CATALYST SEMICONDUCTOR INC
Form 10-Q
December 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

T QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended October 29, 2006

OR

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

0-21488

(Commission File Number)

CATALYST SEMICONDUCTOR, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**77-0083129**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2975 Stender Way Santa Clara, California	**95054**
(Address of Registrant s principal executive offices)	(Zip Code)

(408) 542-1000

(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 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.

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

The number of shares outstanding of the Registrant s Common Stock as of November 30, 2006 was 16,299,541 exclusive of 6,577,082 shares of treasury stock.

CATALYST SEMICONDUCTOR, INC.

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Part I. ***Financial Information***

Item 1. ***Financial Statements***

CATALYST SEMICONDUCTOR, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	October 31, 2006	April 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,142	$ 7,730
Short-term investments	14,870	21,409
Accounts receivable, net	11,257	9,502
Inventories	14,684	14,262
Deferred tax assets	2,771	2,771
Other current assets	617	484
Total current assets	53,341	56,158
Property and equipment, net	11,331	9,408
Deferred tax assets	4,759	4,759
Other assets	60	95
Total assets	$ 69,491	$ 70,420
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 6,196	$ 7,453
Accounts payable related parties	92	143
Accrued expenses	2,947	3,002
Deferred gross profit on shipments to distributors	2,053	2,292
Total current liabilities	11,288	12,890
Commitments and contingencies (Note 8)		
Stockholders equity:		
Preferred stock, $0.001 par value, 2,000 shares authorized; no shares issued and outstanding		
Common stock, $0.001 par value, 45,000 shares authorized; 22,839 shares issued and 16,262 shares outstanding at October 31, 2006 and 22,808 shares issued and 16,350 shares outstanding at April 30, 2006	23	23
Additional paid-in-capital	71,605	70,461
Treasury stock, 6,577 shares at October 31, 2006 and 6,458 shares at April 30, 2006	(27,089)	(26,672)
Retained earnings	13,676	13,759
Accumulated other comprehensive loss	(12)	(41)
Total stockholders equity	58,203	57,530
Total liabilities and stockholders equity	$ 69,491	$ 70,420

See accompanying notes to the unaudited condensed consolidated financial statements.

CATALYST SEMICONDUCTOR, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2006	2005	2006	2005
	(In thousands, except per share data)			
Net revenues	$ 16,310	$ 16,931	$ 31,535	$ 31,607
Cost of revenues (A)	10,523	10,493	20,844	19,451
Gross profit	5,787	6,438	10,691	12,156
Operating expenses:				
Research and development (A)	1,937	1,976	3,826	3,801
Selling, general and administrative (A)	3,828	3,352	7,760	6,716
Income (loss) from operations	22	1,110	(895)	1,639
Interest income and other, net	325	266	644	479
Income (loss) before income taxes	347	1,376	(251)	2,118
Income tax provision (benefit)	171	449	(168)	696
Net income (loss)	$ 176	$ 927	$ (83)	$ 1,422
Net income (loss) per share:				
Basic	$ 0.01	$ 0.05	$ (0.01)	$ 0.08
Diluted	$ 0.01	$ 0.05	$ (0.01)	$ 0.08
Weighted average common shares outstanding:				
Basic	16,284	16,919	16,317	16,785
Diluted	17,118	18,274	16,317	18,214

(A) Results for the three and six months ended October 31, 2006 and 2005 include stock-based compensation expense as follows:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2006	2005	2006	2005
	(In thousands)			
Cost of revenues	$ 13	$	$ 25	$
Research and development	176		359	
Selling, general and administrative	339		752	

See accompanying notes to the unaudited condensed consolidated financial statements.

CATALYST SEMICONDUCTOR, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended October 31,	
	2006	**2005**
Cash flows from operating activities:		
Net income (loss)	$ (83)	$ 1,422
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation of property and equipment	928	898
Stock-based compensation	1,136	
Net provision for excess and obsolete inventory	547	543
Loss on disposal of property and equipment	46	
Tax benefits of options		411
Changes in assets and liabilities:		
Accounts receivable	(1,755)	(2,308)
Inventories	(969)	1,080
Other assets	(98)	61
Accounts payable (including related parties)	(1,308)	556
Accrued expenses	(55)	(502)
Deferred gross profit on shipments to distributors	(239)	(119)
Net cash provided by (used in) operating activities	(1,850)	2,042
Cash flows from investing activities:		
Purchases of short-term investments	(12,825)	(11,756)
Proceeds from sales and maturities of short-term investments	19,393	16,571
Acquisitions of property and equipment	(2,897)	(1,033)
Net cash provided by investing activities	3,671	3,782
Cash flows from financing activities:		
Common stock issuances	8	739
Treasury stock purchases	(417)	(1,685)
Net cash used in financing activities	(409)	(946)
Net increase in cash and cash equivalents	1,412	4,878
Cash and cash equivalents at beginning of the period	7,730	10,978
Cash and cash equivalents at end of the period	$ 9,142	$ 15,856

See accompanying notes to the unaudited condensed consolidated financial statements.

CATALYST SEMICONDUCTOR, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Basis of Presentation

Catalyst Semiconductor, Inc. (the Company), was founded in October 1985, and designs, develops and markets a broad line of reprogrammable non-volatile memory and analog/mixed-signal products.

In the opinion of the management of the Company, the unaudited condensed consolidated interim financial statements included herein have been prepared on the same basis as the Company s April 30, 2006 audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary to fairly state the information set forth herein. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended April 30, 2006. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (U.S. GAAP).

The Company s fiscal year is the 52 or 53-week period ending on the Sunday closest to April 30. In a 52 week year, each fiscal quarter consists of 13 weeks. Fiscal year 2006 was comprised of 52 weeks. Fiscal year 2007 will be comprised of 52 weeks. For ease of presentation, all periods are presented as if they ended on month end. All references to the quarter refer to the Company s fiscal quarter. The fiscal quarter covered by this report ended on October 29, 2006.

Principles of Consolidation

The consolidated financial statements include the accounts of Catalyst Semiconductor, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation.

Uses of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Estimates in these financial statements include inventory valuation, stock compensation, deferral of gross profit on shipments of inventory not sold by the distributors at the end of the period, reserves for stock rotation on sales to distributors, the original equipment manufacturers (OEMs) sales return reserve, reserve for warranty costs, allowances for doubtful accounts receivable and income taxes. Actual results could differ from those estimates.

Note 2 Significant Accounting Policies

Cash and Cash Equivalents

All highly liquid investments purchased with an original maturity of three months or less are considered cash equivalents.

Short-term Investments

All of the Company s short-term investments are classified as available-for-sale. Investments in available-for-sale securities are reported at fair value with unrealized gains and losses, being recorded net of related tax, as a component of accumulated other comprehensive income (loss).

Accounts Receivable

The Company s accounts receivable are reported net of an allowance for doubtful accounts. The Company estimates the collectibility of its accounts receivable at the end of each reporting period. The Company analyzes the aging of accounts receivable and bad debt history, payment history, customer concentration, customer credit worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. The Company maintains an allowance for doubtful accounts, which is created by charges to selling, general and administrative expenses in the condensed consolidated statements of operations.

Fair Value of Financial Instruments

The Company measures its financial assets and liabilities in accordance with U.S. GAAP. For financial instruments, including cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued expenses, the carrying amounts approximate fair value due to their short maturities.

Foreign Currency Translation

The Company uses the U.S. dollar as its functional currency. All of the Company s sales and a substantial majority of its costs are transacted in U.S. dollars. The Company purchases wafers and has test and assembly activities in Asia and supports sales and marketing activities in various countries outside of the United States. Most of these costs are paid for with U.S. dollars. Research and development personnel costs in Romania are tracked against the euro while all other activities are paid in Romanian leu. Foreign currency transaction gains and losses, resulting from remeasuring local currency to the U.S. dollar, are included in determining net income (loss) for the period. The foreign exchange gains and losses were not material for the periods presented.

Recognition of Revenues

The Company generally recognizes revenues as products are shipped if evidence of an arrangement exists, the customer has taken title to the products, services, if any, have been rendered, the sales price is fixed or determinable, collection of the resulting receivable is reasonably assured and product returns are reasonably estimable.

The Company markets and sells products directly through its sales force and sales representatives to OEMs and indirectly through distributors and resellers. Revenues are recognized upon delivery to OEMs and resellers who have no, or limited, product return rights and no price protection rights. Reserves for estimated returns and allowances are provided against net revenues at the time of recognition of revenues. The Company also sells products to certain distributors under agreements that allow certain rights to return the product and provides for price protection rights. These agreements generally permit the distributor to return up to 10%, by value, of the total products they purchased from the Company every six months. As a result, the Company defers recognition of revenues until the time the distributor sells the product to an end-customer, at which time the sales price becomes fixed. Upon shipment to a distributor, the Company records an account receivable from the distributor, relieves inventory for the cost of the product shipped, and records the gross profit, which equals revenues less the cost of revenues, on the consolidated balance sheet as deferred gross profit on shipments to distributors until such time as the inventory is resold by the distributor to its end-customers.

Inventories

Inventory is stated at the lower of standard cost or net realizable value. Standard cost approximates actual cost on a first-in, first-out basis. The Company periodically reviews its inventory for slow moving or obsolete items and writes down the related products to estimated net realizable value. Inventory reserves once established are not reversed until the related inventory has been sold or physically scrapped.

Shipping and Handling Costs

The Company charges inbound freight shipments within the supply chain and associated handling costs to the cost of revenues on its condensed consolidated statements of operations. The Company charges outbound freight shipments and associated handling costs to selling, general and administrative on its condensed consolidated statements of operations. Such outbound freight costs aggregated to $151,000 and $258,000 for the three months ended October 31, 2006 and 2005, respectively, and to $319,000 and $287,000 for the six months ended October 31, 2006 and 2005, respectively.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets. Furniture, office equipment and engineering/test equipment are depreciated over five years with the exception of production mask sets which are depreciated over two years. Computer hardware is depreciated over three years. Computer software is depreciated over three or five years. Buildings are generally depreciated over 30 years. Amortization of leasehold improvements is computed on a straight-line basis and amortized over the shorter of the remaining lease term or the estimated useful lives of the assets.

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and cash equivalents, short-term investments and accounts receivable. Cash and cash equivalents and short-term investments are maintained with high quality financial institutions. The Company s accounts receivable are denominated in U.S. dollars and are derived from sales to customers located principally in North America, Europe and Asia. The Company performs ongoing credit evaluations of its customers and generally does not require collateral.

As of October 31, 2006 and April 30, 2006, no single customer accounted for greater than 10% of gross accounts receivable.

Concentration of Other Risks

The semiconductor industry is characterized by rapid technological change, competitive pricing pressures and cyclical market patterns. The Company s financial results are affected by a wide variety of factors, including general economic conditions worldwide, economic conditions specific to the semiconductor industry, the timely implementation of new manufacturing process technologies and the ability to safeguard patents and intellectual property in a rapidly evolving market. In addition, the semiconductor market has historically been cyclical and subject to significant economic downturns at various times. As a result, the Company may experience significant period to period fluctuations in operating results due to the factors mentioned above or other factors.

Advertising Costs

Costs related to advertising and promotional expenditures are charged to selling, general and administrative on the Company s consolidated statements of operations. Such advertising and promotional expenditures were less than $50,000 in each of the three months ended October 31, 2006 and 2005 and less than $100,000 in each of the six months ended October 31, 2006 and 2005.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) includes all changes in stockholders equity during a period from non-owner sources. Accumulated other comprehensive income (loss) for the Company is comprised of unrealized gains (losses) on securities available-for-sale, net of tax.

