SILICON STORAGE TECHNOLOGY INC
Form 10-Q
November 10, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2008

OR

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

Commission File Number 0-26944

SILICON STORAGE TECHNOLOGY, INC.

(Exact name of Registrant as Specified in its Charter)

California **(State or Other Jurisdiction of** **Incorporation or Organization)**	**77-0225590** **(I.R.S. Employer** **Identification Number)**
1171 Sonora Court, Sunnyvale, CA **(Address of Principal Executive Offices)**	**94086** **(Zip Code)**

(408) 735-9110

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

Large accelerated filer ¨	Accelerated filer 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

Number of shares outstanding of Common Stock, no par value, as of October 31, 2008: 95,492,192

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SILICON STORAGE TECHNOLOGY, INC.

FORM 10-Q: QUARTER ENDED SEPTEMBER 30, 2008

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PART I FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Net revenues:				
Product revenues - unrelated parties	$ 36,861	$ 31,198	$ 111,548	$ 89,638
Product revenues - related parties	60,933	48,603	164,734	130,934
Technology licensing - unrelated parties	9,684	12,472	27,942	36,296
Technology licensing - related parties	25	125	146	315
Total net revenues	107,503	92,398	304,370	257,183
Cost of revenues:				
Cost of revenues - unrelated parties	25,716	19,545	79,559	62,475
Cost of revenues - related parties	47,893	41,876	138,803	114,073
Total cost of revenues	73,609	61,421	218,362	176,548
Gross profit	33,894	30,977	86,008	80,635
Operating expenses:				
Research and development	14,685	14,260	42,012	45,095
Sales and marketing	7,397	6,713	21,701	21,114
General and administrative	7,103	5,931	21,448	20,835
Other	2,319		6,324	
Total operating expenses	31,504	26,904	91,485	87,044
Income (loss) from operations	2,390	4,073	(5,477)	(6,409)
Interest income	1,850	907	5,505	3,306
Dividend income	1,636	1,555	1,666	1,578
Impairment of equity investments	(19,400)		(19,400)	(234)
Other income (expense), net	13	(149)	(27)	(487)
Income (loss) before provision for income taxes and pro rata share of loss from equity investments	(13,511)	6,386	(17,733)	(2,246)
Provision for (benefit from) income taxes	1,233	(438)	2,397	(5,098)
Income (loss) before pro rata share of loss from equity investments	(14,744)	6,824	(20,130)	2,852

Pro rata share of loss from equity investments	1,861	1,903	5,308	6,040
Net income (loss)	$ (16,605)	$ 4,921	$ (25,438)	$ (3,188)
Net income (loss) per share - basic	$ (0.16)	$ 0.05	$ (0.24)	$ (0.03)
Shares used in per share calculation - basic	104,198	99,186	104,113	101,527
Net income (loss) per share - diluted	$ (0.16)	$ 0.05	$ (0.24)	$ (0.03)
Shares used in per share calculation - diluted	104,198	99,676	104,113	101,527

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

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SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(in thousands)

	December 31, 2007	September 30, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 118,157	$ 63,631
Short-term available-for-sale investments	44,067	47,435
Trade accounts receivable-unrelated parties, net of allowance for doubtful accounts of $20 at December 31, 2007 and $102 at September 30, 2008	19,301	16,674
Trade accounts receivable-related parties	37,012	31,169
Inventories	50,178	65,298
Other current assets	6,055	6,235
Total current assets	274,770	230,442
Property and equipment, net	18,247	19,803
Long-term available-for-sale equity investments	36,160	23,544
Long-term available-for-sale debt securities		21,749
Equity investments, GSMC	23,150	23,150
Equity investments, ACET	20,756	15,826
Equity investments, others	10,645	10,490
Goodwill	11,221	11,221
Intangible assets, net	7,391	5,364
Other assets	1,125	1,807
Total assets	$ 403,465	$ 363,396
LIABILITIES		
Current liabilities:		
Borrowing under line of credit facility	$ 6,836	$
Trade accounts payable-unrelated parties	23,572	21,420
Trade accounts payable-related parties	18,495	19,013
Accrued expenses and other liabilities	21,457	17,729
Deferred revenue	3,004	5,211
Total current liabilities	73,364	63,373
Taxes payable	6,194	7,091
Other liabilities	1,354	477
Total liabilities	80,912	70,941
Commitments (Note 7) and Contingencies (Note 8)		
SHAREHOLDERS EQUITY		
Common stock	434,905	420,245
Accumulated other comprehensive income	31,239	18,989

Accumulated deficit		(143,591)		(146,779)
Total shareholders equity		322,553		292,455
Total liabilities and shareholders equity	$	403,465	$	363,396

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

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SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)

	Nine Months Ended September 30,	
	2007	**2008**
Cash flows from operating activities:		
Net loss	$ (25,438)	$ (3,188)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	8,373	8,008
Share-based compensation expense	4,312	4,212
Provision (credits) for doubtful accounts receivable	(95)	82
Provision for (release from) sales returns	(545)	356
Write-down of inventories and provision for adverse purchase commitments	7,591	7,573
Pro rata share of loss from equity investments	5,308	6,058
Impairment loss on equity investment	19,400	
Other	92	216
Changes in operating assets and liabilities:		
Trade accounts receivable unrelated parties	3,984	2,179
Trade accounts receivable related parties	4,835	5,853
Inventories	19,235	(21,891)
Other current and non-current assets	2,101	(366)
Trade accounts payable unrelated parties	(6,495)	(2,152)
Trade accounts payable related parties	(14,986)	518
Accrued expenses and other liabilities	2,878	(6,439)
Deferred revenue	358	2,207
Net cash provided by operating activities	30,908	3,226
Cash flows from investing activities:		
Investments in equity securities	(12,950)	
Purchase of property and equipment	(5,756)	(7,242)
Purchases of available-for-sale investments	(64,171)	(85,269)
Purchase of intellectual property license	(1,585)	(124)
Sales and maturities of available-for-sale and equity investments	38,032	59,875
Other	(500)	(503)
Net cash used in investing activities	(46,930)	(33,263)
Cash flows from financing activities:		
Borrowing against line of credit	1,036	
Payments on line of credit		(6,943)
Issuance of shares of common stock	1,236	1,096
Repurchases of shares of common stock		(17,930)
Principal payments of capital leases	(981)	(863)
Net cash provided by (used in) financing activities	1,291	(24,640)
Effect of changes in foreign currency exchange rates on cash		151

Net decrease in cash and cash equivalents	(14,731)	(54,526)
Cash and cash equivalents at beginning of period	100,973	118,157
Cash and cash equivalents at end of period	$ 86,242	$ 63,631

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

SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

In the opinion of management, the accompanying unaudited condensed interim consolidated financial statements contain all adjustments, all of which are normal and recurring in nature, necessary to fairly state our financial position, results of operations and cash flows. The results of operations for the interim periods presented are not necessarily indicative of the results that may be expected for any future interim periods or for the full fiscal year. The condensed consolidated balance sheet at December 31, 2007 was derived from audited financial statements as of that date but does not include all disclosures required by U.S. generally accepted accounting principles for complete financial statements. These interim financial statements should be read in conjunction with the audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission on March 18, 2008.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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.

Recent Accounting Pronouncements

In May 2008, the Financial Accounting Standards Board, or the FASB, issued Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, or SFAS No. 162. SFAS No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. generally accepted accounting principles. SFAS No. 162 is effective November 15, 2008. We do not expect the adoption of SFAS No. 162 to have material impact on our consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51*, or SFAS No. 160. SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. We have not completed our evaluation of the potential impact, if any, of the adoption of SFAS No. 160 on our consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations*, or SFAS No. 141(R). SFAS No. 141(R) will change the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141(R) will change the accounting treatment and disclosure for certain specific items in a business combination. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Accordingly, any business combinations we engage in will be recorded and disclosed following existing standards until January 1, 2009. We expect SFAS No. 141(R) will have an impact on accounting for business combinations once adopted but the effect is dependent upon acquisitions at that time. We are still assessing the impact of SFAS No. 141(R) on our consolidated financial position, results of operations and cash flows.

Reclassifications

Certain amounts in prior period financial statements have been reclassified to conform to the current period presentation. These reclassifications did not change previously reported net loss, total assets or shareholders equity.

Out of Period Adjustments

During the third quarter of 2008, we identified an error totaling $443,000, related to accrual of certain value added tax liabilities, beginning in the second quarter of 2007. Management has concluded that the impact of this error is not material to the consolidated interim financial statements for the three and nine months ended September 30, 2008, and the correction has been recorded in the third quarter of 2008. Further, management has concluded that the impact of this error is not material to any prior interim or annual period, including the 2007 consolidated

annual financial statements.

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2. Fair Value

Effective January 1, 2008, we adopted SFAS No. 157, *Fair Value Measurements*, or SFAS No. 157. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, which provides a one year deferral of the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually (fair value of reporting units for goodwill impairment tests, non-financial assets and liabilities acquired in a business combination). Therefore, we adopted the provisions of SFAS No. 157 with respect to our financial assets and liabilities only. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS No. 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS No. 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Level 1 assets consist of money market funds and marketable equity investments. These instruments are traded in active markets with sufficient volume and frequency of transactions. Level 2 assets consist of municipal and United States government bonds with quoted market prices, which are traded in less active markets.

The adoption of this statement with respect to our financial assets and liabilities, did not impact our consolidated results of operations and financial condition, but required additional disclosure for assets and liabilities measured at fair value.

In accordance with SFAS No. 157, the following table represents our fair value hierarchy for our financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of September 30, 2008 (in thousands):

Description	Level 1	Level 2	Level 3	Total
Money market funds	$ 8,656	$	$	$ 8,656
Short term available-for-sale investments		47,435		47,435
Long term available-for-sale investments	23,544	21,749		45,293
Total	$ 32,200	$ 69,184	$	$ 101,384

Effective January 1, 2008, we adopted SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities*, or SFAS No. 159. SFAS No. 159 allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for specified financial assets and liabilities on a contract-by-contract basis. We did not elect to adopt the fair value option under SFAS No. 159.

3. Computation of Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the sum of the weighted average number of common shares outstanding and potential common shares (when dilutive).

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A reconciliation of the numerator and the denominator of basic and diluted net income (loss) per share follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Numerator for basic and dilutive net income (loss) per share:				
Net income (loss), as reported	$ (16,605)	$ 4,921	$ (25,438)	$ (3,188)
Denominator for basic net income (loss) per share, weighted average common shares outstanding	104,198	99,186	104,113	101,527
Dilutive potential of common stock equivalents		490		
Shares used in computing diluted net income per share	104,198	99,676	104,113	101,527

Stock options to purchase 9,836,965 shares of common stock were outstanding as of September 30, 2008 with a weighted average exercise price of $4.60 and stock options to purchase 11,617,802 shares of common stock were outstanding as of September 30, 2007 with a weighted average exercise price of $6.80. These stock options were not included in the computation of diluted net loss per share for the nine months ended September 30, 2008 and the three months and nine months ended September 30, 2007 because we had a net loss for these periods. Stock options to purchase 8,631,763 shares with a weighted average per share price of $4.91 were outstanding and not included in the computation of diluted net income per share for the three months ended September 30, 2008 since the exercise price of these options exceeded the average fair market value of our common stock for that period.

4. Stockholders Equity and Share-based Compensation

2008 Equity Incentive Plan

At our Annual Meeting of Shareholders held on June 27, 2008, our shareholders approved our 2008 Equity Incentive Plan, or the 2008 Plan. The 2008 Plan authorizes the issuance or grant of incentive stock options, non-statutory stock options, restricted stock awards, restricted stock unit awards, stock appreciation rights, performance awards, performance cash awards and other stock awards to our employees, officers, directors and consultants and is intended as the successor to and continuation of our 1995 Equity Incentive Plan, or the 1995 Plan. Following the approval of the 2008 Plan by our shareholders, no additional stock awards may be granted under the 1995 Plan. All outstanding stock awards granted under the 1995 Plan will remain subject to the terms of the 1995 Plan. As of June 27, 2008, the total number of shares of our common stock reserved for issuance under the 2008 Plan consisted of 5,000,000 shares plus 9,307,099 shares that are subject to outstanding stock awards under the 1995 Plan that may become available for grant under the 2008 Plan if they expire or terminate for any reason prior to exercise or settlement under the 1995 Plan. Unless sooner terminated by the Board of Directors, the 2008 Plan shall automatically terminate on April 24, 2018, the day before the tenth anniversary of the date the 2008 Plan was adopted by the Board. The Board of Directors may also amend the 2008 Plan at any time subject to applicable laws and regulations, including the rules and regulations of The NASDAQ Stock Market LLC. In general, no amendment or termination of the 2008 Plan may adversely affect any rights under awards already granted to a participant unless agreed to by the affected participant.

Employee Stock Purchase Plan

Our 1995 Employee Stock Purchase Plan, or the Purchase Plan, as amended, has 6.0 million shares of common stock reserved for issuance. The Purchase Plan provides for eligible employees to purchase shares of common stock at a price equal to 90% of the fair value of our common stock six months after the option date by withholding up to 10% of their annual base earnings. As of September 30, 2008, 231,016 shares were available for purchase under the Purchase Plan. Shares issued under the Purchase Plan for the three months and nine months ended September 30, 2008 were 103,000 for $297,000 and 221,000 for $579,000, respectively.

1995 Non-Employee Directors Stock Option Plan

In July 2008, our Board of Directors terminated the 1995 Non-Employee Directors Stock Option Plan, or the Directors Plan, such that no further stock awards will be made pursuant the Directors Plan. As of the termination date, 498,498 shares were subject to outstanding stock awards and will remain subject to the terms of the Directors Plan until their exercise or expiration.

Tender Offer

In May 2008, we completed an offer to amend eligible 409A options and to replace underwater stock options, or the Offer, outstanding under our 1995 Plan. Executive officers and members of the Board of Directors were not eligible to participate. The Offer consisted of two parts, an Offer to Amend and an Offer to Replace. The first part consisted of an amendment of the price of certain stock options with exercise prices that may have been lower than the fair market value of our common stock on the applicable grant date, as determined for tax purposes, or the Offer to Amend. These options, or the Eligible 409A Options, if not amended may therefore have been subject to adverse tax consequences under Section 409A of the Internal Revenue Code of 1986, as amended. These options were amended to reflect the fair market value per share of our common stock on the revised measurement date determined for that option for financial accounting purposes.

