

CATALYST SEMICONDUCTOR INC  
Form 10-K  
July 31, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended April 30, 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 0-21488

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**Catalyst Semiconductor, Inc.**

(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation or organization)

**77-0083129**  
(I.R.S. Employer Identification No.)

**1250 Borregas Avenue, Sunnyvale, California 94089**

(Address of Principal Executive Offices)

Registrant's telephone number, including area code: **(408) 542-1000**

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

**NONE**

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

**Common Stock, \$.001 par value**

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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

## Edgar Filing: CATALYST SEMICONDUCTOR INC - Form 10-K

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer (as defined in Exchange Act Rule 12b-2).

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-5 of the Act). Yes  No

The aggregate market value of voting stock held by non-affiliates of the registrant as of October 31, 2005, the last day of the registrant's most recently completed second quarter, was \$49.5 million based upon the last sales price reported for such date on the NASDAQ Global Market. For purposes of disclosure, shares of common stock held by persons who hold more than 5% of the outstanding shares of common stock and shares held by executive officers and directors of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive.

The number of shares of Registrant's Common Stock outstanding as of June 30, 2006 was 16,350,073.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Items 10, 11, 12, 13, and 14 of Part III of this Form 10-K incorporate information by reference from portions of the registrant's 2006 Definitive Proxy Statement to be filed not later than 120 days after the close of the 2006 fiscal year.

CATALYST SEMICONDUCTOR, INC.  
 FORM 10-K  
 FOR THE FISCAL YEAR ENDED APRIL 30, 2006  
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**CATALYST SEMICONDUCTOR, INC.**

**EXPLANATORY NOTE**

*This report 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. Words such as projected, expects, believes, intends and assumes and similar expressions are used to identify forward-looking statements. These statements are made based upon current expectations and projections about our business and the semiconductor industry and assumptions made by our management are not guarantees of future performance, nor do we assume any obligation to update such forward-looking statements after the date this report is filed. Forward-looking statements contained in this Annual Report include, among others, statements regarding expanding our focus in the analog/mixed signal market, providing the most comprehensive lines of serial and parallel EEPROM products in the industry, the ability to take advantage of growth and market opportunities in the industries we provide our products, continued investment in research and development to improve our memory and analog/mixed signal products, the successful implementation of new strategies to meet our long-term strategic goals, the continued ability to competitively provide non-volatile memory products, the sufficiency of our current cash, cash equivalents and available-for-sale securities, our ability to retain and attract employees, our internal controls, the adequacy of our facilities to meet our customers needs, and the effects of new accounting rules. Actual results may differ materially from those projected in the forward-looking statements as a result of various factors. Factors that could cause actual results to differ materially from those included herein include, but are not limited to: the information contained under the captions Part I, Item 1. Business, Part I, Item 1A. Risk Factors and Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.*

**PART I**

**Item 1. Business**

**Overview**

We design, develop and market a broad line of reprogrammable non-volatile memory products and analog/mixed-signal products. Our products are used by manufacturers of electronic products in a wide range of consumer, computing, communications, industrial and automotive applications. We focus on high volume markets for our cost effective, high quality products. We have been a committed long-term supplier of memory products for the past two decades even through periods of tight manufacturing capacity and cyclical market downturns. We are leveraging our extensive experience in high volume, reprogrammable memory products to develop complementary analog/mixed-signal products that offer our customers a more complete system solution. We supply semiconductor products in high volumes to our diverse customer base of more than 3,400 customers and shipped approximately 104 million units on average in each of the last four fiscal quarters.

We outsource the fabrication of our products to third party foundries for a high quality, efficient and long term supply of our products. We focus our internal efforts on product design, testing, marketing and sales. We have strengthened and expanded the expertise of our research and development team by establishing our own engineering center in Bucharest, Romania and by hiring additional experienced engineers in Romania and in our Sunnyvale, California headquarters. We continue to make substantial investments in research and development to advance our non-volatile memory products, as well as to broaden our product line of analog/mixed-signal products.

We incorporated in California in October 1985. In May 1993, we reincorporated in Delaware. Our principal executive offices are currently located at 1250 Borregas Avenue, Sunnyvale, California 94089, our telephone number is (408) 542-1000 and our website is [www.catsemi.com](http://www.catsemi.com). We have purchased a building that is being prepared for the relocation of our principal executive offices in August 2006. The address is

2975 Stender Way, Santa Clara, CA 95054. Information contained on or accessible through our website does not constitute a part of this report.

Our fiscal year ends on the Sunday closest to April 30 of each year. We refer to the fiscal year ended April 28, 2002 as fiscal 2002, the fiscal year ended April 27, 2003 as fiscal 2003, the fiscal year ended May 2, 2004 as fiscal 2004, the fiscal year ended May 1, 2005 as fiscal 2005 and the fiscal year ended April 30, 2006 as fiscal 2006. Fiscal 2007 will end on April 29, 2007. For presentation purposes only, we refer in this report to April 30 as the end of each fiscal year.

### **Industry Background**

Semiconductor devices may be divided into three broad categories: analog, digital and mixed-signal. Analog products monitor and manipulate real world signals such as sound, light, pressure, motion, temperature and electrical current. Digital circuits, such as microprocessors, use threshold voltages which function as on and off switches, which are expressed in binary code as ones and zeros. The digital components process and manipulate the data while the analog components condition the inputs or signals. Mixed-signal devices incorporate both analog and digital functions into a single semiconductor device. In most cases, these mixed-signal devices convert analog signals to digital signals or vice versa, or these devices may be used to improve the performance of the specific analog application. Non-volatile memory devices require certain building blocks that have analog characteristics included within them in order to perform their memory functions.

### ***Non-Volatile Memory Products***

The principal distinguishing characteristic of non-volatile memory is that it does not require a continuous application of power to retain data while volatile memory, such as dynamic random access memory, or DRAM, requires continuous power. While non-volatile memory products are often considered digital semiconductor devices, these non-volatile memory devices incorporate certain high performance analog blocks. Electronic systems primarily use non-volatile memory to store critical data when the power to the system is turned off. Virtually all electronic systems that use a digital processor or controller, including personal computers, printers, cellular handsets, digital cameras, optical networks, wireless local area networks, digital set-top boxes and automotive systems, incorporate non-volatile memory products such as electrically erasable programmable read only memory, or EEPROM, and/or flash memory. Many electronic systems utilize a combination of volatile and non-volatile memory.

System manufacturers generally prefer non-volatile memory devices that can be reprogrammed efficiently in the system in order to achieve several important advantages in comparison to non-volatile memory devices that are not reprogrammable or which require physical removal for reprogramming. With reprogrammable memory, manufacturers can cost effectively change program codes in response to accelerated product cycles and changing market specifications. Reprogrammable memory greatly simplifies inventory management and manufacturing processes and allows the manufacturer to reconfigure or update a system either locally or remotely through a network connection. In addition, consumers use non-volatile memory devices that can be programmed and reprogrammed to store user selected system configurations in consumer electronics devices, such as phone numbers in mobile telephones. Major non-volatile memory classifications include EEPROM and flash.

EEPROM provides significant programming flexibility to system designers. This non-volatile memory can be erased and reprogrammed electrically within the system hundreds of thousands to millions of times and can be altered one byte or several bytes at a time. In an EEPROM device, each cell, which is the discrete area on the device in which one bit is stored, consists of two transistors, one to store data and one to permit the cell to be selected when erasing data. Serial EEPROM transmits data through a single input-output port while parallel EEPROM transmits data through multiple input-output ports concurrently.

Flash memory provides significant programming flexibility to system designers at a higher density than EEPROM. Although flash memory can be reprogrammed electrically within the system, the number of reprogramming cycles is generally less than EEPROM and only a memory block can be rewritten, not an individual byte. In flash memory, a block consists of an array of memory cells. Flash memory products can be manufactured with storage densities, transfer rates and data alterability comparable to DRAM and can achieve a relatively low manufacturing cost at higher densities. For low-density memory used in high volume applications, flash memory is not cost effective relative to EEPROM. Because of its limitations and cost at low densities, flash memory is not used in certain system critical applications.

The EEPROM market is characterized by high unit volumes sold at relatively low per unit prices. The EEPROM market has a limited number of vendors. Each participant in the EEPROM market has relatively weak pricing power because of interchangeability of available vendors' parts. EEPROM prices are largely a function of the demand for electronic devices in which they are incorporated, available memory manufacturing capacity, product availability and memory density. In light of these competitive dynamics, some suppliers have exited the EEPROM market, leaving fewer alternatives for original equipment manufacturer, or OEM, customers. Manufacturers customarily use flash memory and EEPROM to address different needs but often within the same electronic system. Since most consumer and industrial electronic devices continue to use EEPROM either separately or in conjunction with other memory, OEM customers want to develop relationships with memory vendors who are likely to be long-term vendors of EEPROM and those vendors which are developing and supplying a broad range of products.

#### *Analog/Mixed-Signal Products*

The analog/mixed-signal market is generally divided into two major product categories depending on how the devices are used by system designers:

- general purpose analog/mixed-signal products for standard designs; and
- analog/mixed-signal application specific standard products, or ASSPs, for customized designs.

General purpose analog/mixed-signal products that perform a given function usually are interchangeable with standard components from another supplier. Similarly, in the memory market, most non-volatile memory components are general purpose or industry standard parts and are interchangeable with parts from other suppliers.

General purpose analog/mixed-signal products include power management products, which control and regulate the amount of power delivered to an electronic system. Power management products are critical to overall system performance and cost. These products include direct current to direct current, or DC to DC, converters, switching regulators, low drop out voltage regulators and voltage references. Suppliers of power management products are increasingly integrating discrete power management components into multi-function devices to reduce design time and lower system costs by consuming less board space and power.

ASSPs are a superior solution for systems that have special requirements, such as portability, size constraints or functionality. The relationship between customer and supplier tends to be more dynamic and intertwined in this market with greater reliance on each other. On one hand, the customer has to have enough trust in the supplier to take the risk of committing its supply chain to a single vendor. On the other hand, the supplier faces the risk of investing significant research and development resources to design and develop a customized solution with the uncertainty of the market acceptance of the customer's end product. Suppliers servicing the ASSP market typically have greater pricing power and receive higher margins.

The analog/mixed-signal market is highly fragmented into many segments with numerous vendors serving one or more of the various segments. The general purpose analog/mixed-signal semiconductor market is characterized by long product cycles with a broad, diverse base of customers. As a result, general purpose analog/mixed-signal product prices tend to be more stable than those for non-volatile memory products.

### **Our Competitive Strengths**

We have two decades of experience in the design, testing and sale of reprogrammable non-volatile memory products, including EEPROM and low-density flash. We believe we have established a brand name that our OEM and distribution customers associate with cost effective, high quality and high value products supported by excellent customer service. These strengths have helped us grow in the competitive non-volatile memory market. On April 30, 2006, we completed our eighth consecutive fiscal year of profitability. We intend to leverage our OEM customer base and the design and operational expertise developed in our non-volatile memory products to increase our revenues from our non-volatile memory and analog/mixed-signal product offerings.

We believe the following are our key competitive strengths:

*High Quality Design.* We have invested and intend to continue to invest substantial resources in research and development to improve our memory and analog/mixed-signal products. To complement our Sunnyvale, California engineering capabilities, in 2003, we established our own design and development center in Bucharest, Romania. We previously used contract personnel in Romania but now have an integrated design organization, which currently includes a total of 45 engineers. Through the development of our EEPROM products, we also routinely design and develop high performance analog and mixed-signal functions for use in our non-volatile memory products. As a result, our design personnel have extensive experience in designing analog blocks, which we believe will enable us to expand our focus to include the complementary analog/mixed-signal product market.

*Expertise in High Volume, Efficient Manufacturing.* The markets for our non-volatile memory products are characterized by high unit volumes sold at competitive prices. To reduce cost, we are developing successive generations of our memory products scaled to smaller process geometries which is intended to result in reduced die sizes and lower cost per unit. We conduct the majority of our wafer testing operations in our Sunnyvale, California headquarters and take other steps to maintain and improve the quality of our products. These efforts have improved the yield on our products. We use third party contractors for a majority of our manufacturing, packaging, testing and shipping activities in order to control our costs and to be able to respond quickly to customer requests.

*Long-Term, Established Foundry Relationships.* We have worked with our primary foundry supplier located in Japan for more than 20 years. This long standing foundry relationship has enabled us to optimize our designs for its high volume and high yield processes. To reduce our reliance on a single wafer foundry, we also developed our processes so that different fabrication facilities could replicate them. We purchase volume shipments of our products from a United States based foundry, which currently produces most of our analog/mixed-signal products and can act as a second fabrication facility for some of our non-volatile memory products. We also regularly evaluate other foundries that may support the production of a broad range of high performance analog/mixed-signal products for us.

*Comprehensive EEPROM Product Line.* We believe that we offer one of the most comprehensive lines of serial and parallel EEPROM products in the industry. Our EEPROM products support industry requirements and are available in a broad selection of densities and voltages. Our EEPROM product line includes a wide array of performance characteristics which electronic system manufacturers need, such as interfaces, memory densities, voltages and bus speeds.

*Systems Focused Analog/Mixed-signal Product Line.* We have concentrated our analog/mixed-signal product development and systems understanding on specific applications such as white light emitting diodes, or LED, backlight drivers for liquid crystal display, or LCD, screens and modules; multi-colored LCD applications such as automotive and aircraft interior lighting and instrumentation clusters; and on the portable power management functions that complement the LED driver applications. We believe that this focus enables us to achieve the necessary systems insight more rapidly in order to gain the confidence of, and secure the business of, major OEMs.

*Diverse End Markets and Applications.* Through direct and indirect sales channels, we sell our products in a variety of end markets, including consumer, computing, communications, industrial and automotive. Our solutions are used in a broad array of applications within each of these markets, such as automotive systems, cordless telephones, digital cameras, digital video players, digital set-top boxes, mobile phones, optical networks, personal computers and wireless local area networks. Due to the diversity of our markets and applications, we are not dependent on any individual industry or end user product. In addition, we believe we have the opportunity to take advantage of the markets and growth in any of the industries we serve.

*Strong Customer Base.* We are one of the largest suppliers of EEPROM in the world and we have relationships with many customers including large OEMs through direct sales, distributors and resellers. During fiscal 2006, we served more than 3,400 customers. Through our collaborations with OEM customers in an interactive product design and development process, we have established durable relationships, solidified our customer base and defined the next generation of our products. Consequently, we believe that we are well positioned to continue to sell our existing and future analog/mixed-signal products to these customers, which could use many of these products in conjunction with our memory products.

#### **Our Strategy**

We intend to continue to provide our customers with a reliable source of industry standard non-volatile memory products. We also intend to further improve our non-volatile memory products and become a systems knowledgeable partner to our customers by providing a broad range of standard and custom analog/mixed-signal products. Our strategy includes the following:

*Strengthen EEPROM Product Offering.* We intend to continue to develop high performance EEPROM products and reduce our costs by continuing to migrate to smaller process geometries. We intend to continue to provide high quality, competitively priced products with a broad range of densities and voltages. As a result, we intend to strengthen our position in the EEPROM market.

*Broaden Standard Analog/Mixed-signal Product Offerings.* We have developed a range of industry standard analog/mixed-signal products that serve high volume markets. Leveraging our large OEM customer base and efficient, high volume manufacturing process, we intend to become a reliable, high volume, cost effective supplier of standard analog/mixed-signal products to existing and new OEM customers. We intend to continue to introduce additional industry standard analog/mixed-signal products to increase net revenues, address new applications and increase our portfolio of analog building blocks for internal reuse in other products, such as application specific analog/mixed-signal products. We reuse proven design blocks, which enables us to reduce the design and manufacturing risks associated with new products and assists us in reducing development times and in achieving higher reliability and manufacturing yields.

*Expand Proprietary Analog/Mixed-signal Product Offerings.* We have introduced a range of proprietary analog/mixed-signal products, which often integrate analog elements with reprogrammable non-volatile memory, such as digital potentiometer products, or DPPs, and processor supervisors. We intend to continue to introduce additional embedded memory products and to





leverage our non-volatile memory and analog design expertise. We intend to continue to have these products built for us by our foundry suppliers using our proprietary process technology and open source technology, which supports both analog and non-volatile memory elements in a single manufacturing process. Some of our non-volatile memory customers, who include industry leading OEMs, are also beginning to purchase our standard analog products. We are now working with selected customers to develop more highly integrated, high value added products customized for specific applications. We are targeting selected applications in large segments, such as solid state illumination, which is lighting for displays, consumer electronic devices, automotive and other purposes.

