DIODES INC /DEL/
Form 10-Q
August 09, 2007

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**FORM 10-Q**

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended **June 30, 2007**

Or

**o** Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____.

**Commission file number: 1-5740**

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

| **Delaware** | **95-2039518** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| **15660 North Dallas Parkway Suite 850 Dallas, Texas** (Address of principal executive offices) | **75248** (Zip code) |

**(972) 385-2810**
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one)
Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

The number of shares of the registrant's Common Stock outstanding as of August 8, 2007 was 39,711,040.

---

**Table of Contents**


| | Page |
|---|---|
| **Part I – Financial Information** | 3 |
| Item 1 – Financial Statements | 3 |
| Consolidated Condensed Balance Sheet as of June 30, 2007 and December 31, 2006 | 3 |
| Consolidated Condensed Statements of Income for the Three and Six Months ended June 30, 2007 and 2006 | 5 |
| Consolidated Condensed Statements of Cash Flows for the Six Months ended June 30, 2007 and 2006 | 6 |
| Notes to Consolidated Condensed Financial Statements | 8 |
| Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations | 30 |
| Item 3 – Quantitative and Qualitative Disclosures about Market Risk | 40 |
| Item 4 – Controls and Procedures | 40 |
| **Part II – Other Information** | 40 |
| Item 1 – Legal Proceedings | 40 |
| Item 1A – Risk Factors | 40 |
| Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds | 40 |
| Item 3 – Defaults Upon Senior Securities | 41 |
| Item 4 – Submission of Matters to a Vote of Security Holders | 41 |
| Item 5 – Other Information | 41 |
| Item 6 – Exhibits | 42 |
| **Signature** | 43 |

**PART I - FINANCIAL INFORMATION**

**Item 1 - Financial Statements**

**DIODES INCORPORATED AND SUBSIDIARIES**
**CONSOLIDATED CONDENSED BALANCE SHEET**
*(In thousands, except share data)*

**ASSETS**

| | December 31, 2006 | **June 30, 2007 (unaudited)** |
|---|---|---|
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | $ 48,888 | **$ 42,679** |
| Short-term investments | 291,008 | **309,780** |
| Total cash and short-term investments | 339,896 | **352,459** |
| Accounts receivable | | |
| Trade customers | 72,175 | **79,690** |
| Related parties | 6,147 | **6,126** |
| | 78,322 | **85,816** |
| Allowance for doubtful accounts | (617) | **(462)** |
| Accounts receivable, net of allowances | 77,705 | **85,354** |
| | | |
| Inventories | 48,202 | **48,549** |
| Deferred income taxes, current | 4,650 | **6,511** |
| Prepaid expenses and other | 8,393 | **9,621** |
| **Total current assets** | 478,846 | **502,494** |
| | | |
| **PROPERTY, PLANT AND EQUIPMENT,** net | 95,469 | **110,424** |
| | | |
| **DEFERRED INCOME TAXES,** non-current | 5,428 | **6,906** |
| | | |
| **OTHER ASSETS** | | |
| Intangible assets, net | 10,669 | **10,037** |
| Goodwill | 25,030 | **24,872** |
| Other | 6,697 | **6,690** |
| **Total assets** | $ 622,139 | **$ 661,423** |

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

**DIODES INCORPORATED AND SUBSIDIARIES**
**CONSOLIDATED CONDENSED BALANCE SHEET**

**LIABILITIES AND STOCKHOLDERS' EQUITY**
*(In thousands, except share data)*

| | December 31, 2006 | **June 30, 2007 (unaudited)** |
|---|---|---|
| **CURRENT LIABILITIES** | | |
| Line of credit | $ - | **$ 1,035** |
| Accounts payable | | |
| Trade | 40,029 | **34,787** |
| Related parties | 12,120 | **11,873** |
| Accrued liabilities | 24,967 | **29,269** |
| Income tax payable | 3,433 | **3,342** |
| Current portion of long-term debt | 2,802 | **2,122** |
| Current portion of capital lease obligations | 141 | **143** |
| **Total current liabilities** | 83,492 | **82,571** |
| | | |
| **LONG-TERM DEBT,** net of current portion | | |
| 2.25% convertible senior notes due 2026 | 230,000 | **230,000** |
| Others | 7,115 | **6,412** |
| | | |
| **CAPITAL LEASE OBLIGATIONS**, net of current portion | 1,477 | **1,395** |
| **OTHER LONG-TERM LIABILITIES** | 1,101 | **5,267** |
| **MINORITY INTEREST** | 4,787 | **5,748** |
| **Total liabilities** | 327,972 | **331,393** |
| | | |
| **CONTINGENCIES AND COMMITMENTS** | | |
| **STOCKHOLDERS' EQUITY** | - | **-** |
| Preferred stock - par value $1.00 per share; 1,000,000 shares authorized; no shares issued or outstanding | - | **-** |
| Common stock - par value $0.66 2/3 per share; 70,000,000 shares authorized; 38,941,901 and 39,714,162 issued at December 31, 2006 and June 30, 2007, respectively (1) | 17,308 | **17,651** |
| Additional paid-in capital | 113,449 | **125,856** |
| Retained earnings | 162,802 | **186,104** |
| Accumulated other comprehensive gain | 608 | **419** |
| **Total stockholders' equity** | 294,167 | **330,030** |
| **Total liabilities and stockholders' equity** | $ 622,139 | **$ 661,423** |

(1) Adjusted for the effect of a 3-for-2 stock split in July 2007 (Note O)

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

**DIODES INCORPORATED AND SUBSIDIARIES**
**CONSOLIDATED CONDENSED STATEMENTS OF INCOME**
(Unaudited)
*(In thousands, except share data)*

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2006 | **2007** | 2006 | **2007** |
| **NET SALES** | $ 82,712 | **$ 96,283** | $ 156,301 | **$ 188,303** |
| **COST OF GOODS SOLD** | 55,279 | **65,605** | 104,654 | **128,102** |
| Gross profit | 27,433 | **30,678** | 51,647 | **60,201** |
| **OPERATING EXPENSES** | | | | |
| Selling, general and administrative | 11,716 | **13,397** | 23,000 | **26,075** |
| Research and development | 2,077 | **3,156** | 4,043 | **6,101** |
| Restucturing and impariment of fixed assets | - | **1,770** | 120 | **1,770** |
| Total operating expenses | 13,793 | **18,323** | 27,163 | **33,946** |
| Income from operations | 13,640 | **12,355** | 24,484 | **26,255** |
| **OTHER INCOME (EXPENSES)** | | | | |
| Interest income | 1,004 | **4,285** | 1,738 | **8,320** |
| Interest expense | (133) | **(1,696)** | (273) | **(3,421)** |
| Other | 12 | **72** | (195) | **(56)** |
| Total other income | 883 | **2,661** | 1,270 | **4,843** |
| Income before income taxes and minority interest | 14,523 | **15,016** | 25,754 | **31,098** |
| **INCOME TAX PROVISION** | (2,885) | **(2,221)** | (4,575) | **(4,879)** |
| Income before minority interest | 11,638 | **12,795** | 21,179 | **26,219** |
| Minority interest | (253) | **(546)** | (482) | **(961)** |
| **NET INCOME** | $ 11,385 | **$ 12,249** | $ 20,697 | **$ 25,258** |
| **EARNINGS PER SHARE** (1) | | | | |
| Basic | $ 0.30 | **$ 0.31** | $ 0.54 | **$ 0.64** |
| Diluted | $ 0.27 | **$ 0.29** | $ 0.50 | **$ 0.60** |
| Number of shares used in computation (1) | | | | |
| Basic | 38,281,715 | **39,397,309** | 38,152,320 | **39,219,907** |
| Diluted | 41,991,176 | **42,022,979** | 41,792,910 | **41,897,204** |

(1) Adjusted for the effect of a 3-for-2 stock split in July 2007 (Note O)

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

**DIODES INCORPORATED AND SUBSIDIARIES**
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**
(Unaudited)
*(In thousands)*

| | Six Months Ended June 30, | |
|---|---|---|
| | 2006 | **2007** |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net income | $ 20,697 | **$ 25,258** |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 9,670 | **13,026** |
| Minority interest earnings | 490 | **961** |
| Share-based compensation | 4,085 | **4,654** |
| Loss on disposal of property, plant and equipment | 120 | **348** |
| Changes in operating assets: | | |
| Accounts receivable | 3,409 | **(7,793)** |
| Inventories | (11,516) | **(442)** |
| Prepaid expenses and other current assets | (383) | **(1,876)** |
| Deferred income taxes | 35 | **(3,339)** |
| Changes in operating liabilities: | | |
| Accounts payable | 6,871 | **(5,382)** |
| Accrued liabilities | 1,242 | **415** |
| Other liabilities | - | **2,210** |
| Income taxes payable | 433 | **(88)** |
| Net cash provided by operating activities | 35,153 | **27,952** |
| | | |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchases of property, plant and equipment | (29,650) | **(23,318)** |
| Purchases of short-term investments | (11,069) | **(18,772)** |
| Acquisitions, net of cash acquired | (18,957) | - |
| Proceeds from sale of property, plant and equipment | 54 | **5** |
| Net cash used by investing activities | (59,622) | **(42,085)** |
| | | |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Advances (repayments) on line of credit, net | (928) | **1,056** |
| Net proceeds from issuance of common stock | 1,517 | **3,894** |
| Excess tax benefits | 3,032 | **4,202** |
| Repayments of long-term debt | (3,883) | **(1,383)** |
| Repayments of capital lease obligations | (79) | **(81)** |
| Net cash provided (used) by financing activities | (341) | **7,688** |
| | | |
| **EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS** | 437 | **236** |
| **DECREASE IN CASH** | (24,373) | **(6,209)** |
| **CASH AND CASH EQUIVALENTS,** beginning of period | 73,288 | **48,888** |
| **CASH AND CASH EQUIVALENTS,** end of period | $ 48,915 | **$ 42,679** |

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

**DIODES INCORPORATED AND SUBSIDIARIES**
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Continued)**
(Unaudited)
*(In thousands)*

| | Six Months Ended June 30, | |
|---|---|---|
| | 2006 | **2007** |
| **SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION** | | |
| Cash paid during the year for: | | |
| Interest | $ 1,008 | **$ 2,598** |
| Income taxes | $ 1,306 | **$ 2,147** |
| Non-cash activities: | | |
| Property, plant and equipment purchased on accounts payable | $ (2,175) | **$ 3,943** |
| Liabilities for unrecognized tax benefits recorded as cumulative effect adjustment to equity | $ - | **$ 1,955** |

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

**DIODES INCORPORATED AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**
(Unaudited)

**NOTE A –Basis of Presentation**

Unless the context otherwise requires, the words "Diodes," "we," "us" and "our" refer to Diodes Incorporated and its subsidiaries. The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. They do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America for complete financial statements. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and related notes contained in our Annual Report on Form 10-K for the year ended December 31, 2006. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair presentation of the results of operations for the period presented have been included in the interim period. Operating results for the three months and six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. The condensed consolidated financial data at December 31, 2006 is derived from audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

The consolidated financial statements include Diodes Incorporated and its subsidiaries:

Diodes Taiwan, Inc. ("Diodes-Taiwan") - 100% owned
Diodes Hong Kong Ltd. ("Diodes-Hong Kong") - 100% owned
Anachip Corporation (Diodes-Anachip) - 99.8% owned
Shanghai KaiHong Electronics Co., Ltd. ("Diodes-China") - 95% owned
Shanghai KaiHong Technology Co., Ltd. ("Diodes-Shanghai") - 95% owned
FabTech Incorporated ("FabTech" or "Diodes-FabTech") - 100% owned
Diodes International B.V. ("Diodes-International") - 100% owned

All significant intercompany balances and transactions have been eliminated.

**NOTE B – Functional Currencies, Comprehensive Gain/Loss and Foreign Currency Translation**

Through our subsidiaries, we maintain foreign operations in Taiwan, Hong Kong and China. We believe the New Taiwan ("NT") dollar as the functional currency at Diodes-Taiwan and Diodes-Anachip most appropriately reflects the current economic facts and circumstances of the operations. Assets and liabilities recorded in NT dollars are translated at the exchange rate on the balance sheet date. Income and expense accounts are translated at the average monthly exchange rate during the year. Resulting translation adjustments are recorded as a separate component of accumulated other comprehensive income or loss.