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The second part of the Offer consisted of an exchange of certain stock options, or Eligible Underwater Options, with new vesting terms, or the Offer to Replace. If the Eligible Underwater Option was 100% vested on May 1, 2008, the new option is subject to a one-year cliff vest, with 100% of the new option vesting on May 1, 2009, subject to continued employment. If the Eligible Underwater Option was not fully vested on May 1, 2008, the new option is subject to a four-year vest, with 25% of the new option vesting on May 1, 2009, and 1/48th of the new option vesting monthly thereafter, subject to continued employment through and on each such date.

Pursuant to the Offer to Amend, we accepted for amendment Eligible 409A Options to purchase 1,534,668 shares of common stock. Pursuant to the Offer to Replace, we accepted for replacement Eligible Underwater Options to purchase 4,854,673 shares of common stock and we issued new options to purchase 1,980,937 shares of common stock. The new options have an exercise price of $3.19 per share, the closing price of our common stock as reported on the NASDAQ Global Market on May 1, 2008.

As a result of the Offer, we compared the fair value of the modified awards to the fair value of the original awards immediately before the modification. In accordance with SFAS No. 123 (revised 2004), *Share-Based Payment*, or SFAS No. 123 (R), we are required to recognize as compensation expense any incremental fair value resulting from the modification over the awards remaining vesting period, or immediately if the award is fully vested. The total number of options modified under the Offer was 5,186,208 shares. We expect to incur an additional charge of approximately $0.6 million related to the total incremental compensation cost resulting from the modifications of unvested options over their remaining vesting periods of up to approximately 4 years. Further, to the extent the forfeiture rate is different from what we have anticipated, the modification charge related to the unvested awards will be different from our expectations.

Share-based Compensation

The impact on our results for share-based compensation is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Cost of goods sold	$ 144	$ 142	$ 442	$ 286
Research and development	665	511	2,190	1,830
Sales and marketing	243	125	786	567
General and administrative	261	337	975	1,529
Effect on net income (loss)	$ 1,313	$ 1,115	$ 4,393	$ 4,212

Share-based compensation of $54,000 and $128,000 was capitalized in inventory as of December 31, 2007 and September 30, 2008, respectively. The tax benefit from the exercise of options was $0 for the three months and nine months ended September 30, 2007 and 2008. Included in share-based compensation for the nine months ended September 30, 2008 is a charge of $698,000 for fully vested restricted stock awards granted in the second quarter of 2008. No restricted stock awards were granted during 2007.

As of September 30, 2008, we had unrecognized share-based compensation expense from stock options of $5.3 million excluding estimated forfeitures.

The following assumptions were used during the three and nine months ended September 30, 2008 and 2007 to estimate the fair value of the options granted. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model and assumptions noted in the following table. We estimated stock price expected volatility using our historical stock volatility experienced in our stock prices. The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. We use the simplified method of calculating expected life for new grants, as described in Staff Accounting Bulletin No. 107, *Share-Based Payment*, or SAB No. 107 and Staff Accounting Bulletin No. 110, *Year-End Help for Expensing Employee Stock Option*, or SAB No. 110.

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During the three and nine months ended September 30, 2007 and 2008, assumptions used in the fair value of each option made under our equity award plans are reflected in the table below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Equity Incentive Plan				
Risk-free interest rate	5.0%	3.7%	4.5%-4.7%	3.0%-3.9%
Dividend yield	0.0%	0.0%	0.0%	0.0%
Expected volatility	68.5%	62.1%	68.5%-73.4%	53.1%-63.8%
Expected life	6.0 yrs	6.1 yrs	6.0 yrs	4.8-6.1 yrs

5. Investments

Available-for-sale investments at their estimated fair value and contractual maturities as of September 30, 2008 are as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Corporate bonds and notes	$ 5,982	$	$ (4)	$ 5,978
Government bonds and notes	63,319		(113)	63,206
Foreign listed equity securities	4,992	18,552		23,544
Total bonds, notes and equity securities	$ 74,293	$ 18,552	$ (117)	$ 92,728
Contractual maturity dates for investments in bonds and notes:				
Less than one year				$ 47,435
One to five years				21,749
				$ 69,184

Available-for-sale investments at their estimated fair value and contractual maturities as of December 31, 2007 are as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Corporate bonds and notes	$ 9,955	$	$ (5)	$ 9,950
Government bonds and notes	34,055	62		34,117
Foreign listed equity securities	4,945	31,215		36,160
Total bonds, notes and equity securities	$ 48,955	$ 31,277	$ (5)	$ 80,227
Contractual maturity dates for investments in bonds and notes:				
Less than one year				$ 44,067
One to five years				
				$ 44,067

Securities are classified as current if we expect the security to be realized in cash or sold or consumed during the normal operating cycle of our business. All bonds and notes currently held have contractual maturity dates within two years.

Investments in privately held enterprises and certain restricted stocks are accounted for using either the cost or equity method of accounting, as appropriate. Each period, we evaluate whether an event or change in circumstances has occurred that may indicate an investment has been impaired. If upon further investigation of such events we determine the investment has suffered a decline in value that is other than temporary, we write down the investment to its estimated fair value. As of September 30, 2008 and December 31, 2007 the carrying value of these investments was $49.5 million and $54.6 million, respectively.

King Yuan Electronics Company Limited, or KYE, Insyde Software Corporation, or Insyde, Powertech Technology, Incorporated, or PTI, and Professional Computer Technology Limited, or PCT, are Taiwanese companies that are listed on the Taiwan Stock Exchange. Equity investments in these companies have been included in Long-term available-for-sale equity investments. The shares that are not available for resale within one year of the balance sheet date, due to local securities regulations, are recorded at cost and included in Equity investments, others . If a decline in value is judged to be other than temporary, it is reported as an impairment of equity investments. Cash dividends and other distributions of earnings from the investees, if any, are included in other income when declared.

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We have an equity ownership position of approximately 9.8% in Grace Semiconductor Manufacturing Corporation, or GSMC, as of September 30, 2008, with a carrying value of $23.2 million.

We have an equity ownership position of approximately 38.5% in Advanced Chip Engineering Technology Inc., or ACET, as of September 30, 2008, with a carrying value of $15.8 million. We account for our investment in ACET under the equity method of accounting by including ACET s reported net loss in our condensed consolidated statement of operations in the line item titled Pro rata share of loss from equity investments . We recorded $1.9 million and $6.0 million as our pro rata share of loss in ACET for the three and nine months ended September 30, 2008, respectively. We recorded $1.9 million and $5.3 million as our pro rata share of loss in ACET for the three and nine months ended September 30, 2007, respectively. Included in shareholders equity at September 30, 2008, is a cumulative translation adjustment of $0.6 million related to our investment in ACET.

The table below presents summarized information regarding ACET s results of operations without any pro rata adjustments for our percentage ownership of the outstanding equity of ACET (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Net sales	$ 806	$ 829	$ 1,251	$ 2,094
Gross loss	$ (2,249)	$ (3,375)	$ (6,553)	$ (9,996)
Net loss	$ (3,372)	$ (4,772)	$ (9,838)	$ (15,169)

6. Selected Balance Sheet Detail

Inventories are as follows (in thousands):

	December 31, 2007	September 30, 2008
Raw materials	$ 21,301	$ 34,275
Work in-process	14,742	10,134
Finished goods	8,419	16,979
Finished goods inventories held at logistics center	5,716	3,910
	$ 50,178	$ 65,298

Accrued expenses and other liabilities are as follows (in thousands):

	December 31, 2007	September 30, 2008
Accrued compensation and related items	$ 10,223	$ 7,927
Accrued adverse purchase commitments	111	840
Accrued commissions	1,859	1,755
Accrued warranty	358	282
Accrued legal and accounting fees	6,047	1,745
Accrued liability for stock repurchase		2,599
Other accrued liabilities	2,859	2,581
	$ 21,457	$ 17,729

Our products are generally subject to warranty. A provision of the estimated future cost related to warranty expense is recorded at the time of product shipment. Our warranty obligation is based on historical claims compared to historical revenues for the appropriate class of product. Changes in the warranty reserves during the nine months ended September 30, 2007 and 2008 are as follows (in thousands):

	Nine Months Ended September 30,	
	2007	2008
Beginning balance	$ 298	$ 358
Provisions for warranty	1,385	582
Warranty returns	(919)	(353)
Re-screening, retesting and other settlements	(394)	(305)
Ending balance	$ 370	$ 282

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7. Commitments

Our technology license agreements generally include an indemnification clause that indemnifies the licensee against liability and damages (including legal defense costs) arising from any claims of patent, copyright, trademark or trade secret infringement by our proprietary technology. The terms of these guarantees approximate the terms of the technology license agreements, which typically range from five to ten years. Our current license agreements expire from 2008 through 2014. The maximum possible amount of future payments we could be required to make, if such indemnifications were required on all of these agreements, is $47.1 million. We have not recorded any liabilities as of September 30, 2008 related to these indemnities as no such claims have been made or asserted.

During our normal course of business, we have made certain indemnities, commitments and guarantees under which we may be required to make payments in relation to certain transactions. These include indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease and indemnities to our directors and officers to the maximum extent permitted under the laws of California. In addition, we have contractual commitments to some customers, which could require us to incur costs to repair an epidemic defect with respect to our products outside the normal warranty period if such defect were to occur. The duration of these indemnities, commitments and guarantees varies. The majority of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential future payments that we could be obligated to make. We have not recorded any liability for these indemnities, commitments and guarantees in the accompanying condensed consolidated balance sheets. We do, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is probable and the amount can be reasonably estimated.

8. Contingencies

In January and February 2005 multiple shareholder derivative complaints were filed in California Superior Court for the County of Santa Clara, purportedly on behalf of SST against certain of our directors and officers. The derivative complaints asserted claims for, among other things, breach of fiduciary duty and violations of the California Corporations Code. These derivative actions were consolidated under the caption *In Re Silicon Storage Technology, Inc. Derivative Litigation,* Lead Case No. 1:05CV034387 (Cal. Super. Ct., Santa Clara Co.). On April 28, 2005, the derivative action was stayed by court order. On October 19, 2007, following the dismissal with prejudice of certain federal putative class actions, the court lifted this stay. On December 6, 2007, plaintiffs filed a consolidated amended complaint reiterating some of the previous claims and asserting claims substantially identical to those contained in the *Chuzhoy v. Yeh* (Cal. Super. Ct., Santa Clara Co.) and *In re Silicon Storage Technology, Inc., Derivative Litigation* (N.D. Cal., San Jose Div.) putative derivative actions. We filed a demurrer on May 12, 2008. On October 31, 2008, the court sustained the demurrer and gave plaintiffs leave to amend. We intend to continue to take all appropriate actions in response to this lawsuit. The impact related to the outcome of this matter is undeterminable at this time.

On July 13, 2006, a shareholder derivative complaint was filed in the United States District Court for the Northern District of California by Mike Brien under the caption *Brien v. Yeh, et al*., Case No. C06-04310 JF (N.D. Cal.). On July 18, 2006, a shareholder derivative complaint was filed in the United States District Court for the Northern District of California by Behrad Bazargani under the caption *Bazargani v. Yeh, et al*., Case No. C06-04388 HRL (N.D. Cal.). Both complaints were brought purportedly on behalf of SST against certain of our current directors and certain of our current and former officers and allege among other things, that the named officers and directors: (a) breached their fiduciary duties as they colluded with each other to backdate stock options, (b) violated Rule 10b-5 of the Securities Exchange Act of 1934 through their alleged actions, and (c) were unjustly enriched by their receipt and retention of such stock options. The *Brien* and *Bazargani* cases were consolidated into one case: *In re Silicon Storage Technology, Inc. Derivative Litigation*, Case No. C06-04310 JF and a consolidated amended shareholder derivative complaint was filed on October 30, 2006. On May 9, 2008 plaintiff filed their second consolidated shareholder derivative complaint. We filed a motion to dismiss on October 17, 2008, which is scheduled to be heard on January 16, 2009. On October 31, 2006, a similar shareholder derivative complaint was filed in the Superior Court of the State of California for the County of Santa Clara by Alex Chuzhoy under the caption *Chuzhoy v. Yeh, et al.,* Case No. 1-06-CV-074026. This complaint was brought purportedly on behalf of SST against certain of our current directors and certain of our current and former officers and alleges among other things, that the named officers and directors breached their fiduciary duties as they colluded with each other to backdate stock options and were allegedly unjustly enriched by their actions. The *Chuzhoy* complaint also alleges that certain of our officers and directors violated section 25402 of the California Corporations Code by selling shares of our common stock while in possession of material non-public adverse information. No response is due until after the plaintiff files an amended complaint. We intend to take all appropriate action in responding to all of the complaints.

On or about July 13, 2007, a patent infringement suit was brought by OPTi Inc. in the United States District Court for the Eastern District of Texas alleging infringement of two United State patents related to a Compact ISA-bus Interface . The plaintiff seeks a permanent injunction, and damages for alleged past infringement, as well as any other relief the court may grant that is just and proper. At this time, discovery has not yet commenced, and we intend to vigorously defend the suit.

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From time to time, we are also involved in other legal actions arising in the ordinary course of business. We have accrued certain costs associated with defending these matters. There can be no assurance that the shareholder class action complaints, the shareholder derivative complaints or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring payments in the future which may adversely impact net income. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. As a result, no losses associated with these or other litigation have been accrued in our financial statements as of September 30, 2008.

9. Line of Credit

On August 7, 2007, SST China Limited entered into a one year facility agreement with Bank of America, N.A. Shanghai Branch, a U.S. bank, for RMB 58.40 million revolving line of credit. The line of credit expired August 31, 2008, with no outstanding balance.

10. Goodwill and Intangible Assets

Goodwill and intangible assets include $11.2 million of goodwill, $2.4 million of net identifiable intangible assets acquired from acquisitions made in 2004 and 2005 and $3.0 million of net purchased intellectual property. The goodwill is not being amortized but is tested annually for impairment. We review intangible assets for adjustments when an event or circumstance occurs indicating a possible impairment in value.

Intangible assets consist of the following (in thousands):

	December 31, 2007				September 30, 2008			
	Cost	Accumulated Amortization	Accumulated Impairment	Net	Cost	Accumulated Amortization	Accumulated Impairment	Net
Existing technology	$ 11,791	$ (7,996)	$ (384)	$ 3,411	$ 11,791	$ (9,594)	$ (384)	$ 1,813
Intellectual property	3,053	(98)		2,955	3,154	(190)		2,964
Trade name	1,198	(792)		406	1,198	(972)		226
Customer relationships	1,857	(1,446)		411	1,857	(1,582)		275
Non-compete agreements	810	(602)		208	810	(724)		86
	$ 18,709	$ (10,934)	$ (384)	$ 7,391	$ 18,810	$ (13,062)	$ (384)	$ 5,364

Amortization expense related to intangible assets was $0.7 million and $2.1 million for the three and nine months ended September 30, 2008, respectively. Comparatively, amortization expense was $0.9 million and $2.7 million for the three and nine months ended September 30, 2007, respectively.