We intend to implement our strategies by:

- leveraging our design portfolio and ongoing research and development activities;
- expanding engineering resources in low cost areas, such as our Bucharest, Romania engineering center;
- expanding our design portfolio and making selective acquisitions of complementary companies or technologies;
- using third party foundries to provide wafer fabrication for our products;
- developing our processes in a manner that permits the manufacture of our products in the fabrication facilities of different semiconductor foundries; and
- taking advantage of the flexible capacity and lower fixed costs of the outsourced manufacturing model.

## **Products**

We use our expertise in non-volatile memory to develop and maintain a broad range of EEPROM products and selected flash memory products. In addition, we have expanded our focus to include analog/mixed-signal products.

### ***Parallel and Serial EEPROM***

We offer a broad range of serial EEPROM products compatible with the three popular industry standard bus interface protocols: the inter-integrated circuit, or I<sup>2</sup>C, bus interface of Philips Electronics N.V., the Microwire interface protocol of National Semiconductor Corporation and the serial peripheral interface, or SPI, bus protocol of Motorola, Inc. Additionally, we offer four wire bus interface protocol type products, primarily for Japanese customers. We offer products in a wide variety of densities from 1 kilobit, or Kbit, to 256 Kbit, and voltage ranges from 1.8 volts to 6.0 volts. Serial EEPROM products are used in many applications to store user reconfigurable data. Some of the more common applications are digital cameras, cell phones, digital video recorders, compact disc players, cordless phones, laser printers, memory modules for computers, disk drives, remote controls and various automotive applications.

We offer both standard 5.0 volt and 3.3 volt parallel EEPROM, the latter of which meets most battery operated application requirements. We offer products with a broad range of densities, such as 16 Kbit to 512 Kbit. Parallel EEPROM provides faster transfer rates than serial EEPROM, which transfers data through a single port. Because of the higher number of drivers and packaging, parallel EEPROM is larger and more costly to manufacture than serial EEPROM and, accordingly, is used primarily in high performance applications. Parallel EEPROM is primarily used in applications such as point of sale terminals, industrial controllers, local area network adapters and telecommunication switches.

### ***Flash Memory***

We currently offer flash memory in a small number of densities. We offer Intel licensed flash memory devices in densities ranging from 512 Kbit to 2 megabit, or Mb. This family includes Intel licensed boot block and bulk erase technologies available in 1 Mb and 2 Mb densities.

### ***Analog and Mixed-Signal***

Although analog/mixed-signal products constitute a relatively small portion of our net revenues, we believe that there is a substantial market opportunity for analog/mixed-signal products and have continued leveraging our design, development and sales skills to expand these product lines. Because applications for non-volatile memory incorporate microcontrollers or microprocessors, many of the products interface with the controllers in various applications such as power management, systems supervision and interface support.

*Supervisory Products with EEPROM.* We have introduced a family of microcontroller supervisory products, which combine serial EEPROM with the reset and watchdog functions required by many microcontrollers to ensure safe sustained operation and allow systems to recover more efficiently from power disruptions. These products integrate two functions in the same semiconductor to provide savings in printed circuit board space and component costs. Our initial products are designed for use by the automotive industry and for power metering functions. Currently, we offer 2 Kbit, 16 Kbit, 32 Kbit and 64 Kbit of EEPROM with embedded supervisory functions based on floating gate EEPROM technology.

*Supervisory Products without Memory.* We have also introduced a family of multi-industry supervisory products without EEPROM memory.

*Digitally Programmable Potentiometers (DPP).* We have introduced a number of solid-state DPP products, which replace mechanical potentiometers used to fine tune and trim electronic circuitry in a variety of applications. DPP products are built using the same processes as our EEPROM products. Our DPP products have been included in interactive game consoles, digital cameras and optical transceivers.

*White LED Drivers.* We have introduced several products intended to manage the white LEDs used as backlights in multi-colored LCD screens in cell phones, digital cameras, MP3 music players, personal digital assistants, industrial instrumentation, automotive instrument clusters and home appliances. Color displays require more specialized LED drivers than monochrome displays. Our products tightly regulate the current to the LEDs to ensure the uniform brightness and color purity necessary for the clarity in viewing the color displays.

*DC to DC Converters.* Converting one direct current voltage to another within an electronic system is a common requirement, particularly in battery powered applications where the power available from the batteries will decline over time and use. Our designs allow smooth regulated operation of a system throughout the battery life. Our first generation of DC to DC converters is pin compatible with industry standard circuits.

All of the products described above are available in environmentally friendly packages, generally referred to as green packages.

### **Sales and Marketing**

The majority of our customers order our products through our manufacturers' representatives, distributors and resellers. These manufacturers' representatives, distributors and resellers also create demand for our products, generally focusing on OEM customers who are not directly served by our internal sales managers. For example, our distributors sell to OEM customers or those OEMs' contract manufacturers.

In addition to our sales and marketing organization located in our Sunnyvale, California headquarters facility, we have sales operations in East Dundee, Illinois, Shanghai and Shenzhen, China, Oxford, United Kingdom, Munich, Germany, Yokohama, Japan, Singapore, Seoul, South Korea and Taipei, Taiwan. Our sales offices support OEMs and manufacturers' representatives, distributors and resellers. In addition, our Japanese operation works closely with our Japanese foundry partner, OEM customers and their contract manufacturers, as well as our Japanese manufacturers' representatives, distributors and resellers.

Currently, we have 4 distributors and 2 resellers in North and South America and a network of 7 distributors and 27 resellers throughout Asia, Europe and Africa to support our international business. These firms work with our regional sales managers in developing new opportunities, providing technical support and other value-added services.

We often seek to develop strategic relationships with major OEMs and other customers by providing a high level of customer support and rapid problem solving. Our product knowledge includes a broad range of non-volatile memory and analog and mixed-signal technology compatible with the common industry standards. We also seek to work closely with our customers to provide solutions to address an individual customer's needs.

Our marketing activities consist of several key components:

- targeted print advertising in local languages for trade, technical and business publications;
- online promotion on our website;
- developing with our distributors product evaluation boards that include two or more of the distributor's non-competitive manufacturers thus allowing the distributor's own sales force to promote more than one supplier at a time;
- publishing application notes and journal articles to support the design-in of analog/mixed-signal products;
- development of dedicated demonstration and evaluation boards to assist customer designers in evaluating our products in their systems; and
- conducting on-site customer engineering training in analog/mixed-signal applications.

#### **Research and Development**

We have made and expect to continue to make substantial investments in research and development and to participate in the development of new and existing industry standards. As of April 30, 2006, our research and development staff consisted of 78 engineers working in Sunnyvale, California and Bucharest, Romania.

Our memory engineering group develops non-volatile memory products. Our analog/mixed-signal development group develops products with logic as well as analog circuitry contents. We also routinely design and develop high performance analog and mixed-signal functions using EEPROM technology. Our technology development group develops advanced processes in cooperation with our foundries and also supports the design engineers with device modeling and characterization. Our computer aided design engineering group supports the design tools used by our design and layout engineers and converts the design data into mask shop usable format. Our test engineering group develops test programs for validating the electrical performance of our products in wafer and packaged form.

#### **Intellectual Property**

We rely on a combination of patents, copyrights and trade secrets to establish and protect our intellectual property rights. As of April 30, 2006, we owned 24 U.S. patents and have 13 pending



applications for additional U.S. patents. The expiration dates of our patents range from January 2008 to October 2023. As a result of the rapid changes in technology, the lives of these patents will likely last longer than the economic lives of the technologies they cover. We also have a number of trademarks. There can be no assurance that our pending patent or trademark applications will be allowed or that the issued or pending patents will not be challenged or circumvented by competitors. We also protect our numerous original mask sets under U.S. and foreign copyright laws.

We also own a substantial body of proprietary techniques and trade secrets. We seek to protect our trade secrets and proprietary technology, in part, through confidentiality agreements with employees, consultants and other parties. There can be no assurance that these agreements will not be breached, that we will have adequate remedies for any breach or that our trade secrets will not otherwise become known to or independently developed by others. In addition, the laws of some foreign countries do not offer protection of our proprietary rights to the same extent as the laws of the United States, which is an increasing concern as most of our production is located in foreign countries.

We may become involved in patent or other intellectual property disputes or actions. From time to time, we receive letters alleging patent infringement or inviting us to take a license to other parties' patents. We evaluate these letters on a case by case basis. Offers such as these may lead to litigation if we reject the opportunity to obtain the license or reject the other party's demands. Adverse determinations in any litigation could subject us to significant liabilities to third parties, require us to seek licenses from third parties and prevent us from manufacturing and selling our products. Any of these situations could have a material adverse effect on our business.

### **Manufacturing**

We have established close relationships with our foundry suppliers for our wafer fabrication in an effort to ensure stability in our supply of products and focus our internal efforts on product design and sales. Our designs are manufactured utilizing processes developed jointly by us and our foundry partners. Our Japanese foundry supplier currently manufactures a majority of our high volume production. Our domestic foundry supplier currently manufactures most of our analog/mixed-signal products as well as some of our EEPROM products. We are also working with other foundries in Asia to develop and manufacture additional analog/mixed signal products. We endeavor to develop our processes in a manner that permits the portability of our manufacturing processes. We currently purchase wafer supplies on a purchase order basis. We also maintain a die bank of wafers in order to be able to respond to customer orders quickly and to attempt to manage our exposure to changes in manufacturing capacity and wafer costs.

We have wafer sorting operations at our headquarters facility in Sunnyvale, California to control quality and improve yields and we also utilize a subcontractor in Japan for this purpose. We perform circuit assembly and testing of packaged parts primarily through our subcontractors located in Southeast Asia. In the assembly process, the wafers are separated into individual die, which are then assembled into packages. The packaged devices are further tested and inspected pursuant to our quality assurance program prior to shipment to our customers. The majority of our assembly and test services are provided by subcontractors located in Thailand and in the Philippines and, to a lesser degree, we also utilize assembly and test services provided by companies in Malaysia, Taiwan and China. We also subcontract certain production planning, test engineering, inventory management, shipping and tape and reel activities to a subcontractor in Thailand and are in the process of forming a subsidiary in Thailand to perform a portion of the functions currently subcontracted.

## Competition

The semiconductor industry is highly competitive and has been characterized by price competition, manufacturing capacity constraints and product availability constraints at various times. We compete with major domestic and international semiconductor companies, many of which have substantially greater financial, technical, marketing, distribution and other resources.

Our non-volatile memory products, such as EEPROM devices, compete on the basis of product performance, price, product availability and customer service. We believe that we compete effectively with respect to each of these competitive factors. Price competition is significant and is expected to continue. We believe our principal competitors for our EEPROM products currently include Atmel Corporation, STMicroelectronics N.V. and Microchip Technology Incorporated.

We also manufacture low density flash memory products, which represent a small subsegment of the flash memory market. This subsegment has been characterized by reduced demand for low density memory, which has resulted in lower product availability and higher cost, due to the shift by most customers to the larger flash memory sizes that we do not offer. Our key competitors for low density or similar flash memory products include Silicon Storage Technology, Inc. and Integrated Silicon Solution, Inc.

We currently compete in the analog/mixed-signal product market on the basis of product performance, product availability, price and customer support. The analog and mixed-signal industry is highly fragmented with competition varying with the applicable segment and subsegments, including: Fairchild Semiconductor International, Inc., Intersil Corporation, Linear Technology Corporation, Maxim Integrated Products, Inc., National Semiconductor and Texas Instruments Incorporated.

## Employees

As of April 30, 2006, we had a total of 155 full-time employees worldwide, including 78 in research and development, 40 in sales and marketing and 37 in operations, executive and administrative functions. Our future success will depend on our ability to attract, train, retain and motivate highly qualified employees. Our employees are not represented by any collective bargaining organization or labor unions. We have never experienced any work stoppage and believe that our employee relations are favorable.

## Financial Information About Geographic Areas

For information about revenue and long-lived assets by geography, see Note 8 Segment Reporting in Part IV, Item 15(a)(1) of this Annual Report on Form 10-K.

## Executive Officers

Set forth below is certain information as of April 30, 2006, regarding each of our executive officers:

Name	Age	Principal Occupation
Gelu Voicu	56	President, Chief Executive Officer and Director
Thomas E. Gay III	57	Vice President of Finance and Administration and Chief Financial Officer
Sorin Georgescu	54	Vice President of Technology
Irvin W. Kovalik	68	Vice President of Worldwide Sales
George Smarandoiu	59	Vice President of Product Design
Scott Brown	39	Vice President Marketing for Analog/Mixed-Signal Products

*Mr. Voicu* is the Company's President and Chief Executive Officer, a position he has held since October 2002. Other management positions held with the Company since his joining in 1993 include Executive Vice President and Chief Operating Officer, Vice President of Engineering and Manufacturing, flash product line director and manager of product engineering. Mr. Voicu is also a board member of the Company. Prior to joining the Company, Mr. Voicu was with Cypress Semiconductor, Inc. a semiconductor company, most recently as senior product engineer. Mr. Voicu holds an MS degree in Electrical Engineering from the Polytechnical Institute, Bucharest, Romania.

*Mr. Gay* has been the Company's Vice President of Finance and Administration and Chief Financial Officer since May 1998. Prior to joining the Company, Mr. Gay held positions at Wireless Access, Inc, a communications device manufacturing company, where he was Controller and Sanmina Corporation, a contract manufacturer, where he was the Corporate Controller. Mr. Gay was also the Company's Controller from April 1993 to May 1994. He holds a BS degree in Accounting from San Diego State University.

*Mr. Georgescu* joined the Company in October 2001 as Vice President of Technology. Mr. Georgescu has over 20 years of semiconductor device and process development experience at such firms as Tripath Technology, Inc., SanDisk Corporation and Power Integrations, Inc. His experience includes CMOS, BiCMOS, HVIC (High-Voltage Integrated Circuits) and non-volatile memory technology, processes and architectures. He received a MSEE degree from Polytechnical Institute in Bucharest, Romania.

*Mr. Kovalik* is the Company's Vice President of Sales and joined the Company in November 1998. Prior to joining the Company, Mr. Kovalik held positions at Alliance Semiconductor, Inc., a semiconductor company, where he was Director of Strategic Sales; NovaWeb Technologies, Inc., a modem manufacturer, where he was Vice President of Sales; and Sequel, Inc., a semiconductor company, where he was Director of Strategic Sales. In addition, from June 1992 to June 1995, Mr. Kovalik was the Company's Vice President of Sales. Mr. Kovalik holds a BS degree in Electrical Engineering from the University of Illinois.

*Dr. Smarandoiu* is the Company's Vice President of Design. He joined the Company in October 2002 and has over 20 years of analog, system-on-a-chip and nonvolatile memory integrated circuit development experience. From 1992 to 2002, he was employed at Atmel Corporation, a semiconductor company, and served most recently as Atmel's director of mixed-mode product development. From 1981 to 1992, he was employed by SEEQ Technology, a semiconductor company that was acquired in 1999 by LSI Logic Corporation. At SEEQ he attained the position of director of memory design and was responsible for the development of EEPROM and FLASH products. He received a Doctor of Engineering and Master of Engineering from the University of California, Berkeley.

*Mr. Brown* has served as the Company's Vice President of Marketing for analog/mixed-signal products since September 2005. From October 1997 to August 2005, he was Director of RF and mixed-signal products for Micrel Inc., a semiconductor manufacturer. From September 1989 to September 1997, he was a product marketing manager for National Semiconductor, a semiconductor manufacturer. Mr. Brown holds a BSEE degree from Brunel University in the United Kingdom.

#### **Website Postings**

We file electronically with the SEC our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those Reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Those reports and statements (1) may be read and copied at the SEC's public reference room at 100 F Street, N.E., Washington, DC 20549, (2) are available at the SEC's internet site (<http://www.sec.gov>), which contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC and (3) are available free of charge through our website ([www.catsemi.com](http://www.catsemi.com)) as soon as reasonably practicable after electronic filing with, or furnishing to, the SEC. Information regarding the operation of the SEC's public reference room





may be obtained by calling the SEC at 1-800-SEC-0330. Copies of such documents may be requested by contacting our Investor Relations Representative at (408) 542-1051 or by sending an e-mail through the Investor Relations page on our website. We have adopted a Code of Business Conduct and Ethics for our principal executive officer, principal financial officer, principal accounting officer or controller and persons performing similar functions. We have posted our Code of Business Conduct and Ethics on our website. Any future amendments to this code will also be posted to our website. The information in or that can be accessed through our website is not part of this Annual Report on Form 10-Keport.

