, network access equipment and networked storage devices.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue recognition

We derive revenue mainly from product sales and, to a lesser extent, from engineering services.

Revenue from product sales is recognized upon shipment when persuasive evidence of an arrangement exists, legal title and risk of ownership has transferred, the price is fixed or determined, and collection of the resulting receivables is reasonably assured. Our sales agreements do not provide for any customer acceptance provisions or return rights. We have no obligation to provide any modification or customization, upgrades, enhancements, post-contract customer supports, additional products or enhancements. Customers have no rights of return unless the product

does not perform according to specifications. Provisions for warranty expenses are recorded when revenue is recognized.

From time to time we perform engineering services for third parties. Engineering service revenue is recognized as services are performed, agreed-upon milestones are achieved and customer acceptance, if required, is received from the customer.

In 2002, we entered into a license and technology transfer agreement with Micron Technology which was subsequently amended in May 2003. Under the terms of the agreement, we are entitled to receive payments related to the licensing of certain technology and completion of certain milestones. Revenue related to the licensing of our technology was recognized upon signing the amended agreement as the technology had been delivered, the price was fixed and all of our obligations had been met. Revenue related to milestone payments is recognized when due upon completion of the milestones.

Warranty

We provide a limited warranty on our products for a period ranging from one to five years from the date of sale. We provide for the estimated future costs of repair or replacement upon shipment of the product. Our warranty accrual is estimated based on actual and historical claims compared to historical revenue and assumes that we have to replace products subject to a claim.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

Cash and cash equivalents

We consider all highly liquid investments purchased with a remaining maturity of three months or less at the date of purchase to be cash equivalents. These investments consist of money-market funds, which are readily convertible to cash and are stated at cost, which approximates market value. We deposit cash and cash equivalents with high credit quality financial institutions.

Risks and uncertainties and concentration of credit risk

While we achieved profitability during the year ended December 31, 2005, we have a history of net losses prior to 2005. Our net losses for the years ended December 31, 2004 and 2003 were $12.0 million and $32.0 million, respectively. Our ability to remain profitable is dependent, among other factors, upon the rate of growth of our target markets, continued customer acceptance of our products, continued end-user acceptance of our customer s products, the strategic position of our products related to current or future competitors, our ability to develop new products that fulfill customer s specifications, our ability to lower cost of goods sold through yield improvements and our ability to manage expenses. If we are unable to achieve profitability, we could be required, or could elect, to seek additional funding through public or private equity or debt financing. Such funds may not be available on terms acceptable to us or at all.

We depend on a few key customers for a substantial majority of our sales and the loss of, or a significant reduction in orders from any of them would likely significantly reduce revenues. For the years ended December 31, 2005, 2004 and 2003, our top five customers accounted for approximately 83.6%, 84.5% and 77.9% of total product revenue, respectively. Further, our engineering services revenue of approximately $1.1 million and $3.5 million in 2004 and 2003, or approximately 2% and 26.0% of total revenues in 2004 and 2003, respectively, is not anticipated to carry forward into future periods and, as such, you should not rely on this previous result being an indication of our future operating performance. Because of the substantial market share owned by our top five customers, our revenue in the foreseeable future will likely continue to depend on sales to a relatively small number of customers, as well as the ability of these customers to sell products that use our products. Our revenue would likely decline if one or more of these customers were to significantly reduce, delay or cancel their orders for any reason. In addition, any difficulty associated with collecting outstanding accounts receivable amounts due from our customers, particularly for our top five customers, would harm our financial performance. Because our sales are based upon standard purchase orders and not on long-term contracts, we cannot assure you that our customers will continue to purchase our products at current levels, or at all.

We purchase all of our semiconductor products from third party foundries. Because future foundry capacity may be limited and because we do not have long-term supply agreements with our foundries, we may not be able to secure adequate manufacturing capacity to satisfy the demand for our products. Although we presently utilize two foundries for wafers, we rely on one for current generation product. We provide the two foundries with monthly rolling forecasts of our production requirements. The ability of each foundry to provide wafers to us is limited however, by the foundry s available capacity. Moreover, the price of our wafers may fluctuate based on changes in available industry capacity. Because we do not have long-term supply contracts with any of our foundries, they could choose to prioritize capacity for other customers, particularly larger customers, reduce or eliminate deliveries to us on short notice or increase the prices they charge us. Accordingly, we cannot be certain that our foundries will allocate sufficient capacity to satisfy our requirements. If we are not able to obtain foundry capacity as required, our relationships

with present and future customers would be harmed and our revenue, gross margin and operating results would be materially impacted.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

Financial instruments that potentially subject us to a concentration of credit risk consist of cash, cash equivalents and accounts receivable. Deposits held with financial institutions may exceed the amount of insurance provided on such deposits. To date we have not experienced any losses on our deposits of cash or cash equivalents. Our accounts receivable are derived from revenue earned from customers located in North America and Asia. We perform ongoing credit evaluations of our customers financial condition and, generally, require no collateral.

