SEMTECH CORP
Form 10-K/A
March 29, 2007
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# UNITED STATES

## SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K/A

**Amendment No. 1**

(Mark One)

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended January 29, 2006

OR

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from _______________ to ________________

Commission file number 1-6395

# SEMTECH CORPORATION

**(Exact name of registrant as specified in its charter)**

| **Delaware** | **95-2119684** |
|---|---|
| **(State or other jurisdiction of** | **(I.R.S. Employer** |
| **incorporation or organization)** | **Identification No.)** |

**200 Flynn Road, Camarillo, California, 93012-8790**

**(Address of principal executive offices, Zip Code)**

**Registrant s telephone number, including area code: (805) 498-2111**

**Securities registered pursuant to Section 12(b) of the Act:**

| **Title of each class** | **Name of each exchange** |
|---|---|

| | on which registered |
|---|---|
| **Common Stock par value $.01 per share** | **The NASDAQ Stock Market LLC** |
| **Rights to Purchase Series X Junior Participating Preferred Stock** | **The NASDAQ Stock Market LLC** |

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

**(Title of Class)**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer x Accelerated Filer ¨ Non-accelerated filer ¨

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

Yes ¨ No x

The aggregate market value of the common stock held by non-affiliates of the registrant as of July 31, 2005 was approximately $972 million. Stock held by directors, officers and shareholders owning 5% or more of the outstanding common stock (as reported by shareholders on Schedules 13D and 13G) were excluded as they may be deemed affiliates. This determination of affiliate status is not a conclusive determination for any other purpose.

The number of shares of the Registrant s common stock outstanding at April 3, 2006 was 72,400,389.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the following documents are incorporated by reference in Part III of this report: Definitive Proxy Statement filed on May 9, 2006 in connection with registrant s annual meeting of shareholders held on June 15, 2006.

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**EXPLANATORY NOTE**

**SCOPE OF THIS AMENDMENT NO. 1**

We are filing this Amendment No. 1 ( Amendment No. 1 or Form 10-K/A ) to amend our Annual Report on Form 10-K for the fiscal year ended January 29, 2006 as filed on April 14, 2006 (the Original Report ) to restate our:

(a) Consolidated Statements of Income for the fiscal years ended January 29, 2006; January 30, 2005 and January 25, 2004;

(b) Consolidated Balance Sheets as of January 29, 2006 and January 30, 2005;

(c) Consolidated Statements of Stockholders Equity for the fiscal years ended January 29, 2006; January 30, 2005 and January 25, 2004;

(d) Consolidated Statements of Cash Flows for the fiscal years ended January 29, 2006; January 30, 2005 and January 25, 2004;

(e) selected financial data as of and for the fiscal years ended January 29, 2006; January 30, 2005; January 25, 2004; January 26, 2003 and January 27, 2002;

(f) unaudited quarterly financial data for each of the quarters in the fiscal years ended January 29, 2006 and January 30, 2005; and

(g) related disclosures.

These items are being restated to reflect:

(1) $91.0 million of additional pre-tax non-cash stock-based compensation expense (net of $30,000 capitalized into inventory), and related income tax effects, resulting from stock options granted or modified primarily during fiscal years 1996 to 2003 that were incorrectly accounted for under U.S. generally accepted accounting principles ( GAAP ) ( Restatement Adjustments ). The effect of the Restatement Adjustments extends back to fiscal year 1996 and the cumulative non-cash stock-based compensation expense, including the related income tax impacts, as of the beginning of fiscal year 2002 is recognized as a net decrease to stockholders equity in fiscal year 2002. The amount related to this incorrect option accounting that impacts fiscal year 2007 and future years is immaterial. See Note 1A *Restatement of Consolidated Financial Statements* of the Notes to Consolidated Financial Statements for a detailed discussion of the effect of the restatement. Also see the discussions under *Restatement of Consolidated Financial Statements Based on Review of Stock Option Practices* in this Explanatory Note and in Item 7 and under Item 9A *Controls and Procedures*.

(2) $60,000 increase to income, net of related tax effects, of miscellaneous audit adjustments ( Audit Adjustments ) that were excluded from the fiscal year 2006 financial statements presented in the Original Report based on materiality. See Note 20 Audit Adjustments of the Notes to Consolidated Financial Statements.

This Amendment No. 1 does not result in a change to the cash or cash equivalents previously reported in our consolidated financial statements. The Restatement Adjustments do not result in a change to the net cash provided by operating activities or the revenue previously reported in our consolidated financial statements. However, this report refers to fiscal year 2006 revenue as restated because the Audit Adjustments decreased fiscal year 2006 revenue by $67,000.

References in this report to the restatement are references to the restatement required due to stock option matters (item 1 above) and not to the Audit Adjustments.

**For the convenience of the reader, this Form 10-K/A presents both the items amended due to the restatement and the Audit Adjustments and the portions of the Original Report that are unchanged. Only the following items have been substantively amended as a result of, and to reflect, the restatement and Audit Adjustments, and no other information in the Original Report is substantively amended as a result of the restatement:**

| | |
|---|---|
| Item 1 | Business (updated only as to the data on product development and engineering expenses presented under the caption *Intellectual Capital and Product Development* and sales by region data under the caption *Customers, Sales Data and Backlog*); |
| Item 1A | Risk Factors; |

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Item 6 Selected Financial Data;

Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations;

Item 8 Financial Statements and Supplementary Data, including the *Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting and the Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements*

Item 9A Controls and Procedures

Item 9B Other Information

Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters


This Form 10-K/A also includes an updated Exhibit 23.1 *Consent of Independent Registered Public Accounting Firm* and, in accordance with applicable Securities and Exchange Commission ( SEC ) rules, updated certifications from our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ) as Exhibits 31.1, 31.2, 32.1 and 32.2. We have also included new Exhibits 10.29 and 10.30 with respect to information reported under Item 9B in lieu of filing such information on a separately filed Form 8-K.

Significant events occurring through the date of filing of this Amendment No. 1 that are related to the restatement or its underlying cause are described in Note 19 *Matters Related to Stock Option Review and Restatement* of the Notes to Consolidated Financial Statements in Item 8 of this Amendment No. 1.

Except as required to reflect the effects of the restatement and the Audit Adjustments, we have not substantively modified or updated any information presented in the Original Report or the exhibits thereto (except for updated Exhibits 23.1, 31.1, 31.2, 32.1, and 32.2 described above).

This Form 10-K/A does not reflect events that occurred after the filing of the Original Report or modify or update information affected by subsequent events, except for matters related to the restatement or its underlying cause as specifically referenced herein. Events occurring after the filing of the Original Report or other disclosures to reflect subsequent events have been addressed in Current Reports on Form 8-K or will be addressed in our Quarterly Reports on Form 10-Q for the quarterly periods ended April 30, 2006 ( First Quarter Form 10-Q ), July 30, 2006 ( Second Quarter Form 10-Q ), and October 29, 2006 ( Third Quarter Form 10-Q ) which are being filed concurrently with this Form 10-K/A or in reports filed with the SEC subsequent to the filing of this Form 10-K/A. The First Quarter Form 10-Q, the Second Quarter Form 10-Q, and the Third Quarter Form 10-Q are together referred to as the FY2007 Form 10-Qs. This Form 10-K/A should be read in conjunction with the FY2007 Form 10-Qs, as well as any Current Reports on Form 8-K filed subsequent to the date the Original Report was filed.

We have not amended and do not anticipate amending our Annual Reports on Form 10-K for any years prior to fiscal year 2006, nor will we be amending any of our previously filed Quarterly Reports on Form 10-Q. The financial statements and other information that have been previously filed or otherwise reported for these periods should no longer be relied upon; all such prior information is superseded by the information in this Form 10-K/A, and the FY2007 Form 10-Qs.

## RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

## BASED ON REVIEW OF STOCK OPTION PRACTICES

*Forward Looking and Cautionary Statements*

*This Form 10-K/A contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ). We may also make forward-looking statements in other reports filed with the Securities and Exchange Commission ( SEC ), in materials delivered to shareholders and in press releases. In addition, Company representatives may make oral forward-looking statements from time to time. Forward-looking statements are statements other than historical information or statements of current condition and relate to matters such as our future financial performance, future operational performance, and our plans, objectives and expectations. Some forward-looking statements may be identified by use of terms such as expects, anticipates, intends, estimates, believes, projects, should, will, plans and similar words.*

*Forward-looking statements should be considered in conjunction with the cautionary statements contained in Item 1A Risk Factors and elsewhere in this Form 10-K/A, in our other filings with the SEC, and in material incorporated herein and therein by reference. In light of the risks and uncertainties inherent in all such projected matters, forward-looking statements should not be regarded as a representation by the Company or any other person that our objectives*

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*or plans will be achieved or that any of our operating expectations or financial forecasts will be realized. Financial results could differ materially from those projected in forward-looking statements due to known or unknown risks. We assume no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

*In addition to regarding forward-looking statements with caution, you should consider that the preparation of the restated consolidated financial statements required us to draw conclusions and make interpretations, judgments, and assumptions with respect to certain factual, legal, and accounting matters. Different conclusions, interpretations, judgments or assumptions could have resulted in materially different Restatement Adjustments. See Item 7 of this report for a further discussion of the restatement process.*

Our discussion of this topic is divided into the following segments:

(I) Background of the Restatement

(II) Nature of the Restatement Adjustments

(III) Findings as to Individual Conduct

(IV) Amortization of the Restatement Adjustments

(V) Effect of the Restatement Adjustments on the Previously Reported Financial Statements

(VI) Judgments and Interpretations

(VII) Going Forward

(I) Background of the Restatement

We first learned of issues associated with our past stock option grants on May 17, 2006 when Nasdaq alerted us to a research report published on May 16, 2006 by the Center for Financial Research and Analysis ( CFRA ). On May 18, 2006, we received a letter from the SEC requesting that we voluntarily provide certain information and documents relating to stock option grants dating back to January 1, 1997 (the SEC Letter ).

Upon learning of the CFRA report and receiving the SEC Letter, we began a review of our historical stock option practices with the assistance of outside counsel, Paul, Hastings, Janofsky & Walker LLP. During the course of these efforts, our in-house counsel discovered documents indicating irregularities with respect to certain stock option grants for new employees in fiscal year 2001 (which ended on January 28, 2001). We alerted the Board of Directors ( Board ) to the existence of these documents and immediately began investigating the new hire grants referenced in the documents. After detecting apparent irregularities in these and other new hire grants, we expanded our review to include a more thorough examination of employment files for new hires on and after January 1, 1997. We also began investigating other stock option matters, including delegation authorities for stock option grants, grants to continuing employees, and procedural steps associated with the stock option grant process. We retained Kroll, Inc. to conduct a comprehensive review of the stock option grant issues and FTI Consulting, Inc. to assist in analyzing related accounting issues.

After receiving several management reports on this matter in accordance with previously established procedures regarding accounting complaints, the Audit Committee, at that time comprised of Directors Burra, Hankin and Lindstrom, determined that it should retain independent counsel to assist in conducting an investigation of our stock option grant practices. On June 9, 2006, the Audit Committee retained the law firm of Fenwick & West LLP ( Fenwick ), a law firm not previously used by the Company, to assist in conducting this investigation. Fenwick retained Navigant Consulting, Inc. as its forensic accounting advisor. Directors Burra and Hankin, who had previously served on the Compensation

Committee, recused themselves from the investigation early in July 2006 after Fenwick learned of a new hire stock option grant to an officer in 1996 that was approved by the Compensation Committee and that would be a subject of the investigation. On July 12, 2006, the Board appointed Directors Lindstrom and Piotrowski as a Special Committee ( Special Committee ) fully authorized and empowered to continue the investigation.

Ernst & Young LLP, the Company s independent registered public accounting firm, did not participate in management s review or the Special Committee s investigation, but was kept apprised of the progress and results.

After the initial phase of the investigation, which focused on the processes used to establish option exercise prices and obtain approvals of stock option grants, including procedures relating to initial stock option grants to newly-hired employees and the related measurement dates used for financial reporting purposes, the Special Committee concluded that, pursuant to the requirements of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ) and related authoritative guidance, the accounting measurement dates for certain stock options granted primarily during fiscal years 1998 through 2003 required correction. On July 20, 2006, we announced that

financial statements and the related reports of our independent public accountants, earnings press releases, and similar communications we previously issued should no longer be relied upon pending restatement of our financial statements for fiscal years 2002 through 2006 to record a material level of additional non-cash compensation expense. We also announced that the restatement would affect financial statements for earlier fiscal years and that adjustments for those earlier years would be reflected as part of the opening balances in the financial statements for the restatement period.

The Special Committee s investigation and management s review extended back to January 30, 1995, which was the start of fiscal year 1996. The initial focus was on grants made since the beginning of calendar year 1997, which is the period covered by the informal request received from the SEC. The period covered was expanded to determine if material grant issues existed beyond the periods covered by the SEC request. The Company, with the assistance of Kroll, reviewed grant activity back to 1992 and found no evidence of deliberate manipulation related to grants made prior to fiscal year 1996. The Company concluded that a more detailed review of grants made prior to fiscal year 1996 was not warranted.

(II) Nature of the Restatement Adjustments

This section summarizes the main categories of situations in which the initial accounting was incorrect and describes the measurement date used for the restatement or the other change made for the restatement.

The pre-tax, non-cash, stock-based compensation expense resulting from the revised measurement dates and other adjustments discussed below is approximately $91.0 million in the aggregate for fiscal years 1996 through fiscal year 2006. The following table shows the aggregate financial statement impact of each category of adjustment. In order to avoid double counting, the table reflects an adjustment for items that fall into more than one category.

in thousands, except number of grants

| Category | Number of grants | Expense for all grants | Expense for grants to Section 16 group (1) | Percent of total expense related to Section 16 group |
|---|---|---|---|---|
| (A) Grants to continuing employees | 1,153 | $ 50,473 | $ 7,567 | 15% |
| (B) Grants to new employees | 343 | 19,425 | | 0% |
| (C) Grants lacking evidence of approval | 33 | 149 | | 0% |
| (D) Grants modified after ratification | 83 | 4,545 | | 0% |
| (E) Post-termination arrangements | 68 | 20,854 | 16,396 | 79% |
| (F) Pricing exceptions | 393 | 733 | 107 | 15% |
| | | $ 96,179 | $ 24,070 | 25% |
| Adjustment for duplication among categories | | (5,151) | (107) | 2% |
| Total pre-tax stock option related adjustments | | $ 91,028 | 23,963 | 26% |
| Amount capitalized into inventory | | (30) | | |
| **Total pre-tax stock option compensation expense** | | **$ 90,998** | | |
| **Tax benefits** | | **(28,688)** | | |
| **Net adjustment (2) (3)** | | **$ 62,310** | | |

(1) Expense related to grants made to, or modifications made for, directors, officers and key executives subject to Section 16 of the Securities Exchange Act of 1934 at the time of grant or modification.

(2) The additional non-cash compensation expense is net of forfeitures related to employee terminations.

(3) Amortization of the expense by category is shown in Section (IV) below.

The Company applied APB 25 in determining the correct measurement date in each situation described below. Under APB 25, the measurement date is the first date on which are known both the number of shares that an individual employee is entitled to receive and the option or purchase price, if any. Any intrinsic value that exists at the measurement date must be recognized as compensation cost, generally as a charge to compensation expense in the income statement.

*(A) Grants made by Former Chief Executive Officer John D. Poe ( Former CEO ) from April 1997 to May 2002 to continuing employees*

In April 1997, the Compensation Committee delegated authority to the Former CEO to make option grants as an agent of the Committee for the stated purpose of granting options on a more timely basis. Grants made by the Former CEO were subsequently submitted to the Compensation Committee for approval. The Former CEO granted options under this authority to existing executive and non-executive level employees through May 2002.

Based on the reviews conducted by management and the Special Committee, the Company has concluded that the elements of APB 25 were not satisfied as of the stated grant dates for fifteen of the seventeen grant dates selected

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by the Former CEO from April 1997 through May 2002. There is evidence of intentional manipulation on nine of these grant dates, representing approximately 42% of the shares and approximately 76% of the expense in this category. Based primarily on evidence of the Former CEOs willingness to manipulate grant dates, the Company determined that the grants made during this period were not final until approved by the Compensation Committee. Although the reviews found no specific documentary evidence of manipulation for certain grants, the fact that those grants lack adequate contemporaneous documentation to corroborate the establishment of the grant date, combined with evidence of manipulation of other grants during this period, led to the Company s conclusion that the original measurement date was in error because the terms of the grant were not determined with finality.

The appropriate measurement date for all grants in this category is the date of Compensation Committee ratification, unless the measurement date for a particular grant has been further revised due to one of the issues discussed below.

In August 2002, the Compensation Committee determined that options for continuing employees would be granted in conjunction with regularly scheduled Compensation Committee meetings, thus restoring the delegated authority to the Compensation Committee.

This category also includes adjustments related to miscellaneous grant scenarios, primarily related to acquisitions. The non-cash compensation expense related to these miscellaneous items is approximately $4.6 million pretax.

*(B) Grants to new employees*

In April 1997, the Compensation Committee stated that all option grants communicated via an offer letter would be granted to each employee on his or her start date.

The reviews revealed inconsistencies in grant practices to new hires from April 1997 to August 2002 and evidence of management s willingness to intentionally select favorable grant dates for new hires during this period. More specifically, it was found that a majority of grants during this period were not made as of the recipient s start date. Of those who received a new hire grant on a date other than the actual hire date, approximately 90% received a more favorable price. Of the grants that were made on the hire date, approximately 95% were priced favorably when compared to the price of the stock on the date of the relevant Compensation Committee meeting. The appropriate measurement date for all new hire grants during this period is the date of Compensation Committee approval, unless the measurement date for a particular grant has been further revised due to one of the issues discussed below.

The reviews also identified 76 stock option grants, made between November 1996 and May 2002, that were made to persons before they became employees, including through assignment of the employee to leave of absence status prior to the date the employee began performing services. The appropriate measurement date for these options is the employee s start date. However, a later measurement date tied to the Compensation Committee s approval was applied in a significant number of these cases because grant terms were not determined with finality on the hire date. Compensation expense is amortized over the vesting period, the end of which, for the grants in this group, remains the same but starts at the date of employment. For grants with a measurement date after the stated grant date, amortization related to the first vesting period is accelerated, which could result in more than twelve months of amortization in a fiscal year.

Following a leadership change in the Human Resources Department, the procedures were more fully explained to the HR staff and better enforced, such that beginning in August 2002, new hire grants were made consistently as of the employee s hire date.

In February 2006, the Compensation Committee determined to align the procedure for new hire grants and promotional grants with the procedure in place for annual grants to continuing employees. That is, new hire option grants are now awarded at Compensation Committee meetings rather than on the date of hire.

*(C) Grants lacking evidence of Compensation Committee approval*

The reviews identified 33 grants that lacked evidence of Compensation Committee ratification. The lack of evidence is believed to be the result of administrative issues. For example, some grants to new hires appear in the Company s stock option database without evidence of having been presented to the Compensation Committee for approval. Others in this group were presented to the Compensation Committee for approval then excluded from

the Compensation Committee meeting minutes because the employee had terminated following the meeting or was about to terminate. For grants in this category, management used available relevant information, such as personnel records and Compensation Committee records, to determine the most likely grant date. The Special Committee found these conclusions to be reasonable.

*(D) Grants modified after ratification by the Compensation Committee*

The reviews revealed 84 grants, out of more than 1,600 grants over 23 grant dates, with changes between the grant lists distributed with the Compensation Committee agendas, on which basis the grants were ratified, and the grant lists attached to the minutes for the related meetings. More specifically, the reviews showed 31 new grants, 32 deleted grants (apparently related to employees who terminated in the interim), 12 increased grants, 8 decreased grants, and 1 addition specifically approved by the Compensation Committee. In most cases, these changes were not significant individually or in the aggregate, were not significantly concentrated within individual grant dates, and appear to be the result of administrative error and not indicative of an open-allocation process. The exceptions to these determinations are (i) one grant date in May 1999 for which there is evidence indicating the grant process for ten employees in two departments was incomplete on the award approval date, (ii) 21 grants to continuing employees on one grant date in May 2000 for which the grant process was found to be incomplete on the award approval date, and (iii) five grants to new hires concentrated on one grant date in December 2000 that were made prior to the employees start dates, but not indicative of an open allocation process.

For grants that were added or changed, the measurement date is the date that the Compensation Committee approved the minutes that reflected the changes. With respect to the May 1999 grant, we revised the measurement date for grants to all employees in the two departments with the open allocation process rather than revising the measurement date for only the modified awards. Similarly, with respect to the May 2000 grant, we revised the measurement date for awards to all continuing employees on the second quarter grant list because the list was not finalized on the award approval date.

*(E) Post-termination arrangements*

The reviews identified 21 employees with termination arrangements whereby options were modified through continued vesting and/or extension of the exercise period. Two of these arrangements involved executive level employees transitioned from full-time status to on-call status in anticipation of full retirement. Of the remaining agreements, many involved placing terminated employees below the vice-president level on leave of absence status for stock option purposes. In each of these instances, it has been concluded that the modifications were made in recognition of past services. Specifically, the individuals on leave of absence were no longer required to provide substantive services for the Company and the executives on call did not perform substantive services during the on-call period. Thus, compensation cost for the options affected by the termination arrangements was remeasured on the modification dates and the incremental compensation cost, plus any originally measured but unrecognized compensation cost, has been expensed entirely at the time of modification. These costs were recorded even if the options were exercised by the employee within the originally permitted window following termination of substantive employment.

*(F) Pricing exceptions*

The reviews identified that approximately 9% of the grants made in fiscal years 1996 through 2006 had exercise prices that were determined in a manner inconsistent with our convention of pricing options at the closing price on the day before the grant. The significant majority of the exceptions relate to the use of the closing price on the date of grant. The majority of these grants had pricing exceptions that resulted in pricing unfavorable to the employee, leading to the conclusion that the exceptions were administrative errors. The measurement of compensation cost was corrected to consistently measure compensation cost based on the closing price on the day before the grant date.

For many years we have used the prior date closing methodology set forth in our 1994 stock option plans to determine the exercise price and measure the compensation cost of our employee stock options. Although this methodology is not consistent with the terms of our later option plans, which call for using the weighted-average traded price on date of grant, we have determined, and our accounting advisors and the Special Committee s forensic accountant have concurred, that continued use of the prior date closing methodology was reasonable and acceptable. The Board also concurred and ratified past use of the prior date closing methodology. However, in

October 2006 we amended the operative stock option plans to establish the exercise price based on the closing stock price on the grant date. This change in methodology is not expected to have a material effect on our financial statements.

*Restatement Charges Related to Officers and Key Employees*

The Company s management team during fiscal years 1996 through 2006 included 28 individuals who at various times were subject to the provisions of Section 16 of the Securities Act of 1934 ( Section 16 ) due to their positions as officers or key executives. The eight individuals who served as independent directors at various times during the same period were also subject to Section 16. None of the additional non-cash compensation expense relates to options awarded to independent directors. Approximately 8% of the additional pre-tax non-cash compensation expense is related to options granted to 15 employees after they became officers or key executives subject to Section 16. This expense is almost entirely attributable to Category A, with a small portion attributable to Category F. No Section 16 executive accounted for more than 2.2% of the total non-cash compensation expense due to Category A and F errors. An additional 18% of the total non-cash compensation expense is related to on-call arrangements intended to provide continuity to the Company by transitioning two executives from full-time employment into retirement. Our review indicated that although one executive provided some services during the on-call period, there is no evidence that the other performed any. We determined that since neither employee performed sufficient services to meet the substantive services requirement set forth by current interpretations of applicable accounting standards, the options held by the employees were modified to extend the exercise period and to effectively accelerate vesting on the date they ceased full-time employment and, therefore, a new measurement date was required by APB 25.

(III) Findings as to Individual Conduct

In considering the situations described in (A) through (F) above, the Special Committee concluded that the evidence supports a finding of intentional manipulation of stock option grant dates directed by the Former CEO, that a former human resources executive who was with the Company from October 1999 through May 2002 ( Former HR VP ) participated in this conduct, and that the Chief Financial Officer ( Former CFO ) and the Treasurer ( Former Treasurer ) at the time the Special Committee s report was issued knew, or should have known, of the manipulation and initiated or participated in some manipulative acts. One other executive ( Former Executive ) who left the Company in early January 2007 was found to be significantly less culpable in that he evidenced a willingness to acquiesce in manipulative conduct.

As previously announced, the Former CEO stepped down from his position as Chairman of the Board on August 17, 2006. He also took a leave of absence from the Board, effective the same date, pending the conclusion of the investigation. The Former CEO informed us he was taking these actions to avoid even the appearance of a conflict of interest. Both he and the Former HR VP declined to be interviewed by the Special Committee. Following the Special Committee s report to the Board on October 2, 2006, the Board accepted the recommendation of the Special Committee that the Former CEO be asked to resign and, if he does not do so, that he not be nominated to stand for reelection as a Director at the next annual meeting of shareholders. The Former CEO was asked to immediately resign from the Board. As reported in the Form 8-K we filed on October 25, 2006, we received an October 20, 2006 letter from the Former CEO advising us that he intends to resign his position as a Director effective as of the first date, subsequent to the filing of the Company s restated financial statements, on which the Company regains compliance with Nasdaq continued listing standards and the window for trading by officers and directors of the Company is reasonably expected to be open for a period of at least 30 days.

The Special Committee recommended that the Former CFO and Former Treasurer be asked to resign within a time consistent with Company needs and an orderly transition. As previously announced, the Former CFO and Former Treasurer resigned their positions on November 7, 2006, although they remained with the Company on special assignments through January 22, 2007 and January 31, 2007, respectively.

The Special Committee found some personal benefit to these five individuals in the form of options that were in-the-money, but unvested, at the date of grant. Grants to these five individuals had intrinsic value, meaning value equal to the number of options multiplied by the difference between the stated exercise price and the price on the correct measurement date, of approximately $4.8 million. Options granted by the Company typically vest in equal annual installments over three or four years, beginning on the first anniversary of the grant. After considering unvested options that were forfeited upon termination, the aggregate additional non-cash compensation expense related to grants to these five individuals is approximately $4.5 million.

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Approximately 5% of the intrinsic value related to grants to these five individuals has been realized through exercise of the options. Exercise of options was not permitted during the restatement process. Approximately 41% of the intrinsic value will not be realized because the options have lapsed due to the fixed term of the options expiring during the restatement process or because the 30 day post-termination period for exercising the employee options expired during the restatement process. Approximately 43% of the vested options that expired or lapsed had intrinsic value and 57% had no intrinsic value.

The Board formed a Special Litigation Committee ( Special Litigation Committee ) comprised of Director Baker and Director Edwards, independent Directors who joined the Board in October 2006, to evaluate the existence and extent of any potential claims against these five individuals. The Special Litigation Committee directed management to cancel and rescind all of the outstanding options held by the Former CEO, which amount to over 1.2 million options on a split-adjusted basis, and management has done so. Approximately 19% of the cancelled options had intrinsic value and 81% of the cancelled options had no intrinsic value. Almost all of the cancelled options were vested or would immediately vest upon termination of Board service.

The cancelled, expired and lapsed options had split-adjusted exercise prices ranging from $2.41 to $31.91 per share.

The Special Litigation Committee directed management to cancel one of the Former CFOs grants and to reprice the remainder of his outstanding vested options. However, all of the Former CFOs options (including those to be cancelled) expired or lapsed during the restatement process except for one grant of 240,000 options (split-adjusted) that was issued under one of the Company s prior option plans and is subject to a 90 day post-termination exercise period. Those options have been repriced from $5.31 per share to $6.59 per share (split-adjusted), such that the intrinsic value associated with the options will not be realized by the Former CFO.

The Former Treasurer also has one outstanding grant for 30,000 options (split-adjusted) at an exercise price of $5.88 (split-adjusted) that is subject to a 90 day post-termination exercise period. There is no intrinsic value associated with that grant. The Special Litigation Committee took no action with respect to the Former Treasurer.

The Special Litigation Committee took no action with respect to the Former HR VP or Former Executive.

The status of the intrinsic value associated with options granted to the five individuals is summarized as follows:

(in thousands)

| | **Former CEO** | **Former CFO** | **Three Other Former Executives** | **Total** | |
|---|---|---|---|---|---|
| Realized | $ 19 | $ 16 | $ 193 | $ 228 | 5% |
| Never Vested | | | $ 269 | $ 269 | 6% |
| Expired or Lapsed | | 1,649 | 316 | 1,965 | 41% |
| Cancelled | 1,989 | | | 1,989 | 42% |
| Repriced | | 307 | | 307 | 6% |
| Will Not be Realized | $ 1,989 | $ 1,956 | $ 585 | $ 4,530 | 95% |
| Total Intrinsic Value | $ 2,008 | $ 1,972 | $ 778 | $ 4,758 | 100% |
| Total Intrinsic Value | 42.2% | 41.4% | 16.4% | 100% | |

The Special Committee found that false and misleading information was furnished to the Compensation Committee of the Board. The Special Committee did not recommend, and the Board did not take, any action with respect to current or former Compensation Committee members. The Special Committee did, however, recommend certain remedial measures with respect to corporate governance that we have begun to implement, including establishment of a corporate governance committee at the Board level, development of procedures for certifying genuineness of board materials and minutes, and additional ethics and other training for Directors and employees at all levels.

(IV) Amortization of the Restatement Adjustments

In accordance with APB 25, our restated consolidated financial statements reflect additional compensation expense to the extent the fair market value of a share of our common stock on the correct measurement date exceeded the exercise

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price of the option. The additional non-cash compensation expense was amortized over the required service period, generally over the vesting periods of the respective grants.

The restatement has resulted in additional non-cash stock-based compensation expense related to stock options as follows:

(in thousands)

| Fiscal Year | Additional Compensation Expense | Tax Benefit | Additional Compensation Expense, Net of Tax |
|---|---|---|---|
| 1996 | $ 10 | $ (3) | $ 7 |
| 1997 | 95 | (37) | 58 |
| 1998 | 1,002 | (390) | 612 |
| 1999 | 2,826 | (1,034) | 1,792 |
| 2000 | 6,862 | (2,174) | 4,688 |
| 2001 | 14,050 | (4,017) | 10,033 |
| 2002 | 36,354 | (12,465) | 23,889 |
| 2003 | 13,401 | (3,912) | 9,489 |
| **Subtotal Fiscal Years 1996 - 2003** | 74,600 | (24,032) | 50,568 |
| 2004 | 9,234 | (2,566) | 6,668 |
| 2005 | 5,637 | (1,657) | 3,980 |
| 2006 | 1,527 | (433) | 1,094 |
| **Total Fiscal Years 1996 - 2006** | $ 90,998 | $ (28,688) | $ 62,310 |

The amount related to the restatement that impacts fiscal year 2007 and future years is immaterial.

The additional non-cash compensation expense that resulted from the correction of accounting for stock options granted or modified primarily during fiscal years 1996 through 2003 was generally amortized over the required service period, generally the vesting periods of the respective grants. The following table shows the additional non-cash compensation expense for fiscal years 1996 through 2006. The cumulative after tax adjustment for fiscal years 1996 through 2003 is included in the restated fiscal year 2004 balance sheet as a reduction in stockholders equity.

(in thousands)

| | Fiscal Year | | | | | |
|---|---|---|---|---|---|---|
| **Category** | **1996** | **1997** | **1998** | **1999** | **2000** | **2001** |
| (A) Grants to continuing employees | $ 2 | $ 2 | $ 449 | $ 1,725 | $ 4,530 | $ 9,573 |
| (B) Grants to new employees | 3 | 27 | 506 | 1,073 | 2,003 | 4,499 |
| (C) Grants lacking evidence of approval | 1 | 1 | | 6 | 21 | 24 |
| (D) Grants modified after ratification | | | | | 496 | 1,399 |
| (E) Post-termination arrangements | | | | | 357 | 182 |
| (F) Pricing exceptions | 7 | 71 | 80 | 70 | 103 | 180 |
| | $ 13 | $ 101 | $ 1,035 | $ 2,874 | $ 7,510 | $ 15,857 |
| Adjustment for duplications | (3) | (2) | | (6) | (588) | (1,597) |
| Total pre-tax adjustments | 10 | 99 | 1,035 | 2,868 | 6,922 | 14,260 |
| Amount capitalized into inventory | | (4) | (33) | (42) | (60) | (210) |
| **Total pre-tax compensation expense** | $ 10 | $ 95 | $ 1,002 | $ 2,826 | $ 6,862 | $ 14,050 |
| **Tax benefits** | (3) | (37) | (390) | (1,034) | (2,174) | (4,017) |
| **Net adjustment** | $ 7 | $ 58 | $ 612 | $ 1,792 | $ 4,688 | $ 10,033 |

| | Fiscal Year | | Subtotal FY 1996 through | Fiscal Year | | | Total FY 1996 through |
|---|---|---|---|---|---|---|---|
| **Category** | **2002** | **2003** | **FY 2003** | **2004** | **2005** | **2006** | **FY 2006** |
| (A) Grants to continuing employees | $ 11,729 | $ 9,841 | $ 37,851 | $ 7,101 | $ 4,265 | $ 1,256 | $ 50,473 |
| (B) Grants to new employees | 4,701 | 3,332 | 16,144 | 2,012 | 1,082 | 187 | 19,425 |
| (C) Grants lacking evidence of approval | 89 | (2) | 140 | 5 | 4 | | 149 |
| (D) Grants modified after ratification | 1,380 | 745 | 4,020 | 410 | 112 | 3 | 4,545 |
| (E) Post-termination arrangements | 20,080 | 124 | 20,743 | | 111 | | 20,854 |
| (F) Pricing exceptions | 135 | 67 | 713 | 7 | 12 | 1 | 733 |
| | $ 38,114 | $ 14,107 | $ 79,611 | $ 9,535 | $ 5,586 | $ 1,447 | $ 96,179 |
| Adjustment for duplications | (1,604) | (810) | (4,610) | (422) | (115) | (4) | (5,151) |
| Total pre-tax adjustments | 36,510 | 13,297 | 75,001 | 9,113 | 5,471 | 1,443 | 91,028 |
| Amount capitalized into inventory | (156) | 104 | (401) | 121 | 166 | 84 | (30) |
| **Total pre-tax compensation expense** | $ 36,354 | $ 13,401 | $ 74,600 | $ 9,234 | $ 5,637 | $ 1,527 | $ 90,998 |
| **Tax benefits** | (12,465) | (3,912) | (24,032) | (2,566) | (1,657) | (433) | (28,688) |
| **Net adjustment** | $ 23,889 | $ 9,489 | $ 50,568 | $ 6,668 | $ 3,980 | $ 1,094 | $ 62,310 |

(V) Effect of the Restatement Adjustments on the Previously Reported Financial Statements

*Income Statement Data*

The table below shows the effect of the additional non-cash compensation expense on our previously reported Consolidated Statements of Income for fiscal years 2002 through 2006. The additional non-cash compensation expense

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related to fiscal years 1996 through 2001 is included in the restated 2002 balance sheet as a reduction in stockholders equity.

increase (decrease)

in thousands, except per share data

| | Fiscal Year Ended | | | | |
|---|---|---|---|---|---|
| | **Jan 29 2006** | **Jan 30 2005** | **Jan 25 2004** | **Jan 26 2003** | **Jan 27 2002** |
| **NET SALES** | $ | $ | $ | $ | $ |
| Cost of sales | 213 | 702 | 1,303 | 1,811 | 3,335 |
| **Gross profit** | (213) | (702) | (1,303) | (1,811) | (3,335) |
| **Operating costs and expenses:** | | | | | |
| Selling, general and administrative | 920 | 3,115 | 4,983 | 6,562 | 23,974 |
| Product development and engineering | 394 | 1,820 | 2,948 | 5,028 | 9,045 |
| Acquisition-related items | | | | | |
| Total operating costs and expenses | 1,314 | 4,935 | 7,931 | 11,590 | 33,019 |
| **Operating income** | (1,527) | (5,637) | (9,234) | (13,401) | (36,354) |
| Interest expense | | | | | |
| Interest and other income | | | | | |
| **Income before taxes** | $ (1,527) | $ (5,637) | $ (9,234) | $ (13,401) | $ (36,354) |
| Provision for taxes | 433 | 1,657 | 2,566 | 3,912 | 12,465 |
| **NET INCOME** | $ (1,094) | $ (3,980) | $ (6,668) | $ (9,489) | $ (23,889) |
| **Earnings per share -** | | | | | |
| Basic | ($ 0.02) | ($ 0.05) | ($ 0.09) | ($ 0.13) | ($ 0.34) |
| Diluted | ($ 0.02) | ($ 0.05) | ($ 0.09) | ($ 0.12) | ($ 0.30) |

The additional non-cash compensation expense is allocated among cost of sales; selling, general and administrative; and product development and engineering based on the classification of the employees to whom the stock option causing the adjustment was awarded. The adjustments related to stock options did not affect our revenues or net cash flows for any fiscal year reported.

See Note 1A to the consolidated financial statements included in Item 8 of this report for a side by side comparison of the previously reported amounts with the restated amounts for fiscal years 2006, 2005, and 2004 and Item 7 of this report for a side by side comparison for fiscal years 2003 and 2002.

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*Balance Sheet Data*

The table below shows the effect of the Restatement Adjustments on our previously reported Consolidated Balance Sheets. As noted above, the additional non-cash compensation expense related to fiscal years 1996 through 2001 is included as a reduction in stockholders equity as of the beginning of fiscal year 2002. As detailed below, the primary balance sheet impact in each year was a reclassification between additional paid-in capital and retained earnings.

increase (decrease) in thousands

| | Jan 29 2006 | Jan 30 2005 | Jan 25 2004 | Jan 26 2003 | Jan 27 2002 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Current assets:** | | | | | |
| Cash and cash equivalents | $ | $ | $ | $ | $ |
| Temporary investments | | | | | |
| Receivables, less allowances | | | | | |
| Inventories | 30 | 114 | 281 | 403 | 506 |
| Income taxes refundable | | | | | |
| Deferred income taxes | | | | | |
| Other current assets | | | | | |
| **Total current assets** | 30 | 114 | 281 | 403 | 506 |
| **Property, plant and equipment, net** | | | | | |
| **Investments, maturities in excess of 1 year** | | | | | |
| **Deferred income taxes** | (800) | 945 | 1,382 | 88 | (2,113) |
| **Goodwill** | | | | | |
| **Other intangibles** | | | | | |
| **Other assets** | | | | | |
| **TOTAL ASSETS** | $ (770) | $ 1,059 | $ 1,663 | $ 491 | $ (1,607) |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | | |
| **Current liabilities:** | | | | | |
| Accounts payable | $ | $ | $ | $ | $ |
| Accrued liabilities | | | | | |
| Income taxes payable | | | | | |
| Deferred revenue | | | | | |
| Deferred income taxes | | | | | |
| Other current liabilities | 96 | 96 | 96 | 96 | 96 |
| **Total current liabilities** | 96 | 96 | 96 | 96 | 96 |
| **Convertible subordinated debentures** | | | | | |
| **Deferred income taxes** | | | | | |
| **Other long-term liabilities** | | | | | |
| **Commitments and contingencies** | | | | | |
| **Stockholders equity:** | | | | | |
| Common stock, $0.01 par value | | | | | |
| Treasury stock, at cost | | | | | |
| Additional paid-in capital | 61,446 | 62,180 | 58,804 | 50,964 | 39,376 |
| Retained earnings | (62,312) | (61,217) | (57,237) | (50,569) | (41,079) |
| Accumulated other comprehensive loss | | | | | |
| **Total Stockholders equity** | (866) | 963 | 1,567 | 395 | (1,703) |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **TOTAL LIABILITIES AND STOCKHOLDERS EQUITY** | $ | (770) | $ | 1,059 | $ | 1,663 | $ | 491 | $ | (1,607) |

For a side by side comparison of the previously reported balance sheet line items with the restated amounts for the January 29, 2006 and January 30, 2005 balance sheets, see Note 1A to the financial statements included in Item 8 of this report. See Item 7 of this report for a side by side comparison of the previously reported balance sheet and the restated balance sheet at the end of fiscal years 2004, 2003 and 2002.

*Cash Flow Data*

The Restatement Adjustments had no impact on net cash provided by operating activities or on investing or financing cash flows for the periods presented and had no impact on the Company s total cash balances. The table below shows

the amount of changes in certain captions within the operating section of the cash flow statement due to the Restatement Adjustments. The net impact of these changes on operating cash flow was zero. For a side by side comparison of the previously reported amounts with the restated amounts, see Note 1A to the consolidated financial statements included in Item 8 of this report.

increase (decrease) in thousands

| | Fiscal Year Ended | | |
|---|---|---|---|
| | **Jan. 29, 2006** | **Jan. 30, 2005** | **Jan. 25, 2004** |
| **Cash flows from operating activities:** | | | |
| Net Income | $ (1,094) | $ (3,980) | $ (6,668) |
| Adjustments to reconcile net income to net cash provided by operations: | | | |
| Stock-based compensation | 1,442 | 5,471 | 9,113 |
| Deferred income taxes | 1,744 | 437 | (1,294) |
| Tax benefit of stock option exercises | (2,177) | (2,094) | (1,272) |
| Changes in inventory | 85 | 166 | 121 |
| **Net cash provided by operations** | | | |
| **Net cash provided by (used in) investing activities** | | | |
| **Net cash used in financing activities** | | | |
| **Net increase (decrease) in cash and cash equivalents** | | | |

*Interim Financial Statements*

The impact of the Restatement Adjustments on our previously reported interim results was to decrease income from operations by approximately 11% in the first quarter, 7% in the second quarter, 6% in the third quarter, and 7% in the fourth quarter of fiscal year 2005 and approximately 5% in each of the first two quarters, 3% in the third quarter, and less than one-half of one percent in the fourth quarter of fiscal year 2006. A side by side comparison of previously reported results with the restated results for each of the eight quarterly periods ended January 29, 2006 is presented in Note 21 of the financial statements included in Item 8 of this report.

*Tax Matters*

The recognition of additional non-cash stock-based compensation expense reduced the tax provision for fiscal year 2006 from $11.7 million to $11.2 million and it was further reduced to $11.1 million by the Audit Adjustments. The recognition of additional non-cash stock-based compensation expense reduced the tax provisions for fiscal years 2005 and 2004 from $17.4 million to $15.7 million and from $10.3 million to $7.7 million, respectively.

As a result of the determination that certain grants were issued in prior periods with exercise prices below the market price of our stock on the actual grant date, we have evaluated potential tax consequences under Sections 162(m) and 409A of the Internal Revenue Code (IRC). Section 409A was effective as of January 1, 2005.

We have determined that certain non-cash stock-based compensation expense deducted on our income tax returns for some prior periods was not qualified performance based compensation, as defined in IRC Section 162(m). Our federal and state net operating loss carryforwards have been reduced to reflect this determination. For states in which the available amount of net operating loss carryforwards were inadequate, state tax credit carryforwards have been adjusted. The cumulative effect of this change was to reduce the federal and state non-current deferred tax assets by $9.6 million, of which $1.7 million relates to periods before fiscal year 2002 and $7.9 million relates to fiscal year 2002. We have established a contingency reserve of approximately $96,000 to reflect the anticipated tax, penalties and interest associated with these adjustments. Of this amount, approximately $60,000 is recognized in beginning retained earnings for fiscal year 2002 and approximately $36,000 is recognized as expense in fiscal year 2002.

As applied to stock options, Section 409A generally requires income recognition prior to the exercise date, if the option was granted with an exercise price below the fair market value on the date of grant. To the extent that the Company was required to withhold and remit, and failed to withhold and remit, payroll taxes upon income recognition, the Company is subject to substantial penalties and interest charges. The Company has determined that nearly all of the options subject to 409A had no recognizable income on each of the relevant tax measurement dates. Accordingly, the impact of penalties and interest for failure to withhold and remit payroll taxes does not have a material impact on the

Company s financial statements for fiscal years 2005 or 2006.

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Certain transition rules are in effect that allow remediation of the condition that subjects an option to Section 409A. To be effective, the remediation with respect to executive level employees must have been completed by December 31, 2006 and must be complete for other employees by December 31, 2007. The Company has not taken any actions to remediate these options, since the material options that have been determined to be subject to 409A were issued at exercise prices that are substantially higher than the current price of the Company s stock. Therefore, the future impact of Section 409A is not expected to present a material exposure to the Company under these transitional rules. However, exposure for this item can not ultimately be determined until final guidance is issued. If the final guidance differs significantly from the guidance published to date, the Company s exposure could be material.

(VI) Judgments and Interpretations

To calculate the additional stock-based compensation expense to record, we had to make assumptions and interpretations and draw conclusions about factual, legal, and accounting matters. There is the risk that these assumptions, interpretations, and conclusions could be incorrect or could be disputed by others.

*Assumptions, interpretations and conclusions as to facts*

The risk of an incorrect assumption, interpretation or conclusion as to facts is intensified in situations where the documentation is incomplete. If documentation was incomplete, all reasonably available relevant information was considered in forming conclusions as to the most likely actions that occurred and the dates on which those actions occurred. This is in accordance with a September 19, 2006 letter from the SEC s Office of the Chief Accountant ( OCA Letter ).

Incomplete documentation was an issue particularly with respect to the grants in categories A and C. In category A, there was inadequate contemporaneous evidence to corroborate the stated grant dates for grants made by the Former CEO to continuing employees. This lack of corroboration, when considered with the significant prevalence of evidence that other grants in this category were manipulated and the fact that the control environment, in terms of compensating controls, was the same throughout the period, led to the conclusion that the measurement date should be revised for all grants in Category A. Grants in category C lacked evidence of Compensation Committee ratification. Available relevant information, including personnel records and Compensation Committee records, was used to determine the most likely grant date.

The risk of an incorrect assumption, interpretation or conclusion as to facts also extends to the Special Committee s findings, including those regarding individual behavior. It is important to note that the Former CEO and Former HR VP, who have been determined to be central to the matters under investigation, declined to be interviewed by the Special Committee. The Special Committee and its legal advisors and forensic accountants had to make numerous judgments and assumptions in the process of gathering, reviewing and evaluating the evidence, beginning with the selection of methods to ascertain the available body of evidence and the selection of paper and electronic documents for further examination. The Special Committee also made assumptions and judgments with respect to other matters, such as the credibility of witnesses, the intent behind the wording of emails and other documents, whether and to what extent documents were received, read, or understood by the intended recipients, and the probable date of undated documents.

*Legal interpretations and conclusions*

We made certain legal interpretations regarding, among other things, the requirements under Delaware law for the granting of stock options, the effectiveness of actions taken by our Board and the Compensation Committee, and the status of certain individuals as employees.

*Accounting interpretations and conclusions*

We also made a number of judgments with respect to accounting matters, including interpreting relevant accounting rules and literature and applying those interpretations to our facts and circumstances. For each category A through F we had to interpret and apply APB 25 and related accounting guidance. Specifically, we had to make a determination of the correct measurement dates, which APB 25 defines as the first date on which are known both the option price and the number of shares that an individual employee is entitled to receive.

In coming to our conclusions regarding the correct measurement dates for the grants in each of the categories, we evaluated possible alternatives in situations where there appeared to be more than one potentially feasible measurement date. In choosing from among the alternatives, our conclusions were ultimately based on our good faith assessment of the facts and circumstances and our best effort application of accounting principles to those facts and circumstances. Some of the alternatives considered would have increased the additional non-cash compensation expense and some

would have decreased it. In some cases, proposed alternatives were rejected as inappropriate without measuring the impact on the compensation expense on those dates because the alternatives were clearly not viable.

For category A *Grants made by Former CEO from April 1997 to May 2002 to Existing Employees*, we considered three possible measurement dates in addition to the selected date (Compensation Committee ratification). Identified alternatives considered, but ultimately rejected, included the date of SEC Form 4 filings for employees subject to Section 16 of the Securities Act of 1934, the date that grant data was entered into the Company s option management database, and the date grant notification paperwork was generated and distributed. The Form 4 dates were not selected because Form 4s were filed prior to the date of the Compensation Committee approval on only two occasions, there is evidence that changes were made to grants up to the date of the Compensation Committee meeting and there is evidence that other Form 4s had been filed in error. The date of data entry into the option database was not selected because awards are entered into the system near the end of the quarter, in support of preparation of the quarterly financial statements, and there is no correlation between the date information is entered into the database and the date of grant. We concluded that the grant notification paperwork date was not an appropriate measurement date after considering the informal nature of the notification process, the fact that notification regarding the grant details does not occur simultaneously for all employees, and the lack of accurate tracking logs for the period under review. After considering these alternatives against the relative certainty associated with the Compensation Committee approval date, we determined the date of Compensation Committee approval was the correct measurement date for grants in category A.

With respect to the notification process discussed above, we also note that prior to the Company s implementation of SFAS 123(R), which is discussed in this Item 7 under the heading Recently Issued Accounting Standards, the Company did not believe that notification was a requirement for establishing a measurement date under APB 25, so it had no reason to gather or maintain evidence of the notification date. Based on the review of historical practices, the Company has concluded that it was likely that notification took place within a reasonable time period of the APB 25 measurement date. Thus, using an analogy to FASB Staff Position No. 123R-2, both the consolidated financial statements included in Item 8 of this Report and the SFAS 123 pro-forma footnote included in Note 1 to those financial statements use the APB 25 measurement date.

For category B *Grants to new employees,* we considered using the hire date as the measurement date for all grants in the category, but rejected that concept because there is evidence of management s willingness to intentionally select favorable grant dates for new hires from April 1997 through August 2002 and a majority of the new hires during this period received options on dates after the hire date. The correct measurement date was determined to be the later of the date that the Compensation Committee approved these grants or the date of employment, since that is the first date for which we can confirm that the elements of APB 25 were satisfied. If the hire date had been used for all grants in this category, the pretax restatement charge would have been reduced by approximately $7.4 million.

*Grants lacking evidence of Compensation Committee approval* (category C) were individually evaluated using all available information in order to compile the most comprehensive set of facts and determine the most likely measurement date. Given the lack of complete information, we evaluated alternative measurement dates. Specifically, we made a judgment that the most likely period in which the grant terms were finalized began with the grant date (or earlier hire date, if applicable) and ended with the filing date of the quarterly or annual financial statements that reflect the shares with no record of approval. We then calculated the impact on compensation expense using the hire date (when applicable) and the period high share price. The pretax restatement charge would have increased by approximately $112,000 if the hire date were used for all new hire grants in this category. Use of the period high share price for all grants in this category would have increased the pretax restatement charge by approximately $628,000. We rejected the use of an arbitrary standardized measurement date for grants in this category and instead determined measurement dates based on individual analysis of the facts and circumstances surrounding each grant.

In category D *Grants modified after ratification by the Compensation Committee*, the list attached to the final Compensation Committee meeting minutes, which were ratified at the next meeting, differed from the list that was originally submitted for approval. Upon identification of the exceptions, we reassessed our primary conclusion that all grants from the 23 grant dates involved were finalized when they were submitted to the Compensation Committee. Each modification was investigated and evaluated and, based on this reassessment, we concluded that the errors are administrative in nature and not indicative of an open-allocation process, except for (i) one grant date in May 1999 for which there is evidence indicating the grant process for ten employees in two departments was incomplete on the award approval date, (ii) 21 grants to continuing employees on one grant date in May 2000 for which the grant process was

found to be incomplete on the award approval date, and (iii) five grants to new hires on one grant date in December 2000 that were made prior to the employees start dates.

