

QUICKLOGIC CORPORATION
Form 10-Q
August 07, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 28, 2009

OR

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

For the Transition Period From To

COMMISSION FILE NUMBER: 000-22671

QUICKLOGIC CORPORATION

(Exact name of registrant as specified in its charter)

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DELAWARE
(State or other jurisdiction of
incorporation or organization)

77-0188504
(I.R.S. Employer Identification No.)

1277 ORLEANS DRIVE SUNNYVALE, CA 94089

(Address of principal executive offices, including Zip Code)

(408) 990-4000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller Reporting Company

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

As of August 5, 2009, the registrant had outstanding 30,258,350 shares of common stock, par value \$0.001.

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(in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 28, 2009	June 29, 2008	June 28, 2009	June 29, 2008
Revenue	\$ 2,911	\$ 8,743	\$ 7,463	\$ 19,766
Cost of revenue	1,589	3,982	3,408	9,240
Long-lived asset impairment		1,545		1,545
Gross profit	1,322	3,216	4,055	8,981
Operating expenses:				
Research and development	1,877	2,610	3,489	5,431
Selling, general and administrative	2,709	3,970	5,352	8,290
Long-lived asset impairment		468		468
Restructuring costs		452		452
Loss from operations	(3,264)	(4,284)	(4,786)	(5,660)
Write-down of investment in Tower Semiconductor Ltd.		(417)		(417)
Interest expense	(23)	(72)	(47)	(143)
Interest income and other, net	45	30	(1)	134
Loss before income taxes	(3,242)	(4,743)	(4,834)	(6,086)
Provision for (benefit from) income taxes	(15)		(11)	34
Net loss	\$ (3,227)	\$ (4,743)	\$ (4,823)	\$ (6,120)
Net loss per share:				
Basic	\$ (0.11)	\$ (0.16)	\$ (0.16)	\$ (0.21)
Diluted	\$ (0.11)	\$ (0.16)	\$ (0.16)	\$ (0.21)
Weighted average shares:				
Basic	30,081	29,589	29,994	29,498
Diluted	30,081	29,589	29,994	29,498

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

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QUICKLOGIC CORPORATION
CONDENSED UNAUDITED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value amount)

	June 28, 2009	December 28, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 16,450	\$ 19,376
Short-term investment in Tower Semiconductor Ltd.	286	116
Accounts receivable, net of allowances for doubtful accounts of \$10 and \$10, respectively	1,468	1,746
Inventories	2,042	1,900
Other current assets	721	833
Total current assets	20,967	23,971
Property and equipment, net	3,465	3,493
Investment in Tower Semiconductor Ltd.	144	59
Other assets	676	903
TOTAL ASSETS	\$ 25,252	\$ 28,426
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Revolving line of credit	\$ 2,000	\$ 2,000
Trade payables	2,224	1,992
Accrued liabilities	1,580	1,537
Deferred income on shipments to distributors	11	282
Current portion of debt and capital lease obligations	612	753
Total current liabilities	6,427	6,564
Long-term liabilities:		
Debt and capital lease obligations, less current portion	390	
Total liabilities	6,817	6,564
Commitments and contingencies (see Notes 12 and 13)		
Stockholders' equity:		
Common stock, \$0.001 par value; 100,000 shares authorized; 30,253 and 29,909 shares issued and outstanding, respectively	30	30
Additional paid-in capital	170,987	169,846
Accumulated other comprehensive income	255	
Accumulated deficit	(152,837)	(148,014)
Total stockholders' equity	18,435	21,862
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 25,252	\$ 28,426

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

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QUICKLOGIC CORPORATION

CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended	
	June 28, 2009	June 29, 2008
Cash flows from operating activities:		
Net loss	\$ (4,823)	\$ (6,120)
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation and amortization	914	1,182
Loss on disposal of property and equipment		15
Stock-based compensation	951	1,582
Utilization of wafer credits from Tower Semiconductor Ltd.	213	148
Write-down of inventories	236	1,128
Long-lived asset impairment		2,013
Write-down of marketable securities		417
Bad debt expense		43
Write-off of long-lived asset	13	
Changes in assets and liabilities:		
Accounts receivable	278	208
Inventories	(378)	1,651
Other assets	228	305
Trade payables	43	(2,720)
Accrued liabilities	43	(219)
Deferred income on shipments to distributors	(271)	
Net cash used for operating activities	(2,553)	(367)
Cash flows from investing activities:		
Capital expenditures for property and equipment	(46)	(363)
Net cash used for investing activities	(46)	(363)
Cash flows from financing activities:		
Payment of debt and capital lease obligations	(2,517)	(1,247)
Proceeds from debt obligations	2,000	
Proceeds from issuance of common stock	190	109
Net cash used for financing activities	(327)	(1,138)
Net decrease in cash and cash equivalents	(2,926)	(1,868)
Cash and cash equivalents at beginning of period	19,376	20,868
Cash and cash equivalents at end of period	\$ 16,450	\$ 19,000
Supplemental disclosures of cash flow information:		
Interest paid	\$ 40	\$ 148
Income taxes paid	\$	\$ 16
Supplemental schedule of non-cash investing and financing activities :		
Capital lease obligation to finance capital expenditures and related maintenance	\$ 632	\$
Purchase of equipment included in accounts payable	\$ 189	\$

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements

Table of Contents**QUICKLOGIC CORPORATION****CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(in thousands)**

	Three Months Ended		Six Months Ended	
	June 28, 2009	June 29, 2008	June 28, 2009	June 29, 2008
Net loss	\$ (3,227)	\$ (4,743)	\$ (4,823)	\$ (6,120)
Other comprehensive gain (loss), net of tax:				
Unrealized gain (loss) on available-for-sale investments	134	161	255	(350)
Total comprehensive loss	(3,093)	(4,582)	(4,568)	(6,470)

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 The Company and Basis of Presentation

QuickLogic Corporation, referenced herein as QuickLogic or the Company, was founded in 1988 and reincorporated in Delaware in 1999. The Company develops and markets low power programmable solutions that enable customers to add differentiated features and capabilities to their mobile, consumer and industrial products. The Company is a fabless semiconductor company that operates in a single industry segment where it designs, markets and supports Customer Specific Standard Products, or CSSPs, Field Programmable Gate Arrays, or FPGAs, application solutions, associated design software and programming hardware.

The accompanying interim consolidated financial statements are unaudited. In the opinion of management, these statements have been prepared in accordance with generally accepted accounting principles, or GAAP, and include all adjustments, consisting only of normal recurring adjustments, necessary to provide a fair statement of results for the interim periods presented. The Company recommends that these consolidated financial statements be read in conjunction with the Company's Form 10-K for the year ended December 28, 2008. Operating results for the three and six months ended June 28, 2009 are not necessarily indicative of the results that may be expected for the full year.

QuickLogic's fiscal year ends on the Sunday closest to December 31. QuickLogic's second fiscal quarter for 2009 and 2008 ended Sunday, June 28, 2009 and June 29, 2008, respectively.

Subsequent events have been disclosed through August 7, 2009, the date of the issuance of these Condensed Unaudited Consolidated Financial Statements.

Liquidity

We have financed our operating losses and capital investments through sales of common stock, private equity investments, capital and operating leases, bank lines of credit and cash flow from operations. As of June 28, 2009, our principal sources of liquidity consisted of our cash and cash equivalents of \$16.4 million, available credit under our revolving line of credit with Silicon Valley Bank of \$4.0 million, and our investment in Tower with a market value of approximately \$430,000. As of June 28, 2009, there is no material difference between the fair value and the carrying amount of the debt outstanding under the Company's line of credit and capital leasing arrangements.

The Company anticipates that its existing cash resources will fund operations, finance purchases of capital equipment and provide adequate working capital for the next twelve months. The Company's liquidity is affected by many factors including, among others, the level of revenue and gross profit as a result of the cyclical nature of the semiconductor industry and the current global economic crisis, the conversion of design opportunities into revenue, market acceptance of existing and new products including CSSPs based on our ArcticLink and PolarPro® solution platforms, fluctuations in revenue as a result of product end-of-life, fluctuations in revenue as a result of the stage in the product life cycle of its

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customers' products, costs of securing access to and availability of adequate manufacturing capacity, levels of inventories, wafer purchase commitments, customer credit terms, the amount and timing of research and development expenditures, the timing of new product introductions, production volumes, product quality, sales and marketing efforts, the value and liquidity of its investment portfolio, the amount and financing arrangements for purchases of capital equipment, changes in operating assets and liabilities, the ability to obtain or renew debt financing and to remain in compliance with the terms of existing credit facilities, the ability to raise funds from the sale of shares of Tower Semiconductor Ltd., or Tower, and equity in the Company, the issuance and exercise of stock options and participation in the Company's employee stock purchase plan, and other factors related to the uncertainties of the industry and global economics. Accordingly, there can be no assurance that events in the future will not require the Company to seek additional capital or, if so required, that such capital will be available on terms acceptable to the Company.

Principles of Consolidation

The consolidated financial statements include the accounts of QuickLogic Corporation and its wholly owned subsidiaries, QuickLogic International, Inc., QuickLogic Canada Company, QuickLogic Kabushiki Kaisha and QuickLogic Software (India) Private Ltd. The Company and its subsidiaries use the U.S. dollar as its functional currency. All intercompany accounts and transactions are eliminated in consolidation.

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Foreign Currency

The functional currency of the Company's non-U.S. operations is the U.S. dollar. Accordingly, all monetary assets and liabilities of these foreign operations are translated into U.S. dollars at current period-end exchange rates and non-monetary assets and related elements of expense are translated using historical rates of exchange. Income and expense elements are translated to U.S. dollars using average exchange rates in effect during the period. Gains and losses from the foreign currency transactions of these subsidiaries are recorded as interest income and other, net in the statement of operations.

Uses of Estimates

The preparation of these consolidated financial statements in conformity with generally accepted accounting principles, or GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates, particularly in relation to revenue recognition, the allowance for doubtful accounts, sales returns, valuation of investments, valuation of long-lived assets, valuation of inventories including identification of excess quantities, market value and obsolescence, measurement of stock-based compensation awards, accounting for income taxes and measuring accrued liabilities.

Concentration of Risk

The Company's accounts receivable are denominated in U.S. dollars and are derived primarily from sales to customers located in North America, Europe and Asia Pacific. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. See Note 11 for information regarding concentrations associated with accounts receivable. The Company's investment in Tower is subject to equity risk. See Note 4 for information regarding the Company's investment in Tower Semiconductor Ltd.