The following table summarizes customers who accounted for more than 10% of the total revenue:

	Year Ended December 31,		
	2005	**2004**	**2003**
Solectron Corporation	43%	69%	27%
Solectron Technology SDN BHD	26%		
Mitsui Comtek Corporation	8%	7%	16%
Micron Technology, Inc.		2%	26%

The following table summarizes customers who accounted for more than 10% of the total accounts receivable:

	2005	**2004**	**2003**
Solectron Corporation	51%	64%	48%
Mitsui Comtek Corporation	12%	5%	11%
Micron Technology, Inc.			19%
Celestica Thailand	3%	11%	

Inventories

Inventories are stated at the lower of cost or market, cost being determined using the first-in, first-out method. We provide reserves to adjust inventories when we believe that the net realizable value is less than the carrying value of our inventory. We also provide reserves when the number of units on hand exceeds the number of units that we forecast to sell over a certain period, generally twelve months. In order to determine whether the carrying value of our inventory exceeds its estimated market value, we must estimate the expected manufacturing yield, or the percentage of good product resulting from the manufacturing process, as identified when the product is tested. If actual yields are below estimates, the cost of inventory may exceed its estimated market value and an adjustment could result, having a significant impact on the carrying value of our inventory. In the third quarter of 2003, we accelerated production of a customized version of our knowledge-based

processors designed specifically for Cisco. In the third and fourth quarters of 2003, we shipped a substantial quantity of these knowledge-based processors to Cisco, which processors passed the qualification and testing procedures that Cisco and we had applied to them. We continued to ship a significant number of these processors through the end of 2003; however, in the first quarter of 2004, Cisco began to apply more rigorous testing on its networking systems that identified certain situations in which our products failed to perform to specification. Cisco returned these products to us under the terms of our standard warranty. To eliminate this problem with future products, we modified the design. We replaced the returned units with our processors that passed more stringent testing procedures. As a result of these events, we recorded charges for the write down of inventory and adverse purchase commitments during the third and fourth quarters of 2003. Inventory write downs charged to cost of sales (exclusive of charges for adverse purchase commitments) amounted to $0.6 million in 2003. Adverse purchase commitments charged to cost of sales amounted to $1.2 million and $9.8 million in 2005 and 2003. No adverse commitment charge was recorded in 2004.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

Property and equipment

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Leased assets and leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful life of the asset or the term of the lease.

The depreciation and amortization periods for property and equipment categories are as follows:

Machinery and equipment	3 years
Software	3 years
Furniture and fixtures	5 years

Long-lived assets

We review the recoverability of our long-lived assets, such as property and equipment, whenever 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 our 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 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.

Fair value of financial instruments

Carrying amounts of certain of our financial instruments including cash and cash equivalents, accounts receivable, accounts payable, notes payable and capital lease obligations approximate fair value due to their short maturities and interest rates currently available to us.

Income Taxes

We account for income taxes under an asset and liability approach that requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of timing differences between the carrying amounts and the tax bases of assets and liabilities. Valuation allowances are established when necessary to reduce deferred tax assets to amounts expected to be realized.

Comprehensive income (loss)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) approximated net income (loss) for the years ended December 31, 2005, 2004 and 2003.

Computation of net income (loss) per share

We have computed net income (loss) per share under two methods, basic and diluted. Basic net income (loss) per share is computed by dividing net income(loss) by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the sum of the weighted average number of common shares outstanding and potential common shares (when dilutive).

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

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

	Year Ended December 31,		
	2005	**2004**	**2003**
Numerator:			
Net loss: basic and diluted	$ 16,439	$ (12,031)	$ (31,960)
Denominator:			
Add: weighted-average common shares outstanding	17,834	10,570	3,605
Less: unvested common shares subject to repurchase	(109)	(252)	(702)
Total shares: basic	17,725	10,318	2,903
Add: weighted-average stock options and warrants outstanding	1,158		
Add: shares subject to repurchase	109		
Total shares: diluted	18,992	10,318	2,903

The following outstanding redeemable convertible preferred stock and warrants, common stock warrants, common stock options, and employee stock options were excluded from the computation of diluted net loss per share as they had an anti-dilutive effect (in thousands):

	Year Ended December 31,		
	2005	**2004**	**2003**
Redeemable convertible preferred stock (assuming conversion, using appropriate conversion ratio, to common shares)			9,640
Redeemable convertible preferred stock warrants (assuming conversion, using appropriate conversion ratio, to common shares)			31
Common stock warrants		62	65
Stock options	216	2,213	1,270

Advertising costs

Advertising costs are expensed as incurred. Advertising costs were not significant in 2005, 2004 or 2003.

Research and development

Research and development costs are expensed as incurred.

Stock-based compensation

We account for stock-based employee compensation arrangements using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB No. 25) and the related interpretation, Financial Accounting Standards Board Interpretation (FIN) No. 44 Accounting for Certain Transactions Involving Stock Compensation.

We provide additional pro forma disclosures as required under Statement of Financial Accounting Standards (SFAS) 123, Accounting for Stock-Based Compensation and SFAS No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

The following table illustrates the effect on our net income (loss) as if we had recorded compensation costs based on the estimated grant date fair value as defined by SFAS No. 123 for all granted stock-based awards (in thousands):

	Year Ended December 31,		
	2005	2004	2003
Net income (loss) as reported	$ 16,439	$ (12,031)	$ (31,960)
Add: Stock-based compensation expense included in reported net loss	1,897	5,679	2,786
Deduct: Stock-based compensation expense determined under fair value based method for all awards	(9,938)	(7,806)	(2,984)
Net income (loss) pro forma	$ 8,398	$ (14,158)	$ (32,158)
Net income (loss) per common share:			
As reported:			
Basic	$ 0.93	$ (1.17)	$ (11.01)
Diluted	$ 0.87	$ (1.17)	$ (11.01)
Pro forma:			
Basic	$ 0.47	$ (1.37)	$ (11.08)
Diluted	$ 0.44	$ (1.37)	$ (11.08)

We account for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force Consensus No. 96-18, Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services (EITF 96-18). Under SFAS No. 123 and EITF 96-18, equity instruments issued to non-employees are accounted for at fair value using the Black-Scholes option pricing model. We believe that the fair value of the equity instruments is more reliably measured than the fair value of the services received. The fair value of each non-employee equity instrument is remeasured at each period until a commitment date is reached, which is generally the vesting date.

