

MAXIM INTEGRATED PRODUCTS INC

Form 10-Q

September 30, 2008

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended December 29, 2007

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 NO. 0-16538

**MAXIM INTEGRATED PRODUCTS, INC.**

(Exact name of Registrant as specified in its charter)

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**DELAWARE**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**94-2896096**  
(I.R.S. Employer I.D. No.)

**120 SAN GABRIEL DRIVE,**

**SUNNYVALE, CALIFORNIA**  
(Address of Principal Executive Offices)

**94086**  
(Zip Code)

**Registrant's telephone number, including area code:**

**(408) 737-7600**

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

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

Large Accelerated Filer

Accelerated Filer

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

Smaller reporting company

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

**Class: Common Stock,**  
**\$0.001 par value**

**Outstanding at September 1, 2008**  
**320,553,460 shares**

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS (Unaudited)****MAXIM INTEGRATED PRODUCTS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**

|  | December 29,<br>2007 | June 30,<br>2007    |
|--|----------------------|---------------------|
|  | (in thousands)       |                     |
| <b>ASSETS</b>  |                      |                     |
| Current assets:  |                      |                     |
| Cash and cash equivalents                                      | \$ 1,007,426         | \$ 577,068          |
| Short-term investments   | 147,375              | 722,286             |
| <b>Total cash, cash equivalents and short-term investments</b> | <b>1,154,801</b>     | <b>1,299,354</b>    |
| Accounts receivable, net                                       | 286,675              | 244,998             |
| Inventories  | 255,165              | 262,713             |
| Deferred tax assets  | 233,097              | 247,953             |
| Other current assets   | 52,197               | 15,555              |
| <b>Total current assets</b>                                    | <b>1,981,935</b>     | <b>2,070,573</b>    |
| Property, plant and equipment, net                             | 1,500,819            | 1,431,273           |
| Other assets   | 155,841              | 104,938             |
| <b>TOTAL ASSETS</b>  | <b>\$ 3,638,595</b>  | <b>\$ 3,606,784</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                     |                      |                     |
| Current liabilities:   |                      |                     |
| Accounts payable   | \$ 90,288            | \$ 93,773           |
| Income taxes payable   | 4,002                | 70,302              |
| Accrued salary and related expenses                            | 227,449              | 195,494             |
| Accrued expenses   | 73,671               | 71,694              |
| Deferred income on shipments to distributors                   | 22,250               | 23,641              |
| <b>Total current liabilities</b>                               | <b>417,660</b>       | <b>454,904</b>      |
| Other liabilities  | 31,972               | 19,946              |
| Income taxes payable   | 101,945              |                     |
| <b>Total liabilities</b>                                       | <b>551,577</b>       | <b>474,850</b>      |
| Commitments and contingencies (Note 11)                        |                      |                     |
| Stockholders' equity:  |                      |                     |
| Preferred stock  |                      |                     |
| Common stock   | 321                  | 321                 |
| Additional paid-in capital                                     | 202,097              | 292,603             |
| Retained earnings  | 2,894,268            | 2,847,281           |

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|   |                     |                     |
|---|---------------------|---------------------|
| Accumulated other comprehensive loss                | (9,668)             | (8,271)             |
| Total stockholders' equity                          | 3,087,018           | 3,131,934           |
| <b>TOTAL LIABILITIES &amp; STOCKHOLDERS' EQUITY</b> | <b>\$ 3,638,595</b> | <b>\$ 3,606,784</b> |

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****MAXIM INTEGRATED PRODUCTS, INC****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**

|   | Three Months Ended                            |                      | Six Months Ended     |                      |
|---|---|----------------------|----------------------|----------------------|
|   | December 29,<br>2007                          | December 23,<br>2006 | December 29,<br>2007 | December 23,<br>2006 |
|   | (Amounts in thousands, except per share data) |                      |                      |                      |
| Net revenues  | \$ 540,025                                    | \$ 497,453           | \$ 1,064,106         | \$ 1,000,198         |
| Cost of goods sold                                    | 204,409                                       | 189,270              | 410,924              | 392,957              |
| Gross margin  | 335,616                                       | 308,183              | 653,182              | 607,241              |
| Operating expenses:                                   |   |                      |                      |                      |
| Research and development                              | 138,579                                       | 138,344              | 289,412              | 351,581              |
| Selling, general and administrative                   | 56,460  | 42,993               | 113,654              | 112,684              |
| Total operating expenses                              | 195,039                                       | 181,337              | 403,066              | 464,265              |
| Operating income                                      | 140,577                                       | 126,846              | 250,116              | 142,976              |
| Interest income and other, net                        | 21,926  | 14,767               | 39,280               | 28,156               |
| Income before provision for income taxes              | 162,503                                       | 141,613              | 289,396              | 171,132              |
| Provision for income taxes                            | 55,483  | 44,045               | 98,750               | 53,226               |
| Net income  | \$ 107,020                                    | \$ 97,568            | \$ 190,646           | \$ 117,906           |
| Earnings per share:                                   |   |                      |                      |                      |
| Basic   | \$ 0.33                                       | \$ 0.30              | \$ 0.59              | \$ 0.37              |
| Diluted   | \$ 0.33                                       | \$ 0.30              | \$ 0.58              | \$ 0.36              |
| Shares used in the calculation of earnings per share: |   |                      |                      |                      |
| Basic   | 320,553                                       | 320,553              | 320,553              | 320,317              |
| Diluted   | 326,284                                       | 329,620              | 327,913              | 328,862              |
| Dividends declared per share                          | \$ 0.19                                       | \$ 0.16              | \$ 0.38              | \$ 0.31              |

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****MAXIM INTEGRATED PRODUCTS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

|  | <b>Six Months Ended</b>      |                              |
|--|------------------------------|------------------------------|
|  | <b>December 29,<br/>2007</b> | <b>December 23,<br/>2006</b> |
|  | <b>(in thousands)</b>        |                              |
| <b>Cash flows from operating activities:</b>   |                              |                              |
| Net income   | \$ 190,646                   | \$ 117,906                   |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                              |                              |
| Stock based compensation   | 114,369                      | 252,058                      |
| Depreciation and amortization  | 64,824                       | 50,236                       |
| Gain from sale of property, plant and equipment  | (9,558)                      |                              |
| Deferred taxes   | 18,260                       | (70,115)                     |
| Tax benefit related to stock based compensation  | (3,346)                      | (3,709)                      |
| Excess tax benefit related to stock based compensation                                   | (467)                        | (8,145)                      |
| <b>Changes in assets and liabilities:</b>  |                              |                              |
| Accounts receivable  | (41,677)                     | 20,220                       |
| Inventories  | 7,397                        | (36,979)                     |
| Other current assets   | (21,147)                     | (3,340)                      |
| Accounts payable   | (5,952)                      | (21,001)                     |
| Income tax payable   | (10,018)                     | 1,085                        |
| Deferred income on shipments to distributors   | (1,391)                      | 64                           |
| Accrued liabilities goodwill payments above settlement date fair value                   | (23,753)                     |                              |
| All other accrued liabilities  | (37,468)                     | 2,837                        |
| <b>Net cash provided by operating activities</b>   | <b>240,719</b>               | <b>301,117</b>               |
| <b>Cash flows from investing activities:</b>   |                              |                              |
| Additions to property, plant and equipment   | (133,683)                    | (194,373)                    |
| Proceeds from sale of property, plant, and equipment                                     | 14,158                       |                              |
| Restricted Cash  | (14,158)                     |                              |
| Other non-current assets   | 18,030                       | (1,491)                      |
| Acquisition  | (64,123)                     |                              |
| Purchases of available-for-sale securities   | (111,010)                    | (558,656)                    |
| Proceeds from sales/maturities of available-for-sale securities                          | 687,652                      | 541,250                      |
| <b>Net cash provided by (used in) investing activities</b>                               | <b>396,866</b>               | <b>(213,270)</b>             |
| <b>Cash flows from financing activities:</b>   |                              |                              |
| Excess tax benefit related to stock based compensation                                   | 467                          | 8,145                        |
| Payments on mortgage liability   | (20)                         |                              |
| Settlement date fair value of goodwill payments  | (70,363)                     |                              |
| Cash settlement of vested restricted stock units   | (2,366)                      | (2,254)                      |
| Payouts under the RSU loan program   | (14,738)                     | (10,148)                     |
| Issuance of common stock   |                              | 25,674                       |
| Repurchase of common stock   |                              | (60,767)                     |
| Dividends paid   | (120,207)                    | (100,116)                    |
| <b>Net cash used in financing activities</b>   | <b>(207,227)</b>             | <b>(139,466)</b>             |
| <b>Net increase in and cash equivalents</b>  | <b>430,358</b>               | <b>(51,619)</b>              |
| <b>Cash and cash equivalents:</b>  |                              |                              |

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|   |              |            |
|---|--------------|------------|
| Beginning of period   | 577,068      | 422,333    |
| End of period   | \$ 1,007,426 | \$ 370,714 |
| Supplemental disclosures of cash flow information:                  |              |            |
| Income tax paid   | \$ 118,102   | \$ 125,818 |
| Noncash investing and financing activities:                         |              |            |
| Accounts payable related to property, plant and equipment purchases | \$ 24,176    | \$ 39,704  |

See accompanying Notes to Condensed Consolidated Financial Statements.



