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

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the Quarterly Period Ended April 2, 2006

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the Transition Period From _____ To _____

COMMISSION FILE NUMBER: 000-22671

QUICKLOGIC CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

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

1277 ORLEANS DRIVE SUNNYVALE, CA 94089
(Address of principal executive offices, including Zip Code)

(408) 990-4000
(Registrant's telephone number, including area code)

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

As of May 8, 2006, 28,458,366 shares of the registrant's common stock were outstanding.

**QUICKLOGIC CORPORATION
FORM 10-Q
MARCH 31, 2006**

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PART I. Financial Information

Item 1. Financial Statements

QUICKLOGIC CORPORATION
CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended March 31,	
	2006	2005
Revenue	\$ 9,333	\$ 12,527
Cost of revenue	3,760	4,888
Gross profit	5,573	7,639
Operating expenses:		
Research and development	2,400	2,454
Selling, general and administrative	4,617	4,298
Income (loss) from operations	(1,444)	887
Interest expense	(74)	(53)
Interest income and other, net	292	80
Income (loss) before income taxes	(1,226)	914
Provision for income taxes	2	50
Net income (loss)	\$ (1,228)	\$ 864
Net income (loss) per share:		
Basic	\$ (0.04)	\$ 0.03
Diluted	\$ (0.04)	\$ 0.03
Weighted average shares:		
Basic	28,059	26,385
Diluted	28,059	27,413

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

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

	March 31, 2006	December 31, 2005
ASSETS		

Current assets:			
Cash and cash equivalents	\$	30,186	\$ 28,283
Short-term investment in Tower Semiconductor Ltd.		1,145	1,297
Accounts receivable, net of allowances for doubtful accounts of \$1,042 and \$1,042, respectively		4,114	5,556
Inventory		7,607	7,830
Other current assets		1,369	1,265
Total current assets		44,421	44,231
Property and equipment, net		6,353	5,697
Investment in Tower Semiconductor Ltd.		576	653
Other assets		4,461	4,415
TOTAL ASSETS	\$	55,811	\$ 54,996

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:			
Trade payables	\$	3,306	\$ 3,338
Accrued liabilities		2,843	3,434
Deferred income on shipments to distributors		1,848	1,626
Current portion of debt and capital lease obligations		2,157	1,790
Total current liabilities		10,154	10,188
Long-term liabilities:			
Debt and capital lease obligations, less current portion		1,859	1,163
Deferred royalty revenue		1,502	1,408
Total long-term liabilities		3,361	2,571
Total liabilities		13,515	12,759
Commitments and contingencies (see Notes 14 and 15)			
Stockholders' equity:			
Common stock, \$0.001 par value; 100,000 shares authorized; 28,281 and 27,896 shares issued and outstanding, respectively		28	28
Additional paid-in capital		160,695	159,179
Accumulated other comprehensive income		148	377
Accumulated deficit		(118,575)	(117,347)
Total stockholders' equity		42,296	42,237
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$	55,811	\$ 54,996

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

QUICKLOGIC CORPORATION CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS (In thousands)

	Three Months Ended	
	March 31,	
	2006	2005
Cash flows from operating activities:		
Net income (loss)	\$ (1,228)	\$ 864
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	686	665
Stock-based compensation	452	—
Loss on disposal of property and equipment	—	7
Utilization of wafer credits from Tower Semiconductor Ltd.	25	94
Inventory write-down	232	205
Changes in assets and liabilities:		
Accounts receivable, net of allowances for doubtful accounts	1,442	(1,073)
Inventory	(9)	(940)
Other assets	(17)	256
Trade payables	(32)	260
Accrued liabilities	(591)	23
Deferred income and royalty revenue	316	221
Net cash provided by operating activities	1,276	582
Cash flows from investing activities:		

Capital expenditures for property and equipment	(709)	(407)
Net cash used for investing activities	(709)	(407)
Cash flows from financing activities:		
Payment of debt and capital lease obligations	(660)	(772)
Proceeds from debt obligations	932	—
Proceeds from issuance of common stock	1,064	281
Net cash provided by (used for) financing activities	1,336	(491)
Net increase (decrease) in cash and cash equivalents	1,903	(316)
Cash and cash equivalents at beginning of period	28,283	24,914
Cash and cash equivalents at end of period	\$ 30,186	\$ 24,598
Supplemental disclosures of cash flow information:		
Interest paid	\$ 58	\$ 63
Income taxes paid	\$ 13	\$ 16
Supplemental schedule of non-cash investing and financing activities:		
Capital lease obligation to finance capital expenditures and related maintenance	\$ 791	\$ —

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

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QUICKLOGIC CORPORATION
CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)

	Three Months Ended March 31,	
	2006	2005
Net income (loss)	\$ (1,228)	\$ 864
Other comprehensive gain, net of tax:		
Unrealized loss on investments	(229)	(592)
Total comprehensive income (loss)	\$ (1,457)	\$ 272

See accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

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QUICKLOGIC CORPORATION
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1—The Company and Basis of Presentation

QuickLogic Corporation (“QuickLogic” or the “Company”), founded in 1988, is a Delaware corporation. The Company operates in a single reportable industry segment where it designs, develops, markets and supports advanced field programmable gate arrays (“FPGAs”), Embedded Standard Products (“ESPs”), associated software tools and programming hardware.

The accompanying interim financial statements are unaudited. In the opinion of management, these statements have been prepared in accordance with generally accepted accounting principles and include all adjustments, consisting only of normal recurring adjustments, necessary to provide a fair statement of results for the interim periods presented. The Company recommends that these financial statements be read in conjunction with the Company’s Form 10-K for the year ended December 31, 2005. Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the full year.

QuickLogic’s fiscal year ends on the Sunday closest to December 31. QuickLogic’s fiscal first quarters for 2006 and 2005 ended Sunday, April 2, 2006 and April 3, 2005, respectively. For presentation purposes, the financial statements and notes have been presented as ending on the last day of the nearest calendar month.

Liquidity

The Company anticipates that its existing cash resources will fund operations, finance purchases of capital equipment and provide adequate working capital for the next twelve months. The Company’s liquidity is affected by many factors including, among others, the level of revenue and gross profit, market acceptance of existing and new products including Eclipse™II, QuickPCI®II and PolarPro™ devices, the expected decline in pASIC® 1 and pASIC 2 revenue resulting from the end-of-life of these products, costs of securing access to and availability of adequate manufacturing capacity, inventory levels, wafer purchase commitments, customer credit terms, the amount and timing of research and development expenditures, the timing of new product introductions, production volumes, product quality, sales and marketing efforts, the amount and financing arrangements for purchases of capital equipment, changes in operating assets and

liabilities, the ability to obtain or renew debt financing and to remain in compliance with the terms of credit facilities, the ability to raise funds from the sale of shares of Tower Semiconductor Ltd. ("Tower") and equity in the Company, the issuance and exercise of stock options, the terms of and participation in the Company's employee stock purchase plan, and other factors related to the uncertainties of the industry and global economics. Accordingly, there can be no assurance that events in the future will not require the Company to seek additional capital or, if so required, that such capital will be available on terms acceptable to the Company.

Principles of Consolidation

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

Uses of Estimates

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

QUICKLOGIC CORPORATION **NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Note 2—Significant Accounting Policies

Revenue Recognition

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

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

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

The Company also sells to distributors under agreements that allow for price adjustments and, in the case of unprogrammed parts, certain rights of return on unsold inventory.

Because programmed parts can only be used by a specific customer, it is the Company's practice to agree upon any price adjustments with a distributor prior to shipment. Furthermore, distributors are not allowed any future price adjustments and have no rights of return on programmed parts. Accordingly, revenue is recognized upon delivery to a distributor since title and risk of ownership have transferred to the distributor, the price is fixed, no right of return exists, and collection of the resulting receivable is reasonably assured.

Unprogrammed parts shipped to distributors may be used by multiple end customers and distributors may have certain return and price adjustment privileges on unsold inventory. Accordingly, revenue associated with unprogrammed parts is deferred until resale to the end customer.

Software revenue from sales of design tools is recognized when persuasive evidence of an agreement exists, delivery of the software has occurred, no significant Company obligations with regard to implementation or integration remain, the fee is fixed or determinable and collection is reasonably assured. Software revenue amounted to less than one percent of the Company's revenue for the three months ended March 31, 2006 and 2005.

Long-lived Assets

The Company reviews the recoverability of its long-lived assets, such as property and equipment, prepaid wafer credits and investments, annually and when events or changes in circumstances occur that indicate that the carrying value of the asset or asset group may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the asset or asset group from the expected future pretax cash flows, undiscounted and without interest charges, of the related operations. If these cash flows are less than the carrying value of the asset or asset group, an impairment loss is recognized for the difference between estimated fair value and carrying value, and the carrying value of the related assets is reduced by this difference. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets.

Comprehensive Income (Loss)

Comprehensive income (loss) includes all changes in equity (net assets) during a period from non-owner sources. Comprehensive income (loss) for the Company has included realized and unrealized holding gains or losses on our holdings of Tower ordinary shares. See Note 4.

Stock-Based Compensation

Effective January 2, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "*Share-Based Payment*," ("SFAS No. 123(R)") which requires the measurement and recognition of expense related to the fair value of stock-based compensation awards. Accordingly, stock-based compensation is measured at the grant date, based on the fair value of the award using the Black-Scholes option pricing model ("Black-Scholes"), and is recognized as expense over the requisite service period of the award. Black-Scholes requires the use of highly subjective, complex assumptions, including expected term and the price volatility of the Company's stock. The Company elected to use the modified prospective transition method upon implementation and, therefore, has not restated its financial results for prior periods. The Company previously applied Accounting Principles Board ("APB") Opinion No. 25, "*Accounting for Stock Issued to Employees*"

QUICKLOGIC CORPORATION NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

("APB 25") and related interpretations and provided the required pro forma disclosures of SFAS No. 123, "*Accounting for Stock-Based Compensation*" ("SFAS No. 123"). In March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS No. 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS No. 123(R). See Note 9.

Foreign Currency Transactions

All of the Company's sales and cost of manufacturing are transacted in U.S. dollars. The Company conducts a portion of its research and development activities in Canada and India and has sales and marketing activities in various countries outside of the United States. Most of these international expenses are incurred in local currency. Foreign currency transaction gains and losses are included in interest income and other, net, as they occur. The effect of foreign currency exchange rate fluctuations has not been significant to date. Operating expenses denominated in foreign currencies were approximately 23% and 26% of total operating expenses for the three months ended March 31, 2006 and 2005, respectively. The Company incurred a majority of these foreign currency expenses in Canada. The Company has not used derivative financial instruments to hedge its exposure to fluctuations in foreign currency.

Concentration of Credit Risk

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

One distributor of the Company's products accounted for 42% of the Company's accounts receivable balance at March 31, 2006. Two distributors of the Company's products accounted for 25% and 13%, respectively, of the Company's accounts receivable balance at December 31, 2005. One original equipment manufacturer ("OEM") customer accounted for 18% of the Company's accounts receivable balance at December 31, 2005.

Warranty Costs

The Company generally warrants finished goods against defects in material and workmanship under normal use for twelve months from the date of shipment. The Company does not have significant product warranty related costs or liabilities. The one-time-programmable nature of QuickLogic's products minimizes warranty costs.

Recently Issued Accounting Pronouncements

On December 16, 2004, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 123(R), "*Share-Based Payment*," which is a revision of SFAS No. 123 and supersedes APB 25. SFAS No. 123(R) requires all share-based payments ("SBPs") to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the requisite service period. Under SFAS No. 123(R), pro forma disclosure of the income statement effects of share-based payments is no longer an alternative. SFAS No. 123(R), as amended, is effective for all stock-based awards granted in fiscal years beginning after June 15, 2005. In addition, companies must also recognize compensation expense related to any awards that are not fully vested as of the effective date. Compensation expense for the unvested awards will be measured based on the fair value of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS No. 123. Effective January 2, 2006, the first day of fiscal 2006, the Company adopted SFAS 123(R) on a modified prospective basis. As a result, the Company began to include stock-based compensation charges in its results of operations beginning in the quarter ended March 31, 2006. See Note 9.

In November 2005, the FASB issued Staff Position ("FSP") FAS123(R)-3, "*Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards*." This FSP requires an entity to follow either the transition guidance for the additional-paid-in-capital pool as prescribed in SFAS No. 123(R), or the alternative transition method as described in the FSP. An entity that adopts SFAS No. 123(R) using the modified prospective application may make a one-time election to adopt the transition method described in this FSP.

An entity may take up to one year from the later of its initial adoption of SFAS No. 123(R) or the effective date of this FSP to evaluate its available transition alternatives and make its one-time election. The Company continues to evaluate the impact that the adoption of this FSP could have on its consolidated financial statements.

QUICKLOGIC CORPORATION
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

On March 29, 2005, the SEC issued Staff Accounting Bulletin (“SAB”) No. 107, which provides guidance on the interaction between SFAS No. 123(R), “*Shared-Based Payment*,” and certain SEC rules and regulations. SAB No. 107 provides guidance that may simplify some of the SFAS No. 123(R) implementation challenges and enhances the information that investors receive. Effective January 2, 2006, the first day of fiscal 2006, the Company adopted SFAS 123(R) on a modified prospective basis and applied the principles of SAB No. 107 in conjunction with the adoption of SFAS No. 123(R).

In February 2006, the FASB issued SFAS No. 155, “*Accounting for Certain Hybrid Instruments—An Amendment of FASB Statements No. 133 and No. 144*” (“SFAS No. 155”). SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. It also clarifies which interest-only strips and principal-only strips are not subject to the requirements of FASB Statement No. 133, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. Furthermore, SFAS No. 155 clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and it amends FASB Statement No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year beginning after September 15, 2006. The Company’s adoption of the provisions of SFAS No. 155 is not expected to impact its financial condition or results of operations.

On March 13, 2006, the FASB issued SFAS No. 156, “*Accounting for Servicing of Financial Assets*,” (“SFAS No. 156”). SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract under specified circumstances. SFAS No. 156 also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS No. 156 permits an entity to choose alternative measurement methods for each class of separately recognized servicing assets and servicing liabilities. The Statement is an amendment of SFAS No. 140, “*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125*.” SFAS No. 156 is effective for servicing assets and liabilities acquired or issued after the beginning of an entity’s fiscal year that begins after September 15, 2006. The Company’s adoption of the provisions of SFAS No. 156 is not expected to impact its financial condition or results of operations.