Segment Reporting

The Company reports in accordance with Statement of Financial Accounting Standards (SFAS) No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS No. 131). SFAS No. 131 requires the management approach in identifying reportable segments. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of the company s reportable segments. Based on its operating structure and management reporting, the Company has concluded it has one reporting segment: the semiconductor segment.

Reclassifications

Certain prior year balances have been reclassified to conform to current year presentations. These reclassifications had no impact on total assets, income (loss) from operations or net income (loss).

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 151, *Inventory Costs, an Amendment of Accounting Research Bulletin* (ARB) *No. 43, Chapter 4* (SFAS No. 151). The amendments made by SFAS No. 151 are intended to improve financial reporting by clarifying that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and by requiring the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS No. 151 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS No. 154) a replacement of Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes* (APB No. 20) and FASB Statement No. 3, which changes the requirements for the accounting and reporting of a change in accounting principle effective for fiscal years beginning after December 15, 2005. SFAS No. 154 applies to all voluntary changes in accounting principle as well as to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 eliminates the requirement in APB No. 20, to include the cumulative effect of changes in accounting principle in the statement of operations in the period of change. Instead, to enhance the comparability of prior period financial statements, SFAS No. 154 requires that changes in accounting principles be applied retrospectively. Under retrospective application, the new accounting principle is applied as of the beginning of the first period presented as if that principle had always been used. Under SFAS No. 154, a change in reporting entity is also applied retrospectively as of the beginning of the first period presented. A change in accounting estimate continues to be accounted for in the period of change and future periods if necessary. The adoption of SFAS No. 154 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The adoption of this standard is not expected to have a material impact on the consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation Number 48, *Accounting for Uncertainty in Income Taxes an interpretation of FAS 109* . This Interpretation 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* . This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The guidance will become effective as of the beginning of a company s fiscal year beginning after December 15, 2006. The Company is currently assessing the impact, if any, of adopting this standard on the Company s financial position, results of operations and liquidity.

On September 13, 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The guidance is applicable for the Company s fiscal 2007. The Company is currently assessing the impact, if any, of adopting this standard on the Company s financial position, results of operations and liquidity.

Note 3 Stock-Based Compensation

Effective May 1, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payments* (SFAS No. 123(R)). SFAS No. 123(R) establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at the grant date, based on the fair value of the awards, and is recognized as expense over the requisite employee service period.

Prior to the adoption of SFAS No. 123(R)

Prior to the adoption of SFAS No. 123(R), the Company applied APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), and related interpretations to account for stock-based employee compensation plans. As such, compensation expense was recorded if, on the date of grant, the current fair value per share of the underlying stock exceeded the exercise price per share. The Company provided the disclosures required under SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosures* , in periodic reports.

The pro forma information required under SFAS No. 123(R) for periods prior to fiscal 2007, as if the Company had applied the fair value recognition provisions of SFAS No. 123 to awards granted under equity incentive plans, was as follows for the three and six months ended October 31, 2005 (in thousands, except per share amounts):

	Three Months Ended October 31, 2005	Six Months Ended October 31, 2005
Reported net income	$ 927	$ 1,422
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of tax	(515)	(1,058)
As adjusted net income	$ 412	$ 364
As adjusted net income per share:		
Basic	$ 0.02	$ 0.02
Diluted	$ 0.02	$ 0.02
Reported net income per share:		
Basic	$ 0.05	$ 0.08
Diluted	$ 0.05	$ 0.08

Impact of the adoption of SFAS No. 123(R)

The Company elected to adopt the modified prospective application method beginning May 1, 2006 as provided by SFAS No. 123(R). Accordingly, during the three and six months ended October 31, 2006, the Company recorded stock-based compensation expense equal to the amount that would have been recognized if the fair value method required for pro forma disclosure under SFAS No. 123 had been in effect for expense recognition purposes, adjusted for estimated forfeitures, and stock-based compensation expense for the fair value of options granted during the three and six months ended October 31, 2006, net of forfeitures as calculated under SFAS No. 123(R). The Company recognized stock-based compensation expense using the straight-line attribution method. Previously reported amounts have not been restated. The effect of recording stock-based compensation for the three and six months ended October 31, 2006 was as follows (in thousands, except per share amounts):

	Three Months Ended October 31, 2006	Six Months Ended October 31, 2006
Stock-based compensation expense:		
Employee stock options	$ 528	$ 1,136
Tax effect of stock-based compensation	(60)	(141)
Net effect on net income (loss)	$ 468	$ 995
Effect on net income (loss) per share:		
Basic	$ 0.03	$ 0.06
Diluted	$ 0.03	$ 0.06

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Prior to adopting SFAS No. 123(R), the Company presented all tax benefits resulting from the exercise of stock options as operating cash flows in the consolidated statement of cash flows. However, as required by the adoption of SFAS No. 123(R) beginning May 1, 2006, the Company began classifying cash flows resulting from excess tax benefits as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised options in excess of the deferred tax asset attributable to stock-based compensation for such options. The change in classification on the condensed consolidated statement of cash flows was immaterial because minimal stock options were exercised during the six months ended October 31, 2006.

As of May 1, 2006, the Company had unearned stock-based compensation related to stock options of $4.1 million before the impact of estimated forfeitures. In the pro forma footnote disclosures prior to the adoption of SFAS No. 123(R), the Company accounted for forfeitures upon occurrence. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

During the three months ended October 31, 2006, the Company granted approximately 496,000 stock options with an estimated total grant date fair value of $497,000 and a weighted average grant date fair value of $1.00 per option. During the three and six months ended October 31, 2006, the Company recorded stock-based compensation expense related to stock options of $528,000 and $1,136,000, respectively.

As of October 31, 2006, the aggregate amount of unearned stock-based compensation expense, net of forfeitures, related to stock options was $3.7 million, which the Company will recognize, over an estimated weighted average amortization period of 2.4 years.

Stock-based compensation expense capitalized in inventory at October 31, 2006 was immaterial.

Valuation Assumptions

During the three and six months ended October 31, 2006 and 2005, the Company continued to utilize the Black-Scholes model for calculating the estimated fair value of stock-based compensation awards granted under the Company s stock option plans. The expected term and volatility estimates are based on the Company s historical experience. The fair value of stock options granted under the Company s stock option plans were estimated at the date of grant using a straight-line attribution method with the following weighted average assumptions:

	Stock Options Three Months Ended (Using a Black-Scholes Model)					
	October 31, 2006				**October 31, 2005**	
	Directors and Officers		**Other Employees**		**All Employees**	
Expected life (in years)	3.1		2.9		5.3	
Risk free interest rate	4.75	%	4.75	%	4.05	%
Volatility	38.8	%	38.8	%	66.7	%
Dividend yield						

	Stock Options Six Months Ended (Using a Black-Scholes Model)					
	October 31, 2006				**October 31, 2005**	
	Directors and Officers		**Other Employees**		**All Employees**	
Expected life (in years)	3.0		2.9		5.3	
Risk free interest rate	4.90	%	4.90	%	3.98	%
Volatility	42.4	%	42.4	%	66.6	%
Dividend yield						

Equity Incentive Programs:

Overview

The Company considers equity compensation to be long term compensation and an integral component of efforts to attract and retain exceptional executives, senior management and world-class employees. The Company believes that properly structured equity compensation aligns the long-term interests of stockholders and employees by creating a strong, direct link between employee compensation and stock appreciation, as stock options are only valuable to the Company s employees if the value of the Company s common stock increases after the date of grant.

The Company s board of directors has approved a common stock repurchase program that is described below.

2003 Stock Incentive Plan

In October 1989, the Company adopted a founder stock plan for incentive stock options and non-statutory stock options. The founder stock plan was amended and restated in March 1993 as the Stock Option Plan, which had the effect of extending its expiration date to March 2003. In January 1999 and September 2000, the stockholders authorized an additional 1.8 million shares and 2.5 million shares, respectively, to be reserved under the 1993 Stock Option Plan (the 1993 Plan). In December 2002, the stockholders approved an amendment and restatement of the 1993 Plan, renaming it the 2003 Stock Incentive Plan (SIP), extending its expiration date to November 2012, authorized an additional 1.0 million shares and a provision to automatically authorize annual additions to the plan on the first day of each fiscal year of 1.0 million shares or 5% of the then outstanding shares, whichever is less. A total of 7.4 million shares of common stock have been reserved for issuance under the SIP. Options granted under the SIP are for periods not to exceed 10 years. Incentive stock option and non-statutory stock option grants under the SIP generally must be at prices equal to 100% of the fair market value of the stock at the date of grant. Options generally vest over four years.

2003 Director Stock Option Plan

During 1993, the Company adopted the 1993 Director Stock Option Plan (the 1993 Director SOP), which provides for the grant of non-statutory stock options to non-employee directors. In November 1999 and September 2000, the stockholders authorized an additional 100,000 and 450,000 shares, respectively, to be reserved under the 1993 Director SOP. In December 2002, the stockholders approved an amendment and restatement of the 1993 Director SOP, renaming it the 2003 Director Stock Option Plan (the 2003 Director SOP) and extending its expiration to November 2012. A total of 770,000 shares of common stock have been reserved for issuance under the 2003 Director SOP. Options granted under the 2003 Director SOP prior to May 1, 2000 were for periods not to exceed five years and not to exceed a period of 10 years for grants made thereafter. Option grants under the 2003 Director SOP must be at prices equal to 100% of the fair market value of the stock at the date of grant. Options granted prior to December 2002 vested over a period of three years. Options granted beginning December 2002 vest immediately as of the date of the grant.

1998 Special Equity Incentive Plan

In December 1998, the Company adopted an additional stock option plan entitled the 1998 Special Equity Incentive Plan (SEIP) for incentive stock options and non-statutory stock options for certain directors, officers and consultants of the Company. A total of 3.5 million shares of common stock have been reserved for issuance under the SEIP. Options granted under the SEIP are for periods not to exceed 10 years. Options generally vest over four years.

2001 Common Stock Repurchase Program

In September 2001, the Company s board of directors authorized a program for the open market repurchase of up to 1.5 million shares of its common stock. In subsequent periods, the board of directors amended the program and authorized the purchase up to an aggregate of 3.5 million shares. Upon reaching the maximum number of shares authorized under this program, the board of directors authorized a new stock repurchase program in September 2005. Under the new repurchase program, the Company may repurchase up to 1.0 million shares of its common stock. The purpose of these share repurchase programs are to reduce the long-term potential dilution in earnings per share that might result from issuances under the Company s stock option plans and to take advantage of the relatively low price of the Company s common stock. During the three months ended October 31, 2006, 118,800 shares were repurchased for an approximate cost of $417,000. During the three months ended October 31, 2005, 289,000 shares were repurchased for a cost of $1,426,000. The Company accounts for treasury stock using the cost method. Of the 1.0 million shares currently authorized by the Company s board of directors for repurchase, the Company has repurchased a total of 977,000 shares and, as of October 31, 2006, can repurchase a total of 23,000 additional shares. Subsequent to October 31, 2006, the board of directors amended the program and authorized the purchase of an additional 1.0 million shares under the stock repurchase program.