With respect to (i), after concluding that the May 1999 grant process was incomplete for the ten identified employees in two departments, we revised the measurement date for all grants to employees in those departments from the May 1999 Compensation Committee meeting to the date of the next Compensation Committee meeting in September 1999. Based on our evaluation of the unique facts surrounding the modified grants, we concluded that an open-allocation process did not exist outside of these two departments. Therefore, the correct measurement date for grants to employees in other departments is the date of the May 1999 Compensation Committee meeting. In forming these conclusions about the correct measurement date for the May 1999 grants, we considered relevant guidance in the OCA Letter about changes subsequent to the award date. Given the level of judgment required in reaching these conclusions, we considered two alternatives for the May 1999 grant. The first assumed only the grants for the ten employees were modified and the second assumed grants for all employees were modified. If the first alternative had been selected, the pretax restatement charge would have been decreased by approximately $1.2 million; if the second alternative had been selected, the pretax restatement charge would have increased by approximately $2.6 million. These alternatives, representing each end of the spectrum, were rejected in favor of the less arbitrary and more reasoned approach described above.

With respect to (ii), if we had revised the measurement date only for the 21 grants that were modified after the Compensation Committee meeting rather than for all employees who were on the second quarter grant list, the additional pre-tax compensation expense would have been reduced by $7.8 million.

With respect to (iii), if we had used the hire date as the measurement date for the five grants to new hires on one grant date in December 2000, rather than the date of the Compensation Committee meeting, the additional pre-tax compensation expense would have increased by approximately $81,000.

For category E *Post-Employment Arrangements,* we considered the provisions of APB 25, FASB Interpretation No. 44 *Accounting for Certain Transaction involving Stock Compensation*, and other relevant accounting literature regarding modification of options. We concluded that because options held by employees continued to vest and the time in which to exercise vested options was extended, option modifications occurred for the grants in this category. For the options affected by these 21 agreements, the modification date is the date the Company notified the employee of their leave of absence status or changed employment status, including the related modification to the terms of the grant. The measurement date for the modification to the grants affected by these agreements is the modification date. Given the level of factual information available and the accounting guidance on this issue, we did not assess alternative measurement dates for the modification other than with respect to the on-call agreements. One executive exercised all his vested options one week after entering into an on-call agreement. That is, he exercised them within the original time period permitted by the award agreements. The other executive exercised a portion of his vested options within the original time period permitted. Had we concluded that these vested shares were not modified by the on-call agreements, compensation expense would have been reduced by approximately $10.7 million with respect to the first employee and $1.1 million with respect to the second employee.

With respect to category F *Pricing Exceptions*, we concluded, and our accounting advisors and the Special Committee s forensic accountant have concurred, that using the prior date closing methodology set forth in our 1994 stock option plans to determine the exercise price and measure the compensation cost of our employee stock options was reasonable and acceptable, even though establishing the exercise price in this manner was inconsistent with the terms of our later option plans, which call for using the weighted-average traded price on date of grant. Compensation cost for the options in this category has been remeasured using the prior day closing price. Therefore, compensation cost for all grants during the restatement period has been measured using the prior day closing price methodology. In October 2006, the Board also concurred with the conclusion and ratified past use of the prior date closing methodology.

(VII) Going Forward

Going forward, we do not expect the restatement or the underlying circumstances to have an impact on our fundamental business operations, except to the extent of the disruption caused by the resignations described above and the associated loss of corporate history and knowledge base. Although the financial statement impact of adjustments for past option practices will be immaterial in fiscal year 2007 and future years, we have incurred, and will continue to incur, significant accounting, consulting and legal fees related to the restatement and associated matters such as government inquiries and litigation. These expenses are expected to be significant for some time. We may also incur significant

expense with respect to claims by optionees who were prohibited from exercising expiring or lapsing options during the restatement process. See Note 19 to the consolidated financial statements in Item 8 of this report for additional information about the SEC inquiry and other matters associated with the restatement and its underlying circumstances.

In keeping with our goal of continuous improvement in all areas of our business, we have improved our system of internal controls in recent years. Since the end of fiscal year 2006, we have instituted, or are instituting, additional changes to further enhance our entity level controls, controls with respect to stock options, and our corporate governance practices. Some of these modifications reflect recommendations made by the Special Committee. These improvements include the establishment of an internal audit function in February 2006, the addition of two new independent directors in October 2006, and the Board s adoption of a policy in November 2006 that clarifies its views as to matters requiring prior Board review and provides guidance to the Chief Executive Officer and senior management in identifying matters to be brought to the Board s attention.

We believe that the past intentional manipulation of the stock option granting process discussed above is contrary to the high ethical standards we endeavor to apply to all aspects of our operations. In the second quarter of fiscal year 2007, our senior management formalized a set of Core Values to complement the Code of Conduct adopted in 2004. These Core Values, which have been disseminated to all employees, include *Honesty and Integrity in All We Do*. To the extent portions of the restatement were due to lack of understanding, documentation or procedural lapses, and/or administrative errors, we are recommitted to excellence in carrying out job functions at every level.

Having completed its work, the Special Committee will stand down and be dissolved upon the filing of this Form 10-K/A and the FY2007 Form 10Qs.

We intend to honor the exercise price of options specified in outstanding executory award agreements, except as to those options that the Special Litigation Committee has directed be cancelled or modified.

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**SEMTECH CORPORATION**

**INDEX TO FORM 10-K/A**

**Amendment No. 1**

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*Forward Looking and Cautionary Statements*

*This Amendment No. 1 to Annual Report on Form 10-K (the Form 10-K/A ) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ). We may also make forward-looking statements in other reports filed with the Securities and Exchange Commission ( SEC ), in materials delivered to shareholders and in press releases. In addition, Company representatives may make oral forward-looking statements from time to time. Forward-looking statements are statements other than historical information or statements of current condition and relate to matters such as our future financial performance, future operational performance, and our plans, objectives and expectations. Some forward-looking statements may be identified by use of terms such as expects, anticipates, intends, estimates, believes, projects, should, will, plans and similar words.*

*Forward-looking statements should be considered in conjunction with the cautionary statements contained in Item 1A Risk Factors and elsewhere in this Form 10-K/A, in our other filings with the SEC, and in material incorporated herein and therein by reference. In light of the risks and uncertainties inherent in all such projected matters, forward-looking statements should not be regarded as a representation by the Company or any other person that our objectives or plans will be achieved or that any of our operating expectations or financial forecasts will be realized. Financial results could differ materially from those projected in forward-looking statements due to known or unknown risks. We assume no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

*In addition to regarding forward-looking statements with caution, you should consider that the preparation of the restated consolidated financial statements required us to draw conclusions and make interpretations, judgments, and assumptions with respect to certain factual, legal, and accounting matters. Different conclusions, interpretations, judgments or assumptions could have resulted in materially different Restatement Adjustments. See Item 7 of this report for a further discussion of the restatement process.*

# PART I

## ITEM 1. BUSINESS

The only portions of this item that have been updated substantively are the product development and engineering expenses presented under the caption *Intellectual Capital and Product Development* and the sales by region data under the caption *Customers, Sales Data and Backlog.*

### General

We are a leading supplier of analog and mixed-signal semiconductors and were incorporated in Delaware in 1960. We design, produce and market a broad range of products that are sold principally to customers in the computer, communications and industrial markets. Our products are designed into a wide variety of end applications, including notebook and desktop computers, personal digital assistants (PDAs), cellular phones, wireline networks, high-end consumer devices and semiconductor test platforms. Our end-customers are primarily original equipment manufacturers and their suppliers, including Apple, Cisco, Compal Electronics, Curitel Communications, Dell, Hewlett Packard, Intel, LG Electronics, Motorola, Nortel, Panasonic, Phonak, Quanta Computer and Samsung.

### Overview of the Semiconductor Industry

The semiconductor industry is broadly divided into analog and digital semiconductor products. Analog semiconductors condition and regulate real world functions such as temperature, speed, sound and electrical current. Digital semiconductors process binary information, such as that used by computers. Mixed-signal devices incorporate both analog and digital functions into a single chip and provide the ability for digital electronics to interface with the outside world.

The market for analog and mixed-signal semiconductors differs from the market for digital semiconductors. The analog and mixed-signal industry is typically characterized by longer product life cycles than the digital industry. In addition, analog semiconductor manufacturers tend to have lower capital investment requirements for manufacturing because

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their facilities tend to be less dependent than digital producers on state-of-the-art production equipment. The end-product markets for analog and mixed-signal semiconductors are smaller, more varied and more specialized than the relatively standardized digital semiconductor product markets.

Another difference between the analog and digital markets is the amount of available talented labor. The analog industry relies more heavily than the digital industry on design and applications talent to distinguish its products from one another. Digital expertise is extensively taught in universities due to its overall market size, while analog and mixed-signal expertise tends to be learned over time based on experience and hands-on training. Consequently, personnel with analog training are more scarce than digital trained engineers. This has historically made it more difficult for new suppliers to quickly gain significant market share.

The electronics market is characterized by several trends that we believe drive demand for our products. Electronic systems are being designed to operate at increasingly lower operating voltages, battery-powered devices such as handheld computers and cellular telephones are proliferating, and devices are becoming smaller and requiring higher levels of integration. Our products are designed to address these needs by providing solutions that protect low voltage circuits, extend battery life, meet tighter voltage requirements, improve interface between systems, and support higher transmission and processor speeds. Additionally, as communications functions are increasingly integrated into a range of systems and devices, these products require analog processing capabilities, which increases the number and size of our end-markets. Finally, industrial, medical, consumer and other end-market applications have increasingly incorporated data processing and communications features into their finished systems, which in turn have broadened the opportunities for selling our analog and mixed-signal devices.

Advancements in digital processing technology typically drive the need for corresponding advancements in analog and mixed-signal solutions. We believe that the diversity of our applications allows us to take advantage of areas of relative market strength and reduces our vulnerability to competitive pressure in any one area.

**Semtech End-Markets**

A majority of our products are sold to customers in the computer, communications and industrial markets. Until the mid-1990s, we largely focused on serving the military and aerospace end-market. In calendar year 1996, we used the desktop segment of the computer market as our first major entry into the commercial marketplace for our circuits. Nearly ten years ago, approximately half of our revenues were derived from desktop computer related applications. In recent years, we have seen relative growth from the communications and industrial markets as a percentage of the total. We have also seen a greater diversification within our computer market segment, beyond our initial focus on desktop computer applications.

For the fiscal year ended January 29, 2006, our revenues from the computer end-market were 30% of net sales, the communications end-market, which includes cellular phones applications, was 46%, and the remaining 24% of net sales were from industrial, military and aerospace, and various other end-markets.

Computer market applications include notebook and desktop computers, computer graphics and PDAs. End-product applications for our products within the communication market include cellular phones and base stations, set-top-boxes, and local and wide-area networks. Industrial and other applications include automated test equipment (ATE), power supplies, hearing aids and other medical devices, and meter reading and factory automation systems. We believe that our diversity in end-markets provides stability to our business and opportunity for growth. Presented below is our estimated breakdown of sales by various end-applications for the last three fiscal years.

(fiscal years, percentage of net sales)

| **End-Application** | **2006** | **2005** | **2004** |
|---|---|---|---|
| Cell phone | 27% | 32% | 27% |
| Notebook computers and PDA | 18% | 21% | 22% |
| Desktop computers/server | 11% | 9% | 12% |
| Graphics/gaming | 1% | 3% | 6% |
| Wireline equipment | 19% | 15% | 13% |
| ATE | 4% | 10% | 12% |
| Industrial/other | 20% | 10% | 8% |
| | 100% | 100% | 100% |

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The following table depicts our main product lines and their end-product applications:

| Semtech s Main Product Lines | | Specific End-Product Applications | |
|---|---|---|---|
| | **Computer** | **Communications** | **Industrial / Other** |
| **Power Management** | Desktop PCs, servers, workstations, notebook computers, add-on cards, PDAs, computer gaming systems | Cellular phones, network cards, routers and hubs, telecom network boards | Power supplies, industrial systems |
| **Protection** | Notebook computers, PDAs, USB ports, LAN cards | Cellular phones, base stations, DSL equipment, routers and hubs | Handheld measurement or instrumentation devices |
| **Test and Measurement** | Workstations | Cellular base stations, routers and hubs, SONET networks | Automated test equipment |
| **Advanced Communications** | | SONET networks, routers, hubs, switches, fiber modems | |
| **Wireless and Sensing** | | Wireless headsets and Bluetooth devices | Automated metering reading, industrial control and hearing aids (medical). |

Historically, our results have reflected some seasonality, with demand levels generally being higher in the computer and consumer products segments during the third and fourth quarters of our fiscal year in comparison to the first and second quarters. In recent years, macro-level industry trends and end-application cycles have had a more significant impact than seasonality on our results.

**Business Strategy**

Our objective is to be a leading supplier of analog and mixed-signal devices to the fastest growing segments of our target markets. We intend to leverage our pool of skilled technical personnel to develop new products, or, where appropriate, use acquisitions, to serve the fastest growing segments of these markets. In order to capitalize on our strengths in analog and mixed-signal processing design, developing and marketing, we intend to pursue the following strategies:

*Leverage our rare analog design expertise*

We have developed a strategy to invest heavily in human resources needed to define, design and market high-performance products. We have built a team of experienced engineers who combine industry expertise with advanced semiconductor design expertise to meet customer requirements and enable our customers to get their products to market rapidly. We intend to leverage this strategy to achieve new levels of integration, power reduction and miniaturization, enabling our customers to achieve leading performance in their products.

*Continue to release proprietary new products, achieve new design wins, and cross-sell products*

We are focused on developing unique, new, high-margin products to serve our target markets. These markets have experienced growing consumer demand for increased product performance at competitive price points. We also focus on achieving design wins for our products with current and future customers. Design wins are indications by the customers that they intend to incorporate our products into new designs. Our technical talent works closely with our customers in securing design wins, developing new products and in implementing and integrating our products into

their systems. We also focus on selling additional products to our existing customers, as we believe the technical expertise of our marketing department permits it to identify and capitalize on cross-selling opportunities. Our June 2005 acquisition of XEMICS SA (see Note 18 to our consolidated financial statements) should further help us in the areas of development of new products, securing customer design wins and cross-selling multiple products into customer accounts.

*Focus on fast-growing market segments*

We have chosen to target the analog segments of some of the fastest growing end-markets. We intend to enhance this growth potential by focusing on specific products within the analog and mixed-signal market, including notebook computers, PDAs, cellular phones, wide area networks and certain broad-based industrial markets. These markets are characterized by their need for leading-edge, high-performance analog and mixed-signal semiconductor technology.

*Leverage outsourced semiconductor fabrication capacity*

We outsource most of our manufacturing in order to focus more of our resources on defining, developing and marketing our products. We use outside wafer foundries that are based in Asia, the United States and Europe. Our largest wafer source is a foundry based in China. We believe that outsourcing provides us numerous benefits, including capital efficiency, the flexibility to adopt and leverage emerging process technologies without significant investment risk and a more variable cost of goods, which provides us with greater operating flexibility.

*Increase sales efforts in certain geographic areas*

We believe that certain geographic markets, such as China, Japan and Europe represent opportunities for added sales and end-customer diversity. China is an emerging market with quickly developing opportunities that range from portable consumer devices up to expensive networking equipment. Our subsidiary, Semtech International AG, has developed a local presence in China to provide qualified activities, such as marketing, technical advice and market trends and has leveraged its relationship with its Taiwanese and Korean-based customers that are transferring business into China. Japan and Europe have been major consumers of analog and mixed-signal components for many years. We have bolstered our sales efforts in these regions in hopes of finding added success in these large markets.

**Product Segments**

We have two product segments, both of which are comprised of semiconductor products. A majority of our sales come from our Standard Semiconductor Products, which we consider to be our most strategic product segment. The balance of sales come from our Rectifier, Assembly and Other Products segment. The products in that segment are older-technology products, in many cases dating back to the earliest days of our Company when our focus was primarily the military and aerospace end-markets.

*Standard Semiconductor Products*. Included in Standard Semiconductor Products are integrated circuits (ICs) and discrete components designed for use in standard and specific applications. Standard Semiconductor Products represented approximately 96%, 96% and 95% of our overall net sales for fiscal years 2006, 2005 and 2004, respectively. The main product lines within our Standard Semiconductor Products are described below.

Power Management Circuits. Power management circuits control, alter, regulate and condition the electrical pulses that flow through electronics. The highest volume product types within the power management product line are switching voltage regulators, combination switching and linear regulators, smart regulators and charge pumps. The primary application for these products is power regulation for computer, communications and industrial systems. Internally, we divide the power management product line into three sub-product groups, entitled portable power management, desktop/server power management and networking/industrial power management.

Protection Products. We design and market protection products, which are often referred to as transient voltage suppressors (TVS). TVS devices provide protection for electronic systems where voltage spikes (called transients), such as electrostatic discharge generated by the human body, can permanently damage voltage-sensitive components. We also have developed filter and termination devices that can be sold as a complement to TVS devices. Specific protection product applications are found in computer, data-communications, telecommunications and industrial markets.

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Test and Measurement Circuits. We design and market a wide variety of test and measurement products, namely pin electronics, timing, clock distribution, parametric measurement, and clock products for use in ATE, workstations and communication infrastructure equipment.

Advanced Communication Circuits. We have developed a line of highly proprietary advanced communication ICs, which perform specialized timing and synchronization functions in high-speed networks. Our primary product offering in this area is our SETS product family that is used in metropolitan, wide area, and wireless networks.

Wireless and Sensing Products. Through our June 2005 acquisition of XEMICS, we now offer a line of wireless and sensing products that can be used in a wide variety of industrial, medical, personal area network, and other applications. Our wireless and sensing products include the ability to perform radio frequency (RF) capabilities in the products we sell, along with other sensing and converter technology.

Human Input Devices (HID). Following our acquisition of USAR in fiscal year 2000, we offered a line of HID devices that included touch-screen and touch-pad controllers, pointing stick devices and battery management circuits designed to handle human input and battery functions in portable systems such as notebook computers, PDAs and cellular phones. In the fourth quarter of fiscal year 2006, we made a strategic decision not to further invest in this product offering. Customers have been given a period of time in which to make last time orders for most of our HID products. In fiscal year 2006, HID products represented 2% of Standard Semiconductor Products segment sales.

*Rectifier, Assembly and Other Products*. Rectifiers, assemblies and other products are older-technology products. Rectifier, Assembly and Other Products represented approximately 4%, 4% and 5% of our overall net sales for fiscal years 2006, 2005 and 2004, respectively.

Rectifiers. We have several different categories of silicon rectifiers, which are primarily used to convert alternating current to direct current. These products are sold mainly to military, aerospace, industrial equipment and medical equipment customers.

Assemblies. A rectifier assembly is a package of rectifiers of one or more types, sometimes encased in epoxy or silicon by various molding techniques, constituting one or more basic rectifier circuits. We also offer some non-rectifier assemblies such as voltage multipliers. Assemblies are used in x-ray scanners, microwave ovens, aircraft engines, avionics equipment, airport radar and other specialized applications.

For further financial information on these segments, refer to the information contained in Note 17 to the Consolidated Financial Statements included in Item 8.

**Intellectual Capital and Product Development**

We believe that our emphasis on the development of our intellectual properties and introduction of new proprietary product designs are key to our success. Recruiting and retaining technical talent is the foundation for developing and selling new products into the marketplace. One of our strategies to recruit this talent is the establishment of multiple design center locations. We have dedicated design centers in San Jose, California; Raleigh, North Carolina; Glasgow, Scotland; Romsey, England; Swindon, England and Neuchatel, Switzerland. In addition, dedicated test and measurement circuit design occurs at our San Diego location.

Circuit design engineers are some of our most valuable engineers. Circuit designers perform the critical task of designing and laying out integrated circuits. As of January 29, 2006, we employed more than 80 circuit designers and layout engineers. Many of these individuals have senior-level expertise in the design, development and layout of circuits targeted for use in power management, protection, test, measurement and communication applications. We also employ a very limited number of engineers that specialize in the development of software that is incorporated into certain of our advanced communications and wireless and sensing products.

We incurred $37.9 million or 16% of net sales on product development and engineering in fiscal year 2006. Product development and engineering costs were $35.3 million or 14% of net sales and $33.3 million or 17% of net sales in fiscal years 2005 and 2004, respectively. We intend to make further investments in research and development in the future, which may include including increasing our employee headcount and investing in design and development equipment.

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**Sales and Marketing**

Sales made directly to original equipment manufacturers during fiscal year 2006 were approximately 57% of net sales. The remaining 43% of net sales were made through independent distributors. We have direct sales personnel located throughout the United States who manage the sales activities of independent sales representative firms and independent distributors within North America. We expense our advertising costs as they are incurred.

We operate internationally primarily through our wholly-owned Swiss subsidiary, Semtech International AG. Semtech International serves the European markets from its headquarters in St. Gallen, Switzerland and through its wholly-owned subsidiaries based in France; Germany; Neuchatel, Switzerland; and the United Kingdom. Semtech International maintains branch sales offices, either directly or through one of its wholly owned subsidiaries, in Hong Kong, Taiwan, Korea and Japan. Semtech International also has small representative offices located in Shanghai and Shenzhen, China. Independent representatives and distributors are also used to serve customers throughout the world. Some of our distributors and sales representatives may also offer products from our competitors, as is customary in the industry.

**Customers, Sales Data and Backlog**

For fiscal year 2006, we estimate that more than 1,000 customers purchased our products either directly from us or through our authorized distributors. The following is a sample of our customers by end-markets:

Representative Customers by End-Markets:

| Computer | Communications | Industrial/Other |
|---|---|---|
| Apple | Alcatel | Credence |
| Dell | Motorola | LTX |
| Hewlett Packard | Nortel | Rockwell |
| Intel | Samsung | Siemens |
| LG Electronics | Sony | Phonak |

Our customers include major computer and peripheral manufacturers and their subcontractors, ATE manufacturers, data communications and telecommunications equipment vendors, and a variety of large and small companies serving the industrial, medical, automotive, aerospace and military markets. Customers tend to make their decision on whether to buy our products or our competitors products based on such key factors as price, technical support and product performance.

During fiscal year 2006, 2005 and 2004, U.S. sales contributed 18%, 26% and 31%, respectively of our net sales. Conversely, during fiscal years 2006, 2005 and 2004, foreign sales constituted 82%, 74% and 69%, respectively, of our net sales. A majority of foreign sales were to customers located in the Asia-Pacific region. The remaining foreign sales were primarily to customers in Europe, Canada, and Mexico.

A summary of net sales by region follows:

(fiscal years, in thousands)

| | 2006 | | | | |
|---|---|---|---|---|---|
| | As Previously Reported | Audit Adjustments | As Restated (1) | 2005 | 2004 |
| North America | $ 42,678 | $ (67) | $ 42,611 | $ 65,884 | $ 59,927 |
| Asia-Pacific | 168,796 | | 168,796 | 167,336 | 115,936 |
| Europe | 27,931 | | 27,931 | 20,392 | 16,216 |
| Total Net Sales | $ 239,405 | $ (67) | $ 239,338 | $ 253,612 | $ 192,079 |

(1) See Notes 1A and 20 to the financial statements included in Item 8 of this report.

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One end-customer that is a major manufacturer of cellular phone handsets and other electronic equipment, accounted for 11% of net sales in fiscal year 2006. No end-customer accounted for 10% or more of net sales in fiscal years 2005 and 2004. One of our Asian distributors accounted for approximately 12%, 10% and 14%, respectively, of net sales in fiscal years 2006, 2005 and 2004. For fiscal year 2005 and fiscal year 2004, an Asian distributor formerly used by the Company accounted for approximately 10% of net sales in each year.

Our backlog of orders as of the end of fiscal years 2006, 2005 and 2004 were approximately $46.6 million, $35.6 million and $45.4 million, respectively. Nearly all backlog is deliverable within six months; experience has shown that short-delivery lead times are required by most customers. A backlog analysis at any given time gives little indication of our future business except on a short-term basis, principally within the next 45 days. We do not have any significant contracts with our customers calling for shipments over a period of more than 18 months.

**Manufacturing Capabilities**

Unlike digital products, our products are less reliant on state-of-the-art manufacturing and more reliant on design and applications support. As part of our business strategy, we outsource a majority of our manufacturing functions to third-party contractors that fabricate silicon wafers and package and test our products. We believe this outsourcing permits us to take advantage of the best available technology, leverage the capital investment of others and reduce our operating costs associated with manufacturing assets and increase the variable component of our cost of goods sold.

We perform a very limited amount of probe and final test activities in our Camarillo and San Diego, California; Neuchatel, Switzerland; and Reynosa, Mexico facilities. Our rectifier and assembly product lines are packaged and tested in-house in Reynosa. Almost all of our other products are packaged and tested by outside subcontractors.

In keeping with our business model, we have no wafer fabrication facilities except for our operation in Reynosa, Mexico. For fiscal year 2006, the Reynosa facility provided almost all of the silicon for our rectifier and assembly products, which were approximately 4% of our end product sales. The remaining 96% of our end products were supported with finished silicon wafers purchased from outside wafer foundries in Asia, the United States and Europe. We anticipate that again in fiscal year 2007, virtually all the silicon wafers we require will come from outside foundries.

Despite our use of outside wafer foundries for sourcing a majority of our silicon needs, we do maintain internal process development capabilities. Our process engineers work closely with our outside foundries on the improvement and development of process capabilities. In fiscal year 2006, we purchased the vast majority of our wafers from eight different third-party wafer foundries and used more than 20 different manufacturing processes, including various Bipolar, High-Speed Bipolar, CMOS, and Bi-CMOS processes.

While we do have some redundancy of fab processes by using multiple outside foundries, any interruption of supply by one or more of these foundries could materially impact us. Likewise, we maintain some amount of business interruption insurance to help reduce the risk of wafer supply interruption, but we are not fully insured against such risk.

Although our products are made from basic materials (principally silicon, metals and plastics), all of which are available from a number of suppliers, capacity at wafer foundries sometimes becomes constrained. The limited availability of certain materials, such as silicon wafer substrates, may impact our suppliers ability to meet our needs or impact the price we are charged. Certain other basic materials, such as metals, gases and chemicals used in the production of circuits have all increased in recent years as demand has grown for these basic commodities. In most cases we do not procure these materials ourselves but we are nevertheless reliant on such materials for producing our products because our outside foundry and package and test subcontractors must procure them. To help minimize risks associated with constrained capacity, we use multiple foundries and have taken other steps to reserve capacity at certain foundries.

Our largest wafer source is a foundry in China. In fiscal year 2006, this Chinese foundry provided 58% of our total silicon requirements in terms of finished wafers purchased. We have consigned certain equipment to this foundry to support our specialized processes run at the foundry and to ensure a specified level of capacity over the next few years. The provision of these assets to the wafer foundry is factored into our long-term pricing arrangement with the foundry for any reserved wafers we may purchase.

In fiscal year 2005, we made a prepayment for wafers at our second largest wafer source, a foundry based in Germany. This foundry provided 13% of our total silicon requirements in terms of finished wafers purchased in fiscal year 2006.

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In exchange for the prepayment, the foundry has reserved a specified level of capacity for us through calendar year 2006. We also negotiated favorable wafer pricing with this foundry for any reserved wafers purchased. Any unused capacity at the end of calendar year 2006 will either be applied to purchases made in calendar year 2007 or the corresponding portion of the prepayment will be returned. The balance of our unsecured prepaid account with this foundry is included in other current assets and other assets.

We use third-party contractors to perform almost all of our assembly and test operations. A majority of our assembly and test activity is conducted by third-party contractors based in Malaysia, the Philippines and China. Our subsidiary, Semtech International AG, has an operations office located in the Philippines that supports and coordinates some of the worldwide shipment of products. We have installed our own test equipment at some of our packaging and testing subcontractors in order to ensure a certain level of capacity, assuming the subcontractor has ample employees to operate the equipment. We have a prepayment arrangement with one of our assembly and test contactors to provide us with guaranteed capacity and preferred pricing. The balance with this contractor does not have collateral backing.

Our arrangements with both outside wafer foundries and package and test subcontractors are designed to provide some assurance of capacity but are not expected to assure access to all the manufacturing capacity we may need in the future.

For further information regarding our arrangements with suppliers and the location of our long-lived assets, see Note 5, 8 and 17 to the Consolidated Financial Statements included in Item 8.

**Competition**

The analog and mixed-signal semiconductor industry is highly competitive, and we expect competitive pressures to continue. Our ability to compete effectively and to expand our business will depend on our ability to continue to recruit applications and design talent, our ability to introduce new products, and the rate at which we introduce these new products to offset the generally short product life cycles. Our industry is characterized by decreasing unit selling prices over the life of a product and these decreases are sometimes quite rapid. We believe we compete effectively based upon our ability to capitalize on efficiencies and economies of scale in production and sales, and our ability to maintain or improve our productivity and product yields to reduce manufacturing costs.

We are in direct and active competition, with respect to one or more of our product lines, with at least 30 manufacturers of varying size, technical capability and financial strength. A number of these competitors are dependent on semiconductor products as their principal source of income, and some are much larger than we are. The number of our competitors has grown due to expansion of the market segments in which we participate. We consider our primary competitors to include Texas Instruments, National Semiconductor, Linear Technology, Maxim Integrated Products, Fairchild Semiconductor, Advanced Analogic Technologies, Monolithic Power Systems and Intersil Semiconductor, all with respect to our power management products; ST Microelectronics N.V., Philips ON Semiconductor, Protek and California Micro Devices with respect to our protection products; Analog Devices and Maxim Integrated Products with respect to our test and measurement products; Silicon Laboratories and Zarlink Semiconductor with respect to our advanced communications products; and Marvell and Micrel Semiconductor with respect to our wireless and sensing products.

**Intellectual Property and Licenses**

We own many U.S. and foreign patents and have numerous patent applications pending with respect to our products and to technologies associated with our business. The expiration dates of issued patents range from 2010 to 2025. Although we consider patents to be helpful in maintaining a competitive advantage, we do not believe they create definitive competitive barriers to entry. There can be no assurance that our patent applications will lead to issued patents, that others will not develop or patent similar or superior products or technologies, or that our patents will not be challenged, invalidated, or circumvented by others.

Semtech Neuchatel licenses certain patents and other intellectual property to others in exchange for use of the other party s intellectual property and/or royalties or other fees which, in the aggregate, were not material in fiscal year 2006.

We license some intellectual property from other companies and we believe the duration and other terms of the licenses are appropriate for our needs. At January 29, 2006, other current liabilities and other long-term liabilities include

approximately $155,000 and approximately $150,000, respectively, of fees payable in connection with Semtech Neuchatel s license of certain intellectual property through various dates ranging up to at least 2016.

We have registered many of our trademarks in the U.S. and in various foreign jurisdictions. Registration generally provides rights in addition to basic trademark protections and are typically renewable upon proof of continued use. We have registered, or are in the process of registering, our SEMTECH trademark in many jurisdictions. In one location use of this trademark is prohibited, but we are permitted to use our Semtech International tradename. This restriction has not had a material impact on our business to date and we do not anticipate it will have a material impact in the future.

We also register certain materials in which we have copyright ownership, which provides additional protection for this intellectual property.

**Employees**

As of January 29, 2006, we had 659 full-time employees. There were 148 employees in research and development, 137 in sales, marketing and field services, and 75 in general, administrative and finance. The remaining employees support operational activities, including product and test engineering, assembly, manufacturing, distribution and quality functions. Approximately 44% of our employees are assigned to the Standard Semiconductor Products segment and approximately 19% are assigned to the Rectifier, Assembly and Other Products segment, with the remaining employees, approximately 37%, serving both segments.

We have not had a work stoppage in at least the last decade and the only unionized employees are the approximately 110 Mexican nationals who work at our Reynosa facility, a part of our Rectifier, Assembly and Other Products segment. Our employee relations during the last fiscal year have been, and remain, satisfactory.

We readjust our workforce from time to time to meet the changing needs of our business. Competition for key design and application engineers is significant.

**Government Regulations**

We are required to comply, and it is our policy to comply, with numerous government regulations that are normal and customary to businesses in our industry and that operate in our markets and operating locations.

Our sales that serve the military and aerospace markets primarily consist of products from the Rectifier, Assembly, and Other Products segment that have been qualified to be sold in these markets by the U.S. Department of Defense (DOD). In order to maintain these qualifications, we must comply with certain specifications promulgated by the DOD. As part of maintaining these qualifications, we are routinely audited by the DOD. Based on current specifications, we believe we can maintain our qualifications for the foreseeable future. However, these specifications could be modified by the DOD in the future or we could become subject to other government requirements, which could make the manufacturing of these products more difficult and thus could adversely impact our profitability in those product lines. The U.S. State Department has determined that a small number of special assemblies from the Rectifier, Assembly, and Other Products segment are subject to the International Traffic in Arms Regulations (ITAR). We have a Technical Assistance Agreement in place that permits us to assemble these products in Mexico. International shipments of these products require a State Department license. Sales of products subject to ITAR are not material relative to the total sales of the Company.

Our facilities throughout the world are subject to various environmental laws and regulations and we believe our operations are in substantial compliance with those laws and regulations. Due to the limited nature of our manufacturing operations, the expense related to environmental compliance for our ongoing operations was immaterial for fiscal years 2006, 2005, and 2004 and has not had any material adverse effect on our capital expenditures, net income, or competitive position. New laws or regulations or changes to existing laws or regulations could subject our ongoing operations to different or additional environmental standards that could increase our cost of compliance in the future. In addition, our cost of doing business could increase if our suppliers increase prices to recoup the cost of their compliance with new or revised laws or regulations.

We have incurred, and may continue to incur, liabilities under various statutes for the cleanup of pollutants at locations we have operated and at third-party disposal and recycling sites (see Note 12 to our consolidated financial statements). During fiscal years 2006, 2005, and 2004, the expense incurred with respect to these clean up matters was not material.

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We use an environmental firm, specializing in hydrogeology, to perform periodic monitoring of the groundwater at the facility in Newbury Park, California that we leased for approximately forty years. We vacated the building in May 2002. Certain contaminants have been found in the local groundwater. Monitoring results over a number of years indicate that contaminants are from adjacent facilities. It is currently not possible to determine the ultimate amount of future clean-up costs, if any, that may be required of us for this site. There are no claims pending with respect to environmental matters at the Newbury Park site. Accordingly, no reserve for clean-up has been provided at this time.

**Available Information**

General information about us can be found on our website at www.semtech.com. The information on our website is for information only and should not be relied on for investment purposes. The information on our website is not incorporated by reference into this report and should not be considered part of this or any other report filed with the Securities and Exchange Commission ( SEC ).

We make available free of charge, either by direct access on our website or a link to the SEC website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC. Our reports filed with, or furnished to, the SEC are also available directly at the SEC s website at www.sec.gov.

Financial statements and the related reports of our independent public accounting firms, earnings press releases, and similar communications issued prior to July 20, 2006 should no longer be relied upon and are superseded by the information contained in the Form 10-K/A; our Quarterly Reports on Form 10-Q for the quarterly periods ended April 30, 2006, July 30, 2006, and October 29, 2006 which were filed concurrently with the Form 10-K/A; and in reports filed with the SEC subsequent to the filing of the Form 10-K/A.

**ITEM 1A. RISK FACTORS**

*You should carefully consider and evaluate all of the information in this report, including the risk factors listed below. The risks described below are not the only ones facing our company. Additional risks not now known to us or that we currently deem immaterial may also impair our business operations. If any of these risks actually occur, our business could be materially harmed. If our business is harmed, the trading price of our common stock could decline.*

*As discussed earlier in Forward Looking and Cautionary Statements, this report contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward looking statements as a result of certain factors including the risks faced by us described below and elsewhere in this report, in our other filings with the SEC, and in material incorporated herein and therein by reference. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

*Only the risk factors under the following headings have been updated substantively with respect to the restatement and its underlying circumstances. None of the risk factors have been updated due to the Audit Adjustments.*

*We are subject to an SEC inquiry, a Federal Grand Jury subpoena, and shareholder litigation related to our historical stock option practices*

*We may be required to further amend our financial statements*

*We could face claims by individuals prevented from exercising stock options due to the restatement*

*We are ineligible to use SEC Form S-3 to register securities*

*The costs associated with our general product warranty policy and our indemnification of certain customers, distributors, and other parties could be higher in future periods*

*Our share price could be subject to extreme price fluctuations, and shareholders could have difficulty trading shares*

*The loss of any of our key personnel or the failure to attract or retain specialized technical and management personnel could impair our ability to grow our business*

*We are subject to review by taxing authorities, including the Internal Revenue Service*

*Changes in stock option accounting rules will impact our reported operating results prepared in accordance with generally accepted accounting principles, and may impact our stock price and our competitiveness in the employee marketplace.*

*Failure to maintain effective internal controls could have a material adverse effect on our business and stock price.*

**We are subject to an SEC inquiry, a Federal Grand Jury subpoena, and shareholder litigation related to our historical stock option practices**

See Note 19 to the consolidated financial statements included in Item 8 of this report for information regarding inquiries into our historical stock option practices being conducted by the SEC and under a Federal Grand Jury subpoena. The filing of our restated financial statements does not resolve these matters. In the event that either or both of these investigations lead to action against any of our current or former directors, officers, or employees, or the Company itself, the trading price of our common stock may be adversely impacted. If we are subject to adverse findings in either of these matters, we could be required to pay damages or penalties or have other remedies imposed upon us, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Also see Note 19 to the financial statements included in Item 8 of this report with respect to shareholder derivative litigation and other matters related to the restatement and its underlying circumstances that could have a material adverse effect on our business and the price of our common stock.

If one or more of these matters continues for a prolonged period of time, they may have the same impact regardless of the ultimate outcome.

**We may be required to further amend our financial statements**

We believe this Form 10-K/A, and the FY2007 Form 10-Qs that are being filed concurrently with this report, correct the accounting errors arising from our past stock option practices. However, if the SEC disagrees with the accounting methods we used, objects to the manner in which we disclosed the restated financial information or related qualitative information, or otherwise imposes additional requirements with respect to our restated financial statements or stock option restatements in general, we could be required to further amend these filings. Further restatement could also be required if new facts become available as a result of the SEC inquiry, the Federal Grand Jury subpoena, the shareholder litigation or through other means. A further revision of our financial statements could result in delays in filing subsequent SEC reports, which could in turn result in the delisting of the Company s common stock.

**We could face claims by individuals prevented from exercising stock options due to the restatement**

The exercise of stock options was prohibited during the restatement process because our filings with the SEC were not current. We could face claims from optionees who were prevented from exercising expiring options or from former employees with options that lapsed because exercise was prohibited during the short post-termination period provided for by their award agreements. In this regard, the Compensation Committee has authorized cash payments to some current and former employees and we have made an accrual for certain other potential claims. See Note 19 to the financial statements included in Item 8 of this report.

We could also face claims from individuals whose options have been cancelled or repriced by the Special Litigation Committee. See the discussion of Special Litigation Committee actions in Item 7 of this report.

**We are ineligible to use SEC Form S-3 to register securities**

As a result of our failure to file Quarterly Reports on Form 10-Q for the first three quarters of fiscal year 2007 on a timely basis, we are no longer eligible to use the short-form (Form S-3) to register our securities with the SEC until all

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required reports under the Securities Exchange Act of 1934 have been timely filed for the 12 months prior to the filing of the registration statement for those securities. Although inconvenient, this restriction will not affect our ability to access the capital markets.

**Economic decline may have adverse consequences for our business**

We sell our products into several commercial markets, primarily the computer, communication and industrial end-markets, whose performance is tied to the overall economy. Many of these industries were severely impacted in calendar years 2001 and 2002 due to an economic slowdown in the United States and globally. Our business during these periods reflected the weak economic conditions. Market research analysts have claimed that historically the semiconductor industry is impacted by broad economic factors, such as United States gross domestic product (GDP) and worldwide oil prices.

If economic conditions were to once again worsen or a wider global slowdown were to occur, demand for our products may be reduced. In addition, economic slowdowns may also affect our customers ability to pay for our products. Accordingly, economic slowdowns may harm our business.

**The cyclical nature of the electronics and semiconductor industries may limit our ability to maintain or increase revenue and profit levels during industry downturns**

The semiconductor industry is highly cyclical and has experienced significant downturns, which are characterized by reduced product demand, production overcapacity, increased levels of inventory, industry-wide fluctuations in the demand for semiconductors and the significant erosion of average selling prices. The occurrence of these conditions has adversely affected our business in the past. In fiscal year 2002, our net sales declined by 26% compared to the prior year as a result of a dramatic slowdown in the industry. Past downturns in the semiconductor industry have resulted in a sudden impact on the semiconductor and capital equipment markets. Consequently, any future downturns in the semiconductor industry may harm our business.

**We compete against larger, more established entities and our market share may be reduced if we are unable to respond to our competitors effectively**

The semiconductor industry is intensely competitive and is characterized by price erosion, rapid technological change, and design and other technological obsolescence. We compete with domestic and international semiconductor companies, many of which have substantially greater financial and other resources with which to pursue engineering, manufacturing, marketing and distribution of their products. Some of these competitors include: Texas Instruments, National Semiconductor, Linear Technology, Maxim Integrated Products, Fairchild Semiconductor, Advanced Analogic Technologies, Monolithic Power Systems and Intersil Semiconductor, with respect to our power management products; ST Microelectronics N.V., Philips and California Micro Devices, with respect to our protection products; Analog Devices and Maxim Integrated Products, with respect to our test and measurement products; Zarlink Semiconductor and Silicon Laboratories, with respect to our advanced communications products; and Marvell and Micrel Semiconductor, with respect to our wireless and sensing products. We expect continued competition from existing competitors as well as competition from new entrants in the semiconductor market. Our ability to compete successfully in the rapidly evolving area of integrated circuit technology depends on several factors, including:

- success in designing and manufacturing new products that implement new technologies;
- protection of our processes, trade secrets and know-how;
- maintaining high product quality and reliability;
- pricing policies of our competitors;
- performance of competitors products;

ability to deliver in large volume on a timely basis;

marketing, manufacturing and distribution capability; and

financial strength.

To the extent that our products achieve market success, competitors typically seek to offer competitive products or lower prices, which, if successful, could harm our business.

**A majority of our net sales are into larger, vertical end-market applications. Fluctuations, seasonality and economic downturns in any of our end-markets may have adverse consequences for our business**

A majority of our net sales are into larger, vertical end-market applications such as notebook computers, desktop computers and cellular phones. Vertical end-market applications tend to be highly cyclical over time and highly competitive given the significant unit opportunities they represent. Horizontal markets tend to be less cyclical, but unit volume opportunities are much lower. We consider the industrial market to be a horizontal end-market, because it is much more broad-based and comprised of many non-standardized end-applications.

Many of our products are used in personal computers and related peripherals. For fiscal year 2006, we estimate that 30% of our sales were used in computer applications, including 18% tied to notebook computers and PDAs. Industry-wide fluctuations in demand for desktop and notebook computers have in the past, and may in the future, harm our business. In addition, our past results have reflected some seasonality, with demand levels being higher in computer segments during the third and fourth quarters of the year in comparison to the first and second quarters.

For fiscal year 2006, shipment of our products to ATE customers represented approximately 4% of our net sales. In recent years, shipment of our products to ATE customers have represented 10% or more of net sales. Products sold into the ATE end-market tend to have above average gross margin. Consequently, downturns in the ATE market and declines in the sales of our products used in ATE systems may adversely affect our business.

We estimate that sales related to cellular phone applications represented 27% of our sales in fiscal year 2006. In fiscal year 2005, sales tied to cellular phone applications were estimated at 32% of our sales. Any decline in the number of cellular phones made, especially feature-rich phones with color displays, could adversely affect our business.

**We obtain many essential components and materials and certain critical manufacturing services from a limited number of suppliers and subcontractors, which are principally foreign-based entities**

Our reliance on a limited number of outside subcontractors and suppliers for silicon wafers, packaging, test and certain other processes involves several risks, including potential inability to obtain an adequate supply of required components and reduced control over the price, timely delivery, reliability and quality of components. These risks are attributable to several factors, including limitations on resources, labor problems, equipment failures or the occurrence of natural disasters. There can be no assurance that problems will not occur in the future with suppliers or subcontractors. Disruption or termination of our supply sources or subcontractors could significantly delay our shipments and harm our business. Delays could also damage relationships with current and prospective customers. Any prolonged inability to obtain timely deliveries or quality manufacturing or any other circumstances that would require us to seek alternative sources of supply or to manufacture or package certain components internally could limit our growth and harm our business.

Most of our outside subcontractors and suppliers, including third-party foundries that supply silicon wafers, are located in foreign countries, including China, Malaysia, Korea, the Philippines and Germany. For fiscal year 2006, approximately 58% of our silicon in terms of finished wafers, was supplied by a third-party foundry in China, and this percentage could be even higher in future periods. For fiscal year 2005, approximately 59% of our silicon in terms of finished wafers was supplied by this third-party foundry in China. While we do have some redundancy of fab processes by using multiple outside foundries, any interruption of supply by one or more of these foundries could materially impact us. Likewise, we maintain some amount of business interruption insurance to help reduce the risk of wafer supply interruption, but we are not fully insured against such risk.

A majority of our package and test operations are performed by third-party contractors based in Malaysia, Korea, the Philippines and China. Our international business activities, in general, are subject to a variety of potential risks resulting from political and economic uncertainties. Any political turmoil or trade restrictions in these countries, particularly China, could limit our ability to obtain goods and services from these suppliers and subcontractors. The effect of an economic crisis or a political turmoil on our suppliers located in these countries may impact our ability to meet the demands of our customers. If we find it necessary to transition the goods and services received from our

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existing suppliers or subcontractors to other firms, we would likely experience an increase in production costs and a delay in production associated with such a transition, both of which could have a significant negative effect on our operating results, as these risks are substantially uninsured.

**We may be unsuccessful in developing and selling new products required to maintain or expand our business**

We operate in a dynamic environment characterized by price erosion, rapid technological change, and design and other technological obsolescence. Our competitiveness and future success depend on our ability to achieve design wins for our products with current and future customers and introduce new or improved products that meet customer needs while achieving favorable margins. A failure to achieve design wins, to introduce these new products in a timely manner, or to achieve market acceptance for these products could harm our business.

The introduction of new products presents significant business challenges because product development commitments and expenditures must be made well in advance of product sales. The success of a new product depends on accurate forecasts of long-term market demand and future technological developments, as well as on a variety of specific implementation factors, including:

- timely and efficient completion of process design and development;
- timely and efficient implementation of manufacturing and assembly processes;
- product performance;
- the quality and reliability of the product; and
- effective marketing, sales and service.

The failure of our products to achieve market acceptance due to these or other factors could harm our business.

**Our products may be found to be defective, product liability claims may be asserted against us and we may not have sufficient liability insurance**

One or more of our products may be found to be defective after shipment, requiring a product replacement, recall, or a software solution that would cure the defect but impede performance of the product. We may also be subject to product returns which could impose substantial costs and harm our business. Beyond the potential direct cost associated with product failures, loss of confidence by major customers could cause sales of our other products to drop significantly.

Product liability claims may be asserted with respect to our technology or products. Our products are typically sold at prices that are significantly lower than the cost of the modules or end-products into which they are incorporated. A defect or failure in our product could give rise to failures in the module or the ultimate end-product, so we may face claims for damages that are disproportionately higher than the revenues and profits we receive from the products involved, especially if our customer seeks to recover for damage claims made against it by its own customers. While we maintain some insurance for such events, there can be no assurance that we have obtained a sufficient amount of insurance coverage, that asserted claims will be within the scope of coverage of the insurance, or that we will have sufficient resources to satisfy any asserted claims not covered by insurance.

**The costs associated with our general product warranty policy and our indemnification of certain customers, distributors, and other parties could be higher in future periods**

Our general warranty policy provides for repair or replacement of defective parts. In some cases a refund of the purchase price is offered. In certain instances, we have agreed to other warranty terms, including some indemnification provisions, that could prove to be significantly more

costly than repair, replacement or refund. If there is a substantial increase in the rate of customer claims, if our estimate of probable losses relating to identified warranty exposures prove inaccurate, or if our efforts to contractually limit liability prove inadequate, we may record a charge against future cost of sales.

In the normal course of our business, we indemnify other parties, including customers, distributors, and lessors, with respect to certain matters. These obligations typically arise pursuant to contracts under which we agree to hold the other party harmless against losses arising from a breach of representations and covenants related to certain matters,

such as acts or omissions of our employees, infringement of third-party intellectual property rights, and certain environmental matters. We have also entered into agreements with our current and former directors and certain of our current and former executives indemnifying them against certain liabilities incurred in connection with their duties. Our Certificate of Incorporation and Bylaws contain similar indemnification obligations with respect to our current and former directors and employees, as does the California Labor Code. In some cases there are limits on and exceptions to our potential indemnification liability. We cannot estimate the amount of potential future payments, if any, that we might be required to make as a result of these agreements. Over at least the last decade, we have not incurred any significant expense as a result of agreements of this type. Accordingly, we have not accrued any amounts for such indemnification obligations during fiscal year 2006. However, there can be no assurances that we will not incur expense under these indemnification provisions in the future.

See Note 19 to the consolidated financial statements included in Item 8 of this report for information regarding indemnification expenses associated with the restatement and its underlying circumstances.

**Our share price could be subject to extreme price fluctuations, and shareholders could have difficulty trading shares**

The market for the stock of high technology companies has been volatile, and the market price of our common stock has been and may continue to be subject to significant fluctuations. Fluctuations could be in response to items such as operating results, announcements of technological innovations, or market conditions for technology stocks in general. Additionally, the stock market in recent years has experienced extreme price and volume fluctuations that often have been unrelated to the operating performance of individual companies. These market fluctuations, as well as general economic conditions, may adversely affect the price of our common stock.

In the past, securities class action litigation has often been instituted against a company following periods of volatility in the company s stock price. This type of litigation, if filed against us, could result in substantial costs and divert our management s attention and resources.

In addition, the future sale of a substantial number of shares of common stock by us or by our existing stockholders or option holders (including directors, officers, and employees) may have an adverse impact on the market price of the shares of common stock. There can be no assurance that the trading price of our common stock will remain at or near its current level.

The market price of our common stock may be adversely affected by the restatement and its underlying circumstances as well as by press commentary on the Company s situation and option granting practices in general.

**We sell and trade with foreign customers, which subjects our business to increased risks applicable to international sales**

Sales to foreign customers accounted for approximately 73% of net sales in the fiscal year ended January 29, 2006. Sales to our customers located in Taiwan and Korea constituted 29% and 26%, respectively, of net sales for fiscal year 2006. International sales are subject to certain risks, including unexpected changes in regulatory requirements, tariffs and other barriers, political and economic instability, difficulties in accounts receivable collection, difficulties in managing distributors and representatives, difficulties in staffing and managing foreign subsidiary and branch operations and potentially adverse tax consequences. These factors may harm our business. Our use of the Semtech name may be prohibited or restricted in some countries, which may negatively impact our sales efforts. In addition, substantially all of our foreign sales are denominated in U.S. dollars and currency exchange fluctuations in countries where we do business could harm us by resulting in pricing that is not competitive with prices denominated in local currencies.

**The outbreak of an avian influenza (bird flu) pandemic, severe acute respiratory syndrome (SARS), or other heath related issues, could impact our customer or supply base, especially in Asia**

A large percentage of our sales are to customers located in Asia and a large percentage of our products are manufactured in Asia. One of our largest customer bases in Asia is located in Taiwan. Our largest wafer source is located in China. SARS or other health related issues, such as an avian influenza (bird flu) pandemic, could have a negative impact on consumer demand, on travel needed to secure new business or manage our operations, on

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transportation of our products from our suppliers or to our customers, or on workers needed to sell or manufacture our products or our customers products.

**Our foreign currency exposures may change over time as the level of activity in foreign markets grows and could have an adverse impact upon financial results**

As a global enterprise, we face exposure to adverse movements in foreign currency exchange rates. Certain of our assets, including certain bank accounts, exist in non U.S. dollar-denominated currencies, which are sensitive to foreign currency exchange rate fluctuations. The non U.S. dollar-denominated currencies are principally the Euro, Swiss Francs, and British Pounds Sterling. We also have a significant number of employees that are paid in foreign currency, the largest groups being United Kingdom-based employees who are paid in British Pounds Sterling and Swiss-based employees who are paid in Swiss Francs.

If the value of the U.S. dollar weakens relative to these specific currencies, as it has done in recent years, the cost of doing business in terms of U.S. dollars rises. With the growth of our international business, our foreign currency exposures may grow and under certain circumstances, could harm our business.