We use the U.S. dollar as the functional currency in Diodes-China, Diodes-Shanghai and Diodes-Hong Kong, as substantially all monetary transactions are made in that currency, and other significant economic facts and circumstances currently support that position. As these factors may change in the future, we will periodically assess our position with respect to the functional currency of our foreign subsidiaries. Included in net income are foreign currency exchange losses of approximately $57,000 and $53,000 for the quarter ended June 30, 2006 and 2007,

respectively, and $350,000 and $307,000 for the six months ended June 30, 2006 and 2007, respectively.

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The components of other comprehensive income include foreign currency translation adjustments. Accumulated other comprehensive gain was $608,000 and $419,000 at December 31, 2006 and June 30, 2007, respectively. The $189,000 change of other comprehensive income was primarily a result of currency translation loss during the first six months of 2007.

Total comprehensive income for the three and six months ended June 30, 2006 and 2007 was as follows *(in thousands)*:

**Total Comprehensive Income**

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2006 | **2007** | 2006 | **2007** |
| Net income | $ 11,385 | **$ 12,249** | $ 20,697 | **$ 25,258** |
| Translation adjustment | 465 | **257** | 436 | **(189)** |
| Comprehensive income | $ 11,850 | **$ 12,506** | $ 21,133 | **$ 25,069** |

**NOTE C – Short-term Investments**

Short-term investments at June 30, 2007, were as follows *(in thousands)*:

| | Cost Basis | Unrealized Gains | Unrealized Losses | Recorded Basis |
|---|---|---|---|---|
| State and local government obligations | $ 309,541 | $ - | $ - | $ 309,541 |
| Money market mutual funds | 239 | - | - | $ 239 |
| Total short-term investments | $ 309,780 | $ - | $ - | $ 309,780 |

The estimated fair value of available-for-sale debt securities is $309.5 million, and is based on publicly available market information or other estimates determined by management. Although the maturities of the securities are over 10 years, management intends to use the funds within one year and does not anticipate holding the investments until maturity; therefore, the securities are classified as short-term.

**NOTE D - Inventories**

Inventories are stated at the lower of cost or market value. Cost is determined principally by the first-in, first-out method *(in thousands)*.

| | December 31, 2006 | **June 30, 2007** |
|---|---|---|
| Finished goods | $ 30,626 | **$ 25,485** |
| Work-in-progress | 10,265 | **9,043** |
| Raw materials | 13,464 | **18,389** |
| | 54,355 | **52,917** |
| Less: reserves | (6,153) | **(4,368)** |
| | $ 48,202 | **$ 48,549** |

**NOTE E – Goodwill and Other Intangible Assets**

Changes in goodwill are as follows *(in thousands):*

| | 2006 | | | **2007** | | | |
|---|---|---|---|---|---|---|---|
| | Balance, January 1 | Acquisitions/ purchase accounting adjustments | Currency exchange and other | Balance, December 31 | Acquisitions/ purchase accounting adjustments | Currency exchange and other | **Balance, June 30** |
| Goodwill-China | $ 881 | $ - | $ - | $ 881 | $ - | $ - | **$ 881** |
| Goodwill-FabTech | 4,209 | - | - | 4,209 | - | - | **4,209** |
| Goodwill-Anachip | - | 19,675 | 265 | 19,940 | - | (158) | **19,782** |
| Total | $ 5,090 | $ 19,675 | $ 265 | $ 25,030 | $ - | $ (158) | **$ 24,872** |

Intangible assets subject to amortization are *(in thousands):*

| | | **As of June 30, 2007** | | | |
|---|---|---|---|---|---|
| Amortized Intangible Assets | Useful life | Gross Carrying Amount | Accumulated Amortization | Currency exchange and other | **Net** |
| APD: | | | | | |
| Patents | 15 years | $ 8,569 | $ (359) | $ (167) | **$ 8,043** |
| | | | | | |
| Anachip: | | | | | |
| Patents and trademarks | 3-10 years | $ 2,430 | $ (419) | $ (17) | **$ 1,994** |
| Total: | | $ 10,999 | $ (778) | $ (184) | **$ 10,037** |

Amortization expense related to intangible assets subject to amortization was $72,000 and $209,000 for the three months ended June 30, 2006 and 2007, respectively, and $142,000 and $418,000 for the six months ended June 30,

2006 and 2007, respectively.

**NOTE F – Stockholders' Equity**

As of June 30, 2007, we had approximately 39.7 million outstanding common shares. During the first six months of 2007, shares outstanding increased by approximately 772,000 shares, due to approximately 700,000 shares issued in conjunction with stock option exercises and approximately 72,000 shares issued in conjunction with vested restricted stock units (split adjusted).

Additional paid-in capital increased approximately $12.4 million in the first six months of 2007, primarily due to $2.9 million in stock option expense, $1.7 million in share grant expense, $3.6 million in conjunction with stock option exercises and $4.2 million excess tax benefits associated with share-based compensation.

We adopted the provisions of FASB Interpretation No. 48 ("FIN48") effective January 1, 2007. As a result of the implementation of FIN48, during the first quarter of 2007, we increased our liability for unrecognized tax benefits by approximately $2.0 million, which was accounted for as a reduction to the January 1, 2007, balance of retained earnings.

**NOTE G – Restructuring Costs and Impairment of Fixed Assets**

In the second quarter of 2007, we recorded approximately $1.8 million in restructuring costs related to the consolidation of our analog wafer probe and final test operations from Hsinchu, Taiwan to our manufacturing facilities in Shanghai, China. The expense primarily consisted of approximately $0.8 million in termination and severance costs, $0.3 million in impairment of fixed assets and $0.3 million in relocation charges.

**NOTE H – Income Tax Provision**

We file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. We are no longer subject to U.S. federal income tax examinations by tax authorities for tax years before 2003.

With respect to state and local jurisdictions and countries outside of the United States, with limited exceptions, we are no longer subject to income tax audits for years before 2001. Although the outcome of tax audits is always uncertain, we believe that adequate amounts of tax, interest and penalties, if any, have been provided for any adjustments that are expected to result from these years. We will recognize accrued interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

We adopted the provisions of FIN48 effective January 1, 2007. As a result of the implementation of FIN48, during the first quarter of 2007, we increased our liability for unrecognized tax benefits by approximately $2.0 million, which was accounted for as a reduction to the January 1, 2007, balance of retained earnings. As of January 1 and June 30, 2007, the gross amount of unrecognized tax benefits was approximately $3.2 million and $3.0 million, respectively.

It is reasonably possible that the amount of the unrecognized benefit with respect to certain of our unrecognized tax positions will significantly increase or decrease within the next 12 months. These changes may be the result of settlement of ongoing audits or competent authority proceedings. At this time, an estimate of the range of the reasonably possible outcomes cannot be made.

Income tax expense of $2.2 million and $4.9 million for the three and six months ended June 30, 2007, respectively, was recorded, resulting in an effective tax rate of 15.7%, as compared to 17.8% in the first half of last year. Our lower effective tax rate compared with the same period last year was the result of lower quarterly income in the U.S. as well as a decrease in the amount of repatriation of earnings of our foreign subsidiaries, offset by the increased income tax rate at one of our China subsidiaries (Diodes-Shanghai is subject to a 7.5% preferential tax rate from 2007 through 2009, compared to a 0% tax rate in 2006). As of June 30, 2007, we had accrued $3.3 million for taxes on future

dividends from our foreign subsidiaries.

Our global presence requires us to pay income taxes in a number of jurisdictions. In general, earnings in the U.S. and Taiwan are currently subject to tax rates of 39.0% and 35.0%, respectively. Earnings of Diodes-Hong Kong are subject to a 17.5% tax for local sales or local source sales; all other Hong Kong sales are not subject to foreign income taxes. Earnings at Diodes-Taiwan and Diodes-Hong Kong are also subject to U.S. taxes with respect to those earnings that are derived from product manufactured by our China subsidiaries and sold to customers outside of Taiwan and Hong Kong, respectively. The U.S. tax rate on these earnings is computed as the difference between the foreign effective tax rates and the U.S. tax rate. In accordance with U.S. tax law, we receive credit against our U.S. federal tax liability for income taxes paid by our foreign subsidiaries. Funds repatriated from foreign subsidiaries to the U.S. may be subject to Federal and state income taxes.

Diodes-China is located in the Songjiang district, where the standard central government tax rate is 24.0%. However, as an incentive for establishing Diodes-China, the earnings of Diodes-China were subject to a 0% tax rate by the central government from 1996 through 2000, and to a 12.0% tax rate from 2001 through 2006. In addition, due to an $18.5 million permanent re-investment of Diodes-China earnings in 2004, Diodes-China has re-applied to the Chinese government for additional preferential tax treatment on earnings that are generated by this $18.5 million investment. If approved, those earnings will be exempted from central government income tax for two years, and then subject to a 12.0% tax rate for the following three years.

In addition, the earnings of Diodes-China would ordinarily be subject to a standard local government tax rate of 3.0%. However, as an incentive for establishing Diodes-China, the local government waived this tax from 1996 through 2006. Management expects this tax to be waived for 2007 as well; however, the local government can re-impose this tax at its discretion at any time.

In 2004, we established our second Shanghai-based manufacturing facility, Diodes-Shanghai, located in the Songjiang Export Zone of Shanghai, China. In the Songjiang Export Zone, the central government standard tax rate is 15.0%. There is no local government tax. During 2004, Diodes-Shanghai earnings were subject to the standard 15.0% central government tax rate. As an incentive for establishing Diodes-Shanghai, the 2005 and 2006 earnings of Diodes-Shanghai were exempted from central government income tax, and for the years 2007 through 2009 its earnings will be subject to a 7.5% tax rate. From 2010 onward, Diodes-Shanghai earnings might not continue to be subject to the 15% tax rate as the recently promulgated income tax reform in March 2007 could terminate some existing tax incentives for foreign enterprises doing business in China.

With the recent China government income tax reform, which terminates some existing tax incentives for foreign enterprises doing business in China, it is unclear to what extent our China subsidiaries will continue to receive preferential tax treatment.

As an incentive for the formation of Anachip, earnings of Anachip are subject to a five-year tax holiday (subject to certain qualifications of Taiwanese tax law). In the third quarter of 2006, we elected to begin this five-year tax holiday as of January 1, 2006.

**NOTE I – Deferred Compensation Plan**

Beginning January 1, 2007, the Company began sponsoring a Non-Qualified Deferred Compensation Plan (the “Plan”) for executive officers, key employees and members of the Board of Directors (the “Board”). The Plan allows eligible participants to defer the receipt of eligible compensation until designated future dates. The Company hedges its obligations under the Plan by investing in the actual underlying investments. These investments are classified as trading securities and are carried at fair value. At June 30, 2007, these investments totaled approximately $0.7 million. All gains and losses in these investments are equally offset by corresponding gains and losses in the Company’s deferred compensation liabilities.

**NOTE J – Share-based Compensation**

We maintain share-based compensation plans for our officers, key employees, and our Board, which provide for stock options and stock awards. The share-based compensation plans are described more fully in Note 13 of our audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006.

**Stock Options.** Through March 31, 2006, substantially all stock options granted vest in equal annual installments over a three-year period and expire ten years after the grant date. Beginning April 1, 2006, substantially all stock options granted vest in equal annual installments over a four-year period and expire ten years after the grant date.

Beginning in fiscal year 2006, we adopted Statement of Financial Accounting Standards (SFAS) No. 123R, "Share-Based Payments" (SFAS 123R), on a modified prospective transition method to account for our employee stock options. Under the modified prospective transition method, fair value of new and previously granted but unvested stock options are recognized as compensation expense in the income statement, and prior period results are not restated, and thus do not include the additional compensation expense. For the three months and six months ended June 30, 2007, share-based compensation expense related to stock options recognized in the income statement was as follows *(in thousands)*:

| | June 30, 2007 | |
|---|---|---|
| | Three Months Ended | Six Months Ended |
| Selling, general and administrative expense | $ 1,205 | $ 2,508 |
| Research and development expense | $ 118 | $ 243 |
| Cost of sales | $ 79 | $ 160 |
| **Total stock option expense** | $ 1,402 | **$ 2,911** |

Compensation expense for the three months and six months ended June 30, 2007, for stock options granted during the respective periods was calculated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

| | June 30, 2007 | |
|---|---|---|
| | Three Months Ended | Six Months Ended |
| Expected volatility | 54.52% | 54.52% |
| Expected term (in years) | 6.63 | 6.63 |
| Risk-free interest rate | 4.91% | 4.91% |
| Expected forfeitures | 2.56% | 2.56% |
| Expected dividends | n/a | n/a |

***Expected volatility.*** The Company estimates expected volatility using historical volatility. Public trading volume on options in the Company's stock is not material. As a result, the Company determined that utilizing an implied volatility factor would not be appropriate. The Company calculates historical volatility for the period that is commensurate with the option's expected term assumption.