A summary of activity under the SIP, the 2003 Director SOP and the SEIP is as follows (in thousands except per share amounts):

	Options Available for Grant	Options Outstanding	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Balances, May 1, 2006	1,276	5,662	$ 4.22		
Authorized					
Granted	(119)	119	4.21		
Exercised					
Cancelled	25	(25)	5.93		
Expired	55	(55)	4.99		
Balances, July 31, 2006	1,237	5,701	$ 4.23	6.7	$ 3,026
Authorized					
Granted	(496)	496	3.22		
Exercised		(31)	0.25		
Cancelled	8	(8)	4.31		
Expired	12	(12)	3.02		
Balances, October 31, 2006	761	6,146	$ 4.13	6.7	$ 2,587
Options exercisable at October 31, 2006		4,220	$ 4.01	5.9	$ 2,516

The aggregate intrinsic value in the table above represents the total pretax intrinsic value for in-the-money options as of October 31, 2006, based on the $3.21 closing stock price of our common stock on the NASDAQ Global Market, which would have been received by the option holders had all option holders exercised their options as of that date. The total number of in-the-money options outstanding and exercisable as of October 31, 2006 was 2,122,000 and 2,035,000, respectively.

During the three and six months ended October 31, 2006:

	Three Months Ended October 31, 2006	Six Months Ended October 31, 2006
The weighted average grant date fair value of options granted	$ 1.00 per share	$ 1.10 per share
Total fair value of shares vested (in thousands)	$ 690	$ 1,356
Total intrinsic value of options exercised (in thousands)	$ 93	$ 93
Total cash received from employees as a result of employee stock option exercises (in thousands)	$ 8	$ 8
Tax benefits realized as a result of employee stock option exercises (in thousands)	$ 2	$ 2

The Company settles employee stock option exercises with newly issued shares of common stock. The Company does not have any equity instruments outstanding other than options described above as of October 31, 2006.

Note 4 Net Income Per Share

Basic net income (loss) per share is computed by dividing net income (loss) available to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period. Diluted net income (loss) per share is computed using the weighted number of common shares and potentially dilutive common shares outstanding during the period under the treasury stock method. Under the treasury stock method, the effect of stock options outstanding is not included in the computation of diluted net income (loss) per share for periods when their effect is anti-dilutive, which in the current period includes consideration of unearned stock-based compensation as required by SFAS No. 123(R). In computing diluted net income (loss) per share, the average stock price for the period is used in determining the number of shares assumed to be purchased from the exercise of stock options. A reconciliation of the basic and diluted per share computations is as follows (in thousands, except per share data):

	Three Months Ended October 31,					
	2006			2005		
	Net Income	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
Basic	$ 176	16,284	$ 0.01	$ 927	16,919	$ 0.05
Effect of stock options		834	0.00		1,355	0.00
Diluted	$ 176	17,118	$ 0.01	$ 927	18,274	$ 0.05

Options to purchase 2,185,000 shares of common stock at a weighted average exercise price of $5.91 per share outstanding during the three months ended October 31, 2006 and options to purchase 2,305,000 shares of common stock at a weighted average exercise price of $6.37 per share outstanding during the three months ended October 31, 2005 were not included in the computation of diluted income per share because their option price was greater than the average fair market value for the period.

A reconciliation of the basic and diluted per share computations for the six months ended October 31, 2006 and October 31, 2005 is as follows (in thousands, except per share data):

	Six Months Ended October 31,					
	2006			2005		
	Net Loss	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
Basic	$ (83)	16,317	$ (0.01)	$ 1,422	16,785	$ 0.08
Effect of stock options			0.00		1,429	0.00
Diluted	$ (83)	16,317	$ (0.01)	$ 1,422	18,214	$ 0.08

All options outstanding during the six months ended October 31, 2006 were excluded in the computation of net loss per share because such options were antidilutive due to net loss incurred in the period. Options to purchase 2,308,000 shares of common stock at a weighted average exercise price of $6.39 per share outstanding during the six months ended October 31, 2005 were not included in the computation of diluted income per share because their option price was greater than the average fair market value for the period.

Note 5 Balance Sheet Components

	October 31, 2006			
	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Market Value
	(In thousands)			
Investments available-for-sale:				
U.S. government debt securities with maturities less than one year	$ 14,881	$	$ (11)	$ 14,870

	April 30, 2006			
	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair market Value
	(In thousands)			
Investments available-for-sale:				
U.S. government debt securities with maturities less than one year	$ 21,474	$	$ (65)	$ 21,409

The net unrealized gains (losses) as of October 31, 2006 and April 30, 2006 are recorded in accumulated other comprehensive loss, net of related tax of $4,000 and $24,000, respectively.

The financial instruments in short-term investments are highly liquid and can be converted to cash and cash equivalents without restriction and, accordingly, are classified as current assets in the accompanying consolidated balance sheets.

	October 31, 2006	April 30, 2006
	(In thousands)	
Accounts receivable:		
Accounts receivable	$ 11,395	$ 9,640
Less: Allowance for doubtful accounts	(138)	(138)
	$ 11,257	$ 9,502

The Company did not have any bad debts written off to the allowance for doubtful accounts in the three months or six months ended October 31, 2006 and 2005, respectively.

	October 31, 2006	April 30, 2006
	(In thousands)	
Inventories:		
Work-in-process	$ 10,612	$ 9,220
Finished goods	4,072	5,042
	$ 14,684	$ 14,262
Property and equipment, net:		
Buildings	$ 5,380	$ 2,045
Engineering and test equipment	10,628	9,962
Computer software	1,799	1,779
Computer hardware	664	589
Land	2,525	165
Leasehold improvements	45	671
Furniture and office equipment	976	838
Construction in progress		3,746
Vehicles	69	69
	22,086	19,864
Less: Accumulated depreciation and amortization	(10,755)	(10,456)
Total property and equipment, net	$ 11,331	$ 9,408

	October 31, 2006	April 30, 2006

	(In thousands)	
Accrued expenses:		
Accrued employee compensation	$ 952	$ 866
Accrued income taxes	587	746
Other	1,408	1,390
	$ 2,947	$ 3,002

Note 6 Income Taxes

The provision for income taxes was $171,000, or 49.3% of income before taxes, for the three months ended October 31, 2006. The provision for income taxes was $449,000, or 32.6% of income before taxes, for the three months ended October 31, 2005. The income tax rate for the three months ended October 31, 2006 is higher than the income tax rate for the three months ended October 31, 2005 primarily due to the non-deductible stock compensation charges associated with incentive stock options, as a result of SFAS 123(R).

The benefit from income taxes was $168,000, or 66.9% of loss before taxes, for the six months ended October 31, 2006. The provision for income taxes was $696,000, or 32.9% of income before taxes, for the six months ended October 31, 2005. The income tax rate of the six months ended October 31, 2006 is higher than the income tax rate benefit for the six months ended October 31, 2005 primarily due to the non-deductible stock compensation charges associated with incentive stock options as a result of SFAS 123(R).

Note 7 Segment Reporting

The Company operates in one business segment, the semiconductor segment. Sales transactions are denominated in U.S. dollars.

Net revenues by product group were as follows (in thousands):

	Three Months Ended October 31,		Six Months Ended October 31,	
	2006	2005	2006	2005
EEPROM	$ 13,771	$ 14,554	$ 26,572	$ 27,038
Flash	1,243	1,136	2,242	2,258
Analog/mixed-signal	1,296	1,241	2,721	2,311
Total net revenues	$ 16,310	$ 16,931	$ 31,535	$ 31,607

Net revenues by geography were as follows (in thousands):

	Three Months Ended October 31,		Six Months Ended October 31,	
	2006	2005	2006	2005
United States	$ 1,228	$ 1,947	$ 3,149	$ 3,614
Hong Kong/China	3,397	4,937	6,216	9,294
Japan	1,925	2,091	3,967	4,550
Europe	2,019	1,896	3,698	3,422
South Korea	1,954	1,928	3,503	3,191
Taiwan	1,934	2,446	4,057	4,293
Other Far East	3,048	1,538	6,061	2,988
Other Americas	805	148	884	255
Total net revenues	$ 16,310	$ 16,931	$ 31,535	$ 31,607

For the three months ended October 31, 2006 and 2005, Avnet, Inc., an international distributor, represented 11.2% and 11.5%, respectively, of the Company s net revenues.

For the six months ended October 31, 2006 and 2005, Avnet, Inc. represented 10.7% and 11.9%, respectively, of the Company s net revenues.

Property and equipment geographical breakdown was as follows (in thousands):

	October 31, 2006	April 30, 2006
United States	$ 13,794	$ 12,010
Romania	2,939	2,874
Thailand	2,768	2,695
Japan	2,410	2,191
Other	175	94
	22,086	19,864
Accumulated depreciation and amortization	(10,755)	(10,456)
Total property and equipment, net	$ 11,331	$ 9,408

Note 8 Commitments and Contingencies

Purchase Commitments

Purchase commitments for open purchase orders at October 31, 2006 for which goods and services had not been received were approximately $4.1 million, as compared to approximately $6.2 million at April 30, 2006.

Litigation and Other Claims

In the normal course of business, the Company periodically receives notification of threats of legal action in relation to claims of patent infringement by the Company. Currently there are no such active actions. Although no assurances can be given as to the results of such claims, management does not believe that any such actions will have a material adverse impact on the Company s financial condition, results of operations, or cash flows.

Guarantees

In November 2002, the FASB issued FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). The Company applies the disclosure provisions of FIN 45 to its agreements that contain guarantee or indemnification clauses. FIN 45 requires that a liability be recorded in the guarantor s balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a reconciliation of changes in the entity s product warranty liabilities. These disclosure provisions expand those required by SFAS No. 5, *Accounting for Contingencies,* by requiring that guarantors disclose certain types of guarantees, even if the likelihood of requiring the guarantor s performance is remote. The following is a description of significant arrangements through which the Company is a guarantor:

Indemnification Obligations

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

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

Product Warranties

The Company estimates its product warranty costs based on historical warranty claim experience and applies this estimate to the revenue stream for products under warranty. Included in the Company s sales returns reserves are estimated return exposures associated with product warranties. Estimated future costs for warranties applicable to revenues recognized in the current period are charged to the Company s cost of revenues. The warranty accrual is reviewed quarterly to verify that it properly reflects the remaining obligations based on the anticipated expenditures over the balance of the obligation period. Adjustments are made when actual claim experience differs from estimates. Warranty costs were less than $25,000 for each of the three months ended October 31, 2006 and 2005 and less than $50,000 for each of the six months ended October 31, 2006 and 2005.

Note 9 Related Party Transactions

Elex N.V.

During the fourth quarter of fiscal 2000, the Company began taking delivery of wafers fabricated at X-FAB Texas, Inc. (X-FAB) a wholly owned subsidiary of Elex N.V. (Elex), a Belgian holding company. Roland Duchâtelet, the chairman and chief executive officer of Elex, serves as a member of the Company s board of directors. Elex initially became a related party in 1998 through the purchase of 5.5 million restricted shares of the Company s common stock. The wafers provided by X-FAB include most of the Company s analog/mixed-signal products and supplement some of the same EEPROM designs fabricated at various other foundries the Company utilizes. Other than purchase orders currently open with X-FAB, there is no purchasing agreement in place with X-FAB.

During the six months ended October 31, 2006 and 2005, the Company purchased $682,000 and $1.0 million of wafers and masks, respectively, from X-FAB. As of October 31, 2006 and April 30, 2006, the total amount owed X-FAB by the Company was $92,000 and $143,000, respectively. The Company believes that the terms of these transactions were no less favorable than reasonably could be expected to be obtained from unaffiliated parties.

In fiscal 2004, the board of directors authorized the Company to purchase 600,000 shares from Elex for $6.77 per share for an aggregate purchase price of $4.1 million, which represented a 13% discount from the closing market price on the NASDAQ Stock Market on the last trading date prior to the approval of the transaction by the Company s board of directors. As of October 31, 2006, Elex held 728,700 shares of the Company s common stock, or 4.4% of the outstanding shares of common stock of the Company.