**Item 1A. Risk Factors**

*We are subject to a number of risks. Some of these risks are endemic to the high-technology and semiconductor industry and are the same or similar to those disclosed in our previous SEC filings. The following lists some, but not all, of the risks and uncertainties which may have a material and adverse effect on our business, financial condition or results of operations. The risks and uncertainties set out below are not the only risks and uncertainties we face.*

***Risks related to our Business***

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

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

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



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

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

Analog/mixed-signal products accounted for 7.6%, 4.7% and 2.1% of net revenues for fiscal 2006, 2005 and 2004, respectively. We believe that the growth in our analog/mixed-signal product revenues has been limited due to the extended product design cycles and production lead times, and a sales force that has limited experience selling these products. Despite limited product acceptance to date, we continue to invest in and devote research and development and marketing resources to analog/mixed-signal products with the expectation that our standard analog/mixed-signal products will be accepted by many of our current customers and that we will eventually qualify and sell custom analog/mixed-signal products. Competition is intense as we have initially offered a limited range of products while our more established competitors are offering a much broader array of analog/mixed-signal products. Many customers favor a vendor that offers a broad range of products. If we are unable to realize more revenues from these products, our total revenues may not grow. In addition, if we devote a disproportionate amount of our research and development resources to analog/mixed-signal products, our development of new non-volatile memory products may suffer and operating results may be harmed.

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

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

- the loss of any of our current foundries as a supplier;
- our inability to obtain additional capacity at our current foundry suppliers;
- our inability to qualify our current foundry suppliers for additional products;
- our inability to locate and qualify other wafer manufacturers for desired foundry capacity; or
- any other problems foundries may have causing a significant interruption in our supply of semiconductor wafers.

***We are now required to expense share-based payments to our employees, and our financial statements will have a significant material adverse charge.***

As of May 1, 2006, we are required to expense stock options and other share-based payments to employees and directors, which will require us to record a significant charge to earnings. On

December 16, 2004, the Financial Accounting Standards Board issued SFAS No. 123(R), Share-Based Payment, which is a revision of SFAS No. 123 and supersedes APB Opinion No. 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 will no longer be an alternative. We adopted SFAS No. 123(R) on May 1, 2006, the first day of our fiscal 2007. 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. Our pro forma stock compensation expense was \$2.0 million for fiscal 2006. Adoption of this accounting standard will have a material adverse impact on our consolidated financial statements. We are currently evaluating our stock-based compensation programs to determine what our alternatives may be to reduce this expense in the future. If we choose not to issue stock options at the levels we have in the past, we believe we may face more difficulties in attracting and retaining employees.

***We depend on a small number of suppliers for our supply of wafers and we may be unable to meet customer demand due to our inability to obtain wafers.***

We do not manufacture or process the semiconductor wafers used for our products. In 1985, we began a relationship with our principal foundry supplier. Since 1987, that foundry has supplied wafers to us and has been our principal foundry source. In fiscal 2000, an additional foundry began to provide products to us. We primarily use our principal foundry supplier for fabricating our memory products and our other foundry supplier for fabricating our analog/mixed-signal products. We do not presently have a wafer supply agreement with our foundry suppliers and instead purchase wafers on a purchase order and acceptance basis. Our reliance on these independent foundries involves a number of risks, including:

- inadequate wafer supplies to meet our production needs;
- increased prices charged by these independent foundries;
- reduced control over delivery schedules, manufacturing yields and costs; and
- any other circumstances causing a significant interruption in our supply of semiconductor wafers.

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

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

It is our policy to fully write down all inventories that we do not expect to be sold in a reasonable period of time. During recent fiscal years, as a result of reductions in estimated demand for our various products, we have taken charges for write down of inventories for certain products, primarily our EEPROM products. For example, we recorded inventory write-down charges of \$1.0 million, \$1.1 million and \$853,000 in fiscal 2006, fiscal 2005 and fiscal 2004, respectively, which were partially offset by benefits of \$794,000, \$1.0 million and \$2.0 million, relating to products that were written off in prior periods and

sold during these fiscal years, respectively. We may suffer reductions in values of our inventories in the future and we may be unable to liquidate our inventory at acceptable prices. To the extent we have excess inventories of particular products, our operating results could be adversely affected by charges to cost of revenues that we would be required to recognize due to significant reductions in demand for our products or rapid declines in the market value of inventory, resulting in inventory write downs or other related factors.

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

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

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

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

Distributors and resellers have accounted for a significant portion of our net revenues in the past. For fiscal 2006, sales to Avnet, Inc., an international distributor, represented 12% of our net revenues. For fiscal 2005, none of our direct or indirect customers represented 10% or more of our net revenues. For fiscal 2004, sales to ALR Company Limited, a reseller in China, represented 11% of our net revenues.

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

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

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

The fabrication of semiconductors, particularly EEPROM products, is a highly complex and precise process. Most of our products are currently manufactured by two outside foundries and a number of other vendors participate in assembling, testing and other processing of our products. During manufacturing, each wafer is processed to provide numerous EEPROM, flash or analog/mixed-signal devices. We may

reject or be unable to sell a substantial percentage of wafers or the components on a given wafer because of:

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

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

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

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

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

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

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

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

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

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

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

***We expect to relocate our principal executive offices in August 2006, and the transition of our principal executive offices may cause delays that may harm our future operating results***

Our existing principal executive offices are located in Sunnyvale, California. Our lease in the Sunnyvale facility expires in July 2006 and will become a monthly rent obligation for the remainder of our occupancy. In anticipation of the expiration of this lease, we began renovations of a new headquarters in April 2006 in a building we purchased in Santa Clara, California in March 2006. There can be no assurance that we will be able to successfully transition all of our administrative operations to the new facility without incurring significant additional costs from extending our lease on a month to month basis for the Sunnyvale facility or that we will not experience any delays in establishing the required infrastructure to operate the business effectively. We may also experience network, telecommunications and other infrastructure disruptions in connection with our move to the new facility, which may limit our ability to complete sales and other transactions until the disruptions are resolved and would negatively affect our operating results. The transition of administrative operations to the new facility could place significant strain on our management and engineering resources and result in diversion of management attention from the day to day operation of our business. In addition, the customer and internal qualification of our wafer testing facilities at the Santa Clara location may not occur in a timely manner, if at all, which may increase our operating expenses and force us to operate two facilities until we successfully qualify the Santa Clara facility. There can be no assurance that we will be able to hire additional management, engineering and other personnel, as needed, to manage effectively, the transition to the new facility, which may harm our future operating results.



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

For each of fiscal 2006, fiscal 2005 and fiscal 2004, sales outside the United States accounted for approximately 88% of our net revenues. We expect that sales outside of the United States will continue to represent a significant portion of our net revenues in the future. However, our international operations may be adversely affected by the following factors:

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

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

Additionally, our subcontracted presence in Thailand with Trio-Tech subjects us to additional risks associated with the value of the work-in-process and finished goods inventory located there as well as the test equipment utilized in the operations at the Trio-Tech facility. We are in the process of forming a subsidiary in Thailand that will hire personnel and own certain equipment located in that country in addition to our current operations.

***We may face increased management costs and other risks due to the establishment of our product development group in Romania.***

In January 2003, we formed a wholly owned subsidiary in Romania to provide engineering services for current products and the development of potential new products. In August 2004, we purchased a building in Bucharest for use by our Romanian engineering group at a cost of \$2.1 million. We have no prior experience in establishing or operating engineering services outside of our headquarters in Sunnyvale, California. The expansion of our engineering design operations to remotely situated offices presents a number of substantial risks that could increase our operating expenses and adversely affect our operating results, financial condition and ability to deliver our products and grow our business, including:

- difficulties in staffing and managing foreign operations, in particular attracting and retaining personnel qualified to provide high quality engineering services;
- difficulties in coordinating our engineering operations in Romania with those in California;
- diversion of management attention;



- political and economic instability, which may have an adverse impact on foreign exchange rates of the Romanian leu relative to the U.S. dollar and could impair our ability to conduct our business in Romania;
- difficulties in maintaining uniform standards, controls, procedures and policies with our Romanian subsidiary relative to those of our other locations, including product development management and financial consolidation;
- difficulties in owning and operating real property in Romania; and
- inadequacy of the local infrastructure to support our needs.

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

Our ability to operate successfully will depend, to a large extent, upon the continued service of certain key employees and the continued ability to attract and retain additional highly qualified personnel. Competition for these personnel, particularly for highly skilled design, process and test engineers, is intense and we may not be able to retain these personnel or attract other highly qualified personnel. Our business, financial condition and results of operations could be materially adversely affected by the loss of or failure to attract and retain highly qualified personnel.

***Our low-density flash memory products may become obsolete.***

A significant portion of our net revenues have been and continue to be derived from sales of low density flash memory products. Flash memory products represented 8.3%, 9.6% and 9.4% of our net revenues in fiscal 2006, fiscal 2005 and fiscal 2004, respectively. In general, the market for flash memory products has been characterized by competing technologies, migration of demand to larger memory sizes and intense overall competition. Other flash memory vendors continue to design, develop and sell flash memory devices with larger memory in reaction to changes in market demand. This transition to larger flash memory sizes is resulting in a limited and shrinking market for the low density flash memory products that we currently offer. We have decided not to develop any of the higher density flash memory devices due to the extreme competition in the medium and high density flash memory market and the considerable costs of development associated with it. Due to these and other factors, we may experience declining net revenues from our low-density flash memory products, which could harm our operating results.

#### ***Risks Related to Our Industry and Competition***

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

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

We compete with major domestic and international semiconductor companies, many of which have substantially greater financial, technical, marketing, distribution and other resources. We may not be able to compete successfully in the future. Our more mature products, such as serial and parallel EEPROM devices, compete on the basis of price, product availability and customer service. Principal competitors for

our EEPROM products currently include Atmel, STMicroelectronics and Microchip Technology. Principal competitors for our low density flash products include Silicon Storage Technology and Integrated Silicon Solution. Principal competitors for our analog/mixed-signal products include Fairchild Semiconductor, Intersil, Linear Technology, Maxim Integrated Products, National Semiconductor and Texas Instruments.

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

We operate in a highly cyclical industry that has been subject to significant economic downturns often in connection with, or in anticipation of, maturing product cycles and declines in general economic conditions. These types of downturns have occurred numerous times in the past, most recently, in calendar year 2005. During such downturns, we experience reduced product demand and production overcapacity which result in competitive pricing pressures leading to accelerated erosion of average selling prices and reduced gross margins. These downturns may occur for extended periods. Accordingly, we may experience substantial period-to-period fluctuations in operating results.

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

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

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

#### ***Risks Related to Our Intellectual Property***

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

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

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

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

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

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

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

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

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

To expand our proprietary technologies, we may acquire or make investments in complementary businesses, technologies or products if appropriate opportunities arise. We may be unable to identify suitable acquisition or investment candidates at reasonable prices or on reasonable terms or consummate transactions with such candidates, the failure of which could slow our growth. We may also have difficulty in acquiring licenses to use proprietary technologies of third parties to expand our product lines. We may

have difficulty integrating the acquired products, personnel or technologies of any acquisition we might make. These difficulties could disrupt our ongoing business, limit our future growth, distract our management and employees and increase our expenses.

***Risks Related to Our Stock***

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

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

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

For example, during fiscal 2004, fiscal 2005, fiscal 2006 and to date in fiscal 2007, the trading price of our common stock on the Nasdaq National Market has ranged from a high of \$9.75 per share to a low of \$2.51 per share. If our net revenues and results of operations are below the expectations of investors, significant fluctuations in the market price of our common stock could occur. In addition, the securities markets have, from time to time, experienced significant price and volume fluctuations, which have particularly affected the market prices for high technology companies and often are unrelated and disproportionate to the operating performance of particular companies. These broad market fluctuations, as well as general economic, political and market conditions, may negatively affect the market price of our common stock.

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

Our board of directors has the authority to issue up to 2,000,000 shares of preferred stock and to determine the rights, preferences, privileges and restrictions, including voting rights, of the shares without any further vote or action by our stockholders. If we issue any of these shares of preferred stock in the future, the rights of shareholders of our common stock may be negatively affected. If we issue preferred stock, a change of control of our company could be delayed, deferred or prevented. We have no current plans to issue shares of preferred stock.

Section 203 of the Delaware General Corporation Law restricts certain business combinations with any interested stockholder as defined by that statute. In addition, our certificate of incorporation and bylaws contain certain other provisions that may have the effect of delaying, deferring or preventing a change of control. These provisions include:

- the classification of our board so that only a portion of our directors are elected each year and each director serves a three year term;
- the elimination of actions by written consent of stockholders; and
- the establishment of an advance notice procedure and a minimum holding requirement for stockholder proposals and director nominations to be acted upon at annual meetings of the stockholders.

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

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

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

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

**Item 1B. Unresolved Staff Comments**

Not Applicable.

**Item 2. Properties**

Our principal administrative, sales, marketing, research & development and sort facility is currently located in a building of approximately 42,500 square feet in Sunnyvale, California. The facility has a lease commitment through July 2006 and is under a month to month arrangement thereafter. On March 16, 2006, we purchased a 41,965 square-foot building in Santa Clara, California which will house our principal headquarters currently located in Sunnyvale, California. We are scheduled to move in August 2006.

In addition, we purchased our research and development facility in Bucharest, Romania, consisting of 25,800 square feet, in August 2004 and we lease sales office space in East Dundee, Illinois; Shanghai and Shenzhen, China; Oxford, United Kingdom; Munich, Germany; Yokohama, Japan; Singapore; Seoul,

South Korea; and Taipei, Taiwan; and an operations office in Bangpa-in, Thailand. We believe that our existing facilities are adequate to meet our current needs and that additional or alternative space will be available in the future on commercially reasonable terms.

**Item 3. *Legal Proceedings***

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

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended April 30, 2006.



**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Common Stock Market Prices and Dividends**

Our common stock is quoted on the NASDAQ Global Market under the symbol CATS. The following table sets forth, for the periods indicated, the high and low sale prices per share of our common stock as reported on the NASDAQ Global Market.

	Price Range	
	High	Low
<b>Fiscal year ended April 30, 2005</b>		
First Quarter	\$ 8.40	\$ 5.40
Second Quarter	6.20	4.30
Third Quarter	6.42	5.06
Fourth Quarter	5.44	4.13
<b>Fiscal year ended April 30, 2006</b>		
First Quarter	\$ 5.06	\$ 4.16
Second Quarter	5.19	4.30
Third Quarter	5.20	4.50
Fourth Quarter	5.05	4.60

As of April 30, 2006, there were approximately 151 holders of record of our common stock, excluding those persons holding shares in street or nominee name. The actual number of our stockholders is greater than this number of holders of record.

**Dividend Policy**

We have never declared or paid any cash dividends on our common stock or other securities. We currently expect to retain future earnings for use in the operation and expansion of our business and do not anticipate paying cash dividends in the foreseeable future.

**Purchases of Our Stock**

The following table sets forth certain information regarding purchases by us of shares of our common stock during the fourth quarter of fiscal 2006.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
February 2006	196,410	\$ 4.96	196,410	333,555
March 2006	191,774	4.93	191,774	141,781
April 2006				141,781
Total	388,184	\$ 4.95	388,184	

(1) In September 2005, the board of directors authorized a new stock repurchase program under which we may repurchase up to 1.0 million shares of its common stock. Prior to September 2005, the board of directors authorized the repurchase of 3.5 million shares. Through April 30, 2006, we have repurchased an aggregate of 4,358,219 shares under the board of director's authorized repurchase plans. See Note 7 Stockholders' Equity in Part IV, Item 15(a)(1) of this Annual Report on Form 10-K.



**Item 6.** *Selected Consolidated Financial Data*

The selected consolidated financial data set forth below should be read together with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto in this Annual Report on Form 10-K. Historical results are not necessarily indicative of results to be expected in the future.

	<b>Years Ended April 30,</b>				
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>(In thousands, except per share data)</b>				
<b>Consolidated Statements of Income Data:</b>					
Net revenues	\$ 60,217	\$ 62,320	\$ 63,538	\$ 48,221	\$ 42,791
Cost of revenues	36,900	35,852	37,375	28,396	27,158
Gross profit	23,317	26,468	26,163	19,825	15,633
Research and development	7,472	7,910	7,130	5,223	4,380
Selling, general and administrative	13,445	13,696	11,453	10,020	10,652
Income from operations	2,400	4,862	7,580	4,582	601
Interest income and other, net	1,175	732	379	382	663
Income before income taxes	3,575	5,594	7,959	4,964	1,264
Income tax provision (benefit)	1,019	1,773	(1,408)	(1,354)	494
Net income(1)	\$ 2,556	\$ 3,821	\$ 9,367	\$ 6,318	\$ 770
Net income per share:					
Basic	\$ 0.15	\$ 0.22	\$ 0.57	\$ 0.38	\$ 0.04
Diluted	\$ 0.14	\$ 0.20	\$ 0.48	\$ 0.34	\$ 0.04
Weighted average common shares:					
Basic	16,685	17,507	16,567	16,721	17,829
Diluted	18,220	19,485	19,411	18,339	20,439

(1) In fiscal 2004 and fiscal 2003, our net income was favorably impacted by \$4.7 million and \$1.9 million, respectively, due to the reversals of our tax valuation allowance which is now zero.