***Expected term***. The Company evaluated expected term based on history and exercise patterns across its demographic population. The Company believes that this historical data is the best estimate of the expected term of a new option. The expected term for officers and the Board members is 6.94 years, while the expected term for all other employees is 4.66 years.

***Risk free interest rate***. The Company estimated the risk-free interest rate based on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected term assumption.

***Forfeiture rate.*** The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest as SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term "forfeitures" is distinguished from "cancellations" or "expirations" and represents only the unvested portion of the surrendered option. The Company has applied an annual forfeiture rate of 2.56% to all unvested options and restricted share units as of June 30, 2007. This analysis will be re-evaluated at least annually, and the forfeiture rate will be adjusted as necessary.

***Dividend yield.*** The Company historically has not paid a cash dividend; therefore this input is not applicable.

For the six months ended June 30, 2007, the Company granted stock options to purchase approximately 265,000 shares of the Company's Common Stock, which vest in equal annual installments over a four-year period and expire ten years from the date of grant. Options granted in the three months ended June 30, 2007 had a weighted-average grant date fair value of $14.74. (Split adjusted)

The total intrinsic value (actual gain) of options exercised during the six months ended June 30, 2007 was approximately $13.4 million.

The total net cash proceeds received from stock option exercise for the six months ended June 30, 2007 was $3.9 million.

During the six months ended June 30, 2006 and 2007, there were $3.3 million and $2.9 million, respectively, of total recognized share-based compensation expense related to stock options under the plans.

As of June 30, 2007, total unrecognized share-based compensation expense related to unvested stock options, net of forfeitures, was approximately $10.0 million, before income taxes, and is expected to be recognized over a weighted average of approximately 2.7 years.

A summary of the stock option plans as of June 30, 2007 follows:

| Stock options | Shares (000) | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (yrs) | Aggregate Intrinsic Value ($000) |
|---|---|---|---|---|
| Outstanding at December 31, 2006 (1) | 5,368 | $ 8.49 | 6.4 | $ 81,396 |
| Granted (1) | 265 | 24.96 | | |
| Exercised (1) | (700) | 5.66 | | |
| Forfeited or expired (1) | (89) | 18.41 | | |
| Outstanding at June 30, 2007 (1) | 4,844 | $ 9.69 | 6.3 | $ 87,961 |
| Exercisable at June 30, 2007 (1) | 3,334 | $ 6.51 | 5.4 | $ 71,138 |

(1) Adjusted for the effect of a 3-for-2 stock split in July 2007 (Note O)

The aggregate intrinsic value in the table above is before applicable income taxes and represents the amount optionees would have received if all options had been exercised on the last business day of the period indicated, based on the Company’s closing stock price.

**Share Grants.** Restricted stock awards and restricted stock units generally vest in equal annual installments over a four-year period.

A summary of the Company's share grants as of June 30, 2007 is presented below:

Approximately $0.8 million and $1.7 million of total share-based compensation expense was recognized during the six months ended June 30, 2006 and 2007, respectively, related to stock awards granted under the plans.

| Share Grants | Shares (000) | Weighted-Average Grant-Date Fair Value |
|---|---|---|
| Nonvested at January 1, 2007 (1) | 852 | $ 16.45 |
| Granted (1) | 269 | 25.70 |
| Vested (1) | (72) | 22.37 |
| Forfeited (1) | (23) | 23.59 |
| Nonvested at June 30, 2007 (1) | 1,026 | $ 18.24 |

(1) Adjusted for the effect of a 3-for-2 stock split in July 2007 (Note O)

As of June 30, 2007, total unrecognized share-based compensation expense related to unvested share grants, net of forfeitures, was approximately $14.8 million, before income taxes, and is expected to be recognized over a weighted average of approximately 3.2 years.

**NOTE K–Segment and Enterprise Information**

An operating segment is defined as a component of an enterprise about which separate financial information is available that is evaluated regularly by the chief decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief decision-making group consists of the President and Chief Executive Officer, Chief Financial Officer, Senior Vice President of Operations, Senior Vice President of Sales and Marketing, Asia President, and Senior Vice President of Finance. For financial reporting purposes, we operate in a single segment, standard semiconductor products, through our various manufacturing and distribution facilities. We aggregated our products since the products are similar and have similar economic characteristics, and the products are similar in production process and share the same customer type.

Our operations include the domestic operations (Diodes-North America and Diodes-FabTech) located in the United States, and the Far East operations (Diodes-Taiwan located in Taipei, Taiwan; Anachip Corporation located in HsinChu, Taiwan; Diodes-China and Diodes-Shanghai, both located in Shanghai, China; and Diodes-Hong Kong located in Hong Kong, China). For reporting purposes, European operations, which accounted for approximately 4.2% and 4.3% of total sales for the three months and six months ended June 30, 2007, respectively (4.0% for the second quarter of 2006, and 3.7% for the first half of 2006), are consolidated into the domestic (North America) operations.

**Geographic Information**

The accounting policies of the operations are the same as those described in the summary of significant accounting policies. Revenues are attributed to geographic areas based on the location of the market producing the revenues *(in thousands)*:

| Three Months Ended June 30, 2006 | Far East | North America | Total |
|---|---|---|---|
| Total sales | $ 92,734 | $ 31,496 | $ 124,230 |
| Inter-company sales | (34,739) | (6,779) | (41,518) |
| Net sales | $ 57,995 | $ 24,717 | $ 82,712 |
| | | | |
| Property, plant and equipment | $ 76,502 | $ 12,485 | $ 88,987 |
| Assets | $ 215,516 | $ 124,431 | $ 339,947 |

| **Three Months Ended June 30, 2007** | **Far East** | **North America** | **Total** |
|---|---|---|---|
| Total sales | $ 121,240 | $ 29,943 | **$ 151,183** |
| Inter-company sales | (48,585) | (6,315) | **(54,900)** |
| Net sales | $ 72,655 | $ 23,628 | **$ 96,283** |
| | | | |
| Property, plant and equipment | $ 97,658 | $ 12,766 | **$ 110,424** |
| Assets | $ 199,278 | $ 462,145 | **$ 661,423** |

| Six Months Ended June 30, 2006 | Far East | North America | Total |
|---|---|---|---|
| Total sales | $ 173,386 | $ 58,612 | $ 231,998 |
| Inter-company sales | (64,268) | (11,429) | (75,697) |
| Net sales | $ 109,118 | $ 47,183 | $ 156,301 |
| | | | |
| Property, plant and equipment | $ 76,502 | $ 12,485 | $ 88,987 |
| Assets | $ 215,516 | $ 124,431 | $ 339,947 |

| **Six Months Ended June 30, 2007** | **Far East** | **North America** | **Total** |
|---|---|---|---|
| Total sales | $ 231,907 | $ 60,666 | **$ 292,573** |
| Inter-company sales | (93,395) | (10,875) | **(104,270)** |
| Net sales | $ 138,512 | $ 49,791 | **$ 188,303** |
| | | | |
| Property, plant and equipment | $ 97,658 | $ 12,766 | **$ 110,424** |
| Assets | $ 199,278 | $ 462,145 | **$ 661,423** |

Revenues were derived from (shipped to) customers located in the following countries. “All Others” represents countries with less than 10% of total revenues each *(in thousands)*:

| | Net Sales for the three months ended June 30, | | Percentage of net sales | |
|---|---|---|---|---|
| | 2006 | **2007** | 2006 | **2007** |
| China | $ 27,800 | **$ 37,047** | 33.6% | **38.5%** |
| Taiwan | 20,708 | **23,201** | 25.0% | **24.1%** |
| United States | 19,971 | **20,643** | 24.1% | **21.4%** |
| All Others | 14,233 | **15,392** | 17.3% | **16.0%** |
| **Total** | $ 82,712 | **$ 96,283** | 100.0% | **100.0%** |

| | Net Sales for the six months ended June 30, | | Percentage of net sales | |
|---|---|---|---|---|
| | 2006 | **2007** | 2006 | **2007** |
| China | $ 53,369 | **$ 62,039** | 34.1% | **32.9%** |
| Taiwan | 38,979 | **56,820** | 24.9% | **30.2%** |
| United States | 37,562 | **40,829** | 24.0% | **21.7%** |
| All Others | 26,391 | **28,615** | 17.0% | **15.2%** |
| **Total** | $ 156,301 | **$ 188,303** | 100.0% | **100.0%** |

**NOTE L – Business Acquisition**

APD acquisition **-** On October 19, 2006, we signed an agreement to purchase the net assets of APD Semiconductor, a privately held U.S.-based fabless semiconductor company. The assets related to the business of manufacturing, marketing, selling and distribution of semiconductor products. The initial purchase price of the acquisition was $8.4 million in addition to a potential earn-out provision with respect to pre-defined covered products. The acquisition was completed on November 3, 2006.

The contingent consideration has been recorded as a liability at the date of acquisition. When the contingency is resolved and the consideration is distributable, any excess of the fair value of the contingent consideration payable over the amount that was recognized as a liability shall be recognized as an additional cost of the acquired entity. If the amount initially recognized as a liability exceeds the consideration payable, that excess shall be allocated as a pro rata reduction of the amounts assigned to assets acquired. Any amount that remains after reducing those assets to zero shall be recognized as an extraordinary gain.

The following table (in thousands) summarizes management's estimates of the fair values of the assets acquired and liabilities assumed at the date of acquisition. The allocation of the purchase price is subject to refinement for final determination of fair value and the contingent consideration.

| | Total Allocation |
|---|---|
| Assets acquired | |
| Accounts receivable | $ 299 |
| Inventory | 923 |
| Fixed assets | 125 |
| Patents | 8,399 |
| | |
| Liabilities assumed | |
| Accounts payable | (338) |
| Accrued liabilities | (1,000) |
| Net assets acquired | $ 8,408 |

**NOTE M – Commitments**

**Purchase commitments -** We have non-cancelable purchase contracts for capital expenditures, primarily for manufacturing equipment in China, totaling approximately $10.6 million at June 30, 2007.

**NOTE N – Recently Issued Accounting Pronouncements**

In February 2007, the Financial Accounting Standards Board (FASB) issued FAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115” (“FAS 159”). This Statement permits entities to choose to measure many financial instruments and certain other items at fair value and report unrealized gains and losses on these instruments in earnings. FAS 159 is effective as of January 1, 2008. We have not yet determined the effect, if any, that the implementation of FAS 159 will have on our results of operations or financial condition.

In September 2006, FASB issued FAS 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans - an Amendment of FASB Statements No. 87, 88, 106 and 132(R)” (“FAS 158”). FAS 158 requires an employer that is a business entity and sponsors one or more single employer benefit plans to (1) recognize the funded status of the benefit in its statement of financial position, (2) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period, but are not recognized as components of net periodic benefit cost, (3) measure defined benefit plan assets and obligations as of the date of the employer's fiscal year end statement of financial position and (4) disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs on credits, and transition asset or obligations. We do not expect FAS 158 to have a material impact on our consolidated financial statements.

In September 2006, FASB issued SFAS 157, “Fair Value Measurements” (“FAS 157”). SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, with early adoption permitted. We have not yet determined the effect, if any, that the implementation of FAS 157 will have on our results of operations or financial condition.

