ANALOG DEVICES INC
Form 10-Q
August 15, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 10-Q

(Mark One)

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

For the quarterly period ended July 29, 2006

OR

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

For the transition period from _______________ to ________________

Commission File No. 1-7819

Analog Devices, Inc.

(Exact name of registrant as specified in its charter)

Massachusetts	**04-2348234**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
One Technology Way, Norwood, MA	**02062-9106**
(Address of principal executive offices)	*(Zip Code)*

(781) 329-4700

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 þ NO o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) YES o NO þ

As of July 29, 2006 there were 352,850,890 shares of Common Stock, $0.16 2/3 par value per share, outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ANALOG DEVICES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(thousands, except per share amounts)

	Three Months Ended	
	July 29, 2006	July 30, 2005
Net sales	$ 663,660	$ 582,416
Cost of sales (1)	273,550	244,178
Gross margin	390,110	338,238
Operating expenses:		
Research and development (1)	136,061	119,217
Selling, marketing, general and administrative (1)	99,663	84,407
Purchased in-process research and development	5,500	
	241,224	203,624
Operating income	148,886	134,614
Nonoperating (income) expense:		
Interest expense	4	
Interest income	(26,716)	(19,156)
Other, net	435	94
	(26,277)	(19,062)
Income before income taxes	175,163	153,676
Provision for income taxes	30,478	32,272
Net income	$ 144,685	$ 121,404
Shares used to compute earnings per share basic	357,887	370,985
Shares used to compute earnings per share diluted	369,542	382,830
Earnings per share basic	$ 0.40	$ 0.33

Earnings per share diluted	$	0.39	$	0.32
Dividends declared and paid per share	$	0.16	$	0.10

(1) Includes stock-based compensation expense as follows:				
Cost of sales	$	2,949	$	
Research and development		8,302		1,303
Selling, marketing, general and administrative		8,055		
Total stock-based compensation expense	$	19,306	$	1,303

See accompanying notes.

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ANALOG DEVICES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(thousands, except per share amounts)

	Nine Months Ended	
	July 29, 2006	July 30, 2005
Net sales	$ 1,928,834	$ 1,766,678
Cost of sales (1)	797,266	746,513
Gross margin	1,131,568	1,020,165
Operating expenses:		
Research and development (1)	399,197	373,393
Selling, marketing, general and administrative (1)	293,376	253,561
Purchased in-process research and development	5,500	
Special charges	1,013	
	699,086	626,954
Operating income	432,482	393,211
Nonoperating (income) expense:		
Interest expense	35	22
Interest income	(75,868)	(50,403)
Other, net	(10,261)	568
	(86,094)	(49,813)
Income before income taxes	518,576	443,024
Provision for income taxes	107,513	96,578
Net income	$ 411,063	$ 346,446
Shares used to compute earnings per share basic	362,749	372,407
Shares used to compute earnings per share diluted	375,563	384,425
Earnings per share basic	$ 1.13	$ 0.93

Earnings per share diluted	$ 1.09	$ 0.90
Dividends declared and paid per share	$ 0.40	$ 0.22

(1)Includes stock-based compensation expense as follows:

Cost of sales	$ 4,893	$
Research and development	27,108	3,887
Selling, marketing, general and administrative	25,829	
Total stock-based compensation expense	$ 57,830	$ 3,887

See accompanying notes.

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ANALOG DEVICES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(thousands)

Assets	July 29, 2006	October 29, 2005
Cash and cash equivalents	$ 523,125	$ 627,591
Short-term investments	1,992,936	2,078,351
Accounts receivable, net	359,774	320,523
Inventories (1):		
Raw materials	16,119	12,414
Work in process	264,838	240,064
Finished goods	96,477	73,127
	377,434	325,605
Deferred tax assets	83,977	86,430
Deferred compensation plan investments	1,063	234,376
Prepaid expenses and other current assets	94,619	59,580
Total current assets	3,432,928	3,732,456
Property, plant and equipment, at cost:		
Land and buildings	350,527	345,103
Machinery and equipment	1,380,944	1,323,397
Office equipment	78,570	83,969
Leasehold improvements	108,622	108,345
	1,918,663	1,860,814
Less accumulated depreciation and amortization	1,360,609	1,260,908
Net property, plant and equipment	558,054	599,906
Deferred compensation plan investments	29,203	42,941
Other investments	1,114	2,424
Goodwill	165,435	163,373
Intangible assets, net	15,498	4,203
Deferred tax assets	69,234	13,328
Other assets	20,781	24,580
Total other assets	301,265	250,849
	$ 4,292,247	$ 4,583,211

(1) Includes $4,066 related to stock-based compensation expense at July 29, 2006.
See accompanying notes.

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ANALOG DEVICES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(thousands, except share amounts)

Liabilities and Shareholders Equity	July 29, 2006	October 29, 2005
Accounts payable	$ 166,313	$ 128,317
Deferred income on shipments to distributors	165,850	121,802
Income taxes payable	99,509	172,277
Deferred compensation plan liability	1,063	234,376
Accrued liabilities	152,429	162,151
Total current liabilities	585,164	818,923
Deferred income taxes	3,659	1,735
Deferred compensation plan liability	29,270	44,657
Other non-current liabilities	26,720	26,395
Total non-current liabilities	59,649	72,787
Commitments and Contingencies		
Shareholders Equity		
Preferred stock, $1.00 par value, 471,934 shares authorized, none outstanding		
Common stock, $0.16 2/3 par value, 1,200,000,000 shares authorized, 352,850,890 shares issued and outstanding (366,831,612 on October 29, 2005)	58,810	61,139
Capital in excess of par value	60,244	380,206
Retained earnings	3,534,675	3,269,420
Accumulated other comprehensive loss	(6,295)	(19,264)
Total shareholders equity	3,647,434	3,691,501
	$ 4,292,247	$ 4,583,211

See accompanying notes.

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ANALOG DEVICES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(thousands)

	Nine Months Ended	
	July 29, 2006	July 30, 2005
Cash flows from operating activities:		
Net income	$ 411,063	$ 346,446
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	127,947	115,127
Amortization of intangibles	1,953	2,041
Stock-based compensation expense	57,830	3,887
Deferred income taxes	(32,386)	8,937
Non-cash tax benefit SFAS 123R	(155,956)	
Non-cash portion of special charge	459	
Gain on sale of product line	(13,027)	
Purchased in-process research and development	5,500	
Other non-cash expense	664	924
Changes in operating assets and liabilities	50,320	(4,977)
Total adjustments	43,304	125,939
Net cash provided by operating activities	454,367	472,385
Cash flows from investing activities:		
Purchases of short-term available-for-sale investments	(2,065,104)	(2,581,828)
Maturities of short-term available-for-sale investments	2,158,075	2,195,129
Additions to property, plant and equipment	(87,542)	(64,428)
Decrease in other assets	4,125	1,668
Payments for acquisition	(14,913)	
Proceeds from sale of product line	23,070	
Net cash provided by (used for) investing activities	17,711	(449,459)
Cash flows from financing activities:		
Repurchase of common stock	(667,970)	(284,697)
Net proceeds from employee stock plans	79,852	72,398
Non-cash tax benefit SFAS 123R	155,956	
Dividend payments to shareholders	(145,809)	(81,870)
Net cash used for financing activities	(577,971)	(294,169)
Effect of exchange rate changes on cash	1,427	356
Net decrease in cash and cash equivalents	(104,466)	(270,887)

Cash and cash equivalents at beginning of period	627,591	518,940
Cash and cash equivalents at end of period	$ 523,125	$ 248,053

See accompanying notes.

ANALOG DEVICES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED JULY 29, 2006
(all tabular amounts in thousands except per share amounts and percentages)

Note 1 Basis of Presentation

In the opinion of management, the information furnished in the accompanying condensed consolidated financial statements reflects all normal recurring adjustments that are necessary to fairly state the results for these interim periods and should be read in conjunction with the Company s Annual Report on Form 10-K for the fiscal year ended October 29, 2005 and related notes. The results of operations for the interim periods shown in this report are not necessarily indicative of the results that may be expected for the fiscal year ending October 28, 2006 or any future period.

The Company has a 52-53 week fiscal year that ends on the Saturday closest to the last day in October. Fiscal 2006 and fiscal 2005 are 52-week fiscal years.

Certain amounts reported in previous years have been reclassified to conform to the fiscal 2006 presentation. Such reclassifications were immaterial.

Note 2 Stock-Based Compensation

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS 123R is similar to the approach described in SFAS 123 *Accounting for Stock-Based Compensation*. However, SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement over their vesting period based on their fair values at the date of grant. Pro forma disclosure is no longer an alternative.

On October 30, 2005 (the first day of its 2006 fiscal year), the Company adopted SFAS 123R using the modified prospective method as permitted under SFAS 123R. Under this transition method, compensation cost recognized in fiscal 2006 includes: (a) compensation cost for all share-based payments granted prior to but not yet vested as of October 29, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to October 29, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. In accordance with the modified prospective method of adoption, the Company s results of operations and financial position for prior periods have not been restated.

Equity Compensation Plans

The Company grants, or has granted, stock options and other stock and stock-based awards under the following equity compensation plans:

2006 Stock Incentive Plan (2006 Plan) The 2006 Plan was approved by the Company s Board of Directors on January 23, 2006 and was approved by shareholders on March 14, 2006. The 2006 Plan provides for the grant of up to 15 million shares of the Company s common stock, plus such number of additional shares that were subject to outstanding options under the Company s 1998 Stock Option Plan and the 2001 Broad-Based Stock Option Plan as of January 23, 2006 that are not issued because the applicable option award subsequently terminates or expires without being exercised. The 2006 Plan provides for the grant of incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, or non-statutory stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards. Employees, officers, directors, consultants and advisors of the Company and its subsidiaries are eligible to be granted awards under the 2006 Plan. No award may be made under the 2006 Plan after March 13, 2016, but awards previously granted may extend beyond that date. The Company will not grant further options under the 1998 Plan or the 2001 Plan.

2001 Broad-Based Stock Option Plan (2001 Plan) - The 2001 Plan was adopted by the Company s Board of Directors in December 2001 and subsequently amended in December 2002. The 2001 Plan provides for the issuance of options to purchase up to 50 million shares of common stock to employees, consultants or advisors of the Company and its subsidiaries,

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other than executive officers and directors. Following approval of the 2006 Plan, no further grants will be made under the 2001 Plan.

The 1998 Stock Option Plan (1998 Plan) - The 1998 Plan was approved by shareholders in fiscal 1998 and subsequently amended in December 2001 and December 2002. The 1998 Plan provides for the issuance of nonstatutory and incentive stock options to purchase up to 30 million shares of common stock. In March 2000, the Company s shareholders approved an amendment to the 1998 Plan to increase the shares reserved for issuance under the 1998 Plan by an additional 34 million shares. Following approval of the 2006 Plan, no further grants will be made under the 1998 Plan.

While the Company may grant to employees options that become exercisable at different times or within different periods, the Company has generally granted to employees options that vest over five years and become exercisable in annual installments of 33 1/3% on each of the third, fourth, and fifth anniversaries of the date of grant; in annual installments of 25% on each of the second, third, fourth and fifth anniversaries of the date of grant; or 20% on each of the first, second, third, fourth and fifth anniversaries of the date of grant. The maximum contractual term of all options is ten years.

Employee Stock Purchase Plans - The Company also has employee stock purchase plans (ESPPs) that allow eligible employees to purchase, through payroll deductions, shares of the Company s common stock at 85% of the fair market value at specified dates. Employees may withdraw from an offering before the purchase date and obtain a refund of the amounts withheld through payroll deductions plus accrued interest. The latest offering period began June 1, 2005 and ended on June 1, 2006; therefore, June 1, 2005 is considered the grant date for the purposes of recognizing the stock-based compensation expense for this offering period. During fiscal 2006, the Company s Board of Directors decided that the latest offering period, which ended June 1, 2006, will be the last offering period under the ESPPs. Under APB Opinion No. 25, the Company was not required to recognize stock-based compensation expense for the cost of stock options or shares issued under the Company s ESPPs. Upon adoption of SFAS 123R, the Company began recording stock-based compensation expense related to the ESPPs.

Grant-Date Fair Value

The Company uses the Black-Scholes option pricing model to calculate the grant-date fair value of an award. The fair value of options granted during the three and nine month periods ended July 29, 2006 and July 30, 2005 were calculated using the following estimated weighted-average assumptions:

	Three Months Ended		**Nine Months Ended**	
Stock Options	**July 29, 2006**	**July 30, 2005**	**July 29, 2006**	**July 30, 2005**
Options granted (in thousands)	158	816	8,398	12,513
Weighted-average exercise price	$ 33.46	$ 37.20	$ 39.29	$ 37.65
Weighted-average grant date fair-value	$ 9.84	$ 11.09	$ 11.58	$ 10.87
Assumptions:				
Weighted-average expected volatility	30.2%	30.5%	28.6%	27.4%
Weighted-average expected term (in years)	5.0	5.0	5.0	5.0
Risk-free interest rate	5.1%	3.6%	4.4%	3.6%
Expected dividend yield	1.92%	1.08%	1.24%	0.67%

Expected volatility The Company is responsible for estimating volatility and has considered a number of factors, including third-party estimates, when estimating volatility. For options granted prior to fiscal 2005, the Company used historical volatility to estimate the grant-date fair value of stock options. The Company changed its method of estimating expected volatility for all stock options granted after fiscal 2004 from exclusively relying on historical volatility to exclusively relying on implied volatility. This change was the result of a thorough review the Company undertook which included consultations with several third-party advisors. The Company currently believes that the exclusive use of implied volatility results in a more accurate estimate of the grant-date fair value of employee stock options because it more appropriately reflects the market s expectations of future volatility. Historical volatility during the period commensurate with the expected term of the Company s stock options over the past several years included a period of time that the Company s stock price experienced unprecedented increases and subsequent declines. The Company believes that this past stock price volatility is unlikely to be indicative of future stock price behavior. Options in the Company s stock are actively traded on several exchanges. Implied volatility is calculated for the period that is commensurate with the option s expected term assumption. Because this term often exceeds the period for which there are exchange-traded options in the Company s stock, statistical techniques are used to

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derive the implied volatility for traded options with terms commensurate with the option s expected term of five years. This calculation of implied volatility is derived from the closing prices of both the Company s stock and exchange traded options from the most recent five trading days prior to the grant date of the employee stock option.

