STEC, INC.
Form 10-Q
May 11, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2009

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________

Commission File Number 000-31623

STEC, INC.

(Exact name of Registrant as specified in its charter)

CALIFORNIA	**33-0399154**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
3001 Daimler Street	
Santa Ana, CA	**92705-5812**
(Address of principal executive offices)	**(Zip Code)**

(949) 476-1180

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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

Large Accelerated Filer ¨	Accelerated Filer x	Non-Accelerated Filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

The number of shares outstanding of the registrant s common stock, par value $0.001, as of April 30, 2009 was 48,447,187.

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STEC, INC.

INDEX TO FORM 10-Q FOR THE

QUARTERLY PERIOD ENDED MARCH 31, 2009

Except as otherwise noted in this report, STEC, the Company, we, us and our collectively refer to STEC, Inc. and its subsidiaries.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STEC, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

	March 31, 2009 (unaudited)	December 31, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 57,463	$ 33,379
Short-term investments	5,200	
Accounts receivable, net of allowances of $1,415 at March 31, 2009 and $1,196 at December 31, 2008	37,897	43,516
Inventory	44,699	63,985
Deferred income taxes	1,593	1,302
Other current assets	6,637	7,872
Total current assets	153,489	150,054
Leasehold interest in land	2,618	2,587
Property, plant and equipment	42,537	44,406
Intangible assets	496	573
Goodwill	1,682	1,682
Other long-term assets	2,735	2,720
Deferred income taxes	4,473	4,407
Total assets	$ 208,030	$ 206,429
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 10,674	$ 13,097
Accrued and other liabilities	10,648	10,339
Total current liabilities	21,322	23,436
Long-term income taxes payable	1,494	1,430
Commitments and contingencies (Note 9)		
Shareholders Equity:		
Preferred stock, $0.001 par value, 20,000,000 shares authorized, no shares outstanding		
Common stock, $0.001 par value, 100,000,000 shares authorized, 48,442,686 shares issued and outstanding as of March 31, 2009 and 48,429,348 shares issued and outstanding as of December 31, 2008	48	48
Additional paid-in capital	130,342	129,670
Retained earnings	54,824	51,845
Total shareholders equity	185,214	181,563
Total liabilities and shareholders equity	$ 208,030	$ 206,429

See accompanying notes to unaudited condensed consolidated financial statements.

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STEC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Net revenues	$ 63,536	$ 50,680
Cost of revenues	40,503	34,026
Gross profit	23,033	16,654
Sales and marketing	4,772	4,441
General and administrative	7,366	5,344
Research and development	5,520	4,308
Special charges (Note 7)	1,177	
Total operating expenses	18,835	14,093
Operating income	4,198	2,561
Other (expense) income, net	(12)	777
Income from continuing operations before provision for income taxes	4,186	3,338
Provision for income taxes	992	1,493
Income from continuing operations	3,194	1,845
Discontinued operations (Note 8):		
Loss from discontinued operations	(356)	
Benefit for income taxes	141	
Loss from discontinued operations	(215)	
Net income	$ 2,979	$ 1,845
Net income (loss) per share:		
Basic:		
Continuing operations	$ 0.07	$ 0.04
Discontinued operations	(0.01)	
Total	$ 0.06	$ 0.04
Diluted:		
Continuing operations	$ 0.07	$ 0.04
Discontinued operations	(0.01)	
Total	$ 0.06	$ 0.04
Shares used in net income (loss) per share computation:		
Basic	48,434	49,991

Diluted	49,063	51,323

See accompanying notes to unaudited condensed consolidated financial statements.

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STEC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Cash flows from operating activities:		
Net income	$ 2,979	$ 1,845
Loss from discontinued operations	215	
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,892	1,917
Gain on sale of property, plant and equipment	6	(256)
Impairment loss on assets held for sale		138
Accounts receivable provisions	321	148
Deferred income taxes	(357)	591
Stock-based compensation expense	661	332
Change in operating assets and liabilities:		
Accounts receivable	5,298	2,076
Inventory	19,286	(7,716)
Leasehold interest in land	14	44
Other assets	1,120	(1,925)
Accounts payable	(2,867)	3,809
Accrued and other liabilities	373	794
Net cash provided by operating activities	29,941	1,797
Cash flows from investing activities:		
Purchases of short-term investments	(5,200)	(47,711)
Sales of short-term investments		40,911
Purchase of property, plant and equipment	(690)	(3,742)
Proceeds from sale of property, plant and equipment	22	311
Net cash used in investing activities	(5,868)	(10,231)
Cash flows from financing activities:		
Proceeds from exercise of stock options	4	343
Tax benefit of employee stock option exercise and vesting of restricted stock units	7	437
Stock buyback		(13,003)
Net cash provided by (used in) financing activities	11	(12,223)
Net increase (decrease) in cash and cash equivalents	24,084	(20,657)
Cash and cash equivalents at beginning of period	33,379	94,326
Cash and cash equivalents at end of period	$ 57,463	$ 73,669
Supplemental schedule of noncash investing activities:		
Additions to other assets acquired under accounts payable	$ 145	$

Additions to property, plant and equipment acquired under accounts payable	$ 230	$ 2,265

See accompanying notes to unaudited condensed consolidated financial statements.

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STEC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Basis of Presentation

The accompanying interim condensed consolidated financial statements of STEC, Inc., a California corporation (the Company), are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal and recurring adjustments and the special charges discussed in Note 7) considered necessary for a fair statement of the consolidated financial position of the Company at March 31, 2009, the consolidated results of operations for each of the three months ended March 31, 2009 and 2008, and the consolidated results of cash flows for each of the three months ended March 31, 2009 and 2008 have been included. These interim condensed consolidated financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and, therefore, should be read in conjunction with the consolidated financial statements and related notes contained in the most recent Annual Report on Form 10-K filed with the SEC. The December 31, 2008 balances reported herein are derived from the audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2008. The results for the interim periods are not necessarily indicative of results to be expected for the full year. Certain amounts previously reported have been reclassified to conform with the 2009 presentation.

The condensed consolidated financial statements of the Company include the accounts of the Company s subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities (e.g., sales returns, bad debt, inventory reserves), disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 2 Sales Concentration

As shown in the table below, customer concentrations of accounts receivable and revenues of greater than 10% were as follows:

	For the Three Months Ended March 31, 2009		2008	
	Accounts Receivable	**Revenues**	**Accounts Receivable**	**Revenues**
Customer A	13%	20%	*	*
Customer B	17%	13%	*	*
Customer C	*	12%	*	*
Customer D	21%	12%	21%	13%
Customer E	*	*	33%	44%

* Less than 10%

For the three months ended March 31, 2009 and 2008, international sales comprised 49% and 22%, respectively, of the Company s revenues. During the three months ended March 31, 2009, 20% and 16% of our revenues were derived from billings to customers in Singapore and Taiwan, respectively. No single foreign country accounted for more than 10% of revenues during the three months ended March 31, 2008. The majority of the Company s international sales are export sales, which are shipped from the Company s domestic facility to foreign customers. In the future, we expect substantially all of our foreign sales to originate internationally as our operations in Malaysia become established.

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Note 3 Financial Instruments

Financial instruments consist principally of cash equivalents and short-term investments, accounts receivable and accounts payable. Generally, the Company considers all highly liquid investments that are readily convertible into cash and have an original maturity of three months or less at the time of purchase to be cash equivalents. The Company defines short-term investments as income-yielding securities that can be readily converted into cash. As of March 31, 2009, cash equivalents and short-term investments consisted of FDIC insured certificates of deposits.

Note 4 Income Taxes

The provision for income taxes was $992,000 and $1.5 million for the three months ended March 31, 2009 and March 31, 2008, respectively. The Company s effective tax rates were 23.7% and 44.7% for the three months ended March 31, 2009 and March 31, 2008, respectively. The difference between the Company s effective tax rate and the 35% federal statutory rate for the three months ended March 31, 2009 resulted primarily from foreign earnings taxed at rates lower than the federal statutory rate and federal tax credits related to research and development in the three months ended March 31, 2009. The difference between the Company s effective tax rates and the 35% federal statutory rate for the three months ended March 31, 2008 resulted primarily from foreign losses that were not benefited, which partially offset the benefit from increases in tax-exempt interest income and federal tax credits related to research and development in the three months ended March 31, 2008. The decrease in the effective tax rate for the three months ended March 31, 2009 from the same period in 2008 is due to the transition of certain of our operations to our new 210,000 square foot manufacturing facility in Penang, Malaysia where the Company has been granted a tax holiday subject to meeting certain conditions.

Note 5 Net Income Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding. In computing diluted earnings per share, the weighted average number of shares outstanding is adjusted to reflect the potentially dilutive securities. Options to purchase 4,791,016 and 4,457,431 shares of common stock were outstanding at March 31, 2009 and 2008, respectively. In addition, 215,500 and 355,000 restricted stock units payable in shares of common stock were outstanding at March 31, 2009 and 2008, respectively. For each of the three months ended March 31, 2009 and 2008, potentially dilutive securities consisted solely of options and restricted stock units and resulted in potential common shares of 628,626 and 1,332,481, respectively.

Note 6 Supplemental Balance Sheet Information

Inventory consists of the following (in thousands):

	March 31, 2009	December 31, 2008
Raw materials	$ 28,105	$ 41,554
Work-in-progress	1,015	706
Finished goods	15,579	21,725
Total	$ 44,699	$ 63,985

Accrued and other liabilities consisted of the following (in thousands):

	March 31, 2009	December 31, 2008
Accrued Expenses - Marketing Programs	$ 1,635	$ 5,703
Accrued Expenses - Payroll Costs	5,432	929
Accrued Expenses - Other	3,581	3,707
Total	$ 10,648	$ 10,339

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Note 7 Special Charges

Special charges consist of restructuring charges totaling approximately $1.2 million in the first quarter of 2009. There were no special charges in the first quarter of 2008.

In the first quarter of 2009, the Company commenced a reduction of its workforce primarily at its Santa Ana, California headquarters as part of the transition of certain of its operations to its new 210,000 square foot manufacturing facility in Penang, Malaysia. This reduction, which mostly impacted its U.S.-based workforce, is expected to be completed by the end of 2009. The majority of the reduction occurred during the first quarter of 2009 and affected 185 employees, including 154 in manufacturing, 15 in sales and marketing and 16 in research and development. In connection with this reduction in workforce, the Company recorded a charge of approximately $1.2 million for severance and related costs. The Company expects to incur approximately $500,000 to $1.0 million of additional restructuring costs, primarily consisting of workforce reduction and consolidation of facilities expenses, related to this restructuring plan, which is expected to be completed by the end of 2009. The Company expects substantially all of the expenses associated with the reduction of workforce to result in cash expenditures. Actual amounts and the exact timing of the workforce reductions could differ from these estimates.

