ATHEROS COMMUNICATIONS INC
Form 10-K
March 01, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006

OR

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

Commission File No. 0-50534

ATHEROS COMMUNICATIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**77-0485570**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

5480 Great America Parkway, Santa Clara, CA 95054-3644

(Address of principal executive offices, Zip Code)

(408) 773-5200

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common stock, $0.0005 par value per share	**The NASDAQ Stock Market LLC**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to Form 10-K. x

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of the registrant s common stock held by non-affiliates of the registrant was approximately $752,609,988 based upon the closing price of $19.05 of such common stock on the NASDAQ Global Select National Market on June 30, 2006 (the last business day of the registrant s most recently completed second quarter). Shares of common stock held as of June 30, 2006 by each director and executive officer of the registrant, as well as shares held by each holder of 5% of the common stock known to the registrant, have been excluded for purposes of the foregoing calculation. This determination of affiliate status is not a conclusive determination for other purposes.

As of February 23, 2007, there were 54,977,513 shares of common stock of the registrant outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Items 10 (as to directors, executive officers and Section 16(a) Beneficial Ownership Reporting Compliance), 11, 12 (as to beneficial ownership), 13 and 14 of Part III incorporate by reference information from the registrant s Definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the registrant s 2007 Annual Meeting of Stockholders to be held on May 22, 2007.

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ATHEROS COMMUNICATIONS, INC.

PART I

Item 1. ***Business***

When used in this Report, the words "will," "shall," may, expects, anticipates, intends, estimates, plans, believes, and similar expressions are intended to identify forward-looking statements. These are statements that relate to future periods and include statements about our future results, sources of revenue, our continued growth, our gross margins, market trends, technological developments, the features, benefits and performance of our current and future products the anticipated benefits of our recent acquisitions of ZyDAS Technology Corporation and Attansic Technology Corporation, future price reductions, our dependence on any one third party license, benefits of open source license agreements, our competitive status, our original design manufacturer customer base, our sales in Asia, our dependence on our senior management and our ability to attract and retain key personnel ,our employee relations, the benefits of equity compensation and the related charges, potential litigation, the effects of government regulations, our compliance with laws and regulations related to our encryption technologies, our participation in wireless standards bodies and the effects of the adoption of standards, the expected benefits of our intellectual property, our future office space needs, our expected future expenditure levels for research and development, sales and marketing, and general and administrative expenses, our future capital expenditures, ,fluctuations in our stock price, our payment of dividends, our future liquidity and cash needs ,our credit facility, impact of changes in interest rates, future acquisitions of and investments in complimentary businesses, and the expected impact of various accounting policies and rules adopted by the Financial Accounting Standards Board. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, factors affecting our quarterly results, our ability to manage our growth, our ability to sustain or increase profitability, demand for our chipsets, the effect of declines in average selling prices for our products, our ability to compete, our ability to rapidly develop new technology and introduce new products, our ability to successfully integrate our recent acquisitions, our ability to safeguard our intellectual property, trends in the semiconductor industry and fluctuations in general economic conditions, and the risks set forth throughout this Report, including under Item 1, "Business" and under Item 1A, Risk Factors. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

In this Report, references to Atheros, we, us, our or the Company mean Atheros Communications, Inc. and its subsidiaries, except where it i made clear that the term means only the parent company.

Atheros, Super G, Super AG, XR, eXtended Range, ROCm, and XSPAN are our trademarks. We also refer to trademarks of other corporations and organizations in this document.

Overview

We are a leading developer of highly integrated semiconductor system solutions for communications products. We combine our wireless systems and software expertise with high-performance radio frequency, mixed signal and digital semiconductor design skills to provide highly integrated chipsets that are manufacturable on low-cost, standard complementary metal-oxide semiconductor, or CMOS, processes. We provide system-on-a-chip and software solutions to manufacturers of computing and networking equipment, digital entertainment and broadband access products, and mobile devices. Our product portfolio includes Wireless Local Area Network, or WLAN solutions for the data networking and

consumer markets, Personal Access Systems, or PAS, also referred to as Personal Handyphone Systems, chipsets for handsets and base stations and Fast and Gigabit Ethernet products for PC OEMs.