	<b>April 30,</b>				
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>(In thousands, except per share data)</b>				
<b>Consolidated Balance Sheet Data:</b>					
Cash, cash equivalents and short-term investments	\$ 29,139	\$ 33,793	\$ 33,809	\$ 27,906	\$ 26,295
Total working capital	43,268	48,084	46,338	39,017	36,180
Total assets	70,420	70,061	66,865	50,588	47,924
Total current liabilities	12,890	12,193	12,877	8,235	9,296
Total long-term liabilities and capital lease obligations					3,262
Stockholders' equity	57,530	57,868	53,988	42,353	35,366

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

**EXPLANATORY NOTE**

*The following discussion should be read together with the consolidated financial statements and notes thereto included in this annual report on Form 10-K. Certain statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations are forward-looking statements. These forward-looking statements contained herein are based on current expectations and involve various risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. See the risks and uncertainties identified in Part I, Item 1A, Risk Factors below and in the documents filed by us from time to time with the Securities and Exchange Commission. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.*

**Overview**

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

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

We are leveraging our extensive experience in high volume, reprogrammable memory products to develop complementary analog/mixed-signal products that offer our customers a more complete system solution. We have strengthened and expanded the expertise of our research and development team by establishing our own development center in Bucharest, Romania and by hiring additional engineers in Romania and in our Sunnyvale, California headquarters. In fiscal 2006, we purchased a building in Santa Clara, California that will house our principal offices and our principal wafer test operation, which are presently located in Sunnyvale, California. The move is expected to provide employees with modern facilities and make efficient use of space while reducing our occupancy costs. In addition, in fiscal 2005, we purchased a new building in Bucharest for our Romanian product development team. We continue to make substantial investments in research and development to advance our non-volatile memory products, as well as develop broader solutions with our line of analog/mixed-signal products. We are in the process of forming a subsidiary in Thailand that will perform a portion of the inventory management and processing functions that are currently subcontracted to Trio-Tech. This is expected to reduce our expenses and improve our control over the personnel and assets now located in Thailand.

Sales of our analog/mixed-signal products continue to trend upwards, reaching 7.6% of net revenues in fiscal 2006 as compared to 4.7% of net revenues in fiscal 2005. We expect net revenues from analog/mixed-signal products to comprise a larger portion of our net revenues in the future.

Our business is less capital intensive than traditional semiconductor companies since we outsource to third parties the manufacturing, assembling and most of the testing of our products. We strive to maintain

long-term relationships with our suppliers to ensure stability in our supply of products at a competitive cost. In addition, in an effort to alleviate any potential wafer capacity constraints, we maintain a supply of wafers in a die bank for selected products.

We market and sell our products directly through our sales force and sales representatives to OEMs and indirectly through distributors and resellers who sell to their end customers. Indirect sales were a majority of our total net revenues in fiscal 2006, fiscal 2005 and fiscal 2004, representing 52% of net revenues in fiscal 2006. Our total customer base, including OEMs and end-customers of our distributors and resellers, is relatively diverse and during fiscal 2006 consisted of more than 3,400 customers. We have approximately 40 distributors and resellers.

In fiscal 2006, one customer represented 12% of our net revenues. For fiscal 2005, no one customer accounted for 10% or more of our net revenues. For fiscal 2004, one customer represented 11% of our net revenues.

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

Sales to customers outside the United States comprised the 88% of our net revenues for each of fiscal 2006, fiscal 2005 and fiscal 2004. Substantially all sales of our products are denominated in U.S. dollars, minimizing the effects of foreign currency fluctuations.

Our net revenues in fiscal 2005 benefited by approximately \$1.0 million from the termination of price adjustment and stock rotation rights of certain small regional resellers, which had not historically used those rights that resulted in recognition of revenue and gross margin for the inventories held by such resellers. We did not have similar benefits in fiscal 2006.

#### **Description of Operating Accounts**

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

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

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

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

### **Critical Accounting Policies and Estimates**

The preparation of our consolidated financial statements and related disclosures in conformity with generally accepted accounting principles in the United States requires us to make estimates and judgments that affect the amounts reported in our financial statements and accompanying notes. We evaluate our estimates and judgments based on historical experience and apply them on a consistent basis. These estimates and judgments primarily relate to inventory valuation and warranty liabilities, which affects our cost of sales and gross margin; and the valuation of deferred income taxes and income taxes payable, which affects our income tax expense and benefit. We also have other key accounting policies, such as our policies for revenue recognition and allowance for doubtful accounts receivable and sales returns reserves. The methods, estimates and judgments we use in applying these critical accounting policies have a significant impact on the results we report in our financial statements. We believe that consistent application results in financial statements and accompanying notes that fairly represent our financial condition, operating results and cash flows for all periods presented. However, any factual errors or errors in these estimates and judgments may have a material impact on our financial conditions, operating results and cash flows.

#### ***Recognition of Revenues***

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

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

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

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

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

#### ***Inventory Valuation***

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

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

#### ***Allowance for Doubtful Accounts Receivable***

We estimate the collectibility of our accounts receivable at the end of each reporting period. We analyze the aging of accounts receivable and bad debt history, payment history, customer concentration, customer credit worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. We maintain an allowance for doubtful accounts, which is created by charges to selling, general and administrative expense. Our accounts receivable balance was \$9.5 million, net of allowance for doubtful accounts of \$138,000, as of April 30, 2006.

#### ***Income Taxes***

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

We reassess and may adjust the estimated tax rate quarterly. We apply the current tax rate to our year to date income and our tax provision and related accrual is adjusted accordingly. Our effective income tax rate was 28.5% for fiscal 2006.

We make significant judgments in determining our provision for income taxes, our deferred tax assets and any valuation allowance recorded against our net deferred tax asset. As of April 30, 2006, our gross

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deferred tax assets, consisting primarily of net operating loss carryforwards, tax credit carryforwards and nondeductible reserves and accruals, were valued at \$7.5 million and our valuation allowance was zero.

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

The calculation of tax liabilities involves dealing with uncertainties in the application of complex global tax regulations. We recognize potential liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes will be due. If payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when the Company determines the liabilities are no longer necessary. If the estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result.

### Results of Operations

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

	Years Ended April 30,		
	2006	2005	2004
Net revenues	100.0 %	100.0 %	100.0 %
Cost of revenues	61.3	57.5	58.8
Gross profit	38.7	42.5	41.2
Operating expenses:			
Research and development	12.4	12.7	11.2
Selling, general and administrative	22.3	22.0	18.0
Income from operations	4.0	7.8	12.0
Interest income and other, net	2.0	1.2	0.5
Income before income taxes	6.0	9.0	12.5
Income tax provision (benefit)	1.8	2.9	(2.2 )
Net income	4.2 %	6.1 %	14.7 %

### Comparison of the Fiscal Years Ended April 30, 2006 and 2005

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

	Years Ended April 30,			2005			2004	
	2006							
EEPROM	\$ 50,597	84.1 %	%	\$ 53,397	85.7 %	%	\$ 56,239	88.5 %
Flash	5,016	8.3	%	5,983	9.6	%	5,988	9.4
Analog/mixed-signal	4,604	7.6	%	2,940	4.7	%	1,311	2.1
Net revenues	\$ 60,217	100.0 %	%	\$ 62,320	100.0 %	%	\$ 63,538	100.0 %

*Net Revenues.* Our net revenues decreased \$2.1 million, or 3.4%, to \$60.2 million for fiscal 2006 from \$62.3 million for fiscal 2005. The decrease in net revenues was primarily due to a decrease in EEPROM average selling prices, which led to a decline of net revenues from our EEPROM and flash memory products of \$3.8 million. This decrease was partially offset by an increase in net revenues from our analog/mixed-signal products of \$1.7 million, or 58.6% to \$4.6 million for fiscal 2006 from \$2.9 million for fiscal 2005, which resulted from the introduction of new products and increased sales to our existing OEM



customer base. While we experienced an improved market demand that resulted in a 9% increase in total unit volume sold to end customers in fiscal 2006, net revenues decreased overall because the increase in total unit volume was off-set by increased market competition in the more recent period resulting in a 11% decrease in overall average selling prices.

In addition, our net revenues in fiscal 2005 benefited by approximately \$1.0 million from the termination of price adjustment and stock rotation rights of certain small regional resellers that had not historically used those rights, which resulted in recognition of revenue and gross margin for the inventories held by such resellers. We did not experience a similar benefit in fiscal 2006.

Sales to customers outside the United States represented approximately 88% of net revenues in both fiscal 2006 and fiscal 2005.

*Gross Profit.* Gross profit decreased \$3.2 million, or 11.9%, to \$23.3 million for fiscal 2006 from \$26.5 million for fiscal 2005. Gross margin, which equals gross profit divided by net revenues, was 38.7% for fiscal 2006 and 42.5% for fiscal 2005. The decrease in gross profit was primarily due to increased market competition resulting in a decline in overall average selling prices, as well as the unfavorable impact of movements in our inventory reserves in fiscal 2006 as compared to fiscal 2005. The benefit from sales of previously reserved inventory was \$794,000 for fiscal 2006 and \$1.0 million for fiscal 2005, and provisions for excess and obsolete inventory were \$1.0 million for fiscal 2006 and \$1.1 million for fiscal 2005. The net impact of these inventory provisions was a decrease in gross profit of \$232,000 in fiscal 2006 as compared to a decrease in gross profit of \$83,000 in fiscal 2005.

*Research and Development.* Research and development expense decreased \$438,000, or 5.5%, to \$7.5 million for fiscal 2006 from \$7.9 million for fiscal 2005. As a percentage of net revenues, research and development expense was 12.4% in fiscal 2006 and 12.7% in fiscal 2005. The decrease in research and development expense was primarily attributable to a \$152,000 decrease in employee incentive compensation, a \$143,000 decrease in wafer fabrication and test and assembly costs and a \$133,000 decrease in facilities and insurance costs for our research and development activities.

*Selling, General and Administrative.* Selling, general and administrative expense decreased \$251,000, or 1.8%, to \$13.4 million for fiscal 2006 from \$13.7 million for fiscal 2005. As a percentage of net revenues, selling, general and administrative expense was 22.3% in fiscal 2006 and 22.0% in fiscal 2005. The decrease in selling, general and administrative expense was primarily attributable to a decrease in employee incentive and commission related compensation of \$329,000, a decrease in consulting work performed for Section 404 compliance of \$224,000, offset by an increase in depreciation expense for our new enterprise resource planning systems of \$104,000, an increase in freight expense of \$139,000 for increased unit shipments and an increase in marketing expense of \$58,000.

*Interest Income and Other, net.* We earned interest income and other, net, of \$1.2 million in fiscal 2006 as compared to interest income and other, net, of \$732,000 in fiscal 2005. Our rate of return on our average balance of cash, cash equivalents and short-term investments was approximately 3.4% in fiscal 2006 and approximately 1.8% in fiscal 2005. The change was due to higher average interest rates experienced in fiscal 2006 compared to fiscal 2005, partially offset by lower investable cash.

*Income Tax Provision (Benefit).* The provision for income taxes was \$1.0 million, or 28.5% of income before taxes, for fiscal 2006. The provision for income taxes was \$1.8 million or 31.7% of income before taxes, for fiscal 2005. The income tax rates are impacted by the level of available tax credits as compared to pretax income and the current estimate of the level of income subject to California taxation. The provision for income taxes in fiscal 2006 has also been favorably impacted by the reversal of certain tax accruals upon expiry of the related statute of limitations. Although extension of the federal tax credit provision is expected during 2006, the federal tax law authorizing such credits expired in December 2005. As a result, we cannot reflect the benefit of credits until the related laws are enacted.



*Comparison of the Fiscal Years Ended April 30, 2005 and 2004*

*Net Revenues.* Our net revenues decreased \$1.2 million, or 1.9%, to \$62.3 million for fiscal 2005 from \$63.5 million for fiscal 2004. The decrease in net revenues was primarily due to a decrease in EEPROM unit volume sold, resulting in a decline of net revenues from our EEPROM products of \$2.8 million. This decrease was partially offset by an increase in net revenues from our analog/mixed-signal products of \$1.6 million, or 124% to \$2.9 million for fiscal 2005 from \$1.3 million for fiscal 2004, which resulted from the introduction of new products and increased sales to our existing OEM customer base. Net revenues from our flash memory products remained constant at \$6.0 million for both fiscal 2005 and fiscal 2004.

Net revenues in fiscal 2005 benefited by approximately \$1.0 million from the termination of price adjustment and stock rotation rights of certain small regional resellers that had not historically used those rights, which resulted in recognition of revenues and gross margin for the inventories held by such resellers.

Sales to customers outside the United States represented approximately 88% of net revenues in both fiscal 2005 and fiscal 2004.

*Gross Profit.* Gross profit increased \$305,000, or 1.2%, to \$26.5 million for fiscal 2005 from \$26.2 million for fiscal 2004. Gross margin, which equals gross profit divided by net revenues, was 42.5% for fiscal 2005 and 41.2% for fiscal 2004. The \$305,000 improvement in gross profit in fiscal 2005 from fiscal 2004 was primarily due to a decline in inventory costs and a reduction in our cost of revenues as a result of a \$1.4 million royalty expense we recognized in fiscal 2004 in connection with the settlement of disputed royalty obligations with Philips Electronics. We also benefited from higher average selling prices for our flash memory and analog/mixed signal products in fiscal 2005. These benefits to our gross profit in fiscal 2005 were partially offset by the unfavorable impact of movements in our inventory reserves in fiscal 2005 as compared to fiscal 2004. The benefit from sales of previously reserved inventory was \$1.0 million for fiscal 2005 and \$2.0 million for fiscal 2004, and provisions for excess and obsolete inventory were \$1.1 million for fiscal 2005 and \$853,000 for fiscal 2004. The net impact of these inventory provisions was a decrease in gross profit of \$83,000 in fiscal 2005 as compared to an increase in gross profit of \$1.1 million in fiscal 2004.

*Research and Development.* Research and development expense increased \$780,000, or 10.9%, to \$7.9 million for fiscal 2005 from \$7.1 million for fiscal 2004. As a percentage of net revenues, research and development expense was 12.7% in fiscal 2005 and 11.2% in fiscal 2004. The increase in research and development expense in fiscal 2005 was primarily attributable to a \$435,000 increase in purchases of developmental mask sets and wafer fabrication related to product development and to a \$383,000 increase in personnel-related expenses, primarily as a result of an increase in headcount to support our product development efforts. These increases were partially offset by a reduction in professional services and depreciation expenses.

*Selling, General and Administrative.* Selling, general and administrative expense increased \$2.2 million, or 19.6%, to \$13.7 million for fiscal 2005 from \$11.5 million for fiscal 2004. As a percentage of net revenues, selling, general and administrative expense was 22.0% in fiscal 2005 and 18.0% in fiscal 2004. These increases were primarily attributable to a \$1.5 million increase in fees paid primarily to consultants and accountants related to compliance with the Sarbanes-Oxley Act of 2002 and a \$519,000 increase in sales and marketing personnel-related expenses.

*Interest Income and Other, net.* We earned interest income and other, net, of \$732,000 in fiscal 2005 as compared to interest income and other, net, of \$379,000 in fiscal 2004. Our rate of return on our average balance of cash, cash equivalents and short-term investments was approximately 1.8% in fiscal 2005 and approximately 1.2% in fiscal 2004. The change was due to higher average interest rates experienced in fiscal 2005 compared to fiscal 2004 due to improved market conditions.



*Income Tax Provision (Benefit).* The effective income tax rate was a provision of 31.7% in fiscal 2005, as compared to a benefit of 17.7% in fiscal 2004. The difference between our fiscal 2005 and fiscal 2004 effective tax rates was primarily attributable to the reversal of our valuation allowance recorded against our net deferred tax asset in fiscal 2004.

### **Liquidity and Capital Resources**

At April 30, 2006, we had cash, cash equivalents and short-term investments of \$29.1 million. Our historical sources of cash and capital expenditures have come from our operating activities. During fiscal 2006, we repurchased 912,943 shares of common stock for approximately \$4.5 million and purchased a building in Santa Clara, California for \$3.7 million, which will serve as our principal headquarters when we relocate in August 2006. Additionally, employees exercised stock options to generate \$1.1 million during fiscal 2006. We invest our excess cash in short-term financial instruments to generate interest income. These instruments are U.S. government debt securities, the majority of which have maturities that are less than one year. They are highly liquid and can be converted to cash at any time.

### ***Net Cash from Operating Activities***

In fiscal 2006, we had cash from operating activities of \$4.5 million, which resulted from net income of \$2.6 million, adjusted for non-cash charges including depreciation and amortization of \$1.9 million, a charge of \$232,000 for net movements in inventory reserves and a tax benefit of \$505,000 related to the exercise of employee stock options. Cash provided by operating activities also included a decrease in gross accounts receivable of \$464,000 related to our decrease in net revenues, an increase in accounts payable of \$1.5 million primarily due to the timing and amount of inventory purchases, and a decrease in accrued expenses of \$1.2 million related primarily to tax liabilities. These decreases were partially offset by an increase in gross inventory of \$3.0 million due to faster delivery times from our suppliers, and an increase in our deferred gross profit on shipments to distributors.