Changes in foreign currency exchange rates, particularly Swiss Francs, also impacts our provision for income taxes and other tax-related balance sheet accounts. By impacting our provision for income taxes, foreign currency exchange rates also impact our reported earnings per share.

In the past we have done a limited amount of hedging of our foreign exchange exposure. In fiscal year 2004, we purchased forward contracts that locked in our right to purchase Swiss Francs at an agreed upon rate. Those contracts matured in fiscal year 2005. As a means of managing our foreign exchange exposure, we routinely convert U.S. dollars into foreign currency in advance of the expected payment. Any future use of forward contracts to hedge foreign exchange exposure may be required to be marked-to-market each quarter and can create volatility in net income not directly tied to our operating results.

**Our future results may fluctuate, fail to match past performance or fail to meet expectations**

Our results may fluctuate in the future, may fail to match our past performance or fail to meet the expectations of analysts and investors. Our results and related ratios, such as gross margin, operating income percentage and effective tax rate may fluctuate as a result of:

- general economic conditions in the countries where we sell our products;
- seasonality and variability in the computer market and our other end-markets;
- the timing of new product introductions by us and our competitors;
- product obsolescence;
- the scheduling, rescheduling or cancellation of orders by our customers;
- the cyclical nature of demand for our customers products;
- our ability to develop new process technologies and achieve volume production;

- changes in manufacturing yields;
- capacity utilization;
- product mix and pricing;
- movements in exchange rates, interest rates or tax rates;
- the availability of adequate supply commitments from our outside suppliers;
- the manufacturing and delivery capabilities of our subcontractors; and
- litigation and regulatory matters.

As a result of these factors, our past financial results are not necessarily indicative of our future results.

**We receive a significant portion of our revenues from a small number of customers and the loss of any one of these customers or failure to collect a receivable from them could adversely affect our operations and financial position**

The identity of our largest customers has varied from year to year. Historically, we have had significant customers that individually accounted for 10% or more of consolidated revenues in certain quarters or represented 10% or more of net accounts receivables at any given date. One of our end-customers, a major manufacturer of cellular phone handsets and other electronic equipment, accounted for 11% of net sales in fiscal year 2006. In addition, we had several end-customers in fiscal year 2006 that on an annual basis accounted for more than 5% of net sales, but less than 10% of net sales.

Several of our authorized distributors have regularly accounted for more than 10% of net sales on an annual basis. Depending on the authorized distributor and their strategic focus, they can support anywhere from a few end-customers to many end-customers. For fiscal year 2006, two of our Asian distributors accounted for approximately 12% and 9%, respectively, of net sales. As of the end of fiscal year 2006, these two Asian distributors accounted for approximately 12% and 11%, respectively, of our net accounts receivable.

Sales to our customers are generally made on open account, subject to credit limits we may impose, and the receivables are subject to the risk of being uncollectible.

We primarily conduct our sales on a purchase order basis, rather than pursuant to long-term contracts. The loss of any significant customer, any material reduction in orders by any of our significant customers, the cancellation of a significant customer order or the cancellation or delay of a customer s significant program or product could harm our business.

**Most of our authorized distributors, which together represent more than half of our net sales, can terminate their contract with us with little or no notice. The termination of a distributor could negatively impact our business, including net sales and accounts receivable**

In fiscal year 2006, authorized distributors accounted for approximately 57% of our net sales. We generally do not have long-term contracts with our distributors and most can terminate their agreement with us with little or no notice. For fiscal year 2006, our two largest distributors were based in Asia.

The termination of any distributor could impact our net sales and limit our access to certain end-customers. It could also result in the return of excess inventory of our product they hold as the distributor. Since many distributors simply resell finished products, they generally operate on very thin profit margins. If a distributor were to terminate its agreement with us or go out of business, our unsecured accounts receivable from it would be subject to significant collection risk.

**We face risks associated with companies we have acquired in the past and may acquire in the future**

We have expanded our operations through strategic acquisitions, such as the acquisition of XEMICS SA in June 2005, and we may continue to expand and diversify our operations with additional acquisitions. Acquisitions could use a significant portion of our available liquid assets and/or we could incur debt or issue equity securities to fund acquisitions. Issuance of equity securities could be dilutive to existing shareholders. Debt financing could subject us to restrictive covenants that could have an adverse effect on our business. Although we undertake detailed reviews of proposed acquisition candidates and attempt to negotiate acquisition terms favorable to us, we may encounter difficulties or incur liabilities for which we have no recourse against the selling party. We cannot provide any assurance that any acquisition will have a positive impact on our future performance.

If we are unsuccessful in integrating acquired companies into our operations or if integration is more difficult than anticipated, then we may not achieve anticipated cost savings or synergies and may experience disruptions that could harm our business. Some of the risks that may affect our ability to successfully integrate acquired companies include those associated with:

- conforming the acquired company s standards, processes, procedures and controls with our operations;

- coordinating new product and process development, especially with respect to highly complex technologies;
- assuring acquired products meet our quality standards;
- loss of key employees or customers of the acquired company;
- hiring additional management and other critical personnel;
- increasing the scope, geographic diversity and complexity of our operations;
- consolidation of facilities and functions;
- the geographic distance between the companies; and disparate corporate cultures.

Acquisitions could have a negative impact on our future earnings by way of poor performance by the acquired company or, if we later conclude we are unable to use or sell an acquired product or technology, we could be required to write down the related intangible assets and goodwill. If such write-downs are significant, they could materially harm our business.

**We must commit resources to product production prior to receipt of purchase commitments and could lose some or all of the associated investment**

Sales are made primarily on a current delivery basis, pursuant to purchase orders that may be revised or cancelled by our customers without penalty, rather than pursuant to long-term contracts. Some contracts require that we maintain inventories of certain products at levels above the anticipated needs of our customers. As a result, we must commit resources to the production of products without binding purchase commitments from customers. Our inability to sell products after we devote significant resources to them could harm our business.

**The loss of any of our key personnel or the failure to attract or retain specialized technical and management personnel could impair our ability to grow our business**

Our future success depends upon our ability to attract and retain highly qualified technical, marketing and managerial personnel. We are dependent on a relatively small group of key technical personnel with analog and mixed-signal expertise. Personnel with highly skilled managerial capabilities, and analog and mixed-signal design expertise, are scarce and competition for personnel with these skills is intense. There can be no assurance that we will be able to retain key employees or that we will be successful in attracting, integrating or retaining other highly qualified personnel in the future. If we are unable to retain the services of key employees or are unsuccessful in attracting new highly qualified employees, our business could be harmed.

Our business could be harmed, especially in the near term, by the disruption and associated loss of corporate history and knowledge base caused by the personnel actions described under *Restatement of Consolidated Financial Statements Based on Review of Stock Option Practices* in Item 7 of this report.

If our stock price declines below the exercise price of stock options held by employees, which is now the case for many options held by many employees, the retention incentive aspect of the stock options is lost and there is a greater likelihood we will be unable to retain key talent. If employees prohibited from exercising expiring stock options during the restatement process are not compensated in some fashion, our ability to retain our workforce could be harmed significantly.

**We are subject to government regulations and other standards that impose operational and reporting requirements**

We, our suppliers, and our customers are subject to a variety of United States federal, foreign, state and local governmental laws, rules and regulations, including those related to the use, storage, handling, discharge or disposal of certain toxic, volatile or otherwise hazardous chemicals

and the incorporation of such substances into products available for sale. If we or our suppliers were to incur substantial additional expenses to acquire equipment or otherwise comply with environmental regulations, product costs could significantly increase, thus harming our business. We are also subject to laws, rules, and regulations related to export licensing and customs requirements, including the North American Free Trade Agreement and State Department and Commerce Department rules.

The Sarbanes-Oxley Act of 2002 required us to change or supplement some of our corporate governance and securities disclosure and compliance practices. The SEC and NASDAQ have revised, and continue to revise, their regulations and listing standards. These developments have increased, and may continue to increase, our legal compliance and financial reporting costs. These developments also may make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. This, in turn, could make it more difficult for us to attract and retain qualified members of our board of directors, or qualified executive officers.

Failure to comply with present or future laws, rules and regulations of any kind that govern our business could result in suspension of all or a portion of production, cessation of all or a portion of operations, or the imposition of significant administrative, civil, or criminal penalties, any of which could harm our business.

**Earthquakes or other natural disasters may cause us significant losses; the aftermath of Hurricane Katrina could interrupt our supply chain or disrupt our customer base**

Our corporate headquarters, a portion of our assembly and research and development activities and certain other critical business operations are located near major earthquake fault lines. We do not maintain earthquake insurance and could be harmed in the event of a major earthquake. We generally do not maintain flood coverage, including in our Asian locations where we have certain operations support and sales offices. Such flood coverage has become very expensive; as a result the Company has elected not to purchase this coverage.

Our business could be harmed if natural disasters interfere with production of wafers by our suppliers, assembly and testing of products by our subcontractors, or our distribution network. We maintain some business interruption insurance to help reduce the effect of such business interruptions, but we are not fully insured against such risks. Likewise, our business could be adversely impacted if a natural disaster were to shut down or significantly curtail production at one or more of our end customers. Any such loss of revenue due to a slowdown or cessation of end customer demand is uninsured.

None of our facilities was affected by Hurricane Katrina that struck in August 2005 or by the subsequent flooding. We do not have a significant customer base in the devastated portions of the southeastern States. An issue related to potential disruption of the hydrogen supply for our Rectifier, Assembly and Other Products segment due to the hurricane has been favorably resolved.

**Terrorist attacks, war and other acts of violence may negatively affect our operations and your investment**

Terrorist attacks, such as the attacks that took place on September 11, 2001, wars, such as the war in Iraq, and other acts of violence, such as those that may result from the tension in the Middle East and the Korean peninsula, or any other national or international crisis, calamity or emergency, may result in interruption to the business activities of many entities, business losses and overall disruption of the U.S. economy at many levels. These events may directly impact our physical facilities or those of our customers and suppliers. Additionally, these events or armed conflicts may cause some of our customers or potential customers to reduce the level of expenditures on their services and products that ultimately may reduce our revenue. The consequences of these reductions are unpredictable, and we may not be able to foresee events that could have an adverse effect on our business. For example, as a result of these events, insurance premiums for businesses may increase and the scope of coverage may be decreased. Consequently, we may not be able to obtain adequate insurance coverage for our business and properties. A high or Orange or severe or Red threat condition announced by the Homeland Security Advisory System or similar agency and any consequent effect on the transportation industry may adversely affect our ability to timely import materials from our suppliers located outside the United States or impact our ability to deliver our products to our customers without incurring significant delays. To the extent that these disruptions result in delays or cancellations of customer orders, a general decrease in corporate spending, or our inability to effectively market our services and products, our business and results of operations could be harmed.

**We may be unable to adequately protect our intellectual property rights**

We pursue patents for some of our new products and unique technologies, but we rely primarily on a combination of nondisclosure agreements and other contractual provisions, as well as our employees commitment to confidentiality and loyalty, to protect our know-how and processes. We intend to continue protecting our proprietary technology,

including through trademark and copyright registrations and patents. Despite this intention, we may not be successful in achieving adequate protection. Our failure to adequately protect our material know-how and processes could harm our business. There can be no assurance that the steps we take will be adequate to protect our proprietary rights, that our patent applications will lead to issued patents, that others will not develop or patent similar or superior products or technologies, or that our patents will not be challenged, invalidated, or circumvented by others. Furthermore, the laws of the countries in which our products are or may be developed, manufactured or sold may not protect our products and intellectual property rights to the same extent as laws in the United States.

The semiconductor industry is characterized by frequent claims of infringement and litigation regarding patent and other intellectual property rights. Due to the number of competitors, intellectual property infringement is an ongoing risk since other companies in our industry could have intellectual property rights that may not be identifiable when we initiate development efforts. Litigation may be necessary to enforce our intellectual property rights and we may have to defend ourselves against infringement claims. Any such litigation could be very costly and may divert our management s resources. If one of our products is found to infringe, we may have liability for past infringement and may need to seek a license going forward. If a license is not available or if we are unable to obtain a license on terms acceptable to us, we would either have to change our product so that it does not infringe or stop making the product.

**We could be required to register as an investment company and become subject to substantial regulation that would interfere with our ability to conduct our business**

The Investment Company Act of 1940 requires the registration of companies which are engaged primarily in the business of investing, reinvesting or trading in securities, or which are engaged in the business of investing, reinvesting, owning, holding or trading in securities and which own or propose to acquire investment securities with a value of more than 40% of the company s assets on an unconsolidated basis (other than U.S. government securities and cash). We are not engaged primarily in the business of investing, reinvesting or trading in securities, and we intend to invest our cash and cash equivalents in U.S. government securities to the extent necessary to take advantage of the 40% safe harbor. To manage our cash holdings, we invest in short-term instruments consistent with prudent cash management and the preservation of capital and not primarily for the purpose of achieving investment returns. U.S. government securities generally yield lower rates of income than other short-term instruments in which we have invested to date. Accordingly, investing substantially all of our cash and cash equivalents in U.S. government securities could result in lower levels of interest income and net income.

If we were deemed an investment company and were unable to rely upon a safe harbor or exemption under the Investment Company Act, we would among other things be prohibited from engaging in certain businesses or issuing certain securities. Certain of our contracts might be voidable, and we could be subject to civil and criminal penalties for noncompliance.

**We are subject to review by taxing authorities, including the Internal Revenue Service**

We are subject to review by domestic and foreign taxing authorities, including the Internal Revenue Service (IRS). In fiscal year 2005, the IRS completed a routine review of our 1995 through 2001 tax filings. The final audit adjustments did not have a material impact on our financial statements. However, future audits by taxing authorities could impact us.

We understand that the IRS has established a task force to focus on issues relating to stock option grants. While we have not received an inquiry from any taxing authority regarding this matter, we believe we are likely to be audited with respect to these issues in the future.

Certain transition rules are in effect that allow remediation of the condition that subjects a stock option to Section 409A of the Internal Revenue Code. To be effective, the remediation with respect to executive level employees must have been completed by December 31, 2006 and must be complete for other employees by December 31, 2007. The Company has not taken any actions to remediate these options. Since the material options that have been determined to be subject to 409A were issued at exercise prices that are substantially higher than the current price of the Company s stock, the future impact of Section 409A is not expected to present a material exposure to the Company under these transitional rules. However, exposure for this item can not ultimately be determined until final guidance is issued. If the final guidance differs significantly from the guidance to date, the Company s exposure could be material.

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**Changes in stock option accounting rules will impact our reported operating results prepared in accordance with generally accepted accounting principles, and may impact our stock price and our competitiveness in the employee marketplace.**

Technology companies like ours have a history of using broad based employee stock option programs to hire, incentivize and retain their workforces in a competitive marketplace. Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ( SFAS 123 ) allows companies the choice of either using a fair value method of accounting for options, which would result in expense recognition for all options granted, or using an intrinsic value method, as prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ), with a pro forma disclosure of the impact on net income (loss) of using the fair value option expense recognition method. We have elected to apply APB 25 and accordingly we generally do not recognize any expense with respect to employee stock options as long as such options are granted at exercise prices equal to the fair value of our common stock on the date of grant.

See Note 1A *Restatement of Consolidated Financial Statements* of the Notes to Consolidated Financial Statements in Item 8 of this report for a detailed discussion of the restatement related to historical stock option practices. Also see the discussion under *Restatement of Consolidated Financial Statements Based on Review of Stock Option Practices* in Item 7 *Management s Discussion and Analysis of Financial Condition and Results of Operations*.

A revised standard, SFAS No. 123 (revised 2004), Share Based Payment ( SFAS 123(R) ), which requires all companies to measure compensation cost for all share-based payments (including stock options) at fair value, is effective beginning with a company s first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005. This means SFAS 123(R) is effective for us beginning with the first quarter of fiscal year 2007, which began on January 30, 2006. We have adopted the new standard using the modified prospective transition method.

Had we adopted SFAS 123(R) in prior periods, the impact of this pronouncement would approximate the impact of SFAS 123 described in the disclosure of the pro forma results in Note 1, under the heading Stock-Based Compensation in our Notes to Financial Statements included elsewhere in this report. As indicated in the First Quarter Form 10-Q filed concurrently with this report, stock option expense under SFAS 123(R) reduced earnings for the first quarter of fiscal year 2007 by $3.8 million, pre-tax, or approximately 5 cents per share.

The implementation of SFAS 123(R) will result in lower reported earnings per share, which could negatively impact our future stock price. In addition, this could impact our ability to utilize broad based employee stock plans to reward employees and could result in a competitive disadvantage to us in the employee marketplace.

**Failure to maintain effective internal controls could have a material adverse effect on our business and stock price.**

Section 404 of the Sarbanes-Oxley Act requires an annual management assessment of the effectiveness of internal controls over financial reporting and an annual report by our independent registered public accounting firm addressing the assessment.

Management s report for fiscal year 2006 is included in Item 9A of this report and the required attestation report of our independent registered public accounting firm is included in Part II, Item 8 of this report. Our controls and procedures are also discussed in Item 9A of this report. These assessments and reports have been updated in light of the restatement and its underlying circumstances.

If we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting. Effective internal controls are necessary for us to produce reliable financial reports and are important in the prevention of financial fraud. If we cannot produce reliable financial reports or prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information, and there could be a material adverse effect on our stock price.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the information in this report and in the documents that are incorporated by reference, including the risk factors in this section, contains forward-looking statements. Forward-looking statements are statements other than historical information or statements of current condition and relate to matters such as our future financial performance, future operational performance, and our plans, objectives and expectations. Some forward-looking statements may be identified by use of terms such as expects, anticipates, intends, estimates, believes , projects , should plans and similar words. In light of the risks and uncertainties inherent in all such projected matters, forward-looking statements should not be regarded as a representation by the Company or any other person that our objectives or plans will be achieved or that any of our operating expectations or financial forecasts will be realized. Financial results could differ materially from those projected in forward-looking statements. We assume no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

**ITEM 2. PROPERTIES**

Our headquarters is located in Camarillo, California where we own an approximately 85,000 square foot facility that was completed in 2002. The original parcel on which the headquarters is located will accommodate substantial expansion, and we purchased a vacant lot adjacent to the headquarters when it became available in fiscal year 2003. The Camarillo facility houses a very limited amount of test and probe activity, as well as inside sales, marketing and administrative offices. The Camarillo facility serves as the business headquarters for our Rectifier, Assembly and Other Products segment and all of the product lines that make up the Standard Semiconductor Products segment, with the exception of our test and measurement product line that is headquartered in San Diego, California and our wireless and sensing product line that is headquartered in Neuchatel, Switzerland.

We own a 30,000 square foot building in Reynosa, Mexico that supports the assembly and production needs of our rectifier and assembly product lines.

We also lease a 44,000 square foot facility in Corpus Christi, Texas, which housed a wafer fabrication line, production testing and certain engineering functions for our protection product line (part of the Standard Semiconductor Products segment). In December 2002, we stopped production in the Corpus Christi facility as part of the strategic move to obtain nearly all of our silicon wafers from outside sources. The Corpus Christi lease runs through December 2021, but we have the ability to terminate it in 2011. While we continue to pay rent on this vacant facility, we are investigating sublease opportunities and other alternatives.

Our San Diego, California facility is an approximately 25,000 square foot building that houses design, test and administrative functions and serves as the business headquarters for our test and measurement product line (part of the Standard Semiconductor Product segment). The lease on this facility runs through September 2009.

We also lease space to house certain of our other design, sales and marketing and operations facilities in San Jose, California; Raleigh, North Carolina; China; England; France; Germany; Japan; Korea; the Philippines; Scotland; Switzerland; and Taiwan. The space in New York City that previously housed our HID product group has been sublet.

In December 2000, we purchased a parcel of land in San Diego, California for approximately $7.9 million and began exploring plans to build a facility to support our test and measurement product line. We deferred the project due to the significant downturn in the product line s business. We are contemplating the sale of this parcel of land.

We believe that our existing leased and owned space is more than adequate for our current operations, and that suitable replacement and additional space will be available in the future on commercially reasonable terms.

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**ITEM 3. LEGAL PROCEEDINGS**

From time to time we become subject to legal proceedings in the ordinary course of our business. We are not currently involved in any legal proceedings that we believe will, either individually or in the aggregate, materially and adversely affect our business.

In June 2001, we were notified by the California Department of Toxic Substances Control ( State ) that we may have liability associated with the clean-up of the one-third acre Davis Chemical Company site in Los Angeles, California. We have been included in the clean-up program because we are one of the companies that used the Davis Chemical Company site for waste recycling and/or disposal between 1949 and 1990. We have joined with other potentially responsible parties in an effort to resolve this matter with the State. The group has entered into a Consent Order with the State that requires the group to perform a soils investigation at the site and submit a draft remediation plan. In March 2007, the State approved the group s draft remediation plan, which will be published for public comment before the final remediation plan is submitted. The State has not yet responded to the draft remediation plan. The State has the right to require the removal of contaminated soils and to expand the scope of work to include further investigation of groundwater contamination. The Consent Order does not require the group to remediate the site. To date, our share of the group s expenses has not been material and has been expensed. At this time there is not a specific proposal or budget with respect to any additional studies or the clean-up of the site. Thus, no reserve has been established for this matter.

During fiscal year 2006 we were not subjected to any penalties requiring disclosure under Section 6707A(e) of the Internal Revenue Code.

Significant legal events occurring through the date of filing of this Amendment No. 1 that are related to the restatement or its underlying cause are described in Note 19 *Matters Related to Stock Option Review and Restatement* of the Notes to Consolidated Financial Statements in Item 8 of this Amendment No. 1.

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

During the fourth quarter of the fiscal year covered by this report, no matter was submitted to a vote of security holders through the solicitation of proxies or otherwise.

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## PART II

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

**Market Information**

Our common stock is traded on the NASDAQ National Market under the symbol SMTC. The following table sets forth, for the periods indicated, the high and low sale prices of our common stock, as reported on the NASDAQ National Market, giving effect to all stock splits through the date hereof.

| | High | Low |
|---|---|---|
| **Fiscal year ending January 30, 2005:** | | |
| First Quarter | $ 26.47 | $ 20.58 |
| Second Quarter | $ 25.42 | $ 18.92 |
| Third Quarter | $ 21.50 | $ 15.94 |
| Fourth Quarter | $ 22.43 | $ 17.54 |
| **Fiscal year ending January 29, 2006:** | | |
| First Quarter | $ 20.86 | $ 16.15 |
| Second Quarter | $ 18.86 | $ 16.36 |
| Third Quarter | $ 19.47 | $ 13.89 |
| Fourth Quarter | $ 21.06 | $ 14.42 |

**Holders**

On April 3, 2006, the reported last sale price of our common stock on the NASDAQ National Market was $18.01 per share. As of April 3, 2006, we had 448 stockholders of record.

**Dividends**

The payment of dividends on our common stock is within the discretion of our board of directors. Currently, we intend to retain earnings to finance the growth of our business. We have not paid cash dividends on our common stock during the two most recent fiscal years and our board of directors has not indicated an intent to declare a cash dividend on the common stock in the foreseeable future.

**Securities Authorized for Issuance Under Equity Compensation Plans**

See the information set forth in Item 12 of this Form 10-K.

**Sales of Unregistered Securities**

We did not make any unregistered sales of equity securities during fiscal year 2006.

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**Purchases of Equity**

This table provides information with respect to purchases by the Company of shares of common stock during the fourth quarter of fiscal year 2006.

| Fiscal Month | Total Number of Shares Purchased (2) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program (1) | Approximate Dollar Value of Shares That MayYet Be Purchased Under The Program (1) |
|---|---|---|---|---|
| November (10-31-05 to 11-27-05) | | | | $ 28.4 million |
| December (11-28-05 to 12-25-05) | 378,000 | $ 19.46 | 378,000 | $ 22.0 million |
| January (12-26-05 to 01-29-06) | 346,000 | $ 18.77 | 346,000 | $ 14.5 million |
| Total fourth quarter fiscal year 2006 | 724,000 | $ 19.13 | 724,000 | |

(1) On February 24, 2004 the Company announced that the Board of Directors authorized the repurchase of up to $50 million of the Company s common stock from time to time through negotiated or open market transactions (the 2004 Program ). On July 6, 2005, the Company announced that it had exhausted the initial authorization and that its Board of Directors had approved an additional $50.0 million for the 2004 Program. The 2004 Program does not have an expiration date. No publicly announced plan or program of the Company for the purchase of shares expired during the period covered by the table.

(2) As shown in the table, all shares purchased by the Company during the fourth quarter were purchased through the 2004 Program. The table does not include shares surrendered to the Company in connection with the cashless exercise of stock options by employees and directors.

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**ITEM 6. SELECTED FINANCIAL DATA**

Information that has been previously filed or otherwise reported for the periods presented in this Item 6 is superseded by the information in this report, and the previously filed financial statements and related financial information and opinions of our independent public accounting firms contained in such reports should no longer be relied upon.

The consolidated statement of income data set forth below for fiscal years 2006, 2005 and 2004, and the consolidated balance sheet data as of the end of fiscal years 2006 and 2005, are derived from, and qualified by reference to, the audited restated consolidated financial statements in Item 8 of this report. The consolidated statement of income data for fiscal years 2003 and 2002, and the consolidated balance sheet data as of the end of fiscal years 2004, 2003 and 2002 have been restated to reflect the impact of the Restatement Adjustments and are derived from the books and records of the Company.

This information should be read in conjunction with the Explanatory Note at the beginning of this report, Management s Discussion and Analysis contained in Item 7 of this report, and the audited financial statements and accompanying notes included in Item 8 of this report.

The fiscal year ended January 30, 2005 consisted of fifty-three weeks and all other fiscal years presented consisted of fifty-two weeks. Our past results are not necessarily indicative of our future performance.

Income Statement Data

**Restated Consolidated Statement of Income Data:**

(In thousands, except earnings per share data)

| | Fiscal Year Ended | | | | |
|---|---|---|---|---|---|
| | **Jan 29 2006 (restated) (1)** | **Jan 30 2005 (restated) (1)** | **Jan 25 2004 (restated) (1)** | **Jan 26 2003 (restated) (2)** | **Jan 27 2002 (restated) (2)** |
| Net Sales | $ 239,338 | $ 253,612 | $ 192,079 | $ 192,958 | $ 191,210 |
| Cost of Sales | 105,236 | 106,407 | 82,635 | 84,908 | 101,255 |
| Gross Profit | 134,102 | 147,205 | 109,444 | 108,050 | 89,955 |
| Operating costs and expenses: | | | | | |
| Selling, general & administrative | 45,600 | 46,935 | 42,190 | 40,988 | 57,772 |
| Product development & engineering | 37,928 | 35,312 | 33,319 | 36,364 | 38,789 |
| Acquisition-related items | 4,954 | | | | |
| One-time costs | (129) | 629 | | 13,202 | 2,727 |
| Total operating costs and expenses | 88,353 | 82,876 | 75,509 | 90,554 | 99,288 |
| Operating income | 45,749 | 64,329 | 33,935 | 17,496 | (9,333) |
| Interest and other income (expense), net | 7,286 | 6,304 | (451) | 15,187 | 9,095 |
| Income before taxes | 53,035 | 70,633 | 33,484 | 32,683 | (238) |
| Provision for taxes | 11,084 | 15,725 | 7,686 | 7,991 | (2,352) |
| Net income | $ 41,951 | $ 54,908 | $ 25,798 | $ 24,692 | $ 2,114 |
| Earnings per share: | | | | | |
| Basic | $ 0.57 | $ 0.74 | $ 0.35 | $ 0.34 | $ 0.03 |
| Diluted | $ 0.55 | $ 0.70 | $ 0.33 | $ 0.32 | $ 0.03 |
| Weighted-average number of shares: | | | | | |
| Basic | 73,436 | 74,187 | 73,570 | 73,013 | 69,983 |
| Diluted | 76,114 | 78,257 | 77,634 | 77,963 | 78,143 |

(1) For a side by side comparison of the previously reported amounts with the restated amounts, see Note 1A to the Consolidated Financial Statements inlcuded in Item 8 of this report.

(2) A side by side comparison of the previously reported amounts with the restated amounts is presented in Item 7 of this report.
Acquisition related items for the fiscal year ended January 29, 2006 are related to the June 2005 acquisition of XEMICS SA. The one-time items for fiscal years 2006 and 2005 relate to litigation against our insurers to recoup costs related to a customer dispute settlement in fiscal year 2003.

Interest and other income (expense) for the fiscal year ended January 25, 2004 includes one-time cost of $6.8 million for the retirement of debt and $2.9 million of gain on the extinguishment of debt.

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Interest and other income (expense) for the fiscal year ended January 26, 2003 includes $12.7 million of gain on the extinguishment of debt. Operating costs and expenses for the fiscal year ended January 26, 2003 include one-time costs of $13.2 million, which included $12.0 million associated with the settlement of a customer dispute, $852,000 for an expected loss on the sub-lease of our New York office and $350,000 for asset impairment at our previously operated wafer fabrication facility in Corpus Christi, Texas.

Operating costs and expenses for the fiscal year ended January 27, 2002 include one-time cost of $2.0 million associated with an approximate 200-person reduction in headcount made in the first half of the year and one-time cost of $765,000 associated with a Superfund settlement.

Balance Sheet Data

**Restated Consolidated Balance Sheet Data**
(In thousands)

| | | | Balances as of | | |
|---|---|---|---|---|---|
| | Jan 29 2006 (restated) | Jan 30 2005 (restated) | Jan 25 2004 (restated) | Jan 26 2003 (restated) | Jan 27 2002 (restated) |
| Cash, cash equivalents and investments | $ 278,186 | $ 301,898 | $ 275,477 | $ 489,047 | $ 543,502 |
| Working capital | 235,474 | 221,434 | 217,277 | 421,219 | 403,380 |
| Total assets | 472,946 | 458,984 | 410,136 | 621,037 | 688,794 |
| Convertible subordinated notes | | | | 241,570 | 364,320 |
| Other long-term liabilities | 5,478 | 2,410 | | | |
| Total stockholders equity | 437,653 | 425,329 | 381,177 | 341,835 | 297,092 |

The following tables show the effects of the restatement on consolidated balance sheet data. Fiscal year 2006 also includes the effect of the Audit Adjustments. The cumulative effect of the related after-tax charges for periods prior to fiscal year 2002 was approximately $17.2 million, which is reflected in stockholders equity as of the beginning of fiscal year 2002.

**Restated Consolidated Balance Sheet Data**
(In thousands)

| | Balances as of January 29, 2006 | | | |
|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | Audit Adjustments | As Restated |
| Cash, cash equivalents and investments | $ 278,186 | $ | $ | $ 278,186 |
| Working capital | 235,563 | (66) | (23) | 235,474 |
| Total assets | 473,765 | (770) | (49) | 472,946 |
| Convertible subordinated notes | | | | |
| Other long-term liabilities | 5,478 | | | 5,478 |
| Total stockholders equity | 438,459 | (866) | 60 | 437,653 |

**Consolidated Balance Sheet Data**

(In thousands)

| | January 30, 2005 | | | January 25, 2004 | | | January 26, 2003 | | | January 27, 2002 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | As Previously Reported | Adjs | As Restated | As Previously Reported | Adjs | As Restated | As Previously Reported | Adjs | As Restated | As Previously Reported | Adjs | As Restated |
| Cash, cash equivalents and investments | $ 301,898 | $ | $ 301,898 | $ 275,477 | $ | $ 275,477 | $ 489,047 | $ | $ 489,047 | $ 543,502 | $ | $ 543,502 |
| Working capital | 221,416 | 18 | 221,434 | 217,092 | 185 | 217,277 | 420,912 | 307 | 421,219 | 402,970 | 410 | 403,380 |
| Total assets | 457,925 | 1,059 | 458,984 | 408,473 | 1,663 | 410,136 | 620,546 | 491 | 621,037 | 690,401 | (1,607) | 688,794 |
| Convertible subordinated notes | | | | | | | 241,570 | | 241,570 | 364,320 | | 364,320 |
| | 2,410 | | 2,410 | | | | | | | | | |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Other long-term liabilities | | | | | | | | | | | | |
| Total stockholders equity | 424,366 | 963 | 425,329 | 379,610 | 1,567 | 381,177 | 341,440 | 395 | 341,835 | 298,795 | (1,703) | 297,092 |

All adjustments (Adjs) shown for fiscal years 2002-2005 are Restatement Adjustments.

For a side by side comparison of the previously reported balance sheet line items with the restated amounts as of January 29, 2006 and January 30, 2005, see Note 1A to the Consolidated Financial Statements included in Item 8 of this report. A side by side comparison of the previously reported balance sheet line items with the restated amounts as of the end of fiscal years 2004, 2003 and 2002 is presented in Item 7 of this report.

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

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with Selected Consolidated Financial Data and our audited consolidated financial statements and related notes included elsewhere in this Form 10-K/A.*

*As discussed in Forward Looking and Cautionary Statements earlier in this report, this Form 10-K/A contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward looking statements, including as a result of the risks described in the cautionary statements in Item 1A Risk Factors and elsewhere in this Form 10-K/A, in our other filings with the SEC, and in material incorporated herein and therein by reference. Our business and associated risks may have changed since we filed the Original Report. Except for the forward-looking statements included in Notes 1A, 5 and 19 to the financial statements included in Item 8 of this report, in Item 9A Controls and Procedures, and under the heading Restatement of Consolidated Financial Statements Based on Review of Stock Option Practices in this Item 7, all forward-looking statements contained in this Form 10-K/A, unless they are specifically otherwise stated to be made as of a different date, are made as of the date the Original Report was filed. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

*Management s discussion and analysis set forth below has been amended to reflect the restatement as described in the Explanatory Note and in Notes 1A and 19 to the Consolidated Financial Statements in Item 8. It has not been otherwise updated. As a result, the information set forth in this Item 7 may not be comparable to discussions and data in our previously filed Annual Reports, which should no longer be relied upon.*

**Restatement of Consolidated Financial Statements Based on Review of Stock Option Practices**

Our discussion of this topic is divided into the following segments:

(I) Background of the Restatement

(II) Nature of the Restatement Adjustments

(III) Findings as to Individual Conduct

(IV) Amortization of the Restatement Adjustments

(V) Effect of the Restatement Adjustments on the Previously Reported Financial Statements

(VI) Judgments and Interpretations

(VII) Going Forward

(I) Background of the Restatement

We first learned of issues associated with our past stock option grants on May 17, 2006 when Nasdaq alerted us to a research report published on May 16, 2006 by the Center for Financial Research and Analysis ( CFRA ). On May 18, 2006, we received a letter from the SEC requesting that we voluntarily provide certain information and documents relating to stock option grants dating back to January 1, 1997 (the SEC Letter ).

Upon learning of the CFRA report and receiving the SEC Letter, we began a review of our historical stock option practices with the assistance of outside counsel, Paul, Hastings, Janofsky & Walker LLP. During the course of these efforts, our in-house counsel discovered documents indicating irregularities with respect to certain stock option grants for new employees in fiscal year 2001 (which ended on January 28, 2001). We alerted the Board of Directors ( Board ) to the existence of these documents and immediately began investigating the new hire grants referenced

in the documents. After detecting apparent irregularities in these and other new hire grants, we expanded our review to include a more thorough examination of employment files for new hires on and after January 1, 1997. We also began investigating other stock option matters, including delegation authorities for stock option grants, grants to continuing employees, and procedural steps associated with the stock option grant process. We retained Kroll, Inc. to conduct a comprehensive review of the stock option grant issues and FTI Consulting, Inc. to assist in analyzing related accounting issues.

After receiving several management reports on this matter in accordance with previously established procedures regarding accounting complaints, the Audit Committee, at that time comprised of Directors Burra, Hankin and Lindstrom, determined that it should retain independent counsel to assist in conducting an investigation of our stock option grant practices. On June 9, 2006, the Audit Committee retained the law firm of Fenwick & West LLP

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( Fenwick ), a law firm not previously used by the Company, to assist in conducting this investigation. Fenwick retained Navigant Consulting, Inc. as its forensic accounting advisor. Directors Burra and Hankin, who had previously served on the Compensation Committee, recused themselves from the investigation early in July 2006 after Fenwick learned of a new hire stock option grant to an officer in 1996 approved by the Compensation Committee that would be a subject of the investigation. On July 12, 2006, the Board appointed Directors Lindstrom and Piotrowski as a Special Committee fully authorized and empowered to continue the investigation.

Ernst & Young LLP, the Company s independent registered public accounting firm, did not participate in management s review or the Special Committee s investigation, but was kept apprised of the progress and results.

After the initial phase of the investigation, which focused on the processes used to establish option exercise prices and obtain approvals of stock option grants, including procedures relating to initial stock option grants to newly hired employees and the related measurement dates used for financial reporting purposes, the Special Committee concluded that, pursuant to the requirements of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ) and related authoritative guidance, the accounting measurement dates for certain stock options granted primarily during fiscal years 1998 through 2003 required correction. On July 20, 2006, we announced that financial statements and the related reports of our independent public accountants, earnings press releases, and similar communications we previously issued should no longer be relied upon pending restatement of our financial statements for fiscal years 2002 through 2006 to record a material level of additional non-cash compensation expense. We also announced that the restatement would affect financial statements for earlier fiscal years and that adjustments for those earlier years would be reflected as part of the opening balances in the financial statements for the restatement period.

The Special Committee s investigation and management s review extended back to January 30, 1995, which was the start of fiscal year 1996. The initial focus was on grants made since the beginning of calendar year 1997, which is the period covered by the informal request received from the SEC. The period covered was expanded to determine if material grant issues existed beyond the periods covered by the SEC request. The Company, with the assistance of Kroll, reviewed grant activity back to 1992 and found no evidence of deliberate manipulation related to grants made prior to fiscal year 1996. The Company concluded that a more detailed review of grants made prior to fiscal year 1996 was not warranted.

(II) Nature of the Restatement Adjustments

This section summarizes the main categories of situations in which the initial accounting was incorrect and describes the measurement date used for the restatement or the other change made for the restatement.

The pre-tax, non-cash, stock-based compensation expense resulting from the revised measurement dates and other adjustments discussed below is approximately $91.0 million in the aggregate for fiscal years 1996 through fiscal year 2006. The following table shows the aggregate financial statement impact of each category of adjustment. In order to avoid double counting, the table reflects an adjustment for items that fall into more than one category.

in thousands, except number of grants

| Category | Number of grants | Expense for all grants | Expense for grants to Section 16 group (1) | Percent of total expense related to Section 16 group |
|---|---|---|---|---|
| (A) Grants to continuing employees | 1,153 | $ 50,473 | $ 7,567 | 15% |
| (B) Grants to new employees | 343 | 19,425 | | 0% |
| (C) Grants lacking evidence of approval | 33 | 149 | | 0% |
| (D) Grants modified after ratification | 83 | 4,545 | | 0% |
| (E) Post-termination arrangements | 68 | 20,854 | 16,396 | 79% |
| (F) Pricing exceptions | 393 | 733 | 107 | 15% |
| | | $ 96,179 | $ 24,070 | 25% |
| Adjustment for duplication among categories | | (5,151) | (107) | 2% |
| Total pre-tax stock option related adjustments | | $ 91,028 | 23,963 | 26% |

| | |
|---|---|
| Amount capitalized into inventory | (30) |
| **Total pre-tax stock option compensation expense** | **$ 90,998** |
| **Tax benefits** | **(28,688)** |
| **Net adjustment (2) (3)** | **$ 62,310** |

(1) Expense related to grants made to, or modifications made for, directors, officers and key executives subject to Section 16 of the Securities Exchange Act of 1934 at the time of grant or modification.

(2) The additional non-cash compensation expense is net of forfeitures related to employee terminations.

(3) Amortization of the expense by category is shown in Section (IV) below.

The Company applied APB 25 in determining the correct measurement date in each situation described below. Under APB 25, the measurement date is the first date on which are known both the number of shares that an individual employee is entitled to receive and the option or purchase price, if any. Any intrinsic value that exists at the measurement date must be recognized as compensation cost, generally as a charge to compensation expense in the income statement.

*(A) Grants made by Former Chief Executive Officer John D. Poe (  Former CEO  ) from April 1997 to May 2002 to continuing employees*

In April 1997, the Compensation Committee delegated authority to the Former CEO to make option grants as an agent of the Committee for the stated purpose of granting options on a more timely basis. Grants made by the Former CEO were subsequently submitted to the Compensation Committee for approval. The Former CEO granted options under this authority to existing executive and non-executive level employees through May 2002.

Based on the reviews conducted by management and the Special Committee, the Company has concluded that the elements of APB 25 were not satisfied as of the stated grant dates for fifteen of the seventeen grant dates selected by the Former CEO from April 1997 through May 2002. There is evidence of intentional manipulation on nine of these grant dates, representing approximately 42% of the shares and approximately 76% of the expense in this category. Based primarily on evidence of the Former CEOs willingness to manipulate grant dates, the Company determined that the grants made during this period were not final until approved by the Compensation Committee. Although the reviews found no specific documentary evidence of manipulation for certain grants, the fact that those grants lack adequate contemporaneous documentation to corroborate the establishment of the grant date, combined with evidence of manipulation of other grants during this period, led to the Company  s conclusion that the original measurement date was in error because the terms of the grant were not determined with finality.

The appropriate measurement date for all grants in this category is the date of Compensation Committee ratification, unless the measurement date for a particular grant has been further revised due to one of the issues discussed below.

In August 2002, the Compensation Committee determined that options for continuing employees would be granted in conjunction with regularly scheduled Compensation Committee meetings, thus restoring the delegated authority to the Compensation Committee.

This category also includes adjustments related to miscellaneous grant scenarios, primarily related to acquisitions. The non-cash compensation expense related to these miscellaneous items is approximately $4.6 million pretax.

*(B) Grants to new employees*

In April 1997, the Compensation Committee stated that all option grants communicated via an offer letter would be granted to each employee on his or her start date.

The reviews revealed inconsistencies in grant practices to new hires from April 1997 to August 2002 and evidence of management  s willingness to intentionally select favorable grant dates for new hires during this period. More specifically, it was found that a majority of grants during this period were not made as of the recipient  s start date. Of those who received a new hire grant on a date other than the actual hire date, approximately 90% received a more favorable price. Of the grants that were made on the hire date, approximately 95% were priced favorably when compared to the price of the stock on the date of the relevant Compensation Committee meeting. The appropriate measurement date for all new hire grants during this period is the date of Compensation Committee approval, unless the measurement date for a particular grant has been further revised due to one of the issues discussed below.

The reviews also identified 76 stock option grants, made between November 1996 and May 2002, that were made to persons before they became employees, including through assignment of the employee to leave of absence status prior to the date the employee began performing services. The appropriate measurement date for these options is the employee  s start date. However, a later measurement date tied to the Compensation Committee  s approval was applied in a significant number of these cases because grant terms were not determined with finality on the hire date. Compensation expense is amortized over the vesting period, the end of which, for the grants in this group, remains the same but starts at the date of employment. For grants with a measurement date after the stated grant

date, amortization related to the first vesting period is accelerated, which could result in more than twelve months of amortization in a fiscal year.

Following a leadership change in the Human Resources Department, the procedures were more fully explained to the HR staff and better enforced, such that beginning in August 2002, new hire grants were made consistently as of the employee s hire date.

In February 2006, the Compensation Committee determined to align the procedure for new hire grants and promotional grants with the procedure in place for annual grants to continuing employees. That is, new hire option grants are now awarded at Compensation Committee meetings rather than on the date of hire.

*(C) Grants lacking evidence of Compensation Committee approval*

The reviews identified 33 grants that lacked evidence of Compensation Committee ratification. The lack of evidence is believed to be the result of administrative issues. For example, some grants to new hires appear in the Company s stock option database without evidence of having been presented to the Compensation Committee for approval. Others in this group were presented to the Compensation Committee for approval then excluded from the Compensation Committee meeting minutes because the employee had terminated following the meeting or was about to terminate. For grants in this category, management used available relevant information, such as personnel records and Compensation Committee records, to determine the most likely grant date. The Special Committee found these conclusions to be reasonable.

*(D) Grants modified after ratification by the Compensation Committee*

The reviews revealed 84 grants, out of more than 1,600 grants over 23 grant dates, with changes between the grant lists distributed with the Compensation Committee agendas, on which basis the grants were ratified, and the grant lists attached to the minutes for the related meetings. More specifically, the reviews showed 31 new grants, 32 deleted grants (apparently related to employees who terminated in the interim), 12 increased grants, 8 decreased grants, and 1 addition specifically approved at the Compensation Committee meeting. In most cases, these changes were not significant individually or in the aggregate, were not significantly concentrated within individual grant dates, and appear to be the result of administrative error and not indicative of an open-allocation process. The exceptions to these determinations are (i) one grant date in May 1999 for which there is evidence indicating the grant process for ten employees in two departments was not complete on the award approval date, (ii) 21 grants to continuing employees on one grant date in May 2000 for which the grant process was found to be incomplete on the award approval date, and (iii) five grants to new hires concentrated on one grant date in December 2000 that were made prior to the employees start dates, but not indicative of an open allocation process.

For grants that were added or changed, the measurement date is the date that the Compensation Committee approved the minutes that reflected the changes. With respect to the May 1999 grant, we revised the measurement date for grants to all employees in the two departments with the open allocation process rather than revising the measurement date for only the modified awards. Similarly, with respect to the May 2000 grant, we revised the measurement date for awards to all continuing employees on the second quarter grant list because the list was not finalized on the award approval date.

*(E) Post-termination arrangements*

The reviews identified 21 employees with termination arrangements whereby options were modified through continued vesting and/or extension of the exercise period. Two of these arrangements involved executive level employees transitioned from full-time status to on-call status in anticipation of full retirement. Of the remaining agreements, many involved placing terminated employees below the vice-president level on leave of absence status for stock option purposes. In each of these instances, it has been concluded that the modifications were made in recognition of past services. Specifically, the individuals on leave of absence were no longer required to provide substantive services for the Company and the executives on call did not perform substantive services during the on-call period. Thus, compensation cost for the options affected by the termination arrangements was remeasured on the modification dates and the incremental compensation cost, plus any originally measured but unrecognized compensation cost, has been expensed entirely at the time of modification. These costs were recorded even if the options were exercised by the employee within the originally permitted window following termination of substantive employment.

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*(F) Pricing exceptions*

The reviews identified that approximately 9% of the grants made in fiscal years 1996 through 2006 had exercise prices that were determined in a manner inconsistent with our convention of pricing options at the closing price on the day before the grant. The significant majority of the exceptions relate to the use of the closing price on the date of grant. The majority of these grants had pricing exceptions that resulted in pricing unfavorable to the employee, leading to the conclusion that the exceptions were administrative errors. The measurement of compensation cost was corrected to consistently measure compensation cost based on the closing price on the day before the grant date.

For many years we have used the prior date closing methodology set forth in our 1994 stock option plans to determine the exercise price and measure the compensation cost of our employee stock options. Although this methodology is not consistent with the terms of our later option plans, which call for using the weighted-average traded price on date of grant, we have determined, and our accounting advisors and the Special Committee s forensic accountant have concurred, that continued use of the prior date closing methodology was reasonable and acceptable. The Board also concurred and ratified past use of the prior date closing methodology. However, in October 2006 we amended the operative stock option plans to establish the exercise price based on the closing stock price on the grant date. This change in methodology is not expected to have a material effect on our financial statements.

*Restatement Charges Related to Officers and Key Employees*

The Company s management team during fiscal years 1996 through 2006 included 28 individuals who at various times were subject to the provisions of Section 16 of the Securities Act of 1934 ( Section 16 ) due to their positions as officers or key executives. The eight individuals who served as independent directors at various times during the same period were also subject to Section 16. None of the additional non-cash compensation expense relates to options awarded to independent directors. Approximately 8% of the additional pre-tax non-cash compensation expense is related to options granted to 15 employees after they became officers or key executives subject to Section 16. This expense is almost entirely attributable to Category A, with a small portion attributable to Category F. No Section 16 executive accounted for more than 2.2% of the total pre-tax non-cash compensation expense due to Category A and F errors. An additional 18% of the total pre-tax non-cash compensation expense is related to on-call arrangements intended to provide continuity to the Company by transitioning two executives from full-time employment into retirement. Our review indicated that although one executive provided some services during the on-call period, there is no evidence that the other performed any. We determined that since neither employee performed sufficient services to meet the substantive services requirement set forth by current interpretations of applicable accounting standards, the options held by the employees were modified to extend the exercise period and to effectively accelerate vesting on the date they ceased full-time employment and, therefore, a new measurement date was required by APB 25.

(III) Findings as to Individual Conduct

In considering the situations described in (A) through (F) above, the Special Committee concluded that the evidence supports a finding of intentional manipulation of stock option grant dates directed by the Former CEO, that a former human resources executive who was with the Company from October 1999 through May 2002 ( Former HR VP ) participated in this conduct, and that the Chief Financial Officer ( Former CFO ) and the Treasurer ( Former Treasurer ) at the time the Special Committee s report was issued knew, or should have known, of the manipulation and initiated or participated in some manipulative acts. One other executive ( Former Executive ) who left the Company in early January 2007 was found to be significantly less culpable in that he evidenced a willingness to acquiesce in manipulative conduct.

As previously announced, the Former CEO stepped down from his position as Chairman of the Board on August 17, 2006. He also took a leave of absence from the Board, effective the same date, pending the conclusion of the investigation. The Former CEO informed us he was taking these actions to avoid even the appearance of a conflict of interest. Both he and the Former HR VP declined to be interviewed by the Special Committee. Following the Special Committee s report to the Board on October 2, 2006, the Board accepted the recommendation of the Special Committee that the Former CEO be asked to resign and, if he does not do so, that he not be nominated to stand for reelection as a Director at the next annual meeting of shareholders. The Former CEO was asked to immediately resign from the Board. As reported in the Form 8-K we filed on October 25, 2006, we received an October 20, 2006 letter from the Former CEO advising us that he intends to resign his position as a Director effective as of the first date, subsequent to

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the filing of the Company s restated financial statements, on which the Company regains compliance with Nasdaq continued listing standards and the window for trading by officers and directors of the Company is reasonably expected to be open for a period of at least 30 days.

The Special Committee recommended that the Former CFO and Former Treasurer be asked to resign within a time consistent with Company needs and an orderly transition. As previously announced, the Former CFO and Former Treasurer resigned their positions on November 7, 2006, although they remained with the Company on special assignments through January 22, 2007 and January 31, 2007, respectively.

The Special Committee found some personal benefit to these five individuals in the form of options that were in-the-money, but unvested, at the date of grant. Grants to these five individuals had intrinsic value, meaning value equal to the number of options multiplied by the difference between the stated exercise price and the price on the correct measurement date, of approximately $4.8 million. Options granted by the Company typically vest in equal annual installments over three or four years, beginning on the first anniversary of the grant. After considering unvested options that were forfeited upon termination, the aggregate additional non-cash compensation expense related to grants to these five individuals is approximately $4.5 million.

Approximately 5% of the intrinsic value related to grants to these five individuals has been realized through exercise of the options. Exercise of options was not permitted during the restatement process. Approximately 41% of the intrinsic value will not be realized because the options have lapsed due to the fixed term of the options expiring during the restatement process or because the 30 day post-termination period for exercising the employee options expired during the restatement process. Approximately 43% of the vested options that expired or lapsed had intrinsic value and 57% had no intrinsic value.

The Board formed a Special Litigation Committee ( Special Litigation Committee ) comprised of Director Baker and Director Edwards, independent Directors who joined the Board in October 2006, to evaluate the existence and extent of any potential claims against these five individuals. The Special Litigation Committee directed management to cancel and rescind all of the outstanding options held by the Former CEO, which amount to over 1.2 million options on a split-adjusted basis, and management has done so. Approximately 19% of the cancelled options had intrinsic value and 81% of the cancelled options had no intrinsic value. Almost all of the cancelled options were vested or would immediately vest upon termination of Board service.