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We were incorporated as T-Span Systems Corporation in Delaware in May 1998. In May 2000, we changed our corporate name to Atheros Communications, Inc.

Our website address is http://www.atheros.com. The information contained in our website does not form any part of this Annual Report on Form 10-K. However, we make available free of charge through our website our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file this material with, or furnish it to, the Securities Exchange Commission.

Our Products and Technology

WLAN Products

We are shipping production volumes of our eighth generation of semiconductors, hardware designs and software for WLAN applications. We offer customers guidelines known as reference designs that can be used to design a wide variety of systems, including networking cards and access points, mobile devices and handsets. Our WLAN solutions provide basic standards-compliant connectivity and other features such as substantial throughput enhancement and range enhancement, supporting video, voice and outdoor broadband access. Our products support several encryption and authentication security standards, network management protocols, operating systems, and interfaces to non-computing environments, such as consumer electronics.

We provide a comprehensive portfolio of multi and single chip WLAN products ranging from entry-level wireless networking products for the small office and home office (SOHO) markets to sophisticated wireless infrastructure systems-on-chip with advanced network management capabilities for the enterprise market. Our wireless systems solutions target applications in the personal computer, enterprise access, small office and home networking, mobile communications and consumer electronics markets. Our WLAN products support the Institute of Electrical and Electronics Engineers, or IEEE, family of wireless local area networking, or WLAN, standards, including the 802.11b, 802.11g, 802.11a and anticipated 802.11n standards. Our solutions have been developed over the past nine years and in 2006, we acquired ZyDAS Technology Corporation, a supplier of 802.11 semiconductor solutions for USB adapters and embedded modules, to further expand our product portfolio for new and existing 802.11 markets.

We currently provide wireless system solutions based on four types of semiconductors:

Radio-on-a-chip, or RoC, is one or more CMOS radio transmitters and receivers for either or both of the frequency bands in which our products operate and is primarily an analog radio frequency, or RF, circuit.

MAC + Baseband is an implementation of mixed signal circuitry containing low frequency analog circuits and data converters integrated with a digital interface, media access controller, or MAC, and baseband processor. The MAC contains a silicon implementation to support the protocol for network communications.

Stand-alone Network Processing Unit, or NPU, is our stand-alone processor which supports a variety of clock speeds and network interfaces. The NPU is typically used in products that provide dedicated wireless networking infrastructure solutions.

Wireless system-on-a-chip, or WiSoC, incorporates a MAC + baseband integrated with a network processor and network interfaces, which are otherwise typically, separate components. The processor is a digital device and is integrated to reduce the overall solution cost for wireless networking infrastructure products.

Single chip solutions are highly integrated, complete wireless solutions, including one or more radios-on-a-chip, media access controllers, baseband processors, and optionally, a network processor and network interfaces. These devices encapsulate substantially all of the digital and analog circuitry within a single chip.

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Our WLAN customers use a variety of our chips to create differentiated client and infrastructure solutions to meet the needs of the specific market segment that they address. Infrastructure products, such as an access point, gateway or router, use our wireless subsystems that incorporate either a separate or embedded network processor. Client solutions, such as laptops and cardbus cards, utilize the host processor of the particular product in conjunction with our wireless subsystem. Examples of how our chips can be combined for infrastructure and client solutions are as follows:

Infrastructure Solutions

- WiSOC + RoC(s)
- RoC(s) + MAC/Baseband + NPU
- Single chip solutions with an integrated Atheros processor

Client Solutions

- RoC(s) + MAC/Baseband
- Single chip solutions

Our WLAN products not only meet the appropriate IEEE 802.11 WLAN standards for which they are designed, but also offer enhanced capabilities that benefit the users with enhanced performance and functionality. Some of the key features are:

Super G® and Super AG® are performance enhancing extensions that allow our products with 802.11g and 802.11a WLAN capabilities to operate at link rates of up to 108 Mbps, twice the industry standard maximum link rate of 54 Mbps, while maintaining the ability to work at industry standard data rates. We achieve this by adapting the operating protocols to maximize throughput based on several advanced signaling technologies.