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**MAXIM INTEGRATED PRODUCTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**NOTE 1: BASIS OF PRESENTATION**

The accompanying unaudited condensed interim consolidated financial statements of Maxim Integrated Products, Inc. and all of its majority-owned subsidiaries (collectively, the Company or Maxim ) included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC ). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles of the United States of America ( GAAP ) have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for fair presentation have been included. The year-end condensed balance sheet data was derived from audited financial statements but does not include all disclosures required by GAAP. The results of operations for the three and six months ended December 29, 2007 are not necessarily indicative of the results to be expected for the entire year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Annual Report on Form 10-K for the fiscal year ended June 30, 2007.

The Company has a 52-to-53-week fiscal year that ends on the last Saturday in June. Accordingly, every sixth or seventh fiscal year will be a 53-week fiscal year. Fiscal year 2007 was a 53-week fiscal year.

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES**

The accounting policy below represents an addition to the Company s significant accounting policies as disclosed in the Company s Annual Report on Form 10-K for the year ended June 30, 2007.

*Intangible Assets and Goodwill*

The Company accounts for intangible assets, in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS 144 ), which requires impairment losses to be recorded on intangible assets used in operations when indicators of impairment, such as reductions in demand or significant economic slowdowns in the semiconductor industry, are present. Reviews are performed to determine whether the carrying value of an asset is impaired, based on comparisons to undiscounted expected future cash flows. If this comparison indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using: (i) quoted market prices or (ii) discounted expected future cash flows utilizing a discount rate consistent with the guidance provided in Financial Accounting Standards Board ( FASB ) Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements* ( Concepts Statement 7 ). Impairment is based on the excess of the carrying amount over the fair value of those assets.

Goodwill is recorded as the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the net tangible and intangible assets acquired. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS 142 ), the Company tests goodwill for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis in the fourth quarter or more frequently if the Company believes indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair values of the applicable reporting units with their aggregate carrying values, including goodwill. The Company generally determines the fair value of its reporting units using the income approach methodology of valuation that includes the discounted cash flow method as well as other generally accepted valuation methodologies. If the carrying amount of a reporting unit exceeds the reporting unit s fair value, the Company performs the second step of the goodwill impairment test to determine the amount of impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit s goodwill with the carrying value of that goodwill.

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**MAXIM INTEGRATED PRODUCTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**NOTE 3: RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* ( FIN 48 ), which prescribes comprehensive guidelines for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on tax returns. FIN 48, effective for fiscal years beginning after December 15, 2006, seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. The Company adopted the provisions of FASB Interpretation No. 48 on July 1, 2007 and applied the provisions of FIN 48 to all income tax positions. The cumulative effect of applying FIN 48 was a \$9.4 million and \$19.2 million decrease in retained earnings and additional-paid-in-capital, respectively, at the beginning of fiscal year 2008.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP and expands disclosures about fair value measurements. The statement clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The statement emphasizes that fair value is a market-based measurement and not an entity-specific measurement. It also establishes a fair value hierarchy used in fair value measurements and expands the required disclosures of assets and liabilities measured at fair value. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. In addition, in February 2008, the FASB issued FASB Staff Position ( FSP ) No. 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* ( FSP 157-1 ) and FSP No.157-2, *Effective Date of FASB Statement No. 157* ( FSP 157-2 ). FSP 157-1 amends SFAS 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. The Company is currently evaluating the impact of adopting SFAS 157 on the Company's consolidated financial condition, results of operations and liquidity.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* ( SFAS 158 ). SFAS 158 amends SFAS No. 87, *Employers' Accounting for Pensions*, SFAS No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and SFAS No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*. SFAS 158 requires employers to recognize in the statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status. It also requires employers to measure plan assets and obligations that determine the funded status as of the end of the fiscal year. Lastly, employers are required to recognize changes in the funded status of a defined benefit postretirement plan in the year that the changes occur with the changes reported in comprehensive income. SFAS 158 is required to be adopted by entities with fiscal years ending after December 15, 2006. The adoption of SFAS 158 in fiscal year 2007 did not have a material impact on the Company's consolidated financial condition, results of operations or liquidity.

In September 2006, the SEC released Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ( SAB 108 ), which addresses how uncorrected errors in previous years should be considered when quantifying errors in current year financial statements. SAB 108 requires registrants to consider the effect of all carry over and reversing effects of prior-year misstatements when quantifying errors in current year financial statements. SAB 108 does not change the SEC staff's previous guidance on evaluating the materiality of errors. It allows registrants to record the effects of adopting SAB 108 guidance as a cumulative-effect adjustment to retained earnings. This adjustment must be reported in the annual financial statements of the first fiscal year ending after November 15, 2006. The adoption of this standard did not have a material impact on the Company's consolidated financial condition, results of operations or liquidity.

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**MAXIM INTEGRATED PRODUCTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. The Company is required to adopt the provisions of SFAS 159 as of the beginning of the fiscal year that begins after November 15, 2007, although earlier adoption is permitted. The adoption of SFAS 159 is not expected to have a material impact on the Company's consolidated financial position, results of operations or liquidity.

In March 2007, the FASB ratified Emerging Issues Task Force ( EITF ) Issue No. 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements* ( EITF 06-10 ). EITF 06-10 provides guidance for determining a liability for the post-retirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007, although earlier adoption is permitted. The Company early adopted EITF 06-10 during the three months ended September 29, 2007 and recorded a cumulative effect adjustment as a net reduction to retained earnings of approximately \$14.1 million. No corporate income tax benefit was netted against the charge to retained earnings because the liabilities being accrued are not deductible for corporate income tax purposes.

In June 2007, the FASB ratified EITF Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities* ( EITF 07-3 ). EITF 07-3 requires nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities to be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the related services are performed. Entities should continue to evaluate whether they expect the goods to be delivered or services to be rendered. If an entity does not expect the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense. EITF 07-3 applies prospectively for new contractual arrangements entered into in fiscal years beginning after December 15, 2007. Earlier adoption is not permitted. The adoption of EITF 07-3 is not expected to have a material effect on the Company's consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51* ( SFAS 160 ). SFAS 160 amends Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 improves the relevance, comparability and transparency of financial statements and eliminates diversity in practice that currently exists in accounting for transactions between an entity and noncontrolling interests. This standard is effective for annual periods beginning after December 15, 2008. Earlier adoption is prohibited. The Company does not believe the adoption of SFAS 160 will have a material effect on its consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS 141(R) ) which replaces SFAS No. 141, *Business Combinations*. SFAS 141(R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This standard is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company is currently evaluating the impact of adopting SFAS 141(R) on the Company's consolidated financial position or results of operations.

In December 2007, the FASB ratified EITF Issue No. 07-1, *Accounting for Collaborative Arrangements* ( EITF 07-01 ). EITF 07-1 provides guidance on the classification, income statement presentation and disclosure associated with collaborative arrangements involving parties considered to be active participants to an activity and are exposed to significant risks and rewards which are dependent on the commercial success of the activity. EITF 07-1 is effective for fiscal years beginning after December 15, 2008. The adoption of EITF 07-01 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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**MAXIM INTEGRATED PRODUCTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of SFAS No. 133* ( SFAS 161 ) which changes the disclosure requirements for derivative instruments and hedging activities. SFAS 161 requires the Company to provide enhanced disclosures about (a) how and why the Company uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations, and (c) how derivative instruments and related hedged items affect the Company’s financial position, financial performance and cash flows. These disclosure requirements are effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact of adopting SFAS 161 on its consolidated financial position, results of operations and cash flows.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS 162 ). SFAS 162 identifies the sources of accounting consistent with GAAP. SFAS 162 is effective sixty days following the SEC’s approval of the Public Company Accounting Oversight Board’s amendments to AU Section 411 on September 16, 2008, *The Meaning of Present fairly in conformity with generally accepted accounting principles*. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 162 on its consolidated financial statements.

**NOTE 4: STOCK-BASED COMPENSATION**

The following table shows total stock-based compensation expense by type of award, and resulting tax effect, included in the Condensed Consolidated Statements of Income for the three months and six months ended December 29, 2007 and December 23, 2006:

**Table of Contents****MAXIM INTEGRATED PRODUCTS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

|   | Three Months Ended   |                      | Six Months Ended     |                      |
|---|----------------------|----------------------|----------------------|----------------------|
|   | December 29,<br>2007 | December 23,<br>2006 | December 29,<br>2007 | December 23,<br>2006 |
|   | (in thousands)       |                      |                      |                      |
| Cost of goods sold                          |                      |                      |                      |                      |
| Stock options                               | \$ 7,960             | \$ 10,620            | \$ 19,107            | \$ 41,788            |
| Employee stock purchase plan                |                      |                      |                      | 1,431                |
| Restricted stock units                      | 3,708                | 5,065                | 8,223                | 9,025                |
|   | 11,668               | 15,685               | 27,330               | 52,244               |
| Research and development expense            |                      |                      |                      |                      |
| Stock options                               | 13,678               | 21,955               | 46,142               | 121,103              |
| Employee stock purchase plan                |                      |                      |                      | 4,672                |
| Restricted stock units                      | 9,121                | 12,853               | 20,461               | 24,159               |
|   | 22,799               | 34,808               | 66,603               | 149,934              |
| Selling, general and administrative expense |                      |                      |                      |                      |
| Stock options                               | 4,638                | 8,642                | 14,935               | 42,820               |
| Employee stock purchase plan                |                      |                      |                      | 1,431                |
| Restricted stock units                      | 2,611                | 3,038                | 5,501                | 5,629                |
|   | 7,249                | 11,680               | 20,436               | 49,880               |
| Total stock-based compensation expense      |                      |                      |                      |                      |
| Stock options                               | 26,276               | 41,217               | 80,184               | 205,711              |
| Employee stock purchase plan                |                      |                      |                      | 7,534                |
| Restricted stock units                      | 15,440               | 20,956               | 34,185               | 38,813               |
| Pre-tax stock-based compensation expense    | 41,716               | 62,173               | 114,369              | 252,058              |
| Less: Income tax effect                     | 14,550               | 21,465               | 40,147               | 87,201               |
| Net stock-based compensation expense        | \$ 27,166            | \$ 40,708            | \$ 74,222            | \$ 164,857           |

Compensation cost capitalized as part of inventory as of December 29, 2007 and June 30, 2007 was \$13.0 million and \$15.0 million, respectively.