Note 2 Significant Accounting Policies

There have been no material changes in the Company's significant accounting policies for the second quarter of 2009 from its disclosure in the Annual Report on Form 10-K for the year ended December 28, 2008, except as described below. For a discussion of the significant accounting policies, please see the Annual Report on Form 10-K for the fiscal year ended December 28, 2008 filed with the Securities Exchange Commission, or SEC, on March 11, 2009.

Revenue Recognition

The Company supplies standard products which must be programmed before they can be used in an application. The Company's products may be programmed by the Company, distributors, end-customers or third parties. Once programmed, the Company's parts cannot be erased and, therefore, programmed parts are only useful to a specific customer.

The Company generally recognizes revenue as products are shipped if evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, collection of the resulting receivable is reasonably assured and product returns are reasonably estimable.

Revenue is recognized upon shipment of both programmed and unprogrammed parts to original equipment manufacturer, or OEM, customers, provided that legal title and risk of ownership have transferred.

A significant portion of our sales is made through distributors. In the case of programmed parts and unprogrammed, end-of-life products, it is the Company's practice to agree upon the sales price with a distributor prior to shipment. Furthermore, distributors are not allowed any future price adjustments and have no rights of return. Accordingly, the sales price is fixed or determinable and revenue is recognized upon shipment if persuasive evidence of an arrangement exists, delivery has occurred, collection of the resulting receivable is reasonably assured and title and risk of loss have been transferred.

Until the first quarter of 2009 in the case of unprogrammed, other than end-of-life parts, which may be used by multiple end-customers, the distribution agreements allowed for rights of return and post shipment price adjustments such as Ship from Stock and Debits, or SSDs. These rights of return and SSD provisions prevented us

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

from being able to reasonably estimate the final price of the inventory to be sold and the amount of inventory that could be returned pursuant to these agreements. As a result, the price to the customer was not fixed or determinable at the time we delivered products to our distributors. Accordingly, product revenue from sales made through those distributors was deferred until the distributors shipped the product to the end-customers. Deferred income on shipments to distributors reflected the amount of gross margin expected to be realized when distributors sell through these products purchased from the Company.

During the fourth quarter of 2008, the Company renegotiated the majority of its agreements with its distributors. Under the new agreements, post shipment price adjustments such as SSDs have been eliminated and parts held by distributors may only be returned for quality reasons under the Company's standard warranty policy. Revenue is recognized upon shipment of both programmed and unprogrammed parts to distributors if persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, collection of the resulting receivable is reasonably assured and risk of loss has been transferred. As of the end of the first quarter of 2009, all of the Company's distributors had signed the new agreements.

New Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board, or FASB, issued three FASB Staff Positions, or FSPs, related to fair value measurements, disclosures and other-than-temporary impairments. FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides additional guidance for estimating fair value in accordance with Statement of Financial Accounting Standard, or SFAS, No. 157 when the volume and level of activity for an asset or liability have significantly decreased. FSP FAS 157-4 also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, amends the other-than-temporary impairment guidance in U.S. GAAP to make the guidance more operational and to improve the presentation of other-than-temporary impairments in the financial statements. Finally, FSP FAS 107-1 and Accounting Principles Board, or APB, 28-1, *Interim Disclosures About Fair Value of Financial Instruments*, amends SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments in interim financial statements as well as in annual financial statements and also amends APB Opinion No. 28, *Interim Financial Reporting*, to require those disclosures in all interim financial statements. These FSPs are effective for periods ending after June 15, 2009. Early adoption is permitted for periods ending after March 15, 2009. The Company adopted the FSPs during the second quarter of 2009. The FSPs have no impact on the Company's consolidated results of operations or financial condition.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*, which established general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This standard required the Company to disclose the date through which the Company has evaluated subsequent events and the basis for the date. This standard was effective for interim periods which ended after June 15, 2009. See Note 1, *Basis of Presentation*, for disclosure of the date to which subsequent events are disclosed and Note 15, *Subsequent Events*, for disclosure of subsequent events.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* a replacement of FASB Statement No. 162. SFAS No. 168 replaces SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, and establishes the FASB Accounting Standards Codification, or Codification, as the source of authoritative

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accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles in the United States. All guidance contained in the Codification carries an equal level of authority. On the effective date of SFAS No. 168, the Codification superseded all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. SFAS No. 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company has evaluated this new statement, and determined that it will not have a significant impact on the determination or reporting of our financial results.

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3 Net Loss Per Share

Basic net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share was computed using the weighted average number of common shares outstanding during the period plus potentially dilutive common shares outstanding during the period under the treasury stock method. In computing diluted net loss per share, the average stock price for the period is used in determining the number of shares assumed to be purchased from the exercise of stock options.

For the second quarter and first half of 2009 and 2008, 9.5 million and 8.2 million shares, respectively, associated with equity awards outstanding and the estimated number of shares to be purchased under the current offering period of the 2009 Employee Stock Purchase Plan were not included in the calculation of diluted net loss per share, as they were considered antidilutive due to the net loss the Company experienced during these periods.

Note 4 Investment in Tower Semiconductor Ltd.

On December 12, 2000, the Company entered into several agreements with Tower, as amended, under which the Company agreed to make a strategic investment in Tower of up to \$25 million as part of Tower's plan to build and equip a new wafer fabrication facility. During 2001 and 2002, the Company paid a total of \$21.3 million to Tower to fulfill its investment requirements under the agreement. In partial consideration for the investment, the Company received 1,757,368 Tower ordinary shares with an original cost of \$16.6 million. The Company sold approximately 413,000 of the Tower ordinary shares in fiscal 2003.

During 2008 the Company wrote down the value of its investment in Tower shares by \$1.4 million due to an other than temporary decline in market value, resulting in a carrying value of \$0.13 per share for the period ended December 28, 2008. This determination included factors such as market value and the period of time that the market had been below the carrying value of the shares.

As of June 28, 2009, the Company held 1,344,543 available-for-sale Tower ordinary shares with an unrealized gain of \$255,000 recorded in accumulated other comprehensive income on the balance sheet, representing the difference between the carrying value per share and \$0.32 per share, their market value on the last trading day of the reporting period. Pursuant to SFAS 157, the fair value of the Company's marketable securities as of June 28, 2009 was determined based on Level 1 inputs as described in Note 7. The Company plans to continue to hold 450,000 of the Tower ordinary shares in order to receive preferred product pricing under the agreements with Tower and has recorded these shares as a long-term investment on the balance sheets. The remaining 894,543 shares are classified as a short-term investment on the balance sheets.

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During the years of 2001 and 2002, the Company also received \$4.7 million in prepaid wafer credits in partial consideration for the investment. During 2008, the Company assessed the value of its Tower wafer credit and incurred a long-lived asset impairment of \$1.3 million. As of June 28, 2009, the prepaid wafer credits balance was \$634,000. The Company has guaranteed capacity at Tower through at least 2010. These credits are recorded within long-term other assets on the balance sheets and can be applied toward wafer purchases from Tower at 15% of the value of purchases made through 2010.

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 5 Balance Sheet Components

	June 28, 2009		December 28, 2008
	(in thousands)		
Inventories:			
Raw materials	\$	8	\$ 75
Work-in-process		1,809	1,579
Finished goods		225	246
	\$	2,042	\$ 1,900
Other current assets:			
Prepaid expenses	\$	575	\$ 743
Other		146	90
	\$	721	\$ 833
Property and equipment:			
Equipment	\$	13,563	\$ 13,881
Software		8,696	8,030
Furniture and fixtures		781	840
Leasehold improvements		800	800
		23,840	23,551
Accumulated depreciation and amortization		(20,375)	(20,058)
	\$	3,465	\$ 3,493
Other assets:			
Prepaid wafer credits	\$	634	\$ 846
Other		42	57
	\$	676	\$ 903
Accrued liabilities:			
Employee related accruals	\$	983	\$ 1,047
Other		597	490
	\$	1,580	\$ 1,537

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6 Obligations

	June 28, 2009		December 28, 2008
	(in thousands)		
Debt and capital lease obligations:			
Revolving line of credit	\$	2,000	\$ 2,000
Capital leases		1,002	753
		3,002	2,753
Current portion of debt and capital lease obligations		(2,612)	(2,753)
	\$	390	\$

Revolving Line of Credit

Effective August 2008, the Company amended its Second Amended and Restated Loan and Security Agreement with Silicon Valley Bank. Terms of the amended agreement include a \$6.0 million revolving line of credit available through June 2010, as long as the Company is in compliance with the loan covenants. Upon each advance, the Company can elect a variable interest rate, which is the greater of six percent or the prime rate plus one percent, or a fixed rate which is LIBOR plus 3.50%. During the second quarter of 2009, the Company repaid \$2.0 million of revolving debt and borrowed \$2.0 million of revolving debt with a variable interest rate of 6.0% as of June 28, 2009.

The bank has a first priority security interest in substantially all of the Company's tangible and intangible assets to secure any outstanding amounts under the agreement. Under the terms of the agreement, except as noted above, the Company must maintain a minimum tangible net worth and adjusted quick ratio. The agreement also has certain restrictions including, among others, on the incurrence of other indebtedness, the maintenance of depository accounts, the disposition of assets, mergers, acquisitions, investments, the granting of liens and the payment of dividends. The Company was in compliance with the financial covenants of the agreement as of the end of the current reporting period.

Capital Leases

In 2007, the Company leased design software and related maintenance under a two year capital lease at an imputed interest rate of 7.1% per annum. Terms of the agreement require the Company to make quarterly payments of approximately \$190,000 through November 2009. The Company recorded a capital asset of \$1.2 million and prepaid maintenance of \$256,000 that is being amortized over the term of the agreement and a capital lease obligation of \$1.4 million. As of June 28, 2009, \$370,000 was outstanding under the capital lease, all of which was classified as a current liability.

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In January 2009, the Company leased design software tools and related maintenance under a three-year capital lease at an imputed interest rate of 5.75% per annum. Terms of the agreement require the Company to make semi-annual payments of approximately \$138,000 through August 2011, for a total of approximately \$825,000 over the three years period. As of June 28, 2009, \$632,000 was outstanding under the capital lease, of which \$242,000 was classified as a current liability.

Note 7 Fair Value Measurements

Effective December 31, 2007, the Company adopted the provisions of SFAS No. 157, *Fair Value Measurements*, as amended by FSP FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*, and FSP FAS 157-2, *Effective Date of FASB Statement No. 157*. The adoption of this standard in fiscal 2008 was limited to financial assets and liabilities. The adoption of SFAS 157

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

did not have a material effect on the Company's financial condition or results of operations. The Company adopted FSP FAS 157-2 with respect to the Company's non-financial assets and liabilities on December 29, 2008, and the adoption did not have an effect on its consolidated financial statements.