Expected term The Company uses historical employee exercise and option expiration data to estimate the expected term assumption for the Black-Scholes grant-date valuation. The Company believes that this historical data is currently the best estimate of the expected term of a new option, and that generally our employees exhibit similar exercise behavior.

Risk-free interest rate The yield on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected term assumption is used as the risk-free interest rate.

Expected dividend yield Expected dividend yield is calculated by annualizing the cash dividend declared by the Company s Board of Directors for the current quarter and dividing that result by the closing stock price on the date of grant. Until such time as the Company s Board of Directors declares a cash dividend for an amount that is different from the current quarter s cash dividend, the current dividend will be used in deriving this assumption. Dividends are not paid on options, restricted stock or restricted stock units.

Expense

The Company used the graded attribution method to recognize expense for all stock-based awards prior to the adoption of SFAS 123R. Upon adoption of SFAS 123R on October 30, 2005, the Company changed to the straight-line attribution method to recognize expense for stock-based awards after October 29, 2005. The change to the straight-line attribution method was made so that the expense associated with each stock-based award is recognized evenly over the vesting period. The expense associated with the unvested portion of the pre-adoption grants will continue to be expensed using the graded attribution method.

The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term forfeitures is distinct from cancellations or expirations and represents only the unvested portion of the surrendered stock-based award. The Company currently expects, based on an analysis of its historical forfeitures, that approximately 86% of its stock-based awards will vest, and therefore has applied an annual forfeiture rate of 3.1% to all unvested stock-based awards as of July 29, 2006. The 3.1% represents the portion that is expected to be forfeited each year over the vesting period; therefore, the cumulative amount, on a compounded basis, that is expected to be forfeited is approximately 14% of the aggregate stock-based awards. This analysis will be re-evaluated quarterly and the forfeiture rate will be adjusted as necessary. Ultimately, the actual expense recognized over the vesting period will only be for those shares that vest.

The Company s stock option agreements provide for retirement-related continued vesting for a portion, or all, of certain stock options based on the optionee s age and years of service (the retirement provision) in that regardless of whether the employee continues to provide services, the optionee receives the benefit of the stock option. SFAS 123R clarifies the timing for recognizing stock-based compensation expense for awards subject to continued vesting upon meeting this retirement provision. This compensation expense must be recognized over the period from the date of grant to the date retirement eligibility is met if it is shorter than the required service period. Upon adoption of SFAS 123R in the first quarter of fiscal 2006, the Company s policy regarding the timing of option expense recognition for optionees meeting the criteria of the retirement provision was changed to recognize compensation cost over the period through the date that the optionee is no longer required to provide service to earn the award. Prior to the adoption of SFAS 123R, the Company s policy was to recognize these compensation costs over the vesting term. Had the Company applied these non-substantive vesting provisions required by SFAS 123R to awards granted prior to the adoption of SFAS 123R, the impact on the pro forma net earnings presented below would have been immaterial.

The adoption of SFAS 123R on October 30, 2005 had the following impact on the third quarter of fiscal 2006 results: operating profit before tax was decreased by $19.0 million, net income was decreased by $13.4 million, cash flow from operations was decreased by $141.2 million, cash flow from financing activities was increased by $141.2 million and basic and diluted EPS were each decreased by $0.04 The adoption of SFAS 123R on October 30, 2005 had the following impact on results for the nine months ended July 29, 2006: operating profit before tax was decreased by

$56.6 million, net income was decreased by $40.3 million, cash flow from operations was decreased by $156.0 million, cash flow from financing activities was increased by $156.0 million and basic and diluted EPS were each decreased by $0.11.

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The following table details the effect on net income and earnings per share had stock-based compensation expense been recorded for the three and nine month periods ended July 30, 2005 based on the fair-value method under SFAS 123, *Accounting for Stock-Based Compensation.* The reported and pro forma net income and earnings per share for the three and nine month periods ended July 29, 2006 are the same because stock-based compensation expense was calculated and recorded in the financial statements in accordance with the provisions of SFAS 123R.

	Three Months Ended July 30, 2005	Nine Months Ended July 30, 2005
Net income, as reported	$ 121,404	$ 346,446
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	1,029	3,033
Deduct: Total stock-based compensation expense determined under the fair value based method for all awards, net of related tax effects	(49,793)	(136,434)
Pro forma net income	$ 72,640	$ 213,045
Earnings per share:		
Basic as reported	$ 0.33	$ 0.93
Basic pro forma	$ 0.20	$ 0.57
Diluted as reported	$ 0.32	$ 0.90
Diluted pro forma	$ 0.19	$ 0.55

Prior to the adoption of SFAS 123R, on October 18, 2005, the Company accelerated the vesting of all unvested stock options awarded to employees after December 31, 2000 that had exercise prices of $40.00 per share or greater. Options issued to its corporate officers and directors were not accelerated. Unvested options to purchase approximately 18 million shares became exercisable as a result of the vesting acceleration. Because the exercise price of all the modified options was greater than the market price of the Company s underlying common stock on the date of the modification, no stock-based compensation expense was recorded in the statement of income, in accordance with APB Opinion No. 25. The primary purpose for modifying the terms of these out-of-the-money stock options to accelerate their vesting was to eliminate the need to recognize the remaining unrecognized non-cash compensation expense in the statement of income associated with these options as measured under SFAS 123. The approximately $188 million ($134 million net of tax) of future expense associated with these options would have been disproportionately high compared to the economic value of the options at the date of modification.

As disclosed in Note 10, on November 15, 2005, the Company announced that it reached a tentative settlement with the Securities and Exchange Commission, or SEC, of the SEC s previously announced investigation into certain option grants made by the Company. The Company has determined that no restatement of its historical financial results would be necessary due to the proposed settlement because the effects of using revised measurement dates for options granted in 1998, 1999 and 2001 are not material to any of the fiscal years 1998 through 2005, based on the materiality guidelines contained in Staff Accounting Bulletin 99, *Materiality* (SAB 99). Accordingly, the table presented above has not been restated to reflect the effects of using the revised measurement dates.

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Stock-Based Compensation Activity

A summary of the activity under the Company s stock option plans as of July 29, 2006 and changes during the three and nine month periods then ended is presented below:

	Options Outstanding	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Options outstanding at April 29, 2006	87,396	$ 33.94		
Options granted	158	33.46		
Options exercised	(533)	15.37		
Options forfeited	(256)	34.56		
Options expired	(1,021)	44.44		
Options outstanding at July 29, 2006	85,744	$ 33.93	5.8	$392,259
Options exercisable at July 29, 2006	59,494	$ 33.69	4.7	$320,093
Options vested or expected to vest at July 29, 2006 (1)	83,813	$ 33.85	5.7	$390,797

(1) In addition to the vested options, the Company expects a portion of the unvested options to vest at some point in the future. Options expected to vest is calculated by applying an estimated forfeiture rate to the unvested options.

	Options Outstanding	Weighted-Average Exercise Price Per Share

Options outstanding at October 29, 2005	85,489	$ 32.75
Options granted	8,398	39.29
Options exercised	(4,334)	15.67
Options forfeited	(1,633)	34.02
Options expired	(2,176)	44.61
Options outstanding at July 29, 2006	85,744	$ 33.93

During the three and nine months ended July 29, 2006, the total intrinsic value of options exercised (i.e. the difference between the market price at exercise and the price paid by the employee to exercise the options) was $9.3 million and $96.3 million, respectively, and the total amount of cash received from exercise of these options was $8.2 million and $68.0 million, respectively. The total grant-date fair value of stock options that vested during the three and nine months ended July 29, 2006 was approximately $1.0 million and $108.7 million, respectively.

A summary of the Company s restricted stock award activity as of July 29, 2006 and changes during the three and nine month periods then ended is presented below:

	Options Outstanding	**Weighted-Average Grant Date Fair Value Per Share**
Non-Vested shares outstanding at April 29, 2006	34	$ 37.99
Awards granted		
Restrictions lapsed		
Awards forfeited		
Non-Vested shares outstanding at July 29, 2006	34	$ 37.99

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	Options Outstanding	Weighted-Average Grant Date Fair Value Per Share
Non-Vested shares outstanding at October 29, 2005		
Awards granted	34	$ 37.99
Restrictions lapsed		
Awards forfeited		
Non-Vested shares outstanding at July 29, 2006	34	$ 37.99

As of July 29, 2006, there was $173.0 million of total unrecognized compensation cost related to unvested share-based awards including stock options and restricted shares. That cost is expected to be recognized over a weighted-average period of 1.7 years.

Note 3 Comprehensive Income

Components of comprehensive income include net income and certain transactions that have generally been reported in the consolidated statement of shareholders equity and consist of the following:

	Three Months Ended	
	July 29, 2006	July 30, 2005
Net income	$ 144,685	$ 121,404
Foreign currency translation adjustments	(131)	(1,549)
Unrealized holding gains (losses) (net of taxes of $1,099 and $783, respectively) on securities classified as Short-term Investments	2,040	(1,456)
Unrealized holding (losses) gains (net of taxes of $144 and $0, respectively) on securities classified as Other Investments	(268)	2
Change in unrealized gains (losses) on derivative instruments designated as cash flow hedges	885	(7,652)
Other comprehensive income (loss)	2,526	(10,655)
Comprehensive income	$ 147,211	$ 110,749

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	Nine Months Ended	
	July 29, 2006	July 30, 2005
Net income	$ 411,063	$ 346,446
Foreign currency translation adjustments	575	(886)
Unrealized holding gains (losses) (net of taxes of $2,645 and $5,913, respectively) on securities classified as Short-term Investments	4,911	(10,983)
Unrealized holding losses (net of taxes of $248 and $295, respectively) on securities classified as Other Investments	(461)	(547)
Change in unrealized gains (losses) on derivative instruments designated as cash flow hedges	7,944	(8,736)
Other comprehensive income (loss)	12,969	(21,152)
Comprehensive income	$ 424,032	$ 325,294

The components of accumulated other comprehensive loss at July 29, 2006 and October 29, 2005 consisted of the following:

	July 29, 2006	October 29, 2005
Foreign currency translation adjustment	$ 4,151	$ 3,576
Unrealized losses on available-for-sale securities	(7,977)	(12,427)
Unrealized gains (losses) on derivative instruments	3,598	(4,346)
Minimum pension liability adjustment	(6,067)	(6,067)
Total accumulated other comprehensive loss	$ (6,295)	$ (19,264)

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Note 4 Earnings Per Share

Basic earnings per share is computed using only the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted-average number of common shares outstanding during the period, plus the dilutive effect of potential future issuances of common stock relating to stock option programs and other potentially dilutive securities. In calculating diluted earnings per share, the dilutive effect of stock options is computed using the treasury stock method, in which the assumed proceeds includes the average unrecognized compensation expense of in-the-money stock options. Potential shares related to certain of the Company s outstanding stock options were excluded because they were anti-dilutive. Those potential shares related to the Company s outstanding stock options could be dilutive in the future. The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended	
	July 29, 2006	July 30, 2005
Basic:		
Net income	$ 144,685	$ 121,404
Weighted shares outstanding	357,887	370,985
Earnings per share	$ 0.40	$ 0.33
Diluted:		
Net income	$ 144,685	$ 121,404
Weighted shares outstanding	357,887	370,985
Assumed exercise of common stock equivalents	11,655	11,845
Weighted-average common and common equivalent shares	369,542	382,830
Earnings per share	$ 0.39	$ 0.32
Anti-dilutive common stock equivalents related to outstanding stock options	56,118	37,998

	Nine Months Ended	
	July 29, 2006	July 30, 2005
Basic:		
Net income	$ 411,063	$ 346,446
Weighted shares outstanding	362,749	372,407
Earnings per share	$ 1.13	$ 0.93

Diluted:		
Net income	$ 411,063	$ 346,446
Weighted shares outstanding	362,749	372,407
Assumed exercise of common stock equivalents	12,814	12,018
Weighted-average common and common equivalent shares	375,563	384,425
Earnings per share	$ 1.09	$ 0.90
Anti-dilutive common stock equivalents related to outstanding stock options	50,813	45,037

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Note 5 Special Charges

A summary of the Company s special charges is as follows:

Income Statement	Closure of Wafer Fabrication Facility	Reorganization of Product Development and Support Programs	Total Special Charges
Fiscal 2005 Charges:			
Workforce reductions	$ 20,315	$ 11,165	$ 31,480
Total Fiscal 2005 Charges	$ 20,315	$ 11,165	$ 31,480
Fiscal 2006 Charges:			
Facility closure costs	$	$ 554	$ 554
Abandonment of equipment		459	459
Total Fiscal 2006 Charges		1,013	1,013
Total Special Charges	$ 20,315	$ 12,178	$ 32,493

Accrued Restructuring	Closure of Wafer Fabrication Facility	Reorganization of Product Development and Support Programs	Total Special Charges
Balance at October 29, 2005	$ 20,315	$ 10,708	$ 31,023
Special charges		1,013	1,013
Severance payments		(4,527)	(4,527)
Non-cash impairment charge		(459)	(459)
Balance at January 28, 2006	$ 20,315	$ 6,735	$ 27,050
Severance payments	$	$ (1,111)	$ (1,111)

Facility closure costs				(69)		(69)
Balance at April 29, 2006	$	20,315	$	5,555	$	25,870
Severance payments	$		$	(1,199)	$	(1,199)
Facility closure costs				(358)		(358)
Balance at July 29, 2006	$	20,315	$	3,998	$	24,313

Closure of Wafer Fabrication Facility

During the fourth quarter of fiscal 2005, the Company recorded a special charge of $20 million as a result of the Company s decision to close its California wafer fabrication operations and transfer production to Company-owned fabrication facilities located in Massachusetts and Ireland, as well as to third-party wafer fabricators. The charge was for severance and fringe benefit costs that were recorded pursuant to SFAS 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, under the Company s ongoing benefit plan for 339 manufacturing employees and 28 general and administrative employees. The severance benefit is calculated based on length of past service, and employees must continue to be employed until they are involuntarily terminated in order to receive the severance benefit. As of July 29, 2006, all affected employees continued to be employed by the Company. The employment of these employees is expected to terminate upon the closure of the wafer fabrication facility, which is planned for October 2006. In addition to the charge recorded in the fourth quarter of fiscal 2005, the Company recorded additional expense in each of the first, second and third quarters of fiscal 2006, which consisted of $5.4 million per quarter in the first and second quarters and $5.2 million in the third quarter of non-cash cost of sales expenses for additional depreciation due to shortened useful lives of certain manufacturing equipment and $0.5 million per quarter for stay-on bonuses. In accordance with GAAP, the Company expects to incur additional expenses related to this action during the fourth quarter of fiscal 2006 of approximately $13.5 million, of which approximately $5.6 million will be for non-cash cost of sales expense for additional depreciation, approximately $0.5 million will be for stay-on bonuses and approximately $7.4 million will be for estimated lease termination, clean-up and closure costs. The closure of these facilities is expected to be completed by the end of fiscal 2006.