*SFAS No. 123(R) Share-Based Payment* ( SFAS 123(R) ) requires cash flows resulting from excess tax benefits to be classified as a part of cash flows from financing activities. Since the Company has adopted the alternative transition method, described in FSP SFAS 123(R)-3 *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*, 100% of the realized tax benefits generated by stock based employee awards that were fully vested and outstanding upon the adoption of SFAS 123(R) are classified as excess tax benefits. Stock-based employee awards partially vested upon, or granted after, the adoption of SFAS 123(R) generate excess tax benefits to the extent that realized tax benefits exceed the deferred tax asset and proforma deferred tax asset attributable to such awards. The Company recorded \$0.5 million and \$8.1 million of excess tax benefits as financing cash inflows for the six months ended December 29, 2007 and December 23, 2006, respectively.

*Share-Based Compensation and Other Adjustments Resulting From the Blackout Period*

On September 8, 2006, the SEC was notified that the Company would delay filing its Annual Report on Form 10-K for the fiscal year ended June 24, 2006 due September, 23, 2006 as a result of the ongoing stock option investigation into the Company's historical stock option granting

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practices. As a result of such delay, the Company has suspended the issuance of shares to employees upon exercise of stock options, vesting of restricted stock units or pursuant to planned purchases of stock under the Employee Stock Participation Plan until the Company becomes current with all of its required SEC filings and its registration statements on Form S-8 are declared effective ( Blackout Period ). The Company instituted multiple programs in an attempt to make employees whole during this period, as described below.

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**MAXIM INTEGRATED PRODUCTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

*Restricted Stock Unit ( RSU ) Loan Program*

In October 2006, the Company offered certain domestic employees an opportunity to receive cash in the form of a non-recourse loan ( RSU Loan ) for common stock that they would have otherwise been able to receive in settlement for RSUs that vested during the Blackout Period. The program was not offered to executive officers or the Board of Directors. Employees accepting the offer were also entitled to additional shares of common stock if the Company's stock price appreciates ( SAR ) between the vest date and the settlement date at the end of the Blackout Period. Employees foregoing the loan would receive shares of common stock at the conclusion of the Blackout Period. The Company also offered to cash-settle RSUs vesting during the Blackout Period held by foreign employees. These aforementioned loan offers were considered modifications of the RSUs triggering a change in the classification from equity to liability for all eligible awards vesting during the Blackout Period. In October 2006 the Company recorded a reclassification from additional paid in capital to accrued salary and related expenses of \$19.4 million on the modification date and incremental compensation expenses of \$2.2 million from the modifications. Vesting of eligible awards and changes in stock price will result in additional reclassifications from additional paid in capital to accrued salary and related expenses and additional compensation expenses in periods they occur. The Company made cash payments of \$14.7 million pursuant to the RSU loan program and \$2.4 million for settlement of RSUs held by foreign employees during the six months ended December 29, 2007 as a result of this program.

During the six months ended December 29, 2007 the Company recorded additional compensation expenses of \$25.0 million and reclassifications from additional paid-in capital to accrued salary and related expenses of \$1.7 million. The SAR given to domestic employees accepting the loan offer was valued using the Black-Scholes model at the date of grant. The Company recorded compensation expenses of \$1.1 million and \$3.1 million, respectively, from fully vested SARs issued in the three and six months ended December 29, 2007.

*Other Modifications*

*Employee Stock Participation Plan ( ESPP )*

As a result of the aforementioned suspension of the issuance of shares under the Form S-8 registration statements, the September 30, 2006 planned stock purchases under the Company's ESPP did not occur and all employee contributions made during the September 30, 2006 purchase period were refunded on or about September 28, 2006. The Company ceased withholdings as no future stock purchases can be made until the Company is current with all of its required SEC filings.

The Company had unrecognized compensation expenses of \$6.2 million as of June 24, 2006 related to its ESPP. In addition, the Company began a new offering period on July 3, 2006 for new plan participants with a fair value of \$1.3 million. The Company determined that the contribution refund results in a cancellation of all awards associated with the respective offerings without a concurrent offer to grant a replacement award, which is considered a repurchase for no consideration under SFAS 123(R). Accordingly, the Company recognized compensation expense including the acceleration of all unrecognized compensation expense totaling \$7.5 million in the six months ended December 23, 2006.

*Extension of Options that Expire after Reaching 10 Year Contractual Term and Cash Settlements of Such Expired Options*

In September 2006, the Company approved the extension of the terms of vested stock options that expire during the Blackout Period as a result of the expiration of the 10 year contractual term. The extension was considered a modification under SFAS 123(R). The incremental compensation expense of the modification was based on the fair value of the option at the modification date after the extension compared to the fair value of the options prior to modification. The Company recognized additional compensation expense totaling \$118.9 million for 8.3 million options in the three months ended September 23, 2006. The stock-based compensation expense adjustment was based on modified vested options held by employees that expired during the period from September 22, 2006 through the end of the Blackout Period.

**Table of Contents****MAXIM INTEGRATED PRODUCTS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

In September 2007 as a result of changes in NASDAQ regulations the Company decided to cash settle all options expiring during the Blackout Period ( goodwill payment ) based on the price at which 10% of the daily close prices of the Company's common stock fall above this price for trading days from August 7, 2006 (the date on which the Company initiated a trading blackout on officers and other individuals) through the expiration date of the option. The cash payment is subject to the option holder executing a release of all claims relating to the option. The goodwill payment modification changed the classification of the associated awards from equity to liability instruments. The modification resulted in a reclassification from additional paid-in capital to accrued salaries and related expenses of \$126.8 million and incremental compensation expenses of \$27.5 million. At the end of each period, the Company will recognize any change in fair value of the options in its consolidated statements of income in the period of change until the options are settled.

*Extension of Post-Termination Exercise Period*

In September 2006, the Company also decided to extend the post-termination exercise period for employees holding vested options granted under the Dallas Semiconductor stock option plans, which were assumed by the Company as part of its acquisition of Dallas Semiconductor Corporation, who were terminated after September 22, 2006 and whose stock options would expire prior to reaching the 10 year contractual term during the Blackout Period. The extension provided these employees with 90 days to exercise vested options from the end of the Blackout Period. The Company calculated the incremental compensation expense of this modification in accordance with SFAS 123(R) and recognized compensation expense in the first quarter of its fiscal year 2007 totaling \$0.8 million for 0.2 million options for the extension of the options held by these employees terminating employment during the Blackout Period.

*Fair Value*

The fair value of share-based awards granted to employees was estimated using a Black-Scholes option pricing model that used the following weighted-average assumptions:

|                                    | Stock Option Plan<br>Three Months Ended |                   | Stock Option Plan<br>Six Months Ended |                   |
|------------------------------------|---|-------------------|---------------------------------------|-------------------|
|                                    | December 29, 2007                       | December 23, 2006 | December 29, 2007                     | December 23, 2006 |
| Expected holding period (in years) | 6.3                                     | 6.3               | 6.4                                   | 6.3               |
| Risk-free interest rate            | 4.1%                                    | 4.7%              | 4.5%                                  | 4.9%              |
| Expected stock price volatility    | 45%                                     | 30%               | 38%                                   | 31%               |
| Dividend yield                     | 2.9%                                    | 2.1%              | 2.6%                                  | 2.1%              |

The fair value of each option is estimated on the date of grant using the Black-Scholes option valuation model. Expected volatilities are based on the implied volatilities from traded options on the Company's stock except for the period during the Company's black-out where the Company used historical stock prices to calculate volatilities. The Company analyzes historical exercise patterns of relatively homogeneous groups of employees to estimate the expected holding period. The risk-free interest rate is based on the U.S. Treasury yield. The Company determines dividend yield by dividing the annualized dividends per share by the quarter's average stock price. The result is analyzed by the Company to decide whether it represents expected future dividend yield. Modification of the assumption is made as necessary. As required by SFAS 123(R), the Company also estimates forfeitures at the time of grant and makes revisions if the estimates change or the actual forfeitures differ from those estimates.