Atheros eXtended Range®, or Atheros XR®, is a range enhancing extension that can more than double the distance at which an Atheros client device can maintain a connection with an Atheros access point minimizing dead spots and providing better coverage in large homes from a single access point. We achieve this by adapting the OFDM algorithms in the baseband to increase the sensitivity of the receiver when the signal level is too low for standard operation. *XSPAN products* take advantage of multiple radio, smart antenna technologies including multiple-input multiple-output, or MIMO, designs to increase the performance of wireless networks. Our XSPAN family of products is designed to meet the latest draft 802.11n specification approved by the IEEE. Our highest performance XSPAN solution uses a unique triple-radio RF design and delivers up to 300 Mbps physical data rate in each radio band, with real end user throughput of 150-180 Mbps.

Power Management Technology enables our products to use significantly less power in the transmit, receive and sleep operating modes, which offers the benefit of longer battery life for the access device. This is achieved by monitoring functions and using custom timing circuits to keep non-active circuitry in sleep mode when possible.

We are actively developing new extensions to further benefit users as the standards continue to evolve.

We believe that WLANs and other wireless products will continue to improve by transitioning from multi-chip systems to more highly integrated systems providing radio, baseband and MAC functionality on a single silicon chip such as those offered by us. We have released in volume a family of single chip WLAN solutions, and expect to continue to both integrate additional functionality in these solutions as well as develop single chip solutions for other markets.

To enable our customers to easily incorporate our wireless systems solutions into their products, we support a network of authorized design centers and contract engineering firms based in the United States, Europe and Japan that we have trained in the use of our tools and technologies. These design centers have enabled our customers to introduce a number of products based upon our wireless system solutions, extending our market reach. In addition, we provide technical and design support to our customers developing products based on our chips through our main

office in Santa Clara, California and our local offices throughout Asia.

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PAS Products

In 2005, we introduced our solution for the PAS cellular market. Our highly integrated PAS solution is used in both handset and base station products sold primarily in the China market. Our PAS product enables service providers in China to transition their network capabilities from wireline to wireless, allowing them to offer both mobile wireless voice and data services. Our solution consists of a single chip that implements a complete cellular transceiver, baseband, application processor, audio paths, power management, keyboard, speaker and display interfaces. PAS, which is widely deployed in China, Japan and Taiwan, is an advanced Time Division Multiple Access-Time Division Duplex, or TDMA-TDD, technology operating at 1.9 gigahertz, or GHz, providing high quality voice, advanced data services and long battery life. Our unique, highly integrated single chip solution for PAS products provides full support for the PAS networking standard and a robust set of product features at a competitive price.

Fast and Gigabit Ethernet Products

In December 2006, we acquired Attansic Technology Corporation, a supplier of Gigabit and Fast Ethernet semiconductor solutions. The Attansic acquisition complements our existing portfolio of products for access points, routers and gateways, which typically include Ethernet physical layer, transceivers and switches, and expands our portfolio for personal computer customers into Local Area Network-on-motherboard, or LOM applications. These products provide Ethernet connectivity in accordance with the IEEE 802.3ab, or Gigabit, or IEEE 802.3u , or Fast Ethernet, standards.

The Gigabit and Fast Ethernet controller products are targeted for wired connectivity on desktop and notebook personal computer, or PC, platforms. Our family of single-chip controllers integrates our Gigabit/Fast Ethernet physical integrated circuit, or PHY and Media Access Controller, or MAC, with a comprehensive software suite. These cost-effective solutions are targeted for client network interface cards, or NICs, and LOM applications.

Our Fast Ethernet and Gigabit Ethernet transceivers are designed for the small and medium business, or SMB and enterprise networking systems. Our transceiver products utilize sophisticated signal processing algorithm and advanced power management features to achieve high performance and low power consumption. Target applications include PC LOMs, Access Points, or APs, routers, broadband gateways, and SMB switches.