Estimated future intangible asset amortization expense for the next five years is as follows (in thousands):

Fiscal Year	Amortization of Intangible Assets
2008 (remaining three months)	$ 822
2009	2,467
2010	1,092
2011	802
2012 and thereafter	181
Total expected amortization expense	$ 5,364

There was no change in the carrying amount of goodwill for the nine months ended September 30, 2008 from December 31, 2007.

11. Segment Reporting

Our Memory Product segment, which is comprised of NOR flash memory products, includes the Multi-Purpose Flash or MPF family, the Multi-Purpose Flash Plus or MPF+ family, the Concurrent SuperFlash or CSF family, the Firmware Hub or FWH family, the Serial Flash family, the ComboMemory family, the Many-Time Programmable or MTP family, and the Small Sector Flash or SSF family.

Our Non-Memory Products segment is comprised of all other semiconductor products including flash microcontrollers, smartcard ICs and modules, radio frequency ICs and modules, NAND controllers and NAND-controller based modules.

Technology Licensing includes both up-front fees and royalties generated from the licensing of our SuperFlash technology to semiconductor manufacturers for use in embedded flash applications.

We do not allocate operating expenses, interest and other income/expense, impairment of equity investments or provision for or benefit from income taxes to any of these segments for internal reporting purposes, as we do not believe that allocating these expenses is beneficial in evaluating segment performance. Additionally, we do not allocate assets to segments for internal reporting purposes as we do not manage our segments by such metrics. The following table shows our revenues and gross profit for each segment (in thousands):

	Three Months Ended September 30, 2007		Three Months Ended September 30, 2008	
	Revenues	Gross Profit	Revenues	Gross Profit
Memory	$ 87,176	$ 21,871	$ 68,521	$ 14,110
Non-Memory	10,618	2,314	11,280	4,270
Technology Licensing	9,709	9,709	12,597	12,597
	$ 107,503	$ 33,894	$ 92,398	$ 30,977

	Nine Months Ended September 30, 2007		Nine Months Ended September 30, 2008	
	Revenues	Gross Profit	Revenues	Gross Profit
Memory	$ 247,091	$ 51,723	$ 191,064	$ 36,555
Non-Memory	29,191	6,197	29,508	7,469
Technology Licensing	28,088	28,088	36,611	36,611
	$ 304,370	$ 86,008	$ 257,183	$ 80,635

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12. Related Party Transactions and Balances

The following table is a summary of our related party revenues and purchases for the three and nine months ended September 30, 2007 and 2008, and our related party accounts receivable and accounts payable and accruals as of December 31, 2007 and September 30, 2008 (in thousands):

	Revenues			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Silicon Technology Co., Ltd.	$	$	$ 280	$
Apacer Technology, Inc. & related entities	1,158	672	2,533	2,531
Silicon Professional Technology Ltd.	59,775	47,931	161,921	128,403
Grace Semiconductor Manufacturing Corp.	25	125	146	315
	$ 60,958	$ 48,728	$ 164,880	$ 131,249

	Purchases			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Advance Chip Engineering Technology, Inc.	$ 97	$ 228	$ 97	$ 770
Grace Semiconductor Manufacturing Corp.	18,328	21,493	50,391	64,297
King Yuan Electronics Company, Limited	5,978	6,377	18,153	17,953
Powertech Technology, Incorporated	5,664	5,314	14,655	15,576
	$ 30,067	$ 33,412	$ 83,296	$ 98,596

	Trade Accounts Receivable		Accounts Payable and Accruals	
	December 31, 2007	September 30, 2008	December 31, 2007	September 30, 2008
Advance Chip Engineering Technology, Inc.	$	$	$ 11	$ 232
Apacer Technology, Inc. & related entities	51	474		
Silicon Professional Technology Ltd.	36,789	30,619	624	534
Grace Semiconductor Manufacturing Corp.	172	76	8,490	10,359
King Yuan Electronics Company, Limited			5,509	4,489
Powertech Technology, Incorporated			3,861	3,399
	$ 37,012	$ 31,169	$ 18,495	$ 19,013

Professional Computer Technology Limited, or PCT, earns commissions for point-of-sales transactions to customers. PCT s commissions are paid at the same rate as all of our other stocking representatives in Asia. In addition, we pay Silicon Professional Technology Ltd., or SPT, a wholly-owned subsidiary of PCT, a fee for providing logistics center functions. This fee is based on a percentage of revenue for each product shipped through SPT to our end customers. The fee paid to SPT covers the costs of warehousing and insuring inventory and processing accounts receivable, the personnel costs required to maintain logistics and information technology functions and the costs to perform demand forecasting, billing and collection of accounts receivable.

13. Comprehensive Loss

The components of comprehensive loss are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Net income (loss)	$ (16,605)	$ 4,921	$ (25,438)	$ (3,188)
Net unrealized gains (losses) on investments, net of tax	3,864	(11,277)	5,923	(12,837)
Cumulative translation adjustment	24	(927)	(180)	587
Total comprehensive loss	$ (12,717)	$ (7,283)	$ (19,695)	$ (15,438)

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14. Income Taxes

We maintained a full valuation allowance on our net deferred tax assets as of September 30, 2008. The valuation allowance was determined in accordance with the provisions of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, or SFAS No. 109, which requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. We intend to maintain a full valuation allowance on the U.S. deferred tax assets until sufficient positive evidence exists to support reversal of the valuation allowance.

Our tax benefit for the three and nine months ended September 30, 2008 was approximately $0.4 million and $5.1 million, respectively. The nine month provision consists of a $7.9 million benefit due to a refund from an Internal Revenue Service settlement from an amended return, partially offset by a $2.8 million charge related to foreign income and withholding taxes. The tax refund of $7.9 million included $6.1 million of tax and $1.8 million of interest. Our tax provision for the three and nine months ended September 30, 2007 was $1.2 million and $2.4 million, respectively. This consists primarily of foreign income and withholding taxes. We periodically receive dividend payments from our investments in foreign companies, which are subject to withholding of income tax. We record these taxes, as well as any refunds of these taxes, on a cash basis.

The provision for income tax decreased approximately $7.5 million for the nine months ended September 30, 2008 as compared to the same period in 2007. The decrease is due primarily to an IRS settlement from an amended return partially offset by other increases due to current year unrecognized tax benefits. Since the tax position taken in the refund claim did not meet the more likely than not recognition threshold under FIN 48, we had not previously recognized the tax benefit of this position. Therefore, upon settlement with the IRS the entire amount of the refund was recorded as a benefit provision in the first quarter. We do not anticipate any material changes to our uncertain tax positions over the next 12 months. We continue to include interest and penalties, if any, in tax expense. The provision for income tax decreased approximately $1.7 million for the three months ended September 30, 2008 as compared to the same period in 2007. The decrease is primarily due to the shift in income between jurisdictions.

15. Stock Repurchase Program

In January, 2008, our Board of Directors approved a stock repurchase program of up to $30.0 million of our common stock. The program commenced February 11, 2008 and we may repurchase shares at any time. The program does not obligate us to acquire shares at any particular price per share and may be suspended at any time and at our discretion. The repurchased shares are not available for reissuance.

The following cumulative repurchases under the above program ocurred in the periods presented below (in thousands):

Three months ended	**Number of Shares Repurchased**	**Aggregate Cost of Shares Repurchased (1)**
March 31, 2008	2,204	$ 6,164
June 30, 2008	1,861	5,758
September 30, 2008	2,701	8,607
Program to date as of September 30, 2008	6,766	$ 20,529

(1) Includes broker commissions.

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

The following discussion may be understood more fully by reference to the consolidated financial statements, notes to the consolidated financial statements and management s discussion and analysis of financial condition and results of operations contained in our Annual Report on Form 10-K for the year ended December 31, 2007, as filed with the Securities and Exchange Commission on March 18, 2008.

The following discussion contains forward-looking statements, which involve risk and uncertainties. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors which are difficult to forecast and can materially affect our quarterly or annual operating results. Fluctuations in revenues and operating results may cause volatility in our stock price. Please also see Item 1A. Risk Factors.

Business Overview

We are a leading supplier of NOR flash memory semiconductor devices for the digital consumer, networking, wireless communications and Internet computing markets. NOR flash memory is a form of nonvolatile memory that allows electronic systems to retain information when the system is turned off. NOR flash memory is now used in hundreds of millions of consumer electronics and computing products annually.

We produce and sell many products based on our SuperFlash design and manufacturing process technology. Our products are incorporated into products sold by many well-known companies including Apple, Asustek, Cambridge Silicon Radio, Canon, Compal, Dell, Epson, Foxconn (or Honhai), Fujitsu, Funai, Garmin, Gigabyte, GN Netcom, Haier, Hewlett Packard, Huawei, Infineon, Intel, IBM, Inventec, JVC, Lenovo, Lexmark, LG Electronics, Lite-On IT, Matsushita (or Panasonic), Micronas, Motorola, NEC, Nintendo, Philips, Pioneer, Quanta, Sagem, Samsung, Sanyo, Seagate, Sony, Sony Ericsson, TCL, Thomson, TiVO, Toshiba, USI, Western Digital and ZTE.

We also produce and sell other semiconductor products including flash microcontrollers, smartcard ICs and modules, radio frequency, or RF, ICs and modules, NAND controllers and NAND-controller based modules.

One of our key initiatives is the active development of our non-memory business. Our objective is to transform SST from a pure play in flash memory to a multi-product line semiconductor company and a leading licensor of embedded flash technology. We continue to execute on our plan to derive a significant portion of our revenue from non-memory products, which includes embedded controllers, NAND-controller based modules, smartcard ICs and radio frequency ICs and modules. We believe non-memory products represent an area in which we have significant competitive advantages and also an area that can yield profitable revenue with higher and more stable gross margins than our memory products in the long run.

Operations Overview

During 2008, we have seen many positive developments in our non-memory business, including the first meaningful revenue from our NANDrive devices, with unit shipments increasing throughout the nine months ended September 30, 2008. In the third quarter of 2008, we shipped nearly 400,000 units, into applications including IP set-top boxes, mobile internet devices and industrial applications. During 2008, we introduced additional products to our NANDrive line and we continue to work on many design-in opportunities. As we ramp up production, we expect to see significant fluctuations in both revenue and unit shipments, and we further expect our near term results to be significantly impacted by the challenging overall economic environment.

We are beginning to see traction in the adoption of our radio frequency ICs and modules, targeted at a wide range of wireless and multimedia applications, including cell phones. Using advanced technologies, these devices feature a highly-efficient, low-power, small-footprint design that supports 802.11g wireless standard. Due to the complexity of these new product families, the design-in and qualification cycle is expected to be long.

Our memory business benefited from positive seasonality during third quarter of 2008, with revenue up 12.5% from the second quarter of 2008. During the fourth quarter of 2008 we expect that demand for NOR memory products will decline significantly and that product gross margins will decline as well, as a result of a weak economic environment, price erosion in the high density NOR market and significant competition in the low density NOR market. Accordingly, we have reduced our expectations for fourth quarter revenue and gross margins, and have implemented measures to manage expenditures. The progress of these measures is visible in the decreased operating expenses for the third quarter of 2008, as compared with the second quarter of 2008 and third quarter of 2007.

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Our investment in producing innovative solutions continues to build on the success of our core memory and technology licensing business, and during the third quarter of 2008 we announced two developments in serial flash. The first was a new addition to our 1.8V SPI serial flash product family; a 4-Mbit, small form factor product which is ideal for battery-powered, space-constrained mobile applications. Second, we announced a collaboration with Freescale Semiconductor, in which our SPI serial flash devices enable Freescale s latest products to deliver dramatically enhanced battery life. Also, in the area of memory technologies, we are continuing to reduce manufacturing costs through the transition to more advanced process technologies that generally carry a lower cost per die, with wafer starts primarily now in the 180 and 250 nanometer geometry.

The semiconductor industry has historically been cyclical, characterized by periodic changes in business conditions caused by product supply and demand imbalance. When the industry experiences downturns, they often occur in connection with, or in anticipation of, maturing product cycles and declines in general economic conditions. These downturns are characterized by weak product demand, excessive inventory and accelerated decline of selling prices. We believe we are facing such a downturn and we cannot predict the extent or duration of the downturn.

Concentrations

We derived 88.8% and 87.7% of our net product revenues during the year ended December 31, 2007 and in the nine months ended September 30, 2008, respectively, from product shipments to Asia. In addition, substantially all of our wafer suppliers and packaging and testing subcontractors are located in Asia.

Shipments to our top ten end customers, which exclude transactions through stocking representatives and distributors, accounted for 17.8% and 20.8% of our net product revenues in the year ended December 31, 2007 and in the nine months ended September 30, 2008, respectively.

No single end customer, which we define as original equipment manufacturers, or OEMs, original design manufacturers, or ODMs, contract electronic manufacturers, or CEMs, or end users, represented 10% or more of our net product revenues during 2007 or in the nine months ended September 30, 2008.

We ship products to, and have accounts receivable from, OEMs, ODMs, CEMs, stocking representatives, distributors and our logistics center. Our stocking representatives, distributors and logistics center reship our products to our end customers, including OEMs, ODMs, CEMs and end users. Shipments, by us or our logistics center, to our top three stocking representatives for reshipment accounted for 60.3% and 55.0% of our product shipments in the year ended December 31, 2007 and in the nine months ended September 30, 2008, respectively. In addition, the same three stocking representatives solicited sales, for which they received a commission, for 9.1% and 6.7% of our product shipments to end users in the year ended December 31, 2007 and in the nine months ended September 30, 2008, respectively.

We out-source our end customer service logistics in Asia to Silicon Professional Technology Ltd., or SPT, which supports our customers in Taiwan, China and other Southeast Asia countries. SPT provides forecasting, planning, warehousing, delivery, billing, collection and other logistic functions for us in these regions. SPT is a wholly-owned subsidiary of one of our stocking representatives in Taiwan, Professional Computer Technology Limited, or PCT. Please see a description of our relationship with PCT under Note 12, Related Party Transactions. Products shipped to SPT are accounted for as our inventory held at our logistics center, and revenue is recognized when the products have been delivered and are considered as sold to our end customers by SPT. For the year ended December 31, 2007 and in the nine months ended September 30, 2008, SPT serviced end customer sales accounting for 60.1% and 58.4% of our net product revenues recognized. At December 31, 2007 and September 30, 2008, SPT represented 65.3% and 64.0% of our net accounts receivable, respectively.