The weighted-average fair value of stock options granted during the second quarter and first six months of fiscal year 2008 was \$9.37 per share and \$9.71 per share, respectively. The weighted-average fair value of stock options granted during the second quarter and first six months of fiscal year 2007 was \$9.14 per share and \$8.54 per share, respectively.



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## MAXIM INTEGRATED PRODUCTS, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

STOCK OPTION PLANSStock Options and Restricted Stock Units

The following table summarizes outstanding, exercisable and vested and expected to vest stock options as of December 29, 2007 and their activity during the period then ended:

|  | Number of<br>Shares | Weighted Average<br>Exercise Price | Weighted Average<br>Remaining<br>Contractual Term<br>(in Years) | Aggregate<br>Intrinsic<br>Value(1) |
|--|---------------------|------------------------------------|---|------------------------------------|
| <b>Balance at June 30, 2007</b>                | 87,072,099          | \$ 34.01                           |   |                                    |
| Options Granted                                | 1,175,709           | 28.70                              |   |                                    |
| Options Exercised                              |                     |                                    |   |                                    |
| Options Cancelled                              | (6,684,367)         | 18.87                              |   |                                    |
| <b>Balance at December 29, 2007</b>            | 81,563,441          | 35.17                              |   |                                    |
| Exercisable, December 29, 2007                 | 48,117,345          | 33.82                              | 3.9   | \$ 71,082,095                      |
| Vested and expected to vest, December 29, 2007 | 79,303,957          | 35.14                              | 5.0   | \$ 76,856,443                      |

(1) Aggregate intrinsic value for stock options represents the difference between exercise price and the closing price per share of the Company's common stock on December 29, 2007, multiplied by the number of stock options outstanding, exercisable, or vested and expected to vest as of December 29, 2007.

As of December 29, 2007, there was \$184.1 million of unrecognized stock compensation related to 33.4 million unvested stock options which is expected to be recognized over a weighted average period of approximately 1.9 years.

The following table summarizes outstanding and vested restricted stock units ( RSUs ) as of December 29, 2007 and their activity during the period then ended:

|                                     | Number<br>of<br>Shares | Weighted Average<br>Remaining<br>Contractual Term<br>(in Years) | Aggregate<br>Intrinsic<br>Value(1) |
|-------------------------------------|------------------------|---|------------------------------------|
| <b>Balance at June 30, 2007</b>     | 6,657,429              |   |                                    |
| Restricted stock units granted      | 1,123,366              |   |                                    |
| Restricted stock units released     |                        |   |                                    |
| Restricted stock units cancelled    | (278,240)              |   |                                    |
| <b>Balance at December 29, 2007</b> | 7,502,555              | 1.6   | \$ 195,066,430                     |
| Expected to vest, December 29, 2007 | 4,087,681              | 1.6   | \$ 106,279,682                     |

(1) Aggregate intrinsic value for RSUs represents the closing price per share of the Company's stock on December 29, 2007, multiplied by the number of RSUs outstanding or expected to vest as of December 29, 2007.

As of December 29, 2007, there was \$14.0 million of unrecognized compensation expense related to 4.4 million unvested RSUs not subject to the RSU Loan Program, which is expected to be recognized over a weighted average period of approximately 2.7 years.

**Table of Contents****MAXIM INTEGRATED PRODUCTS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)****NOTE 5: INVENTORIES**

The components of inventories consist of:

|                 | December 29,<br>2007 | June 30,<br>2007 |
|-----------------|----------------------|------------------|
|                 | (in thousands)       |                  |
| Raw materials   | \$ 19,655            | \$ 24,117        |
| Work-in-process | 180,824              | 175,746          |
| Finished goods  | 54,686               | 62,850           |
|                 | \$ 255,165           | \$ 262,713       |

Inventory write downs were \$8.2 million and \$7.6 million, and \$16.8 million and \$14.6 million for the three and six months ended December 29, 2007 and December 23, 2006, respectively.

**NOTE 6: EARNINGS PER SHARE**

Basic earnings per share are computed using the weighted average number of common shares outstanding during the period. For purposes of computing basic earnings per share, the weighted average number of outstanding common shares excludes unvested RSUs. Diluted earnings per share incorporates the incremental shares issuable upon the assumed exercise of stock options, assumed release of unvested RSUs and assumed issuance of stock under the ESPP using the treasury stock method. As discussed in Note 4, the Company will cash settle options that are expected to expire (reach the ten year contractual term) during the Blackout Period and cash settle vested RSUs. These options and RSUs are considered liability instruments under SFAS 123(R) and as such are excluded from the diluted earnings per share calculation.

The following table sets forth the computation of basic and diluted earnings per share.

|   | Three Months Ended                            |                      | Six Months Ended     |                      |
|---|---|----------------------|----------------------|----------------------|
|   | December 29,<br>2007                          | December 23,<br>2006 | December 29,<br>2007 | December 23,<br>2006 |
|   | (Amounts in thousands, except per share data) |                      |                      |                      |
| Numerator for basic earnings per share and diluted earnings per share |   |                      |                      |                      |
| Net income  | \$ 107,020                                    | \$ 97,568            | \$ 190,646           | \$ 117,906           |
| Denominator for basic earnings per share                              | 320,553                                       | 320,553              | 320,553              | 320,317              |
| Effect of dilutive securities:  |   |                      |                      |                      |
| Stock options, RSUs, and ESPP   | 5,731   | 9,067                | 7,360                | 8,545                |
| Denominator for diluted earnings per share                            | 326,284                                       | 329,620              | 327,913              | 328,862              |
| Earnings per share:   |   |                      |                      |                      |
| Basic   | \$ 0.33                                       | \$ 0.30              | \$ 0.59              | \$ 0.37              |
| Diluted   | \$ 0.33                                       | \$ 0.30              | \$ 0.58              | \$ 0.36              |

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Approximately 68.2 million and 66.3 million of the Company's stock options were excluded from the calculation of diluted earnings per share for the three months ended December 29, 2007 and December 23, 2006, respectively. Approximately 63.7 million and 67.0 million of the Company's stock options were excluded from the calculation of diluted earnings per share for the six months ended December 29, 2007 and December 23, 2006, respectively. These options were excluded because they were determined to be antidilutive. However, such options could be dilutive in the future and, under those circumstances, would be included in the calculation of diluted earnings per share.

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**MAXIM INTEGRATED PRODUCTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**NOTE 7: SHORT-TERM INVESTMENTS**

All short-term investments at December 29, 2007 are classified as available-for-sale and consist primarily of U.S. Treasury and Federal Agency debt securities with original maturities beyond three months. Unrealized gains and losses, net of tax, on securities in this category are included in accumulated other comprehensive loss which is a separate component of stockholders' equity. The cost of securities sold is based on the specific identification method. Interest earned on securities is included in Interest income and other, net in the Condensed Consolidated Statements of Income.

**NOTE 8: SEGMENT INFORMATION**

The Company operates and tracks its results as one reportable segment. The Company designs, develops, manufactures and markets a broad range of analog integrated circuits. The Chief Executive Officer has been identified as the Chief Operating Decision Maker as defined by SFAS 131, *Disclosures about Segments of an Enterprise and Related Information* ( SFAS 131 ).

The Company has fifteen operating segments which aggregate into one reportable segment under SFAS 131. Under SFAS 131, two or more operating segments may be aggregated into a single operating segment for financial reporting purposes if aggregation is consistent with the objective and basic principles of SFAS 131, if the segments have similar economic characteristics, and if the segments are similar in each of the following areas:

the nature of products and services;

the nature of the production processes;

the type or class of customer for their products and services; and

the methods used to distribute their products or provide their services.

The Company meets each of the aggregation criteria for the following reasons:

the sale of analog and mixed signal integrated circuits is the primary source of revenue for each of the Company's fifteen operating segments;

the integrated circuits sold by each of the Company's operating segments are manufactured using similar semiconductor manufacturing processes;

the integrated circuits marketed by each of the Company's operating segments are sold to the same types of customers; and

all of the Company's integrated circuits are sold through a centralized sales force and common wholesale distributors.

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All of the Company's operating segments share similar economic characteristics as they have a similar long term business model. The causes for variation among the Company's operating segments are the same and include factors such as (i) life cycle and price and cost fluctuations, (ii) number of competitors, (iii) product differentiation and (iv) size of market opportunity. Additionally, each operating segment is subject to the overall cyclical nature of the semiconductor industry. The number and composition of employees and the amounts and types of tools and materials required are similar for each operating segment. Finally, even though the Company periodically reorganizes its operating segments based upon changes in customers, end markets or products, acquisitions, long-term growth strategies, and the experience and bandwidth of the senior executives in charge, the common financial goals for each operating segment remain constant.

Enterprise-wide information is provided in accordance with SFAS 131. Geographical revenue information is based on the customers' ship-to location. Long-lived assets consist of property, plant and equipment. Property, plant and equipment information is based on the physical location of the assets at the end of each reporting period.