Note 3—Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the weighted average number of common shares outstanding during the period plus potentially dilutive common shares outstanding during the period under the treasury stock method. In computing diluted net income (loss) per share, the average stock price for the period is used in determining the number of shares assumed to be purchased from the exercise of stock options. A reconciliation of the basic and diluted per share computations is as follows (in thousands, except per share amounts):

	Three Months Ended March 31,					
	2006			2005		
	Net Loss	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
Basic	\$ (1,228)	28,059	\$ (0.04)	\$ 864	26,385	\$ 0.03
Effect of stock options	—	—	—	—	1,028	—
Diluted	\$ (1,228)	28,059	\$ (0.04)	\$ 864	27,413	\$ 0.03

For the three months ended March 31, 2006, potential common shares of 5,700,000, the number of vested options outstanding, were not included in the calculation of diluted net loss per share, as they were considered antidilutive due to the net loss the Company experienced during the period. For the three months ended March 31, 2005, approximately 5,017,000 shares of common stock subject to outstanding options were antidilutive and,

QUICKLOGIC CORPORATION
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

therefore, were not included in the calculation of diluted net income per share, as the per share exercise price for such options exceeded the average trading price of the Company’s common stock during the period.

Note 4—Investment in Tower Semiconductor Ltd.

On December 12, 2000, the Company entered into several agreements with Tower, as amended, under which the Company agreed to make a strategic investment in Tower of up to \$25 million as part of Tower's plan to build and equip a new wafer fabrication facility. During 2001 and 2002, the Company paid a total of \$21.3 million to Tower to fulfill its investment requirements under the Agreement. In partial consideration for the investment, the Company received 1,757,368 Tower ordinary shares with an original cost of \$16.6 million. Due to write-downs in fiscal years 2001, 2002, 2004 and 2005 as a result of "other than temporary" declines in market value, the adjusted cost of the Company's Tower ordinary shares is \$1.6 million, or \$1.17 per share. The Company sold a portion of the Tower ordinary shares in fiscal 2003.

As of March 31, 2006, the Company held 1,344,543 available for sale Tower ordinary shares with an unrealized gain of \$148,000 recorded in accumulated other comprehensive income, representing the difference between the adjusted cost per share and \$1.28 per share, their market value on the last trading day of the reporting period. The Company plans to continue to hold 450,000 of the Tower ordinary shares in order to receive competitive product pricing under the Agreement and has recorded these shares as a long-term investment on the balance sheets. The remaining 894,543 shares are classified as a short-term investment on the balance sheets.

The Company also received \$4.7 million in prepaid wafer credits in partial consideration for the investment, \$4.2 million of which remained available as of March 31, 2006. The credits have no stated maturity and the Company has guaranteed capacity at Tower through at least 2010. These credits are recorded within long-term other assets on the balance sheets and can be applied toward wafer purchases from Tower at 15% of the value of future purchases.

QUICKLOGIC CORPORATION
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Note 5—Balance Sheet Components

	March 31, 2006	December 31, 2005
	(in thousands)	
Inventory:		
Raw materials	\$ 1,114	\$ 916
Work-in-process	6,084	6,314
Finished goods	409	600
	<u>\$ 7,607</u>	<u>\$ 7,830</u>
Other current assets:		
Prepaid expenses	\$ 1,142	\$ 1,064
Employee receivables	30	20
Other	197	181
	<u>\$ 1,369</u>	<u>\$ 1,265</u>
Property and equipment:		
Equipment	\$ 13,898	\$ 13,264
Software	9,318	8,610
Furniture and fixtures	825	825
Leasehold improvements	802	802
	24,843	23,501
Accumulated depreciation and amortization	(18,490)	(17,804)
	<u>\$ 6,353</u>	<u>\$ 5,697</u>
Other assets:		
Prepaid wafer credits	\$ 4,202	\$ 4,227
Other	259	188
	<u>\$ 4,461</u>	<u>\$ 4,415</u>
Accrued liabilities:		
Employee related accruals	\$ 1,751	\$ 2,026
Other	1,092	1,408
	<u>\$ 2,843</u>	<u>\$ 3,434</u>

QUICKLOGIC CORPORATION
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Note 6—Obligations

	March 31, 2006	December 31, 2005
(in thousands)		
Debt and capital lease obligations:		
Notes payable to bank	\$ 2,049	\$ 1,443
Capital leases	1,967	1,510
	4,016	2,953
Current portion of debt and capital lease obligations	(2,157)	(1,790)
	<u>\$ 1,859</u>	<u>\$ 1,163</u>

Revolving Line of Credit and Notes Payable to Bank

Effective June 2005, the Company modified its Amended and Restated Loan and Security Agreement with Silicon Valley Bank. Terms of the modified agreement included an \$8.0 million revolving line of credit available through June 2006 and an additional \$3.0 million of borrowing capacity under the equipment line of credit that is available to be drawn against through June 2006. The revolving line of credit provides for formula advances based upon a percentage of eligible accounts receivable and for non-formula advances not to exceed \$4.0 million. Advances under the equipment line of credit must be repaid in either 30 or 36 monthly equal installments, depending upon the nature of the items financed. Terms of the various advances under the modified agreement are as follows (in thousands):

	Original Balance	Balance at March 31, 2006	Available Credit	Interest Rate	Maturity Date
Revolving Line of Credit:					
Formula advances	n/a	\$ —	\$ 4,742	Prime + 0.50%	June 26, 2006
Non-formula advances	n/a	—	3,258	Prime + 1.50%	June 26, 2006
Equipment Line of Credit:					
Notes payable	2,136	348	n/a	Prime + 2.00%	Multiple draws maturing on or before December 1, 2006
Notes payable	859	416	n/a	Prime + 2.00%	Multiple draws maturing on or before December 31, 2007
Notes payable	550	353	n/a	Prime + 2.00%	Multiple draws maturing on or before June 30, 2008
Notes payable	932	932	n/a	Prime + 1.75%	Multiple draws maturing on or before March 31, 2009
Notes payable	n/a	—	2,068	Prime + 1.75%	30 or 36 months from date of advance
Total		<u>\$ 2,049</u>			

The bank has a first priority security interest in substantially all of the Company's tangible and intangible assets to secure any outstanding amounts under the modified agreement. Under the terms of the modified agreement, the Company must maintain a minimum tangible net worth and adjusted quick ratio. The modified agreement also has certain restrictions including, among others, on the incurrence of other indebtedness, the maintenance of depository accounts, the disposition of assets, mergers, acquisitions, investments, the granting of liens and the payment of dividends. The Company was in compliance with the financial covenants of the modified agreement as of March 31, 2006.

QUICKLOGIC CORPORATION NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

At March 31, 2006, the prime rate under the credit facility was 7.75%. As of March 31, 2006 and December 31, 2005, \$864,000 and \$387,000, respectively, of amounts outstanding under the equipment line of credit were classified as long-term obligations.

Capital Lease

In December 2005, the Company leased design software and related maintenance under a two-year capital lease at an imputed interest rate of 8.5% per annum. Terms of the agreement require the Company to make quarterly payments of approximately \$204,000 through November 2007. Accordingly, the Company recorded a capital asset for \$1.2 million that is being depreciated over the term of the agreement, prepaid maintenance of \$270,000 that is being amortized over the term of the agreement and a capital lease obligation of \$1.5 million. As of March 31, 2006, \$1.3 million was outstanding under the capital lease, \$589,000 of which was classified as a long-term obligation.

In January 2006, the Company leased design software tools and related maintenance under a three-year capital lease at an imputed interest rate of 9.0% per annum. Terms of the agreement require the Company to make semi-annual payments of approximately \$148,000 through July 2008. Accordingly, the Company recorded a capital asset for \$633,000 that is being depreciated over the term of the agreement, prepaid maintenance of \$158,000 that is being amortized over the term of the agreement and a capital lease obligation of \$791,000. As of March 31, 2006, \$649,000 was outstanding under the capital lease, \$406,000 of which was classified as a long-term obligation.

Note 7—Deferred Royalty Revenue

In October 2000, the Company entered into a technology license and wafer supply agreement with Aeroflex Incorporated (“Aeroflex”). Under the terms of the agreement, the Company received \$750,000 of prepaid royalties. In addition, Aeroflex receives a prepaid royalty credit for a portion of the amounts paid for wafers purchased from the Company under the agreement. These prepaid royalties are recorded as a long-term liability and will be recognized as revenue when Aeroflex sells products incorporating the licensed technology. As of March 31, 2006 and December 31, 2005, the Company had recorded approximately \$1.5 million and \$1.4 million, respectively, of deferred royalty revenue under this agreement. As of March 31, 2006, no royalty revenue had been earned under the agreement.

Note 8—Employee Stock Plans

1989 Stock Option Plan

The 1989 Stock Option Plan (the “1989 Plan”) provided for the issuance of incentive and nonqualified options for the purchase of up to 4.6 million shares of common stock. Options granted under the 1989 Plan have a term of up to 10 years, and typically vest at a rate of 25% of the total grant per year over a four-year period. In September 1999, the Company adopted the 1999 Stock Plan and no further stock option grants were made under the 1989 Plan.

1999 Stock Plan

The 1999 Stock Plan (the “1999 Plan”) was adopted by the board of directors in August 1999 and was approved by the Company’s stockholders in September 1999. As of March 31, 2006, approximately 13.8 million shares were reserved for issuance under the 1999 Plan. In addition, each January an annual increase is added to the 1999 Plan equal to the lesser of (i) 5,000,000 shares, (ii) 5% of the Company’s outstanding shares on such date, or (iii) a lesser amount determined by the board of directors. Options that are canceled under the 1989 Plan also become available for grant under the 1999 Plan. Options granted under the 1999 Plan have a term of up to 10 years. Options typically vest at a rate of 25% one year after the vesting commencement date, and one forty-eighth for each month of service thereafter. However, the Company has implemented a different vesting schedule in the past and may implement different vesting schedules in the future with respect to any new stock option grant.

QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Employee Stock Purchase Plan

The 1999 Employee Stock Purchase Plan (“ESPP”) was adopted by the board of directors in August 1999 and was approved by the Company’s stockholders in September 1999. As of March 31, 2006, approximately 4.2 million shares were reserved for issuance under the ESPP. In addition, each August an annual increase is added to the ESPP equal to the lesser of (i) 1,500,000 shares, (ii) 4% of the Company’s outstanding shares on such date, or (iii) a lesser amount determined by the board of directors.

Through the purchase period ending November 2005, the ESPP contained consecutive, overlapping, twenty-four month offering periods. Each offering period included four six-month purchase periods. The ESPP permitted participants to purchase shares through payroll deductions at 85% of the lower of the fair market value of the common stock at the beginning of an offering period or the end of a purchase period.

Effective November 2005, the board of directors amended the plan to provide for six-month offering periods. The amended ESPP permits participants to purchase shares through payroll deductions of up to 20% of an employee’s total compensation (maximum of 20,000 shares per offering period) at either: (i) 85% of the fair market value of the common stock at the end of the offering period; or (ii) 85% of the lower of the fair market value of the common stock at the beginning or the end of an offering period. The default provision under the amended ESPP provides that shares will be purchased at 85% of the fair market value of the common stock at the end of an offering period. The board of directors has determined that purchases in the current offering period, ending in May 2006, will be made under the default provision.

Note 9—Stock-Based Compensation

Effective January 2, 2006, the Company adopted the provisions of SFAS No. 123(R), using the modified prospective transition method, which requires the measurement and recognition of expense related to the fair value of stock-based compensation awards made to employees and directors, over the requisite service period.

Periods Prior to Adoption of SFAS No. 123(R)

Prior to the adoption of SFAS No. 123(R), the Company applied APB 25 and related interpretations and provided the required pro forma disclosures of SFAS No. 123, as amended by SFAS No. 148, “*Accounting for Stock-Based Compensation — Transition and Disclosures.*” The pro forma information in the following table illustrates the effect on net income and net income per share for the three months ended March 31, 2005 as if the Company had applied the fair value recognition provisions of SFAS No. 123 (in thousands, except per share amounts):

	Three Months Ended March 31, 2005
Net income – as reported	\$ 864
Less: Stock-based compensation expense related to stock option plans determined under the fair value based method, net of tax	(870)
Less: Stock-based compensation expense related to the stock purchase plan determined under fair value based method, net of tax	—
Net loss – as adjusted	<u>\$ (6)</u>
Net income per share – as reported:	
Basic	\$ 0.03
Diluted	<u>\$ 0.03</u>
Net loss per share – as adjusted:	
Basic	\$ 0.00
Diluted	<u>\$ 0.00</u>

QUICKLOGIC CORPORATION
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

In the Company's pro forma information required under SFAS No. 123 for the periods prior to fiscal 2006, the Company used Black-Scholes to value stock-based compensation awards and accounted for forfeitures as they occurred.

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

The Company adopted SFAS No. 123(R) using the modified prospective transition method beginning January 2, 2006, the first day of the Company's fiscal year 2006. In accordance with the modified prospective transition method, the Company's consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). Effective with the adoption of SFAS No. 123(R), stock-based compensation expense is recognized in the Company's Consolidated Statements of Operations and includes (i) compensation expense for stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the pro forma provisions of SFAS No. 123 and (ii) compensation expense for the stock-based compensation awards granted or modified subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). The impact of SFAS No. 123(R) on the Company's consolidated financial statements as of and for the three months ended March 31, 2006 was as follows (in thousands, except per share amounts):

	Three Months Ended March 31, 2006
Cost of revenue	\$ 49
Research and development	146
Selling, general and administrative	257
Total costs and expenses	<u>\$ 452</u>
Effect on net loss per share:	
Basic	\$ (0.01)
Diluted	<u>\$ (0.01)</u>

Stock-based compensation expense recorded in the three months ended March 31, 2006 had no effect on cash flows or the provision for income taxes.