Activity and liability balances related to the first quarter of 2009 restructuring plan through March 31, 2009 are as follows (in thousands):

	Workforce Reductions	Facilities and Other	Total
Charged to costs and expenses	$ 1,177	$	$ 1,177
Cash payments	(1,139)		(1,139)
Restructuring balance, March 31, 2009	$ 38	$	$ 38

Note 8 Discontinued Operations

On February 9, 2007, the Company entered into an Asset Purchase Agreement (Purchase Agreement) with Fabrik, Inc. (Fabrik) and Fabrik Acquisition Corp. (together with Fabrik, the Purchasers) for the sale of assets relating to a portion of the Company s business which was engaged in the designing, final assembling, selling, marketing and distributing consumer-oriented products based on Flash memory, Dynamic Random Access Memory (DRAM) technologies and external storage solutions known as the Consumer Division of the Company. The consideration paid to the Company pursuant to the Purchase Agreement consisted of cash in the amount of approximately $43.0 million. The purchase price was subject to a post-closing adjustment for accrued expenses, reserves on inventory, reserves on accounts receivables and overhead capitalization of the Consumer Division (Purchase Price Adjustment). Subsequent to the closing of the sale, the Purchasers disputed certain amounts calculated by the Company in regards to the Purchase Price Adjustment. The original claim amount was approximately $6.7 million. In accordance with the Purchase Agreement, both parties agreed to resolve their Purchase Price Adjustment disputes through a third-party arbitrator. During the arbitration proceeding, the Purchasers conceded approximately $4.0 million of their original disputed amounts. In January 2008, the arbitrator rejected substantially all of the Purchasers claims. Since the Company has been unable to resolve the remaining open issues with Fabrik related to the sale of the Consumer Division and as a result of the indemnification period for claims as specified in the Purchase Agreement having expired in February 2009, the Company recorded $215,000, net of taxes, related to the write off of amounts owed to the Company under the original purchase as loss from discontinued operations in the first quarter of 2009.

Operating results of the Consumer Division as discontinued operations for the three months ended March 31, 2009 are summarized as follows (in thousands):

	Three Months Ended March 31, 2009
Net sales	$0
Loss from discontinued operations	($356)
Income tax benefit	141

Loss from discontinued operations, net of taxes	($215)

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Note 9 Commitments and Contingencies

The Company is currently not a party to any material legal proceedings. However, the Company is involved in other suits and claims in the ordinary course of business, and the Company may from time to time become a party to other legal proceedings arising in the ordinary course of business.

As is common in the industry, the Company currently has in effect a number of agreements in which the Company has agreed to defend, indemnify and hold harmless certain of its suppliers and customers from damages and costs which may arise from the infringement by the Company s products of third-party patents, trademarks or other proprietary rights. The scope of such indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorneys fees. The Company s insurance does not cover intellectual property infringement. The term of these indemnification agreements is generally perpetual any time after execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company has never incurred significant costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of March 31, 2009.

Note 10 Intangible Assets and Goodwill

The following table presents detail of the Company s intangible assets, related accumulated amortization and goodwill (in thousands):

	As of March 31, 2009			As of December 31, 2008		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Developed technology (five years)	$ 1,070	$ 690	$ 380	$ 1,070	$ 637	$ 433
Customer relationships (five years)	792	676	116	792	652	140
Total intangible assets	$ 1,862	$ 1,366	$ 496	$ 1,862	$ 1,289	$ 573
Goodwill	$ 1,682	$	$ 1,682	$ 1,682	$	$ 1,682

In accordance with FAS No. 142, Goodwill and Other Intangible Assets, goodwill and other intangible assets with indeterminate lives are not subject to amortization but are tested for impairment annually or whenever events or changes in circumstances indicate that the asset might be impaired. Intangible assets with finite lives continue to be subject to amortization, and any impairment is determined in accordance with FAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The Company recorded amortization expense of $77,000 and $96,000 for each of the three months ended March 31, 2009 and 2008, respectively. Estimated intangible asset amortization expense (based on existing intangible assets) for the remainder of the year ending December 31, 2009 and the years ending December 31, 2010 and 2011 is $204,000, $180,000 and $112,000, respectively.

Note 11 Credit Facility

On July 30, 2008, the Company entered into an agreement for a $35 million two-year senior unsecured revolving credit facility (the Credit Facility) with Wachovia Bank, National Association (Wachovia). The Credit Facility will bear interest at a floating rate equivalent to, at the option of the Company, either (i) LIBOR plus 0.70% - 1.20% depending on the Company s leverage ratio at each quarter end or (ii) Wachovia s prime rate, announced from time to time, less 1.00% - 1.50% depending on the Company s leverage ratio at each quarter end. The Credit Facility is guarantied by certain domestic subsidiaries of the Company. In addition, in the event the Company makes a loan to any of its foreign subsidiaries, the Company has agreed to pledge to Wachovia the Company s intercompany note from such foreign subsidiary. The Credit Facility agreement contains customary affirmative and negative covenants, some of which require the maintenance of specified leverage and minimum liquidity ratios. The Company was subject to a maximum leverage ratio of 2.0 to 1.0 for the quarter ended March 31, 2009 and a minimum liquidity ratio of 1.0 to 5.0 through March 31, 2009. The Credit Facility matures on July 30, 2010.

As of March 31, 2009, there were no borrowings outstanding. As of March 31, 2009, the Company was in compliance with all required covenants. The Credit Facility will be used to maintain liquidity and fund working capital requirements, on an as needed basis.

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Note 12 Shareholders Equity

The 2000 Stock Incentive Plan (the Plan) was adopted by the Company s board of directors and approved by its shareholders in September 2000. On April 17, 2006, the Plan was amended and restated by the Board and approved by the Company s shareholders on May 25, 2006. The Plan provides for the direct issuance or sale of shares and the grant of options to purchase shares of the Company s common stock to officers and other employees, non-employee board members and consultants. The Company issues new shares to satisfy stock option exercises and stock purchases under the Company s share-based plans. Under the Plan, eligible participants may be granted options to purchase shares of common stock at an exercise price not less than 100% of the fair market value of those shares on the grant date. In addition, the Plan as amended and restated, allows for the issuance of restricted stock units to officers and other employees, non-employee board members and consultants. Restricted stock units are share awards that entitle the holder to receive shares of the Company s common stock upon vesting. The Company s board of directors, its compensation committee or its equity awards committee determines eligibility and vesting schedules for options and restricted stock units granted under the Plan. Options expire within a period of not more than ten years from the date of grant.

At March 31, 2009, the Plan provided for the issuance of up to 23,128,277 shares of common stock. The number of shares of common stock reserved for issuance under the Plan will automatically increase on the first trading day in January in each calendar year by an amount equal to 4% of the total number of shares of common stock outstanding on the last trading day in December of the prior calendar year, but in no event will exceed 2,500,000 shares.

During the three months ended March 31, 2009, options for the purchase of 60,000 shares at a weighted-average option price of $4.84 per share, with annual vesting of 20%, were awarded. The contractual lives of 2009 awards are consistent with those of prior years. The per share fair values of the options granted in the three months ended March 31, 2009 were estimated with the following weighted average assumptions:

Expected term (years)	5.8
Risk-free interest rate	1.9%
Volatility	63%
Dividend rate	0.0%

At March 31, 2009, 7,509,878 shares of common stock were available for grant under the Plan.

From time to time the Company s board of directors has authorized various programs to repurchase shares of its common stock depending on market conditions and other factors. In November 2008, the board of directors authorized a share repurchase program effective November 19, 2008 enabling the Company to repurchase up to $10 million of its common stock over an 18-month period expiring on May 18, 2010. At March 31, 2009, $5 million was still authorized for the repurchase of shares under this plan. The Company did not make any share repurchases in the three months ended March 31, 2009.

Note 13 New Accounting Pronouncements

In December 2007, the FASB issued FAS No. 141(R), Business Combinations, and FAS No. 160, Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements, an Amendment of ARB No. 51. These new standards significantly change the financial accounting and reporting of business combination transactions and noncontrolling (or minority) interests in consolidated financial statements. The Company adopted FAS No. 141(R) and FAS No. 160 on January 1, 2009. The adoption of FAS No. 141(R) and FAS No. 160 did not have an impact on its consolidated financial statements.

The Company has implemented all new accounting pronouncements that are in effect and that may impact its consolidated financial statements and does not believe that there are any other new accounting pronouncements that have been issued that might have a material impact on its consolidated financial statements.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Cautionary Statement

Certain statements in this report, including statements regarding our strategy, financial performance and revenue sources, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, and are subject to the safe harbors created by those sections. These forward-looking statements are based on our current expectations, estimates and projections about our industry, management s beliefs, and certain assumptions made by us. Such statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors. We undertake no obligation to revise or update any forward-looking statements for any reason. The section entitled Risk Factors set forth in this Form 10-Q and similar discussions in filings with the Securities and Exchange Commission made from time to time, including other quarterly reports on Form 10-Q, our Annual Reports on Form 10-K, and in our other SEC filings, discuss some of the important risk factors that may affect our business, results of operations and financial condition.

The following discussion should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this Form 10-Q.

Overview

STEC, Inc. designs, develops, manufactures and markets custom memory solutions based on Flash memory and DRAM technologies. Headquartered in Santa Ana, California, we specialize in developing high-speed, high-capacity Flash solid-state drives (SSDs) and memory cards, used in sensitive and highly-volatile environments, and high-density DRAM modules.

We market our products to original equipment manufacturers (OEMs), leveraging our custom design capabilities to offer custom memory solutions to address their specific needs.

We are focusing on several revenue growth initiatives, including:

- Continuing to develop and qualify customized Flash-based products, including our Zeus^{IOPS} and Mach8^{IOPS} product lines, for the enterprise-storage and enterprise-server applications, respectively; and

- Expanding our international business in Asia and Europe.

Over the past several years we have expanded our custom design capabilities of Flash products for OEM applications. We have invested significantly in the design and development of customized Flash controllers, firmware and hardware and made strategic acquisitions that have expanded our Flash design capabilities and sales and marketing infrastructure. Flash product revenue increased 91% from $29.3 million in the first quarter of 2008 to $56.1 million in the first quarter of 2009. We expect our continued investments in Flash custom design capabilities and controller development to result in sustained revenue growth from our Flash product line in 2009.