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Reorganization of Product Development and Support Programs

During the fourth quarter of fiscal 2005, the Company recorded a special charge of $11 million as a result of its decision to reorganize its product development and support programs with the goal of providing greater focus on its analog and DSP product programs. The charge was for severance and fringe benefit costs that were recorded pursuant to SFAS 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, under the Company s ongoing benefit plan or statutory requirements at foreign locations for 60 manufacturing employees and 154 engineering and selling, marketing and general and administrative employees. These employees must continue to be employed until they are involuntarily terminated in order to receive the severance benefit. As of July 29, 2006, the employment of 172 of these employees had been terminated. During the first quarter of fiscal 2006, the Company recorded an additional special charge of $1.0 million related to this reorganization action. This charge was for lease obligation costs for a facility the Company ceased using during the first quarter of fiscal 2006 and the write-off of property, plant and equipment at this facility. The Company does not plan to incur any material additional charges related to this reorganization action. These organizational changes are expected to be fully completed by the end of fiscal 2006.

Note 6 Segment Information

The Company operates and tracks its results in one reportable segment. The Company designs, develops, manufactures and markets a broad range of integrated circuits. The Chief Executive Officer has been identified as the Chief Operating Decision Maker as defined by Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

Note 7 Goodwill and Intangible Assets

The Company annually evaluates goodwill for impairment as well as whenever events or changes in circumstances suggest that the carrying value of goodwill may not be recoverable. Because the Company has one reporting segment under SFAS 142, the Company utilizes the entity-wide approach for assessing goodwill for impairment and compares its market value to its net book value to determine if an impairment exists. No impairment of goodwill resulted from the Company s most recent evaluation of goodwill for impairment, which occurred in the fourth quarter of fiscal 2005. The Company s next annual impairment assessment will be made in the fourth quarter of fiscal 2006.

In the third quarter of fiscal 2006, the Company purchased certain assets from TTPCom Limited (see Note 16). As a result of the acquisition, the Company recognized $13.2 million of intangible assets. The acquired intangible assets consisted of the following:

Acquired Intangible Assets	**Amount**	**Amortization Period**
Technology-based	$ 11,600	5 years
Other	$ 1,600	5 years

Intangible assets, which continue to be amortized, consisted of the following:

	July 29, 2006		October 29, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Technology-based	$ 29,023	$ 15,290	$ 17,423	$ 13,567
Tradename	1,167	913	1,167	820
Other	7,747	6,236	6,147	6,147
Total	$ 37,937	$ 22,439	$ 24,737	$ 20,534

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Intangible assets acquired prior to the third quarter of fiscal 2006 continue to be amortized on a straight-line basis over their estimated useful lives, which range from five to ten years. The $13.2 million of intangible assets acquired during the third quarter of fiscal 2006 will be amortized over their estimated useful lives of five years using an accelerated method of amortization that is expected to reflect the estimated pattern of economic use. Amortization expense related to intangibles was $1.1 million and $0.7 million for the three-month periods ended July 29, 2006 and July 30, 2005, respectively, and $2.0 million in each of the nine-month periods ended July 29, 2006 and July 30, 2005.

The Company expects amortization expense for these intangible assets to be:

Fiscal Years	Amortization Expense
Remainder of 2006	$ 1,491
2007	5,598
2008	4,230
2009	2,273
2010	1,393
2011	513

Note 8 Pension Plans

The Company has various defined benefit pension and other retirement plans for certain non-U.S. employees that are consistent with local statutory requirements and practices. The Company s funding policy for its foreign defined benefit pension plans is consistent with the local requirements of each country. The plans assets consist primarily of U.S. and non-U.S. equity securities, bonds, property and cash.

Net periodic pension cost of non-U.S. plans is presented in the following table:

	Three Months Ended	
	July 29, 2006	July 30, 2005
Service cost	$ 2,712	$ 2,020
Interest cost	1,850	1,586
Expected return on plan assets	(1,819)	(1,776)
Amortization of prior service cost	30	45
Amortization of transitional (asset) or obligation	(7)	17
Recognized actuarial loss	398	158
Net periodic pension cost	$ 3,164	$ 2,050

	Nine Months Ended	
	July 29, 2006	July 30, 2005
Service cost	$ 7,836	$ 6,280
Interest cost	5,344	4,944
Expected return on plan assets	(5,257)	(5,540)
Amortization of prior service cost	86	141
Amortization of transitional (asset) or obligation	(20)	52
Recognized actuarial loss	1,146	490
Net periodic pension cost	$ 9,135	$ 6,367

Contributions of $2.6 million and $6.1 million were made by the Company during the three and nine months ended July 29, 2006, respectively. The Company presently anticipates contributing an additional $0.6 million to fund its defined benefit pension plans in fiscal year 2006 for a total of $6.7 million.

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Note 9 Product Warranties

The Company generally offers a 12-month warranty for its products. The Company s warranty policy provides for replacement of the defective product. Specific accruals are recorded for known product warranty issues. Product warranty expenses were not material during any of the three and nine month periods ended July 29, 2006 and July 30, 2005.

Note 10 Commitments and Contingencies

Tentative Settlement of the SEC s Previously Announced Stock Option Investigation

In the Company s Form 10-K filing dated November 30, 2004, the Company disclosed that the Securities and Exchange Commission (SEC) had initiated an inquiry into its stock option granting practices, focusing on options that were granted shortly before the issuance of favorable financial results. On November 15, 2005, the Company announced that it had reached a tentative settlement with the SEC.

Since receiving notice of this inquiry, the Company has cooperated with the SEC. The Company and its President and CEO, Mr. Jerald G. Fishman, have made an offer of settlement to the Staff of the SEC, which is subject to agreement regarding the specific language of the SEC s administrative order and other settlement documents. The SEC Staff has decided to recommend the offer of settlement to the Commission. A final settlement is subject to review and approval by the Commission.

The Company s Board of Directors and Mr. Fishman believe that it is in the best interests of the Company s shareholders to settle this case on the proposed terms rather than face a protracted dispute with the SEC.

The contemplated settlement addresses two separate issues. The first issue concerns the Company s disclosure regarding grants of options to employees and directors prior to the release of favorable financial results. Specifically, the issue relates to options granted to employees (including officers) of the Company on November 30, 1999 and to employees (including officers) and directors of the Company on November 10, 2000. The SEC settlement would conclude that the Company should have made disclosures in its proxy filings to the effect that the Company priced these stock options prior to releasing favorable financial results.

The second issue addressed by the tentative settlement concerns the grant dates for options granted to employees (including officers) in 1998 and 1999, and the grant date for options granted to employees (including officers) and directors in 2001. Specifically, the settlement would conclude that the appropriate grant date for the September 4, 1998 options should have been September 8th (which is one trading day later than the date that was used to price the options); the appropriate grant date for the November 30, 1999 options should have been November 29th (which is one trading day earlier than the date that was used); and the appropriate grant date for the July 18, 2001 options should have been July 26th (which is five trading days after the original date).

In connection with the contemplated settlement, the Company would consent to a cease-and-desist order under Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, would pay a civil money penalty of $3 million, and would reprice options granted to Mr. Fishman and other directors in certain years. Options granted to all other employees would be excluded from the repricing. Mr. Fishman would consent to a cease-and-desist order under Sections 17(a)(2) and (3) of the Securities Act, would pay a civil money penalty of $1 million, and would make a disgorgement payment with respect to options granted in certain years. With the exception of options granted in 1998, Mr. Fishman has not exercised or sold any of the options identified in this matter. The Company and Mr. Fishman would settle this matter without admitting or denying the Commission s findings.

The Company has determined that no restatement of its historical financial results would be necessary due to the proposed settlement, because the effects of using revised measurement dates for options granted in 1998, 1999 and 2001 are not material to any of the fiscal years 1998 through 2005, based on the materiality guidelines contained in SAB 99. If a stock-based compensation charge had been taken as a result of the revised measurement dates for these option grants to all employees (including officers) and directors, the net income of the Company for fiscal years 1998 through 2005 would have been reduced by $21.8 million in total. During this period, the Company earned cumulative net income of over $2.5 billion. There would be no impact on revenue, cash flow from operations, or shareholders equity as a result of using the revised measurement dates. The impact on net income in individual fiscal years would have been as follows: fiscal 1998 ($0.2 million), fiscal 1999 ($1.4

million), fiscal 2000 ($1.8 million), fiscal 2001 ($3.7 million), fiscal 2002 ($8.1 million), fiscal 2003 ($6.1 million), fiscal 2004 ($0.5 million).

IRS Examination

The United States Internal Revenue Service (the IRS) has completed their examination of fiscal years 2001, 2002 and 2003 and issued their report. The Company has agreed to accept this report and has filed their 2005 tax return and an amended return for 2004 to conform to the methodologies agreed to during the 2001-2003 examination. The result of the examination did not have a material impact on the Company s financial position.

As a result of the completion of this examination and the application of the methodology used in those audited tax years to all subsequent fiscal periods, a total of $8.5 million of accruals included in the Company s income tax payable account were no longer required. Therefore, the Company recorded a tax benefit of $8.5 million in the third quarter of fiscal 2006.

Overall, the settlement resulted in a net reduction of the Company s income tax payable account by $121 million, which was primarily accomplished by the utilization of deductions for stock option exercises during those years.

The Company s income tax payable at July 29, 2006 was approximately $99.5 million, which included approximately $90.1 million for current U.S. federal, state and foreign tax filings. The remaining $9.4 million of income tax payable is for interest payments on U.S. federal returns for fiscal years 2001 through 2003 and various other income taxes. The Company has outstanding tax refund claims for which the ultimate refund is uncertain. In the event the Company receives the refund, it will be recorded as a benefit in the period received.

During fiscal year 2006, the IRS invited the Company to participate in the Compliance Assurance Process (CAP) which is a voluntary pilot program the IRS is conducting for a limited number of large business taxpayers. The objective of CAP is to reduce taxpayer burden associated with IRS audits while assuring the IRS of the accuracy of tax returns prior to filing. The Company has agreed to participate in CAP. Under the program, the IRS will contemporaneously work with the Company to achieve federal tax compliance and resolve issues prior to the filing of a tax return. CAP is designed to eliminate or substantially reduce the need for post-filing examinations of future tax returns. The routine audit of fiscal years 2004 and 2005 is currently underway.

Other Commitments and Contingencies

On November 6, 2003, Enron Corporation commenced a proceeding in the United States Bankruptcy Court for the Southern District of New York. On December 1, 2003, Enron filed an amended complaint to add the Company as a defendant in such proceeding. The amended complaint alleges that transfers made by Enron in satisfaction of obligations it had under commercial paper are recoverable as preferential transfers and fraudulent transfers and are subject to avoidance under the United States Bankruptcy Code. It is alleged that payments made in premature satisfaction of obligations under commercial paper totaling approximately $20 million are recoverable from J.P. Morgan Securities, Inc., Fleet Capital Markets, Fleet National Bank and/or the Company. The Company sold $20 million of Enron commercial paper to Fleet and did not enter into any direct transactions with Enron. The Company filed a motion to dismiss the adversary proceeding. The motion to dismiss was denied by order dated June 30, 2005. The Company intends to vigorously defend against these claims. Although the Company believes it has meritorious defenses to the asserted claims, it is unable at this time to predict the outcome of this proceeding. The Company believes that the final disposition of this matter will not have a material adverse effect on the Company or its financial position.

On June 14, 2005, Biax Corporation filed its first amended complaint for patent infringement in the United States District Court for the Eastern District of Texas against the Company and Intel Corporation, alleging that the Company infringed three patents owned by Biax relating to parallel processors. Prior to the filing of the first amended complaint, the Company was unaware of Biax or this action. The first amended complaint seeks injunctive relief, unspecified damages with interest, as well as Biax s costs, expenses and fees. On August 3, 2005, the Company filed an answer and counterclaimed against Biax. In the counterclaim, the Company seeks rulings that the patents are not infringed, the patents are invalid and the patents are unenforceable. On November 7, 2005, Biax filed a second amended complaint alleging that the Company infringed two additional patents. The case is currently in the discovery phase. The Company intends to vigorously defend against these allegations. The Company is unable at this time to predict the outcome of this litigation; however, the Company believes that the final disposition of this matter will not have a material adverse effect on the Company or its financial position.

On or about May 5, 2006, Mr. Gregory Bender filed a complaint for patent infringement in the U.S. District Court for the Eastern District of Texas against the Company, Civil Action Number 2:06-CV-192. Prior to the filing of the complaint, the Company was unaware of Mr. Bender or this action. In his complaint, Mr. Bender alleges that certain of the Company s amplifier products infringe a patent Mr. Bender owns. He seeks unspecified damages as well as a permanent injunction enjoining the Company from infringing his patent. Mr. Bender has not yet served his complaint on the Company. The Company intends to vigorously defend against these allegations. The Company cannot predict the outcome of this matter, but believes that the disposition of the matter will not have a material adverse effect on the Company or its financial position.

In April 2006, the Company received a demand from a purported shareholder to inspect the Company s books and records relating to certain grants of options made to directors and officers of the Company at diverse times. On May 19, 2006, the demand was withdrawn by the purported shareholder.

In May 2006, the Company received a demand from a purported shareholder with respect to certain grants of options made to directors and officers of the Company during the years 1998, 1999 and 2001. That demand seeks, among other things, the commencement of an action by the directors of the Company on behalf of the Company against those directors and officers for breach of fiduciary duties arising from the granting of the options. A special committee of the Board of Directors of the Company was formed to review the allegations contained in the demand and to respond appropriately. After reviewing the facts underlying the allegations, the special committee decided to reject the purported shareholder s demand. The Company does not know whether the purported shareholder will take further action.

On June 12, 2006, a purported derivative complaint was filed in the United States District Court for the District of Massachusetts naming the Company as nominal defendant and also naming as defendants certain officers and directors of the Company. The complaint alleges purported violations of state and federal law in connection with the Company s option granting practices during the years 1998, 1999 and 2001, including violation of Section 14(a) of the Securities Exchange Act of 1934, breaches of fiduciary duties of care, loyalty and good faith, gross mismanagement, waste of corporate assets, and unjust enrichment. The complaint seeks monetary damages in unspecified amounts, as well as equitable and injunctive relief. The Board and management intend to review the allegations and respond appropriately.

In May 2006, the Company received a document subpoena from the U.S. Attorney for the Southern District of New York requesting records from 2000 to the present relating to the Company s granting of stock options. The Company believes that the options at issue in this matter are the same option grants which have been the subject of investigation by the SEC. The Company is cooperating with the office of the U.S. Attorney in connection with this subpoena. The Company cannot predict the outcome of this matter, but believes the disposition of the matter will not have a material adverse effect on the Company or its financial position.

From time to time as a normal incidence of the nature of the Company s business, various claims, charges and litigation are asserted or commenced against the Company arising from, or related to, contractual matters, patents, trademarks, personal injury, environmental matters, product liability, insurance coverage and personnel and employment disputes. As to such claims and litigation the Company can give no assurance that it will prevail.

While the Company does not believe that any of the matters described above will have a material adverse effect on the Company s financial position, an adverse outcome of any of these matters is possible and could have a material adverse effect on the Company s consolidated results of operations or cash flows in the quarter or annual period in which one or more of these matters are resolved.

Note 11 Common Stock Repurchase

In August 2004, the Company s Board of Directors approved the repurchase of up to $500 million of the Company s common stock. On May 11, 2005, the Company s Board of Directors amended the stock repurchase program by increasing the total amount of the Company s common stock the Company is authorized to repurchase from $500 million to $1 billion of common stock. On March 14, 2006, the Board of Directors authorized the repurchase by the Company of an additional $1 billion of the Company s common stock, increasing the total amount of the Company s common stock the Company can repurchase from $1 billion to $2 billion of the Company s common stock. Under the repurchase program, the Company may repurchase outstanding shares of its common stock from time to time in the open market and through privately negotiated transactions. Unless terminated earlier by resolution of the Company s Board of Directors, the repurchase program will expire when the Company has repurchased all shares authorized under the program. The Company repurchased a total of 9.3 million shares for approximately $305 million during the third quarter of fiscal 2006. As of July 29, 2006, the Company had repurchased approximately 37 million shares of its common stock for approximately $1,331 million under this program. The repurchased shares are held as authorized but unissued shares of common stock.

Note 12 Related Party Transactions

One of the Company s directors, who has served on the Company s Board of Directors since 1988, became a director of Taiwan Semiconductor Manufacturing Company, or TSMC, in fiscal 2002 and currently serves as a director of TSMC. The Company purchased approximately $76 million and $52 million of products from TSMC during the three-month periods ended July 29, 2006 and July 30, 2005, respectively, and approximately $216 million and $174 million in the nine-month periods ended July 29, 2006 and July 30, 2005, respectively. Approximately $37 million and $27 million was payable to TSMC as of July 29, 2006 and October 29, 2005, respectively. The Company anticipates that it will make significant purchases from TSMC in the remaining quarter of fiscal year 2006.

Note 13 New Accounting Standards

Accounting for Uncertainty in Income Taxes

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standards (SFAS) 109, *Accounting for Income Taxes.* FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently analyzing FIN 48 and believes the adoption of FIN 48 will not have a material impact on the Company s financial condition, results of operations or liquidity.

Accounting Changes and Error Corrections

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS 154) which supersedes APB Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements.* SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes, unless impractical, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. The correction of an error in previously issued financial statements is not an accounting change. However, the reporting of an error correction involves adjustments to previously issued financial statements similar to those generally applicable to reporting an accounting change retroactively. Therefore, the reporting of a correction of an error by restating previously issued financial statements is also addressed by SFAS 154 and is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not expect the adoption of SFAS 154 to have a material impact on the Company s financial condition, results of operations or liquidity.

Asset Retirements

In March 2005, the FASB issued FIN 47, *Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143.* FIN 47 clarifies that the term conditional asset retirement obligation as used in SFAS 143, *Accounting for Asset Retirement Obligations,* and refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. The Company is currently analyzing FIN 47 and believes the adoption of FIN 47 will not have a material impact on the Company s financial condition, results of operations or liquidity.

Inventory Costs

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs, an amendment of Accounting Research Bulletin (ARB) No. 43, Chapter 4* (SFAS 151). SFAS 151 amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) should be recognized as current-period charges. In addition, SFAS 151 requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS 151 are effective for fiscal years beginning after June 15, 2005. The adoption of SFAS 151 in the first quarter of fiscal 2006 did not impact the Company s financial condition, results of operations or liquidity.

Note 14 Deferred Compensation Plan Investments and Liability

As a result of certain provisions of the American Jobs Creation Act, participants had the opportunity until December 31, 2005 to elect to withdraw amounts previously deferred under the Company s Deferred Compensation Plan. As a result of withdrawals pursuant to elections under these provisions or upon termination of their employment with the Company, participants withdrew approximately $254.1 million of deferred compensation during the first nine months of fiscal 2006. This amount represented compensation and/or stock option gains previously deferred by those participants pursuant to the terms of the Deferred Compensation Plan.

Note 15 Gain on Sale of Product Line

During the second quarter of fiscal 2006, on February 21, 2006, the Company completed the sale to Ikanos Communications, Inc. of its DSP-based digital subscriber line (DSL) application-specific integrated circuit (ASIC) and network processor product line. The Company received approximately $23.1 million in cash for the product line and after providing for the write-off of inventory, fixed assets and other costs incurred to complete the transaction, recorded a net gain of approximately $13.0 million in nonoperating income during the second quarter of fiscal 2006.

Note 16 Acquisitions

In the third quarter of fiscal 2006, the Company completed a transaction with TTPCom Limited whereby TTPCom transferred to the Company intellectual property, engineering resources, and related assets associated with the support and customization of TTPCom s GSM/GPRS/EDGE modem software for use on the Company s existing and future generations of SoftFone(R) baseband processors. The Company also acquired development rights for AJAR, TTPCom s advanced applications platform. As a result of this transaction, the Company became the single point of contact for both hardware and software support for its new and existing wireless handset customers, thus improving the Company s abilities to service the needs of individual customers. The Company paid $11.9 million in initial cash payments and may become obligated to make additional cash payments of up to an aggregate of $12 million based on the achievement during the period from May 2006 through November 2006 of technological milestones. The purchase price was allocated to the tangible and intangible assets acquired based on their estimated fair values at the date of acquisition. The estimated fair values of the assets exceeded the initial payments by $7.8 million, resulting in negative goodwill. Pursuant to SFAS 141, the Company recorded a liability for the contingent consideration that will be accounted for as additional purchase price, up to the amount of the negative goodwill. As contingent payments become due, the payments will be applied against the contingent liability. Contingent payments in excess of $7.8 million, if any, will be recorded as goodwill. As of July 29, 2006, the Company had paid $3 million of contingent payments, and the remaining contingent liability was $4.8 million. The purchase price included $5.5 million of in-process technology that had not yet reached technological feasibility, had no alternative future use and was charged to operations during the third quarter of fiscal 2006. The acquisition also included $13.2 million of intangible assets that will be amortized over their estimated useful lives of five years using an accelerated amortization method that reflects the estimated pattern of economic use.

Note 17 Income Taxes

The United States Internal Revenue Service (the IRS) has completed their examination of fiscal years 2001, 2002 and 2003 and issued their report. The Company has agreed to accept this report and has filed their 2005 tax return and an amended return for 2004 to conform to the methodologies agreed to during the 2001-2003 examination. The result of the examination did not have a material impact on the Company s financial position.

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As a result of the completion of this examination and the application of the methodology used in those audited tax years to all subsequent fiscal periods, a total of $8.5 million of accruals included in the Company s income tax payable account were no longer required. Therefore, the Company recorded a tax benefit of $8.5 million in the third quarter of fiscal 2006.

Overall, the settlement resulted in a net reduction of the Company s income tax payable account by $121 million, which was primarily accomplished by the utilization of deductions for stock option exercises during those years.

The Company s income tax payable at July 29, 2006 was approximately $99.5 million, which included approximately $90.1 million for current U.S. federal, state and foreign tax filings. The remaining $9.4 million of income tax payable is for interest payments on U.S. federal returns for fiscal years 2001 through 2003 and various other income taxes. The Company has outstanding tax refund claims for which the ultimate refund is uncertain. In the event the Company receives the refund, it will be recorded as a benefit in the period received.

During fiscal year 2006, the IRS invited the Company to participate in the Compliance Assurance Process (CAP) which is a voluntary pilot program the IRS is conducting for a limited number of large business taxpayers. The objective of CAP is to reduce taxpayer burden associated with IRS audits while assuring the IRS of the accuracy of tax returns prior to filing. The Company has agreed to participate in CAP. Under the program, the IRS will contemporaneously work with the Company to achieve federal tax compliance and resolve issues prior to the filing of a tax return. CAP is designed to eliminate or substantially reduce the need for post-filing examinations of future tax returns. The routine audit of fiscal years 2004 and 2005 is currently underway.

Note 18 Subsequent Events

In the fourth quarter of fiscal 2006, on July 31, 2006, the Company acquired privately-held Integrant Technologies, Inc. (Integrant) of Seoul, Korea. An innovator in the field of high-performance analog circuits designed for reconfigurable radio frequency (RF) signal processing, Integrant is the leading supplier of low-power radio tuners that allow mobile communications, computer, and consumer devices to receive digital television (TV) and digital radio broadcasts. Under the terms of the share purchase agreement, the Company paid approximately $127 million in cash at the closing in exchange for substantially all of the outstanding shares of Integrant. A portion of the consideration payable to the shareholders of Integrant was placed into escrow to secure potential indemnification claims under the share purchase agreement and to facilitate the acquisition of the remaining shares not acquired at closing. The Company may pay up to an additional $33 million upon the satisfaction of certain conditions. The Company expects to record a one-time charge of approximately $12 million in the fourth quarter of fiscal 2006, which ends October 28, 2006, for purchased in-process research and development expenses.

On August 9, 2006, the Company s Board of Directors declared a cash dividend of $0.16 per outstanding share of common stock. The dividend will be paid on September 13, 2006 to all shareholders of record at the close of business on August 25, 2006.

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

This information should be read in conjunction with the unaudited condensed consolidated financial statements and related notes included in Item 1 of this Quarterly Report on Form 10-Q and the audited consolidated financial statements and related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended October 29, 2005.

This Quarterly Report on Form 10-Q, including the section below entitled Outlook, contains or incorporates forward-looking statements within the meaning of section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934. These forward-looking statements are based on current expectations, estimates, forecasts and projections about the industry and markets in which we operate and our management s beliefs and assumptions. In addition, other written or oral statements that constitute forward-looking statements may be made by or on our behalf. Words such as expect, anticipate, intend, plan, believe, seek, estimate, variations of such similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. We have included important factors in the cautionary statements below under the heading Factors That May Affect Future Results that we believe could cause our actual results to differ materially from the forward-looking statements we make. We do not intend to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Results of Operations

Overview

	Three Months Ended		Nine Months Ended	
	July 29, 2006	**July 30, 2005**	**July 29, 2006**	**July 30, 2005**
Net Sales	$663,660	$582,416	$1,928,834	$1,766,678
Gross Margin %	58.8%	58.1%	58.7%	57.7%
Diluted EPS	$ 0.39	$ 0.32	$ 1.09	$ 0.90
Net Income	$144,685	$121,404	$ 411,063	$ 346,446
Net Income as a % of Sales	21.8%	20.8%	21.3%	19.6%

Sales

Net sales in the third quarter of fiscal 2006 increased by $81.2 million, or 14%, from the amount recorded in the third quarter of fiscal 2005. Net sales increased $162.2 million, or 9%, in the nine months ended July 29, 2006 from the comparable period in fiscal 2005.

Revenue Trends by End Market

Industrial Revenues from products sold into the industrial end market (which includes factory automation, scientific and medical instrumentation, semiconductor automatic test equipment (ATE), defense electronics and automotive applications) increased 3% in the third quarter of fiscal 2006 compared to the second quarter of fiscal 2006. Revenue from this end market increased 16% and 14% in the three and nine months ended July 29, 2006, respectively, as compared to the same periods of fiscal 2005. These increases reflect a broad based increase in demand for our products across a wide range of our customers in this end market. The industrial end market represented approximately 42% of our total revenue in the third quarter of fiscal 2006.

Consumer Revenues from products sold into the consumer end market increased 3% in the third quarter of fiscal 2006 compared to the second quarter of fiscal 2006. Revenue from this end market increased 14% and 20% in the three and nine months ended July 29, 2006, respectively, as compared to the same periods of fiscal 2005. These increases were primarily the result of the success of our products in digital home applications and to a lesser extent in a broad array of audio and video applications. The consumer end market represented approximately 17% of our total revenue in the third quarter of fiscal 2006.

Communications Revenues from products sold into the communications end market increased 6% in the third quarter of fiscal 2006 compared to the second quarter of fiscal 2006. Revenue from this end market increased 26% and 7% in the three and nine months ended July 29, 2006, respectively, as compared to the same periods of fiscal 2005. The three month year-to-year increase was primarily attributable to wireless infrastructure and wireless handset revenue increases and to a lesser extent sales of products used in optical communications. The sales growth attributable to networking customers was partially offset by the loss of sales from our DSP-based DSL ASIC and network processor product line that we sold in the second quarter of fiscal 2006. The communications end market represented approximately 30% of our total revenue in the third quarter of fiscal 2006.

Computer Revenues from products sold into the computer end market declined 2% in the third quarter of fiscal 2006 as compared to the second quarter of fiscal 2006 and declined 15% as compared to the same period of fiscal 2005. Revenue from this end market decreased 11% in the nine months ended July 29, 2006 as compared to the same period of fiscal 2005. The computer end market represented approximately 11% of our total revenue in the third quarter of fiscal 2006.

Revenue Trends by Product

	Three Months Ended		Nine Months Ended	
	July 29, 2006	July 30, 2005	July 29, 2006	July 30, 2005
Analog products as a % of sales	84%	84%	83%	81%
DSP products as a % of sales	16%	16%	17%	19%

Our analog product sales increased 15% and 12% in the three and nine month periods ended July 29, 2006, respectively, as compared to the same periods of fiscal 2005 as a result of increases in sales of converter and amplifier products. Our DSP product sales increased 11% in the three month period ended July 29, 2006 from the comparable period of fiscal 2005 primarily due to the increase in wireless handset revenue that was partially offset by the loss of sales from our DSP-based DSL ASIC and network processor product line that we sold in the second quarter of fiscal 2006. Our DSP product sales decreased 4% in the nine month period ended July 29, 2006 from the same period in fiscal 2005 primarily due to the loss of sales from our DSP-based DSL ASIC and network processor product line that we sold in the second quarter of fiscal 2006.

Revenue Trends by Geographic Region

Sales by geographic region, based upon point of sale, for the three and nine month periods ended July 29, 2006 and July 30, 2005 are as follows:

	Three Months Ended		Nine Months Ended	
Region	**July 29, 2006**	**July 30, 2005**	**July 29, 2006**	**July 30, 2005**
North America	$164,842	$149,093	$487,103	$445,279
% of sales	25%	26%	25%	25%
Europe	$148,721	$131,336	$422,749	$410,952
% of sales	22%	22%	22%	23%
Japan	$123,169	$116,883	$360,501	$331,950
% of sales	18%	20%	19%	19%
China	$ 90,178	$ 57,574	$256,773	$195,384
% of sales	14%	10%	13%	11%
Rest of Asia	$136,750	$127,530	$401,708	$383,113
% of sales	21%	22%	21%	22%

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Gross Margin

	Three Months Ended		Nine Months Ended	
	July 29, 2006	**July 30, 2005**	**July 29, 2006**	**July 30, 2005**
Gross Margin	$390,110	$338,238	$1,131,568	$1,020,165
Gross Margin %	58.8%	58.1%	58.7%	57.7%

Gross margin percentage increased 70 basis points in the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005 and increased 100 basis points for the nine months ended July 29, 2006 compared to the same period of fiscal 2005. The increase in gross margin percentage in the three months ended July 29, 2006 as compared to the comparable period of fiscal 2005 was primarily related to the increase in utilization. The increase in gross margin percentage for the nine month period was primarily the result of the increased sales of higher margin products during the first nine months of fiscal 2006 as compared to the same period in the prior year. These three and nine month increases were partially offset by stock-based compensation expense and restructuring-related expense during such periods. Gross margin included $8.7 million and $22.4 million of stock-based compensation expense and restructuring-related expenses in the three and nine months ended July 29, 2006, respectively.

Stock-based Compensation Expense

During the first quarter of fiscal 2006, on October 30, 2005, we adopted the Financial Accounting Standards Board s Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment,* or SFAS 123R, using the modified prospective application method. Compensation cost is calculated on the date of grant using the fair value of the options as calculated by the use of the Black-Scholes valuation model. The Black-Scholes valuation model requires us to make several assumptions. One of the key assumptions is expected volatility. For options granted prior to fiscal 2005, we used historical volatility to estimate the grant-date fair value of stock options. We changed our method of estimating expected volatility for all stock options granted after fiscal 2004 from exclusively relying on historical volatility to exclusively relying on implied volatility. This change was the result of a thorough review we undertook which included consultations with several third-party advisors. We currently believe that the exclusive use of implied volatility results in a more accurate estimate of the grant-date fair value of employee stock options because it more appropriately reflects the market s expectations of future volatility. Historical volatility during the period commensurate with the expected term of our stock options over the past several years included a period of time during which our stock price experienced unprecedented increases and subsequent declines. We believe that this past stock price volatility is unlikely to be indicative of future stock price behavior.

In the third quarter of fiscal 2006, we recognized $19.0 million of stock-based compensation expense, or 2.9% of net sales, as a result of the adoption of SFAS 123R. The adoption of SFAS 123R reduced diluted EPS for the third quarter of fiscal 2006 by $0.04. For the nine months ended July 29, 2006, we recognized $56.6 million of stock-based compensation expense, or 2.9% of net sales, as a result of the adoption of SFAS 123R. The adoption of SFAS 123R reduced diluted EPS for the nine month period ended July 29, 2006 by $0.11. We expect that our adoption of SFAS 123R will reduce diluted EPS by $0.04 in the fourth quarter of fiscal 2006.

Prior to the adoption of SFAS 123R, we accounted for share-based payments to employees using APB Opinion No. 25, *Accounting for Stock Issued to Employees*, intrinsic value method and, as such, generally recognized no compensation cost for employee stock options. The adoption of SFAS 123R under the modified prospective application method allowed us to recognize compensation cost beginning with the effective date (a) based on the requirement of SFAS 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date. Under the modified prospective application method, prior periods are not restated for the effect of SFAS 123R. We used the graded attribution method to recognize expense for all options granted prior to the adoption of SFAS 123R. Upon adoption of SFAS 123R on October 30, 2005, we switched to the straight-line attribution method to recognize expense for all grants made after October 29, 2005. The expense associated with the unvested portion of the pre-adoption grants will continue to be expensed using the graded attribution method.

Prior to the adoption of SFAS 123R, on October 18, 2005, we accelerated the vesting of all unvested stock options awarded to employees after December 31, 2000 that had exercise prices of $40.00 per share or greater. Options issued to our corporate

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officers and directors were not accelerated. Unvested options to purchase approximately 18 million shares became exercisable as a result of the vesting acceleration. Because the exercise price of all the modified options was greater than the market price of our underlying common stock on the date of the modification, no stock-based compensation expense was recorded in the statement of income in accordance with APB Opinion No. 25. The primary purpose for modifying the terms of these out-of-the-money stock options to accelerate their vesting was to eliminate the need to recognize the remaining unrecognized non-cash compensation expense in our statement of income associated with these stock options as measured under SFAS 123, *Accounting for Stock-Based Compensation*. The approximately $188 million ($134 million net of tax) of future expense associated with these options would have been disproportionately high compared to the economic value of the options at the date of modification.

As of July 29, 2006, the total compensation cost related to unvested awards not yet recognized in the statement of income was approximately $173.0 million, which will be recognized over a weighted average period of 1.7 years. See Note 2 to our Consolidated Financial Statements contained in Item 1 of this Quarterly Report on Form 10-Q for further information regarding our adoption of SFAS 123R.

Research and Development

	Three Months Ended		**Nine Months Ended**	
	July 29, 2006	**July 30, 2005**	**July 29, 2006**	**July 30, 2005**
R&D Expenses	$ 136,061	$ 119,217	$ 399,197	$ 373,393
R&D Expenses as a % of Net Sales	20.5%	20.5%	20.7%	21.1%

Research and development, or R&D, expenses increased $16.8 million, or 14%, in the third quarter of fiscal 2006 as compared to the third quarter of fiscal 2005. The increase in R&D expenses for the three months ended July 29, 2006 as compared to the same period in fiscal year 2005 was primarily the result of recognizing $8.0 million of stock-based compensation expense in the third quarter of fiscal 2006 as the result of the adoption of SFAS 123R, along with increases in employee bonus expense and various other expenses.

R&D expense increased $25.8 million, or 7%, in the first nine months of fiscal 2006 compared to the amount recorded in the comparable period of fiscal 2005 primarily due to recognizing $25.8 million of stock-based compensation expense in the first nine months of fiscal 2006 as the result of the adoption of SFAS 123R, along with an increase in employee bonus expenses. These items were partially offset by the reductions of various other expenses.

R&D expense as a percentage of net sales will fluctuate from quarter to quarter depending on the amount of net sales and the success of new product development efforts, which we view as critical to our future growth. At any point in time we have hundreds of R&D projects underway, and we believe that none of these projects is material on an individual basis. We expect to continue the development of innovative technologies and processes for new products, and we believe that a continued commitment to R&D is essential in order to maintain product leadership with our existing products and to provide innovative new product offerings. Therefore, we are planning to continue to make significant R&D investments in the future.

Selling, Marketing, General and Administrative

	Three Months Ended		**Nine Months Ended**	
	July 29, 2006	**July 30, 2005**	**July 29, 2006**	**July 30, 2005**
SMG&A Expenses	$ 99,663	$ 84,407	$ 293,376	$ 253,561
SMG&A Expenses as a % of Net Sales	15.0%	14.5%	15.2%	14.4%

Selling, marketing, general and administrative, or SMG&A, expenses increased $15.3 million, or 18%, in the third quarter of fiscal 2006 as compared to the third quarter of fiscal 2005. This increase was primarily the result of recording $8.1 million of stock-based compensation expense related to the adoption of SFAS 123R along with higher employee salary, benefit and bonus expenses in the third quarter of fiscal 2006. SMG&A expenses increased $39.8 million, or 16%, in the first nine months of fiscal 2006 as compared to the comparable period of fiscal 2005. This increase was primarily the result of recording $25.8 million of stock-based compensation expense as the result of the adoption of SFAS 123R along with higher employee salary, benefit and bonus expenses.

Purchased In-process Research and Development

In the third quarter of fiscal 2006, we incurred a charge of $5.5 million for the write-off of in-process research and development in connection with the acquisition of certain intellectual property assets of TTPCom Limited. See -Acquisitions below for further information regarding this acquisition.

Special Charges

Closure of Wafer Fabrication Facility During the fourth quarter of fiscal 2005, we recorded a special charge of $20 million as a result of a decision to close our California wafer fabrication operations and transfer production to our facilities located in Massachusetts and Ireland, as well as to third-party wafer fabricators. The charge was for severance and fringe benefit costs that were recorded pursuant to SFAS 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, under our ongoing benefit plan for 339 manufacturing employees and 28 general and administrative employees. The severance benefit is calculated based on length of past service, and employees must continue to be employed until they are involuntarily terminated in order to receive the severance benefit. As of July 29, 2006, all affected employees continued to be employed by us. The employment of these employees is expected to terminate upon the closure of the wafer fabrication facility, which is planned for October 2006. In addition to the charge recorded in the fourth quarter of fiscal 2005, we recorded additional expense in each of the first, second and third quarters of fiscal 2006, which consisted of $5.4 million per quarter in the first and second quarters and $5.2 million in the third quarter of non-cash cost of sales expenses for additional depreciation due to shortened useful lives of certain manufacturing equipment and $0.5 million per quarter for stay-on bonuses. In accordance with GAAP, we expect to incur additional expenses related to this action in the fourth quarter of fiscal 2006 of approximately $13.5 million, of which approximately $5.6 million will be for non-cash cost of sales expense for additional depreciation, approximately $0.5 million will be for stay-on bonuses and approximately $7.4 million will be for estimated lease termination, clean-up and closure costs. The closure of these facilities is expected to be completed by the end of fiscal 2006 and is estimated to result in cost savings of approximately $44 million per year beginning in fiscal 2007. These savings are expected to be realized as follows: approximately $43 million in cost of sales, of which approximately $7 million relates to non-cash depreciation savings, and approximately $1 million in selling, marketing, general and administrative expense.

Reorganization of Product Development and Support Programs During the fourth quarter of fiscal 2005, we recorded a special charge of $11 million as a result of our decision to reorganize our product development and support programs with the goal of providing greater focus on our analog and DSP product programs. The charge was for severance and fringe benefit costs that were recorded pursuant to SFAS 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, under our ongoing benefit plan or statutory requirements at foreign locations for 60 manufacturing employees and 154 engineering and selling, marketing, general and administrative employees. These employees must continue to be employed until they are involuntarily terminated in order to receive the severance benefit. As of July 29, 2006, the employment of 172 of these employees had been terminated. During the first quarter of fiscal 2006, we recorded an additional special charge of $1 million related to this reorganization action. This charge was for lease obligation costs for a facility we ceased using during the first quarter of fiscal 2006 and the write-off of property, plant and equipment at this facility. We do not plan to incur any material additional charges related to this reorganization action. These organizational changes are expected to result in savings of approximately $19 million per year once fully completed by the end of fiscal 2006. These savings are expected to be realized as follows: approximately $9 million in research and development expense, approximately $6 million in selling, marketing, general and administrative expense and approximately $4 million in cost of sales.

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Operating Income

	Three Months Ended		Nine Months Ended	
	July 29, 2006	**July 30, 2005**	**July 29, 2006**	**July 30, 2005**
Operating Income	$ 148,886	$ 134,614	$ 432,482	$ 393,211
Operating Income as a % of Net Sales	22.4%	23.1%	22.4%	22.3%

The $14.3 million increase in operating income in the third quarter of fiscal 2006 as compared to the third quarter of fiscal 2005 was primarily a result of a 14% increase in net sales and a 70 basis point increase in gross margin percentage. These increases were partially offset by $16.0 million of stock-based operating expenses associated with the adoption of SFAS 123R and $6.2 million related to the previously-announced transaction with TTPCom included in the results for the third quarter of fiscal 2006.

The $39.3 million increase in operating income in the first nine months of fiscal 2006 as compared to the same period of fiscal 2005 was primarily a result of a 9% increase in net sales and a 100 basis point increase in gross margin percentage. These increases were partially offset by $51.6 million of stock-based operating expenses associated with the adoption of SFAS 123R and $6.2 million related to the previously-announced transaction with TTPCom included in the results for the first nine months of fiscal 2006.

Nonoperating (Income) Expense

	Three Months Ended		Nine Months Ended	
	July 29, 2006	**July 30, 2005**	**July 29, 2006**	**July 30, 2005**
Interest expense	$ 4	$	$ 35	$ 22
Interest income	(26,716)	(19,156)	(75,868)	(50,403)
Other (income) / expense, net	435	94	(10,261)	568
Total nonoperating income	$ (26,277)	$ (19,062)	$ (86,094)	$ (49,813)

Nonoperating income increased by $7.2 million and $36.3 million in the three and nine months ended July 29, 2006, respectively, as compared to the same periods in the prior fiscal year. These increases were primarily the result of higher interest income which was primarily attributable to higher interest rates in the three and nine months ended July 29, 2006 as compared to the same periods of fiscal 2005. The nine month year-to-year increase in nonoperating income also included a $13.0 million gain on the sale of our DSP-based DSL ASIC and network processor product line during the second quarter of fiscal 2006.

Provision for Income Taxes

	Three Months Ended		Nine Months Ended	
	July 29, 2006	**July 30, 2005**	**July 29, 2006**	**July 30, 2005**
Provision for Income Taxes	$ 30,478	$ 32,272	$ 107,513	$ 96,578
Effective Income Tax Rate	17.4%	21.0%	20.7%	21.8%

Our effective tax rate reflects the applicable tax rate in effect in the various tax jurisdictions around the world where our income is earned. The tax rate was lower for the three and nine month periods ended July 29, 2006 as compared to the comparable periods of fiscal 2005 primarily due to a one time tax benefit of $8.5 million associated with the settlement of the IRS examination during the third quarter of fiscal 2006 offset by an increase in the tax rate related to the expiration at the end of calendar 2005 of the U.S. research and development tax credit.

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Net Income

	Three Months Ended		Nine Months Ended	
	July 29, 2006	July 30, 2005	July 29, 2006	July 30, 2005
Net Income	$ 144,685	$ 121,404	$ 411,063	$ 346,446
Net Income as a % of Net Sales	21.8%	20.8%	21.3%	19.6%
Diluted EPS	$ 0.39	$ 0.32	$ 1.09	$ 0.90

Net income in the third quarter of fiscal 2006 was higher than in the third quarter of fiscal 2005 by approximately $23.3 million primarily as the result of the 14% increase in net sales, the improvement in gross margin percentage and the increase in nonoperating income. These items were partially offset by a year-to-year increase in operating expenses of $37.6 million primarily as a result of $16.0 million of stock-based operating expenses related to the adoption of SFAS 123R and $6.2 million of expenses related to the previously-announced transaction with TTPCom recorded in the third quarter of fiscal 2006.

In the nine-month period ended July 29, 2006, net income was higher than in the same period in the prior year by approximately $64.6 million primarily as a result of the 9% increase in net sales, the improvement in gross margin percentage and the increase in nonoperating income as a result of higher interest income and the sale of the DSP-based DSL ASIC and network processor product line in the second quarter of fiscal 2006. These items were partially offset by a year-to-year increase in operating expenses of $72.1 million primarily as a result of $51.6 million of stock-based operating expenses related to the adoption of SFAS 123R and $6.2 million of expenses related to the previously-announced transaction with TTPCom recorded in the nine months ended July 29, 2006.

Acquisitions

In the third quarter of fiscal 2006, we completed a transaction with TTPCom Limited whereby TTPCom transferred to us intellectual property, engineering resources, and related assets associated with the support and customization of TTPCom s GSM/GPRS/EDGE modem software for use on our existing and future generations of SoftFone(R) baseband processors. We also acquired development rights for AJAR, TTPCom s advanced applications platform. As a result of this transaction, we became the single point of contact for both hardware and software support for our new and existing wireless handset customers, thus improving our abilities to service the needs of individual customers. We paid $11.9 million in initial cash payments and may become obligated to make additional cash payments of up to an aggregate of $12 million based on the achievement during the period from May 2006 through November 2006 of technological milestones. The purchase price was allocated to the tangible and intangible assets acquired based on their estimated fair values at the date of acquisition. The estimated fair values of the assets exceeded the initial payments by $7.8 million, resulting in negative goodwill. Pursuant to SFAS 141, we recorded a liability for the contingent consideration that will be accounted for as additional purchase price, up to the amount of the negative goodwill. As contingent payments become due, the payments will be applied against the contingent liability. Contingent payments in excess of $7.8 million, if any, will be recorded as goodwill. As of July 29, 2006, we had paid $3 million of contingent payments, and the remaining contingent liability was $4.8 million. The purchase price included $5.5 million of in-process technology that had not yet reached technological feasibility, had no alternative future use and was charged to operations during the third quarter of fiscal 2006. The acquisition also included $13.2 million of intangible assets that will be amortized over their estimated useful lives of five years using an accelerated amortization method that reflects the estimated pattern of economic use.

Related Party Transactions

One of our directors, who has served on our Board of Directors since 1988, became a director of Taiwan Semiconductor Manufacturing Company, or TSMC, in fiscal 2002 and continues to serve as a director of TSMC. We purchased approximately $76 million and $52 million of products from TSMC during the three-month periods ended July 29, 2006 and July 30, 2005, respectively, and approximately $216 million and $174 million in the nine-month periods ended July 29, 2006 and July 30, 2005, respectively. Approximately $37 million and $27 million was payable to TSMC as of July 29, 2006 and October 29, 2005, respectively. We anticipate that we will make significant purchases from TSMC in the remaining quarter of fiscal year 2006.

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Outlook

While it is difficult to forecast revenue in the semiconductor industry, we are currently planning for revenue in the fourth quarter of fiscal 2006 to be approximately equal to the third quarter of fiscal 2006. We are also planning for our gross margin percentage in the fourth quarter to be approximately the same as the third quarter of fiscal 2006. Operating expenses in the fourth quarter of fiscal 2006 are planned to increase by approximately $21.9 million compared to the third quarter of fiscal 2006, primarily due to the previously announced restructuring and acquisition-related expenses. Diluted EPS is planned to be in the range of $0.33 to $0.34 in the fourth quarter of fiscal 2006. This estimate of diluted EPS includes an approximately $0.04 per share impact related to stock-based compensation expense, $0.02 per share for previously announced restructuring-related expenses and $0.03 per share for previously announced acquisition-related expenses.

Liquidity and Capital Resources

	Nine Months Ended	
	July 29, 2006	**July 30, 2005**
Net Cash Provided by Operations	$ 454,367	$ 472,385
Net Cash Provided by Operations as a % of Net Sales	23.6%	26.7%

At July 29, 2006, cash, cash equivalents and short-term investments totaled $2,516 million, a decrease of $189.9 million from the fourth quarter of fiscal 2005. Our statement of cash flows reflects $156.0 million of operating cash outflow for the non-cash tax benefit from the exercise of stock options over a period of years. There is an offsetting inflow for the same amount in the financing section in the statement of cash flows for this non-cash item. Approximately $115.5 million of this $156.0 million relates to the settlement of the IRS examination. The primary sources of funds for the first nine months of fiscal 2006 were net cash generated from operating activities of $454.4 million (which is net of the $156.0 million of non-cash tax benefit discussed above), proceeds from the sale of a product line of $23.1 million and proceeds of $79.9 million from our various employee stock plans. The principal uses of funds for the first nine months of fiscal 2006 were the repurchase of approximately 18.8 million shares of our common stock for an aggregate of $668.0 million, dividend payments of $145.8 million, capital expenditures of $87.5 million and payments for acquisitions of $14.9 million.

	July 29, 2006	**October 29, 2005**
Accounts Receivable	$ 359,774	$ 320,523
Days Sales Outstanding	49	47
Inventory	$ 377,434	$ 325,605
Days Cost of Sales in Inventory	126	115

Accounts receivable at July 29, 2006 increased $39.3 million, or 12%, from the end of the fourth quarter of fiscal 2005 and days sales outstanding increased by two days. The increase in receivables was primarily related to the higher sales in the third quarter of fiscal 2006 as compared to the fourth quarter of fiscal 2005.

Inventory at July 29, 2006 increased by $51.8 million, or 16%, from the end of fiscal 2005. Approximately $13.5 million of this increase is in preparation for the planned closure of our wafer fabrication facility in California and approximately $4.1 million relates to the capitalization of manufacturing related stock-based compensation expense as a result of the adoption of SFAS 123R in the first quarter of fiscal 2006. The remainder of the increase primarily relates to an increase to support the anticipated higher sales demand in the fourth quarter of fiscal 2006 as compared to the first quarter of fiscal 2006.

Current liabilities decreased to $585.2 million at July 29, 2006, a decrease of $233.8 million, or 29%, from $818.9 million at the end of fiscal 2005. The decrease in current liabilities was largely the result of a $233.3 million net decrease in the current portion of the deferred compensation plan liability primarily as a result of withdrawals by plan participants in response to certain provisions of the American Jobs Creation Act, as more fully described below. Additionally, income taxes payable decreased by a net of $72.8 million due primarily to the settlement of the IRS examination for fiscal years 2001, 2002 and 2003. These decreases were partially offset by a $44.0 million increase to deferred income on shipments to distributors due to the increase in inventory held by our distributors as a results of increases in demand for our products during the first nine months of fiscal 2006.

During the first nine months of fiscal 2006, we distributed $254.1 million from our amended and restated deferred compensation plan, or the Deferred Compensation Plan, as a result of participant terminations or at the direction of the participants. This amount represented compensation and/or stock option gains previously deferred by those participants pursuant to the terms of our Deferred Compensation Plan. As a result of certain provisions of the American Jobs Creation Act, participants had the opportunity until December 31, 2005 to elect to withdraw amounts previously deferred. As a result of withdrawals pursuant to elections under these provisions or upon termination, participants have withdrawn approximately $254.1 million of deferred compensation, of which $234.4 million was previously reflected in the Less than 1 Year column and $19.7 million in the More than 5 Years column of the contractual obligations table contained in the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the fiscal year ended October 29, 2005.

Net additions to property, plant and equipment were $87.5 million in the first nine months of fiscal 2006 and were funded with a combination of cash on hand and cash generated from operations. Capital expenditures are expected to be approximately $40 million in the fourth quarter of fiscal 2006.

On August 9, 2006, our Board of Directors declared a cash dividend of $0.16 per outstanding share of our common stock. The dividend is payable on September 13, 2006 to shareholders of record on August 25, 2006 and is expected to be approximately $57 million in the aggregate. The payment of future dividends will be based on several factors including our financial performance, outlook and liquidity. Quarterly dividends are expected to continue at $0.16 per share, subject to declaration or change by our Board of Directors.

At July 29, 2006, our principal source of liquidity was $2,516 million of cash and cash equivalents and short-term investments. We believe that our existing sources of liquidity and cash expected to be generated from future operations, together with anticipated available long-term financing, will be sufficient to fund operations, capital expenditures, research and development efforts, dividend payments (if any) and purchases of stock (if any) under our stock repurchase program for at least the next twelve months and thereafter for the foreseeable future.

New Accounting Pronouncements

Accounting for Uncertainty in Income Taxes

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standards (SFAS) 109, *Accounting for Income Taxes.* FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently analyzing FIN 48 and believe the adoption of FIN 48 will not have a material impact on our financial condition, results of operations or liquidity

Accounting Changes and Error Corrections

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* which supersedes APB Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements* (SFAS 154). SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. The correction of an error in previously issued financial statements is not an accounting change. However, the reporting of an error correction involves adjustments to previously issued financial statements similar to those generally applicable to reporting an accounting change retroactively. Therefore, the reporting of a correction of an error by restating previously issued financial statements is also addressed by this Statement. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We do not expect the adoption of SFAS 154 to have a material impact on our financial condition, results of operations or liquidity.

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Asset Retirements

In March 2005, the FASB issued FIN 47, *Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143.* FIN 47 clarifies that the term conditional asset retirement obligation as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations,* refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. We are currently analyzing FIN 47 and believe the adoption of FIN 47 will not have a material impact on our financial condition, results of operations or liquidity.

Inventory Costs

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs, an amendment of Accounting Research Bulletin (ARB) No. 43, Chapter 4* (SFAS 151). SFAS 151 amends the guidance in ARB No 43, Chapter 4, Inventory Pricing, to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) should be recognized as current-period charges. In addition, SFAS 151 requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS 151 are effective for fiscal years beginning after June 15, 2005. The adoption of SFAS 151 in the first quarter of fiscal 2006 did not impact our financial condition, results of operations or liquidity.

Critical Accounting Policies and Estimates

Management s discussion and analysis of the financial condition and results of operations is based upon the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates and judgments on historical experience, knowledge of current conditions and beliefs of what could occur in the future given available information. We consider the following accounting policies to be both those most important to the portrayal of our financial condition and those that require the most subjective judgment. If actual results differ significantly from management s estimates and projections, there could be a material effect on our financial statements. We also have other policies that we consider key accounting policies, such as our policy for revenue recognition, including the deferral of revenue on sales to distributors until the products are sold to the end user; however, the application of these policies does not require us to make significant estimates or judgments that are difficult or subjective.

Inventory Valuation

Inventories are valued at the lower of cost (first-in, first-out method) or market. Because of the cyclical nature of the semiconductor industry, changes in inventory levels, obsolescence of technology, and product life cycles, we write down inventories to net realizable value. We employ a variety of methodologies to determine the amount of inventory reserves necessary. While a portion of the reserve is determined via reference to the age of inventory and lower of cost or market calculations, an element of the reserve is subject to significant judgments made by us about future demand for our inventory. If actual demand for our products is less than our estimates, additional reserves for existing inventories may need to be recorded in future periods.

Allowance for Doubtful Accounts

We maintain allowances for doubtful accounts, when appropriate, for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, our actual losses may exceed our estimates, and additional allowances would be required.

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Long-Lived Assets

We review property, plant, and equipment for impairment whenever events or changes in circumstances indicate that the carrying value of assets may not be recoverable. Recoverability of these assets is measured by comparison of their carrying value to future undiscounted cash flows the assets are expected to generate over their remaining economic lives. If such assets are considered to be impaired, the impairment to be recognized in earnings equals the amount by which the carrying value of the assets exceeds their fair market value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique. Although we have recognized no material impairment adjustments related to our property, plant, and equipment during the past three fiscal years, except those made in conjunction with restructuring actions, deterioration in our business in the future could lead to such impairment adjustments in future periods. Evaluation of impairment of long-lived assets requires estimates of future operating results that are used in the preparation of the expected future undiscounted cash flows. Actual future operating results and the remaining economic lives of our long-lived assets could differ from the estimates used in assessing the recoverability of these assets. These differences could result in impairment charges, which could have a material adverse impact on our results of operations. In addition, in certain instances, assets may not be impaired but their estimated useful lives may have decreased. In these situations, we amortize the remaining net book values over the revised useful lives.

Goodwill

In accordance with SFAS 142, *Goodwill and Other Intangible Assets*, goodwill is subject to annual impairment tests, or earlier if indicators of potential impairment exist and suggest that the carrying value of goodwill may not be recoverable from estimated discounted future cash flows. Because we have one reporting segment under SFAS 142, we utilize the entity-wide approach to assess goodwill for impairment and compare our market value to our net book value to determine if an impairment exists. These impairment tests may result in impairment losses that could have a material adverse impact on our results of operations.

Accounting for Income Taxes

We account for income taxes in accordance with SFAS 109, *Accounting for Income Taxes*, which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized. We evaluate the realizability of our deferred tax assets quarterly. At July 29, 2006, we had gross deferred tax assets of $192.9 million primarily resulting from temporary differences between the book and tax bases of assets and liabilities. We have conducted an assessment of the likelihood of realization of those deferred tax assets and concluded that a $43.3 million valuation allowance is needed to reserve the amount of the deferred tax assets that may not be realized due to the expiration of state credit carryovers. In reaching our conclusion, we evaluated certain relevant criteria including the existence of deferred tax liabilities that can be used to absorb deferred tax assets, the taxable income in prior carryback years that can be used to absorb net operating losses and taxable income in future years. Our judgments regarding future profitability may change due to future market conditions, changes in U.S. or international tax laws and other factors. These changes, if any, may require material adjustments to these deferred tax assets, resulting in a reduction in net income or an increase in net loss in the period when such determinations are made.

In the ordinary course of global business, there are many transactions and calculations where the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of cost reimbursement and royalty arrangements among related entities. Although we believe our estimates are reasonable, no assurance can be given that the final tax outcome of these matters will not be different than that which is reflected in our historical income tax provisions and accruals. Such differences could have a material impact on our income tax provision and operating results in the period in which such determination is made.

Stock-Based Compensation

The adoption of SFAS 123R in the first quarter of fiscal 2006 requires that stock-based compensation expense associated with stock options be recognized in the statement of income, rather than being disclosed in a pro forma footnote to the consolidated financial statements. Determining the amount of stock-based compensation to be recorded requires us to develop estimates to be used in calculating the grant-date fair value of stock options. We calculate the grant-date fair values using the Black-Scholes valuation model. The use of valuation models requires us to make estimates of the following assumptions:

Expected volatility We are responsible for estimating volatility and have considered a number of factors, including third-party estimates, when estimating volatility. For options granted prior to fiscal 2005, we used historical volatility to estimate the grant-date fair value of stock options. We changed our method of estimating expected volatility for all stock options granted after fiscal 2004 from exclusively relying on historical volatility to exclusively relying on implied volatility. This change was the result of a thorough review we undertook which included consultations with several third-party advisors. We currently believe that the exclusive use of implied volatility results in a more accurate estimate of the grant-date fair value of employee stock options because it more appropriately reflects the market s expectations of future volatility. Historical volatility during the period commensurate with the expected term of our stock options over the past several years included a period of time that our stock price experienced unprecedented increases and subsequent declines. We believe that this past stock price volatility is unlikely to be indicative of future stock price behavior. Options in our stock are actively traded on several exchanges. Implied volatility is calculated for the period that is commensurate with the option s expected term assumption. Because this term often exceeds the period for which there are exchange-traded options in our stock, statistical techniques are used to derive the implied volatility for traded options with terms commensurate with the option s expected term of five years. This calculation of implied volatility is derived from the closing prices of the company s stock and exchange traded options from the most recent five trading days prior to the grant date of the employee stock option. In general, the higher the expected volatility used in the Black-Scholes valuation model, the higher the grant-date fair value of the option.

Expected term We use historical employee exercise and option expiration data to estimate the expected term assumption for the Black-Scholes grant date valuation. We believe that this historical data is currently the best estimate of the expected term of a new option, and that generally, all of our employees exhibit similar exercise behavior. In general, the longer the expected term used in the Black-Scholes valuation model, the higher the grant-date fair value of the option.

Risk-free interest rate The yield on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected term assumption is used as the risk-free interest rate.

Expected dividend yield Expected dividend yield is calculated by annualizing the cash dividend declared by our Board of Directors for the current quarter and dividing that result by the closing stock price on the date of grant. Until such time as our Board of Directors declares a cash dividend for an amount that is different from the current quarter s cash dividend, the current dividend will be used in deriving this assumption. Dividends are not paid on options, restricted stock or restricted stock units.

The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term forfeitures is distinct from cancellations or expirations and represents only the unvested portion of the surrendered option. We currently expect, based on an analysis of our historical forfeitures, that approximately 86% of our options will vest, and therefore have applied an annual forfeiture rate of 3.1% to all unvested options as of July 29, 2006. The 3.1% represents the portion that is expected to be forfeited each year over the vesting period, therefore, the cumulative amount, on a compounded basis, that is expected to be forfeited is approximately 14% of the aggregate options granted. This analysis will be re-evaluated quarterly and the forfeiture rate will be adjusted as necessary. Ultimately, the actual expense recognized over the vesting period will only be for those shares that vest.

Contingencies

From time to time, we receive notices that our products or manufacturing processes may be infringing the patent or intellectual property rights of others. We periodically assess each matter to determine if a contingent liability should be recorded in accordance with SFAS 5, *Accounting for Contingencies*. In making this determination, we may, depending on the nature of the matter, consult with internal and external legal counsel and technical experts. Based on the information we obtain, combined with our judgment regarding all the facts and circumstances of each matter, we determine whether it is probable that a contingent loss may be incurred and whether the amount of such loss can be reasonably estimated. Should a loss be probable and reasonably estimable, we record a contingent loss in accordance with SFAS 5. In determining the amount of a contingent loss, we consider advice received from experts in the specific matter, current status of legal proceedings, settlement negotiations that may be ongoing, prior case history and other factors. Should the judgments and estimates made by us be incorrect, we may need to record additional contingent losses that could materially adversely impact our results of operations. See Note 10 to our Consolidated Financial Statements contained in Item 1 of this Quarterly Report on Form 10-Q.

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Factors That May Affect Future Results

Our future operating results are difficult to predict and may materially fluctuate.

Our future operating results are difficult to predict and may be materially affected by a number of factors, including the timing of new product announcements or introductions by us or our competitors, competitive pricing pressures, fluctuations in manufacturing yields, adequate availability of wafers and other raw materials, and manufacturing, assembly and test capacity, the risk that our backlog could decline significantly, the timing, delay or cancellation of significant customer orders and our ability to manage inventory, our ability to hire, retain and motivate adequate numbers of engineers and other qualified employees to meet the demands of our customers, changes in product or customer mix, the effect of adverse changes in economic conditions in the United States and international markets and the effects of public health emergencies, natural disasters, terrorist activities, international conflicts and other events beyond our control. In addition, the semiconductor market has historically been cyclical and subject to significant economic downturns. Our business is subject to rapid technological changes and there can be no assurance, depending on the mix of future business, that products stocked in inventory will not be rendered obsolete before we ship them. As a result of these and other factors, there can be no assurance that we will not experience material fluctuations in future operating results on a quarterly or annual basis. In addition, if our operating results do not meet the expectations of securities analysts or investors, the market price of our common stock may decline.

Long-term contracts are not typical for us and reductions, cancelations or delays in orders for our products could adversely affect our operating results.

In certain markets where end-user demand may be particularly volatile and difficult to predict, some customers place orders that require us to manufacture product and have it available for shipment, even though the customer is unwilling to make a binding commitment to purchase all, or even any, of the product. At any given time, this situation could affect a portion of our backlog. As a result, we are subject to the risk of cancelation of orders leading to a sharp reduction of sales and backlog. Further, those orders may be for products that meet the customer s unique requirements so that those canceled orders would, in addition, result in an inventory of unsaleable products, resulting in potential inventory write-offs. As a result of lengthy manufacturing cycles for certain of the products that are subject to these uncertainties, the amount of unsaleable product could be substantial. Reductions, cancelations or delays in orders for our products could adversely affect our operating results.

Our future success depends upon our ability to continue to improve our products, develop and market new products, and enter new markets.

Our success significantly depends on our continued ability to improve our products and develop and market new products. There can be no assurance that we will be able to develop and introduce new and improved products in a timely manner or that new and improved products, if developed, will achieve market acceptance. In addition, our customers generally impose very high quality standards on our products, which often change and may be difficult or costly to satisfy. Any inability to satisfy such quality standards may adversely affect demand for our products and our results of operations. In addition, our growth is dependent on our continued ability to penetrate new markets where we have limited experience and competition is intense. There can be no assurance that the markets we serve will grow in the future, that our existing and new products will meet the requirements of these markets, that our products will achieve customer acceptance in these markets, that competitors will not force prices to an unacceptably low level or take market share from us, or that we can achieve or maintain profits in these markets. Furthermore, a decline in demand in one or several of our end-user markets could have a material adverse effect on the demand for our products and our results of operations. Also, some of our customers in these markets are less established, which could subject us to increased credit risk.

We may not be able to compete successfully in markets within the semiconductor industry in the future.

Many other companies offer products that compete with our products. Some have greater financial, manufacturing, technical and marketing resources than we have. Additionally, some formerly independent competitors have been purchased by larger companies. Our competitors also include emerging companies selling specialized products to markets we serve. Existing or new competitors may develop products or technologies that more effectively address the demands of our markets with enhanced features and functionality, lower power requirements, greater levels of integration or lower cost. Increased competition in certain markets has resulted in and may continue to result in declining average selling prices, reduced gross margins and loss of market share in such markets. There can be no assurance that we will be able to compete successfully in

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the future against existing or new competitors, or that our operating results will not be adversely affected by increased price competition.

We rely on third-party subcontractors and manufacturers for some industry-standard wafers and assembly/test services, and therefore cannot control their availability or conditions of supply.

We rely, and plan to continue to rely, on assembly and test subcontractors and on third-party wafer fabricators to supply most of our wafers that can be manufactured using industry-standard submicron processes. This reliance involves several risks, including reduced control over availability, delivery schedules, manufacturing yields, quality assurance and costs. Additionally, we utilize third-party wafer fabricators as sole-source suppliers, primarily Taiwan Semiconductor Manufacturing Company. These suppliers manufacture components in accordance with our proprietary designs and specifications. We have no written supply agreements with these sole-source suppliers and purchase our custom components through individual purchase orders. If these sole-source suppliers are unable or unwilling to manufacture and deliver sufficient quantities of components to us, on the time schedule and of the quality that we require, we may be forced to seek to engage additional or replacement suppliers, which could result in additional expenses and delays in product development or shipment of product to our customers.