As required by SFAS No. 123(R), the Company has made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest. The cumulative effect of forfeitures upon adoption of SFAS No. 123(R) was not material.

The current offering period under the ESPP provides that shares will be purchased at 85% of the fair market value of the common stock at the end of the offering period. Accordingly, the fair value of stock-based compensation awards under the ESPP was recognized based upon employee deductions and the purchase discount, rather than using a pricing model. In the three months ended March 31, 2006, stock-based compensation relating to the ESPP was \$35,000.

Valuation Assumptions

SFAS No. 123(R) requires companies to estimate the fair value of stock-based compensation awards on the grant date using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Consolidated Statements of Operations. The Company measures the fair value of stock-based compensation awards using Black-Scholes. Black-Scholes, as well as other currently accepted option valuation models, was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions. These assumptions differ significantly from the characteristics of the Company's stock-based compensation awards. Black-Scholes also requires the use of highly subjective, complex assumptions, including expected term and the price volatility of the Company's stock.

QUICKLOGIC CORPORATION
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	Three Months Ended March 31,	
	2006	2005
Expected term (years)	5.75	5.00
Risk-free interest rate	4.75%	3.71%
Expected volatility	82%	88%
Estimated pre-vesting annual forfeiture rate	8.10%	—
Dividend yield	—	—

The methodologies for determining the above values were as follows:

- *Expected term:* The expected term represents the period that the Company's stock-based awards are expected to be outstanding and is estimated based on historical experience.
- *Risk-free interest rate:* The risk-free interest rate assumption is based upon observed interest rate appropriate for the expected term of the Company's employee stock options.
- *Expected volatility:* The Company determines expected volatility based on historical volatility of the Company's common stock, and other factors.
- *Dividend yield:* The dividend yield assumption is based on the Company's intent not to issue a dividend under its dividend policy.
- *Estimated pre-vesting forfeitures:* When estimating pre-vesting forfeitures, the Company considers termination behavior based on actual historical information.

The weighted average estimated fair value for options granted during the three months ended March 31, 2006 and 2005 was \$3.60 and \$1.91 per option, respectively. As of March 31, 2006, the fair value of unvested stock-based compensation awards, net of expected forfeitures, was \$1.1 million which is expected to be recognized over the next four years.

Stock-Based Compensation Award Activity

The following table summarizes stock-based compensation award activity under the 1989 Plan and the 1999 Plan, and the related weighted average exercise price, for the three months ended March 31, 2006 and the year ended December 31, 2005:

	Shares Available for Grant (in thousands)	Options Outstanding	
		Number of Shares (in thousands)	Weighted Average Exercise Price
Balance at December 31, 2004	4,010	8,888	\$ 5.48
Authorized	1,316	—	—
Granted	(207)	207	3.77
Forfeited or expired	1,539	(1,539)	7.45
Exercised	—	(821)	2.20
Balance at December 31, 2005	6,658	6,735	5.37
Authorized	1,394	—	—
Granted	(79)	79	5.02
Forfeited or expired	63	(63)	3.65
Exercised	—	(385)	2.76
Balance at March 31, 2006	8,036	6,366	\$ 5.55

As of March 31, 2006 and December 31, 2005, options to purchase 5,700,000 and 5,830,000 shares were vested, respectively.

QUICKLOGIC CORPORATION
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Significant exercise price ranges of options outstanding, related weighted average exercise prices and contractual life information at March 31, 2006 was as follows:

Options Outstanding			Options Exercisable			
Weighted Average Remaining	Weighted Average	Aggregate	Options	Weighted Average Remaining	Weighted Average	Aggregate

Range of Exercise Prices	Options Outstanding	Contractual Life	Exercise Price	Intrinsic Value	Vested and Exercisable	Contractual Life	Exercise Price	Intrinsic Value
	(in thousands)	(in years)		(in thousands)	(in thousands)	(in years)		(in thousands)
\$ 0.97 – \$ 2.75	1,775	6.75	\$ 2.11	\$ 6,447	1,379	6.62	\$ 2.10	\$ 5,015
2.83 – 4.08	1,661	6.71	3.45	3,812	1,470	6.45	3.45	3,363
4.25 – 6.04	1,720	4.79	4.90	1,516	1,641	4.55	4.90	1,460
6.33 – 34.56	1,210	4.43	14.39	—	1,210	4.43	14.39	—
\$ 0.97 – \$34.56	6,366	5.77	\$ 5.55	\$ 11,775	5,700	5.51	\$ 5.86	\$ 9,838

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on the Company's closing stock price of \$5.74 as of the end of the Company's current reporting period which would have been received by the option holders had all option holders exercised their options as of that date. The total number of shares of common stock underlying in-the-money options exercisable as of March 31, 2006 was 4,231,000.

The total intrinsic value of options exercised during the three months ended March 31, 2006 was \$820,000. Total cash received from employees as a result of employee stock option exercises during the three months ended March 31, 2006 was approximately \$1.1 million. The Company settles employee stock option exercises with newly issued common shares. In connection with these exercises, there was no tax benefit realized by the Company due to the Company's current loss position.

The status of the Company's nonvested shares as of March 31, 2006 and changes during the three months ended March 31, 2006 and the year ended December 31, 2005 was as follows (in thousands, except per share amounts):

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2004	2,900	\$ 3.03
Granted	207	3.77
Vested	(1,870)	3.34
Forfeited	(332)	3.16
Nonvested at December 31, 2005	905	2.52
Granted	79	5.02
Vested	(269)	2.51
Forfeited	(49)	2.40
Nonvested at March 31, 2006	666	\$ 2.83

On December 21, 2005, the Compensation Committee of the Company's Board of Directors approved the vesting acceleration of unvested, "out-of-the-money" stock options awarded under its 1999 Stock Plan. The purpose of the accelerated vesting was to reduce future compensation expense associated with the accelerated stock options upon adoption of SFAS No.123(R) by approximately \$380,000 and because the outstanding options were not fully achieving their original objective of incentive compensation and employee retention due to exercise prices which were in excess of current market value. A total of 187,703 shares with exercise prices ranging from \$4.08 to \$8.70 were accelerated under the program. The accelerated stock options had a weighted average exercise price of \$5.45. On average, the accelerated options would otherwise have completed vesting over 1.6 years from the date of acceleration.

Note 10—Shelf Registration Statement

On July 12, 2005, the Company filed a shelf registration statement on Form S-3, which was declared effective on July 26, 2005 by the Securities and Exchange Commission. Under this filing, the Company has the

QUICKLOGIC CORPORATION NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

ability to raise up to \$30.0 million, in one or more transactions, by selling common stock, preferred stock, depositary shares, and warrants. As of March 31, 2006, the Company had not raised any funds in connection with this filing.

Note 11—Rights Plan

In November 2001, the board of directors adopted a Rights Agreement, which provides for a dividend of one Preferred Stock Purchase Right (each a "Right" and collectively, the "Rights") for each share of common stock of the Company. Each Right will entitle stockholders to buy one ten-thousandth of a share of Series A Junior Participating Preferred Stock of QuickLogic at an exercise price of \$32.50, subject to adjustment. The Rights will become exercisable only if a person or group becomes the beneficial owner of 15% or more of the common stock, or commences a tender or exchange offer which would result in the offeror beneficially owning 15% or more of the common stock, without the approval of the board of directors. The Company is entitled to redeem the Rights at \$0.001 per Right up to ten business days after the public announcement of a 15% holder. If not earlier terminated or redeemed, the Rights will expire on November 27, 2011.

Note 12—Income Taxes

In the three months ended March 31, 2006 and 2005, the Company recorded income tax expense of \$2,000 and \$50,000,

respectively, which consisted primarily of income taxes on foreign operations.

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

At December 31, 2005, the Company had net operating loss carryforwards for federal and state income tax purposes of approximately \$72.0 million and \$18.3 million, respectively. These carryforwards, if not utilized to offset future taxable income and income taxes payable, will expire beginning in 2006 for federal and state purposes.

Under the Tax Reform Act of 1986, the amount of and the benefit from net operating losses that can be carried forward may be impaired in certain circumstances. Events which may cause changes in the Company's tax carryforwards include, but are not limited to, a cumulative ownership change of more than 50% over a three-year period. Since inception, the Company has had cumulative changes in ownership which will limit the loss carryforward deduction under IRC Section 382. However, the Company believes that such limitations will not have a material effect on the future utilization of the losses.

Note 13—Information Concerning Product Lines, Geographic Information and Revenue Concentration

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

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

	Three Months Ended March 31,	
	2006	2005
Revenue by product family(1):		
Mature products	\$ 5,082	\$ 8,548
Embedded standard products	2,508	2,387
Advanced embedded standard products	1,743	1,592
Total revenue	<u>\$ 9,333</u>	<u>\$ 12,527</u>

- (1) The mature products family includes pASIC 1, pASIC 2 and pASIC 3 products. The embedded standard products family includes QuickRAM, QuickPCI, QuickDSP, QuickFC, and V3 products. The advanced embedded standard products family includes Eclipse, Eclipse II, QuickPCI II, PolarPro and QuickMIPS products, as well as programming hardware and software.

QUICKLOGIC CORPORATION **NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

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

	Three Months Ended March 31,	
	2006	2005
Revenue by geography:		
United States	\$ 4,836	\$ 5,881
Europe	2,033	3,137
Japan	988	2,083
China	605	141
Rest of North America	594	714
Rest of Asia Pacific	277	571
Total revenue	<u>\$ 9,333</u>	<u>\$ 12,527</u>

Two distributors of the Company's products accounted for 33% and 13% of revenue, respectively, in the three months ended March 31, 2006. Three distributors of the Company's products accounted for approximately 24%, 16% and 13% of revenue, respectively, in the three months ended March 31, 2005. One domestic OEM accounted for 12% and 11% of revenue for the three months ended March 31, 2006 and 2005, respectively.

As of March 31, 2006 less than 10% of the Company's long-lived assets, including property and equipment and other assets, were located outside the United States.

Note 14—Commitments

Certain of the Company's wafer manufacturers require the Company to forecast wafer starts several months in advance. The Company is committed to take delivery of and pay for a portion of forecasted wafer volume. As of March 31, 2006 and December 31, 2005, the Company had \$2.8 million and \$2.7 million, respectively, of outstanding commitments for the purchase of wafer inventory.

The Company leases, with an option to renew, its primary facility under a non-cancelable operating lease that expires in 2009. In

addition, the Company rents development facilities in Canada and India as well as sales offices in Europe and Asia. Total rent expense, net of sublease income, for the three months ended March 31, 2006 and 2005 was approximately \$235,000 and \$260,000, respectively. The Company has subleased a portion of its primary facilities to a tenant until November 2007.

Note 15—Litigation

On October 26, 2001, a putative securities class action was filed in the U.S. District Court for the Southern District of New York against certain investment banks that underwrote QuickLogic's initial public offering, QuickLogic and some of QuickLogic's officers and directors. The complaint alleges excessive and undisclosed commissions in connection with the allocation of shares of common stock in QuickLogic's initial and secondary public offerings and artificially high prices through "tie-in" arrangements which required the underwriters' customers to buy shares in the aftermarket at pre-determined prices in violation of the federal securities laws. Plaintiffs seek an unspecified amount of damages on behalf of persons who purchased QuickLogic's stock pursuant to the registration statements between October 14, 1999 and December 6, 2000. Various plaintiffs have filed similar actions asserting virtually identical allegations against over 300 other public companies, their underwriters, and their officers and directors arising out of each company's public offering. These actions, including the action against QuickLogic, have been coordinated for pretrial purposes and captioned *In re Initial Public Offering Securities Litigation, 21 MC 92*. A stipulation of settlement for the claims against the issuer defendants, including the Company, has been signed and was submitted to the court. Under the stipulation of settlement, the plaintiffs will dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all the related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers will be required to pay the amount, if any, by which \$1.0 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. On February 15, 2005, the court preliminarily approved the settlement contingent on specified modifications. The settlement is still subject to court approval and a number of other conditions. There is no guarantee that the settlement will become effective.

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QUICKLOGIC CORPORATION NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

On July 3, 2003, a putative securities class action was filed in the U.S. District Court for the Southern District of New York by shareholders of Tower Semiconductor Ltd. against Tower, several of its directors, and several of its investors, including QuickLogic. QuickLogic was named solely as an alleged control person. On August 19, 2004, the court dismissed the claims against all defendants, including QuickLogic, with prejudice. On September 29, 2004, one of the plaintiffs filed a notice of appeal from the judgment.

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

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

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as information contained in "Risk Factors" in Part II, Item 1A and elsewhere in this Quarterly Report on Form 10-Q, contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We intend that these forward-looking statements be subject to the safe harbors created by those provisions. Forward-looking statements are generally written in the future tense and/or are preceded by words such as "will," "may," "should," "forecast," "could," "expect," "suggest," "believe," "anticipate," "intend," "plan," or other similar words. Forward-looking statements include statements regarding our revenue levels, our gross profit and factors that affect gross profit, our level of operating expenses, our research and development efforts, our liquidity, our partners and suppliers, industry trends and the commercial success of our products. The following discussion should be read in conjunction with the attached condensed unaudited consolidated financial statements and notes thereto, and with our audited financial statements and notes thereto for the fiscal year ended December 31, 2005, found in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 17, 2006.