A major area of our Flash-based product investment has been focused on solid-state drive (SSD) technology. We believe the advantages of SSD technology are currently being defined in several distinct market segments; a) enterprise-storage applications, b) enterprise-server applications, c) video-on-demand (VoD) applications, d) PC mobile computing and consumer-related markets and e) military and industrial applications. We see opportunities to leverage our SSD expertise across each of these markets where we believe our technology can outperform existing solutions. In addition, we believe the SSD market will continue to expand over the next few years as overall unit volume growth is expected, aided by the decline in Flash component pricing, which will serve to improve the comparative economics of Flash-based SSDs versus hard disk drives (HDDs) in both new and existing storage applications. We expect continued growth in the sales of our Flash-based SSD Zeus^{IOPS} products through the first half of 2009 based on the accelerated adoption of our Zeus^{IOPS} SSDs into most of the major enterprise-storage and enterprise-server OEM customers.

In 2008 we entered the mobile computer market with our ultra-mobile SSDs. While we have qualified and sold this product into a leading PC OEM in this market segment, we believe that our technology and SSD product offerings will be primarily focused on the other market segments for SSD technology enterprise-storage and enterprise-server and expect our revenues in this segment to decline significantly beyond the second quarter of 2009. Further, we have received recent indications from our existing PC OEM customer that they may end-of-life the program which utilizes our ultra-mobile SSD product. In this circumstance, we may have excess inventory which was purchased specifically for this customer in accordance with their purchase orders and sales forecasts. In the event the customer decides to formally end this sales program, we believe that they remain contractually obligated to either take delivery of or compensate us for any excess inventory that we purchased for their ultra-mobile SSD program in accordance with the purchase orders that we received from this customer.

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We offer both monolithic DRAM modules and DRAM modules based on our stacking technology. DRAM product revenue decreased 67% from $19.8 million in the first quarter of 2008 to $6.6 million in the first quarter of 2009. We expect sales of DRAM modules to decline over time as we continue to focus on growing our Flash-based product lines.

Historically, a limited number of customers have accounted for a significant percentage of our revenue. Our ten largest customers accounted for an aggregate of 79.3% of our revenues in the first three months of 2009, compared to 76.1% of our total revenues in the first three months of 2008. We had four customers account for more than 10.0% of our revenues, at 20.2%, 13.4%, 12.2% and 12.0%, for the three months ended March 31, 2009, compared to two customers, which accounted for more than 10.0% of our revenues, at 43.5% and 12.6%, for the same period in 2008.

The composition of our major customer base changes from quarter to quarter as the market demand for our products changes, and we expect this variability will continue in the future. We expect that sales of our products to a limited number of customers will continue to account for a majority of our revenues in the foreseeable future. The loss of, or a significant reduction in purchases by any of our major customers, would harm our business, financial condition and results of operations. See Risk Factors Sales to a limited number of customers represent a significant portion of our revenues and the loss of any key customer would materially reduce our revenues.

International sales, which are derived from billings to foreign customers, accounted for 49.2% of our revenues in the first three months of 2009, compared to 21.9% of our revenues in the first three months of 2008. During the three months ended March 31, 2009, 20.4% and 15.6% of our revenues were derived from billings to customers in Singapore and Taiwan, respectively. No foreign geographic area or single foreign country accounted for more than 10% of revenues during the three months ended March 31, 2008. In the future, we expect substantially all of our foreign sales to originate internationally as our operations in Malaysia become established. For the three months ended March 31, 2009 and 2008, more than 95% of our international sales were denominated in U.S. dollars. In addition, our purchases of DRAM and Flash components are currently denominated in U.S. dollars. However, we do face risks associated with doing business in foreign countries. See Risk Factors We face risks associated with doing business in foreign countries, including foreign currency fluctuations and trade barriers, that could lead to a decrease in demand for our products or an increase in the cost of the components used in our products.

Results of Operations

The following table sets forth, for the periods indicated, certain consolidated statement of operations data reflected as a percentage of revenues.

	Three Months Ended March 31,	
	2009	**2008**
Net revenues	100.0%	100.0%
Cost of revenues	63.7	67.1
Gross profit	36.3	32.9
Operating expenses:		
Sales and marketing	7.5	8.8
General and administrative	11.6	10.5
Research and development	8.7	8.5
Special charges	1.9	0.0
Total operating expenses	29.7	27.8
Operating income	6.6	5.1
Other (expense) income, net	0.0	1.5
Income from continuing operations before provision for income taxes	6.6	6.6

Comparison of Three Months Ended March 31, 2009 to Three Months Ended March 31, 2008

Net Revenues. Our revenues were $63.5 million in the first quarter of 2009, compared to $50.7 million in the same period in 2008. Revenues increased 25.4% in the first quarter of 2009 due primarily to a 72% increase in average sales price, or ASP, from $36 in the first quarter of 2008 to $62 in the first quarter of 2009, partially offset by a 26% decrease in unit shipments. The increase in revenues and ASP was due primarily to a

91% increase in Flash memory sales and a 123% increase in ASP for Flash products, partially offset by a 67% decrease in sales of DRAM products and a 22% decline in our DRAM ASP. Within Flash memory sales, shipments of our Zeus^{IOPS} SSDs into the enterprise-storage market grew to $25.7 million for the first quarter of 2009, an increase of 267.1% from $7.0 million for the first quarter of 2008. The increase in our Flash ASP resulted from increased sales of higher ASP Zeus^{IOPS} and Mach8^{IOPS} products in the first quarter of 2009, compared to the same period in 2008. The decrease in our DRAM ASP resulted primarily from a decrease in selling prices for DRAM modules. Unit shipments decreased due primarily to declines in sales of our DRAM modules and CompactFlash products, partially offset by increased sales of our ultra-mobile SSDs. However, going forward, we expect sales of our ultra-mobile SSD products to decline as we continue to focus on growing our higher ASP Zeus ^{IOPS} and Mach8^{IOPS} products.

Sales of our products are made through individual purchase orders and, in certain cases, are made under master agreements governing the terms and conditions of the relationships. Customers may change, cancel or delay orders with limited or no penalties. Our ability to predict future sales is limited because a majority of our quarterly product revenues come from orders that are received and fulfilled in the same quarter.

Gross Profit. Our gross profit was $23.0 million in the first quarter of 2009, compared to $16.7 million in the same period in 2008. Gross profit as a percentage of revenues was 36.3% in the first quarter of 2009, compared to 32.9% in the first quarter of 2008. The increase in gross profit in absolute dollars was due primarily to increased revenues and ASP for Flash products. Gross profit as a percentage of revenue in the first quarter of 2009 increased due primarily to a shift in product mix toward higher gross profit margin Flash products, partially offset by an increase in production and labor overhead due primarily to a $1.3 million increase in write-downs of our inventory related to obsolescence, excess quantities and declines in market value below our costs.

Sales and Marketing. Sales and marketing expenses are primarily comprised of personnel costs and travel expenses for our domestic and international sales and marketing employees, commissions paid to internal salespersons and independent manufacturers representatives, shipping costs and marketing programs. Sales and marketing expenses were $4.8 million and $4.4 million in the first quarters of 2009 and 2008, respectively. Sales and marketing expenses as a percentage of revenue were 7.5% in the first quarter of 2009, compared to 8.8% in the first quarter of 2008. The increase in sales and marketing expenses in absolute dollars was due to increased commissions related to higher revenues. The decrease in sales and marketing expenses as a percentage of revenues was due primarily to the termination of certain outside manufacturing representative firm commission agreements in the second half of 2008 and the first quarter of 2009. We expect our sales and marketing expenses to increase in absolute dollars as our revenues grow.

General and Administrative. General and administrative expenses are primarily comprised of personnel costs for our executive and administrative employees, professional fees and facilities overhead. General and administrative expenses were $7.4 million in the first quarter of 2009, compared to $5.3 million in the first quarter of 2008. General and administrative expenses as a percentage of revenues were 11.6% in the first quarter of 2009, compared to 10.5% in the first quarter of 2008. The increase in general and administrative expenses in absolute dollars and as a percentage of revenues was due primarily to a $1.1 million increase in legal expenses, a $410,000 increase in payroll and payroll-related costs, a $260,000 increase in depreciation expense related to our new facility in Malaysia. Legal expenses increased primarily as the result of an IP-litigation matter which began in the second quarter of 2008 and was settled in the first quarter of 2009. Payroll and payroll-related costs increased due to higher stock-based compensation and an increase in employee headcount.

Research and Development. Research and development expenses are comprised primarily of personnel costs for our engineering and design staff and the cost of prototype supplies. Research and development expenses were $5.5 million in the first quarter of 2009, compared to $4.3 million in the first quarter of 2008. Research and development expenses as a percentage of revenues were 8.7% in the first quarter of 2009 compared to 8.5% in first quarter of 2008. Research and development expenses increased due primarily to an increase in payroll and payroll-related costs from our expanding global research and development efforts from our facilities in the United States, United Kingdom, Taiwan and Malaysia predominantly related to our Flash product line which includes the advancement of high-performance SSDs.

Special Charges. Special charges consist of restructuring charges totaling approximately $1.2 million in the first quarter of 2009. There were no special charges in the first quarter of 2008.

In the first quarter of 2009, we commenced a reduction of our workforce primarily at our Santa Ana, California headquarters as part of the transition of certain of our operations to our new 210,000 square foot manufacturing facility in Penang, Malaysia. This reduction, which is primarily in our U.S.-based workforce, is expected to be completed by the end of 2009. The majority of the reduction occurred during the first quarter of 2009 and affected 185 employees, including 154 in manufacturing, 15 in sales and marketing and 16 in research and development. In connection with this reduction in workforce, we recorded a charge of approximately $1.2 million for severance and related costs. We expect to incur approximately $500,000 of additional restructuring costs, primarily consisting of workforce reduction and consolidation of facilities expenses, related to this restructuring plan, which is expected to be completed by the end of 2009. We expect substantially all of the expenses associated with the reduction of workforce to result in cash expenditures that will be funded from available cash balances. Actual amounts and the exact timing of the workforce reductions could differ from these estimates. Future cash payments related to the restructuring plan are not expected to significantly impact our liquidity.

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We expect that this restructuring action will reduce annual operating expenses by approximately $14.2 million, including approximately $11.2 million in cost of sales, approximately $1.1 million in sales and marketing expenses and approximately $1.1 million in research and development expenses and approximately $800,000 in general and administrative expenses. We expect to begin to realize the benefit of these reductions beginning in the second half of 2009. We expect the cost savings from the restructuring plan to be partially offset by approximately $5.1 million in incremental cost increases at our foreign subsidiaries, primarily related to manufacturing headcount increases for our Malaysia facility as our operations in Malaysia continue to advance.

Activity and liability balances related to the first quarter of 2009 restructuring plan through March 31, 2009 are as follows (in thousands):

	Workforce Reductions	Facilities and Other	Total
Charged to costs and expenses	$ 1,177	$	$ 1,177
Cash payments	(1,139)		(1,139)
Restructuring balance, March 31, 2009	$ 38	$	$ 38

Other (Expense) Income, Net. Other (expense) income, net consists primarily of interest earned on our cash and cash equivalents and short-term investments and foreign currency transactions. Interest income was $7,000 in the first quarter of 2009 and $746,000 in the first quarter of 2008. This decrease in interest income resulted primarily from a lower average cash and cash equivalents and short-term investments balance and lower interest rates in the first quarter of 2009 compared to the first quarter of 2008.