In fiscal 2005, we had cash from operating activities of \$4.9 million, which resulted from net income of \$3.8 million, adjusted for non-cash charges including depreciation and amortization of \$1.6 million, a net charge of \$1.1 million for movements in inventory reserves, a reduction in gross accounts receivable of \$2.6 million, an increase in accounts payable of \$1.1 million primarily due to the timing and amount of inventory purchases and an increase in accrued expenses and accrued expenses of \$463,000 related primarily to tax liabilities. These increases were partially offset by a reduction of gross inventories of \$4.6 million and a decrease of \$2.2 million for deferred gross profit on distributor sales due to decreased distributor inventories.

In fiscal 2004, we had cash from operating activities of \$10.7 million, which resulted from net income of \$9.4 million, adjusted for non-cash charges including depreciation and amortization of \$1.4 million, additions to inventory reserves of \$853,000, a reduction of gross inventories of \$2.6 million, an increase in accounts payable of \$1.3 million primarily due to the timing and amount of inventory purchases, an increase in accrued expenses and other liabilities of \$891,000 related primarily to the tax provision and an increase of \$2.7 million for deferred gross profit on distributor sales due to increased distributor inventories. These increases were partially offset by releases of inventory reserves of \$2.0 million resulting from shipments of previously reserved inventory and an increase in gross accounts receivable of \$4.7 million due to increased shipments.

### ***Net Cash from Investing Activities***

In fiscal 2006, cash used by investing activities was \$4.3 million. During fiscal 2006 our short-term investments decreased by \$1.4 million. We used \$5.7 million to acquire property and equipment, of which

\$3.7 million was used for the purchase of a building in Santa Clara, California, which will replace the leased principal headquarters in Sunnyvale, California

In fiscal 2005, cash used by investing activities was \$10.4 million. During fiscal 2005, our short-term investments increased by \$6.3 million as we transferred those funds from cash and cash equivalents. We also used \$4.1 million, which was primarily for the purchase of our new building for our R&D operations in Romania and for continuing investments in our new enterprise resource planning and supply chain management systems.

In fiscal 2004, investing activities provided \$1.7 million. During fiscal 2004, our short-term investments declined by \$3.5 million as we transferred those funds to cash and cash equivalents. We also used \$1.7 million primarily for the acquisition of test equipment.

***Net Cash from Financing Activities***

In fiscal 2006, cash used by financing activities was \$3.4 million, consisting of \$4.5 million used for the repurchase of an aggregate of 912,943 shares of common stock on the open market, at an average price per share of \$4.93, which was partially offset by \$1.1 million in proceeds from the sale of common stock through the exercise of stock options by employees.

In fiscal 2005, cash used by financing activities was \$724,000, consisting of \$9.6 million for the repurchase of an aggregate of 1,901,176 shares of common stock on the open market, at an average price per share of \$5.02, which was partially offset by \$8.0 million in net proceeds from our public offering of 1,450,000 shares of common stock in July 2004 and \$843,000 in proceeds from the sale of common stock through the exercise of stock options by employees.

In fiscal 2004, cash used by financing activities was \$3.0 million. In a private transaction we purchased 600,000 shares from Elex N.V., our largest stockholder, for \$6.77 per share and an aggregate of \$4.1 million, which represented a 13% discount from the closing market price on the Nasdaq National Market on the last trading date prior to the approval of the transaction by our Board of Directors. Separately, we purchased 74,000 shares of our common stock from the open market as part of our open market repurchase program. We also received \$1.3 million of proceeds upon the exercise of stock options by employees.

***Common Stock Repurchase Plan***

In September 2001, our board of directors authorized a program for the open market repurchase of up to 1.5 million shares of our common stock. In subsequent periods, the board of directors amended the program and authorized the purchase up to an aggregate of 3,500,000 shares. Upon reaching the maximum number of shares authorized under this program, the board of directors authorized a new stock repurchase program of up to 1.0 million shares in September 2005. The purpose of these share repurchase programs are to reduce the long-term potential dilution in earnings per share that might result from issuances under our stock option plans. The following table summarizes the activity of the open market repurchase programs for fiscal 2006, fiscal 2005 and fiscal 2004 and does not include our repurchases of shares from Elex N.V.:

	Years Ended April 30,			
	Total	2006	2005	2004
Shares repurchased in open market	2,888,119	912,943	1,901,176	74,000
Total cost of shares	\$ 14,272,000	\$ 4,503,000	\$ 9,553,000	\$ 216,000
Average cost per share	\$ 4.94	\$ 4.93	\$ 5.02	\$ 2.92

Through April 30, 2006 (excluding repurchases of shares from Elex N.V.) we have repurchased 4,358,219 shares under the board of director s authorized repurchase plans at a total cost of \$17,922,088 or an average cost per share of \$4.11 per share.

### ***Contractual Obligations and Commercial Commitments***

The following table summarizes our contractual obligations as of April 30, 2006 and the effects these obligations and commitments are expected to have on our liquidity and cash flows in future periods (in thousands):

	<b>Years Ended April 30,</b>				
	<b>Total</b>	<b>Less Than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>More Than 5 Years</b>
<i>Contractual cash obligations</i>					
Operating leases(1)	\$ 1,706	\$ 424	\$ 1,002	\$ 280	\$
Wafer purchases	5,472	5,472			
Other purchase commitments	694	694			
<b>Total contractual cash obligations</b>	<b>\$ 7,872</b>	<b>\$ 6,590</b>	<b>\$ 1,002</b>	<b>\$ 280</b>	<b>\$</b>

(1) On March 16, 2006, we purchased a building in Santa Clara, California for \$3.7 million, which will replace the leased principal headquarters in Sunnyvale, California that expires July 2006.

### ***Off-Balance Sheet Arrangements***

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities of financial partnerships, such as entities often referred to as structured finance or special purpose entities, or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purpose. As of April 30, 2006, we were not involved in any SPE transactions.

### ***Future Liquidity***

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

### **Effects of Transactions with Related Parties**

#### ***Elex N.V.***

During the fourth quarter of fiscal 2000, we began taking delivery of wafers fabricated at X-FAB Texas, Inc. ( X-FAB ) a wholly owned subsidiary of Elex N.V. ( Elex ), a Belgian holding company. Roland Duchâtelet, the Chairman and Chief Executive Officer of Elex, serves as a member of our Board of Directors. Elex initially became a related party in 1998 through the purchase of 5.5 million restricted

shares of our common stock. The wafers provided by X-FAB include most of our analog/mixed-signal products and supplement some of the same EEPROM designs fabricated at various other foundries we utilize. Other than purchase orders currently open with X-FAB, there is no purchasing agreement in place with X-FAB. During fiscal 2006, fiscal 2005 and fiscal 2004, we purchased \$2.5 million, \$2.4 million and \$3.7 million of wafers, respectively, from X-FAB. As of April 30, 2006 and 2005, the total amount owed X-FAB by us was \$143,000 and \$314,000, respectively. In the first quarter of fiscal 2005, Elex reduced its holdings from 3,578,700 shares, or 21.8% of our outstanding shares as of April 30, 2004, to 728,700 shares, or 4.4% of the outstanding shares of the Company as of April 30, 2005.

We believe that the terms of these transactions were no less favorable than reasonably could be expected to be obtained from unaffiliated parties.

### Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) SFAS No. 123 (revised 2004), *Share-Based Payment*, or SFAS No. 123(R). SFAS No. 123(R) eliminates the alternative of applying the intrinsic value measurement provisions of Accounting Principals Board ( APB ) Opinion No. 25, or APB 25, to stock compensation awards issued to employees. The new standard requires enterprises to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the date of grant. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, usually the vesting period.

The pro forma effects on net income and earnings per share as if we had applied the fair value recognition provisions of original SFAS No. 123 on stock compensation awards (rather than applying the intrinsic value measurement provisions of APB 25) are in the Notes to Consolidated Financial Statements (see Note 1). Although the pro forma effects of applying original SFAS No. 123 may be indicative of the effects of adopting SFAS No. 123(R), the provisions of these two statements differ in some important respects. The actual effects of adopting SFAS No. 123(R) will be dependent on numerous factors including, but not limited to, the valuation model chosen by us to value stock-based awards; the assumed award forfeiture rate; the accounting policies adopted concerning the method of recognizing the fair value of awards over the requisite service period; and the transition method chosen for adopting SFAS No. 123(R). Adoption of this accounting standard will have a material adverse impact on our consolidated financial statements. SFAS No. 123(R) will be effective for our fiscal quarter ending July 31, 2006.

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

On May 30, 2005, the FASB issued SFAS No. 154, *Accounting Changes and Err or Corrections*, a replacement of APB Opinion No. 20 and FASB Statement No. 3, which changes the requirements for the accounting and reporting of a change in accounting principle effective for fiscal years beginning after December 15, 2005. SFAS No. 154 applies to all voluntary changes in accounting principle as well as to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 eliminates the requirement in APB Opinion No. 20, *Accounting Changes*, to include the cumulative effect of changes in accounting principle in the income statement in the period of change.



Instead, to enhance the comparability of prior period financial statements, SFAS No. 154 requires that changes in accounting principles be applied retrospectively. Under retrospective application, the new accounting principle is applied as of the beginning of the first period presented as if that principle had always been used. Under SFAS No. 154, a change in reporting entity is also applied retrospectively as of the beginning of the first period presented. A change in accounting estimate continues to be accounted for in the period of change and future periods if necessary. We are currently assessing the impact of adopting SFAS No. 154 and believe the new standard will not have a material impact on its financial statements.

In July 2006, the Financial Accounting Standards Board (FASB) released its final Interpretation on uncertain tax positions, FIN 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FAS 109*. This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The guidance will become effective as of the beginning of a company's fiscal year beginning after December 15, 2006. The Company is currently assessing the impact of adopting this standard.

**Item 7A. *Quantitative and Qualitative Disclosures about Market Risk***

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

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

**Item 8. *Financial Statements and Supplementary Data***

The Consolidated Financial Statements required by this Item are set forth at the pages indicated in Part IV, Item 15(a).

The following table presents selected unaudited consolidated statements of income data for our eight most recently completed fiscal quarters. The information for each of these quarters is unaudited and has been prepared on the same basis as the audited consolidated financial statements appearing elsewhere in this report. In our opinion, all necessary adjustments, consisting only of normal recurring adjustments, have been included to present fairly the unaudited quarterly results when read together with our consolidated financial statements and related notes included elsewhere in the report. We believe that results of operations for interim periods should not be relied upon as any indication of the results to be expected or achieved in any future period or any fiscal year as a whole.

	<b>Three Months Ended</b>							
	<b>Apr. 30, 2006</b>	<b>Jan. 31, 2006</b>	<b>Oct. 31, 2005</b>	<b>July 31, 2005</b>	<b>Apr. 30, 2005</b>	<b>Jan. 31, 2005</b>	<b>Oct. 31, 2004</b>	<b>July 31, 2004</b>
	<b>(Unaudited) (In thousands, except per share data)</b>							
Net revenues	\$ 14,187	\$ 14,423	\$ 16,931	\$ 14,676	\$ 16,325	\$ 13,680	\$ 15,604	\$ 16,711
Gross profit	4,946	6,215	6,438	5,718	6,185	5,248	6,360	8,675
Income (loss) from operations	(283 )	1,041	1,110	532	507	(55 )	1,036	3,374
Net income(1)	\$ 270	\$ 864	\$ 927	\$ 495	\$ 516	\$ 107	\$ 1,004	\$ 2,194
Net income per share:								
Basic	\$ 0.02	\$ 0.05	\$ 0.05	\$ 0.03	\$ 0.03	\$ 0.01	\$ 0.06	\$ 0.13
Diluted	\$ 0.02	\$ 0.05	\$ 0.05	\$ 0.03	\$ 0.03	\$ 0.01	\$ 0.05	\$ 0.12

(1) In the quarter ended April 30, 2006, our net income was favorably impacted by \$226,000 due to the expiry of a state income tax statute of limitation.

#### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

#### **Item 9A. 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 Annual Report on Form 10-K. 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 recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

##### **Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our management assessed the effectiveness of the company's internal control over financial reporting as of April 30, 2006. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*.

Based on this assessment, our management concluded that, as of April 30, 2006, our internal control over financial reporting was effective.

Management's assessment of the effectiveness of our internal control over financial reporting as of April 30, 2006, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

**Changes in Internal Control Over Financial Reporting**

During the three months ended October 31, 2005, we implemented a new supply chain management, or SCM, system designed to provide additional operational and financial reporting functionality by allowing users to monitor inventory and business activities at a greater level of detail and with increased timeliness. During the three months ended January 31, 2006, we completed the SCM system implementation.

**Item 9B. Other Information**

None.

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**PART III**

Certain information required by Part III is incorporated by reference from the Company's 2006 definitive proxy statement to be filed not later than 120 days following the close of the 2006 fiscal year ( 2006 Definitive Proxy Statement ).

**Item 10. Directors and Executive Officers of the Registrant**

Certain information regarding our executive officers required by this Item 10 is contained under Part 1, Item 1, Executive Officers and is incorporated herein by reference.

The information required under this Item is hereby incorporated by reference from the Company's 2006 Definitive Proxy Statement.

**Item 11. Executive Compensation**

The information required under this Item is hereby incorporated by reference from the Company's 2006 Definitive Proxy Statement.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required under this Item is hereby incorporated by reference from the Company's 2006 Definitive Proxy Statement.

**Item 13. Certain Relationships and Related Transactions**

The information required under this Item is hereby incorporated by reference from the Company's 2006 Definitive Proxy Statement.

**Item 14. Principal Accountant Fees and Services**

The information required under this Item is hereby incorporated by reference from the Company's 2006 Definitive Proxy Statement.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

**(a)(1) Financial Statements**

See Index to Consolidated Financial Statements on page F-1 hereof.

**(a)(2) Financial Statement Schedules**

Schedule II Valuation and Qualifying Accounts.

All other schedules are omitted because they are not required or the required information is shown in the financial statements or notes thereto.

**(b) Exhibits**

Exhibit No.	Description
3.2(7)	Restated Certificate of Incorporation of Registrant
3.4(6)	Bylaws of Registrant
4.1(12)	Specimen Stock Certificate

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- 4.2(3) Preferred Shares Rights Agreement, dated as of December 3, 1996, between Catalyst Semiconductor, Inc. and FirstNational Bank of Boston
- 4.2.1(10) Amendment No. 1 to Preferred Shares Rights Agreement dated as of May 22, 1998 between Registrant and BankBoston, N.A., as rights agent
- 4.2.2(10) Amendment No. 2 to Preferred Shares Rights Agreement dated as of September 14, 1998 between Registrant and BankBoston, N.A., as rights agent
- 4.2.3(9) Amendment No. 3 to Preferred Shares Rights Agreement dated as of September 27, 2001 between Registrant and Equiserve Trust Company N.A., as rights agent
- 4.2.4(10) Amendment No. 4 to Preferred Shares Rights Agreement dated as of July 17, 2002 between Registrant and Equiserve Trust Company N.A., as rights agent
- 4.2.5(13) Amendment No. 5 to Preferred Shares Rights Agreement dated as of April 22, 2004 between the Registrant and Equiserve Trust Company, as rights agent
- 4.2.6(14) Amendment No. 6 to Preferred Shares Rights Agreement dated as of June 18, 2004 between the Registrant and Equiserve Trust Company, as rights agent
- 4.6(11) 2003 Stock Incentive Plan
- 4.6.1(24) Form of Stock Option Agreement under 2003 Stock Incentive Plan.
- 4.7(11) 2003 Director Stock Option Plan
- 4.7.1(24) Form of 2003 Director Option Plan (same as 4.6.1)
- 4.8(8) 1998 Special Equity Incentive Plan
- 10.27(1)\* Form of Indemnification Agreement entered into by Registrant with each of its directors and executive officers.
- 10.38(2) Standard Industrial Lease dated March 22, 1996 between Marin County Employees Retirement Association and Registrant
- 10.61(4) Standstill Agreement dated as of May 26, 1998 between the Registrant and Elex N.V.
- 10.61.1(5) Amended and Restated Standstill Agreement dated as of September 14, 1998 between the Registrant and Elex N.V.
- 10.61.2(13) Amendment No. 1 to Amended and Restated Standstill Agreement dated as of April 22, 2004
- 10.61.3(13) Second Amended and Restated Standstill Agreement dated as of June 10, 2004
- 10.83(9) Stock Purchase Agreement dated April 19, 2002 between Elex NV and Registrant
- 10.84(10)\* Form of Change of Control Agreement between Registrant and its non-employee directors
- 10.85(15)\* Employment Agreement dated May 23, 2003 between Gelu Voicu and Registrant
- 10.86(13) Stock Transfer Agreement dated as of April 22, 2004 between the Registrant and Elex N.V.
- 10.87(17)\* Severance Agreement dated October 14, 2002 between George Smarandoiu and Registrant
- 10.88(16) Sale-Purchase Promissory Agreement dated November 6, 2003 between Registrant and S.C. Hathor Impex SRL
- 10.89(4) Common Stock Purchase Agreement dated as of May 26, 1998 between Registrant and Elex N.V.