Note 10 Other Comprehensive Income (Loss)

The components of other comprehensive income (loss), net of tax, are presented in the following table (in thousands):

	Three Months Ended October 31,		Six Months Ended October 31,	
	2006	2005	2006	2005
Reported net income (loss)	$ 176	$ 927	$ (83)	$ 1,422
Other comprehensive income:				
Unrealized gain (loss) on available-for-sale investments, net of related tax	12	(13)	29	23
Total comprehensive income (loss)	$ 188	$ 914	$ (54)	$ 1,445

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors that include, but are not limited to, the risks discussed in Part II. Item 1A. Risk Factors and elsewhere in this Quarterly Report on From 10-Q. These forward-looking statements include, but are not limited to: the statements relating to downward pricing trends; average selling prices; the statements relating to the increasing portion of our net revenues from analog/mixed-signal products; the statements relating to the sufficiency of our cash resources and cash flows to fund our operating and capital requirements and the risks associated with seeking additional financing. These forward-looking statements are based on current expectations and entail various risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements.

Overview

We design, develop and market a broad line of reprogrammable non-volatile memory products and analog/mixed-signal products. Our products are used by manufacturers of electronic products in a wide range of consumer, computing, communications, industrial and automotive applications. We generally target high volume markets for our cost effective, high quality products. We have been a committed long-term supplier of memory products including through periods of tight manufacturing capacity and cyclical market downturns.

The market for our non-volatile memory is highly competitive and market participants have relatively weak pricing power. Average selling prices of our non-volatile memory products have declined over time and prices are sensitive to conditions in our OEM customers target markets. For example, beginning in fiscal 2005 and continuing in fiscal 2006, we experienced a downward trend in average selling prices and unit volumes for our non-volatile memory products due to weakening market demand. In general, we expect the average selling price for a given memory product to decline in the future, primarily due to market competition, product availability and manufacturing capacity. In response to that trend, we continue to work with our foundries and other vendors to increase the manufacturing efficiency of our products.

We are leveraging our extensive experience in high volume, reprogrammable memory products to develop complementary analog/mixed-signal products that offer our customers a more complete system solution. In fiscal 2003, we strengthened and expanded the expertise of our research and development team by establishing our own development center in Bucharest, Romania and by hiring additional engineers in Romania and in our California headquarters. In fiscal 2005, we purchased a new building in Bucharest for our Romanian product development team. We continue to make substantial investments in research and development to advance our non-volatile memory products, as well as develop broader solutions with our line of analog/mixed-signal products.

Sales of our analog/mixed-signal products continue to trend upwards, reaching 8.6% of net revenues in the six months ended October 31, 2006 as compared to 7.3% of net revenues in the similar period in the prior year.

Our business is less capital intensive than traditional semiconductor companies because we outsource the manufacturing, assembling and a significant portion of the testing of our products to third parties. We strive to maintain long-term relationships with our suppliers to ensure stability in our supply of products at a competitive cost. In addition, in an effort to alleviate any potential wafer capacity constraints, we maintain a supply of wafers in a die bank for most products.

We market and sell our products directly through our sales force and sales representatives to OEMs and indirectly through distributors and resellers who sell to their end customers. Indirect sales were a majority of our total sales in fiscal 2006 and for the six months ended October 31, 2006. Our total customer base, including OEMs and end-customers of our distributors and resellers, is relatively diverse and during fiscal 2006 consisted of more than 3,400 customers. We have approximately 40 distributors and resellers.

For the six months ended October 31, 2006 and 2005, Avnet, Inc. represented 10.7% and 11.9%, respectively, of our net revenues.

Our sales are initiated by purchase orders received from our customers and are typically shipped within a few weeks of receiving the order. Since industry practice allows customers to reschedule or cancel orders on relatively short notice, we do not use backlog to forecast our future net revenues. Cancellations of customer orders, distributor price protection and distributor stock rotation rights, all industry standards, could result in the loss of future net revenues without allowing us sufficient time to reduce our inventory and operating expenses.

Sales to customers outside the United States comprised the vast majority of our net revenues in recent periods. This increasing non-United States growth in net revenues was consistent with the trend towards outsourcing of the manufacturing process, particularly to companies who manufacture in Asia. Substantially all sales of our products are denominated in U.S. dollars, minimizing the effects of currency fluctuations.

Description of Operating Accounts

Net Revenues. Net revenues consist of product sales, net of returns and allowances.

Gross Profit. Gross profit is net revenues less cost of revenues and is affected by a number of factors, including competitive pricing, product mix, foundry pricing, the cost of test and assembly services and manufacturing yields. Cost of revenues consists primarily of costs of manufacturing, assembly and testing of our products as well as compensation (including stock-based compensation) and associated costs related to manufacturing support, inbound freight shipments and quality assurance personnel. It also can include, on occasion, adjustments to inventory valuations based on demand and average selling prices expected in future periods.

Research and Development. Research and development expense consists primarily of compensation (including stock-based compensation) and associated costs for engineering, technical and support personnel, contract engineering services, depreciation of equipment and cost of wafers and mask sets used to evaluate new products and new versions of current products.

Selling, General and Administrative. Selling, general and administrative expense consists primarily of compensation (including stock-based compensation) and associated costs for sales, marketing and administrative personnel, commissions, promotional activities, bad debt expense, outbound freight shipments, professional fees and director and officer insurance.

Critical Accounting Estimates

The preparation of our consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, cost of revenues, expenses and related disclosure of contingencies. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, inventory valuation, accounts receivable and allowance for doubtful accounts, stock-based compensation and income taxes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, and apply them on a consistent basis. We believe that such consistent application results in condensed consolidated financial statements and accompanying notes that fairly represent our financial condition, operating results and cash flows for all periods presented. However, any factual errors or errors in these estimates and judgments may have a material impact on our financial conditions, operating results and cash flows.

Recognition of Revenues

We generally recognize revenues as products are shipped if all of the following criteria are met:

- we have evidence that a sales arrangement exists;
- our customer has taken title to the products;
- we have performed the services, if any;
- the sales price is fixed or determinable;
- we believe that collection of the resulting receivable is reasonably assured; and
- we can reasonably estimate product returns.

We sell our products directly through our sales force and sales representatives to OEMs and indirectly through distributors and resellers who sell to their end customers. We recognize revenues upon delivery to OEM customers and resellers who have no, or limited, product return rights and no price protection rights. We deem that delivery occurs when legal title and the risk of loss transfers to the customer. Delivery is generally defined by the customers shipping terms, as stated in the related purchase order. If the customers purchase orders do not define the shipping terms, the shipping terms will be Ex-Works as defined in our invoice. We record an estimated allowance for returns from OEM customers and resellers, based on a percentage of our revenues. This estimate is based on historical averages.

We sell to some of our distributors under agreements which provide for product return and price protection rights. These agreements generally permit the distributor to return up to 10% by value of the total products that the distributor has purchased from us every six months. We defer recognition of revenues until such time as the distributor resells the product to an end-customer, at which time the sales price becomes fixed. On a monthly basis, we receive point of sales and ending inventory information from each distributor. Using this information, we determine the amount of revenues to recognize. For distributors who have product return rights, we also record an inventory reserve to address the cost of products we anticipate that we will not be able to resell after their return by the distributors. For distributors who have price protection rights, distributors may take the associated credits immediately and in general, we process the credits one or two months after the credit is earned by the distributor. We record a reserve to cover the estimated liability of those unprocessed credits. We re-evaluate our revenue recognition policies periodically and no less often than annually.

We defer the recognition of revenue for certain resellers who have no product return rights and no price protection rights. In accordance with our policy, we will generally defer the recognition of revenue for certain resellers based on their high dollar volume of purchases.

Inventory Valuation

We value our inventory at the lower of standard cost or net realizable value. Standard cost approximates actual cost on a first-in, first-out basis. We routinely evaluate the value and quantities of our inventory in light of the current market conditions and market trends and we record reserves for quantities in excess of demand, cost in excess of market value and product age. Our analysis may take into consideration historical usage, expected demand, anticipated sales price, new product development schedules, the effect new products might have on the sales of existing products, product age, customer design activity, customer concentration and other factors. Our forecasts for our inventory may differ from actual inventory use. The lives of our products are usually long and obsolescence has not been a significant factor historically in the valuation of our inventories.

We reduce the value of our inventory by analyzing on-hand quantities and open purchase orders which are in excess of demand equal to the cost of inventory that exceeds expected demand for approximately the next 12 to 15 months. We make judgments in establishing these reserves and do not establish reserves if we believe we can sell the excess inventory. If market conditions are less favorable than those we estimate, we may be required to write down inventory. If we overestimate the future selling prices, we will incur additional losses when the inventory is sold for a lower price or when we establish additional write downs to cover the even lower estimated sales price. Once written down, we establish a new cost basis and accordingly we do not reverse inventory provisions until the associated inventory has been sold or physically scrapped.

Allowance for Doubtful Accounts

We estimate the collectibility of our accounts receivable at the end of each reporting period. We analyze the aging of accounts receivable and bad debt history, payment history, customer concentration, customer credit worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. We maintain an allowance for doubtful accounts, which is created by charges to selling, general and administrative expenses. Our accounts receivable balance was $11.3 million, net of allowance for doubtful accounts of $138,000, as of October 31, 2006**.**

Stock-Based Compensation

Effective May 1, 2006, we adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment*s (SFAS No. 123(R)). We estimate the fair value of stock options using the Black-Scholes model, consistent with the provisions of SFAS No. 123(R) and Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 107, *Share-Based Payment*. Option-pricing models require the input of highly subjective assumptions, including the price volatility of the underlying stock. The expected term assumption used in calculating the estimated fair value of our stock-based compensation awards using the Black-Scholes model is based primarily on detailed historical data about employees exercise behavior, vesting schedules, and death and disability probabilities. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. We estimate the forfeiture rate based on historical experience of our stock-based awards that have been granted, exercised and cancelled. Stock-based compensation is amortized on a straight-line basis and allocated to cost of revenues, research and development and sales, general and administrative expenses in the accompanying condensed consolidated statements of operations based on the related employee s function.

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 jurisdictions in which we operate. This process involves estimating our current tax exposure and assessing temporary differences resulting from differing treatment of items, such as deferred revenues, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included on our balance sheet on a net basis. We then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we establish a valuation allowance or increase this allowance in a period, we will include an additional tax provision in the statement of operations.

We reassess and may adjust the estimated tax rate quarterly. We apply the current tax rate to our year-to-date income (loss) and our tax provision and related accrual is adjusted accordingly. Our effective income tax benefit rate was 66.9% for the six months ended October 31, 2006 and effective income tax expense rate was 32.9% for the six months ended October 31, 2005.

We make significant judgments in determining our provision for income taxes, our deferred tax assets and any valuation allowance recorded against our net deferred tax asset. As of October 31, 2006, our gross deferred tax assets, consisting primarily of net operating loss carryforwards, tax credit carryforwards and nondeductible reserves and accruals, were valued at $7.5 million and our valuation allowance was zero.

We have concluded that all of our deferred tax assets will be realizable, based on available objective evidence and our history of taxable income.