18

In July 2006, FASB issued FASB Interpretation (FIN) No. 48, “Accounting for Uncertainty in Income Taxes,” which clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, “Accounting for Income Taxes”. FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, tax positions shall initially be recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements to include an annual tabular rollforward of unrecognized tax benefits. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted the provisions of FIN48 effective January 1, 2007. As a result of the implementation of FIN48, during the first quarter of 2007, we increased our liability for unrecognized tax benefits by approximately $2.0 million, which was accounted for as a reduction to the January 1, 2007, balance of retained earnings. As of January 1 and June 30, 2007, the gross amount of unrecognized tax benefits was approximately $3.2 million and $3.0 million, respectively.

**NOTE O – Subsequent Event**

On July 10, 2007, we declared a three-for-two stock split in the form of a 50% stock dividend payable on July 30, 2007 to stockholders of record on July 20, 2007.

Under the terms of this stock dividend, Diodes' stockholders received one additional share for every two shares held on the record date. The dividend was paid in authorized but unissued shares of Common Stock. Fractional shares created by the stock dividend were paid in cash based upon the closing price of our Common Stock on the record date.

As of July 31, 2007, the number of outstanding shares of Common Stock after the stock dividend was increased from approximately 26.5 million to approximately 39.7 million shares. The par value of the Company's stock will not be affected by the dividend and will remain at $0.66 2/3 per share. The outstanding shares stated on the balance sheet have been adjusted to reflect the additional shares issued for the stock split; and the consolidated condensed statement of income and disclosures have been adjusted to reflect the effects of stock split.

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

*Except for the historical information contained herein, the matters addressed in this Item 2 constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements are subject to a variety of risks and uncertainties, including those discussed below under the heading "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q, that could cause actual results to differ materially from those anticipated by the Company's management. The Private Securities Litigation Reform Act of 1995 (the "Act") provides certain "safe harbor" provisions for forward-looking statements. All forward-looking statements made on this Quarterly Report on Form 10-Q are made pursuant to the Act. The Company undertakes no obligation to publicly release the results of any revisions to their forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unexpected events. Unless the context otherwise requires, the words "Diodes," "we," "us" and "our" refer to Diodes Incorporated and its subsidiaries.*

*This management's discussion should be read in conjunction with the management's discussion included in the Company's Annual Report on Form 10-K for the fiscal year-ended December 31, 2006, previously filed with Securities and Exchange Commission.*

**Overview**

We are a global supplier of discrete and analog semiconductor products. We design, manufacture and market these semiconductors focusing on diverse end-use applications in the consumer electronics, computing, industrial, communications and automotive sectors. Our semiconductors, which provide electronic signal amplification and switching functions, are basic building-block electronic components that are incorporated into almost every electronic device. We believe that our product focus provides us with a meaningful competitive advantage relative to broadline semiconductor companies that provide a wider range of semiconductor products.

We are headquartered in Dallas, Texas. Our two manufacturing facilities are located in Shanghai, China; our wafer fabrication facility is near Kansas City, Missouri; our sales and marketing and logistical centers are located in Taipei, Taiwan, and Shanghai, Shenzhen and Hong Kong , China, and San Jose and Westlake Village, CA; and our IC design company, Anachip, is located in Hsinchu, Taiwan. We also have regional sales offices or representatives in: Derbyshire, England; Toulouse, France; Frankfurt, Germany; and in various cities in the United States.

Our strategy is to continue to enhance our position as a global supplier of standard semiconductor products, and to continue to add other product lines, such as power management products, using our packaging technology capability.

The principal elements of this strategy include the following:

*Focus on technology innovation* — In 2006, we strengthened our product design centers in Dallas, San Jose, Shanghai and Taipei to position our design engineers to work more closely with our customers and enable Diodes to deliver a stream of innovative solutions in our targeted product categories. By working closely with our market-leading customers and tailoring our R&D efforts to their specific needs, we have gained a superior understanding of their requirements and can anticipate and quickly respond to their emerging product development needs. As the trend toward converged consumer electronics devices in ever smaller form factors continues to drive demand for products that can help our customers achieve enhanced performance and energy efficiencies while shrinking printed circuit board real estate, we have been able to introduce market-leading innovative products to address our customer needs.

Sales of new products for the quarter amounted to 33.5% of total sales, compared to 24.9% a year ago, and this growth includes the contribution of the Anachip acquisition as well as the acquired SBRâ technology. New product revenue was driven by products in sub-miniature array, QFN, PowerDIÔ323, PowerDIÔ123, PowerDIÔ5, SBRâ and Schottky

platforms in both the discrete and analog product lines. Diodes released 54 products covering 13 product families during the second quarter of 2007.

*Expand our available market opportunities* -- We intend to aggressively maximize our opportunities in the standard semiconductor market as well as in related markets where we can apply our semiconductor design and manufacturing expertise. A key element of this is leveraging our highly integrated packaging expertise through our Application Specific Multi-Chip Circuit (ASMCC) product platform, which consists of standard arrays, function specific arrays and end-equipment specific arrays. We intend to achieve this by:

- Continuing to focus on increasing packaging integration, particularly with our existing standard array and customer-specific array products, in order to achieve products with increased circuit density, reduced component count and lower overall product cost;

- Expanding existing products and developing new products in our function specific array lines, which combine multiple discrete semiconductor components to achieve specific common electronic device functionality at a low cost; and

- Developing new product lines, which we refer to as end-equipment specific arrays, which combine discrete components with logic and/or standard analog circuits to provide system-level solutions for high-volume, high-growth applications.

Our extension into the Hall effect sensors and Power Management product lines provides us with a market opportunity that focuses on high growth areas that have higher margins. In addition, these product lines share essentially the same customers and end-user applications as our current product lines, providing us with cross-selling opportunities, and helping us to expand and deepen our customer relationships. Overall, we believe that our strong results for the year reflect our customers' acceptance of our broader product lines and reaffirm our confidence in the soundness of our strategic direction.

In order to extend our distribution network in Europe, on July 9, 2007, we signed a distribution agreement with SILICA, an Avnet, Inc. (NYSE:AVT) company, and one of the largest suppliers and distributors of semiconductor products in Europe. SILICA is a highly specialized semiconductor distributor with 36 branch offices throughout Europe providing customers with a broad portfolio of semiconductor products along with in-depth technical and logistic support as well as other value-added services. SILICA's specialized focus on semiconductor products and extensive local presence in Europe will improve our ability to service our customer's logistic requirements, enhance our competitiveness and strengthen our brand recognition. Since entering the European market in 2001, we have consistently grown our sales and expanded our market share, successfully building our European customer base in the automotive, communications and industrial end-markets. We believe that Europe will make an important contribution to Diodes' long term profitable growth.

*Maintain intense customer focus* — We intend to strengthen and deepen our customer relationships. We believe that continued focus on customer service would increase our net sales, operating performance and overall market share. To accomplish this, we intend to continue to closely collaborate with our customers to design products that meet their specific needs. A critical element of this strategy is to continue to further reduce our design cycle time in order to quickly provide our customers with innovative products. Diodes' customer service culture pervades all levels of our organization and has enabled us to build a customer base that includes global industry leaders in the computing, consumer electronics, communications, industrial and automotive sectors. Our engineers work with customers side by side to understand their requirements and to help them reduce component count and footprint and to improve functionality. And our flexible manufacturing facilities will quickly shift production to accommodate customer needs and scale up production on customized application specific devices. This level of responsiveness has enabled Diodes to stay ahead of the curve on our customers' ongoing and future needs and expand our position with each new generation of end devices. We deliver world-class service support to our clients from our sales, engineering and marketing teams in the United States, Asia and Europe.

21

*Enhance manufacturing efficiency* — A key element of our success is our overall low-cost base. We operate two state-of-the-art manufacturing facilities in China. During 2006, we invested $32 million in new manufacturing capacity and increased our total output by 43% to over 11.8 billion devices per year, and in the first half of 2007, we have invested $27.3 million. We remain committed to achieving the lowest cost and highest quality position in our industry by our relentless pursuit of continuous improvement in manufacturing efficiencies through product innovation and economies of scale. We will continue to deliver the highest quality products and services our customers have come to expect as well as maintain our customer-centered approach to adjust and reconfigure our production schedule to deliver devices of outstanding reliability for high-volume applications within very tight delivery schedules. We believe that our approach to manufacturing excellence, quality, flexibility and reliability at a very competitive cost is key to our business strategy and success, and has positioned Diodes as a premier supplier to some of the leading OEMs in the world.

In order to optimize the synergies from the business integration with Anachip, which we acquired in January 2006, we announced plans to consolidate our analog wafer probe and final test operations from Hsinchu, Taiwan to our manufacturing facilities in Shanghai, China. We recorded a restructuring charge of $1.8 million in the second quarter of 2007 (see Note G).

*Pursue selective strategic acquisitions* — As part of our strategy to expand our standard semiconductor product offerings and to maximize our market opportunities, we may acquire discrete, analog or mixed-signal technologies, product lines or companies in order to support our ASMCC product platform and enhance our standard and new product offerings.

In December 2005, we announced the acquisition of Anachip Corporation, a fabless Taiwanese semiconductor company focused on analog ICs designed for specific applications, and headquartered in the Hsinchu Science Park in Taiwan. This acquisition, which was completed on January 10, 2006, fits in the center of our long-term strategy. Anachip's main product focus is power management ICs. The analog devices they produce are used in LCD monitor/TV's, wireless LAN 802.11 access points, brushless DC motor fans, portable DVD players, datacom devices, ADSL modems, TV/satellite set-top boxes, and power supplies. Anachip brings a design team with strong capabilities in a range of targeted analog and power management technologies.

In November 2006, we purchased the net assets of APD Semiconductor, Inc., a privately held U.S.-based fabless semiconductor company. APD Semiconductor is headquartered in Redwood City, California, with a sales, application, and administration center in Taipei, Taiwan. APD Semiconductor's main product focus is its patented and trademarked Super Barrier Rectifier ("SBR") technology. Utilizing a low cost IC wafer process, the SBR technology uses a MOS cellular design to replace standard traditional Schottky or PN junction diodes. The SBR technology uses an innovative-patented process technique that allows its key parameters to be easily tuned to optimize any customer applications. This adaptive and scalable technology allows for increased power saving with better efficiency and reliability at higher operating temperatures for end user applications like digital audio players, DC/DC converters. AC/DC power supplies, LCD monitors, Power-over-Ethernet (POE), Power Factor Correction (PFC) and TV/satellite set-top boxes. The SBR technology offers industry-leading products like the SBR20U100CT, which has the lowest forward voltage and highest efficiency and power saving in its class. The APD acquisition will enhance our product capabilities and technology leadership position in the low pin count standard product semiconductor market and expand our product capabilities across important segments of our end-markets.

In implementing these strategies, the following factors have affected, and, we believe, will continue to affect, our results of operations:

· Since 1998, we have experienced increases in the demand for our products, and substantial pressure from our customers and competitors to reduce the selling price of our products. We expect future increases in net income to result primarily from increases in sales volume and improvements in product mix in order to offset reduced average

selling prices of our products.

· As part of our growth strategy, in January 2006 we acquired Anachip Corporation, a fabless Taiwanese semiconductor company focused on the standard analog markets. At December 31, 2005, we had purchased an aggregate of 9,433,613 shares (or approximately 18.9%) of the 50,000,000 outstanding shares of the capital stock of Anachip. On January 10, 2006, (the closing date of the acquisition) we purchased an additional 40,470,212 shares and therefore, we hold approximately 99.81% of the Anachip capital stock. As of result of the additional Anachip interest acquired during 2006, Anachip was consolidated beginning the first fiscal quarter of 2006. The purchase price of the acquisition was NT$20 per share (approximately US$31 million). The acquired intangible assets include patents and trademarks of $2.4 million with an approximately 10-year weighted-average useful life. The acquisition was accretive to our 2006 earnings, and is expected to be accretive to our full-year 2007 earnings.

· In 2006 and the six months ended June 30, 2007, 28.2% and 32.7%, respectively, of our net sales were derived from products introduced within the last three years, which we term “new products,” compared to 15.3% in 2005. The significant increase in new products primarily resulted from the Anachip acquisition. New products generally have gross profit margins that are higher than the margins of our standard products. We expect net sales derived from new products to increase in absolute terms, although our net sales of new products as a percentage of our net sales will depend on the demand for our standard products, as well as our product mix.