The cancelled, expired and lapsed options had split-adjusted exercise prices ranging from $2.41 to $31.91 per share.

The Special Litigation Committee directed management to cancel one of the Former CFOs grants and to reprice the remainder of his outstanding vested options. However, all of the Former CFOs options (including those to be cancelled) expired or lapsed during the restatement process except for one grant of 240,000 options (split-adjusted) that was issued under one of the Company s prior option plans and is subject to a 90 day post-termination exercise period. Those options have been repriced from $5.31 per share to $6.59 per share (split-adjusted), such that the intrinsic value associated with the options will not be realized by the Former CFO.

The Former Treasurer also has one outstanding grant for 30,000 options (split-adjusted) at an exercise price of $5.88 (split-adjusted) that is subject to a 90 day post-termination exercise period. There is no intrinsic value associated with that grant. The Special Litigation Committee took no action with respect to the Former Treasurer.

The Special Litigation Committee took no action with respect to the Former HR VP or Former Executive.

The status of the intrinsic value associated with options granted to the five individuals is summarized as follows:

(in thousands)

| | Former CEO | Former CFO | Three Other Former Executives | Total | |
|---|---|---|---|---|---|
| Realized | $ 19 | $ 16 | $ 193 | $ 228 | 5% |
| Never Vested | | | 269 | 269 | 6% |
| Expired or Lapsed | | 1,649 | 316 | 1,965 | 41% |
| Cancelled | 1,989 | | | 1,989 | 42% |
| Repriced | | 307 | | 307 | 6% |
| Will Not be Realized | $ 1,989 | $ 1,956 | $ 585 | $ 4,530 | 95% |
| Total Intrinsic Value | $ 2,008 | $ 1,972 | $ 778 | $ 4,758 | 100% |
| Total Intrinsic Value | 42.2% | 41.4% | 16.4% | 100% | |

The Special Committee found that false and misleading information was furnished to the Compensation Committee of the Board. The Special Committee did not recommend, and the Board did not take, any action with respect to current or former Compensation Committee members. The Special Committee did, however, recommend certain remedial measures with respect to corporate governance that we have begun to implement, including establishment of a corporate governance committee at the Board level, development of procedures for certifying genuineness of board materials and minutes, and additional ethics and other training for Directors and employees at all levels.

(IV) Amortization of the Restatement Adjustments

In accordance with APB 25, our restated consolidated financial statements reflect additional compensation expense to the extent the fair market value of a share of our common stock on the correct measurement date exceeded the exercise price of the option. The additional non-cash compensation expense was amortized over the required service period, generally over the vesting periods of the respective grants.

The restatement has resulted in additional non-cash stock-based compensation expense related to stock options as follows:

(in thousands)

| Fiscal Year | Additional Compensation Expense | Tax Benefit | Additional Compensation Expense, net of tax |
|---|---|---|---|
| 1996 | $ 10 | $ (3) | $ 7 |
| 1997 | 95 | (37) | 58 |
| 1998 | 1,002 | (390) | 612 |
| 1999 | 2,826 | (1,034) | 1,792 |
| 2000 | 6,862 | (2,174) | 4,688 |
| 2001 | 14,050 | (4,017) | 10,033 |
| 2002 | 36,354 | (12,465) | 23,889 |
| 2003 | 13,401 | (3,912) | 9,489 |
| **Subtotal Fiscal Years 1996 - 2003** | 74,600 | (24,032) | 50,568 |

| | | | |
|---|---|---|---|
| 2004 | 9,234 | (2,566) | 6,668 |
| 2005 | 5,637 | (1,657) | 3,980 |
| 2006 | 1,527 | (433) | 1,094 |
| **Total Fiscal Years 1996 - 2006** | $ 90,998 | $ (28,688) | $ 62,310 |

The amount related to the restatement that impacts fiscal year 2007 and future years is immaterial.

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The additional non-cash compensation expense that resulted from the correction of accounting for stock options granted or modified primarily during fiscal years 1996 through 2003 was generally amortized over the required service period, generally the vesting periods of the respective grants. The following table shows the additional non-cash compensation expense for fiscal years 1996 through 2006. The cumulative after tax adjustment for fiscal years 1996 through 2003 is included in the restated fiscal year 2004 balance sheet as a reduction in retained earnings.

(in thousands)

| | Fiscal Year | | | | | |
|---|---|---|---|---|---|---|
| **Category** | **1996** | **1997** | **1998** | **1999** | **2000** | **2001** |
| (A) Grants to continuing employees | $ 2 | $ 2 | $ 449 | $ 1,725 | $ 4,530 | $ 9,573 |
| (B) Grants to new employees | 3 | 27 | 506 | 1,073 | 2,003 | 4,499 |
| (C) Grants lacking evidence of approval | 1 | 1 | | 6 | 21 | 24 |
| (D) Grants modified after ratification | | | | | 496 | 1,399 |
| (E) Post-termination arrangements | | | | | 357 | 182 |
| (F) Pricing exceptions | 7 | 71 | 80 | 70 | 103 | 180 |
| | $ 13 | $ 101 | $ 1,035 | $ 2,874 | $ 7,510 | $ 15,857 |
| Adjustment for duplications | (3) | (2) | | (6) | (588) | (1,597) |
| Total pre-tax adjustments | 10 | 99 | 1,035 | 2,868 | 6,922 | 14,260 |
| Amount capitalized into inventory | | (4) | (33) | (42) | (60) | (210) |
| **Total pre-tax compensation expense** | $ 10 | $ 95 | $ 1,002 | $ 2,826 | $ 6,862 | $ 14,050 |
| **Tax benefits** | (3) | (37) | (390) | (1,034) | (2,174) | (4,017) |
| **Net adjustment** | $ 7 | $ 58 | $ 612 | $ 1,792 | $ 4,688 | $ 10,033 |

| | Fiscal Year | | Subtotal FY 1996 through | Fiscal Year | | | Total FY 1996 through |
|---|---|---|---|---|---|---|---|
| **Category** | **2002** | **2003** | **FY 2003** | **2004** | **2005** | **2006** | **FY 2006** |
| (A) Grants to continuing employees | $ 11,729 | $ 9,841 | $ 37,851 | $ 7,101 | $ 4,265 | $ 1,256 | $ 50,473 |
| (B) Grants to new employees | 4,701 | 3,332 | 16,144 | 2,012 | 1,082 | 187 | 19,425 |
| (C) Grants lacking evidence of approval | 89 | (2) | 140 | 5 | 4 | | 149 |
| (D) Grants modified after ratification | 1,380 | 745 | 4,020 | 410 | 112 | 3 | 4,545 |
| (E) Post-termination arrangements | 20,080 | 124 | 20,743 | | 111 | | 20,854 |
| (F) Pricing exceptions | 135 | 67 | 713 | 7 | 12 | 1 | 733 |
| | $ 38,114 | $ 14,107 | $ 79,611 | $ 9,535 | $ 5,586 | $ 1,447 | $ 96,179 |
| Adjustment for duplications | (1,604) | (810) | (4,610) | (422) | (115) | (4) | (5,151) |
| Total pre-tax adjustments | 36,510 | 13,297 | 75,001 | 9,113 | 5,471 | 1,443 | 91,028 |
| Amount capitalized into inventory | (156) | 104 | (401) | 121 | 166 | 84 | (30) |
| **Total pre-tax compensation expense** | $ 36,354 | $ 13,401 | $ 74,600 | $ 9,234 | $ 5,637 | $ 1,527 | $ 90,998 |
| **Tax benefits** | (12,465) | (3,912) | (24,032) | (2,566) | (1,657) | (433) | (28,688) |
| **Net adjustment** | $ 23,889 | $ 9,489 | $ 50,568 | $ 6,668 | $ 3,980 | $ 1,094 | $ 62,310 |

(V) Effect of the Restatement Adjustments on the Previously Reported Financial Statements

*Income Statement Data*

The table below shows the effect of the additional non-cash compensation expense on our previously reported Consolidated Statements of Income for fiscal years 2002 through 2006. The additional non-cash compensation expense related to fiscal years 1996 through 2001 is included in the restated 2002 balance sheet as a reduction in stockholders equity.

increase (decrease)

in thousands, except per share data

| | Fiscal Year Ended | | | | |
|---|---|---|---|---|---|
| | **Jan 29 2006** | **Jan 30 2005** | **Jan 25 2004** | **Jan 26 2003** | **Jan 27 2002** |
| **NET SALES** | $ | $ | $ | $ | $ |
| Cost of sales | 213 | 702 | 1,303 | 1,811 | 3,335 |
| Gross profit | (213) | (702) | (1,303) | (1,811) | (3,335) |
| **Operating costs and expenses:** | | | | | |
| Selling, general and administrative | 920 | 3,115 | 4,983 | 6,562 | 23,974 |
| Product development and engineering | 394 | 1,820 | 2,948 | 5,028 | 9,045 |
| Acquisition-related items | | | | | |
| Total operating costs and expenses | 1,314 | 4,935 | 7,931 | 11,590 | 33,019 |
| **Operating income** | (1,527) | (5,637) | (9,234) | (13,401) | (36,354) |
| Interest expense | | | | | |
| Interest and other income | | | | | |
| **Income before taxes** | (1,527) | (5,637) | (9,234) | (13,401) | (36,354) |
| Provision for taxes | 433 | 1,657 | 2,566 | 3,912 | 12,465 |
| **NET INCOME** | $ (1,094) | $ (3,980) | $ (6,668) | $ (9,489) | $ (23,889) |
| **Earnings per share -** | | | | | |
| Basic | (0.02) | (0.05) | (0.09) | (0.13) | (0.34) |
| Diluted | (0.02) | (0.05) | (0.09) | (0.12) | (0.30) |

The additional non-cash compensation expense is allocated among cost of sales; selling, general and administrative; and product development and engineering based on the classification of the employees to whom the stock option causing the adjustment was awarded. The adjustments related to stock options did not affect our revenues or net cash flows for any fiscal year reported.

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See Note 1A to the consolidated financial statements included in Item 8 of this report for a side by side comparison of the previously reported amounts with the restated amounts for fiscal years 2006, 2005, and 2004. The following table shows a side by side comparison for fiscal years 2003 and 2002.

(in thousands, except per share data)

| | Fiscal Year 2003 | | | Fiscal Year 2002 | | |
|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| **NET SALES** | $ 192,958 | $ | $ 192,958 | $ 191,210 | $ | $ 191,210 |
| Cost of sales | 83,097 | 1,811 | 84,908 | 97,920 | 3,335 | 101,255 |
| **Gross profit** | 109,861 | (1,811) | 108,050 | 93,290 | (3,335) | 89,955 |
| **Operating costs and expenses:** | | | | | | |
| Selling, general and administrative | 34,426 | 6,562 | 40,988 | 33,798 | 23,974 | 57,772 |
| Product development and engineering | 31,336 | 5,028 | 36,364 | 29,744 | 9,045 | 38,789 |
| One-time costs | 13,202 | | 13,202 | 2,727 | | 2,727 |
| Total operating costs and expenses | 78,964 | 11,590 | 90,554 | 66,269 | 33,019 | 99,288 |
| **Operating income** | 30,897 | (13,401) | 17,496 | 27,021 | (36,354) | (9,333) |
| Interest expense | (15,125) | | (15,125) | (18,917) | | (18,917) |
| Interest and other income | 30,312 | | 30,312 | 28,012 | | 28,012 |
| **Income before taxes** | 46,084 | (13,401) | 32,683 | 36,116 | (36,354) | (238) |
| Provision for taxes | 11,903 | (3,912) | 7,991 | 10,113 | (12,465) | (2,352) |
| **NET INCOME** | $ 34,181 | $ (9,489) | $ 24,692 | $ 26,003 | $ (23,889) | $ 2,114 |
| **Earnings per share** | | | | | | |
| Basic | $ 0.47 | $ (0.13) | $ 0.34 | $ 0.37 | $ (0.34) | $ 0.03 |
| Diluted | $ 0.44 | $ (0.12) | $ 0.32 | $ 0.33 | $ (0.30) | $ 0.03 |
| **Weighted-average number of shares** | | | | | | |
| Basic | 73,013 | | 73,013 | 69,983 | | 69,983 |
| Diluted | 77,789 | 174 | 77,963 | 77,747 | 396 | 78,143 |

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*Balance Sheet Data*

The table below shows the effect of the Restatement Adjustments on our previously reported Consolidated Balance Sheets. As noted above, the additional non-cash compensation expense related to fiscal years 1996 through 2001 is included as a reduction in stockholders equity as of the beginning of fiscal year 2002. As detailed below, the primary balance sheet impact in each year was a reclassification between additional paid in capital and retained earnings.

increase (decrease) in thousands

| | Jan 29 2006 | Jan 30 2005 | Jan 25 2004 | Jan 26 2003 | Jan 27 2002 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Current assets:** | | | | | |
| Cash and cash equivalents | $ | $ | $ | $ | $ |
| Temporary investments | | | | | |
| Receivables, less allowances | | | | | |
| Inventories | 30 | 114 | 281 | 403 | 506 |
| Income taxes refundable | | | | | |
| Deferred income taxes | | | | | |
| Other current assets | | | | | |
| **Total current assets** | 30 | 114 | 281 | 403 | 506 |
| **Property, plant and equipment, net** | | | | | |
| **Investments, maturities in excess of 1 year** | | | | | |
| **Deferred income taxes** | (800) | 945 | 1,382 | 88 | (2,113) |
| **Goodwill** | | | | | |
| **Other intangibles** | | | | | |
| **Other assets** | | | | | |
| **TOTAL ASSETS** | $ (770) | $ 1,059 | $ 1,663 | $ 491 | $ (1,607) |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | | |
| **Current liabilities:** | | | | | |
| Accounts payable | $ | $ | $ | $ | $ |
| Accrued liabilities | | | | | |
| Income taxes payable | | | | | |
| Deferred revenue | | | | | |
| Deferred income taxes | | | | | |
| Other current liabilities | 96 | 96 | 96 | 96 | 96 |
| **Total current liabilities** | 96 | 96 | 96 | 96 | 96 |
| **Convertible subordinated debentures** | | | | | |
| **Deferred income taxes** | | | | | |
| **Other long-term liabilities** | | | | | |
| **Commitments and contingencies** | | | | | |
| **Stockholders equity:** | | | | | |
| Common stock, $0.01 par value | | | | | |
| Treasury stock, at cost | | | | | |
| Additional paid-in capital | 61,446 | 62,180 | 58,804 | 50,964 | 39,376 |
| Retained earnings | (62,312) | (61,217) | (57,237) | (50,569) | (41,079) |
| Accumulated other comprehensive loss | | | | | |
| **Total Stockholders equity** | (866) | 963 | 1,567 | 395 | (1,703) |

| | | | | | |
|---|---|---|---|---|---|
| **TOTAL LIABILITIES AND STOCKHOLDERS EQUITY** | $ (770) | $ 1,059 | $ 1,663 | $ 491 | $ (1,607) |

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For a side by side comparison of the previously reported balance sheet line items with the restated amounts for the January 29, 2006 and January 30, 2005 balance sheets, see Note 1A to the financial statements included in Item 8 of this report. The following tables show the effects of the restatement on the consolidated balance sheet at the end of fiscal years 2004, 2003 and 2002.

| in thousands | **January 25, 2004** | | | **January 26, 2003** | | | **January 27, 2002** | | |
|---|---|---|---|---|---|---|---|---|---|
| | **As Previously Reported** | **Restatement Adjustments** | **As Restated** | **As Previously Reported** | **Restatement Adjustments** | **As Restated** | **As Previously Reported** | **Restatement Adjustments** | **As Restated** |
| **ASSETS** | | | | | | | | | |
| **Current assets:** | | | | | | | | | |
| Cash and cash equivalents | $ 96,314 | $ | $ 96,314 | $ 137,041 | $ | $ 137,041 | $ 46,300 | $ | $ 46,300 |
| Temporary investments | 93,044 | | 93,044 | 273,382 | | 273,382 | 324,870 | | 324,870 |
| Receivables, less allowances | 20,362 | | 20,362 | 17,676 | | 17,676 | 19,181 | | 19,181 |
| Inventories | 22,166 | 281 | 22,447 | 16,351 | 403 | 16,754 | 22,728 | 506 | 23,234 |
| Income taxes refundable | 5,795 | | 5,795 | | | | 2,019 | | 2,019 |
| Deferred income taxes | 5,212 | | 5,212 | 11,731 | | 11,731 | 11,786 | | 11,786 |
| Other current assets | 3,062 | | 3,062 | 2,267 | | 2,267 | 3,372 | | 3,372 |
| **Total current assets** | 245,955 | 281 | 246,236 | 458,448 | 403 | 458,851 | 430,256 | 506 | 430,762 |
| **Property, plant & equipment, net** | 49,579 | | 49,579 | 51,547 | | 51,547 | 51,516 | | 51,516 |
| **Investments, maturities in excess of 1 year** | 86,119 | | 86,119 | 78,624 | | 78,624 | 172,332 | | 172,332 |
| **Deferred income taxes** | 25,552 | 1,382 | 26,934 | 27,143 | 88 | 27,231 | 27,659 | (2,113) | 25,546 |
| **Goodwill** | | | | | | | | | |
| **Other intangibles** | | | | | | | | | |
| **Other assets** | 1,268 | | 1,268 | 4,784 | | 4,784 | 8,638 | | 8,638 |
| **TOTAL ASSETS** | $ 408,473 | $ 1,663 | $ 410,136 | $ 620,546 | $ 491 | $ 621,037 | $ 690,401 | $ (1,607) | $ 688,794 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | | | | | | |
| **Current liabilities:** | | | | | | | | | |
| Accounts payable | $ 8,554 | $ | $ 8,554 | $ 5,725 | $ | $ 5,725 | $ 7,341 | $ | $ 7,341 |
| Accrued liabilities | 16,894 | | 16,894 | 26,596 | | 26,596 | 16,845 | | 16,845 |
| Income taxes payable | 1,699 | | 1,699 | 3,593 | | 3,593 | 1,099 | | 1,099 |
| Deferred revenue | 1,689 | | 1,689 | 1,583 | | 1,583 | 1,936 | | 1,936 |
| Deferred income taxes | | | | | | | | | |
| Other current liabilities | 27 | 96 | 123 | 39 | 96 | 135 | 65 | 96 | 161 |
| **Total current liabilities** | 28,863 | 96 | 28,959 | 37,536 | 96 | 37,632 | 27,286 | 96 | 27,382 |
| **Convertible subordinated debentures** | | | | 241,570 | | 241,570 | 364,320 | | 364,320 |
| **Deferred income taxes** | | | | | | | | | |
| **Other long-term liabilities** | | | | | | | | | |
| **Commitments and contingencies** | | | | | | | | | |
| **Stockholders equity:** | | | | | | | | | |
| Common stock, $0.01 par value | 742 | | 742 | 740 | | 740 | 722 | | 722 |
| Treasury stock, at cost | | | | (9,072) | | (9,072) | | | |
| Additional paid-in capital | 189,945 | 58,804 | 248,749 | 182,524 | 50,964 | 233,488 | 162,856 | 39,376 | 202,232 |
| Retained earnings | 188,321 | (57,237) | 131,084 | 165,640 | (50,569) | 115,071 | 131,459 | (41,079) | 90,380 |
| Accumulated other comprehensive income | 602 | | 602 | 1,608 | | 1,608 | 3,758 | | 3,758 |
| **Total Stockholders equity** | 379,610 | 1,567 | 381,177 | 341,440 | 395 | 341,835 | 298,795 | (1,703) | 297,092 |
| **TOTAL LIABILITIES AND STOCKHOLDERS EQUITY** | $ 408,473 | $ 1,663 | $ 410,136 | $ 620,546 | $ 491 | $ 621,037 | $ 690,401 | $ (1,607) | $ 688,794 |

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*Cash Flow Data*

The Restatement Adjustments had no impact on net cash from operating activities or on investing or financing cash flows for the periods presented and no impact on the Company s total cash balances. The table below shows the amount of changes in certain captions within the operating section of the cash flow statement due to the Restatement Adjustments. The net impact of these changes on operating cash flow was zero. For a side by side comparison of the previously reported amounts with the restated amounts, see Note 1A to the consolidated financial statements included in Item 8 of this report.

increase (decrease) in thousands

| | Fiscal Year Ended | | |
|---|---|---|---|
| | **Jan. 29, 2006** | **Jan. 30, 2005** | **Jan. 25, 2004** |
| **Cash flows from operating activities:** | | | |
| Net Income | $ (1,094) | $ (3,980) | $ (6,668) |
| Adjustments to reconcile net income to net cash provided by operations: | | | |
| Stock based compensation | 1,442 | 5,471 | 9,113 |
| Deferred income taxes | 1,744 | 437 | (1,294) |
| Tax benefit of stock option exercises | (2,177) | (2,094) | (1,272) |
| Changes in inventory | 85 | 166 | 121 |
| **Net cash provided by operations** | | | |
| **Net cash provided by (used in) investing activities** | | | |
| **Net cash used in financing activities** | | | |
| **Net increase (deccrease) in cash and cash equivalents** | | | |
| **Cash and cash equivalents at end of period** | | | |

*Interim Financial Statements*

The impact of the Restatement Adjustments on our previously reported interim results was to decrease income from operations by approximately 11% in the first quarter, 7% in the second quarter, 6% in the third quarter, and 7% in the fourth quarter of fiscal year 2005 and approximately 5% in each of the first two quarters, 3% in the third quarter, and less than one-half of one percent in the fourth quarter of fiscal year 2006. A side by side comparison of previously reported results with the restated results for each of the eight quarterly periods ended January 29, 2006 is presented in Note 21 of the financial statements included in Item 8 of this report.

*Tax Matters*

The recognition of additional non-cash stock-based compensation expense reduced the tax provision for fiscal year 2006 from $11.7 million to $11.2 million and it was further reduced to $11.1 million by the Audit Adjustments. The recognition of additional non-cash stock-based compensation expense reduced the tax provisions for fiscal years 2005 and 2004 from $17.4 million to $15.7 million and from $10.3 million to $7.7 million, respectively.

As a result of the determination that certain grants were issued in prior periods with exercise prices below the market price of our stock on the actual grant date, we have evaluated potential tax consequences under Sections 162(m) and 409A of the Internal Revenue Code (IRC). Section 409A was effective as of January 1, 2005.

We have determined that certain non-cash stock-based compensation expense deducted on our income tax returns for some prior periods was not qualified performance based compensation, as defined in IRC Section 162(m). Our federal and state net operating loss carryforwards have been reduced to reflect this determination. The cumulative effect of this change was to reduce the federal and state non-current deferred tax assets by $9.6 million, of which $1.7 million relates to periods before fiscal year 2002 and $7.9 million relates to fiscal year 2002. We have established a contingency reserve of approximately $96,000 to reflect the anticipated tax, penalties and interest associated with these adjustments. Of this amount, approximately $60,000 is recognized in beginning retained earnings for fiscal year 2002 and approximately $36,000 is recognized as expense in fiscal year 2002.

As applied to stock options, Section 409A generally requires income recognition prior to the exercise date, if the option was granted with an exercise price below the fair market value on the date of grant. To the extent that the Company was required to withhold and remit, and failed to withhold and remit, payroll taxes upon income recognition, the

Company is subject to substantial penalties and interest charges. The Company has determined that nearly all of the options subject to 409A had no recognizable income on each of the relevant tax measurement dates. Accordingly, the impact of penalties and interest for failure to withhold and remit payroll taxes does not have a material impact on the Company s financial statements for fiscal years 2005 or 2006.

Certain transition rules are in effect that allow remediation of the condition that subjects an option to Section 409A. To be effective, the remediation with respect to executive level employees must have been completed by December 31, 2006 and must be complete for other employees by December 31, 2007. The Company has not taken any actions to remediate these options, since the material options that have been determined to be subject to 409A were issued at exercise prices that are substantially higher than the current price of the Company s stock. Therefore, the future impact of Section 409A is not expected to present a material exposure to the Company under these transitional rules. However, exposure for this item can not ultimately be determined until final guidance is issued. If the final guidance differs significantly from the guidance published to date, the Company s exposure could be material.

(VI) Judgments and Interpretations

To calculate the additional stock-based compensation expense to record, we had to make assumptions and interpretations and draw conclusions about factual, legal, and accounting matters. There is the risk that these assumptions, interpretations, and conclusions could be incorrect or could be disputed by others.

*Assumptions, interpretations and conclusions as to facts*

The risk of an incorrect assumption, interpretation or conclusion as to facts is intensified in situations where the documentation is incomplete. If documentation was incomplete, all reasonably available relevant information was considered in forming conclusions as to the most likely actions that occurred and the dates on which those actions occurred. This is in accordance with a September 19, 2006 letter from the SEC s Office of the Chief Accountant ( OCA Letter ).

Incomplete documentation was an issue particularly with respect to the grants in categories A and C. In category A, there was inadequate contemporaneous evidence to corroborate the stated grant dates for grants made by the Former CEO to continuing employees. This lack of corroboration, when considered with the significant prevalence of evidence that other grants in this category were manipulated and the fact that the control environment, in terms of compensating controls, was the same throughout the period, led to the conclusion that the measurement date should be revised for all grants in Category A. Grants in category C lacked evidence of Compensation Committee ratification. Available relevant information, including personnel records and Compensation Committee records, was used to determine the most likely grant date.

The risk of an incorrect assumption, interpretation or conclusion as to facts also extends to the Special Committee s findings, including those regarding individual behavior. It is important to note that the Former CEO and Former HR VP, who have been determined to be central to the matters under investigation, declined to be interviewed by the Special Committee. The Special Committee and its legal advisors and forensic accountants had to make numerous judgments and assumptions in the process of gathering, reviewing and evaluating the evidence, beginning with the selection of methods to ascertain the available body of evidence and the selection of paper and electronic documents for further examination. The Special Committee also made assumptions and judgments with respect to other matters, such as the credibility of witnesses, the intent behind the wording of emails and other documents, whether and to what extent documents were received, read, or understood by the intended recipients, and the probable date of undated documents.

*Legal interpretations and conclusions*

We made certain legal interpretations regarding, among other things, the requirements under Delaware law for the granting of stock options, the effectiveness of actions taken by our Board and the Compensation Committee, and the status of certain individuals as employees.

*Accounting interpretations and conclusions*

We also made a number of judgments with respect to accounting matters, including interpreting relevant accounting rules and literature and applying those interpretations to our facts and circumstances. For each category A through F we had to interpret and apply APB 25 and related accounting guidance. Specifically, we had to make a determination of the correct measurement date, which APB 25 defines as the first date on which are known both the option price and the number of shares that an individual employee is entitled to receive.

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In coming to our conclusions regarding the correct measurement dates for the grants in each of the categories, we evaluated possible alternatives in situations where there appeared to be more than one potentially feasible measurement date. In choosing from among the alternatives, our conclusions were ultimately based on our good faith assessment of the facts and circumstances and our best effort application of accounting principles to those facts and circumstances. Some of the alternatives considered would have increased the additional non-cash compensation expense and some would have decreased it. In some cases, proposed alternatives were rejected as inappropriate without measuring the impact on the compensation expense on those dates because the alternatives were clearly not viable.

For category A *Grants made by Former CEO from April 1997 to May 2002 to Existing Employees*, we considered three possible measurement dates in addition to the selected date (Compensation Committee Ratification). Identified alternatives considered, but ultimately rejected, included the date of SEC Form 4 filings for employees subject to Section 16 of the Securities Act of 1934, the date that grant data was entered into the Company s option management database, and the date grant notification paperwork was generated and distributed. The Form 4 dates were not selected because Form 4s were filed prior to the date of the Compensation Committee approval on only two occasions, there is evidence that changes were made to grants up to the date of the Compensation Committee meeting and there is evidence that other Form 4s had been filed in error. The date of data entry into the option database was not selected because awards are entered into the system near the end of the quarter, in support of preparation of the quarterly financial statements, and there is no correlation between the date information is entered into the database and the date of grant. We concluded that the grant notification paperwork date was not an appropriate measurement date after considering the informal nature of the notification process, the fact that notification regarding the grant details does not occur simultaneously for all employees, and the lack of accurate tracking logs for the period under review. After considering these alternatives against the relative certainty associated with the Compensation Committee approval date, we determined the date of Compensation Committee approval was the correct measurement date for grants in category A.

With respect to the notification process discussed above, we also note that prior to the Company s implementation of SFAS 123(R), which is discussed in this Item 7 under the heading Recently Issued Accounting Standards, the Company did not believe that notification was a requirement for establishing a measurement date under APB 25, so it had no reason to gather or maintain evidence of the notification date. Based on the review of historical practices, the Company has concluded that it was likely that notification took place within a reasonable time period of the APB 25 measurement date. Thus, using an analogy to FASB Staff Position No. 123R-2, both the consolidated financial statements included in Item 8 of this Report and the SFAS 123 pro-forma footnote included in Note 1 to those financial statements use the APB 25 measurement date.

For category B *Grants to new employees,* we considered using the hire date as the measurement date for all grants in the category, but rejected that concept because there is evidence of management s willingness to intentionally select favorable grant dates for new hires from April 1997 through August 2002 and a majority of the new hires during this period received options on dates after the hire date. The correct measurement date was determined to be the later of the date that the Compensation Committee approved these grants or the date of employment, since that is the first date for which we can confirm that the elements of APB 25 were satisfied. If the hire date had been used for all grants in this category, the pretax restatement charge would have been reduced by approximately $7.4 million.

*Grants lacking evidence of Compensation Committee approval* (category C) were individually evaluated using all available information in order to compile the most comprehensive set of facts and determine the most likely measurement date. Given the lack of complete information, we evaluated alternative measurement dates. Specifically, we made a judgment that the most likely period in which the grant terms were finalized began with the grant date (or earlier hire date, if applicable) and ended with the filing date of the quarterly or annual financial statements that reflect the shares with no record of approval. We then calculated the impact on compensation expense using the hire date (when applicable) and the period high share price. The pretax restatement charge would have increased by approximately $112,000 if the hire date were used for all new hire grants in this category. Use of the period high share price for all grants in this category would have increased the pretax restatement charge by approximately $628,000. We rejected the use of an arbitrary standardized measurement date for grants in this category and instead determined measurement dates based on individual analysis of the facts and circumstances surrounding each grant.

In category D *Grants modified after ratification by the Compensation Committee*, the list attached to the final Compensation Committee meeting minutes, which were ratified at the next meeting, differed from the list that was originally submitted for approval. Upon identification of the exceptions, we reassessed our primary conclusion that all

grants from the 23 grant dates involved were finalized when they were submitted to the Compensation Committee. Each modification was investigated and evaluated and, based on this reassessment, we concluded that the errors are administrative in nature and not indicative of an open-allocation process, except for (i) one grant date in May 1999 for which there is evidence indicating the grant process for ten employees in two departments was incomplete on the award approval date, (ii) 21 grants to continuing employees on one grant date in May 2000 for which the grant process was found to be incomplete on the award approval date, and (iii) five grants to new hires on one grant date in December 2000 that were made prior to the employees start dates.

With respect to (i), after concluding that the May 1999 grant process was incomplete for the ten identified employees in two departments, we revised the measurement date for all grants to employees in those departments from the May 1999 Compensation Committee meeting to the date of the next Compensation Committee meeting in September 1999. Based on our evaluation of the unique facts surrounding the modified grants, we concluded that an open-allocation process did not exist outside of these two departments. Therefore, the correct measurement date for grants to employees in other departments is the date of the May 1999 Compensation Committee meeting. In forming these conclusions about the correct measurement date for the May 1999 grants, we considered relevant guidance in the OCA Letter about changes subsequent to the award date. Given the level of judgment required in reaching these conclusions, we considered two alternatives for the May 1999 grant. The first assumed only the grants for the ten employees were modified and the second assumed grants for all employees were modified. If the first alternative had been selected, the pretax restatement charge would have been decreased by approximately $1.2 million; if the second alternative had been selected, the pretax restatement charge would have increased by approximately $2.6 million. These alternatives, representing each end of the spectrum, were rejected in favor of the less arbitrary and more reasoned approach described above.

With respect to (ii), if we had revised the measurement date only for the 21 grants that were modified after the Compensation Committee meeting rather than for all employees who were on the second quarter grant list, the additional pre-tax compensation expense would have been reduced by $7.8 million.

With respect to (iii), if we had used the hire date as the measurement date for the five grants to new hires on one grant date in December 2000, rather than the date of the Compensation Committee meeting, the additional pre-tax compensation expense would have increased by approximately $81,000.

For category E *Post-Employment Arrangements,* we considered the provisions of APB 25, FASB Interpretation No. 44 *Accounting for Certain Transaction involving Stock Compensation*, and other relevant accounting literature regarding modification of options. We concluded that because options held by employees continued to vest and the time in which to exercise vested options was extended, option modifications occurred for the grants in this category. For the options affected by these 21 agreements, the modification date is the date the Company notified the employee of their leave of absence status or changed employment status, including the related modification to the terms of the grant. The measurement date for the modification to the grants affected by these agreements is the modification date. Given the level of factual information available and the accounting guidance on this issue, we did not assess alternative measurement dates for the modification other than with respect to the on-call agreements. One executive exercised all his vested options one week after entering into an on-call agreement. That is, he exercised them within the original time period permitted by the award agreements. The other executive exercised a portion of his vested options within the original time permitted. Had we concluded that these vested shares were not modified by the on-call agreements, compensation expense would have been reduced by approximately $10.7 million with respect to the first employee and $1.1 million with respect to the second employee.

With respect to category F *Pricing Exceptions*, we concluded, and our accounting advisors and the Special Committee s forensic accountant have concurred, that using the prior date closing methodology set forth in our 1994 stock option plans to determine the exercise price and measure the compensation cost of our employee stock options was reasonable and acceptable, even though establishing the exercise price in this manner was inconsistent with the terms of our later option plans, which call for using the weighted-average traded price on date of grant. Compensation cost for the options in this category has been remeasured using the prior day closing price. Therefore, compensation cost for all grants during the restatement period has been measured using the prior day closing price methodology. In October 2006, the Board also concurred with the conclusion and ratified past use of the prior date closing methodology.

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(VII) Going Forward
Going forward, we do not expect the restatement or the underlying circumstances to have an impact on our fundamental business operations, except to the extent of the disruption caused by the resignations described above and the associated loss of corporate history and knowledge base. Although the financial statement impact of adjustments for past option practices will be immaterial in fiscal year 2007 and future years, we have incurred, and will continue to incur, significant accounting, consulting and legal fees related to the restatement and associated matters such as government inquiries and litigation. These expenses are expected to be significant for some time. We may also incur significant expense with respect to claims by optionees who were prohibited from exercising expiring or lapsing options during the restatement process. See Note 19 to the consolidated financial statements in Item 8 of this report for additional information about the SEC inquiry and other matters associated with the restatement and its underlying circumstances.

In keeping with our goal of continuous improvement in all areas of our business, we have improved our system of internal controls in recent years. See the discussion under Item 9A *Controls and Procedures* regarding some of the changes to our practices implemented prior to fiscal year 2006. Since the end of fiscal year 2006, we have instituted, or are instituting, additional changes to further enhance our entity level controls, controls with respect to stock options, and our corporate governance practices. Some of these modifications reflect recommendations made by the Special Committee. These improvements include the establishment of an internal audit function in February 2006, the addition of two new independent directors in October 2006, and the Board s adoption of a policy in November 2006 that clarifies its views as to matters requiring prior Board review and provides guidance to the Chief Executive Officer and senior management in identifying matters to be brought to the Board s attention.

We believe that the past intentional manipulation of the stock option granting process discussed above is contrary to the high ethical standards we endeavor to apply to all aspects of our operations. In the second quarter of fiscal year 2007, our senior management formalized a set of Core Values to complement the Code of Conduct adopted in 2004. These Core Values, which have been disseminated to all employees, include *Honesty and Integrity in All We Do*. To the extent portions of the restatement were due to lack of understanding, documentation or procedural lapses, and/or administrative errors, we are recommitted to excellence in carrying out job functions at every level.

Having completed its work, the Special Committee will stand down and be dissolved upon the filing of this Form 10-K/A and the FY2007 Form 10Qs.

We intend to honor the exercise price of options specified in outstanding executory award agreements, except as to those options that the Special Litigation Committee has directed be cancelled or modified.

*The remainder of Management s discussion and analysis set forth below has been amended to reflect the restatement and the minor fiscal year 2006 Audit Adjustments as described above in the Explanatory Note and in Notes 1A, 19 and 20 to the Consolidated Financial Statement included in Item 8. It has not been otherwise substantively updated.*

**Overview**

We design, produce and market a broad range of products that are sold principally to customers in the computer, communications and industrial markets for a wide variety of end applications. Computer end market applications include notebook and desktop computers, computer graphics, and personal digital assistants (PDAs). Products within the communications market include products for set-top boxes, local area networks, metro and wide area networks, cellular phones and base stations. Industrial and other applications include automated test equipment (ATE), power supplies, hearing aids and other medical devices, and meter reading and factory automation systems. Our end-customers are primarily original equipment manufacturers and their suppliers, including Alcatel, Apple, Agilent, Cisco, Compal Electronics, Dell, Hewlett Packard, IBM, Intel, LG Electronics, Motorola, Phonak, Quanta Computer, Samsung, Siemens, Sony and Unisys.

We recognize product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable. Product design and engineering revenue is recognized during the period in which services are performed. We defer revenue recognition on shipment of certain products to distributors where return privileges exist until the products are sold through to end-users. Gross profit is equal to our net sales less our cost of sales. Our cost of sales includes materials, depreciation on fixed assets used in the manufacturing process, shipping costs, direct labor and overhead. We determine the cost of inventory by the first-in, first-out method. Our

operating costs and expenses generally consist of selling, general and administrative (SG&A), product development and engineering costs (R&D), costs associated with acquisitions, and other operating related charges.

Most of our sales to customers are made on the basis of individual customer purchase orders. Many customers include liberal cancellation provisions in their purchase orders. Trends within the industry toward shorter lead-times and just-in-time deliveries have resulted in our reduced ability to predict future shipments. As a result, we rely on orders received and shipped within the same quarter for a significant portion of our sales. Sales made directly to original equipment manufacturers during fiscal year 2006 were 43% of net sales. The remaining 57% of net sales were made through independent distributors.

We divide and operate our business based on two reportable segments: Standard Semiconductor Products and Rectifier, Assembly and Other Products. We evaluate segment performance based on net sales and operating income of each segment. We do not track segment data or evaluate segment performance on additional financial information. We do not track balance sheet items by individual reportable segments. As such, there are no separately identifiable segment assets nor are there any separately identifiable statements of income data (below operating income). The Standard Semiconductor Products segment makes up the vast majority of overall sales and includes our power management, protection, test and measurement, advanced communications and wireless and sensing product lines. The Rectifier, Assembly and Other Products segment includes our line of assembly and rectifier devices, which are the remaining products from our founding as a supplier into the military and aerospace market.

Our business involves reliance on foreign-based entities. Most of our outside subcontractors and suppliers, including third-party foundries that supply silicon wafers, are located in foreign countries, including China, Malaysia, Korea, the Philippines and Germany. For the fiscal year ended January 29, 2006, approximately 58% of our silicon, in terms of finished wafers purchased, was manufactured in China. Foreign sales for fiscal year 2006 constituted approximately 73% of our net sales. Approximately 90% of foreign sales in fiscal year 2006 were to customers located in the Asia-Pacific region. The remaining foreign sales were primarily to customers in Europe, Canada, and Mexico.

**Acquisition**

On June 23, 2005, we acquired through our wholly-owned Swiss subsidiary, Semtech International AG, all of the outstanding shares of XEMICS SA (XEMICS) in a cash-for-stock transaction pursuant to a share purchase and sales agreement. Following the acquisition we changed the name of the company from XEMICS SA to Semtech Neuchatel SA (Semtech Neuchatel).

Semtech Neuchatel is a research and development intensive company based in Switzerland that applies low-power, low-voltage design expertise across its core technologies, namely sensor interfacing/data acquisition, 8-bit RISC microcontrollers, radio frequency transceivers and audio converters. These capabilities are aimed at adding value in next generation, highly integrated battery powered wireless and sensing applications. Semtech Neuchatel, which continues to operate from its Switzerland location, is also referred to as our Wireless and Sensing Products product line and is included in the Standard Semiconductor Products Segment.

We believe this acquisition strategically enhances our competitive edge in developing high-performance analog ICs. The acquired company offered proprietary technology (including patents and other exclusive IP), access to applied research, and an existing business to combine with our market presence and capital resources, existing relationships with industry leaders, and worldwide infrastructure of sales, marketing and manufacturing resources. The addition of XEMICS represents a convergence of technology between our key analog disciplines of power management and over-voltage protection and XEMICS s core capabilities in designing ultra low power building blocks. We believe that the acquisition of XEMICS broadens our capabilities and that the integration of its core functions with ours will be critical in winning new designs. Since the acquisition, we have worked to integrate Semtech Neuchatel into our organization in the areas of information systems, accounting and financial reporting, quality, and operational procedures. We have also trained our sales force on targeted applications for this product line.

In addition to the $ 43.0 million we paid to the selling shareholders of XEMICS in June 2005, the acquisition contract provides for the possibility of additional payments of up to $16.0 million if Semtech Neuchatel meets certain performance objectives during an earn-out period of approximately one year that ends on April 30, 2006. Any earn-out would be payable, at the earliest, in the second quarter of fiscal year 2007. The payment could occur in a later quarter if

there is any dispute surrounding the calculations underlying the adjustment. Although the earn-out period has not yet ended, based on period-to-date performance against the targeted objectives, we do not believe any earn-out will be payable to the selling shareholders.

The former XEMICS shareholders made certain representations, warranties and covenants with respect to the financial condition of XEMICS and other matters. A portion of the purchase price was not immediately disbursed to the selling shareholders but is being held in escrow for fifteen months after the closing to ensure some funds are available in the event liability attaches to the selling shareholders as a result of a breach of the representations and warranties. Six of the selling shareholders will remain liable for five years after the closing as to certain representations related to organization, capital structure, and tax matters. The share purchase and sales agreement provides for certain conditions and limitations on the selling shareholders liability. We have not made any claims against the escrow account, but continue to monitor and assess whether there are any qualifying items in excess of the threshold for making a claim.

Consistent with purchase accounting treatment of the acquisition, we included XEMICS results of operations subsequent to the close of the transaction on June 23, 2005 in our consolidated results of operations. We also assumed the assets and liabilities of XEMICS as of the closing date.

During the second quarter of fiscal year 2006 a one-time acquisition related charge to earnings of $4.0 million was recorded for the write-off of in-process research and development. From the close date of June 23, 2005 until the end of our fiscal year 2006 on January 29, 2006, we incurred $954,000 of expense for amortization of other intangible items. The remaining $5.5 million balance of other intangible items as of end the end of fiscal year 2006 will be amortized over future periods. There are no tax-related benefits from these acquisition related costs.

Additional information regarding the acquisition is provided in this Item 7 under the caption *Critical Accounting Policies and Estimates* and in Note 18 to the financial statements included in this report.

**Insurance Settlements**

In March 2003, we announced that we resolved a customer dispute. Under the terms of the settlement, we agreed to pay the customer $12.0 million in cash in two equal annual installments, plus rebates on the future purchase of certain products by the customer through the end of March 2005. At the time of the customer settlement, we stated that we would vigorously pursue insurance coverage for the full value of the settlement. We subsequently filed lawsuits against three of our insurance companies and reached settlements with two of the three insurance companies in the second quarter of fiscal year 2006. We recorded a $3.0 million gain in fiscal year 2006 for these insurance settlements. In fiscal year 2006, we also recorded $2.9 million of related legal expenses under the operating expense category of selling, general and administrative. The case against the remaining insurance company is expected to go to trial sometime in fiscal year 2007. We are unable to predict if settlement will be reached prior to trial. There is no assurance that we will prevail at trial or that the insurance company will not appeal if we do prevail. Legal fees and expenses related to pursuit of the insurance recovery have been, and will continue to be, expensed in the period incurred. If the settlement amount or amount awarded at trial is less than we seek, if we fail to prevail at trial, or if we or the insurance company appeal the decision, total legal expenses associated with the litigation may exceed the amount recovered from the insurance companies.

Additional information regarding the insurance settlements is provided in Note 12 to the financial statements included in this report.

**Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires us 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 the reported amounts of revenues and expenses during the reporting period.

On an ongoing basis, we evaluate and discuss with our audit committee our estimates, including those related to our allowance for doubtful accounts and sales returns, inventory reserves, asset impairments and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the

circumstances, which together form the basis for making judgments about the carrying values of assets and liabilities. Our critical accounting policies and estimates do not vary between our two reportable segments. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies, among others, affect the significant judgments and estimates we use in the preparation of our consolidated financial statements:

Accounting for Temporary and Long-Term Investments

Our temporary and long-term investments consist of government, bank and corporate obligations. Temporary investments mature within twelve months of the balance sheet date. Long-term investments have maturities in excess of one year from the date of the balance sheet. We classify our investments as available for sale because we expect to possibly sell some securities prior to maturity. We include any unrealized gain or loss, net of tax, in the comprehensive income portion of our Consolidated Statements of Stockholders Equity.

Allowance for Doubtful Accounts

We evaluate the collectibility of our accounts receivable based on a combination of factors. If we are aware of a customer s inability to meet its financial obligations to us, we record an allowance to reduce the net receivable to the amount we reasonably believe we will be able to collect from the customer. For all other customers, we recognize allowances for doubtful accounts based on the length of time the receivables are past due, the current business environment, the size and number of certain large accounts and our historical experience. If the financial condition of our customers were to deteriorate or if economic conditions worsen, additional allowances may be required in the future.

Revenue Recognition

We recognize product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable. We defer revenue recognition on shipment of products to certain customers, principally distributors, where return privileges exist until these products are sold through to end-users or the return privilege lapses. The estimated deferred gross margin on these sales, where there are no outstanding receivables, are recorded on the balance sheet under the heading of Deferred Revenue. We record a provision for estimated sales returns in the same period as the related revenues are recorded. We base these estimates on historical sales returns and other known factors. Actual returns could be different from our estimates and current provisions for sales returns and allowances, resulting in future charges to earnings.

Inventory Valuation

Our inventories are stated at lower of cost or market and consist of materials, labor and overhead. We determine the cost of inventory by the first-in, first-out method. At each balance sheet date, we evaluate our ending inventories for excess quantities and obsolescence. This evaluation includes analyses of sales levels by product and projections of future demand. In order to state our inventory at lower of cost or market, we maintain reserves against our inventory. If future demand or market conditions are less favorable than our projections, a write-down of inventory may be required, and would be reflected in cost of goods sold in the period the revision is made.

Contingencies and Litigation

We are involved in various disputes and litigation matters as a claimant and as defendant. We record any amounts recovered in these matters when collection is certain. We record liabilities for claims against us when the losses are probable and estimable. Any amounts recorded are based on reviews by outside counsel, in-house counsel and management. Actual results may differ from estimates.

Stock-Based Compensation

In fiscal years 1997 through 2006, we included in the Notes to our Consolidated Financial Statements a pro forma

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disclosure of the impact stock options would have on net income (loss) using the fair value stock option expense recognition method, as allowed under Statement of Financial Accounting Standards No. 123 and using an intrinsic value method, as prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees . Also see Notes 1A and 19 to the Consolidated Financial Statements with respect to non-cash stock-based compensation expense recognized due to correction of the accounting measurement dates for certain stock options granted or modified primarily during fiscal years 1998 through 2003.

A revised standard, SFAS No.123 (revised 2004), Share Based Payment ( SFAS 123(R) ), which requires all companies to measure compensation cost for all share-based payments (including stock options) at fair value, is effective beginning with a company s first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005. This means SFAS 123(R) is effective for us beginning with the first quarter of fiscal year 2007, which began on January 30, 2006. The adoption of SFAS 123(R) requires us to apply a valuation model, which includes estimates and assumptions on the rate of forfeiture and expected life of options and stock price volatility. Actual results may differ from estimates. See Note 1 to the Consolidated Financial Statements for additional information regarding the adoption of SFAS 123 (R).

Goodwill and Intangible Assets

The Company accounts for goodwill and other intangible assets in accordance with SFAS No. 142, Goodwill and Other Intangible Assets ( SFAS 142 ). Goodwill is recorded at the time of an acquisition and is calculated as the difference between the aggregate consideration paid for an acquisition and the fair value of the net tangible and intangible assets acquired.

Accounting for acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired, including in-process research and development (IPR&D). Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to annual impairment tests. The amounts and useful lives assigned to other intangible assets impact the amount and timing of future amortization, and the amount assigned to IPR&D is expensed immediately. If the assumptions and estimates used to allocate the purchase price are not correct, or if business conditions change, purchase price adjustments or future asset impairment charges could be required.

Impairment of Goodwill and Other Intangible Assets

In accordance with SFAS 142, the Company tests goodwill for impairment on an annual basis or more frequently if the Company believes indicators of impairment exist. The value of our intangible assets, including goodwill, could be impacted by future adverse changes such as: (i) any future declines in our operating results, (ii) a decline in the valuation of technology company stocks, including the valuation of our common stock, (iii) a significant slowdown in the worldwide economy and the semiconductor industry or (iv) any failure to meet the performance projections included in our forecasts of future operating results. We evaluate these assets, including purchased intangible assets deemed to have indefinite lives, on an annual basis or more frequently if indicators of impairment exist. In the process of our annual impairment review, we primarily use the income approach methodology of valuation that includes the discounted cash flow method as well as other generally accepted valuation methodologies to determine the fair value of the assets. Significant management judgment is required in the forecasts of future operating results that are used in the discounted cash flow method of valuation. The estimates we have used are consistent with the plans and estimates that we use to manage our business. It is possible, however, that the plans and estimates used may be incorrect. If our actual results, or the plans and estimates used in future impairment analysis, are lower than the original estimates used to assess the recoverability of these assets, we could incur additional impairment charges in a future period.

The Company accounts for other purchased intangible assets, in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ( SFAS 144 ), which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment, such as reductions in demand or significant economic slowdowns in the semiconductor industry, are present. Reviews are performed to determine whether the carrying value of an asset is impaired, based on comparisons to undiscounted expected future cash flows. If this comparison indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using: (i) quoted market prices and/or (ii) discounted expected future cash flows utilizing a discount rate consistent with the guidance provided in FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements. Impairment is based on the excess of the carrying amount over the fair value of those assets.

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In-Process Research and Development

In-process research and development (IPR&D) expense totaled $4.0 million during fiscal year 2006. The amount allocated to IPR&D was determined through established valuation techniques used in the high technology industry and was expensed upon acquisition as it was determined that the underlying project had not reached technological feasibility and no alternative future uses existed. In accordance with SFAS No. 2, Accounting for Research and Development Costs , as clarified by FIN No. 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method , an Interpretation of FASB Statement No. 2, amounts assigned to IPR&D meeting the above-stated criteria were charged to expense as part of the allocation of the purchase price.

The fair value of the acquired IPR&D was determined using the income approach. Under this approach, the expected future cash flows for the project under development are estimated and discounted to their net present value at an appropriate risk-adjusted rate of return. Significant factors considered in the calculation of the rate of return are the weighted-average cost of capital and return on assets, as well as the risks inherent in the development process, including the likelihood of achieving technological success and market acceptance. The unique technological innovations, the existence and reliance on core technology, the existence of any alternative future use or current technological feasibility, and the complexity, cost and time to complete the remaining development were considered. Future cash flows were estimated based on forecasted revenue and costs, taking into account product life-cycles, market penetration and growth rates.