Fair value disclosures

We calculated the fair value of each employee option grant on the date of grant using the following assumptions:

	Year Ended December 31,		
	2005	2004	2003
Risk-free interest rate	4.02%	2.07% 3.62%	1.95% 3.07%
Expected life of options (in years)	3.7 years	4 years	4 years
Expected dividend yield			
Volatility	71%	0% 80%	0%

The weighted average fair value of employee stock option grants was $9.62, $8.02 and $10.97 for the years ended December 31, 2005, 2004 and 2003, respectively. Options granted to employees prior to the filing of our initial Form S-1 with the Securities and Exchange Commission on April 16, 2004 were valued using the minimum value method as prescribed by SFAS 123.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

Recent accounting pronouncements

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment. SFAS No. 123(R) would require us to measure all employee stock-based compensation awards using a fair value method and record such expense in our financial statements. In addition, the adoption of SFAS No. 123(R) will require additional accounting related to the income tax effects and additional disclosure regarding the cash flow effects resulting from share-based payment arrangements. We have adopted SFAS No. 123(R) effective January 1, 2006. We plan to use the modified-prospective method of recognition of compensation expense related to share-based payments and use the Black-Scholes option pricing model to estimate the fair value of stock-based compensation awards. The adoption of SFAS No. 123(R) will have a material adverse impact on our results of operations. The balance of unearned stock-based compensation to be included in the period 2006 through 2009 related to share-based awards unvested at December 31, 2005, as previously calculated under the disclosure-only requirements of SFAS 123, is approximately $13.0 million, of which approximately $7.4 million is expected to be recorded as expense in 2006.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4 . SFAS No. 151 clarifies that abnormal inventory costs such as costs of idle facilities, excess freight and handling costs, and wasted materials (spoilage) are required to be recognized as current period charges. The provisions of SFAS No.151 are effective for us beginning in the first quarter of fiscal 2006. The adoption of SFAS No. 151 is not expected to have a material impact on our financial position, results of operations and cash flows.

NOTE 2 BALANCE SHEET COMPONENTS:

	December 31,	
	2005	**2004**
	(in thousands)	
Accounts receivable:		
Trade accounts receivable	$ 6,032	$ 6,158
Less: Allowance for doubtful accounts	(60)	(285)
	$ 5,972	$ 5,873
Inventories:		
Finished goods	$ 2,108	$ 4,790
Work-in-progress	6,714	2,969
	$ 8,822	$ 7,759

Property and equipment, net:		
Machinery and equipment	$ 3,764	$ 3,266
Software	9,536	6,929
Furniture and fixtures	154	154
Leasehold improvements		653
	13,454	11,002
Less: Accumulated depreciation and amortization	(9,442)	(8,049)
	$ 4,012	$ 2,953

Property and equipment includes $1.7 million of machinery and equipment and leasehold improvements under capital lease arrangements at December 31, 2005 and 2004. Accumulated amortization of assets under capital leases totaled $1.7 million at December 31, 2005 and 2004, respectively.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

Depreciation and amortization expense for the years ended December 31, 2005, 2004 and 2003 was $2.1 million, $1.6 million and $2.1 million, respectively.

	December 31,	
	2005	2004
	(in thousands)	
Accrued liabilities:		
Payroll and related expenses	$ 2,489	$ 752
Accrued inventory purchases	692	1,030
Accrued warranty	531	381
Accrued engineering expenses	254	1,282
Accrued adverse purchase commitments	931	214
Accrued professional services	991	286
Other accrued expenses	1,546	219
	$ 7,434	$ 4,164

The following table summarizes the activity related to the product warranty liability during the years ended December 31, 2005, 2004 and 2003 (in thousands):

	Year Ended December 31,	
	2005	2004
Warranty accrual:		
Beginning balance	$ 381	$ 1,051
Provision for warranty	1,102	30
Settlements made during the period	(840)	(400)
Other adjustments	(112)	(300)
Ending balance	$ 531	$ 381

NOTE 3 Revolving Line of Credit:

In March 2004, we amended the terms of a line of credit with Silicon Valley Bank (the Working Capital Line), which we originally obtained in October 2003. The terms of the amended agreement eliminated the requirement for a $5.0 million deposit with the bank and allowed us to borrow up to $4.5 million for working capital purposes to the extent we have cash, cash equivalents and short term investments in the custody of the bank. In addition, the portion of the facility that was also available based on certain accounts receivable balances was replaced by an accounts receivable financing facility. The accounts receivable financing facility allowed us to borrow up to $10.0 million based on a percentage of certain customer purchase orders and accounts receivable balances.