· Our gross profit margin was 31.9% in the second quarter of 2007, compared to 33.2% in the same period of 2006 and 32.1% in the first quarter of 2007. Our gross margin percentage was lower sequentially as average selling prices have been declining during the second quarter of 2007 due to market competition. Furthermore, we are still under process of integrating analog product line. With the addition of Anachip, we can now pursue adjacent product categories that significantly expand our growth opportunities as well as gross margin potential.

· As of June 30, 2007, we had invested approximately $151.7 million in our Asian manufacturing facilities. For the six months ended June 30, 2007, we invested approximately $27.3 million in capital expenditures, primarily in our Asian manufacturing facilities, which was approximately 14.5% of revenue. We expect our full-year capital expenditures to be at the upper-end of our guidance of 10-12% of total revenue. Our capital expenditure objective is to meet increased demand by investing in equipment to increase our manufacturing efficiencies, and to integrate the analog business.

· During the second quarter of 2007, the percentage of our net sales derived from our Asian subsidiaries was 75.5%, compared to 71.6% in the first quarter of 2007, 71.9% in 2006 and 65.4% in 2005. We expect our net sales to the Asian market to continue to increase as a percentage of our total net sales as a result of our customers' continuing to shift their manufacturing of electronic products from the U.S. to Asia.

· We have increased our investment in research and development from $2.1 million, or 2.5% of net sales, in the second quarter of 2006 to $3.2 million, or 3.3% of net sales, in the second quarter of 2007, as we completed the Anachip acquisition, continued investing in enhancing current product features, and developed new products. We continue to seek to hire qualified engineers who fit our focus on proprietary discrete and analog processes and packaging technologies. Our goal is to maintain research and development expenses at approximately 3.0% of net sales as we bring additional proprietary devices to the market.

· During 2005, we sold 3.2 million (split adjusted) shares of our Common Stock in a follow-on public offering, raising approximately $72.0 million (net of commissions and expenses). We used approximately $31 million of the net proceeds to acquire Anachip and will use the remaining net proceeds from this offering for working capital and other general corporate purposes, including additional acquisitions.

· On November 3, 2006, we completed the agreement to purchase the assets of APD Semiconductor, a privately held U.S.-based fabless discrete semiconductor company. Headquartered in Redwood City, California, APD's main product focus is its patented and trademarked Super Barrier Rectifier™ technology. The initial purchase price of the acquisition was $8.4 million in addition to a potential earn-out provision with respect to pre-defined covered products. APD revenue was $0.5 million for 2006 and $1.5 million for the first six months of 2007. The APD acquisition is aligned with our strategy of strengthening our technology leadership in the discrete semiconductor market and expanding our product capabilities across important segments of our end-markets.

· On October 5, 2006, we issued $230 million in aggregate principal amount of convertible senior notes due on October 1, 2026. The notes pay interest semiannually at a rate of 2.25% per annum. The notes will be convertible, in certain circumstances, into cash up to the principal amount, and any conversion value above the principal amount will be redeemable, at our option, into cash or shares of Common Stock, at an initial conversion rate of 25.6419 shares per $1,000 principal amount of notes (which represents an initial conversion price of $39.00 per share, split adjusted). The initial conversion price represents an approximate 40% conversion premium, based on the sale price of $27.92 (split

adjusted) of Company's Common Stock on October 5, 2006. We expect this transaction to be accretive to earnings per share given the current short-term interest environment and intend to use the net proceeds from this offering for working capital and other general corporate purposes, including acquisitions.

***Related Parties***

We conduct business with one related party, Lite-On Semiconductor Corporation ("LSC") (and its subsidiaries and affiliates) and one significant party, Keylink International (formerly Xing International) (and its subsidiaries). LSC is our largest stockholder and owned 22.0% of our outstanding Common Stock as of June 30, 2007. Keylink International is our 5% joint venture partner in Diodes-China and Diodes-Shanghai. C.H. Chen, our previous President and Chief Executive Officer, and Vice Chairman of our Board of Directors, is also Vice Chairman of LSC, and Raymond Soong, the Chairman of our Board of Directors, is the Chairman of Lite-On Technology Corporation, a significant shareholder of LSC, as well as the Chairman of LSC.

The Audit Committee of our Board of Directors reviews related party transactions for potential conflict of interest situations, and approves or ratifies all such transactions, in accordance with such procedures as it may adopt from time to time. We believe that related party transactions are on terms no less favorable to us than would be obtained from unaffiliated third parties.

During the three and six months ended June 30, 2007, we sold silicon wafers to LSC totaling 6.4% and 6.8% (6.5% in 2006 and 9.6% in 2005) of our net sales, respectively, making LSC our largest customer. Also for the three months ended June 30, 2007, 10.7% (14.2% in 2006 and 14.7% in 2005) of our net sales were from discrete semiconductor products purchased from LSC for subsequent sale by us, making LSC our largest outside supplier. We believe such transactions are on terms no less favorable to us than could be obtained from unaffiliated third parties. The Audit Committee of our Board of Directors has approved the contracts associated with these related party transactions.

During the three and six months ended June 30, 2007, we sold silicon wafers to companies owned by Keylink International totaling 0.9% and 0.4% (0.4% in 2006 and 0.6% in 2005) of our net sales, respectively. Also for the three months ended June 30, 2007, 1.5% (2.3% in 2006 and 3.0% in 2005) of our net sales were from discrete semiconductor products purchased from companies owned by Keylink International. In addition, Diodes-China and Diodes-Shanghai lease their manufacturing facilities from, and subcontract a portion of their manufacturing process (metal plating and environmental services) to, Keylink International. We also pay a consulting fee to Keylink International. In 2006, and the three and six months ended June 30, 2007, we paid Keylink International an aggregate of $7.9 million, 2.2 million and $4.3 million, respectively, with respect to these items, respectively. We believe such transactions are on terms no less favorable to us than could be obtained from unaffiliated third parties. The Audit Committee of our Board of Directors has approved the contracts associated with these related party transactions.

In December 2005, we entered into a definitive stock purchase agreement to acquire Anachip Corporation, a Taiwanese fabless analog IC company, and headquartered in the Hsinchu Science Park in Taiwan. The selling shareholders included LSC (which owned approximately 60% of Anachip's outstanding capital stock), and two Taiwanese venture capital firms (together owning approximately 20% of Anachip's stock), as well as current and former Anachip employees. At December 31, 2005, we had purchased an aggregate of 9,433,613 shares (or approximately 18.9%) of the 50,000,000 outstanding shares of the capital stock of Anachip. On January 10, 2006 (the closing date of the acquisition), we purchased an additional 40,470,212 shares and therefore, we now hold approximately 99.81% of the Anachip capital stock.

Concurrent with the acquisition, Anachip entered into a wafer purchase agreement with LSC, pursuant to which LSC will sell to Anachip, according to Anachip's requirements, during the two year period ending on December 31, 2007, wafers of the same or similar type, and meeting the same specifications, as those wafers purchased from LSC by Anachip at the time of the acquisition. Anachip will purchase such wafers on terms (including purchase price, delivery schedule, and payment terms) no less favorable to Anachip than those terms on which Anachip purchased such wafers from LSC at the time of the acquisition, provided, however, that the purchase price will be the lower of the current price or the most favorable customer pricing. If the price of raw wafers increases by more than 20% within any six-month period, Anachip and LSC will renegotiate in good faith the price of wafers to reflect the cost increase.

24

***Available Information***

Our Internet address is http://www.diodes.com. We make available, free of charge through our Internet website, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy statements, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (the "SEC"). To support our global customer-base, particularly in Asia and Europe, our website is language-selectable into English, Chinese, and Korean, giving us an effective marketing tool for worldwide markets. With its extensive online Product (Parametric) Catalog with advanced search capabilities, our website facilitates quick and easy product selection. Our website provides easy access to worldwide sales contacts and customer support, and incorporates a distributor-inventory check to provide component inventory availability and a small order desk for overnight sample fulfillment. Our website also provides access to investor financial information, including SEC filings and press releases, as well as stock quotes and information on corporate governance compliance.

**Cautionary Statement for Purposes of the "Safe Harbor" Provision of the Private Securities Litigation Reform Act of 1995**

Except for the historical information contained herein, the matters addressed in this Quarterly Report on Form 10-Q constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We generally identify forward-looking statements by the use of terminology such as "may," "will," "could," "should," "potential," "continue," "expect," "inten "estimate," "anticipate," "believe," or similar phrases or the negatives of such terms. Such forward-looking statements are subject to a variety of risks and uncertainties, including those discussed under "Risks Related To Our Business" and elsewhere in this Quarterly Report on Form 10-Q that could cause actual results to differ materially from those anticipated by our management. The Private Securities Litigation Reform Act of 1995 (the "Act") provides certain "safe harbor" provisions for forward-looking statements. All forward-looking statements made on this Quarterly Report on Form 10-Q are made pursuant to the Act.

All forward-looking statements contained in this Quarterly Report on Form 10-Q are subject to, in addition to the other matters described in this Quarterly Report on Form 10-Q, a variety of significant risks and uncertainties. The following discussion highlights some of these risks and uncertainties. Further, from time to time, information provided by us or statements made by our employees may contain forward-looking information. There can be no assurance that actual results or business conditions will not differ materially from those set forth or suggested in such forward-looking statements as a result of various factors, including those discussed below.

For more detailed discussion of these factors, see the "Risk Factors" discussion in Item 1A of the Company's most recent Annual Report on Form 10-K. The forward-looking statements included in this Quarterly Report on Form 10-Q are made only as of the date of this report, and the Company undertakes no obligation to update the forward-looking statements to reflect subsequent events or circumstances.

**Risks Related To Our Business**

- *Downturns in the highly cyclical semiconductor industry or changes in end-market demand could affect our operating results and financial condition.*

- *The semiconductor business is highly competitive, and increased competition may harm our business and our operating results.*

- *We receive a significant portion of our net sales from a single customer. In addition, this customer is also our largest external supplier and is a related party. The loss of this customer or supplier could harm our business and*

*results of operations.*

- *Delays in initiation of production at new facilities, implementing new production techniques or resolving problems associated with technical equipment malfunctions could adversely affect our manufacturing efficiencies.*

- *We are and will continue to be under continuous pressure from our customers and competitors to reduce the price of our products, which could adversely affect our growth and profit margins.*

- *Our customer orders are subject to cancellation or modification usually with no penalty. High volumes of order cancellation or reductions in quantities ordered could adversely affect our results of operations and financial condition.*

- *New technologies could result in the development of new products by our competitors and a decrease in demand for our products, and we may not be able to develop new products to satisfy changes in demand, which could result in a decrease in net sales and loss of market share.*

- *We may be subject to claims of infringement of third-party intellectual property rights or demands that we license third-party technology, which could result in significant expense and reduction in our intellectual property rights.*

- *We depend on third-party suppliers for timely deliveries of raw materials, parts and equipment, as well as finished products from other manufacturers, and our results of operations could be adversely affected if we are unable to obtain adequate supplies in a timely manner.*

- *If we do not succeed in continuing to vertically integrate our business, we will not realize the cost and other efficiencies we anticipate and our ability to compete, profit margins and results of operations may suffer.*

- *Part of our growth strategy involves identifying and acquiring companies with complementary product lines or customers. We may be unable to identify suitable acquisition candidates or consummate desired acquisitions and, if we do make any acquisitions, we may be unable to successfully integrate any acquired companies with our operations.*

- *We are subject to many environmental laws and regulations that could affect our operations or result in significant expenses.*

- *Our products may be found to be defective and, as a result, product liability claims may be asserted against us, which may harm our business and our reputation with our customers.*

- *We may fail to attract or retain the qualified technical, sales, marketing and management personnel required to operate our business successfully.*

- *We may not be able to maintain our growth or achieve future growth and such growth may place a strain on our management and on our systems and resources.*

- *Our business may be adversely affected by obsolete inventories as a result of changes in demand for our products and change in life cycles of our products.*

- *If OEMs do not design our products into their applications, a portion of our net sales may be adversely affected.*

- *We rely heavily on our internal electronic information and communications systems, and any system outage could adversely affect our business and results of operations.*

- *We are subject to interest rate risk that could have an adverse effect on our cost of working capital and interest expenses.*

-

*If we fail to maintain an effective system of internal controls or discover material weaknesses in our internal controls over financial reporting, we may not be able to report our financial results accurately or detect fraud, which could harm our business and the trading price of our Common Stock.*