The following table summarizes the key assumptions of the acquired IPR&D project as of the acquisition date:

| Development project | Wireless & sensing chips and protocols |
|---|---|
| Average estimated percent complete | 23% |
| Average estimated time to complete | 1.5 years |
| Estimated cost to complete (in millions) | $3.9 |
| Risk adjusted discount rate | 25% |
| IPR&D (in millions) | $4.0 |

As of the acquisition date, the cost to complete development was estimated to be $3.9 million and revenue related to the acquired IPR&D was projected to begin in the fourth quarter of fiscal year 2007. As a result of a shift in strategic market positioning, R&D priorities were revised and related resources were reallocated, resulting in a reduction in development activity and a delay in projected release to market of certain IPR&D related products. Current projections with respect to estimated cost and effort to complete are consistent with the original assumptions. However, the shift in priorities is expected to reduce cash flow from IPR&D related projects by approximately $1.8 million over the next three years. The assumptions consist primarily of expected completion dates, estimated cost to complete, and revenue and expense projections for the product once it enters the market.

Accounting for Income Taxes

The SFAS 109, Accounting for Income Taxes , establishes financial accounting and reporting standards for the effect of income taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity s financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our financial position or our results of operations.

As part of the process of preparing our consolidated condensed financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax liability together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated

balance sheet. We must assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. Generally, to the extent we change the valuation allowance in a period, the change is recorded through the tax provision in the statement of operations. If a valuation allowance relates to benefits from stock option exercise activity, any adjustment to the valuation allowance would be recorded to paid-in-capital in the period of the adjustment. Any release of a valuation allowance established against a pre-acquisition XEMICS net operating loss carryforward will be recorded to goodwill. Management continually evaluates our deferred tax assets to assess whether it is likely that the deferred tax assets will be realized.

We are subject to income taxes in the United States and numerous foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax impact is uncertain. The calculation of tax liabilities involves dealing with uncertainties in the application of complex tax laws. We recognize probable liabilities for anticipated tax audit issues in the United States and other tax jurisdictions based on an estimate of the ultimate resolution of whether, and the extent to which, additional taxes may be due. As a result of the restatement, our tax contingency reserve increased from $1.2 million to $1.3 million, to reflect the estimated tax, penalties and interest related to the impact of certain option grants that were issued in prior periods with exercise prices below the market price of our stock on the actual grant date.

Although we believe the estimates are reasonable, no assurance can be given that the final outcome of these matters will not be different than what is reflected in the historical income tax provisions and accruals. Should additional taxes be assessed as a result of an audit or litigation, a material effect on our income tax provision and net income in the period or periods for which that determination is made could result.

In addition to the risks to the effective tax rate discussed above, the effective tax rate reflected in forward-looking statements is based on current enacted tax law. Significant changes in enacted tax law could materially affect these estimates.

On October 22, 2004 the American Jobs Creation Act of 2004 (the Act ) was signed into law and creates a temporary incentive for U.S. corporations to repatriate foreign subsidiary earnings by providing an elective 85% dividends received deduction for certain dividends from controlled foreign corporations. The deduction is subject to a number of limitations and requirements, including adoption of a specific domestic reinvestment plan for the repatriated funds. On January 13, 2005 the U.S. Treasury published Notice 2005-10 providing guidance on the implementation of the repatriation deduction. We have not repatriated any funds under this Act.

**Results of Operations**

***Fiscal Year 2006 Compared With Fiscal Year 2005***

***Net Sales.*** Net sales for fiscal year 2006 were $239.3 million, a decline of 6% from $253.6 million for fiscal year 2005. Included in net sales for fiscal year 2006 were $14.8 million of incremental sales as a result of the June 2005 acquisition of XEMICS. Net sales for fiscal year 2005 had no sales contributions from XEMICS.

Semiconductor and electronics industry conditions improved in the second half of fiscal year 2006 compared to the first half of fiscal year 2006. Fiscal year 2005 was characterized by a strong first half, but a weaker second half of fiscal year 2005. Our quarterly sales levels reflected these periods of strength and weakness. Worldwide semiconductor sales grew in calendar year 2005 according to industry sources.

Presented below is our estimate of sales by end-market. End-products in the computer end-market include notebook and desktop computers, graphics applications, PDAs and computer gaming systems. Communications end products include cellular phone handsets, wireless base stations, set-top boxes, and networking, broadband and long-haul communications infrastructure equipment. The industrial/other products category includes traditional industrial and automation equipment, power supplies, military, aerospace and medical applications.

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(fiscal years, in thousands)

| | 2006 | | | | 2005 | | |
|---|---|---|---|---|---|---|---|
| **End-Markets** | **Previously Reported Net Sales** | **Audit Adjustments** | **Restated Net Sales** | **% total** | **Net Sales** | **% total** | **Change** |
| Computer | $ 71,079 | $ | $ 71,079 | 30% | $ 81,156 | 32% | -12% |
| Communications | 110,366 | | 110,366 | 46% | 121,734 | 48% | -9% |
| Industrial/Other | 57,960 | (67) | 57,893 | 24% | 50,722 | 20% | 14% |
| Net sales | $ 239,405 | $ (67) | $ 239,338 | 100% | $ 253,612 | 100% | -6% |

(1) For information regarding the Audit Adjustments, see Note 20 to the financial statements included in Item 8 of this report.

Within the computer end-market category, sales to notebook computer customers decreased by 18% during fiscal year 2006, sales of products used in desktop computers and servers were up 20%, and sales related to computer graphics/gaming systems were down about 70%. Sales in the communications category were most impacted by a 20% decline in sales of products used in cellular handsets that was partially offset by a greater than 15% increase in networking and communications infrastructure applications. The increase in the industrial end-market category reflected a 62% decline of sales into the automated test equipment (ATE) market, which was more than offset by a 96% increase in other industrial/other applications (primarily as a result of the June 2005 XEMICS acquisition).

Standard Semiconductor Products represented 96% of net sales in fiscal year 2006, with the Rectifier, Assembly and Other Products segment contributing the remaining 4%. Included in Standard Semiconductor Products net sales for fiscal year 2006 were $14.8 million of incremental sales as a result of the June 2005 acquisition of XEMICS. Standard Semiconductor Products net sales for fiscal year 2005 had no sales contributions from XEMICS.

Details on net sales by reportable segment are presented below.

(fiscal years, in thousands)

| | 2006 As restated (1)(2) | | 2005 | | |
|---|---|---|---|---|---|
| **Reportable Segment** | **Net Sales** | **% total** | **Net Sales** | **% total** | **Change** |
| Standard Semiconductor Products | $ 229,425 | 96% | $ 243,202 | 96% | -6% |
| Rectifier, Assembly and Other Products | 9,913 | 4% | 10,410 | 4% | -5% |
| Net Sales | $ 239,338 | 100% | $ 253,612 | 100% | -6% |

(1) Restated for $67,000, net of related tax effects, of Audit Adjustments. See Note 20 to the financial statements included in Item 8 of this report.

(2) For a side by side comparison of the previously reported amounts with the restated amounts, see Note 17 to the financial statements included in Iten 8 of this report.

The 6% decline in sales of Standard Semiconductor Products reflected the fall off in the key end-markets of notebook computers, cellular phones and ATE, which were only partially offset by strength in wireline, desktop computers and industrial applications.

Sales of our Rectifier, Assembly and Other Products declined by 5% in fiscal year 2006 due to weak demand for these older technology products which are used mostly in military and certain industrial applications.

***Gross Profit.*** Gross profit for fiscal year 2006 was $134.1 million, compared to $147.2 million for the prior year. This decrease was due to a 6% decline in net sales and a lower gross margin percentage compared to fiscal year 2005. Our gross margin was 56% for fiscal year 2006, down from 58% in fiscal year 2005. Our strategy is to develop new products that offer more advanced or more complex features than the competition, which in turn generally provides for higher gross margin. However, margin improvements may be offset by price erosion due to competition and other factors tied to industry conditions.

In fiscal year 2006 and fiscal year 2005, we sold $200,000 and $507,000, respectively, of inventory of the Standard Semiconductor Products segment that had been written-down during the second quarter of fiscal year 2002.

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***Operating Costs and Expenses*****.** Operating costs and expenses were $88.4 million for fiscal year 2006, up from $82.9 million in fiscal year 2005. Detailed below are the operating costs and expenses for fiscal years 2006 and 2005.

Restated (1)

(fiscal years, in thousands)

| | 2006 | | 2005 | | |
|---|---|---|---|---|---|
| | (restated) | | (restated) | | |
| **Operating Costs & Exp.** | **Costs/Exp.** | **% sales** | **Costs/Exp.** | **% sales** | **Change** |
| Selling, general and administrative | $ 45,471 | 19% | $ 47,564 | 19% | -4% |
| Product development and engineering | 37,928 | 16% | 35,312 | 14% | 7% |
| Acquisition related items | 4,954 | 2% | | 0% | N/A |
| Total operating costs and expenses | $ 88,353 | 37% | $ 82,876 | 33% | 7% |

(1) For a side by side comparison of the previously reported amounts with the restated amounts, see Note 1A of the financial statements included in Item 8 of this report.

The increase in operating costs and expenses in fiscal year 2006 reflects primarily a 7% increase in spending in the area of product development and engineering, also referred to as research and development (R&D), and was largely a result of the June 2005 acquisition of XEMICS. Also impacting fiscal year 2006 operating expenses were acquisition-related expense items, namely $4.0 million of written-off in-process research and development (see In-Process Research and Development above) and $954,000 of amortization of intangibles, all resulting from the acquisition of XEMICS (see Acquisition above and Note 18 to the financial statements included in this report). These increases were partially offset by a decline of $3.2 million in the amortization of intrinsic value related to prior period stock option grants.

Included in fiscal year 2006 operating expenses under the category of selling, general and administrative is a $3.0 million gain associated with insurance settlements and $2.9 million of related legal expenses for the year (see Insurance Settlements above and Note 12 to the financial statements included in this report).

As a percentage of net sales, operating costs were higher in fiscal year 2006 compared to fiscal year 2005 due to higher absolute spending and lower sales levels.

***Operating Income*****.** Operating income was $45.8 million in fiscal year 2006, down from operating income of $64.3 million in fiscal year 2005. Operating income was impacted by lower sales levels, lower gross margin and higher operating costs and expenses.

We evaluate segment performance based on net sales and operating income of each segment. Detailed below is operating income by reportable segment.

Restated

(fiscal years, in thousands)

| | 2006 | | 2005 | | |
|---|---|---|---|---|---|
| | (restated) | | (restated) | | |
| **Reportable Segment** | **Op. Income** | **% total** | **Op. Income** | **% total** | **Change** |
| Standard Semiconductor Products | $ 44,006 | 96% | $ 61,576 | 96% | -29% |

| | | | | | |
|---|---|---|---|---|---|
| Rectifier, Assembly and Other Products | 1,743 | 4% | 2,753 | 4% | -37% |
| Total operating income | $ 45,749 | 100% | $ 64,329 | 100% | -29% |

(1) For a side by side comparison of the previously reported amounts with the restated amounts, see Note 17 to the financial statements included in Iten 8 of this report.

(2) For information regarding the Restatement Adjustments and Audit Adjustments, see Notes 1A and 20 to the financial statements included in Item 8 of this report.

Operating income for the Standard Semiconductor Products decreased in fiscal year 2006 by 29% due to lower sales levels and higher operating costs and expenses. Operating income for the Rectifier, Assembly and Other Products declined by 37% in fiscal year 2006 due to lower sales and lower manufacturing efficiencies.

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***Interest and Other Income (Expense), Net.*** Interest and other income (expense), net was income of $7.3 million for fiscal year 2006, up from income of $6.3 million in fiscal year 2005. For fiscal years 2006 and 2005, a vast majority of interest and other income was interest income from investments.

The improvement in net interest and other income and expense in fiscal year 2006 was mostly due to higher rates of return on investments, that was partially offset by a $23.7 million decline in cash and investments that generate interest income.

***Provision for Taxes.*** The provision for income taxes was $11.1 million for fiscal year 2006, compared to $15.7 million in fiscal year 2005. The effective tax rates for fiscal years 2006 and 2005 were 21% and 22%, respectively. The decline is due to increased sales by our foreign-based subsidiaries that are in lower tax jurisdictions. Specifically, in the current period, we received a favorable tax ruling in a foreign jurisdiction regarding eligibility for a sales exclusion provision. This exclusion reduced our current period tax provision by approximately $2.4 million, of which approximately $2.1 million relates to the twelve-month period ending January 29, 2006 and approximately $259,000 relates to the fiscal year ending January 30, 2005.

***Fiscal Year 2005 Compared With Fiscal Year 2004***

***Net Sales.*** Net sales for fiscal year 2005 were $253.6 million, an increase of 32% over the $192.1 million for fiscal year 2004. Semiconductor and electronics industry conditions improved dramatically in the fiscal year, especially during the first half of the year. The significant increase in sales reflected both the strength of fiscal year 2005 and the general weakness that occurred during fiscal year 2004.

Presented below are the estimated sales by end-market. End-products in the computer end-market include notebook and desktop computers, graphics applications, PDAs and computer gaming systems. Communications include cellular phone handsets, wireless base stations, set-top boxes, and networking, broadband and long-hail communications infrastructure equipment. The end-market for industrial/other products includes traditional industrial and automation equipment, power supplies, military, aerospace and medical applications.

(fiscal years, in thousands)

| | 2005 | | 2004 | | |
|---|---|---|---|---|---|
| **End-Markets** | **Net Sales** | **% total** | **Net Sales** | **% total** | **Change** |
| Computer | $ 81,156 | 32% | $ 76,809 | 40% | 6% |
| Communications | 121,734 | 48% | 76,046 | 40% | 60% |
| Industrial/Other | 50,722 | 20% | 39,224 | 20% | 29% |
| Net sales | $ 253,612 | 100% | $ 192,079 | 100% | 32% |

Within the computer end-market category, sales to notebook computer customers increased more than 20% during fiscal year 2005, while sales of products used in desktop computers were down about 7% and computer graphics/gaming systems were down about 21%. Sales in the communications category were most impacted by a greater than 55% increase in sales of products used in cellular handsets and a greater than 60% increase in networking and communications infrastructure applications. The increase in the industrial end-market category reflected increased sales into the automated test equipment (ATE), which was up about 12%, and a greater than 50% increase in more broad-based industrial end-market segments.

Standard Semiconductor Products represented 96% of net sales in fiscal year 2005, while 4% were represented by the Rectifier, Assembly and Other Products segment. Details on net sales by reportable segment are presented below.

(fiscal years, in thousands)

| | 2005 | | 2004 | | |
|---|---|---|---|---|---|
| **Reportable Segment** | **Net Sales** | **% total** | **Net Sales** | **% total** | **Change** |
| Standard Semiconductor Products | $ 243,202 | 96% | $ 182,522 | 95% | 33% |
| Rectifier, Assembly and Other Products | 10,410 | 4% | 9,557 | 5% | 9% |

| Net Sales | $ 253,612 | 100% | $ 192,079 | 100% | 32% |
|---|---|---|---|---|---|

Increased sales of Standard Semiconductor Products reflected broad-based strength, especially in portable applications such as notebook computers and cellular phones, communications infrastructure and test systems applications.

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Sales of our Rectifier, Assembly and Other Products increased in fiscal year 2005 due to improved demand for these older technology products that are used in military, medical and certain industrial applications.

***Gross Profit*.** Gross profit for fiscal year 2005 was $147.2 million, compared to $109.4 million for the prior year. This increase was due to higher absolute sales levels in fiscal year 2005 and slightly higher gross margin on products sold. Our gross margin was 58% for fiscal year 2005, which was a slight increase compared to 57% for fiscal year 2004.

In fiscal years 2005 and 2004, we sold $507,000 and $1.4 million, respectively, of inventory of the Standard Semiconductor Products segment that had been written-down during the second quarter of fiscal year 2002.

***Operating Costs and Expenses*.** Operating costs and expenses were $82.9 million for the fiscal year 2005, up from $75.5 million in fiscal year 2004. Detailed below are the operating costs and expenses for fiscal years 2005 and 2004.

Restated (1)

(fiscal years, in thousands)

| | 2005 (restated) | | 2004 (restated) | | |
|---|---|---|---|---|---|
| **Operating Costs & Exp.** | **Costs/Exp.** | **% sales** | **Costs/Exp.** | **% sales** | **Change** |
| Selling, general and administrative | $ 47,564 | 19% | $ 42,190 | 22% | 13% |
| Product development and engineering | 35,312 | 14% | 33,319 | 17% | 6% |
| Total operating costs and expenses | $ 82,876 | 33% | $ 75,509 | 39% | 10% |

(1) For a side by side comparison of the previously reported amounts with the restated amounts, see Note 1A of the financial statements included in Item 8 of this report.

The increase in selling, general and administrative costs in fiscal year 2005 reflects higher headcount and added variable costs associated with higher sales levels. They also reflect increased legal expenses and the costs associated with compliance with new SEC regulations. The increase in product development and engineering costs, also referred to as research and development (R&D), was mostly due to higher spending related to salaries, variable compensation and increased new product development efforts. These increases were partially offset by a decline of approximately $1.8 million in the amortization of intrinsic value related to prior period stock option grants. As a percentage of net sales, operating costs were lower in fiscal year 2005 compared to fiscal year 2004 due to better efficiencies as sales levels increased.

***Operating Income*.** Operating income was $64.3 million in fiscal year 2005, up from operating income of $33.9 million in fiscal year 2004. Operating income was impacted by higher sales levels, a slight improvement in gross margin and better efficiencies on operating costs and expenses.

We evaluate segment performance based on net sales and operating income of each segment. Detailed below is operating income by reportable segment.

Restated (1)

(fiscal years, in thousands)

| | 2005 | 2004 | Change |
|---|---|---|---|

| Reportable Segment | (restated) Op. Income | % total | (restated) Op. Income | % total | |
|---|---|---|---|---|---|
| Standard Semiconductor Products | $ 61,576 | 96% | $ 31,774 | 94% | 94% |
| Rectifier, Assembly and Other Products | 2,753 | 4% | 2,161 | 6% | 27% |
| Total operating income | $ 64,329 | 100% | $ 33,935 | 100% | 90% |

(1) For a side by side comparison of the previously reported amounts with the restated amounts, see Note 17 to the financial statements included in Iten 8 of this report.

(2) For information regarding the Restatement Adjustments, see Note A to the financial statements included in Item 8 of this report.

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Operating income for the Standard Semiconductor Products increased in fiscal year 2005 due to higher sales levels and better efficiencies on operating costs and expenses. Operating income for the Rectifier, Assembly and Other Products segment improved in fiscal year 2005 due to higher sales and better manufacturing efficiencies.

***Interest and Other Income (Expense), Net.*** Interest and other income (expense), net was income of $6.3 for fiscal year 2005, up from net expense of $451,000 in fiscal year 2004. For fiscal year 2005, a vast majority of interest and other income was interest income from investments. In fiscal year 2004, interest and other income (expense), net was made of interest income on investment, a small amount of interest expense associated with our previously outstanding convertible subordinated notes, and gain and expense on the extinguishment of debt.

The improvement in net interest and other income and expense in fiscal year 2005 was mostly due to the absence of one-time cost of $6.8 million for the retirement of debt, partially offset by $2.9 million of gain on the extinguishment of debt that occurred in fiscal year 2004.

***Provision for Taxes.*** Provision for income taxes was $15.7 million for fiscal year 2005, compared to $7.7 million in fiscal year 2004. The effective tax rates for fiscal years 2005 and 2004 were 22% and 23%, respectively. The decline is due to increased sales by our foreign-based subsidiaries that are in lower tax jurisdictions.

**Liquidity and Capital Resources**

We evaluate segment performance based on net sales and operating income of each segment. We do not track segment data or evaluate segment performance or additional financial information. As such, there are no separately identifiable segment assets and liabilities.

On February 14, 2000, we completed a private offering of $400.0 million principal amount of 4 1/2% convertible subordinated notes. The notes were due in 2007 and were callable beginning in February of 2003. Through an ongoing buyback program, we had bought back and retired a portion of the convertible subordinated notes in open market transactions. On July 18, 2003, we called the remaining $165.0 million outstanding balance of the convertible subordinated notes.

As of January 29, 2006, we had working capital of $235.5 million, compared with $221.4 million as of January 30, 2005 and $217.3 million as of January 25, 2004. The ratio of current assets to current liabilities as of January 29, 2006 was 10.0 to 1, compared to 8.6 to 1 as of January 30, 2005 and 8.5 to 1 as of January 25, 2004. The increase in working capital as of January 29, 2006 compared to the prior year was most impacted by a $22.0 million increase in temporary investments. Cash and cash equivalents declined by $16.6 million during fiscal year 2006, in part as funds were invested in temporary investments. The small increase in working capital as of January 30, 2005 compared to the prior year was mostly the result of a modest $4.3 million increase in current assets, only slightly offset by a $155,000 increase in current liabilities.

Cash provided by operating activities was $65.1 million for fiscal year 2006, compared to $70.1 million for fiscal year 2005 and $35.8 million for fiscal year 2004. Net operating cash flows were impacted by non-cash charges for depreciation and amortization of $11.8 million, $9.8 million and $9.0 million in fiscal years 2006, 2005 and 2004, respectively. The Restatement Adjustments had no impact on net cash provided by operating activities or on investing, or financing cash flows for the periods presented and had no impact on the Company s total cash balances.

Net operating cash flows in fiscal year 2006 were positively impacted by net income of $42.0 million, a $3.3 million tax benefit from stock option exercises, a decrease of $7.1 million in deferred income taxes, the add back of a $4.0 million non-cash write-off of in-process research and development, a $4.2 million decline in inventories, a $2.5 million increase in other liabilities and other smaller items. These positive operating cash flow items were only partially offset by a $4.1 million decline in accrued liabilities, $2.8 million decline in income taxes payable, a $2.0 million increase in accounts receivable, a decline of $1.5 million associated with deferred revenue, a decline of $1.0 million in accounts payable and other smaller items.

Net operating cash flows in fiscal year 2005 were positively impacted by net income of $54.9 million, an $11.2 million tax benefit from stock option exercises, a decline of $5.8 million in income taxes refundable, a decline of $2.4 million in other liabilities and other smaller items. These positive operating cash flow items were only partially offset by a $15.0 million increase in other assets, a $5.2 million decline in accrued liabilities and smaller increases in receivables

and inventories. Net operating cash flows in fiscal year 2004 were most positively impacted by net income of $25.8 million and by a decline in deferred income taxes, loss on extinguishment of debt, increase in accounts payable, tax benefit from stock option exercises and declines in other assets. These were partially offset by increases in receivables, inventories, income taxes refundable, other assets, and declines in accrued liabilities, income taxes payable and other liabilities.

Investing activities used $46.0 million in cash in fiscal year 2006 compared to net cash used by investing activities of $58.4 million in fiscal year 2005 and net cash provided by investing activities of $164.2 million in fiscal year 2004. The largest cash outlay related to investing activities was the use of $42.4 million of cash to acquire XEMICS in June 2005. We spent $10.6 million on capital purchases in fiscal year 2006, and the net decrease in available-for sale investments contributed $7.0 million of cash to investing activities.

In fiscal year 2005, we spent $16.5 million on capital purchases and had a net increase of $42.1 million in available-for-sale investments. For fiscal year 2004, we spent $7.5 million on capital purchases and had a net decline of $171.6 million in available-for-sale investments. For fiscal years 2005 and 2004, investing activity included small amounts provided by the sale of property, plant and equipment.

Our financing activities used $35.9 million in cash during fiscal year 2006, compared to financing activities using $25.8 million during fiscal year 2005 and $241.0 million in the fiscal year 2004. Financing activities in fiscal year 2006 reflect $9.5 million of proceeds from stock option exercises and $3.0 million from the reissuance of treasury stock, which were more than offset by $46.9 million of cash used to repurchase common stock and $1.4 million used to pay off notes payable acquired as part of the XEMICS acquisition. Financing activities in fiscal year 2005 reflect the $11.4 million of proceeds from stock option exercises and $1.4 million from the reissuance of treasury stock, which were more than offset by $38.6 million of cash used to repurchase common stock. Financing activities in fiscal year 2004 reflect the proceeds from stock option exercises, which were more than offset by $241.6 million of cash used to retire long-term debt and $7.0 million to repurchase common stock.

In order to develop, design and manufacture new products, we have incurred significant expenditures during the past five years. We expect to continue these investments aimed at developing new products, including the hiring of many design and applications engineers and related purchase of equipment. Our intent is to continue to invest in those areas that have shown potential for viable and profitable market opportunities. Certain of these expenditures, particularly the addition of design engineers, do not generate significant payback in the short-term. We plan to finance these expenditures with cash generated by operations and investments.

A meaningful portion of our capital resources, and the related liquidity they represent, are held by our foreign subsidiaries. If we needed these funds for investment in domestic operations, any repatriation could have negative tax implications.

For all periods presented, the purchases of new capital equipment were made to expand our test capacity, support other engineering functions, including product design and qualification and information technology equipment needed to run our business. These purchases were funded from our operating cash flows and cash reserves.

We believe that operating cash flows together with cash reserves are sufficient to fund operations and capital expenditures for the foreseeable future.

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements, as those arrangements are defined by the SEC, that are reasonably likely to have a material effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

We do not have any unconsolidated subsidiaries or affiliated entities. We have no special purpose or limited purpose entities that provide off-balance sheet financing, liquidity or market or credit risk support, engage in leasing, hedging, research and development services, or other relationships that expose us to liability that is not reflected on the face of the financial statements.

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Noted below under Contractual Obligations are various commitments we have associated with our business such as lease commitments, open purchase obligations and other items that are not recorded as liabilities on our balance sheet because we have not yet received the related goods or services as of January 29, 2006.

**Contractual Obligations**

Presented below is a summary of our contractual obligations as of January 29, 2006.

(in thousands)

| | Payments due by period | | | | |
|---|---|---|---|---|---|
| | Less than 1 year | 1-3 years | 4-5 years | After 5 years | Total |
| Long-term debt | $ | $ | $ | $ | $ |
| Operating leases | 2,792 | 4,532 | 2,182 | 989 | 10,495 |
| Open capital purchase commitments | 1,125 | | | | 1,125 |
| Other open purchase commitments | 28,630 | | | | 28,630 |
| XEMICS acquisition contingent earn-out | 16,000 | | | | 16,000 |
| Other long-term liabilities | | 694 | 238 | 4,546 | 5,478 |
| Total contractual cash obligations | $ 48,547 | $ 5,226 | $ 2,420 | $ 5,535 | $ 61,728 |

As of January 29, 2006, we had approximately $10.5 million in operating lease commitments that extend over a nine year period. The portion of these operating lease payments due during fiscal year fiscal 2007 is approximately $2.8 million.

Capital purchase commitments and other open purchase commitments are for the purchase of plant, equipment, raw material, supplies and services. They are not recorded as liabilities on our balance sheet as of January 29, 2006, as we have not yet received the related goods or taken title to the property.

The XEMICS acquisition contract provides for the possibility of additional payments of up to $16.0 million if the acquired company meets certain performance objectives during an earn-out period of approximately one year that ends on April 30, 2006. Although the earn-out period has not yet ended, based on period-to-date performance against the targeted objectives, we do not believe any earn-out will be payable to the selling shareholders. For additional information, see Note 18 to the financial statements included in Item 8 of this report.

Late in fiscal year 2004, we established a deferred compensation plan for certain officers and key executives that allows participants to defer a portion of their compensation for future distribution at various times permitted by the plan. We match a portion of the employee s deferral, with the match subject to a vesting period. Compensation expense under this plan totaled $744,000 in fiscal year 2006 and $161,000 in fiscal year 2005. Our liability for deferred compensation totaled $4.5 million as of January 29, 2006 and $2.4 million as of January 30, 2005, and is included in other long-term liabilities on the balance sheet and in the table above. We have purchased whole life insurance on the lives of certain of the deferred compensation plan participants. This company-owned life insurance is held in a grantor trust and is intended to cover a majority of our costs of the deferred compensation plan. The cash surrender value of our company-owned life insurance was $4.5 million as of January 29, 2006 and $2.2 million as of January 30, 2005, and is included in other assets.

**Inflation**

Inflationary factors have not had a significant effect on our performance over the past several years. A significant increase in inflation would affect our future performance.

**Recently Issued Accounting Standards**

In November 2004, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4. The amendments made by SFAS No. 151 clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted

materials (spoilage) should be recognized as current-period charges and require the allocation of fixed production overheads to inventory based on the normal capacity of the production

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facilities. The pronouncement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years after November 23, 2004. The adoption of this pronouncement is not expected to have a material effect on our financial condition, the results of operations or liquidity.

On December 16, 2004, the FASB issued SFAS No. 123(R), which supersedes APB 25 and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure under this provision is no longer an alternative in future years.

The provisions of SFAS 123(R) are effective for fiscal years beginning after June 15, 2005. This means SFAS 123(R) is effective for us beginning with the first quarter of fiscal year 2007, which began on January 30, 2006. We have adopted the new standard using the modified prospective transition method. The exact impact of adopting this pronouncement cannot be predicted at this time because it will depend on many factors, including the levels of share-based payments granted in the future. However, had we adopted this pronouncement in prior periods, the impact of this pronouncement would approximate the impact of SFAS 123 described in the disclosure of the pro forma results in Note 1, under the heading Stock-Based Compensation in our Notes to Financial Statements included elsewhere in this report. As indicated in the First Quarter Form 10-Q filed concurrently with this report, stock option expense under SFAS 123(R) reduced earnings for the first quarter of fiscal year 2007 by $3.8 million, pre-tax, or approximately 5 cents per share**.**

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

We are subject to a variety of market risks, such as the foreign exchange and interest rate risks that are detailed below. Many of the factors that can impact on our market risk are external to the company, and so we are unable to fully predict them.

**Foreign Currency Risk**

As a global enterprise, we face exposure to adverse movements in foreign currency exchange rates and we could experience currency gains or losses. Because of the relatively small size of each individual currency exposure, we generally do not use forward contracts to mitigate foreign currency exposures. Our foreign currency exposures may change over time as the level of activity in foreign markets grows and could have an adverse impact upon our financial results.

Certain of our assets, including certain bank accounts and accounts receivable, exist in non U.S. dollar-denominated currencies, which are sensitive to foreign currency exchange rate fluctuations. The non U.S. dollar-denominated currencies are principally the Euro, Swiss Francs and British Pounds Sterling. Additionally, certain of our current and long-term liabilities are denominated principally in British Pounds Sterling currency, which is also sensitive to foreign currency exchange rate fluctuations.

Substantially all of our foreign sales, which amounted to $196.7 million in fiscal year 2006, are denominated in United States dollars. Currency exchange fluctuations in countries where we do business could harm our business by resulting in pricing that is not competitive with prices denominated in local currencies.

For the fiscal year ended January 29, 2006, we had approximately $10.0 million of expenses that were settled in British Pound Sterling, approximately $7.0 million of expenses that were settled in Swiss Francs, $2.0 million of expenses that were settled in Euros and $2.5 million of expenses that were settled in Mexican Pesos. Had rates of these various foreign currencies been 10% higher relative to the U.S. dollar in fiscal year 2006, our costs would have increased approximately $1.0 million related to expenses settled in British Pound Sterling, approximately $700,000 related to expenses settled in Swiss Francs, $200,000 related to expenses settled in Euros and $250,000 related to expenses settled in Mexican pesos.

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As of the end of fiscal year 2006, we held as part of cash and cash equivalents $3.2 million of British Pound Sterling, $2.0 million of Swiss Francs, $781,000 of Euros and $29,000 of Mexican Pesos. If rates of these foreign currencies were to move higher or lower by some percentage, it would have equal effect on the relative U.S. dollar value of the balances we hold.

In fiscal year 2004, we entered into a forward contract to purchase 2.8 million Swiss Francs in fiscal year 2005 in exchange for $2.0 million. The forward contract was entered into as a partial hedge against future tax payments in Swiss Francs and shortly after maturity was used to help settle such tax liabilities.

**Interest Rate and Market Risk**

As of January 29, 2006, we had no long-term debt outstanding. We do not currently hedge any potential interest rate exposure.

Interest rates affect our return on excess cash and investments. As of January 29, 2006, we had $65.5 million of cash and cash equivalents and $212.6 million of temporary and long-term investments. A majority of our cash and cash equivalents and investments generate interest income based on prevailing interest rates. Investments and cash and cash equivalents generated interest income of $8.0 million in fiscal year 2006. A significant change in interest rates would impact the amount of interest income generated from our excess cash and investments. It would also impact the market value of our investments. As of January 29, 2006, we estimate that our pool of investments had an effective duration of 0.67 (245-day weighted average days to maturity), which implies that a 1% increase in the prevailing interest rate could result in approximately $1.4 million of additional unrealized loss on our investments.

Our investments are subject to market risk, primarily interest rate and credit risk. Our investments are managed by a limited number of outside professional managers within investment guidelines set by us. Such guidelines include security type, credit quality and maturity and are intended to limit market risk by restricting our investments to high quality debt instruments with relatively short-term maturities.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The information required by Item 8 is presented in the following order:


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| Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting | 76 |
| Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements | 78 |
| Consolidated Statements of Income Fiscal Years 2006, 2005 and 2004 (as restated) | 79 |
| Consolidated Balance Sheets January 29, 2006 and January 30, 2005 (as restated) | 80 |
| Consolidated Statements of Stockholders Equity Fiscal Years 2006, 2005, and 2004 (as restated) | 81 |
| Consolidated Statements of Cash Flows Fiscal Years 2006, 2005, and 2004 (as restated) | 82 |
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| Schedule II Valuation and Qualifying Accounts | 135 |


**MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The report called for by Item 308(a) of Regulation S-K is incorporated herein by reference to the *Report of Management on Internal Control Over Financial Reporting* that is included in Part II, Item 9A of this report.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL**

**OVER FINANCIAL REPORTING**

The Board of Directors and Stockholders of Semtech Corporation

We have audited management s assessment, included in the Report of Management on Internal Control Over Financial Reporting set forth in Item 9A of this Form 10-K/A, that Semtech Corporation did not maintain effective internal control over financial reporting as of January 29, 2006 because of the effect of a material weakness identified in management s assessment as described below, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Semtech Corporation 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 an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit 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. Our audit included 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 considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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 (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) 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 (3) 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.

In our report dated April 7, 2006, we expressed an unqualified opinion on management s assessment that the Company maintained effective internal control over financial reporting and an unqualified opinion that the Company maintained, in all material respects, effective internal control over financial reporting as of January 29, 2006 based on the COSO criteria. As described in the following paragraph, the Company subsequently identified material misstatements in its consolidated financial statements, which caused such consolidated financial statements to be restated. Management subsequently revised its assessment due to the identification of the material weakness described in the following paragraph and concluded that the Company s internal control over financial reporting was not effective as of January 29, 2006. Accordingly, our opinion on the effectiveness of the Company s internal control over financial reporting as of January 29, 2006, expressed herein is different from that expressed in our previous report.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness in the Company s control environment has been identified and included in management s assessment: At January 29, 2006 the Company was under the leadership of the Former CEO, who was found by the Special Committee to have manipulated option grants in prior fiscal years, and the Former CFO, who the Special Committee found to have known or should have known of the past manipulation and initiated or participated in some manipulative acts in prior fiscal years. This material weakness, which resulted in the restatement of the fiscal year 2006 financial statements, was considered in determining the nature, timing, and extent of audit tests applied in our audit of the fiscal year 2006 consolidated financial statements, and this report does not affect our report dated April 7, 2006, except for Notes 1, 1A, 11, 14, 17, 19 and 20 as to which the date is March 26, 2007, on those financial statements.

In our opinion, management s revised assessment that Semtech Corporation did not maintain effective internal control over financial reporting as of January 29, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Semtech Corporation has not maintained effective internal control over financial reporting as of January 29, 2006, based on the COSO criteria.

/s/ Ernst and Young LLP

Woodland Hills, California

April 7, 2006, except for the effects

of the material weakness described

in the sixth paragraph, as to which

the date is March 26, 2007

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON THE CONSOLIDATED**

**FINANCIAL STATEMENTS**

The Board of Directors and Stockholders of Semtech Corporation

We have audited the accompanying consolidated balance sheets of Semtech Corporation (a Delaware Corporation) and subsidiaries as of January 29, 2006 (restated) and January 30, 2005 (restated), and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended January 29, 2006 (as restated). Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Semtech Corporation at January 29, 2006 (restated) and January 30, 2005 (restated), and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 29, 2006 (as restated), in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects, the information set forth therein.

As described in Note 1A, Restatement of Consolidated Financial Statements, the Company has restated its financial statements as of January 29, 2006 and January 30, 2005 and for each of the three years in the period ended January 29, 2006 to correct its accounting for stock-based compensation.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Semtech Corporation s internal control over financial reporting as of January 29, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 7, 2006, except for the effects of the material weakness described in the sixth paragraph, as to which the date is March 26, 2007, expressed an unqualified opinion on management s assessment and an adverse opinion on the effectiveness of internal control over financial reporting.

/s/ Ernst and Young LLP

Woodland Hills, California

April 7, 2006, except for Notes 1,

1A, 11, 14, 17, 19 and 20, as to which

the date is March 26, 2007

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**SEMTECH CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**

THREE YEARS ENDED JANUARY 29, 2006

(RESTATED)

*(In thousands, except earnings per share data)*

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| | (restated) | (restated) | (restated) |
| **NET SALES** | **$ 239,338** | $ 253,612 | $ 192,079 |
| Cost of sales | **105,236** | 106,407 | 82,635 |
| **Gross profit** | **134,102** | 147,205 | 109,444 |
| **Operating costs and expenses:** | | | |
| Selling, general and administrative | **45,471** | 47,564 | 42,190 |
| Product development and engineering | **37,928** | 35,312 | 33,319 |
| Acquisition-related items | **4,954** | | |
| Total operating costs and expenses | **88,353** | 82,876 | 75,509 |
| **Operating income** | **45,749** | 64,329 | 33,935 |
| Interest expense | **(180)** | (17) | (4,162) |
| Interest and other income | **7,466** | 6,321 | 3,711 |
| **Income before taxes** | **53,035** | 70,633 | 33,484 |
| Provision for taxes | **11,084** | 15,725 | 7,686 |
| **NET INCOME** | **$ 41,951** | $ 54,908 | $ 25,798 |
| **Earnings per share -** | | | |
| Basic | **$ 0.57** | $ 0.74 | $ 0.35 |
| Diluted | **$ 0.55** | $ 0.70 | $ 0.33 |
| **Weighted-average number of shares -** | | | |
| Basic | **73,436** | 74,187 | 73,570 |
| Diluted | **76,114** | 78,257 | 77,634 |

*See accompanying notes.*

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**SEMTECH CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

AS OF JANUARY 29, 2006 AND JANUARY 30, 2005

(RESTATED)

*(In thousands, except share data)*

| | 2006 (restated) | 2005 (restated) |
|---|---|---|
| **ASSETS** | | |
| **Current assets:** | | |
| Cash and cash equivalents | **$ 65,543** | $ 82,154 |
| Temporary investments | **130,185** | 108,167 |
| Receivables, less allowances of $462 in 2006 and $512 in 2005 | **27,141** | 22,098 |
| Inventories | **23,595** | 24,848 |
| Deferred income taxes | **6,361** | 7,255 |
| Other current assets | **8,757** | 6,026 |
| **Total current assets** | **261,582** | 250,548 |
| **Property, plant and equipment, net** | **56,957** | 55,674 |
| **Investments, maturities in excess of 1 year** | **82,458** | 111,577 |
| **Deferred income taxes** | **22,578** | 27,861 |
| **Goodwill** | **33,132** | |
| **Other intangibles** | **5,476** | |
| **Other assets** | **10,763** | 13,324 |
| **TOTAL ASSETS** | **$ 472,946** | $ 458,984 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| **Current liabilities:** | | |
| Accounts payable | **$ 12,325** | $ 9,504 |
| Accrued liabilities | **11,064** | 11,697 |
| Income taxes payable | **701** | 3,495 |
| Deferred revenue | **1,360** | 2,879 |
| Deferred income taxes | **562** | 1,443 |
| Other current liabilities | **96** | 96 |
| **Total current liabilities** | **26,108** | 29,114 |
| **Deferred income taxes** | **3,707** | 2,131 |
| **Other long-term liabilities** | **5,478** | 2,410 |
| **Commitments and contingencies** | | |
| **Stockholders equity:** | | |
| Common stock, $0.01 par value, 250,000,000 authorized, 76,773,473 issued and 72,693,804 outstanding in 2006 and 75,605,005 issued and 73,845,130 outstanding in 2005 | **770** | 758 |
| Treasury stock, 4,079,669 at cost in 2006 and 1,759,875 at cost in 2005 | **(73,963)** | (35,060) |
| Additional paid-in capital | **290,932** | 276,753 |
| Retained earnings | **220,758** | 183,820 |
| Accumulated other comprehensive loss | **(844)** | (942) |

| | | |
|---|---|---|
| **Total Stockholders equity** | **437,653** | 425,329 |
| **TOTAL LIABILITIES AND STOCKHOLDERS EQUITY** | **$ 472,946** | $ 458,984 |

*See accompanying notes.*

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**SEMTECH CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

THREE YEARS ENDED JANUARY 29, 2006

(RESTATED)

*(In thousands, except share amounts)*

| | Common Stock | | | | | | |
|---|---|---|---|---|---|---|---|
| | Number of Shares | Amount | Additional Paid-in Capital | Retained Earnings | Treasury Stock, at Cost | Accumulated Other Comprehensive Income (Loss) | Stockholders Equity |
| **Previously Reported Balance at January 26, 2003** | **73,165,414** | **$ 740** | **$ 182,524** | **$ 165,640** | **$ (9,072)** | **$ 1,608** | **$ 341,440** |
| Adjustments | | | 50,964 | (50,569) | | | 395 |
| **Restated Balance at January 26, 2003** | **73,165,414** | **740** | **233,488** | **115,071** | **(9,072)** | **1,608** | **341,835** |
| Comprehensive income: | | | | | | | |
| Net income | | | | 25,798 | | | 25,798 |
| Change in unrealized gains/losses on investments, net of taxes | | | | | | (1,276) | (1,276) |
| Translation adjustment | | | | | | 270 | 270 |
| Comprehensive income | | | | | | | 24,792 |
| Stock-based compensation | | | 7,840 | | | | 7,840 |
| Treasury stock repurchase | (350,000) | | | | (7,038) | | (7,038) |
| Treasury stock reissued | 971,200 | 1 | | (9,785) | 16,110 | | 6,326 |
| Exercise of stock options | 339,070 | 1 | 1,346 | | | | 1,347 |
| Tax benefit from exercised stock options | | | 6,075 | | | | 6,075 |
| **Restated Balance at January 25, 2004** | **74,125,684** | **742** | **248,749** | **131,084** | | **602** | **381,177** |
| Comprehensive income: | | | | | | | |
| Net income | | | | 54,908 | | | 54,908 |
| Change in unrealized gains/losses on investments, net of taxes | | | | | | (1,500) | (1,500) |
| Translation adjustment | | | | | | (44) | (44) |
| Comprehensive income | | | | | | | 53,364 |
| Stock-based compensation | | | 3,376 | | | | 3,376 |
| Treasury stock repurchase | (1,915,700) | | | | (38,589) | | (38,589) |
| Treasury stock reissued | 155,825 | 2 | | (2,172) | 3,529 | | 1,359 |
| Exercise of stock options | 1,479,321 | 14 | 11,368 | | | | 11,382 |
| Tax benefit from exercised stock options | | | 13,260 | | | | 13,260 |
| **Restated Balance at January 30, 2005** | **73,845,130** | **758** | **276,753** | **183,820** | **(35,060)** | **(942)** | **425,329** |
| Comprehensive income: | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Net income | | | | 41,951 | | | 41,951 |
| Change in unrealized gains/losses on investments, net of taxes | | | | | | (72) | (72) |
| Translation adjustment | | | | | | 170 | 170 |
| Comprehensive income | | | | | | | 42,049 |
| Stock-based compensation | | | 4,730 | | | | 4,730 |
| Treasury stock repurchase | (2,682,100) | | | | (46,869) | | (46,869) |
| Treasury stock reissued | 365,306 | | | (5,024) | 7,966 | | 2,942 |
| Exercise of stock options | 1,165,468 | 12 | 3,983 | | | | 3,995 |
| Tax benefit from exercised stock options | | | 5,466 | | | | 5,466 |
| Other | | | | 11 | | | 11 |
| **Restated Balance at January 29, 2006** | **72,693,804** | **$ 770** | **$ 290,932** | **$ 220,758** | **$ (73,963)** | **$ (844)** | **$ 437,653** |

*See accompanying notes.*

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**SEMTECH CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

THREE YEARS ENDED JANUARY 29, 2006

(RESTATED)

(in thousands)

| | 2006 (restated) | 2005 (restated) | 2004 (restated) |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Net income | **$ 41,951** | $ 54,908 | $ 25,798 |
| Adjustments to reconcile net income to net cash provided by operations: | | | |
| Depreciation and amortization | **11,752** | 9,790 | 9,000 |
| Stock-based compensation | **1,442** | 5,471 | 9,113 |
| Deferred income taxes | **7,118** | 604 | 6,816 |
| Write-off of in-process research and development | **4,000** | | |
| Loss (gain) on disposition of property, plant and equipment | **27** | 362 | (41) |
| Loss on extinguishment of debt | | | 3,909 |
| Provision (reduction) for doubtful accounts | | (144) | 118 |
| Tax benefit of stock option exercises | **3,289** | 11,166 | 4,803 |
| Changes in assets and liabilities: | | | |
| Receivables | **(1,977)** | (1,592) | (2,804) |
| Inventories | **4,154** | (2,402) | (5,694) |
| Income taxes refundable | | 5,795 | (5,795) |
| Other assets | **206** | (14,953) | (756) |
| Accounts payable | **(1,019)** | 950 | 2,829 |
| Accrued liabilities | **(4,052)** | (5,197) | (9,702) |
| Deferred revenue | **(1,519)** | 1,190 | 106 |
| Income taxes payable | **(2,794)** | 1,796 | (1,894) |
| Other liabilities | **2,477** | 2,383 | (13) |
| **Net cash provided by operating activities** | **65,055** | 70,127 | 35,793 |
| **Cash flows from investing activities:** | | | |
| Purchase of available-for-sale investments | **(98,392)** | (183,265) | (224,600) |
| Proceeds from sales and maturities of available-for-sale investments | **105,421** | 141,185 | 396,167 |
| Proceeds from sale of property, plant and equipment | | 208 | 102 |
| Purchases of property, plant and equipment | **(10,564)** | (16,523) | (7,495) |
| Acquisition of XEMICS SA, net of cash acquired | **(42,445)** | | |
| **Net cash provided by (used in) investing activities** | **(45,980)** | (58,395) | 164,174 |
| **Cash flows from financing activities:** | | | |
| Repayment of notes payable | **(1,400)** | | |
| Exercise of stock options | **9,458** | 11,382 | 1,347 |
| Repurchase of treasury stock | **(46,869)** | (38,589) | (7,038) |
| Reissuance of treasury stock | **2,955** | 1,359 | 6,326 |
| Repurchase of convertible subordinated notes | | | (72,356) |
| Retirement of convertible subordinated notes | | | (169,243) |
| **Net cash used in financing activities** | **(35,856)** | (25,848) | (240,964) |
| Effect of exchange rate changes on cash and cash equivalents | **170** | (44) | 270 |

| | | | |
|---|---|---|---|
| **Net decrease in cash and cash equivalents** | **(16,611)** | (14,160) | (40,727) |
| **Cash and cash equivalents at beginning of period** | **82,154** | 96,314 | 137,041 |
| **Cash and cash equivalents at end of period** | **$ 65,543** | $ 82,154 | $ 96,314 |

*See accompanying notes.*

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**SEMTECH CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Summary of Significant Accounting Policies**

**Business**

Semtech Corporation and its directly and indirectly wholly owned subsidiaries (Semtech International AG, Semtech Corpus Christi Corporation, Semtech Corpus Christi SA de CV, Semtech Limited, Semtech Germany GmbH, Semtech France SARL, Semtech Switzerland GmbH, Semtech San Diego Corporation, Semtech New York Corporation and Semtech Neuchatel SA, together, the Company ) is a supplier of analog and mixed-signal semiconductors. The Company designs, manufacturers and markets a wide range of products for commercial applications, the majority of which are sold into the communications, industrial and computer markets. The end-customers for the Company s products are primarily original equipment manufacturers, or OEMs, that produce and sell electronics. The Company s primary facilities are in Camarillo, San Jose and San Diego, California; Morrisville, North Carolina; St. Gallen and Neuchatel, Switzerland; Reynosa, Mexico; Manila, The Philippines; and Glasgow and Southampton, United Kingdom.

**Fiscal Year**

The Company reports results on the basis of fifty-two and fifty-three week periods. The Company s fiscal year ends on the last Sunday of January. The fiscal years ended January 29, 2006 and January 25, 2004 each consisted of fifty-two weeks. The fiscal year ended January 30, 2005 consisted of fifty-three weeks.

**Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of Semtech Corporation and its wholly owned subsidiaries. All intercompany transactions and accounts have been eliminated.

**Translation**

The assets and liabilities of the Company s foreign subsidiaries are translated using currency exchange rates at fiscal year-end. Income statement items are translated at average exchange rates prevailing during the period. The translation gains or losses are included as a component of accumulated other comprehensive income (loss) in the accompanying consolidated financial statements. Transaction gains and losses are included in the determination of net income and have been insignificant.

**Cash, Cash Equivalents and Investments**

The Company considers all highly liquid investments with an original maturity of 90 days or less to be cash equivalents. The Company maintains cash balances and investments in highly qualified financial institutions. At various times such amounts are in excess of insured limits. The Company accounts for its investments, which are all available for sale securities, under the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 115, Accounting for Certain Investments in Debt and Securities. Investments consist of government and corporate obligations. The Company s investment policy restricts investments to high credit quality investments with limits on the length to maturity and the amount invested with any one issuer. These investments, especially corporate obligations, are subject to default risk.

**Accounts Receivable and Allowance for Doubtful Accounts**

The Company evaluates the collectibility of its accounts receivable based on a combination of factors. If the Company becomes aware of a customer s inability to meet its financial obligations after a sale has occurred, it records an allowance to reduce the net receivable to the amount it reasonably believes it will be able to collect from the customer. For all other customers, the Company recognizes allowances for doubtful accounts based on the length of time the receivables are past due, the current business environment and historical experience. If the financial condition of the

Company s customers were to deteriorate or if economic conditions worsen, additional allowances may be required in the future. All of the Company s accounts receivables are trade-related receivables.

**Inventories**

Inventories are stated at lower of cost or market and consist of materials, labor and overhead. The Company determines the cost of inventory by the first-in, first-out method. The Company evaluates inventories for excess quantities and obsolescence. This evaluation includes analyses of sales levels by product and projections of future demand. In order to state the inventory at lower of cost or market, the Company maintains reserves against its inventory. If future demand or market conditions are less favorable than the Company s projections, a write-down of inventory may be required, and would be reflected in cost of goods sold in the period the revision is made.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost. Depreciation is computed primarily using the straight-line method over the following estimated useful lives: buildings for either thirty or thirty-nine years; leasehold improvements for the lesser of estimated useful life or lease term; machinery and equipment for two to six years; and furniture and office equipment for three to seven years. Maintenance and repairs are charged to expense as incurred and the costs of additions and betterments that increase the useful lives of the assets are capitalized. When property or equipment is disposed of, the cost and related accumulated depreciation and amortization are removed from the accounts and any gain or loss is included in operations. Depreciation expense was $10.8 million, $9.8 million and $8.8 million in fiscal years 2006, 2005 and 2004, respectively.

**Goodwill and Purchased Intangible Assets**

Accounting for acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired, including in-process research and development (IPR&D). Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to annual impairment tests. The amounts and useful lives assigned to other intangible assets impact the amount and timing of future amortization, and the amount assigned to IPR&D is expensed immediately. If the assumptions and estimates used to allocate the purchase price are not correct, or if business conditions change, purchase price adjustments or future asset impairment charges could be required.