Customers

We sell our products directly to original equipment manufacturers, or OEMs, who include our chipsets in their products, and to original design manufacturers, or ODMs, who in turn include our chipsets in products they supply to OEMs. For direct sales to OEMs, the OEM incorporates our wireless system solutions directly into their products, and the OEM is the licensee and the end-user of the technology. However, we primarily sell directly to ODMs, as many OEMs choose to specify an ODM to integrate our technology in a module, such as a peripheral component interconnect, or PCI, card, which is then delivered to the OEM customer. For OEMs who use an ODM as an intermediary, our shipments and revenue are directly with the ODM. However, we attempt to maintain close relationships with the target OEM and the initial technology design win is generally awarded by the OEM. We also have ongoing contact with the OEM for forecasting and technology update purposes. Currently, our target markets include the retail wireless networking, personal computer OEM, enterprise and carrier infrastructure equipment, mobile communications, and consumer electronics markets.

In 2006, Hon-Hai Precision Industry Co. Ltd. and UT Starcom, Inc. accounted for 20% and 10% of our net revenue, respectively. In 2005, Alpha Networks, Inc., Hon-Hai Precision Industry Co. Ltd., Cameo Communications, Inc., and Askey Computer Corporation accounted for 15%, 15%, 13% and 10% of our net revenue, respectively. In 2004, Hon-Hai Precision Industry Co. Ltd., Askey Computer Corporation, Cameo Communications, Inc. and Alpha Networks, Inc. accounted for 23%, 17%, 12% and 10% of our net revenue, respectively.

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While we primarily sell directly to ODMs, the ODM generally identifies on its purchase order the OEM for whom they are purchasing our product. We do not have the ability to directly confirm with the sell-through party that they received the final product from the ODM. Based on the sell-through information provided to us by the ODMs, the following companies or their subsidiaries are among those that have incorporated Atheros products through ODMs during the year ended December 31, 2006:

2Wire, Inc.

3Com Corporation

Acer Co. Ltd

Apple, Inc.

Belkin Corporation

Buffalo, Inc.

Cisco Systems, Inc. (including The Linksys Group, Inc.)

Corega

D-Link Corporation

Fujitsu Limited

Fujitsu Siemens Computers

Hewlett-Packard Company

Lenovo (Singapore) PTE Ltd (formerly IBM Singapore PTE Ltd)

NEC Electronics Corporation

NETGEAR, Inc.

Proxim, Inc.

Siemens AG

Sony Corporation

Toshiba Corporation

TP-LINK Technologies Co. Ltd.

UTStarcom, Inc.

Sales and Marketing

We have direct sales staff strategically located near our major customers in the United States and Asia who support our major OEM and ODM customers. Each salesperson has specific end-user market expertise.

We also have field application engineers, or FAEs, who provide technical support and assistance to existing and potential customers in designing, testing and qualifying systems that incorporate our products. Our FAE organization is segmented by end-user market as well as core competencies in hardware, software and radio frequency necessary to support our customers.

To supplement our direct sales, we have independent sales representatives and distributors with locations throughout the world. We selected these independent representatives and distributors based on their ability to provide effective field sales, marketing communications and technical support for our products. With the independent sales representatives, our customers place orders directly with us rather than with the representatives and our representatives do not generally maintain product inventory. With our distributors, our customers generally place orders directly with the distributor and our distributors generally maintain product inventory.

Our third-party design centers provide expertise in RF design, board layout, operating system and driver development, industrial design and prototyping to customize our software or hardware for smaller customers requirements. These third-party design centers typically provide their services on a contract engineering basis and enable rapid time-to-market in areas of expertise.

In addition to providing chipsets, we also license software in source code form to some of our customers. Since the licensing of software in source code requires that we enter into a technology license directly with end

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customers, we usually maintain a direct relationship with the end customer whether they have purchased chipsets directly from us or through one of our ODMs or independent representatives. Contractual obligations of our licensees not to disclose or misuse our source code may not sufficiently protect us from misuse or disclosure of our intellectual property. The costs of enforcing contractual rights could substantially increase our operating costs and may not ultimately succeed in protecting our proprietary rights. If our competitors access our source code, they may gain further insight into our technology and duplicate or design around our products, which would harm our competitive position.