- *Terrorist attacks, or threats or occurrences of other terrorist activities whether in the United States or internationally may affect the markets in which our Common Stock trades, the markets in which we operate and our profitability.*

- *We currently have a significant amount of debt following our convertible senior notes offering. Our substantial indebtedness could adversely affect our business, financial condition and results of operations and our ability to meet our payment obligations under the notes and our other debt.*

**Risks Related To Our International Operations**

- *Our international operations subject us to risks that could adversely affect our operations.*

- *We have significant operations and assets in China, Taiwan and Hong Kong and, as a result, will be subject to risks inherent in doing business in those jurisdictions, which may adversely affect our financial performance.*

- *We are subject to foreign currency risk as a result of our international operations.*

- *We may not continue to receive preferential tax treatment in China, thereby increasing our income tax expense and reducing our net income.*

- *The distribution of any earnings of our foreign subsidiaries to the United States may be subject to U.S. income taxes, thus reducing our net income.*

**Risks Related To Our Common Stock**

- *Variations in our quarterly operating results may cause our stock price to be volatile.*

- *We may enter into future acquisitions and take certain actions in connection with such acquisitions that could affect the price of our Common Stock.*

- *Our directors, executive officers and significant stockholders hold a substantial portion of our Common Stock, which may lead to conflicts with other stockholders over corporate transactions and other corporate matters.*

- *Our early corporate records are incomplete. As a result, we may have difficulty in assessing and defending against claims relating to rights to our Common Stock purporting to arise during periods for which our records are incomplete.*

- *Conversion of our convertible senior notes will dilute the ownership interest of existing shareholders, including holders who had previously converted their notes.*

**Financial Operations Overview**

**Net Sales**

We generate a substantial portion of our net sales through the sale of discrete and analog semiconductor products designed and manufactured by third parties or us. We also generate a portion of our net sales from outsourcing manufacturing capacity to third parties and from the sale of silicon wafers to manufacturers of discrete semiconductor components. We serve customers across diversified industries, including the consumer electronics, computing, industrial, communications and automotive markets.

We recognize revenue from product sales when title to and risk of loss of the product have passed to the customer, there is persuasive evidence of an arrangement, the sale price is fixed or determinable and collection of the related receivable is reasonably assured. These criteria are generally met upon shipment to our customers. Net sales is stated net of reserves for pricing adjustments, discounts, rebates and returns.

The principal factors that have affected or could affect our net sales from period to period are:

- the condition of the economy in general and of the semiconductor industry in particular;
- our customers' adjustments in their order levels;
- changes in our pricing policies or the pricing policies of our competitors or suppliers;
- the termination of key supplier relationships;
- the rate of introduction of new products to, and acceptance by, our customers;
- our ability to compete effectively with our current and future competitors;
- our ability to enter into and renew key corporate and strategic relationships with our customers, vendors and strategic alliances;
- changes in foreign currency exchange rates;
- a major disruption of our information technology infrastructure; and
- unforeseen catastrophic events, such as armed conflict, terrorism, fires, typhoons and earthquakes.

**Cost of Goods Sold**

Cost of goods sold includes manufacturing costs for our semiconductor products and our wafers. These costs include raw materials used in our manufacturing processes as well as the labor costs and overhead expenses. Cost of goods sold is also impacted by yield improvements, capacity utilization and manufacturing efficiencies. In addition, cost of goods sold includes the cost of products that we purchase from other manufacturers and sell to our customers. Cost of goods sold is also affected by inventory obsolescence if our inventory management is not efficient.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses relate primarily to compensation and associated expenses for personnel in general management, sales and marketing, information technology, engineering, human resources, procurement,

planning and finance, and sales commissions, as well as outside legal, accounting and consulting expenses, share-based compensation expenses, and other operating expenses. We expect our selling, general and administrative expenses to increase in absolute dollars as we hire additional personnel and expand our sales, marketing and engineering efforts and information technology infrastructure.

**Research and Development Expenses**

Research and development expenses consist of compensation and associated costs of employees engaged in research and development projects, as well as materials and equipment used for these projects. Research and development expenses are primarily associated with our wafer facility near Kansas City, Missouri, our analog IC facilities in Taipei, Taiwan, and our manufacturing facilities in China, as well as our engineers at our U.S. headquarters. All research and development expenses are expensed as incurred, and we expect our research and development expenses to increase in absolute dollars as we invest in new technologies and product lines.

**Interest Income / Expense**

Interest income consists of interest earned on our cash and investment balances. Interest expense consists of interest payable on our outstanding credit facilities.

**Income Tax Provision**

We recognized income tax expense of $2.2 million for the second quarter of 2007, resulting in an effective tax rate of 14.8%, as compared to 19.8% in the same period of last year. Our lower effective tax rate reflected the decrease in the amount of expected repatriation of earnings of our foreign subsidiaries, partially offset by the impact of one of our China subsidiaries, Diodes-Shanghai, which is now subject to 7.5% preferential tax rate from 2007 through 2009, compared to a 0% tax rate in 2006. Going forward, we anticipate our tax rate to be in the 14 to 16% range. We continue to take advantage of available strategies to optimize our tax rate across the jurisdictions in which we operate.

**Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, inventory reserves and income taxes, among others. Our estimates are based upon historical experiences, market trends and financial forecasts and projections, and upon various other assumptions that management believes to be reasonable under the circumstances and at that certain point in time. Actual results may differ, significantly at times, from these estimates under different assumptions or conditions.

We believe the following critical accounting policies and estimates affect the significant estimates and judgments we use in the preparation of our consolidated financial statements, and may involve a higher degree of judgment and complexity than others.

**Revenue Recognition**

We recognize revenue when there is persuasive evidence that an arrangement exists, when delivery has occurred, when our price to the buyer is fixed or determinable and when collectability of the receivable is reasonably assured. These elements are met when title to the products is passed to the buyers, which is generally when our product is shipped.

We reduce revenue in the period of sale for estimates of product returns, distributor price adjustments and other allowances, the majority of which are related to our North American operations. Our reserve estimates are based upon historical data as well as projections of revenues, distributor inventories, price adjustments, average selling prices and market conditions. Actual returns and adjustments could be significantly different from our estimates and provisions,

resulting in an adjustment to revenues.

**Inventory Reserves**

Inventories are stated at the lower of cost or market value. Cost is determined principally by the first-in, first-out method. On an on-going basis, we evaluate our inventory, both finished goods and raw material, for obsolescence and slow-moving items. This evaluation includes analysis of sales levels, sales projections, and purchases by item, as well as raw material usage related to our manufacturing facilities. Based upon this analysis, as well as an inventory aging analysis, we accrue a reserve for obsolete and slow-moving inventory. If future demand or market conditions are different than our current estimates, an inventory adjustment may be required, and would be reflected in cost of goods sold in the period the revision is made.

**Accounting for Income Taxes**

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the tax jurisdictions in which we operate. This process involves using an asset and liability approach whereby deferred tax assets and liabilities are recorded for differences in the financial reporting bases and tax bases of our assets and liabilities. Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities. Management continually evaluates its deferred tax asset as to whether it is likely that the deferred tax assets will be realized. If management ever determined that our deferred tax asset was not likely to be realized, a write-down of the asset would be required and would be reflected as an expense in the accompanying period.

We are involved in various tax matters, with respect to some of which the outcome is uncertain. For purposes of evaluating whether or not a tax position is uncertain (1) we presume the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information, (2) technical merits of a tax position are derived from authorities such as legislation and statutes, legislative intent, regulations, rulings and case law and their applicability to the facts and circumstances of the tax position, and (3) each tax position is evaluated without consideration of the possibility of offset or aggregation with other tax positions taken. A tax benefit from an uncertain position may be recognized only if it is “more likely than not” that the position is sustainable, based on its technical merits and the tax benefit of a qualifying position is the largest amount of tax benefits that is greater than 50% likely of being realized upon ultimate settlement with a taxing authority having full knowledge of all relevant information.

We adopted the provisions of FIN48 effective January 1, 2007. As a result of the implementation of FIN48, during the first quarter of 2007, we increased our liability for unrecognized tax benefits by approximately $2.0 million, which was accounted for as a reduction to the January 1, 2007, balance of retained earnings.

**Allowance for Doubtful Accounts**

Management evaluates the collectability of our accounts receivable based upon a combination of factors, including the current business environment and historical experience. If we are aware of a customer’s inability to meet its financial obligations to us, we record an allowance to reduce the receivable to the amount we reasonably believe we will be able to collect from the customer. For all other customers, we record an allowance based upon the amount of time the receivables are past due. If actual accounts receivable collections differ from these estimates, an adjustment to the allowance may be necessary with a resulting effect on operating expense.

**Goodwill**

As of June 30, 2007, goodwill was $24.9 million ($19.8 million related to the Anachip acquisition, $4.2 million related to the FabTech acquisition, and $0.9 million related to Diodes-China). We account for goodwill in accordance with SFAS No. 142, “*Goodwill and Other Intangible Assets,*” for which goodwill is tested for impairment at least annually.

30

**Impairment of Long-Lived Assets**

We assess the impairment of long-lived assets, including goodwill, on an on-going basis and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Our impairment review process is based upon (i) an income approach from a discounted cash flow analysis, which uses our estimates of revenues, costs and expenses, as well as market growth rates, and (ii) a market multiples approach which measures the value of an asset through an analysis of recent sales or offerings or comparable public entities. If ever the carrying value of the goodwill is determined to be less than the fair value of the underlying asset, a write-down of the asset will be required, with the resulting expense charged in the period that the impairment was determined.

**Share-Based Compensation**

Effective in January 1, 2006, we adopted SFAS No. 123R, “Share-Based Payments,” using the modified prospective method. Under SFAS 123R, we are required to select a valuation technique or option-pricing model that meets the criteria as stated in the standard, which includes a binomial model and the Black-Scholes model. At the present time, the Company is continuing to use the Black-Scholes model, consistent with prior period valuations under SFAS 123. No modifications were made to any outstanding share-options prior to the adoption of SFAS 123R.

The adoption of SFAS 123R, applying the “modified prospective method,” as elected by the Company, requires the Company to value stock options prior to its adoption of SFAS 123 under the fair value method and expense these amounts over the stock options’ remaining vesting period. This resulted in the Company expensing $1.4 million and $2.9 million in the three and six months ended June 30, 2007, respectively, which was recorded within the cost of goods sold expense, general and administrative expense and research and development expense on the Company’s condensed consolidated income statement. In addition, SFAS 123R requires the Company to reflect any tax savings resulting from tax deductions in excess of expense reflected in its financial statements as a financing cash inflow in its statement of cash flows rather than as an operating cash flow as in prior periods (See “Note J - Share-based Compensation” for details). The Company has changed its primary award type to employees from stock options to stock awards as an improved method of employee reward and retention. In general, the Company extended the vesting period from three years to four years, and reduced the number of shares subject to the award by a factor of three.

The Company had 677,346 restricted stock grants outstanding as of June 30, 2007. The restricted stock grants will be recorded each quarter as a non-cash operating expense item. As of June 30, 2007, there was $14.8 million of total unrecognized compensation cost related to non-vested share-based compensation. This cost is expected to be recognized over a weighted-average period of 3.2 years. In the three months and six months ended June 30, 2007, an expense of $0.8 million and $1.7 million was recorded, respectively. In addition to the expense, the effects of the restricted stock grants are included in the diluted shares outstanding calculation.