The value of our intangible assets, including goodwill, could be impacted by future adverse changes such as: (i) any future declines in our operating results, (ii) a decline in the valuation of technology company stocks, including the valuation of our common stock, (iii) a significant slowdown in the worldwide economy and the semiconductor industry or (iv) any failure to meet the performance projections included in our forecasts of future operating results. We evaluate these assets, including purchased intangible assets deemed to have indefinite lives, on an annual basis or more frequently if indicators of impairment exist. In the process of our annual impairment review, we primarily use the income approach methodology of valuation that includes the discounted cash flow method as well as other generally accepted valuation methodologies to determine the fair value of the assets. Significant management judgment is required in the forecasts of future operating results that are used in the discounted cash flow method of valuation. The estimates we have used are consistent with the plans and estimates that we use to manage our business. It is possible, however, that the plans and estimates used may be incorrect. If our actual results, or the plans and estimates used in future impairment analysis, are lower than the original estimates used to assess the recoverability of these assets, we could incur additional impairment charges.

***In-Process Research and Development.*** In-process research and development (IPR&D) expense totaled $4.0 million during fiscal year 2006. The amount allocated to IPR&D was determined through established valuation techniques used in the high technology industry and was expensed upon acquisition as it was determined that the underlying project, wireless and sensing chips and protocols, had not reached technological feasibility and no alternative future uses existed. In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 2, Accounting for Research and Development Costs, as clarified by FIN No. 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, an Interpretation of FASB Statement No. 2, amounts assigned to IPR&D meeting the above-stated criteria were charged to expense as part of the allocation of the purchase price.

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The fair value of the acquired IPR&D was determined using the income approach. Under this approach, the expected future cash flows for the project under development are estimated and discounted to their net present value at an appropriate risk-adjusted rate of return. Significant factors considered in the calculation of the rate of return are the weighted-average cost of capital and return on assets, as well as the risks inherent in the development process, including the likelihood of achieving technological success and market acceptance. The unique technological innovations, the existence and reliance on core technology, the existence of any alternative future use or current technological feasibility, and the complexity, cost and time to complete the remaining development were considered. Future cash flows were estimated based on forecasted revenue and costs, taking into account product life-cycles, market penetration and growth rates.

The following table summarizes the key assumptions of the acquired IPR&D project as of the acquisition date:

| Development project | Wireless & sensing chips and protocols |
|---|---|
| Average estimated percent complete | 23% |
| Average estimated time to complete | 1.5 years |
| Estimated cost to complete (in millions) | $3.9 |
| Risk adjusted discount rate | 25% |
| IPR&D (in millions) | $4.0 |

As of the acquisition date, the estimated cost to complete development was estimated to be $3.9 million and revenue related to the acquired IPR&D was projected to begin in the fourth quarter of fiscal year 2007. As a result of a shift in strategic market positioning, R&D priorities were revised and related resources were reallocated, resulting in a reduction in development activity and a delay in projected release to market of certain IPR&D related products. Current projections with respect to estimated cost and effort to complete are consistent with the original assumptions. However, the shift in priorities is expected to reduce cash flow from IPR&D related projects by approximately $1.8 million over the next three years. The assumptions consist primarily of expected completion dates, estimated cost to complete, and revenue and expense projections for the product once it enters the market.

**Software Development Costs**

In accordance with SFAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed, development costs related to software products are expensed as incurred until the technological feasibility of the product has been established. The cost of purchased software is capitalized when related to a product which has achieved technological feasibility or that has an alternative future use. Software development costs incurred prior to achieving technological feasibility as well as certain licensing costs are charged to product development and engineering expense as incurred. Development of software costs is basically completed once technological feasibility is established.

**Income Taxes**

The Company follows the liability method of accounting for income taxes as set forth in SFAS No. 109, Accounting for Income Taxes ( SFAS 109 ). Current income taxes payable and deferred income taxes resulting from temporary differences between the financial statements and the tax basis of assets and liabilities are separately classified on the Consolidated Balance Sheets.

As part of the process of preparing the Company s consolidated financial statements, the Company is required to estimate income taxes in each of the jurisdictions in which it operates. This process involves estimating actual current tax liability together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included on the Company s consolidated balance sheet. The Company must assess the likelihood that its deferred tax assets will be recovered from future taxable income and, to the extent the Company believes that recovery is not likely, it must establish a valuation allowance. Except as described below, to the extent the Company changes its valuation allowance in a period, the change is recorded through the tax provision on the statement of operations.

As a result of historical tax deductions associated with stock option exercise activity, the Company has generated substantial U.S. net operating loss carryforwards. The size of the deferred tax assets attributable to federal net operating

losses and credit carryforwards, compared to the projected levels of federal taxable income, has elevated the Company s concern regarding the ability to fully utilize these deferred tax assets prior to expiration. Accordingly, the Company has provided a valuation allowance to address this concern. A significant portion of this valuation allowance relates to a benefit from stock option exercise activity. Therefore, any adjustment to this portion of the established valuation allowance is recorded through paid-in-capital in the period of the adjustment, rather than through the tax provision.

The Company has determined that certain non-cash stock-based compensation expense deducted on the Company s income tax returns for prior periods was not qualified performance based compensation, as defined in IRC Section 162(m). The federal and state net operating loss carryforwards have been reduced to reflect this determination. The cumulative effect of this change was to reduce the federal and state non-current deferred tax assets by $9.6 million, of which $1.7 million related to periods prior to fiscal year 2002 and $7.9 million related to fiscal year 2002. A tax contingency reserve of approximately $96,000 has been established to reflect the anticipated tax, penalties and interest associated with these adjustments. Of this amount, approximately $60,000 is recognized in beginning retained earnings for fiscal year 2002 and approximately $36,000 is recognized as expense in fiscal year 2002.

In the current period, the Company received a favorable tax ruling in a foreign jurisdiction regarding eligibility for a sales exclusion provision. This exclusion reduced our current period tax provision by approximately $2.4 million, of which approximately $2.1 million relates to the twelve month period ending January 29, 2006 and approximately $259,000 relates to the fiscal year ending January 30, 2005.

On June 23, 2005, Semtech Corporation, through its wholly owned Swiss subsidiary, Semtech International AG, acquired all of the outstanding shares of XEMICS SA ( XEMICS ) in a cash-for-stock transaction pursuant to a share purchase and sales agreement. As a result of pre-acquisition losses, XEMICS generated substantial net operating loss carryforwards. These net operating losses have a relatively short life. Therefore, the Company has established a $5.1 million valuation allowance against this deferred tax asset to address utilization risk. Any future release of this valuation allowance will be recorded to goodwill.

As of January 29, 2006 and January 30, 2005, the Company had $37.4 million and $30.1 million, respectively, of valuation reserves. Management continually evaluates the Company s deferred tax assets to assess whether it is likely that the deferred tax assets will be realized. If management ever determined that a deferred tax asset was not likely to be realized, a write-down of that asset would be required.

U.S. federal and state income taxes have not been accrued for the undistributed earnings of the Company s foreign operations. The Company s policy is to leave the income permanently reinvested offshore. The amount of earnings designated as indefinitely reinvested offshore is based upon the actual deployment of such earnings in the Company s offshore assets and expectations of the future cash needs of U.S. and foreign entities. Income tax considerations are also a factor in determining the amount of foreign earnings to be repatriated.

**Revenue Recognition**

The Company recognizes product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable. Product design and engineering revenue is recognized during the period in which services are performed. The Company defers revenue recognition on shipment of products to certain customers, principally distributors, where return privileges exist until these products are sold through to end-users or the return privilege lapses. The estimated deferred gross margin on these sales, where there are no outstanding receivables, are recorded on the balance sheet under the heading of Deferred Revenue. The Company records a provision for estimated sales returns in the same period as the related revenues are recorded. The Company bases these estimates on historical sales returns and other known factors. Actual returns could be different from the estimates and current provisions for sales returns and allowances, resulting in future charges to earnings.

**Cost of Sales**

Cost of sales includes materials, depreciation on fixed assets used in the manufacturing process, shipping costs, direct labor and overhead.

**Sales and Marketing**

We expense our sales and marketing costs, which include advertising costs, as they are incurred. Advertising costs were $524,000, $441,000 and $496,000 for fiscal years 2006, 2005 and 2004, respectively.

**Product Development and Engineering**

Product development and engineering costs are charged to expense as incurred.

**Earnings per Share**

Basic earnings per common share is computed using the weighted-average number of common shares outstanding during the period. Diluted earnings per common share incorporate the incremental shares issuable, calculated using the treasury stock method, upon the assumed exercise of stock options. The weighted-average number of shares used to compute basic earnings per share in fiscal years 2006, 2005 and 2004 was approximately 73,436,000, 74,187,000 and 73,570,000, respectively. Diluted earnings per share is computed by dividing net income for the period by the weighted-average number of common shares outstanding, plus the dilutive effect of its outstanding stock options ( common stock equivalents ), or approximately 76,114,000, 78,257,000 and 77,634,000 in fiscal years 2006, 2005 and 2004, respectively.

Options to purchase 3,142,157, 3,168,746 and 3,372,071 shares were not included in the computation of fiscal years 2006, 2005 and 2004 diluted net income per share because the grant price of such options was above the average stock price for the period and, therefore, the options were considered anti-dilutive. For fiscal year 2004, shares associated with the Company s outstanding convertible subordinated debentures were not included in the computation of net income per share as they were anti-dilutive.

**Stock-Based Compensation**

The Company accounts for its employee stock options under the intrinsic value method prescribed by Accounting Principles Board Opinion ( APB ) No. 25, Accounting for Stock Issued to Employees ( APB 25 ), and related interpretations, and has adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123 ( SFAS 123 ).

SFAS 123, and as amended by SFAS 148, permits companies to recognize, as expense over the vesting period, the fair value of all stock-based awards on the date of grant. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. Because the Company s stock-based compensation plans have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, management believes that the existing option valuation models do not necessarily provide a reliable single measure of the fair value of awards from the plan. Therefore, as permitted, the Company applies the existing accounting rules under APB 25 and provides pro forma net income and pro forma net income per share disclosures for stock-based awards made during the year as if the fair value method defined in SFAS 123, as amended, had been applied. Net income and net income per share for each of the three years ended January 29, 2006 would have been reduced to the following pro forma amounts. See Note 1A regarding the Restatement Adjustments and Note 20 regarding the Audit Adjustments.

**(fiscal years)**

| **(in thousands, except earnings per share data)** | **2006** | | | |
|---|---|---|---|---|
| | **As Previously Reported** | **Restatement Adjustments** | **Audit Adjs** | **As Restated** |
| Net income | $ 42,985 | $ (1,094) | $ 60 | $ 41,951 |
| Add: stock-based compensation costs included in reported net income, net of tax | | 1,094 | | 1,094 |
| Deduct: stock-based compensaton expense determined under fair value based method, net of tax (1) | (20,105) | 5,962 | | (14,143) |
| Pro forma net income | $ 22,880 | $ 5,962 | $ 60 | $ 28,902 |
| Earnings per share - basic | $ 0.59 | $ (0.02) | $ | $ 0.57 |
| Earnings per share - diluted | $ 0.57 | $ (0.02) | $ | $ 0.55 |
| Pro forma earnings per share - basic | $ 0.31 | $ 0.08 | $ | $ 0.39 |
| Pro forma earnings per share - diluted | $ 0.30 | $ 0.08 | $ | $ 0.38 |

(1) The amount in the Restatement Adjustments column also includes an adjustment for cancellations that had not previously been taken into account.

**(fiscal years)**

| (in thousands, except earnings per share data) | 2005 | | | 2004 | | |
|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| Net income | $ 58,888 | $ (3,980) | $ 54,908 | $ 32,466 | $ (6,668) | $ 25,798 |
| Add: stock-based compensation costs included in reported net income, net of tax | | 3,980 | 3,980 | | 6,668 | 6,668 |
| Deduct: stock-based compensation expense determined under fair value based method, net of tax (1) | (24,349) | 3,551 | (20,798) | (24,815) | 2,824 | (21,991) |
| Pro forma net income | $ 34,539 | $ 3,551 | $ 38,090 | $ 7,651 | $ 2,824 | $ 10,745 |
| Earnings per share - basic | $ 0.79 | $ (0.05) | $ 0.74 | $ 0.44 | $ (0.09) | $ 0.35 |
| Earnings per share - diluted | $ 0.75 | $ (0.05) | $ 0.70 | $ 0.42 | $ (0.09) | $ 0.33 |
| Pro forma earnings per share - basic | $ 0.47 | $ 0.04 | $ 0.51 | $ 0.10 | $ 0.04 | $ 0.14 |
| Pro forma earnings per share - diluted | $ 0.44 | $ 0.04 | $ 0.49 | $ 0.10 | $ 0.03 | $ 0.13 |

(1) The amount in the Restatement Adjustments column also includes an adjustment for cancellations that had not previously been taken into account.

See Note 21 for pro forma information for fiscal years 2005 and 2006 on a quarterly basis.

Option valuation models require the input of highly subjective assumptions such as expected option life and expected stock price volatility. The following assumptions were applied: (i) expected dividend yields of 0% for all periods, (ii) expected volatility rates of 43% for fiscal year 2006, 64% for fiscal year 2005 and 71% for fiscal year 2004, (iii) expected lives of 4 to 6 years for all years, and (iv) risk-free interest rates ranging from 2.14% to 7.01% for all years. Pro forma compensation expense is determined using a straight-line allocation over the expected life of the option.

Prior to the Company s implementation of SFAS 123(R), discussed in this Note 1 under Recently Issued Accounting Standards, the Company did not track the date employees were notified of their stock option awards. The Company did not believe that notification was a requirement for establishing a measurement date under APB 25, so it had no reason to gather or maintain evidence of the notification date. Based on the review of historical practices, the Company has concluded that it was likely that notification took place within a reasonable time period of the APB 25 measurement date. Thus, based on an analogy to FASB Staff Position No. 123R-2, the APB 25 measurement date reflected in these consolidated financial statements and grant date determined for purposes of the SFAS 123 pro-forma information are the same.

**Fair Value of Financial Instruments**

The Company s financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, are carried at cost, which approximate their fair market value due to the short-term nature of those instruments. The fair value of long-term debt obligations is estimated based on current interest rates available to the Company for debt instruments with similar terms, degrees of risk and remaining maturities. The carrying values of these obligations approximate their fair values.

**Foreign Exchange Contracts**

In fiscal year 2004, the Company entered into a forward contract to purchase 2.8 million Swiss Francs in fiscal year 2005 in exchange for $2.0 million. The forward contract was entered into as a partial hedge against future tax payments in Swiss Francs and shortly after maturity was used to help settle such tax liabilities.

**Recently Issued Accounting Standards**

In November 2004, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4. The amendments made by SFAS 151 clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognized as current-period charges and require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The pronouncement is effective for inventory costs incurred during fiscal years beginning

after June 15,

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2005. Earlier application is permitted for inventory costs incurred during fiscal years after November 23, 2004. The adoption of this pronouncement is not expected to have a material effect on the Company s financial condition, the results of operations or liquidity.

On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment, which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation ( SFAS 123(R) ). SFAS 123(R) supersedes APB 25 and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach in SFAS 123(R) is similar to the approach described in SFAS No. 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure under this provision is no longer an alternative in future years.

The provisions of this statement became effective for fiscal years beginning after June 15, 2005. The Company adopted this in the first quarter of fiscal year 2007 that ended on April 30, 2006. The exact impact of adopting this pronouncement cannot be predicted at this time because it will depend on many factors, including the levels of share-based payments granted in the future. However, had the Company adopted this pronouncement in prior periods, the impact of this pronouncement would approximate the impact of SFAS 123 described in the disclosure of the pro forma results shown in this Note 1 under the heading Stock-Based Compensation. As indicated in the First Quarter Form 10-Q filed concurrently with this report, stock option expense under SFAS 123(R) reduced earnings for the first quarter of fiscal year 2007 by $3.8 million, pre-tax, or approximately 5 cents per share**.**

**Reclassifications**

Certain prior year balances have been reclassified to be consistent with current year presentation.

**Estimates Used by Management**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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**1A. Restatement of Consolidated Financial Statements**

As a result of a May 16, 2006 third-party report and a letter received from the Securities and Exchange Commission ( SEC ) on May 18, 2006 requesting the voluntary submission of certain information and documents relating to stock option grants dating back to January 1, 1997, management and its accounting and legal advisors began a review of the Company s historical stock option practices and provided reports to the Audit Committee of the Board of Directors. On June 9, 2006, the Audit Committee, with the assistance of independent counsel and forensic accountants, commenced an investigation of the Company s stock option practices and associated accounting. On July 12, 2006, the Board of Directors appointed a Special Committee, comprised of Directors who had not served the Company or the Board in any capacity prior to December 2002, to continue the Audit Committee investigation. The Company s independent registered public accounting firm did not participate in management s review or the Special Committee s investigation, but was kept apprised of the progress and results.

After the initial phase of the investigation, the Special Committee concluded that, pursuant to the requirements of APB 25 and related authoritative guidance, the accounting measurement dates for certain stock options granted primarily during fiscal years 1998 through 2003 required correction. On July 20, 2006, the Company announced that financial statements and the related reports of its independent public accountants, earnings press releases, and similar communications it previously issued should no longer be relied upon pending restatement of its financial statements for fiscal years 2002 through 2006 to record a material level of additional non-cash compensation expense. We also announced that the restatement would affect financial statements for earlier fiscal years and that adjustments for those earlier years would be reflected as part of the opening balances in the financial statements for the restatement period. After the Special Committee completed its investigative and analytical work, it reported its findings to the Board on October 2, 2006.

The Special Committee s investigation and management s review extended back to January 30, 1995, which was the start of fiscal year 1996. The initial focus was on grants made since the beginning of calendar year 1997, which is the period covered by the informal request received from the SEC. The period covered was expanded to determine if material grant issues existed beyond the periods covered by the SEC request. The Company, with the assistance of Kroll, reviewed grant activity back to 1992 and found no evidence of deliberate manipulation related to grants made prior to fiscal year 1996. The Company concluded that a more detailed review of grants made prior to fiscal year 1996 was not warranted.

The accounting issues underlying the restatement have been classified into the following categories based on the reviews by the Special Committee and management. The discussion below describes the measurement date used for the restatement or other change made for the restatement.

The Company applied APB 25 in determining the correct measurement date in each situation described below. Under APB 25, the measurement date is the first date on which are known both the number of shares that an individual employee is entitled to receive and the option or purchase price, if any. Any intrinsic value that exists at the measurement date must be recognized as compensation cost, generally as a charge to compensation expense in the income statement.

*(A) Grants made by Former Chief Executive Officer John D. Poe ( Former CEO ) from April 1997 to May 2002 to continuing employees*

In April 1997, the Compensation Committee delegated authority to the Former CEO to make option grants as an agent of the Committee for the stated purpose of granting options on a more timely basis. Grants made by the Former CEO were subsequently submitted to the Compensation Committee for approval. The Former CEO granted options under this authority to existing executive and non-executive level employees through May 2002.

Based on the reviews conducted by management and the Special Committee, the Company has concluded that the elements of APB 25 were not satisfied as of the stated grant dates for fifteen of the seventeen grant dates selected by the Former CEO from April 1997 through May 2002. There is evidence of intentional manipulation on nine of these grant dates, representing approximately 42% of the shares and approximately 76% of the expense in this category. Based primarily on evidence of the Former CEOs willingness to manipulate grant dates, the Company determined that the grants made during this period were not final until approved by the Compensation Committee. Although the reviews found no specific documentary evidence of manipulation for certain grants, the fact that those grants lack adequate contemporaneous documentation to corroborate the establishment of the grant date, combined

with evidence of manipulation of other grants during this period, led to the Company s conclusion that the original measurement date was in error because the terms of the grant were not determined with finality.

The appropriate measurement date for all grants in this category is the date of Compensation Committee ratification, unless the measurement date for a particular grant has been further revised due to one of the issues discussed below.

In August 2002, the Compensation Committee determined that options for continuing employees would be granted in conjunction with regularly scheduled Compensation Committee meetings, thus restoring the delegated authority to the Compensation Committee.

This category also includes adjustments related to miscellaneous grant scenarios, primarily related to acquisitions. The non-cash compensation expense related to these miscellaneous items is approximately $4.6 million pretax.

*(B) Grants to new employees*

In April 1997, the Compensation Committee stated that all option grants communicated via an offer letter would be granted to each employee on his or her start date.

The reviews revealed inconsistencies in grant practices to new hires from April 1997 to August 2002 and evidence of management s willingness to intentionally select favorable grant dates for new hires during this period. More specifically, it was found that a majority of grants during this period were not made as of the recipient s start date. Of those who received a new hire grant on a date other than the actual hire date, approximately 90% received a more favorable price. Of the grants that were made on the hire date, approximately 95% were priced favorably when compared to the price of the stock on the date of the relevant Compensation Committee meeting. The appropriate measurement date for all new hire grants during this period is the date of Compensation Committee approval, unless the measurement date for a particular grant has been further revised due to one of the issues discussed below.

The reviews also identified 76 stock option grants, made between November 1996 and May 2002, that were made to persons before they became employees, including through assignment of the employee to leave of absence status prior to the date the employee began performing services. The appropriate measurement date for these options is the employee s start date. However, a later measurement date tied to the Compensation Committee s approval was applied in a significant number of these cases because grant terms were not determined with finality on the hire date. Compensation expense is amortized over the vesting period, the end of which, for the grants in this group, remains the same but starts at the date of employment. For grants with a measurement date after the stated grant date, amortization related to the first vesting period is accelerated, which could result in more than twelve months of amortization in a fiscal year.

Following a leadership change in the Human Resources Department, the procedures were more fully explained to the HR staff and better enforced, such that beginning in August 2002, new hire grants were made consistently as of the employee s hire date.

In February 2006, the Compensation Committee determined to align the procedure for new hire grants and promotional grants with the procedure in place for annual grants to continuing employees. That is, new hire option grants are now awarded at Compensation Committee meetings rather than on the date of hire.

*(C) Grants lacking evidence of Compensation Committee approval*

The reviews identified 33 grants that lacked evidence of Compensation Committee ratification. The lack of evidence is believed to be the result of administrative issues. For example, some grants to new hires appear in the Company s stock option database without evidence of having been presented to the Compensation Committee for approval. Others in this group were presented to the Compensation Committee for approval then excluded from the Compensation Committee meeting minutes because the employee had terminated following the meeting or was about to terminate. For grants in this category, management used available relevant information, such as personnel records and Compensation Committee records, to determine the most likely grant date. The Special Committee found these conclusions to be reasonable.

*(D) Grants modified after ratification by the Compensation Committee*

The reviews revealed 84 grants, out of more than 1,600 grants over 23 grant dates, with changes between the grant lists distributed with the Compensation Committee agendas, on which basis the grants were ratified, and the grant lists attached to the minutes for the related meetings. More specifically, the reviews showed 31 new grants, 32 deleted grants (apparently related to employees who terminated in the interim), 12 increased grants, 8 decreased grants and 1 addition specifically approved at the Compensation Committee meeting. In most cases, these changes were not significant individually or in the aggregate, were not significantly concentrated within individual grant dates, and appear to be the result of administrative error and not indicative of an open-allocation process. The exceptions to these determinations are (i) one grant date in May 1999 for which there is evidence indicating the grant process for ten employees in two departments was incomplete on the award approval date, (ii) 21 grants to continuing employees on one grant date in May 2000 for which the grant process was found to be incomplete on the award approval date, and (iii) five grants to new hires concentrated on one grant date in December 2000 that were made prior to the employees start dates, but not indicative of an open allocation process.

For grants that were added or changed, the measurement date is the date that the Compensation Committee approved the minutes that reflected the changes. With respect to the May 1999 grant, we revised the measurement date for grants to all employees in the two departments with the open allocation process rather than revising the measurement date for only the modified awards. Similarly, with respect to the May 2000 grant, we revised the measurement date for awards to all continuing employees on the second quarter grant list because the list was not finalized on the award approval date.

*(E) Post-termination arrangements*

The reviews identified 21 employees with termination arrangements whereby options were modified through continued vesting and/or extension of the exercise period. Two of these arrangements involved executive level employees transitioned from full-time status to on-call status in anticipation of full retirement. Of the remaining agreements, many involved placing terminated employees below the vice-president level on leave of absence status for stock option purposes. In each of these instances, it has been concluded that the modifications were made in recognition of past services. Specifically, the individuals on leave of absence were no longer required to provide substantive services for the Company and the executives on call ultimately did not perform substantive services during the on-call period. Thus, compensation cost for the options affected by the termination arrangements was remeasured on the modification dates and the incremental compensation cost, plus any originally measured but unrecognized compensation cost, has been expensed entirely at the time of modification. These costs were recorded even if the options were exercised by the employee within the originally permitted window following termination of substantive employment.

*(F) Pricing exceptions*

The reviews identified that approximately 9% of the grants made in fiscal years 1996 through 2006 had exercise prices that were determined in a manner inconsistent with our convention of pricing options at the closing price on the day before the grant. The significant majority of the exceptions relate to the use of the closing price on the date of grant. The majority of these grants had pricing exceptions that resulted in pricing unfavorable to the employee, leading to the conclusion that the exceptions were administrative errors. The measurement of compensation cost was corrected to consistently measure compensation cost based on the closing price on the day before the grant date.

For many years we have used the prior date closing methodology set forth in our 1994 stock option plans to determine the exercise price and measure the compensation cost of our employee stock options. Although this methodology is not consistent with the terms of our later option plans, which call for using the weighted-average traded price on date of grant, we have determined, and our accounting advisors and the Special Committee s forensic accountant have concurred, that continued use of the prior date closing methodology was reasonable and acceptable. The Board also concurred and ratified past use of the prior date closing methodology. However, in October 2006 we amended the operative stock option plans to establish the exercise price based on the closing stock price on the grant date. This change in methodology is not expected to have a material effect on our financial statements.

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In accordance with APB 25, our restated consolidated financial statements reflect additional compensation expense to the extent the fair market value of a share of our common stock on the correct measurement date exceeded the exercise price of the option.

in thousands, except number of grants

| Category | Number of grants | Expense for all grants |
|---|---|---|
| (A) Grants to continuing employees | 1,153 | $ 50,473 |
| (B) Grants to new employees | 343 | 19,425 |
| (C) Grants lacking evidence of approval | 33 | 149 |
| (D) Grants modified after ratification | 83 | 4,545 |
| (E) Post-termination arrangements | 68 | 20,854 |
| (F) Pricing exceptions | 393 | 733 |
| | | $ 96,179 |
| Adjustment for duplication among categories | | (5,151) |
| Total pre-tax stock option related adjustments | | $ 91,028 |
| Amount capitalized into inventory | | (30) |
| **Total pre-tax stock option compensation expense** | | **$ 90,998** |
| **Tax benefits** | | **(28,688)** |
| **Net adjustment** | | **$ 62,310** |

The additional non-cash compensation expense is net of forfeitures related to employee terminations.

The cumulative, pre-tax, non-cash, stock-based compensation expense resulting from the revised measurement dates and other option related adjustments discussed above was approximately $91.0 million (net of approximately $30,000 capitalized into inventory). This expense was amortized over the required service period, generally over the vesting periods of the respective grants.

(in thousands)

| Fiscal Year | Additional Compensation Expense | Tax Benefit | Additional Compensation Expense, net of tax |
|---|---|---|---|
| 1996 | $ 10 | $ (3) | $ 7 |
| 1997 | 95 | (37) | 58 |
| 1998 | 1,002 | (390) | 612 |
| 1999 | 2,826 | (1,034) | 1,792 |
| 2000 | 6,862 | (2,174) | 4,688 |
| 2001 | 14,050 | (4,017) | 10,033 |
| 2002 | 36,354 | (12,465) | 23,889 |
| 2003 | 13,401 | (3,912) | 9,489 |
| **Subtotal Fiscal Years 1996 - 2003** | 74,600 | (24,032) | 50,568 |
| 2004 | 9,234 | (2,566) | 6,668 |
| 2005 | 5,637 | (1,657) | 3,980 |
| 2006 | 1,527 | (433) | 1,094 |

| | | | |
|---|---|---|---|
| **Total Fiscal Years 1996 - 2006** | $ 90,998 | $ (28,688) | $ 62,310 |

The cumulative effect of the after-tax charges for periods prior to fiscal year 2004 of approximately $50.6 million is reflected in stockholders equity as of the beginning of fiscal year 2004. The amount related to the restatement that impacts fiscal year 2007 and future years is immaterial. These adjustments are referred to as the Restatement Adjustments.

As described in Note 20, the restated financial statements for fiscal year 2006 also include $60,000 increase to income, net of related tax effects, of miscellaneous audit adjustments ( Audit Adjustments ).

References to the restatement are references to the restatement required due to stock option matters and not to the Audit Adjustments.

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**Consolidated Statements of Income**

Three years ended January 29, 2006

The following tables show the consolidated statements of income for the fiscal years indicated, showing previously reported amounts and restated amounts giving effect to the Restatement Adjustments described above and the minor fiscal year 2006 Audit Adjustments described in Note 20.

(in thousands, except per share data)

| | Fiscal Year 2006 | | | |
|---|---|---|---|---|
| | **As Previously Reported** | **Restatement Adjustments** | **Audit Adjustments** | **As Restated** |
| **NET SALES** | $ 239,405 | $ | $ (67) | $ 239,338 |
| Cost of sales | 104,996 | 213 | 27 | 105,236 |
| **Gross profit** | 134,409 | (213) | (94) | 134,102 |
| **Operating costs and expenses:** | | | | |
| Selling, general and administrative | 44,551 | 920 | | 45,471 |
| Product development and engineering | 37,534 | 394 | | 37,928 |
| Acquisition-related items | 4,954 | | | 4,954 |
| Total operating costs and expenses | 87,039 | 1,314 | | 88,353 |
| **Operating income** | 47,370 | (1,527) | (94) | 45,749 |
| Interest expense | (180) | | | (180) |
| Interest and other income | 7,466 | | | 7,466 |
| **Income before taxes** | 54,656 | (1,527) | (94) | 53,035 |
| Provision for taxes | 11,671 | (433) | (154) | 11,084 |
| **NET INCOME** | $ 42,985 | $ (1,094) | $ 60 | $ 41,951 |
| **Earnings per share -** | | | | |
| Basic | $ 0.59 | $ (0.02) | | $ 0.57 |
| Diluted | $ 0.57 | $ (0.02) | | $ 0.55 |
| **Weighted-average number of shares -** | | | | |
| Basic | 73,436 | | | 73,436 |
| Diluted | 75,992 | 122 | | 76,114 |

(in thousands, except per share data)

| | Fiscal Year 2005 | | | Fiscal Year 2004 | | |
|---|---|---|---|---|---|---|
| | **As Previously Reported** | **Restatement Adjustments** | **As Restated** | **As Previously Reported** | **Restatement Adjustments** | **As Restated** |
| **NET SALES** | $ 253,612 | $ | $ 253,612 | $ 192,079 | $ | $ 192,079 |
| Cost of sales | 105,705 | 702 | 106,407 | 81,332 | 1,303 | 82,635 |
| **Gross profit** | 147,907 | (702) | 147,205 | 110,747 | (1,303) | 109,444 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Operating costs and expenses:** | | | | | | |
| Selling, general and administrative | 44,449 | 3,115 | 47,564 | 37,207 | 4,983 | 42,190 |
| Product development and engineering | 33,492 | 1,820 | 35,312 | 30,371 | 2,948 | 33,319 |
| One-time costs | | | | | | |
| Total operating costs and expenses | 77,941 | 4,935 | 82,876 | 67,578 | 7,931 | 75,509 |
| **Operating income** | 69,966 | (5,637) | 64,329 | 43,169 | (9,234) | 33,935 |
| Interest expense | (17) | | (17) | (4,162) | | (4,162) |
| Interest and other income | 6,321 | | 6,321 | 3,711 | | 3,711 |
| **Income before taxes** | 76,270 | (5,637) | 70,633 | 42,718 | (9,234) | 33,484 |
| Provision for taxes | 17,382 | (1,657) | 15,725 | 10,252 | (2,566) | 7,686 |
| **NET INCOME** | $ 58,888 | $ (3,980) | $ 54,908 | $ 32,466 | $ (6,668) | $ 25,798 |
| **Earnings per share** | | | | | | |
| Basic | $ 0.79 | $ (0.05) | $ 0.74 | $ 0.44 | $ (0.09) | $ 0.35 |
| Diluted | $ 0.75 | $ (0.05) | $ 0.70 | $ 0.42 | $ (0.09) | $ 0.33 |
| **Weighted average number of shares** | | | | | | |
| Basic | 74,187 | | 74,187 | 73,570 | | 73,570 |
| Diluted | 78,124 | 133 | 78,257 | 77,504 | 130 | 77,634 |

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**Consolidated Balance Sheets**

The following table sets forth the consolidated balance sheets for the Company as of the dates indicated, showing previously reported amounts and restated amounts giving effect to the Restatement Adjustments described above and the minor fiscal year 2006 Audit Adjustments described in Note 20.

(in thousands, except per share data)

| | January 29, 2006 | | | | January 30, 2005 | | |
|---|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | Audit Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| **ASSETS** | | | | | | | |
| **Current assets:** | | | | | | | |
| Cash and cash equivalents | $ 65,543 | $ | $ | $ 65,543 | $ 82,154 | $ | $ 82,154 |
| Temporary investments | 130,185 | | | 130,185 | 108,167 | | 108,167 |
| Receivables (1) | 27,194 | | (53) | 27,141 | 22,098 | | 22,098 |
| Inventories | 23,678 | 30 | (113) | 23,595 | 24,734 | 114 | 24,848 |
| Deferred income taxes | 6,327 | | 34 | 6,361 | 7,255 | | 7,255 |
| Other current assets | 8,757 | | | 8,757 | 6,026 | | 6,026 |
| **Total current assets** | 261,684 | 30 | (132) | 261,582 | 250,434 | 114 | 250,548 |
| **Property, plant and equipment, net** | 56,957 | | | 56,957 | 55,674 | | 55,674 |
| **Investments, maturities in excess of 1 year** | 82,458 | | | 82,458 | 111,577 | | 111,577 |
| **Deferred income taxes** | 23,295 | (800) | 83 | 22,578 | 26,916 | 945 | 27,861 |
| **Goodwill** | 33,132 | | | 33,132 | | | |
| **Other intangibles** | 5,476 | | | 5,476 | | | |
| **Other assets** | 10,763 | | | 10,763 | 13,324 | | 13,324 |
| **TOTAL ASSETS** | $ 473,765 | $ (770) | $ (49) | $ 472,946 | $ 457,925 | $ 1,059 | $ 458,984 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | | | | |
| **Current liabilities:** | | | | | | | |
| Accounts payable | $ 12,325 | $ | $ | $ 12,325 | $ 9,504 | $ | $ 9,504 |
| Accrued liabilities | 11,064 | | | 11,064 | 11,697 | | 11,697 |
| Income taxes payable | 738 | | (37) | 701 | 3,495 | | 3,495 |
| Deferred revenue | 1,432 | | (72) | 1,360 | 2,879 | | 2,879 |
| Deferred income taxes | 562 | | | 562 | 1,443 | | 1,443 |
| Other current liabilities | | 96 | | 96 | | 96 | 96 |
| **Total current liabilities** | 26,121 | 96 | (109) | 26,108 | 29,018 | 96 | 29,114 |
| **Deferred income taxes** | 3,707 | | | 3,707 | 2,131 | | 2,131 |
| **Other long-term liabilities** | 5,478 | | | 5,478 | 2,410 | | 2,410 |
| **Commitments and contingencies** | | | | | | | |
| **Stockholders equity:** | | | | | | | |
| Common stock, $0.01 par value (2) | 770 | | | 770 | 758 | | 758 |
| Treasury stock (3) | (73,963) | | | (73,963) | (35,060) | | (35,060) |
| Additional paid-in capital | 229,486 | 61,446 | | 290,932 | 214,573 | 62,180 | 276,753 |
| Retained earnings | 283,010 | (62,312) | 60 | 220,758 | 245,037 | (61,217) | 183,820 |
| Accumulated other comprehensive loss | (844) | | | (844) | (942) | | (942) |
| **Total Stockholders equity** | 438,459 | (866) | 60 | 437,653 | 424,366 | 963 | 425,329 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **TOTAL LIABILITIES AND STOCKHOLDERS EQUITY** | $ 473,765 | $ (770) | $ (49) | $ 472,946 | $ 457,925 | $ 1,059 | $ 458,984 |

(1) Less allowances of $462,000 at January 29, 2006 and $512,000 at January 30, 2005.

(2) 250,000,000 authorized. 76,773,473 issued and 72,693,804 outstanding at January 29, 2006. 75,605,005 issued and 73,845,130 outstanding at January 30, 2005.

(3) 4,079,669 at cost at January 29, 2006 and 1,759,875 at cost at January 30, 2005.

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**Consolidated Statement of Cash Flows**

Three years ended January 29, 2006

The following tables show the consolidated statements of cash flows for the fiscal years indicated, showing previously reported amounts and restated amounts giving effect to the Restatement Adjustments described above and the minor fiscal year 2006 Audit Adjustments described in Note 20.

(in thousands)

| | Fiscal Year 2006 | | | |
|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | Audit Adjustments | As Restated |
| **Cash flows from operating activities:** | | | | |
| Net Income | $ 42,985 | $ (1,094) | $ 60 | $ 41,951 |
| Adjustments to reconcile net income to net cash provided by operations: | | | | |
| Depreciation and amortization | 11,752 | | | 11,752 |
| Stock-based compensation | | 1,442 | | 1,442 |
| Deferred income taxes | 5,490 | 1,745 | (117) | 7,118 |
| Write-off of in-process research and development | 4,000 | | | 4,000 |
| Loss (gain) on disposition of property, plant and equipment | 27 | | | 27 |
| Loss on extinguishment of debt | | | | |
| Provision (reduction) for doubtful accounts | | | | |
| Tax benefit of stock option exercises | 5,466 | (2,177) | | 3,289 |
| Changes in assets and liabilities: | | | | |
| Receivables | (2,030) | | 53 | (1,977) |
| Inventories | 3,957 | 84 | 113 | 4,154 |
| Income taxes refundable | | | | |
| Other assets | 206 | | | 206 |
| Accounts payable | (1,019) | | | (1,019) |
| Accrued liabilities | (4,052) | | | (4,052) |
| Deferred revenue | (1,447) | | (72) | (1,519) |
| Income taxes payable | (2,757) | | (37) | (2,794) |
| Other liabilities | 2,477 | | | 2,477 |
| **Net cash provided by operating activities** | 65,055 | | | 65,055 |
| **Cash flows from investing activities:** | | | | |
| Purchase of available-for-sale investments | (98,392) | | | (98,392) |
| Proceeds from sales and maturities of available-for-sale investments | 105,421 | | | 105,421 |
| Proceeds from sale of property, plant and equipment | | | | |
| Purchases of property, plant and equipment | (10,564) | | | (10,564) |
| Acquisition of XEMICS SA, net of cash acquired | (42,445) | | | (42,445) |
| **Net cash used in investing activities** | (45,980) | | | (45,980) |
| **Cash flows from financing activities:** | | | | |
| Repayment of notes payable | (1,400) | | | (1,400) |
| Exercise of stock options | 9,458 | | | 9,458 |
| Repurchase of treasury stock | (46,869) | | | (46,869) |
| Reissuance of treasury stock | 2,955 | | | 2,955 |
| Repurchase of convertible subordinated notes | | | | |
| Retirement of convertible subordinated notes | | | | |
| **Net cash used in financing activities** | (35,856) | | | (35,856) |
| Effect of exchange rate changes on cash and cash equivalents | 170 | | | 170 |

| | | | | |
|---|---|---|---|---|
| **Net decrease in cash and cash equivalents** | (16,611) | | | (16,611) |
| **Cash and cash equivalents at beginning of period** | 82,154 | | | 82,154 |
| **Cash and cash equivalents at end of period** | $ 65,543 | $ | $ | $ 65,543 |

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(in thousands)

| | Fiscal Year 2005 | | | Fiscal Year 2004 | | |
|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| **Cash flows from operating activities:** | | | | | | |
| Net income | $ 58,888 | $ (3,980) | $ 54,908 | $ 32,466 | $ (6,668) | $ 25,798 |
| Adjustments to reconcile net income to net cash provided by operations: | | | | | | |
| Depreciation and amortization | 9,790 | | 9,790 | 9,000 | | 9,000 |
| Stock-based compensation | | 5,471 | 5,471 | | 9,113 | 9,113 |
| Deferred income taxes | 167 | 437 | 604 | 8,110 | (1,294) | 6,816 |
| Write-off of in-process research and development | | | | | | |
| Loss (gain) on disposition of property, plant and equipment | 362 | | 362 | (41) | | (41) |
| Loss on extinguishment of debt | | | | 3,909 | | 3,909 |
| Provision (reduction) for doubtful accounts | (144) | | (144) | 118 | | 118 |
| Tax benefit of stock option exercises | 13,260 | (2,094) | 11,166 | 6,075 | (1,272) | 4,803 |
| Changes in assets and liabilities: | | | | | | |
| Receivables | (1,592) | | (1,592) | (2,804) | | (2,804) |
| Inventories | (2,568) | 166 | (2,402) | (5,815) | 121 | (5,694) |
| Income taxes refundable | 5,795 | | 5,795 | (5,795) | | (5,795) |
| Other assets | (14,953) | | (14,953) | (756) | | (756) |
| Accounts payable | 950 | | 950 | 2,829 | | 2,829 |
| Accrued liabilities | (5,197) | | (5,197) | (9,702) | | (9,702) |
| Deferred revenue | 1,190 | | 1,190 | 106 | | 106 |
| Income taxes payable | 1,796 | | 1,796 | (1,894) | | (1,894) |
| Other liabilities | 2,383 | | 2,383 | (13) | | (13) |
| **Net cash provided by operating activities** | 70,127 | | 70,127 | 35,793 | | 35,793 |
| **Cash flows from investing activities:** | | | | | | |
| Purchase of available-for-sale investments | (183,265) | | (183,265) | (224,600) | | (224,600) |
| Proceeds from sales and maturities of available-for-sale investments | 141,185 | | 141,185 | 396,167 | | 396,167 |
| Proceeds from sale of property, plant and equipment | 208 | | 208 | 102 | | 102 |
| Purchases of property, plant and equipment | (16,523) | | (16,523) | (7,495) | | (7,495) |
| Acquisition of XEMICS SA, net of cash acquired | | | | | | |
| **Net cash provided by (used in) investing activities** | (58,395) | | (58,395) | 164,174 | | 164,174 |
| **Cash flows from financing activities:** | | | | | | |
| Repayment of notes payable | | | | | | |
| Exercise of stock options | 11,382 | | 11,382 | 1,347 | | 1,347 |
| Repurchase of treasury stock | (38,589) | | (38,589) | (7,038) | | (7,038) |
| Reissuance of treasury stock | 1,359 | | 1,359 | 6,326 | | 6,326 |
| Repurchase of convertible subordinated notes | | | | (72,356) | | (72,356) |
| Retirement of convertible subordinated notes | | | | (169,243) | | (169,243) |
| **Net cash used in financing activities** | (25,848) | | (25,848) | (240,964) | | (240,964) |
| Effect of exchange rate changes on cash and cash equivalents | (44) | | (44) | 270 | | 270 |
| **Net decrease in cash and cash equivalents** | (14,160) | | (14,160) | (40,727) | | (40,727) |
| **Cash and cash equivalents at beginning of period** | 96,314 | | 96,314 | 137,041 | | 137,041 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cash and cash equivalents at end of period** | $ | 82,154 | $ | | $ | 82,154 | $ | 96,314 | $ | | $ | 96,314 |

**2. Stock Repurchase Programs**
In the first quarter of fiscal year 2005, the Company announced that its Board of Directors had approved a program to repurchase up to $50.0 million of its common stock. In the second quarter of fiscal year 2006, the Company announced that it had exhausted the initial authorization and that its Board of Directors had approved increasing the program by an additional $50.0 million.

As of January 29, 2006, the Company had repurchased 4,597,800 shares of its common stock at a cost of $85.5 million under this program. Of the repurchased shares, 518,131 have been reissued as a result of stock option exercises and the remainder are being held as treasury shares. Treasury shares are expected to be reissued in the future as a result of stock option exercises.

**3. Temporary and Long-Term Investments**

Temporary and long-term investments consist of government, bank and corporate obligations. Temporary investments have original maturities in excess of three months, but mature within twelve months of the balance sheet date. Long-term investments have maturities in excess of one year from the date of the balance sheet. As of January 29, 2006, the Company had $130.2 million of temporary investments and $82.5 million of long-term investments. As of January 30, 2005, the Company had $108.2 million of temporary investments and $111.6 million of long-term investments. Certain short-term, highly liquid investments, namely money-market accounts are accounted for as cash and cash equivalents.

The Company classifies its investments as available for sale because it expects to possibly sell some securities prior to maturity. The Company s investments are subject to market risk, primarily interest rate and credit risk. The Company s investments are managed by a limited number of outside professional managers within investment guidelines set by the Company. Such guidelines include security type, credit quality and maturity, and are intended to limit market risk by restricting the Company s investments to high quality debt instruments with relatively short-term maturities.

As a result of fluctuations in the market value of investments, the Company included $72,000, $1.5 million and $1.3 million related to the change in the unrealized gain or loss on investments, net of tax, in the comprehensive income portion of the Consolidated Statements of Stockholders Equity for fiscal years 2006, 2005 and 2004, respectively. The tax associated with these comprehensive income items were benefits of $47,000, $1.0 million and $855,000 in fiscal years 2006, 2005 and 2004, respectively.

Temporary and long-term investments consist of the following security types, stated at fair market value and cost, with the difference in these amounts booked as part of comprehensive income:

Investments (in thousands)

| | January 29, 2006 | | | January 30, 2005 | | |
|---|---|---|---|---|---|---|
| | Market Value | Cost Basis | Unrealized (Loss) | Market Value | Cost Basis | Unrealized (Loss) |
| U.S. government issues | $ 54,678 | $ 55,574 | $ (896) | $ 41,231 | $ 41,724 | $ (493) |
| State and local government issues | 10,013 | 10,013 | | 38,452 | 38,452 | |
| Corporate issues | 147,952 | 149,479 | (1,527) | 140,061 | 141,872 | (1,811) |
| Investments | $ 212,643 | $ 215,066 | $ (2,423) | $ 219,744 | $ 222,048 | $ (2,304) |

The Company regularly invests in auction rate securities, which within the fixed income market are very common and generally considered highly liquid. The auction rate securities the Company holds reset their coupon rate either monthly or quarterly, although the contractual maturity of auction rate securities is usually several years in the future. For purposes of reporting these securities, the Company has used the contractual maturity date, not the date of the next reset.

As of January 29, 2006, all of the Company s investments mature on various dates through fiscal year 2008.

Investments maturities (in thousands)

| | January 29, 2006 | | January 30, 2005 | |
|---|---|---|---|---|
| | Market Value | Cost Basis | Market Value | Cost Basis |
| Within 1 year | $ 130,185 | $ 131,224 | $ 108,167 | $ 108,728 |
| After 1 year through 5 years | 82,458 | 83,842 | 111,577 | 113,320 |
| Investments | $ 212,643 | $ 215,066 | $ 219,744 | $ 222,048 |

Investments and interest from cash and cash equivalents generated interest income of $8.0 million, $6.3 million and $7.4 million in fiscal years 2006, 2005 and 2004, respectively. In fiscal year 2006, interest income of $1.6 million was generated from government issues and $6.4 million from corporate and money market issues. In fiscal year 2005, interest income of $976,000 million was generated from government issues and

$5.3 million from corporate and money

market issues. In fiscal year 2004, interest income of $3.2 million was generated from government issues and $4.2 million from corporate and money market issues.

**4. Inventories**

Inventories consist of the following:

(in thousands)

| | As of January 29, 2006 | | | | As of January 30, 2005 | | |
|---|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | Audit Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| Raw materials | $ 2,223 | $ | $ | $ 2,223 | $ 726 | $ | $ 726 |
| Work in progress | 15,587 | | (124) | 15,463 | 16,746 | | 16,746 |
| Finished goods | 5,868 | 30 | 11 | 5,909 | 7,262 | 114 | 7,376 |
| Inventories | $ 23,678 | $ 30 | $ (113) | $ 23,595 | $ 24,734 | $ 114 | $ 24,848 |

For information regarding the Restatement Adjustments and the Audit Adjustments, see Note 1A and Note 20, respectively.

**5. Other Current Assets**

Other current assets consist of the following:

Other Current Assets (in thousands)

| | January 29, 2006 | January 30, 2005 |
|---|---|---|
| Prepaid capacity with suppliers | $ 4,581 | $ 2,910 |
| VAT receivable | 706 | 225 |
| Prepaid software maintenance | 620 | 806 |
| Earned interest on withheld tax | 589 | 317 |
| Receivable from suppliers | 517 | 575 |
| Prepaid rent and property taxes | 349 | 313 |
| Prepaid insurance | 230 | 303 |
| Other | 1,165 | 577 |
| Other Current Assets | $ 8,757 | $ 6,026 |

The Company has several arrangements with outside wafer foundries and package and test subcontractors, which appear as prepaid capacity with suppliers and receivable from suppliers. In most cases, the Company receives repayment under these arrangements based on the level of wafers and package and test services purchased over time. Repayment under these arrangements would still be expected even if specific capacity or purchase levels were not achieved. These arrangements are designed to provide some assurance of capacity, but are not expected to assure access to all the manufacturing capacity that may be needed in the future.

Certain prepaid amounts included in other current assets, such as software maintenance and insurance policies, are expensed over the period in which they cover.

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**6. Property, Plant and Equipment**

Property, plant and equipment consist of the following:

Property, Plant and Equipment (in thousands)

| | January 29, 2006 | January 30, 2005 |
|---|---|---|
| Property | $ 14,213 | $ 14,213 |
| Buildings | 16,695 | 16,751 |
| Leasehold improvements | 1,775 | 2,116 |
| Machinery and equipment | 66,137 | 51,008 |
| Furniture and office equipment | 18,742 | 14,671 |
| Construction in progress | 1,118 | 738 |
| Property, plant and equipment, gross | 118,680 | 99,497 |
| Less accumulated depreciation and amortization | (61,723) | (43,823) |
| Property, Plant and Equipment, Net | $ 56,957 | $ 55,674 |

As part of the relationship with its largest third-party wafer foundry, which is located in China, the Company has agreed to consign certain equipment to the foundry to support specialized processes the foundry runs for the Company and ensure a specified level of capacity over the next few years. The Company retains title to all the consigned assets located at the wafer foundry.

**7. Convertible Subordinated Debentures**

The Company no longer has any convertible subordinated notes outstanding. As described below, the Company called the remaining outstanding balance of its convertible subordinated notes in July 2003.

On February 14, 2000, the Company completed a private offering of $400.0 million principal amount of convertible subordinated notes that pay interest semiannually at a rate of 4 1/2% and were convertible into common stock at a conversion price of $42.23 per share. The notes were due on February 1, 2007 and were callable by the Company on or after February 6, 2003. Since the offering date, the Company had repurchased through a buyback program a portion of the convertible subordinated notes in open market transactions and on July 18, 2003, the Company called the remaining convertible subordinated notes.

In connection with the issuance of these convertible subordinated notes, the Company incurred $11.5 million in underwriter fees and other costs. The underwriter fees and other costs were amortized as interest expense using the effective interest method for outstanding notes and written off against the gain for those notes repurchased and retired prior to maturity. The Company used the net proceeds of the offering for general corporate purposes, including working capital, expansion of sales, marketing and customer service capabilities, and product development.

On July 18, 2003, the Company called the remaining $165.0 million outstanding balance of its convertible subordinated notes. The Company incurred a pre-tax charge related to the calling of the notes of $6.8 million or a net-of-tax impact of approximately 7 cents per diluted share in the second quarter of fiscal year 2004. The pre-tax charge was made up of a $4.2 million call premium and $2.6 million of non-cash expense associated with previously paid note issuance costs.