Our marketing groups focus on our product strategy, product development road maps, new product introduction process, demand assessment, competitive analysis, customer application support, customer program management and corporate communications. These groups also ensure that product development activities, product launches, channel marketing program activities, and ongoing demand and supply planning occur in a well-managed, timely basis in coordination with our development, operations, and sales groups, as well as our ODMs, OEMs and representatives.

Our sales are made primarily pursuant to standard purchase orders. Because industry practice allows customers to reschedule or cancel orders on relatively short notice, we believe that backlog is not a good indicator of our future sales.

Substantially all of our sales are to customers outside the United States and Canada. Sales to customers in Asia accounted for 98% of net revenue in 2006, 96% of net revenue in 2005 and 98% of net revenue in 2004. Our net revenue consisted of sales to customers in the following countries for the periods indicated in the following table:

	Year Ended December 31,		
	2006	2005	2004
Taiwan	53%	70%	86%
China	35	16	3
United States	1	3	1
Other	11	11	10

Regulatory Environment and Industry Standards

Our wireless products and our customers products transmit and receive radio signals across both licensed and unlicensed regulated spectrum. To certify our products for use in a broad geographic market, we maintain communication with a variety of government and certification agencies in the United States and international markets, including, but not limited to, Japan, China, Taiwan, Korea, France, Germany and the United Kingdom. As the wireless communications market is particularly influenced by regulations and policy on spectrum allocations and licensing provisions, this direct contact gives us insight into market requirements and appropriate product plans. We have developed and obtained necessary certifications for certain proprietary technologies and algorithms that enable our products to roam between and adapt to various standards and to international regulatory and operational requirements. These technologies are not necessarily exclusive to us, but have been refined by us and are a requirement for many multinational equipment manufacturers.

We intend to participate in, support our employees participation in, or monitor, as appropriate, the activities of various standards bodies, including the IEEE standards group, the European Telecommunications Standards, or ETSI, the International Telecommunications Union, or ITU, the WiFi Alliance, WiMax, a nonprofit group formed to create and promote the development of IEEE wireless broadband standard 802.16,

Digital Living Networking Alliance, or DLNA, the Personal Handyphone System Memorandum of Understanding Group, or PHS MoU Group, the Peripheral Component Interconnect Special Interest Group, or PCI SIG and the Bluetooth Special Interest Group, or Bluetooth SIG.

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The rights to use spectrum are subject to changes made by the government entities that allocate and regulate radio spectrum. Changes in United States and international spectrum policy may limit our ability to sell or prevent us from selling products, require substantial engineering effort and expense to address and work around any such changes, and substantially and adversely affect the time it takes our customers to bring their products to market and our future revenue. In addition, our products and our customers products could be denied the regulatory certifications required to sell these products, or the time and cost required to obtain regulatory certifications could reduce our revenue and profitability.

Our products include encryption technologies that are regulated by the U.S. and foreign governments. We believe we are in compliance with all export and import laws and regulations related to our encryption technologies. However, these laws and regulations may change and limit our ability to continue to export and import our products internationally until we can adapt to these changes.

Intellectual Property

Our success will depend in part on our ability to protect our intellectual property. We rely on a portfolio of intellectual property rights, both foreign and domestic, including patents, trademark registrations, copyright rights, trade secrets, contractual provisions and licenses to protect our intellectual property. Many of our issued patents and pending patent applications relate to algorithms, integrated circuit, or IC, designs, software and systems related to wireless communications and networking, with a focus on innovations we believe we have achieved in our implementations of industry standards-compliant wireless networking.

Patents

As of December 31, 2006, we held 75 U.S. issued patents and 85 pending U.S. patent applications. We continue to pursue actively the filing of additional patent applications in both the United States and foreign jurisdictions. Our domestic patents and applications have expiration dates from September 2019 through December 2026.