The forward-looking statements contained in this Quarterly Report involve a number of risks and uncertainties, many of which are outside of our control. Factors that could cause actual results to differ materially from projected results include, but are not limited to, risks associated with the expected decline in revenue from our pASIC® 1 and pASIC 2 products, the commercial and technical success of our new products such as PolarPro™, Eclipse™ II and QuickPCI® II, limited visibility into demand for our products, including demand from significant customers or for new products, our dependence upon single suppliers to fabricate and assemble our products, our relationship with and the manufacturing of our products by Tower Semiconductor Ltd., and the liquidity required to support our future operating and capital requirements. Although we believe that the assumptions underlying the forward-looking statements contained in this Quarterly Report are reasonable, any of the assumptions could be inaccurate, and therefore there can be no assurance that such statements will be accurate. The risk, uncertainties and assumptions referred to above that could cause our results to differ materially from the results expressed or implied by such forward looking statements include, but are not limited to, those discussed under the

heading “Risk Factors” in Part II Item 1A hereto and the risks, uncertainties and assumptions discussed from time to time in our other public filings and public announcements. All forward-looking statements included in this document are based on information available to us as of the date hereof. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that the results or conditions described in such statements or our objectives and plans will be achieved. Furthermore, past performance in operations and share price is not necessarily indicative of future performance. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

We operate in a single industry segment where we design and sell field programmable gate arrays, or FPGAs, embedded standard products, or ESPs, associated software and programming hardware. ESPs, products that combine standard functions and programmable logic in a single device, provide design engineers with the ease-of-use, guaranteed functionality, high performance, low non-recurring engineering charges and immediate availability of application specific standard products, or ASSPs, combined with the flexibility and time-to-market advantages of programmable logic. Our FPGA and ESP devices are standard products that can be programmed to perform desired logic functions or combined with intellectual property to provide customers with desired solutions. We design these devices based on our proprietary ViaLink technology. We believe that the underlying attributes of our ViaLink technology, including low power consumption, high reliability, design security and design efficiency enable us to differentiate our silicon solutions.

Our objective is to be the leading provider of the lowest-power programmable logic solutions. In addition to offering the lowest-power, full-featured FPGAs, our products also provide:

- *“Bulletproof” IP Security*—we believe our products provide “bulletproof” programmable logic design security, since it is virtually impossible to clone or reverse engineer designs implemented using our ViaLink technology;
- *Small Form Factor*—since our products do not require an additional device to store configuration data, we can provide single chip full-featured solutions, in packages as small as 8x8 millimeters;

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- *Instant On*—our ViaLink based products require no configuration bit stream and thus are live at power up. This is critical in applications that need to be active as soon as power is supplied; and
- *High Reliability*—our ViaLink-based devices are consistently more robust in harsh environments than SRAM-based FPGA products, since ViaLink-based products do not rely on an SRAM-cell that is susceptible to alpha particles, or brownouts, to define and maintain their functionality.

Competitively, our products can offer significant power, performance and design security benefits when compared to traditional FPGAs; lower cost of ownership, time-to-market and increased system flexibility benefits when compared to the use of application specific integrated circuits, or ASICs; and increased system flexibility, product differentiation and design security benefits when compared to application specific standard products, or ASSPs. We believe that developing products around our ViaLink technology will continue to allow us to provide products that address the design flexibility, system power, performance, intellectual property security and price points demanded by our target markets.

We believe that important industry trends in our target markets include lower power consumption, higher performance, shorter time-to-market, increased intellectual property security, higher ASIC development expenses and higher product development risks. We believe our products are designed to address many of these trends.

The market for programmable logic devices is expected to grow more quickly than the semiconductor industry, and we believe the FPGA programmable logic market will grow more quickly than the market for complex programmable logic devices, or CPLDs. One factor fueling this high growth is the migration from ASIC circuit designs to programmable logic circuit designs. System designers often choose programmable logic solutions over ASIC solutions, due to the relatively low development cost, low development risk, quick time-to-market and high adaptability or flexibility of programmable logic devices, and due to the ability of programmable logic suppliers to reduce the unit costs of their products over time.

Within the programmable logic device market, we believe that the market for low-power embedded applications will be a relatively high-growth market. We anticipate that original equipment manufacturers, or OEMs, will expand their offering of consumer or professional portable products. These new product offerings are expected to include portable 3-D GPS products incorporating micro hard drive capability, portable media players, personal video recorders or handheld POS terminals incorporating Wi-Fi and micro hard drive capabilities and cellular data cards interfacing a processor and a cellular radio. This adoption of new features by embedded system designers is increasing the use of low-power programmable logic, since embedded processors often do not have the native ability to interface to components such as Wi-Fi modules or micro hard disk drives, which were designed to work in a personal computer environment. Our Eclipse II, QuickPCI II and PolarPro products offer compelling advantages in these programmable interconnect applications, where customers benefit from their lowest power consumption, small form factor and high bandwidth.

In the fourth quarter of 2004, we completed the design of our Eclipse II and QuickPCI II products which provide a low-power solution for applications requiring medium to small amounts of programmable logic. These devices offer the lowest power consumption during all phases of operation – power-up, quiescent and dynamic operation – on the market today.

Our PolarPro architecture and related products were announced in November 2005. These products improve on our Eclipse II and QuickPCI II low-power leadership by providing lower power consumption and a more cost-effective architecture. Our PolarPro

architecture combines the industry's lowest-power FPGA with embedded circuitry for implementing high-bandwidth bus-to-bus interfaces. All device circuitry is optimized for low power consumption through the new and innovative Very Low Power mode, or VLP, which provides an instant ability to lower power consumption when the device function is not needed. When put in VLP mode, we believe that our PolarPro products draw less than 10 micro amps of quiescent current. PolarPro products also exhibit the FPGA industry's lowest dynamic power consumption, with operational power consumption up to three times lower than competing alternatives. Based on our engineering analysis of portable media players, we believe designers of handheld, battery-powered products using PolarPro products can now extend battery life by as much as four times as compared to a standard product implementation, setting a new standard for low power consumption through the use

of our FPGAs. Our first PolarPro product, the QL1P100, was released for production in the first quarter of 2006. We expect to sample additional PolarPro products during 2006.

We market a range of solutions to our customers, including:

- *complete solutions* incorporating our devices, intellectual property and software drivers. These complete solutions are targeted at specific low-power application segments that have similar connectivity and performance requirements. By providing solutions for customers we increase their ability to meet the time-to-market pressures associated with their markets;
- *Embedded Standard Products* incorporating a fixed function along with programmable logic in a low-power device. Our customers build on this "known good starting point" to develop unique solutions required for their products, which eliminates the need to acquire and assemble industry standard IP, thus reducing design risk and improving time-to-market; and
- *FPGAs* which are general purpose FPGAs used by customers who value the low power consumption, high IP security, instant on and reliability of our devices. These products give customers the ability to create a design specifically tailored for their needs.

Our new products are also being designed into applications in our traditional markets, such as data communications, instrumentation and test and military-aerospace, where customers value the low power consumption, instant-on, IP security, reliability and fast time-to-market of our products.

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

Our proprietary ViaLink programmable metal-to-metal technology is the core of our FPGA products and the foundation of our ESP products. Our ViaLink technology allows us to create devices smaller than competitors' products on comparable technology, thereby minimizing silicon area and cost. In addition, our ViaLink technology has lower electrical resistance and capacitance than other programmable technologies and, consequently, supports higher signal-speed and low power consumption. Our user-programmable platform facilitates full utilization of a device's logic cells, clocks and input/output pins. These logic cells have been optimized to efficiently implement a wide range of logic functions at high speed, thereby enabling greater usable device density and design flexibility. Our architecture uses our ViaLink technology to maximize interconnects at every routing wire intersection, which allows more paths between logic cells. As a consequence, system designers are able to use our devices with smaller gate counts to implement their designs than if they had used competing FPGAs. The abundance of interconnect resources also provides a dense connection between the ASSP and the FPGA portions of Embedded Standard Products.

Our ViaLink technology also provides our products with what we believe to be "bulletproof" intellectual property security, especially compared to SRAM-based FPGA or ASIC solutions, since it is virtually impossible to clone or reverse engineer designs implemented using our ViaLink technology. We believe intellectual property security is important to system designers who choose to implement proprietary algorithms or features in programmable logic.

We sell programmed and unprogrammed products through distributors and directly to system manufacturers. We recognize revenue at the time of shipment of products directly to system manufacturers. However, we sell the majority of our products through distributors who earn a negotiated margin on the sale of our products. We defer recognition of revenue from sales of unprogrammed products to distributors until after they have sold our products to systems manufacturers. We recognize revenue on programmed products at the time of shipment to our distributors. During the three months ended March 31, 2006 and 2005, respectively, approximately 51% and 68%, respectively, of the units shipped to our distributors were programmed by us and, accordingly, are not returnable.

The percentage of sales derived through distributors was 61% and 70% in the three months ended March 31, 2006 and 2005, respectively.

Two distributors of our products accounted for 33% and 13% of our revenue, respectively, in the three months ended March 31, 2006. Three distributors of our products accounted for 24%, 16% and 13% of our revenue, respectively, in the three months ended March 31, 2005. One domestic manufacturer accounted for 12% and 11% of revenue for the three months ended March 31, 2006 and

2005, respectively. We anticipate that a limited number of distributors and customers will continue to account for a significant portion of our revenue and that individual distributors could account for a larger portion of our revenue.

Our international sales were 48% and 53% of our revenue in the three months ended March 31, 2006 and 2005, respectively. We expect that revenue from sales to international customers will continue to represent a significant portion of our revenue. All of our sales originate in the United States and are denominated in U.S. dollars.

We outsource the wafer manufacturing, assembly and test of all of our products. We currently rely upon Taiwan Semiconductor Manufacturing Company Ltd., or TSMC, Cypress Semiconductor Corporation, Tower, Kawasaki Microelectronics, Inc. and Samsung Semiconductor, Inc. to manufacture our products, and we rely primarily upon Amkor Technology, Inc. to assemble, test and program our products. In 2001 and 2002, we made a \$21.3 million investment in Tower to obtain access to manufacturing capacity for our new products. Our wafer suppliers' lead times are often as long as three months and sometimes longer. In addition, Tower requires us to provide them with a monthly wafer start forecast. Under the terms of our agreement with them, we are limited in the quantity that we can increase or decrease our wafer forecast and we are committed to take delivery of and pay for a minimum portion of the forecasted wafer volume. Our long manufacturing cycle times conflict with our customers' desire for short delivery lead times and, as a result, we typically purchase wafers based on our internal forecasts of customer demand.

Critical Accounting Policies and Estimates

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our financial statements. The U.S. Securities and Exchange Commission, or SEC, has defined critical accounting policies as those that are most important to the portrayal of our financial condition and results of operations and require us to make our most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, our critical policies include revenue recognition including sales returns and allowances, inventory valuation including identification of excess quantities and product obsolescence, allowance for doubtful accounts, valuation of investments, valuation of long-lived assets, measurement of stock-based compensation, accounting for income taxes, and estimating accrued liabilities. We believe that we apply judgments and estimates in a consistent manner and that such consistent application results in financial statements and accompanying notes that fairly represent all periods presented. However, any factual errors or errors in these judgments and estimates may have a material impact on our statement of operations and financial condition. For a discussion of critical accounting policies and estimates, please see Item 1A in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005 filed with the SEC on March 17, 2006 with the exception of stock-based compensation as discussed below.

Stock-Based Compensation

Effective January 2, 2006, we adopted the provisions of Statement of Financial Accounting Standards, or SFAS, No. 123 (revised 2004), "*Share-Based Payment*," or SFAS No. 123(R), which requires the measurement and recognition of expense related to the fair value of stock-based compensation awards. Accordingly, stock-based compensation is measured at the grant date, based on the fair value of the award using the Black-Scholes option pricing model, or Black-Scholes, and is recognized as expense over the requisite service period of the award. Black-Scholes requires the use of highly subjective, complex assumptions, including expected term and the price volatility of our stock. We elected to use the modified prospective transition method upon implementation and, therefore, have not restated our financial results for prior periods. As a result of adopting SFAS No. 123(R), we recognized \$452,000 of stock-based compensation expense in the first quarter of 2006. We previously applied Accounting Principles Board Opinion No. 25, "*Accounting for Stock Issued to Employees*", or APB 25, and restated interpretations and provided the required pro forma disclosures of SFAS No. 123, "*Accounting for Stock-Based compensation*."

Results of Operations

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

	Three Months Ended March 31,	
	2006	2005
Revenue	100.0%	100.0%
Cost of revenue	40.3	39.0
Gross profit	59.7	61.0
Operating expenses:		
Research and development	25.7	19.6
Selling, general and administrative	49.5	34.3
Income (loss) from operations	(15.5)	7.1
Interest expense	(0.8)	(0.4)
Interest income and other, net	3.1	0.6
Income (loss) before income taxes	(13.2)	7.3
Provision for income taxes	—	0.4
Net income (loss)	(13.2)%	6.9%

Three Months Ended March 31, 2006 and 2005

Revenue. Our revenue for the three months ended March 31, 2006 was \$9.3 million, representing a decline of \$3.2 million, or

25.5%, from revenue of \$12.5 million in the three months ended March 31, 2005. Our Mature product family revenue declined by \$3.5 million as a result of a \$4.2 million decline in our pASIC 1 and pASIC 2 product revenue due to their end-of-life, partially offset by a \$700,000 increase in our pASIC 3 product revenue, primarily due to higher demand and customers migrating designs from pASIC 2 products to pASIC 3 products. Our Advanced ESP product family revenue increased by approximately \$200,000 due to an increase in sales of our new Eclipse II and QuickPCI II products of approximately \$900,000, partially offset by a decline in our Eclipse product revenue as a result of lower demand from a Japanese customer purchasing product through a distributor. Our ESP product family revenue increased by approximately \$100,000 year-over-year.

Our revenue for the three months ended March 31, 2006 was 9.5% lower sequentially, declining by approximately \$980,000 to \$9.3 million from \$10.3 million in the three months ended December 31, 2005. This sequential revenue decrease was primarily due to a \$620,000 decline in Mature product family revenue, principally due to a \$1.3 million reduction in pASIC 1 and pASIC 2 revenue, due to the end-of-life of these products, which was partially offset by a \$660,000 increase in pASIC 3 revenue due to higher demand and the conversion of customer designs to the use of pASIC 3 from the use of pASIC 2. ESP and Advanced ESP product family revenue declined by a combined \$360,000 primarily due to customer demand and requested shipping dates.

Our foundry agreement with the supplier that fabricated our pASIC 1 and pASIC 2 products expired at the end of 2005. We announced an end-of-life for these products in 2004 and requested that our customers take delivery of lifetime buy orders before the end of 2005. These products contributed \$2.3 million and \$6.4 million of our revenue in the three months ended March 31, 2006 and 2005, respectively. We currently believe that a majority of our customers that use pASIC 1 and pASIC 2 products have either purchased sufficient quantities of our product to satisfy their demand throughout the expected life of their products or have converted to using other of our products, such as pASIC 3, which is pin compatible with pASIC 2. While we may have limited future production capacity for these products, we experienced a significant reduction in pASIC 1 and pASIC 2 revenue during the fourth quarter of 2005 and the first quarter of 2006. Further, although we may record revenue from these products in the third quarter of 2006, we anticipate that pASIC 1 and pASIC 2 products may contribute no revenue in the third quarter of 2006 and beyond.