In March 2004, in connection with the amendment to the Working Capital Line, we issued the bank a warrant to purchase approximately 15,000 shares of our Series E Redeemable Convertible Preferred Stock at $19.95 per share. The warrant remained outstanding at December 31, 2005 and expires in March 2011. The fair value of the warrants of $223,000 was being amortized as interest expense over the remaining 18-month life of the agreement. The fair value of the warrant was estimated using the Black-Scholes model using a risk-free interest rate of 3.49%, the seven-year contractual life of the warrant, expected dividend yield of zero, volatility of approximately 80% and a fair value of $4.88 per share. During the year ended December 31, 2005 and 2004, we recorded $112,000 and $111,000 of amortization expense, respectively, associated with the warrants.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

In July 2004, we repaid in full $10.5 million outstanding under the Working Capital Line. Subsequent to our initial public offering on July 14, 2004, the Working Capital Line was amended twice and our line of credit was increased to $14.5 million available for general working capital purposes.

The Working Capital Line expired on October 2, 2005 and was not renewed as management determined that the Company s currently available liquid resources were adequate for its operational needs for the foreseeable future.

NOTE 4 CONVERTIBLE PROMISSORY NOTES:

In March 2004, we issued $7.6 million in convertible promissory notes (the Notes) bearing interest at 10.0% per annum and warrants to purchase 76,500 shares of common stock at $2.00 per share to existing stockholders, directors and management. The Notes were convertible at a conversion price of $3.25 at the option of the holder in March 2005 into approximately 2.6 million shares of Series D Redeemable Convertible Preferred Stock, if not earlier repaid. The difference between the conversion price and the fair value of the common stock on the transaction date resulted in a beneficial conversion feature of $2.5 million. The warrants had a fair value of $1.0 million, estimated using the Black-Scholes valuation model, with a risk-free interest rate of 2.44%, a four-year life of the warrants, expected dividend yield of zero, volatility of 90% and a fair value of $3.55. The beneficial conversion feature and the fair value of the warrants were recorded as a discount to the promissory notes. Both the beneficial conversion feature and the warrants were being charged to interest expense over the term of the notes.

In July 2004, the promissory notes and accrued interest were repaid in full following the closing of the initial public offering of our common stock. As the Notes were issued and fully repaid in 2004, the entire value of the beneficial conversion feature and the warrants aggregating $3.5 million was charged to interest expense during the year ended December 31, 2004.

NOTE 5 REDEEMABLE CONVERTIBLE PREFERRED STOCK:

Prior to our initial public offering in July 2004, we had 38,560,664 shares of Series A, B, C, D and E redeemable convertible preferred stock (the Preferred Stock) outstanding. The holders of the Preferred Stock were entitled to certain dividend and liquidation preference rights. No dividends were declared or paid related to the Preferred Stock. Each share of the Preferred Stock was convertible at the option of the holder, or upon our completion of a qualifying public offering of common stock. Upon completion of our initial public offering in July 2004, all outstanding shares of the Preferred Stock were converted into 9,640,145 shares of our common stock.

NOTE 6 COMMON STOCK:

Our Certificate authorizes us to issue 200,000,000 shares of $0.01 par value Common Stock. A portion of the shares sold are subject to a right of repurchase by us subject to vesting, which is generally over a four year period from the earlier of grant date or employee hire date, as applicable, until vesting is complete. At December 31, 2005 and 2004, there were 109,000 and 252,000 shares, respectively, subject to repurchase.

Warrants for common stock

At December 31, 2005, warrants to purchase approximately 58,000 shares of Common Stock at an exercise prices ranging from $0.80 to $19.50 per share remain outstanding and expire at various dates through March 2011.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

NOTE 7 NOTES RECEIVABLE FROM STOCKHOLDERS:

Notes receivable from stockholders include full recourse promissory notes issued in conjunction with the exercise of options by employees. The notes bear interest rates of 6% and 7% compounded semi-annually or annually. Accrued interest and principal are due and payable upon the earlier of the termination of the employees or the maturity of the notes. The terms of the notes range from 4 to 8 years. Notes receivables from stockholders totaled $44,000 and $0.4 million at December 31, 2005 and 2004, respectively. Accrued interest on the notes receivables from stockholders was $14,000 and $116,000 at December 31, 2005 and 2004, respectively and was recorded as other assets.

NOTE 8 STOCK OPTION PLANS:

We have two stock option plans, the 2004 Equity Incentive Plan and the 2000 Stock Plan (collectively, the Plans). The Plans provide for the granting of stock options to employees and consultants. Options granted under the Plans may be either incentive stock options or nonqualified stock options. Incentive stock options (ISO) may be granted only to our employees (including officers and directors who are also employees). Nonqualified stock options (NSO) may be granted to our employees and consultants. We no longer grant options under the 2000 Stock Plan.

Options under the Plans may be granted for periods of up to ten years and at prices no less than 85% of the estimated fair value of the shares on the date of grant as determined by the Board of Directors, provided, however, that (i) the exercise price of an ISO and NSO shall not be less than 100% and 85% of the estimated fair value of the shares on the date of grant, respectively, and (ii) the exercise price of an ISO and NSO granted to a 10% stockholder shall not be less than 110% of the estimated fair value of the shares on the date of grant, respectively. Options granted under the 2000 Stock Plan are exercisable immediately subject to repurchase options held by us which lapse over a maximum period of five years at such times and under such conditions as determined by the Board of Directors. We have an option to repurchase, in the event of a termination of the optionee s employment relationship, any unvested shares at a price per share equal to the original exercise price per share for the option. When the unvested shares are issued with a promissory note, we have a right to repurchase these unvested shares at the lower of the fair market value of our Common Stock as of the time the repurchase option is exercised and the original purchase price per share. To date, options granted generally vest over four years.