Provision for Income Taxes. The provision for income taxes was $992,000 and $1.5 million in the first quarters of 2009 and 2008, respectively. As a percentage of income before provision for income taxes, provision for income taxes decreased from 44.7% in the first quarter of 2008 to 23.7% in the first quarter of 2009 due primarily to an increase in foreign earnings taxed at rates lower than the federal statutory rate and federal tax credits related to research and development in the three months ended March 31, 2009. The decrease in the effective tax rate for the three months ended March 31, 2009 from the same period in 2008 is due to the transition of certain of our operations to our new 210,000 square foot manufacturing facility in Penang, Malaysia where the Company has been granted a tax holiday subject to meeting certain conditions.

Income from Continuing Operations. Income from continuing operations was $3.2 million and $1.8 million in the first quarters of 2009 and 2008, respectively. The $6.4 million increase in gross profit was offset by a $4.7 million increase in operating expenses in the first quarter of 2009. The increase in operating expenses was due primarily to special charges incurred in the first quarter of 2009 related to our restructuring plan, expansion efforts in Asia and Europe, an increase in employee compensation costs, increased commissions related to higher sales, higher legal fees, and increased investments in research and development for new Flash products.

Loss from Discontinued Operations. On February 9, 2007, we entered into an Asset Purchase Agreement (Purchase Agreement) with Fabrik, Inc. (Fabrik) and Fabrik Acquisition Corp. (together with Fabrik, the Purchasers) for the sale of assets relating to a portion of our business which was engaged in the designing, final assembling, selling, marketing and distributing consumer-oriented products based on Flash memory, DRAM technologies and external storage solutions known as our Consumer Division. The consideration paid to us pursuant to the Purchase Agreement consisted of cash in the amount of approximately $43.0 million. The purchase price was subject to a post-closing adjustment for accrued expenses, reserves on inventory, reserves on accounts receivables and overhead capitalization of the Consumer Division (Purchase Price Adjustment). Subsequent to the closing of the sale, the Purchasers disputed certain amounts calculated by us in regards to the Purchase Price Adjustment. The original claim amount was approximately $6.7 million. In accordance with the Purchase Agreement, both parties agreed to resolve their Purchase Price Adjustment disputes through a third-party arbitrator. During the arbitration proceeding, the Purchasers conceded approximately $4.0 million of their original disputed amounts. In January 2008, the arbitrator rejected substantially all of the Purchasers claims. Since we have not been able to resolve the remaining open issues with Fabrik related to the sale of the Consumer Division and as a result of the indemnification period for claims as specified in the Purchase Agreement having expired in February 2009, we recorded $215,000, net of taxes, related to the write off of amounts owed to us under the original purchase as loss from discontinued operations in the first quarter of 2009.

Liquidity and Capital Resources

Working Capital, Cash and Cash Equivalents and Short-term Investments

As of March 31, 2009, we had working capital of $132.2 million, including $57.5 million of cash and cash equivalents and $5.2 million of short-term investments, compared to working capital of $126.6 million, including $33.4 million of cash and cash equivalents as of December 31, 2008 and working capital of $121.4 million, including $73.7 million of cash and cash equivalents as of March 31, 2008. We had no short-term investments as of December 31, 2008 and March 31, 2008. Current assets were 7.2 times current liabilities at March 31, 2009, compared to 6.4 times current liabilities at December 31, 2008, and 5.0 times current liabilities at March 31, 2008.

Cash Provided by Operating Activities in the Three Months Ended March 31, 2009

Net cash provided by operating activities was $29.9 million for the three months ended March 31, 2009 and resulted primarily from a $19.3 million decrease in inventory, a $5.6 million decrease in accounts receivable, net of reserves, a $1.1 million decrease in other assets, net income of $3.0 million and non-cash depreciation and amortization of $2.9 million, partially offset by a $2.9 million decrease in accounts payable. Inventory decreased due to an increase in sales in the first quarter of 2009, compared to the fourth quarter of 2008. In 2008, we had increased our inventory in anticipation of increased production volumes for SSD products based on customer forecast and orders related to new product launches. Accounts receivable, net of reserves, decreased due primarily to an increase in accounts receivable turnover and lower sales in March 2009, compared to December 2008. Other assets decreased primarily due to a decrease in income taxes receivable. Accounts payable decreased as a result of lower inventory purchases and capital expenditures in the three months ended March 31, 2009 compared to the three months ended December 31, 2008.

Cash Used in Investing Activities for the Three Months Ended March 31, 2009

Net cash used in investing activities was $5.9 million for the three months ended March 31, 2009 resulting primarily from a $5.2 million increase in short-term investments and $690,000 in purchases of property, plant and equipment primarily related to production equipment for the United States and Malaysia locations.

As of March 31, 2009, we have made capital expenditures of approximately $33 million for our Malaysia facility primarily related to building construction costs, acquisition of land and purchases of production equipment. We estimate that total investments in land, facilities and capital equipment will be approximately $20 million over the next five years ending March 31, 2014. We expect that the substantial majority of these estimated investments will relate to our Malaysia facility.

Cash Provided by Financing Activities for the Three Months Ended March 31, 2009

From time to time our board of directors has authorized various programs to repurchase shares of our common stock depending on market conditions and other factors. In November 2008, our board of directors authorized a share repurchase program effective November 19, 2008 enabling us to repurchase up to $10 million of our common stock over an 18-month period expiring on May 18, 2010. At March 31, 2009, $5 million was still authorized for the repurchase of shares under this plan. We did not make any share repurchases in the three months ended March 31, 2009.

On July 30, 2008, we entered into an agreement for a $35 million two-year senior unsecured revolving credit facility (the Credit Facility) with Wachovia Bank, National Association (Wachovia). The Credit Facility will bear interest at a floating rate equivalent to, at our option, either (i) LIBOR plus 0.70% - 1.20% depending on our leverage ratio at each quarter end or (ii) Wachovia s prime rate, announced from time to time, less 1.00% - 1.50% depending on our leverage ratio at each quarter end. The Credit Facility is guarantied by certain of our domestic subsidiaries. In addition, in the event we make a loan to any of our foreign subsidiaries, we have agreed to pledge to Wachovia our intercompany note from such foreign subsidiary. The Credit Facility agreement contains customary affirmative and negative covenants, some of which require the maintenance of specified leverage and minimum liquidity ratios. We were subject to a maximum leverage ratio of 2.0 to 1.0 for the quarter ended March 31, 2009, and a minimum liquidity ratio of 1.0 to 5.0 through March 31, 2009. The Credit Facility matures on July 30, 2010. As of March 31, 2009, there were no borrowings outstanding under our Credit Facility with Wachovia. As of March 31, 2009, we were in compliance with all required covenants. The Credit Facility will be used to maintain liquidity and fund working capital requirements, on an as needed basis

We believe that our existing assets, cash, cash equivalents and investments on hand, together with amounts available under our $35 million credit facility and cash that we expect to generate from our operations, will be sufficient to meet our capital needs for at least the next twelve months. However, it is possible that we may need or elect to raise additional funds to fund our activities beyond the next year to provide additional working capital if our revenues increase substantially, to expand our international operations or to consummate acquisitions of other businesses, products or technologies. We could raise such funds by selling more stock to the public or to selected investors, or by borrowing money. In addition, even though we may not need additional funds, we may still elect to sell additional equity securities or obtain credit facilities for other reasons. There can be no assurance that we will be able to obtain additional funds on commercially favorable terms, or at all. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing shareholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of the holders of our common stock.

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We determine our future capital and operating requirements and liquidity based, in large part, upon our projected financial performance, and we regularly review and update these projections due to changes in general economic conditions, our current and projected operating and financial results, the competitive landscape and other factors. Although we believe we have sufficient capital to fund our activities for at least the next twelve months, our future capital requirements may vary materially from those now planned. The amount of capital that we will need in the future will depend on many factors, including:

- general economic and political conditions and specific conditions in the markets we address, including the continuing volatility in the technology sector and semiconductor industry, and the current global economic recession;
- the inability of certain of our customers who depend on credit to have access to their traditional sources of credit to finance the purchase of products from us, particularly in the current global economic environment, which may lead them to reduce their level of purchases or to seek credit or other accommodations from us;
- whether our revenues increase substantially;
- our relationships with suppliers and customers;
- the market acceptance of our products;
- expansion of our international business, including the opening of offices and facilities in foreign countries;
- price discounts on our products to our customers;
- our pursuit of strategic transactions, including acquisitions, joint ventures and capital investments;
- our business, product, capital expenditure and research and development plans and product and technology roadmaps;
- the levels of inventory and accounts receivable that we maintain;
- our entrance into new markets;
- capital improvements to new and existing facilities;
- technological advances; and
- competitors responses to our products.

Contractual Obligations and Off-Balance Sheet Arrangements

Other than lease commitments incurred in the normal course of business (see Contractual Obligation table below), we do not have any material off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any obligation arising out of a material variable interest in an unconsolidated entity. We do not have any majority-owned subsidiaries that are not included in the consolidated financial statements. Additionally, we do not have any interest in, or relationship with, any special purpose entities.

In the ordinary course of business, we may provide indemnifications of varying scope and terms to customers, vendors, lessors, business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of our breach of such agreements, services to be provided by us, or from intellectual property infringement claims made by third parties. In addition, we have entered into indemnification agreements with our directors and certain of our officers that will require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. We maintain director and officer insurance, which may cover certain liabilities arising from our obligation to indemnify our directors and officers in certain circumstances. It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Such indemnification agreements may not be subject to maximum loss clauses. Historically, we have not incurred material costs as a result of obligations under these agreements.

