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

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 1, 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 number: 000-29823

SILICON LABORATORIES INC.
(Exact name of registrant as specified in its charter)

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

(512) 416-8500
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☑ Yes o No

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

Large accelerated filer ☑ 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).

o Yes ☑ No

As of July 18, 2006, 55,991,923 shares of common stock of Silicon Laboratories Inc. were outstanding.

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Cautionary Statement

Except for the historical financial information contained herein, the matters discussed in this report on Form 10-Q (as well as documents incorporated herein by reference) may be considered "forward-looking" statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements include declarations regarding the intent, belief or current expectations of Silicon Laboratories Inc. and its management and may be signified by the words "expects," "anticipates," "intends," "believes" or similar language. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties. Actual results could differ materially from those indicated by such forward-looking statements. Factors that could cause or contribute to such differences include those discussed under "Risk Factors" and elsewhere in this report. Silicon Laboratories disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

SILICON LABORATORIES INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	July 1, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 179,205	$ 100,504
Short-term investments	227,764	263,206
Accounts receivable, net of allowance for doubtful accounts of $1,088 at July 1, 2006 and December 31, 2005	75,686	68,824
Inventories	38,187	23,132
Deferred income taxes	14,118	11,505
Prepaid expenses and other	15,173	9,670
Total current assets	550,133	476,841
Property, equipment and software, net	30,854	32,584
Goodwill	69,856	62,877
Other intangible assets, net	22,545	14,838
Other assets, net	39,302	25,863
Total assets	$ 712,690	$ 613,003
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 47,626	$ 43,846
Accrued expenses	15,637	11,307
Deferred income on shipments to distributors	39,046	34,036
Income taxes payable	12,935	18,348
Total current liabilities	115,244	107,537
Long-term obligations and other liabilities	15,377	7,418
Total liabilities	130,621	114,955
Commitments and contingencies		
Stockholders' equity:		
Preferred stock—$0.0001 par value; 10,000 shares authorized; no shares issued and outstanding	—	—

Common stock—$0.0001 par value; 250,000 shares authorized; 55,987 and 54,530 shares issued and outstanding at July 1, 2006 and December 31, 2005, respectively	6	5
Additional paid-in capital	396,998	335,284
Deferred stock compensation	—	(1,105)
Retained earnings	185,065	163,864
Total stockholders' equity	582,069	498,048
Total liabilities and stockholders' equity	$ 712,690	$ 613,003

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

SILICON LABORATORIES INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	Three Months Ended		Six Months Ended	
	July 1, 2006	July 2, 2005	July 1, 2006	July 2, 2005
Revenues	$ 123,504	$ 107,156	$ 238,044	$ 211,920
Cost of revenues	52,996	48,576	104,296	97,136
Gross profit	70,508	58,580	133,748	114,784
Operating expenses:				
Research and development	30,467	21,374	58,024	40,927
Selling, general and administrative	26,163	19,297	50,865	36,175
In-process research and development	2,600	—	2,600	—
Operating expenses	59,230	40,671	111,489	77,102
Operating income	11,278	17,909	22,259	37,682
Other income (expense):				
Interest income	3,623	1,992	6,826	3,404
Interest expense	(225)	(45)	(400)	(101)
Other income (expense), net	45	(178)	291	(193)
Income before income taxes	14,721	19,678	28,976	40,792
Provision for income taxes	4,584	4,064	7,775	7,805
Net income	$ 10,137	$ 15,614	$ 21,201	$ 32,987
Net income per share:				
Basic	$ 0.18	$ 0.29	$ 0.38	$ 0.62
Diluted	$ 0.18	$ 0.28	$ 0.37	$ 0.60
Weighted-average common shares outstanding:				
Basic	55,842	53,149	55,460	52,807
Diluted	57,858	55,027	57,761	55,196

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

SILICON LABORATORIES INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(IN THOUSANDS)

	Six Months Ended	
	July 1, 2006	July 2, 2005
OPERATING ACTIVITIES		
Net income	$ 21,201	$ 32,987
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization of property, equipment and software	8,397	8,492
Loss (gain) on disposal of property, equipment and software	(129)	60
Amortization of other intangible assets and other assets	2,145	1,298
Stock compensation expense	19,739	3,321
In-process research and development	2,600	—
Additional income tax benefit from employee stock-based awards	10,153	—
Excess income tax benefit from employee stock-based awards	(5,719)	1,609
Changes in operating assets and liabilities:		
Accounts receivable	(6,862)	(13,542)
Inventories	(14,856)	9,998
Prepaid expenses and other assets	(11,903)	(933)
Accounts payable	8,935	(2,279)
Accrued expenses	3,606	1,389

Deferred income on shipments to distributors	5,010	6,124
Deferred income taxes	(2,617)	(184)
Income taxes payable	(5,413)	5,702
Net cash provided by operating activities	34,287	54,042
INVESTING ACTIVITIES		
Purchases of short-term investments	(120,505)	(233,191)
Sales and maturities of short-term investments	155,947	242,373
Purchases of property, equipment and software	(8,402)	(6,340)
Proceeds from sale of property, equipment and software	839	215
Purchases of other assets	(5,317)	(466)
Acquisition of businesses, net of cash acquired	(16,011)	(6)
Net cash provided by investing activities	6,551	2,585
FINANCING ACTIVITIES		
Proceeds from Employee Stock Purchase Plan	1,568	1,429
Proceeds from exercises of stock options	31,350	4,391
Excess income tax benefit from employee stock-based awards	5,719	—
Payments on debt	(774)	—
Net cash provided by financing activities	37,863	5,820
Increase in cash and cash equivalents	78,701	62,447
Cash and cash equivalents at beginning of period	100,504	48,636
Cash and cash equivalents at end of period	$ 179,205	$ 111,083
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$ 336	$ 127
Income taxes paid	$ 5,680	$ 467
Supplemental Disclosure of Non-Cash Activity:		
Stock issued for acquisition of business	$ —	$ 18,980
Receivable for sale of property, equipment and software	$ 1,381	$ —

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

SILICON LABORATORIES INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
July 1, 2006

1. Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements, other than the condensed consolidated balance sheet as of December 31, 2005, included herein are unaudited; however, they contain all normal recurring accruals and adjustments which, in the opinion of management, are necessary to present fairly the condensed consolidated financial position of Silicon Laboratories Inc. and its subsidiaries (collectively, the "Company") at July 1, 2006, the condensed consolidated results of its operations for the three and six months ended July 1, 2006 and July 2, 2005, and the condensed consolidated statements of cash flows for the six months ended July 1, 2006 and July 2, 2005. All intercompany accounts and transactions have been eliminated. The condensed consolidated results of operations for the three and six months ended July 1, 2006 are not necessarily indicative of the results to be expected for the full year.

The accompanying unaudited condensed consolidated financial statements do not include certain footnotes and financial presentations normally required under U.S. generally accepted accounting principles. Therefore, these condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2005, included in the Company's Form 10-K/A filed with the Securities and Exchange Commission (SEC) on April 24, 2006.

Reclassifications

Certain reclassifications have been made to prior period financial statements. Previously, the Company recorded amortization of stock compensation as a separate line item of the consolidated statements of income. The Securities and Exchange Commission (SEC) released Staff Accounting Bulletin No. 107, "Share-Based Payment," (SAB 107) which states that companies should present the expense related to share-based payment arrangements in the same line or lines as cash compensation paid to the same employees. Accordingly, the Company has reclassified share-based payments previously recorded as "amortization of stock compensation" to the appropriate functional categories. The reclassifications had no impact on the Company's financial position, operating income or net income. The following table summarizes amortization of stock compensation that is now recorded within functional categories in the condensed consolidated statements of income (in thousands):

	July 2, 2005	
	Three Months Ended	Six Months Ended
Cost of revenues	$ 10	$ 20
Research and development	479	1,065
Selling, general and administrative	160	317
Total	$ 649	$ 1,402

SILICON LABORATORIES INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

Additional stock compensation was recorded in selling, general and administrative during the three and six months ended July 2, 2005 in connection with certain modifications of non-employee stock compensation.

The Company has also reclassified investments in variable-rate demand notes from cash and cash equivalents to short-term investments in prior periods to conform to the current year presentation. Accordingly, the Company has reclassified the purchase and maturity of these investments in variable-rate demand notes in its condensed consolidated statements of cash flows, which decreased cash flows from investing activities by $113.1 million for the six months ended July 2, 2005. The reclassifications had no impact on the Company's results of operations or its overall financial position.

Inventories

Inventories are stated at the lower of cost, determined using the first-in, first-out method, or market. Shipping and handling costs are classified as a component of cost of revenue in the condensed consolidated statements of income. Inventories consist of the following (in thousands):

	July 1, 2006	December 31, 2005
Work in progress	$ 24,403	$ 15,409
Finished goods	13,784	7,723
	$ 38,187	$ 23,132

Other Comprehensive Income

There were no significant differences between net income and comprehensive income during any of the periods presented**.**

Income Taxes

The examination of the Company's 2002 and 2003 federal income tax returns by the U.S. Internal Revenue Service has been completed and there was no material adverse effect on the Company's financial statements.

The effective tax rate for the three and six months ended July 1, 2006 reflects the non-renewal of the federal research and development credit. If the federal research and development credit is renewed, the effective tax rate may be substantially reduced.

SILICON LABORATORIES INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) 48, "Accounting for Uncertainty in Income Taxes". FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement of Financial Accounting Standards (SFAS) 109, "Accounting for Income Taxes". This Interpretation defines the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the effect that the adoption of FIN 48 will have on its financial position and results of operations.

Earnings Per Share

The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	July 1, 2006	July 2, 2005	July 1, 2006	July 2, 2005
Net income	$ 10,137	$ 15,614	$ 21,201	$ 32,987
Basic:				
Weighted-average shares of common stock outstanding	55,842	53,296	55,460	52,983
Weighted-average shares of common stock subject to repurchase	—	(147)	—	(176)
Shares used in computing basic net income per share	55,842	53,149	55,460	52,807
Effect of dilutive securities:				
Weighted-average shares of common stock subject to repurchase	—	119	—	135
Contingent shares, acquisition	—	356	—	535
Stock options and awards	2,016	1,403	2,301	1,719
Shares used in computing diluted net income per share	57,858	55,027	57,761	55,196

Basic net income per share	$ 0.18	$ 0.29	$ 0.38	$ 0.62
Diluted net income per share	$ 0.18	$ 0.28	$ 0.37	$ 0.60

Approximately 3.4 million, 4.6 million, 2.9 million and 4.4 million weighted-average dilutive potential shares of common stock have been excluded from the diluted net income per share calculation for the three months ended July 1, 2006 and July 2, 2005, and for the six months ended July 1, 2006 and July 2, 2005, respectively, as they are anti-dilutive. The Company issued 1.5 million shares of common stock during the six months ended July 1, 2006.