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Net revenues from unaffiliated customers by geographic region were as follows:

|               | Three Months Ended   |                      | Six Months Ended     |                      |
|---------------|----------------------|----------------------|----------------------|----------------------|
|               | December 29,<br>2007 | December 23,<br>2006 | December 29,<br>2007 | December 23,<br>2006 |
|               | (in thousands)       |                      |                      |                      |
| United States | \$ 103,545           | \$ 110,514           | \$ 207,379           | \$ 224,803           |
| China         | 183,808              | 143,983              | 363,008              | 277,945              |
| Japan         | 41,143               | 51,824               | 86,884               | 101,117              |
| Rest of Asia  | 111,120              | 93,670               | 205,708              | 195,759              |
| Europe        | 88,783               | 84,925               | 177,888              | 175,215              |
| Rest of World | 11,626               | 12,537               | 23,239               | 25,359               |
|               | \$ 540,025           | \$ 497,453           | \$ 1,064,106         | \$ 1,000,198         |

Net long-lived assets by geographic region were as follows:

|               | December 29,<br>2007 | Jun. 30<br>2007 |
|---------------|----------------------|-----------------|
|               | (in thousands)       |                 |
| United States | \$ 1,152,479         | \$ 1,107,743    |
| Philippines   | 203,602              | 204,354         |
| Rest of World | 144,738              | 119,176         |
|               | \$ 1,500,819         | \$ 1,431,273    |

**NOTE 9: COMPREHENSIVE INCOME**

Comprehensive income consists of net income and net unrealized gains (losses) on available-for-sale investments and forward exchange contracts, and deferred income taxes on unrealized exchange gains (losses) on intercompany receivables. The components of comprehensive income and related tax effects were as follows:

|  | Three Months Ended   |                      | Six Months Ended     |                      |
|--|----------------------|----------------------|----------------------|----------------------|
|  | December 29,<br>2007 | December 23,<br>2006 | December 29,<br>2007 | December 23,<br>2006 |
|  | (in thousands)       |                      |                      |                      |
| Net income, as reported  | \$ 107,020           | \$ 97,568            | \$ 190,646           | \$ 117,906           |
| Change in unrealized gains (losses) on investments, net of tax benefit (expense) of \$60, \$(710), \$(530) and \$(2,683), respectively   | (104)                | 1,237                | 923                  | 4,507                |
| Change in unrealized losses on forward exchange contracts, net of tax benefit (expense) of \$(142), \$(96), \$9 and \$(13), respectively | 246                  | 165                  | (16)                 | 25                   |
| Deferred tax on unrealized exchange gain (loss) on intercompany receivables  | (2,244)              | (616)                | (2,304)              | (1,778)              |

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|                            |            |           |            |            |
|----------------------------|------------|-----------|------------|------------|
| Total comprehensive income | \$ 104,918 | \$ 98,354 | \$ 189,249 | \$ 120,660 |
|----------------------------|------------|-----------|------------|------------|

Accumulated other comprehensive gain (loss) presented in the Condensed Consolidated Balance Sheets as of December 29, 2007 and June 30, 2007 consist of net unrealized gains (losses) on available-for-sale investments of \$0.6 million and \$(0.4) million, respectively, net unrealized gains (losses) on forward exchange contracts of \$0.1 million and \$0.1 million, respectively, net foreign currency translation gain (loss) adjustments of \$(1.5) million and \$(1.5) million, respectively and deferred income tax of \$(8.8) million and \$(6.5) million, respectively on unrealized exchange gains related to an intercompany receivable that is of a long-term investment nature.

### **NOTE 10: INCOME TAXES**

The effective income tax rate for the three months ended December 29, 2007 and December 23, 2006 was 34.1% and 31.1%, respectively. The effective income tax rate for the six months ended December 29, 2007 and December 23, 2006 was also 34.1% and 31.1%, respectively. The increase in the effective tax rate for three and six months



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**MAXIM INTEGRATED PRODUCTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

ended December 29, 2007 compared to the three and six months ended December 23, 2006 was primarily due to the final phase out of the extraterritorial income exclusion by the American Jobs Creation Act of 2004 and the expiration of the Federal research tax credit on December 31, 2007. The effective rates were lower than the U.S. federal and state combined statutory rate primarily due to tax benefits generated by the research and development credit and the domestic production activities deduction.

The Company's net deferred tax asset at December 29, 2007 was \$305.0 million. The Company believes it is more likely than not that the net deferred tax assets will be realized based on historical earnings and expected levels of future taxable income. Levels of future taxable income are subject to the various risks and uncertainties as described in this Report and in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007. An increase in the valuation allowance against net deferred tax assets may be necessary if it becomes more likely than not that all or a portion of the net deferred tax assets will not be realized. The Company periodically assesses the need for increases to the deferred tax asset valuation allowance.

On July 1, 2007, the Company adopted FASB Interpretation No. 48, or FIN 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. The Company has historically classified unrecognized tax benefits as income taxes payable, which was included within the current liabilities section of the Company's Condensed Consolidated Balance Sheet or as a reduction to deferred tax assets to the extent that the unrecognized tax benefits related to net operating loss or tax credit carryforwards. As a result of the adoption of FIN 48, the Company now classifies unrecognized tax benefits as a current liability to the extent that settlement is anticipated within one year, as a non-current liability to the extent that settlement is anticipated beyond one year, or as a reduction to deferred tax assets to the extent that the unrecognized tax benefit relates to deferred tax assets such as operating loss or tax credit carryforwards.

The Company evaluated and assessed its tax positions under the recognition and measurement guidelines of FIN 48. The adoption of FIN 48 resulted in an increase to the Company's contingent tax liability reserves of \$28.6 million. Of this amount, approximately \$9.4 million was accounted for as a reduction to beginning retained earnings and approximately \$19.2 million as a reduction to additional paid-in capital. The amount of unrecognized tax benefits at the beginning of fiscal year 2008 was \$123.6 million, excluding interest and penalties of \$9.8 million. Of this amount, \$61.3 million relates to unrecognized tax benefits that, if recognized, would impact the Company's effective tax rate and the remaining \$62.3 million relates to unrecognized tax benefits that, if recognized, would be credited to additional paid-in capital. The Company reports interest and penalties related to unrecognized tax benefits as a component of income tax expense, which is consistent with its methodology prior to the adoption of FIN 48. The amount of interest and penalties accrued as of the beginning of fiscal year 2008 was \$9.8 million. The amount of interest and penalties accrued during the three and six months ended December 29, 2007 was \$1.6 million and \$3.2 million respectively.

A summary of the tax years that remain subject to examination, as of December 29, 2007, for the Company's major jurisdictions are:

|                                |                |
|--------------------------------|----------------|
| United States - Federal        | 2004 - forward |
| United States - Various States | 2003 - forward |
| Japan                          | 2007 - forward |
| Philippines                    | 2005 - forward |
| Thailand                       | 2003 - forward |
| United Kingdom                 | 2007 - forward |

The Company has various state income tax returns that are currently being examined by the state taxing authorities. Management expects that these examinations will conclude within the next 12 months and that as a result unrecognized tax benefits could reasonably be expected to decline by between \$4.1 million and \$5.1 million within the next 12 months.

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**MAXIM INTEGRATED PRODUCTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**NOTE 11: COMMITMENTS AND CONTINGENCIES**

*Stock Option Litigation*

Beginning on or about May 22, 2006, several derivative actions were filed against certain current and former executive officers and directors of the Company. These derivative lawsuits were filed in: (1) the U.S. District Court for the Northern District of California, as *In re Maxim Integrated Products, Inc. Derivative Litigation*, Lead Case No. 5:06-cv-03344-JW, which consolidates *McKinney v. Beck, et al.* (Case No. 06-3344) and *Horkay v. Beck, et al.* (Case No. 06-3395), *City of Pontiac Policemen s and Firemen s Retirement System v. Hood, et al.* (Case No. 06-03754) and *Corey v. Gifford, et al.* (Case No. 06-03755); (2) the California Superior Court, Santa Clara County, as *Louisiana Sheriffs Pension & Relief Fund v. Gifford et al.* (Case No. 1-06-CV-065626); and (3) the Delaware Court of Chancery, as *Ryan v. Gifford, et al.* (Case No. Civ 2213-N). The complaints allege, among other things, that certain of Maxim s current and former executive officers and directors breached their fiduciary duties to the Company by engaging in alleged wrongful conduct of back-dating stock options as well as violating Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The Company is named solely as a nominal defendant against whom the plaintiffs seek no recovery.

The parties to the Delaware derivative litigation entered into a stipulated settlement agreement on September 16, 2008, conditioned upon approval of the Delaware Court of Chancery and subject to dismissal of all other pending derivative lawsuits. Currently, there is no trial date scheduled in any of the other actions.

On February 6, 2008, a class action lawsuit was filed in the United States District Court for the Northern District of California against Maxim and its former chief executive officer and former chief financial officer. The complaint alleges that the Company and certain of its officers and directors violated the federal securities laws by making false and misleading statements and omissions relating to the grants of stock options. The complaint seeks, on behalf of persons who purchased the Company s common stock during the period from April 29, 2003 to January 17, 2008, unspecified damages, interest and costs and expenses, including attorneys fees and disbursements. The action has been stayed pending completion of the restatement of the Company s consolidated financial statements.

*Stock Option Inquiry by Regulatory Authorities*

On June 6, 2006, the Company was contacted by the SEC regarding an informal inquiry relating to the Company s past stock options grants and practices. On December 4, 2007, the Company settled the matter with the SEC without admission of any guilt or wrongdoing and without any assessment of penalties against the Company. On June 29, 2006, the Company received a subpoena from the U.S. Attorney for the Northern District of California ( U.S. Attorney ) requesting documents relating to its stock option grants and practices. The Company cooperated with the U.S. Attorney and was informed that the U.S. Attorney s office does not intend to pursue the matter.