SFAS No. 157 specifies a hierarchy of valuation techniques based upon whether the inputs to those valuation techniques reflect assumptions other market participants would use based upon market data obtained from independent sources (observable inputs) or reflect the company's own assumption of market participant valuation (unobservable inputs). The fair value hierarchy consists of the following three levels:

- *Level 1* Inputs are quoted prices in active markets for identical assets or liabilities.

- *Level 2* Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable and market-corroborated inputs which are derived principally from or corroborated by observable market data.

- *Level 3* Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable.

The following table presents the Company's financial assets that are measured at fair value on a recurring basis as of June 28, 2009 consistent with the fair value hierarchy provisions of SFAS No. 157 (in thousands):

	Total	As of June 28, 2009			Total	As of December 28, 2008		
		Level 1	Level 2	Level 3		Level 1	Level 2	Level 3
Assets:								
Money market funds								
(1)	\$ 12,714	\$ 12,714	\$	\$	\$ 19,376	\$ 19,376	\$	\$
Investment in Tower Semiconductor Ltd.	430	430			175	175		
Total assets	\$ 13,144	\$ 13,144	\$	\$	\$ 19,551	\$ 19,551	\$	\$

(1) Money market funds are presented as a part of cash and cash equivalents on the accompanying consolidated balance sheets.

The Company does not have any financial liabilities that are subject to the provision of SFAS No. 157.

Note 8 Employee Stock Plans

1989 Stock Option Plan

The 1989 Stock Option Plan, or 1989 Plan, provided for the issuance of incentive and nonqualified options for the purchase of up to 4.6 million shares of common stock. Options granted under the 1989 Plan have a term of up to ten years, and typically vest at a rate of 25% of the total grant per year over a four year period. In September 1999, the Company adopted the 1999 Stock Plan and no further stock option grants were made under the 1989 Plan.

1999 Stock Plan

The 1999 Stock Plan, or 1999 Plan, provided for the issuance of incentive and nonqualified options, restricted stock units and restricted stock. Equity awards granted under the 1999 Plan have a term of up to ten years. Options typically vest at a rate of 25% one year after the vesting commencement date, and one forty-eighth for each month of service thereafter. In March 2009, the Board adopted the 2009 Stock Plan which was approved by the

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Company's stockholders on April 22, 2009. Effective April 22, 2009, no further stock options may be granted under the 1999 Plan.

2009 Stock Plan

The 2009 Stock Plan, or 2009 Plan, was adopted by the Board of Directors in March 2009 and approved by the Company's stockholders on April 22, 2009. As of June 28, 2009, approximately 2.5 million shares were reserved for issuance under the 2009 Plan. Equity awards that are cancelled, forfeited or repurchased under the 1999 Plan also become available for grant under the 2009 Plan, up to a maximum of an additional 7,500,000 shares. Equity awards granted under the 2009 Plan have a term of up to ten years. Options typically vest at a rate of 25% one year after the vesting commencement date, and one forty-eighth for each month of service thereafter. The Company may implement different vesting schedules in the future with respect to any new equity awards.

Employee Stock Purchase Plan

The 1999 Employee Stock Purchase Plan, or 1999 ESPP, was adopted by the Board of Directors in August 1999 and was approved by the Company's stockholders in September 1999. The 1999 ESPP provided for standard six month offering periods.

In April 2009, the Company adopted the 2009 Employee Stock Purchase Plan, or 2009 ESPP, and the last purchase under the 1999 ESPP was made on May 15, 2009. The 2009 ESPP, was adopted by the Board of Directors in March 2009 and approved by the Company's stockholders in April 2009. 2.3 million shares have been reserved for issuance under the 2009 ESPP. The 2009 ESPP provides for six month offering periods. Participants purchase shares through payroll deductions of up to 20% of an employee's total compensation (maximum of 20,000 shares per offering period). The 2009 ESPP permits the Board of Directors to determine, prior to each offering period, whether participants purchase shares at: (i) 85% of the fair market value of the common stock at the end of the offering period; or (ii) 85% of the lower of the fair market value of the common stock at the beginning or the end of an offering period. The Board of Directors has determined that, until further notice, future offering periods will be made at 85% of the lower of the fair market value of the common stock at the beginning or the end of an offering period.

Note 9 Stock-Based Compensation

Under SFAS 123(R), stock-based compensation expense is recognized in the Company's consolidated statements of operations and includes: (i) compensation expense for stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated and re-measured upon modification in accordance with the pro forma provisions of SFAS 123, and (ii) compensation expense for the stock-based compensation awards granted or modified subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). The impact of SFAS 123(R) on the Company's consolidated financial statements for the second quarter and first half of 2009 and 2008 was as follows (in thousands):

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	Three Months Ended		Six Months Ended	
	June 28, 2009	June 29, 2008	June 28, 2009	June 29, 2008
Cost of revenue	\$ 71	\$ 106	\$ 122	\$ 171
Research and development	138	196	226	354
Selling, general and administrative	358	615	603	1,057
Total costs and expenses	\$ 567	\$ 917	\$ 951	\$ 1,582

The amount of stock-based compensation included in inventories as of June 28, 2009 and December 28, 2008 was not significant.

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Valuation Assumptions

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

	Three Months Ended		Six Months Ended	
	June 28, 2009	June 29, 2008	June 28, 2009	June 29, 2008
Expected term (years)	5.15	6.28	5.14	5.65
Risk-free interest rate	1.98%	3.16%	1.97%	2.91%
Expected volatility	51.04%	55.95%	51.00%	52.77%
Expected dividend				

The weighted average estimated fair value for options granted during the second quarter of 2009 and 2008 was \$0.75 and \$1.39 per option, respectively. The weighted average estimated fair value for options granted during the first half of 2009 and 2008 was \$0.74 and \$1.40 per option, respectively. As of June 28, 2009, the fair value of unvested stock options, net of expected forfeitures, was approximately \$4.1 million. This unrecognized stock-based compensation expense is expected to be recorded over a weighted average period of 2.94 years.

Stock-Based Compensation Award Activity

The following table summarizes the shares available for grant under the 2009 Plan for the first half of 2009:

	Shares Available for Grant (in thousands)
Balance at December 28, 2008	8,313
Authorized	2,500
Options granted	(2,095)
Options forfeited or expired	(6,964)
RSAs granted	
RSUs granted	
RSUs forfeited or expired	599
Balance at June 28, 2009	2,353

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Options

The following table summarizes stock options outstanding and stock option activity under the 1989 Plan, the 1999 Plan and the 2009 Plan, and the related weighted average exercise price, for the first half of 2009:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Term (in years)	Aggregate Intrinsic Value (in thousands)
Balance outstanding at December 28, 2008	7,367	\$ 4.13		
Granted	2,095	1.60		
Forfeited or expired	(416)	3.28		
Exercised				
Balance outstanding at June 28, 2009	9,046	\$ 3.58	6.56	\$ 573
Exercisable at June 28, 2009	4,754	\$ 5.10	4.20	\$ 13
Vested and expected to vest at June 28, 2009	9,046	\$ 3.58	6.56	\$ 573

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on the Company's closing stock price of \$1.37 as of the end of the Company's current reporting period, which would have been received by the option holders had all option holders exercised their options as of that date.

There were no stock option exercises during the first half of 2009. The total intrinsic value of options exercised during the first half of 2008 was \$30,000. Total cash received from employees as a result of employee stock option exercises during the first half of 2008 was approximately \$96,000. The Company settles employee stock option exercises with newly issued common shares. In connection with these exercises, there was no tax benefit realized by the Company due to its current loss position.

Restricted Stock Awards and Restricted Stock Units

The Company began issuing RSAs in the second quarter of 2007 and RSUs in the third quarter of 2007 under the 1999 Plan. RSAs entitle the holder to purchase shares of common stock at par value during a short period of time, and purchased shares are held in escrow until they vest. RSUs entitle the holder to receive, at no cost, one common share for each restricted stock unit as it vests. A summary of the Company's RSA and RSU activity and related information are as follows:

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	RSAs and RSUs Outstanding		
	Number of Shares (in thousands)		Weighted Average Grant Date Fair Value
Nonvested at December 28, 2008	654	\$	3.35
Granted			
Vested			
Forfeited	(599)		3.57
Nonvested at June 28, 2009	55	\$	0.96

As of June 28, 2009, the unrecognized stock-based compensation expense related to outstanding performance based RSUs which are not currently expected to vest, was \$15,000. The Company will recognize this expense to the extent it determines these performance based RSUs are likely to vest.

Employee Stock Purchase Plan

Under the 2009 ESPP, the Company issued 343,491 shares at a price of \$0.55 per share during the six months ended June 28, 2009. As of June 28, 2009, 2,300,000 shares under the 2009 ESPP remained available for issuance. For the three and six months ended June 28, 2009, the Company recorded compensation expense related to the ESPP of \$105,000 and \$127,000, respectively.

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The fair value of rights issued pursuant to the Company's ESPP was estimated on the commencement date of each offering period using the following weighted average assumptions:

	Three Months Ended		Six Months Ended	
	June 28, 2009	June 29, 2008	June 28, 2009	June 29, 2008
Expected term (months)	6.00	6.00	6.00	6.00
Risk-free interest rate	0.29%	3.56%	0.29%	3.56%
Expected volatility	126.98%	49.57%	126.98%	49.57%
Expected dividend				

As of June 28, 2009, the unrecognized stock-based compensation expense relating to the Company's ESPP was \$109,000 and is expected to be recognized over a weighted average period of approximately 4.5 months.

Note 10 Income Taxes

In the second quarter of 2009 and 2008, the Company recorded an income tax benefit of \$15,000 and \$0, respectively, which consisted primarily of income taxes on foreign operations offset by the monetization of prior year federal research credits. In the first half of 2009 and 2008, the Company recorded an income tax benefit of \$11,000 and an income tax expense of \$34,000, respectively, which consisted primarily of income taxes on foreign operations offset by the monetization of prior year federal research credits.

Due to the uncertainties surrounding the realization of the deferred tax assets resulting from the Company's accumulated deficit and net tax losses in previous years, the Company has provided a full valuation allowance against the associated deferred tax assets. The Company will continue to assess the realizability of the deferred tax assets in future periods.

The Company had approximately \$68,000 and \$66,000 of unrecognized tax benefits at June 28, 2009 and December 28, 2008, respectively. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of June 28, 2009, the Company had approximately \$11,000 of accrued interest and penalties related to uncertain tax positions.

The Company is no longer subject to U.S. federal, state and non-U.S. income tax audits by taxing authorities for fiscal years through 1992. The Company estimates that any unrecognized tax benefit will not change significantly within the next twelve months.