2. Segment Reporting

The Company has one operating segment, mixed-signal analog intensive integrated circuits (ICs), consisting of numerous product areas. The Company's chief operating decision maker is considered to be the Chief Executive Officer. The chief operating decision maker allocates resources and assesses performance of the business and other activities at the operating segment level.

3. Stock-Based Compensation

The Company has two stock-based compensation plans, the 2000 Stock Incentive Plan and the Employee Stock Purchase Plan, which are described below. Prior to fiscal 2006, the Company accounted for those plans under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees", and related Interpretations, as permitted by FASB SFAS No. 123, "Accounting for Stock-Based Compensation", (SFAS 123). Compensation costs related to stock options granted at fair value under those plans were not recognized in the consolidated statements of income. Compensation costs related to restricted stock, restricted stock units (RSUs) and stock options granted below fair value were recognized in the consolidated statements of income.

In December 2004, FASB issued SFAS 123 (revised 2004), "Share-Based Payment", (SFAS 123R). Under the new standard, companies are no longer able to account for share-based compensation transactions using the intrinsic value method in accordance with APB Opinion No. 25. Instead, companies are required to account for such transactions using a fair-value method and recognize the expense in the consolidated statement of income.

Effective January 1, 2006, the Company adopted SFAS 123R using the modified-prospective-transition method. Under this transition method, stock compensation cost recognized beginning January 1, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted on or subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. Results for prior periods have not been restated.

The Company's income before income taxes for the three and six months ended July 1, 2006, was lower by $6.9 million and $14.1 million, respectively, and net income was lower by $6.0 million and $11.9 million, respectively, than if the Company had continued to account for share-based compensation under APB Opinion No. 25. For the same periods, basic earnings per share was $0.11 and $0.22 lower, respectively, and diluted earnings per share was $0.10 and $0.20 lower, respectively, due to the Company adopting SFAS 123R.

Prior to adopting SFAS 123R, the Company presented all tax benefits of deductions resulting from the exercise of stock grants as operating cash flows in the consolidated statements of cash flows. SFAS 123R requires the cash flows resulting from the tax benefits from tax deductions in excess of the compensation cost recognized (excess tax benefits) to be classified as financing cash flows. As a result, $5.7 million of excess tax benefits for the six months ended July 1, 2006 have been classified as financing cash flows.

2000 Stock Incentive Plan

In fiscal 2000, the Company's board of directors and stockholders approved the 2000 Stock Incentive Plan (the 2000 Plan). The Company granted 25,000 stock options from the 2000 Plan during the three and six months ended July 1, 2006. There were no significant modifications made to any stock grants during these periods.

Employee Stock Purchase Plan

The Employee Stock Purchase Plan (the Purchase Plan) was adopted by the Company's board of directors in fiscal 2000. Eligible employees may purchase a limited number of shares of the Company's common stock at 85% of the market value during a series of offering periods. Each offering period is divided into semi-annual purchase intervals and has a maximum term of 24 months. During the six months ended on July 1, 2006, the Company issued 70,577 shares under the Purchase Plan.

Accounting for Stock Compensation

Stock-based compensation costs are generally based on the fair value calculated from the Black-Scholes option-pricing model on the date of grant for stock options and on the date of enrollment for the Purchase Plan. RSU fair values generally equal their intrinsic value on the date of grant.

The fair values of stock grants are amortized as compensation expense on a straight-line basis over the vesting period of the grants. Compensation expense recognized is shown in the operating activities section of the consolidated statements of cash flow.

In anticipation of adopting SFAS 123R, the Company evaluated the assumptions used in the Black-Scholes model. As a result, the Company changed its methodology for computing expected volatility and expected term. Calculation of expected volatility was changed from being based solely on historical volatility to a combination of

both historical volatility and implied volatility derived from traded options on the Company's stock in the marketplace. The Company believes that the combination of historical volatility and implied volatility provides a better estimate of future stock price volatility. The expected term was previously calculated based on an analysis of historical exercises of stock options. The Company believes that an analysis of historical exercises and remaining contractual life of options provides a better estimate of future exercise pattern.

The Company continues to base the estimate of risk-free rate on the U.S. Treasury yield curve in effect at the time of grant. The Company has never paid cash dividends and does not currently intend to pay cash dividends, thus has assumed a 0% dividend yield.

As part of the requirements of SFAS 123R, the Company is required to estimate potential forfeitures of stock grants and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods.

The fair value of share-based payments was estimated using the Black-Scholes option-pricing model with the following assumptions:

	Six Months Ended	
	July 1, 2006	July 2, 2005
2000 Stock Incentive Plan:		
Expected volatility	60.8%	56.4%
Risk-free interest rate %	4.9%	3.8%
Expected term (in years)	5.0	4.3
Dividend yield	—	—
Employee Stock Purchase Plan:		
Expected volatility	49.7%	55.0%
Risk-free interest rate %	4.9%	3.4%
Expected term (in months)	9.0	15.0
Dividend yield	—	—

A summary of the Company's stock compensation activity with respect to the six months ended July 1, 2006 follows:

Stock Options	Shares (000s)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value ($000s)
Outstanding at December 31, 2005	9,374	$ 29.23		
Granted	25	57.26		
Exercised	(1,374)	22.82		
Cancelled or expired	(260)	30.62		
Outstanding at July 1, 2006	7,765	$ 30.41	6.71	$ 58,487
Vested at July 1, 2006 and expected to vest	7,520	$ 30.33	6.67	$ 57,426
Exercisable at July 1, 2006	4,387	$ 28.49	5.88	$ 42,310

Restricted Stock Units	Shares (000s)	Weighted-Average Exercise Price	Weighted-Average Remaining Vesting Term	Aggregate Intrinsic Value ($000s)
Outstanding at December 31, 2005	1,151	$ 0.00		
Granted	444	0.00		
Issued	(15)	0.00		
Cancelled or expired	(37)	0.00		
Outstanding at July 1, 2006	1,543	$ 0.00	2.60	$ 54,229
Vested at July 1, 2006 and expected to vest	1,354	$ 0.00	2.49	$ 47,593
Exercisable at July 1, 2006	—	$ —	—	$ —

The following summarizes the Company's weighted average fair value per share at the date of grant:

	Six Months Ended	
	July 1, 2006	July 2, 2005
Stock Options	$ 32.19	$ 13.83
RSUs	$ 42.34	$ 27.26

The following summarizes the Company's stock-based payment and stock option values (in millions):

	Six Months Ended	
	July 1, 2006	July 2, 2005
Intrinsic value of stock options exercised	$ 22.6	$ 2.8
Intrinsic value of RSUs that vested	$ 0.7	$ —
Fair value of stock options that vested	$ 18.9	$ 20.1
Fair value of RSUs that vested	$ 0.4	$ —

The Company had approximately $111 million of total unrecognized compensation costs related to stock options and RSUs at July 1, 2006 that are expected to be recognized over a weighted-average period of 2.5 years. There were no significant stock compensation costs capitalized into assets as of July 1, 2006.

The Company received cash of $8.3 million and $31.4 million for the exercise of stock options during the three and six months ended July 1, 2006, respectively. Cash was not used to settle any equity instruments previously granted. The Company issues shares from the 2000 Stock Incentive Plan reserve upon the exercise of stock options and vesting of RSUs. The Company does not currently expect to repurchase shares from any source to satisfy such obligation under the Plan.

The following are the stock-based compensation costs recognized in the Company's condensed consolidated statements of income (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	July 1, 2006	July 2, 2005	July 1, 2006	July 2, 2005
Cost of revenues	$ 219	$ 10	$ 363	$ 20
Research and development	4,756	479	9,058	1,065
Selling, general and administrative	4,942	2,078	10,318	2,236
Total decrease in income before income taxes	9,917	2,567	19,739	3,321
Decrease in provision for income taxes	(1,403)	(965)	(3,136)	(1,249)
Decrease in net income	$ 8,514	$ 1,602	$ 16,603	$ 2,072

As discussed above, results for prior periods have not been restated to reflect the effects of implementing SFAS 123R. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock options granted under the Company's stock option plans for the three and six months ended July 2, 2005. For purposes of this pro forma disclosure, the value of the stock options was estimated using a Black-Scholes option-pricing formula and amortized to expense over the options' vesting periods (in thousands, except per-share amounts):

	July 2, 2005	
	Three Months Ended	Six Months Ended
Net income - as reported	$ 15,614	$ 32,987
Total stock-based compensation cost, net of related tax effects included in the determination of net income as reported	1,602	2,072
The stock-based employee compensation cost, net of related tax effects, that would have been included in the determination of net income if the fair value based method had been applied to all awards	(8,321)	(14,760)
Pro forma net income	$ 8,895	$ 20,299
Net income per share:		
Basic - as reported	$ 0.29	$ 0.62
Basic - pro forma	$ 0.17	$ 0.38
Diluted - as reported	$ 0.28	$ 0.60
Diluted - pro forma	$ 0.16	$ 0.37

4. Commitments and Contingencies

Operating Leases

The Company leases its facilities under operating lease agreements that expire at various dates through 2013. Some of these arrangements contain renewal options and require the Company to pay taxes, insurance and maintenance costs.

The minimum annual future rentals under the terms of these leases at July 1, 2006 are as follows (in thousands):

FISCAL YEAR	
2006	$ 3,544
2007	6,667
2008	6,361
2009	5,678
2010	3,324
Thereafter	6,171
Total minimum lease payments	31,745
Minimum sublease rental income	(4,570)
Total net minimum lease payments	$ 27,175

In March 2006, the Company entered into an operating lease agreement and a related participation agreement (collectively, the "lease") for a facility in Austin, Texas for its corporate headquarters. The lease has a term of seven years. The base rent for the term of the lease is an amount equal to the interest accruing on $44.3 million at 110 basis points over the three-month LIBOR (which would be approximately $19.7 million over the remaining term assuming LIBOR averages 5.5% during such term).