*Other Legal Proceedings*

In the third quarter of fiscal year 2007, the Company settled ongoing litigation involving trade secret allegations brought by Analog Devices, Inc. ( ADI ) against the Company, and certain of its employees, relating to analog to digital converters. Under the terms of the settlement agreement, the Company paid ADI \$19.0 million in fiscal 2007, which amount was accrued in the fourth quarter of fiscal year 2006. The Company also agreed that for a four year period from the date of settlement, the Company will not develop new standalone analog to digital converters having certain specified resolutions, speeds and purposes. This restriction does not include the use of analog to digital converters when embedded on the same die with a more comprehensive device, system or functionality.

In December 2005, Master Chips bvba ( Master Chips ), a former distributor of the Company s products in Belgium, filed a demand for arbitration against the Company before the International Court of Arbitration of the International Chamber of Commerce alleging that the Company failed to give adequate advance notice to Master Chips of termination of the distribution agreement under Belgian law and that the Company failed to pay Master Chips commissions on part sales (Case No. 14 123 RCH/JHN). Master Chips sought the recovery of the alleged value of their entire business at the time of termination which they claimed exceeded \$12 million and an unspecified amount for the alleged underpayment of commissions. In response to the arbitration demand, the Company asserted a claim against Master Chips alleging that the Company over-paid commissions on part sales. In July 2008, the arbitrator issued a final award awarding Master Chips approximately \$9.1 million on all claims. The

Company accrued for this award in fiscal year 2006.

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**MAXIM INTEGRATED PRODUCTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

Following the issuance of the partial arbitration award and before the issuance of the final award, in March 2008 the Company filed a petition to vacate the arbitration award in the U.S. District Court for the Northern District of California alleging that the interim award, along with the final award when so issued, should be vacated (C 08-00721 JW). In its answer, Master Chips asserted that the partial award (along with any final award) should not be vacated and filed a cross-petition to confirm the arbitration award. In August 2008, the Court denied the Company's petition to vacate the arbitration award and confirmed the arbitration award.

In addition to the above, the Company is subject to other legal proceedings and claims that arise in the normal course of business. The Company does not believe that the ultimate outcome of matters arising in the normal course of business will have a material adverse effect on the financial position of the Company.

*Potential Tax Liabilities Under Section 409A of the Internal Revenue Code and Other Tax Penalties*

As a result of the Company's investigation into its historical stock option granting practices, the Company has determined that a number of its outstanding stock option awards were granted at exercise prices below the fair market value of its stock on the appropriate accounting measurement date. A significant adverse tax consequence is that the re-measured options vesting after December 31, 2004, or options that are materially modified after October 3, 2004, are potentially subject to option holder excise tax under Section 409A of the Internal Revenue Code (and, as applicable, similar excise taxes under state law) (Section 409A). Option holders who hold options which are determined to have been granted with exercise prices below the fair market value of the underlying shares of common stock on the appropriate measurement date would be subject to taxes, penalties and interest under Section 409A if no action is taken to cure the options from exposure under Section 409A before December 31, 2008. The Company took action in fiscal year 2008 to cure certain options from exposure under Section 409A. There can be no assurance that Maxim's action cured all potential circumstances in which Section 409A would apply. Should it be found that excise taxes under Section 409A apply to option holders subsequent to the Company's ability to cure the options from exposure to Section 409A, and the Company decides to reimburse option holders for such taxes, the Company's results of operations may be materially adversely affected.

Also as a result of the Company investigation into equity awards, the Company has determined that certain payroll taxes, interest and penalties apply under various sections of the Internal Revenue Code, various state tax statutes, and tax statutes in various foreign jurisdictions. Maxim has reviewed these potential liabilities and accrued estimated probable amount of the liability. There can be no assurance that Maxim's accruals covered all potential circumstances in which additional payroll taxes, interest and penalties would apply. Should it be found that additional payroll taxes, interest and penalties would apply, the Company's results of operations may be materially adversely affected.

*Indemnifications*

The Company indemnifies certain customers, distributors, suppliers, and subcontractors for attorney fees and damages and costs awarded against these parties in certain circumstances in which the Company's products are alleged to infringe third party intellectual property rights, including patents, registered trademarks, or copyrights. The terms of the Company's indemnification obligations are generally perpetual from the effective date of the agreement. In certain cases, there are limits on and exceptions to the Company's potential liability for indemnification relating to intellectual property infringement claims.

*Legal Fees Associated with Indemnification Obligations, Defense and Other Related Costs*

Pursuant to the Company's charter documents and indemnification agreements, the Company has certain indemnification obligations to its officers, directors, and certain former officers and directors. Pursuant to such obligations, the Company has incurred expenses related to legal fees and expenses advanced to certain former officers of the Company who are subject to pending civil charges by the SEC and other governmental agencies in connection with Maxim's historical stock option granting practices. The Company expenses such amounts as incurred.

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**MAXIM INTEGRATED PRODUCTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**NOTE 12: SELF-INSURANCE ACCRUALS**

The Company is self-insured with respect to defective product claims, employment practice claims and general liability. Accruals are primarily based on the actuarially estimated, undiscounted cost of claims, which includes incurred-but-not-reported claims. Amounts accrued for defective product claims, employment practice claims, workers' compensation claims and general liability in the amount of \$14.3 million and \$14.5 million, are included in accrued expenses in the Condensed Consolidated Balance Sheets as of December 29, 2007 and June 30, 2007, respectively.

In addition to the above, the Company is primarily self-insured with respect to healthcare benefits for most of its domestic employees. Accruals are primarily based on estimated incurred-but-not-reported claims. Amounts accrued for employee healthcare claims included in accrued salary and salary related expenses in the Condensed Consolidated Balance Sheets were immaterial as of December 29, 2007 and June 30, 2007, respectively.

**NOTE 13: COMMON STOCK REPURCHASES**

From fiscal years 2002 through 2006, the Board of Directors authorized the Company to repurchase up to 53.5 million shares of the Company's common stock from time to time at the discretion of the Company's management. As of December 29, 2007, approximately 5.7 million shares remained available for repurchase under the repurchase authorization approved by the Board of Directors, which has no expiration date.

The Company repurchased 2.1 million shares of its common stock for \$60.8 million during the first quarter of fiscal year 2007. Common stock repurchased is retired and is not held as treasury stock.

In connection with the stock options investigation, the Company suspended repurchases of stock under this program as of September 23, 2006.

**NOTE 14: BENEFITS**

The Company and the former Chief Executive Officer ( CEO ) entered into a deferred compensation plan, pursuant to which the CEO deferred receipt of a portion of his cash compensation. Deferred compensation bears interest and was payable to the CEO over a stipulated period. On December 31, 2006, John F. Gifford retired from his positions as Company President, Chief Executive Officer, and Chairman of the Board of Directors. On January 5, 2007, the Company and Mr. Gifford entered into a Binding Memorandum of Understanding ( MOU ) which superseded the employment agreement and amended the deferred compensation plan previously entered into between the Company and Mr. Gifford. He remained with the Company on a part-time basis as a strategic advisor until January 26, 2007. In connection with the MOU, the Company recorded a \$3.1 million post retirement obligation for Mr. Gifford. In addition, in January 2007 and May 2008, the Company paid Mr. Gifford \$22.4 million and \$7.1 million, respectively, representing the vested balance of his deferred compensation account. As of December 29, 2007 and June 30, 2007, the deferred compensation balances, including interest thereon, totaled \$7.0 million and \$6.9 million, respectively, which is included in accrued salary and related expenses in the Condensed Consolidated Balance Sheets.

The Company's former CEO resigned in fiscal year 2007. As part of his resignation, he was provided with certain retirement benefits which included office space, administrative assistance, and health benefits. In accordance with SFAS No. 112, *Employers' Accounting for Postemployment Benefit*, the Company recorded a charge for the net present value of these benefits of \$3.1 million in fiscal year 2007. Accrued in other liabilities in the Consolidated Balance Sheet at December 29, 2007 and June 30, 2007 was \$2.9 million and \$3.0 million for such benefits.

As a result of the Company's historical acquisition of Dallas Semiconductor, the Company assumed responsibility associated with certain split-dollar life insurance policies held by certain former Dallas Semiconductor officers and directors. The policies are owned by the individuals with the Company maintaining a limited collateral assignment on each policy. As a result of the adoption of EITF 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements*, during the first quarter of 2008, the Company recognized a \$14.1 million cumulative effect



**Table of Contents****MAXIM INTEGRATED PRODUCTS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

adjustment to retained earnings. The Company had \$6.5 million included in other assets as of December 29, 2007 associated with the limited collateral assignment to the policies. The Company had a \$13.4 million obligation included in other liabilities as of December 29, 2007 related to the anticipated continued funding associated with these policies.