Note 11 Information Concerning Product Lines, Geographic Information and Revenue Concentration

The Company identifies its business segments based on business activities, management responsibility and geographic location. For all periods presented, the Company operated in a single business segment.

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a breakdown of revenue by product line (in thousands):

	Three Months Ended		Six Months Ended	
	June 28, 2009	June 29, 2008	June 28, 2009	June 29, 2008
<i>Revenue by product line</i>				
<i>(1):</i>				
New products	\$ 816	\$ 2,564	\$ 1,474	\$ 5,162
Mature products	1,879	4,591	5,485	8,915
End-of-life products	216	1,588	504	5,689
Total revenue	\$ 2,911	\$ 8,743	\$ 7,463	\$ 19,766

(1) For all periods presented: New products include ArcticLink, PolarPro II, PolarPro, Eclipse II and QuickPCI® II products. Mature products include pASIC® 3, QuickRAM®, Eclipse, QuickDSP and QuickFC products, as well as royalty revenue, programming hardware and software. End-of-life products include pASIC 1, pASIC 2, V3, QuickMIPS and QuickPCI products.

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

	Three Months Ended		Six Months Ended	
	June 28, 2009	June 29, 2008	June 28, 2009	June 29, 2008
<i>Revenue by geography:</i>				
United States	\$ 1,245	\$ 3,148	\$ 3,455	\$ 7,691
Europe	564	1,376	1,561	3,145
Taiwan	16	1,917	11	3,976
Japan	449	684	815	1,558
China	353	940	673	2,176
Rest of North America	111	172	328	557
Rest of Asia Pacific	173	506	620	663
Total revenue	\$ 2,911	\$ 8,743	\$ 7,463	\$ 19,766

The following distributors and customers accounted for 10% or more of the Company's revenue for the periods presented:

	Three Months Ended		Six Months Ended	
	June 28, 2009	June 29, 2008	June 28, 2009	June 29, 2008
Distributor A	19%	11%	25%	14%
Distributor B	20%	*	16%	13%
Distributor C	11%	*	*	*

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Customer A	*	21%	*	19%
Customer B	*	17%	14%	12%

* Represents less than 10% of revenue for the period presented.

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The following distributors and customers accounted for 10% or more of the Company's accounts receivable as of the dates presented:

	June 28, 2009	December 28, 2008
Distributor A	16%	20%
Distributor B	19%	*
Distributor C	11%	13%
Distributor D	*	12%
Distributor E	10%	*

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

As of June 28, 2009, less than 10% of the Company's long-lived assets, including property and equipment and other assets, were located outside the United States.

Note 12 Commitments and Contingencies

Certain of the Company's wafer manufacturers require the Company to forecast wafer starts several months in advance. The Company is committed to take delivery of and pay for a portion of forecasted wafer volume. As of June 28, 2009 and December 28, 2008, the Company had \$3.5 million and \$4.8 million, respectively, of outstanding commitments for the purchase of wafer inventory.

The Company leases, with an option to renew, its primary facility under a non-cancelable operating lease that expires in 2012. In addition, the Company rents development facilities in Canada and India as well as sales offices in Europe and Asia. Total rent expense for the second quarter of 2009 and 2008 was approximately \$145,000 and \$180,000, respectively, and rent expense for the first half of 2009 and 2008 was approximately \$290,000 and \$360,000, respectively.

Future minimum lease commitments under the Company's operating leases, and excluding property taxes and insurance are as follows:

	Operating Leases
	(in thousands)
<u>Fiscal Years</u>	

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Rest of 2009	\$	297
2010		429
2011		396
2012		396
2013 and thereafter		
	\$	1,518

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 13 Litigation

On October 26, 2001, a putative securities class action was filed in the U.S. District Court for the Southern District of New York against certain investment banks that underwrote QuickLogic's initial public offering, QuickLogic and some of QuickLogic's officers and directors. The complaint alleges excessive and undisclosed commissions in connection with the allocation of shares of common stock in QuickLogic's initial and secondary public offerings and artificially high prices through tie-in arrangements which required the underwriters' customers to buy shares in the aftermarket at pre-determined prices in violation of the federal securities laws. Plaintiffs seek an unspecified amount of damages on behalf of persons who purchased QuickLogic's stock pursuant to the registration statements between October 14, 1999 and December 6, 2000. Various plaintiffs have filed similar actions asserting virtually identical allegations against over 300 other public companies, their underwriters, and their officers and directors arising out of each company's public offering. These actions, including the action against QuickLogic, have been coordinated for pretrial purposes and captioned *In re Initial Public Offering Securities Litigation, 21 MC 92*.

In June 2004, a stipulation of settlement and release of claims against the issuer defendants, including QuickLogic, was submitted to the court for approval. On August 31, 2005, the Court preliminarily approved the settlement. In December 2006, the appellate Court overturned the certification of classes in the six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceedings. Because class certification was a condition of the settlement, it was unlikely that the settlement would receive final Court approval. On June 25, 2007, the Court entered an order terminating the proposed settlement based upon a stipulation among the parties to the settlement. Plaintiffs have filed amended master allegations and amended complaints, in the six test cases. On March 26, 2008, the Court denied the defendants' motion to dismiss the amended complaints.

The parties recently reached a global settlement of the litigation. On June 9, 2009, the Court issued an order granting preliminary approval of the settlement. The final approval hearing has been set for September 10, 2009. Under the settlement, the insurers would pay the full amount of settlement share allocated to the Company, and the Company would bear no financial liability. The Company, as well as the officer and director defendants who were previously dismissed from the action pursuant to tolling agreements, would receive complete dismissals from the case. If the settlement does not receive final Court approval, and litigation against the Company continues, the Company believes it has meritorious defenses and intends to defend the action vigorously.

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

From time to time, the Company is involved in legal actions arising in the ordinary course of business, including but not limited to intellectual property infringement and collection matters. Absolute assurance cannot be given that third party assertions will be resolved without costly litigation in a manner that is not adverse to the Company's financial position, results of operations or cash flows or without requiring royalty or other payments in the future which may adversely impact gross profit.

Table of Contents**QUICKLOGIC CORPORATION****NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 14 Restructuring Charges**

In April 2008, the Company decided to outsource certain development functions that were previously performed in-house. This reorganization resulted in a headcount reduction of approximately 13% of employees worldwide. In June 2008, the Company announced the completion of its CSSP focused operational realignment which included an additional 17% reduction in headcount worldwide, resulting in a total reduction in worldwide headcount of approximately 30%. The purpose of the operational realignment is to lower fixed costs in order to conserve cash, to reduce the Company's break-even revenue level and enable a quicker return to profitability, to provide optimal profitability scaling with revenue growth and to provide greater headroom for discretionary costs to enable new product revenue growth. Our restructuring liabilities were included in the Accrued Liabilities line item in our consolidated balance sheets as of June 28, 2009 and December 28, 2008, and the remaining balance is expected to be paid by the end of fiscal year 2009.

	Restructuring Liabilities	
	(in thousands)	
Balance at December 28, 2008	\$	121
Payments		(73)
Balance at June 28, 2009	\$	48

Note 15 Subsequent Events

Effective in July 2009, the Company implemented an across the board salary reduction plan for the second half of 2009. As a result, all executives and most of the Company's employees will take a 10% reduction of cash based compensation and, in its place, receive RSUs that vest in two tranches over a four month period. Our Chief Executive Officer will take a 20% reduction in salary for the second half of 2009 and will receive RSUs on the same basis as the other employees.

Effective in the third quarter of 2009, the Board members will take a 20% reduction in their cash compensation and the Company will substitute the reduction amount with fully vested RSUs.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as information contained in Risk Factors in Part II, Item 1A and elsewhere in this Quarterly Report on Form 10-Q, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend that these forward-looking statements be subject to the safe harbors created by those provisions. Forward-looking statements are generally written in the future tense and/or are preceded by words such as will, may, should, forecast, could, expect, suggest, believe, anticipate, intend, plan, or other similar words. Forward-looking statements include statements regarding (1) the conversion of our design opportunities into revenue, (2) our revenue levels, including the commercial success of our Customer Specific Standard Products, or CSSPs, and new products, and the effect of our end-of-life products, (3) our liquidity, (4) our gross profit and factors that affect gross profit, (5) our level of operating expenses, (6) our research and development efforts, (7) our partners and suppliers and (8) industry trends. The following discussion should be read in conjunction with the attached condensed unaudited consolidated financial statements and notes thereto, and with our audited consolidated financial statements and notes thereto for the fiscal year ended December 28, 2008, found in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 11, 2009.

Overview

QuickLogic Corporation was founded in 1988 and reincorporated in Delaware in 1999. We develop and market low power customizable semiconductor solutions that enable customers to add differentiated features and capabilities to their mobile, prosumer (derived from the term professional consumer), consumer and industrial products. We are a fabless semiconductor company that operates in a single industry segment where we design, market and support primarily Customer Specific Standard Products, or CSSPs, and, secondarily, Field Programmable Gate Arrays, or FPGAs, associated design software and programming hardware. Our CSSPs are customized semiconductor building blocks created from our new solution platforms including ArcticLink® II, ArcticLink, PolarPro® II, PolarPro, Eclipse™ II and QuickPCI® II (all of which fall into our new product category); our mature product family includes pASIC® 3, QuickRAM®, Eclipse, and EclipsePlus, as well as royalty revenue, programming hardware and design software; our end-of-life product family includes pASIC 1, pASIC 2, V3, QuickMIPS, QuickPCI and QuickFC.

We are marketing CSSPs to Original Equipment Manufacturers, or OEMs, and Original Design Manufactures, or ODMs, offering differentiated mobile products. Our target mobile markets include:

- *Cellular* including multimedia and smartphones;
- *Computing* including Mobile Internet Devices, or MIDs, Netbooks, Smartbooks, Ultra Mobile PCs, or UMPCs, industrial personal digital assistants, or PDAs, handheld point-of-sales, or POS, terminals and broadband 3G data cards; and
- *Consumer Electronics* including portable media players, or PMPs, personal navigation devices, or PNDs, and wireless hard disk drives or wireless storage devices.

In addition to working directly with our customers, we partner with other companies with expertise in certain technologies to develop additional intellectual property, reference platforms and system software to provide application solutions. We also work with mobile processor manufacturers and companies that supply storage, networking or graphics components for embedded systems. The depth of these relationships varies depending on the partner and the dynamics of the end market being targeted, but is typically a co-marketing program that includes joint account calls, promotional activities and/or engineering collaboration and developments, such as reference designs.