Our product sales are made primarily using short-term cancelable purchase orders. The quantities actually purchased by the customer, as well as shipment schedules, are frequently revised to reflect changes in the customer s needs and in our supply of product. Accordingly, our backlog of open purchase orders at any given time is not a meaningful indicator of future sales. Changes in the amount of our backlog do not necessarily reflect a corresponding change in the level of actual or potential sales.

Critical Accounting Estimates

For information related to our revenue recognition and other critical accounting estimates, please refer to the Critical Accounting Estimates section of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2007. There have been no significant changes to our critical accounting estimates, except for the item discussed below:

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Fair Value Measurements

Effective January 1, 2008, we adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, or SFAS No. 157. In February 2008, the Financial Accounting Standards Board, or the FASB, issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, which provides a one year deferral of the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually (fair value of reporting units for goodwill impairment tests, non-financial assets and liabilities acquired in a business combination). Therefore, we adopted the provisions of SFAS No. 157 with respect to our financial assets and liabilities only. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS No. 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS No. 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The adoption of this statement did not impact our consolidated results of operations and financial condition, but required additional disclosure for assets and liabilities measured at fair value.

Results of Operations:

Net Revenues (in thousands, except percentages)

	Three Months Ended						
	September 30, 2007	**June 30, 2008**	**September 30, 2008**	**3Q08-Over-3Q07 Change**		**3Q08-Over-2Q08 Change**	
Memory revenue	$ 87,176	$ 60,883	$ 68,521	$ (18,655)	(21.4)%	$ 7,638	12.5%
Non-memory revenue	10,618	10,190	11,280	662	6.2%	1,090	10.7%
Product revenues	97,794	71,073	79,801	(17,993)	(18.4)%	8,728	12.3%
Technology licensing	9,709	12,627	12,597	2,888	29.7%	(30)	(0.2)%
Total net revenues	$ 107,503	$ 83,700	$ 92,398	$ (15,105)	(14.1)%	$ 8,698	10.4%

	Nine Months Ended			
	September 30, 2007	**September 30, 2008**	**3Q08-Over-3Q07 Change**	
Memory revenue	$ 247,091	$ 191,064	$ (56,027)	(22.7)%
Non-memory revenue	29,191	29,508	317	1.1%

Product revenues	276,282	220,572	(55,710)	(20.2)%
Technology licensing	28,088	36,611	8,523	30.3%
Total net revenues	$ 304,370	$ 257,183	$ (47,187)	(15.5)%

We offer low-to-medium density NOR flash memory devices (256 Kbit to 64 Mbit) and other products that target a broad range of existing and emerging applications in the digital consumer, networking, wireless communications and Internet computing markets. Our products are defined largely based upon attributes such as density, voltage, access speed, package and target application. We divide our products into two reportable segments: Memory Products and Non-Memory Products.

Our Memory Products segment, which is comprised of NOR flash memory products, includes the Multi-Purpose Flash family, or MPF, the Multi-Purpose Flash Plus family, or MPF+, the Concurrent SuperFlash family, or CSF, the Firmware Hub family, or FWH, the Serial Flash family, the ComboMemory family, the Many-Time Programmable family, or MTP, and the Small Sector Flash family, or SSF.

Our Non-Memory Products segment includes other semiconductor products including flash microcontrollers, smartcard ICs and modules, radio frequency ICs and modules, NAND controllers and NAND-controller based modules.

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Memory Products

Memory product revenue increased 12.5% in the third quarter of 2008 from the second quarter of 2008, based on an increase in unit shipments of 9.8%, led by Multi-Purpose Flash. Memory product revenue decreased 21.4% in the third quarter of 2008 compared to the third quarter of 2007, primarily due to a 17.2% decrease in unit shipments. Revenue from our ComboMemory products was down 54.4%, while reduced demand for digital consumer products resulted in a 20.9% decrease in revenue from Multi-Purpose Flash on lower unit shipments. Memory product revenue decreased 22.7% in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007, due to a 16.0% decrease in unit shipments and a decrease in average selling prices of 8.0%. The decline in average selling prices was primarily the result of price erosion from continuing competitive pressures in the low density markets. We anticipate that memory product revenues will decline significantly in the fourth quarter of 2008, and may continue to fluctuate significantly in the future.

Non-Memory Products

Non-memory product revenue increased 10.7% in the third quarter of 2008 from the second quarter of 2008, primarily due to increased unit shipments for products with higher average selling prices, despite a 25.9% decrease in overall unit shipments for non-memory products. Non-memory product revenue increased 6.2% in the third quarter of 2008 compared to the third quarter of 2007, with a 45.3% increase in average selling prices, from product mix, partially offset by a 16.2% decrease in unit shipments. Non-memory product revenue increased 1.1% in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007, with an 18.5% increase in average selling prices largely offset by a 16.2% decrease in unit shipments. Non-memory product revenue increased in the third quarter of 2008 over comparative periods largely due to increased shipments and stable average selling prices for NAND-controller based modules. This increase was partially offset by declines in both unit shipments and average selling prices for smartcard IC and radio frequency controller products. We expect non-memory product revenue to fluctuate significantly throughout 2008 and 2009 due to current economic conditions, as well as the start-up nature of our new product lines and diversification in our customer base.

Technology Licensing Revenue

Technology licensing revenue includes a combination of up-front fees and royalties. Technology licensing revenue in the third quarter of 2008 was comparable to the second quarter of 2008, and increased 29.7% compared to the third quarter of 2007. Technology licensing revenue in the nine months ended September 30, 2008 increased 30.3% compared to the nine months ended September 30, 2007, primarily due to an ongoing trend toward flash technology within micro-controller markets. We anticipate revenues from technology licensing may fluctuate significantly in the future.

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Gross Profit (in thousands, except percentages)

	Three Months Ended						
	September 30, 2007	June 30, 2008	September 30, 2008	3Q08-Over-3Q07 Change		3Q08-Over-2Q08 Change	
Memory gross profit	$ 21,871	$ 9,799	$ 14,110	$ (7,761)	(35.5)%	$ 4,311	44.0%
Memory gross margin	25.1%	16.1%	20.6%				
Non-memory gross profit	2,314	1,523	4,270	1,956	84.5%	2,747	180.4%
Non-memory gross margin	21.8%	14.9%	37.9%				
Product gross profit	24,185	11,322	18,380	(5,805)	(24.0)%	7,058	62.3%
Product gross margin	24.7%	15.9%	23.0%				
Technology licensing gross profit	9,709	12,627	12,597	2,888	29.7%	(30)	(0.2)%
Technology licensing gross margin	100.0%	100.0%	100.0%				
Total gross profit	$ 33,894	$ 23,949	$ 30,977	$ (2,917)	(8.6)%	$ 7,028	29.3%
Total gross margin	31.5%	28.6%	33.5%				

	Nine Months Ended			
	September 30, 2007	September 30, 2008	3Q08-Over-3Q07 Change	
Memory gross profit	$ 51,723	$ 36,555	$ (15,168)	(29.3)%
Memory gross margin	20.9%	19.1%		
Non-memory gross profit	6,197	7,469	1,272	20.5%
Non-memory gross margin	21.2%	25.3%		
Product gross profit	57,920	44,024	(13,896)	(24.0)%
Product gross margin	21.0%	20.0%		
Technology licensing gross profit	28,088	36,611	8,523	30.3%
Technology licensing gross margin	100.0%	100.0%		
Total gross profit	$ 86,008	80,635	$ (5,373)	(6.2)%
Total gross margin	28.3%	31.4%		

Product Gross Profit

Memory products

Gross profit for memory products increased 44.0% in the third quarter of 2008 compared to the second quarter of 2008, primarily due to increased unit shipments for products with higher average selling prices, as well as favorable cost variances for Serial Flash products and sale of ComboMemory inventory which had been written down in the second quarter. Gross profit decreased 35.5% in the third quarter of 2008 compared to the third quarter of 2007, primarily due to a 17.2% decrease in unit shipments. Memory product gross profit decreased 29.3% in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007, due to a 16.0% decrease in unit shipments, led by Multi-Purpose Flash, as well as write-downs on our ComboMemory products in the second quarter of 2008, in response to declining average selling prices.

Non-memory products

Gross profit for non-memory products in the third quarter of 2008 increased 180.4% compared to the second quarter of 2008 and 84.5% compared to the third quarter of 2007. Gross profit increased 20.5% in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. Non-memory product gross profit increased in the third quarter of 2008 over comparative periods largely due to increased shipments for NAND-controller based modules, as well as the sale of product which had been previously expensed as held for

engineering use. Gross profit also increased in the third quarter of 2008 due to an adjustment made to correct an error. Please also see Note 1. Basis of Presentation Out of Period Adjustments .

For other factors that could affect our gross profit, please also see Item 1A. Risk Factors We incurred significant inventory valuation and adverse purchase commitment adjustments in 2007 and the nine months ended September 30, 2008 and we may incur additional significant inventory valuation adjustments in the future.

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Operating Expenses (in thousands, except percentages)

Research and development

	Three Months Ended						
	September 30, 2007	June 30, 2008	September 30, 2008	3Q08-Over-3Q07 Change		3Q08-Over-2Q08 Change	
Research and development	$ 14,685	$ 15,223	$ 14,260	$ (425)	(2.9)%	$ (963)	(6.3)%
Percent of revenue	13.7%	18.2%	15.4%				

	Nine Months Ended			
	September 30, 2007	September 30, 2008	3Q08-Over-3Q07 Change	
Research and development	$ 42,012	$ 45,095	$ 3,083	7.3%
Percent of revenue	13.8%	17.5%		

Research and development expenses include costs associated with the development of new products, enhancements to existing products, quality assurance activities and occupancy costs. These costs consist primarily of employee salaries, stock-based compensation and other benefit-related expenses, software and intellectual property licenses, the cost of materials such as wafers and masks and the cost of design and development tools.

Research and development expenses for the third quarter of 2008 decreased by $963,000, or 6.3% from the second quarter of 2008, due primarily to decreases of $462,000 for salaries and employee benefits, $330,000 for stock-based compensation and $109,000 for product development related expenses including wafers, masks and evaluation parts. Research and development expenses for the third quarter of 2008 decreased by $425,000, or 2.9% from the third quarter of 2007, due primarily to decreases of $420,000 for employee benefits, $317,000 for facilities related expenses and $154,000 for stock-based compensation. These decreases were partially offset by higher product development related expenses of $266,000 and software and intellectual property licenses of $162,000. Research and development expenses for the nine months ended September 30, 2008 increased by $3,083,000, or 7.3% from the nine months ended September 30, 2007 due primarily to increases of $2,146,000 for product related expenses, $842,000 for software and $680,000 for intellectual property licenses. Total research and development expense related to compensation and benefits for the nine months ended September 30, 2008 was comparable to the nine months ended September 30, 2007. Although salary expense increased due to a year over year increase in headcount within research and development, this expense was offset by reductions in stock-based compensation and employee benefits. Due to a decline in revenue forecast, we have implemented measures to manage expenditures. However, it is unlikely that these measures will significantly impact our research and development expenses for the fourth quarter of 2008, as compared to the third quarter of 2008. Further, these expenses may continue to fluctuate based on the timing of engineering projects for new product introductions and the development of new technologies to support future growth.

Sales and marketing

	Three Months Ended						
	September 30, 2007	June 30, 2008	September 30, 2008	3Q08-Over-3Q07 Change		3Q08-Over-2Q08 Change	
Sales and marketing	$ 7,397	$ 6,918	$ 6,713	$ (684)	(9.2)%	$ (205)	(3.0)%
Percent of revenue	6.9%	8.3%	7.3%				

	Nine Months Ended			
	September 30, 2007	September 30, 2008	3Q08-Over-3Q07 Change	
Sales and marketing	$ 21,701	$ 21,114	$ (587)	(2.7)%
Percent of revenue	7.1%	8.2%		

Sales and marketing expenses consist primarily of commissions, employee salaries, stock-based compensation expense and other benefit-related expenses, as well as travel and entertainment expenses.

Sales and marketing expenses for the third quarter of 2008 decreased $205,000, or 3.0% from the second quarter of 2008, due to lower expenses for employee benefits. Sales and marketing expenses for the third quarter of 2008 decreased by $684,000, or 9.2% from the third quarter of 2007, due to decreases of $637,000 for compensation related expenses, including salaries, bonuses, employee benefits and stock-based compensation.

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These decreases in compensation related expenses, such as bonuses, are consistent with declining product revenues for the third quarter of 2008, as compared with in the third quarter of 2007. Sales and marketing expenses for the nine months ended September 30, 2008 decreased by $587,000, or 2.7% from the nine months ended September 30, 2007 due to lower commissions and logistics center fees, which is consistent with declining product revenues. We expect that sales and marketing expenses will remain flat or decline somewhat in the fourth quarter, as compared to the third quarter, due to an expected reduction in commission expenses, commensurate with the declining revenue forecast.

General and administrative

	Three Months Ended						
	September 30, 2007	June 30, 2008	September 30, 2008	3Q08-Over-3Q07 Change		3Q08-Over-2Q08 Change	
General and administrative	$ 7,103	$ 7,721	$ 5,931	$ (1,172)	(16.5)%	$ (1,790)	(23.2)%
Percent of revenue	6.6%	9.2%	6.4%				

	Nine Months Ended			
	September 30, 2007	September 30, 2008	3Q08-Over-3Q07 Change	
General and administrative	$ 21,448	$ 20,835	$ (613)	(2.9)%
Percent of revenue	7.0%	8.1%		

General and administrative expenses mainly consist of employee salaries, stock-based compensation, and other benefit-related expenses for administrative, executive and finance personnel, recruiting costs, professional services and legal fees and allowances for doubtful accounts.

General and administrative expenses for the third quarter of 2008 decreased $1,790,000, or 23.2% from the second quarter of 2008, due primarily to decreases of $831,000 for salaries and employee benefits, $432,000 for stock-based compensation and $282,000 for bad debt expense, as well as a $352,000 reduction in accrued liability for tax penalties related to stock options exercises. General and administrative expenses for the third quarter of 2008 decreased by $1,172,000, or 16.5% from the third quarter of 2007, due primarily to decreases of $484,000 for salaries and employee benefits and $631,000 for outside services. General and administrative expenses for the nine months ended September 30, 2008 decreased by $613,000, or 2.9% from the nine months ended September 30, 2007, due primarily to lower expenses for outside services of $1,390,000, reflecting the completion of various finance and accounting and information technology projects. This was partially offset by an increase in stock-based compensation of $555,000, due in part to a charge of $244,000 for fully vested restricted stock awards granted in the second quarter of 2008. Due to a decline in revenue forecast, we have implemented measures to manage expenditures. However, it is unlikely that these measures will significantly impact our general and administrative expenses for the fourth quarter of 2008, as compared to the third quarter of 2008. Further, due to the favorable adjustments we recorded in the third quarter of 2008 for bad debt expense and accrued liability for tax penalties, general and administrative expenses in the fourth quarter of 2008 may increase somewhat, as compared to the third quarter of 2008.