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Set forth in the table below is our estimate of our significant contractual obligations at March 31, 2009 (in thousands):

		Payment due by period			
Contractual Obligation	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Operating lease obligations	$ 5,529	$ 738	$ 1,360	$ 1,291	$ 2,140
Non-cancelable capital equipment purchase commitments	2,099	2,099			
Non-cancelable inventory purchase commitments	37,914	37,914			
Other non-cancelable purchase commitments	1,070	1,070			
Total	$ 46,612	$ 41,821	$ 1,360	$ 1,291	$ 2,140

Inflation

Inflation was not a material factor in either revenue or operating expenses during each of the first three months ended March 31, 2009 and 2008.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses for each period. Information with respect to our critical accounting policies which we believe could have the most significant effect on our reported results and require subjective or complex judgments is contained in the notes to the consolidated financial statements in the Annual Report on Form 10-K for the fiscal year ended December 31, 2008. There have been no significant changes in our critical accounting policies and estimates during the three months ended March 31, 2009 as compared to what was previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

New Accounting Pronouncements

In December 2007, the FASB issued Statement of Financial Accounting Standards (FAS) No. 141(R), Business Combinations, and FAS No. 160, Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements, an Amendment of ARB No. 51. These new standards significantly change the financial accounting and reporting of business combination transactions and noncontrolling (or minority) interests in consolidated financial statements. We adopted FAS No. 141(R) and FAS No. 160 on January 1, 2009. The adoption of FAS No. 141(R) and FAS No. 160 did not have an impact on our consolidated financial statements.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

At March 31, 2009, our cash and cash equivalents and short-term investments were $62.7 million invested in certificates of deposit, money market funds and other interest bearing accounts. Our main investment objectives are the preservation of investment capital and the maximization of after-tax returns on our investment portfolio. Consequently, we invest in the securities that meet high credit quality standards and we limit the amount of our credit exposure to any one issuer. We do not use derivative instruments for speculative or investment purposes.

At any time, fluctuations in interest rates could affect interest earnings on our cash and cash equivalents and short-term investments. We believe that the effect, if any, of reasonably possible near-term changes in interest rates on our financial position, results of operations, and cash flows would not be material. Currently, we do not hedge these interest rate exposures. The primary objective of our investment activities is to preserve capital. We have not used derivative financial instruments in our investment portfolio.

In a declining interest rate environment, as short-term investments mature, reinvestment occurs at less favorable market rates. Given the short-term nature of certain investments, the current interest rate environment may negatively impact our investment income.

Current economic conditions have had widespread negative effects on the financial markets. Due to credit concerns and lack of liquidity in the short-term funding markets, we have shifted a larger percentage of our portfolio to U.S. Treasury and other government securities and FDIC insured time deposits, which may negatively impact our investment income, particularly in the form of declining yields.

The carrying amount, principal maturity and estimated fair value of our cash and cash equivalents and short-term investments as of March 31, 2009 were as follows:

	Expected Maturity Date			
	Before April 1, 2010	Thereafter	Total	Fair Value 3/31/2009
Cash and cash equivalents:				
Money market funds	$ 37,463,000	$	$ 37,463,000	$ 37,463,000
Certificates of deposit	20,000,000		20,000,000	20,000,000
Short-term investments:				
Certificates of deposit	5,200,000		5,200,000	5,200,000
Total cash and cash equivalents and short-term investments	$ 62,663,000	$	$ 62,663,000	$ 62,663,000
Weighted average interest rate	0.12%		0.12%	0.12%

We are also exposed to interest rate risks due to the possibility of changing interest rates under our $35 million two-year senior unsecured revolving credit facility with Wachovia Bank. Borrowings under the credit facility will bear interest at a floating rate equivalent to, at our option, either (i) LIBOR plus 0.70% - 1.20% depending on our leverage ratio at each quarter end or (ii) Wachovia s prime rate, announced from time to time, less 1.00% - 1.50% depending on our leverage ratio at each quarter end. The credit facility matures on July 30, 2010. As of March 31, 2009, there were no borrowings outstanding under our credit facility.

Foreign Currency Exchange Rate Risk

More than 95% of our international sales are denominated in U.S. dollars. Consequently, if the value of the U.S. dollar increases relative to a particular foreign currency, our products could become relatively more expensive. In addition, we purchase substantially all of our IC components from local distributors of Japanese, Korean and Taiwanese suppliers. Fluctuations in the currencies of Japan, Korea or Taiwan could have an adverse impact on the cost of our raw materials. To date, we have not entered any derivative instruments to manage risks related to interest rate or foreign currency exchange rates.

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ITEM 4. CONTROLS AND PROCEDURES

Inherent Limitations on Effectiveness of Controls

Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

Evaluation of Disclosure Controls and Procedures

An evaluation as of the end of the period covered by this report was carried out under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on their evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report to ensure that we record, process, summarize, and report information required to be disclosed by us in our reports filed under the Exchange Act within the time periods specified by the Securities and Exchange Commission s (SEC) rules and forms.

Changes in Internal Control Over Financial Reporting

During the three months ended March 31, 2009, there have not been any changes in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Seagate Patent Infringement Lawsuit

On April 14, 2008, a patent infringement lawsuit was filed in the United States District Court, Northern District of California by Seagate Technology LLC, Seagate Technology International, Seagate Singapore International Headquarters Pte. Ltd. and Maxtor Corporation (collectively, Seagate) alleging that we infringe four of Seagate s patents U.S. Patent Nos. 6,404,647, 6,849,480, 6,336,174 and 7,042,664. On May 1, 2008, Seagate filed an amended complaint asserting that we infringe an additional Seagate patent U.S. Patent No. 5,261,058. The lawsuit sought injunctive relief and unspecified compensatory and treble damages and attorneys fees for the alleged patent infringement. On February 18, 2009, we, Seagate, and William D. Watkins entered into a Settlement Agreement (the Settlement Agreement) to dismiss with prejudice their respective claims in the lawsuit. Pursuant to the Settlement Agreement, the parties jointly filed a stipulated order of dismissal with prejudice with the court on February 18, 2009. Under the terms of the Settlement Agreement, the parties also agreed to release each other from liability for all claims asserted by the other in the lawsuit, with each party bearing its own fees and costs incurred in connection with the lawsuit. As part of the dismissal, no money was exchanged and neither party licensed its technology to the other.

ITEM 1A. RISK FACTORS

This Report contains forward-looking statements based on the current expectations, assumptions, estimates and projections about our industry and us. These forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those discussed in these forward-looking statements as a result of certain factors, as more fully described in this section and elsewhere in this Report. You should carefully consider these risks before you decide to buy shares of our common stock. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties, including those risks set forth in Management s Discussion and Analysis of Financial Condition and Results of Operations above, may also adversely impact and impair our business. If any of these risks actually occur, our business, results of operations or financial condition would likely suffer. In such case, the trading price of our common stock could decline, and you may lose all or part of the money you paid to buy our stock. We do not undertake to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future. The descriptions below include any material changes to and supersede the description of the risk factors affecting our business previously disclosed in Part I, Item 1A. Risk Factors of our Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

Current economic conditions and the global financial crisis may have an impact on our business and financial condition in ways that we currently cannot predict.

Our operations and performance depend on worldwide economic conditions and their impact on levels of business spending, which have deteriorated significantly in many countries and regions, including without limitation the United States, and may remain depressed for the foreseeable future. Uncertainties in the financial and credit markets have caused our customers to postpone or cancel purchases, and continued uncertainties may reduce future sales of our products and services. For example, during the fourth quarter of 2008 we experienced the cancellation of previously anticipated orders that negatively affected our revenues and operating results. These worldwide economic conditions make it extremely difficult for our customers, our vendors and us to accurately forecast and plan future business activities, and they could cause our customers to further slow spending on our products, which would delay and lengthen sales cycles. Furthermore, during challenging economic times our customers may face issues gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. If that were to occur, we may experience increased collection times or greater write-offs, which could have a material adverse effect on our revenues and cash flow. Similarly, our vendors may face issues gaining timely access to sufficient credit, which could result in an impairment of their ability to supply us with components that are needed in the manufacture of our products. If that were to occur, we may experience delays in our production and increased costs associated with our qualification of additional new vendors and replacement of their components, which could have a material adverse effect on our revenues and cash flow. Finally, our ability to access the capital markets may be restricted at a time when we would like, or need, to do so, which could have an impact on our flexibility to pursue additional expansion opportunities and maintain our desired level of revenue growth in the future. These and other economic factors could have a material adverse effect on demand for our products and services and on our financial condition and operating results.

We expect our quarterly operating results to fluctuate in future periods, causing our stock price to fluctuate or decline.

Our quarterly operating results have fluctuated in the past, and we believe they will continue to do so in the future. Fluctuations in our operating results may be due to a number of factors, including, but not limited to, those listed below and those identified throughout this Risk Factors section, some of which may contribute to more pronounced fluctuations in an uncertain global economic environment:

- Impact of changing and recently volatile U.S. and global economic conditions;
- Our suppliers production levels for the components used in our products;
- Our ability to procure required components;
- Market acceptance of new and enhanced versions of our products;
- Expansion of our international business, including the opening of offices and facilities in foreign countries;
- The timing of the introduction of new products or components and enhancements to existing products or components by us, our competitors or our suppliers;
- Fluctuations in the cost of components and changes in the average sales prices of our products;
- Fluctuating market demand for our products;
- Changes in our customer and product revenue mix;
- Our ability to successfully integrate any acquired businesses or assets;
- Expenses associated with the start up of new operations or divisions;
- Order cancellations, product returns, inventory buildups by customers and inventory write-downs;
- Manufacturing inefficiencies associated with the start-up of new products and volume production;
- Expenses associated with strategic transactions, including acquisitions, joint ventures and capital investments;

Our ability to adequately support potential future rapid growth;

Our ability to absorb manufacturing overhead if revenues decline;

The effects of litigation; and

Increases in our sales and marketing expenses in connection with decisions to pursue new product initiatives.

Due to the above and other factors, quarterly revenues and results of operations are difficult to forecast, and period-to-period comparisons of our operating results may not be predictive of future performance. In one or more future quarters, our results of operations may fall below the expectations of securities analysts and investors. In that event, the trading price of our common stock would likely decline. In addition, the trading price of our common stock may fluctuate or decline regardless of our operating performance.

Disruption of operations at our manufacturing facilities and the unsuccessful ramp-up of our production capabilities in Penang, Malaysia would substantially harm our business.

Our manufacturing operations are located in our facilities in Santa Ana, California and Penang, Malaysia. Over time, we expect substantially all of our manufacturing operations to be located in Penang, Malaysia as we continue to transition certain of our operations to our Penang facility. Due to this geographic concentration, a disruption of our manufacturing operations, resulting from sustained process abnormalities, human error, government intervention or natural disasters, including earthquakes, power failures, fires or floods, could cause us to cease or limit our manufacturing operations and consequently harm our business, financial condition and results of operations.

Our Penang operation will continue to ramp production in subsequent quarters. While our management team is overseeing the increase in production capabilities at our Penang facility, the operation itself has a limited operating history and we have limited experience operating in foreign countries. As a result, a disruption of our manufacturing operations resulting from ramp-up related challenges such as obtaining sufficient raw materials, hiring of qualified factory personnel, installation and efficient operation of new equipment, facility audits by customers, and management and coordination of a new logistics network within our global operations could cause us to cease, delay, or limit our manufacturing operations and consequently harm our business, financial condition and results of operations.

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Our dependence on a small number of suppliers for components, including integrated circuit devices, and inability to obtain a sufficient supply of these components on a timely basis could harm our ability to fulfill orders.