During the second quarter we completed development, and released for manufacturing the latest in our family of VEE-enabled solution platforms - ArcticLink II, VX2 and VX4. The VX family embeds the second generation Visual Enhancement Engine, or VEE , Proven System Block (PSB), which improves the user s video viewing experience while extending system battery life by allowing reduction in the power used by a mobile device s single biggest consumer of power, the backlight. The VX4 platform also embeds the Qualcomm developed MDDI serial interface for ease of connection with their mobile processors. The VX2 platform also embeds an LCD Controller and optional CellularRAM frame buffer for storing display content. By embedding the frame buffer, the mobile processor can be powered down more frequently, saving previous energy and extending battery life. Both

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the VX2 and VX4 embed a programmable fabric for integrating additional PSBs that can reduce BOM cost, reduce PCB space, and can optimize system power consumption.

Although the semiconductor industry as a whole has seen a dramatic decline in 2009 with modest growth predicted in 2010, consumer products remain a strong driver for semiconductor sales. We believe that the target mobile markets for our CSSPs continue to provide growth potential. Trends in the rapidly growing sub-segments of the consumer market in which we participate include:

- **Mobile, Handheld Devices:** In 2008, more than 1.2 billion cellular phones, ranging from multimedia to ultra low cost phones, were sold (according to iSuppli, a market intelligence company). More importantly, iSuppli predicts that the smartphone segment of the overall cellular phone segment will increase 62% over the next three years, from 219 million units in 2008 to 356 million units, by the end of 2011. In fact, the smartphone segment is predicted to be one of the higher growth segments during the current economic downturn.
- **Netbook/Smartbook Category:** iSuppli predicts shipments of wirelessly-enabled netbooks will more than triple by 2012, rising to 36.3 million units, up from 10.3 million in 2008. This segment is largely driven by the desire for a consumer platform that combines the mobile computing and Internet experience of Notebooks with the day-long battery life of Multimedia and Smartphones.
- **USB-Based Broadband Data Card:** Mobile data service providers anticipate consumer demand for these data cards to reach nearly 40 million units in 2009, according to the market research firm ABI Research. These data cards enable consumers to connect their Notebook, Netbook, Smartbook or PC to the cellular network as a broadband internet connection. During our second quarter, QuickLogic announced the selection of a CSSP, based on the ArcticLink solution platform, for the Icera Espresso® 300 3G soft modem platform. Icera is a leader in software-defined wireless chipsets and is the only company to deliver software-based cellular modems for broadband data cards, USB sticks, and mobile internet devices. Icera's reference design uses a wafer-level chip scale (WLCSP) version of the ArcticLink solution platform to compliment its second-generation baseband chip design.

Underlying industry trends affecting the large market for mobile devices include the use of platforms to enable rapid product proliferation, the need for high bandwidth solutions enabling mobile Internet and streaming video, miniaturization and the need to increase battery life. Another important trend is shrinking product life cycles, which drives a need for faster, lower risk product development. There is intense pressure on the total product cost of these devices, including per unit component costs and non-recurring development costs. As more people experience the advantages of a mobile lifestyle at home, they demand the same advantages in their professional lives, and while they are on the go, or mobile. Therefore, we believe that these trends toward mobile, handheld products which have a small form factor and maximize battery life will also be evident in other segments such as industrial, medical and military.

Critical Accounting Estimates

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our consolidated financial statements. The SEC has defined critical accounting policies as those that are most important to the portrayal of our financial condition and results of operations and require us to make our most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, our critical policies include revenue recognition, valuation of inventories including identification of excess quantities and product obsolescence, allowance for doubtful accounts, valuation of investments,

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valuation of long-lived assets, measurement of stock-based compensation, accounting for income taxes, fair value measurements of financial assets and liabilities, and measuring accrued liabilities. We believe that we apply judgments and estimates in a consistent manner and that such consistent application results in consolidated financial statements and accompanying notes that fairly represent all periods presented. However, any factual errors or errors in these judgments and estimates may have a material impact on our statements of operations and financial condition. For a discussion of critical accounting policies and estimates, please see Item 7 in our Annual Report on Form 10-K for the fiscal year ended December 28, 2008 filed with the SEC on March 11, 2009.

Table of Contents**Results of Operations**

The following table sets forth the percentage of revenue for certain items in our statements of operations for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 28, 2009	June 29, 2008	June 28, 2009	June 29, 2008
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue (1)	54.6	45.5	45.7	46.7
Long-lived asset impairment		17.7		7.8
Gross profit	45.4	36.8	54.3	45.5
Operating expenses:				
Research and development	64.5	29.8	46.8	27.5
Selling, general and administrative	93.0	45.4	71.7	42.0
Long-lived asset impairment		5.4		2.4
Restructuring costs		5.2		2.3
Loss from operations	(112.1)	(49.0)	(64.2)	(28.7)
Write-down of investment in Tower Semiconductor Ltd.		(4.7)		(2.1)
Interest expense	(0.8)	(0.8)	(0.6)	(0.7)
Interest income and other, net	1.5	0.3		0.7
Loss before income taxes	(111.4)	(54.2)	(64.8)	(30.8)
Provision for (benefit from) income taxes	(0.5)		(0.1)	0.2
Net loss	(110.9)%	(54.2)%	(64.7)%	(31.0)%

(1) The second quarter of 2009 and 2008 includes \$58,000 and \$172,000, respectively, of costs for the write-down of inventories and related charges, which represents 2.0% and 2.0% of revenue, respectively. The first half of 2009 and 2008 includes \$236,000 and \$1.1 million, respectively, of costs for the write-down of inventories and related charges, which represents 3.2% and 5.7% of revenue, respectively.

Table of Contents**Three Months Ended June 28, 2009 and June 29, 2008***Revenue*

The table below sets forth the changes in revenue for the three months ended June 29, 2008 as compared to the three months ended June 28, 2009 (in thousands, except percentage data):

	Three Months Ended		June 29, 2008		Year-Over-Year Change	
	June 28, 2009	% of Total Revenues	June 29, 2008	% of Total Revenues		
	Amount		Amount			
New products	\$ 816	28%	\$ 2,564	29%	\$ (1,748)	(68)%
Mature products	1,879	65	4,591	53	(2,712)	(59)
End-of-life products	216	7	1,588	18	(1,372)	(86)
Total revenue	\$ 2,911	100%	\$ 8,743	100%	\$ (5,832)	(67)%

For all periods presented, new products include ArcticLink, PolarPro, Eclipse II and QuickPCI II products; mature products include pASIC 3, QuickRAM, Eclipse, QuickDSP and QuickFC products, as well as royalty revenue, programming hardware and design software; end-of-life products include pASIC 1, pASIC 2, V3, QuickMIPS and QuickPCI products.

The decline in revenue was due to declines in both our legacy and new product lines. The decline in new product revenue was caused by the expected end of life by the manufacturer of a product family of a personal navigation device, or PND, and by delays in new product production ramp-up with several major customers. The decline in mature product revenue resulted from the general economic slowdown. Our mature product revenue decreased as a result of lower customer demand for pASIC 3 and QuickRAM products. One of our U.S. customers, purchasing primarily pASIC 3 devices, accounted for 8% and 17% of total revenue in the second quarters of 2009 and 2008, respectively.

In order to grow our revenue from its current level, we are dependent upon increased revenue from our existing products, especially revenue from CSSPs designed using our ArcticLink and PolarPro solution platforms and the development of additional new products and CSSPs.

We continue to seek to expand our revenue, including the pursuit of high volume sales opportunities in the consumer market segment, by providing CSSPs incorporating intellectual property such as boot from managed NAND or industry standard interfaces such as USB 2.0 OTG, SDIO and integrated drive electronics, or IDE. Our industry is characterized by intense price competition and by lower margins as order volumes increase. While winning large volume sales opportunities will increase our revenue, we believe these opportunities may decrease our gross profit as a percentage of revenue.

Gross Profit

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The table below sets forth the changes in gross profit for the three months ended June 29, 2008 as compared to the three months ended June 28, 2009 (in thousands, except percentage data):

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	Three Months Ended					
	June 28, 2009			June 29, 2008		
	Amount	% of Total Revenues	Amount	% of Total Revenues	Year-Over-Year Change	
Revenue	\$ 2,911	100%	\$ 8,743	100%	\$ (5,832)	(67)%
Cost of revenue	1,589	55	3,982	46	(2,393)	(60)
Long-lived asset impairment			1,545	18	(1,545)	(100)%
Gross Profit	\$ 1,322	45%	\$ 3,216	36%	\$ (1,894)	(59)%

The decline in gross profit was mainly due to the decline in revenue in the second quarter of 2009 as compared to the second quarter of 2008. The second quarter 2009 gross profit decline was partially offset by the absence in the second quarter of 2009 of long-lived asset impairments which accounted for \$1.5 million of gross profit charges in the second quarter of 2008; a change in product mix towards mature products which carry higher gross margins than new products; and a reduction of excess and obsolescence provisions in the second quarter of 2009 as compared to the second quarter of 2008. The sale of previously reserved inventories contributed \$94,000, or 3.2% of revenue, to gross profit in the second quarter of 2009 and \$153,000, or 1.7% of revenue, in the second quarter of 2008.

Our semiconductor products have historically had a long product life cycle and obsolescence has not been a significant factor in the valuation of inventories. However, as we pursue opportunities in the mobile market and continue to develop new CSSPs and products, we believe our product life cycle will be shorter and increase the potential for obsolescence. We also regularly review the cost of inventories against estimated market value and record a lower of cost or market reserve for inventories that have a cost in excess of estimated market value, which could have a material impact on our gross margin and inventory balances based on additional write-downs to net realizable value or a benefit from inventories previously written down.

Operating Expenses

The table below sets forth the changes in operating expenses for the three months ended June 29, 2008 as compared to the three months ended June 28, 2009 (in thousands, except percentage data):

	Three Months Ended					
	June 28, 2009			June 29, 2008		
	Amount	% of Total Revenues	Amount	% of Total Revenues	Year-Over-Year Change	
R&D expense	\$ 1,877	64%	\$ 2,610	30%	\$ (733)	(28)%
SG&A expense	2,709	93	3,970	45	(1,261)	(32)
Long-lived asset impairment			468	5	(468)	(100)
Restructuring costs			452	5	(452)	(100)
Total operating expenses	\$ 4,586	157%	\$ 7,500	85%	\$ (2,914)	(39)%

Research and Development

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Our research and development expenses consist primarily of personnel, overhead and other costs associated with engineering process improvements, programmable logic design, ASSP design and software development. The decrease in R&D expenses results primarily from measures undertaken in the second quarter of 2008 to change certain development activities to an on-demand, outsourced model from an in-house, fixed cost model. As a result of this decision, our research and development staffing in Toronto, Canada was reduced during the second quarter of 2008. The \$0.7 million decrease in R&D expenses in the second quarter of 2009 as compared to the second quarter of 2008 is attributable primarily to a \$540,000 or 56% decrease in compensation expenses due to reduced headcount; a \$280,000 or 47% decrease in expense allocations to R&D such as facilities and other corporate costs; a \$60,000 or 30% decrease in stock based compensation expenses, and a \$30,000 or 64% decrease in travel and entertainment expenses, offset by an increase of \$230,000 or 51% in outside services.