Other operating expenses

	Three Months Ended						
	September 30, 2007	June 30, 2008	September 30, 2008	3Q08-Over-3Q07 Change		3Q08-Over-2Q08 Change	
Other operating expenses	$ 2,319	$	$	$ (2,319)	(100.0)%	$	0.0%
Percent of revenue	2.2%	0.0%	0.0%				

	Nine Months Ended			
	September 30, 2007	September 30, 2008	3Q08-Over-3Q07 Change	
Other operating expenses	$ 6,324	$	$ (6,324)	(100.0)%
Percent of revenue	2.1%	0.0%		

As we announced in 2007, we conducted a voluntary independent review of our historical stock option granting practices. During the nine months ended September 30, 2007, we incurred $6.3 million of these expenses, which included legal, tax, accounting, equity and other

professional services related to this review. Our voluntary independent review of our historical option granting practices was completed in 2007. During the nine months ended September 30, 2008, we did not incur any expenses related to this review.

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Interest and dividend income

	Three Months Ended						
	September 30, 2007	June 30, 2008	September 30, 2008	3Q08-Over-3Q07 Change		3Q08-Over-2Q08 Change	
Interest and dividend income	$ 3,486	$ 1,120	$ 2,462	$ (1,024)	(29.4)%	$ 1,342	119.8%
Percent of revenue	3.2%	1.3%	2.7%				

	Nine Months Ended			
	September 30, 2007	September 30, 2008	3Q08-Over-3Q07 Change	
Interest and dividend income	$ 7,171	$ 4,884	$ (2,287)	(31.9)%
Percent of revenue	2.4%	1.9%		

Interest and dividend income includes interest and dividends from cash and short-term cash equivalents, long-term available for sale investments and marketable securities, and equity investments in publicly held companies.

Interest and dividend income for the third quarter of 2008 increased $1,342,000, or 119.8% from the second quarter of 2008, due primarily to dividends of $1,555,000 from our investments in public companies in Taiwan, which was partially offset by a reduction in interest income. Interest and dividend income for the third quarter of 2008 decreased $1,024,000, or 29.4% from the third quarter of 2007 and interest and dividend income for the nine months ended September 30, 2008 decreased $2,287,000, or 31.9% from the nine months ended September 30, 2007. Decreases in interest income were primarily due to declining interest rates, as well as declining cash balances, due in part to our stock repurchase program. We expect that interest and dividend income will fluctuate due to changing economic conditions in the United States and Taiwan, as well as fluctuating short-term and long-term interest rates.

Impairment of equity investments

In the first quarter of 2008, we fully reserved a note receivable from a third party in the amount of $216,000 due to our expected inability to collect it. In the third quarter of 2007 we determined that our investment in GSMC was impaired, as GSMC contemplated a follow-on equity offering at a price that was substantially lower than our carrying value. As a result we recorded a charge of $19.4 million for the quarter ended September 30, 2007 to write-down the carrying value of the investment to its estimated fair value.

Other income (expense), net

	Three Months Ended						
	September 30, 2007	June 30, 2008	September 30, 2008	3Q08-Over-3Q07 Change		3Q08-Over-2Q08 Change	
Other income (expense), net	$ 13	$ (144)	$ (149)	$ (162)	(1246.2)%	$ (5)	3.5%
Percent of revenue	0.0%	(0.2)%	(0.2)%				

	Nine Months Ended			
	September 30, 2007	September 30, 2008	3Q08-Over-3Q07 Change	
Other income (expense), net	$ (27)	$ (487)	$ (460)	1703.7%
Percent of revenue	0.0%	(0.2)%		

Other income (expense), net includes interest expense, foreign currency translation gains and losses and other miscellaneous transactions. In the nine months ended September 30, 2008, other income (expense) consists primarily of translation loss of $650,000, interest expense of $120,000, and miscellaneous income of $283,000 as remuneration received for the participation of certain of our officers on the boards of directors of companies in which we hold equity investments. By comparison, in the nine months ended September 30, 2007, we recorded interest expense of $363,000 and a translation gain of $34,000. Interest expense declined in the nine months ended September 30, 2008 compared with the nine months ended September 30, 2007 as we paid down our credit line during the first quarter of 2008 and do not have any other significant outstanding debt. The line of credit expired on August 31, 2008 with no outstanding balance. Other income (expense) will fluctuate significantly

year to year but we do not expect it to have material impact to our consolidated statement of operations.

Pro rata share of loss from equity investments

	Three Months Ended						
	September 30, 2007	June 30, 2008	September 30, 2008	3Q08-Over-3Q07 Change		3Q08-Over-2Q08 Change	
Pro rata share of loss from equity investments	$ 1,861	$ 2,241	$ 1,903	$ 42	2.3%	$ (338)	(15.1)%

	Nine Months Ended			
	September 30, 2007	September 30, 2008	3Q08-Over-3Q07 Change	
Pro rata share of loss from equity investments	$ 5,308	$ 6,040	$ 732	13.8%

Our loss from equity investments primarily represents our pro rata share of loss in ACET. Our pro rata share of loss for the third quarter of 2008 and 2007 and the second quarter of 2008 was $1.9 million, $1.9 million and $2.2 million, respectively. Our total investment represents 38.5% of the outstanding equity of ACET at September 30, 2008. Our pro rata share of loss from equity investments for the nine months ended September 30, 2008 and 2007 was $6.0 million and $5.3 million, respectively.

Provision for (benefit from) income taxes

The income tax benefit for the three and nine months ended September 30, 2008 was approximately $0.4 million and $5.1 million, respectively. The nine month provision consists primarily of a refund from an Internal Revenue Service settlement from an amended return partially offset by foreign income and withholding taxes. We maintained a full valuation allowance on our net deferred tax assets as of September 30, 2008. The valuation allowance was determined in accordance with the provisions of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, or SFAS No. 109, which requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. We intend to maintain a full valuation allowance on the U.S. deferred tax assets until sufficient positive evidence exists to support reversal of the valuation allowance.

The provision for income tax decreased approximately $7.5 million for the nine months ended September 30, 2008 as compared to the same period in 2007. The decrease is due primarily to an IRS settlement from an amended return partially offset by other increases due to current year unrecognized tax benefits. Since the tax position taken in the refund claim did not meet the more likely than not recognition threshold under FIN 48, we had not previously recognized the tax benefit of this position. Therefore, upon settlement with the IRS the entire amount of the refund was recorded as a benefit provision in the first quarter. We do not anticipate any material changes to our uncertain tax positions over the next 12 months. We continue to include interest and penalties, if any, in tax expense. The provision for income tax decreased approximately $1.7 million for the three months ended September 30, 2008 as compared to the same period in 2007. The decrease is primarily due to the shift in income between jurisdictions.

Liquidity and Capital Resources (in thousands)

	Nine Months Ended September 30,	
	2007	2008
Cash provided by (used in):		
Operating activities	$ 30,908	$ 3,226
Investing activities	$ (46,930)	$ (33,263)
Financing Activities	$ 1,291	$ (24,640)

Principal sources of liquidity at September 30, 2008 consists of $111.1 million of cash, cash equivalents and short-term available-for-sale investments.

Operating Activities. Operating activities provided $3.2 million of cash for the nine months ended September 30, 2008, compared with $30.9 million of cash generated during the nine months ended September 30, 2007. For the nine months ended September 30, 2008, the primary source of cash from operating activities was an $8.5 million decrease in net trade accounts receivable, due primarily to a decline in revenue. Offsetting this source of cash flow was a $15.1 million increase in net inventories, due primarily to easing of capacity constraints, and a $3.7 million reduction in our accrued expenses and other liabilities. Although we reported a net loss of $3.2 million for the nine months ended September 30,

2008, this loss was offset by non-cash operating expenses including $8.0 million in depreciation and amortization and $4.2 million in stock-based compensation, in addition to $6.0 million in non-cash losses related to our equity interest in ACET. The primary source of operating cash flows for the nine months ended September 30, 2007 was a $26.9 million reduction in net inventories resulting from capacity constraints at one of our major foundries, and an $8.2 million reduction in net accounts receivable. Offsetting these sources of operating cash was a decrease of $21.5 million in accounts payable.

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Investing Activities. We used $33.3 million for investing activities during the nine months ended September 30, 2008, compared to $46.9 million during the nine months ended September 30, 2007. Cash used in investing activities was lower in the nine months ended September 30, 2008 than in the nine months ended September 30, 2007 due to purchases of equity securities of $12.9 million in the nine months ended September 30, 2007, consisting primarily of the purchase of shares in ACET.

Financing Activities. Net cash used by financing activities totaled $24.6 million for the nine months ended September 30, 2008, including $17.9 million for repurchase of common stock and $6.9 million for repayment of our line of credit.

Stock Repurchase Program. Under our stock repurchase program, we are authorized to repurchase up to $30.0 million of our common stock. The program commenced February 11, 2008 and we may repurchase shares at any time. The program does not obligate us to acquire shares at any particular price per share and may be suspended at any time and at our discretion. During the nine months ended September 30, 2008, we repurchased 6.8 million shares for $20.5 million through open market repurchases. See Item 2. Unregistered Sales of Equity Securities and Use of Proceeds for further discussion of our stock repurchase program.

Credit Market Risk

As of September 30, 2008, we held corporate bonds and notes of $6.0 million and government bonds and notes of $63.2 million. These securities cash flows are funded by the principal and interest payments of the underlying corporate loans and federal, state and local governmental loans. The recent credit market instability may adversely impact our disposition of these securities at or near their quoted fair market value. We evaluate these investments at each balance sheet date. There is the risk that at future balance sheet dates we may record a charge for a decline in the fair value that is considered other than temporary and a loss would be recognized in the income statement at that time.

Based on our current business plan, our cash and cash equivalents balances are sufficient to cover our currently anticipated fiscal 2008 and 2009 cash flow requirements.

As of September 30, 2008, other than as described below, there were no material changes in long-term debt obligations, capital lease obligations, operating lease obligations, purchase obligations or any other long-term liabilities reflected on our condensed consolidated balance sheet as compared to December 31, 2007.

Purchase Commitments. As of September 30, 2008, we had outstanding purchase commitments with our foundry vendors of $18.9 million for delivery in 2008. We have recorded a liability of $800,000 for adverse purchase commitments. In comparison, as of December 31, 2007, we had outstanding purchase commitments with our foundry vendors of $42.0 million for delivery in 2008, with a recorded liability of $111,000 for adverse purchase commitments.

Operating Capital Requirements. We believe our cash balances, together with the funds we expect to generate from operations, will be sufficient to meet our projected working capital and other cash requirements through at least the next twelve months. However, if we fail to execute to our business strategies, we could experience declines in our cash balances. There can be no assurance that future events will not require us to seek additional borrowings or capital and, if so required, that such borrowing or capital will be available on acceptable terms. Factors that could affect our short-term and long-term cash used or generated from operations and as a result, our need to seek additional borrowings or capital include:

- the average selling prices of our products;
- customer demand for our products;
- the need to secure future wafer production capacity from our suppliers;
- the timing of significant orders and of license and royalty revenue;

- the ability to manage our inventory levels according to plan; and

- unanticipated research and development expenses associated with new product introductions.

Please also see Item 1A. Risk Factors Our operating results fluctuate materially and an unanticipated decline in revenues may disappoint securities analysts or investors and result in a decline in our stock price.

In January and February 2005, multiple putative shareholder class action complaints were filed against us and certain of our directors and officers in the United States District Court for the Northern District of California. Following the filing of the putative class action lawsuits, multiple shareholder derivative complaints were filed in California Superior Court for the County of Santa Clara, purportedly on behalf of SST against certain of our directors and officers. In addition, in July and October 2006, multiple shareholder derivative complaints were filed against us and certain of our directors and officers in the United States District Court for the Northern District of California.

In the event of unfavorable outcome of the suits, we may be required to pay damages. For more information, please also see Item 1A. Risk Factors We are engaged in derivative suits, which may become time consuming, costly and divert management resources and could impact our stock price.

From time to time, we are also involved in other legal actions arising in the ordinary course of business. We have accrued certain costs associated with defending these matters. There can be no assurance that the shareholder class action complaints, the shareholder derivative complaints or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring royalty payments in the future which may adversely impact gross margins. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. As a result, no losses have been accrued in our financial statements as of September 30, 2008.

Recent Accounting Pronouncements

In May 2008, the Financial Accounting Standards Board, or the FASB, issued Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, or SFAS No. 162. SFAS No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. generally accepted accounting principles. SFAS No. 162 is effective November 15, 2008. We do not expect the adoption of SFAS No. 162 to have material impact on our consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51*, or SFAS No. 160. SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. We have not completed our evaluation of the potential impact, if any, of the adoption of SFAS No. 160 on our consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations*, or SFAS No. 141(R). SFAS No. 141(R) will change the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141(R) will change the accounting treatment and disclosure for certain specific items in a business combination. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Accordingly, any business combinations we engage in will be recorded and disclosed following existing standards until January 1, 2009. We expect SFAS No. 141(R) will have an impact on accounting for business combinations once adopted but the effect is dependent upon acquisitions at that time. We are still assessing the impact of SFAS No. 141(R) on our consolidated financial position, results of operations and cash flows.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to risks associated with foreign exchange rate fluctuations due to our international manufacturing and sales activities. These exposures may change over time as business practices evolve and could negatively impact our operating results and financial condition. Currently, we do not hedge these foreign exchange rate exposures. Substantially all of our sales are denominated in U.S. dollars. An increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive and therefore reduce the demand for our products, a decrease in the value of the U.S. dollar relative to foreign currencies could raise the costs to manufacture our products. Such a decline in the demand could reduce revenues and/or result in operating losses. In addition, a downturn in the economies of China, Japan or Taiwan could impair the value of our equity investments in companies with operations in these countries. If we consider the value of these companies to be impaired, we will write off, or expense, some or all of our investments.