The Company has granted certain rights and remedies to the lessor in the event of certain defaults, including the right to terminate the lease, to bring suit to collect damages, and to compel the Company to purchase the facility. The lease contains other customary representations, warranties, obligations, conditions, indemnification provisions and termination provisions, including covenants that the Company shall maintain unencumbered cash and highly-rated short term investments of at least $75 million and a ratio of funded debt to earnings before interest expense, income taxes, depreciation, amortization, lease expense and other non-cash charges (EBITDAR) over the four prior fiscal quarters of no greater than 1.5 to 1. As of July 1, 2006, the Company believes it was in compliance with all covenants of the lease.

During the term of the lease, the Company has an on-going option to purchase the building for a total purchase price of approximately $44.3 million. Alternatively, the Company can cause the property to be sold to third parties provided it is not in default under the lease. The Company is contingently liable for the guaranteed residual value associated with this property in the event that the net sale proceeds are less than the original financed cost of the facility. The Company is contingently liable for the residual value guarantee associated with the lease of approximately $35.3 million. To the extent that the net proceeds generated from the sale of the facility to a third party exceed $9.0 million, the Company would have the right to receive (a) substantially all of such excess proceeds if the sale occurs prior to the end of the term or (b) up to approximately $35.3 million of such excess proceeds if the sale occurs after the end of the term.

In accordance with the FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," the Company determined that the fair value associated with the guaranteed residual value was $1.0 million. The amount was recorded in "Other assets, net" and "Long-term obligations and other liabilities" in the condensed consolidated balance sheets and is being amortized over the term of the lease.

The Company is required to periodically evaluate the expected fair value of the facility at the end of the lease term. If the Company determines that it is estimable and probable that the expected fair value will be less than $44.3 million, it will ratably accrue the loss up to a maximum of approximately $35.3 million over the remaining lease term. As of July 1, 2006, the Company has determined that a loss contingency accrual is not required.

Securities Litigation

On December 6, 2001, a class action complaint for violations of U.S. federal securities laws was filed in the United States District Court for the Southern District of New York against the Company, four officers individually and the three investment banking firms who served as representatives of the underwriters in connection with the Company's initial public offering of common stock. The Consolidated Amended Complaint alleges that the registration statement and prospectus for the Company's initial public offering did not disclose that (1) the underwriters solicited and received additional, excessive and undisclosed commissions from certain investors, and (2) the underwriters had agreed to allocate shares of the offering in exchange for a commitment from the customers to purchase additional shares in the aftermarket at pre-determined higher prices. The action seeks damages in an unspecified amount and is being coordinated with approximately 300 other nearly identical actions filed against other companies. A court order dated October 9, 2002 dismissed without prejudice the four officers of the Company who had been named individually. On February 19, 2003, the Court denied the motion to dismiss the complaint against the Company. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. Plaintiffs have not yet moved to certify a class in the Silicon Laboratories case. The underwriter defendants have appealed the class certification decision and the Second Circuit has accepted the appeal. The Company has approved a settlement agreement and related agreements which set forth the terms of a settlement between the Company, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of the Company and the individual defendants for the conduct alleged in the action to be wrongful. The Company would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims the Company may have against its underwriters. The settlement agreement also provides a guaranteed recovery of $1 billion to plaintiffs for the cases relating to all of the approximately 300 issuers. To the extent that the underwriter

defendants settle all of the cases for at least $1 billion, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. On April 20, 2006, JPMorgan Chase & Co. and the plaintiffs reached a preliminary agreement for a settlement for $425 million. The JPMorgan Chase settlement has not yet been approved by the Court. However, if it is finally approved, the maximum amount that the issuers will be potentially liable for is $575 million. The Company anticipates that its potential financial obligation to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be covered by existing insurance. The Company is not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from its insurance carriers. Its carriers appear to be solvent, and the Company is not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, the Company does not expect that the settlement would involve any material payment by it. Furthermore, even if the Company's insurance was unavailable due to insurer insolvency or otherwise, the Company expects that its maximum financial obligation to plaintiffs pursuant to the settlement agreement would be approximately $3.3 million. However, if the JPMorgan Chase settlement is finally approved, the Company's maximum financial obligation to the plaintiffs pursuant to the settlement agreement would be approximately $1.9 million. On February 15, 2005, the Court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. On March 20, 2006, the underwriter defendants submitted objections to the settlement to the Court. The Court held a hearing regarding these and other objections to the settlement at a fairness hearing on April 24, 2006, but has not issued a ruling yet. There is no assurance that the Court will grant final approval to the settlement. If the settlement agreement is not approved and the Company is found liable, the Company is unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than the Company's insurance coverage, or whether the outcome would have a material impact on the Company's results of operations or financial position.

Trade Secret and Patent Infringement Litigation

On February 17, 2004, the Company filed a lawsuit against Axiom Microdevices Inc., a California corporation, and a former employee in the United States District Court for the Western District of Texas, Austin Division, alleging theft of trade secrets by Axiom and the individual. The lawsuit also alleged that the former employee breached his ethical, contractual and fiduciary obligations to the Company by disclosing trade secrets and confidential information to Axiom and that Axiom tortiously interfered with the former employee's contractual obligations to the Company. On September 14, 2004, the Company added claims for infringement of United States Patents 6,549,071 and 6,788,141 to the pending suit. The patents relate to the Company's proprietary technology for complementary metal oxide semiconductor (CMOS) RF power amplifiers. On May 23, 2006, the Court entered its final judgment. The Court found that Axiom misappropriated trade secret data sheets including the Company's confidential information and that the misappropriation was done with malice, fraud or gross negligence. The Court did not find breach of obligations by the Company's former employee, nor tortious interference with the former employee's contractual relationship. The Court found the '071 and '141 patents to be valid, but not infringed by the accused products. The Court ordered Axiom to return the Company's information and to not use such information in the future. The Court denied the Company's motion for a permanent injunction enjoining Axiom from selling its products and did not award the Company financial damages from Axiom's misappropriation of the Company's data sheets. The Court ordered Axiom to pay $250,000, in addition to other sanctions previously paid to the Company, due to Axiom's conduct during the lawsuit.

On December 14, 2005, Power-One, Inc. (Power-One), a Delaware corporation, filed a lawsuit against the Company, in the United States District Court for the Eastern District of Texas, Marshall Division, alleging willful infringement of United States Patents 6,936,999 and 6,949,916, and of patent applications Nos. 2004/0123164A1 and 2004/0093533A1. On February 28, 2006, the Company filed a declaratory judgment action in the United States District Court for the Western District of Texas, Austin Division seeking a declaration that Power-One's U.S. Patent No. 7,000,125 (the patent that issued from the patent application No. 2004/0123164A1) is not infringed by the Company. The lawsuits relate to the Company's Si825x family of digital power supply controllers. At this time, the Company cannot estimate the outcome of this matter or resulting financial impact to it, if any.

Other Litigation

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

5. Acquisition

Silembia

On May 11, 2006, the Company completed its acquisition of Silembia, a privately held company based in Rennes, France. Silembia develops semiconductor intellectual property for digital demodulation and channel decoding. The Company acquired all of the outstanding capital stock of Silembia in exchange for approximately $20.5 million, which includes direct acquisition costs. Of such consideration, $2.8 million was withheld as security for breaches of representations and warranties and certain other expressly enumerated matters. The acquisition was accounted for as a purchase business combination in accordance with SFAS No. 141, "Business Combinations", and accordingly, the results of Silembia's operations are included in the Company's consolidated results of operations from the date of the acquisition. Through the acquisition, the Company acquired engineering expertise and reduced the time required to develop new technologies and products. These factors contributed to a purchase price that was in excess of the fair value of the net assets acquired and, as a result, the Company recorded goodwill. None of the goodwill is deductible for tax purposes. The purchase price was allocated as follows (in thousands):

	Amount	Weighted-Average Amortization Period (Years)
Intangible assets:		
Core & developed technology	$ 9,400	7.9
Employment-related	100	1.9
In-process research and development	2,600	

		12,100
Fair value of net tangible assets		1,433
Goodwill		6,979
Total purchase price	$	20,512

The purchase price allocation for this acquisition is preliminary and subject to revision as more detailed analysis is completed and additional information about the fair value of assets and liabilities becomes available. Any change in the fair value of the net assets of Silembia is expected to change the amount of the purchase price allocable to goodwill.

The in-process research and development (IPR&D) had not achieved technological feasibility and had no alternative future use, therefore, the costs were expensed in the condensed consolidated statement of income on the date of acquisition. The IPR&D consisted of three projects, including two terrestrial broadcast technologies and a satellite broadcast technology. The fair value of the projects was determined using discounted cash flow analysis. The discount rate applicable to the cash flows was 32%. This rate reflects the weighted-average cost of capital and the risks inherent in the development process. The Company doesn't expect the products derived from these technologies to begin to contribute to revenues prior to fiscal 2007. In-process research and development consists of the following (in thousands):

Technology	Fair Value Assigned	Projected Costs to Complete
Terrestrial broadcasting projects	$ 1,300	$ 530
Satellite broadcast project	1,300	234
Total	$ 2,600	$ 764

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes thereto included elsewhere in this report. This discussion contains forward-looking statements. Please see the "Cautionary Statement" above and "Risk Factors" below for a discussion of the uncertainties, risks and assumptions associated with these statements. Our fiscal year-end financial reporting periods are a 52- or 53- week year ending on the Saturday closest to December 31st. Fiscal year 2006 will have 52 weeks. Our second quarter of fiscal year 2006 ended July 1, 2006. Our second quarter of fiscal year 2005 ended July 2, 2005. All of the quarterly periods reported in this quarterly report on Form 10-Q had thirteen weeks.

Overview

We design and develop proprietary, analog-intensive, mixed-signal integrated circuits (ICs) for a broad range of applications. Our innovative ICs can dramatically reduce the cost, size and system power requirements of the products that our customers sell. We currently offer ICs that can be incorporated into communications devices, such as wireless phones and modems, as well as cable and satellite set-top boxes, residential communication gateways for Voice over Broadband, FM broadcast radio tuners and networking equipment. We also offer a family of 8-bit microcontrollers (MCUs) for use in applications such as consumer electronics, industrial automation and control, automotive sensors and controls, medical instrumentation, and electronic test and measurement equipment. Our major customers include Agere Systems, Arima, Chi Mei, Compal, LG Electronics, Motorola, Sagem, Samsung, Tellabs and Thomson.