In order to maintain or grow our revenue from its current level after the end-of-life period for our pASIC 1 and pASIC 2 products, we are dependent upon increased revenue from our existing products, especially our new PolarPro, Eclipse II and QuickPCI II products, and the development of additional new products.

We continue to seek to expand our revenue, including the pursuit of high volume sales opportunities in the consumer market segment, by providing low power solutions incorporating industry standard interfaces such as PCI, SDIO or IDE. Our industry is characterized by intense price competition and by lower prices as order volumes increase. While winning large volume sales opportunities will increase our revenue, we believe these opportunities may decrease our average selling price and gross profit as a percentage of revenue.

Gross Profit. Gross profit was \$5.6 million and \$7.6 million in the three months ended March 31, 2006 and 2005, respectively, which represented 59.7% and 61.0% of revenue for those periods. The \$2.1 million decline in gross profit was primarily due to a decline in revenue, which contributed approximately \$2.2 million to the decline, and lower absorbed overhead of approximately \$380,000, primarily due to lower production volumes, which was partially offset by better product mix, which improved gross profit by approximately \$250,000, and improvements in other production variances. Cost of revenue for the three months ended March 31, 2006, includes \$49,000 related to the recognition of stock-based compensation in accordance with SFAS No. 123(R). In the three months ended March 31, 2006, we provided inventory reserves primarily for excess quantities in the amount of \$232,000 and sold \$323,000 of inventory that was previously reserved. In the three months ended March 31, 2005, we provided inventory reserves primarily for excess quantities in the amount of \$205,000 and sold \$255,000 of inventory that was previously reserved.

Research and Development Expense. Research and development expense was \$2.4 million and \$2.5 million in the three months ended March 31, 2006 and 2005, respectively, which represented 25.7% and 19.6% of revenue for those periods. The decrease of approximately \$50,000 was primarily due to lower headcount and related spending, partially offset by \$146,000 related to the recognition of stock-based compensation in accordance with SFAS No. 123(R). We believe that continued or increased investments in product development and process technology are essential for us to remain competitive in the markets we serve. We expect that these development efforts will allow us to expand our product offering, increase our revenue and provide additional value to our customers and stockholders.

Selling, General and Administrative Expense. Selling, general and administrative expense was \$4.6 million and \$4.3 million for the three months ended March 31, 2006 and 2005, respectively, which represented 49.5% and 34.3% of revenue for those periods. The \$320,000 increase in selling, general and administrative expense was primarily the result of the recognition of stock-based compensation in accordance with SFAS No. 123(R) of \$257,000 and a \$140,000 recovery of an account receivable in the first quarter of 2005 that did not repeat in the first quarter of 2006.

Interest Expense. Interest expense increased to \$74,000 for the three months ended March 31, 2006 as compared to \$53,000 for the three months ended March 31, 2005. This \$21,000 increase was primarily due to higher interest rates and higher average outstanding debt and capital lease balances.

Interest Income and Other, Net. Interest income and other, net increased to \$292,000 of income for the three months ended March 31, 2006 as compared to \$80,000 of income for the three months ended March 31, 2005. The \$212,000 increase in interest income and other, net is primarily due to increased interest income received as a result of higher invested cash balances and higher interest rates.

Provision for Income Taxes. For the three months ended March 31, 2006 we incurred a net loss of \$1.2 million and recorded a provision for income taxes of \$2,000, which consisted of income taxes on foreign operations. For the three months ended March 31, 2005, we recorded a provision for income taxes of \$50,000, which consisted of income taxes on foreign operations of \$30,000 and federal

alternate minimum income taxes of \$20,000. Our ability to utilize our income tax loss carryforwards in future periods is uncertain and, accordingly, we recorded a full valuation allowance against the related tax benefit. We will continue to assess the realizability of the deferred tax assets in future periods.

Stock-based Compensation. Effective January 2, 2006, we adopted the provisions of Statement of Financial Accounting Standards (“SFAS”) No. 123 (revised 2004), “*Share-Based Payment*,” or SFAS 123(R), which requires the measurement and recognition of expense related to the fair value of stock-based compensation awards. Accordingly, stock-based compensation is measured at the grant date, based on the fair value of the award using the Black-Scholes option pricing model, and is recognized as expense over the requisite service period of the award. Black-Scholes requires the use of highly subjective, complex assumptions, including expected term and the price

volatility of our stock. We elected to use the modified prospective transition method as permitted by SFAS 123(R) and, therefore, we have not restated our financial results for prior periods. We previously applied Accounting Principles Board, or APB, Opinion No. 25, “*Accounting for Stock Issued to Employees*,” or APB 25, and related interpretations and provided the required pro forma disclosures of SFAS No. 123, “*Accounting for Stock-Based Compensation*.” In March 2005, the SEC issued Staff Accounting Bulletin No. 107, or SAB 107, relating to SFAS 123(R). We have applied the provisions of SAB 107 in our adoption of SFAS 123(R).

In the first quarter of 2006 and 2005, stock-based compensation totaled \$452,000 and zero, respectively, and was included in the statement of operations as follows (in thousands):

	Three Months Ended	
	March 31,	
	2006	2005
Cost of revenue	\$ 49	\$ —
Research and development	146	—
Selling, general and administrative	257	—
Total	\$ 452	\$ —

Liquidity and Capital Resources

We have financed our operating losses and capital investments through sales of common stock, private equity investments, capital and operating leases, bank lines of credit and cash flow from operations. As of March 31, 2006, our principal sources of liquidity consisted of our cash and cash equivalents of \$30.2 million, available credit under our revolving line of credit with Silicon Valley Bank of approximately \$8.0 million, available credit under our equipment line of credit of approximately \$2.1 million, and our investment in Tower with a market value of approximately \$1.7 million.

On July 12, 2005, we filed a shelf registration statement on Form S-3 with the SEC, which has been declared effective. Under this filing, we may raise up to \$30.0 million, in one or several transactions, by selling common stock, preferred stock, depository shares, and warrants.

As of March 31, 2006, our interest-bearing debt consisted of \$2.0 million outstanding from Silicon Valley Bank and \$2.0 million outstanding under capital leases. As of March 31, 2006, our accumulated deficit was \$118.6 million. Capital expenditures, which are largely driven by the development of new products and manufacturing levels, could be up to \$4.0 million in the next twelve months.

In June 2005, we modified our Amended and Restated Loan and Security Agreement with Silicon Valley Bank. Terms of the modified agreement include an \$8.0 million revolving line of credit available through June 2006 and an additional \$3.0 million of borrowing capacity under an equipment financing line of credit that is available to be drawn against through June 2006. The revolving line of credit provides for formula advances based upon a percentage of eligible accounts receivable and for non-formula advances not to exceed \$4.0 million. As of March 31, 2006, we had no balances outstanding under the revolving line of credit and had available formula and non-formula advances totaling \$8.0 million. As of March 31, 2006, we had \$2.0 million outstanding under the current and previous equipment lines of credit and \$2.1 million available to be drawn against future equipment purchases. Advances under the new equipment line of credit must be repaid in either 30 or 36 equal monthly installments, depending upon the nature of the items financed. The bank has a first priority security interest on substantially all of our tangible and intangible assets to secure any outstanding amounts under the modified agreement. Under the terms of the modified agreement, we must maintain a minimum tangible net worth and an adjusted quick ratio. The modified agreement also has certain restrictions including, among others, on the incurrence of other indebtedness, the maintenance of depository accounts, the disposition of assets, mergers, acquisitions, the granting of liens and the payment of dividends. We were in compliance with all loan covenants as of March 31, 2006. We are currently negotiating the renewal of the credit facility, which expires on June 26, 2006. We may not renew the facility or it may not remain available to us on acceptable terms.

As of March 31, 2006, we had \$1.3 million outstanding under a capital lease obligation to finance electronic design automation software and related maintenance. The capital lease obligation has an imputed interest rate of 8.5% per annum and is being repaid in quarterly amounts of \$204,000 through November 2007.

As of March 31, 2006, we also had \$649,000 outstanding under a capital lease obligation to finance design software tools and related maintenance. The capital lease obligation has an imputed interest rate of 9.0% per annum and is being repaid in semi-annual amounts of \$148,000 through July 2008.

Net cash from operating activities

Net cash provided by operating activities was \$1.3 million in the three months ended March 31, 2006. The cash provided by operating activities resulted primarily from a net loss of \$1.2 million, adjusted for \$1.4 million of non-cash charges including depreciation and amortization of \$686,000, stock-based compensation of \$452,000 and reserves for excess inventory of \$232,000. In addition, changes in working capital accounts provided cash in the amount of \$1.1 million primarily as a result of a decrease of \$1.4 million in accounts receivable, net of allowances for doubtful accounts, due to a reduction in revenue levels and the timing of shipments in the period and a \$316,000 increase in deferred income and royalty revenue due primarily to higher inventories at distributors on which revenue is deferred. These sources of cash were partially offset by a \$591,000 decrease in accrued liabilities.

Net cash provided by operating activities was \$582,000 in the three months ended March 31, 2005. The cash provided resulted primarily from net income of \$864,000, adjusted for \$971,000 of non-cash charges including depreciation and amortization of \$665,000 and reserves for excess inventory of \$205,000. In addition, changes in working capital accounts used cash in the amount of \$1.3 million primarily as a result of an increase of \$1.1 million in accounts receivable, net of allowances for doubtful accounts, and a \$940,000 increase in work-in-process and finished goods inventory in anticipation of increased future sales, partially offset by a \$260,000 increase in trade payables related to the increase in inventory, a \$256,000 reduction in other current assets due to the amortization of prepaid expenses and a \$221,000 increase in deferred income and royalty revenue due primarily to higher inventories at distributors on which revenue is deferred.

Net cash from investing activities

Net cash used for investing activities for the three months ended March 31, 2006 and 2005 was \$709,000 and \$407,000, respectively, as a result of capital expenditures made primarily to acquire equipment and software used in the development and production of our products.

Net cash from financing activities

Net cash provided by financing activities was \$1.3 million for the three months ended March 31, 2006, resulting from \$1.1 million in proceeds related to the issuance of common shares upon the exercise of stock options by employees and \$932,000 in proceeds from borrowings under our equipment line of credit, partially offset by scheduled repayments of \$660,000 under the terms of our debt and capital lease obligations.

Net cash used for financing activities was \$491,000 for the three months ended March 31, 2005. The use of funds was due to scheduled repayments of \$772,000 under the terms of our debt and capital lease obligations, partially offset by \$281,000 of proceeds related to the issuance of common shares upon the exercise of stock options by employees.

We require substantial working capital to fund our business, particularly to finance our operations, the acquisition of property and equipment, the repayment of debt and for working capital requirements. Our future liquidity will depend on many factors such as these, as well as our level of revenue and gross profit, market acceptance of our existing and new products, the decline in revenue from our pASIC 1 and pASIC 2 products, wafer purchase commitments, the amount and timing of research and development expenditures, the timing of new product introductions, production volumes, the quality of our products, sales and marketing efforts, our ability to obtain debt financing and to remain in compliance with the terms of our credit facilities, our ability to raise funds from the sale of Tower shares and equity in the Company, the exercise of employee stock options and participation in our employee stock purchase plan, and other factors related to the uncertainties of the industry and global economics. However, we believe that our existing cash resources will be sufficient to fund operations, capital expenditures of up to \$4.0 million, and provide adequate working capital for at least the next twelve months. As our liquidity is affected by many factors as mentioned above and as discussed in our "Risk Factors," there can be no assurance that we will not seek additional capital during the next twelve months or that such capital will be available on terms acceptable to

us. After the next twelve months, our capital and operating requirements will depend on many factors, including our level of revenue and gross profit, the market acceptance of our new products, the levels at which we maintain inventory and accounts receivable, costs of securing access to adequate manufacturing capacity, new product development efforts, capital expenditures and the level of our operating expenses.

Contractual Obligations and Commercial Commitments

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

Total	Payments Due by Period			
	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years

Contractual cash obligations:

Operating leases	\$ 2,369	\$ 2,731	\$ 1,489	\$ 109	\$ —
Wafer purchases (1)	2,791	2,441	381	—	—
Other purchase commitments	2,822	2,441	381	—	—
Total contractual cash obligations	7,932	5,953	1,870	109	—
Other commercial commitments (2):					
Notes payable to bank	2,049	1,185	864	—	—
Capital lease obligations	1,967	972	995	—	—
Total commercial commitments	4,016	2,157	1,859	—	—
Total contractual obligations and commercial commitments	\$ 11,948	\$ 8,110	\$ 3,729	\$ 109	\$ —

(1) Certain of our wafer manufacturers require us to forecast wafer starts several months in advance. We are committed to take delivery of and pay for a portion of forecasted wafer volume. Wafer purchase commitments of \$2.8 million include both firm purchase commitments and a portion of our forecasted wafer starts as of March 31, 2006.

(2) Other commercial commitments are included as liabilities on our balance sheet as of March 31, 2006.

Inflation

The impact of inflation on our business has not been material for the periods presented.

Off-Balance Sheet Arrangements

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

Recently Issued Accounting Pronouncements

On December 16, 2004, the Financial Accounting Standards Board, or FASB, issued SFAS No. 123(R), “*Share-Based Payment*,” which is a revision of SFAS No. 123 and supersedes APB 25. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the requisite service period. Pro forma disclosure of the income statement effects of share-based payments is no longer an alternative. SFAS No. 123(R), as amended, is effective for all stock-based awards granted in fiscal years beginning after June 15, 2005. In addition, companies must also recognize compensation expense related to any awards that are not fully vested as of the effective date. Compensation expense for the unvested awards will be measured based on the fair value of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS No. 123. Effective January 2, 2006, the first day of our fiscal 2006, we adopted SFAS 123(R) on a modified prospective basis. As a result, we began to include

stock-based compensation charges in our results of operations beginning in the quarter ended March 31, 2006. See Notes 2 and 9 to our Condensed Unaudited Consolidated Financial Statements.