Results of Operations

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

	Three Months Ended October 31,				Six Months Ended October 31,			
	2006		2005		2006		2005	
Net revenues	100.0	%	100.0	%	100.0	%	100.0	%
Cost of revenues	64.5		62.0		66.1		61.5	
Gross profit	35.5		38.0		33.9		38.5	
Operating expenses:								
Research and development	11.9		11.7		12.1		12.0	
Selling, general and administrative	23.5		19.8		24.6		21.3	
Income from operations	0.1		6.5		(2.8	)	5.2	
Interest income and other, net	2.0		1.6		2.0		1.5	
Income before income taxes	2.1		8.1		(0.8	)	6.7	
Income tax provision	1.0		2.6		(0.5	)	2.2	
Net income	1.1	%	5.5	%	(0.3	)%	4.5	%

Comparison of the three months ended October 31, 2006 and October 31, 2005

The following table sets forth net revenues (in thousands) and percentage of net revenues by product group:

	Three Months Ended October 31,					
	2006			2005		
EEPROM	$ 13,771	84.4	%	$ 14,554	86.0	%
Flash	1,243	7.7		1,136	6.7	
Analog/mixed-signal	1,296	7.9		1,241	7.3	
Net revenues	$ 16,310	100.0	%	$ 16,931	100.0	%

Net Revenues. Our net revenues decreased approximately $621,000, or 3.7%, to $16.3 million for the three months ended October 31, 2006 from $16.9 million for three months ended October 31, 2005. The decrease in net revenues was primarily due to a decline in EEPROM average selling prices, which led to reduced net revenues from our EEPROM products of $783,000, or 5.4%, to $13.8 million for the three months ended October 31, 2006 from $14.6 million for the three months ended October 31, 2005. This decrease was partially offset by the impact of an increase in total unit volume from 118.0 million for the three months ended October 31, 2005 to 122.0 million for the three months ended October 31, 2006.

Sales to customers outside the United States represented approximately 92.5% and 88.5%, respectively of net revenues for the three months ended October 31, 2006 and 2005.

Gross Profit. Gross profit decreased $651,000, or 10.1%, to $5.8 million for the three months ended October 31, 2006 from $6.4 million for three months ended October 31, 2005. The decrease in gross profit was primarily due to declining overall average selling prices resulting from increased market competition and product mix. The benefit from sales of previously written down inventory was $176,000 for the three months ended October 31, 2006 and $73,000 for the three months ended October 31, 2005. The provision recorded for excess and obsolete inventory was $582,000 for the three months ended October 31, 2006 and $537,000 for the three months ended October 31, 2005. The net impact of these inventory provisions was a decrease in gross profit of $406,000 for the three months ended October 31, 2006 and a decrease in gross profit of $464,000 for the three months ended October 31, 2005.

Research and Development. Research and development expense decreased $39,000, or 2.0%, to $1.9 million for the three months ended October 31, 2006 from $2.0 million for the three months ended October 31, 2005. As a percentage of net revenues, research and development expense was 11.9% and 11.7% for the three months ended October 31, 2006 and 2005, respectively. For the three months ended October 31, 2006, we experienced an increase in salary and benefits of approximately $181,000, of which $176,000 was related to stock-based compensation costs resulting from our adoption of SFAS 123(R). These amounts were offset by a decrease in depreciation and amortization, materials costs, and other professional services of approximately $225,000.

Selling, General and Administrative. Selling, general and administrative expense increased $476,000, or 14.2%, to $3.8 million for the three months ended October 31, 2006 from $3.4 million for the three months ended October 31, 2005. As a percentage of net revenues, selling, general and administrative expense was 23.5% and 19.8% for the three months ended October 31, 2006 and 2005, respectively. The increase was primarily attributable to a $437,000 increase in salary and benefits, of which $339,000 was related to stock-based compensation costs resulting from our adoption of SFAS 123(R) and $132,000 related to an increase in headcount within the sales and marketing function.

Interest Income and Other, net. We earned interest income and other, net, of $325,000 for the three months ended October 31, 2006 compared to interest income and other, net, of $266,000 for the three months ended October 31, 2005. Our rate of return on our average balance of cash, cash equivalents and short-term investments was approximately 4.9% for the three months ended October 31, 2006 and approximately 3.2% for the three months ended October 31, 2005. The increase in interest income was primarily attributable to the higher rates of return.

Income Tax Provision. The provision for income taxes was $171,000, or 49.3% of income before taxes, for the three months ended October 31, 2006. The provision for income taxes was $449,000, or 32.6% of income before taxes, for the three months ended October 31, 2005. The income tax rate for the three months ended October 31, 2006 is higher than the income tax rate for the three months ended October 31, 2005, primarily due to the non-deductible stock compensation charges associated with incentive stock options, as a result of SFAS 123(R).

Comparison of the six months ended October 31, 2006 and October 31, 2005

The following table sets forth net revenues (in thousands) and percentage of net revenues by product group:

	Six Months Ended October 31,					
	2006			2005		
EEPROM	$ 26,572	84.3	%	$ 27,038	85.6	%
Flash	2,242	7.1		2,258	7.1	
Analog/mixed-signal	2,721	8.6		2,311	7.3	
Net revenues	$ 31,535	100.0	%	$ 31,607	100.0	%

Net Revenues. Our net revenues decreased approximately $72,000, or 0.2%, to $31.5 million for the six months ended October 31, 2006 from $31.6 million for the six months ended October 31, 2005. The decrease in net revenues was primarily due to a decrease of approximately $0.5 million for our EEPROM products due to decline in market demand resulting in a decrease in unit volume sold to end customers, offset by an increase of approximately $0.4 million for analog/mixed-signal products. In addition, sales to OEM s and resellers increased $3.2 million, but were offset by a decrease of $3.4 million in sales through distributors.

Sales to customers outside the United States represented approximately 90.0% of net revenues for the six months ended October 31, 2006 as compared to 88.5% of net revenues for the six months ended October 31, 2005.

Gross Profit. Gross profit decreased $1.5 million, or 12.1%, to $10.7 million for the six months ended October 31, 2006 from $12.2 million for the six months ended October 31, 2005. The decrease in gross profit was primarily attributable to a decline in average selling prices of our products due to product mix and sales of more expensive inventory acquired in previous quarters. The benefit from sales of previously written down inventory was $261,000 for the six months ended October 31, 2006 and $298,000 for the six months ended October 31, 2005. The provision for excess and obsolete inventory was $808,000 for the six months ended October 31, 2006 and $841,000 for the six months ended October 31, 2005. The net impact of these inventory provisions was a decrease in gross profit of $547,000 for the six months ended October 31, 2006 and a decrease in gross profit of $543,000 for the six months ended October 31, 2005.

Research and Development. Research and development expense was flat at $3.8 million for the six months ended October 31, 2006 and 2005. As a percentage of net revenues, research and development expense was 12.1% and 12.0% for the six months ended October 31, 2006 and 2005, respectively. For the six months ended October 31, 2006, we experienced an increase in salary and benefits of approximately $388,000, of which $359,000 was related to stock-based compensation costs resulting from our adoption of SFAS 123(R). These amounts were offset by a decrease in depreciation and amortization, materials costs, and other professional service of approximately $353,000.

Selling, General and Administrative. Selling, general and administrative expense increased $1.0 million, or 15.5%, to $7.7 million for the six months ended October 31, 2006 from $6.7 million for the six months ended October 31, 2005. As a percentage of net revenues, selling, general and administrative expense was 24.6% and 21.2% for the six months ended October 31, 2006 and 2005, respectively. The increase was primarily attributable to an $873,000 increase in salary and benefits, of which $752,000 was related to stock-based compensation costs resulting from our adoption of SFAS 123(R). Additionally, the cost of other professional services increased by approximately $131,000.

Interest Income and Other, net. We earned interest income and other, net, of $644,000 for the six months ended October 31, 2006, as compared to interest income and other, net, of $479,000 for the six months ended October 31, 2005. The increase in interest income and other, net, primarily relates to a higher rate of return, despite the lower average balances of our cash, cash equivalents and short-term investments for the six months ended October 31, 2006. Our rate of return was approximately 4.6% for the six months ended October 31, 2006 compared to approximately 2.9% for the six months ended October 31, 2005.

Income Tax Provision (Benefit). The benefit from income taxes was $168,000, or 66.9% of net loss before taxes, for the six months ended October 31, 2006. The provision for income taxes was $696,000, or 32.9% of net income before taxes, for the six months ended October 31, 2005. The income tax rate of the six months ended October 31, 2006 is higher than the income tax rate benefit for the six months ended October 31, 2005 primarily due to the non-deductible stock compensation charges associated with incentive stock options, as a result of SFAS 123(R).

Liquidity and Capital Resources

At October 31, 2006, we had cash, cash equivalents and short-term investments of $24.0 million as compared to $29.1 million at April 30, 2006. During the six months ended October 31, 2006, we repurchased 118,800 shares of our common stock for approximately $417,000. Additionally, employees exercised stock options to generate $8,000. We invest our excess cash in short-term financial instruments to generate interest income. These instruments are U.S. government debt securities, the majority of which have maturities that are less than one year. They are highly liquid and can be converted to cash at any time.

Historically, our primary source of cash has been provided through operations and through issuance of our common stock. Our historical uses of cash have primarily been for operating activities as well as capital expenditures. Supplemental information pertaining to our historical sources and uses of cash is presented as follows and should be read in conjunction with our Unaudited Condensed Consolidated Statements of Cash Flows and notes thereto:

	Six Months Ended October 31,	
	2006	2005
	(In thousands)	
Net cash provided by (used in) operating activities	$ (1,850)	$ 2,042
Net cash proceeds from sales and purchases of short-term investments	6,568	4,815
Acquisition of property and equipment	(2,897)	(1,033)
Treasury stock purchases	(417)	(1,685)

Net Cash from Operating Activities

In the six months ended October 31, 2006, we used cash in operating activities of $1.9 million, which was primarily due to net losses of $83,000, adjusted for depreciation and amortization of $928,000 and other non-cash items such as stock-based compensation of $1.1 million and a net increase in inventory reserves of $547,000. Cash used in operating activities included increases in gross inventory, accounts receivable and other assets of $969,000, $1.8 million, and $98,000, respectively. We made significant payments to vendors during the six months ended October 31, 2006 for amounts that became due as a result of our increased purchases of inventory at the end of fiscal 2006. As a result, accounts payable decreased by $1.3 million for the six months ended October 31, 2006. In addition, our deferred gross profit from distributors decreased $239,000 for the six months ended October 31, 2006.

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In the six months ended October 31, 2005, we had operating cash flows of $2.0 million which was primarily due to net income of $1.4 million, adjusted for depreciation and amortization of $898,000. Non-cash items included a net increase in inventory reserves of $543,000 and a tax benefit of $411,000 related to the exercise of employee stock options. Cash provided by operating activities included a decrease in gross inventory of $1.1 million due to decrease in wafer purchases and resulting in higher unit volumes, and an increase in accounts payable of $556,000 related to higher inventory purchases in the last month of the quarter. Such sources of cash were partially offset by an increase in accounts receivable of $2.3 million related to increased shipments and a net decrease in accrued liabilities of $502,000 related to lower incentive compensation expense and federal income tax expense for fiscal 2005.

Net Cash from Investing Activities

In the six months ended October 31, 2006, investing activities provided $3.7 million, primarily related to the proceeds from the sales and maturities of our short-term investments of $19.4 million and purchases of short-term investments of $12.8 million. We had capital expenditures of $2.9 million, mostly for construction costs related to our newly acquired headquarters building, as well as for production mask sets and equipment.

In the six months ended October 31, 2005, investing activities provided $3.8 million, primarily related to the proceeds from the sales and maturities of our short-term investments of $16.6 million and purchases of short-term investments of $11.8 million. We purchased $1.0 million of property and equipment, mostly production mask sets.

Net Cash from Financing Activities

In the six months ended October 31, 2006, net cash used in our financing activities was $409,000, consisting primarily of $417,000 used to repurchase an aggregate of 118,800 shares of our common stock on the open market during the six months ended October 31, 2006 offset by proceeds of $8,000 from the sale of common stock through the exercise of stock options.