Our company was founded in 1996. Our business has grown since our inception, as reflected by our employee headcount, which increased to 699 as of July 1, 2006, from 588 employees at the end of fiscal 2004. As a "fabless" semiconductor company, we rely on third-party semiconductor fabricators in Asia, and to a lesser extent the United States, to manufacture the silicon wafers that reflect our IC designs. Each wafer contains numerous die, which are cut from the wafer to create a chip for an IC. We rely on third-parties in Asia to assemble, package, and, in the substantial majority of cases, test these devices and ship these units to our customers. We also rely on third-party providers of software to supply a complete AeroFONE™ mobile handset solution to our customers. We have increased the portion of testing performed by such third parties, which facilitates faster delivery of products to our customers (particularly those located in Asia), shorter production cycle times, lower inventory requirements, lower costs and increased flexibility of test capacity.

Our product set has expanded to a broad portfolio targeting mobile handset and broad-based mixed-signal applications. Our expertise in analog-intensive, high-performance, mixed-signal ICs enables us to develop highly differentiated solutions that address multiple markets. For example, our silicon direct access arrangement (DAA) product family is optimized for the personal computer (PC) modem market; our ISOmodemâ family of embedded modems has been widely adopted by satellite set-top box manufacturers; our ProSLIC® products have gained market share in VoIP residential equipment; and our Aero® Global System for Mobile Communications (GSM)/General Packet Radio Services (GPRS) transceiver family is being shipped in mobile handsets worldwide. We continue to introduce next generation ICs with added functionality and further integration. In fiscal 2005, we introduced a family of FM broadcast radio tuner products, a family of digital power products, families of oscillators (XOs) and voltage-controlled oscillators (VCXOs), the Aero IIe single-chip EDGE transceiver, the fax ISOmodem embedded modem, the AeroFONE single-chip phone, the Quad ProSLIC and the SiRX™ satellite receivers. In the first six months of fiscal 2006, we introduced a family of digital isolator products, a Power over Ethernet controller and expanded our MCU portfolio with the addition of new USB MCUs, Embedded Ethernet solutions and new small form factor devices. Through acquisitions and internal development efforts, we have continued to further diversify our product portfolio. We plan to continue to introduce products that increase the content we provide for existing applications and enable us to serve markets we do not currently address, thereby expanding our total available market opportunity.

We group our products into two categories, mobile handset products and broad-based mixed-signal products. Mobile handset products include our Aero Transceivers, the AeroFONE single-chip phone, Power Amplifiers (PA), and to the extent incorporated into handsets, FM broadcast radio tuners. Broad-based mixed-signal products include our silicon DAA, ISOmodem embedded modems, ProSLIC subscriber line interface circuits, microcontroller products, DSL analog front end, SiPHY® optical physical layer transceivers, precision clock & data recovery ICs (CDRs), XM satellite radio tuner, digital power products, Power over Ethernet controller, FM broadcast radio tuners for non-handset applications, oscillators (XOs), voltage-controlled oscillators (VCXOs), general purpose RF Synthesizers and SiRX satellite receivers.

During the six months ended July 1, 2006, two customers, Sagem and Samsung, represented 12% and 11% of our revenues, respectively. No other single end customer accounted for more than 10% of our revenues during the six months ended July 1, 2006. In addition to direct sales to customers, some of our end customers purchase products indirectly from us through distributors and contract manufacturers. An end customer purchasing through a contract manufacturer typically instructs such contract manufacturer to obtain our products and incorporate such products with other components for sale by such contract manufacturer to the end customer. Although we actually sell the products to, and are paid by, the distributors and contract manufacturers, we refer to such end customer as our customer. One of our distributors, Edom Technology, represented 37% of our revenues during the six months ended July 1, 2006. There were no other distributors or contract manufacturers that accounted for more than 10% of our revenues during the six months ended July 1, 2006.

The percentage of our revenues derived from customers located outside of the United States was 91% in fiscal 2005, 89% in fiscal 2004 and 80% in fiscal 2003. This percentage increase in the two most recent years reflects our product and customer diversification and increased market penetration for our products, as many of our mobile handset, and increasingly, broad-based mixed-signal customers manufacture and design their products in Asia. All of our revenues to date have been denominated in U.S. dollars. We believe that a majority of our revenues will continue to be derived from customers outside of the United States.

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

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

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

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

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

Research and development. Research and development expense consists primarily of personnel-related expenses, including stock compensation, new product mask, wafer, packaging and test costs, external consulting and services costs, amortization of purchased software, equipment tooling, equipment depreciation, amortization of acquired intangible assets, acquired research and development resulting from acquisitions, as well as an allocated portion of our occupancy costs for such operations. We generally depreciate our research and development equipment over four years and amortize our purchased software from computer-aided design tool vendors over the shorter of the estimated useful life or the license term. Research and development activities include the design of new products and software, refinement of existing products and design of test methodologies to ensure compliance with required specifications.

Selling, general and administrative. Selling, general and administrative expense consists primarily of personnel-related expenses, including stock compensation, related allocable portion of our occupancy costs, sales commissions to independent sales representatives, applications engineering support, professional fees, directors' and officers' liability insurance, patent litigation legal fees, other promotional and marketing expenses, and reserves for bad debt.

In-process research and development. In-process research and development represents acquired technology resulting from business combinations that has not achieved technological feasibility and has no alternative future use. These costs are expensed on the date of acquisition.

Interest income. Interest income reflects interest earned on average cash, cash equivalents and investment balances. We generally invest in tax-exempt short-term investments.

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

Other income (expense), net. Other income (expense), net primarily reflects the gain on the disposal of fixed assets.

Provision for Income Taxes. We accrue a provision for domestic and foreign income tax at the applicable statutory rates adjusted for non-deductible expenses, research and development tax credits and interest income from tax-exempt short-term investments.

Results of Operations

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

	Three Months Ended		Six Months Ended	
	July 1, 2006	July 2, 2005	July 1, 2006	July 2, 2005
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	42.9	45.3	43.8	45.8
Gross profit	57.1	54.7	56.2	54.2
Operating expenses:				
Research and development	24.7	19.9	24.4	19.3
Selling, general and administrative	21.2	18.1	21.4	17.1
In process research and development	2.1	—	1.1	—
Operating expenses	48.0	38.0	46.9	36.4
Operating income	9.1	16.7	9.3	17.8
Other income (expense):				
Interest income	3.0	1.9	3.0	1.6
Interest expense	(0.2)	(0.0)	(0.2)	(0.0)
Other income (expense), net	0.0	(0.2)	0.1	(0.1)
Income before income taxes	11.9	18.4	12.2	19.3
Provision for income taxes	3.7	3.8	3.3	3.7
Net income	8.2%	14.6%	8.9%	15.6%

Comparison of the Three and Six Months Ended July 1, 2006 to the Three and Six Months Ended July 2, 2005.

Revenues

	Three Months Ended				Six Months Ended			
(in millions)	July 1, 2006	July 2, 2005	Change	% Change	July 1, 2006	July 2, 2005	Change	% Change
Mobile Handsets	$ 57.5	$ 47.4	$ 10.1	21.5%	$ 110.2	$ 92.8	$ 17.4	18.8%
Broad-Based Mixed-Signal	66.0	59.8	6.2	10.3	127.8	119.1	8.7	7.3
Total	$ 123.5	$ 107.2	$ 16.3	15.3%	$ 238.0	$ 211.9	$ 26.1	12.3%

Mobile Handsets: The growth in the sales of our mobile handset products for the recent three and six month periods was primarily driven by revenues from our FM broadcast radio tuners and our Aero Transceiver family of products. Unit volumes of our mobile handset products increased compared to the three and six months ended July 2, 2005 by 61.2% and 63.4%, respectively. This increase was offset in part by declining average selling prices compared to the three and six months ended July 2, 2005 of 24.6% and 27.3%, respectively partially due to product transitions.

Broad-Based Mixed-Signal: The growth in the sales of our broad-based mixed-signal products for the recent three and six month periods was primarily driven by increased revenues from our: (1) ProSLIC products reflecting growth in demand in the Voice over Internet Protocol (VoIP) market; and (2) microcontroller products. Such growth was offset in part by a decline in revenue from our modem products (consisting of our DAA and ISOmodem products). Unit volumes of our broad-based mixed-signal products increased compared to the three and six months ended July 2, 2005 by 14.8% and 0.6%, respectively. Average selling prices of our broad-based mixed-signal products decreased compared to the three months ended July 2, 2005 by 4.1%. Average selling prices increased compared to the six months ended July 2, 2005 by 6.6%.

As our products become more mature, we expect to experience decreases in average selling prices in the future. Our revenues will be dependent on our ability to increase sales volumes and introduce higher priced, next generation products and product extensions.

Gross Profit

	Three Months Ended				Six Months Ended			
(in millions)	July 1, 2006	July 2, 2005	Change	% Change	July 1, 2006	July 2, 2005	Change	% Change
Gross profit	$ 70.5	$ 58.6	$ 11.9	20.4%	$ 133.7	$ 114.8	$ 18.9	16.5%
Percent of revenue	57.1%	54.7%			56.2%	54.2%		

The increase in gross profit for the recent three and six month periods was primarily due to increased revenue and product mix. We may experience declines in the average selling prices of our mobile handset products and certain of our broad-based mixed-signal products. This downward pressure on gross profit as a percentage of revenues may be offset to the extent we are able to: 1) introduce higher margin new products and gain market share with our ICs; or 2) achieve lower production costs from our wafer foundries and third-party assembly and test sub-contractors.

Research and Development

(in millions)	Three Months Ended July 1, 2006	Three Months Ended July 2, 2005	Change	% Change	Six Months Ended July 1, 2006	Six Months Ended July 2, 2005	Change	% Change
Research and development	$ 30.5	$ 21.4	$ 9.1	42.5%	$ 58.0	$ 40.9	$ 17.1	41.8%
Percent of revenue	24.7%	19.9%			24.4%	19.3%		

The increase in research and development expense for the recent three and six month periods was principally due to: (1) increases of $4.3 million and $8.0 million, respectively, due to stock compensation expense resulting from our adoption of SFAS 123R in the first quarter of fiscal 2006 and the issuance of restricted stock awards; and (2) increases of $2.5 million and $4.6 million, respectively for other personnel-related expenses. The increase for the recent six month period also includes decreases of $1.1 million for a foreign research grant credit. Some of our more significant development projects in the mobile-handset product area included the AeroFONE single-chip phone and the Aero IIe single-chip EDGE transceiver. Significant development projects in the broad-based mixed-signal product area included families of oscillators (XOs) and voltage-controlled oscillators (VCXOs), the fax ISOmodem embedded modem, the SiRX satellite receivers, a family of digital isolator products and the Power over Ethernet controller. All of these development projects have been completed. Additionally, many of these new products are being sampled by certain of our customers and are in the design-in phase. We don't expect the products derived from these projects to begin to contribute to revenues in a meaningful way before late fiscal 2006. We expect that research and development expense will increase in absolute dollars in future periods as we continue to increase our staffing and associated costs to pursue additional new product development opportunities, and may fluctuate as a percentage of revenues due to changes in sales and the timing of certain expensive items related to new product development initiatives, such as engineering mask and wafer costs.

Selling, General and Administrative

(in millions)	Three Months Ended July 1, 2006	Three Months Ended July 2, 2005	Change	% Change	Six Months Ended July 1, 2006	Six Months Ended July 2, 2005	Change	% Change
Selling, general and administrative	$ 26.2	$ 19.3	$ 6.9	35.6%	$ 50.9	$ 36.2	$ 14.7	40.6%
Percent of revenue	21.2%	18.1%			21.4%	17.1%		

The increase in the dollar amount of selling, general and administrative expense for the recent three and six month periods was principally attributable to: (1) increases of $2.9 million and $8.1 million, respectively, due to stock compensation expense resulting from our adoption of SFAS 123R and the issuance of restricted stock awards; and (2) increases of $2.1 million and $3.9 million, respectively, for other personnel-related expenses. The increase for the recent six month period was also due to an increase of approximately $1.1 million for higher legal fees related to litigation. We expect that selling, general and administrative expense will increase in absolute dollars in future periods as we continue to expand our sales channels, marketing applications efforts and administrative infrastructure. In addition, we expect selling, general and administrative expense to fluctuate as a percentage of revenues because of (1) potential variability in our future revenues; (2) increased support costs related to new product introduction; and (3) fluctuating legal costs related to litigation and intellectual property matters.

In-process research and development

In-process research and development (IPR&D) related to the acquisition of Silembia was $2.6 million for the three and six months ended July 1, 2006. The IPR&D had not achieved technological feasibility and had no alternative future use, therefore, the costs were expensed in the condensed consolidated statement of income on the date of acquisition. The IPR&D consisted of three projects, including two terrestrial broadcast technologies and a satellite broadcast technology. We estimate that these projects ranged from 8% to 40% complete at the date of acquisition. The remaining research and development efforts include additional design, integration and testing. The significant risks associated with the successful completion of these projects include our potential inability to finish the product designs, produce working models and gain customer acceptance. Failure to complete these projects in a timely manner could result in lost revenues. The Company doesn't expect the products derived from these technologies to begin to contribute to revenues prior to fiscal 2007.

There was no IPR&D for the three and six months ended July 2, 2005.

Interest Income

(in millions)	Three Months Ended July 1, 2006	Three Months Ended July 2, 2005	Change	Six Months Ended July 1, 2006	Six Months Ended July 2, 2005	Change
Interest income	$ 3.6	$ 2.0	$ 1.6	$ 6.8	$ 3.4	$ 3.4

The increase in the dollar amount of interest income for the recent three and six month periods was due to a greater amount of cash and short-term investments balances and to an increase in the interest rates of the underlying instruments during the period.

Interest Expense

Interest expense for the three and six months ended July 1, 2006 was $0.2 million and $0.4 million, respectively, as compared to $0.0 million and $0.1 million for the three and six months ended July 2, 2005, respectively.

Other Income (Expense), Net

Other income (expense), net for the three and six months ended July 1, 2006 was $0.0 million and $0.3 million, respectively, as compared to $(0.2) million for the three and six months ended July 2, 2005.

Provision for Income Taxes

	Three Months Ended	Six Months Ended

(in millions)	July 1, 2006	July 2, 2005	Change	July 1, 2006	July 2, 2005	Change
Provision for income taxes	$ 4.6	$ 4.1	$ 0.5	$ 7.8	$ 7.8	$ (0.0)
Effective tax rate	31.1%	20.7%		26.8%	19.1%	

The effective tax rate for the three and six months ended July 1, 2006 was higher than the three and six months ended July 2, 2005, primarily due to the recording of stock compensation expense at a lower than average effective tax rate, the non-deductibility of the write-off of in-process research and development expense and the non-renewal of the federal research and development tax credit. The total unfavorable effective tax rate impact of these items was partially offset by an increase in tax exempt interest income.

The effective tax rates for each of the periods presented differ from the federal statutory rate of 35% due to the amount of income earned in foreign jurisdictions where the tax rate may be lower than the federal statutory rate, tax-exempt interest income, stock compensation expense deductible at a corporate blended tax rate lower than 35%, and other permanent items. The effective rate for the three and six months ended July 2, 2005 also differs from the federal statutory rate of 35% due to the federal research and development tax credit.

Business Outlook

We expect revenues in the third quarter of fiscal 2006 to be in the range of $122 million to $127 million. Furthermore, we expect our diluted net income per share to be in the range of $0.18 to $0.21.

Liquidity and Capital Resources

Our principal sources of liquidity as of July 1, 2006 consisted of $407.0 million in cash, cash equivalents and short-term investments. Our short-term investments consist primarily of corporate and U.S. Government Agency debt securities.

Net cash provided by operating activities was $34.3 million during the six months ended July 1, 2006, compared to net cash provided of $54.0 million during the six months ended July 2, 2005. Operating cash flows during the six months ended July 1, 2006 reflect our net income of $21.2 million, adjustments of $37.2 million for depreciation, amortization, stock compensation, in-process research and development and tax benefits associated with the exercise of stock options, and a net increase in the components of our working capital of $24.1 million.

Net cash provided by investing activities was $6.6 million during the six months ended July 1, 2006, compared to net cash provided of $2.6 million during the six months ended July 2, 2005. The increase was principally due to an increase of $26.3 million in net sales and maturities of short-term investments, offset by a $16.0 million payment related to the acquisition of Silembia, net of cash acquired, and a $6.3 million increase in net purchases of other assets and property, equipment and software. We have reclassified investments in variable-rate demand notes from cash and cash equivalents to short-term investments in prior periods to conform to the current year presentation. See “Reclassifications” in Note 1 for additional information.

We anticipate capital expenditures of approximately $20 to $25 million for fiscal 2006. Additionally, as part of our growth strategy, we expect to evaluate opportunities to invest in or acquire other businesses, intellectual property or technologies that would complement or expand our current offerings, expand the breadth of our markets or enhance our technical capabilities.

Net cash provided by financing activities was $37.9 million during the six months ended July 1, 2006, compared to net cash provided of $5.8 million during the six months ended July 2, 2005. The increase was principally due to higher proceeds from the exercise of employee stock options and excess tax benefits from such exercises.

Our future capital requirements will depend on many factors, including the rate of sales growth, market acceptance of our products, the timing and extent of research and development projects, potential acquisitions of companies or technologies and the expansion of our sales and marketing activities. We believe our existing cash and short-term investment balances are sufficient to meet our capital requirements through at least the next 12 months, although we could be required, or could elect, to seek additional funding prior to that time. We may enter into acquisitions or strategic arrangements in the future which also could require us to seek additional equity or debt financing.

Off-Balance Sheet Arrangements

In March 2006, we entered into an operating lease agreement and a related participation agreement (collectively, the “lease”) for a facility in Austin, Texas for our corporate headquarters. The lease has a term of seven years. The base rent for the term of the lease is an amount equal to the interest accruing on $44.3 million at 110 basis points over the three-month LIBOR (which would be approximately $19.7 million over the remaining term assuming LIBOR averages 5.5% during such term).

We have granted certain rights and remedies to the lessor in the event of certain defaults, including the right to terminate the lease, to bring suit to collect damages, and to compel us to purchase the facility. The lease contains other customary representations, warranties, obligations, conditions, indemnification provisions and termination provisions, including covenants that we shall maintain unencumbered cash and highly-rated short term investments of at least $75 million and a ratio of funded debt to earnings before interest expense, income taxes, depreciation, amortization, lease expense and other non-cash charges (EBITDAR) over the four prior fiscal quarters of no greater than 1.5 to 1. As of July 1, 2006, we believe we were in compliance with all covenants of the lease.

During the term of the lease, we have an on-going option to purchase the building for a total purchase price of approximately $44.3 million. Alternatively, we can cause the property to be sold to third parties provided we are not in default under the lease. We are contingently liable for the guaranteed residual value associated with this property in the event that the net sale proceeds are less than the original financed cost of the facility. We are contingently liable for the residual value guarantee associated with the lease of approximately $35.3 million. To the extent that the net proceeds generated from the sale of the facility to a third party exceed $9.0 million, we would have the right to receive (a) substantially all of such excess proceeds if the sale occurs prior to the end of the term or (b) up to approximately $35.3 million of such excess proceeds if the sale occurs after the end of the term.

In accordance with the FASB Interpretation No. 45, “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,” we determined that the fair value associated with the guaranteed residual value was $1.0 million. The amount was recorded in “Other assets, net” and “Long-term obligations and other liabilities” in the condensed consolidated balance sheets and is being amortized over the term of the lease.

We are required to periodically evaluate the expected fair value of the facility at the end of the lease term. If we determine that it is estimable and probable that the expected fair value will be less than $44.3 million, we will ratably accrue the loss up to a maximum of approximately $35.3 million over the remaining lease term. As of July 1, 2006, we have determined that a loss contingency accrual is not required.

Critical Accounting Policies and Estimates

The preparation of financial statements and accompanying notes in conformity with U.S. generally accepted accounting principles requires that we make estimates and assumptions that affect the amounts reported. Changes in facts and circumstances could have a significant impact on the resulting estimated amounts included in the financial statements. We believe the following critical accounting policies affect our more complex judgments and estimates. We also have other policies that we consider to be key accounting policies, such as our policies for revenue recognition, including the deferral of revenues and cost of revenues on sales to distributors; however, these policies do not meet the definition of critical accounting estimates because they do not generally require us to make estimates or judgments that are difficult or subjective.

Allowance for doubtful accounts — We evaluate the collectibility of our accounts receivable based on a combination of factors. In circumstances where we are aware of a specific customer's inability to meet its financial obligations to us, we record a specific allowance to reduce the net receivable to the amount we reasonably believe will be collected. For all other customers, we recognize allowances for doubtful accounts based on a variety of factors including the length of time the receivables are past their contractual due date, the current business environment, and our historical experience. If the financial condition of our customers were to deteriorate or if economic conditions worsened, additional allowances may be required in the future.