Table of Contents*Selling, General and Administrative Expense*

Our selling, general and administrative expenses consist primarily of personnel and related overhead costs for sales, marketing, finance, administration, human resources and general management. The \$1.3 million quarter to quarter decrease in SG&A expenses resulted from our effort to realign resources with our expected revenue outlook and was primarily due to a \$430,000 or 24% decrease in compensation expenses as a result of headcount reductions; a \$520,000 or 48% decrease in outside services such as consulting, temporary help and legal, a \$110,000 or 21% decrease in occupancy costs including rent, utilities and insurance expenses, and \$260,000 or 42% decrease in stock based compensation expenses.

Long-Lived Assets Impairment

In the second quarter of 2008, we recorded a \$468,000 long-lived asset impairment charge to operating expenses as a result of our decision to outsource design implementation activity, which resulted in unutilized EDA software licenses. There were no long-lived asset impairment charges in the second quarter of 2009.

Restructuring Costs

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

Interest and Other Income (Expense), net

The table below sets forth the changes in Interest and Other Income (Expense), net, from the three months ended June 29, 2008 as compared to the three months ended June 28, 2009:

	Three Months Ended	
	June 28, 2009	June 29, 2008
	(in thousands)	
Write-down of investment in Tower Semiconductor Ltd.	\$	\$ (417)
Interest expense	(23)	(72)
Interest income and other, net	45	30
	\$	\$ (459)

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In the second quarter of 2008, we determined that our investment in Tower had suffered a decline in value that was determined to be other than temporary. This determination included factors such as market value and the period of time that the market value has been below the carrying value. Accordingly, we recorded a write-down of \$417,000 in the second quarter of 2008 based on the quoted market price of the stock on the last day of the reporting period. There were no write-downs of marketable securities in the second quarter of 2009.

The decrease in interest expense is due primarily to the reduction of our average debt obligation to \$3.1 million in the second quarter of 2009 from \$4.1 million in the second quarter of 2008. The decrease in interest income is due primarily to the drop in investment yields between the second quarter of 2008 and the second quarter of 2009.

We conduct a portion of our research and development activities in Canada and India and we have sales and marketing activities in various countries outside of the United States. Most of these international expenses are incurred in local currency. Foreign currency transaction gains and losses are included in interest income and other,

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net, as they occur. We do not use derivative financial instruments to hedge our exposure to fluctuations in foreign currency and, therefore, our results of operations are and will continue to be susceptible to fluctuations in foreign exchange gains or losses.

Provision for (Benefit from) Income Taxes

Three Months Ended
June 28, 2009 June 29, 2008
(in thousands)

Income tax provision (benefit)	\$	(15)	\$
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The income tax provision (benefit) for the second quarters of 2009 and 2008 are primarily for our foreign operations which are cost-plus entities offset by the monetization of prior year federal research credits. As of the end of the second quarter of 2009, our ability to utilize our income tax loss carryforwards in future periods is uncertain and, accordingly, we recorded a full valuation allowance against the related US tax benefit. We will continue to assess the realizability of deferred tax assets in future periods.

Six Months Ended June 28, 2009 and June 29, 2008

Revenue

The table below sets forth the changes in revenue for the six months ended June 29, 2008 as compared to the six months ended June 28, 2009 (in thousands, except percentage data):

	June 28, 2009		Six Months Ended June 29, 2008		Year-Over- Year Change	
	Amount	% of Total Revenues	Amount	% of Total Revenues		
New products	\$ 1,474	20%	\$ 5,162	26%	\$ (3,688)	(71)%
Mature products	5,485	73	8,915	45	(3,430)	(38)
End-of-life products	504	7	5,689	29	(5,185)	(91)
Total revenue	\$ 7,463	100%	\$ 19,766	100%	\$ (12,303)	(62)%

For all periods presented, new products include ArcticLink, PolarPro, Eclipse II and QuickPCI II products; mature products include pASIC 3, QuickRAM, Eclipse, QuickDSP and QuickFC products, as well as royalty revenue, programming hardware and design software; end-of-life products include pASIC 1, pASIC 2, V3, QuickMIPS and QuickPCI products.

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The decline in revenue was due to declines in both our legacy and new product lines. The decline in new product revenue was caused by the expected end of life of a product family of a personal navigation device, or PND, manufacturer and by delays in new product production ramp-up with several major customers. The decline in mature product revenue resulted from the general economic slowdown. Our mature product revenue decreased as a result of lower customer demand for pASIC 3 and QuickRAM products. One of our U.S. customers, purchasing primarily pASIC 3 devices, accounted for 14% and 12% of total revenue in the first half of 2009 and 2008, respectively.

Table of Contents*Gross Profit*

The table below sets forth the changes in gross profit for the six months ended June 29, 2008 as compared to the six months ended June 28, 2009 (in thousands, except percentage data):

	Six Months Ended		Six Months Ended		Year-Over-Year Change	
	June 28, 2009		June 29, 2008			
	Amount	% of Total Revenues	Amount	% of Total Revenues		
Revenue	\$ 7,463	100%	\$ 19,766	100%	\$ (12,303)	(62)%
Cost of revenue	3,408	46	9,240	47	(5,832)	(63)
Long-lived asset impairment			1,545	8	(1,545)	(100)%
Gross Profit	\$ 4,055	54%	\$ 8,981	45%	\$ (4,926)	(55)%

The decline in gross profit was mainly due to the decline in revenue in the first half of 2009 as compared to the first half of 2008. The gross profit decline during the first half of 2009 was partially offset by the absence of long-lived asset impairments which accounted for \$1.5 million of gross profit charges in the first half of 2008; a change in product mix towards mature products which carry higher gross margins than new products; a reduction of excess and obsolescence provisions in the first half of 2009 as compared to the first half of 2008; and a change to favorable purchase price variances in the first half of 2009 from unfavorable purchase price variances in the first half of 2008. The sale of previously reserved inventories contributed \$215,000, or 2.9% of revenue, to gross profit in the first half of 2009 and \$384,000, or 1.9% of revenue, in the first half of 2008.

Operating Expenses

The table below sets forth the changes in operating expenses for the six months ended June 29, 2008 as compared to the six months ended June 28, 2009 (in thousands, except percentage data):

	Six Months Ended		Six Months Ended		Year-Over-Year Change	
	June 28, 2009		June 29, 2008			
	Amount	% of Total Revenues	Amount	% of Total Revenues		
R&D expense	\$ 3,489	47%	\$ 5,431	27%	\$ (1,942)	(36)%
SG&A expense	5,352	72	8,290	42	(2,938)	(35)
Long-lived asset impairment			468	2	(468)	(100)
Restructuring costs			452	2	(452)	(100)
Total operating expenses	\$ 8,841	119%	\$ 14,641	73%	\$ (5,800)	(40)%

Research and Development

Our research and development expenses consist primarily of personnel, overhead and other costs associated with engineering process improvements, programmable logic design, ASSP design and software development. The decrease in R&D expenses results primarily from measures undertaken in the second quarter of 2008 to change certain development activities to an on-demand, outsourced model from an in-house, fixed cost model. As a result of this decision, our research and development staffing in Toronto, Canada was reduced during the second quarter of 2008. The \$1.9 million decrease in R&D expenses in the first half of 2009 as compared to the first half of 2008 is attributable primarily to a \$1.2 million or 57% decrease in compensation expenses due to reduced headcount; a

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\$610,000 or 47% decrease in expense allocations to R&D such as facilities and other corporate costs; and a \$130,000 or 36% decrease in stock based compensation expenses.

Selling, General and Administrative Expense

Our selling, general and administrative expenses consist primarily of personnel and related overhead costs for sales, marketing, finance, administration, human resources and general management. The \$2.9 million decrease in SG&A expenses in the first half of 2009 as compared to the first half of 2008 resulted from our effort to realign resources with our expected revenue outlook and was primarily due to a \$1.1 million or 28% decrease in compensation expenses as a result of headcount reductions; a \$1.2 million or 53% decrease in outside services such as consulting, temporary help and legal, and a \$210,000 or 22% decrease in occupancy costs including rent, utilities and insurance expenses, and a \$450,000 or 43% decrease in stock based compensation expenses.

Long-Lived Assets Impairment

In the first half of 2008, we recorded a \$468,000 long-lived asset impairment charge to operating expenses as a result of our decision to outsource design implementation activity, which resulted in unutilized EDA software licenses. There were no long-lived asset impairment charges in the first half of 2009.

Restructuring Costs

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

Interest and Other Income (Expense), net

The table below sets forth the changes in Interest and Other Income (Expense), net, for the six months ended June 29, 2008 as compared to the six months ended June 28, 2009:

Six Months Ended	
June 28, 2009	June 29, 2008
(in thousands)	

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Write-down of investment in Tower Semiconductor Ltd.	\$		\$	(417)
Interest expense		(47)		(143)
Interest income and other, net		(1)		134
	\$	(48)	\$	(426)

In the first half of 2008, we determined that our investment in Tower had suffered a decline in value that was determined to be other than temporary. This determination included factors such as market value and the period of time that the market value has been below the carrying value. Accordingly, we recorded a write-down of \$417,000 in the first half of 2008 based on the quoted market price of the stock on the last day of the reporting period. There were no write-downs of marketable securities in the first half of 2009.

The decrease in interest expense is due primarily to the reduction of our average debt obligation to \$2.9 million in the first half of 2009 from \$4.4 million in the first half of 2008. The decrease in interest income is due primarily to the drop in investment yields between the first half of 2008 and the first half of 2009.

Table of Contents*Provision for (benefit from) Income Taxes*

Six Months Ended
June 28, 2009 **June 29, 2008**
(in thousands)

Income tax provision (benefit)	\$	(11)	\$	34
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The income tax provision (benefit) for the second half of 2009 and 2008 are primarily for our foreign operations which are cost-plus entities offset by the monetization of prior year federal research credits. As of the end of the second half of 2009, our ability to utilize our income tax loss carryforwards in future periods is uncertain and, accordingly, we recorded a full valuation allowance against the related US tax benefit. We will continue to assess the realizability of deferred tax assets in future periods.