At any time, fluctuations in interest rates could affect interest earnings on our cash, cash equivalents and available-for-sale investments, or the fair value of our investment portfolio. A 10% move in interest rates as of September 30, 2008 would have an immaterial effect on our financial position, results of operations and cash flows. Currently, we do not hedge these interest rate exposures. As of September 30, 2008, the carrying value of our available-for-sale investments approximated fair value. The table below presents the carrying value and related weighted average interest rates for our cash, cash equivalents and available-for-sale investments as of September 30, 2008 (in thousands, except percentages):

	Carrying Value	Interest Rate
Cash and cash equivalents - variable rate	$ 63,631	1.4%
Short-term available-for-sale investments - fixed rate	$ 47,435	3.2%
Long-term available-for-sale investments - fixed rate	$ 21,749	3.0%
	$ 132,815	

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Item 4. Controls and Procedures
Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted pursuant to the Securities Exchange Act of 1934, as amended, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures also are designed to ensure that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)) as of September 30, 2008. Based on their evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that, as of September 30, 2008, our disclosure controls and procedures were not effective and we have not completed the remediation of the material weakness in internal controls, due to a significant portion of the deficiency relating to the annual physical inventory count that will be held in December, 2008. For 2006 and 2007, our disclosure controls and procedures were not effective because of the material weakness described below. Notwithstanding the material weakness that existed at September 30, 2008 as described below, management has concluded that the condensed consolidated financial statements, and other financial information included in the report, fairly present in all material respects our financial condition, results of operations and cash flows.

Material Weakness in Internal Control Over Financial Reporting

A material weakness is a control deficiency, or combination of control deficiencies, in internal control over financial reporting such that there is reasonable possibility that a material misstatement of the annual or interim annual statement will not be presented or detected on a timely basis.

At September 30, 2008 and for the years ended December 31, 2006 and 2007, we did not maintain effective controls over the completeness, accuracy, valuation, presentation and disclosure of inventory and the related cost of revenue accounts. Specifically, control over our process of accounting for inventory was not effective. These control deficiencies resulted in audit adjustments to the 2006 and 2007 consolidated annual financial statements and to 2007 and 2008 consolidated interim financial statements. Additionally, this control deficiency could result in misstatements to the inventory and the related cost of revenue accounts and disclosures that would result in a material misstatement of the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, we determined that this control deficiency constitutes a material weakness at September 30, 2008.

Remediation Plan for Material Weakness

We had previously decided that our existing inventory tracking and management system needed improvement and began planning for the implementation of a new system in 2006. In August 2007, we began implementing Oracle Shop Floor Management, or OSFM, a computerized inventory tracking and management system that is integrated with our other accounting and information technology systems. We have completed the implementation of OSFM and believe it currently provides adequate controls over inventory. However, as of September 30, 2008, the previous deficiency related to the annual physical count has not been remediated because the count will be held in December 2008. We have, however, improved our procedures surrounding inventory control and believe that the material weakness will be remediated by the end of 2008.

In addition, we have conducted a significant review of our methodology for calculating inventory reserves and continue to improve on this process. We are also adding new staff and increasing the technical knowledge and experience of our current staff as well as improving the training and education of our people in the accounting and other departments that impact inventory controls.

Changes in Internal Control Over Financial Reporting

Except as discussed above, there have been no changes in our internal control over financial reporting during the quarter ended September 30, 2008 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

In January and February 2005 multiple shareholder derivative complaints were filed in California Superior Court for the County of Santa Clara, purportedly on behalf of SST against certain of our directors and officers. The derivative complaints asserted claims for, among other things, breach of fiduciary duty and violations of the California Corporations Code. These derivative actions were consolidated under the caption *In Re Silicon Storage Technology, Inc. Derivative Litigation,* Lead Case No. 1:05CV034387 (Cal. Super. Ct., Santa Clara Co.). On April 28, 2005, the derivative action was stayed by court order. On October 19, 2007, following the dismissal with prejudice of certain federal putative class actions, the court lifted this stay. On December 6, 2007, plaintiffs filed a consolidated amended complaint reiterating some of the previous claims and asserting claims substantially identical to those contained in the *Chuzhoy v. Yeh* (Cal. Super. Ct., Santa Clara Co.) and *In re Silicon Storage Technology, Inc., Derivative Litigation* (N.D. Cal., San Jose Div.) putative derivative actions. We filed a demurrer on May 12, 2008. On October 31, 2008, the court sustained the demurrer and gave plaintiffs leave to amend. We intend to continue to take all appropriate actions in response to this lawsuit. The impact related to the outcome of this matter is undeterminable at this time.

On July 13, 2006, a shareholder derivative complaint was filed in the United States District Court for the Northern District of California by Mike Brien under the caption *Brien v. Yeh, et al*., Case No. C06-04310 JF (N.D. Cal.). On July 18, 2006, a shareholder derivative complaint was filed in the United States District Court for the Northern District of California by Behrad Bazargani under the caption *Bazargani v. Yeh, et al*., Case No. C06-04388 HRL (N.D. Cal.). Both complaints were brought purportedly on behalf of SST against certain of our current directors and certain of our current and former officers and allege among other things, that the named officers and directors: (a) breached their fiduciary duties as they colluded with each other to backdate stock options, (b) violated Rule 10b-5 of the Securities Exchange Act of 1934 through their alleged actions, and (c) were unjustly enriched by their receipt and retention of such stock options. The *Brien* and *Bazargani* cases were consolidated into one case: *In re Silicon Storage Technology, Inc. Derivative Litigation*, Case No. C06-04310 JF and a consolidated amended shareholder derivative complaint was filed on October 30, 2006. On May 9, 2008 plaintiff filed their second consolidated shareholder derivative complaint. We filed a motion to dismiss on October 17, 2008, which is scheduled to be heard on January 16, 2009. On October 31, 2006, a similar shareholder derivative complaint was filed in the Superior Court of the State of California for the County of Santa Clara by Alex Chuzhoy under the caption *Chuzhoy v. Yeh, et al.,* Case No. 1-06-CV-074026. This complaint was brought purportedly on behalf of SST against certain of our current directors and certain of our current and former officers and alleges among other things, that the named officers and directors breached their fiduciary duties as they colluded with each other to backdate stock options and were allegedly unjustly enriched by their actions. The *Chuzhoy* complaint also alleges that certain of our officers and directors violated section 25402 of the California Corporations Code by selling shares of our common stock while in possession of material non-public adverse information. No response is due until after the plaintiff files an amended complaint. We intend to take all appropriate action in responding to all of the complaints.

On or about July 13, 2007, a patent infringement suit was brought by OPTi Inc. in the United States District Court for the Eastern District of Texas alleging infringement of two United State patents related to a Compact ISA-bus Interface . The plaintiff seeks a permanent injunction, and damages for alleged past infringement, as well as any other relief the court may grant that is just and proper. At this time, discovery has not yet commenced, and we intend to vigorously defend the suit.

From time to time, we are also involved in other legal actions arising in the ordinary course of business. We have accrued certain costs associated with defending these matters. There can be no assurance that the shareholder class action complaints, the shareholder derivative complaints or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring payments in the future which may adversely impact net income. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. As a result, no losses associated with these or other litigation have been accrued in our financial statements as of September 30, 2008.

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Item 1A. Risk Factors
Risks Related to Our Business

Our operating results fluctuate materially, and an unanticipated decline in revenues may disappoint securities analysts or investors and result in a decline in our stock price.

Although we were profitable for the year ended December 31, 2004, we incurred net losses in the nine months ended September 30, 2008 and for the years ended December 31, 2007, 2006, and 2005. Our operating results have fluctuated significantly and our past financial performance should not be used to predict future operating results. Our recent quarterly and annual operating results have fluctuated, and may continue to fluctuate, due to the following factors, all of which are difficult to forecast and many of which are out of our control:

- the availability, timely delivery and cost of wafers or other manufacturing and assembly services from our suppliers;
- competitive pricing pressures and related changes in selling prices;
- fluctuations in manufacturing yields and significant yield losses;
- new product announcements and introductions of competing products by us or our competitors;
- product obsolescence;
- lower of cost or market, obsolescence or other inventory adjustments;
- changes in demand for, or in the mix of, our products;
- the gain or loss of significant customers;
- market acceptance of products utilizing our SuperFlash® technology;
- changes in the channels through which our products are distributed and the timeliness of receipt of distributor resale information;
- exchange rate fluctuations;
- general economic, political and environmental-related conditions, such as natural disasters;
- changes in our allowance for doubtful accounts;

- valuation allowances on deferred tax assets based on changes in estimated future taxable income;
- difficulties in forecasting, planning and management of inventory levels;
- unanticipated research and development expenses associated with new product introductions;
- the timing of significant orders and of license and royalty revenue;
- valuation of investments and long-term assets; and
- the impact of the sub-prime mortgage crisis on our cash and other investments.

As recent experience confirms, a downturn in the market for goods that incorporate our products can also harm our operating results. We believe we are currently facing such a downturn and we cannot predict the extent or duration of the downturn. Our operations and performance depend on global economic conditions. The global economy recently experienced, and could continue to experience, an economic downturn due to the crisis in credit markets, slower economic activity, concerns about inflation, increased energy costs, decreased consumer confidence, and other adverse business conditions. Such fluctuations in the global economy could cause, among others, deterioration and continued decline in consumer spending and increase in the cost of labor and materials. Uncertainty about global economic conditions could result in lower consumer and business spending in response to tighter credit markets, negative financial news and declines in income or asset values. As a result, our operating results and business could be harmed.

The tightening of the credit markets, low level of liquidity in many financial markets and volatility in fixed income, credit, currency and equity markets could also affect our suppliers, distributors and customers, possibly resulting in product delivery delays, delays in payment and insolvencies. If any of these occur our operating results and business would be harmed.

The selling prices for our products are extremely volatile and have historically declined during periods of over capacity or industry downturns.

The semiconductor industry has historically been cyclical, characterized by periodic changes in business conditions caused by product supply and demand imbalance. When the industry experiences downturns, they often occur in connection with, or in anticipation of, maturing product cycles and declines in general economic conditions. These downturns are characterized by weak product demand, excessive inventory and accelerated decline of selling prices. We believe we are currently facing such a downturn and we cannot predict the extent or duration of the downturn.

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Our operating expenses are relatively fixed, and we order materials in advance of anticipated customer demand. Therefore, we have limited ability to reduce expenses quickly in response to any revenue shortfalls.

Our operating expenses are relatively fixed, and we therefore have limited ability to reduce expenses quickly in response to any revenue shortfalls. Consequently, our operating results will be harmed if our revenues do not meet our projections. We may experience revenue shortfalls for the following reasons:

- sudden drops in consumer demand which may cause customers to cancel backlog, push out shipment schedules, or reduce new orders, possibly due to a slowing economy or inventory corrections among our customers;
- significant declines in selling prices that occur because of competitive price pressure during an over-supply market environment;
- sudden shortages of raw materials for fabrication, test or assembly capacity constraints that lead our suppliers to allocate available supplies or capacity to other customers which, in turn, harm our ability to meet our sales obligations; and
- the reduction, rescheduling or cancellation of customer orders.

In addition, political or economic events beyond our control can suddenly result in increased operating costs. In addition, we are now required to record compensation expense on stock option grants and purchases under our employee stock purchase plan which substantially increases our operating costs and impacts our earnings (loss) per share.

We incurred significant inventory valuation and adverse purchase commitment adjustments in 2007 and the nine months ended September 30, 2008 and we may incur additional significant inventory valuation adjustments in the future.

We typically plan our production and inventory levels based on internal forecasts of customer demand, which are highly unpredictable and can fluctuate materially. The value of our inventory is dependent on our estimate of future average selling prices, and, if our projected average selling prices are over estimated, we may be required to adjust our inventory value to reflect the lower of cost or market. As of September 30, 2008, we had $65.3 million of net inventory on hand, an increase of $15.1 million, or 30.1%, from December 31, 2007. Total valuation adjustments to inventory and adverse purchase commitments were $7.6 million in both the nine months ended September 30, 2007 and 2008. Due to the large number of units in our inventory, even a small change in average selling prices could result in a significant adjustment and could harm our financial results. Some of our customers have requested that we ship them product that has a finished goods date of manufacture that is less than one year. As of September 30, 2008, our allowance for excess and obsolete inventories includes an allowance for our on hand finished goods inventory with a date of manufacture of greater than two years and for certain products with a date of manufacture of greater than one year. In the event that this becomes a common requirement, it may be necessary for us to provide for an additional allowance for our on hand packaged goods inventory with a date of manufacture of greater than one year, which could result in a significant adjustment and could harm our financial results.

Cancellations or rescheduling of backlog may result in lower future revenue and harm our business.

Due to possible customer changes in delivery schedules and cancellations of orders, our backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. A reduction of backlog during any particular period, or the failure of our backlog to result in future revenue, could harm our business in the future. We have historically experienced a decrease in the average selling prices of our products during periods of industry-wide oversupply and excessive inventory. We have recently experienced price erosion in selected areas in the nine months ended September 30, 2008 and our business could be further harmed by a continued industry-wide prolonged downturn.

Our business may suffer due to risks associated with international sales and operations.

During 2006, 2007 and the nine months ended September 30, 2008, our international product and licensing revenues accounted for 94.7%, 94.3% and 93.3% of our net revenues, respectively. Our international business activities are subject to a number of risks, each of which could impose unexpected costs on us that would harm our operating results. These risks include:

difficulties in complying with regulatory requirements and standards;

tariffs and other trade barriers;

costs and risks of localizing products for foreign countries;

reliance on third parties to distribute our products;

extended accounts receivable payment cycles;

potentially adverse tax consequences;

limits on repatriation of earnings; and

burdens of complying with a wide variety of foreign laws.

In addition, we have made equity investments in companies with operations in several Asian countries. The value of our investments is subject to the economic and political conditions particular to their industries and their countries, foreign exchange rates, and the global economy. If we determine that a change in the recorded value of an investment is other than temporary, we will adjust the value of the investment. Such an expense could have a negative impact on our operating results.

We derived 87.7%, 88.8% and 87.7% of our net product revenues from Asia during 2006, 2007 and nine months ended September 30, 2008, respectively. Additionally, substantially all of our wafer suppliers and packaging and testing subcontractors are located in Asia. Any kind of economic, political or environmental instability in this region of the world can have a severe negative impact on our operating results due to the large concentration of our production and sales activities in this region. If countries where we do business experience severe currency fluctuation and economic deflation, it can negatively impact our revenues and also negatively impact our ability to collect payments from customers. In this event, the lack of capital in the financial sectors of these countries may make it difficult for our customers to open letters of credit or other financial instruments that are guaranteed by foreign banks. Finally, the economic situation can exacerbate a decline in selling prices for our products as our competitors reduce product prices to generate needed cash.

It should also be noted that we are greatly impacted by the political, economic and military conditions in Taiwan. Taiwan and China are continuously engaged in political disputes and both countries have continued to conduct military exercises in or near the other s territorial waters and airspace. Such disputes may continue and even escalate, resulting in an economic embargo, a disruption in shipping or even military hostilities. Any of these events can delay production or shipment of our products. Any kind of activity of this nature or even rumors of such activity can harm our operations, revenues, operating results and stock price.