Typically, integrated circuit, or IC, devices represent more than 80% of the component costs of our products. We are dependent on a small number of suppliers that supply key components used in the manufacture of our products. Since we have no long-term supply contracts, there is no assurance that our suppliers will agree to supply the quantities of components we may need to meet our production goals. Samsung currently supplies substantially all of the IC devices used in our Flash memory products. Micron and Samsung currently supply substantially all of the DRAM IC devices used in our DRAM products.

Our customers qualify specific controller, Flash and DRAM ICs that are components in our products as part of the product qualification process. If any of our suppliers experience quality control problems, our products that utilize that supplier s IC may be disqualified by one or more of our customers. This would disrupt our supply of ICs, reduce the number of suppliers available to us and adversely affect our ability to fulfill our customers product orders. Further, we may be required to qualify a new supplier s IC, which could negatively impact our revenues during the new qualification process. There can be no assurance that we would be able to find and successfully qualify new suppliers in a timely manner or obtain ICs from new suppliers on commercially reasonable terms.

Moreover, from time to time, our industry experiences shortages in IC devices and foundry services which have resulted in placing their customers, ourselves included, on component allocation. This means that while we may have customer orders, we may not be able to obtain the materials that we need to fill those orders in a timely manner or at competitive prices. As a result, our reputation could be harmed, we may lose business from our customers, our revenues may decline, and we may lose market share to our competitors.

In addition to Flash and DRAM ICs, a number of other components that we use in our products are available from only a single or limited number of suppliers. In the development of our own ASICs, we also depend on certain foundry subcontractors to manufacture these ASICs as well as on certain third-party subcontractors to assemble, obtain packaging materials for, and test these ASICs. Our dependence on a small number of suppliers and the lack of any guaranteed sources of supply expose us to several risks, including:

- The inability to obtain an adequate supply of components;
- Price increases, late deliveries and poor component quality;
- An unwillingness of a supplier to supply such components to us;
- A key supplier s or sub-supplier s inability to access credit necessary to operate its business;
- Failure of a key supplier to remain in business or adjust to market conditions;
- Consolidation among suppliers may result in some suppliers exiting the industry or discontinuing the manufacture of components; or
- Failure of a supplier to meet our quality, yield or production requirements.

A disruption in or termination of our supply relationship with any of our significant suppliers or our inability to develop relationships with new suppliers, if required, would cause delays, disruptions or reductions in product shipments or require product redesigns which could damage relationships with our customers, could increase our costs or the prices of our products and adversely affect our revenues and business.

Sales to a limited number of customers represent a significant portion of our revenues, and the loss of any key customer would materially reduce our revenues.

Historically, a relatively limited number of customers have accounted for a significant percentage of our revenues. Our ten largest customers accounted for an aggregate of 79.3% and 76.1% of our revenues in the three months ended March 31, 2009 and 2008, respectively. We had four customers account for more than 10.0% of our revenues, at 20.2%, 13.4%, 12.2% and 12.0%, for the three months ended March 31, 2009 compared to two customers, at 43.5% and 12.6%, for the same period in 2008.

Consolidation in some of our customers industries may result in increased customer concentration and the potential loss of customers as a result of acquisitions. In addition, the composition of our major customer base changes from quarter to quarter as the market demand for our customers products changes, and we expect this variability to continue in the future. We expect that sales of our products to a limited number of customers will continue to contribute materially to our revenues in the foreseeable future. The loss of, or a significant reduction in purchases by, any of our major customers, could harm our business, financial condition and results of operations.

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Ineffective management of inventory levels or product mix, order cancellations, product returns and inventory write-downs could adversely affect our results of operations.

If we are unable to properly monitor, control and manage our inventory and maintain an appropriate level and mix of products with our customers, we may incur increased and unexpected costs associated with this inventory. For example, if we manufacture products in anticipation of future demand that does not materialize, or if a customer cancels outstanding orders, we could experience an unanticipated increase in our inventory that we may be unable to sell in a timely manner, if at all. As a result, we could incur increased expenses associated with writing off excess or obsolete inventory. We also maintain inventory, or hubbing, arrangements with certain of our customers. Pursuant to these arrangements, we deliver products to a customer or a designated third-party warehouse based upon the customer s projected needs but do not recognize product revenue unless and until the customer has removed our product from the warehouse to incorporate into its end products. If a customer does not take our products under a hubbing arrangement in accordance with the schedule it originally provided us, our predicted future revenue stream could vary substantially from our forecasts and our results of operations could be materially and adversely affected. Additionally, since we own inventory that is physically located in a third party s warehouse, our ability to effectively manage inventory levels may be impaired, causing our total inventory turns to decrease, which could increase expenses associated with excess and obsolete inventory and negatively impact our cash flow. In addition, while we may not be contractually obligated to accept returned products, we may determine that it is in our best interest to accept returns in order to maintain good relations with our customers. Product returns would increase our inventory and reduce our revenues. Alternatively, we could end up with too little inventory and we may not be able to satisfy demand, which could have a material adverse effect on our customer relationships. Our risks related to inventory management are exacerbated by our strategy of closely matching inventory levels with product demand, leaving limited margin for error. We have had to write-down inventory in the past for reasons such as obsolescence, excess quantities and declines in market value below our costs. These inventory write-downs were $1.3 million and $0 during the three months ended March 31, 2009 and 2008, respectively.

We have no long-term volume commitments from our customers. Sales of our products are made through individual purchase orders and, in certain cases, are made under master agreements governing the terms and conditions of the relationships. Customers may change, cancel or delay orders with limited or no penalties. It is difficult to accurately predict what or how many products our customers will need in the future. Anticipating demand is challenging because our customers face volatile pricing and unpredictable demand for their own products, and are increasingly focused on cash preservation and tighter inventory management. We have experienced cancellations of orders and fluctuations in order levels from period-to-period and we expect to continue to experience similar cancellations and fluctuations in the future, which could result in fluctuations in our revenues.

We have received recent indications from our existing PC OEM customer that they may end-of-life the program which utilizes our ultra-mobile SSD product. In this circumstance, we may have excess inventory which was purchased specifically for this customer in accordance with their purchase orders and sales forecasts.

We may be less competitive if we fail to develop new and enhanced products and introduce them in a timely manner.

The enterprise-storage, enterprise-server, video-on-demand (VoD), PC mobile computing and consumer-related markets and military and industrial applications markets are subject to rapid technological change, product obsolescence, frequent new product introductions and enhancements, changes in end-user requirements and evolving industry standards. Our ability to compete in these markets will depend in significant part upon our ability to successfully develop, introduce and sell new and enhanced products on a timely and cost-effective basis, and to respond to changing customer requirements.

We have experienced, and may in the future experience, delays in the development and introduction of new products. These delays would provide a competitor a first-to-market opportunity and allow a competitor to achieve greater market share. Once a customer designs a competitor s product into its product offering, it becomes significantly more difficult for us to sell our products to that customer because changing suppliers involves significant cost, time, effort and risk for the customer. Our product development is inherently risky because it is difficult to foresee developments in technology, anticipate the adoption of new standards, coordinate our technical personnel, and identify and eliminate design flaws. Defects or errors found in our products after commencement of commercial shipments could result in delays in market acceptance of these products. New products, even if first introduced by us, may not gain market acceptance or result in future profitability. Lack of market acceptance for our new products will jeopardize our ability to recoup research and development expenditures, hurt our reputation and harm our business, financial condition and results of operations. In addition, after we have developed a new product, our customers will usually test and evaluate our products. Our customers may need three or more months to test, evaluate and adopt our products and an additional three or more months to begin volume production of equipment that incorporates our products. Even if a customer selects our product to incorporate into its equipment, we have no assurance that the customer will ultimately bring its product to market or that such effort by our customer will be successful.

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We may also seek to develop products with new standards for our industry. It will take time for these new standards and products to be adopted, for customers to accept and transition to these new products and for significant sales to be generated from them, if this happens at all. Moreover, broad acceptance of new standards or products by customers may reduce demand for our older products. If this decreased demand is not offset by increased demand for our new products, our results of operations could be harmed. We cannot assure you that any new products or standards we develop will be commercially successful.

We may not be able to maintain or improve our competitive position because of the intense competition in the memory industry.

We conduct business in an industry characterized by intense competition, rapid technological change, evolving industry standards, declining average sales prices and rapid product obsolescence. Our primary competitors for storage products include: Intel, Samsung, SanDisk, Seagate, Toshiba and Western Digital; and for DRAM products include: Micron and SMART Modular. Our competitors include many large domestic and international companies that have substantially greater financial, technical, marketing, distribution and other resources, broader product lines, lower cost structures, greater brand recognition and longer-standing relationships with customers and suppliers. As a result, our competitors may be in a better position to influence or respond to new or emerging technologies or standards and to changes in customer requirements than us. Our competitors may also be able to devote greater resources to the development, promotion and sale of products, and may be able to deliver competitive products at a lower price.

In addition, some of our significant suppliers, including Micron and Samsung Semiconductor, are also our competitors, many of whom have the ability to manufacture competitive products at lower costs as a result of their higher levels of integration. We also face competition from current and prospective customers that evaluate our capabilities against the merits of manufacturing products internally. Competition may arise from new and emerging companies or due to the development of cooperative relationships among our current and potential competitors or third parties to increase the ability of their products to address the needs of our prospective customers. We expect our competitors will continue to improve the performance of their current products, reduce their prices and introduce new products that may offer greater performance, improved pricing or render our technology or products obsolete or uncompetitive, any of which could cause a decline in sales or loss of market acceptance of our products.

Our stock price is likely to be volatile and could drop unexpectedly.

Our common stock has been publicly traded since September 2000. The market price of our common stock has been subject to significant fluctuations since the date of our initial public offering. The stock market has from time to time experienced significant price and volume fluctuations that have affected the market prices of securities, particularly securities of technology companies. As a result, the market price of our common stock may materially decline, regardless of our operating performance. In the past, following periods of volatility in the market price of a particular company s securities, securities class action litigation has often been brought against that company. We may become involved in this type of litigation in the future. Litigation of this type is often expensive and diverts management s attention and resources.

Our efforts to expand our business internationally may not be successful and may expose us to additional risks that may not exist in the United States, which in turn could cause our business and operating results to suffer.

We sell our products to customers in foreign countries and seek to increase our level of international business activity through the expansion of our operations into select international markets, including Asia and Europe. Such strategy may include opening sales offices in foreign countries, the outsourcing of manufacturing operations to third-party contract manufacturers, establishing joint ventures with foreign partners, and the establishment of manufacturing operations in foreign countries.