Liquidity and Capital Resources

We have financed our operating losses and capital investments through sales of common stock, private equity investments, capital and operating leases, bank lines of credit and cash flow from operations. As of June 28, 2009, our principal sources of liquidity consisted of our cash and cash equivalents of \$16.4 million, available credit under our revolving line of credit with Silicon Valley Bank of \$4.0 million, and our investment in Tower with a market value of approximately \$430,000. As of June 28, 2009, there is no material difference between the fair value and the carrying amount of the debt outstanding under the Company's line of credit and capital leasing arrangements.

Most of our cash and cash equivalents were invested in a US Treasury money market fund rated AAAM/Aaa. Our interest-bearing debt consisted of \$2.0 million of revolving debt outstanding from Silicon Valley Bank and \$1.0 million outstanding under capital leases (see Note 6 of the Condensed Unaudited Consolidated Financial Statements). The term of the revolving debt facility runs until June 2010. Upon each advance, the Company can elect a variable interest rate, which is the greater of six percent or the prime rate plus one percent, or a fixed rate which is the LIBOR plus 3.50%. We were in compliance with all loan covenants as of the end of the current reporting period. Our investment in Tower had a market value of approximately \$430,000 as of June 28, 2009. We intend to hold 450,000 of these shares, valued at \$144,000 as of the end of the second quarter of 2009 in order to obtain preferred wafer pricing from Tower.

Net cash from operating activities

Net cash used for operating activities was \$2.6 million in the first half of 2009. The cash used for operating activities resulted primarily from a net loss of \$4.8 million, which included \$2.3 million of non-cash charges. These non-cash charges included stock-based compensation of \$951,000, depreciation and amortization of \$914,000, a write-down of inventory of \$236,000 and utilization of wafer credits of \$213,000. In addition, changes in working capital accounts in the first half of 2009 accounted for used cash of \$71,000 which consisted of a decrease in current assets of \$114,000 partially offset by a decrease in current liabilities of \$185,000 in the first half of 2009. The decrease in current assets resulted from a decrease in accounts receivable of \$278,000 due primarily to higher collection effort in the last month of the quarter and a decrease in other current assets of \$228,000 partially offset by an increase in inventories of \$378,000. The decrease in current liabilities resulted primarily from a decrease in deferred income on shipments to distributors of \$271,000.

Net cash used for operating activities was \$367,000 in the first half of 2008. The Company's net loss of \$6.1 million, excluding non-cash charges of \$6.5 million, provided \$408,000 of cash flow. This was reduced by \$775,000 for changes in working capital accounts. The non-cash charges included \$2.0 million of long-lived asset impairment, stock-based compensation of \$1.6 million, depreciation and amortization of \$1.2 million, write-down of inventories of \$1.1 million, write-down of marketable securities of \$417,000 and decrease in wafer credits of \$148,000. Changes in working capital accounts used cash as a result of a decrease in accounts payable of \$2.7 million due to timing of expenditures and purchases of inventories and a decrease in deferred income and royalty revenue of \$210,000. These cash uses were partially offset by a decrease in inventories of \$1.7 million, decrease in other assets of \$305,000 and a decrease in accounts receivable of \$208,000.

Table of Contents*Net cash from investing activities*

Net cash used for investing activities for the first half of 2009 and 2008 was \$46,000 and \$363,000, respectively, as a result of capital expenditures made primarily to acquire software used in the development and production of our products and solutions. Capital expenditures, which are largely driven by the development of new products and manufacturing levels, are projected to be approximately \$100,000 during the rest of fiscal year 2009.

Net cash from financing activities

Net cash used for financing activities was \$327,000 for the first half of 2009, resulting from scheduled payments under the terms of our debt and capital lease obligations, partially offset by \$190,000 in proceeds related to the issuance of common shares to employees under our equity plans. During the first half of 2009, we repaid \$2.0 million of revolving debt and borrowed \$2.0 million of revolving debt with a variable interest rate of 6.0%.

Net cash used for financing activities was \$1.1 million for the first half of 2008, resulting from scheduled payments of \$1.2 million under the terms of our debt and capital lease obligations, partially offset by \$109,000 in proceeds related to the issuance of common shares to employees under our equity plans.

We require substantial cash to fund our business. However, we believe that our existing cash resources will be sufficient to fund operations and capital expenditures, and provide adequate working capital for at least the next twelve months. After the next twelve months, our cash requirements will depend on many factors, including our level of revenue and gross profit, the market acceptance of our existing and new products, the levels at which we maintain inventories and accounts receivable, costs of securing access to adequate manufacturing capacity, new product development efforts, capital expenditures and the level of our operating expenses.

Contractual Obligations and Commercial Commitments

The following table summarizes our contractual obligations and commercial commitments as of June 28, 2009 and the effect such obligations and commitments are expected to have on our liquidity and cash flows in future fiscal periods (in thousands):

	Total	Payments Due by Period		
		Less than 1 Year	1-3 Years	More than 3 Years
<i>Contractual cash obligations:</i>				
Operating leases	\$ 1,518	\$ 528	\$ 792	\$ 198
Wafer purchases(1)	3,511	3,511		
Other purchase commitments	1,364	1,264	100	
<i>Total contractual cash obligations</i>	<i>6,393</i>	<i>5,303</i>	<i>892</i>	<i>198</i>

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Other commercial commitments(2):

Revolving line of credit	2,000	2,000		
Capital lease obligations	1,002	612	390	
<i>Total commercial commitments</i>	3,002	2,612	390	
Total contractual obligations and commercial commitments (3)	\$ 9,395	\$ 7,915	\$ 1,282	\$ 198

(1) Certain of our wafer manufacturers require us to forecast wafer starts several months in advance. We are committed to take delivery of and pay for a portion of forecasted wafer volume. Wafer purchase

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commitments of \$3.5 million include both firm purchase commitments and a portion of our forecasted wafer starts as of June 28, 2009.

(2) Other commercial commitments are included as liabilities on our balance sheets as of June 28, 2009.

(3) Does not include unrecognized tax benefits of \$68,000 as of June 28, 2009. See Note 10 of the Condensed Unaudited Consolidated Financial Statements.

Concentration of Suppliers

We depend on a limited number of contract manufacturers, subcontractors, and suppliers for wafer fabrication, assembly, programming and test of our devices, and for the supply of programming equipment, and these services are typically provided by one supplier for each of our devices. We generally purchase these single or limited source services through standard purchase orders or under our agreement with Tower. Because we rely on independent subcontractors to perform these services, we cannot directly control product delivery schedules, costs or quality levels. Our future success also depends on the financial viability of our independent subcontractors. These subcontract manufacturers produce products for other companies and we must place orders in advance of expected delivery. As a result, we have only a limited ability to react to fluctuations in demand for our products, which could cause us to have an excess or a shortage of inventories of a particular product, and our ability to respond to changes in demand is limited by these suppliers' ability to provide products with the quantity, quality, cost and timeliness that we require. The decision not to provide these services to us or the inability to supply these services to us, such as in the case of a natural or financial disaster, would have a significant impact on our business. Increased demand from other companies could result in these subcontract manufacturers allocating available capacity to customers that are larger or have long-term supply contracts in place and we may be unable to obtain adequate foundry and other capacity at acceptable prices, or we may experience delays or interruption in supply. Additionally, volatility of economic, market, social and political conditions in countries where these suppliers operate may be unpredictable and could result in a reduction in product revenue or increase our cost of revenue and could adversely affect our business, financial condition and results of operations.

Off-Balance Sheet Arrangements

We do not maintain any off-balance sheet partnerships, arrangements or other relationships with unconsolidated entities or others, often referred to as structured finance or special purpose entities, which are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Recently Issued Accounting Pronouncements

See Note 2 of the Condensed Unaudited Consolidated Financial Statements for a description of recent accounting pronouncements, including the respective dates of adoption and effects on results of operations and financial condition.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio and variable rate debt. We do not use derivative financial instruments to manage our interest rate risk. We ensure the safety and preservation of invested funds by limiting default, market risk and reinvestment risk. Our investment portfolio is generally comprised of investments that meet high credit quality standards and have active secondary and resale markets. Since these securities are subject to interest rate risk, they could decline in value if interest rates fluctuate or if the liquidity of the investment portfolio were to change. Due to the short duration and conservative nature of our investment portfolio, we do not anticipate any material loss with respect to our investment portfolio. A 10% move in interest rates as of the end of the second quarter of 2009 would have an immaterial effect on our financial position, results of operations and cash flows.

Foreign Currency Exchange Rate Risk

All of our sales and cost of manufacturing are transacted in U.S. dollars. We conduct a portion of our research and development activities in Canada and India and have sales and marketing offices in several locations outside of the United States. We use the U.S. dollar as our functional currency. Most of the costs incurred at these international locations are in local currency. If these local currencies strengthen against the U.S. dollar, our payroll and other local expenses will be higher than we currently anticipate. Since our sales are transacted in U.S. dollars, this negative impact on expenses would not be offset by any positive effect on revenue. Operating expenses denominated in foreign currencies were approximately 18% and 26% of total operating expenses for the first half 2009 and 2008, respectively. A currency exchange rate fluctuation of 10% would have caused our operating expenses to change by approximately \$160,000 in the first half of 2009.

Equity Price Risk

Our exposure to equity price risk for changes in market value relates primarily to our investment in Tower Semiconductor Ltd., or Tower. Tower's ordinary shares trade on the Nasdaq Global Market under the symbol TSEM. Since these securities are publicly traded on the open market, they are subject to market fluctuations. Temporary market fluctuations are reflected by increasing or decreasing the presented value of the related securities and recording accumulated other comprehensive income (loss) in the equity section of the balance sheet. An other than temporary decline in market value is reflected by decreasing the carrying value of the related securities and recording a charge to operating expenses in the income statement. We wrote down the value of the Tower shares due to an other than temporary decline in their market value by \$15.1 million between 2001 and December 28, 2008. The determination that the decline in market value was other than temporary included factors such as the then current market value and the period of time that the market value had been below the carrying value in each of the respective periods.

There have been no changes since the end of the last fiscal year, in the risk exposures described above or the management of such exposures and there are no expected changes going forward.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in the reports we file or submit pursuant to the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management, with the participation of the Chief Executive Officer and Chief Financial Officer, has performed an evaluation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of June 28, 2009, our disclosure controls and procedures were effective.

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Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

See Note 13 of the Condensed Unaudited Consolidated Financial Statements for a description of legal proceedings.

Item 1A. Risk Factors

This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in our filings made with SEC. Because of the following risk factors, as well as other variables affecting our operating results, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

Risk Factors

Our CSSP design opportunities may not result in the revenue we expect

We have transitioned from being a broad-based supplier of FPGA devices to being a supplier of CSSPs primarily to the mobile market. We have developed a significant pipeline of design opportunities for CSSPs in our target markets and we are focused on converting these design opportunities into revenue. Revenue contributions from new mobile products will be important over the next two to four quarters in order to grow our business, achieve profitability and maintain or increase our cash and cash equivalent balances. Mobile product life cycles are short and we must replace revenue lost at the end of each product life cycle with sales from new design wins. In addition, we expect revenue from the rest of our business to continue to decline due to the stage of our customers' product life cycles.

The generation of revenue from mobile market design opportunities is influenced by a number of factors, such as our ability to supply solutions that meet customers' cost targets and performance requirements, the value and price of our solutions relative to competing solutions, our customers' decisions whether to produce in volume the products utilizing our solution, the timing of our customers' product introduction dates, the

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market success of our customers' products and general economic conditions. If these design opportunities result in revenue that is later or significantly lower than we expect, our results of operations and financial condition will be adversely affected.

Our business could be adversely affected by the current financial crisis

The downturn in general worldwide economic conditions may continue to cause a reduction in the consumption of the products that use our devices, cause the cancellation of or delay our customers' introduction of new products using our devices, disrupt supply chains and affect the financial health of our customers or suppliers. As such, the financial crisis may continue to adversely impact our customer and supplier relationships, revenue level, product prices, the value of our inventories and long-lived assets, reserves for excess and obsolete inventory, production capability, collectability of accounts receivable, access to inventory or equipment at suppliers and liquidity, which may materially harm our business.

We may not have the liquidity to support our future operations and capital requirements

As a result of current revenue and operating expense levels, changes in working capital and interest and debt payments, we will need to generate significantly higher revenue to generate positive cash flow. In addition, our new products such as our ArcticLink and PolarPro solution platforms and products currently under development, have been generating lower gross margin as a percentage of revenue than the rest of our historical business due to the markets that we have targeted and the larger order quantities associated with these applications. Whether we can achieve cash flow levels sufficient to support our operations cannot be accurately predicted, and our investment portfolio is subject to a degree of interest rate and liquidity risk. Unless such cash flow levels are achieved and our

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investment portfolio remains liquid and its capital is preserved, we may need to borrow additional funds or sell debt or equity securities, or some combination thereof, to provide funding for our operations. Such additional funding source may not be available on commercially reasonable terms, or at all. If adequate funds are not available when needed, our financial condition and operating results would be materially and adversely affected and we may not be able to operate our business without significant changes in our operations, or at all.

Restrictive covenants in the indentures and agreements governing our current and future indebtedness could restrict our operating flexibility

The indentures and agreements governing our existing debt, and debt we may incur in the future, contain, or may contain, affirmative and negative covenants that materially limit our ability to take certain actions, including our ability to incur debt, pay dividends and repurchase stock, make certain investments and other payments, enter into certain mergers and consolidations, engage in sale leaseback transactions and encumber and dispose of assets. In addition, our future debt agreements may contain financial covenants and ratios.

The breach of any of these covenants by us or the failure by us to meet any of these ratios or conditions could result in a default under any or all of such indebtedness. If a default occurs under any such indebtedness, all of the outstanding obligations thereunder could become immediately due and payable, which could result in a default under our other outstanding debt and could lead to an acceleration of obligations related to other outstanding debt. The existence of such a default or event of default could also preclude us from borrowing funds under our revolving credit facilities. Our ability to comply with the provisions of the indentures, credit facilities and other agreements governing our outstanding debt and indebtedness we may incur in the future can be affected by events beyond our control and a default under any debt instrument, if not cured or waived, could have a material adverse effect on us.

If we fail to successfully develop, introduce and sell CSSPs and new products, or if our CSSP design opportunities do not generate the revenue we expect, we may be unable to compete effectively in the future

The market for differentiated mobile devices is highly competitive and dynamic, with short end market product life cycles and rapid obsolescence of existing products. To compete successfully, we must obtain access to advanced fabrication capacity and dedicate significant resources to specify, design, develop, manufacture and sell new or enhanced CSSPs that provide increasingly higher levels of performance, low power consumption, new features, reliability and/or cost savings to our customers. Due to the short product life cycle of these devices our revenue is subject to fluctuation in a short period of time and our ability to grow our business depends on accelerating our design win activity. We often make significant investments in CSSP and silicon platform development, selling and marketing, long before we generate revenue, if any, from our efforts. The markets we are targeting typically have higher volumes and greater price pressure than our traditional business. In addition we quote opportunities in anticipation of future cost reductions and may aggressively price products to gain market share. In order to react quickly to opportunities or to obtain favorable wafer prices, we make significant investments in and commitments to purchase inventories and capital equipment before we have firm commitments from customers. Our gross margin and valuation of inventories may be affected by these strategies if, for instance, we generate significant revenue before we are able to reduce our costs or if an opportunity priced to gain market share becomes significant to our quarterly revenue.

We expect our business growth to be driven by CSSPs, and CSSP revenue growth needs to be strong enough to achieve profitability while offsetting expected declines in other parts of our business. The gross margin associated with our CSSPs and new products is generally lower than the gross margin of our mature and end-of-life products, due primarily to the price sensitive nature of the higher volume mobile consumer opportunities that we are pursuing with CSSPs. If our mature product revenue were to decline more quickly than expected, it could have a significant effect on our results of operations and cash flows. Because the product life cycle of mobile products is short, we must replace revenue at the end of a product life cycle with sales from new design opportunities. In addition, sales of our mature product family could decline if

competitors replace us in these design opportunities. While we expect revenue and gross profit growth from CSSPs will offset the expected decline in revenue and gross profit from our mature products and the effect of short mobile product life cycles, there is no assurance whether or when this will occur. In order to grow our revenue from its current level, we are dependent upon increased revenue from our existing products, especially CSSPs based on our ArcticLink and PolarPro solution platforms, and the development of CSSPs, additional new products and solutions.

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If (i) we are unable to design, produce and sell new CSSPs that meet design specifications, address customer requirements and generate sufficient revenue and gross profit; (ii) market demand for our CSSPs and other products fails to materialize; (iii) we are unable to obtain adequate capacity on a timely basis; (iv) we are unable to develop CSSPs or solutions in a timely manner; or (v) our customers do not successfully introduce products incorporating our devices, our revenue and gross margin will be materially harmed, our liquidity and cash flows will be materially affected, we may be required to write-off related inventories and long-lived assets or there may be other adverse effects on our business or the price of our common stock.

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

Our current product delivery cycle can be longer than our customers' known requirements for product. As a result, we may have low visibility to product demand in any given quarter. If our customers cannot provide us with accurate delivery lead times, we may not be able to deliver product to our customers in a timely fashion. Furthermore, our ability to respond to increased demand is limited to inventories on hand or on order, the capacity available at our contract manufacturers and our capacity to program products to customer specifications. If we fail to accurately estimate customer demand, record revenue, or if our available capacity is less than needed to meet customer demand, our results of operations could be harmed and our stock price could materially fluctuate.

We have a limited number of significant customers and limited visibility into the long-term demand for our products from these customers

A few end-customers can represent a significant portion of our total revenue in a given reporting period and the likelihood of this occurring will increase in the future as we target market leading manufacturers of high volume mobile applications. As in the past, future demand from these customers may fluctuate significantly from quarter to quarter. These customers typically order products with short requested delivery lead times, and do not provide a commitment to purchase product past the period covered by purchase orders, which may be rescheduled or cancelled. In addition, our manufacturing lead times are longer than the delivery lead times requested by these customers, and we make significant purchases of inventory and capital expenditures in anticipation of future demand. If revenue from any significant customer were to decline substantially, we may be unable to offset this decline with increased revenue and gross margin from other customers and we may purchase excess inventories. These factors could severely harm our business.

In addition, we may make a significant investment in long-lived assets for the production of our products based upon historical and expected demand. If demand for our products or gross margin generated from our products does not meet our expectations or if we are unable to collect amounts due from significant customers, we may be required to write-off inventories, provide for uncollectible accounts receivable or incur charges against long-lived assets, which would materially harm our business.

We depend upon third parties to fabricate, assemble, test and program our products, and they may discontinue manufacturing our products, fail to give our products priority, be unable to successfully manufacture our products to meet performance, volume or cost targets, or inaccurately report inventories to us

We contract with third parties to fabricate, assemble, test and program our devices. Our devices are generally fabricated, assembled and programmed by single suppliers, and the loss of a supplier, transfer of manufacturing to a new location, expiration of a supply agreement or the inability of our suppliers to manufacture our products to meet volume, performance and cost targets could have a material adverse effect on our

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business. Our relationship with our suppliers could change as a result of a merger or acquisition. If for any reason these suppliers or any other vendor becomes unable or unwilling to continue to provide services of acceptable quality, at acceptable costs and in a timely manner, our ability to operate our business or deliver our products to our customers could be severely impaired. We would have to identify and qualify substitute suppliers, which could be time consuming, difficult and result in unforeseen operational problems, or we could announce an end-of-life program for these products. Alternate suppliers might not be available to fabricate, assemble, test and program our devices or, if available, might be unwilling or unable to offer services on acceptable terms.

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In addition, if competition for wafer manufacturing capacity increases, if we need to migrate to more advanced wafer manufacturing technology, or if competition for assembly services increases, we may be required to pay or invest significant amounts to secure access to this capacity. For example, between 2001 and 2002 we invested \$21.3 million in equity and prepaid wafer credits to obtain guaranteed wafer fabrication capacity at Tower Semiconductor until at least 2010. The number of companies that provide these services is limited and some of them have limited operating histories and financial resources. In the event our current suppliers refuse or are unable to continue to provide these services to us, or if we are unable to secure sufficient capacity from our current suppliers on commercially reasonable terms, we may be unable to procure services from alternate suppliers in a timely manner, if at all. Moreover, our reliance on a limited number of suppliers subjects us to reduced control over delivery schedules, quality assurance and costs. This lack of control may cause unforeseen product shortages or may increase our cost to manufacture and test our products, which would adversely affect our operating results and cash flows.

We record a majority of our inventory transactions based on information from our subcontractors. If we do not receive prompt and accurate information from our suppliers, we could be unable to meet our delivery commitments to customers or commit to manufacturing inventories that are not required to meet customer delivery commitments, which could materially harm our business.

Our future results depend on our relationship with Tower

We have invested approximately \$21.3 million in Tower. In return for our investment, we received equity, prepaid wafer credits, favorable wafer pricing and committed production capacity in Tower's foundry facility. We believe that Tower's long-term operation of this fabrication facility depends on its ability to attract sufficient customer demand, to obtain additional financing, to increase capacity, to obtain the release of grants and approvals for changes in grant programs from the Israeli government's Investment Center and its ability to remain in compliance with the terms of its grant and