**Results of Operations for the Three Months Ended June 30, 2006 and 2007**

The following table sets forth, for the periods indicated, the percentage that certain items in the statement of income bear to net sales and the percentage dollar increase (decrease) of such items from period to period.

| | Percent of Net Sales Three months ended June 30, | | Percentage Dollar Increase (Decrease) |
|---|---|---|---|
| | 2006 | **2007** | **'06 to '07** |
| Net sales | 100 | **100** | **16.4** |
| Cost of goods sold | (66.8) | **(68.1)** | **18.7** |
| Gross profit | 33.2 | **31.9** | **11.8** |
| Operating expenses | (16.7) | **(19.0)** | **32.8** |
| Operating income | 16.5 | **12.9** | **(9.4)** |
| Interest income, net | 1.1 | **2.7** | **197.2** |
| Other income (expense) | - | **0.1** | **500.0** |
| Income before taxes and minority interest | 17.6 | **15.7** | **3.4** |
| Income tax provision | (3.5) | **(2.3)** | **(23.0)** |
| Income before minority interest | 14.1 | **13.4** | **9.9** |
| Minority interest | (0.3) | **(0.6)** | **115.8** |
| Net income | 13.8 | **12.7** | **7.6** |

The following discussion explains in greater detail our consolidated operating results and financial condition for the three months ended June 30, 2007, compared to the three months ended June 30, 2006. This discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this quarterly report *(in thousands)*.

| | 2006 | 2007 |
|---|---|---|
| **Net sales** | $ 82,712 | **$ 96,283** |

Net sales increased approximately $13.6 million for the three months ended June 30, 2007, compared to the same period last year. The 16.4% increase in net sales was due to a 27.4% increase in units sold, partially offset by a 8.6% decrease in average selling prices (“ASP”) primarily due to market price competition as well as demand induced product mix changes.

| | 2006 | 2007 |
|---|---|---|
| **Cost of goods sold** | $ 55,279 | **$ 65,605** |

| | | | | |
|---|---|---|---|---|
| **Gross profit** | $ | 27,433 | **$** | **30,678** |
| **Gross profit margin percentage** | | 33.2% | | **31.9%** |

Cost of goods sold increased approximately $10.3 million, or 18.7%, for the three months ended June 30, 2007 compared to the same period in 2006. As a percent of sales, cost of goods sold increased from 66.8% for the three months ended June 30, 2006 to 68.1% for the three months ended June 30, 2007. Our average unit cost ("AUP") decreased 6.8% from the second quarter of 2006. As per SFAS 123R, included in cost of goods sold was $0.1 million of non-cash, stock option compensation expense related to our manufacturing facilities.

Gross profit increased in the second quarter of 2007 by approximately $3.2 million, or 11.8%, compared to the three months ended June 30, 2006. Gross margin, as a percentage of net sales, decreased to 31.9% for the three months ended June 30, 2007, compared to 33.2% for the same period of 2006, as the AUP decrease was not sufficient to offset the ASP decline.

| | 2006 | 2007 |
|---|---|---|
| **SG&A** | $ 11,716 | **$ 13,397** |

SG&A for the three months ended June 30, 2007 increased approximately $1.6 million, or 14.3%, compared to the same period last year, due primarily to (i) share grant expense increase of $0.5 million in the second quarter of 2007, (ii) $0.3 million increase in outside sales commissions due to increased shares, (iii) $0.8 million increase in wages associated with increased sales, and (iv) $0.3 million increase in audit, legal and consulting expenses associated with Sarbanes-Oxley Act compliance, as well as $0.1 million increase in depreciation expense. SG&A, as a percentage of sales, was 13.9% in the current quarter, down from 14.2% in the prior-year quarter, due primarily to the increased sales.

| | 2006 | 2007 |
|---|---|---|
| **R&D** | $ 2,077 | **$ 3,156** |

Investment in R&D in the current quarter was $3.2 million, an increase of approximately $1.1 million from the same period last year. Of the $1.1 million increase, compensation costs increased $0.8 million as a result of hiring additional engineers, $0.1 million reflected Diodes' investment in developing new products in discrete, analog and mixed signal, while $0.1 million was associated with APD patents amortization. R&D, as a percentage of sales, was 3.3% in the second quarter 2007 compared to 2.5% in the same period in 2006.

| | 2006 | 2007 |
|---|---|---|
| **Restructuring costs and impairment of fixed assets** | $ 0 | **$ 1,770** |

In the second quarter of 2007 we recorded approximately $1.8 million in restructuring costs related to the consolidation of our analog wafer probe and final test operations from Hsinchu, Taiwan to our manufacturing facilities in Shanghai, China. The expense was comprised of approximately $0.8 million in termination and severance costs, $0.3 million in impairment of fixed assets and $0.3 million in relocation charges.

| | 2006 | 2007 |
|---|---|---|
| **Interest income** | $ 1,004 | **$ 4,285** |

Interest income for the three months ended June 30, 2007 was $4.3 million, compared to $1.0 million in the same period in 2006, due primarily to interest income earned on short-term investment securities purchased with the proceeds of the $230 million convertible bonds.

| | 2006 | 2007 |
|---|---|---|
| **Interest expense** | $ 133 | **$ 1,696** |

Interest expense for the three months ended June 30, 2007 was $1.7 million, compared to $0.1 million in the same period 2006, due primarily to interest expense related to the 2.25% convertible bonds, and to a lesser extent, $0.3 million in amortization related convertible bonds issuance costs.

| | 2006 | 2007 |
|---|---|---|
| **Income tax provision** | $ 2,885 | **$ 2,221** |

We recognized income tax expense of $2.2 million for the second quarter of 2007, resulting in an effective tax rate of 14.8%, as compared to 19.8% in the same period of last year. Our lower effective tax rate reflected the decrease in the amount of expected repatriation of earnings of our foreign subsidiaries, partially offset by the impact of one of our China subsidiaries, Diodes-Shanghai, which is now subject to 7.5% preferential tax rate from 2007 through 2009, compared to a 0% tax rate in 2006. Going forward, we anticipate our tax rate to be in the 14 to 16% range. We continue to take advantage of available strategies to optimize our tax rate across the jurisdictions in which we operate.

| | 2006 | 2007 |
|---|---|---|
| **Minority interest** | $ 253 | **$ 546** |

Minority interest in joint venture earnings represented the minority investor's share of the earnings of Diodes-China, Diodes-Shanghai and Diodes-Anachip for the period. The reciprocal investment in the above subsidiaries and their equity balances were eliminated in the consolidations of our financial statements, and the activities of Diodes-China, Diodes-Shanghai and Anachip were included therein. As of June 30, 2007, we had 95% controlling interests in Diodes-China and Diodes-Shanghai, and a 99.81% controlling interest in Anachip.

**Results of Operations for the Six Months Ended June 30, 2006 and 2007**

The following table sets forth, for the periods indicated, the percentage that certain items in the statement of income bear to net sales and the percentage dollar increase (decrease) of such items from period to period.

| | Percent of Net Sales Six months ended June 30, 2006 | 2007 | Percentage Dollar Increase (Decrease) '06 to '07 |
|---|---|---|---|
| Net sales | 100 | **100** | **20.5** |
| Cost of goods sold | (67.0) | **(68.0)** | **22.4** |
| Gross profit | 33.0 | **32.0** | **16.6** |
| Operating expenses | (17.4) | **(18.0)** | **25.0** |
| Operating income | 15.6 | **14.0** | **7.2** |
| Interest income, net | 0.9 | **2.6** | **234.5** |
| Other income (expense) | (0.1) | **(0.1)** | **(70.8)** |
| Income before taxes and minority interest | 16.4 | **16.5** | **20.8** |
| Income tax provision | (2.9) | **(2.6)** | **6.6** |
| Income before minority interest | 13.5 | **13.9** | **23.8** |
| Minority interest | (0.3) | **(0.5)** | **99.4** |
| Net income | 13.2 | **13.4** | **22.0** |

The following discussion explains in greater detail our consolidated operating results and financial condition for the six months ended June 30, 2007, compared to the six months ended June 30, 2006. This discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this quarterly report *(in thousands)*.

| | 2006 | 2007 |
|---|---|---|
| **Net sales** | $ 156,301 | **$ 188,303** |

Net sales increased approximately $32.0 million for the six months ended June 30, 2007, compared to the same period last year. The 20.5% increase in net sales was due to a 32.9% increase in units sold, partially offset by a 9.4% decrease in average selling prices primarily due to market price competition as well as demand induced product mix changes.

| | 2006 | 2007 |
|---|---|---|
| **Cost of goods sold** | $ 104,654 | **$ 128,102** |
| **Gross profit** | $ 51,647 | **$ 60,201** |

| | | |
|---|---|---|
| **Gross profit margin percentage** | 33.0% | **32.0%** |

Cost of goods sold increased approximately $23.4 million, or 22.4%, for the six months ended June 30, 2007 compared to the same period in 2006. As a percent of sales, cost of goods sold increased from 67.0% for the six months ended June 30, 2006 to 68.0% for the six months ended June 30, 2007. AUP decreased 7.9% year-over-year. As per SFAS 123R, included in cost of goods sold was $0.2 million of non-cash, stock option compensation expense related to our manufacturing facilities.

Gross profit increased in the six months of 2007 by approximately $8.6 million, or 16.6%, compared to the six months ended June 30, 2006. Gross margin, as a percentage of net sales, decreased to 32.0% for the six months ended June 30, 2007, compared to 33.0% for the same period of 2006, as the AUP decrease was not sufficient to offset the ASP decline.

| | 2006 | 2007 |
|---|---|---|
| **SG&A** | $ 23,000 | **$ 26,075** |

SG&A for the six months ended June 30, 2007 increased approximately $3.1 million, or 13.4%, compared to the same period last year, due primarily to (i) share-based compensation expense increase of $0.5 million in the first six months of 2007, (ii) $0.5 million increase in outside sales commissions, $1.0 million increase in wages and marketing expenses associated with increased sales, and (iii) $0.5 million audit, legal and consulting expenses associated with Sarbanes-Oxley Act compliance, as well as $0.3 million increase in depreciation expense. SG&A, as a percentage of sales, was 13.8% in the first six months of 2007, down from 14.7% in the same period of last year, due primarily to the increased sales.

| | 2006 | 2007 |
|---|---|---|
| **R&D** | $ 4,043 | **$ 6,101** |

Investment in R&D in the first six months of 2007 was $6.1 million, an increase of approximately $2.1 million from that in the same period last year. Of the $2.1 million increase, compensation costs increased $1.3 million as a result of hiring additional engineers, $0.3 million reflected Diodes' investment in developing new products in discrete, analog and mixed signal, while $0.3 million was associated with APD patents amortization. R&D, as a percentage of sales, was 3.2% of the first six months of 2007 sales compared to 2.6% in the same period 2006.

| | 2006 | 2007 |
|---|---|---|
| **Restructuring costs and impairment of fixed assets** | $ 120 | **$ 1,770** |

In the second quarter of 2007 we recorded approximately $1.8 million in restructuring costs related to the consolidation of our analog wafer probe and final test operations from Hsinchu, Taiwan to our manufacturing facilities in Shanghai, China. The expense was comprised of approximately $0.8 million in termination and severance costs, $0.3 million in impairment of fixed assets and $0.3 million in relocation charges.

| | 2006 | 2007 |
|---|---|---|
| **Interest income** | $ 1,738 | **$ 8,320** |

Interest income for the six months ended June 30, 2007 was $8.3 million, compared to $1.7 million in the same period in 2006, due primarily to interest income earned on short-term investment securities purchased with the proceeds of the $230 million convertible bonds.

| | 2006 | 2007 |
|---|---|---|
| **Interest expense** | $ 273 | **$ 3,421** |

Interest expense for the six months ended June 30, 2007 was $3.4 million, compared to $0.3 million in the same period 2006, due primarily to interest expense related to the 2.25% convertible bonds, and to a lesser extent, $0.6 million in amortization related convertible bonds issuance costs.

| | 2006 | 2007 |
|---|---|---|
| **Income tax provision** | $ 4,575 | **$ 4,879** |

We recognized income tax expense of $4.9 million for the six months ended June 30, 2007, resulting in an effective tax rate of 15.7%, as compared to 17.8% in the same period of last year. Our lower effective tax rate reflected the decrease in the amount of expected repatriation of earnings of our foreign subsidiaries, partially offset by the impact of one of our China subsidiaries, Diodes-Shanghai, which is now subject to 7.5% preferential tax rate from 2007 through 2009, compared to a 0% tax rate in 2006. Going forward, we anticipate our tax rate to be in the 14 to 16% range. We continue to take advantage of available strategies to optimize our tax rate across the jurisdictions in which we operate.

**Financial Condition**

**Liquidity and Capital Resources**

Our primary sources of liquidity are cash, funds from operations and borrowings under our credit facilities. Our primary liquidity requirements have been to meet our inventory and capital expenditure needs. At December 31, 2006 and June 30, 2007, our working capital was $395.4 million and $419.9 million, respectively. We anticipate our working capital position will be sufficient for at least the next 12 months.