In the six months ended October 31, 2005, net cash used in our financing activities was $946,000, consisting primarily of $1.7 million used to repurchase an aggregate of 344,168 shares of our common stock on the open market during the six months ended October 31, 2005 offset by proceeds of $739,000 from the sale of common stock through the exercise of stock options.

Common Stock Repurchase Plan

In September 2001, our board of directors authorized a program for the open market repurchase of up to 1.5 million shares of our common stock. In subsequent periods, the board of directors amended the program and authorized purchases up to an aggregate of 3.5 million shares of our common stock. Upon reaching the maximum number of shares authorized under this program, the board of directors authorized a new stock repurchase program of up to 1.0 million shares in September 2005. The purpose of these share repurchase programs are to reduce the long-term potential dilution in earnings per share that might result from issuances under our stock option plans. The following table summarizes the activity of the open market repurchase program for the stated periods and does not include our repurchases of shares from Elex N.V.:

	Six Months Ended October 31,			
	2006		2005	
Shares repurchased in open market	118,800		344,168	
Total cost of shares	$	417,051	$	1,684,802
Average cost per share	$	3.51	$	4.90

Subsequent to October 31, 2006, the board of directors amended the program and authorized the purchase of an additional 1.0 million shares under the stock repurchase program.

Contractual Obligations and Commercial Commitments

The following table summarizes our contractual obligations as of October 31, 2006 and the effects these obligations and commitments are expected to have on our liquidity and cash flows in future periods (in thousands):

	Payments Due by Period				
	Total	**Less Than 1 Year**	**1-3 Years**	**4-5 Years**	**More Than 5 Years**
Contractual cash obligations					
Operating leases(1)	$ 1,612	$ 252	$ 1,018	$ 342	$
Wafer purchases	3,139	3,139			
Other purchase commitments	922	922			
Total contractual cash obligations	$ 5,673	$ 4,313	$ 1,018	$ 342	$

(1) In July 2006, our primary facility lease in Sunnyvale, California expired and in August 2006 we moved into a building we purchased in Santa Clara, California.

Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities of financial partnerships, such as entities often referred to as structured finance or special purpose entities (SPEs), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purpose. As of October 31, 2006, we are not involved in any SPE transactions.

Future Liquidity

We believe that our current cash, cash equivalents and available-for-sale securities will be sufficient to meet our anticipated operating and capital requirements for at least the next 12 months. We have no current plans, nor are we currently negotiating, to obtain additional financing. Our long-term plan is to finance our core business operations with cash we generate from operations. However, from time to time we may raise additional capital through a variety of sources, including the public equity market, private financings, collaborative arrangements and debt. The additional capital we raise could be used for working capital purposes, to fund our research and development activities or our capital expenditures or to acquire complementary businesses or technologies. If we raise additional capital through the issuance of equity or securities convertible into equity, our stockholders may experience dilution. Those securities may have rights, preferences or privileges senior to those of the holders of the common stock. Additional financing may not be available to us on favorable terms, if at all. If we are unable to obtain financing, or to obtain it on acceptable terms, we may be unable to successfully support our business requirements.

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 151, *Inventory Costs, an Amendment of Accounting Research Bulletin* (ARB) *No. 43, Chapter 4* (SFAS No. 151). The amendments made by SFAS No. 151 are intended to improve financial reporting by clarifying that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and by requiring the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS No. 151 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS No. 154) a replacement of Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes* (APB No. 20) and FASB Statement No. 3, which changes the requirements for the accounting and reporting of a change in accounting principle effective for fiscal years beginning after December 15, 2005. SFAS No. 154 applies to all voluntary changes in accounting principle as well as to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 eliminates the requirement in APB No. 20, to include the cumulative effect of changes in accounting principle in the statement of operations in the period of change. Instead, to enhance the comparability of prior period financial statements, SFAS No. 154 requires that changes in accounting principles be applied retrospectively. Under

retrospective application, the new accounting principle is applied as of the beginning of the first period presented as if that principle had always been used. Under SFAS No. 154, a change in reporting entity is also applied retrospectively as of the beginning of the first period presented. A change in accounting estimate continues to be accounted for in the period of change and future periods if necessary. The adoption of SFAS No. 154 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The adoption of this standard is not expected to have a material impact on the consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation Number 48, *Accounting for Uncertainty in Income Taxes an interpretation of FAS 109* . This Interpretation 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* . This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The guidance will become effective as of the beginning of a company s fiscal year beginning after December 15, 2006. We are currently assessing the impact, if any, of adopting this standard on our financial position, results of operations and liquidity.

On September 13, 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The guidance is applicable for our fiscal 2007. We are currently assessing the impact, if any, of adopting this standard on our financial position, results of operations and liquidity.

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

Interest Rate Risk. We do not use derivative financial instruments in our investment portfolio. Our investment portfolio is generally comprised of U.S. government debt securities and cash deposits. Our policy is to place these investments in instruments that meet high credit quality standards and have maturities of less than two years with an overall average maturity of less than one year. These securities are subject to interest rate risk and could decline in value if interest rates fluctuate. Due to the short duration of the securities in which we invest and the conservative nature of our investment portfolio, a 10% move in interest rates would have an immaterial effect on our financial position, results of operations and cash flows.

Foreign Currency Exchange Rate Risk. A significant majority of our sales, manufacturing costs, and research and development and marketing expenses are transacted in U.S. dollars. Accordingly, our net profitability is not currently subject directly to material foreign exchange rate fluctuations. Gains and losses from such fluctuations have not been material to us to date.

Item 4. ***Controls and Procedures***

Disclosure Controls and Procedures

Based on their evaluation as of October 31, 2006, our management, including our chief executive officer and chief financial officer, have concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, or the Exchange Act) were effective to ensure that the material information required to be disclosed by us in this Quarterly Report on Form 10-Q was recorded, processed, summarized and reported within the time periods specified in the SEC s rules and instructions for Form 10-Q. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in its Exchange Act reports is accumulated and communicated to the issuer s management, including its principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting

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

Inherent Limitations on Effectiveness of Controls

Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or our internal controls, will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Catalyst Semiconductor, Inc. have been detected.

PART II

OTHER INFORMATION

Item 1. ***Legal Proceedings***

We are not a party to any material legal proceedings as of the date of this report.

Item 1A. ***Risk Factors***

Factors Affecting Future Operating Results

We are subject to a number of risks and some of these risks are endemic to the high-technology and semiconductor industry. This section should be read in conjunction with the unaudited condensed consolidated financial statements and the accompanying notes thereto, and the other parts of Management s Discussion and Analysis of Financial Condition and Results of Operations included in this Report on Form 10-Q.. The following lists some, but not all, of the risks and uncertainties which may have a material and adverse effect on our business, financial condition or results of operations. Additional factors and uncertainties not currently known to us or that we currently consider immaterial could also harm our business, operating results and financial condition.

Risks related to our Business

Our quarterly operating results may fluctuate due to many factors and are difficult to forecast, which may cause the trading price of our common stock to decline substantially.

Our operating results have historically been and in the future may be adversely affected or otherwise fluctuate due to factors such as:

- fluctuations in customer demand for the electronic devices into which our products are incorporated;
- volatility in supply and demand affecting semiconductor prices generally, such as an increase in the supply of competitive products and a significant decline in average selling prices;
- establishment of additional inventory reserves if sales of our inventory fall below our expected sales, or the anticipated selling prices of our products fall below the amounts paid to produce and sell certain parts;
- changes in our product mix including product category, density, package type, lead content, or voltage;
- inadequate visibility of future demand for our products;
- timing of new product introductions and orders for our products;
- increases in expenses associated with new product introductions and promotions, process changes and/or expansion of our sales channels;
- increases in wafer prices due to increased market demand and other factors;
- increases in prices charged by our suppliers due to increased costs, decreased competition and other factors;
- fluctuations in manufacturing yields;
- gains or losses of significant OEM customers or indirect channel sellers, such as distributors or resellers; and
- general economic conditions.

Our net revenues and operating results are difficult to forecast. We base our expense levels, in significant part, on our expectations of future net revenues and our expenses are therefore relatively fixed in the short term. If our net revenues fall below our forecasts, our operating results are likely to be disproportionately adversely affected because our costs are difficult to reduce significantly in the short term.

We may never realize a material portion of our net revenues from our analog/mixed-signal products, despite our expenditure of a disproportionate amount of our research and development and marketing resources on these products.

Analog/mixed-signal products accounted for 8.6% and 7.3% of net revenues for the six months ended October 31, 2006 and 2005, respectively. We believe that the growth in our analog/mixed-signal product revenues has been limited due to the extended product design cycles and production lead times, and a sales force that has limited experience selling these products. Despite limited product acceptance to date, we continue to invest in and devote research and development and marketing resources to analog/mixed-signal products with the expectation that our standard analog/mixed-signal products will be accepted by many of our current customers and that we will eventually qualify and sell custom analog/mixed-signal products. Competition is intense as we have initially offered a limited range of products while our more established competitors are offering a much broader array of analog/mixed-signal products. Many customers favor a vendor that offers a broad range of products. If we are unable to realize more revenues from these products, our total revenues may not grow. In addition, if we devote a disproportionate amount of our research and development resources to analog/mixed-signal products, our development of new non-volatile memory products may suffer and operating results may be harmed.

We have in the past been unable and in the future we may be unable to obtain sufficient quantities of wafers from our current foundry suppliers to fulfill customer demand.

We currently purchase a majority of our production wafers from two foundries. In addition, we do not presently have a wafer supply agreement with our foundry suppliers and instead purchase wafers on a purchase order and acceptance basis. To address our wafer supply concerns, we plan to continue expanding our foundry capability at our primary supplier by qualifying our products in multiple fabrication plants owned by a supplier and to expand our foundry capacity with other suppliers. As the need arises, from time to time, we may pursue additional wafer sources. However, we cannot be certain that these efforts will provide us with access to adequate capacity in the future at costs which will enable us to remain profitable. Even if such capacity is available from another manufacturer, the qualification process and time required to make the foundry fully operational for us could take many months or longer and be subject to other factors described below and the prices could be materially higher. Our business, financial condition and results of operations could be materially adversely affected by:

- inadequate wafer supplies to meet our production needs;
- the loss of any of our current foundries as a supplier;
- increased prices charged by these independent foundries;
- reduced control over delivery schedules, manufacturing yields and costs;
- our inability to qualify our current foundry suppliers for additional products; and
- any other problems foundries may have causing a significant interruption in our supply of semiconductor wafers.

Expensing employee stock options materially and aversely affects our reported operating results and could adversely affect our competitive position as well.

As of May 1, 2006, we are required to expense stock options and other share-based payments to employees and directors. Since our inception, we have used stock options as fundamental components of our compensation packages. Prior to May 1, 2006, we had not recognized compensation cost for employee stock options. We believe that our stock option program directly motivates our employees and, through the use of vesting, encourage our employees to remain with us. In December 2004, the FASB issued SFAS No. 123(R), which requires the measurement and recognition of compensation expense for all stock-based compensation payments. SFAS No. 123(R) requires that we record compensation expense for stock options using the fair value of those awards. During the three and six months ended October 31, 2006, we recorded $528,000 and $1.1 million related to stock-based compensation, respectively, which negatively impacted our operating results. We believe that SFAS No. 123(R) will continue to negatively impact our operating results.

To the extent that SFAS No. 123(R) makes it more expensive to grant stock options, we may decide to incur increased cash compensation costs. In addition, actions that we may take to reduce stock-based compensation expense that may be more severe than any actions our competitors may implement may make it difficult to attract, retain and motivate employees, which could adversely affect our competitive position as well as our business and operating results.