In January 2008, we completed the construction of our 210,000 square foot manufacturing facility in Malaysia that will serve as a major hub for our international operational activities including manufacturing, sales and marketing, procurement, and logistics. A failure to successfully and timely integrate these operations into our global infrastructure will have a negative impact on our overall operations, cause us to delay or forego some of the original perceived benefits of operating internationally such as lower average production and engineering labor costs, better access to growing markets in Asia, improved supply chain efficiency, reduced lead times, increased manufacturing efficiency through investments in new state-of-the-art equipment and a lower overall long-term effective tax rate.

Establishing operations in a foreign country or region presents numerous risks, including:

- difficulties and costs of staffing and managing operations in certain foreign countries;

foreign laws and regulations, which may vary country by country, may impact how we conduct our business;

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- higher costs of doing business in certain foreign countries, including different employment laws;
- difficulty protecting our intellectual property rights from misappropriation or infringement;
- political or economic instability;
- changes in import/export duties;
- necessity of obtaining government approvals;
- trade restrictions;
- work stoppages or other changes in labor conditions;
- difficulties in collecting of accounts receivables on a timely basis or at all;
- taxes;
- longer payment cycles and foreign currency fluctuations; and
- seasonal reductions in business activity in some parts of the world, such as Europe.

In addition, changes in policies and/or laws of the United States or foreign governments resulting in, among other things, higher taxation, currency conversion limitations, restrictions on fund transfers or the expropriation of private enterprises, could reduce the anticipated benefits of our international expansion. We may also encounter potential adverse tax consequences if taxing authorities in different jurisdictions worldwide disagree with our interpretation of various tax laws or our determinations as to the income and expenses attributable to specific jurisdictions, which could result in our paying additional taxes, interest and penalties. Furthermore, any actions by countries in which we conduct business to reverse policies that encourage foreign trade or investment could adversely affect our business. If we fail to realize the anticipated revenue growth of our future international operations, our business and operating results could suffer.

We expect that our strategy to expand our international operations will require the expenditure of significant resources and involve the efforts and attention of our management. Unlike some of our competitors, we have limited experience operating our business in foreign countries. Some of our competitors may have substantial advantage over us in attracting customers in certain foreign countries due to earlier established operations in that country, greater knowledge with respect to cultural differences of customers residing in that country and greater brand recognition and longer-standing relationships with customers in that country. If our international expansion efforts in any foreign country are unsuccessful, we may decide to cease these foreign operations, which would likely harm our reputation and cause us to incur expenses and losses.

We are involved from time to time in claims and litigation over intellectual property rights, which may adversely affect our ability to manufacture and sell our products.

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights. We believe that it may be necessary, from time to time, to initiate litigation against one or more third parties to preserve our intellectual property rights. Some of our suppliers and licensors have generally agreed to provide us with various levels of intellectual property indemnification for products and technology we purchase or license from them. A third-party could claim that our products infringe a patent or other proprietary right. In addition, from time to time, we have received, and may continue to receive in the future, notices that claim we have infringed upon, misappropriated or misused other parties proprietary rights. Any of the foregoing events or claims could result in litigation. Such litigation, whether as plaintiff or defendant, would likely result in significant expense to us and divert the efforts of our technical and management personnel, whether or not such litigation is ultimately determined in our favor. In the event of an adverse result in such litigation, we could be required to pay substantial damages, cease the manufacture, use and sale of certain products, expend significant resources to develop non-infringing technology, discontinue the use of certain processes or obtain licenses to use the infringed technology. In addition, our suppliers and licensors obligation to indemnify us for intellectual property infringement may be insufficient or inapplicable to any such litigation. A license may not be available on commercially reasonable terms, if at all. Our failure to obtain a license on commercially reasonable terms, or at all, could cause us to incur substantial costs and suspend manufacturing products using the infringed technology. If we obtain a license, we would likely be required to pay license fees or make royalty payments for sales under the license. Such payments would increase our costs of revenues and reduce our gross margins and gross profit. If we are unable to obtain a license from a third party for technology, we could incur substantial liabilities or be required to expend substantial resources redesigning our products to eliminate the infringement. There can be no assurance that we would be successful in redesigning our products or that we could obtain licenses on commercially reasonable terms, if at all. Product development or license negotiating would likely result in significant expense to us and divert the efforts of our technical and management personnel.

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Our indemnification obligations for the infringement by our products of the intellectual property rights of others could require us to pay substantial damages.

As is common in the industry, we currently have in effect a number of agreements in which we have agreed to defend, indemnify and hold harmless our customers and suppliers from damages and costs which may arise from the infringement by our products of third-party patents, trademarks or other proprietary rights. The scope of such indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorneys fees. Our insurance does not cover intellectual property infringement. The term of these indemnification agreements is generally perpetual any time after execution of the agreement. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. We may periodically have to respond to claims and litigate these types of indemnification obligations. Any such indemnification claims could require us to pay substantial damages that may result in a material adverse effect on our business and results of operations.

Our indemnification obligations to our customers and suppliers for product defects could require us to pay substantial damages.

A number of our product sales and product purchase agreements provide that we will defend, indemnify and hold harmless our customers and suppliers from damages and costs which may arise from product warranty claims or claims for injury or damage resulting from defects in our products. We maintain insurance to protect against certain claims associated with the use of our products, but our insurance coverage may not be adequate to cover all or any part of the claims asserted against us. A successful claim brought against us that is in excess of, or excluded from, our insurance coverage could substantially harm our business, financial condition and results of operations.

Our intellectual property may not be adequately protected, which could harm our competitive position.

Our intellectual property is critical to our success. We protect our intellectual property rights through patents, trademarks, copyrights and trade secret laws, confidentiality procedures and employee disclosure and invention assignment agreements. It is possible that our efforts to protect our intellectual property rights may not:

- Prevent the challenge, invalidation or circumvention of our existing patents;
- Result in patents that lead to commercially viable products or provide competitive advantages for our products;
- Prevent our competitors from independently developing similar products, duplicating our products or designing around the patents owned by us;
- Prevent third-party patents from having an adverse effect on our ability to do business;
- Provide adequate protection for our intellectual property rights;
- Prevent disputes with third parties regarding ownership of our intellectual property rights;
- Prevent disclosure of our trade secrets and know-how to third parties or into the public domain; and
- Result in patents from any of our pending applications.

In addition, despite our efforts to protect or intellectual property rights and confidential information, third parties could copy or otherwise obtain and make unauthorized use of our technologies or independently develop similar technologies. In addition, if any of our patents are challenged and found to be invalid, our ability to exclude competitors from making, using or selling the same or similar products related to such patents would cease. We have on at least one occasion applied for and may in the future apply for patent protection in foreign countries**.** The laws of foreign countries, however, may not adequately protect our intellectual property rights. Many U.S. companies have encountered substantial infringement problems in foreign countries. Because we sell our products overseas, we have exposure to foreign intellectual property risks.

Declines in our average sales prices may result in declines in our revenues and gross profit.

Our industry is competitive and characterized by historical declines in average sales prices. Our average sales prices may decline due to several factors, including overcapacity in the worldwide supply of DRAM and Flash memory component as a result of increased manufacturing efficiencies, new manufacturing processes and manufacturing capacity expansions by component suppliers. In the past, overcapacity has resulted in significant declines in component prices, which has negatively impacted our average sales prices, revenues and gross profit. In addition, our competitors and customers also impose significant pricing pressures on us. Since a large percentage of our sales are to a small number of customers that are primarily distributors and large OEMs, these customers have exerted, and we expect they will continue to exert, pressure on us to make price concessions. If not offset by increases in demand for our products, decreases in average sales prices would likely have a material adverse effect on our business and operating results.

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We are subject to the cyclical nature of the semiconductor industry and any future downturn could adversely affect our business.

The semiconductor industry, including the memory markets in which we compete, is highly cyclical and 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 downturns often connected with, or in anticipation of, maturing product cycles of both semiconductor companies and their customers products and declines in general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average sales prices. Prior downturns in the semiconductor industry negatively impacted our average sales prices, revenues and earnings. Any future downturns could have a material adverse effect on our business and results of operations.

Our level of indebtedness could adversely affect our cash flow and prevent us from fulfilling our financial obligations.

On July 30, 2008, we entered into a credit agreement for a $35 million revolving credit facility. Our debt could have important consequences, such as:

- requiring us to dedicate a portion of our cash flow from operations and other capital resources to debt service, thereby reducing our ability to fund working capital, capital expenditures, and other cash requirements;
- increasing our vulnerability to adverse economic and industry conditions;
- limiting our flexibility in planning for, or reacting to, changes and opportunities in, our business and industry, which may place us at a competitive disadvantage; and
- limiting our ability to incur additional debt on acceptable terms, if at all.

Additionally, if we were to default under our credit agreement and were unable to obtain a waiver for such a default, interest on the obligations would accrue at an increased rate and the lenders could accelerate our obligations under the credit agreement; however that acceleration will be automatic in the case of bankruptcy and insolvency events of default.

Additionally, to the extent we have made intercompany loans to our subsidiaries that have required us to pledge such loans to the lenders under the credit agreement, our subsidiaries would be required to pay the amount of the intercompany loans to the lenders in the event we are in default under the credit agreement. Any actions taken by the lenders against us in the event we are in default under the credit agreement could harm our financial condition.

Failure to maintain effective internal control over financial reporting could result in a negative market reaction.

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we undertake a thorough examination of our internal control systems and procedures for financial reporting. We also are required to completely document and test those systems. Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal control over financial reporting as of the end of each year, and to include a management report assessing the effectiveness of our internal control over financial reporting in our annual reports. Section 404, as updated, also requires our independent registered public accounting firm to annually attest to, and report on, the effectiveness of our internal control over financial reporting.

Although our management has determined, and our independent registered public accounting firm has attested, that our internal control over financial reporting was effective as of December 31, 2008, we cannot assure you that we or our independent registered public accounting firm will not identify a material weakness in our internal controls in the future. If our internal control over financial reporting is not considered adequate, we may experience a loss of public confidence, which could have an adverse effect on our business and our stock price.

Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq rules, have required most public companies, including us, to devote additional internal and external resources to various governance and compliance matters. Because we have a relatively small corporate staff, we have incurred significant costs on outside professional advisers to assist us with these efforts. These costs have included increased accounting related fees associated with preparing the attestation report on our internal controls over financial reporting as required under Section 404 of the Sarbanes-Oxley Act of 2002. In addition, these new or changed laws, regulations and standards are subject to varying interpretations, as well as modifications by the government and Nasdaq. The way in which they are applied and implemented may change over time, which could result in even higher costs to address and implement revisions to compliance (including disclosure) and governance practices. We intend to invest the necessary resources to comply with evolving laws, regulations and standards. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may be harmed and we will be required to incur additional expenses.

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We may make acquisitions that are dilutive to existing shareholders, result in unanticipated accounting charges or otherwise adversely affect our results of operations.