During 2005, we sold 3.2 million (stock split adjusted) shares of our Common Stock in a follow-on public offering, raising approximately $72 million (net of commissions and expenses). We used approximately $31 million of the net proceeds in connection with the Anachip acquisition, and approximately $9 million for the APD acquisition, and we intend to use the remaining net proceeds from this offering for working capital and other general corporate purposes, including additional acquisitions.

On October 5, 2006, we issued $230 million in aggregate principal amount of convertible senior notes due on October 1, 2026. We received approximately $224 million of net proceeds from this debt offering and intend to use the net proceeds from this offering for working capital and other general corporate purposes, including acquisitions.

Capital expenditures for the three and six months ended June 30, 2007 were $14.9 million and $27.3 million, respectively. Our capital expenditures for these periods were primarily related to manufacturing expansion in our facilities in China and, to a lesser extent, our wafer fabrication facility in the U.S. Year-to-date capital expenditures were at approximately 14.5% of revenue as of June 30, 2007, ahead of our 10-12% full-year estimate as we continue to invest for expected growth. We had originally planned our 2007 capital expenditures to be at the upper end of our guidance, and front-loaded in the first half of the year to allow us to take advantage of projected second half growth prospects. Our first half actual at 14.5% of revenue is in-line with this plan. We are continuing to evaluate our second half plans in light of our original plan and the developing market environment.

**Discussion of Cash Flow**

Cash and short-term investments have increased from $339.9 million at December 31, 2006, to $352.5 million at June 30, 2007.

***Operating Activities***

Net cash provided by operating activities during the first six months of 2007 was $28.0 million, resulting primarily from $25.3 million of net income in this period, as well as $13.0 million in depreciation and amortization. Net cash provided by operating activities was $35.2 million for the same period in 2006. Net cash provided by operations decreased $7.2 million from the first six months of 2007 compared to the same period in 2006. This decrease resulted primarily from a $5.0 million increase in operating assets changes during the six-month period ($11.1 million increase in accounts receivable, $11.2 million decrease in inventory, and $4.9 million increase in other assets), and $11.4 million decrease in liabilities, offset by $4.6 million increase in our net income (from $20.7 million in 2006 to $25.3 million in 2007), $0.6 million increase in non-cash, share-based compensation expense, and $3.4 million increase in depreciation and amortization expense.

***Investing Activities***

Net cash used in investing activities was $42.1 million for the first six months of 2007 compared to $59.6 million for the same period of 2006. The $17.5 million decrease in investing activities primary relates to the $19.0 million payment for Anachip acquisition (net of cash acquired) in the first quarter of 2006, and a $6.3 million decrease in capital expenditures, partially offset by a $7.7 million decrease in investment in available for sale securities.

***Financing Activities***

Our financing activities include net borrowings, share issuances and excess tax benefits associated with stock options exercised. Net cash provided by financing activities totaled $7.7 million in the first six months of 2007 compared to $0.3 million net cash used in the same period of 2006. This increase is primarily the result of an increase of $2.4 million in proceeds from stock option exercised during the first six month of 2007.

***Debt Instruments***

On August 29, 2006, we amended our U.S. credit arrangements with Union Bank of California, N.A. (Union Bank). Under the second amendment to our amended and restated credit agreement, we have available a revolving credit commitment of up to $20.0 million, including a $5.0 million letter of credit sub-facility. In addition, and in connection with this amendment, one of our subsidiaries, Diodes-FabTech, also amended and restated a term note and related agreement with respect to an existing term loan arrangement, which we refer to as the FabTech term loan. After giving effect to this amendment, the principal amount under the FabTech term loan was increased to $5.0 million.

The revolving credit commitment expires on August 29, 2008. The FabTech term loan, which amortizes monthly, matures on August 29, 2010. As of June 30, 2007, we had no amounts outstanding under our revolving credit facility, and there was $3.4 million outstanding under the FabTech term loan. Loans to Diodes Incorporated under our credit facility are guaranteed by FabTech, and in turn, the FabTech term loan is guaranteed by Diodes Incorporated. The purpose of the revolving credit facility is to provide cash for domestic working capital purposes, and to fund permitted acquisitions.

Any amounts borrowed under the credit facility and the FabTech term loan are collateralized by all of Diodes Incorporated's and FabTech's accounts, instruments, chattel paper, documents, general intangibles, inventory, equipment, furniture and fixtures, pursuant to security agreements entered into by Diodes Incorporated and FabTech

in connection with these credit arrangements.

Both amounts borrowed under the revolving credit facility and the FabTech term loan bear interest at LIBOR plus 1.15%. At June 30, 2007, the effective rate under both the credit agreement and the FabTech term loan was 6.51%.

The credit agreement contains covenants that require us to maintain a leverage ratio not greater than 3.25 to 1.0, an interest expense coverage ratio of not less than 2.0 to 1 and a current ratio of not less than 1.0 to 1. It also requires us to achieve a net profit before taxes, as of the last day of each fiscal quarter, for the two consecutive fiscal quarters ending on that date of not less than $1. The credit agreement permits us to pay dividends to our stockholders to the extent that any such dividends declared or paid in any fiscal year do not exceed an amount equal to 50% of our net profit after taxes for such fiscal year. However, it limits our ability to dispose of assets, incur additional indebtedness, engage in liquidation or merger, acquisition, partnership or other combination (except permitted acquisitions). The credit agreement also contains customary representations, warranties, affirmative and negative covenants and events of default. As of June 30, 2007, we were in compliance with the bank covenants.

The agreements governing the FabTech term loan do not contain any financial or negative covenants. However, they provide that a default under our credit agreement will cause a cross-default under the FabTech term loan.

As of June 30, 2007, our Asia subsidiaries have available lines of credit of up to an aggregate of $26.7 million, with a number of Chinese and Taiwanese financial institutions. These lines of credit, except for one Taiwanese credit facility, are collateralized by its premises, are unsecured, uncommitted and, in some instances, may be repayable on demand. Loans under these lines of credit bear interest at LIBOR or similar indices plus a specified margin.

As of June 30, 2007, Diodes-Shanghai owed $0.8 million under a note to one of our customers, which debt was incurred in connection with our investing in manufacturing equipment. We repay this unsecured and interest-free note in quarterly price concession installments, with any remaining balance due in July 2008.

On October 12, 2006, we issued and sold convertible senior notes with an aggregate principal amount of $230 million due 2026 (“Notes”), which pay 2.25% interest per annum on the principal amount of the notes, payable semi-annually in arrears on April 1 and October 1 of each year, beginning on April 1, 2007. Interest will accrue on the notes from and including October 12, 2006 or from and including the last date in respect of which interest has been paid or provided for, as the case may be, to, but excluding, the next interest payment date or maturity date, as the case may be. Commencing with the six-month period beginning October 1, 2011, and for each six-month period thereafter, we will, on the interest payment date for such interest period, pay contingent interest to the holders of the notes under certain circumstances and in amounts described in the indenture.

Note holders may require us to repurchase all or a portion of their notes upon a fundamental change, as defined, at a repurchase price in cash equal to 100% of the principal amount of the notes to be repurchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date. Future minimum interest payments related to the Notes as of December 31, 2006 are $5.2 million for each year from 2007 through 2011. Future minimum payments related to the Notes as of December 31, 2006 for 2011 and thereafter include $77.5 million in interest and $230 million in principal for a total of $307.5 million.

In connection with the issuance of the Notes, we incurred approximately $6.2 million of issuance costs, which primarily consisted of investment banker fees, legal and accounting fees. These costs are classified within other assets and are amortized as a component of interest expense using the straight-line method over the life of the Notes from issuance through October 12, 2011.

***Off-Balance Sheet Arrangements***

We do not have any transactions, arrangements and other relationships with unconsolidated entities that will affect our liquidity or capital resources. We have no special purpose entities that provided off-balance sheet financing, liquidity or market or credit risk support, nor do we engage in leasing, swap agreements, or outsource of research and development services, that could expose us to liability that is not reflected on the face of our financial statements.

39

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our exposure to financial market risk results primarily from fluctuations in interest and currency rates. There have been no material changes to our market risks as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006.

**Item 4. Controls and Procedures**

Our Chief Executive Officer, Keh-Shew Lu, and Chief Financial Officer, Carl C. Wertz, with the participation of the Company's management, carried out an evaluation of the effectiveness of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer believe that, as of the end of the period covered by this report, our disclosure controls and procedures are effective at the reasonable assurance level in making known to them material information relating to us (including our consolidated subsidiaries) required to be included in this report.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity's disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures such as simple errors, mistakes or intentional circumvention of the established processes.

There was no change in our internal control over financial reporting, known to the Chief Executive Officer or the Chief Financial Officer that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are, from time to time, involved in litigation incidental to the conduct of our business. We do not believe we are currently a party to any pending litigation.

**Item 1A. Risk Factors**

There have been no material changes from the risk factors disclosed in the “Risk Factors” section of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, filed on March 1, 2007.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

There are no matters to be reported under this heading.

**Item 3. Defaults Upon Senior Securities**

There are no matters to be reported under this heading.

**Item 4. Submission of Matters to a Vote of Security Holders**

The Company submitted to a vote of its security holders at an annual meeting of stockholders on May 31, 2007, the election of members of the Board. The directors were each elected to serve until the 2008 annual meeting or until their successors are elected and have qualified. The results of the tabulation for each nominee for director of the Company is as follows (voting shares have not been adjusted for the three-for-two stock split in July 2007):

| | | |
|---|---|---|
| C.H. Chen, Director | For: | 14,752,104 |
| | Withheld: | 9,978,539 |
| Michael R. Giordano, Director | For: | 18,499,238 |
| | Withheld: | 6,231,405 |
| Keh-Shew Lu, Director | For: | 23,988,337 |
| | Withheld: | 742,306 |
| L.P. Hsu, Director | For: | 22,836,689 |
| | Withheld: | 1,893,935 |
| Shing Mao, Director | For: | 14,870,070 |
| | Withheld: | 9,859,573 |
| Raymond Soong, Director | For: | 22,979,832 |
| | Withheld: | 1,750,811 |
| John M. Stich, Director | For: | 24,413,805 |
| | Withheld: | 316,838 |

The Company also submitted to a vote of its security holders at an annual meeting of shareholders on May 31, 2007, the appointment of Moss Adams LLP as the Company’s independent registered public accounting firm for the fiscal year ending December 31, 2007. The result of the tabulation was 24,159,902 shares voted in favor of the proposal, 522,582 shares voted against, and 48,159 abstained from voting on the proposal. No broker non-votes with respect to this proposal were received.

**Item 5. Other Information**

There are no matters to be reported under this heading.

**Item 6. Exhibits**

| | |
|---|---|
| 3.1 | Certificate of Incorporation, as amended (incorporated by reference to Exhibit 3.1 of Amendment No. 1 to the Company's Registration Statement on Form S-3 (File No. 333-127833) filed on September 8, 2006). |
| 3.2 | Amended Bylaws of the Company dated July 19, 2007 (incorporated by reference to Exhibit 3 on Form 8-K filed with the Commission on July 23, 2007). |
| 11 | Computation of Earnings Per Share |
| 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification Pursuant to 18 U.S.C. 1350 Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification Pursuant to 18 U.S.C. 1350 Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

**SIGNATURE**

Pursuant to the requirements 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.

DIODES INCORPORATED (Registrant)

By: /s/ Carl C. Wertz August 8, 2007
CARL C. WERTZ
Chief Financial Officer, Treasurer and Secretary
(Duly Authorized Officer and Principal Financial and
Chief Accounting Officer)

**INDEX TO EXHIBITS**

| | |
|---|---|
| 3.1 | Certificate of Incorporation, as amended (incorporated by reference to Exhibit 3.1 of Amendment No. 1 to the Company's Registration Statement on Form S-3 (File No. 333-127833) filed on September 8, 2006). |
| 3.2 | Amended Bylaws of the Company dated July 19, 2007 (incorporated by reference to Exhibit 3 on Form 8-K filed with the Commission on July 23, 2007). |
| 11 | Computation of Earnings Per Share |
| 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification Pursuant to 18 U.S.C. 1350 Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification Pursuant to 18 U.S.C. 1350 Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |