SILICON LABORATORIES INC
Form 10-K/A
April 25, 2005

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

FORM 10-K/A

AMENDMENT NO. 1

(Mark One)

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended January 1, 2005

Or

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

For the transition period from to

Commission file number: 000-29823

SILICON LABORATORIES INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**74-2793174** (I.R.S. Employer Identification No.)
4635 Boston Lane, Austin, Texas (Address of principal executive offices)	**78735** (Zip Code)

(512) 416-8500

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None.

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

Common Stock, $0.0001 Par Value

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). ý Yes o No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the registrant s most recently completed second fiscal quarter (July 2, 2004) was $1,742,469,341 (assuming, for this purpose, that only directors and officers are deemed affiliates).

There were 52,646,075 shares of the registrant s common stock issued and outstanding as of February 4, 2005.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the registrant s 2005 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

EXPLANATORY NOTE

This Amendment No. 1 to the Annual Report on Form 10-K of Silicon Laboratories Inc. for the fiscal year ended January 1, 2005 is being filed in order to classify our investments in auction rate securities as short-term investments rather than cash and cash equivalents on our consolidated balance sheets at January 1, 2005 and January 3, 2004 included in our Annual Report on Form 10-K filed on February 15, 2005 (the Original Report). Subsequent to the filing of the Original Report, additional clarification was provided regarding the financial statement classification of auction rate securities held as investments. We have also made corresponding adjustments to the consolidated statements of cash flows for each of the three fiscal years in the period ended January 1, 2005. The reclassifications had no impact on our consolidated statements of income or stockholders equity. See RECLASSIFICATIONS in Note 2 of the Notes to Consolidated Financial Statements included in this Form 10-K/A for additional information. References herein to the Form 10-K refer to our Original Report, as amended by this Amendment No. 1.

Except for matters related to the aforementioned reclassification, this Amendment No.1 does not modify or update other disclosures in the Original Report, including the nature and character of such disclosure to reflect events occurring after the filing date of the Original Report. While we are amending only certain portions of our Form 10-K, for convenience and ease of reference, we are filing the entire Form 10-K, except for certain exhibits. Accordingly, this Form 10-K/A should be read in conjunction with our filings made with the Securities and Exchange Commission.

SILICON LABORATORIES INC.

FORM 10-K ANNUAL REPORT

TABLE OF CONTENTS

CAUTIONARY STATEMENT

EXCEPT FOR THE HISTORICAL FINANCIAL INFORMATION CONTAINED HEREIN, THE MATTERS DISCUSSED IN THIS REPORT ON FORM 10-K (AS WELL AS DOCUMENTS INCORPORATED HEREIN BY REFERENCE) MAY BE CONSIDERED FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. SUCH FORWARD-LOOKING STATEMENTS INCLUDE DECLARATIONS REGARDING THE INTENT, BELIEF OR CURRENT EXPECTATIONS OF SILICON LABORATORIES INC. AND ITS MANAGEMENT AND MAY BE SIGNIFIED BY THE WORDS EXPECTS, ANTICIPATES, INTENDS, BELIEVES OR SIMILAR LANGUAGE. YOU ARE CAUTIONED THAT ANY SUCH FORWARD-LOOKING STATEMENTS ARE NOT GUARANTEES OF FUTURE PERFORMANCE AND INVOLVE A NUMBER OF RISKS AND UNCERTAINTIES. ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE INDICATED BY SUCH FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE OR CONTRIBUTE TO SUCH DIFFERENCES INCLUDE THOSE DISCUSSED UNDER FACTORS AFFECTING OUR FUTURE OPERATING RESULTS AND ELSEWHERE IN THIS REPORT. SILICON LABORATORIES DISCLAIMS ANY INTENTION OR OBLIGATION TO UPDATE OR REVISE ANY FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE.

PART I

Item 1. Business and Factors Affecting Our Future Operating Results

GENERAL

Silicon Laboratories Inc. designs and develops proprietary, analog-intensive, mixed-signal integrated circuits (ICs) for a broad range of applications. Mixed-signal ICs are electronic components that convert real-world analog signals, such as sound and radio waves, into digital signals that electronic products can process. Therefore, mixed-signal ICs are critical components in numerous applications, including mobile handsets, cable and satellite set-top boxes, personal computer modems, Voice over Internet Protocol on data networks, voice over digital subscriber line (DSL) modems, personal video recorders, telephone equipment and optical networking equipment. With our acquisition of Cygnal Integrated Products (Cygnal) in December 2003, we now sell mixed-signal 8-bit microcontrollers (MCUs), which are incorporated in a broad range of applications in a variety of markets, including automotive, communications, consumer, industrial, medical and power management.

Our world-class, mixed-signal design engineers use standard complementary metal oxide semiconductor, or CMOS, technology to create our innovative ICs that can improve the performance and dramatically reduce the cost, size and system power requirements of devices that our customers sell to their end-user customers. Our expertise in analog-intensive, mixed-signal IC design in CMOS allows us to develop new and innovative products that are highly integrated, which simplifies our customers designs and improves their time-to-market.

INDUSTRY BACKGROUND

According to market research firm Gartner, personal computers (PCs) and mobile handsets are expected to remain the most significant market drivers for semiconductor consumption through 2008. In wired communications, increased enterprise equipment spending and capital expenditures by service providers combined with broadband and Voice over Packet technology continue to represent growth areas in the communications IC market which Gartner expects to top $80 billion by 2008.

Recent growth in the market for ICs has been due to a number of factors, including the growth of Internet usage, development of new communications technologies, availability of improved communications services at lower costs, broad deployment of optical networks and remote access requirements for corporate networks. This demand has fueled tremendous growth in the number of electronic devices. For example, in mobile handset markets, the demand for wireless phones and other wireless devices, such as personal digital assistants, has grown steadily as digital wireless services have become increasingly popular and affordable. In other markets, demand has increased for a wide range of electronic products, including PCs, cable and satellite set-top boxes, fax machines, credit card verification machines, automated teller machines, satellite radios and personal video recorders (PVRs). Consumers increasingly demand higher capacity connections at their residences using cable modems or high speed DSL. Voice over Internet Protocol technology, which enables voice traffic over data networks, is emerging as a viable alternative to traditional telephone networks. The demand for greater and faster Internet access by households and businesses has increased the need to significantly upgrade the communications backbone to handle this traffic, increasing the need for smaller,

faster and better performing networking systems that route this traffic.

Numerous devices require analog-intensive, mixed-signal circuits. Traditional designs for electronic devices have used mixed-signal solutions built with numerous discrete analog and digital components. While these traditional designs provide the required functionality, they can be inefficient and inadequate for use in markets where size, cost, power consumption and performance are increasingly important product differentiators. In order to improve their competitive position, electronic device manufacturers need advanced mixed-signal ICs that reduce the number of discrete components and required board space to create smaller products with improved price/performance characteristics. Additionally, these manufacturers require programmable ICs that can be reconfigured to comply with numerous and constantly evolving international electronic standards without altering the fundamental design of a product.

Manufacturers of electronic devices face accelerating time-to-market demands and must adapt to evolving industry standards and new technologies. Because analog-intensive, mixed-signal IC design expertise is difficult to find, these manufacturers increasingly are turning to third parties, like us, to provide advanced mixed-signal ICs. Designing the analog component of a mixed-signal IC involves great complexity and difficulty, because the performance of an analog IC depends on the creative analog expertise of engineers to optimize speed, power, amplitude and resolution within the constraints of standard manufacturing processes. The development of analog design expertise typically requires years of practical analog design experience under the guidance of a senior engineer, and engineers with the required level of skill and expertise are in short supply.

Many third-party IC providers lack sufficient analog expertise to develop compelling mixed-signal ICs. As a result, manufacturers of electronic devices value third-party providers that can supply them with mixed-signal ICs with greater functionality, smaller size and lower power requirements at a reduced cost and shorter time-to-market.

PRODUCTS

We provide analog-intensive, mixed-signal ICs for use in a variety of electronic products in a broad range of applications including mobile handsets, PC modems, satellite set top boxes, automotive controls and sensors, personal video recorders, industrial monitoring and control, central office telephone equipment and optical networking equipment. Our products integrate complex mixed-signal functions that are frequently performed by numerous discrete components in competitive products into single chips or chipsets. By doing so, we are able to create products that, compared to many competitive products:

- Require less board space;
- Reduce the use of external components;
- Can offer superior performance;
- Provide increased reliability;
- Reduce system power requirements;
- Are easier for customers to use; and
- Reduce costs.

We group our products into two categories: mobile handset products and broad-based mixed-signal products. The mobile handset category includes the Aero® Transceivers, to the extent incorporated into handsets, the RF Synthesizers and the Power Amplifier (PA). The broad-based mixed-signal category includes our silicon DAA, ISOmodem®, ProSLIC®, DSL analog front end, clock chips, SiPHY®· optical transceivers and clock & data recovery ICs (CDRs), general purpose RF Synthesizers for non-handset applications, and MCU products. The following table summarizes the diverse product areas and applications for the various ICs that we have introduced to customers:

PRODUCT AREAS and DESCRIPTION	APPLICATIONS

MOBILE HANDSET PRODUCTS

RF Synthesizer for GSM A radio frequency, or RF, synthesizer generates high frequency signals that are used in wireless communications systems to select a particular radio channel. We provide RF Synthesizers for the Global System for Mobile Communications (GSM)/General Packet Radio Services (GPRS) markets. GPRS brings wireless Internet access to GSM users through data transfer and signaling over GSM radio networks. Our synthesizers are well-suited to meet the increasing requirement for highly-integrated electronics that reduce component count and consume less power. Customers for our synthesizer products for mobile handsets are typically migrating to our Aero Transceiver family of products which integrates the RF synthesizer with the transceiver.	GSM/GPRS wireless phones GSM/GPRS data communications devices

Aero Transceiver The Aero Transceiver family provides highly integrated transmit and receive radio functionality that is found between the antennae electronics and the digital baseband section of a GSM/GPRS/Enhanced Data Rates for Global Evolution (EDGE) mobile handset or wireless data communication device. The latest generation of the Aero Transceiver family, Aero II, is the only single chip GSM/GPRS transceiver available in CMOS. This solution requires a smaller footprint than competing solutions in this form-factor sensitive market and can be paired with virtually any baseband. The Aero Transceivers are designed using 100% standard CMOS process technology which facilitates cost reduction and integration.	GSM/GPRS/EDGE wireless phones GSM/GPRS/EDGE data communications devices Personal digital assistants
Power Amplifier Our Power Amplifier for dual-band cellular handsets is the first functionally complete, monolithic GSM PA solution, and the first to be implemented in CMOS, creating high levels of integration and performance without sacrificing quality or reliability. Our PA integrates power control circuits, innovative temperature and overvoltage protection circuits, input and output matching networks and harmonic filters. Our PA provides customers with flexibility to meet key specifications and a system that is easy to design into new or existing handset platforms. This product is still in the early stages of customer adoption and is not yet being produced in volume.	Dual band GSM/GPRS handsets
BROAD-BASED MIXED-SIGNAL PRODUCTS	
Silicon Direct Access Arrangement (DAA) Our DAA provides the functionality of both a direct access arrangement and a codec. A direct access arrangement provides electrical isolation between a wireline device, such as a modem, and the telephone line to guard against power surges in the telephone line, while the codec provides analog-to-digital and digital-to-analog conversion. Traditional direct access arrangement implementations contain numerous discrete components to provide functionality comparable to that which we provide in a single chipset. This family of products includes offerings to support different computer interface standards. Some versions of this chipset are programmable for differing international telephone standards, which enables manufacturers to distribute their products globally without costly country-specific design modifications.	PCI desktop modems Audio Modem Riser Cards Mobile Daughter Cards Notebook modems Communication and Network Riser (CNR) Cards Modem on motherboard Mini PCI cards Fax machines Handheld organizers Set-top boxes Video conferencing systems PBXs Voice recognition systems Web telephony products Multi-function printer cards
ISOmodem Embedded Modems The ISOmodem combines an analog modem with a silicon DAA, resulting in a complete modem implemented in a very small form factor. The ISOmodem products are designed for embedded modem applications, outside of the personal computer area such as set-top boxes and PVRs. The ISOmodem contains a programmable line interface that meets global telephone line	Set-top boxes Digital cable boxes Credit card verification Industrial monitoring

requirements, allowing manufacturers to implement a single modem design world-wide. The ISOmodem family includes embedded modem solutions for speeds ranging from 2400 bps to 56Kbps, suitable for a wide range of applications.	Postage meters Security systems Remote medical monitoring Gaming consoles PVRs Point of sale (POS) terminals
ProSLIC Subscriber Line Interface Circuits The ProSLIC provides the analog telephone interface on the source end of the telephone which generates dial tone, busy tone, caller ID and ring signal. Our ProSLIC product family has offerings for short-haul applications suitable for the customer premises as well as long-haul applications suitable for the traditional telephone company central office.	IP telephony Wireless local loop providing remote access for a wireline system Voice over broadband modems and terminal adapters VoIP residential gateways PBXs Wired long loop and central office systems

Microcontroller Products Our C8051F family of microcontrollers integrate intelligent data capture in the form of high-resolution data converters, a traditional MCU computing function, Flash memory and a highly programmable set of communication interfaces in a single system on a chip. The combination of configurable high-performance analog, up to 100 million instructions per second (MIPS), 8051 core and in-system field programmability provides the user with design flexibility, improved time-to-market, superior system performance and greater end product differentiation. These products are designed for use in a large variety of end-markets, including the automotive, communications, consumer, industrial, medical and power management markets.	Industrial automation and control Automotive sensors and controls Medical instrumentation Electronic test and measurement equipment Power management Weigh scales Optical line cards Digital cameras Computer peripherals Wireless headsets Magstripe readers Gaming consoles Electronic toys
DSL Analog Front End The DSL Analog Front End, or AFE, is designed to provide the connectivity functions for business or residential asymmetric digital subscriber line, or ADSL, connection at the user end in customer premises equipment. Such a connection addresses the business and residential demand for high-speed connectivity. The DSL AFE supports several ADSL communication standards enabling various upload and download data rates.	Personal computer modems External modems Residential gateways Network interface devices
SiPHY Optical Physical Layer Transceivers We offer a family of high-speed physical layer ICs that meet the high-speed fiber Synchronous Optical Network (SONET) and Synchronous Digital Hierarchy (SDH) specifications. As part of this family we offer transceivers that operate at rates up to 2.7 Gbps (giga bits per second), a transmission speed commonly referred to as OC-48. The transceiver IC provides both the receive path deserialization and transmit path serialization as required by the SONET/SDH physical layer. We also offer a family of clock and data recovery chips to provide specific functions at multiple speeds up to the OC-48 rate. All of our physical layer products utilize our proprietary digital signal processing technology to reduce the device s sensitivity to board-level noise and improve performance.	Optical port cards for SONET/SDH optical networking equipment Optical test equipment High speed serial back plane interfaces
Precision Clock Integrated Circuits Our precision clock product family includes various products ranging from general purpose clock multiplier products up to high performance multi-port, redundant, multiple frequency range clock multipliers and regenerators. Network systems require very high precision, low jitter, clock sources. Our knowledge gained in developing the physical layer transceiver subsections provided us the technology to offer these high performance clock products. Traditionally, these clock sources have been implemented using expensive, bulky modules, numerous crystal sources, complicated discrete circuitry requiring numerous components, or hybrid IC/discrete solutions that offer limited functionality. The frequency agility, performance, and integration offered by these devices are key design features for our customer base.	Optical port cards for SONET/SDH optical networking equipment Networking test equipment Short and long haul networking equipment

Satellite Radio Tuner The Satellite Radio Tuner combines our RF Synthesizer with a highly integrated tuner for a complete satellite radio tuner chipset. By leveraging CMOS technology, our satellite radio tuner minimizes the use of external components such as external voltage-controlled oscillators (VCOs), varactor diodes, and loop filters. The tuner provides strong system performance, meets stringent quality standards and fits into a very small footprint.	Consumer and automotive satellite radios
General Purpose RF Synthesizer A radio frequency, or RF, synthesizer generates high frequency signals that are used in wireless communications systems to select a particular radio channel. We provide general purpose RF Synthesizers for a variety of wireless communications devices, other than mobile handsets, including the industrial, science, medical (ISM) band applications and satellite radio applications. Our synthesizers are well-suited to meet the increasing requirement for highly-integrated electronics that reduce component count and consume less power.	Satellite radio Wireless local area networks Cordless phones Wireless headsets Wireless LAN (802.11b) modems

During fiscal year 2004 and fiscal year 2003, sales of our mobile handset products and broad-based mixed-signal products each accounted for approximately 50% of our revenues. During fiscal year 2002, sales of our mobile handset products and broad-based mixed-signal products accounted for 37% and 63% of our revenues, respectively.

CUSTOMERS, SALES AND MARKETING

We market our products to original equipment manufacturers (OEM) and other providers of applications in various markets through our direct sales force, a network of independent sales representatives, and electronics distributors. Direct and distributor customers buy on an individual purchase order basis, rather than pursuant to long-term agreements.

We consider our customer to be the end customer purchasing either directly from a distributor, a contract manufacturer or us. An end customer purchasing through a contract manufacturer typically instructs such contract manufacturer to obtain our products and incorporate such products with other components for sale by such contract manufacturer to the end customer. Although we actually sell the products to, and are paid by, the distributors and contract manufacturers, we refer to such end customer as our customer.

Two of our distributors, Edom Technology and Uniquest, each selling products to customers in Asia, represented 20% and 12% of our fiscal 2004 revenues, respectively. Distributors are not considered end customers, but rather serve as a sales channel to our end customers. No other distributor accounted for 10% or more of revenues for fiscal 2004.

During fiscal 2004, our ten largest end customers accounted for 51% of our revenues. We had one end customer, Samsung, which represented 17% of our revenues. No other single end customer accounted for more than 10% of our revenues. The following is a list of our largest end customers during fiscal 2004:

Agere Systems
Conexant
Hughes Network Systems
Intel
LG Electronics
Sagem
Samsung
Sendo
Smart Link
Thomson

We maintain five sales offices in North America. We provide European sales support through our subsidiaries in the United Kingdom, France and Germany. Our Asia Pacific sales are supported through our subsidiaries in Japan and Hong Kong, as well as sales offices in Korea, Taiwan and China. Revenue is attributed to a geographic area based on the end customer s shipped-to location. The percentage of our revenues to customers located outside of the United States was 89% in fiscal 2004, 80% in fiscal 2003 and 79% in fiscal 2002. In fiscal 2004, South Korea, Taiwan and China accounted for 28%, 16% and 10% of revenues, respectively.

Our direct sales force includes regional sales managers in the field and area business managers at our headquarters to further support customer communications. Many of these managers have engineering degrees. We maintain a dedicated website for our field sales organization, which includes technical documentation, backlog information, order status, product availability and new product introduction information to support our communications with that organization. Additionally, we provide direct communication to all field sales personnel as part of a structured sales communications program.

We also utilize independent sales representatives and distributors to generate sales of our products. We have relationships with many independent sales representatives and distributors worldwide whom we have selected based on their understanding of the mixed-signal IC marketplace and their ability to provide effective field sales applications support for our products.

Our marketing efforts are targeted at both identified industry leaders and emerging market participants. Direct marketing activities are supplemented by a focused marketing communications effort that seeks to raise awareness of our company and products. Our public relations efforts are focused on leading trade and business publications. Our external website is used to deliver corporate information and product information. We also pursue targeted advertising in key trade publications and we have a cooperative marketing program that allows our distributors and representatives to promote our products to their local markets in conjunction with their own advertising activities. Finally we maintain a presence at strategic trade shows and industry events. These activities, in combination with direct sales activities, help drive demand for our products.

Due to the complex and innovative nature of our ICs, we employ experienced applications engineers who work closely with customers to support the design-win process, and can significantly accelerate the customer s time required to bring a product to market. A design-win occurs when a customer has designed our ICs into its product architecture. A considerable amount of effort to assist the customer in incorporating our ICs into its products is typically required prior to any sale. In many cases, our innovative ICs require significantly different implementations than existing approaches and, therefore, successful implementations may require extensive communication with potential customers. The amount of time required to achieve a design-win can vary substantially depending on a customer s development cycle, which can be relatively short (such as three months) or very long (such as two years) based on a wide variety of customer factors. Not all design wins ultimately result in revenue. However, once a completed design architecture has been implemented and produced in high volumes, our customers are reluctant to significantly alter their designs due to this extensive design-win process. We believe this process, coupled with our intellectual property protection, promotes relatively longer product life cycles for our ICs and high barriers to entry for competitive products, even if such competing products are offered at lower prices. Finally, our close collaboration with our customers provides us with knowledge of derivative product ideas or completely new product line offerings that may not otherwise arise in other new product discussions.

RESEARCH AND DEVELOPMENT

Through our research and development efforts, we apply our experienced analog and mixed-signal engineering talent and expertise to create new ICs that integrate functions typically performed inefficiently by multiple discrete components. This integration generally results in lower costs, smaller die sizes, lower power demands and enhanced price/performance characteristics. We attempt to reuse successful techniques for integration in new applications where similar benefits can be realized. We believe that reliable and precise analog and mixed-signal ICs can only be developed by teams of engineers that coordinate their efforts under the direction of senior engineers who have significant analog experience and are familiar with the intricacies of designing these ICs for commercial volume production. The development of test methodologies is a critical activity in releasing a new product for commercial success. We believe that we have attracted some of the best engineers in our industry.

Research and development expenses were $74.9 million, $48.3 million and $32.0 million in fiscal 2004, 2003, and 2002, respectively.

TECHNOLOGY

Our product development process facilitates the design of highly-innovative, analog-intensive, mixed-signal ICs. Our senior engineers start the product development process by forming an understanding of our customers products and needs and then design alternatives with increased functionality and with decreasing power, size and cost requirements. Our engineers deep knowledge of existing and emerging standards and performance requirements help us to assess the technical feasibility of a particular IC. We target areas where we can provide compelling product improvements. Once we have solved the primary challenges, our field engineers continue to work closely with our customers design teams to maintain and develop an understanding of our customers needs, allowing us to formulate derivative products and refined features.

In providing mixed-signal ICs for our customers, we believe our key competitive advantages are:

- analog CMOS design expertise;
- digital signal processing design expertise;
- microcontroller design expertise; and
- our broad understanding of systems technology and trends.

To fully capitalize on these advantages, we have assembled a world-class development team with exceptional analog and mixed-signal design expertise led by accomplished senior engineers.

ANALOG CMOS DESIGN EXPERTISE

We believe that our most significant core competency is our world-class analog design capability. Additionally, we strive to design all of our ICs in CMOS processes. There are several modern process technologies for manufacturing semiconductors including CMOS, Bipolar, BiCMOS, silicon germanium and gallium arsenide. While it is significantly more difficult to design analog ICs in CMOS, CMOS provides multiple benefits versus existing alternatives, including significantly reduced cost, reduced technology risk and greater worldwide foundry capacity. CMOS is the most commonly used process technology for manufacturing digital ICs and as a result is most likely to be used for the manufacturing of ICs with finer line geometries, which enable smaller and faster ICs. By designing our ICs in CMOS, we enable our products to benefit from this trend towards finer line geometries, which allows us to integrate more digital functionality into our mixed-signal ICs.

Designing analog ICs is significantly more complicated than designing digital ICs. While advanced software tools exist to help automate digital IC design, there are far fewer tools for advanced analog IC design. In many cases, our analog circuit design efforts begin at the fundamental transistor level. We believe that we have a demonstrated ability to design the most difficult analog and RF circuits using standard CMOS technologies. For example, our DAA product family replaces bulky, discrete modem components, such as transformers, relays and opto-isolators, with highly integrated CMOS mixed-signal ICs. Similarly, bulky wireless phone components such as voltage controlled oscillators and intermediate frequency surface acoustic wave filters are replaced by our integrated CMOS frequency synthesizer and AERO transceiver products. Our design expertise in the technically challenging optical networking market has allowed us to reduce the number of supplemental components used in our customers products while providing lower levels of noise in the circuit operation. This is a key technical consideration in high speed optical networks.

DIGITAL SIGNAL PROCESSING DESIGN EXPERTISE

We consider the partitioning of a circuit s functionality to be a proprietary and creative design technique. Our digital signal processing design expertise maximizes the price/performance characteristics of both the analog and digital functions and allows our ICs to work in an optimized manner to accomplish particular tasks. Generally, we surround core analog circuitry with digital CMOS transistors, which allows our ICs to perform the required analog functions with increased digital capabilities. For example, our ProSLIC product is designed to function more efficiently than traditional products for the source end of the telephone line, which involve a two chip combination requiring more board space and numerous external components. The ProSLIC product is partitioned by combining a core analog design that provides analog-to-digital conversion and digital-to-analog conversion with optimized digital signal processing functions such as data compression, data expansion, filtering and tone generation. In this manner, we can isolate the higher voltage required to ring a telephone in low-cost, off-chip high voltage transistors or a small, complementary high voltage chip, thereby enabling us to fulfill the remaining core functions with a single CMOS chip. As a further example, our SiPHY Optical Physical Layer Transceivers utilize an architecturally advanced phase locked loop circuit based principally on digital signal processing. By performing a significant portion of this function in the digital domain in a monolithic chip, the circuit has been able to satisfy the demanding specifications of the optical network SONET standard using inexpensive CMOS transistors.

MICROCONTROLLER DESIGN EXPERTISE

As a result of the acquisition of Cygnal Integrated Products, we now have the required engineering talent and circuit integration methodologies to combine precision analog, high-speed digital, Flash memory and in-system programmability into a single, monolithic CMOS integrated circuit. Our microcontroller products are designed to capture an external analog signal, convert it to a digital signal, compute digital functions on the stream of data and then communicate the results through a standard digital interface. The ability to develop standard products with the broadest possible customer application base while being cost efficient with the silicon area of the monolithic CMOS integrated circuit requires a keen sense of customer value and engineering capabilities. Additionally, to manage the wide variety of signals on a monolithic piece of silicon including electrical noise, harmonics and other electronic distortions requires a fundamental knowledge of devices physics and accumulated design expertise.

UNDERSTANDING OF SYSTEMS TECHNOLOGY AND TRENDS

Our focused expertise in mixed-signal ICs is the result of the breadth of engineering talent we have assembled with experience working in analog-intensive CMOS design for a wide variety of applications. This expertise, which we consider a competitive advantage, is the foundation of our in-depth understanding of the technology and trends that impact electronic systems and markets. Our expertise includes:

isolation, which is critical for existing and emerging telecom networks;

frequency synthesis, which is core technology for wireless and clocking applications; and

signal processing and precision analog, which forms the heart of consumer, industrial, medical and automotive electronics applications.

Our understanding of the role of analog/digital interfaces within electronic systems, standards evolution, and end market drivers enables us to identify product development opportunities and capitalize on market trends.

MANUFACTURING

As a fabless IC manufacturer, we conduct IC design and development in our facilities and electronically transfer our proprietary IC designs to third-party semiconductor fabricators who process silicon wafers to produce the ICs that we design. Our IC designs use industry-standard CMOS manufacturing process technology to achieve a level of performance normally associated with more expensive special-purpose IC fabrication technology. We believe the use of CMOS technology facilitates the rapid production of our ICs within a lower cost framework. Our IC production employs submicron process geometries which are readily available from leading foundry suppliers worldwide, thus increasing the likelihood that manufacturing capacity will be available throughout our products life cycles. We currently partner principally with Taiwan Semiconductor Manufacturing Co. (TSMC) to manufacture substantially all of our semiconductor wafers. We believe that our fabless manufacturing model significantly reduces our capital requirements and allows us to focus our resources on design, development and marketing of our ICs.

Once the silicon wafers have been produced, they are shipped directly to our third-party assembly subcontractors. The assembled ICs are then forwarded for final testing, either to our third-party test subcontractors or our facilities in Austin, Texas, prior to shipping to our customers. We have increasingly utilized offshore third-party test subcontractors, typically in Asia where the parts are assembled and where the products are frequently delivered to our customers. During the fourth quarter of 2004, more than 90% of our units produced were tested by offshore third-party test subcontractors. We expect that our utilization of offshore third-party test subcontractors will remain at this level during fiscal 2005.

BACKLOG

As of January 1, 2005, our backlog was approximately $69.9 million, compared to approximately $86.1 million as of January 3, 2004. We include in backlog accepted product purchase orders from customers and worldwide distributor stocking orders. We only include orders with an expected shipping date from us within six months. Product orders in our backlog are subject to changes in delivery schedules or cancellation at the option of the purchaser typically without penalty. Our backlog may fluctuate significantly depending upon customer order patterns which may, in turn, vary considerably based on rapidly changing business circumstances. Backlog from distributors is not recognized as revenue until the products are sold by the distributors. Additionally, our arrangements with distributors typically provide for price protection and stock rotation activities. Accordingly, we do not believe that our backlog at any time is necessarily representative of actual sales for any succeeding period.

COMPETITION

The markets for semiconductors generally, and for analog and mixed-signal ICs in particular, are intensely competitive. We believe the principal competitive factors in our industry are:

- Product size;
- Level of integration;
- Product capabilities;
- Reliability;
- Price;
- Performance;
- Intellectual property;
- Customer support;
- Reputation;
- Ability to rapidly introduce new products to market; and
- Power requirements.

We believe that we are competitive with respect to these factors, particularly because our ICs typically are smaller in size, are highly integrated, achieve high performance specifications at lower price points than competitive products and are manufactured in standard CMOS which generally enables us to supply them on a relatively rapid basis to customers to meet their product introduction schedules. However, disadvantages we face include our relatively short operating history in certain of our markets and the need for customers to redesign their products and modify their software to implement our ICs in their products.

We anticipate that the market for our products will continually evolve and will be subject to rapid technological change. For example, the mobile handset markets may increasingly require compliance with Wideband Code Division Multiple Access (WCDMA) or EDGE standards, in addition to the GSM/GPRS standard. Our GSM/GPRS mobile handset products have accounted for substantially all of our mobile handset revenue to date. If we are not able to develop EDGE and/or WCDMA compliant products that gain similar acceptance, our mobile handset revenue and overall operating results would be adversely affected. In addition, as we target and supply products to numerous markets and applications, we face competition from a relatively large number of competitors. Across our product offerings, we compete with Agere Systems, Atmel, AMCC, Analog Devices, Broadcom, Conexant, Cypress, ESS, Freescale, Fujitsu, Infineon Technologies, Legerity, Maxim Integrated Products, Microchip, National Semiconductor, Philips, Renesas, RF Micro Devices, Semtech, Skyworks Solutions, Texas Instruments, Vitesse Semiconductor and others. We expect to face competition in the future from our current competitors, other manufacturers and designers of semiconductors, and innovative start-up semiconductor design companies. Our competitors may also offer bundled chipset kit arrangements offering a more complete product, which may negatively impact our competitive position despite the technical merits or advantages of our products. In addition, our customers could develop products or technologies internally that would replace their need for our products and would become a source of competition. As the markets for electronic products grow, we also may face competition from traditional electronic device companies. These companies may enter the mixed-signal semiconductor market by introducing their own products, including components within their products that would eliminate the need for our ICs, or by entering into strategic relationships with or acquiring other existing IC providers.

Many of our competitors and potential competitors have longer operating histories, greater name recognition, access to larger customer bases, complementary product offerings, and significantly greater financial, sales and marketing, manufacturing, distribution, technical and other resources than us. Current and potential competitors have established or may establish financial and strategic relationships between themselves or with our existing or potential customers, resellers or other third parties. Accordingly, it is possible that new competitors or alliances among competitors could emerge and rapidly acquire significant market share.

INTELLECTUAL PROPERTY

Our future success depends in part upon our proprietary technology. We seek to protect our technology through a combination of patents, copyrights, trade secrets, trademarks and confidentiality procedures. As of January 1, 2005, we had more than 450 issued or pending United States patents in the IC field. We also frequently file for patent protection in a variety of international jurisdictions with respect to the proprietary technology covered by our U.S. patents and patent applications. There can be no assurance that patents will ever be issued with respect to these applications. Furthermore, it is possible that any patents held by us may be invalidated, circumvented, challenged or licensed to others. In addition, there can be no assurance that such patents will provide us with competitive advantages or adequately safeguard our proprietary rights. The patents and patent applications described above will expire at various times in the distant future.

In addition, we claim copyright protection for proprietary documentation used in our products. We have filed for registration, or are in the process of filing for registration, of the visual image of each IC that we have manufactured in commercial quantities with the United States Copyright Office. We have registered the Silicon Laboratories logo and a variety of other product and product family names as trademarks in the United States and selected foreign jurisdictions. All other trademarks, service marks or trade names appearing in this report are the property of their respective owners. We also attempt to protect our trade secrets and other proprietary information through agreements with our customers, suppliers, employees and consultants, and through other customary security measures. We intend to protect our rights vigorously, but there can be no assurance that our efforts will be successful. In addition, the laws of other countries in which our products are sold may not protect our products and intellectual property rights to the same extent as the laws of the United States.

While our ability to effectively compete depends in large part on our ability to protect our intellectual property, we believe that our technical expertise and ability to introduce new products in a timely manner will be an important factor in maintaining our competitive position.

Many participants in the semiconductor and electronics industries have a significant number of patents and have frequently demonstrated a readiness to commence litigation based on allegations of patent and other intellectual property infringement. From time to time, third parties may assert infringement claims against us. We may not prevail in any such litigation or may not be able to license any valid and infringed patents from third parties on commercially reasonable terms, if at all. Litigation, regardless of the outcome, is likely to result in substantial cost and diversion of our resources, including our management s time. Any such litigation could materially adversely affect us. For further information regarding patent litigation, please see Part I, Item 3. Legal Proceedings.

Our licenses include industry standard licenses with our vendors, such as wafer fabrication tool libraries, third party core libraries, computer-aided design applications and business software applications.

EMPLOYEES

As of January 1, 2005, we employed 588 people. Our success depends on the continued service of our key technical and senior management personnel and on our ability to continue to attract, retain and motivate highly skilled analog and mixed-signal engineers. The competition for such personnel is intense. We have never had a work stoppage and none of our employees are represented by a labor organization. We consider our employee relations to be good.

ENVIRONMENTAL REGULATION

Federal, state and local regulations impose various environmental controls on the storage, use, discharge and disposal of certain chemicals and gases used in the semiconductor industry. Our compliance with these laws and regulations has not had a material impact on our financial position or results of operations.

FACTORS AFFECTING OUR FUTURE OPERATING RESULTS

RISKS RELATED TO OUR BUSINESS

WE MAY NOT BE ABLE TO MAINTAIN OUR HISTORICAL GROWTH AND MAY EXPERIENCE SIGNIFICANT PERIOD-TO-PERIOD FLUCTUATIONS IN OUR REVENUES AND OPERATING RESULTS, WHICH MAY RESULT IN VOLATILITY IN OUR STOCK PRICE

Although we have generally experienced revenue growth in our recent history, we may not be able to sustain this growth. We may also experience significant period-to-period fluctuations in our revenues and operating results in the future due to a number of factors, and any such variations may cause our stock price to fluctuate. It is likely that in some future period our revenues or operating results will be below the expectations of public market analysts or investors. If this occurs, our stock price may drop, perhaps significantly. For example, our revenues in the third and fourth quarters of fiscal 2004 fell below analyst expectations and resulted in significant declines in our stock price.

A number of factors, in addition to those cited in other risk factors applicable to our business, may contribute to fluctuations in our revenues and operating results, including:

the timing and volume of orders received from our customers;

the timeliness of our new product introductions;

the rate of acceptance of our products by our customers, including the acceptance of new products we may develop for integration in the products manufactured by such customers, which we refer to as design wins ;

the time lag and realization rate between design wins and production orders;

the demand for, and life cycles of, the products incorporating our ICs;

the rate of adoption of mixed-signal ICs in the markets we target;

deferrals or reductions of customer orders in anticipation of new products or product enhancements from us or our competitors or other providers of ICs;

changes in product mix;

the average selling prices for our products could drop suddenly due to competitive offerings or competitive predatory pricing, especially with respect to our mobile handset products;

changes in market standards;

impairment charges related to inventory, equipment or other long-lived assets;

significant legal costs to defend our intellectual property rights or respond to claims against us; and

the rate at which new markets emerge for products we are currently developing or for which our design expertise can be utilized to develop products for these new markets.

The markets for mobile handsets, personal computers, satellite television set-top boxes and VOIP applications are characterized by rapid fluctuations in demand and seasonality that result in corresponding fluctuations in the demand for our products that are incorporated in such devices. Additionally, the rate of technology acceptance by our customers results in fluctuating demand for our products as customers are reluctant to incorporate a new IC into their products until the new IC has achieved market acceptance. Once a new IC achieves market acceptance, demand for the new IC can quickly accelerate to a point and then level off such that rapid historical growth in sales of a product should not be viewed as indicative of continued future growth. In addition, demand can quickly decline for a product when a new IC product is introduced and receives market acceptance. For example, mobile handset transceivers that provide some of the functionality provided by our RF Synthesizers have been introduced to market by us and our competitors. The introduction of these competing transceivers, including our Aero Transceiver, has resulted in a rapid decline in our sales of RF Synthesizers. Due to the various factors mentioned above, the results of any prior quarterly or annual periods should not be relied upon as an indication of our future operating performance.

WE DEPEND ON A LIMITED NUMBER OF CUSTOMERS FOR A SUBSTANTIAL PORTION OF OUR REVENUES, AND THE LOSS OF, OR A SIGNIFICANT REDUCTION IN ORDERS FROM, ANY KEY CUSTOMER COULD SIGNIFICANTLY REDUCE OUR REVENUES

The loss of any of our key customers, or a significant reduction in sales to any one of them, would significantly reduce our revenues and adversely affect our business. During fiscal 2004, our ten largest customers accounted for 51% of our revenues. We had one customer, Samsung, which represented 17% of our revenues. No other single customer accounted for more than 10% of our revenues during fiscal 2004. Most of the markets for our products are dominated by a small number of potential customers. Therefore, our operating results in the foreseeable future will continue to depend on our ability to sell to these dominant customers, as well as the ability of these customers to sell products that incorporate our IC products. In the future, these customers may decide not to purchase our ICs at all, purchase fewer ICs than they did in the past or alter their purchasing patterns, particularly because:

we do not have material long-term purchase contracts with our customers;

substantially all of our sales to date have been made on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with little or no notice to us and without penalty;

some of our customers may have efforts underway to actively diversify their vendor base which could reduce purchases of our ICs; and

some of our customers have developed or acquired products that compete directly with products these customers purchase from us, which could affect our customers purchasing decisions in the future.

While we have been a significant supplier of the direct access arrangement, or DAA, ICs used in many of our customers soft modem DAA products and have also been a substantial supplier of transceivers to Samsung and other major GSM handset manufacturers, our customers regularly evaluate alternative sources of supply in order to diversify their supplier base, which would increase their negotiating leverage with us and protect their ability to secure these components. We believe that any expansion of our customers supplier bases could have an adverse effect on the prices we are able to charge and volume of product that we are able to sell to our customers, which would negatively affect our revenues and operating results.

WE ARE SUBJECT TO RISKS RELATING TO PRODUCT CONCENTRATION AND LACK OF REVENUE DIVERSIFICATION

We derive a substantial portion of our revenues from a limited number of products, and we expect these products to continue to account for a large percentage of our revenues in the near term. Continued market acceptance of these products, is therefore, critical to our future success. In addition, substantially all of our products that we have sold include technology related to one or more of our issued U.S. patents. If these patents are found to be invalid or unenforceable, our competitors could introduce competitive products that could reduce both the volume and price per unit of our products. Our business, operating results, financial condition and cash flows could therefore be adversely affected by:

a decline in demand for any of our more significant products, including our Aero Transceiver, DAA, ISOmodem or ProSLIC;

failure of our products to achieve continued market acceptance;

an improved version of our products being offered by a competitor;

technological change that we are unable to address with our products; and

a failure to release new products or enhanced versions of our existing products on a timely basis and/or the failure of these products to achieve market acceptance.

We are particularly dependent on sales of our mobile handset products, which constituted 50% of our total revenues in fiscal 2004 and fiscal 2003. In particular, our Aero Transceiver mobile handset product and its subsequent derivatives represented approximately 50% of our total revenues in fiscal 2004 and approximately 40% of our total revenues in fiscal 2003. If the market for the Aero Transceiver or the market for GSM/GPRS mobile handsets in which these products are incorporated deteriorates, our operating results would be materially and adversely affected.

IF WE ARE UNABLE TO DEVELOP NEW AND ENHANCED PRODUCTS THAT ACHIEVE MARKET ACCEPTANCE IN A TIMELY MANNER, OUR OPERATING RESULTS AND COMPETITIVE POSITION COULD BE HARMED

Our future success will depend on our ability to reduce our dependence on a few products by developing new ICs and product enhancements that achieve market acceptance in a timely and cost-effective manner. The development of mixed-signal ICs is highly complex, and we have experienced delays in completing the development and introduction of new products and product enhancements. Successful product development and market acceptance of our products depend on a number of factors, including:

changing requirements of customers;

accurate prediction of market and technical requirements, such as any shift of GSM/GPRS to EDGE and WCDMA;

timely completion and introduction of new designs;

timely qualification and certification of our ICs for use in our customers products;

commercial acceptance and volume production of the products into which our ICs will be incorporated;

availability of foundry, assembly and test capacity;

achievement of high manufacturing yields;

quality, price, performance, power use and size of our products;

availability, quality, price and performance of competing products and technologies;

our customer service and support capabilities and responsiveness;

successful development of our relationships with existing and potential customers;

changes in technology, industry standards or end-user preferences; and

cooperation of software partners and semiconductor partners to support our chips within a system.

We cannot provide any assurance that products which we recently have developed or may develop in the future will achieve market acceptance. We have introduced to market or are in development of many ICs. If our ICs fail to achieve market acceptance, or if we fail to develop new products on a timely basis that achieve market acceptance, our growth prospects, operating results and competitive position could be adversely affected.

OUR RESEARCH AND DEVELOPMENT EFFORTS ARE FOCUSED ON A LIMITED NUMBER OF NEW TECHNOLOGIES AND PRODUCTS, AND ANY DELAY IN THE DEVELOPMENT, OR ABANDONMENT, OF THESE TECHNOLOGIES OR PRODUCTS BY INDUSTRY PARTICIPANTS, OR THEIR FAILURE TO ACHIEVE MARKET ACCEPTANCE, COULD COMPROMISE OUR COMPETITIVE POSITION

Our ICs are used as components in electronic devices in various markets. As a result, we have devoted and expect to continue to devote a large amount of resources to develop products based on new and emerging technologies and standards that will be commercially introduced in the future. Research and development expense for the year ended January 1, 2005 was $74.9 million, or 16.4% of revenues. A number of large companies are actively involved in the development of these new technologies and standards. Should any of these companies delay or abandon their efforts to develop commercially available products based on new technologies and standards, our research and development efforts with respect to these technologies and standards likely would have no appreciable value. In addition, if we do not correctly anticipate new technologies and standards, or if the products that we develop based on these new technologies and standards fail to achieve market acceptance, our competitors may be better able to address market demand than we would. Furthermore, if markets for these new technologies and standards develop later than we anticipate, or do not develop at all, demand for our products that are currently in development would suffer, resulting in lower sales of these products than we currently anticipate. For example, we have introduced to market the Aero Transceiver product for use in wireless phones operating on the GSM/GPRS standard. We believe this market is now in the early stages of adopting the EDGE and/or WCDMA standards, which allow for enhanced data generation and transmission using mobile handsets. Forecasters expect the EDGE and WCDMA markets to develop and expand in 2005 and 2006. In July 2004, we extended our Aero family to meet the EDGE standard with the Aero EDGE Radio. However, we cannot be certain that the use of this technology will not change in the future and thereby make our products unsuitable. Furthermore, we cannot be certain that any product we develop for these standards will achieve market acceptance.

WE HAVE INCREASED OUR INTERNATIONAL ACTIVITIES SIGNIFICANTLY AND PLAN TO CONTINUE SUCH EFFORTS, WHICH SUBJECTS US TO ADDITIONAL BUSINESS RISKS INCLUDING INCREASED LOGISTICAL AND FINANCIAL COMPLEXITY, POLITICAL INSTABILITY AND CURRENCY FLUCTUATIONS

We recently established additional international subsidiaries and have opened additional offices in international markets to expand our international activities in Europe and the Pacific Rim region. This has included the establishment of a headquarters in Singapore for non-U.S. operations. The percentage of our revenues to customers located outside of the United States was 89% in fiscal 2004, 80% in fiscal 2003 and 79% in fiscal 2002. We may not be able to maintain or increase international market demand for our products. Our international operations are subject to a number of risks, including:

increased complexity and costs of managing international operations, including our headquarters for non-U.S. operations in Singapore;

protectionist laws and business practices that favor local competition in some countries;

multiple, conflicting and changing laws, regulations and tax schemes;

longer sales cycles;

greater difficulty in accounts receivable collection and longer collection periods;

high levels of distributor inventory subject to price protection and rights of return to us;

political and economic instability;

greater difficulty in hiring qualified technical sales and applications engineers and administrative personnel; and

the need to have business and operations systems that can meet the need of our international business and structure.

To date, all of our sales to international customers and purchases of components from international suppliers have been denominated in U.S. dollars. As a result, an increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive for our international customers to purchase, thus rendering our products less competitive.

FAILURE TO MANAGE OUR DISTRIBUTION CHANNEL RELATIONSHIPS COULD IMPEDE OUR FUTURE GROWTH

The future growth of our business will depend in large part on our ability to manage our relationships with current and future distributors and sales representatives, develop additional channels for the distribution and sale of our products and manage these relationships. As we execute our indirect sales strategy, we must manage the potential conflicts that may arise with our direct sales efforts. For example, conflicts with a distributor may arise when a customer begins purchasing directly from us rather than through the distributor. The inability to successfully execute or manage a multi-channel sales strategy could impede our future growth. In addition, relationships with our distributors often involve the use of price protection and inventory return rights. This often requires a significant amount of sales management s time and system resources to manage properly.

WE ARE SUBJECT TO INCREASED INVENTORY RISKS AND COSTS BECAUSE WE BUILD OUR PRODUCTS BASED ON FORECASTS PROVIDED BY CUSTOMERS BEFORE RECEIVING PURCHASE ORDERS FOR THE PRODUCTS

In order to ensure availability of our products for some of our largest customers, we start the manufacturing of our products in advance of receiving purchase orders based on forecasts provided by these customers. However, these forecasts do not represent binding purchase commitments and we do not recognize sales for these products until they are shipped to the customer. As a result, we incur inventory and manufacturing costs in advance of anticipated sales. Because demand for our products may not materialize, manufacturing based on forecasts subjects us to increased risks of high inventory carrying costs, increased obsolescence and increased operating costs. These inventory risks are exacerbated when our customers purchase indirectly through contract manufacturers or hold component inventory levels greater than their consumption rate because this causes us to have less visibility regarding the accumulated levels of inventory for such customers. A resulting write-off of unusable or excess inventories would adversely affect our operating results.

OUR PRODUCTS ARE COMPLEX AND MAY CONTAIN ERRORS WHICH COULD LEAD TO PRODUCT LIABILITY, AN INCREASE IN OUR COSTS AND/OR A REDUCTION IN OUR REVENUES

Our products are complex and may contain errors, particularly when first introduced or as new versions are released. We rely primarily on our in-house testing personnel to design test operations and procedures to detect any errors prior to delivery of our products to our customers. Because our products are manufactured by third parties, should problems occur in the operation or performance of our ICs, we may experience delays in meeting key introduction dates or scheduled delivery dates to our customers. These errors also could cause us to incur significant re-engineering costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations and business reputation problems. Any defects could require product replacement or recall or we could be obligated to accept product returns. Any of the foregoing could impose substantial costs and harm our business.

Product liability claims may be asserted with respect to our products. Our products are typically sold at prices that are significantly lower than the cost of the end-products into which they are incorporated. A defect or failure in our product could cause failure in our customer s end-product, so we could face claims for damages that are disproportionately higher than the revenues and profits we

receive from the products involved. Furthermore, product liability risks are particularly significant with respect to medical and automotive applications because of the risk of serious harm to users of these products. There can be no assurance that any insurance we maintain will sufficiently protect us from any such claims.

An increasing number of our new product developments are being designed in even more complex processes. For example, our Aero II was designed in a .13 micron CMOS process, which adds cost, complexity and elements of experimentation and development, particularly in the area of advanced mixed-signal design.

OUR CUSTOMERS REQUIRE OUR PRODUCTS TO UNDERGO A LENGTHY AND EXPENSIVE QUALIFICATION PROCESS WITHOUT ANY ASSURANCE OF PRODUCT SALES

Prior to purchasing our products, our customers require that our products undergo an extensive qualification process, which involves testing of the products in the customer s system as well as rigorous reliability testing. This qualification process may continue for six months or longer. However, qualification of a product by a customer does not ensure any sales of the product to that customer. Even after successful qualification and sales of a product to a customer, a subsequent revision to the IC, changes in its manufacturing process or the selection of a new supplier by us may require a new qualification process, which may result in delays and in us holding excess or obsolete inventory. After our products are qualified, it can take an additional six months or more before the customer commences volume production of components or devices that incorporate our products. We are experiencing this lengthy introduction to volume production cycle time with our CMOS Power Amplifier, which was introduced in the early part of fiscal 2004 and is not expected to contribute to our revenues prior to the second half of fiscal 2005. Despite these uncertainties, we devote substantial resources, including design, engineering, sales, marketing and management efforts, toward qualifying our products with customers in anticipation of sales. If we are unsuccessful or delayed in qualifying any of our products with a customer, such failure or delay would preclude or delay sales of such product to the customer, which may impede our growth and cause our business to suffer.

WE RELY ON THIRD PARTIES TO MANUFACTURE, ASSEMBLE AND TEST OUR PRODUCTS AND THE FAILURE TO SUCCESSFULLY MANAGE OUR RELATIONSHIPS WITH OUR MANUFACTURERS AND SUBCONTRACTORS WOULD NEGATIVELY IMPACT OUR ABILITY TO SELL OUR PRODUCTS

We do not have our own wafer fab manufacturing facilities. Therefore, we rely principally on one third-party vendor, Taiwan Semiconductor Manufacturing Co. (TSMC), to manufacture the ICs we design. We also currently rely principally on two offshore third-party assembly subcontractors, Advanced Semiconductor Engineering (ASE) and Amkor Technology, to assemble and package the silicon chips provided by the wafers for use in final products. Additionally, we rely on these offshore subcontractors for a substantial portion of the testing requirements of our products prior to shipping. Although we also maintain testing facilities in Austin, Texas, we have increasingly utilized offshore third-party test subcontractors, typically in Asia, where the parts are assembled and where the products are frequently delivered to our customers. We expect utilization of offshore third-party test subcontractors to continue in the future.

The cyclical nature of the semiconductor industry drives wide fluctuations in available capacity at third-party vendors. On occasion, we have been unable to adequately respond to unexpected increases in customer demand due to capacity constraints and, therefore, were unable to benefit from this incremental demand. We may be unable to obtain adequate foundry, assembly or test capacity from our third-party subcontractors to meet our customers delivery requirements even if we adequately forecast customer demand.

There are significant risks associated with relying on these third-party foundries and subcontractors, including:

- failure by us, our customers or their end customers to qualify a selected supplier;

potential insolvency of the third-party subcontractors;

reduced control over delivery schedules and quality;

limited warranties on wafers or products supplied to us;

potential increases in prices;

increased need for international-based supply, logistics and financial management;

their inability to supply or support new or changing packaging technologies; and

low test yields.

We typically do not have long-term supply contracts with our third-party vendors which obligate the vendor to perform services and supply products to us for a specific period, in specific quantities, and at specific prices. Our third-party foundry, assembly and test subcontractors typically do not guarantee that adequate capacity will be available to us within the time required to meet demand for our products. In the event that these vendors fail to meet our demand for whatever reason, we expect that it would take up to twelve months to transition performance of these services to new providers. Such a transition may also require qualification of the new providers by our customers or their end customers.

Since our inception, substantially all of the silicon wafers for the products that we have shipped were manufactured either by TSMC or its affiliates. Our customers typically complete their own qualification process. If we fail to properly balance customer demand across the existing semiconductor fabrication facilities that we utilize or are required by our foundry partners to increase, or otherwise change the number of fab lines that we utilize for our production, we might not be able to fulfill demand for our products and may need to divert our engineering resources away from new product development initiatives to support the fab line transition, which would adversely affect our operating results.

OUR INABILITY TO MANAGE GROWTH COULD MATERIALLY AND ADVERSELY AFFECT OUR BUSINESS

In recent periods, we have significantly increased the scope of our operations and expanded our workforce from 486 employees at the end of fiscal 2003 to 588 employees at the end of fiscal 2004. This growth has placed, and any future growth of our operations will continue to place, a significant strain on our management personnel, systems and resources. We anticipate that we will need to implement a variety of new and upgraded sales, operational and financial enterprise-wide systems, information technology infrastructure, procedures and controls, including the improvement of our accounting and other internal management systems to manage this growth and maintain compliance with regulatory guidelines, including Sarbanes-Oxley Act requirements. While we believe that we are in compliance with all Sarbanes-Oxley Act requirements today, as our business grows our internal management systems and processes will need to improve to ensure that we remain in compliance. We also expect that we will need to continue to expand, train, manage and motivate our workforce. All of these endeavors will require substantial management effort, and we anticipate that we will require additional management personnel and internal processes to manage these efforts and to plan for the succession from time to time of certain persons who have been key management and technical personnel. If we are unable to effectively manage our expanding global operations, our business could be materially and adversely affected.

WE DEPEND ON OUR KEY PERSONNEL TO MANAGE OUR BUSINESS EFFECTIVELY IN A RAPIDLY CHANGING MARKET, AND IF WE ARE UNABLE TO RETAIN OUR CURRENT PERSONNEL AND HIRE ADDITIONAL PERSONNEL, OUR ABILITY TO DEVELOP AND SUCCESSFULLY MARKET OUR PRODUCTS COULD BE HARMED

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering, sales and marketing personnel. We believe that our future success will be dependent on retaining the services of our key personnel, developing their successors and certain internal processes to reduce our reliance on specific individuals, and on properly managing the transition of key roles when they occur. For example, at the beginning of fiscal 2004, Navdeep Sooch, our co-founder and chairman of the board, transitioned out of his role as CEO and Daniel Artusi, our Chief Operating Officer and President, assumed the role of CEO. There is currently a shortage of qualified personnel with significant experience in the design, development, manufacturing, marketing and sales of analog and mixed-signal ICs. In particular, there is a shortage of engineers who are familiar with the intricacies of the design and manufacturability of analog elements, and competition for such personnel is intense. Our key technical personnel represent a significant asset and serve as the primary source for our technological and product innovations. We may not be successful in attracting and retaining sufficient numbers of technical personnel to support our anticipated growth. The loss of any of our key employees or the inability to attract or retain qualified personnel both in the United States and internationally, including engineers and sales and marketing personnel, could delay the development and introduction of, and negatively impact our ability to sell, our products.

ANY ACQUISITIONS WE MAKE COULD DISRUPT OUR BUSINESS AND HARM OUR FINANCIAL CONDITION

As part of our growth and product diversification strategy, we continue to evaluate opportunities to acquire other businesses, intellectual property or technologies that would complement our current offerings, expand the breadth of our markets or enhance our technical capabilities. The Cygnal acquisition and other acquisitions that we may potentially make in the future entail a number of risks that could materially and adversely affect our business and operating results, including:

problems integrating the acquired operations, technologies or products with our existing business and products;

diversion of management s time and attention from our core business;

need for financial resources above our planned investment levels;

difficulties in retaining business relationships with suppliers and customers of the acquired company;

risks associated with entering markets in which we lack prior experience;

risks associated with the transfer of licenses of intellectual property;

potential loss of key employees of the acquired company; and

potential impairment of related goodwill and intangible assets.

In connection with the Cygnal acquisition, we are obligated to potentially issue up to a maximum of 1,290,963 additional shares of our common stock based upon the achievement of product revenue milestones (of which approximately 369,000 shares have been issued thus far), which could distract our management and employees and lead to disputes with former Cygnal stockholders. Future acquisitions also could cause us to incur debt or contingent liabilities or cause us to issue equity securities that could negatively impact the ownership percentages of existing shareholders.

OUR STOCK PRICE MAY BE VOLATILE

The market price of our common stock has been volatile in the past and may be volatile in the future. The market price of our common stock may be significantly affected by the following factors:

actual or anticipated fluctuations in our operating results;

changes in financial estimates by securities analysts or our failure to perform in line with such estimates;

changes in market valuations of other technology companies, particularly semiconductor companies;

announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;

introduction of technologies or product enhancements that reduce the need for our products;

the loss of, or decrease in sales to, one or more key customers;

a large sale of stock by a significant shareholder;

dilution from the issuance of our stock in connection with acquisitions;

departures of key personnel; and

the required expensing of stock options under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) 123 (revised 2004), SHARE-BASED PAYMENT.

The stock market has experienced extreme volatility that often has been unrelated to the performance of particular companies. These market fluctuations may cause our stock price to fall regardless of our performance.

MOST OF OUR CURRENT MANUFACTURERS, ASSEMBLERS, TEST SERVICE PROVIDERS, AND CUSTOMERS ARE CONCENTRATED IN THE SAME GEOGRAPHIC REGION, WHICH INCREASES THE RISK THAT A NATURAL DISASTER, EPIDEMIC, LABOR STRIKE, WAR OR POLITICAL UNREST COULD DISRUPT OUR OPERATIONS OR SALES

Most of our current semiconductor wafer manufacturer s foundries and one of our assembly and test subcontractor s sites are primarily located in the same region within Taiwan and our other assembly and test subcontractors are located in the Pacific Rim region. In addition, many of our customers, particularly mobile handset manufacturers, are located in the Pacific Rim region. The risk of earthquakes in Taiwan and the Pacific Rim region is significant due to the proximity of major earthquake fault lines in the area. We are not currently covered by insurance against business disruption caused by earthquakes as such insurance is not currently available on terms that we believe are commercially reasonable. Earthquakes, fire, flooding, lack of water or other natural disasters in Taiwan or the Pacific Rim region, or an epidemic, political unrest, war, labor strikes or work stoppages in countries where our semiconductor manufacturer, assemblers and test subcontractors are located, likely would result in the disruption of our foundry, assembly or test capacity. There can be no assurance that such alternate capacity could be obtained on favorable terms, if at all.

A natural disaster, epidemic, labor strike, war or political unrest where our customers facilities are located would likely reduce our sales to such customers. For example, Samsung, our largest customer, is based in South Korea and represented 17% of our revenues in fiscal 2004. North Korea s decision to withdraw from the nuclear Non-Proliferation Treaty and related geopolitical maneuverings have created unrest. Such unrest could create economic uncertainty or instability, could escalate to war or otherwise adversely affect South Korea and our South Korean customers and reduce our sales to such customers, which would materially and adversely affect our operating results. In addition, a significant portion of the assembly and testing of our mobile handset products occurs in South Korea. Any disruption resulting from these events could also cause significant delays in shipments of our products until we are able to shift our manufacturing, assembling or testing from the affected subcontractor to another third-party vendor.

WE MAY BE UNABLE TO PROTECT OUR INTELLECTUAL PROPERTY, WHICH WOULD NEGATIVELY AFFECT OUR ABILITY TO COMPETE

Our products rely on our proprietary technology, and we expect that future technological advances made by us will be critical to sustain market acceptance of our products. Therefore, we believe that the protection of our intellectual property rights is and will continue to be important to the success of our business. We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We also enter into confidentiality or license agreements with our employees, consultants, intellectual property providers and business partners, and control access to and distribution of our documentation and other proprietary information. Despite these efforts, unauthorized parties may attempt to copy or otherwise obtain and use our proprietary technology. Monitoring unauthorized use of our technology is difficult, and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. We cannot be certain that patents will be issued as a result of our pending applications nor can we be certain that any issued patents would protect or benefit us or give us adequate protection from competing products. For example, issued patents may be circumvented or challenged and declared invalid or unenforceable. We also cannot be certain that others will not develop effective competing technologies on their own.

THE SEMICONDUCTOR MANUFACTURING PROCESS IS HIGHLY COMPLEX AND, FROM TIME TO TIME, MANUFACTURING YIELDS MAY FALL BELOW OUR EXPECTATIONS, WHICH COULD RESULT IN OUR INABILITY TO SATISFY DEMAND FOR OUR PRODUCTS IN A TIMELY MANNER

The manufacture of our products is a highly complex and technologically demanding process. Although we work closely with our foundries to minimize the likelihood of reduced manufacturing yields, our foundries from time to time have experienced lower than anticipated manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials by our foundries could result in lower than anticipated manufacturing yields or unacceptable performance deficiencies. If our foundries fail to deliver fabricated silicon wafers of satisfactory quality in a timely manner, we will be unable to meet our customers demand for our products in a timely manner, which would adversely affect our operating results and damage our customer relationships.

WE DEPEND ON OUR CUSTOMERS TO SUPPORT OUR PRODUCTS, AND SOME OF OUR CUSTOMERS OFFER COMPETING PRODUCTS

Our products are currently used by our customers to produce modems, telephony equipment, mobile handsets, networking equipment and a broad range of other devices. We rely on our customers to provide hardware, software, intellectual property indemnification and other technical support for the products supplied by our customers. If our customers do not provide the required functionality or if our customers do not provide satisfactory support for their products, the demand for these devices that incorporate our products may diminish or we may otherwise be materially adversely affected. Any reduction in the demand for these devices would significantly reduce our revenues.

In certain products such as the DAA, some of our customers (including Agere Systems, Conexant and Smart Link) offer their own competitive products. These customers may find it advantageous to support their own offerings in the marketplace in lieu of promoting our products.

23

SIGNIFICANT LITIGATION OVER INTELLECTUAL PROPERTY IN OUR INDUSTRY MAY CAUSE US TO BECOME INVOLVED IN COSTLY AND LENGTHY LITIGATION WHICH COULD SERIOUSLY HARM OUR BUSINESS

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. From time to time, we receive letters from various industry participants alleging infringement of patents, trademarks or misappropriation of trade secrets or from customers requesting indemnification for claims brought against them by third parties. The exploratory nature of these inquiries has become relatively common in the semiconductor industry. We respond when appropriate and as advised by legal counsel. We have been involved in litigation to protect our intellectual property rights in the past and may become involved in such litigation again in the future. For example, in April 2003, we paid $17 million to settle patent infringement claims brought against us by TDK Semiconductor Corporation (TDK). In February 2004, we filed a lawsuit against a former employee and Axiom Microdevices alleging theft of trade secrets. In September 2004, we added claims for patent infringement to such suit. In the future, we may become involved in additional litigation to defend allegations of infringement asserted by others, both directly and indirectly as a result of certain industry-standard indemnities we may offer to our customers. Legal proceedings could subject us to significant liability for damages or invalidate our proprietary rights. Legal proceedings initiated by us to protect our intellectual property rights could also result in counterclaims or countersuits against us. Any litigation, regardless of its outcome, would likely be time-consuming and expensive to resolve and would divert our management s time and attention. Most intellectual property litigation also could force us to take specific actions, including:

cease selling products that use the challenged intellectual property;

obtain from the owner of the infringed intellectual property a right to a license to sell or use the relevant technology, which license may not be available on reasonable terms, or at all;

redesign those products that use infringing intellectual property; or

pursue legal remedies with third parties to enforce our indemnification rights, which may not adequately protect our interests.

WE COULD SEEK TO RAISE ADDITIONAL CAPITAL IN THE FUTURE THROUGH THE ISSUANCE OF EQUITY OR DEBT SECURITIES, BUT ADDITIONAL CAPITAL MAY NOT BE AVAILABLE ON TERMS ACCEPTABLE TO US, OR AT ALL

We believe that our existing cash, cash equivalents and investments will be sufficient to meet our working capital needs, capital expenditures, investment requirements and commitments for at least the next 12 months. However, it is possible that we may need to raise additional funds to finance our activities or to facilitate acquisitions of other businesses, products, intellectual property or technologies. We believe we could raise these funds, if needed, by selling equity or debt securities to the public or to selected investors. In addition, even though we may not need additional funds, we may still elect to sell additional equity or debt securities or obtain credit facilities for other reasons. However, we may not be able to obtain additional funds on favorable terms, or at all. If we decide to raise additional funds by issuing equity or convertible debt securities, the ownership percentages of existing shareholders would be reduced.

24

WE ARE A RELATIVELY SMALL COMPANY WITH LIMITED RESOURCES COMPARED TO SOME OF OUR CURRENT AND POTENTIAL COMPETITORS AND WE MAY NOT BE ABLE TO COMPETE EFFECTIVELY AND INCREASE MARKET SHARE

Some of our current and potential competitors have longer operating histories, significantly greater resources and name recognition and a larger base of customers than we have. As a result, these competitors may have greater credibility with our existing and potential customers. They also may be able to adopt more aggressive pricing policies and devote greater resources to the development, promotion and sale of their products than we can to ours. In addition, some of our current and potential competitors have already established supplier or joint development relationships with the decision makers at our current or potential customers. These competitors may be able to leverage their existing relationships to discourage their customers from purchasing products from us or persuade them to replace our products with their products. Our competitors may also offer bundled chipset kit arrangements offering a more complete product despite the technical merits or advantages of our products. These competitors may elect not to support our products which could complicate our sales efforts. These and other competitive pressures may prevent us from competing successfully against current or future competitors, and may materially harm our business. Competition could decrease our prices, reduce our sales, lower our gross profits or decrease our market share.

PROVISIONS IN OUR CHARTER DOCUMENTS AND DELAWARE LAW COULD PREVENT, DELAY OR IMPEDE A CHANGE IN CONTROL OF US AND MAY REDUCE THE MARKET PRICE OF OUR COMMON STOCK

Provisions of our certificate of incorporation and bylaws could have the effect of discouraging, delaying or preventing a merger or acquisition that a stockholder may consider favorable. For example, our certificate of incorporation and bylaws provide for:

the division of our board of directors into three classes to be elected on a staggered basis, one class each year;

the ability of our board of directors to issue shares of our preferred stock in one or more series without further authorization of our stockholders;

a prohibition on stockholder action by written consent;

elimination of the right of stockholders to call a special meeting of stockholders;

a requirement that stockholders provide advance notice of any stockholder nominations of directors or any proposal of new business to be considered at any meeting of stockholders; and

a requirement that a supermajority vote be obtained to amend or repeal certain provisions of our certificate of incorporation.

We also are subject to the anti-takeover laws of Delaware which may discourage, delay or prevent someone from acquiring or merging with us, which may adversely affect the market price of our common stock.

WE ARE SUBJECT TO CREDIT RISKS RELATED TO OUR ACCOUNTS RECEIVABLE, ESPECIALLY WHEN OVERSEAS CUSTOMERS PURCHASE OUR PRODUCTS

We do not generally obtain letters of credit or other security for payment from customers, distributors or contract manufacturers. Accordingly, we are not protected against accounts receivable default or bankruptcy by these entities. If we are unable to collect our accounts receivable, our operating results could be materially harmed.

THE PERFORMANCE OF OUR DSL ANALOG FRONT END (AFE) AND MODEM RELATED PRODUCTS MAY BE ADVERSELY AFFECTED BY SEVERE ENVIRONMENTAL CONDITIONS THAT MAY REQUIRE MODIFICATIONS, WHICH COULD LEAD TO AN INCREASE IN OUR COSTS OR A REDUCTION IN OUR REVENUES

Although our DSL AFE and modem related products are compliant with published specifications, these established specifications might not adequately address all conditions that must be satisfied in order to operate in harsh environments. This includes environments where there are wide variations in electrical quality, telephone line quality, static electricity and operating temperatures or that may be affected by lightning or improper handling by customers and end users. These environmental factors may result in unanticipated returns of our products. Any necessary modifications could cause us to incur significant re-engineering costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations and business reputation problems.

RISKS RELATED TO OUR INDUSTRY

WE ARE SUBJECT TO THE CYCLICAL NATURE OF THE SEMICONDUCTOR INDUSTRY, WHICH HAS BEEN SUBJECT TO SIGNIFICANT FLUCTUATIONS

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. The industry has experienced significant fluctuations, often connected with, or in anticipation of, maturing product cycles and new product introductions of both semiconductor companies and their customers products and fluctuations in general economic conditions.

Downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. For example, in fiscal 2001, the semiconductor industry suffered a downturn due to reductions in the actual unit sales of personal computers and wireless phones as compared to previous robust forecasts. This downturn resulted in a material adverse effect on our business and operating results in fiscal 2001.

Upturns have been characterized by increased product demand and production capacity constraints created by increased competition for access to third-party foundry, assembly and test capacity. We are dependent on the availability of such capacity to manufacture, assemble and test our ICs. None of our third-party foundry, assembly or test subcontractors have provided assurances that adequate capacity will be available to us.

THE AVERAGE SELLING PRICES OF OUR PRODUCTS COULD DECREASE RAPIDLY WHICH MAY NEGATIVELY IMPACT OUR REVENUES AND GROSS PROFITS

We may experience substantial period-to-period fluctuations in future operating results due to the erosion of our average selling prices, particularly for mobile handset products. We have reduced the average unit price of our products in anticipation of or in response to competitive pricing pressures, new product introductions by us or our competitors and other factors. If we are unable to offset any such reductions in our average selling prices by increasing our sales volumes and reducing production costs, our gross profits and revenues will suffer. To maintain our gross profit percentage, we will need to develop and introduce new products and product enhancements on a timely basis and continually reduce our costs. Our failure to do so would cause our revenues and gross profit percentage to decline.

26

COMPETITION WITHIN THE NUMEROUS MARKETS WE TARGET MAY REDUCE SALES OF OUR PRODUCTS AND REDUCE MARKET SHARE

The markets for semiconductors in general, and for mixed-signal ICs in particular, are intensely competitive. We expect that the market for our products will continually evolve and will be subject to rapid technological change. In addition, as we target and supply products to numerous markets and applications, we face competition from a relatively large number of competitors. Across all of our product areas, we compete with Agere Systems, Atmel, AMCC, Analog Devices, Broadcom, Conexant, Cypress, ESS, Freescale, Fujitsu, Infineon Technologies, Legerity, Maxim Integrated Products, Microchip, National Semiconductor, Philips, Renesas, RF Micro Devices, Semtech, Skyworks Solutions Inc., Texas Instruments, Vitesse Semiconductor and others. We expect to face competition in the future from our current competitors, other manufacturers and designers of semiconductors, and start-up semiconductor design companies. Some of our customers, such as Agere Systems, Broadcom, Intel, Motorola, Samsung and Texas Instruments, are also large, established semiconductor suppliers. Our sales to and support of these customers may enable them to become a source of competition to us, despite our efforts to protect our intellectual property rights. As the markets for communications products grow, we also may face competition from traditional communications device companies. These companies may enter the mixed-signal semiconductor market by introducing their own ICs or by entering into strategic relationships with or acquiring other existing providers of semiconductor products.

In addition, large companies may restructure their operations to create separate companies or may acquire new businesses that are focused on providing the types of products we produce or acquire our customers. For example, in May 2003, Conexant acquired PC-Tel s modem business. In the future, Conexant may seek to supplant our silicon DAA products that have historically been incorporated in PC-Tel s products with Conexant s own competing DAA product. In 2004, Motorola separated its semiconductor operations into Freescale Semiconductor, a publicly traded company focused on communications and integrated electronic systems. As an additional example, in February 2004, Conexant and GlobespanVirata merged to form a company focused on communication semiconductors. This combined entity will focus on all broadband applications and may compete with our DAA, ISOmodem and asymmetric digital subscriber line (ADSL) product lines.

OUR PRODUCTS MUST CONFORM TO INDUSTRY STANDARDS AND TECHNOLOGY IN ORDER TO BE ACCEPTED BY END USERS IN OUR MARKETS

Generally, our products comprise only a part of a device. All components of such devices must uniformly comply with industry standards in order to operate efficiently together. We depend on companies that provide other components of the devices to support prevailing industry standards. Many of these companies are significantly larger and more influential in affecting industry standards than we are. Some industry standards may not be widely adopted or implemented uniformly, and competing standards may emerge that may be preferred by our customers or end users. If larger companies do not support the same industry standards that we do, or if competing standards emerge, market acceptance of our products could be adversely affected which would harm our business.

Products for communications applications are based on industry standards that are continually evolving. For example, GSM mobile handsets now commonly use the GPRS specification for enabling data communications. Certain suppliers are now offering mobile handset devices utilizing the WCDMA protocol to support higher data communication rates on WCDMA networks. We do not currently have a WCDMA mobile handset product. Other suppliers, including us, are now offering mobile handset devices utilizing the EDGE protocol to support higher data communication rates on GSM networks. Our ability to compete in the future will depend on our ability to identify and ensure compliance with these evolving industry standards. The emergence of new industry standards could render our products incompatible with products developed by other suppliers. As a result, we could be required to invest significant time and effort and to incur significant expense to redesign our products to ensure compliance with relevant standards. If our products are not in compliance with prevailing industry standards for a significant period of time, we could miss opportunities to achieve crucial design wins.

Our pursuit of necessary technological advances may require substantial time and expense. We may not be successful in developing or using new technologies or in developing new products or product enhancements that achieve market acceptance. If our ICs fail to achieve market acceptance, our growth prospects, operating results and competitive position could be adversely affected.

AVAILABLE INFORMATION

Our Internet website address is http://www.silabs.com. Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available through the investor relations page of our Internet website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC). Our Internet website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

Item 2. Properties

Our primary facilities, housing test operations, sales and marketing, research and development, and administration, are located in Austin, Texas. These facilities consist of approximately 200,000 square feet of leased floor space with lease terms expiring at various dates through April 2010. In addition to these properties, we lease facilities in New Hampshire for engineering activities and various other smaller locations throughout the United States, England, France, Germany, Japan, Singapore, Hong Kong, Malaysia, Korea, Taiwan and China for sales, marketing, administrative, design and manufacturing support activities.

We believe that these facilities are suitable and adequate to meet our current operating needs.

Item 3. Legal Proceedings

Securities Litigation

On December 6, 2001, a class action complaint for violations of U.S. federal securities laws was filed in the United States District Court for the Southern District of New York against us, four of our officers individually and the three investment banking firms who served as representatives of the underwriters in connection with our initial public offering of common stock. The Consolidated Amended Complaint alleges that the registration statement and prospectus for our initial public offering did not disclose that (1) the underwriters solicited and received additional, excessive and undisclosed commissions from certain investors, and (2) the underwriters had agreed to allocate shares of the offering in exchange for a commitment from the customers to purchase additional shares in the aftermarket at pre-determined higher prices. The action seeks damages in an unspecified amount and is being coordinated with approximately 300 other nearly identical actions filed against other companies. A court order dated October 9, 2002 dismissed without prejudice our four officers who had been named individually. On February 19, 2003, the Court denied the motion to dismiss the complaint against us. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. Plaintiffs have not yet moved to certify a class in the Silicon Laboratories case. We have approved a settlement agreement and related agreements which set forth the terms of a settlement between us, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of us and the individual defendants for the conduct alleged in the action to be wrongful. We would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims we may have against our underwriters. The settlement agreement also provides a guaranteed recovery of $1 billion to plaintiffs for the cases relating to all of the approximately 300 issuers. To the extent that the underwriter defendants settle all of the cases for at least $1 billion, no payment will be required under the issuers settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. We anticipate that our potential financial obligation to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be covered by existing insurance. We are not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from our insurance carriers. Our carriers appear to be solvent, and we are not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, we do not expect that the settlement would involve any material payment by us. Furthermore, even if our insurance were unavailable due to insurer insolvency or otherwise, we expect that our maximum financial obligation to plaintiffs pursuant to the settlement agreement would be less than $3.4 million. The settlement agreement has been submitted to the Court for approval. Approval by the Court cannot be assured. We are unable to determine whether or when a settlement will occur or be finalized. As approval by the Court cannot be assured, we are unable at this time to determine whether the outcome of the litigation would have a material impact on our results of operations or financial condition.

Trade Secret and Patent Infringement Litigation

On February 17, 2004, we filed a lawsuit against a former employee and Axiom Microdevices Inc., a California corporation, in the United States District Court for the Western District of Texas, Austin Division, alleging theft of trade secrets by the individual and Axiom. The lawsuit also alleges that the employee breached his ethical, contractual and fiduciary obligations to us by disclosing trade secrets and confidential information to Axiom and that Axiom tortiously interfered with the employee s contractual obligations to us. On September 14, 2004, we added claims for infringement of United States Patents 6,549,071 and 6,788,141 to the pending suit. The patents relate to our proprietary technology for CMOS RF power amplifiers. At this time, we cannot estimate the outcome of this matter or resulting financial impact to us, if any.

Other Litigation

We are involved in various other legal proceedings that have arisen in the normal course of business. While the ultimate results of these matters cannot be predicted with certainty, we do not expect them to have a material adverse effect on the consolidated financial position or results of operations.

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

None.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock has been quoted on the Nasdaq National Market under the symbol SLAB since our initial public offering on March 23, 2000. The table below shows the high and low per-share sales prices of our common stock for the periods indicated, as reported by the Nasdaq National Market. As of January 1, 2005, the end of our 2004 fiscal year, there were 343 holders of record of our common stock.

	HIGH	LOW
Fiscal Year Ended January 3, 2004		
First Quarter	$ 30.27	$ 18.89
Second Quarter	32.56	24.22
Third Quarter	53.01	26.10
Fourth Quarter	58.88	39.61
Fiscal Year Ended January 1, 2005		
First Quarter	$ 59.92	$ 44.00
Second Quarter	59.45	42.88
Third Quarter	43.95	29.02
Fourth Quarter	37.50	26.89

We have never declared or paid any cash dividends on our common stock and we do not intend to pay cash dividends in the foreseeable future. We currently expect to retain any future earnings to fund the operation and expansion of our business.

Our registration statement (Registration No. 333-94853) under the Securities Act of 1933, as amended, relating to our initial public offering of our common stock became effective on March 23, 2000. A total of 3,680,000 shares of common stock were registered. We sold a total of 3,200,000 shares of our common stock and selling stockholders sold a total of 480,000 shares to an underwriting syndicate. The managing underwriters were Morgan Stanley & Co. Incorporated, Lehman Brothers Inc., and Salomon Smith Barney Inc. The offering commenced and was completed on March 24, 2000, at a price to the public of $31.00 per share. The initial public offering resulted in net proceeds to us of $90.6 million, after deducting underwriting commissions of $6.9 million and offering expenses of $1.6 million. We used $15 million of the proceeds as part of the consideration paid in the acquisition of Krypton Isolation, Inc. on August 9, 2000. Another $4.3 million was used to pay off equipment loans provided by Imperial Bank. We used another $1.0 million of the proceeds as part of the consideration paid in the acquisition of

SNR Semiconductor Incorporated (SNR) on October 2, 2000. In December 2002, we prepaid $2.4 million in satisfaction of our remaining debt and lease obligations to three equipment financing institutions. In December 2003, we paid $0.9 million in direct acquisition costs for professional and legal fees related to the acquisition of Cygnal. As of January 1, 2005, the remaining proceeds were invested in short-term, investment-grade interest-bearing instruments.

No securities were repurchased during the fourth quarter of fiscal 2004.

Item 6. Selected Consolidated Financial Data

The selected consolidated balance sheet data as of fiscal year ended 2004 and 2003 and the selected consolidated statements of operations data for fiscal 2004, 2003 and 2002 have been derived from the audited consolidated financial statements included in this Form 10-K. The selected consolidated balance sheet data as of fiscal year ended 2002, 2001 and 2000 and the selected consolidated statements of operations data for fiscal 2001 and 2000 have been derived from audited consolidated financial statements not included in this Form 10-K. You should read this selected consolidated financial data in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, our consolidated financial statements and the notes to those statements included in this Form 10-K.

CONSOLIDATED STATEMENTS OF OPERATIONS DATA

	Fiscal Year				
	2004	2003	2002	2001	2000
	(in thousands, except per share data)				
Revenues	$ 456,225	$ 325,305	$ 182,016	$ 74,065	$ 103,103
Cost of revenues	206,230	162,173	79,939	31,930	35,601
Gross profit	249,995	163,132	102,077	42,135	67,502
Operating expenses:					
Research and development	74,917	48,296	32,001	28,978	19,419
Selling, general and administrative	64,156	42,836	33,877	20,056	17,648
Write off of in-process research & development		1,600			394
Goodwill amortization				4,187	3,307
Impairment of goodwill and other intangible assets			37	34,885	
Amortization of deferred stock compensation	4,237	4,986	5,173	5,276	3,761
Operating expenses	143,310	97,718	71,088	93,382	44,529
Operating income (loss)	106,685	65,414	30,989	(51,247)	22,973
Other income (expense):					
Interest income	3,054	1,368	1,582	3,624	3,964
Interest expense	(311)	(49)	(617)	(751)	(1,162)
Other income (expense), net	2,148	(537)	(647)	(2)	74
Income (loss) before income taxes	111,576	66,196	31,307	(48,376)	25,849
Provision (benefit) for income taxes	34,883	21,480	10,590	(2,803)	11,832
Net income (loss)	$ 76,693	$ 44,716	$ 20,717	$ (45,573)	$ 14,017
Net income (loss) per share:					
Basic	$ 1.49	$ 0.92	$ 0.44	$ (0.99)	$ 0.37
Diluted	$ 1.39	$ 0.86	$ 0.41	$ (0.99)	$ 0.29
Weighted-average common shares outstanding:					
Basic	51,471	48,850	47,419	45,914	38,326
Diluted	54,983	52,288	50,811	45,914	48,788

CONSOLIDATED BALANCE SHEET DATA:

	January 1, 2005	January 3, 2004	December 28, 2002	December 29, 2001	December 30, 2000
			(in thousands)		
Cash, cash equivalents and short-term investments	$ 277,106	$ 190,313	$ 115,166	$ 101,248	$ 96,438
Working capital	294,557	202,712	122,354	106,556	103,347
Total assets	484,402	378,095	197,065	145,021	184,840
Long-term obligations and other liabilities	2,570	9,962	949	3,817	5,125
Total stockholders equity	399,484	287,205	155,722	125,407	162,951

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

THE FOLLOWING DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS SHOULD BE READ IN CONJUNCTION WITH THE CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES THERETO INCLUDED ELSEWHERE IN THIS REPORT ON FORM 10-K. THIS DISCUSSION CONTAINS FORWARD-LOOKING STATEMENTS. PLEASE SEE THE CAUTIONARY STATEMENT ABOVE AND FACTORS AFFECTING OUR FUTURE OPERATING RESULTS UNDER ITEM 1 FOR A DISCUSSION OF THE UNCERTAINTIES, RISKS AND ASSUMPTIONS ASSOCIATED WITH THESE STATEMENTS. OUR FISCAL YEAR-END FINANCIAL REPORTING PERIODS ARE A 52- OR 53- WEEK YEAR ENDING ON THE SATURDAY CLOSEST TO DECEMBER 31ST. FISCAL 2004 HAD 52 WEEKS AND ENDED ON JANUARY 1, 2005. FISCAL 2003 HAD 53 WEEKS WITH THE EXTRA WEEK OCCURRING IN THE FOURTH QUARTER OF THE YEAR AND ENDED ON JANUARY 3, 2004. FISCAL 2002 HAD 52 WEEKS AND ENDED ON DECEMBER 28, 2002.