Inventory valuation — We assess the recoverability of inventories through the application of a consistent set of methods, assumptions and estimates. In determining net realizable value, we write down inventory that may be slow moving or have some form of obsolescence, including inventory that has aged more than nine months. We also adjust the valuation of inventory when its standard cost exceeds the estimated market value. We assess the potential for any unusual customer returns based on known quality or business issues and establish reserves based on the estimated inventory losses for scrap or non-saleable material. Inventory not otherwise identified to be written down is compared to an assessment of our 12-month forecasted demand. The result of this methodology is compared against the product life cycle and competitive situations in the marketplace to determine the appropriateness of the resulting inventory levels. Demand for our products may fluctuate significantly over time, and actual demand and market conditions may be more or less favorable than those that we project. In the event that actual demand is lower or market conditions are worse than originally projected, additional inventory write-downs may be required.

Stock compensation — Prior to fiscal 2006, we accounted for stock-based compensation plans under the recognition and measurement provisions of APB Opinion No. 25. Effective January 1, 2006, we adopted the provisions of SFAS 123R using the modified-prospective-transition method. SFAS 123R requires companies to recognize the fair-value of stock-based compensation transactions in the statement of income. The fair value of our stock-based awards is estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes valuation calculation requires us to estimate key assumptions such as future stock price volatility, expected terms, risk-free rates and dividend yield. Expected stock price volatility is based on implied volatility from traded options on our stock in the marketplace and historical volatility of our stock. We use historical data to estimate option exercises and employee terminations within the valuation model. The expected term of options granted is derived from an analysis of historical exercises and remaining contractual life of stock options, and represents the period of time that options granted are expected to be outstanding. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. We have never paid cash dividends, and do not currently intend to pay cash dividends, and thus have assumed a 0% dividend yield. If our actual experience differs significantly from the assumptions used to compute our stock-based compensation cost, or if different assumptions had been used, we may have recorded too much or too little stock-based compensation cost. In addition, we are required to estimate the expected forfeiture rate of our stock grants and only recognize the expense for those shares expected to vest. If the actual forfeiture rate is materially different from our estimate, our stock-based compensation expense could be materially different. See Note 3 to the Condensed Consolidated Financial Statements for a further discussion on stock-based compensation.

Impairment of goodwill and other long-lived assets — We review long-lived assets which are held and used, including fixed assets and purchased intangible assets, for impairment whenever changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Such evaluations compare the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset over its expected useful life and are significantly impacted by estimates of future prices and volumes for our products, capital needs, economic trends and other factors which are inherently difficult to forecast. If the asset is considered to be impaired, we record an impairment charge equal to the amount by which the carrying value of the asset exceeds its fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique. Occasionally, we may hold certain assets for sale. In those cases, the assets are reclassified on our balance sheet from long-term to current, and the carrying value of such assets are reviewed and adjusted each period thereafter to the fair value less expected cost to sell.

We test our goodwill for impairment annually as of the first day of our fourth fiscal quarter and in interim periods if certain events occur indicating that the carrying value of goodwill may be impaired. The goodwill impairment test is a two-step process. The first step of the impairment analysis compares our fair value to our net book value. In determining fair value, the accounting guidance allows for the use of several valuation methodologies, although it states quoted market prices are the best evidence of fair value. If the fair value is less than the net book value, the second step of the analysis compares the implied fair value of our goodwill to its carrying amount. If the carrying amount of goodwill exceeds its implied fair value, we recognize an impairment loss equal to that excess amount.

Income taxes — We are required to estimate income taxes in each of the jurisdictions in which we operate. This process involves estimating the actual current tax liability together with assessing temporary differences in recognition of income (loss) for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. We then assess the likelihood that the deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, we establish a valuation allowance against the deferred tax asset. Further, we operate within multiple taxing jurisdictions and are subject to audit in these jurisdictions. These audits can involve complex issues which may require an extended period of time to resolve and could result in additional assessments of income tax. We believe adequate provisions for income taxes have been made for all periods.

Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation (FIN) 48, "Accounting for Uncertainty in Income Taxes". FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB SFAS 109, "Accounting for Income Taxes". This Interpretation defines the

minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the effect that the adoption of FIN 48 will have on our financial position and results of operations.

Qualitative and Quantitative Disclosures about Market Risk

Our financial instruments include cash, cash equivalents and short-term investments. Our main investment objectives are the preservation of investment capital and the maximization of after-tax returns on our investment portfolio. Our interest income is sensitive to changes in the general level of U.S. interest rates. Based on our cash, cash equivalents and short-term investments holdings as of July 1, 2006, an immediate 100 basis point decline in the yield for such instruments would decrease our annual interest income by approximately $4.1 million. We believe that our investment policy is conservative, both in the duration of our investments and the credit quality of the investments we hold.

In March 2006, we entered into an operating lease agreement for a facility in Austin, Texas for our corporate headquarters. The lease has a term of seven years. The base rent for the term of the lease is an amount equal to the interest accruing on $44.3 million at 110 basis points over the three-month LIBOR. LIBOR is sensitive to changes in the general level of U.S. interest rates. An immediate 100 basis point increase in the three-month LIBOR would increase our annual base rent by approximately $0.4 million.

Available Information

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Information related to quantitative and qualitative disclosures regarding market risk is set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations under Item 2 above. Such information is incorporated by reference herein.

Item 4. Controls and Procedures

We have performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act). Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective as of July 1, 2006 to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. There was no change in our internal controls during the fiscal quarter ended July 1, 2006 that materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Securities Litigation

On December 6, 2001, a class action complaint for violations of U.S. federal securities laws was filed in the United States District Court for the Southern District of New York against us, four of our officers individually and the three investment banking firms who served as representatives of the underwriters in connection with our initial public offering of common stock. The Consolidated Amended Complaint alleges that the registration statement and prospectus for our initial public offering did not disclose that (1) the underwriters solicited and received additional, excessive and undisclosed commissions from certain investors, and (2) the underwriters had agreed to allocate shares of the offering in exchange for a commitment from the customers to purchase additional shares in the aftermarket at pre-determined higher prices. The action seeks damages in an unspecified amount and is being coordinated with approximately 300 other nearly identical actions filed against other companies. A court order dated October 9, 2002 dismissed without prejudice our four officers who had been named individually. On February 19, 2003, the Court denied the motion to dismiss the complaint against us. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. Plaintiffs have not yet moved to certify a class in the Silicon Laboratories case. The underwriter defendants have appealed the class certification decision and the Second Circuit has accepted the appeal. We have approved a settlement agreement and related agreements which set forth the terms of a settlement between us, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of us and the individual defendants for the conduct alleged in the action to be wrongful. We would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims we may have against our underwriters. The settlement agreement also provides a guaranteed recovery of $1 billion to plaintiffs for the cases relating to all of the approximately 300 issuers. To the extent that the underwriter defendants settle all of the cases for at least $1 billion, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. On April 20, 2006, JPMorgan Chase & Co. and the plaintiffs reached a preliminary agreement for a settlement for $425 million. The JPMorgan Chase settlement has not yet been approved by the Court. However, if it is finally approved, then the maximum amount that the issuers will be potentially liable for is $575 million. We anticipate that our potential financial obligation to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be covered by existing insurance. We are not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from our insurance carriers. Our carriers appear to be solvent, and we are not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, we do not expect that the settlement would involve any material payment by us. Furthermore, even if our insurance was unavailable due to insurer insolvency or otherwise, we expect that our maximum financial obligation to plaintiffs pursuant to the settlement agreement would be approximately $3.3 million. However, if the JPMorgan Chase settlement is finally approved, our maximum financial obligation to the plaintiffs pursuant to the settlement agreement would be approximately $1.9 million. On February 15, 2005, the Court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. On March 20, 2006, the underwriter defendants submitted objections to the settlement to the Court. The Court held a hearing regarding these and other objections to the settlement at a fairness hearing on April 24, 2006, but has not yet issued a ruling. There is no assurance that the Court will grant final approval to the settlement. If the settlement agreement is not approved and we are found liable, we are unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than our insurance coverage, or whether the outcome would have a material impact on our results of operations or financial position.

Trade Secret and Patent Infringement Litigation

On February 17, 2004, we filed a lawsuit against Axiom Microdevices Inc., a California corporation, and a former employee in the United States District Court for the Western District of Texas, Austin Division, alleging theft of trade secrets by Axiom and the individual. The lawsuit also alleged that the former employee breached his ethical, contractual and fiduciary obligations to us by disclosing trade secrets and confidential information to Axiom and that Axiom tortiously interfered with the former employee's contractual obligations to us. On September 14, 2004, we added claims for infringement of United States Patents 6,549,071 and 6,788,141 to the pending suit. The patents relate to our proprietary technology for CMOS RF power amplifiers. On May 23, 2006, the Court entered its final judgment. The Court found that Axiom misappropriated trade secret data sheets including our confidential information and that the misappropriation was done with malice, fraud or gross negligence. The Court did not find breach of obligations by our former employee, nor tortious interference with the former employee's contractual relationship. The Court found our '071 and '141 patents to be valid, but not infringed by the accused products. The Court ordered Axiom to return our information and to not use such information in the future. The Court denied our motion for a permanent injunction enjoining Axiom from selling its products and did not award us financial damages from Axiom's misappropriation of our data sheets. The Court ordered Axiom to pay $250,000, in addition to other sanctions previously paid to us, due to Axiom's conduct during the lawsuit.

On December 14, 2005, Power-One, Inc. (Power-One), a Delaware corporation, filed a lawsuit against us, in the United States District Court for the Eastern District of Texas, Marshall Division, alleging willful infringement of United States Patents 6,936,999 and 6,949,916, and of patent applications Nos. 2004/0123164A1 and 2004/0093533A1. On February 28, 2006, we filed a declaratory judgment action in the United States District Court for the Western District of Texas, Austin Division seeking a declaration that Power-One's U.S. Patent No. 7,000,125 (the patent that issued from the patent application No. 2004/0123164A1) is not infringed by us. The lawsuits relate to our Si825x family of digital power supply controllers. At this time, we cannot estimate the outcome of this matter or resulting financial impact to us, if any.

Other Litigation

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

Item 1A. Risk Factors

Risks Related to our Business

We may not be able to maintain our historical growth and may experience significant period-to-period fluctuations in our revenues and operating results, which may result in volatility in our stock price

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

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

- The timing and volume of orders received from our customers;
- The timeliness of our new product introductions and the rate at which our new products may cannibalize our older products;
- The rate of acceptance of our products by our customers, including the acceptance of new products we may develop for integration in the products manufactured by such customers, which we refer to as "design wins";
- The time lag and realization rate between "design wins" and production orders;
- The demand for, and life cycles of, the products incorporating our ICs;
- The rate of adoption of mixed-signal ICs in the markets we target;
- Deferrals or reductions of customer orders in anticipation of new products or product enhancements from us or our competitors or other providers of ICs;
- Changes in product mix;
- The average selling prices for our products could drop suddenly due to competitive offerings or competitive predatory pricing, especially with respect to our mobile handset and modem products;
- The average selling prices for our products generally decline over time;
- Changes in market standards;
- Impairment charges related to inventory, equipment or other long-lived assets;
- The software used in our products and provided by third-party software providers must meet the needs of our customers;
- Significant legal costs to defend our intellectual property rights or respond to claims against us; and
- The rate at which new markets emerge for products we are currently developing or for which our design expertise can be utilized to develop products for these new markets.

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

We depend on a limited number of customers for a substantial portion of our revenues, and the loss of, or a significant reduction in orders from, any key customer could significantly reduce our revenues

The loss of any of our key customers, or a significant reduction in sales to any one of them, would significantly reduce our revenues and adversely affect our business. During the first six months of fiscal 2006, our ten largest customers accounted for 53% of our revenues. We had two customers, Sagem and Samsung, which represented 12% and 11% of our revenues, respectively. Most of the markets for our products are dominated by a small number of potential customers. Therefore, our operating results in the foreseeable future will continue to depend on our ability to sell to these dominant customers, as well as the ability of these customers to sell products that incorporate our IC products. In the future, these customers may decide not to purchase our ICs at all, purchase fewer ICs than they did in the past or alter their purchasing patterns, particularly because:

- We do not have material long-term purchase contracts with our customers;
- Substantially all of our sales to date have been made on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with little or no notice to us and without penalty;
- Some of our customers may have efforts underway to actively diversify their vendor base which could reduce purchases of our ICs; and
- Some of our customers have developed or acquired products that compete directly with products these customers purchase from us, which could affect our customers' purchasing decisions in the future.

While we have been a significant supplier of ICs used in many of our customers' products, our customers regularly evaluate alternative sources of supply in order to diversify their supplier base, which increases their negotiating leverage with us and protects their ability to secure these components. We believe that any expansion of our customers' supplier bases could have an adverse effect on the prices we are able to charge and volume of product that we are able to sell to our customers, which would negatively affect our revenues and operating results.

We are subject to risks relating to product concentration and lack of revenue diversification

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

- A decline in demand for any of our more significant products, including our Aero Transceiver, modem products or ProSLIC;
- Failure of our products to achieve continued market acceptance;
- An improved version of our products being offered by a competitor;
- Technological standard or change that we are unable to address with our products;
- A failure to release new products or enhanced versions of our existing products on a timely basis; and
- The failure of our new products to achieve market acceptance.

We are particularly dependent on sales of our mobile handset products which constituted 46% of our total revenues during the first six months of fiscal 2006 and 44% of our total revenues in fiscal 2005. In particular, our Aero Transceiver mobile handset product and its subsequent derivatives represent a substantial portion of our mobile handset product revenues. If the market for the Aero Transceiver or the market for GSM/GPRS or Enhanced Data Rates for Global Evolution (EDGE) mobile handsets in which these products are incorporated deteriorates, our operating results would be materially and adversely affected.

If we are unable to develop or acquire new and enhanced products that achieve market acceptance in a timely manner, our operating results and competitive position could be harmed

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

- Changing requirements of customers;
- Accurate prediction of market and technical requirements, such as the shift of GSM/GPRS to EDGE and Wideband Code Division Multiple Access (WCDMA);

- Timely completion and introduction of new designs;
- Timely qualification and certification of our ICs for use in our customers' products;

- Commercial acceptance and volume production of the products into which our ICs will be incorporated;
- Availability of foundry, assembly and test capacity;
- Achievement of high manufacturing yields;
- Quality, price, performance, power use and size of our products;
- Availability, quality, price and performance of competing products and technologies;
- Our customer service, application support capabilities and responsiveness;
- Successful development of our relationships with existing and potential customers;
- Changes in technology, industry standards or end-user preferences; and
- Cooperation of third-party software providers and our semiconductor vendors to support our chips within a system.

We cannot provide any assurance that products which we recently have developed or may develop in the future will achieve market acceptance. We have introduced to market or are in development of many ICs. If our ICs fail to achieve market acceptance, or if we fail to develop new products on a timely basis that achieve market acceptance, our growth prospects, operating results and competitive position could be adversely affected. For example, in October 2005, we introduced the AeroFONE single-chip phone. This product is in the early stages of customer adoption and we cannot be certain that it will achieve market acceptance.

Our research and development efforts are focused on a limited number of new technologies and products, and any delay in the development, or abandonment, of these technologies or products by industry participants, or their failure to achieve market acceptance, could compromise our competitive position

Our ICs are used as components in electronic devices in various markets. As a result, we have devoted and expect to continue to devote a large amount of resources to develop products based on new and emerging technologies and standards that will be commercially introduced in the future. Research and development expense during the six months ended July 1, 2006 was $58.0 million, or 24.4% of revenues. A number of large companies are actively involved in the development of these new technologies and standards. Should any of these companies delay or abandon their efforts to develop commercially available products based on new technologies and standards, our research and development efforts with respect to these technologies and standards likely would have no appreciable value. In addition, if we do not correctly anticipate new technologies and standards, or if the products that we develop based on these new technologies and standards fail to achieve market acceptance, our competitors may be better able to address market demand than we would. Furthermore, if markets for these new technologies and standards develop later than we anticipate, or do not develop at all, demand for our products that are currently in development would suffer, resulting in lower sales of these products than we currently anticipate. For example, we have introduced to market the Aero Transceiver product for use in wireless phones operating on the GSM/GPRS standard. We believe this market is now in the early stages of adopting the EDGE and WCDMA standards, which allow for enhanced data generation and transmission using mobile handsets. Forecasters expect the EDGE and WCDMA markets to further develop and expand in 2006 and 2007. In September 2005, we extended our Aero family to meet the EDGE standard with the Aero IIe single-chip EDGE Radio. However, we cannot be certain that the use of this technology will not change in the future and thereby make our products unsuitable. Furthermore, we cannot be certain that any product we develop for these standards will achieve market acceptance.

We have increased our international activities significantly and plan to continue such efforts, which subjects us to additional business risks including increased logistical and financial complexity, political instability and currency fluctuations

We have established additional international subsidiaries and have opened additional offices in international markets to expand our international activities in Europe and the Pacific Rim region. This has included the establishment of a headquarters in Singapore for non-U.S. operations. The percentage of our revenues to customers located outside of the United States was 91% in fiscal 2005, 89% in fiscal 2004 and 80% in fiscal 2003. We may not be able to maintain or increase international market demand for our products. Our international operations are subject to a number of risks, including:

- Increased complexity and costs of managing international operations and related tax obligations, including our headquarters for non-U.S. operations in Singapore;
- Protectionist laws and business practices that favor local competition in some countries;
- Multiple, conflicting and changing tax laws and regulations that may impact both our international and domestic tax liabilities and result in increased complexity and costs;
- Longer sales cycles;
- Greater difficulty in accounts receivable collection and longer collection periods;
- High levels of distributor inventory subject to price protection and rights of return to us;
- Political and economic instability;
- Greater difficulty in hiring and retaining qualified technical sales and applications engineers and administrative personnel; and
- The need to have business and operations systems that can meet the needs of our international business and operating structure.

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

Failure to manage our distribution channel relationships could impede our future growth

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

We are subject to increased inventory risks and costs because we build our products based on forecasts provided by customers before receiving purchase orders for the products

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

Our products are complex and may contain errors which could lead to product liability, an increase in our costs and/or a reduction in our revenues

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

Product liability claims may be asserted with respect to our products. Our products are typically sold at prices that are significantly lower than the cost of the end-products into which they are incorporated. A defect or failure in our product could cause failure in our customer's end-product, so we could face claims for damages that are disproportionately higher than the revenues and profits we receive from the products involved. Furthermore, product liability risks are particularly significant with respect to medical and automotive applications because of the risk of serious harm to users of these products. There can be no assurance that any insurance we maintain will sufficiently protect us from any such claims.

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

Our customers require our products to undergo a lengthy and expensive qualification process without any assurance of product sales

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

We rely on third parties to manufacture, assemble and test our products and the failure to successfully manage our relationships with our manufacturers and subcontractors would negatively impact our ability to sell our products

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

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

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

- Failure by us, our customers or their end customers to qualify a selected supplier;
- Potential insolvency of the third-party subcontractors;
- Reduced control over delivery schedules and quality;
- Limited warranties on wafers or products supplied to us;
- Potential increases in prices or payments in advance for capacity;
- Increased need for international-based supply, logistics and financial management;

- Their inability to supply or support new or changing packaging technologies; and
- Low test yields.

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

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

Our products incorporate technology licensed from third parties

We incorporate technology (including software) licensed from third parties in our products. We could be subjected to claims of infringement regardless of our lack of involvement in the development of the licensed technology. Although a third party licensor is typically obligated to indemnify us if the licensed technology infringes on another party's intellectual property rights, such indemnification is typically limited in amount and may be worthless if the licensor becomes insolvent. See "Significant litigation over intellectual property in our industry may cause us to become involved in costly and lengthy litigation which could seriously harm our business." Furthermore, any failure of third party technology to perform properly would adversely affect sales of our products incorporating such technology.

Our inability to manage growth could materially and adversely affect our business

In recent periods, we have increased the scope of our operations and expanded our workforce from 588 employees at the end of fiscal 2004 to 699 employees at July 1, 2006. This growth has placed, and any future growth of our operations will continue to place, a significant strain on our management personnel, systems and resources. We anticipate that we will need to implement a variety of new and upgraded sales, operational and financial enterprise-wide systems, information technology infrastructure, procedures and controls, including the improvement of our accounting and other internal management systems to manage this growth and maintain compliance with regulatory guidelines, including Sarbanes-Oxley Act requirements. As our business grows our internal management systems and processes will need to improve to ensure that we remain in compliance. We also expect that we will need to continue to expand, train, manage and motivate our workforce. All of these endeavors will require substantial management effort, and we anticipate that we will require additional management personnel and internal processes to manage these efforts and to plan for the succession from time to time of certain persons who have been key management and technical personnel. If we are unable to effectively manage our expanding global operations, including our international headquarters in Singapore, our business could be materially and adversely affected.