We invest in companies for strategic reasons and may not realize a return on our investments.

We make investments in companies around the world to further our strategic objectives and support our key business initiatives. Such investments include investments in equity securities of public companies and investments in non-marketable equity securities of private companies, which range from early-stage companies that are often still defining their strategic direction to more mature companies whose products or technologies may directly support our products or initiatives. The success of these companies is dependent on product development, market acceptance, operational efficiency and other key business success factors. The private companies in which we invest may fail because they may not be able to secure additional funding, obtain favorable investment terms for future financings, or take advantage of liquidity events such as initial public offerings, mergers, and private sales. If any of these private companies fail, we could lose all or part of our investment in that company. If we determine that an other-than-temporary decline in the fair value exists for the equity securities of the public and private companies in which we invest, we write down the investment to its fair value and recognize the related write-down as an investment loss. For the years ended December 31, 2006 and 2007, we recorded impairments on our investments of $44.1 million and $22.4 million, respectively. Furthermore, when the strategic objectives of an investment have been achieved, or if the investment or business diverges from our strategic objectives, we may decide to dispose of the investment. Our investments in non-marketable equity securities of private companies are not liquid, and we may not be able to dispose of these investments on favorable terms or at all. The occurrence of any of these events could negatively affect our results of operations.

Our investment portfolio may be impaired by further deterioration of the capital markets.

Our cash and cash equivalents and short-term and long-term investment portfolio as of September 30, 2008 consists of money market funds, federal, state and municipal government obligations, foreign and public corporate debt securities and listed equity securities. We follow an established investment policy and set of guidelines to monitor, manage and limit our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer. As a result of current adverse financial market conditions, some financial instruments, such as structured investment vehicles, sub-prime mortgage-backed securities and collateralized debt obligations, may pose risks arising from liquidity and credit concerns. As of September 30, 2008, we had no direct holdings in these categories of investments and our exposure to these financial instruments through our indirect holdings in money market mutual funds was not material to total cash, cash equivalents and short-term investments. Also, as a result of current market conditions, the value of our investments in publicly held companies in Taiwan, a component of our long-term investment portfolio, have declined significantly. For the nine months ended September 30, 2008, we had no impairment charge associated with our investment portfolio. However, we cannot predict future market conditions or market liquidity and our investment portfolio may be impaired by future events.

Terrorist attacks and threats, and government responses thereto, could harm our business.

Terrorist attacks in the United States or abroad against American interests or citizens, U.S. retaliation for these attacks, threats of additional terrorist activity and the war in Iraq have caused our customer base to become more cautious. Any escalation in these events or similar future events may disrupt our operations or those of our customers, distributors and suppliers, affect the availability of materials needed to manufacture our products, or affect the means to transport those materials to manufacturing facilities and finished products to customers. In addition, these

events have had and may continue to have an adverse impact on the U.S. and world economy in general and consumer spending in particular, which could harm our business.

We do not typically enter into long-term contracts with our customers, and the loss of a major customer could harm our business.

We do not typically enter into long-term contracts with our customers. In addition, we cannot be certain as to future order levels from our customers. In the past, when we have entered into a long-term contract, the contract has generally been terminable at the convenience of the customer.

We depend on stocking representatives and distributors to generate a majority of our revenues.

We rely on stocking representatives and distributors to establish and maintain customer relationships and to sell our products. These stocking representatives and distributors could discontinue their relationship with us or discontinue selling our products at any time. The majority of our stocking representatives are located in Asia. The loss of our relationship with any stocking representative or distributor could harm our operating results by impairing our ability to sell our products to our end customers.

We depend on Silicon Professional Technology Ltd., or SPT, our logistics center, to support many of our customers in Asia.

We out-source our end customer service logistics in Asia to Silicon Professional Technology Ltd., or SPT, which supports our customers in Taiwan, China and other Southeast Asia countries. SPT provides forecasting, planning, warehousing, delivery, billing, collection and other logistic functions for us in these regions. SPT is a wholly-owned subsidiary of one of our stocking representatives in Taiwan, Professional Computer Technology Limited, or PCT. Please see a description of our relationship with PCT under Related Party Transactions and Balances in our Annual Report on Form 10-K for the year ended December 31, 2007. Products shipped to SPT are accounted for as our inventory held at our logistics center, and revenue is recognized when the products have been delivered and are considered as a sale to our end customers by SPT. For 2006, 2007 and the nine months ended September 30, 2008, SPT serviced end customer sales accounting for 59.1%, 60.1% and 58.4% of our net product revenues recognized. As of December 31, 2006, 2007 and September 30, 2008, SPT represented 68.9%, 65.3% and 64.0% of our net accounts receivable, respectively.

We do not have any long-term contracts with SPT, PCT or Silicon Professional Alliance Corporation, or SPAC, another subsidiary of PCT. SPT, PCT or SPAC may cease providing services to us at any time. If SPT, PCT or SPAC were to terminate their relationship with us we would experience a delay in reestablishing warehousing, logistics and distribution functions, and it could impair our ability to collect accounts receivable from SPT and may harm our business.

We depend on a limited number of foreign foundries to manufacture our products, and these foundries may not be able to satisfy our manufacturing requirements, which could cause our revenues to decline.

We outsource substantially all of our manufacturing and testing activities. We currently buy all of our wafers and sorted die from a limited number of suppliers. The majority of our products are manufactured by five foundries, Grace and Shanghai Hua Hong NEC Electronic Company Limited, or HHNEC, in China and TSMC in Taiwan, Seiko-Epson and Yasu in Japan. We have an equity investment in GSMC, a Cayman Islands company, which owns a wafer foundry subsidiary, Grace, in Shanghai, China. We anticipate that these foundries, together with Sanyo in Japan, Samsung in Korea and Powerchip Semiconductor Corporation, or PSC, in Taiwan will continue to manufacture substantially all of our products in the foreseeable future. If these suppliers fail to satisfy our requirements on a timely basis at competitive prices we could suffer manufacturing delays, a possible loss of revenues or higher than anticipated costs of revenues, any of which could harm our operating results.

Our revenues may be impacted by our ability to obtain adequate wafer supplies from our foundries. The foundries with which we currently have arrangements, together with any additional foundry at which capacity might be obtained, may not be willing or able to satisfy all of our manufacturing requirements on a timely basis at favorable prices. In addition, we have encountered delays in qualifying new products and in ramping-up new product production and we could experience these delays in the future. During the first quarter of 2006, we experienced fabrication issues with one of our wafer foundries and capacity constraints for certain package types at one of our backend suppliers. We are also subject to the risks of service disruptions, raw material shortages and price increases by our foundries. Such disruptions, shortages and price increases could harm our operating results.

Manufacturing capacity has in the past been difficult to secure and if capacity constraints arise in the future our revenues may decline.

In order to grow, we need to increase our present manufacturing capacity. The existing capacity from Grace, HHNEC and TSMC available were insufficient during 2007. Events that we have not foreseen could arise which would further limit our capacity. Similar to our investment in GSMC, we may determine that it is necessary to invest substantial capital in order to secure appropriate production capacity commitments. If we cannot secure additional manufacturing capacity on acceptable terms, our ability to grow will be impaired and our operating results will be harmed.

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Our cost of revenues may increase if we are required to purchase manufacturing capacity in the future.

To obtain additional manufacturing capacity, we may be required to make deposits, equipment purchases, loans, joint ventures, equity investments or technology licenses in or with wafer fabrication companies. These transactions could involve a commitment of substantial amounts of our capital and technology licenses in return for production capacity. We may be required to seek additional debt or equity financing if we need substantial capital in order to secure this capacity and we cannot assure you that we will be able to obtain such financing.

If our foundries fail to achieve acceptable wafer manufacturing yields, we will experience higher costs of revenues and reduced product availability.

The fabrication of our products requires wafers to be produced in a highly controlled and ultra-clean environment. Semiconductor companies that supply our wafers have, from time to time, experienced problems achieving acceptable wafer manufacturing yields. Semiconductor manufacturing yields are a function of both our design technology and the foundry s manufacturing process technology. Low yields may result from marginal design or manufacturing process drift. Yield problems may not be identified until the wafers are well into the production process, which often makes them difficult, time consuming and costly to correct. Furthermore, we rely on independent foundries for our wafers which increases the effort and time required to identify, communicate and resolve manufacturing yield problems. If our foundries fail to achieve acceptable manufacturing yields, we will experience higher costs of revenues and reduced product availability, which could harm our operating results.

If our foundries discontinue the manufacturing processes needed to meet our demands, or fail to upgrade the technologies needed to manufacture our products, we may face production delays and lower revenues.

Our wafer and product requirements typically represent a small portion of the total production of the foundries that manufacture our products. As a result, we are subject to the risk that a foundry will cease production on an older or lower-volume manufacturing process that it uses to produce our parts. Additionally, we cannot be certain our foundries will continue to devote resources to advance the process technologies on which the manufacturing of our products is based. Either one of these events could increase our costs and harm our ability to deliver our products on time.

Our dependence on third-party subcontractors to assemble and test our products subjects us to a number of risks, including an inadequate supply of products and higher costs of materials.

We depend on independent subcontractors to assemble and test our products. Our reliance on these subcontractors involves the following significant risks:

- reduced control over delivery schedules and quality;
- the potential lack of adequate capacity during periods of strong demand;
- difficulties selecting and integrating new subcontractors;
- limited warranties on the service they provide to us;
- potential increases in prices due to capacity shortages and other factors; and
- potential misappropriation of our intellectual property.

These risks may lead to increased costs, delayed product delivery or loss of competitive advantage, which would harm our profitability and customer relationships.

Because our flash memory products typically have lengthy sales cycles, we may experience substantial delays between incurring expenses related to research and development and the generation of revenues.

Due to the flash memory product cycle we usually require more than nine months to realize volume shipments after we first contact a customer. We first work with customers to achieve a design-in, which may take three months or longer. Our customers then complete the design, testing and evaluation process and begin to ramp up production, a period which typically lasts an additional nine months or longer. As a result, a significant period of time may elapse between our research and development efforts and our realization of revenue, if any, from volume purchasing of our products by our customers.

We face intense competition from companies with significantly greater financial, technical and marketing resources that could harm sales of our products.

We compete with major domestic and international semiconductor companies, many of which have substantially greater financial, technical, marketing, distribution, and other resources than we do. Many of our competitors have their own facilities for the production of semiconductor memory components and have recently added significant capacity for such production. Our low density memory products, medium density memory products, and high density memory products, if we are successful in developing these products, face substantial competition. In addition, we may in the future experience direct competition from our foundry partners.

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We have licensed to our foundry partners the right to fabricate products based on our technology and circuit design, and to sell such products worldwide, subject to our receipt of royalty payments. Competition may also come from alternative technologies such as ferroelectric random access memory devices, or FRAM, magneto-resistive random access memory, or MRAM, or other developing technologies.

Our markets are subject to rapid technological change and, therefore, our success depends on our ability to develop and introduce new products.

The markets for our products are characterized by:

- rapidly changing technologies;
- evolving and competing industry standards;
- changing customer needs;
- frequent new product introductions and enhancements;
- increased integration with other functions; and
- rapid product obsolescence.

To develop new products for our target markets, we must develop, gain access to and use leading technologies in a cost-effective and timely manner and continue to expand our technical and design expertise. In addition, we must have our products designed into our customers future products and maintain close working relationships with key customers in order to develop new products that meet their changing needs. In addition, products for communications applications are based on continually evolving industry standards. Our ability to compete will depend on our ability to identify and ensure compliance with these industry standards. As a result, we could be required to invest significant time and effort and incur significant expense to redesign our products and ensure compliance with relevant standards. We believe that products for these applications will encounter intense competition and be highly price sensitive. While we are currently developing and introducing new products for these applications, we cannot assure you that these products will reach the market on time, will satisfactorily address customer needs, will be sold in high volume, or will be sold at profitable margins.

We cannot assure you that we will be able to identify new product opportunities successfully, develop and bring to market new products, achieve design wins or respond effectively to new technological changes or product announcements by our competitors. In addition, we may not be successful in developing or using new technologies or in developing new products or product enhancements that achieve market acceptance. Our pursuit of necessary technological advances may require substantial time and expense. Failure in any of these areas could harm our operating results.

Our future success depends in part on the continued service of our key design engineering, sales, marketing and executive personnel and our ability to identify, recruit and retain additional personnel.

We are highly dependent on Bing Yeh, our President and Chief Executive Officer, as well as the other principal members of our management team and engineering staff. There is intense competition for qualified personnel in the semiconductor industry, in particular the highly skilled design, applications and test engineers involved in the development of flash memory technology. Competition is especially intense in Silicon Valley, where our corporate headquarters are located. We may not be able to continue to attract and retain engineers or other qualified personnel necessary for the development of our business or to replace engineers or other qualified personnel who may leave our employ in the future. Our anticipated growth is expected to place increased demands on our resources and will likely require the addition of new management and engineering personnel and the development of additional expertise by existing management personnel. The failure to recruit and retain key design engineers or other technical and management personnel could harm our business.

Our ability to compete successfully depends, in part, on our ability to protect our intellectual property rights.

We rely on a combination of patent, trade secrets, copyrights, mask work rights, nondisclosure agreements and other contractual provisions and technical measures to protect our intellectual property rights. Policing unauthorized use of our products, however, is difficult, especially in foreign countries. Litigation may continue to be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Litigation could result in substantial costs and diversion of resources and could harm our business, operating results and financial condition regardless of the outcome of the litigation. As of September 30, 2008, we held 254 patents in the United States relating to certain aspects of our products and processes, with expiration dates ranging from 2010 to 2028 and have filed for several more. In addition, we hold several patents in Europe, Japan, Korea, Taiwan and China. We cannot assure you that any pending patent application will be granted. Our operating results could be harmed by the failure to protect our intellectual property.

The matters relating to the review of our historical stock option granting practices and the restatement of our consolidated financial statements has resulted in litigation, which could harm our financial results.

In March 2007, our Board of Directors determined to conduct a voluntary review of our historical stock option grant practices covering the time from our initial public offering in 1995 through 2007. The review was led by the Chairman of the Audit Committee of the Board of Directors with the assistance of outside independent legal counsel, and began on or about March 15, 2007. As described further in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 2. to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2006, the Chairman of the Audit Committee has reached the conclusion that incorrect measurement dates were used for financial accounting purposes for stock option grants made in certain prior periods. As a result, we have recorded additional non-cash stock-based compensation expense, and related tax effects, related to stock option grants and have restated our historical financial statements. The review of our historical stock option granting practices has also required us to incur substantial expenses for legal, accounting, tax and other professional services, totaling $12.0 million for the year ended December 31, 2007. In addition, the review diverted management s attention from our business, and could in the future harm our business, financial condition, results of operations and cash flows.