In November 2005, the FASB issued Staff Position, or FSP, FAS123(R)-3, “*Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards*.” This FSP requires an entity to follow either the transition guidance for the additional-paid-in-capital pool as prescribed in SFAS No. 123(R), or the alternative transition method as described in the FSP. An entity that adopts SFAS No. 123(R) using the modified prospective application may make a one-time election to adopt the transition method described in this FSP. An entity may take up to one year from the later of its initial adoption of SFAS No. 123(R) or the effective date of this FSP to evaluate its available transition alternatives and make its one-time election. We continue to evaluate the impact that the adoption of this FSP could have on our consolidated financial statements.

On March 29, 2005, the SEC issued SAB No. 107, which provides guidance on the interaction between SFAS No. 123(R), “*Share-Based Payment*,” and certain SEC rules and regulations. SAB No. 107 provides guidance that may simplify some of the SFAS No. 123(R) implementation challenges and enhance the information that investors receive. Effective January 2, 2006, the first day of our fiscal 2006, we adopted SFAS 123(R) on a modified prospective basis and applied the principles of SAB No. 107 in conjunction with the adoption of SFAS No. 123(R).

In February 2006, the FASB issued SFAS No. 155, “*Accounting for Certain Hybrid Instruments—An Amendment of FASB Statements No. 133 and No. 144*,” or SFAS No. 155. SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. It also clarifies which interest-only strips and principal-only strips are not subject to the requirements of FASB Statement No. 133, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. Furthermore, SFAS No. 155 clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and it amends FASB Statement No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year beginning after September 15, 2006. We do not expect the adoption of the provisions of SFAS No. 155 to impact our financial condition or results of operations.

On March 13, 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets," or SFAS No. 156. SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract under specified circumstances. SFAS No. 156 also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS No. 156 permits an entity to choose alternative measurement methods for each class of separately recognized servicing assets and servicing liabilities. The Statement is an amendment of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125." SFAS No. 156 is effective for servicing assets and liabilities acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006. We do not expect the adoption of the provisions of SFAS No. 156 to impact our financial condition or results of operations.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio and variable rate debt. We do not use derivative financial instruments to manage our interest rate risk. We are adverse to principal loss and ensure the safety and preservation of invested funds by limiting default, market and reinvestment risk. Our investment portfolio is generally comprised of investments that meet high credit quality standards. Since these securities are subject to interest rate risk, they could decline in value if interest rates fluctuate. Due to the short duration and conservative nature of our investment portfolio, we do not anticipate any material loss with respect to our investment portfolio. A 10% move in interest rates as of March 31, 2006 would have an immaterial effect on our financial position, results of operations and cash flows.

Foreign Currency Exchange Rate Risk

All of our sales and cost of manufacturing are transacted in U.S. dollars. We conducted a portion of our research and development activities in Canada and India and have sales and marketing offices in several locations outside of the United States. We use the U.S. dollar as our functional currency. Most of the costs incurred at these international locations are in local currency. If these local currencies strengthen against the U.S. dollar, our payroll and other local expenses will be higher than we currently anticipate. Since our sales are transacted in U.S. dollars, this negative impact on expenses would not be offset by any positive effect on revenue. Operating expenses denominated in foreign currencies were approximately 23% and 26% of total operating expenses for the three months ended March 31, 2006 and 2005, respectively. A majority of these foreign expenses were incurred in Canada. A currency exchange rate fluctuation of 10% would have caused our operating expenses to change by approximately \$180,000 in the three months ended March 31, 2006.

Equity Price Risk

Our exposure to equity price risk for changes in market value relates primarily to our investment in Tower Semiconductor Ltd., or Tower. Tower's ordinary shares trade on the Nasdaq National Market under the symbol "TSEM". Since these securities are publicly traded on the open market, they are subject to market fluctuations. Temporary market fluctuations are reflected by increasing or decreasing the presented value of the related securities and recording "other comprehensive income (loss)" in the equity section of the balance sheet. An "other than temporary" decline in market value is reflected by decreasing the adjusted cost of the related securities and recording a charge to operating expenses on the income statement. We wrote down the value of the Tower shares due to an "other than temporary" decline in their market value by \$1.5 million, \$1.5 million, \$3.8 million and \$6.8 million in fiscal 2005, 2004, 2002 and 2001, respectively. The determination that the decline in market value was "other than temporary" included factors such as market value and the period of time that the market value had been below the carrying value in each of the respective periods. A market value fluctuation of 10% would have caused us to reduce accumulated other comprehensive income by approximately \$170,000 in the three months ended March 31, 2006.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, while no cost-effective control system will preclude all errors and irregularities, our current disclosure controls and procedures are effective to provide reasonable assurance that the financial statements and other disclosures in our SEC reports are reliable.

Changes in Internal Control Over Financial Reporting

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

Part II. Other Information

Item 1. Legal Proceedings

On October 26, 2001, a putative securities class action was filed in the U.S. District Court for the Southern District of New York against certain investment banks that underwrote QuickLogic's initial public offering, QuickLogic and some of QuickLogic's officers and directors. The complaint alleges excessive and undisclosed commissions in connection with the allocation of shares of common stock in QuickLogic's initial and secondary public offerings and artificially high prices through "tie-in" arrangements which required the underwriters' customers to buy shares in the aftermarket at pre-determined prices in violation of the federal securities laws. Plaintiffs seek an unspecified amount of damages on behalf of persons who purchased QuickLogic's stock pursuant to the registration statements between October 14, 1999 and December 6, 2000. Various plaintiffs have filed similar actions asserting virtually identical allegations against over 300 other public companies, their underwriters, and their officers and directors arising out of each company's public offering. These actions, including the action against QuickLogic, have been coordinated for pretrial purposes and captioned *In re Initial Public Offering Securities Litigation, 21 MC 92*. A stipulation of settlement for the claims against the issuer defendants, including the Company, has been signed and was submitted to the court. Under the stipulation of settlement, the plaintiffs will dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all the related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers will be required to pay the amount, if any, by which \$1.0 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. On February 15, 2005, the court preliminarily approved the settlement contingent on specified modifications. The settlement is still subject to court approval and a number of other conditions. There is no guarantee that the settlement will become effective.

On July 3, 2003, a putative securities class action was filed in the U.S. District Court for the Southern District of New York by shareholders of Tower Semiconductor Ltd. against Tower, several of its directors, and several of its investors, including QuickLogic. QuickLogic was named solely as an alleged control person. On August 19, 2004, the court dismissed the claims against all defendants, including QuickLogic, with prejudice. On September 29, 2004, one of the plaintiffs filed a notice of appeal from the judgment.

Item 1A. Risk Factors

This description includes any material changes to the description of the risk factors associated with our business previously disclosed in Item 1A of our 2005 Annual Report on Form 10-K filed with the SEC on March 17, 2006. Because of the following risk factors, as well as other variables affecting our operating results, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

Risk Factors

We expect the announced end-of-life of our pASIC 1 and pASIC 2 products will result in a decline in our revenue

Our foundry agreement with the supplier that fabricates our pASIC 1 and pASIC 2 products expired on December 31, 2005. We announced an end-of-life for these products in 2004 and asked our customers to take delivery of lifetime buy orders before the end of 2005. As a result, we will experience a reduction in revenue from these products. Revenue from these products was \$6.4 million, \$5.1 million, \$6.0 million and \$3.5 million in the first, second, third and fourth quarters of 2005, respectively, and \$2.3 million in the first quarter of 2006. We believe that revenue from these products may contribute no revenue in the third quarter of 2006 and beyond. We believe that a majority of our customers that use pASIC 1 and pASIC 2 products have purchased enough pASIC 1 and pASIC 2 product to satisfy demand through the expected life of their products rather than migrate to other QuickLogic products. While we may have limited fabrication capacity for these products in 2006, we currently expect that the supplier will replace the equipment used to fabricate our devices with other equipment by the third quarter of 2006, which would end our ability to purchase additional wafers. Our operating results and liquidity will be adversely affected by the end-of-life of our pASIC 1 and pASIC 2 products. To mitigate the affects of the end-of-life of our pASIC 1 and pASIC 2 products, we plan to: migrate customers to other QuickLogic products; develop customer demand for new products, such as PolarPro, Eclipse II and QuickPCI II, which have strong customer design activity but limited revenue history; and increase revenue and gross profit from our other products. The pASIC 1 and

pASIC 2 revenue decline may be more rapid than the revenue growth from our PolarPro, Eclipse II, QuickPCI II and other products. While we expect revenue growth from PolarPro, Eclipse II, QuickPCI II, other products and new products will offset the expected decline in pASIC 1 and pASIC 2 revenue, there is no assurance when this will occur, if at all.

If we fail to successfully develop, introduce and sell new products, we may be unable to compete effectively in the future

We operate in a highly competitive, quickly changing environment marked by rapid obsolescence of existing products. To compete

successfully, we must obtain access to advanced fabrication capacity and dedicate significant resources to specify, design, develop, manufacture and sell new or enhanced products and solutions that provide increasingly higher levels of performance, low power consumption, new features, reliability and/or cost savings to our customers. We experience a long delay between the time when we expend these product definition and development resources and invest in related long-lived assets, and the time when we begin to generate revenue, if any, from these expenditures.

We are marketing our Eclipse II, QuickPCI II and PolarPro products to new customers and markets and expect a significant portion of our future revenues to be generated from these new products. We believe our low-power Eclipse II, QuickPCI II and PolarPro products have a compelling advantage in low-power applications, and that this business will provide long-term revenue growth for QuickLogic, but there is no assurance when this will occur, if at all. Some of these opportunities are in the rapidly changing consumer market, which typically has shorter product life cycles, higher volumes and greater price pressure than our traditional business. In order to react quickly to opportunities, we have made significant investments in Eclipse II and QuickMIPS inventory. If we are unable to design, produce and sell new products and solutions that meet design specifications, address customer requirements, and generate sufficient revenue and gross profit, if market demand for our products fails to materialize, if we are unable to obtain adequate capacity, or if our customers do not successfully introduce products incorporating our devices, our revenue and gross margin will be materially harmed and we may be required to write-off related inventory and long-lived assets or have other adverse effects on our business.

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

We offer our customers a short delivery lead-time and a majority of our shipments during a quarter are ordered by customers in that quarter. As a result, we often have low visibility to the current quarter's revenue, and our revenue levels can change significantly in a short period of time. Furthermore, our ability to respond to increased demand is limited to inventory on hand or on order, the capacity available at our contract manufacturers and our capacity to program products to customer specifications. In addition, a significant portion of our revenue is deferred until our distributors ship unprogrammed parts to end customers since the price is not fixed or determinable until that time. Therefore, we are highly dependent on the accuracy and timeliness of resale and inventory reports from our distributors. Inaccurate distributor resale or inventory reports, as well as unanticipated changes in distributor inventory levels, could contribute to our difficulty in predicting and reporting our quarterly revenue and results of operations. If we fail to accurately estimate customer demand, record revenue, or if our available capacity is less than needed to meet customer demand, our results of operations could be harmed and our stock price could materially fluctuate.

Our future results depend on our relationship with Tower

We have invested approximately \$21.3 million in Tower. In return for our investment, we received equity, prepaid wafer credits and committed production capacity in Tower's foundry facility. We believe that Tower's long-term operation of this fabrication facility depends on its ability to attract sufficient customer demand, to obtain additional financing, to increase capacity, to obtain the release of grants and approvals for changes in grant programs from the Israeli government's Investment Center, and its ability to remain in compliance with the terms of its grant and credit agreements. The current political uncertainty and security situation in the Middle East where Tower's fabrication facility is located, the cyclical nature of the market for foundry manufacturing services, Tower's financial condition, or other factors may adversely impact Tower's business prospects and may discourage future investments in Tower from outside sources. We may decide to invest additional funds in Tower, which could have an impact on our cash position and liquidity. If Tower is unable to obtain adequate financing and increase

production output in a timely manner, the value of our investment in Tower may decline significantly or possibly become worthless, our wafer credit from Tower may decline in value or possibly become worthless, and we would have to identify and qualify a substitute supplier to manufacture our products. This could require significant development time, cause product shipment delays, impair long-lived assets and the value of our wafer credits, damage our liquidity and severely harm our business. In addition, Tower solely manufactures our Eclipse II, PolarPro, certain QuickPCI II, QuickMIPS and other new products currently under development.

The value of our investment in Tower and its corresponding wafer credits may also be adversely affected by a deterioration of conditions in the market for foundry manufacturing services and the market for semiconductor products. At March 31, 2006, the aggregated value of our Tower investment and wafer credits recorded on our balance sheets was \$5.9 million. If the fair value of our Tower investment or our wafer credits are deemed to be impaired, we will record charges to our statement of operations. For instance, the fair value of our Tower investment was \$2.26 per share at the end of 2004 as compared to \$1.17 per share at the end of the second quarter of 2005. Since the value of our Tower investment remained below \$2.26 per share for a period of time, we recorded a \$1.5 million write-down of marketable securities in the second quarter of 2005.

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

We contract with third parties to fabricate, assemble, test and program our devices. Our devices are generally fabricated, assembled and programmed by single suppliers, and the loss of a supplier, expiration of a supply agreement or the inability of our suppliers to manufacture our products to meet volume, performance and cost targets could have a material adverse effect on our business. Tower solely manufactures our Eclipse II, PolarPro, certain QuickPCI II, QuickMIPS and other new products currently under development. Furthermore, a single supplier fabricates our pASIC 1 and pASIC 2 products under an agreement that expired in December 2005. While we may be able to purchase limited pASIC 1 and pASIC 2 wafers in 2006, these products contributed 44% of 2005 revenue and we anticipate that revenue from these products may be zero by the third quarter of 2006. In addition, demand for assembly capacity at one of our suppliers has increased. For this and other reasons, capacity available to us may be constrained.