We depend on our key personnel to manage our business effectively in a rapidly changing market, and if we are unable to retain our current personnel and hire additional personnel, our ability to develop and successfully market our products could be harmed

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

Any acquisitions we make could disrupt our business and harm our financial condition

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

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

- Diversion of management's time and attention from our core business;
- Need for financial resources above our planned investment levels;
- Difficulties in retaining business relationships with suppliers and customers of the acquired company;
- Risks associated with entering markets in which we lack prior experience;
- Risks associated with the transfer of licenses of intellectual property;
- Acquisition-related disputes, including disputes over earn-outs and escrows;
- Potential loss of key employees of the acquired company; and
- Potential impairment of related goodwill and intangible assets.

Future acquisitions also could cause us to incur debt or contingent liabilities or cause us to issue equity securities that could negatively impact the ownership percentages of existing shareholders.

Our stock price may be volatile

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

- Actual or anticipated fluctuations in our operating results;
- Changes in financial estimates by securities analysts or our failure to perform in line with such estimates;
- Changes in market valuations of other technology companies, particularly semiconductor companies;
- Announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;
- Introduction of technologies or product enhancements that reduce the need for our products;
- The loss of, or decrease in sales to, one or more key customers;
- A large sale of stock by a significant shareholder;
- Dilution from the issuance of our stock in connection with acquisitions;
- The addition or removal of our stock to or from a stock index fund;
- Departures of key personnel; and
- The required expensing of stock options.

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

Most of our current manufacturers, assemblers, test service providers and customers are concentrated in the same geographic region, which increases the risk that a natural disaster, epidemic, labor strike, war or political unrest could disrupt our operations or sales

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

A natural disaster, epidemic, labor strike, war or political unrest where our customers' facilities are located would likely reduce our sales to such customers. For example, Samsung is based in South Korea and represented 11% of our revenues during the first six months of fiscal 2006. North Korea's decision to withdraw from the nuclear Non-Proliferation Treaty and related geopolitical maneuverings has created unrest. Such unrest could create economic uncertainty or instability, could escalate to war or otherwise adversely affect South Korea and our South Korean customers and reduce our sales to such customers, which would materially and adversely affect our operating results. In addition, a significant portion of the assembly and testing of our mobile handset products occurs in South Korea. Any disruption resulting from these events could also cause significant delays in shipments of our products until we are able to shift our manufacturing, assembling or testing from the affected subcontractor to another third-party vendor.

We may be unable to protect our intellectual property, which would negatively affect our ability to compete

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

The semiconductor manufacturing process is highly complex and, from time to time, manufacturing yields may fall below our expectations, which could result in our inability to satisfy demand for our products in a timely manner

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

We depend on our customers to support our products, and some of our customers offer competing products

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

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

Significant litigation over intellectual property in our industry may cause us to become involved in costly and lengthy litigation which could seriously harm our business

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. From time to time, we receive letters from various industry participants alleging infringement of patents, trademarks or misappropriation of trade secrets or from customers requesting indemnification for claims brought against them by third parties. The exploratory nature of these inquiries has become relatively common in the semiconductor industry. We respond when we deem appropriate and as advised by legal counsel. We have been involved in litigation to protect our intellectual property rights in the past and may become involved in such litigation again in the future. For example, in December 2005, Power-One, Inc. filed a lawsuit against us alleging patent infringement related to our digital power supply products. In the future, we may become involved in additional litigation to defend allegations of infringement asserted by others, both directly and indirectly as a result of certain industry-standard indemnities we may offer to our customers. Legal proceedings could subject us to significant liability for damages or invalidate our proprietary rights. Legal proceedings initiated by us to protect our intellectual property rights could also result in counterclaims or countersuits against us. Any litigation, regardless of its outcome, would likely be time-consuming and expensive to resolve and would divert our management's time and attention. Most intellectual property litigation also could force us to take specific actions, including:

- Cease selling products that use the challenged intellectual property;
- Obtain from the owner of the infringed intellectual property a right to a license to sell or use the relevant technology, which license may not be available on reasonable terms, or at all;
- Redesign those products that use infringing intellectual property; or
- Pursue legal remedies with third parties to enforce our indemnification rights, which may not adequately protect our interests.

We could seek to raise additional capital in the future through the issuance of equity or debt securities, but additional capital may not be available on terms acceptable to us, or at all

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

We are a relatively small company with limited resources compared to some of our current and potential competitors and we may not be able to compete effectively and increase market share

Some of our current and potential competitors have longer operating histories, significantly greater resources and name recognition and a larger base of customers than we have. As a result, these competitors may have greater credibility with our existing and potential customers. They also may be able to adopt more aggressive pricing policies and devote greater resources to the development, promotion and sale of their products than we can to ours. In addition, some of our current and potential competitors have already established supplier or joint development relationships with the decision makers at our current or potential customers. These competitors may

be able to leverage their existing relationships to discourage their customers from purchasing products from us or persuade them to replace our products with their products. Our competitors may also offer bundled chipset kit arrangements offering a more complete product despite the technical merits or advantages of our products. These competitors may elect not to support our products which could complicate our sales efforts. These and other competitive pressures may prevent us from competing successfully against current or future competitors, and may materially harm our business. Competition could decrease our prices, reduce our sales, lower our gross profits or decrease our market share.

Provisions in our charter documents and Delaware law could prevent, delay or impede a change in control of us and may reduce the market price of our common stock

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

- The division of our board of directors into three classes to be elected on a staggered basis, one class each year;
- The ability of our board of directors to issue shares of our preferred stock in one or more series without further authorization of our stockholders;
- A prohibition on stockholder action by written consent;
- Elimination of the right of stockholders to call a special meeting of stockholders;
- A requirement that stockholders provide advance notice of any stockholder nominations of directors or any proposal of new business to be considered at any meeting of stockholders; and
- A requirement that a supermajority vote be obtained to amend or repeal certain provisions of our certificate of incorporation.

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

We are subject to credit risks related to our accounts receivable

We do not generally obtain letters of credit or other security for payment from customers, distributors or contract manufacturers. Accordingly, we are not protected against accounts receivable default or bankruptcy by these entities. Our ten largest customers or distributors represent a substantial majority of our accounts receivable. If any such customer or distributor were to become insolvent or otherwise not satisfy their obligations to us, we could be materially harmed.

The performance of our products may be adversely affected by severe environmental conditions that may require modifications, which could lead to an increase in our costs or a reduction in our revenues

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

Risks related to our industry

We are subject to the cyclical nature of the semiconductor industry, which has been subject to significant fluctuations

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

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

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

The average selling prices of our products could decrease rapidly which may negatively impact our revenues and gross profits

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

Competition within the numerous markets we target may reduce sales of our products and reduce market share

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

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

Our products must conform to industry standards and technology in order to be accepted by end users in our markets

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

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

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Our registration statement (Registration No. 333-94853) under the Securities Act of 1933, as amended, relating to our initial public offering of our common stock became effective on March 23, 2000.

No securities were repurchased during the second quarter of fiscal 2006.

Item 3. Defaults Upon Senior Securities

Not applicable

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

On April 19, 2006, we held our Annual Meeting of Shareholders. The matters voted upon at the meeting and the results of those votes were as follows:

Election of Class II Directors

	Total Votes For Each Director	Total Votes Withheld From Each Director
Necip Sayiner	50,593,477	2,438,990
David R. Welland	47,019,490	6,012,977
Harvey B. Cash	46,423,946	6,608,521

Ratification of the appointment of Ernst & Young LLP as independent auditors for the fiscal year ending December 30, 2006.

Votes For	Votes Against	Votes Abstaining	Broker Non-Votes
49,880,729	955,650	6,855	2,189,233

The following individuals, who were not up for election at this Annual Meeting of Shareholders, continue to serve as directors: Navdeep S. Sooch, William G. Bock, Robert Ted Enloe, III, Laurence G. Walker and William P. Wood.

Item 5. Other Information

Not applicable

Item 6. Exhibits

The following exhibits are filed as part of this report:

Exhibit Number	
2.1*	Agreement and Plan of Merger, dated August 19, 2005, by and among Silicon Laboratories Inc., Sabine Merger Sub, Inc., and Silicon MAGIKE, Inc. (filed as Exhibit 2.1 to the Form 8-K filed August 22, 2005).
3.1*	Form of Fourth Amended and Restated Certificate of Incorporation of Silicon Laboratories Inc. (filed as Exhibit 3.1 to the Registrant's Registration Statement on Form S-1 (Securities and Exchange Commission File No. 333-94853) (the "IPO Registration Statement")).
3.2*	Second Amended and Restated Bylaws of Silicon Laboratories Inc (filed as Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended January 3, 2004).
4.1*	Specimen certificate for shares of common stock (filed as Exhibit 4.1 to the IPO Registration Statement).
10.1*	Share Purchase Agreement, dated May 11, 2006, by and between Silicon Laboratories France and the shareholders of Silembia (filed as Exhibit 10.1 to the Form 8-K filed May 15, 2006).
31.1	Certification of the Principal Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Accounting Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification as required by Section 906 of the Sarbanes-Oxley Act of 2002.

* Incorporated herein by reference to the indicated filing.

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.

SILICON LABORATORIES INC.

July 24, 2006
Date

/s/ Necip Sayiner
Necip Sayiner
President and
Chief Executive Officer
(Principal Executive Officer)

July 24, 2006
Date

/s/ Paul V. Walsh, Jr.
Paul V. Walsh, Jr.
Interim Chief
Financial Officer
(Principal Accounting Officer)

Exhibit 31.1

Certification to the Securities and Exchange Commission
by Registrant's Chief Executive Officer, as required by Section 302
of the Sarbanes-Oxley Act of 2002

I, Necip Sayiner, certify that:

1. I have reviewed this report on Form 10-Q of Silicon Laboratories Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons fulfilling the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: July 24, 2006

/s/ Necip Sayiner

Necip Sayiner
President and
Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

Certification to the Securities and Exchange Commission
by Registrant's Chief Financial Officer, as required by Section 302
of the Sarbanes-Oxley Act of 2002

I, Paul V. Walsh, Jr., certify that:

1. I have reviewed this report on Form 10-Q of Silicon Laboratories Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons fulfilling the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: July 24, 2006

/s/ Paul V. Walsh, Jr.

Paul V. Walsh, Jr.
Interim Chief Financial Officer
(Principal Accounting Officer)

Exhibit 32.1

Certification of Chief Executive Officer and Chief Financial Officer

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned officers of Silicon Laboratories Inc. (the "Company") hereby certify that:

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the fiscal quarter ended July 1, 2006 as filed with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities Exchange Commission or its staff upon request.

Date: July 24, 2006

/s/ Necip Sayiner

Necip Sayiner
President and
Chief Executive Officer

/s/ Paul V. Walsh, Jr.

Paul V. Walsh, Jr.
Interim Chief Financial Officer