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10.90(5)	Common Stock Purchase Agreement dated as of September 14, 1998 between Registrant and Elex N.V.
10.91(18)	Fiscal 2005 Bonus Plan.
10.92(19)	Severance Agreement dated August 23, 2005 between Thomas Gay and Registrant.
10.93(19)	Severance Agreement dated August 23, 2005 between Sorin Georgescu and Registrant.
10.94(19)	Severance Agreement dated August 23, 2005 between Irvin Kovalik and Registrant.
10.95(19)	Severance Agreement dated August 23, 2005 between George Smarandoiu and Registrant
10.96(20)	Fiscal 2006 Bonus Plan.
10.97(21)	Separation agreement effective as of July 29, 2005 between Barry Wiley and
10.98(22)	Offer Letter with Scott Brown dated August 18, 2005.
10.99(23)	Agreement of Sale by and between 2975 Stender Associates LLC and Catalyst Semiconductor, Inc. effective as of February 3, 2006.
10.100(25)	Lease Agreement entered into on March 6, 2006 by and between Catalyst Semiconductor International, Inc. and Stars Microelectronics.
21.1	List of Subsidiaries of Registrant
23.1	Consent of Independent Registered Public Accounting Firm
24.1	Power of Attorney (included on page 47)
31.1	Certification of Chief Executive Officer pursuant to U.S.C. Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to U.S.C. Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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- (1) Incorporated by reference to Registrant's Registration Statement on Form S-1 filed with the Securities and Exchange Commission on May 11, 1993 (File No. 33-60132), as amended.
  - (2) Incorporated by reference to Registrant's Form 10-K filed with the Securities and Exchange Commission for the year ended April 30, 1996.
  - (3) Incorporated by reference to Registrant's Form 8-A filed with the Securities and Exchange Commission on January 22, 1997.
  - (4) Incorporated by reference to Registrant's Form 10-K filed with the Securities and Exchange Commission for the year ended May 3, 1998.
  - (5) Incorporated by reference to Registrant's Form 10-Q filed with the Securities and Exchange Commission for the quarter ended August 2, 1998.
  - (6) Incorporated by reference to Registrant's Form 10-Q/A filed with the Securities and Exchange Commission for the quarter ended November 1, 1998.
  - (7) Incorporated by reference to an Appendix to Registrant's Definitive Proxy Statement filed with the Securities and Exchange Commission on December 18, 1998.

- (8) Incorporated by reference to an Appendix to Registrant's Definitive Proxy Statement previously filed with the Securities and Exchange Commission on July 27, 2000.
- (9) Incorporated by reference to Registrant's Form 10-Q filed with the Securities and Exchange Commission for the quarter ended October 28, 2001.
- (10) Incorporated by reference to Registrant's Form 10-K filed with the Securities and Exchange Commission for the year ended April 30, 2002.
- (11) Incorporated by reference to Registrant's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on December 24, 2002 (File No. 333-102201).
- (12) Incorporated by reference to Registrant's Registration Statement on Form 8-A/A filed with the Securities and Exchange Commission on April 29, 1993.
- (13) Incorporated by reference to Registrant's Registration Statement on Form S-3 filed with the Securities and Exchange Commission on June 14, 2004 (File No. 333-116425).
- (14) Incorporated by reference to Registrant's Registration Statement on Form S-3/A filed with the Securities and Exchange Commission on June 22, 2004 (File No. 333-116425).
- (15) Incorporated by reference to Registrant's Form 10-K filed with the Securities and Exchange Commission for the year ended April 27, 2003.
- (16) Incorporated by reference to Registrant's Form 10-Q filed with the Securities and Exchange Commission for the quarter ended February 1, 2004.
- (17) Incorporated by reference to Registrant's Form 10-K filed with the Securities and Exchange Commission for the year ended May 2, 2004.
- (18) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on August 5, 2005.
- (19) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on August 26, 2005.
- (20) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on September 7, 2005.
- (21) Incorporated by reference to Registrant's Form 10-Q filed with the Securities and Exchange Commission for the quarter ended July 31, 2005.
- (22) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on October 11, 2005.
- (23) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on February 9, 2006.

(24) Incorporated by reference to Registrant's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on March 3, 2006 (File No. 333-132204).

(25) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on March 10, 2006.

Confidential treatment has been granted as to a portion of this Exhibit. Such portion has been redacted and filed separately with the Securities and Exchange Commission.

\* Constitutes a management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 14(c) of Form 10-K.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, in the City of Sunnyvale and State of California, on July 31, 2006.

CATALYST SEMICONDUCTOR, INC.

By:

/s/ GELU VOICU

Gelu Voicu

*President, Chief Executive Officer and Director*

**POWER OF ATTORNEY**

**KNOW ALL PERSONS BY THESE PRESENTS**, that each person whose signature appears below constitutes and appoints Gelu Voicu and Thomas E. Gay III, and each of them, as his attorneys-in-fact, with the full power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-K and to file the same with exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorneys-in-fact, or his substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of Registrant and in the capacities and on July 31, 2006.

By:	/s/ GELU VOICU Gelu Voicu	President, Chief Executive Officer and Director ( <i>Principal Executive Officer</i> ) Vice President of Finance and	July 31, 2006
By:	/s/ THOMAS E. GAY III Thomas E. Gay III	Administration and Chief Financial Officer ( <i>Principal Financial and Accounting Officer</i> )	July 31, 2006
By:	/s/ ROLAND M. DUCHÂTELET Roland M. Duchâtelet	Director	July 31, 2006
By:	/s/ GARRETT GARRETTSON Garrett Garrettson	Director	July 31, 2006
By:	/s/ HENRY C. MONTGOMERY Henry C. Montgomery	Chairman of the Board	July 31, 2006
By:	/s/ GLEN G. POSSLEY Glen G. Possley	Director	July 31, 2006

**CATALYST SEMICONDUCTOR, INC.**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Catalyst Semiconductor, Inc.

We have completed integrated audits of Catalyst Semiconductor, Inc.'s fiscal 2006 and 2005 consolidated financial statements and of its internal control over financial reporting as of April 30, 2006, and an audit of its 2004 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

**Consolidated financial statements and financial statement schedule**

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Catalyst Semiconductor, Inc. and its subsidiaries at April 30, 2006 and May 1, 2005, and the results of their operations and their cash flows for each of the three years in the period ended April 30, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

**Internal control over financial reporting**

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of April 30, 2006 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of April 30, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other

procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP  
San Jose, California  
July 31, 2006

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**CATALYST SEMICONDUCTOR, INC.**  
**CONSOLIDATED BALANCE SHEETS**

	April 30, 2006	2005
	(In thousands except per share amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 7,730	\$ 10,978
Short-term investments	21,409	22,815
Accounts receivable, net	9,502	9,966
Inventories	14,262	11,455
Deferred tax assets	2,771	4,188
Other current assets	484	875
Total current assets	56,158	60,277
Property and equipment, net	9,408	5,582
Deferred tax assets	4,759	4,128
Other assets	95	74
Total assets	\$ 70,420	\$ 70,061
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,453	\$ 5,755
Accounts payable - related parties	143	314
Accrued expenses	3,002	4,245
Deferred gross profit on shipments to distributors	2,292	1,879
Total current liabilities	12,890	12,193
Commitments and contingencies (Notes 5 and 9)		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 2,000 shares authorized; no shares issued and outstanding		
Common stock, \$0.001 par value, 45,000 shares authorized; 22,808 shares issued and 16,350 shares outstanding at April 30, 2006 and 22,135 shares issued and 16,590 shares outstanding at April 30, 2005	23	22
Additional paid-in-capital	70,461	68,872
Treasury stock, 6,458 shares at April 30, 2006 and 5,545 shares at April 30, 2005	(26,672 )	(22,169 )
Retained earnings	13,759	11,203
Accumulated other comprehensive loss	(41 )	(60 )
Total stockholders' equity	57,530	57,868
Total liabilities and stockholders' equity	\$ 70,420	\$ 70,061

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

**CATALYST SEMICONDUCTOR, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**

	Years Ended April 30,		
	2006	2005	2004
	(In thousands, except per share data)		
Net revenues	\$ 60,217	\$ 62,320	\$ 63,538
Cost of revenues	36,900	35,852	37,375
Gross profit	23,317	26,468	26,163
Operating expenses:			
Research and development	7,472	7,910	7,130
Selling, general and administrative	13,445	13,696	11,453
Income from operations	2,400	4,862	7,580
Interest income and other, net	1,175	732	379
Income before income taxes	3,575	5,594	7,959
Income tax provision (benefit)	1,019	1,773	(1,408 )
Net income	\$ 2,556	\$ 3,821	\$ 9,367
Net income per share:			
Basic	\$ 0.15	\$ 0.22	\$ 0.57
Diluted	\$ 0.14	\$ 0.20	\$ 0.48
Weighted average common shares outstanding:			
Basic	16,685	17,507	16,567
Diluted	18,220	19,485	19,411

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

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**CATALYST SEMICONDUCTOR, INC.**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME**

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	Common Stock Shares Outstanding (In thousands)	Par Value	Additional Paid-In Capital	Treasury Stock	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at April 30, 2003	16,276	\$ 19	\$ 52,632	\$ (8,340 )	\$ (1,985 )	\$ 27	\$ 42,353
Exercise of stock options	811	1	1,536				1,537
Purchase of stock for treasury	(674 )			(4,276 )			(4,276 )
Tax benefits of stock options			5,060				5,060
Unrealized losses on investments, net of taxes						(53 )	
Net income					9,367		
Comprehensive income							9,314
Balance at April 30, 2004	16,413	20	59,228	(12,616 )	7,382	(26 )	53,988
Exercise of stock options	628	1	842				843
Purchase of stock for treasury	(1,901 )			(9,553 )			(9,553 )
Tax benefits of stock options			817				817
Secondary public offering of common stock	1,450	1	7,985				7,986
Unrealized losses on investments, net of taxes						(34 )	
Net income					3,821		
Comprehensive income							3,787
Balance at April 30, 2005	16,590	22	68,872	(22,169 )	11,203	(60 )	57,868
Exercise of stock options	673	1	1,084				1,085
Purchase of stock for treasury	(913 )			(4,503 )			(4,503 )
Tax benefits of stock options			505				505
Unrealized gains on investments, net of taxes						19	
Net income					2,556		
Comprehensive income							2,575
Balance at April 30, 2006	16,350	\$ 23	\$ 70,461	\$ (26,672 )	\$ 13,759	\$ (41 )	\$ 57,530

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



**CATALYST SEMICONDUCTOR, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Years Ended April 30,		
	2006	2005	2004
	(In thousands)		
<b>Cash flows from operating activities:</b>			
Net income	\$ 2,556	\$ 3,821	\$ 9,367
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of property and equipment	1,891	1,621	1,442
Benefit from sale of inventory previously written down	(794 )	(1,002 )	(1,976 )
Provision for excess and obsolete inventory	1,026	1,085	853
Loss on disposal of property and equipment	11	257	39
Tax benefits of options	505	817	5,060
Changes in deferred tax assets	786	806	(7,208 )
Changes in assets and liabilities:			
Accounts receivable	464	2,581	(4,684 )
Inventories	(3,039 )	(4,578 )	2,586
Other assets	370	144	298
Accounts payable (including related parties)	1,527	1,053	1,324
Accrued expenses	(1,243 )	463	891
Deferred gross profit on shipments to distributors	413	(2,200 )	2,662
Net cash provided by operating activities	4,473	4,868	10,654
<b>Cash flows from investing activities:</b>			
Purchases of short-term investments	(24,114 )	(47,292 )	(43,191 )
Proceeds from sales and maturities of short-term investments	25,539	41,007	46,652
Acquisition of property and equipment	(5,728 )	(4,126 )	(1,724 )
Net cash provided by (used in) investing activities	(4,303 )	(10,411 )	1,737
<b>Cash flows from financing activities:</b>			
Common stock issuances	1,085	843	1,302
Net proceeds from secondary public offering		7,986	
Treasury stock purchases	(4,503 )	(9,553 )	(4,276 )
Net cash used in financing activities	(3,418 )	(724 )	(2,974 )
Net increase (decrease) in cash and cash equivalents	(3,248 )	(6,267 )	9,417
Cash and cash equivalents at beginning of the period	10,978	17,245	7,828
Cash and cash equivalents at end of the period	\$ 7,730	\$ 10,978	\$ 17,245
Non-cash financing activity:			
Deferred compensation on exercised stock options	\$	\$	\$ 235
Supplemental cash flow disclosures:			
Cash paid during the year for:			
Income taxes	\$ 43	\$ 100	\$ 51

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

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 The Company and Basis of Presentation**

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

The Company's fiscal year ends on the Sunday closest to April 30. Fiscal 2006, 2005 and 2004 ended on April 30, 2006, May 1, 2005 and May 2, 2004, respectively. Fiscal 2006 and 2005 were comprised of 52 weeks. Fiscal 2004 was comprised of 53 weeks with the extra week added to the third quarter. For presentation purposes only, the financial information has been presented as ending on the last day of the nearest calendar month.

*Principles of Consolidation*

The consolidated financial statements include the accounts of Catalyst Semiconductor, Inc. and its wholly owned subsidiaries, Nippon Catalyst KK (NCKK), a sales organization in Yokohama, Japan and Catalyst Semiconductor Romania SRL (CSR), a product development center in Bucharest, Romania. All significant intercompany accounts and transactions are eliminated in consolidation.

*Uses of Estimates*

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

*Stock-Based Compensation*

The Company has elected to measure employee stock-based compensation costs using the intrinsic value method prescribed by the Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*. Accordingly, no compensation expense has been recorded for stock options granted with exercise prices greater than or equal to the fair value of the underlying common stock at the option grant date.

Pro forma information regarding net income and earnings per share is required by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. SFAS No. 123 requires the disclosure of pro forma net income and earnings per share as if the Company had adopted the fair value method. Stock-based compensation to employees under SFAS No. 123 is based on the fair value of the option, estimated using the Black-Scholes Option Pricing Model on the date of grant. The related stock-based compensation expense is recognized over the vesting period.

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the weighted-average assumptions used in the SFAS No. 123 calculation:

	2006	2005	2004
Expected term (in years)	3.8	4.0 - 5.3	4.0
Risk-free interest rate	4.74 %	3.90%	2.69 %
Volatility	48 %	66% - 68%	69 %
Dividend yield		%	%

The following table illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

	Years Ended April 30,		
	2006	2005	2004
	(In thousands, except per share amounts)		
Reported net income	\$ 2,556	\$ 3,821	\$ 9,367
Add: Stock-based employee compensation expense included in reported net income, net of tax			
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of tax	(2,026 )	(2,085 )	(2,835 )
As adjusted net income	\$ 530	\$ 1,736	\$ 6,532
As adjusted net income per share:			
Basic	\$ 0.03	\$ 0.10	\$ 0.39
Diluted	\$ 0.03	\$ 0.09	\$ 0.34
Reported net income per share:			
Basic	\$ 0.15	\$ 0.22	\$ 0.57
Diluted	\$ 0.14	\$ 0.20	\$ 0.48

During the periods presented, the Company accounted for compensation cost related to employee stock options in accordance with the provisions of APB No. 25 and related interpretations. As such, compensation expense would be recorded on the date of grant only if the current market prices of the underlying stock exceeded the exercise price. The Company applies SFAS No. 123, which allows entities to continue to apply the provision of APB No. 25 and provide pro forma net income and pro forma earnings per share disclosures for employee stock option grants as if the fair value based method defined in SFAS No. 123 had been applied.

The accounting for stock-based compensation involves a number of estimates about the expected lives of stock options, interest rates, stock volatility and assumptions as well as the selection of a valuation model. The Company has elected to use the Black-Scholes option valuation model to value its stock-based compensation. A change in any of the estimates used in the model, or the selection of a different option pricing model, could have a material impact on the Company's pro forma net income (loss) disclosures in the periods presented and on its financial statements in future periods.

The weighted-average grant-date fair value of options granted during fiscal 2006, fiscal 2005 and fiscal 2004 was \$2.72, \$2.83 and \$3.11, respectively.