We may forecast incorrectly and produce excess or insufficient inventories of particular products, which may adversely affect our results of operations.

Since we must order products and build inventory substantially in advance of product shipments, we may forecast incorrectly and produce excess or insufficient inventories of particular products. The ability of our customers to reschedule or cancel orders without significant penalty could adversely affect our liquidity, as we may be unable to adjust our purchases from our wafer suppliers to match any customer changes and cancellations. As part of our business strategy, we maintain a substantial inventory of sorted wafers in a die bank but limit our investment in finished goods. We may have adequate wafer inventory to meet customer needs but may be unable to finish the manufacturing process prior to the delivery date specified by the customer. Demand for our products is volatile and customers often place orders with short lead times. Our inventory may not be reduced by the fulfillment of customer orders and in the future we may produce excess quantities of our products.

It is our policy to fully write down all inventories that we do not expect to be sold in a reasonable period of time. During recent fiscal years, as a result of reductions in estimated demand for our various products, we have taken charges for write down of inventories for certain products, primarily our EEPROM products. For example, we recorded inventory write-down charges of $808,000 and $841,000 for the six months ended October 31, 2006 and 2005, respectively, which were partially offset by benefits of $261,000 and $298,000, relating to products that were written off in prior periods and sold during these periods, respectively. We may suffer reductions in values of our inventories in the future and we may be unable to liquidate our inventory at acceptable prices. To the extent we have excess inventories of particular products, our operating results could be adversely affected by charges to cost of revenues that we would be required to recognize due to significant reductions in demand for our products or rapid declines in the market value of inventory, resulting in inventory write downs or other related factors.

We may be unable to fulfill all our customers orders according to the schedule originally requested due to the constraints in our wafer supply and processing time from die bank to finished goods, which could result in reduced revenues or higher expenses.

Due to the lead time constraints in our wafer supply, foundry activities and other manufacturing processes, from time to time we have been unable to fulfill all our customers orders on the schedule originally requested. Although we attempt to anticipate pending orders and maintain an adequate supply of wafers and communicate to our customers delivery dates that we believe we can reasonably expect to meet, our customers may not accept the alternative delivery date or may cancel their outstanding orders. Reductions in orders received or cancellation of outstanding orders would result in lower net revenues and reduced operating results, excess inventories and increased inventory reserves. We may also be required to pay substantially higher per wafer prices to replenish our die bank, which could harm our gross margins. If we were requested to pay rush charges to our manufacturing or foundry suppliers to meet a customer s requested delivery date, our expenses would increase and possibly harm our operating results.

We rely on distributors and resellers for a substantial portion of our net revenues and if our relationships with one or more of those distributors or resellers were to terminate, our operating results may be harmed.

We market and distribute our products primarily through independent distributors and resellers, which typically offer competing products. These distribution channels have been characterized by rapid change, including consolidations and financial difficulties.

Distributors and resellers have accounted for a significant portion of our net revenues in the past. For the six months ended October 31, 2006 and 2005, Avnet, Inc. represented 10.7% and 11.9%, respectively, of the Company s net revenues.

In addition, we have experienced and may continue to experience lower margins on sales to distributors and resellers as a result of volume pricing arrangements. We also do not typically enter into long-term arrangements with our distributors and resellers and we cannot be certain as to future order levels from our distributors and resellers. When we do enter into long-term arrangements, the contracts are generally terminable at the convenience of either party and it may be difficult to replace that source of revenues in the short-term upon cancellation.

Our business depends on these third parties to sell our products. As a result, our operating results and financial condition could be materially adversely affected by the loss of one or more of our current distributors or resellers, additional volume pricing arrangements, order cancellations, delay in shipment by one of our distributors or resellers or the failure of our distributors or sellers to successfully sell our products.

We face risks from failures in our manufacturing processes and the processes of our foundries and vendors.

The fabrication of semiconductors, particularly EEPROM products, is a highly complex and precise process. Most of our products are currently manufactured by two outside foundries and a number of other vendors participate in assembling, testing and other processing of our products. During manufacturing, each wafer is processed to provide numerous EEPROM, flash or analog/mixed-signal devices. We may reject or be unable to sell a substantial percentage of wafers or the components on a given wafer because of:

- minute impurities;
- difficulties in the fabrication process, such as failure of special equipment, operator error or power outages;
- defects in the masks used to imprint circuits on a wafer;
- nonconforming electrical and/or optical performance;
- breakage of wafers; or
- other factors.

We refer to the proportion of final components that have been processed, assembled and tested relative to the gross number of components that could be constructed from the raw materials as our manufacturing yield. We have in the past experienced lower than expected manufacturing yields, which have delayed product shipments and negatively impacted our results of operations. We may experience difficulty maintaining acceptable manufacturing yields in the future.

In addition, the maintenance of our outsourced fabrication, manufacturing and assembly model is subject to risks, including:

- the demands of managing and coordinating workflow between geographically separate production facilities;
- disruption of production in one facility as a result of a slowdown or shutdown in another facility; and
- higher operating costs from managing geographically separate manufacturing facilities.

We depend on certain vendors for foundry services, materials and test and assembly services. We maintain stringent policies regarding qualification of these vendors. However, if these vendors processes vary in reliability or quality, they could negatively affect our products and our results of operations.

We rely on third party subcontractors to sort, assemble, test and ship our products to customers, which reduces our control over quality, delivery schedules and capacity.

We outsource all or a portion of the production planning, assembly, test and finish work of our products, as well as our inventory management function to subcontractors who are primarily located in Thailand and the Philippines. We do not have long-term contractual arrangements with these subcontractors. Our reliance on third parties subjects us to risks such as reduced control over delivery schedules and quality, a potential lack of adequate capacity during periods when demand is high and potential increases in product costs due to factors outside our control such as capacity shortages and pricing changes. Our outsourcing model could lead to delays in product deliveries, lost sales and increased costs which could harm our relationships with OEM customers and indirect sales channels and result in lower operating results. Because we utilize the services of a group of assembly and test providers, this makes our operation highly complex, requiring a high degree of diligence in managing the costs of production and overall logistics of our manufacturing operations.

While we believe that we currently have adequate internal control over financial reporting, we are exposed to risks from recent legislation requiring companies to evaluate internal control over financial reporting and cannot be certain that our internal control over financial reporting will be effective or sufficient in the future.

Section 404 of the Sarbanes-Oxley Act of 2002 requires our management to report on and our independent registered public accounting firm to attest to the effectiveness of our internal control over financial reporting. We have an ongoing program to perform the system and process evaluation and testing necessary to comply with these requirements.

It may be difficult to design and implement effective internal control over financial reporting for combined operations and differences in existing controls of acquired businesses may result in weaknesses that require remediation when internal control over financial reporting are combined. For example, in fiscal 2006 we experienced unanticipated delays in closing our books and completing our assessment of the effectiveness of our internal control over financial reporting as required by the Sarbanes-Oxley Act under Section 404. As such, we were not able to file our Annual Report on Form 10-K by the original due date without unreasonable expense or effort. Our ability to manage our operations and growth will require us to improve our operations, financial and management controls, as well as our internal control over financial reporting. We may not be able to implement improvements to our internal control over financial reporting in an efficient and timely manner and may discover deficiencies and weaknesses in existing systems and controls; especially when such systems and controls are tested by increased scale of growth.

As a result, we expect to continue to incur related expenses and to devote additional resources to Section 404 compliance. In addition, it is difficult for us to predict how long it will take to complete the assessment of the effectiveness of our internal control over financial reporting each year and we may not be able to complete the process on a timely basis. In the event that our chief executive officer, chief financial officer or independent registered public accounting firm determine that our internal control over financial reporting is not effective as defined under Section 404, we cannot predict how regulators will react or how the market prices of our shares will be affected.

International sales comprise a significant portion of our product sales, which exposes us to foreign political and economic risks.

For each the six months ended October 31, 2006 and 2005, sales outside the United States accounted for approximately 90.0% and 88.5% of our net revenues, respectively. We expect that sales outside of the United States will continue to represent a significant portion of our net revenues in the future. However, our international operations may be adversely affected by the following factors:

- greater fluctuations in demand for our products due to the increased sensitivity to pricing changes in certain markets, particularly Asia;
- longer payment cycles;
- fluctuations in exchange rates;
- imposition of government controls;
- difficulties in staffing international operations;
- political, socioeconomic and financial instability, such as the military actions in Afghanistan and Iraq;
- trade restrictions;
- the impact of communicable diseases, such as severe acute respiratory syndrome and avian bird flu; and
- changes in regulatory requirements.

Our business is also subject to other risks because of our design center in Romania and our relationships with foreign subcontractors including, but not limited to, foreign government regulations and political and financial unrest which may cause disruptions or delays in shipments to our customers or access to our inventories. We do not currently hedge against any foreign currency exchange rate risks.

Additionally, our subcontracted presence in Thailand with Trio-Tech subjects us to additional risks associated with the value of the work-in-process and finished goods inventory located there as well as the test equipment utilized in the operations at the Trio-Tech facility. We recently formed Catalyst Semiconductor (Thailand) Company Limited, a subsidiary in Bangkok, Thailand, that will serve as the Company s inventory management and logistics center.

Our ability to operate successfully depends upon the continued service of certain key employees and the continued ability to attract and retain additional highly qualified personnel.

Our ability to operate successfully will depend, to a large extent, upon the continued service of certain key employees and the continued ability to attract and retain additional highly qualified personnel. Competition for these personnel, particularly for highly skilled design, process and test engineers, is intense and we may not be able to retain these personnel or attract other highly qualified personnel. We have historically used stock options and other forms of stock-based compensation as a means to hire, motivate and retain our employees, and to align employees interests with those of our stockholders. As a result of our adoptions of SFAS 123(R), we incur increased compensation costs associated with our stock-based compensation awards, which may affect this form of compensation to hire and retain employees. Our business, financial condition and results of operations could be materially adversely affected by the loss of or failure to attract and retain highly qualified personnel.

Our low-density flash memory products may become obsolete.

A portion of our net revenues have been and continue to be derived from sales of low density flash memory products. Flash memory products represented 7.1% of our net revenues for the six months ended October 31, 2006 and 2005. In general, the market for flash memory products has been characterized by competing technologies, migration of demand to larger memory sizes and intense overall competition. Other flash memory vendors continue to design, develop and sell flash memory devices with larger memory in reaction to changes in market demand. This transition to larger flash memory sizes is resulting in a limited and shrinking market for the low density flash memory products that we currently offer. We have decided not to develop any of the higher density flash memory devices due to the extreme competition in the medium and high density flash memory market and the considerable costs of development associated with it. Due to these and other factors, we may experience declining net revenues from our low-density flash memory products, which could harm our operating results.

Risks Related to Our Industry and Competition

Competition in our markets may lead to reduced average selling prices of our products, reduced sales of our products or gross margins.

The non-volatile memory market is competitive and has been characterized by rapid price erosion, manufacturing capacity constraints and limited product availability. Average selling prices in the non-volatile memory market generally, and for our products in particular, have fluctuated significantly over the life of each product and, over the long term, the average selling price of each product has tended to decline. Declines in average selling prices for our products, if not offset by reductions in the cost of producing those products or by sales of new products with higher gross margins, would decrease our overall gross margins, could cause a negative adjustment to the value of our inventories and could materially and adversely affect our operating results.