The Plans also allowed for the grant of restricted common stock. During 2004 and 2003, the Board of Directors granted 3,000 and 7,000 shares of restricted common stock, respectively. No restricted shares were granted in 2005. The restricted common stock grants in 2004 and 2003 were fully vested upon grant and we recorded compensation expense equal to the fair value of the common stock on the date of grant. Compensation expense related to these grants were $6,000 and $21,000 for the years ended December 31, 2004 and 2003, respectively.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

A summary of all options activity under the Plans is presented below (number of shares in thousands):

		Options Outstanding	
	Shares Available for Grant	Number of Shares Outstanding	Weighted Average Exercise Price
Balances at December 31, 2002	116	818	$ 1.88
Options authorized	738		
Options granted	(691)	691	2.00
Options exercised		(76)	1.96
Options cancelled	163	(163)	1.96
Balances at December 31, 2003	326	1,270	1.96
Options authorized	3,823		
Options granted	(1,450)	1,450	8.00
Options exercised		(454)	1.93
Options cancelled	16	(16)	3.72
Balances at December 31, 2004	2,715	2,250	5.81
Options authorized	150		
Options granted	(1,562)	1,562	18.72
Options exercised		(449)	2.96
Options cancelled	223	(223)	5.82
Balances at December 31, 2005	1,526	3,140	12.63

	Options Outstanding at December 31, 2005			Options Exercisable at December 31, 2005	
Exercise Price	Number of Shares	Weighted-Average Remaining Contractual Life (in Years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
$ 0.80 $ 2.00	699	7.20	$ 1.98	699	$ 1.98
$ 6.04 $ 9.00	318	8.84	6.56	83	6.53

$ 9.12	$12.00	420	8.60	11.67	117	11.92
$12.23	$15.28	681	8.98	12.86	252	13.00
$17.00	$21.34	533	9.67	19.25	30	19.06
$21.41	$27.85	489	9.88	25.06	260	27.23
		3,140	8.78	12.63	1,441	9.88

Deferred Stock-Based Compensation

During the year ended December 31, 2005, 2004 and 2003, we recorded deferred stock-based compensation of $0.2 million, $4.9 million and $7.1 million, respectively, due to the difference between the exercise price and the estimated fair value of common stock. Deferred-stock based compensation is being amortized over the vesting period of four years. We recognized compensation expense of $1.9 million, $5.7 million and $2.8 million during 2005, 2004 and 2003, respectively.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

We granted stock options and stock purchase rights with exercise prices below their estimated fair market value as follows:

Grants Made During Quarter Ended	Number of Options Granted (000s)	Weighted-Average Exercise Price	Weighted-Average Fair Value per Share	Weighted-Average Intrinsic Value per Share
March 31, 2003	117	$ 2.00	$ 10.44	$ 8.44
June 30, 2003	255	$ 2.00	$ 12.24	$ 10.24
September 30, 2003	108	$ 2.00	$ 13.76	$ 11.76
December 31, 2003	211	$ 2.00	$ 14.20	$ 12.20
March 31, 2004	407	$ 2.00	$ 14.20	$ 12.20
June 30, 2005	48	$ 13.54	$ 17.53	$ 3.99

The intrinsic value per share is being recognized as compensation expense over the applicable vesting period (which equals the service period).

Management determined, retrospectively, the fair value for the grants made during the quarters ended June 30, 2003, September 30, 2003 and March 31, 2004. The fair value for the grants during the quarter ended June 30, 2005 was determined based on the quoted market price of our common stock.

2004 Employee Stock Purchase Plan

In July 2004, we adopted the 2004 Employee Stock Purchase Plan (the Purchase Plan) and reserved 750,000 shares of our common stock under this plan. The Purchase Plan permits eligible employees (as defined in the plan) to purchase up to $25,000 worth of our common stock annually over the course of two six-month offering periods, other than the initial two-year offering period which commenced on July 8, 2004. The purchase price to be paid by participants is 85.0% of the price per share of our common stock either at the beginning or the end of each six-month offering period, whichever is less. The Purchase Plan complies with the requirements of Section 423 of the Code., The shares reserved under the Purchase Plan are subject to an automatic increase on January 1 of each year in the number of shares equal to the lesser of 75,000 shares or 0.5% of the outstanding shares of our common stock on the effective date of our initial public offering. As of December 31, 2005, approximately 46,000 shares have been issued under the Purchase Plan and approximately 779,000 shares remain available for future issuance. The Purchase Plan will terminate in May 2014.