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 2 Significant Accounting Policies**

*Cash and Cash Equivalents*

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

*Short-term Investments*

All of the Company's short-term investments are classified as available-for-sale. Investments in available-for-sale securities are reported at fair value with unrealized gains and losses, being recorded net of related tax, as a component of accumulated other comprehensive income (loss). Refer to Note 4 for details related to available-for-sale securities.

*Accounts Receivable*

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

*Fair Value of Financial Instruments*

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

*Foreign Currency Translation*

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

*Revenue Recognition*

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

The Company markets and sells products directly through its sales force and sales representatives to original equipment manufacturers ( OEM ) and indirectly through distributors and resellers. Revenues are recognized upon delivery to OEMs and resellers who have no, or limited, product return rights and no

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

price protection rights. Reserves for estimated returns and allowances are provided against net revenues at the time of recognition of revenues. The Company also sells products to certain distributors under agreements that allow certain rights to return the product and provides for price protection rights. These agreements generally permit the distributor to return up to 10%, by value, of the total products they purchased from the Company every six months. As a result, the Company defers recognition of revenues until the time the distributor sells the product to an end-customer. Upon shipment to a distributor, the Company records an account receivable from the distributor, relieves inventory for the cost of the product shipped, and records the gross profit, which equals revenues less the cost of revenues, on the consolidated balance sheet as deferred gross profit on shipments to distributors until such time as the inventory is resold by the distributor to its end-customers.

***Inventories***

Inventory is stated at the lower of standard cost or net realizable value. Standard cost approximates actual cost on a first-in, first-out basis. The Company periodically reviews its inventory for slow moving or obsolete items and writes down the related products to estimated net realizable value. Inventory reserves once established are not reversed until the related inventory has been sold or physically scrapped. Purchases of inventory from two of the Company's vendors represented 43% of total purchases of inventory for fiscal 2006.

***Shipping and Handling Costs***

The Company charges inbound freight shipments within the supply chain and associated handling costs to the cost of revenues on its consolidated statements of income. The Company charges outbound freight shipments and associated handling costs to selling, general and administrative on its consolidated statements of income. Such outbound freight costs aggregated to \$658,000, \$516,000 and \$624,000 in fiscal 2006, fiscal 2005 and fiscal 2004, respectively.

***Property and Equipment***

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

***Income Taxes***

The provision for income taxes is determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax basis of our assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of April 30, 2006, and based on the tax laws in effect at that time, the Company intended to continue to indefinitely reinvest undistributed foreign earnings and accordingly, no deferred tax liability had been recorded on these undistributed foreign earnings.

The calculation of tax liabilities involves dealing with uncertainties in the application of complex global tax regulations. The Company recognizes potential liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on its estimate of whether, and the extent to which, additional taxes will be due. If payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when the Company determines the liabilities are no longer necessary. If the estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result.

***Concentration of Credit Risk***

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

As of April 30, 2006 no single customer accounted for greater than 10% of gross accounts receivable. As of April 30, 2005, one customer accounted for 12% of gross accounts receivable.

***Concentration of Other Risks***

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

***Advertising Costs***

Costs related to advertising and promotional expenditures are charged to selling, general and administrative on the Company's consolidated statements of income. Costs related to advertising and promotional expenditures were less than \$125,000 for each of fiscal 2006, fiscal 2005 and fiscal 2004.

***Accumulated Other Comprehensive Income (Loss)***

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

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Segment Reporting***

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

***Recently Issued Accounting Standards***

In December 2004, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) SFAS No. 123 (revised 2004), *Share-Based Payment*, or SFAS No. 123(R). SFAS No. 123(R) eliminates the alternative of applying the intrinsic value measurement provisions of Accounting Principles Board ( APB ) Opinion No. 25, or APB 25, to stock compensation awards issued to employees. The new standard requires enterprises to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the date of grant. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, usually the vesting period.

The pro forma effects on net income and earnings per share as if the Company had applied the fair value recognition provisions of original SFAS No. 123 on stock compensation awards (rather than applying the intrinsic value measurement provisions of APB 25) are in the Notes to Consolidated Financial Statements (see Note 1). Although the pro forma effects of applying original SFAS No. 123 may be indicative of the effects of adopting SFAS No. 123(R), the provisions of these two statements differ in some important respects. The actual effects of adopting SFAS No. 123(R) will be dependent on numerous factors including, but not limited to, the valuation model chosen by the Company to value stock-based awards; the assumed award forfeiture rate; the accounting policies adopted concerning the method of recognizing the fair value of awards over the requisite service period; and the transition method chosen for adopting SFAS No. 123(R). Adoption of this accounting standard will have a material adverse impact on its consolidated financial statements. SFAS No. 123(R) will be effective for the Company's fiscal quarter ending July 31, 2006.

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

On May 30, 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, a replacement of APB Opinion No. 20 and FASB Statement No. 3, which changes the requirements for the accounting and reporting of a change in accounting principle effective for fiscal years beginning after December 15, 2005. SFAS No. 154 applies to all voluntary changes in accounting principle as well as to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 eliminates the requirement in APB Opinion No. 20, *Accounting Changes*, to include the cumulative effect of changes in accounting principle in the income statement in the period of change.

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Instead, to enhance the comparability of prior period financial statements, SFAS No. 154 requires that changes in accounting principle be retrospectively applied. Under retrospective application, the new accounting principle is applied as of the beginning of the first period presented as if that principle had always been used. Under SFAS No. 154, a change in reporting entity is also retrospectively applied as of the beginning of the first period presented. A change in accounting estimate continues to be accounted for in the period of change and future periods if necessary. The Company is currently assessing the impact of adopting SFAS No. 154 and believes the new standard will not have a material impact on its financial statements.

In July 2006, the Financial Accounting Standards Board (FASB) released its final Interpretation on uncertain tax positions, FIN 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FAS 109*. This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The guidance will become effective as of the beginning of a company's fiscal year beginning after December 15, 2006. The Company is currently assessing the impact of adopting this standard.

**Note 3 Net Income Per Share**

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

	Years Ended April 30, 2006			2005			2004		
	Net Income	Shares	Per Share Amount	Net Income	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
Basic	\$ 2,556	16,685	\$ 0.15	\$ 3,821	17,507	\$ 0.22	\$ 9,367	16,567	\$ 0.57
Effect of stock options		1,535	(0.01 )		1,978	(0.02 )		2,844	(0.09 )
Diluted	\$ 2,556	18,220	\$ 0.14	\$ 3,821	19,485	\$ 0.20	\$ 9,367	19,411	\$ 0.48

Options to purchase 2,278,000 shares of common stock at a weighted average exercise price of \$6.30 per share outstanding during fiscal 2006 were not included in the computation of diluted income per share because their option price was greater than the average fair market value for the period.

Options to purchase 1,822,000 shares of common stock at a weighted average exercise price of \$6.79 per share outstanding during fiscal 2005 were not included in the computation of diluted income per share because their option price was greater than the average fair market value for the period.



**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Options to purchase 508,000 shares of common stock at a weighted average exercise price of \$6.60 per share outstanding during fiscal 2004 were not included in the computation of diluted income per share because their option price was greater than the average fair market value for the period.

**Note 4 Balance Sheet Components**

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

The unrealized losses as of April 30, 2006 are recorded in accumulated other comprehensive income (loss) of the consolidated statements of stockholders' equity and comprehensive income, net of tax of \$19,000.

	<b>April 30, 2005</b>		
	<b>Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>
	<b>(In thousands)</b>		
			<b>Estimated Fair Market Value</b>
<b>Investments available-for-sale:</b>			
U.S. government debt securities with maturities less than one year	\$ 20,901	\$	\$ (88 )
U.S. government debt securities with maturities over one year	2,008		(6 )
			2,002
Total investments available-for-sale	\$ 22,909	\$	\$ (94 )
			\$ 22,815

The unrealized losses as of April 30, 2005 are recorded in accumulated other comprehensive income (loss) of the consolidated statements of stockholders' equity and comprehensive income, net of tax of \$34,000.

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

	<b>April 30, 2006</b>	<b>April 30, 2005</b>
	<b>(In thousands)</b>	
<b>Accounts receivable:</b>		
Accounts receivable	\$ 9,640	\$ 10,104
Less: Allowance for doubtful accounts	(138 )	(138 )
	\$ 9,502	\$ 9,966

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Bad debts in aggregate of \$0, \$0 and \$87,000 were written off to the allowance for doubtful accounts in fiscal 2006, fiscal 2005 and fiscal 2004, respectively.

	April 30, 2006	April 30, 2005
	(In thousands)	
<b>Inventories:</b>		
Work-in-process	\$ 9,220	\$ 7,450
Finished goods	5,042	4,005
	\$ 14,262	\$ 11,455
<b>Property and equipment:</b>		
Building	\$ 2,045	\$ 2,046
Engineering and test equipment	9,962	8,198
Computer software	1,779	1,240
Computer hardware	589	1,201
Land	165	165
Leasehold improvements	671	672
Furniture and office equipment	838	867
Construction in progress	3,746	
Vehicles	69	
	19,864	14,389
Less: accumulated depreciation and amortization	(10,456 )	(8,807 )
	\$ 9,408	\$ 5,582

Software amortization expense for fiscal 2006, fiscal 2005 and fiscal 2004 was \$308,000, \$220,000 and \$159,000, respectively.

On March 16, 2006, the Company purchased a building in Santa Clara, California for \$3.7 million, which will replace the principal headquarters currently leased under an operating lease in Sunnyvale, California.

	April 30, 2006	April 30, 2005
	(In thousands)	
<b>Accrued expenses:</b>		
Accrued employee compensation	\$ 866	\$ 1,671
Accrued income taxes	733	1,075
Other	1,403	1,499
	\$ 3,002	\$ 4,245

**Note 5 Leases**

The Company leases its office facilities under operating leases which have various expiration dates. The lease commitment for the Company's primary business office in Sunnyvale expires in July 2006, and is under a month to month arrangement thereafter. The Company is scheduled to move into its newly purchased business office in August 2006 (see Note 4).

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Total rent expense under these leases was \$623,000, \$601,000 and \$703,000 for fiscal 2006, fiscal 2005 and fiscal 2004, respectively. The aggregate future minimum lease payments, by fiscal year, under operating leases with initial terms of one year or more as of April 30, 2006 are as follows (in thousands):

	Years Ended April 30,					
	Total	2007	2008	2009	2010	2011
Operating leases	\$ 1,706	\$ 424	\$ 334	\$ 334	\$ 334	\$ 280

**Note 6 Income Taxes**

The Company's provision for income taxes was comprised as follows (in thousands):

	Years Ended April 30,		
	2006	2005	2004
Current:			
Federal	\$ 143	\$ 360	\$ 1,743
State	24	(237 )	11
Foreign	66	14	81
Total current income taxes	233	137	1,835
Deferred:			
Federal	868	1,498	1,004
State	(82 )	138	434
Reversal of valuation allowance			(4,681 )
Total deferred income taxes	786	1,636	(3,243 )
Provision (benefit) for income taxes	\$ 1,019	\$ 1,773	\$ (1,408 )

The provision for income taxes differed from the amount of income tax determined by applying the applicable statutory federal income tax rate to pretax income as a result of the following (dollars in thousands):

	Years Ended April 30,					
	2006		2005		2004	
Statutory federal tax rate	\$ 1,216	34.0 %	\$ 1,902	34.0 %	\$ 2,786	35.0 %
State taxes	77	2.2	(99 )	(1.8 )	289	3.6
Research credits	(232 )	(6.5 )	(144 )	(2.5 )	(96 )	(1.2 )
Foreign	66	1.8			81	1.0
Reversal of valuation allowance					(4,681 )	(58.8 )
Deferred tax asset rate adjustment			168	3.0		
Other	(108 )	(3.0 )	(54 )	(1.0 )	213	2.7
Total	\$ 1,019	28.5 %	\$ 1,773	31.7 %	\$ (1,408 )	(17.7 )%

Income before income taxes includes income (losses) relating to non-U.S. operations of \$47,000, \$99,000 and \$13,000 in fiscal 2006, fiscal 2005 and fiscal 2004, respectively.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes.

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Significant components of the Company's net deferred tax assets and liabilities for federal and state income taxes at April 30, 2006 and 2005 consist of (in thousands):

	April 30, 2006	2005
Deferred tax assets:		
Capitalized research	\$ 337	\$ 812
Non-deductible reserves and accruals	944	822
Credit carryforwards	3,643	3,315
Loss carryforwards	1,699	2,721
Deferred income and sales returns reserves	829	693
Other	78	35
Gross deferred tax assets	7,530	8,398
Deferred tax liabilities:		
Fixed assets	( )	(82 )
Other		
Gross deferred tax liabilities	( )	(82 )
Total net deferred tax assets	\$ 7,530	\$ 8,316

Based on available objective evidence and the recent history of profits, in fiscal 2004 management concluded that all of the Company's net deferred tax assets will be realizable. Accordingly, the Company released the remaining \$8.6 million of its valuation allowance as of April 30, 2004. Approximately \$3.9 million of the valuation allowance that reversed in fiscal 2004 was attributable to certain carryforwards, resulting from the exercise of employee stock options, and was accounted for as a credit to additional paid-in-capital rather than a reduction of the income tax provision. In addition, approximately \$1.2 million of the benefit attributable to the fiscal 2004 employee stock option activity was also credited to additional paid-in-capital.

At April 30, 2006, the Company had a federal net operating loss carryforward of approximately \$5.0 million available to offset future taxable income that expires between fiscal 2018 and 2025 if not utilized.

At April 30, 2006, the Company had approximately \$2.4 million and \$1.6 million of federal and state credit carryovers, respectively, available to offset future taxable income. The federal credits expire between fiscal 2009 and 2026 if not utilized. The state credits carryovers are indefinite.

Under the Internal Revenue Code, the amounts of and benefits from net operating loss and tax credit carryforwards may be impaired or limited in certain circumstances. Events which cause limitations in the amount of net operating losses and tax credit carryforwards that the Company may utilize in any one year include, but are not limited to, a cumulative ownership change of more than 50%, as defined, over a three-year period.

During the year, the Company reversed approximately \$226,000 of tax reserves upon expiry of the statute of limitations. These tax reserves had been established to allow for potential tax exposures relating to the level of income apportioned to California in the Company's state tax returns.

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 7 Stockholders Equity**

The Company completed a secondary public offering of its common stock in July 2004. The Company sold 1,450,000 common shares at \$6.00 per share. Proceeds to the Company, net of underwriting discounts and commissions and related offering expenses of \$714,000 were approximately \$8.0 million. In connection with this transaction, Elex N.V., a related party and other selling stockholders sold 2,850,000 and 300,000 common shares, respectively, at \$6.00 per share. In aggregate, 4,600,000 common shares were sold.

***Common and Preferred Stock***

The Company was originally incorporated in California in October 1985 and reincorporated in Delaware in May 1993. The Board of Directors approved a recapitalization that authorized 45 million shares of common stock and 2 million shares of undesignated preferred stock. In December 1996, the Board of Directors designated 60,000 shares of preferred stock as Series A Participating Preferred Stock. The Board of Directors has the authority to determine the powers, preferences, rights and the qualifications, limitations or restrictions granted to or imposed upon any wholly unissued shares of undesignated preferred stock, without any further vote or action by the Company's shareholders.

***2003 Stock Incentive Plan***

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

***2003 Director Stock Option Plan***

During 1993, the Company adopted the 1993 Director Stock Option Plan, which provides for the grant of nonstatutory stock options to non-employee directors. In November 1999 and September 2000, the stockholders authorized an additional 100,000 and 450,000 shares, respectively, to be reserved under the 1993 Director Stock Option Plan. In December 2002, the stockholders approved an amendment and restatement of the 1993 Director Stock Option Plan, renaming it the 2003 Director Stock Option Plan (Director SOP) and extending its expiration to November 2012. A total of 770,000 shares of Common Stock have been reserved for issuance under the Director SOP. Options granted under the Director SOP prior to May 1, 2000 were for periods not to exceed five years and not to exceed a period of 10 years for grants made thereafter. Option grants under the Director SOP must be at prices equal to 100% of the fair market value of the stock at the date of grant. Options granted prior to December 2002 vested over a period of three years. Options granted beginning December 2002 vest immediately as of the date of the grant. As of April 30, 2006, a total of 210,000 options at exercise prices ranging from \$2.49 to \$7.49 per share are outstanding under the Director SOP, all of which were exercisable.

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*1998 Special Equity Incentive Plan*

In December 1998, the Company adopted an additional stock option plan entitled the 1998 Special Equity Incentive Plan ( SEIP ) for incentive stock options and non-statutory stock options for certain directors, officers and consultants of the Company. A total of 3.5 million shares of common stock have been reserved for issuance under the SEIP. Options granted under the SEIP are for periods not to exceed ten years. Options generally vest over four year periods. During fiscal 1999, options totaling 3.0 million shares were granted under the plan when the market price was \$0.125 per share and subsequently approved by the Company's shareholders when the market price was at \$0.33 per share. As a result, an aggregate of \$483,000 of compensation expense was recognized over the four-year vesting period of the options. All compensation expense was fully recognized by January 31, 2003.