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**8. Other Assets**

Other assets consist of the following:

Other Assets (in thousands)

| | January 29 2006 | January 30 2005 |
|---|---|---|
| Prepaid capacity with suppliers | $ 5,323 | $ 6,741 |
| Company-owned life insurance | 4,515 | 2,208 |
| Deposit on equipment to be consigned to supplier | 576 | 4,128 |
| Other | 349 | 247 |
| Other Assets | $ 10,763 | $ 13,324 |

The Company has several arrangements with outside wafer foundries and package and test subcontractors, which appear as prepaid capacity with suppliers and deposit on equipment to be consigned to supplier. These arrangements are designed to provide some assurance of capacity, but are not expected to assure access to all the manufacturing capacity that may be needed in the future.

The Company has purchased whole life insurance on the lives of certain current and former deferred compensation plan participants. This company-owned life insurance is intended to cover a majority of the accrued liability for the deferred compensation plan. The Company-owned life insurance associated with the deferred compensation plan totaled $4.5 million as of January 29, 2006 and $2.2 million as of January 30, 2005. See Note 10 regarding the long-term liability associated with the plan.

**9. Accrued Liabilities**

Accrued liabilities consist of the following:

Accrued Liabilities

(in thousands)

| | January 29 2006 | January 30 2005 |
|---|---|---|
| Payroll and related | $ 6,001 | $ 6,868 |
| Commissions | 1,511 | 1,363 |
| VAT payable | 647 | |
| Scrap allowance | 644 | 638 |
| Legal expense | 403 | 377 |
| Project costs | 315 | |
| Due supplier | 269 | |
| Lease loss | 259 | 1,150 |
| Treasury stock buyback | | 450 |
| Other | 1,015 | 851 |
| Accrued liabilities | $ 11,064 | $ 11,697 |

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### 10. Other Long-Term Liabilities

Other long-term liabilities consist of the following:

Other Long-term Liabilities (in thousands)

| | January 29 2006 | January 30 2005 |
|---|---|---|
| Deferred compensation plan | $ 4,546 | $ 2,253 |
| Office leases | 580 | |
| Deferred rent | 202 | 157 |
| Other | 150 | |
| Other long-term liabilities | $ 5,478 | $ 2,410 |

The Company has a deferred compensation plan for certain officers and key executives that allow participants to defer a portion of their compensation for future distribution at various times permitted by the plan. A portion of the employee s deferral is matched by the Company, with the match subject to a vesting period. The Company s liability for deferred compensation totaled $4.5 million as of January 29, 2006 and $2.2 million as of January 30, 2005. See Note 8 regarding the asset intended to offset the majority of this liability and Note 12 for further details regarding this deferred compensation plan.

### 11. Income Taxes

The provision for income taxes consists of the following:

Provision for Income Taxes

(fiscal years, in thousands)

| | 2006 | | | | 2005 | | | 2004 | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | As Previsously Reported | Retsatement Adjustments | Audit Adjs | As Restated | As Previsously Reported | Restatement Adjustments | As Restated | As Previsously Reported | Restatement Adjustments | As Restated |
| Current: | | | | | | | | | | |
| Federal | $ 4,986 | $ | $ | $ 4,986 | $ 5,804 | $ | $ 5,804 | $ 5,853 | $ | $ 5,853 |
| State | 603 | | | 603 | 2,474 | | 2,474 | 3,297 | | 3,297 |
| Foreign | 22 | | | 22 | 2,604 | | 2,604 | 1,731 | | 1,731 |
| Subtotal | 5,611 | | | 5,611 | 10,882 | | 10,882 | 10,881 | | 10,881 |
| Deferred: | | | | | | | | | | |
| Federal | 4,057 | (382) | (135) | 3,540 | 8,266 | (1,460) | 6,806 | 870 | (2,262) | (1,392) |
| State | 560 | (51) | (19) | 490 | (2,154) | (197) | (2,351) | (1,499) | (304) | (1,803) |
| Foreign | 1,443 | | | 1,443 | 388 | | 388 | | | |
| Subtotal | 6,060 | (433) | (154) | 5,473 | 6,500 | (1,657) | 4,843 | (629) | (2,566) | (3,195) |
| Provision for taxes | $ 11,671 | $ (433) | $ (154) | $ 11,084 | $ 17,382 | $ (1,657) | $ 15,725 | $ 10,252 | $ (2,566) | $ 7,686 |

For information regarding the Restatement Adjustments and the Audit Adjustments, see Note 1A and Note 20, respectively.

The benefit related to tax deductions from the exercise of non-qualified stock options in excess of compensation cost recognized for financial reporting purposes is recorded as an increase to additional paid-in capital when realized. Therefore, the change in the net deferred tax asset differs from the deferred tax provision.

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The components of the net deferred income tax assets at January 29, 2006 and January 30, 2005 are as follows:

Net Deferred Income Tax Asset

(in thousands)

| | As of January 29, 2006 | | | | As of January 30, 2005 | | |
|---|---|---|---|---|---|---|---|
| | **As Previously Reported** | **Restatement Adjustments** | **Audit Adjs** | **As Restated** | **As Previously Reported** | **Restatement Adjustments** | **As Restated** |
| Current deferred tax asset: | | | | | | | |
| Payroll and related | $ 2,569 | $ | $ | $ 2,569 | $ 1,785 | $ | $ 1,785 |
| Deferred revenue | 1,387 | | | 1,387 | 1,713 | | 1,713 |
| Inventory reserve | 2,050 | | 34 | 2,084 | 3,402 | | 3,402 |
| Bad debt reserve | | | | | 72 | | 72 |
| Deferred rent | 197 | | | 197 | 177 | | 177 |
| Accrued service fees | 59 | | | 59 | 48 | | 48 |
| Other deferred assets | 65 | | | 65 | 58 | | 58 |
| Total current deferred tax asset | 6,327 | | 34 | 6,361 | 7,255 | | 7,255 |
| Long-term deferred tax asset | | | | | | | |
| Deferred tax assets: | | | | | | | |
| Research and development charges | 4,627 | | | 4,627 | 3,990 | | 3,990 |
| Research credit carryforward | 20,583 | (1,141) | | 19,442 | 19,672 | (1,141) | 18,531 |
| Manufacturing investment credit carryforward | | | | | 426 | | 426 |
| AMT credit carryforward | 556 | | | 556 | 83 | | 83 |
| NOL carryforward | 25,786 | (8,471) | | 17,315 | 27,373 | (8,471) | 18,902 |
| Acquired NOL carryforward - foreign | 5,112 | | | 5,112 | | | |
| Environmental | 6 | | | 6 | 2 | | 2 |
| Dispute settlement charges | 2,590 | | | 2,590 | 3,719 | | 3,719 |
| Stock-based compensation | | 8,814 | | 8,814 | | 10,558 | 10,558 |
| Other deferred assets | 511 | | | 511 | 869 | | 869 |
| Comprehensive income; mark-to-market | 974 | | | 974 | 926 | | 926 |
| Valuation reserve | (37,450) | (2) | 83 | (37,369) | (30,144) | (1) | (30,145) |
| Total non-current deferred tax asset | 23,295 | (800) | 83 | 22,578 | 26,916 | 945 | 27,861 |
| Current deferred tax liability: | | | | | | | |
| Bad debt reserve - Foreign | (420) | | | (420) | (124) | | (124) |
| Depreciation and amortization - Foreign | (102) | | | (102) | (18) | | (18) |
| Inventory reserve - Foreign | (40) | | | (40) | (1,301) | | (1,301) |
| Non-current deferred tax liability: | | | | | | | |
| Depreciation and amortization | (856) | | | (856) | (915) | | (915) |
| Depreciation and amortization - Foreign | (1,635) | | | (1,635) | | | |
| Tax contingency reserve | (1,216) | | | (1,216) | (1,216) | | (1,216) |
| Total deferred tax liability | (4,269) | | | (4,269) | (3,574) | | (3,574) |
| Net deferred tax asset | $ 25,353 | $ (800) | $ 117 | $ 24,670 | $ 30,597 | $ 945 | $ 31,542 |

For information regarding the Restatement Adjustments and the Audit Adjustments, see Note 1A and Note 20, respectively.

As of January 29, 2006, the Company had a federal net operating loss carryforward available of approximately $47.6 million, which can be used to offset taxable income, expiring though 2023.

Approximately $17.6 million of federal net operating loss and tax credit deferred tax assets were generated from stock option exercises. A corresponding valuation allowance of $17.1 million has been established to reflect the Company s deferred tax asset utilization concerns. To the extent that a tax benefit is received for a reserved portion of these deferred tax assets, the corresponding amount of valuation allowance will be reduced, and shareholders equity or additional paid-in capital will be credited. In fiscal year 2006, no portion of this valuation reserve was released.

Realization of the net deferred tax assets is dependent on generating sufficient taxable income during the periods in which temporary differences will reverse. Although realization is not assured, management believes it is more likely than not that the net deferred tax assets will be realized. The amount of the net deferred tax assets considered realizable, however, could be adjusted in the near term if estimates of future taxable income during the reversal periods are revised. The change in valuation reserve reflected in the following reconciliation excludes valuation reserves that have been set up against deferred tax assets that were generated from stock option exercise activity.

The Company is subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgment is required in determining the worldwide provision for income taxes. In the ordinary course of business, there are many transactions and calculations where the ultimate tax determination is uncertain. The calculation of tax liabilities involves dealing with uncertainties in the application of complex tax laws. The Company recognizes

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probable liabilities for anticipated tax audit issues in the United States and other tax jurisdictions based on an estimate of the ultimate resolution of whether, and the extent to which, additional taxes may be due. As a result of the restatement, our tax contingency reserve increased from $1.2 million to $1.3 million to reflect the estimated tax, penalties and interest related to the impact of certain option grants that were issued in prior periods with exercise prices below the market price of our stock on the grant date. Although the Company believes the estimates are reasonable, no assurance can be given that the final outcome of these matters will not be different than what is reflected in the historical income tax provisions and accruals. Should additional taxes be assessed as a result of an audit or litigation, a material effect on the Company s income tax provision and net income in the period or periods for which that determination is made could result.

The provision for taxes reconciles to the amount computed by applying the statutory federal rate to income before taxes as follows:

(fiscal years, in thousands)

| | **2006** | | | | **2005** | | | **2004** | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **As Previously Reported** | **Restatement Adjs** | **Audit Adjs** | **As Restated** | **As Previously Reported** | **Adjs** | **As Restated** | **As Previously Reported** | **Adjs** | **As Restated** |
| Federal income tax at statutory rate | $ 19,129 | $ (399) | $ (135) | $ 18,595 | $ 26,694 | $ (1,972) | $ 24,722 | $ 14,951 | $ (3,233) | $ 11,718 |
| State income taxes, net of federal benefit | 1,281 | (51) | (19) | 1,211 | 1,693 | (197) | 1,496 | 2,013 | (304) | 1,709 |
| Foreign taxes at rates less than federal rates | (2,667) | 130 | | (2,537) | (10,072) | 488 | (9,584) | (4,797) | 1,002 | (3,795) |
| Tax credits generated | (1,433) | | | (1,433) | (2,521) | | (2,521) | | | |
| Changes in valuation reserve | 1,959 | (82) | | 1,877 | 1,630 | | 1,630 | 1,694 | | 1,694 |
| Changes in tax contingency reserves | | | | | 1,216 | | 1,216 | | | |
| Permanent differences | 1,002 | | | 1,002 | (1,109) | | (1,109) | (3,422) | | (3,422) |
| Sales exclusion - foreign jurisdiction | (7,310) | | | (7,310) | | | | | | |
| Other | (290) | (31) | | (321) | (149) | 24 | (125) | (187) | (31) | (218) |
| Provision for taxes | $ 11,671 | $ (433) | $ (154) | $ 11,084 | $ 17,382 | $ (1,657) | $ 15,725 | $ 10,252 | $ (2,566) | $ 7,686 |

All adjustments in fiscal years 2004 and 2003 relate to the restatement.

For information regarding the Restatement Adjustments and the Audit Adjustments, see Note 1A and Note 20, respectively.

As of January 29, 2006, the Company had approximately $146.1 million of unremitted income related to the Company s wholly owned European subsidiaries. U.S. federal and state income taxes have not been provided for the undistributed earnings of the Company s foreign operations. The Company s policy is to leave the income permanently reinvested offshore. The amount of earnings designated as indefinitely reinvested to offshore is based upon the actual deployment of such earnings in the Company s offshore assets and expectations of the future cash needs of the Company s U.S. and foreign entities. Income tax considerations are also a factor in determining the amount of foreign earnings to be repatriated.

As of January 29, 2006, the Company had federal and state research credits available of approximately $14.2 million and $8.0 million for federal and state income tax purposes, respectively, which can be used to offset taxable income, expiring through 2024. As of January 29, 2006, the Company had federal Alternative Minimum Tax (AMT) credits of approximately $556,000.

Our newly acquired entity, Semtech Neuchatel, enjoys a Cantonal tax holiday in Switzerland. Under the terms of this holiday, 80% of the income of Semtech Neuchatel earned through 2007 is not taxable by the Canton of Neuchatel. As a result of cumulative operating losses generated by this entity in prior years, the Company does not expect to receive any benefit from this tax holiday.

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**12. Commitments and Contingencies**

See Note 19 with respect to legal matters associated with the restatement and its underlying circumstances.

Leases

The Company leases facilities and certain equipment under operating lease arrangements expiring in various years through fiscal year 2015. The aggregate minimum annual lease payments under leases in effect on January 29, 2006 are as follows:

Minimum Annual Lease Payments (in thousands)

| | |
|---|---|
| Fiscal year ending: | |
| 2007 | $ 2,792 |
| 2008 | 2,330 |
| 2009 | 2,202 |
| 2010 | 1,546 |
| 2011 | 636 |
| Thereafter | 989 |
| Total minimum lease commitments | $ 10,495 |

Not included in operating lease commitments is expected sub-lease income to the Company. Sub-lease agreements are scheduled to provide between $324,000 to $375,000 of annual income in each of the next five fiscal years.

Annual rent expense was $2.5 million, $2.4 million and $2.1 million, for fiscal years 2006, 2005, and 2004, respectively. The Company received $230,000 and $136,000 of sub-lease income in fiscal years 2006 and 2005, respectively.

XEMICS Acquisition

As further detailed in Note 18, the Company has a contingent obligation that required the Company to pay up to an additional $16 million to the former shareholders of XEMICS if certain performance objectives are met during an earn-out period of approximately one year that ends on April 30, 2006. Although the earn-out period has not yet ended, based on currently available information, the Company does not believe any additional amount will be payable to the selling shareholders.

Also, as detailed in Note 18, a portion of the purchase price is being held in escrow for fifteen months after the closing to provide a source of funds in the event liability attaches to the selling shareholders as a result of a breach of their representations and warranties. The Company has not made any claims against the escrow account, but continues to monitor and assess whether there are any qualifying items in excess of the threshold for making a claim.

Deferred Compensation Plan

Late in fiscal year 2004, the Company established a deferred compensation plan for certain officers and key executives that allows participants to defer a portion of their compensation for future distribution at various times permitted by the plan. A portion of the employee s deferral is matched by the Company, with the match subject to a vesting period. Compensation expense under this plan totaled $744,000 and $161,000 in fiscal years 2006 and 2005, respectively. The Company s liability for deferred compensation totaled $4.5 million as of January 29, 2006, and is included in other long-term liabilities, as shown in Note 10.

The Company has purchased whole life insurance on the lives of certain current and former deferred compensation plan participants. This company-owned life insurance is intended to cover a majority of the accrued liability for the deferred compensation plan. The cash surrender value of the company-owned life insurance was $4.5 million as of January 29, 2006, and is included in other assets, as shown in Note 8.

Legal Matters

From time to time in the ordinary course of its business, the Company is involved in various claims, litigation, and other legal actions that are normal to the nature of its business, including with respect to intellectual property, contract, product liability, employment, and environmental matters.

The Company records any amounts recovered in these matters when collection is certain. Liabilities for claims against the Company are accrued when it is probable that a liability has been incurred and the amount can reasonably be estimated. Any amounts recorded are based on periodic reviews by outside counsel, in-house counsel and management and are adjusted as additional information becomes available or assessments change.

While some insurance coverage is maintained for such matters, there can be no assurance that the Company has a sufficient amount of insurance coverage, that asserted claims will be within the scope of coverage of the insurance, or that the Company will have sufficient resources to satisfy any amount due not covered by insurance.

Management is of the opinion that the ultimate resolution of such matters now pending will not, individually or in the aggregate have a material adverse effect on the Company s consolidated results of operations, financial position or cash flows. However, the outcome of legal proceedings cannot be predicted with any degree of certainty.

Some of the Company s more significant pending legal matters are discussed below. In addition, significant legal events occurring through the date of filing of this Amendment No. 1 that are related to the restatement or its underlying cause are described in Note 19 *Matters Related to Stock Option Review and Restatement*.

Settled Customer Dispute and Related Insurance Matters

In March 2003, the Company announced that it had resolved a customer dispute. Under the terms of the settlement, the Company agreed to pay the customer $12.0 million in cash in two equal annual installments, plus rebates on the future purchase of certain products by the customer through the end of March 2005. The rebates, which can be up to 10%, are dependent upon the amount of eligible products the customer purchases. The Company paid the first $6.0 million installment in the first quarter of fiscal year 2004 and paid the second $6.0 million installment in the first quarter of fiscal year 2005. Amounts paid or accrued for the rebates during fiscal years 2006, 2005 and 2004 are not material.

At the time of the customer settlement, The Company stated that it would vigorously pursue insurance coverage for the full value of the settlement. The Company subsequently filed lawsuits against three of its insurance companies and reached settlements with two of the three insurance companies in the second quarter of fiscal year 2006. The Company recorded a $3.0 million gain in the second quarter of fiscal year 2006 for these insurance settlements. In fiscal year 2006, the Company also recorded $2.9 million of related legal expenses under the operating expense category of selling, general and administrative.

The case against the remaining insurance company is expected to go to trial sometime in fiscal year 2007. The Company is unable to predict if settlement will be reached prior to trial. There is no assurance that the Company will prevail at trial or that the insurance company will not appeal if the Company does prevail. Legal fees and expenses related to pursuit of the insurance recovery have been, and will continue to be, expensed in the period incurred. If the settlement amount or amount awarded at trial is less than the Company seeks, if the Company fails to prevail at trial, or if the Company or insurance company appeals the decision, total legal expenses associated with the litigation may exceed the amount recovered from the insurance companies.

Environmental Matters

In June 2001, we were notified by the California Department of Toxic Substances Control ( State ) that we may have liability associated with the clean-up of the one-third acre Davis Chemical Company site in Los Angeles, California. We have been included in the clean-up program because we are one of the companies that used the Davis Chemical Company site for waste recycling and/or disposal between 1949 and 1990. We have joined with other potentially responsible parties in an effort to resolve this matter with the State. The group has entered into a Consent Order with the State that requires the group to perform a soils investigation at the site and submit a draft remediation plan. In March 2007, the State approved the group s draft remediation plan, which will be published for public comment before the final remediation plan is submitted. The State has the right to require the removal of contaminated soils and to expand the scope of work to include further investigation of

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groundwater contamination. The Consent Order does not require the group to remediate the site. To date, our share of the group s expenses has not been material and has been expensed. At this time there is not a specific proposal or budget with respect to any additional studies or the clean-up of the site. Thus, no reserve has been established for this matter.

The Company uses an environmental consulting firm, specializing in hydrogeology, to perform periodic monitoring of the groundwater at the facility in Newbury Park, California that it leased for approximately forty years. Certain contaminants have been found in the local groundwater. Monitoring results over a number of years indicate that contaminants are from adjacent facilities. It is currently not possible to determine the ultimate amount of possible future clean-up costs, if any, that may be required of the Company for this site. There are no claims pending with respect to environmental matters at the Newbury Park site. Accordingly, no reserve for clean up has been provided at this time.

Stockholder Protection Agreement

Effective June 11, 1998, the Company s board of directors approved a Stockholder Protection Agreement to issue a Right for each share of common stock outstanding on July 31, 1998 and each share issued thereafter (subject to certain limitations). These Rights, if not cancelled by the Board of Directors, can be exercised into a certain number of Series X Junior Participating Preferred Stock after a person or group of affiliated persons acquire 25% or more of the Company s common stock and subsequently allow the holder to receive certain additional Company or acquirer common stock if the Company is acquired in a hostile takeover.

**13. Product Warranty and Indemnification**

The Company s general warranty policy provides for repair or replacement of defective parts. In some cases a refund of the purchase price is offered. In certain instances the Company has agreed to other warranty terms, including some indemnification provisions.

The product warranty accrual, which is included in cost of sales, reflects the Company s best estimate of probable liability under its product warranties. The Company accrues for known warranty issues if a loss is probable and can be reasonably estimated, and accrues for estimated incurred but unidentified issues based on historical experience.

The following table details the change in the product warranty accrual.

Product Warranty Accrual (fiscal years, in thousands)

| | 2006 | 2005 |
|---|---|---|
| Beginning balance | $ 32 | $ 250 |
| Payments made | | (391) |
| Net expense accrued | 18 | 173 |
| Ending balance | $ 50 | $ 32 |

If there is a substantial increase in the rate of customer claims, if the Company s estimates of probable losses relating to identified warranty exposures prove inaccurate, or its efforts to contractually limit liability prove inadequate, the Company may record a charge against future cost of sales. Over at least the last decade, warranty expense has been immaterial to our financial statements.

In the normal course of its business, the Company indemnifies other parties, including customers, distributors, and lessors, with respect to certain matters. These obligations typically arise under contracts under which the Company customarily agrees to hold the other party harmless against losses arising from a breach of representations and covenants related to certain matters, such as acts or omissions of Company employees, infringement of third-party intellectual property rights, and certain environmental matters. The Company has also entered into agreements with its current and former directors and some current and former Company executives indemnifying them against certain liabilities incurred in connection with their duties. The Company s Certificate of Incorporation and Bylaws contain similar indemnification obligations with respect to the Company s current and former directors and employees, as does

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the California Labor Code. In some cases there are limits on, and exceptions to, the Company s potential indemnification liability. The Company cannot estimate the amount of potential future payments, if any, that the Company might be required to make as a result of these agreements. Over at least the last decade, the Company has not incurred any significant expense as a result of agreements of this type. Accordingly, the Company has not accrued any amounts for such indemnification obligations for fiscal year 2006. However, there can be no assurances that the Company will not incur expense under these indemnification provisions in the future. See Note 19 regarding indemnification expenses associated with the restatement and its underlying circumstances.

**14. Stockholders Equity**

The Company has various stock option plans that provide for granting equity-based awards, including options to purchase shares of the Company s common stock to employees and directors of the Company and some prior plans also provided for the granting of options to consultants. The plans provide for the granting of options that meet the Internal Revenue Code qualifications to be incentive stock options, as well as nonstatutory options. Most options granted by the Company expire within ten years from the date of grant and vest in equal annual increments over three to four years from the date of grant. The Company has also issued some stock options outside of any plan, including inducement options awarded as recruitment incentives.

The plans from which options are currently granted were adopted in the late 1990s and provide for the issuance of 16.8 million shares over the life of the plans. One of the plans also provides for the further issuance of up to 8.0 million additional shares, which are reacquired in the open market or in a private transaction, if authorized by the board. The board has authorized the repurchase and issuance of shares under this provision. See Note 2.

The following table presents information with respect to the Company s stock option plans. Certain amounts have been adjusted to reflect non-material differences caused by administrative errors and resulted in the ending outstanding option balance as of January 29, 2006 to be 2,000 shares higher than previously reported.

(fiscal years)

(share amounts in thousands)

| | 2006 | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|
| | **Shares Under Option** | **Weighted Average Exercise Price** | **Shares Under Option** | **Weighted Average Exercise Price** | **Shares Under Option** | **Weighted Average Exercise Price** |
| Options outstanding, beginning of year | 16,037 | $ 14.50 | 15,787 | $ 13.38 | 14,923 | $ 12.28 |
| Granted | 1,890 | $ 15.83 | 2,689 | $ 18.83 | 2,689 | $ 17.38 |
| Cancelled | (2,158) | $ 18.81 | (804) | $ 20.63 | (520) | $ 21.26 |
| Exercised | (1,528) | $ 8.11 | (1,635) | $ 7.79 | (1,305) | $ 5.86 |
| Options outstanding, end of year | 14,241 | $ 14.71 | 16,037 | $ 14.50 | 15,787 | $ 13.38 |
| Options exercisable at the end of year | 9,501 | $ 13.62 | 10,038 | $ 12.40 | 9,863 | $ 10.54 |
| Weighted-average fair value of options granted during year (restated) | | $ 6.87 | | $ 10.86 | | $ 10.54 |

The weighted average fair values of options granted during the year shown above have decreased from the amounts in the Original Report because the calculations use revised data for options with corrected measurement dates.

The following table summarizes information about stock options outstanding at January 29, 2006 . Certain amounts in the table were adjusted to reflect non-material differences caused by administrative errors and resulted in the ending outstanding option balance as of January 29, 2006 to be 2,000 shares higher than previously reported. The weighted-average exercises prices are unchanged from those previously reported.

(share amounts in thousands)

| Exercise Prices | Number Outstanding | Weighted Average Exercise Price | Weighted Average Remaining Contract Life | Number Exercisable | Weighted Average Exercise Price |
|---|---|---|---|---|---|
| $ 1.03-$ 4.60 | 2,069 | $ 3.03 | 2.1 Years | 2,069 | $ 3.03 |
| $ 4.61-$ 9.20 | 1,877 | $ 6.37 | 2.3 Years | 1,876 | $ 6.37 |
| $ 9.21-$13.80 | 506 | $ 12.76 | 6.2 Years | 310 | $ 12.67 |
| $13.81-$18.40 | 6,799 | $ 16.09 | 6.8 Years | 2,750 | $ 15.63 |
| $18.41-$23.00 | 620 | $ 20.68 | 5.8 Years | 296 | $ 20.32 |
| $23.01-$27.60 | 1,918 | $ 25.34 | 4.6 Years | 1,809 | $ 25.41 |
| $27.61-$32.20 | 340 | $ 29.71 | 5.3 Years | 279 | $ 29.79 |
| $32.21-$36.80 | 73 | $ 33.53 | 5.9 Years | 73 | $ 33.53 |
| $36.81-$41.40 | 39 | $ 38.32 | 4.2 Years | 39 | $ 38.32 |
| $ 1.03-$41.40 | 14,241 | $ 14.71 | 5.1 Years | 9,501 | $ 13.62 |

**15. Interest and Other Income**

Interest and other income, net, consist of the following:

Interest and Other Income (fiscal years, in thousands)

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| Interest income | $ 8,016 | $ 6,284 | $ 7,409 |
| Gain (loss) on sale of assets | (54) | (320) | 109 |
| Loss on the retirement of debt | | | (3,903) |
| Foreign currency transaction gain (loss) | (402) | 367 | (61) |
| Miscellaneous (expense) income | (94) | (10) | 157 |
| Interest and other income, net | $ 7,466 | $ 6,321 | $ 3,711 |

**16. Statements of Cash Flows**

Income taxes paid in fiscal years 2006, 2005, and 2004, were $3.3 million, $1.1 million and $3.0, respectively. For those same periods, the Company paid interest in the amounts of $180,000, $17,000 and $4.2 million, respectively. The Company contributed $769,000, $821,000 and $737,000, respectively, in fiscal years 2006, 2005 and 2004 to the company-sponsored 401(k) retirement plan for its employees.

**17. Business Segments and Concentrations of Risk**

As of January 29, 2006, the Company operates in two reportable segments: Standard Semiconductor Products and Rectifier, Assembly and Other Products. The Rectifier, Assembly and Other Products segment has represented less than 10% of net sales for the last three fiscal years.

The Standard Semiconductor Products segment makes up the vast majority of overall sales and includes the power management, protection, test and measurement, advanced communications, wireless and sensing and human input device product lines. The Rectifier, Assembly and Other Products segment includes the Company s line of assembly

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and rectifier devices, which are the remaining products from its original founding as a supplier into the military and aerospace market.

The Company s wireless and sensing product line, which is part of the Standard Semiconductor Products segment, came by way of the June 2005 acquisition of XEMICS. The balances for goodwill and other intangibles in the Consolidated Balance Sheets are related to the acquisition of XEMICS and this product line.

The accounting policies of the segments are the same as those described above in the summary of significant accounting policies. The Company evaluates segment performance based on net sales and operating income of each segment. Management does not track segment data or evaluate segment performance on additional financial information. As such, there are no separately identifiable segment assets nor are there any separately identifiable statements of income data (below operating income).

The Company does not track or assign assets to individual reportable segments. Likewise, depreciation expense and capital additions are also not tracked by reportable segments.

Net sales by segment are:

(fiscal years, in thousands)

| | 2006 | | | | |
|---|---|---|---|---|---|
| | **As Previously Reported** | **Audit Adjustments** | **As Restated** | **2005** | **2004** |
| Standard Semiconductor Products | $ 229,425 | $ | $ 229,425 | $ 243,202 | $ 182,522 |
| Rectifier, Assembly and Other Products | 9,980 | (67) | 9,913 | 10,410 | 9,557 |
| Total net sales | $ 239,405 | $ (67) | $ 239,338 | $ 253,612 | $ 192,079 |

See Note 20 regarding the Audit Adjustments.
Operating income by segment is:

(fiscal years, in thousands)

| | 2006 | | | |
|---|---|---|---|---|
| | **As Previously Reported** | **Restatement Adjustments** | **Audit Adjustments** | **As Restated** |
| Standard Semiconductor Products | $ 45,487 | $ (1,444) | $ (37) | $ 44,006 |
| Rectifier, Assembly and Other Products | 1,883 | (83) | (57) | 1,743 |
| Total operating income | $ 47,370 | $ (1,527) | $ (94) | $ 45,749 |

See Note 1A regarding the Restatement Adjustments and Note 20 regarding the Audit Adjustments.

(fiscal years, in thousands)

| | 2005 | | | 2004 | | |
|---|---|---|---|---|---|---|
| | **As Previously Reported** | **Restatement Adjustments** | **As Restated** | **As Previously Reported** | **Restatement Adjustments** | **As Restated** |

| | | | | | | |
|---|---|---|---|---|---|---|
| Standard Semiconductor Products | $ 66,901 | $ (5,325) | $ 61,576 | $ 40,402 | $ (8,628) | $ 31,774 |
| Rectifier, Assembly and Other Products | 3,065 | (312) | 2,753 | 2,767 | (606) | 2,161 |
| Total operating income | $ 69,966 | $ (5,637) | $ 64,329 | $ 43,169 | $ (9,234) | $ 33,935 |

See Note 1A regarding the Restatement Adjustments.

One end-customer that is a major manufacturer of cellular phone handsets and other electronic equipment, accounted for 11% of net sales in fiscal year 2006. No end-customer accounted for 10% or more of net sales in fiscal years 2005

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and 2004. For fiscal years 2006, 2005 and 2004, one of the Company s Asian distributors accounted for approximately 12%, 10% and 14%, respectively, of net sales. For fiscal year 2005 and fiscal year 2004, an Asian distributor formerly used by the Company accounted for approximately 10% of net sales in each year.

As of the end of fiscal years 2006, 2005, and 2004, one of the Company s Asian distributors accounted for approximately 12%, 12% and 11%, respectively, of net accounts receivable. As of the end of fiscal years 2006, another one of the Company s Asian distributors accounted for approximately 11% of net accounts receivable. Sales to our customers and distributors are generally made on open account, subject to credit limits we may impose, and the receivables are subject to the risk of being uncollectible.

The Company s total credit risk as of January 29, 2006, which includes accounts receivables, prepayments to certain vendors and receivables from certain vendors, is estimated to be approximately $46.7 million. This total credit risk amount does not include backlog of orders from customers, which as of January 29, 2006 was $46.6 million. Any significant cancellation of backlog would negatively impact the Company s rate of shipments in future periods.

The Company does not track customer sales by region for each individual reporting segment. A summary of net external sales by region follows:

(fiscal years, in thousands)

| | 2006 | | | | |
|---|---|---|---|---|---|
| | **As Previously Reported** | **Audit Adjustments** | **As Restated** | **2005** | **2004** |
| North America | $ 42,678 | $ (67) | $ 42,611 | $ 65,884 | $ 59,927 |
| Asia-Pacific | 168,796 | | 168,796 | 167,336 | 115,936 |
| Europe | 27,931 | | 27,931 | 20,392 | 16,216 |
| Total Net Sales | $ 239,405 | $ (67) | $ 239,338 | $ 253,612 | $ 192,079 |

See Note 20 regarding the Audit Adjustments.

For fiscal year 2006, the Company generated income before tax of approximately $21.6 million from domestic operations and $31.4 million from foreign operations. The Company generated income before tax of approximately $31.2 million from domestic operations and $39.4 million from foreign operations in fiscal year 2005. In fiscal year 2004, the Company generated income before tax of approximately $17.2 million from domestic operations and $14.3 million from foreign operations.

Long-lived assets, consisting principally of property and equipment, which are located within the United States as of the end of fiscal years 2006, 2005 and 2004 were approximately $34.3 million, $40.0 million and $38.3 million, respectively. Long-lived assets located outside the United States as of the end of fiscal years 2006, 2005 and 2004 were approximately $22.7 million, $15.7 million, and $11.3 million, respectively. Some of the Company s assets are located at facilities of its suppliers.

The Company relies on a limited number of outside subcontractors and suppliers for silicon wafers, packaging and certain other tasks. Disruption or termination of supply sources or subcontractors could delay shipments and could have a material adverse effect on the Company. Several of the Company s outside subcontractors and suppliers, including third-party foundries that supply silicon wafers, are located in foreign countries, including China, Malaysia, the Philippines and Germany. A significant amount of the Company s assembly and test operations are conducted by third-party contractors in Malaysia and the Philippines, and the largest source of silicon wafers come from an outside foundry located in China.

**18. Acquisition**

On June 23, 2005 the Company, through its wholly owned Swiss subsidiary, Semtech International AG ( Semtech International ), acquired all of the outstanding shares of XEMICS in a cash-for-stock transaction pursuant to a share purchase and sales agreement.

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XEMICS is a research and development intensive company based in Switzerland that applies low-power, low-voltage design expertise across its core technologies: sensor interfacing/data acquisition, 8-bit RISC microcontrollers, radio frequency transceivers and audio converters. These capabilities are aimed at adding value in next generation, highly integrated battery powered wireless and sensing applications. XEMICS, which has been renamed Semtech Neuchatel, continues to operate from its Switzerland location and is also now referred to as Semtech s Wireless and Sensing Products product line. Activity for this product line is included in the Standard Semiconductor Products segment.

The transaction with former XEMICS shareholders is valued at approximately $59.0 million, assuming all variable portions of the purchase price are paid and including payments associated with settling loans from former shareholders. Semtech International paid approximately $43.3 million upon closing of the transaction. An additional $16.0 million may be payable if XEMICS meets certain performance objectives during an earn-out period of approximately one year that ends on April 30, 2006. Semtech has agreed to certain covenants related to support of XEMICS business during the earn-out period. Any purchase price adjustment would be payable, at the earliest, in the second quarter of fiscal year 2007. The payment could occur in a later quarter if there is any dispute surrounding the calculations underlying the adjustment. The Company intends to fund any purchase price adjustment from available cash and investments balances. Although the earn-out period has not yet ended, the Company does not believe any purchase price adjustment will be payable to the selling shareholders.

The acquisition has been accounted for using the purchase method of accounting. Revenues and expenses of XEMICS have been included in the accompanying consolidated statement of income beginning on the date of acquisition. Any purchase price adjustment will be accrued as an additional cost of the transaction when payment is deemed to be probable and can be reasonably estimated by the Company.

The allocation of purchase price to the acquired assets and liabilities was based on their respective fair values, a portion of which was based on a valuation report performed by a third party. As part of the acquisition, the Company assumed debt totaling $1.4 million related to a factoring line of credit, which was subsequently paid down. Also included in the purchase price allocation is approximately $400,000 of cash outlays for legal advice, travel and other acquisition related expenses.

Consistent with purchase accounting treatment of the acquisition, during the second quarter of fiscal year 2006 a one-time acquisition related charge to earnings of $4.0 million was recorded for the write-off of in-process research and development. This amount is included in the line item entitled Acquisition related items in the consolidated statement of income.

Presented below is the condensed balance sheet of XEMICS as of the date of the acquisition.

Xemics Purchase Price Allocation (in thousands)

| | At June 23, 2005 |
|---|---|
| Cash paid | $ 42,919 |
| Acquisition costs | 415 |
| Total purchase price | 43,334 |
| | |
| Allocation of purchase price: | |
| Cash and cash equivalents acquired | 890 |
| Accounts receivable | 3,141 |
| Inventory | 3,197 |
| Other current assets | 889 |
| Property, plant and equipment | 1,544 |
| Identifiable intangible assets | 10,430 |
| Accounts payable and accrued liabilities | (7,707) |
| Line of credit | (1,400) |
| Other long-term liabilities | (591) |
| | |
| Goodwill | $ 32,941 |

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The goodwill associated with the purchase of XEMICS was $33.1 million as of January 29, 2006, an insignificant amount of which is expected to be deductible for tax purposes. Presented below is a summary of the impact of changes to goodwill since the date of acquisition.

| | Beginning balance on date of acqusuition | Adjustments to date | Balance as of January 29, 2006 |
|---|---|---|---|
| Goodwill | $ 32,941 | $ 191 | $ 33,132 |

There was $954,000 of expense for amortization of other intangible items incurred in fiscal year 2006 associated with the acquisition of XEMICS. The remaining $5.5 million balance of other intangible items, as detailed below, will be amortized over future periods. No significant residual value is expected. There are no tax-related benefits from these acquisition related costs.

Other Intangibles (in thousands)

| | Beginning balance on date of acquisition | Amortization to date | Balance as of January 29, 2006 | Remaining period to be amortized |
|---|---|---|---|---|
| Backlog associated with customer design wins | $ 400 | $ (311) | $ 89 | 2 months |
| Core technologies | 6,000 | (636) | 5,364 | 59 months |
| Customer relationships | 30 | (7) | 23 | 23 months |
| Other Intangibles | $ 6,430 | $ (954) | $ 5,476 | |

The former XEMICS shareholders made certain representations, warranties and covenants with respect to the financial condition of XEMICS and other matters. A portion of the purchase price was not immediately disbursed to the selling shareholders but is being held in escrow for fifteen months after the closing to assure some funds are available in the event liability attaches to the selling shareholders as a result of a breach of the representations and warranties. Six of the selling shareholders will remain liable for five years after the closing as to certain representations related to organization, capital structure, and tax matters. The share purchase and sales agreement provides for certain conditions and limitations on the selling shareholders liability. The Company has not made any claims against the escrow account, but continues to monitor and assess whether there are qualifying items in excess of the threshold for making a claim. Any successful claim against the escrow account will be accrued as a reduction of the cost of the acquisition.

The Company completed the acquisition of XEMICS on June 23, 2005. Presented below is pro forma data that gives effect to the acquisition of XEMICS as if it had occurred at the beginning of our fiscal year 2005.

Pro Forma

(fiscal years, in thousands, expect per share data)

| | 2006 | | | | 2005 | | |
|---|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | Audit Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| Pro forma net sales | $ 248,219 | $ | $ (67) | $ 248,152 | $ 274,857 | $ | $ 274,857 |
| Pro forma net income | 41,124 | (1,094) | 60 | 40,090 | 51,152 | (3,980) | 47,172 |
| Pro forma earnings per share - basic | $ 0.56 | $ (0.02) | $ | $ 0.54 | $ 0.69 | $ (0.05) | $ 0.64 |
| Pro forma earnings per share - diluted | $ 0.54 | $ (0.02) | $ | $ 0.52 | $ 0.65 | $ (0.05) | $ 0.60 |
| Earnings per share - basic, as reported | $ 0.59 | $ (0.02) | $ | $ 0.57 | $ 0.79 | $ (0.05) | $ 0.74 |

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Earnings per share - diluted, as reported | $ | 0.57 | $ | (0.02) | $ | | $ | 0.55 | $ | 0.75 | $ | (0.05) | $ | 0.70 |

See Note 1A regarding the Restatement Adjustments and Note 20 regarding the Audit Adjustments.

Pro forma data for fiscal year 2005 presented above is the combination of Semtech s reported results for the fiscal year ended January 30, 2005 and XEMICS fiscal year ended December 31, 2004, which most closely approximates the comparable period.

**19. Matters Related to Stock Option Review and Restatement**

*Government Inquiries*

On May 18, 2006, the Company received a letter from the SEC requesting that it voluntarily provide information regarding stock options granted since January 1, 1997 as part of an informal inquiry. Additionally, on June 13, 2006, the Company received a Grand Jury subpoena, dated June 8, 2006, from the United States District Court, Southern District of New York, requesting documents relating to the Company s stock option practices since 1996. The Company responded to these requests in a timely manner and intends to continue to fully cooperate in these inquiries.

If the Company is subject to adverse findings in either of these matters, it could be required to pay damages or penalties or have other remedies imposed upon it, which could have a material adverse effect on its business, financial condition, results of operations and cash flows. In addition, if either or both of these investigations continue for a prolonged period of time, they may have the same impact regardless of the ultimate outcome.

*Shareholder Derivative Lawsuits*

The Company has been served with five purported shareholder derivative lawsuits making various allegations with respect to stock option improprieties and financial reporting. The Company is named solely as a nominal defendant against whom the plaintiffs seek no monetary recovery. These lawsuits name various current and former directors, officers, and executives as individual defendants from whom various forms of monetary damages are sought.

Two purported derivative lawsuits with virtually identical complaints were filed in the Superior Court of the State of California, *Guardino v. Poe, et al* (filed in May 2006) and *Graham v. Poe, et al* (filed in June 2006), were consolidated in July 2006 into one case captioned *In re Semtech Corporation Derivative Litigation* ( State Derivative Litigation ). An amended complaint in this action was filed in October 2006. Defendants are not required to respond to the amended complaint because in December 2006 the Court stayed the State Derivative Litigation in favor of the duplicative Federal Derivative Litigation discussed below.

A purported shareholder derivative lawsuit captioned *Employer-Teamsters Local Nos. 175 & 505 Pension Trust Fund v. Poe et al* was filed in June 2006 in the U.S. District Court for the Central District of California. In July 2006 the Court entered an order designating this case *In re Semtech Corporation Derivative Litigation* ( Federal Derivative Litigation ). An amended complaint was filed in December 2006 and Defendants are scheduled to respond to the amended complaint in April 2007.

In October 2006, two purported shareholder derivative lawsuits with virtually identical complaints, *Lamba v. Maheswaran et al* and *Jobe v. Maheswaran et al*, were filed in the U.S. District Court for the Central District of California. These cases have been consolidated with the prior-filed Federal Derivative Litigation.

These complaints include claims for violations of federal securities laws, breach of fiduciary duty, abuse of control, corporate waste, unjust enrichment, gross mismanagement, insider selling and misappropriation of information, and violations of the California Corporations Code. Not all claims are included in each case.

The relief sought varies among the cases. Generally, the plaintiffs are seeking an accounting, monetary damages and pre-judgment interest from the individual defendants; equitable relief; costs, fees, and expenses; orders directing the Company with respect to certain corporate governance actions, and such other relief as the Court deems just and proper.

The Special Litigation Committee was charged by the Board with evaluating whether the Company should pursue any of the claims asserted in the derivative lawsuits described above. The Special Litigation Committee has closely examined the various claims in these cases and has determined it is not in the interests of shareholders or the Company to pursue those claims, and has determined that the Company should seek to have these suits terminated.

The Company is unable to predict the outcome of these matters at this time.

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*Shareholder Communications*

Our Board of Directors received a letter dated June 16, 2006, purportedly on behalf of an unidentified shareholder, that demanded the Company bring suit against specified and unnamed current and former directors and officers for alleged violations of Section 16(b) of the Securities Exchange Act of 1934. The Board considered this demand and determined there was no basis for such action. The letter stated that the unidentified shareholder may initiate an action on the Company s behalf if the Board did not comply with the demand letter by August 8, 2006. To the Company s knowledge, no such shareholder action has been initiated.

The Company received a letter dated August 3, 2006 on behalf of a purported shareholder, the Employer-Teamsters Local Nos. 175 & 505 Pension Trust Fund, making a demand for inspection of books and records under the California Corporations Code and asserting that the purported shareholder would avail itself fully of legal and equitable remedies if the Company s responses were uncooperative, untimely or insufficient. In September 2006, the Company responded that the demand was defective, unreasonable, and inappropriate, especially in light of the derivative litigation already underway at the behest of the purported shareholder. Nothing further has been heard from this purported shareholder, other than in the context of the Federal Derivative Litigation.

*Listing on The NASDAQ Stock Market*

On June 15, 2006, the Company received a staff determination letter from the Nasdaq Stock Market ( Nasdaq ) stating that its failure to timely file its quarterly report on Form 10-Q for the fiscal quarter ended April 30, 2006 (the First Quarter Form 10-Q ) was a violation of Nasdaq continued listing requirements and that its securities were subject to delisting from the Nasdaq Global Market. The Company requested a hearing before a Nasdaq Listing Qualifications Panel ( Panel ), which stayed the delisting pending the outcome of the hearing. Following a hearing held in August 2006, the Company received notice from Nasdaq that its securities would not be delisted if it filed its First Quarter Form 10-Q and all required restatements on or prior to November 10, 2006.

On September 13, 2006, the Company received an Additional Staff Determination from Nasdaq (the September Notice ) indicating that the Company s failure to timely file its Form 10-Q for the fiscal quarter ended July 30, 2006 ( Second Quarter Form 10-Q ) was another instance of noncompliance with Nasdaq continued listing standards and an additional basis for delisting. The September Notice stated that the additional deficiency would be considered by the Panel in rendering a determination regarding the Company s continued listing. The delayed filing of the Second Quarter Form 10-Q had been previously contemplated by the Company and was therefore incorporated into the plan of compliance presented by the Company to the Panel at the hearing in August 2006. As announced in September 2006, the Company expected to file the Second Quarter Form 10-Q by the November 10, 2006 deadline established by Nasdaq with respect to its restated historical financial statements and the First Quarter Form 10-Q.

On November 6, 2006, the Panel granted the Company s request for additional time to regain compliance and set November 27, 2006 (the latest deadline the Panel was authorized to establish) as the date by which the Company would be required to file all required restatements, the First Quarter Form 10-Q, and the Second Quarter Form 10-Q.

On November 27, 2006 and at the Company s request, the Nasdaq Listing and Hearings Review Council notified the Company that it had called the Panel s decision for review and has stayed any future Panel determinations to suspend the Company s securities from trading until the review process runs its course. If the Listing Council determines it is appropriate, it may grant the Company additional time to regain compliance with Nasdaq s filing requirement, until the earlier of 60 days from the date of its decision or 180 days from the Panel s decision.

On December 14, 2006 the Company received an Additional Staff Determination letter from Nasdaq (the December Notice ) indicating that the Company s failure to timely file its Form 10-Q for the fiscal quarter ended October 29, 2006 ( Third Quarter Form 10-Q ) was another instance of noncompliance with Nasdaq continued listing standards and an additional basis for delisting. As noted above, the Listing Council has stayed any future Panel determinations to suspend the Company s securities from trading until the review process runs its course. The Listing Council has not yet rendered a decision.

Upon the filing of this Form 10-K/A and the FY2007 Form 10-Qs that are being filed concurrently with this report, the Company believes it will be in compliance with Nasdaq Marketplace Rule 4310(c)(14) and Nasdaq s other continued listing requirements. However, if the SEC disagrees with the methods used by the Company to account for and report

the financial impact of past stock option practices or imposes additional requirements, it could require the Company to further amend these filings and there could be further delays in filing subsequent SEC reports that might result in the delisting of the Company s common stock.

*Expiration of Stock Options During the Restatement Process*

The exercise of stock options was prohibited during the restatement process because the Company s filings with the SEC were not current. If employees prohibited from exercising expiring stock options during the restatement process are not compensated in some fashion, the Company s ability to retain its workforce could be harmed significantly. In this regard, the Compensation Committee of the Board of Directors authorized cash payments of approximately $435,000 to three current employees, with the expense recognized during the third quarter of fiscal year 2007. Likewise, in the third quarter of fiscal year 2007 the Compensation Committee authorized a cash payment of approximately $55,000 to a former employee who protested the inability to exercise his options within the established post-termination period. The Company may be subject to similar claims by other optionees and, in that regard, has accrued $2.1 million pre-tax in the fourth quarter of fiscal year 2007 for certain employee and director options that expired or lapsed in the fourth quarter of fiscal year 2007 and the first quarter of fiscal year 2008 excluding, most notably, expired and lapsed options held by the Former CFO and Former Treasurer.

*Costs of Restatement and Legal Activities; Possible Effect on Financial Condition*

The Company has incurred substantial expenses for legal, accounting, tax and other professional services in connection with the internal review, the Special Committee investigation, government inquiries, the preparation of the restated financial statements, the related derivative litigation, and other matters associated with or stemming from the restatement and the underlying circumstances. These expenses are in excess of $9.7 million in aggregate through the end of fiscal year 2007. The Company expects to continue to incur significant expense in connection with these matters. These expenses include claims for advancement of legal expenses to current and former directors, officers and executives under pre-existing indemnification agreements and to other current and former employees under the California Labor Code and a resolution of the Board authorizing such advances. These advances, which total approximately $500,000 in the aggregate through the end of fiscal year 2007, are subject to an undertaking to repay the funds to the Company in certain circumstances.

The Company is unable to predict the outcome of the government inquiries, the derivative litigation or any of the other matters associated with or stemming from the restatement and its underlying circumstances. These matters have occupied and will continue to occupy the time and attention of management, could negatively impact the Company s business and could have a material adverse impact on the Company s financial condition, results of operations, and cash flow.

**20. Audit Adjustments**

The restated fiscal year 2006 financial statements include a $60,000 increase to income, net of related tax effects, of miscellaneous audit adjustments that were excluded from the original Form 10-K filed in April 2006 based on materiality. None of the adjustments is material on a stand-alone basis. These adjustments are reflected in the financial statements for the fourth quarter of fiscal year 2006.

**21. Selected Quarterly Financial Data (Unaudited)**

The following tables set forth our unaudited consolidated statements of income data for each of the eight quarterly periods ended January 29, 2006, as well as that data expressed as a percentage of our net sales for the quarters presented. Per our fiscal calendar, fiscal year 2005 was a fifty-three week year, with the third quarter ending October 31, 2004 being a fourteen week quarter. All other quarters presented consisted of thirteen weeks. The sum of quarterly per share amounts may differ from year to date amounts due to rounding.