OVERVIEW

We design and develop proprietary, analog-intensive, mixed-signal integrated circuits (ICs) for a broad range of applications. Our innovative ICs can dramatically reduce the cost, size and system power requirements of the products that our customers sell to consumers. We currently offer ICs that can be incorporated into communications devices, such as wireless phones and modems, as well as cable and satellite set-top boxes, residential communication gateways for cable or digital subscriber line (DSL), satellite radios and networking equipment. We also offer a family of 8-bit microcontrollers (MCUs) for use in a broad array of applications such as industrial automation and control, automotive sensors and controls, medical instrumentation, and electronic test and measurement equipment. Our major customers include Agere Systems, Conexant, Hughes Network Systems, Intel, LG Electronics, Sagem, Samsung, Sendo, Smart Link and Thomson.

Our company was founded in 1996. Our business has grown rapidly since our inception, as reflected by our employee headcount, which increased to 588 at the end of fiscal 2004, from 486 employees at the end of fiscal 2003 and 364 employees at the end of fiscal 2002. As a fabless semiconductor company, we rely on third-party semiconductor fabricators in Asia, and to a lesser extent the United States, to manufacture the silicon wafers that reflect our IC designs. Each wafer contains numerous die, which are cut from the wafer to create a chip for an IC. We also rely on third-parties in Asia to assemble, package, and, in the substantial majority of cases, test these die and ship these units to our customers. We have increased the amount of testing performed by such third parties, which facilitates faster delivery of products to our customers (particularly those located in Asia), shorter production cycle times, lower inventory requirements, lower costs and increased flexibility of test capacity. We implemented supply chain management software during fiscal 2003 which improved our ability to scale our operations, reduced our inventory requirements and improved the quality of our shipment scheduling commitments with our customers through improved efficiency.

Our product set has expanded to a broad portfolio targeting mobile handset and broad-based mixed-signal applications. Our expertise in analog-intensive, high-performance, mixed-signal ICs enables us to develop highly differentiated solutions that address multiple markets. For example, our silicon direct access arrangement (DAA) product family is optimized for the personal computer (PC) modem market; our ISOmodem® family of embedded modems has been widely adopted by satellite set-top box manufacturers; and our Aero® Global System for Mobile Communications (GSM)/General Packet Radio Services (GPRS) transceiver family is being shipped in mobile handsets worldwide. We continue to introduce next generation ICs with added functionality and further integration. In February 2004, we introduced a power amplifier product for GSM/GPRS mobile handsets that is in the sampling stage to wireless customers. In June 2004, we introduced the Aero II transceiver that provides increased performance and integration over our prior offerings. In July 2004, we introduced and are now sampling the Aero EDGE Radio, which addresses the Enhanced Data Rates for Global Evolution (EDGE) standard for mobile handsets. Through our recently acquired MCU business and our internal development efforts, we further diversified our product portfolio. We plan to continue to diversify our product portfolio by introducing products that increase the content we provide for existing applications and by introducing ICs for markets we do not currently address, thereby expanding our total available market opportunity.

We group our products into two categories, mobile handset products and broad-based mixed-signal products. Mobile handset products include the Aero Transceivers, to the extent incorporated into handsets, the RF Synthesizers and the Power Amplifier. Broad-based mixed-signal products include our silicon DAA, ISOmodem, ProSLIC, satellite tuner, DSL analog front end, clock chips, optical transceivers and clock & data recovery ICs (CDRs), general purpose RF Synthesizers for non-handset applications, as well as the microcontroller products.

During fiscal 2004, 2003 and 2002, one customer, Samsung, represented 17%, 21% and 16% of our revenues, respectively. No other single end customer accounted for more than 10% of our revenues in any of these years. In addition to direct sales to customers, some of our end customers purchase products indirectly from us through distributors and contract manufacturers. An end customer purchasing through a contract manufacturer typically instructs such contract manufacturer to obtain our products and incorporate such products with other components for sale by such contract manufacturer to the end customer. Although we actually sell the products to, and are paid by, the distributors and contract manufacturers, we refer to such end customer as our customer. Two of our distributors, Edom Technology and Uniquest, each selling products to customers in Asia, represented 20% and 12% of our fiscal 2004 revenues, respectively. There was one distributor, Edom Technology, which accounted for 13% of our total revenues during fiscal 2003. Two of our distributors, Uniquest and Edom Technology, represented 20% and 16% of our fiscal 2002 revenues, respectively. There were no other distributors or contract manufacturers that accounted for more than 10% of our revenues in fiscal years 2004, 2003 or 2002.

The percentage of our revenues derived from customers located outside of the United States was 89% in fiscal 2004, 80% in fiscal 2003 and 79% in fiscal 2002. This percentage increase in the two most recent years reflects our product and customer diversification and increased market penetration for our products, as many of our mobile handset, and increasingly, broad-based mixed-signal customers manufacture and design their products in Asia. All of our revenues to date have been denominated in U.S. dollars. We believe that a majority of our revenues will continue to be derived from customers outside of the United States.

The sales cycle for the test and evaluation of our ICs can range from one month to 12 months or more. An additional three to six months or more are usually required before a customer ships a significant volume of devices that incorporate our ICs. Due to this lengthy sales cycle, we typically experience a significant delay between incurring expenses for research and development and selling, general and administrative efforts, and the generation of corresponding sales. Consequently, if sales in any quarter do not occur when expected, expenses and inventory levels could be disproportionately high, and our operating results for that quarter and, potentially, future quarters would be adversely affected. Moreover, the amount of time between initial research and development and commercialization of a product, if ever, can be substantially longer than the sales cycle for the product. Accordingly, if we incur substantial research and development costs without developing a commercially successful product, our operating results, as well as our growth prospects, could be adversely affected.

Because many of our ICs are designed for use in consumer products such as personal computers (PCs), personal video recorders, set-top boxes and mobile handsets, we expect that the demand for our products will be typically subject to some degree of seasonal demand resulting in increased sales in the third and fourth quarters of each year when customers place orders to meet holiday demand. However, rapid changes in our markets and across our product areas make it difficult for us to accurately estimate the impact of seasonal factors on our business.

The following describes the line items set forth in our consolidated statements of income:

REVENUES. Revenues are generated almost exclusively by sales of our ICs. We recognize revenue on sales when all of the following criteria are met: 1) there is persuasive evidence that an arrangement exists, 2) delivery of goods has occurred, 3) the sales price is fixed or determinable, and 4) collectibility is reasonably assured. Generally, we recognize revenue from product sales direct to customers and contract manufacturers upon shipment. Certain of our sales are made to distributors under agreements allowing certain rights of return and price protection on products unsold by distributors. Accordingly, we defer the revenue and cost of revenue on such sales until the distributors sell the product to the end customer. Our products typically carry a one-year replacement warranty. Replacements have been insignificant to date. Our revenues are subject to variation from period to period due to the volume of shipments made within a period and the prices we charge for our products. The vast majority of our revenues were negotiated at prices that reflect a discount from the list prices for our products. These discounts are made for a variety of reasons, including: 1) to establish a relationship with a new customer, 2) as an incentive for customers to purchase products in larger volumes, and 3) to provide profit margin to our distributors who resell our products or in response to competition. In addition, as a product matures, we expect that the average selling price for such product will decline due to the greater availability of competing products. Our ability to increase revenues in the future is dependent on increased demand for our established products and our ability to ship larger volumes of those products in response to such demand, as well as our ability to develop or acquire new products and subsequently achieve customer acceptance of newly introduced products.

COST OF REVENUES. Cost of revenues includes the cost of purchasing finished silicon wafers processed by independent foundries; costs associated with assembly, test and shipping of those products; costs of personnel and equipment associated with manufacturing support, logistics and quality assurance; costs of software royalties and amortization of purchased software, other intellectual property license costs, and certain acquired intangible assets; an allocated portion of our occupancy costs; allocable depreciation of testing equipment and leasehold improvements; impairment charges related to certain manufacturing equipment held for sale or abandoned; and, for prior periods, a portion of the settlement costs associated with a patent infringement lawsuit. Generally, we depreciate equipment over four years on a straight-line basis and leasehold improvements over the shorter of the estimated useful life or the applicable lease term. Recently introduced products tend to have higher cost of revenues per unit due to initially low production volumes required by our customers and higher costs associated with new package variations. Generally, as production volumes for a product increase, unit production costs tend to decrease as our yields improve and our semiconductor fabricators, assemblers and test operations achieve greater economies of scale for that product. Additionally, the cost of wafer procurement and assembly and test services, which are significant components of cost of goods sold, vary cyclically with overall demand for semiconductors and our suppliers available capacity of such products and services.

RESEARCH AND DEVELOPMENT. Research and development expense consists primarily of compensation and related costs of employees engaged in research and development activities, new product mask, wafer, packaging and test costs, external consulting and services costs, amortization of purchased software, equipment tooling, equipment depreciation, amortization of acquired intangible assets, as well as an allocated portion of our occupancy costs for such operations. We generally depreciate our research and development equipment over four years and amortize our purchased software from computer-aided design tool vendors over three to four years. Research and development activities include the design of new products, refinement of existing products and design of test methodologies to ensure compliance with required specifications.

SELLING, GENERAL AND ADMINISTRATIVE. Selling, general and administrative expense consists primarily of personnel-related expenses, related allocable portion of our occupancy costs, sales commissions to independent sales representatives, professional fees, directors and officers liability insurance, patent litigation legal fees, other promotional and marketing expenses, and reserves for bad debt. Write-offs of uncollectible accounts have been insignificant to date.

WRITE OFF OF IN-PROCESS RESEARCH & DEVELOPMENT. Write off of in-process research & development reflects the write off of in-process research and development costs which we acquired in connection with our acquisition of Cygnal in fiscal 2003 and Krypton Isolation, Inc. (Krypton) in fiscal 2000.

IMPAIRMENT OF GOODWILL AND OTHER INTANGIBLE ASSETS. Impairment of goodwill and other intangible assets reflects the charge to write-down that portion of the carrying value of goodwill and other intangible assets that was in excess of its fair market value.

AMORTIZATION OF DEFERRED STOCK COMPENSATION. In connection with the grant of stock options and direct issuances of stock to our employees, we record deferred stock compensation, representing, for accounting purposes, the difference between the exercise price of option grants, or the issuance price of direct issuances of stock, as the case may be, and the fair value of our common stock at the time of such grants or issuances. The deferred stock compensation is amortized over the vesting period of the applicable options or shares, generally five to eight years. The amortization of deferred stock compensation is recorded as an operating expense.

INTEREST INCOME. Interest income reflects interest earned on average cash, cash equivalents and investment balances. We generally invest in tax-exempt short-term investments which yield lower nominal interest proceeds.

INTEREST EXPENSE. Interest expense consists of interest on our short and long-term obligations.

OTHER INCOME (EXPENSE), NET. Other income (expense), net primarily reflects our share of income and losses related to our equity investments and the gain on the disposal of fixed assets.

PROVISION FOR INCOME TAXES. We accrue a provision for federal, state and foreign income tax at the applicable statutory rates adjusted for non-deductible expenses, research and development tax credits and interest income from tax-exempt short-term investments.

RESULTS OF OPERATIONS

The following table sets forth our consolidated statements of income data as a percentage of revenues for the periods indicated:

	Year Ended		
	January 1, 2005	**January 3, 2004**	**December 28, 2002**
Revenues	100.0%	100.0%	100.0%
Cost of revenues	45.2	49.9	43.9
Gross profit	54.8	50.1	56.1
Operating expenses:			
Research and development	16.4	14.8	17.6
Selling, general and administrative	14.1	13.2	18.6
Write-off of in-process research & development		0.5	
Impairment of goodwill and other intangible assets			0.0
Amortization of deferred stock compensation	0.9	1.5	2.8
Operating expenses	31.4	30.0	39.0
Operating income	23.4	20.1	17.1
Other income (expense):			
Interest income	0.7	0.4	0.9
Interest expense	(0.1)	(0.0)	(0.4)

Other income (expense), net	0.4	(0.2)	(0.4