We compete with major domestic and international semiconductor companies, many of which have substantially greater financial, technical, marketing, distribution and other resources. We may not be able to compete successfully in the future. Our more mature products, such as serial and parallel EEPROM devices, compete on the basis of price, product availability and customer service. Principal competitors for our EEPROM products currently include Atmel Corporation, STMicroelectronics N.V and Microchip Technology Incorporated. Principal competitors for our low density flash products include Silicon Storage Technology, Inc. and Integrated Silicon Solution, Inc. Principal competitors for our analog/mixed-signal products include Fairchild Semiconductor International, Inc., Intersil Corporation, Linear Technology Corporation, Maxim Integrated Products, National Semiconductor and Texas Instruments Incorporated.

The semiconductor industry is highly cyclical in nature, which may cause our operating results to fluctuate.

We operate in a highly cyclical industry that has been subject to significant economic downturns often in connection with, or in anticipation of, maturing product cycles and declines in general economic conditions. During such downturns, we experience reduced product demand and production overcapacity which result in competitive pricing pressures leading to accelerated erosion of average selling prices and reduced gross margins. These downturns may occur for extended periods. Accordingly, we may experience substantial period-to-period fluctuations in operating results.

Our continued success depends in large part on the continued growth of various electronics industries that use semiconductors. We attempt to identify changes in market conditions as soon as possible; however, market dynamics make our prediction of and timely reaction to such events difficult. Our business could be harmed in the future by additional cyclical downturns in the semiconductor industry or by slower growth by any of the markets served by our end customers products.

If our products fail to keep pace with the rapid changes in the semiconductor industry, we could lose customers and revenues.

The markets for our products are characterized by rapidly changing customer demand, over or under utilization of manufacturing capacity and price fluctuations. To compete successfully, we must introduce new products in a timely manner at competitive price, quality and performance levels. In particular, our future success will depend on our ability to develop and implement new design and process technologies which enable us to reduce product costs. Our business, financial condition and results of operations could be materially adversely affected by delays in developing new products, achievement of volume production and market acceptance of new products, successful completion of technology transitions of our existing products to new process geometries or foundries with acceptable yields and reliability.

Risks Related to Our Intellectual Property

Our business may be harmed if we fail to protect our proprietary technology.

We rely on a combination of patents, trademarks, copyrights, trade secret laws, confidentiality procedures and licensing arrangements to protect our intellectual property rights. We currently have 25 patents granted and 15 pending in the United States and intend to seek further United States and international patents on our technology. The expiration dates of our patents range from January 2008 to October 2023. We cannot be certain that patents will be issued from any of our pending applications, that patents will be issued in all countries where our products can be sold or that any issued patents will be of sufficient scope or strength to provide meaningful protection or any commercial advantage. Our competitors may also be able to design around our patents. The laws of some countries in which our products are or may be developed, manufactured or sold, may not protect our products or intellectual property rights to the same extent as do the laws of the United States, increasing the possibility of piracy of our technology and products. Although we intend to vigorously defend our intellectual property rights, we may not be able to prevent misappropriation of our technology. Our competitors may also independently develop technologies that are substantially equivalent or superior to our technology.

Our ability to produce our products may suffer if someone claims we infringe on their intellectual property.

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights or positions, which have resulted in significant and often protracted and expensive litigation. In addition, it is typical for companies in the industry to receive notices from time to time that allege infringement of patents or other intellectual property rights. We may receive other notices or become a party to other proceedings alleging our infringement of patents or intellectual property rights in the future. If it is necessary or desirable, we may seek licenses under such patents or other intellectual property rights. However, we cannot be certain that licenses will be offered or that we would find the terms of licenses that are offered acceptable or commercially reasonable. Our failure to obtain a license from a third party for technology used by us could cause us to incur substantial liabilities and to suspend the manufacture of the affected products. Furthermore, we may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Litigation by or against us could result in significant expense and divert the efforts of our technical personnel and management, whether or not the litigation results in a favorable resolution. In the event of an adverse result in any litigation, we could be required to:

- pay substantial damages;
- pay amounts to indemnify our customers;
- stop the manufacture and sale of the infringing products;
- expend significant resources to develop non-infringing technology;
- discontinue the use of certain processes; or
- obtain licenses to the technology.

We may be unsuccessful in developing non-infringing products or negotiating licenses with reasonable terms, or at all. These problems might not be resolved in time to avoid harming our results of operations. If any third party makes a successful claim against our customers or us and a license is not made available to us on commercially reasonable terms, our business could be harmed.

We may be subject to damages resulting from claims that we have wrongfully used the alleged trade secrets of our employees former employers.

Many of our employees were previously employed at other companies, including our competitors or potential competitors. Although we have no current or pending claims against us, we may be subject to claims that we have relied on information that these employees have inadvertently, or otherwise, disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. If we fail in defending such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights or personnel. A loss of key research personnel or their work product could hamper or prevent our ability to develop new products, which could severely harm our business. Even if we are successful, litigation could result in substantial costs and be a distraction to management.

We may not be able to expand our proprietary technology if we do not acquire rights to use key technologies, consummate potential acquisitions or investments or successfully integrate them with our business.

To expand our proprietary technologies, we may acquire or make investments in complementary businesses, technologies or products if appropriate opportunities arise. We may be unable to identify suitable acquisition or investment candidates at reasonable prices or on reasonable terms or consummate transactions with such candidates, the failure of which could slow our growth. We may also have difficulty in acquiring licenses to use proprietary technologies of third parties to expand our product lines. We may have difficulty integrating the acquired products, personnel or technologies of any acquisition we might make. These difficulties could disrupt our ongoing business, limit our future growth, distract our management and employees and increase our expenses.

Risks Related to Our Stock

Our stock is subject to substantial price and volume fluctuations due to a number of factors, many of which are beyond our control, and those fluctuations may prevent our stockholders from reselling our common stock at a profit.

The trading price of our common stock has in the past been and could in the future be subject to significant fluctuations in response to:

- quarterly variations in our results of operations;
- announcements of technological innovations or new products by us, our customers or competitors;
- our failure to achieve the operating results anticipated by analysts or investors;
- sales or the perception in the market of possible sales of a large number of shares of our common stock by our directors, officers, employees or principal stockholders;
- international political, socioeconomic and financial instability, including instability associated with military action in Afghanistan, Iraq or other conflicts;
- releases or reports by or changes in security analysts recommendations; and
- developments or disputes concerning patents or proprietary rights or other events.

If our net revenues and results of operations are below the expectations of investors, significant fluctuations in the market price of our common stock could occur. In addition, the securities markets have, from time to time, experienced significant price and volume fluctuations, which have particularly affected the market prices for high technology companies and often are unrelated and disproportionate to the operating performance of particular companies. These broad market fluctuations, as well as general economic, political and market conditions, may negatively affect the market price of our common stock.

Our charter documents, Delaware law and our stockholder rights plan contain provisions that may inhibit potential acquisition bids, which may adversely affect the market price of our common stock, discourage merger offers or prevent changes in our management.

Our board of directors has the authority to issue up to 2,000,000 shares of preferred stock and to determine the rights, preferences, privileges and restrictions, including voting rights, of the shares without any further vote or action by our stockholders. If we issue any of these shares of preferred stock in the future, the rights of shareholders of our common stock may be negatively affected. If we issue preferred stock, a change of control of our company could be delayed, deferred or prevented. We have no current plans to issue shares of preferred stock. Section 203 of the Delaware General Corporation Law restricts certain business combinations with any interested stockholder as defined by that statute. In addition, our certificate of incorporation and bylaws contain certain other provisions that may have the effect of delaying, deferring or preventing a change of control. These provisions include:

- the classification of our board so that only a portion of our directors are elected each year and each director serves a three year term;

- the elimination of actions by written consent of stockholders; and

- the establishment of an advance notice procedure and a minimum holding requirement for stockholder proposals and director nominations to be acted upon at annual meetings of the stockholders.

In 1996, our board of directors adopted a stockholder rights plan with an initial term of ten years which will expire in December 2006. Under this plan, we issued a dividend of one right for each share of our common stock. Each right initially entitles stockholders to purchase one one-thousandth of a share of our preferred stock for $18.00. However, the rights are not immediately exercisable. If a person or group acquires, or announces a tender or exchange offer that would result in the acquisition of 15% of our common stock, unless the rights are redeemed by us for $0.01 per right, the rights will become exercisable by all rights holders, except the acquiring person or group, for shares of our common stock or the stock of the third party acquirer having a value of twice the right s then-current exercise price.

These provisions are designed to encourage potential acquirers to negotiate with our board of directors and give our board of directors an opportunity to consider various alternatives to increase stockholder value. These provisions are also intended to discourage certain tactics that may be used in proxy contests. However, the potential issuance of preferred stock, our charter and bylaw provisions, the restrictions in Section 203 of the Delaware General Corporation Law and our stockholder rights plan could discourage potential acquisition proposals and could delay or prevent a change in control, which may adversely affect the market price of our stock. These provisions and plans may also have the effect of preventing changes in our management or board of directors.

We may be the subject of securities class action litigation due to future stock price volatility.

In the past, when the market price of a stock has been volatile, holders of that stock have often initiated securities class action litigation against the company that issued the stock. If any of our stockholders brought a lawsuit against us, we could incur substantial costs defending the lawsuit. The lawsuit could also divert the time and attention of our management.

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

In September 2001, our board of directors authorized a program for the open market repurchase of up to 1.5 million shares of our common stock. In subsequent periods, the board of directors amended the program and authorized the purchase up to an aggregate of 3.5 million shares of our common stock. Upon reaching the maximum number of shares authorized under this program, the board of directors authorized a new stock repurchase program of up to 1.0 million shares in September 2005. The purpose of these share repurchase programs are to reduce the long-term potential dilution in earnings per share that might result from issuances under our stock option plans. During the three months ended October 31, 2006, we repurchased an aggregate of 118,800 shares of our common stock on the open market for $417,000. Subsequent to October 31, 2006, the board of directors amended the program and authorized the purchase of an additional 1.0 million shares under the stock repurchase program.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Be Purchased Under the Plan
August 1, 2006 - August 31, 2006				141,781
September 1, 2006 - September 30, 2006	118,800	$ 3.51	118,800	22,981
October 1, 2006 - October 29, 2006				22,981
Total	118,800	$ 3.51	118,800	

Item 3. ***Defaults Upon Senor Securities***

Not applicable.

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

At the Company s Annual Meeting of Stockholders held on September 22, 2006, the following proposals were adopted by the votes indicated.

Proposal	Voted For	Number of Shares Withheld
1. To elect two Class II Directors to serve for a three-year term expiring at the 2009 Annual Meeting of Stockholders or until such director s successors is elected or appointed and qualified.		
Garrett A. Garrettson Class II Director	15,342,333	460,901
Glen G. Possley Class II Director	15,534,933	259,301

The term of office of directors Henry C. Montgomery, Roland Duchatelet and Gelu Voicu continued after the annual meeting.

Proposal	Voted For	Vote Against	Abstain	Broker Nonvotes
2. To ratify the appointment of PricewaterhouseCoopers LLP as independent registered public accounting firm for the fiscal year ending April 29, 2007.	15,745,167	53,354	4,713	

Item 5. ***Other Information***

None.

Item 6. ***Exhibits***

Exhibit Number		Description

10.99.1(1)		Amendment No. 1 dated October 19, 2006 to Lease Agreement by and between Catalyst Semiconductor (Thailand) Company Limited and Stars Microelectronics
31.1		Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2		Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32		Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(1)		Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on October 25, 2006.

SIGNATURES

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.

Date: December 8, 2006	By:	/s/ GELU VOICU Gelu Voicu *President, Chief Executive Officer and Director*
Date: December 8, 2006	By:	/s/ THOMAS E. GAY III Thomas E. Gay III *Vice President of Finance and Administration and Chief Financial Officer*

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