Programming capacity at our suppliers is also dependent on our investment in sufficient programming hardware to meet fluctuating demand. Our relationship with our suppliers could change as a result of a merger or acquisition. If for any reason these suppliers or any other vendor becomes unable or unwilling to continue to provide services of acceptable quality, at acceptable costs and in a timely manner, our ability to operate our business or deliver our products to our customers could be severely impaired. We would have to identify and qualify substitute suppliers, which could be time consuming and difficult and could result in unforeseen operational problems, or we could announce an end-of-life program for these products, as we did with our pASIC 1 and pASIC 2 products. Alternate suppliers might not be available to fabricate, assemble, test and program our devices or, if available, might be unwilling or unable to offer services on acceptable terms.

In addition, if competition for wafer manufacturing capacity increases, if we need to migrate to more advanced wafer manufacturing technology, or if competition for backend services increases, we may be required to pay or invest significant amounts to secure access to this capacity. The number of companies that provide these services is limited and some of them have limited operating histories and financial resources. In the event our current suppliers refuse or are unable to continue to provide these services to us, we may be unable to procure services from alternate suppliers in a timely manner, if at all. Furthermore, if customer demand for our products increases, we may be unable to secure sufficient additional capacity from our current suppliers on commercially reasonable terms, if at all. Moreover, our reliance on a limited number of suppliers subjects us to reduced control over delivery schedules, quality assurance and costs. This lack of control may cause unforeseen product shortages or may increase our cost to manufacture and test our products, which would adversely affect our operating results and cash flows.

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

Our customers may cancel or change their product plans after we have expended substantial time and resources in the design of their products

Our customers often evaluate our products for six months or more before designing them into their systems, and they may not commence volume shipments for up to an additional six to twelve months, if at all. During this lengthy sales cycle, our potential customers may cancel or change their product plans. In addition, customers may discontinue products incorporating our devices at any time or they may choose to replace our products with lower cost semiconductors. If customers cancel, reduce or delay product orders from us or choose not to release equipment that incorporates our products after we have spent substantial time and resources in assisting them with their product design, our business could be materially harmed.

We are expending substantial time and effort to develop solutions with partners that depend on the availability and success of technology owned by the partner

Our approach to developing system solutions for potential customers involves embedded processors or peripheral devices developed by other parties and specific industry standards such as PCI, IDE and Secure Digital Input/Output, or SDIO. We have entered into informal partnerships with these other parties that involve the development of solutions that interface with their devices. These informal partnerships also may involve joint marketing campaigns and sales calls. For example, we have developed a system solution incorporating a specific embedded processor, a micro hard disk drive and our Eclipse II device that lowers the overall power consumption of a system and improves system performance. If our solution is not incorporated into customer products, if our partners discontinue production of their products, if our customers do not incorporate our solution into their product, or if the informal partnership is significantly reduced or terminated, our revenue and gross margin will be materially harmed and we may be required to write-off related long-lived assets.

We will be unable to compete effectively if we fail to anticipate product opportunities based upon emerging technologies and standards and fail to develop products that incorporate these technologies and standards in a timely manner

We spend significant time and money to design and develop products and customer solutions around an industry standard, such as Peripheral Component Interconnect, or PCI, and Integrated Drive Electronics, or IDE, or emerging technology, such as advanced process technology or lead-free packaging. We intend to develop additional products and solutions and adopt new technology in the future. If system manufacturers adopt alternative standards or technologies, if an industry standard or emerging technology that we have targeted fails to achieve broad market acceptance, or if we are unable to bring the technology or solutions to market in a timely manner, we may be unable to generate significant revenue from our research and development efforts. As a result, our business would be materially harmed and we may be required to write-off related inventory and long-lived assets.

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

Our cash and cash equivalents balance at March 31, 2006 was \$30.2 million. At March 31, 2006, our interest-bearing debt consisted of \$2.0 million outstanding from Silicon Valley Bank and \$2.0 million outstanding under capital leases. On June 27, 2005, we modified our credit facility with Silicon Valley Bank. Terms of the modified agreement include an \$8.0 million revolving line of credit available through June 2006 and \$3.0 million of borrowing capacity under the equipment line of credit that is available to be drawn through June 2006. We are currently negotiating the renewal of the credit facility, which expires on June 26, 2006. We may not renew the facility or it may not remain available on acceptable terms. At March 31, 2006, we had approximately \$8.0 million available to borrow under our revolving credit facility and approximately \$2.1 million available to borrow under our equipment line of credit.

At the end of the first quarter of 2006, we held 1,344,543 Tower ordinary shares available for sale valued at approximately \$1.7 million based upon the market closing price of \$1.28 per share on such date. Our ability to obtain capacity at competitive pricing from Tower is tied to our ownership of at least 450,000 of these Tower shares.

Capital expenditures, which are largely driven by development activities and the introduction and initial manufacturing of new products, could be up to \$4.0 million in the next twelve months. As of March 31, 2006, we had commitments to purchase \$2.8 million of wafer inventory.

On July 12, 2005, we filed a shelf registration statement on Form S-3 with the SEC, which has been declared effective. Under this filing, we may decide to raise up to \$30.0 million, in one or several transactions, by selling common stock, preferred stock, depositary shares, and warrants.

As a result of potential investments, the expected fluctuation in revenue from our pASIC 1 and pASIC 2 products, operating expenses, changes in working capital and interest and debt payments, we will need to generate higher revenue and gross profit, especially from our new Eclipse II, QuickPCI II and PolarPro products and products currently under development, to maintain positive cash flow. Whether we can achieve cash flow levels sufficient to support our operations cannot be accurately predicted. Unless such cash flow levels are achieved, we may borrow additional funds or sell debt or equity securities, or some combination thereof, to provide funding for our operations. If adequate funds are not available when needed, our financial condition and operating results would be materially adversely affected and we may not be able to operate our business without significant changes in our operations, or at all.

If we fail to adequately forecast demand for our products, we may incur product shortages or excess product inventory

Our agreements with third-party manufacturers require us to provide forecasts of our anticipated manufacturing orders, and place binding manufacturing commitments in advance of receiving purchase orders from our customers. This may result in product shortages or excess product inventory because we are limited in our ability to increase or decrease our forecasts under such agreements. Other manufacturers supply us product on a purchase order basis. The allocation of capacity is determined solely by our suppliers over which we have no direct control. Additionally, we provide programming equipment to our suppliers to program our products to customer specifications. The programming equipment is manufactured to our specifications and has significant order lead-times. Obtaining additional supply in the face of product, programming equipment or capacity shortages may be costly, or not possible, especially in the short term since most of our products and programming equipment are supplied by a single vendor. Our failure to adequately forecast demand for our products could materially harm our business.

Fluctuations in our manufacturing processes and product yields and quality, especially for new products, may increase our costs

Difficulties encountered during the complex semiconductor manufacturing process can render a substantial percentage of semiconductor wafers nonfunctional, and manufacturing fluctuations may change the performance distribution of manufactured products. We have, in the recent past, experienced manufacturing runs that have contained substantially reduced or no functioning devices, or that generated devices with below normal performance characteristics. In addition, manufacturing yield problems may take a significant period of time to analyze and correct. Our reliance on third party suppliers may extend the period of time required to analyze and correct these problems. Once corrected, our customers may be required to redesign or requalify their products. As a result, we may incur substantially higher manufacturing costs, inventory shortages or reduced customer demand.

Yield fluctuations frequently occur in connection with the manufacture of newly introduced products, with changes in product architecture, with manufacturing at new facilities or on new manufacturing processes. Newly introduced products and products that incorporate new intellectual property, such as our Eclipse II and PolarPro products, are often more complex and more difficult to produce, increasing the risk of manufacturing-related defects. New manufacturing facilities or processes, such as at Tower, are often more complex and take a period of time to achieve expected quality levels and product costs. While we test our products, including our software development tools, they may still contain errors or defects that are found after we have commenced commercial production, that occur due to manufacturing variations or as new intellectual property is incorporated into our products. If our products contain undetected or unresolved defects, we may lose market share, experience delays in or loss of market acceptance, reserve or scrap inventory, or be required to issue a product recall. In addition, we would be at risk of product liability litigation if defects in our products were discovered. Although we attempt to limit our liability to end users through disclaimers of special, consequential and indirect damages and similar provisions, we cannot assure you that such limitations of liability will be legally enforceable.

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

A few of our end customers can represent a significant portion of our total revenue in a given reporting period and the likelihood of this occurring will increase in the future as we target high-volume consumer applications. As in the past, future demand from these customers may fluctuate significantly. These customers typically order products with short requested delivery lead times, and do not provide a firm commitment to purchase product past the period covered by purchase orders. In addition, our manufacturing lead times are longer than the delivery lead times requested by these customers, and we make significant inventory purchases in anticipation of future demand. For example, a U.S.-based instrumentation and test customer accounted for 13% of revenue in fiscal 2005. If revenue from any significant customer were to decline substantially, we may be unable to offset this decline with increased revenue from other customers and we may purchase excess inventory. These factors could severely harm our business.

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

We have a history of losses and cannot assure you that we will again be profitable in the future

We incurred significant losses in 2004, 2003 and 2002. Our accumulated deficit as of March 31, 2006 was \$118.6 million. Although we recorded net income of \$2.4 million for the year ended December 31, 2005, we recorded a net loss of \$1.2 million in the first quarter of 2006 and we may not return to profitability in any future periods. Our profitability for the year ended December 31, 2005 and in certain years prior to 2001 cannot be relied upon as any indication of our future operating results or prospects.

We depend upon third party distributors to market and sell our products, and they may discontinue sale of our products, fail to give our products priority or be unable to successfully market, sell and support our products

We contract with third-party distributors to market and sell a significant portion of our products. We typically have only a few distributors serving each geographic market, and, in the future, we may have a single distributor covering a geographic market. Although we have contracts with our distributors, our agreements with them may be terminated on short notice by either party and, if terminated, we may be unable to recruit additional or replacement distributors. Additionally, distributors that we have contracted with may acquire, be acquired or merge with other distributors which may result in the termination of our contract or less effort being placed on the marketing, sale and support of our products. As a result, our future performance will depend in part on our ability to retain our existing distributors and attract new distributors that will be able to effectively market, sell and support our products. The loss of one or more of our principal distributors, or our inability to attract new distributors, could materially harm our business.

Many of our distributors, including our principal distributors, market and sell products for other companies, and many of these products may compete directly or indirectly with our products. We generally are not one of the principal suppliers of products to our distributors. If our distributors give higher priority or greater attention to the products of other companies, including products that compete with our products, our business would be materially harmed.

Individual distributors and original equipment manufacturers often represent a significant portion of our accounts receivable. If we are unable to collect funds due from these distributors and customers, our financial results may be materially harmed.

Our future operating results are likely to fluctuate and therefore may fail to meet expectations, which could cause our stock price to decline

Our operating results have varied widely in the past and are likely to do so in the future. In addition, our past operating results may not be an indicator of future operating results. Our future operating results will depend on many factors and may fail to meet our expectations for a number of reasons, including those set forth in these risk factors. Any failure to meet expectations could cause our stock price to significantly fluctuate or decline.

Factors that could cause our operating results to fluctuate include:

- the effect of end-of-life programs;
- a significant change in sales to or the collectibility of accounts receivable from our largest customers;
- successful development and market acceptance of our products and system solutions incorporating our products;
- our ability to accurately forecast product volumes and mix, and to respond to rapid changes in customer demand;
- changes in sales volume, product mix, average selling prices or production variances that affect gross profit;
- our ability to adjust our manufacturing capacity and costs in response to economic and competitive pressures;
- our reliance on subcontract manufacturers for product capacity, yield and quality;
- our competitors' product portfolio and product pricing policies;
- timely implementation of efficient manufacturing technologies;
- changes in accounting and corporate governance rules;
- the issuance of stock options, or changes in the terms of our employee stock purchase plan;
- mergers or acquisitions;

- impact of import and export laws and regulations;
- the cyclical nature of the semiconductor industry and general economic, market, political and social conditions in the countries where we sell our products and the related effect on our customers, distributors and suppliers; and
- our ability to obtain capital, debt financing and insurance on commercially reasonable terms.

Although certain of these factors are out of our immediate control, unless we can anticipate and be prepared with contingency plans that respond to these factors, our business may be materially harmed.

We may encounter periods of industry-wide semiconductor oversupply, resulting in pricing pressure, as well as undersupply, resulting in a risk that we could be unable to fulfill our customers' requirements

The semiconductor industry has historically been characterized by wide fluctuations in the demand for, and supply of, its products. These fluctuations have resulted in circumstances when supply of and demand for semiconductors have been widely out of balance. An industry-wide semiconductor oversupply could result in severe downward pricing pressure from customers. In a market with undersupply of manufacturing capacity, we would have to compete with larger foundry and assembly customers for limited manufacturing resources. In such an environment, we may be unable to have our products manufactured in a timely manner, at a cost that generates adequate gross profit, or in sufficient quantities. Since we outsource all of our manufacturing and generally have a single-source of wafer supply, test, assembly and programming for our products, we are particularly vulnerable to such supply shortages and capacity limitations. As a result, we may be unable to fulfill orders and may lose customers. Any future industry-wide oversupply or undersupply of semiconductors could materially harm our business.

Customers may cancel or defer significant purchase orders or our distributors may return our products, which would cause our inventory levels to increase and our revenue to decline

Our distributors or customers may cancel purchase orders at any time with little or no penalty. Contractually, our distributors are generally permitted to return unprogrammed products worth up to 10%, by value, of the products

they purchase from us. If our distributors or customers cancel or defer significant purchase orders or return our products, our accounts receivable collections would decrease and inventories would increase, which would materially harm our business.

Problems associated with international business operations could affect our ability to manufacture and sell our products

Most of our products are manufactured outside of the United States at manufacturing facilities operated by our suppliers in Taiwan, South Korea, the Philippines, Israel and Malaysia. We expect to manufacture a majority of our new products and the products that we currently have under development in Israel and to assemble these products in South Korea, the Philippines, Malaysia, Wales or China. As a result, these manufacturing operations and new product introductions are subject to risks of political instability, including the risk of conflict between Taiwan and the People's Republic of China, between South Korea and North Korea, and conflicts involving Israel or Malaysia.