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Restated

(in thousands, except per share data)

| | Fiscal Year 2006 (restated) | | | | Fiscal Year 2005 (restated) | | | |
|---|---|---|---|---|---|---|---|---|
| | Quarters Ended | | | | | | | |
| | **May 1 2005** | **July 31 2005** | **Oct 30 2005** | **Jan 29 2006** | **Apr 25 2004** | **July 25 2004** | **Oct 31 2004** | **Jan 30 2005** |
| Net sales | $ 56,174 | $ 57,989 | $ 60,870 | $ 64,305 | $ 61,893 | $ 68,305 | $ 64,987 | $ 58,427 |
| Cost of sales | 24,577 | 25,934 | 26,648 | 28,077 | 25,362 | 27,663 | 27,905 | 25,477 |
| Gross profit | 31,597 | 32,055 | 34,222 | 36,228 | 36,531 | 40,642 | 37,082 | 32,950 |
| Operating costs and expenses: | | | | | | | | |
| Selling, general & administrative | 10,857 | 11,230 | 11,738 | 11,775 | 11,500 | 12,069 | 11,973 | 11,393 |
| Product development & engineering | 8,813 | 9,462 | 10,204 | 9,449 | 8,589 | 8,934 | 9,183 | 8,606 |
| One-time costs | 594 | (1,726) | 502 | 501 | 22 | 62 | 63 | 482 |
| Acquisition related items | | 4,136 | 409 | 409 | | | | |
| One-time costs | | | | | | | | |
| Total operating costs and expenses | 20,264 | 23,102 | 22,853 | 22,134 | 20,111 | 21,065 | 21,219 | 20,481 |
| Operating income | 11,333 | 8,953 | 11,369 | 14,094 | 16,420 | 19,577 | 15,863 | 12,469 |
| Interest and other income, net | 1,935 | 1,402 | 1,929 | 2,020 | 894 | 1,288 | 2,142 | 1,980 |
| Income before taxes | 13,268 | 10,355 | 13,298 | 16,114 | 17,314 | 20,865 | 18,005 | 14,449 |
| Provision for taxes | 2,838 | 3,371 | 2,026 | 2,849 | 4,047 | 4,498 | 4,184 | 2,996 |
| Net income | $ 10,430 | $ 6,984 | $ 11,272 | $ 13,265 | $ 13,267 | $ 16,367 | $ 13,821 | $ 11,453 |
| Earnings per share: | | | | | | | | |
| Basic | $ 0.14 | $ 0.10 | $ 0.15 | $ 0.18 | $ 0.18 | $ 0.22 | $ 0.19 | $ 0.15 |
| Diluted | $ 0.14 | $ 0.09 | $ 0.15 | $ 0.18 | $ 0.17 | $ 0.21 | $ 0.18 | $ 0.15 |
| Weighted-average number of shares: | | | | | | | | |
| Basic | 73,845 | 73,816 | 73,239 | 72,845 | 74,226 | 74,452 | 74,000 | 74,067 |
| Diluted | 76,833 | 76,495 | 75,564 | 75,494 | 78,965 | 78,795 | 77,608 | 77,887 |

Restated

| | Fiscal Year 2006 (restated) | | | | Fiscal Year 2005 (restated) | | | |
|---|---|---|---|---|---|---|---|---|
| | Quarters Ended | | | | | | | |
| | **May 1 2005** | **July 31 2005** | **Oct 30 2005** | **Jan 29 2006** | **Apr 25 2004** | **July 25 2004** | **Oct 31 2004** | **Jan 30 2005** |
| Net sales | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| Cost of sales | 44% | 45% | 44% | 44% | 41% | 40% | 43% | 44% |
| Gross profit | 56% | 55% | 56% | 56% | 59% | 60% | 57% | 56% |
| Operating costs and expenses: | | | | | | | | |
| Selling, general & administrative | 19% | 19% | 19% | 18% | 19% | 18% | 19% | 19% |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Product development & engineering | 16% | 16% | 17% | 15% | 14% | 13% | 14% | 15% |
| One time costs | 1% | -3% | 1% | 1% | 0% | 0% | 0% | 1% |
| Acquisition related items | 0% | 7% | 1% | 1% | 0% | 0% | 0% | 0% |
| One-time costs | | | | | | | | |
| Total operating costs and expenses | 36% | 39% | 38% | 35% | 33% | 31% | 33% | 35% |
| Operating income | 20% | 16% | 19% | 21% | 26% | 29% | 24% | 21% |
| Interest and other income, net | 3% | 2% | 3% | 3% | 1% | 2% | 3% | 3% |
| Income before taxes | 24% | 18% | 22% | 24% | 27% | 31% | 27% | 25% |
| Provision for taxes | 5% | 6% | 3% | 4% | 7% | 7% | 6% | 5% |
| Net income | 19% | 12% | 19% | 20% | 20% | 24% | 21% | 20% |

Sales of previously written-off inventory were approximately $297,000, $67,000, $59,000 and $84,000 in the first, second, third and fourth quarters, respectively, of fiscal year 2005 and approximately $18,000, $107,000, $43,000 and $30,000 in the first, second, third and fourth quarters, respectively, of fiscal year 2006.

Net insurance-related legal expenses (and settlements) included in selling, general and administrative expenses were approximately $33,000, $51,000, $63,000 and $482,000 in the first, second, third and fourth quarters, respectively, of fiscal year 2005 and approximately $594,000, ($1,726,000), $502,000 and $501,000 in the first, second, third and fourth quarters, respectively, of fiscal year 2006.

Acquisition related items are related to the June 2005 acquisition of XEMICS SA.

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The following tables show previously reported amounts and restated amounts giving effect to the Restatement Adjustments described in Note 1A and the minor fiscal year 2006 Audit Adjustments described in Note 20.

(in thousands, except per share data)

| | May 1, 2005 | | | Jul 31, 2005 | | |
|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| Net sales | $ 56,174 | $ | $ 56,174 | $ 57,989 | $ | $ 57,989 |
| Cost of sales | 24,502 | 75 | 24,577 | 25,867 | 67 | 25,934 |
| Gross profit | 31,672 | (75) | 31,597 | 32,122 | (67) | 32,055 |
| Operating costs and expenses: | | | | | | |
| Selling, general & administrative | 11,108 | 343 | 11,451 | 9,189 | 315 | 9,504 |
| Product development & engineering | 8,633 | 180 | 8,813 | 9,321 | 141 | 9,462 |
| Acquisition related items | | | | 4,136 | | 4,136 |
| Total operating costs and expenses | 19,741 | 523 | 20,264 | 22,646 | 456 | 23,102 |
| Operating income | 11,931 | (598) | 11,333 | 9,476 | (523) | 8,953 |
| Interest and other income, net | 1,935 | | 1,935 | 1,402 | | 1,402 |
| Income before taxes | 13,866 | (598) | 13,268 | 10,878 | (523) | 10,355 |
| Provision for taxes | 3,018 | (180) | 2,838 | 3,518 | (147) | 3,371 |
| Net income | $ 10,848 | $ (418) | $ 10,430 | $ 7,360 | $ (376) | $ 6,984 |
| Earnings per share: | | | | | | |
| Basic | $ 0.15 | ($ 0.01) | $ 0.14 | $ 0.10 | ($ 0.01) | $ 0.09 |
| Diluted | $ 0.14 | | $ 0.14 | $ 0.10 | ($ 0.01) | $ 0.09 |
| Weighted-average number of shares: | | | | | | |
| Basic | 73,845 | | 73,845 | 73,816 | | 73,816 |
| Diluted | 76,708 | 125 | 76,833 | 76,372 | 123 | 76,495 |

| | Oct 30, 2005 | | | Jan 29, 2006 | | | |
|---|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | Audit Adjs | As Restated |
| Net sales | $ 60,870 | $ | $ 60,870 | $ 64,372 | $ | $ (67) | $ 64,305 |
| Cost of sales | 26,605 | 43 | 26,648 | 28,022 | 28 | 27 | 28,077 |
| Gross profit | 34,265 | (43) | 34,222 | 36,350 | (28) | (94) | 36,228 |
| Operating costs and expenses: | | | | | | | |
| Selling, general & administrative | 12,003 | 237 | 12,240 | 12,251 | 25 | | 12,276 |
| Product development & engineering | 10,143 | 61 | 10,204 | 9,437 | 12 | | 9,449 |
| Acquisition related items | 409 | | 409 | 409 | | | 409 |
| Total operating costs and expenses | 22,555 | 298 | 22,853 | 22,097 | 37 | | 22,134 |
| Operating income | 11,710 | (341) | 11,369 | 14,253 | (65) | (94) | 14,094 |
| Interest and other income, net | 1,929 | | 1,929 | 2,020 | | | 2,020 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Income before taxes | 13,639 | (341) | 13,298 | 16,273 | (65) | (94) | 16,114 |
| Provision for taxes | 2,121 | (95) | 2,026 | 3,014 | (11) | (154) | 2,849 |
| Net income | $ 11,518 | $ (246) | $ 11,272 | $ 13,259 | $ (54) | $ 60 | $ 13,265 |
| Earnings per share: | | | | | | | |
| Basic | $ 0.16 | ($ 0.01) | $ 0.15 | $ 0.18 | | | $ 0.18 |
| Diluted | $ 0.15 | | $ 0.15 | $ 0.18 | | | $ 0.18 |
| Weighted-average number of shares: | | | | | | | |
| Basic | 73,239 | | 73,239 | 72,845 | | | 72,845 |
| Diluted | 75,449 | 115 | 75,564 | 75,365 | 129 | | 75,494 |

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(in thousands, except per share data)

| | Apr 25, 2004 | | | Jul 25, 2004 | | |
|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| Net sales | $ 61,893 | $ | $ 61,893 | $ 68,305 | $ | $ 68,305 |
| Cost of sales | 25,111 | 251 | 25,362 | 27,470 | 193 | 27,663 |
| Gross profit | 36,782 | (251) | 36,531 | 40,835 | (193) | 40,642 |
| Operating costs and expenses: | | | | | | |
| Selling, general & administrative | 10,341 | 1,181 | 11,522 | 11,323 | 808 | 12,131 |
| Product development & engineering | 7,907 | 682 | 8,589 | 8,435 | 499 | 8,934 |
| Acquisition related items | | | | | | |
| Total operating costs and expenses | 18,248 | 1,863 | 20,111 | 19,758 | 1,307 | 21,065 |
| Operating income | 18,534 | (2,114) | 16,420 | 21,077 | (1,500) | 19,577 |
| Interest and other income, net | 894 | | 894 | 1,288 | | 1,288 |
| Income before taxes | 19,428 | (2,114) | 17,314 | 22,365 | (1,500) | 20,865 |
| Provision for taxes | 4,663 | (616) | 4,047 | 4,946 | (448) | 4,498 |
| Net income | $ 14,765 | $ (1,498) | $ 13,267 | $ 17,419 | $ (1,052) | $ 16,367 |
| Earnings per share: | | | | | | |
| Basic | $ 0.20 | ($ 0.02) | $ 0.18 | $ 0.23 | ($ 0.01) | $ 0.22 |
| Diluted | $ 0.19 | ($ 0.02) | $ 0.17 | $ 0.22 | ($ 0.01) | $ 0.21 |
| Weighted-average number of shares: | | | | | | |
| Basic | 74,226 | | 74,226 | 74,452 | | 74,452 |
| Diluted | 78,819 | 146 | 78,965 | 78,658 | 137 | 78,795 |

| | Oct 31, 2004 | | | Jan 30, 2005 | | |
|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| Net sales | $ 64,987 | $ | $ 64,987 | $ 58,427 | $ | $ 58,427 |
| Cost of sales | 27,767 | 138 | 27,905 | 25,357 | 120 | 25,477 |
| Gross profit | 37,220 | (138) | 37,082 | 33,070 | (120) | 32,950 |
| Operating costs and expenses: | | | | | | |
| Selling, general & administrative | 11,438 | 598 | 12,036 | 11,347 | 528 | 11,875 |
| Product development & engineering | 8,826 | 357 | 9,183 | 8,324 | 282 | 8,606 |
| Acquisition related items | | | | | | |
| Total operating costs and expenses | 20,264 | 955 | 21,219 | 19,671 | 810 | 20,481 |
| Operating income | 16,956 | (1,093) | 15,863 | 13,399 | (930) | 12,469 |
| Interest and other income, net | 2,142 | | 2,142 | 1,980 | | 1,980 |
| Income before taxes | 19,098 | (1,093) | 18,005 | 15,379 | (930) | 14,449 |
| Provision for taxes | 4,503 | (319) | 4,184 | 3,270 | (274) | 2,996 |
| Net income | $ 14,595 | $ (774) | $ 13,821 | $ 12,109 | $ (656) | $ 11,453 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Earnings per share: | | | | | | |
| Basic | $ 0.20 | ($ 0.01) | $ 0.19 | $ 0.16 | ($ 0.01) | $ 0.15 |
| Diluted | $ 0.19 | ($ 0.01) | $ 0.18 | $ 0.16 | ($ 0.01) | $ 0.15 |
| Weighted-average number of shares: | | | | | | |
| Basic | 74,000 | | 74,000 | 74,067 | | 74,067 |
| Diluted | 77,486 | 122 | 77,608 | 77,758 | 129 | 77,887 |

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The following table shows previously reported amounts and restated amounts giving effect to the Restatement Adjustments described in Note 1A as of the end of each of the first three quarters of fiscal year 2006. This balance sheet information as of January 29, 2006, the end of the fourth quarter of fiscal year 2006, is presented in Note 1A to the financial statements in Item 8 of this report.

in thousands

| | May 1, 2005 | | | July 31, 2005 | | | October 30, 2005 | | |
|---|---|---|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| **ASSETS** | | | | | | | | | |
| **Current assets:** | | | | | | | | | |
| Cash and cash equivalents | $ 80,961 | $ | $ 80,961 | $ 41,920 | $ | $ 41,920 | $ 57,808 | $ | $ 57,808 |
| Temporary investments | 126,458 | | 126,458 | 108,921 | | 108,921 | 109,540 | | 109,540 |
| Receivables, less allowances | 23,714 | | 23,714 | 26,864 | | 26,864 | 27,029 | | 27,029 |
| Inventories | 25,293 | 92 | 25,385 | 30,708 | 72 | 30,780 | 27,127 | 51 | 27,178 |
| Income taxes refundable | | | | | | | | | |
| Deferred income taxes | 7,264 | | 7,264 | 7,229 | | 7,229 | 6,975 | | 6,975 |
| Other current assets | 6,749 | | 6,749 | 11,818 | | 11,818 | 7,765 | | 7,765 |
| **Total current assets** | 270,439 | 92 | 270,531 | 227,460 | 72 | 227,532 | 236,244 | 51 | 236,295 |
| **Property, plant & equipment, net** | 58,565 | | 58,565 | 58,378 | | 58,378 | 58,313 | | 58,313 |
| **Investments, maturities in excess of 1 year** | 96,001 | | 96,001 | 111,890 | | 111,890 | 100,482 | | 100,482 |
| **Deferred income taxes** | 25,421 | 926 | 26,347 | 25,662 | 195 | 25,857 | 24,376 | (231) | 24,145 |
| **Goodwill** | | | | 32,941 | | 32,941 | 33,212 | | 33,212 |
| **Other intangibles** | | | | 6,294 | | 6,294 | 5,885 | | 5,885 |
| **Other assets** | 10,843 | | 10,843 | 10,817 | | 10,817 | 11,225 | | 11,225 |
| **TOTAL ASSETS** | $ 461,269 | $ 1,018 | $ 462,287 | $ 473,442 | $ 267 | $ 473,709 | $ 469,737 | $ (180) | $ 469,557 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | | | | | | |
| **Current liabilities:** | | | | | | | | | |
| Notes payable to bank | $ | $ | $ | $ 1,288 | $ | $ 1,288 | $ 527 | $ | $ 527 |
| Accounts payable | 11,776 | | 11,776 | 16,086 | | 16,086 | 13,562 | | 13,562 |
| Accrued liabilities | 7,638 | | 7,638 | 10,951 | | 10,951 | 11,220 | | 11,220 |
| Income taxes payable | 3,606 | | 3,606 | 3,217 | | 3,217 | 1,846 | | 1,846 |
| Deferred revenue | 2,547 | | 2,547 | 1,890 | | 1,890 | 1,974 | | 1,974 |
| Deferred income taxes | 1,466 | | 1,466 | 1,645 | | 1,645 | 1,681 | | 1,681 |
| Other current liabilities | | 96 | 96 | | 96 | 96 | | 96 | 96 |
| **Total current liabilities** | 27,033 | 96 | 27,129 | 35,077 | 96 | 35,173 | 30,810 | 96 | 30,906 |
| **Deferred income taxes** | 2,143 | | 2,143 | 2,198 | | 2,198 | 2,327 | | 2,327 |
| **Other long-term liabilities** | 2,894 | | 2,894 | 4,395 | | 4,395 | 5,442 | | 5,442 |
| **Commitments and contingencies** | | | | | | | | | |
| **Stockholders equity:** | | | | | | | | | |
| Common stock, $0.01 par value (1) | 762 | | 762 | 764 | | 764 | 766 | | 766 |
| Treasury stock, at cost (2) | (43,366) | | (43,366) | (50,648) | | (50,648) | (64,373) | | (64,373) |
| Additional paid-in capital | 217,414 | 62,557 | 279,971 | 221,496 | 62,182 | 283,678 | 223,506 | 61,980 | 285,486 |
| Retained earnings | 255,598 | (61,635) | 193,963 | 261,378 | (62,011) | 199,367 | 272,356 | (62,256) | 210,100 |
| Accumulated other comprehensive income | (1,209) | | (1,209) | (1,218) | | (1,218) | (1,097) | | (1,097) |
| **Total Stockholders equity** | 429,199 | 922 | 430,121 | 431,772 | 171 | 431,943 | 431,158 | (276) | 430,882 |
| **TOTAL LIABILITIES AND STOCKHOLDERS EQUITY** | $ 461,269 | $ 1,018 | $ 462,287 | $ 473,442 | $ 267 | $ 473,709 | $ 469,737 | $ (180) | $ 469,557 |

(1) 250,000,000 authorized. 76,050,974 issued and 73,834,681 outstanding on May 1, 2005. 76,230,243 issued and 73,554,640 outstanding on July 31, 2005. 76,386,168 issued and 72,824,215 outstanding on October 30, 2005.

(2) 2,216,293 shares as of May 1, 2005. 2,675,603 shares as of July 31, 2005. 3,561,953 shares as of October 30, 2005.

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The following table shows previously reported amounts and restated amounts giving effect to the Restatement Adjustments described in Note 1A as of the end of each of the first three quarters of fiscal year 2005. This balance sheet information as of January 30, 2005, the end of the fourth quarter of fiscal year 2005, is presented in Note 1A to the financial statements in Item 8 of this report.

in thousands

| | April 25, 2004 | | | July 25, 2004 | | | October 31, 2004 | | |
|---|---|---|---|---|---|---|---|---|---|
| | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated | As Previously Reported | Restatement Adjustments | As Restated |
| **ASSETS** | | | | | | | | | |
| **Current assets:** | | | | | | | | | |
| Cash and cash equivalents | $ 66,115 | $ | $ 66,115 | $ 62,776 | $ | $ 62,776 | $ 79,362 | $ | $ 79,362 |
| Temporary investments | 90,378 | | 90,378 | 100,325 | | 100,325 | 93,683 | | 93,683 |
| Receivables, less allowances | 22,339 | | 22,339 | 25,028 | | 25,028 | 18,232 | | 18,232 |
| Inventories | 23,880 | 238 | 24,118 | 29,335 | 197 | 29,532 | 29,803 | 155 | 29,958 |
| Income taxes refundable | 5,795 | | 5,795 | 5,795 | | 5,795 | | | |
| Deferred income taxes | 4,650 | | 4,650 | 4,897 | | 4,897 | 4,830 | | 4,830 |
| Other current assets | 8,431 | | 8,431 | 9,341 | | 9,341 | 6,652 | | 6,652 |
| **Total current assets** | 221,588 | 238 | 221,826 | 237,497 | 197 | 237,694 | 232,562 | 155 | 232,717 |
| **Property, plant & equipment, net** | 51,819 | | 51,819 | 55,691 | | 55,691 | 57,594 | | 57,594 |
| **Investments, maturities in excess of 1 year** | 122,412 | | 122,412 | 119,815 | | 119,815 | 122,682 | | 122,682 |
| **Deferred income taxes** | 25,199 | 1,608 | 26,807 | 24,092 | 1,430 | 25,522 | 21,224 | 931 | 22,155 |
| **Goodwill** | | | | | | | | | |
| **Other intangibles** | | | | | | | | | |
| **Other assets** | 1,884 | | 1,884 | 4,055 | | 4,055 | 12,128 | | 12,128 |
| | | | | | | | | | |
| **TOTAL ASSETS** | $ 422,902 | $ 1,846 | $ 424,748 | $ 441,150 | $ 1,627 | $ 442,777 | $ 446,190 | $ 1,086 | $ 447,276 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | | | | | | |
| **Current liabilities:** | | | | | | | | | |
| Notes payable to bank | $ | $ | $ | $ | $ | $ | $ | $ | $ |
| Accounts payable | 13,822 | | 13,822 | 18,845 | | 18,845 | 9,408 | | 9,408 |
| Accrued liabilities | 7,808 | | 7,808 | 10,752 | | 10,752 | 15,349 | | 15,349 |
| Income taxes payable | 2,117 | | 2,117 | 2,537 | | 2,537 | 2,896 | | 2,896 |
| Deferred revenue | 3,097 | | 3,097 | 3,312 | | 3,312 | 3,044 | | 3,044 |
| Deferred income taxes | | | | | | | | | |
| Other current liabilities | | 96 | 96 | | 96 | 96 | 29 | 96 | 125 |
| **Total current liabilities** | 26,844 | 96 | 26,940 | 35,446 | 96 | 35,542 | 30,726 | 96 | 30,822 |
| **Deferred income taxes** | | | | | | | | | |
| **Other long-term liabilities** | 615 | | 615 | 1,072 | | 1,072 | 1,701 | | 1,701 |
| **Commitments and contingencies Stockholders equity:** | | | | | | | | | |
| Common stock, $0.01 par value (1) | 746 | | 746 | 749 | | 749 | 753 | | 753 |
| Treasury stock, at cost (2) | (3,080) | | (3,080) | (16,099) | | (16,099) | (25,648) | | (25,648) |
| Additional paid-in capital | 194,832 | 60,485 | 255,317 | 200,324 | 61,317 | 261,641 | 205,042 | 61,551 | 266,593 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Retained earnings | 203,086 | (58,735) | 144,351 | 220,505 | (59,786) | 160,719 | 233,868 | (60,561) | 173,307 |
| Accumulated other comprehensive income | (141) | | (141) | (847) | | (847) | (252) | | (252) |
| Total Stockholders equity | 395,443 | 1,750 | 397,193 | 404,632 | 1,531 | 406,163 | 413,763 | 990 | 414,753 |
| **TOTAL LIABILITIES AND STOCKHOLDERS EQUITY** | $ 422,902 | $ 1,846 | $ 424,748 | $ 441,150 | $ 1,627 | $ 442,777 | $ 446,190 | $ 1,086 | $ 447,276 |

(1) 250,000,000 authorized. 74,511,537 issued and 74,376,537 outstanding on April 25, 2004.
74,916,136 issued and 74,162,136 outstanding on July 25, 2004.

75,284,357 issued and 74,002,224 outstanding on October 31, 2004.

(2) 135,000 shares as of April 25, 2004. 754,000 shares as of July 25, 2004. 1,282,133 shares as of October 31, 2004.

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As discussed in Note 1, the Company provides pro forma disclosures for stock-based awards made during the year as if the fair value method defined in SFAS 123, as amended, had been applied. The following tables show pro forma net income and pro forma earnings per share for each quarter of fiscal years 2006 and 2005. See the detailed discussion regarding pro forma disclosures in Note 1.

Pro Forma Net Income

(in thousands, except earnings per share data)

| | Unaudited Three Months Ended | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | May 1, 2005 | | | July 31, 2005 | | | October 30, 2005 | | | January 29, 2006 | | | |
| | As Previously Reported | Adjs (1) | As Restated | As Previously Reported | Adjs (1) | As Restated | As Previously Reported | Adjs (1) | As Restated | As Previously Reported (3) | Adjs (1) | Audit Adjs (4) | As Restated |
| Net income | $ 10,848 | $ (418) | $ 10,430 | $ 7,360 | $ (376) | $ 6,984 | $ 11,518 | $ (246) | $ 11,272 | $ 13,259 | $ (54) | $ 60 | $ 13,265 |
| Add: stock-based compensation included in reported net income, net of tax | | 418 | 418 | | 376 | 376 | | 246 | 246 | | 54 | | 54 |
| Deduct stock-based compensation expense determined under fair value based method, net of tax (2) | (4,555) | 129 | (4,426) | (3,850) | 238 | (3,612) | (13,163) | 10,050 | (3,113) | 1,463 | 4,455 | | (2,992) |
| Pro forma net income | $ 6,293 | $ 129 | $ 6,422 | $ 3,510 | $ 238 | $ 3,748 | $ (1,645) | $ 10,050 | $ 8,405 | $ 14,722 | $ 4,455 | $ 60 | $ 10,327 |
| Earnings per share - basic | $ 0.15 | $ (0.01) | $ 0.14 | $ 0.10 | $ | $ 0.10 | $ 0.16 | $ (0.01) | $ 0.15 | $ 0.18 | $ | $ | $ 0.18 |
| Earnings per share - diluted | $ 0.14 | $ | $ 0.14 | $ 0.10 | $ (0.01) | $ 0.09 | $ 0.15 | $ | $ 0.15 | $ 0.18 | $ | $ | $ 0.18 |
| Pro forma earnings per share - basic | $ 0.09 | $ | $ 0.09 | $ 0.05 | $ | $ 0.05 | $ (0.02) | $ 0.13 | $ 0.11 | $ 0.20 | $ (0.06) | $ | $ 0.14 |
| Pro forma earnings per share - diluted | $ 0.08 | $ | $ 0.08 | $ 0.05 | $ | $ 0.05 | $ (0.02) | $ 0.13 | $ 0.11 | $ 0.20 | $ (0.06) | $ | $ 0.14 |

(1) Restatement Adjustments. See Note 1A.

(2) The amount in the Restatement Adjustments column also includes an adjustment for cancellations that had not previously been taken into account.

(3) Pro forma stock-based compensation expense for the fourth quarter was not previously reported on a separate basis.

(4) Audit Adjustments. See Note 20.

Pro Forma Net Income

(in thousands, except earnings per share data)

**Unaudited**

| | Three Months Ended | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | April 25, 2004 | | | July 25, 2004 | | | October 31, 2004 | | | January 30, 2005 | | |
| | As Previously Reported | Adjs (1) | As Restated | As Previously Reported | Adjs (1) | As Restated | As Previously Reported | Adjs (1) | As Restated | As Previously Reported (3) | Adjs (1) | As Restated |
| Net income, as reported | $ 14,765 | $ (1,498) | $ 13,267 | $ 17,419 | $ (1,052) | $ 16,367 | $ 14,595 | $ (774) | $ 13,821 | $ 12,109 | $ (656) | $ 11,453 |
| Add: stock-based compensation included in reported net income, net of tax | | 1,498 | 1,498 | | 1,052 | 1,052 | | 774 | 774 | | 656 | 656 |
| Deduct stock-based compensation expense determined under fair value based method, net of tax (2) | (6,020) | 244 | (5,766) | (5,950) | 1,184 | (4,766) | (12,330) | 7,099 | (5,231) | (49) | 4,976 | (5,025) |
| Pro forma net income | $ 8,745 | $ 244 | $ 8,989 | $ 11,469 | $ 1,184 | $ 12,653 | $ 2,265 | $ 7,099 | $ 9,364 | $ 12,060 | $ 4,976 | $ 7,084 |
| Earnings per share - basic | $ 0.20 | $ (0.02) | $ 0.18 | $ 0.23 | $ (0.01) | $ 0.22 | $ 0.20 | $ (0.01) | $ 0.19 | $ 0.16 | $ (0.01) | $ 0.15 |
| Earnings per share - diluted | $ 0.19 | $ (0.02) | $ 0.17 | $ 0.22 | $ (0.01) | $ 0.21 | $ 0.19 | $ (0.01) | $ 0.18 | $ 0.16 | $ (0.01) | $ 0.15 |
| Pro forma earnings per share - basic | $ 0.12 | $ | $ 0.12 | $ 0.15 | $ 0.02 | $ 0.17 | $ 0.03 | $ 0.10 | $ 0.13 | $ 0.16 | $ (0.07) | $ 0.09 |
| Pro forma earnings per share - diluted | $ 0.11 | $ | $ 0.11 | $ 0.15 | $ 0.01 | $ 0.16 | $ 0.03 | $ 0.09 | $ 0.12 | $ 0.16 | $ (0.07) | $ 0.09 |

(1) Restatement Adjustments. See Note 1A.

(2) The amount in the Restatement Adjustments column also includes an adjustment for cancellations that had not previously been taken into account.

(3) Pro forma stock-based compensation expense for the fourth quarter was not previously reported on a separate basis.

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**ITEM 9. CHANGES IN OR DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**
Not applicable.

**ITEM 9A. CONTROLS AND PROCEDURES**
**Disclosure Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of Company s disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of January 29, 2006. Based on that evaluation, the Company s Chief Executive Officer and Chief Financial Officer concluded in April 2006, in connection with the filing of the Original Report, that such disclosure controls and procedures were effective in alerting them in a timely manner to material information relating to the Company required to be included in its periodic reports filed with the Securities and Exchange Commission.

When we conducted the updated assessment of internal control described below, we also updated our previous assessment of our disclosure controls and procedures as of January 29, 2006. Based upon the updated evaluation, the Company s Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of January 29, 2006 because of the material weakness in internal control over financial reporting described below. More specifically, the Former CEO and Former CFO, who were determined to have varying degrees of culpability with respect to improprieties in the Company s historical stock option practices, had key roles in the disclosure process as of January 29, 2006. This situation has been remediated by the departure of these individuals from active management of the Company in the third and fourth quarters of fiscal year 2007.

**Internal Control Over Financial Reporting**

*Management s Consideration of the Restatement and its Underlying Circumstances*

We recently completed an investigation of our historical stock option practices since the beginning of fiscal year 1996. During the course of the review, we identified stock option grants to continuing employees and new hires for which an incorrect measurement date was used for financial accounting purposes. We also found incorrect accounting for some stock option grants that lacked evidence of Compensation Committee approval or that were modified after ratification by the Compensation Committee. We also determined that incorrect accounting was used with respect to certain stock option grants that were modified through post-termination arrangements and that some stock option grants were priced in a manner inconsistent with our convention of pricing options at the closing price on the day before grant.

The Special Committee of the Board of Directors separately investigated the stock option granting practices and found evidence that intentional manipulation of stock option grant dates occurred prior to fiscal year 2003 and made various levels of adverse findings as to certain former members of management. More specifically, the Special Committee found the Former CEO to have manipulated stock option grants in the past and that the Former CFO knew, or should have known, of the past manipulation and initiated or participated in some manipulative acts.

The adjustments to our consolidated financial statements for fiscal 2006 were the result of amortization of additional non-cash compensation expense resulting from revisions made to measurement dates, modifications, and pricing inconsistencies for certain stock options granted or modified primarily during fiscal years 1996 to 2003.

Details of the restatement and its underlying circumstances are discussed in the Explanatory Note at the beginning of this report, in Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this report and in Note 1A of Notes to Consolidated Financial Statements in Item 8 of this report.

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In light of, and in conjunction with, the restatement, we conducted an updated assessment of the Company s internal controls over financial reporting as of January 29, 2006.

The updated assessment was conducted under the supervision and with the participation of individuals to whom no improper behavior has been attributed by the Special Committee: Chief Executive Officer Maheswaran who joined the Company in April 2006 and Chief Financial Officer Emeka Chukwu, who joined the Company in November 2006. It was carried out primarily with in-house resources, including our Internal Audit Manager and focused on internal controls and processes related to stock option matters and to the control environment and other entity level controls.

In performing the updated assessment, we considered the testing done to support the conclusion in the previous assessment, the overall result of which was that no deficiencies existed related to stock option matters or the control environment or other entity level controls. We also considered the following items in making the updated assessment:

Testing by Kroll, Inc. With Respect to Stock Options. In June 2006, management retained Kroll Inc. ( Kroll ), a world leader in risk consulting with extensive forensic accounting abilities, to assist in a review of the Company s stock option practices. In performing its work, Kroll reviewed and analyzed a multitude of documents covering a span of approximately fourteen years. Although this work by Kroll was not done expressly to support the updated assessment of internal control, the extensive procedures carried out by Kroll and the results thereof were considered in making the updated assessment.

Additional Testing by the Company s Internal Audit Manager. In October 2006, the Internal Audit Manager was asked to perform additional testing, beyond that done in conjunction with our previous assessment, to assist in determining the design and operating effectiveness of internal controls related to the stock options process as of January 29, 2006. No exceptions were encountered in this testing.

Comparison of Semtech s FY06 Stock Option Procedures to Best Practices Defined by Radford Group and Remedial Actions Suggested by the Special Committee. In September 2006, management engaged Radford Surveys & Consulting ( Radford ) to gather information on stock option best practices and provide a report of its findings. Upon receipt of Radford s report, the best practices set forth therein were compared to the Company s practices during fiscal year 2006. The comparison also took into account the Special Committee s recommended remedial measures, which in many cases were the same as or similar to the reported best practices.

Corporate Culture and Entity Level Controls. We considered the Company s commitment to a culture of honesty and high ethics during fiscal year 2006, as set forth in the Code of Conduct that was formally adopted by the Board in April 2004. We also considered entity level controls in place during fiscal year 2006 such as training on the Code of Conduct, the confidential hotline that may be accessed anonymously by employees to report perceived problems, the Company s investigative and disciplinary practices, and the role of the Audit Committee regarding oversight of business conduct matters.

Review of Other Areas. As part of our updated assessment of internal control, we also reviewed other areas of financial reporting or internal control, particularly those areas subject to judgment and estimation, for any evidence of manipulation or the possibility of manipulation by the Former CEO or the Former CFO during fiscal year 2006. Our review noted no such instances of manipulation.

Financial Impact of the Restatement. Our updated assessment of internal control also took into consideration the financial impact of the restatement on the fiscal year 2006 consolidated financial statements. We do not believe the fact that the Company has restated its financial statements for fiscal year 2006, standing alone, evidences a material weakness as of January 29, 2006. This is especially true when considering that virtually all of the additional charges in fiscal year 2006 stem from adjustments for stock options granted or modified in prior fiscal years.

Changes in Internal Controls in Recent Years. Based on its intense review of historical stock option granting practices carried out with the assistance of legal counsel and forensic accountants, and after considering the findings of the Special Committee, management has concluded that the stock option granting process was deficient in fiscal years 1997 through 2003. Specifically, the Company lacked controls to sufficiently monitor the use of delegated authority in those fiscal years. This situation has been remediated by returning option granting authority to the Board level and there is no evidence of the control failing since it was established.

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Purpose of Internal Controls. We also considered that the purpose of our system of internal controls is to assure that the current activities of the Company are carried out in accordance with approved procedures and in a manner that provides reasonable assurance that the current year financial statements will be reliable. No system of internal controls is designed to examine activities that occurred many years in the past, absent a red flag or other particular reason to do so.

Special Committee s Findings on Individual Behavior. As discussed earlier in this Form 10-K/A, the Special Committee found evidence that intentional manipulation of stock option grant dates occurred prior to August 2002 and made various levels of adverse findings as to five individuals. Although four of these individuals were in executive leadership and finance positions during fiscal year 2006, there is no evidence of intentional manipulation of option grant dates after fiscal year 2003. Although we considered that Jason Carlson, to whom no improper behavior has been attributed by the Special Committee, served as Chief Executive Officer for much of fiscal year 2006, we attributed greater weight to the fact that individuals to whom the Special Committee ascribed improper behavior were part of the senior management team during that year.

*Management s Conclusion Regarding Internal Controls*

Notwithstanding the items discussed above, the overriding factor in the reassessment was that during fiscal year 2006 the Company was under the leadership of the Former CEO, who was found by the Special Committee to have manipulated option grants in the past, and the Former CFO, who the Special Committee found to have known or should have known of the past manipulation and initiated or participated in some manipulative acts.

After considering the provisions of Public Company Accounting Oversight Board Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements,* we concluded that a material weakness in internal control over financial reporting existed as of January 29, 2006 because there was a material weakness in the Company s control environment. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Specifically, at January 29, 2006 the Company was under the leadership of the Former CEO, who was found by the Special Committee to have manipulated option grants in prior fiscal years, and the Former CFO, who the Special Committee found to have known or should have known of the past manipulation and initiated or participated in some manipulative acts in prior fiscal years. Two other executives active in the management of the Company during fiscal year 2006 were also found to have some degree of culpability.

The material weakness discussed above was remediated after January 29, 2006 by the departure of the implicated executives from active management of the Company through resignation from office in November and December 2006 and subsequent termination of employment or, in the case of the Former CEO, through a leave of absence from the Board of Directors in August 2006 and a determination by the Board not to nominate him for re-election.

**Changes in Internal Control Over Financial Reporting**

There has been no change in the Company s internal control over financial reporting during the quarter ended January 29, 2006 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

**Report of Management on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework set forth in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control Integrated Framework, including provisions regarding restatements and antifraud programs and controls, our management has concluded that as of January 29, 2006 the Company s internal control over financial reporting was not effective 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 because there was a material weakness in the Company s control environment. Specifically, as of January 29, 2006 the Company was under the leadership of the Former CEO, who was found by the Special Committee to have manipulated option grants in prior fiscal years, and the Former CFO, who the Special Committee found to have known or should have known of the past manipulation and initiated or participated in some manipulative acts in prior fiscal years.

Ernst & Young LLP, the independent registered public accounting firm that audited the consolidated financial statements included in this report, has issued an attestation report on our management s updated assessment of our internal control over financial reporting as of January 29, 2006. Ernst & Young LLP s *Report of Independent Registered Public Accounting Firm On Internal Control Over Financial Reporting* is included in Item 8 of this report.

**ITEM 9B OTHER INFORMATION**

We believe that all information that was required to be disclosed in a report on Form 8-K during the fourth quarter of fiscal year 2006 was reported on a Form 8-K during that period.

As permitted by applicable SEC rules, the Company has elected to include the following information in this Form 10-K/A in lieu of reporting it under Item 5.02(e) of a separately filed Form 8-K: On March 28, 2007 and at the direction of the Special Litigation Committee, the Company cancelled all of the approximately 1.2 million outstanding split-adjusted options held by the Former CEO. On the same date, the Company cancelled all outstanding vested options held by the Former CFO under an October 14, 1998 award agreement (although those options had lapsed during the restatement process) and repriced 240,000 split-adjusted options outstanding under a November 13, 1997 award agreement from the stated split-adjusted exercise price of $5.31 per share to a split-adjusted exercise price of $6.59 per share. The letters effectuating these actions are attached hereto as Exhibits 10.29 and 10.30.

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## PART III

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

We have adopted a written Code of Conduct that applies to everyone in the Company, including our Chief Executive Officer, Chief Financial Officer and Controller. See Exhibit 14, which incorporates by reference the copy of our Code of Conduct filed as Exhibit 14 to our Form 10-K for fiscal year 2004. The Code of Conduct is also available at the Corporate Governance section of our website at www.semtech.com. If we make any substantive amendments to the Code of Conduct or grant any waiver, including an implicit waiver, from the Code of Conduct to our Chief Executive Officer, Chief Financial Officer or Controller, we will within four business days of the event disclose the nature of the amendment or waiver on our website or in a report on Form 8-K.

The following individuals comprise our Board of Directors:

| | |
|---|---|
| John D. Poe<br>Chairman of the Board | Owner of Kirschbaum LLC, a private farming company; former President and Chief Executive Officer of Semtech Corporation |
| Rockell N. Hankin<br>Vice Chairman of the Board | Private Investor |
| Glen M. Antle | Former Chairman of the Board, Quickturn Design Systems, Inc, an electronic design automation company |
| James P. Burra | Chief Executive Officer, Endural Division of Hoover Group, Inc., a manufacturer of high density polyethylene containers |
| James T. Lindstrom | Chief Financial Officer, eSilicon Corporation, a company that designs and manufacturers custom semiconductor chips |
| Mohan R. Maheswaran | President and Chief Executive Officer, Semtech Corporation |
| John L. Piotrowski | General (retired) United States Air Force |
| James T. Schraith | Private Investor and Management Consultant |

The Executive Officers and Key Executives of the Company are:

| | |
|---|---|
| Mohan R. Maheswaran | President and Chief Executive Officer |
| David G. Franz, Jr. | Vice President and Chief Financial Officer |
| Kenneth W. Bauer | Vice President, Human Resources |
| John M. Baumann | Treasurer |
| Kevin P. Caffey | Vice President, Manufacturing and Quality |
| Alain Dantec | Vice President, Wireless and Sensing Products |
| Mark R. Drucker | Vice President, Test and Measurement Products |
| Suzanna Fabos | Corporate Counsel and Secretary |
| Stewart Kelly | Director, Advanced Communications |
| Lawrence A. King | Vice President, Engineering Power Management Products |
| Resat N. Necar | Vice President, Business Development |
| Michaeal S. Panesis | Vice President, Information Technology |

| | |
|---|---|
| Paul D. Peterson | Vice President, Sales and Marketing |
| Jeffrey T. Pohlman | Vice President, Protection Products |
| J. Michael Wilson | Vice President, Power Management Products |

Other information called for by Item 10 is incorporated by reference from the Company s Definitive Proxy Statement filed on May 9, 2006 in connection with its annual meeting of shareholders held on June 15, 2006.

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**ITEM 11. EXECUTIVE COMPENSATION**

The information called for by Item 11 is incorporated by reference from the Company s Definitive Proxy Statement filed on May 9, 2006 in connection with its annual meeting of shareholders held on June 15, 2006.

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

**Securities Authorized for Issuance under Equity Compensation Plans**

The following table sets forth information with respect to shares of common stock that may be issued under our equity compensation plans as of January 29, 2006. This table reflects both current plans and plans under which options are outstanding but from which awards are no longer being made.

| Plan Category | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the issued column) |
|---|---|---|---|
| Equity compensation plans approved by security holders | 9,020,614 | $ 11.78 | 1,480,942 |
| Equity compensation plans not approved by security holders | 5,141,519 | $ 19.76 | 4,794,241 |
| Total | 14,162,133 | $ 14.68 | 6,275,183 |

Equity compensation plans not approved by security holders include the Non-Director and Non-Executive Officer Long-Term Stock Incentive Plan that was approved by our board of directors in fiscal year 2000. The Non-Director and Non-Executive Officer Long-Term Stock Incentive Plan allows for the issuance of options for up to 8,000,000 shares of our common stock to non-directors and non-executive officers. This number has been adjusted for stock splits and under the terms of the plan, is subject to further adjustment in the event that the number of outstanding shares of our common stock are adjusted by reason of a stock split, stock dividend, or the like. Further, any shares granted under the plan that are forfeited back to the Company because of a failure to meet an award contingency or condition are available for delivery pursuant to new awards granted under the plan. All securities remaining available for future issuance under equity compensation plans not approved by security holders are related to the Non-Director and Non-Executive Officer Long-Term Stock Incentive Plan.

Included in the outstanding options portion of equity compensation plans not approved by security holders are non-plan grants of options to our non-employee directors that occurred in fiscal year 1998.

The material features of the Non-Director and Non-Executive Officer Long-Term Stock Incentive Plan and the non-plan grants referred to above are substantially similar to the material features of the plans that have been approved by shareholders. See Note 14. Stockholders Equity to the financial statements included in this report.

Other information called for by Item 12 is incorporated by reference from the Company s Definitive Proxy Statement filed on May 9, 2006 in connection with its annual meeting of shareholders held on June 15, 2006.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information called for by Item 13 is incorporated by reference from the Company s Definitive Proxy Statement filed on May 9, 2006 in connection with its annual meeting of shareholders held on June 15, 2006.

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**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information called for by Item 14 is incorporated by reference from the Company s Definitive Proxy Statement filed on May 9, 2006 in connection with its annual meeting of shareholders held on June 15, 2006.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

(a)(1) The financial statements, schedules, and reports included in this Form 10-K. are listed in the index under Item 8 in this report.

(a)(2) Schedules other than those listed above are omitted since they are not applicable, not required, or the information required to be set forth herein is included in the consolidated financial statements or notes thereto.

(a)(3) Exhibits. These exhibits are available without charge upon request directed to the Company s Secretary at 200 Flynn Road, Camarillo, CA 93012. Documents that are not physically filed with this report are incorporated herein by reference to the location indicated. Exhibits 10.1 through 10.23, 10.29 and 10.30 constitute management contracts or compensatory plans or arrangements.

| Exhibit No. | Description | Location |
|---|---|---|
| 3.1 | Restated Certificate of Incorporation of Semtech Corporation | Exhibit 3.1 to the Company s Quarterly Report on Form 10-Q for the quarterly period ended October 26, 2003 |
| 3.2 | Bylaws of Semtech Corporation | Exhibit 3.2 to the Company s Quarterly Report on Form 10-Q for the quarterly period ended October 26, 2003 |
| 10.1 | Summary of Named Executive Officer Compensation | Exhibit 10.1 to the Company s Annual Report on Form 10-K for the fiscal year ended January 29, 2006 (filed April 14, 2006) |
| 10.2 | Summary of Director Compensation | Exhibit 10.2 to the Company s Annual Report on Form 10-K for the fiscal year ended January 29, 2006 (filed April 14, 2006) |
| 10.3 | The Company s 1994 Long-term Stock Incentive Plan, as amended | Exhibit 4.1 to the Company s Registration Statement on Form S-8 (333-44033) filed January 9, 1998 |
| 10.4 | The Company s 1994 Non-Employee Directors Stock Option Plan, as amended | Exhibit 4.1 to the Company s Registration Statement on Form S-8 (333-00599) filed January 31, 1996 |
| 10.5 | Form of Non-Statutory Stock Option Agreement | Exhibit 4.2 to the Company s Registration Statement of Form S-8 (333-60396) filed May 8, 2001 |
| 10.6 | The Company s Long-term Stock Incentive Plan, as amended | Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q for the quarterly period ended October 31, 2004 |

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| Exhibit No. | Description | Location |
|---|---|---|
| 10.7 | The Company s Non-Director and Non-Executive Officer Long-Term Stock Incentive Plan, as amended | Exhibit 10.2 to the Company s Quarterly Report on Form 10-Q for the quarterly period ended October 31, 2004 |
| 10.8 | Form of Option Agreement for Options Awarded to Non-Employee Directors on December 5, 2002 | Exhibit 10.2 to the Company s Quarterly Report on Form 10-Q for the quarterly period ended October 27, 2002 |
| 10.9 | Option Agreement dated October 6, 2003 with respect to options granted to Non-Employee Chairman John D. Poe | Exhibit 10.9 to the Company s Annual Report on Form 10-K for the fiscal year ended January 25, 2004 |
| 10.10 | Form of Long-Term Stock Incentive Plan Award Agreement (Non-Employee Directors) | Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q for the quarterly period ended July 25, 2004 |
| 10.11 | Form of Long-Term Stock Incentive Plan Award Agreement (Executive Officers) | Exhibit 10.2 to the Company s Quarterly Report on Form 10-Q for the quarterly period ended July 25, 2004 |
| 10.12 | Form of Non-Director and Non-Executive Officer Long-Term Stock Incentive Plan Award Agreement | Exhibit 10.3 to the Company s Quarterly Report on Form 10-Q for the quarterly period ended July 25, 2004 |
| 10.13 | Adoption Agreement dated as of January 1, 2004 adopting The Executive Nonqualified Excess Plan known as the Semtech Executive Compensation Plan | Exhibit 10.12 to the Company s Annual Report on Form 10-K for the fiscal year ended January 25, 2004 |
| 10.14 | Plan Document for The Executive Nonqualified Excess Plan adopted by Semtech Corporation as of January 1, 2004 (known as the Semtech Executive Compensation Plan) | Exhibit 10.13 to the Company s Annual Report on Form 10-K for the fiscal year ended January 25, 2004 |
| 10.15 | Trust Agreement dated as of January 1, 2004 between Semtech Corporation and Bankers Trust Company, as Trustee, related to the Semtech Executive Compensation Plan | Exhibit 10.14 to the Company s Annual Report on Form 10-K for the fiscal year ended January 25, 2004 |
| 10.16 | Form of Indemnification Agreement for Directors and Executive Officers | Exhibit 10.18 to the Company s Annual Report on Form 10-K for the fiscal year ended January 30, 2005 |
| 10.17 | Cash Bonus Incentive Plan amended and restated as of January 30, 2006 | Exhibit 10.1 to the Company s Current Report on Form 8-K filed March 1, 2006 |
| 10.18 | Agreement and Release effective as of June 9, 2005 Anthony E. Giraudo | Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q for the quarterly period ended May 1, 2005 |
| 10.19 | Agreement and Release effective as of October 10, 2005 Jason L. Carlson | Exhibit 10.1 to the Company s Current Report on Form 8-K filed October 14, 2005 |
| 10.20 | Employment Offer Letter to Mohan Maheswaran, accepted as of March 12, 2006 | Exhibit 10.1 to the Company s Current Report on Form 8-K filed March 14, 2006 |

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| Exhibit No. | Description | Location |
|---|---|---|
| 10.21 | Agreement dated April 3, 2006 with respect to inducement award of restricted stock to Mohan Maheswaran | Exhibit 10.1 to the Company s Current Report on Form 8-K filed April 5, 2006 |
| 10.22 | Option Award Agreement dated April 3, 2006 with respect to time-vested inducement options awarded to Mohan Maheswaran | Exhibit 10.2 to the Company s Current Report on Form 8-K filed April 5, 2006 |
| 10.23 | Option Award Agreement dated April 3, 2006 with respect to performance-vested inducement options awarded to Mohan Maheswaran | Exhibit 10.3 to the Company s Current Report on Form 8-K filed April 5, 2006 |
| 10.24 | Share Purchase and Sale Agreement dated June 17, 2005 among Semtech International AG and various selling shareholders regarding Xemics SA | Exhibit 10.1 to the Company s Current Report on Form 8-K filed June 20, 2005 |
| 10.25 | Settlement Agreement dated as of May 28, 2005 among American Manufacturers Mutual Insurance Company, Lumbermens Mutual Casualty Company, and Semtech Corporation | Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q for the quarterly period ended July 31, 2005 |
| 10.26 | Settlement Agreement dated as of July 14, 2005 between Royal Indemnity Company, as successor to the Royal Insurance Company of America, and Semtech Corporation | Exhibit 10.1 to the Company s Current Report on Form 8-K filed July 19, 2005 |
| 10.27 | Letter Agreement dated as of July 14, 2005 between Royal Indemnity Company, as successor to the Royal Insurance Company of America, and Semtech Corporation | Exhibit 10.2 to the Company s Current Report on Form 8-K filed July 19, 2005 |
| 10.28 | Stockholder Protection Agreement, dated June 25, 1998, between Semtech Corporation and Chase Mellon Shareholder Services as rights agent | Exhibit 4.1 to the Company s Current Report on Form 8-K filed July 16, 1998 |
| 10.29 | Letter to John D. Poe dated March 28, 2007 | |
| 10.30 | Letter to David G. Franz, Jr. dated March 28, 2007 | |
| 14 | Semtech Corporation Code of Conduct | Exhibit 14 to the Company s Annual Report on Form 10-K for the fiscal year ended January 25, 2004 |
| 21.1 | Subsidiaries of the Company | Exhibit 21.1 to the Company s Annual Report on Form 10-K for the fiscal year ended January 29, 2006 (filed April 14, 2006) |
| 23.1 | Consent of Independent Registered Public Accounting Firm | |
| 31.1 | Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934 as amended. | |
| 31.2 | Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934 as amended. | |

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| Exhibit No. | Description | Location |
|---|---|---|
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002 (As set forth in Exhibit 32.1 hereof, Exhibit 32.1 is being furnished and shall not be deemed filed .) | |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002 (As set forth in Exhibit 32.2 hereof, Exhibit 32.2 is being furnished and shall not be deemed filed .) | |

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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.

Date: March 28, 2007

Semtech Corporation

By: /s/ Mohan R. Maheswaran
Mohan R. Maheswaran

President and Chief Executive Officer

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**SCHEDULE II**

**SEMTECH CORPORATION AND SUBSIDIARIES**

**SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS**

**THREE YEARS ENDED JANUARY 29, 2006**

| | Balance at Beginning of Year | Charged (Reversal) to Costs and Expenses | Deductions | Balance at End of Year |
|---|---|---|---|---|
| Year ended January 25, 2004 | | | | |
| Allowance for doubtful accounts | $ 619,000 | $ 80,000 | $ (43,000) | $ 656,000 |
| Year ended January 30, 2005 | | | | |
| Allowance for doubtful accounts | $ 656,000 | $ (144,000) | $ | $ 512,000 |
| Year ended January 29, 2006 | | | | |
| Allowance for doubtful accounts | $ 512,000 | $ (23,000) | $ (27,000) | $ 462,000 |