**NOTE 15: OTHER ASSETS**

The components of other assets consist of:

|  | December 29, 2007 | June 30, 2007 |
|--|-------------------|---------------|
|  | (in thousands)    |               |
| Deferred tax assets                        | \$ 71,948         | \$ 61,027     |
| Intangible assets                          | 62,386            | 4,934         |
| Deposits for property, plant and equipment | 1,123             | 17,709        |
| Other                                      | 20,384            | 21,268        |
|  | \$ 155,841        | \$ 104,938    |

**NOTE 16: ACQUISITIONS**

On October 29, 2007 the Company acquired the Storage Products Division of Vitesse Semiconductor. The total cash consideration associated with the acquisition was \$64.1 million consisting of \$62.8 million in cash, \$0.8 million in direct legal costs associated with the acquisition, \$0.5 million related to the buyout of an existing arrangement between Vitesse and a vendor. The Company also assumed \$2.0 million of liabilities. The Company will pay additional cash consideration of up to \$12.0 million based on product shipments of the acquired business. The contingent consideration will be payable on a quarterly basis and such amounts will be recorded as goodwill. The Company allocated the acquisition cost to assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The acquired assets included \$4.9 million in tangible assets, \$0.9 million in customer order backlog, \$28.4 million in intellectual property, \$22.2 million in customer relationships and \$9.6 million in goodwill.

The unaudited condensed consolidated financial statements for the six months ended December 29, 2007 include the operations of Vitesse's Storage Products Division commencing as of the acquisition date. No supplemental pro forma information is presented for the acquisition due to the immaterial effect of the acquisition on the Company's results of operations.

**NOTE 17: GOODWILL AND INTANGIBLE ASSETS**

The Company classifies goodwill and acquired intangible assets within other assets in the Condensed Consolidated Balance Sheets.

The Company's carrying value of goodwill as of December 29, 2007 is \$9.6 million which relates to the acquisition. In connection with the Company's acquisition of the Storage products division of Vitesse Semiconductor the Company obtained \$28.4 million in intellectual property, \$22.2 million in customer relationships, \$0.9 million in customer order backlog, and \$9.6 million in goodwill. The useful lives of the significant definite lived intangible assets are as follows:

| Asset                  | Life     |
|------------------------|----------|
| Intellectual Property  | 5 years  |
| Customer Relationships | 10 years |

Intangible assets consisted of the following:

|                                | December 29, 2007 |   |                  |
|--------------------------------|-------------------|---|------------------|
|                                | Original<br>Cost  | Accumulated<br>Amortization<br>(in thousands) | Net              |
| Intellectual property          | \$ 28,430         | \$ 948  | \$ 27,482        |
| Customer relationships         | 22,230            | 371   | 21,859           |
| <b>Total intangible assets</b> | <b>\$ 50,660</b>  | <b>\$ 1,319</b>                               | <b>\$ 49,341</b> |



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Amortization expense of \$0.9 million associated with intellectual property was recorded in cost of goods sold during the second quarter of fiscal year 2008 while amortization expense of \$0.4 million associated with customer relationships was recorded in Selling, general and administrative expenses in the second quarter of fiscal year 2008.

The following table presents the amortization of intangible assets:

|                                | Three Months Ended   |                      | Nine Months Ended    |                      |
|--------------------------------|----------------------|----------------------|----------------------|----------------------|
|                                | December 29,<br>2007 | December 23,<br>2006 | December 29,<br>2007 | December 23,<br>2006 |
|                                | (in thousands)       |                      | (in thousands)       |                      |
| Intellectual property          | \$ 948               | \$                   | \$ 948               | \$                   |
| Customer relationships         | 371                  |                      | 371                  |                      |
| Total accumulated amortization | \$ 1,319             | \$                   | \$ 1,319             | \$                   |

The following table represents the estimated future amortization expense of intangible assets as of December 29, 2007:

| Fiscal Year               | Amount<br>(in thousands) |
|---------------------------|--------------------------|
| 2008 (remaining 6 months) | \$ 3,955                 |
| 2009                      | 7,909                    |
| 2010                      | 7,909                    |
| 2011                      | 7,909                    |
| 2012                      | 7,909                    |
| 2013                      | 4,118                    |
| Thereafter                | 9,632                    |
| Total intangible assets   | \$ 49,341                |

**NOTE 18: SUBSEQUENT EVENTS**

In January 2008, the Company announced the wind down and eventual closure of its wafer manufacturing facility in Dallas over an 18-month time period and the restructuring of certain businesses including the cancellation of research and development for the handset radio frequency transceiver product line. Estimated restructuring costs associated with these actions of \$6.2 million will be incurred over the 18 month time period for severance and benefits for the employees to be terminated. In connection with the closure of the Dallas facility, the Company also reevaluated the useful lives and salvage values of the fixed assets used in the facility based on the new period of intended use. As a result, the Company changed its depreciable lives and salvage values resulting in the recognition of additional depreciation of \$22.6 million in fiscal year 2008.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The Company disclaims any duty to and undertakes no obligation to update any forward-looking statement, whether as a result of new information relating to existing conditions, future events or otherwise or to release publicly the results of any future revisions it may make to forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events except as required by federal securities laws. Readers are cautioned not to place undue reliance on such statements, which speak only as of the date of this Quarterly Report on Form 10-Q. Readers should carefully review future reports and documents that the Company files from time to time with the SEC, such as its annual reports on Form 10-K (particularly Management's Discussion and Analysis of Financial Condition and Results of Operations), its quarterly reports on 10-Q (particularly Management's Discussion and Analysis of Financial Condition and Results of Operations), and any current reports on Form 8-K.

**Overview**

Maxim Integrated Products, Inc. (Maxim or the Company and also referred to as we, our or us) designs, develops, manufactures, and markets a broad range of linear and mixed-signal integrated circuits, commonly referred to as analog circuits, for a large number of geographically diverse customers and is incorporated in the state of Delaware. The Company also provides a range of high-frequency process technologies and capabilities that can be used in custom designs. The analog market is fragmented and characterized by many diverse applications, a great number of product variations and, with respect to many circuit types, relatively long product life cycles. The Company is a global company with manufacturing facilities in the United States, testing facilities in the Philippines and Thailand, and sales and circuit design offices throughout the world. The major end-markets the Company's products are sold in are the communications, computing, consumer and industrial markets.

**CRITICAL ACCOUNTING POLICIES**

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our financial statements. The SEC has defined the most critical accounting policies as the ones that are most important to the portrayal of our financial condition and results of operations, and that require us to make our most difficult and subjective accounting judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, our most critical accounting policies include revenue recognition and accounts receivable allowances, which impact the recording of revenues, valuation of inventories, which impacts costs of goods sold and gross margins, the assessment of recoverability of long-lived assets, which impacts write-offs of fixed assets, accounting for stock-based compensation, which impacts cost of goods sold, gross margins and operating expenses, accounting for income taxes, which impacts the income tax provision, and assessment of contingencies, which impacts charges recorded in cost of goods sold and selling, general and administrative expenses. We have other significant accounting policies that either do not generally require estimates and judgments that are as difficult or subjective, or it is less likely that such accounting policies would have a material impact on our reported results of operations for a given period. The accounting policy below represents an addition to the Company's significant accounting policies as disclosed in our Annual Report on Form 10-K for the year ended June 30, 2007.

*Intangible Assets and Goodwill*

We account for intangible assets, in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Asset* (SFAS 144), which requires impairment losses to be recorded on intangible assets used in operations when indicators of impairment, such as reductions in demand or significant economic slowdowns in the semiconductor industry, are present. Reviews are performed to determine whether the carrying value of an asset is impaired, based on comparisons to undiscounted expected future cash flows. If this comparison indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using: (i) quoted market prices or (ii) discounted expected future cash flows utilizing a discount rate consistent with the guidance provided in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements* Concepts Statement 7. Impairment is based on the excess of the carrying amount over the fair value of those assets.

Goodwill is recorded as the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the net tangible and intangible assets acquired. In accordance with SFAS No. 142, *Goodwill and Other*

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*Intangible Asset* ( SFAS 142 ), we test goodwill for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis in the fourth quarter or more frequently if we believe indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair values of the applicable reporting units with their aggregate carrying values, including goodwill. We generally determine the fair value of our reporting units using the income approach methodology of valuation that includes the discounted cash flow method as well as other generally accepted valuation methodologies. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, we perform the second step of the goodwill impairment test to determine the amount of impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit's goodwill with the carrying value of that goodwill.

**RESULTS OF OPERATIONS**

**Net Revenues**

Net revenues were \$540.0 million and \$497.5 million for the three months ended December 29, 2007 and December 23, 2006, respectively, an increase of 8.5%. Net revenues for the six months ended December 29, 2007 and December 23, 2006, were \$1,064.1 million and \$1,000.2 million, respectively, an increase of 6.4%. The increase in net revenues for the three and six months ended December 29, 2007 as compared to the three and six months ended December 23, 2006 was primarily due to increased unit shipments of approximately 11% and 11%, respectively. The increase in unit shipments was offset somewhat by a change in product mix related to increased sales of products with lower average selling prices.

During the three months ended December 29, 2007 and December 23, 2006, approximately 81% and 78%, respectively, of net revenues were derived from customers outside of the United States. During the six months ended December 29, 2007 and December 23, 2006, approximately 81% and 78%, respectively, of net revenues were derived from customers outside of the United States. While the majority of these sales are denominated in U.S. dollars, we enter into foreign currency forward contracts to mitigate our risks on firm commitments and net monetary assets denominated in foreign currencies. The impact of changes in foreign exchange rates on revenue and our results of operations for the three and six months ended December 29, 2007 and December 23, 2006 was immaterial.