A significant portion of our total revenue comes from sales to customers located outside the United States. We anticipate that sales to customers located outside the United States will continue to represent a significant portion of our total revenue in future periods. In addition, most of our domestic customers sell their products outside of North America, thereby indirectly exposing us to risks associated with foreign commerce and economic instability. In addition to overseas sales offices, we have significant research and development activities in Canada and India. Accordingly, our operations and revenue are subject to a number of risks associated with foreign commerce, including the following:

- managing foreign distributors;
- collecting amounts due;
- staffing and managing foreign offices;
- political and economic instability;
- foreign currency exchange fluctuations;
- changes in tax laws, import and export regulations, tariffs and freight rates;
- timing and availability of export licenses;
- supplying products that meet local environmental regulations; and
- inadequate protection of intellectual property rights.

In the past, we have denominated sales of our products to foreign countries exclusively in U.S. dollars. As a result, any increase in the value of the U.S. dollar relative to the local currency of a foreign country will increase the price of our products in that country so that our products become relatively more expensive to customers in the local currency of that foreign country. As a result, sales of our products in that foreign country may decline. To the extent any such risks materialize, our business could be materially harmed.

In addition, we incur costs in foreign countries that may be difficult to reduce quickly because of employee-related laws and practices in those foreign countries.

Many system manufacturers may be unwilling to switch to our products because of their familiarity with the products offered by our direct competitors, such as Xilinx and Altera, which dominate the programmable logic market

The semiconductor industry is intensely competitive and characterized by:

- erosion of selling prices over product lives;
- rapid technological change;
- short product life cycles; and
- strong domestic and foreign competition.

If we are not able to compete successfully in this environment, our business will be materially harmed.

Many of our competitors have substantially greater financial, technical, manufacturing, marketing, sales, distribution, name recognition and other resources than we do. In addition, many of our competitors have well-established relationships with our current and potential customers and have extensive knowledge of system applications. In the past, we have lost potential customers to competitors for various reasons, including, but not limited to, re-programmability and lower price. Our current direct competitors include suppliers of complex programmable logic devices and field programmable gate arrays, such as Xilinx, Inc., Altera Corporation, Actel Corporation, and Lattice Semiconductor Corporation. Xilinx and Altera together have a majority share of the programmable logic market. Many system manufacturers may be unwilling or unable to switch to our products due to their familiarity with competitors' products or other inhibiting factors.

We also face competition from companies that offer ASICs, which may be purchased for a lower price at higher volumes and typically have greater logic capacity, additional features and higher performance than those of our products. We may also face competition from suppliers of embedded microprocessors, such as Freescale Semiconductor, Inc., or from suppliers of products based on new or emerging technologies. Our inability to successfully compete in any of the following areas could materially harm our business:

- the development of new products and advanced manufacturing technologies;
- the quality, performance characteristics, price and availability of devices, programming hardware and software development tools;
- the ability to engage with companies that provide synergistic products and services;
- the incorporation of industry standards in our products;
- the diversity of product offerings available to customers; or
- the quality and cost effectiveness of design, development, manufacturing and marketing efforts.

We may be unable to successfully grow our business if we fail to compete effectively with others to attract and retain key personnel

We believe our future success will depend upon our ability to attract and retain engineers and other highly competent personnel. Our employees are at-will and not subject to employment contracts. Hiring and retaining qualified sales, technical and financial personnel is difficult due to the limited number of qualified professionals, economic conditions and the size of our company. Competition for these types of employees is intense. In addition, new hires frequently require extensive training before they achieve desired levels of productivity. We have in the past experienced difficulty in recruiting and retaining qualified senior management, sales, finance and technical personnel. Failure to attract, hire, train and retain personnel could materially harm our business.

We may be unable to adequately protect our intellectual property rights, and may face significant expenses as a result of future litigation

Protection of intellectual property rights is crucial to our business, since that is how we keep others from copying the innovations that are central to our existing and future products. From time to time, we receive letters alleging patent infringement or inviting us to license other parties' patents. We evaluate these requests on a case-by-case basis. These situations may lead to litigation if we reject the

offer to obtain the license.

We have in the past and are currently involved in litigation relating to alleged infringement by us of others' patents or other intellectual property rights. This kind of litigation is expensive and consumes large amounts of management's time and attention. Additionally, matters that we initially consider not material to our business could become costly. For example, we incurred substantial costs associated with the litigation and settlement of our dispute with Actel, which materially harmed our business. In addition, if the letters we sometimes receive alleging patent infringement or other similar matters result in litigation that we lose, a court could order us to pay substantial damages and/or royalties, and prohibit us from making, using, selling or importing essential technologies. For these and other reasons, this kind of litigation could materially harm our business.

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Also, although we may seek to obtain a license under a third party's intellectual property rights in order to bring an end to certain claims or actions asserted against us, we may not be able to obtain such a license on reasonable terms, or at all. We have entered into technology license agreements with third parties which give those parties the right to use patents and other technology developed by us, and which give us the right to use patents and other technology developed by them. We anticipate that we will continue to enter into these kinds of licensing arrangements in the future; however, it is possible that desirable licenses will not be available to us on commercially reasonable terms. If we lose existing licenses to key technology, or are unable to enter into new licenses that we deem important, it could materially harm our business.

Because it is critical to our success that we continue to prevent competitors from copying our innovations, we intend to continue to seek patent and trade secret protection for our products. The process of seeking patent protection can be long and expensive, and we cannot be certain that any currently pending or future applications will actually result in issued patents, or that, even if patents are issued, they will be of sufficient scope or strength to provide meaningful protection or any commercial advantage to us. Furthermore, others may develop technologies that are similar or superior to our technology or design around the patents we own. We also rely on trade secret protection for our technology, in part through confidentiality agreements with our employees, consultants and other third parties. However, these parties may breach these agreements, and we may not have adequate remedies for any breach. In any case, others may come to know about or determine our trade secrets through a variety of methods. In addition, the laws of certain territories in which we develop, manufacture or sell our products may not protect our intellectual property rights to the same extent as the laws of the United States.

We may engage in manufacturing, distribution or technology agreements that involve numerous risks, including the use of cash, diversion of resources and significant write-offs

We have entered into and, in the future, intend to enter into agreements that have involved numerous risks, including the use of significant amounts of our cash; diversion of resources from other development projects or market opportunities; our ability to incorporate licensed technology in our products; our ability to introduce related products in a cost-effective and timely manner; our ability to collect amounts due under these contracts; and market acceptance of related products. For instance, we have licensed certain microprocessor technology from MIPS Technologies and obtained other elements of our products from third-party companies. In the fourth quarter of 2004, we determined that the expected revenue and gross profit from these products would not be sufficient to recover the full carrying value of the related third party elements and other long-lived assets, and we recorded a \$3.2 million long-lived asset impairment charge. If we fail to recover the cost of these or other assets from the cash flow generated by the related products, our assets will become impaired and our financial results would be harmed.

Our business is subject to the risks of earthquakes, other catastrophic events and business interruptions for which we may maintain limited insurance

Our operations and the operations of our suppliers are vulnerable to interruption by fire, earthquake, power loss, flood, terrorist acts and other catastrophic events beyond our control. In particular, our headquarters is located near earthquake fault lines in the San Francisco Bay area. In addition, we rely on sole suppliers to manufacture our products and would not be able to qualify an alternate supplier of our products for several quarters. Our suppliers often hold significant quantities of our inventory which, in the event of a disaster, could be destroyed. In addition, our business processes and systems are vulnerable to computer viruses, break-ins, and similar disruptions from unauthorized tampering. Any catastrophic event, such as an earthquake or other natural disaster, the failure of our computer systems, war or acts of terrorism, could significantly impair our ability to maintain our records, pay our suppliers, or design, manufacture or ship our products. The occurrence of any of these events could also affect our customers, distributors and suppliers and produce similar disruptive effects upon their business. If there is an earthquake or other catastrophic event near our headquarters, our customers' facilities, our distributors' facilities or our suppliers' facilities, our business could be seriously harmed.

We do not have a detailed disaster recovery plan. In addition, we do not maintain sufficient business interruption and other insurance policies to compensate us for all losses that may occur. Any losses or damages incurred by us as a result of a catastrophic event or any other significant uninsured loss could have a material adverse effect on our business.

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Our principal stockholders have significant voting power and may vote for actions that may not be in the best interests of our other stockholders

Our officers, directors and principal stockholders together control a significant portion of our outstanding common stock. As a

result, these stockholders, if they act together, will be able to significantly influence our operations, affairs and all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. This concentration of ownership may have the effect of delaying or preventing a change in control and might affect the market price of our common stock. This concentration of ownership may not be in the best interest of our other stockholders.

Our Shareholder Rights Plan, Certificate of Incorporation, Bylaws and Delaware law contain provisions that could discourage a takeover that is beneficial to stockholders

Our Shareholder Rights Plan as well as provisions of our Certificate of Incorporation, our Bylaws and Delaware law could make it difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders.

The market price of our common stock may fluctuate significantly and could lead to securities litigation

Stock prices for many companies in the technology and emerging growth sectors have experienced wide fluctuations that have often been unrelated to the operating performance of such companies. In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. In the future, we may be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources.

Changes to existing accounting pronouncements or taxation rules or practices may cause adverse revenue fluctuations, affect our reported results of operations or how we conduct our business

Generally Accepted Accounting Principles, or GAAP, are promulgated by, and are subject to the interpretation of, FASB and the SEC. New accounting pronouncements or taxation rules and varying interpretations of accounting pronouncements or taxation practice have occurred and may occur in the future. Any future changes in accounting pronouncements or taxation rules or practices may have a significant effect on how we report our results and may even affect our reporting of transactions completed before the change is effective. This change to existing rules, future changes, if any, or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

For example, FASB has issued SFAS No. 123(R), "Share-Based Payment," which we adopted in the first quarter of 2006. SFAS No. 123(R) requires us to measure compensation costs for all stock-based compensation awards (including our stock options and our employee stock purchase plan, as currently constructed) at fair value and record compensation expense equal to that value. If this accounting pronouncement had been in effect during fiscal 2005, we estimate that we would have reported a significantly lower net income.

Compliance with changing regulations related to corporate governance and public disclosure may result in additional expenses

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and the Nasdaq National Market rules, are creating uncertainty for companies such as ours. These new or changed laws, regulations and standards are subject to varying interpretations in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from profit-generating activities. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may be harmed and the market price of our common stock could be affected.

While we believe that we currently have adequate internal control procedures in place, we are still exposed to potential risks from recent legislation requiring companies to evaluate controls under Section 404 of the Sarbanes-Oxley Act of 2002

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

As of December 2005, we have evaluated our internal control systems in order to allow management to report on, and our independent registered public accounting firm to attest to, our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. We performed the system and process evaluation and testing required in an effort to comply with the management certification and independent registered public accounting firm attestation requirements of Section 404. As a result, we incurred additional expenses and a diversion of management's time. While we believe that our internal control procedures are adequate and we intend to continue to fully comply with the requirements relating to internal control and all other aspects of Section 404, our controls necessary for continued compliance with the Act may not operate effectively at all times and may result in a material control disclosure. The identification of a material weakness in internal controls over financial reporting, if any, could indicate a lack of proper controls to generate accurate financial statements. Furthermore, we cannot be certain as to the outcome of future evaluations, testing and remediation actions or the impact of the same on our operations. If we are not able to remain in compliance with the requirements of Section 404, we

might be subject to sanctions or investigation by regulatory authorities, such as the SEC or the Nasdaq National Market. Any such action could adversely affect our financial results and the market price of our common stock.

We have implemented import and export control procedures to comply with United States regulations but we are still exposed to potential risks from import and export activity

Our products, technology and software are subject to import and export control laws and regulations which, in some instances, may impose restrictions on business activities, or otherwise require licenses or other authorizations from agencies such as the U.S. Department of State, U.S. Department of Commerce and U.S. Department of the Treasury. We have import and export licensing and compliance procedures in place for purposes of conducting our business consistent with U.S. and applicable international laws and regulations, and we periodically review these procedures to maintain compliance with the requirements relating to import and export regulations. If we are not able to remain in compliance with import and export regulations, we might be subject to investigation, sanctions or penalties by regulatory authorities. Such penalties can include civil, criminal or administrative remedies (such as loss of export privileges). We cannot be certain as to the outcome of an evaluation, investigation, inquiry or other action or the impact of these items on our operations. Any such action could adversely affect our financial results and the market price of our common stock.

Item 6. Exhibits

a. Exhibits

The following Exhibits are filed with this report:

<u>Exhibit Number</u>	<u>Description</u>
3.1(1)	Amended and Restated Certificate of Incorporation of Registrant.
3.2(2)	Bylaws of Registrant.
31.1	CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	CEO and CFO Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- (1) Incorporated by reference to the Company's Registration Statement on Form S-1 declared effective October 14, 1999 (Commission File No. 333-28833).
- (2) Incorporated by reference to the Company's Current Report on Form 8-K (Item 5.03) filed May 2, 2005.

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

QUICKLOGIC CORPORATION

/s/ CARL M. MILLS

Carl M. Mills

*Vice President, Finance and Chief Financial Officer
(as Principal Accounting and Financial Officer and on behalf of
Registrant)*

Date: May 12, 2006

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EXHIBIT INDEX

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CERTIFICATIONS

I, E. Thomas Hart, certify that:

1. I have reviewed this quarterly report on Form 10-Q of QuickLogic Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 12, 2006

/s/ E. Thomas Hart
E. Thomas Hart
Chief Executive Officer

I, Carl M. Mills, certify that:

1. I have reviewed this quarterly report on Form 10-Q of QuickLogic Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 12, 2006

/s/ Carl M. Mills

Carl M. Mills

Chief Financial Officer

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, E. Thomas Hart, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of QuickLogic Corporation on Form 10-Q for the quarter ended April 2, 2006, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of QuickLogic Corporation.

By: /s/ E. Thomas Hart
Date: May 12, 2006
Name: E. Thomas Hart
Title: *Chief Executive Officer*

I, Carl M. Mills, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of QuickLogic Corporation on Form 10-Q for the quarter ended April 2, 2006, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of QuickLogic Corporation.

By: /s/ Carl M. Mills
Date: May 12, 2006
Name: Carl M. Mills
Title: *Chief Financial Officer*