NOTE 9 INCOME TAXES:

The components of the provision for income taxes are as follows (in thousands):

	Year ended December 31,		
	2005	**2004**	**2003**
Current:			
Federal	$ 313	$	$
State	46		
Foreign	20		
Total current	379		
Deferred			
Federal			
State			
Foreign			
Total deferred			
Provision for income taxes	$ 379	$	$

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

The provision for income taxes differs from the amount computed by applying the U.S. statutory federal rate to income (loss) before income tax provision as a result of the following (in thousands):

	Year ended December 31,		
	2005	**2004**	**2003**
Tax at statutory rate	$ 5,759	$ (4,090)	$ (10,866)
State taxes, net of federal benefit	46		
Change in Valuation allowance	(5,446)	4,090	10,866
Foreign	20		
	$ 379	$	$

Deferred tax assets and liabilities consist of the following (in thousands):

	December 31,	
	2005	**2004**
Deferred Tax Assets:		
Net operating loss carryforwards	$ 19,355	$ 24,639
Accrued liabilities and other	2,251	1,263
Deferred stock-based compensation	780	1,120
Depreciation and amortization	657	2,940
Research and Development Tax Credits	7,718	6,118
Gross deferred tax assets	30,761	36,080
Valuation Allowance	(30,761)	(36,080)
Net Deferred Tax Assets	$	$

Due to the uncertainty surrounding the realization of the deferred tax asset in future tax returns, we have placed a valuation allowance against our net deferred tax assets.

At December 31, 2005, we had federal and state net operating loss carryforwards of approximately $55.0 million and $11.4 million, respectively. These net operating loss carryforwards will expire commencing in 2022 and 2014 for federal and sate purposes, respectively. We also have federal and state research and development tax credit carryforwards of approximately $4.2 million and $4.5 million, respectively. The federal tax credits carryforwards will expire commencing in 2019 and California tax credits have no expiration date.

For federal and state purposes, a portion of our net operating loss carryforwards may be subject to limitation on annual utilization in case of a change in ownership, as defined by federal and state tax law.

NOTE 10 COMMITMENTS AND CONTINGENCIES:

Leases

We lease office space and equipment under noncancelable operating and capital leases with various expiration dates through 2011. Rent expense for the years ended December 31, 2005, 2004 and 2003 was $0.7 million, $0.5 million and $0.4 million, respectively. The terms of the facility lease provide for rental payments on a graduated scale. We recognize rent expense on a straight-line basis over the lease period and accrue for rent expense incurred but not paid.

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

Purchase Commitments

At December 31, 2005, we had approximately $5.7 million in non-cancelable purchase commitments with suppliers. We have recorded a liability of $0.9 million for adverse purchase commitments related to a portion of these commitments which is considered unsalable.

Contingencies

We are party to claims and litigation proceedings arising in the normal course of business. Although the legal responsibility and financial impact with respect to such claims and litigation cannot currently be ascertained, we do not believe that these matters will result in the payment of monetary damages, net of any applicable insurance proceeds, that, in the aggregate, would be material in relation to our business, financial position, results of operations or cash flows. There can be no assurance that these matters will be resolved without costly litigation, in a manner that is not adverse to our business, financial position, results of operations or cash flows, or without requiring royalty payments in the future which may adversely impact gross margins.

Indemnities, Commitments and Guarantees

In the normal course of business, we have made certain indemnities, commitments and guarantees under which we may be required to make payments in relation to certain transactions. These include agreements to indemnify our customers with respect to liabilities associated with the infringement of other parties technology based upon our products, obligation to indemnify our lessors under facility lease agreements, and obligation to indemnify our directors and officers to the maximum extent permitted under the laws of the state of Delaware. The duration of such indemnification obligations, commitments and guarantees varies and, in certain cases, is indefinite. We have not recorded any liability for any such indemnification obligations, commitments and guarantees in the accompanying balance sheets. We do, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is probable.

Under master purchase agreements signed with Cisco in November 2005, we have agreed to indemnify Cisco for costs incurred in rectifying epidemic failures, up to the greater of (on a per claim basis) 25% of all amounts paid to us by Cisco during the preceding 12 months or $9.0 million, plus replacement costs. If we are required to make payments under the indemnity, our operating results may be adversely affected.

Future minimum lease payments under noncancelable operating and capital leases are as follows (in thousands):

Year Ending December 31,	Capital Leases	Operating Leases
2006	360	707
2007	327	722
2008		737
2009		753
2010 and thereafter		1,158
Total minimum lease payments	687	$ 4,077
Less: Amount representing interest		
Present value of capital lease obligations	687	
Less: Current portion	360	
Long-term portion of capital lease obligations	$ 327	

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NETLOGIC MICROSYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005

NOTE 11 SEGMENT INFORMATION:

We operate in one business segment and sell our products directly to customers in the United States, Asia and Europe. Sales for the geographic regions reported below are based upon the customer headquarter locations. Following is a summary of the geographic information related to revenues for the years ended December 31, 2005, 2004 and 2003 (in thousands):

	Year Ended December 31,		
	2005	**2004**	**2003**
Revenue:			
United States	$ 54,952	$ 44,700	$ 12,259
Malaysia	21,349		
Asia, excluding Malaysia	4,418	2,037	767
Europe	1,040	1,096	509
Total	$ 81,759	$ 47,833	$ 13,535

All of our long-lived assets are located in the United States of America.

NOTE 12 EMPLOYEE BENEFIT PLAN:

We sponsor a 401(k) defined contribution plan covering all employees. Contributions made by us are determined annually by the Board of Directors. To date we have made no contributions to the plan.

NOTE 13 RELATED PARTY:

We lease our headquarters facility in Mountain View, California from an affiliate of Berg & Berg Enterprises, LLC, which holds shares of our common stock. During the year ended December 31, 2005 and 2004, we made lease payments of approximately $634,000 and $284,000, respectively, under this lease arrangement.