We are engaged in derivative suits, which may become time consuming, costly and divert management resources and could impact our stock price.

Securities class action law suits are often brought against companies, particularly technology companies, following periods of volatility in the market price of their securities. Irrespective of the validity or the successful assertion of such claims, we could incur significant costs and management resources in defending against such claims. Our historical stock option granting practices and the restatement of our prior financial statements have exposed us to greater risks associated with litigation. As described in Item 1. Legal Proceedings, several derivative complaints have been filed against our directors and certain of our executive officers pertaining to allegations relating to stock option grants.

The complaints were brought purportedly on behalf of SST against certain of our current and former officers and directors and allege, among other things, that the named officers and directors: (a) breached their fiduciary duties as they colluded with each other to backdate stock options, (b) violated Rule 10b-5 of the Securities Exchange Act of 1934 through their alleged actions, and (c) were unjustly enriched by their receipt and retention of such stock options. These or future similar complaints, or any future litigation may not result in the same conclusions reached by the Chairman of the Audit Committee. The conduct and resolution of these matters or other litigation will be time consuming, expensive and may distract management from the conduct of our business.

Former employees may also bring lawsuits against us or engage us in arbitration relating to their stock options and other matters. These lawsuits may be time consuming and expensive, and cause further distraction from the operation of our business. The adverse resolution of any specific lawsuit could harm our business, financial condition and results of operations.

From time to time, we are also involved in other legal actions arising in the ordinary course of business. There can be no assurance that the shareholder class action complaints, the shareholder derivative complaints or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring payments in the future which may adversely impact gross margins. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. As a result, no losses have been accrued in our financial statements as of September 30, 2008.

During the course of these lawsuits there may be public announcements of the results of hearings, motions, and other interim proceedings or developments in the litigation. If securities analysts or investors perceive these results to be negative, it could harm the market price of our stock. We have incurred certain costs associated with defending these matters, and at any time, additional claims may be filed against us, which could increase the risk, expense and duration of the litigation. Further, because of the amount of discovery required in connection with this type of litigation, there is a risk that some of our confidential information could be compromised by disclosure. For more information with respect to our litigation, please also see Item 1 Legal Proceedings.

If we are accused of infringing the intellectual property rights of other parties we may become subject to time consuming and costly litigation. If we lose, we could suffer a significant impact on our business and be forced to pay damages.

Third parties may assert that our products infringe their proprietary rights, or may assert claims for indemnification resulting from infringement claims against us. Any such claims may cause us to delay or cancel shipment of our products or pay damages that could harm our business, financial condition and results of operations. In addition, irrespective of the validity or the successful assertion of such claims, we could incur significant costs in defending against such claims.

We receive from time to time, letters or communications from other companies stating that such companies have patent rights that involve our products. Since the design of most of our products is based on SuperFlash technology, any legal finding that the use of our SuperFlash technology infringes the patent of another company would have a significantly negative effect on our entire product line and operating results. Furthermore, if such a finding were made, there can be no assurance that we could license the other company s technology on commercially reasonable terms or that we could successfully operate without such technology. Moreover, if we are found to infringe, we could be required to pay damages to the owner of the protected technology and could be prohibited from making, using, selling, offering to sell or importing into the United States any products that infringe the protected technology.

In addition, the management attention consumed by and legal cost associated with any litigation could harm our operating results. During the course of these lawsuits there may be public announcements of the results of hearings, motions, and other interim proceedings or developments in the litigation. If securities analysts or investors perceive these results to be negative, it could harm the market price of our stock.

If an earthquake or other natural disaster strikes our manufacturing facility or those of our suppliers, we would be unable to manufacture our products for a substantial amount of time and we would experience lost revenues.

Our corporate headquarters are located in California near major earthquake faults. In addition, some of our suppliers are located near fault lines. In the event of a major earthquake or other natural disaster near our headquarters, our operations could be harmed. Similarly, a major earthquake or other natural disaster such as typhoon near one or more of our major suppliers, like the earthquakes in April 2006 and December 2006 or the typhoons in September 2001 and July 2005 that occurred in Taiwan, could potentially disrupt the operations of those suppliers, which could then limit the supply of our products and harm our business.

A virus or viral outbreak in Asia could harm our business.

We derive substantially all of our revenues from Asia and our logistics center is located in Taiwan. A virus or viral outbreak in Asia, such as the SARS outbreak in early 2003 or threat of the Avian flu, could harm the operations of our suppliers, distributors, logistics center and those of our end customers, which could harm our business.

Prolonged electrical power outages, energy shortages, or increased costs of energy could harm our business.

Our design and process research and development facilities and our corporate offices are located in California, which is susceptible to power outages and shortages as well as increased energy costs. To limit this exposure, all corporate computer systems at our main California facilities are on battery back-up. In addition, all of our engineering and back-up servers and selected corporate servers are on generator back-up. While the majority of our production facilities are not located in California, more extensive power shortages in the state could delay our design and process research and development as well as increase our operating costs.

Our growth has in the past placed a significant strain on our management systems and resources and if we fail to manage our growth, our ability to market or sell our products or develop new products may be harmed.

Our business has in the past experienced rapid growth which strained our internal systems and future growth will require us to continuously develop sophisticated information management systems in order to manage our business effectively. We have implemented a supply-chain management system and a vendor electronic data interface system. There is no guarantee that these measures, in themselves, will be adequate to address any growth, or that we will be able to foresee in a timely manner other infrastructure needs before they arise. Our success depends on the ability of our executive officers to effectively manage our growth. If we are unable to manage our growth effectively, our results of operations will be harmed. If we fail to successfully implement new management information systems, our business may suffer severe inefficiencies that may harm the results of our operations.

We have determined that we have a material weakness in our internal control over financial reporting. As a result, current and potential stockholders could lose confidence in our financial reporting, which would harm our business and the trading price of our stock.

Under Section 404 of the Sarbanes-Oxley Act of 2002, we are required to evaluate and determine the effectiveness of our internal control over financial reporting. We have dedicated a significant amount of time and resources to ensure compliance with this legislation for the nine months ended September 30, 2008 and will continue to do so for future fiscal periods. We may encounter problems or delays in completing the review, evaluation, and the implementation of improvements. Additionally, management s assessment of our internal control over financial reporting may identify deficiencies that need to be addressed in our internal control over financial reporting or other matters that may raise concerns for investors.

The restatement of financial statements for the years ended December 31, 1997 through December 31, 2005 in prior filings with the SEC is a strong indicator of the existence of a material weakness in the design or operation of internal control over financial reporting. We concluded that the control deficiencies that resulted in the restatement of the previously issued consolidated financial statements were remediated, and thus concluded that the control deficiencies relating to our historical stock option grant practices that resulted in the restatement of the previously-issued financial statements did not constitute a material weakness as of December 31, 2006. However, as of December 31, 2006 and 2007 and the quarter and nine months ended September 30, 2008, we did not maintain effective controls over the completeness, accuracy, valuation and presentation and disclosure of inventory and the related cost of revenue accounts. Specifically, our controls over the recording of

inventory adjustments resulting from physical inventory observations, capitalization of production variances into inventory and valuation of inventory related reserves in accordance with generally accepted accounting principles in the United States, were not effective. These control deficiencies resulted in audit adjustments to the 2006 and 2007 consolidated annual financial statements and to the interim financial statements for the quarters ended March 31, 2008 and September 30, 2008. Additionally, these control deficiencies could result in misstatements to the inventory and the related cost of revenue accounts and disclosures that would result in a material misstatement of the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, we determined that these control deficiencies constitute a material weakness at December 31, 2006 and 2007.

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Because of this material weakness, our management concluded that, as of December 31, 2006 and 2007, we did not maintain effective internal control over financial reporting based on those criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As a result, PricewaterhouseCoopers LLP, issued an adverse opinion with respect to the effectiveness of our internal control over financial reporting for the years ended December 31, 2006 and 2007.

Should we determine in future fiscal periods that we have additional material weaknesses in our internal controls over financial reporting, the reliability of our financial reports may be impacted, and our results of operations or financial condition may be harmed and the price of our common stock may decline.

Future changes in financial accounting standards or practices or existing taxation rules or practices may cause adverse unexpected revenue fluctuations and affect our reported results of operations.

A change in accounting standards or practices or a change in existing taxation rules or practices can have a significant effect on our reported results and may even affect reporting of transactions completed before the change is effective. New accounting pronouncements and taxation rules and varying interpretations of accounting pronouncements and taxation practice have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business. For example, we adopted SFAS No. 123(R) in the first quarter of 2006 which requires us to record charges to earnings for the stock options we grant and purchases of our common stock under our employee stock purchase plan.

Evolving regulation of corporate governance and public disclosure may result in additional expenses and continuing uncertainty.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, SEC regulations and NASDAQ Marketplace rules are creating uncertainty for public companies. We continually evaluate and monitor developments with respect to new and proposed rules and cannot predict or estimate the amount of the additional costs we may incur or the timing of such costs. These new or changed laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we have invested resources to comply with evolving laws, regulations and standards, and this investment has resulted in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. 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, regulatory authorities may initiate legal proceedings against us and we may be harmed.

Acquisitions could result in operating difficulties, dilution and other harmful consequences.

In the past five years we have acquired Emosyn, LLC a fabless semiconductor manufacturer specializing in the design and marketing of smartcard ICs for SIM applications, G-Plus, Inc., a semiconductor manufacturer specializing in the design and marketing of radio frequency ICs and monolithic microwave ICs and Actrans Systems Inc., a fabless semiconductor company that designs flash memory and EEPROMs. We expect to continue to evaluate and consider a wide array of potential strategic transactions, including business combinations, acquisitions and dispositions of businesses, technologies, services, products and other assets, including interests in our existing subsidiaries and joint ventures. At any given time we may be engaged in discussions or negotiations with respect to one or more of such transactions. Any such transactions could be material to our financial condition and results of operations. There is no assurance that any such discussions or negotiations will result in the consummation of any transaction. The process of integrating any acquired business may create unforeseen operating difficulties and expenditures and is itself risky. The areas where we may face difficulties include:

- diversion of management time, as well as a shift of focus from operating the businesses to issues of integration and future products;
- declining employee morale and retention issues resulting from changes in compensation, reporting relationships, future prospects, or the direction of the business;

the need to integrate each company s accounting, management information, human resource and other administrative systems to permit effective management, and the lack of control if such integration is delayed or not implemented;

the need to implement controls, procedures and policies appropriate for a public company at companies that prior to acquisition had lacked such controls, procedures and policies; and

in some cases, the need to transition operations onto our technology platforms.

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International acquisitions involve additional risks, including those related to integration of operations across different cultures and languages, currency risks, and the particular economic, political, and regulatory risks associated with specific countries. Moreover, we may not realize the anticipated benefits of any or all of our acquisitions. As a result of future acquisitions or mergers, we might need to issue additional equity securities, spend our cash, or incur debt, contingent liabilities, or amortization expenses related to intangible assets, any of which could reduce our profitability and harm our business.

Risks Related to Our Industry

Our success is dependent on the growth and strength of the flash memory market.

Substantially all of our products, as well as all new products currently under design, are stand-alone flash memory devices or devices embedded with flash memory. A memory technology other than SuperFlash may be adopted as an industry standard. Our competitors are generally in a better financial and marketing position than we are from which to influence industry acceptance of a particular memory technology. In particular, a primary source of competition may come from alternative technologies such as FRAM or MRAM devices if such technology is commercialized for higher density applications. To the extent our competitors are able to promote a technology other than SuperFlash as an industry standard; our business will be seriously harmed.

There is seasonality in our business and if we fail to continue to introduce new products this seasonality may become more pronounced.

Sales of our products in the consumer electronics applications market are subject to seasonality. As a result, sales of these products are impacted by seasonal purchasing patterns with higher sales generally occurring in the second half of each year. In the past we have been able to mitigate such seasonality with the introduction of new products throughout the year. If we fail to continue to introduce new products, our business may suffer and the seasonality of a portion of our sales may become more pronounced.

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

The following table shows purchases of our common stock and the available funds to purchase additional common stock for each month in the quarter ended September 30, 2008 (in thousands, except per share data):

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share (2)	Total Number of Shares Purchased As Part of Publicly Announced Plan	Approximate Dollar Value That May Yet be Purchased Under the Plan
July 1, 2008 to July 31, 2008	1,077	$ 3.15	1,077	$ 14,687
August 1, 2008 to August 31, 2008	274	$ 3.26	274	$ 13,795
September 1, 2008 to September 30, 2008	1,350	$ 3.20	1,350	$ 9,471
Total	2,701	$ 3.19	2,701	$ 9,471

(1) In the January 2008, our Board of Directors approved a stock repurchase program of up to $30.0 million of our common stock at any time commencing February 11, 2008. The program does not obligate us to acquire shares at any particular price per share and may be suspended at any time at our discretion.

(2) Includes broker commissions.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

On July 7, 2008 we announced that the SEC has formally notified us that the SEC investigation related to our historical stock option grant practices has been terminated. No enforcement action has been recommended. In addition, we announced that the NASDAQ Stock Market LLC has formally notified us that with the holding of our annual meeting on June 27, 2008 we have regained compliance with NASDAQ listing requirements.

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Item 6. Exhibits

We incorporate by reference all exhibits filed in connection with our Annual Report on Form 10-K for the year ended December 31, 2007.

		Incorporated by Reference				
Exhibit No.	**Exhibit Description**	**Schedule/Form**	**File Number**	**Exhibit**	**Filing Date**	**Filed Herewith**
10.3	1995 Non-Employee Director s Stock Option Plan, as amended, and related form of stock option agreement	10-Q	000-26944	10.3	8/11/08	
31.1	Certification of President and Chief Executive Officer as required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.					X
31.2	Certification of Senior Vice President, Finance and Chief Financial Officer as required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.					X
32.1(1)	Certification of President and Chief Executive Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended.					X
32.2(1)	Certification of Senior Vice President, Finance and Chief Financial Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended.					X

(1) The certifications attached as Exhibit 32.1 and Exhibit 32.2 accompany the Quarterly Report on Form 10-Q, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Silicon Storage Technology, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Sunnyvale, County of Santa Clara, State of California, on the 7th day of November, 2008.

SILICON STORAGE TECHNOLOGY, INC.

By: /S/ BING YEH
Bing Yeh
Chairman, President and

Chief Executive Officer

(*Principal Executive Officer*)

/S/ JAMES B. BOYD
James B. Boyd
Senior Vice President, Finance and

Chief Financial Officer

(*Principal Financial and Accounting Officer*)

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