We intend to grow our business through business combinations or other acquisitions of businesses, products or technologies that allow us to complement our existing product offerings, expand our market coverage, increase our engineering workforce or enhance our technological capabilities. If we make any future acquisitions, we could issue stock that would dilute our shareholders percentage ownership, incur substantial debt, reduce our cash reserves or assume contingent liabilities. Furthermore, acquisitions may require material infrequent charges and could result in adverse tax consequences, substantial depreciation, deferred compensation charges, in-process research and development charges, the amortization of amounts related to deferred compensation and identifiable purchased intangible assets or impairment of goodwill, any of which could negatively impact our results of operations.

Our limited experience in acquiring other businesses, product lines and technologies may make it difficult for us to overcome problems encountered in connection with any acquisitions we may undertake.

We continually evaluate and explore strategic opportunities as they arise, including business combinations, strategic partnerships, capital investments and the purchase, licensing or sale of assets. Our experience in acquiring other businesses, product lines and technologies is limited. The attention of our small management team may be diverted from our core business if we undertake any future acquisitions. Any potential future acquisition involves numerous risks, including, among others:

- Problems and delays in successfully assimilating and integrating the purchased operations, personnel, technologies, products and information systems;
- Unanticipated costs and expenditures associated with the acquisition, including any need to infuse significant capital into the acquired operations;
- Adverse effects on existing business relationships with suppliers, customers and strategic partners;
- Risks associated with entering markets and foreign countries in which we have no or limited prior experience;
- Contractual, intellectual property or employment issues;
- Potential loss of key employees of purchased organizations; and
- Potential litigation arising from the acquired company s operations before the acquisition.

These risks could disrupt our ongoing business, distract our management and employees, harm our reputation and increase our expenses. Our inability to overcome problems encountered in connection with any acquisitions could divert the attention of management, utilize scarce corporate resources and otherwise harm our business. These challenges are magnified as the size of an acquisition increases, and we cannot assure you that we will realize the intended benefits of any acquisition. For example, in June 2004 we discontinued the operation of our Xiran Division, which was formed in 2002 as a result of our acquisition of technology for networked storage applications. We were unable to successfully bring the Xiran Division products to market after funding its operations for over two years. In connection with the discontinued operation, we recorded a non-cash charge of approximately $3.0 million in the second quarter of 2004.

We are unable to predict whether or when any prospective acquisition candidate will become available or the likelihood that any acquisition will be completed. Even if we do find suitable acquisition opportunities, we may not be able to consummate the acquisitions on commercially acceptable terms or realize the anticipated benefits of any acquisitions we do undertake.

Three of our beneficial shareholders could control all matters requiring shareholder approval and two of our beneficial shareholders have substantial influence over our operations.

Our founders, Manouch Moshayedi, Mike Moshayedi and Mark Moshayedi, are brothers and beneficially own approximately 50% of our outstanding common stock at March 31, 2009 (assuming the inclusion of shares of common stock subject to options that are presently exercisable or will become exercisable within 60 days of such date). In addition, Manouch Moshayedi and Mark Moshayedi are executive officers and directors. As a result, they potentially have the ability to control or influence all matters requiring approval by our shareholders, including the election and removal of directors, approval of significant corporate transactions and the decision of whether a change in control will occur. This potential control could affect the price that certain investors may be willing to pay in the future for shares of our common stock.

We face risks associated with doing business in foreign countries, including foreign currency fluctuations and trade barriers, that could lead to a decrease in demand for our products or an increase in the cost of the components used in our products.

The volatility of general economic conditions and fluctuations in currency exchange rates affect the prices of our products and the prices of the components used in our products. International sales, which are derived from billings to foreign customers, accounted for 49% and 22% of our revenues for each of the three months ended March 31, 2009 and 2008, respectively. During the three months ended March 31, 2009, 20% and 16% of our revenues were derived from billings to customers in Singapore and Taiwan, respectively. No foreign geographic area or single foreign country accounted for more than 10% of revenues during the three months ended March 31, 2008. For each of the three months ended March 31, 2009 and 2008, more than 95% of our international sales were denominated in U.S. dollars. However, if there is a significant devaluation of the currency in a specific country, the prices of our products will increase relative to that country s currency and our products may be less competitive in that country. In addition, we cannot be sure that our international customers will continue to be willing to place orders denominated in U.S. dollars. If they do not, our revenues and results of operations will be subject to foreign exchange fluctuations, which could harm our business. We do not hedge against foreign currency exchange rate risks.

We purchase a majority of the DRAM and Flash components used in our products from local distributors of foreign suppliers. Although our purchases of DRAM and Flash components are currently denominated in U.S. dollars, devaluation of the U.S. dollar relative to the currency of a foreign supplier would likely result in an increase in our cost of DRAM and Flash components.

Our international sales are subject to other risks, including regulatory risks, tariffs and other trade barriers, timing and availability of export licenses, political and economic instability, difficulties in accounts receivable collections, difficulties in managing distributors, lack of a significant local sales presence, difficulties in obtaining governmental approvals, compliance with a wide variety of complex foreign laws and treaties and potentially adverse tax consequences. In addition, the United States or foreign countries may implement quotas, duties, taxes or other charges or restrictions upon the importation or exportation of our products, leading to a reduction in sales and profitability in that country.

The manufacturing of our products is complex and subject to yield problems, which could decrease available supply and increase costs.

The manufacture of our Flash memory products, stacked DRAM products and Flash controllers is a complex process, and it is often difficult for companies to achieve acceptable product yields. Reduced yields could decrease available supply and increase costs. Flash controller yields depend on both our product design and the manufacturing process technology unique to our semiconductor foundry partners. Because low yields may result from either design defects or process difficulties, we may not identify yield problems until well into the production cycle, when an actual product defect exists and can be analyzed and tested. In addition, many of these yield problems are difficult to diagnose and time consuming or expensive to remedy.

The execution of our growth strategy depends on our ability to retain key personnel, including our executive officers, and to attract qualified personnel.

Competition for employees in our industry is intense. We have had and may continue to have difficulty hiring the necessary engineering, sales and marketing and management personnel to support our growth. The successful implementation of our business model and growth strategy depends on the continued contributions of our senior management and other key research and development, sales and marketing and operations personnel, including Manouch Moshayedi, our Chief Executive Officer, Mark Moshayedi, our President, Chief Operating Officer, Chief Technical Officer and Secretary, and Raymond Cook, our Chief Financial Officer. The loss of any key employee, the failure of any key employee to perform in his or her current position, or the inability of our officers and key employees to expand, train and manage our employee base would prevent us from executing our growth strategy.

During the first quarter of 2009, we commenced a reduction of our workforce primarily at our Santa Ana, California headquarters as part of the transition of certain of our operations to our new 210,000 square foot manufacturing facility in Penang, Malaysia. While this action may help us achieve our growth strategy, it may negatively impact employee morale and our ability to attract, retain and motivate employees. Our inability to attract and retain additional key employees could have an adverse effect on our business, financial condition and results of operations.

Failure to comply with governmental laws and regulations could harm our business.

Our business is subject to regulation by various federal and state governmental agencies. Such regulation includes employment and labor laws, workplace safety, product safety, environmental laws, consumer protection laws, import/export controls and tax. We are also subject to regulation in other countries where we conduct business. In certain jurisdictions, such regulatory requirements may be more stringent than in the United States. Noncompliance with applicable regulations or requirements could subject us to investigations, sanctions, mandatory product recalls, enforcement actions, disgorgement of profits, fines, damages, civil and criminal

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penalties, or injunctions. These enforcement actions could harm our business, financial condition, results of operations and cash flows. If any governmental sanctions are imposed, or if we do not prevail in any possible civil or criminal litigation, our business, financial condition, results of operations and cash flows could be materially adversely affected. In addition, responding to any action will likely result in a significant diversion of management s attention and resources and an increase in professional fees.

In addition from time to time we have received, and expect to continue to receive, correspondence from former employees terminated by us who threaten to bring claims against us alleging that we have violated one or more labor and employment regulations. In certain of these instances the former employee has brought claims against us and we expect that we will encounter similar actions against us in the future. An adverse outcome in any such litigation could require us to pay contractual damages, compensatory damages, punitive damages, attorneys fees and costs.

Anti-takeover provisions in our charter documents and stock option plan could prevent or delay a change in control and, as a result, negatively impact our shareholders.

We have taken a number of actions that could have the effect of discouraging a takeover attempt. For example, provisions of our articles of incorporation and bylaws could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our shareholders. These provisions also could limit the price that certain investors might be willing to pay in the future for shares of our common stock.

These provisions include:

- limitations on who may call special meetings of shareholders;
- advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon by shareholders at shareholder meetings;
- elimination of cumulative voting in the election of directors;
- the right of a majority of directors in office to fill vacancies on the board of directors;
- the ability of our board of directors to issue, without shareholder approval, blank check preferred stock to increase the number of outstanding shares and thwart a takeover attempt.

Provisions of our 2000 Stock Incentive Plan allow for the automatic vesting of all outstanding equity awards granted under the 2000 Stock Incentive Plan upon a change in control under certain circumstances. Such provisions may have the effect of discouraging a third party from acquiring us, even if doing so would be beneficial to our shareholders.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

The number of shares of our common stock repurchased and the average price paid per share for the three months ended March 31, 2009 are as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares as Part of Publicly	Maximum Dollar Value that May Yet be Purchased

				Announced Program (1)	Under the Program
As of December 31, 2008	1,335,541	$	3.74	$ 4,999,967	$ 5,000,033
January 1 through January 31, 2009		$			$
February 1 through February 28, 2009		$			$
March 1 through March 31, 2009		$			$
Total	1,335,541	$	3.74	$ 4,999,967	$ 5,000,033

(1) In November 2008, our board of directors authorized a share repurchase program effective November 19, 2008 enabling us to repurchase up to $10 million of our common stock over an 18-month period expiring on May 18, 2010. Repurchases under our share repurchase program was and will be made in open market or privately negotiated transactions in compliance with Rule 10b-18 promulgated under the Securities Exchange Act of 1934, as amended. There is no guarantee as to the exact number of shares that will be repurchased by us, and we may discontinue purchases at any time that management determines that additional purchases are not warranted. Repurchased shares were returned to the status of authorized but unissued shares of common stock and may be issued by us in the future. All shares were purchased pursuant to our existing share repurchase program.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit Number	Description
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* The information in Exhibits 32.1 and 32.2 shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or otherwise subject to the liabilities of that section, nor shall they be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act (including this Report), unless STEC, Inc. specifically incorporates the foregoing information into those documents by reference.

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SIGNATURES

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

	STEC, INC.,
	a California corporation
Date: May 11, 2009	/s/ RAYMOND COOK Raymond Cook Chief Financial Officer
	(Principal Financial Officer and Duly Authorized Signatory)

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STEC, INC.

Index to Exhibits

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