We may not be able to satisfy increasing demand for our products, and increased production may lead to overcapacity and lower prices.

The cyclical nature of the semiconductor industry has resulted in sustained and short-term periods when demand for our products has increased or decreased rapidly. During these periods of rapid increases in demand, our available capacity may not be sufficient to satisfy the available demand. In addition, we may not be able to expand our workforce and operations in a sufficiently timely manner to respond effectively to changes in demand for our existing products or to the demand for new products requested by our customers, and our current or future business could be materially and adversely affected. Conversely, if we expand our operations and workforce too rapidly in anticipation of increased demand for our products, and such demand does not materialize at the pace at which we expect, our operating results may be adversely affected. These capacity expansions by us and other semiconductor manufacturers could also lead to overcapacity in our target markets which could lead to price erosion that would adversely impact our operating results.

Our revenue may not increase enough to offset the expense of additional capacity.

We, and the semiconductor industry generally, expand production facilities and access to third-party foundries in response to periods of increased demand which can cause operating expenses to increase. Should customer demand fail to increase or should the semiconductor industry enter a period of reduced customer demand, our financial position and results of operations could be adversely impacted as a result of increased operating expenses, reduced margins, underutilization of capacity or asset impairment charges.

We may be unable to adequately protect our proprietary rights, which may limit our ability to compete effectively.

Our success depends, in part, on our ability to protect our intellectual property. We primarily rely on patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to protect our proprietary technologies and processes. Despite our efforts to protect our proprietary technologies and processes, it is possible that competitors or other unauthorized third parties may obtain, copy, use or disclose our technologies and processes. Moreover, the laws of foreign countries in which we design, manufacture and market our products may afford little or no effective protection of our proprietary technology.

There can no assurance that the claims allowed in our issued patents will be sufficiently broad to protect our technology. In addition, any of our existing or future patents may be challenged, invalidated or circumvented. As such, any rights granted under these patents may not provide us with meaningful protection. We may not have foreign patents or pending applications corresponding to our U.S. patents and applications. Even if foreign patents are granted, effective enforcement in foreign countries may not be available. If our patents do not adequately protect our technology, our competitors may be able to offer products similar to ours. Our competitors may also be able to develop similar technology independently or design around our patents. Other companies or individuals have obtained patents covering a variety of semiconductor designs and processes, and we might be required to obtain licenses under some of these patents or be precluded from making and selling the infringing products, if such patents are found to be valid. There can be no assurance that we would be able to obtain licenses, if required, upon commercially reasonable terms, or at all.

We generally enter into confidentiality agreements with our employees, consultants and strategic partners. We also try to control access to and distribution of our technologies, documentation and other proprietary information. Despite these efforts, internal or external parties may attempt to copy, disclose, obtain or use our products, services or technology without our authorization. Also, former employees may seek employment with our business partners, customers or competitors, and there can be no assurance that the confidential nature of our proprietary information will be maintained in the course of such future employment.

We are involved in frequent litigation regarding intellectual property rights, which could be costly to defend and could require us to redesign products or pay significant royalties.

The semiconductor industry is characterized by frequent claims and litigation involving patent and other intellectual property rights, including claims arising under our contractual indemnification of our customers. We have received from time to time, and may receive in the future, claims from third parties asserting that our products or processes infringe their patents or other intellectual property rights. In the event a third party makes a valid intellectual property claim against us and a license is not available to us on commercially reasonable terms, or at all, we could be forced either to redesign or to stop production of products incorporating that intellectual property, and our operating results could be materially and adversely affected. Litigation may be necessary to enforce our patents or other of our intellectual property rights or to defend us against claims of infringement, and this litigation could be costly and divert the attention of our key personnel. See Note 10 in the Notes to our Consolidated Financial Statements contained in Item 1 of this Quarterly Report on Form 10-Q for information concerning certain pending litigation that involves us. An adverse outcome in these matters or other litigation could have a material adverse effect on our consolidated financial position or on our consolidated results of operations or cash flows in the period in which the litigation is resolved.

If we do not retain our key personnel, our ability to execute our business strategy will be limited.

Our success depends to a significant extent upon the continued service of our executive officers and key management and technical personnel, particularly our experienced engineers, and on our ability to continue to attract, retain, and motivate qualified personnel. The competition for these employees is intense. The loss of the services of one or more of our key personnel could have a material adverse effect on our operating results. In addition, there could be a material adverse effect on us should the turnover rates for engineers and other key personnel increase significantly or if we are unable to continue to attract qualified personnel. We do not maintain any key person life insurance policy on any of our officers or employees.

To remain competitive we may need to acquire other companies or purchase or license technology from third parties in order to introduce new products and services or enhance our existing products and services.

An element of our business strategy involves expansion through the potential acquisitions of businesses, assets, products or technologies that allow us to complement our existing product offerings, expand our market coverage, increase our engineering workforce or enhance our technological capabilities. We may not be able to find businesses that have the technology or resources we need and, if we find such businesses, may not be able to purchase or license the technology or resources on commercially favorable terms or at all. Acquisitions and technology licenses are difficult to identify and complete for a number of reasons, including the cost of potential transactions, competition among prospective buyers and licensees and the need for regulatory approvals. In order to finance a potential transaction, we may need to raise additional funds by selling our stock or borrowing money. We may not be able to find financing on favorable terms, and the sale of our stock may result in the dilution of our existing shareholders or the issuance of securities with rights that are superior to the rights of our common stockholders. Acquisitions also involve a number of risks, including:

- difficulty integrating acquired technologies, operations and personnel with our existing businesses;
- diversion of management attention in connection with both negotiating the acquisitions and integrating the assets;
- strain on managerial and operational resources as management tries to oversee larger operations;

the future funding requirements for acquired companies, which may be significant;

exposure to unforeseen liabilities of acquired companies; and

increased risk of costly and time-consuming litigation.

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If we are unable to successfully address these risks, we may not realize some or all of the expected benefits of the acquisition, which may have an adverse effect on our business and results of operations.

We rely on manufacturing capacity located in geologically unstable areas, which could affect the availability of supplies and services.

We, and many companies in the semiconductor industry, rely on internal manufacturing capacity located in California as well as wafer fabrication foundries in Taiwan and other sub-contractors in geologically unstable locations around the world. This reliance involves risks associated with the impact of earthquakes on us and the semiconductor industry, including temporary loss of capacity, availability and cost of key raw materials and equipment and availability of key services including transport. Any prolonged inability to utilize one of our manufacturing facilities, or those of our subcontractors or third party wafer-fabrication foundries, as a result of fire, natural disaster, unavailability of electric power or otherwise, would have a material adverse effect on our results of operations and financial condition.

We are exposed to business, economic, political and other risks through our significant worldwide operations.

During the third quarter of fiscal 2006, approximately 75% of our revenues were derived from customers in international markets. Although we engage in hedging transactions to reduce our exposure to currency exchange rate fluctuations, there can be no assurance that our competitive position will not be adversely affected by changes in the exchange rate of the United States dollar against other currencies. Potential interest rate increases, particularly in the United States and China, as well as high energy costs could have an adverse impact on industrial and consumer spending patterns and could adversely impact demand for our products. We have manufacturing facilities outside the United States in Ireland and the Philippines. In addition to being exposed to the ongoing economic cycles in the semiconductor industry, we are also subject to the economic and political risks inherent in international operations and their impact on the United States economy in general, including the risks associated with ongoing uncertainties and political and economic instability in many countries around the world as well as the economic disruption from acts of terrorism, and the response to them by the United States and its allies. Other business risks associated with international operations include air transportation disruptions, expropriation, currency controls, currency exchange rate movement, additional costs related to foreign taxes, tariffs and freight rate increases, exposure to different business practices and legal standards, particularly with respect to intellectual property, trade and travel restrictions, pandemics, import and export license requirements and restrictions, difficulties in staffing and managing worldwide operations, and accounts receivable collections.

Our future operating results are dependent on the performance of independent distributors and sales representatives.

A significant portion of our sales are through independent distributors that are not under our control. These independent distributors generally represent product lines offered by several companies and thus could reduce their sales efforts applied to our products or terminate their representation of us. We generally do not require letters of credit from our distributors and are not protected against accounts receivable default or bankruptcy by these distributors. Our inability to collect open accounts receivable could adversely affect our results of operations. Termination of a significant distributor, whether at our initiative or the distributor s initiative, could disrupt our current business. If we are unable to find suitable replacements in the event of terminations by significant distributors or sales representatives, our operating results could be adversely affected.

Our manufacturing processes are highly complex and may be interrupted.

We have manufacturing processes that utilize a substantial amount of technology as the fabrication of integrated circuits is a highly complex and precise process. Minute impurities, contaminants in the manufacturing environment, difficulties in the fabrication process, defects in the masks used in the wafer manufacturing process, manufacturing equipment failures, wafer breakage or other factors can cause a substantial percentage of wafers to be rejected or numerous dice on each wafer to be nonfunctional. While we have significant expertise in semiconductor manufacturing, it is possible that some processes could become unstable. This instability could result in manufacturing delays and product shortages, which could have a material adverse effect on our financial position or results of operations.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the information provided under Item 7A. Qualitative and Quantitative Disclosures about Market Risk set forth in our Annual Report on Form 10-K for the year ended October 29, 2005.

ITEM 4. Controls and Procedures

(a) *Evaluation of Disclosure Controls and Procedures*. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of Analog s disclosure controls and procedures as of July 29, 2006. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of July 29, 2006, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

(b) *Changes in Internal Control over Financial Reporting*. No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the third quarter ended July 29, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. Legal Proceedings

In April 2006, we received a demand from a purported shareholder to inspect the Company s books and records relating to certain grants of options made to our directors and officers at diverse times. On May 19, 2006, the demand was withdrawn by the purported shareholder.

In May 2006, we received a demand from a purported shareholder with respect to certain grants of options made to our directors and officers during the years 1998, 1999 and 2001. That demand seeks, among other things, the commencement of an action by our directors on behalf of us against those directors and officers for breach of fiduciary duties arising from the granting of the options. A special committee of our Board of Directors was formed to review the allegations contained in the demand and to respond appropriately. After reviewing the facts underlying the allegations, the special committee decided to reject the purported shareholder s demand. We do not know whether the purported shareholder will take further action.

On or about May 5, 2006, Mr. Gregory Bender filed a complaint for patent infringement in the U.S. District Court for the Eastern District of Texas against us, Civil Action Number 2:06-CV-192. Prior to the filing of the complaint, we were unaware of Mr. Bender or this action. In his complaint, Mr. Bender alleges that certain of our amplifier products infringe a patent Mr. Bender owns. He seeks unspecified damages as well as a permanent injunction enjoining us from infringing his patent. Mr. Bender has not yet served his complaint on us. We intend to vigorously defend against these allegations. We cannot predict the outcome of this matter, but believe that the disposition of the matter will not have a material adverse effect on us or our financial position.

In May 2006, we received a document subpoena from the U.S. Attorney for the Southern District of New York requesting records from 2000 to the present relating to our granting of stock options. We believe that the options at issue in this matter are the same option grants which have been the subject of investigation by the SEC. We are cooperating with the office of the U.S. Attorney in connection with this subpoena. We cannot predict the outcome of this matter, but believe that the disposition of the matter will not have a material adverse effect on us or our financial position.

On June 12, 2006, a purported derivative complaint was filed in the United States District Court for the District of Massachusetts naming us as nominal defendant and also naming as defendants certain of our officers and directors. The complaint alleges purported violations of state and federal law in connection with our option granting practices during the years 1998, 1999 and 2001, including violation of Section 14(a) of the Securities Exchange Act of 1934, breaches of fiduciary duties of care, loyalty and good faith, gross mismanagement, waste of corporate assets, and unjust enrichment. The complaint seeks monetary damages in unspecified amounts, as well as equitable and injunctive relief. Our Board and management intend to review the allegations and respond appropriately.

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ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds
Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid Per Share (a)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (b)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
April 30, 2006 through May 27, 2006	1,978,338	$ 35.95	1,978,338	$ 903,491,859
May 28, 2006 through June 24, 2006	2,904,774	$ 33.14	2,904,774	$ 807,223,573
June 25, 2006 through July 29, 2006	4,380,810	$ 31.45	4,380,810	$ 669,454,906
Total	9,263,922	$ 32.94	9,263,922	$ 669,454,906

(a) The average price paid per share of stock repurchased under the stock repurchase program includes the commissions paid to the brokers.

(b) Repurchased pursuant to the stock repurchase program publicly announced on August 12, 2004, as amended on May 11, 2005, under which our Board of Directors authorized the repurchase of up

to an aggregate of $1 billion of our common stock.
On March 14, 2006, our Board of Directors authorized the repurchase by us of an additional $1 billion of our common stock, increasing the total amount of our common stock we can repurchase from $1 billion to $2 billion of our common stock. Under the repurchase program, we may repurchase outstanding shares of our common stock from time to time in the open market and through privately negotiated transactions. Unless terminated earlier by resolution of our Board of Directors, the repurchase program will expire when we have repurchased all shares authorized for repurchase under the repurchase

program.

ITEM 6. Exhibits

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

SIGNATURES

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

ANALOG DEVICES, INC.

Date: August 15, 2006	By: /s/ Jerald G. Fishman Jerald G. Fishman President and Chief Executive Officer (Principal Executive Officer)
Date: August 15, 2006	By: /s/ Joseph E. McDonough Joseph E. McDonough Vice President-Finance and Chief Financial Officer (Principal Financial and Accounting Officer)

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Exhibit Index

Exhibit No.	Description
31.1	Certification Pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer).
31.2	Certification Pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer).
32.1	Certification Pursuant to 18 U.S.C. Section 1350 (Chief Executive Officer).
32.2	Certification Pursuant to 18 U.S.C. Section 1350 (Chief Financial Officer).