NOTE 14 SUBSEQUENT EVENT:

On February 15, 2006, we completed the acquisition of Cypress Semiconductor Corporation s (Cypress) Network Search Engine products pursuant to an Agreement for the Purchase and Sale of Assets entered into on January 25, 2006, as amended. Upon closing the transaction, we acquired assets relating to Cypress network search engine (NSE) business, including all intellectual property related primarily to the acquired NSE business (including all intellectual property related to the Sahasra algorithmic technology), the NSE70K and Ayama product families and all inventory and fixed assets for those product families. We did not acquire any of Cypress TCAM1, TCAM2, TCAM2-CR, TurboCAM or Toy Cam products and inventory.

We paid Cypress approximately $50 million in shares of common stock in connection with the closing of the transaction. We may pay an additional $10 million in cash and up to approximately $10 million in shares of common stock upon achieving specific revenue objectives as outlined in the agreement.

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Selected Consolidated Quarterly Financial Data (Unaudited)

The following table presents selected unaudited consolidated financial data for each of the eight quarters in the two-year period ended December 31, 2005. In our opinion, this unaudited information has been prepared on the same basis as the audited information and includes all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of the financial information for the period presented.

	Quarter			
	First	Second	Third	Fourth
	(in thousands, except per share data)			
Year Ended December 31, 2005				
Total revenue	$ 21,802	$ 18,707	$ 20,029	$ 21,221
Gross profit	$ 12,318	$ 10,487	$ 12,233	$ 13,306
Net income	$ 5,423	$ 2,425	$ 3,608	$ 4,983
Net income per share basic	$ 0.31	$ 0.14	$ 0.20	$ 0.28
Net income per share diluted	$ 0.29	$ 0.13	$ 0.19	$ 0.26

	Quarter			
	First	Second	Third	Fourth
	(in thousands, except per share data)			
Year Ended December 31, 2004				
Total revenue	$ 8,267	$ 11,876	$ 12,441	$ 15,249
Gross profit	$ 2,697	$ 5,541	$ 5,580	$ 7,351
Net loss	$ (5,405)	$ (2,912)	$ (3,638)	$ (75)
Net loss per share basic and diluted	$ (1.58)	$ (0.78)	$ (0.22)	$ (0.00)

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of December 31, 2005. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management s Report on Internal Control Over Financial Reporting

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.

Our management assessed the effectiveness of the company s internal control over financial reporting as of December 31, 2005. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework.* Based on this assessment using those criteria, management concluded that, as of December 31, 2005, our internal control over financial reporting was effective. Our management s assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

Information relating to our executive officers and directors will be presented under the caption Executive Officers and Directors in our definitive proxy statement in connection with our 2005 Annual Meeting of Stockholders to be held on or about May 18, 2006. That information is incorporated into this report by reference. Certain information required by this item concerning executive officers is set forth in Item 1 of Part I of this Report under the caption Executive Officers of the Registrant.

We have adopted a Code of Conduct and Ethics that applies to our principal executive officer, principal financial officer and all other employees of NetLogic Microsystems, Inc. This Code of Conduct and Ethics is posted in the corporate governance section on our website at www.netlogicmicro.com. We intend to satisfy the disclosure requirement under Item 10 of Form 8-K regarding an amendment to, or waiver from, a provision of this Code of Conduct and Ethics by posting such information in the corporate governance section on our website at *www.netlogicmicro.com.*

ITEM 11. EXECUTIVE COMPENSATION.

Information relating to executive compensation will be presented under the caption Executive Compensation in the proxy statement for our 2006 Annual Meeting of Stockholders. That information is incorporated into this report by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Information relating to the security ownership of our common stock by our management and other beneficial owners will be presented under the caption Security Ownership of Certain Beneficial Owners and Management in our definitive proxy statement. That information is incorporated into this report by reference. Information relating to securities authorized for issuance under equity compensation plans will be presented under the caption Securities Authorized for Issuance under Equity Compensation Plans in the proxy statement for our 2006 Annual Meeting of Stockholders. That information is incorporated into this report by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

Information required by this Item is incorporated by reference from the information contained under the caption Certain Relationships and Related Transactions in the proxy statement for our 2006 Annual Meeting of Stockholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by this item is incorporated by reference from the information contained under the caption Ratification of Independent Accountants Principal Accountant Fees and Services and Ratification of Independent Accountants Pre-Approval Policies and Procedures in the proxy statement for our 2006 Annual Meeting of Stockholders.

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PART IV

ITEM 15. Exhibits and Financial Statement Schedules.

(a) The following documents are filed as part of this report on Form 10-K:

(1) *Financial Statements.* Reference is made to the Index to the registrant s the Financial Statements under Item 8 in Part II of this Form 10-K.

(2) *Financial Statement Schedules.* The following consolidated financial statement schedule of the registrant is filed as part of this report on Form 10-K and should be read in conjunction with the Financial Statements of NetLogic Microsystems, Inc.:

Schedule II (i) Valuation and Qualifying Accounts for the year ended December 31, 2005.

Schedules not listed above are omitted because they are not required, they are not applicable or the information is already included in the consolidated financial statements or notes thereto.

(3) *Exhibits.* The exhibits listed on the accompanying index to exhibits in Item 15(c) below are filed as part of, or hereby incorporated by reference into, this report on Form 10-K.

(b) *Exhibits.*

The exhibits listed below are required by Item 601 of Regulation S-K.