A summary of activity under the 2003 Stock Incentive Plan, the 2003 Director Stock Option Plan and the 1998 Special Equity Incentive Plan is as follows (in thousands):

	<b>Options Available for Grant</b>	<b>Options Outstanding</b>	<b>Weighted Average Price Per Share</b>
Balance at April 30, 2003	1,436	5,150	\$ 2.62
Additional shares authorized	814		
Granted	(1,514 )	1,514	\$ 5.85
Canceled	90	(90 )	\$ 2.17
Expired	45	(45 )	\$ 8.34
Exercised		(811 )	\$ 1.61
Balance at April 30, 2004	871	5,718	\$ 3.58
Additional shares authorized	821		
Granted	(1,363 )	1,363	\$ 4.69
Canceled	86	(86 )	\$ 4.44
Expired	40	(40 )	\$ 4.96
Exercised		(628 )	\$ 1.35
Balance at April 30, 2005	455	6,327	\$ 4.02
Additional shares authorized	829		
Granted	(568 )	568	\$ 4.75
Canceled	327	(327 )	\$ 4.90
Expired	233	(233 )	\$ 6.66
Exercised		(673 )	\$ 1.61
Balance at April 30, 2006	1,276	5,662	\$ 4.22

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The table below summarizes information regarding stock options outstanding at April 30, 2006. The options exercisable as of April 30, 2005 and April 30, 2004 were 3,674,914 and 3,208,128, respectively.

Actual Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number Outstanding at April 30, 2006	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number Exercisable At April 30, 2006	Weighted-Average Exercise Price	
\$0.13 - 0.13	63,038	2.5	\$ 0.13	63,038	\$ 0.13	
0.25 - 0.33	128,142	2.9	0.29	128,142	0.29	
1.73 - 2.49	1,709,787	6.1	2.04	1,547,565	2.02	
2.67 - 3.85	269,378	7.0	2.75	216,022	2.74	
4.07 - 6.07	2,235,074	7.9	4.83	959,092	5.13	
6.38 - 8.22	1,256,523	6.8	7.04	901,717	7.08	
\$0.13 - 8.22	5,661,942	6.9	\$ 4.22	3,815,576	\$ 3.95	

***1996 Shareholders Rights Plan***

In December 1996, the Company implemented the Preferred Shares Rights Agreement. Under the Preferred Shares Rights Agreement, each share of the Company's outstanding common stock carries one preferred share purchase right (Right). The Right entitles the holder, subject to certain conditions, to purchase one one-thousandth of a share of Series A Participating Preferred Stock and, under certain circumstances, to instead purchase shares of common stock of the Company or its acquirer at a discounted price. The rights are redeemable by the Company and will expire in December 2006.

***2001 Common Stock Repurchase Program***

In September 2001, our board of directors authorized a program for the open market repurchase of up to 1.5 million shares of our common stock. In subsequent periods, the board of directors amended the program and authorized the purchase up to an aggregate of 3,500,000 shares. Upon reaching the maximum number of shares authorized under this program, the board of directors authorized a new stock repurchase program in September 2005. Under the new repurchase program, the Company may repurchase up to 1.0 million shares of its common stock. The purpose of these share repurchase programs are to reduce the long-term potential dilution in earnings per share that might result from issuances under our stock option plans and to take advantage of the relatively low price of our common stock. During fiscal 2006, fiscal 2005 and fiscal 2004, respectively, total shares repurchased under the Repurchase Program were 912,943, 1,901,176 and 74,000, for a cost of \$4.5 million, \$9.6 million and \$216,000.

In fiscal 2004, the Board authorized the Company to purchase 600,000 shares from Elex N.V. for \$6.77 per share for an aggregate purchase price of \$4.1 million, which represented a 13% discount from the closing market price on the Nasdaq National Market on the last trading date prior to the approval of the transaction by the Company's Board of Directors.

The Company accounts for treasury stock using the cost method.

***Other Employee Benefit Plans***

In January 2004, the Company implemented a Section 401(k) Plan. The 401(k) Plan provides participating employees with an opportunity to accumulate funds for retirement and hardship. The 401(k) Plan provides for a 25% matching contribution which vests immediately. In fiscal 2006, fiscal 2005

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

and fiscal 2004, the Company made matching contributions of \$190,000, \$192,000 and \$63,000, respectively.

**Note 8 Segment Reporting**

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

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

	Years Ended April 30,		
	2006	2005	2004
EEPROM	\$ 50,597	\$ 53,397	\$ 56,239
Flash	5,016	5,983	5,988
Analog/mixed-signal	4,604	2,940	1,311
Total net revenues	\$ 60,217	\$ 62,320	\$ 63,538

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

	Years Ended April 30,		
	2006	2005	2004
United States	\$ 7,127	\$ 7,470	\$ 7,320
Hong Kong/China	17,901	14,513	12,876
Japan	8,716	11,724	11,288
Taiwan	8,344	8,960	8,704
Europe	6,977	8,160	7,432
South Korea	5,886	6,947	6,316
Other Far East	4,807	2,531	6,068
Other Americas	459	2,015	3,534
Total net revenues	\$ 60,217	\$ 62,320	\$ 63,538

Distributors and resellers have accounted for a significant portion of the Company's net revenues in the past. For fiscal 2006, sales to Avnet, an international distributor, represented 12% of our net revenues. For fiscal 2005, none of the Company's customers represented 10% or more of the Company's net revenues. For fiscal 2004, sales to ALR Company Limited, a reseller in China, represented 11% of the Company's net revenues.



**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

	<b>Years Ended April 30,</b>	
	<b>2006</b>	<b>2005</b>
United States	\$ 12,010	\$ 7,659
Thailand	2,695	2,277
Romania	2,874	2,764
Japan	2,191	1,650
Other	94	39
	19,864	14,389
Less: accumulated depreciation and amortization	(10,456 )	(8,807 )
Total net property and equipment	\$ 9,408	\$ 5,582

**Note 9 Commitments and Contingencies**

***Purchase Commitments***

Purchase commitments for open purchase orders at April 30, 2006 and April 30, 2005 for which goods and services had not been received were approximately \$6.2 million and \$3.9 million, respectively.

***Contingencies***

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

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

***Indemnification Obligations***

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

**CATALYST SEMICONDUCTOR, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

some instances, the Company may have recourse against third parties for certain payments made by it under these agreements.

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

***Product Warranties***

The Company estimates its product warranty costs based on historical warranty claim experience and applies this estimate to the revenue stream for products under warranty. Included in the Company's sales returns reserves are estimated return exposures associated with product warranties. Estimated future costs for warranties applicable to revenues recognized in the current period are charged to the Company's cost of revenues. The warranty accrual is reviewed quarterly to verify that it properly reflects the remaining obligations based on the anticipated expenditures over the balance of the obligation period. Adjustments are made when actual claim experience differs from estimates. Warranty costs were less than \$100,000 for each of fiscal 2006, fiscal 2005 and fiscal 2004.

**Note 10 Related Party Transactions**

***Elex N.V.***

During the fourth quarter of fiscal 2000, the Company began taking delivery of wafers fabricated at X-FAB Texas, Inc. ( X-FAB ) a wholly owned subsidiary of Elex N.V. ( Elex ), a Belgian holding company. Roland Duchâtelet, the Chairman and Chief Executive Officer of Elex, serves as a member of the Company's Board of Directors. Elex initially became a related party in 1998 through the purchase of 5.5 million restricted shares of the Company's common stock. The wafers provided by X-FAB include most of the Company's analog/mixed-signal products and supplement some of the same EEPROM designs fabricated at various other foundries the Company utilizes. Other than purchase orders currently open with X-FAB, there is no purchasing agreement in place with X-FAB. During fiscal 2006, fiscal 2005 and fiscal 2004, the Company purchased \$2.5 million, \$2.4 million and \$3.7 million of wafers, respectively, from X-FAB. As of April 30, 2006 and 2005, the total amount owed X-FAB by the Company was \$143,000 and \$314,000, respectively. In the first quarter of fiscal 2005, Elex reduced its holdings from 3,578,700 shares, or 21.8% of the outstanding shares of the Company as of April 30, 2004, to 728,700 shares, or 4.4% of the outstanding shares of the Company as of April 30, 2005.

The Company believes that the terms of these transactions were no less favorable than reasonably could be expected to be obtained from unaffiliated parties.

## Schedule II Valuation and Qualifying Accounts

Year Ended April 30,	Balance at Beginning of Year (In thousands)	Additions Charged to Costs and Expenses	Deductions	Balance at End of Year
<b>2006</b>				
Allowance for doubtful accounts receivable	\$ 138	\$	\$	\$ 138
OEM sales returns allowance	\$ 107	\$ 87	\$ (84 )	\$ 110
<b>2005</b>				
Allowance for doubtful accounts receivable	\$ 138	\$	\$	\$ 138
OEM sales returns allowance	\$ 39	\$ 147	\$ (79 )	\$ 107
<b>2004</b>				
Allowance for doubtful accounts receivable	\$ 225	\$	\$ (87 )	\$ 138
Valuation allowance for deferred tax assets	\$ 8,646	\$ (8,646 )	\$	\$
OEM sales returns allowance	\$ 154	\$ 46	\$ (161 )	\$ 39

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**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
3.2(7)	Restated Certificate of Incorporation of Registrant
3.4(6)	Bylaws of Registrant
4.1(12)	Specimen Stock Certificate
4.2(3)	Preferred Shares Rights Agreement, dated as of December 3, 1996 between Catalyst Semiconductor, Inc. and FirstNational Bank of Boston
4.2.1(10)	Amendment No. 1 to Preferred Shares Rights Agreement dated as of May 22, 1998 between Registrant and BankBoston, N. A., as rights agent
4.2.2(10)	Amendment No. 2 to Preferred Shares Rights Agreement dated as of September 14, 1998 between Registrant and BankBoston, N. A., as rights agent
4.2.3(9)	Amendment No. 3 to Preferred Shares Rights Agreement dated as of September 27, 2001 between Registrant and Equiserve Trust Company N.A., as rights agent
4.2.4(10)	Amendment No. 4 to Preferred Shares Rights Agreement dated as of July 17, 2002 between Registrant and Equiserve Trust Company N.A., as rights agent
4.2.5(13)	Amendment No. 5 to Preferred Shares Rights Agreement dated as of April 22, 2004 between the Registrant and Equiserve Trust Company, as rights agent
4.2.6(14)	Amendment No. 6 to Preferred Shares Rights Agreement dated as of June 18, 2004 between the Registrant and Equiserve Trust Company, as rights agent
4.6(11)	2003 Stock Incentive Plan
4.6.1(24)	Form of Stock Option Agreement under 2003 Stock Incentive Plan.
4.7(11)	2003 Director Stock Option Plan
4.7.1(24)	Form of 2003 Director Option Plan (same as 4.6.1)
4.8(8)	1998 Special Equity Incentive Plan
10.27(1)*	Form of Indemnification Agreement entered into by Registrant with each of its directors and executive officers.
10.38(2)	Standard Industrial Lease dated March 22, 1996 between Marin County Employees Retirement Association and Registrant
10.61(4)	Standstill Agreement dated as of May 26, 1998 between the Registrant and Elex N.V.
10.61.1(5)	Amended and Restated Standstill Agreement dated as of September 14, 1998 between the Registrant and Elex N.V.
10.61.2(13)	Amendment No. 1 to Amended and Restated Standstill Agreement dated as of April 22, 2004
10.61.3(13)	Second Amended and Restated Standstill Agreement dated as of June 10, 2004
10.83(9)	Stock Purchase Agreement dated April 19, 2002 between Elex NV and Registrant
10.84(10)*	Form of Change of Control Agreement between Registrant and its non-employee directors
10.85(15)*	Employment Agreement dated May 23, 2003 between Gelu Voicu and Registrant
10.86(13)	Stock Transfer Agreement dated as of April 22, 2004 between the Registrant and Elex N.V.
10.87(17)*	Severance Agreement dated October 14, 2002 between George Smarandoiu and Registrant
10.88(16)	Sale-Purchase Promissory Agreement dated November 6, 2003 between Registrant and S.C. Hathor Impex SRL

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10.89(4)	Common Stock Purchase Agreement dated as of May 26, 1998 between Registrant and Elex N.V.
10.90(5)	Common Stock Purchase Agreement dated as of September 14, 1998 between Registrant and Elex N.V.
10.91(18)	Fiscal 2005 Bonus Plan.
10.92(19)	Severance Agreement dated August 23, 2005 between Thomas Gay and Registrant.
10.93(19)	Severance Agreement dated August 23, 2005 between Sorin Georgescu and Registrant.
10.94(19)	Severance Agreement dated August 23, 2005 between Irvin Kovalik and Registrant.
10.95(19)	Severance Agreement dated August 23, 2005 between George Smarandoiu and Registrant
10.96(20)	Fiscal 2006 Bonus Plan.
10.97(21)	Separation agreement effective as of July 29, 2005 between Barry Wiley and
10.98(22)	Offer Letter with Scott Brown dated August 18, 2005.
10.99(23)	Agreement of Sale by and between 2975 Stender Associates LLC and Catalyst Semiconductor, Inc. effective as of February 3, 2006.
10.100(25)	Lease Agreement entered into on March 6, 2006 by and between Catalyst Semiconductor International, Inc. and Stars Microelectronics.
21.1	List of Subsidiaries of Registrant
23.1	Consent of Independent Registered Public Accounting Firm
24.1	Power of Attorney (included on page 47)
31.1	Certification of Chief Executive Officer pursuant to U.S.C. Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to U.S.C. Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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- (1) Incorporated by reference to Registrant's Registration Statement on Form S-1 filed with the Securities and Exchange Commission on May 11, 1993 (File No. 33-60132), as amended.
  - (2) Incorporated by reference to Registrant's Form 10-K filed with the Securities and Exchange Commission for the year ended April 30, 1996.
  - (3) Incorporated by reference to Registrant's Form 8-A filed with the Securities and Exchange Commission on January 22, 1997.
  - (4) Incorporated by reference to Registrant's Form 10-K filed with the Securities and Exchange Commission for the year ended May 3, 1998.
  - (5) Incorporated by reference to Registrant's Form 10-Q filed with the Securities and Exchange Commission for the quarter ended August 2, 1998.
  - (6) Incorporated by reference to Registrant's Form 10-Q/A filed with the Securities and Exchange Commission for the quarter ended November 1, 1998.
  - (7) Incorporated by reference to an Appendix to Registrant's Definitive Proxy Statement filed with the Securities and Exchange Commission on December 18, 1998.
  - (8) Incorporated by reference to an Appendix to Registrant's Definitive Proxy Statement previously filed with the Securities and Exchange Commission on July 27, 2000.
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- (9) Incorporated by reference to Registrant's Form 10-Q filed with the Securities and Exchange Commission for the quarter ended October 28, 2001.
- (10) Incorporated by reference to Registrant's Form 10-K filed with the Securities and Exchange Commission for the year ended April 30, 2002.
- (11) Incorporated by reference to Registrant's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on December 24, 2002 (File No. 333-102201).
- (12) Incorporated by reference to Registrant's Registration Statement on Form 8-A/A filed with the Securities and Exchange Commission on April 29, 1993.
- (13) Incorporated by reference to Registrant's Registration Statement on Form S-3 filed with the Securities and Exchange Commission on June 14, 2004 (File No. 333-116425).
- (14) Incorporated by reference to Registrant's Registration Statement on Form S-3/A filed with the Securities and Exchange Commission on June 22, 2004 (File No. 333-116425).
- (15) Incorporated by reference to Registrant's Form 10-K filed with the Securities and Exchange Commission for the year ended April 27, 2003.
- (16) Incorporated by reference to Registrant's Form 10-Q filed with the Securities and Exchange Commission for the quarter ended February 1, 2004.
- (17) Incorporated by reference to Registrant's Form 10-K filed with the Securities and Exchange Commission for the year ended May 2, 2004.
- (18) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on August 5, 2005.
- (19) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on August 26, 2005.
- (20) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on September 7, 2005.
- (21) Incorporated by reference to Registrant's Form 10-Q filed with the Securities and Exchange Commission for the quarter ended July 31, 2005.
- (22) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on October 11, 2005.
- (23) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on February 9, 2006.
- (24) Incorporated by reference to Registrant's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on March 3, 2006 (File No. 333-132204).

(25) Incorporated by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on March 10, 2006.

Confidential treatment has been granted as to a portion of this Exhibit. Such portion has been redacted and filed separately with the Securities and Exchange Commission.

\* Constitutes a management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 14(c) of Form 10-K.

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