**Gross Margin**

Our gross margin as a percentage of net revenues was 62.1% and 62.0% for the three months ended December 29, 2007 and December 23, 2006, respectively. The gross margin percentage increased primarily due to a \$4.0 million decrease in stock-based compensation during the three months ended December 29, 2007 as compared to the three months ended December 23, 2006. Inventory write downs increased by \$0.6 million during the three months ended December 29, 2007 as compared to the three months ended December 23, 2006. Inventory write downs were \$8.2 million for the three months ended December 29, 2007 as compared to \$7.6 million for the three months ended December 23, 2006, respectively. In addition to the above, gross margin was negatively impacted due to product mix changes combined with decreased average unit selling prices which contributed to an unfavorable impact on gross margin percentage for the for the three months ended December 29, 2007 as compared to the three months ended December 23, 2006.

Our gross margin percentage was 61.4% and 60.7% for the six months ended December 29, 2007 and December 23, 2006, respectively. The increase in the gross margin percentage for the six months ended December 29, 2007 as compared to the six months ended December 23, 2006, is due to a \$24.9 million decrease in stock-based compensation. This decrease was primarily due to the extension of the terms of vested stock options that expire during the Blackout Period as a result of the expiration of the 10 year contractual term and the resulting modification charge. The above was offset by a \$2.2 million increase in inventory write downs for inventory in excess of demand during the six months ended December 29, 2007 as compared to the six months ended December 23, 2006. Inventory write downs were \$16.8 million and \$14.6 million for the six months ended December 29, 2007 and December 23, 2006, respectively. In addition, product mix combined with decreased average unit selling prices contributed to an unfavorable impact on gross margin percentage for the for the three months ended December 29, 2007 as compared to the three months ended December 23, 2006.

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**Research and Development**

Research and development expenses were \$138.6 million and \$138.3 million for the three months ended December 29, 2007 and December 23, 2006, respectively, which represented 25.7% and 27.8% of net revenues, respectively. Although research and development expenses in absolute dollars was flat quarter over quarter, stock-based compensation decreased by \$12.0 million. This decrease was offset by \$9.4 million increase in salary and related expenses primarily from salary increases and hiring additional engineers to support our research and development and process development efforts for the three months December 29, 2007 as compared to the three months ended December 23, 2006.

Research and development expenses were \$289.4 million and \$351.6 million for the six months ended December 29, 2007 and December 23, 2006, respectively, which represented 27.2% and 35.2% of net revenues, respectively. The decrease in research and development expenses was primarily due to decreased stock-based compensation. Stock-based compensation decreased by \$83.3 million primarily due to the extension of the terms of vested stock options that expire during the Blackout Period as a result of the expiration of the 10 year contractual term and the resulting modification charge. The above decrease was offset by a \$22.5 million increase in salary and related expenses primarily from salary increases and hiring additional engineers to support our research and development and process development efforts for the six months December 29, 2007 as compared to the six months ended December 23, 2006.

The level of research and development expenditures as a percentage of net revenues will vary from period to period, depending, in part, on the level of net revenues and, in part, on our success in recruiting the technical personnel needed for our new product introductions and process development, and on the level of stock-based compensation expense. We view research and development expenditures as critical to maintaining a high level of new product introductions, which in turn are critical to our plans for future growth.

**Selling, General and Administrative**

Selling, general and administrative expenses were \$56.5 million and \$43.0 million for the three months ended December 29, 2007 and December 23, 2006, respectively, which represented 10.5% and 8.6% of net revenues, respectively. The increase in selling, general, and administrative expenses for the three months ended December 29, 2007 as compared to the three months ended December 23, 2006 was primarily due to an increase of \$6.0 million in legal expenses and an increase of \$7.0 million in accounting fees associated with our stock option investigation, subsequent restatement of our previously filed financial statements, private litigation and other associated activities. In addition, salary and related expenses increased by \$1.9 million due to increased headcount for the three months ended December 29, 2007 as compared to the three months ended December 24, 2006. The above increases were offset by a decrease of \$4.4 million in stock-based compensation during the three months ended December 29, 2007 as compared to the three months ended December 23, 2006.

Selling, general and administrative expenses were \$113.7 million and \$112.7 million for the six months ended December 29, 2007 and December 23, 2006, respectively, which represented 10.7% and 11.3% of net revenues, respectively. The decrease in selling, general, and administrative expenses for the six months ended December 29, 2007 as compared to the six months ended December 23, 2006 was primarily due to the decrease of stock-based compensation. Stock based compensation decreased by \$29.4 million primarily due to the extension of the terms of vested stock options that expire during the Blackout Period as a result of the expiration of the 10 year contractual term and the resulting modification charge. The above decrease was offset by an increase of \$11.4 million in legal expenses and an increase of \$10.9 million in accounting fees associated with our stock option investigation, subsequent restatement of our previously filed financial statements, private litigation and other associated activities. In addition, salary and related expenses increased by \$4.7 million due to salary increases and hiring headcount during the six months ended December 29, 2007 as compared to the six months ended December 24, 2006.

The level of selling, general and administrative expenditures as a percentage of net revenues will vary from period to period, depending on the level of net revenues, our success in recruiting sales and administrative personnel needed to support our operations, and the level of stock-based compensation expense. We expect a significant increase in selling, general and administrative expenditures in fiscal years 2007 and 2008 for expenses associated with our restatement, related private litigation and other associated activities, particularly, for accounting, legal and other professional service fees.

**Table of Contents****Stock-based Compensation**

The following table shows total stock-based compensation expense by type of award, and resulting tax effect, included in the Condensed Consolidated Statements of Income for the three months and six months ended December 29, 2007 and December 23, 2006:

|   | Three Months Ended   |                      | Six Months Ended     |                      |
|---|----------------------|----------------------|----------------------|----------------------|
|   | December 29,<br>2007 | December 23,<br>2006 | December 29,<br>2007 | December 23,<br>2006 |
|   | (in thousands)       |                      |                      |                      |
| Cost of goods sold                          |                      |                      |                      |                      |
| Stock options                               | \$ 7,960             | \$ 10,620            | \$ 19,107            | \$ 41,788            |
| Employee stock purchase plan                |                      |                      |                      | 1,431                |
| Restricted stock units                      | 3,708                | 5,065                | 8,223                | 9,025                |
|   | 11,668               | 15,685               | 27,330               | 52,244               |
| Research and development expense            |                      |                      |                      |                      |
| Stock options                               | 13,678               | 21,955               | 46,142               | 121,103              |
| Employee stock purchase plan                |                      |                      |                      | 4,672                |
| Restricted stock units                      | 9,121                | 12,853               | 20,461               | 24,159               |
|   | 22,799               | 34,808               | 66,603               | 149,934              |
| Selling, general and administrative expense |                      |                      |                      |                      |
| Stock options                               | 4,638                | 8,642                | 14,935               | 42,820               |
| Employee stock purchase plan                |                      |                      |                      | 1,431                |
| Restricted stock units                      | 2,611                | 3,038                | 5,501                | 5,629                |
|   | 7,249                | 11,680               | 20,436               | 49,880               |
| Total stock-based compensation expense      |                      |                      |                      |                      |
| Stock options                               | 26,276               | 41,217               | 80,184               | 205,711              |
| Employee stock purchase plan                |                      |                      |                      | 7,534                |
| Restricted stock units                      | 15,440               | 20,956               | 34,185               | 38,813               |
| Pre-tax stock-based compensation expense    | 41,716               | 62,173               | 114,369              | 252,058              |
| Less: Income tax effect                     | 14,550               | 21,465               | 40,147               | 87,201               |
| Net stock-based compensation expense        | \$ 27,166            | \$ 40,708            | \$ 74,222            | \$ 164,857           |

**Interest Income and Other, Net**

Interest income and other, net was \$21.9 million and \$14.8 million for the three months ended December 29, 2007 and December 23, 2006, respectively. This increase was primarily due to a \$9.6 million gain on sale of certain fixed assets. This increase was offset slightly by decreased interest income due to lower average interest rates combined with lower invested cash, cash equivalents, and short-term investments balances.

Interest income and other, net was \$39.3 million and \$28.2 million for six months ended December 23, 2006, respectively. This increase was primarily due to a \$9.6 million gain on sale of certain fixed assets and increased interest income resulting from higher average interest rates offset slightly by lower average invested cash, cash equivalents, and short-term investments balances.

**Provision for Income Taxes**

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The effective income tax rate for the three and six months ended December 29, 2007 and December 23, 2006 was 34.1% and 31.1%, respectively. The increase in the effective tax rate for three and six months ended December 29, 2007 compared to three and six months ended December 23, 2006 was primarily due to the final phase out of the extraterritorial income exclusion by the American Jobs Creation Act of 2004 and the expiration of the Federal research tax credit on December 31, 2007. The effective rates were lower than the U.S. federal and state combined statutory rate primarily due to tax benefits generated by the research and development credit and the domestic production activities deduction.

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The Company's net deferred tax asset at December 29, 2007 was \$305.0 million. The Company believes it is more likely than not that the net deferred tax assets will be realized based on historical earnings and expected levels of future taxable income. Levels of future taxable income are subject to the various risks and uncertainties as described in this report. An increase in the valuation allowance against net deferred tax ass