Exhibit	Description
2.1	Agreement for the Purchase and Sale of Assets by and between the registrant and Cypress Semiconductor Corporation dated as of January 25, 2006, as amended. (11)
3.1	Restated Certificate of Incorporation of the registrant filed on August 2, 2004 (1)
3.4	Bylaws of the registrant (2)
4.1	Specimen common stock certificate (3)
4.2	Second Amended and Restated Investor Rights Agreement dated August 31, 2001, as amended by the Amendments to Second Amended and Restated Investor Rights Agreement dated March 18, 2004, April 16, 2004 and June 12, 2004 (4)
4.3	Rights Agreement by and between the registrant and Wells Fargo Bank, National Association, dated July 7, 2004 (5)
10.1	2000 Stock Plan and forms of related agreements (6)
10.2	2004 Equity Incentive Plan (3)
10.2.1	Form of Stock Option Agreement under 2004 Equity Incentive Plan (7)

10.2.2	Form of Restricted Stock Agreement under 2004 Equity Incentive Plan
10.3	2004 Employee Stock Purchase Plan and forms of related agreements (8)
10.4	Form of Indemnity Agreement (6)
10.5	License and Technology Transfer Agreement by and between the registrant and Micron Technology, Inc. dated December 12, 2002 (6)
10.9	Form of Change-In-Control Agreement between the registrant and each of certain officers thereof (12)
10.10	Incentive Bonus Plan effective May 5, 2005 (9)
10.11	Form of Master Purchase Agreement by and between the registrant and Cisco Systems, Inc. (10)

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Exhibit	Description
10.12	Form of Promissory Note Secured by Pledge of Stock issued to the registrant by certain officers thereof (6)
10.13	Intentionally omitted
10.14	Intentionally omitted
10.15	Standard Form Lease by and between the registrant and Mission West Properties, L.P. dated May 3, 2004 (2)
10.16	Employment offer letter, dated April 12, 2000, between the registrant and Ronald Jankov (2)
10.17	Employment offer letter, dated April 1, 1999, between the registrant and Roland Cortes (4)
10.18	Employment offer letter, dated March 15, 2002, between the registrant and Ibrahim Korgav, as amended (2)
10.19	Employment offer letter, dated February 9, 1996, between the registrant and Varadarajan Srinivasan (2)
10.20	Employment offer letter, dated June 7, 1999, between the registrant and Marcia Zander (2)
10.21	Employment offer letter, dated December 5, 2003, between the registrant and Donald Witmer (2)
10.22	Description of the registrant s Patent Incentive and Recognition Program (4)
23.1	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm
31.1	Rule 13a-14 certification
31.2	Rule 13a-14 certification
32.1	Section 1350 certification
32.2	Section 1350 certification

(1) Incorporated by reference to the same-numbered exhibit to the registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2004, filed with the Securities and Exchange Commission as of August 20, 2004.

(2) Incorporated by reference to the same-numbered exhibit to Amendment No. 1 to Form S-1 (Registration No. 333-114549) filed by the registrant with the Securities and Exchange Commission as of May 19, 2004.

(3) Incorporated by reference to the same-numbered exhibit to Amendment No. 3 to Form S-1 (Registration No. 333-114549) filed by the registrant with the Securities and Exchange Commission as of June 21, 2004.

(4) Incorporated by reference to the same-numbered exhibit to Amendment No. 2 to Form S-1 (Registration No. 333-114549) filed by the registrant with the Securities and Exchange Commission as of June 14, 2004.

(5) Incorporated by reference to Exhibit (i) to Form 8-A (Registration No. 000-50838) filed by the registrant with the Securities and Exchange Commission as of July 8, 2004.

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Confidential treatment has been requested for certain portions of this exhibit.

(c) *Financial statements and schedules.*

Reference is made to Item 15(a) above.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: February 28, 2006

NETLOGIC MICROSYSTEMS, INC.

By /s/ RONALD JANKOV

Ronald Jankov

President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Ronald Jankov and Donald Witmer as his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ RONALD JANKOV **Ronald Jankov**	Chief Executive Officer and Director (Principal Executive Officer)	February 28, 2006
/s/ DONALD WITMER **Donald Witmer**	Vice President Finance and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	February 28, 2006
/s/ LEONARD PERHAM **Leonard Perham**	Director	February 28, 2006
/s/ NORMAN GORDINHO **Norman Gordinho**	Director	February 28, 2006

/s/ ALAN KROCK **Alan Krock**	Director	February 28, 2006
 Douglas Broyles	Director	
/s/ STEVE DOMENIK **Steve Domenik**	Director	February 28, 2006

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SCHEDULE II (i)

VALUATION AND QUALIFYING ACCOUNTS

FOR THE YEAR ENDED DECEMBER 31, 2005

	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Write-offs/ Adjustments	Balance at End of Period
Year ended December 31, 2005				
Allowance for doubtful accounts	$ 285,000	$ 22,000	$ (247,000)	$ 60,000
Year ended December 31, 2004				
Allowance for doubtful accounts	$ 93,000	$ 192,000		$ 285,000
Year ended December 31, 2003				
Allowance for doubtful accounts	$ 13,000	$ 80,000		$ 93,000

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EXHIBIT INDEX

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2.1	Agreement for the Purchase and Sale of Assets by and between the registrant and Cypress Semiconductor Corporation dated as of January 25, 2006. (11)
3.1	Restated Certificate of Incorporation of the registrant filed on August 2, 2004 (1)
3.4	Bylaws of the registrant (2)
4.1	Specimen common stock certificate (3)
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