We may not receive competitive advantages from the rights granted under our patents and other intellectual property rights. Our continued success and future growth is based on execution capability, technical expertise, speed of implementation and process management abilities of our employees and our ability to defend our intellectual property. Our existing and future patents may be circumvented, blocked, licensed to others or challenged as to inventorship, ownership, scope, validity or enforceability. It is possible that literature we may be advised of by third parties in the future could negatively affect the scope or enforceability of either our present or future patents. Furthermore, our pending and future patent applications may not issue with the scope of claims sought by us, if at all, or the scope of claims we are seeking may not be sufficiently broad to protect our proprietary technologies. Others may develop technologies that are similar or superior to our proprietary technologies, duplicate our proprietary technologies or design around the patents owned or licensed by us. If our products, patents or patent applications are found to conflict with any patents held by third parties, we could be prevented from selling our products, our patents may be declared invalid or our patent applications may not result in issued patents. In addition, in foreign countries, we may not receive effective patent and trademark protection. We cannot be sure that steps we take to protect our proprietary technologies will prevent misappropriation of our technologies.

Intellectual Property Litigation

The wireless communications and networking industries are characterized by frequent litigation and other vigorous protection and pursuit of intellectual property rights or positions. There are also numerous patents in the wireless communications and networking industries and new patents are being issued at a rapid rate. This often results in significant and often protracted and expensive litigation. Questions of infringement involve highly technical and subjective analyses. Litigation may be necessary in the future to enforce any patents we may be

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granted and other 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 made against our products or our customers products, and we may not prevail in any future litigation. In the last few years, we and our customers have received several written notices and license offers from research institutions, intellectual property holding firms, our competitors and others claiming to have patent and other intellectual property rights that apply to the IEEE family of wireless local area networking standards, including the 802.11a, 802.11b, 802.11e, 802.11g and 802.11n wireless standards, as well as other intellectual property relevant to our chips, software, and system solutions. These notices or offers have been made directly to us and to our U.S. and foreign customers. We have responded directly or indirectly through our customers, to these notices, and continue to correspond regarding the offers with some of the parties that have sent the notices. In addition, at least two of our customers have been sued in the U.S. for allegedly infringing patents related to 802.11a, 802.11b and 802.11g technology. Neither that litigation nor any of these notices has to date resulted in litigation directly against us. We have received legal advice and opinions from our patent counsel regarding these matters. We believe that the rights offered are either already licensed to us or our products do not infringe any valid claim to the issued patents identified to date. We cannot assure you that any of these or other third-parties will not pursue litigation or assert their patent and other intellectual property rights against us in the future. We have certain indemnification obligations to customers with respect to infringement of third-party patents and intellectual property rights by our products. We cannot assure you that our potential obligations to indemnify such customers will not harm us, our business or our financial condition and results of operations. We may intervene in litigation on behalf of one or more of our customers, incurring substantial expense. The results of any litigation are inherently uncertain. Any successful infringement claim or litigation against us or our customers could have a significant adverse impact on our business.

If it is necessary or desirable, we may seek licenses under third-party patents or other intellectual property rights. However, we cannot be sure that third parties will offer licenses to us or that we will find and secure acceptable terms for any offered licenses. If we fail to obtain a license from a third party for proprietary technologies that we use, we could incur substantial liabilities, or suspend sales or use of our products or our use of processes requiring the technologies. Whether or not any litigation is determined in our favor or settled, it could cause us to incur significant expenses, harm our sales of the challenged technologies or products and divert the attention and efforts of our technical and management personnel, whether or not a court decides the litigation in our favor. Adverse determinations in litigation could result in the loss or impairment of our proprietary rights, subject us to significant liabilities and money damages, require us to seek licenses from third parties, cause us to spend significant resources and revenues to design around or develop non-infringing technology, or prevent us from licensing our technology or selling our products, any of which could harm our business.

Copyrights and Trademarks

We claim copyright and trademark protection for proprietary documentation and a variety of branding marks. We also pursue foreign copyrights and trademarks where applicable and necessary. The branding marks are sublicensed to our customers and used by them to identify and promote their products capabilities in markets, including, but not limited to, computing and consumer electronics. As of December 31, 2006, we held 12 registered U.S. trademarks.

Licenses

We also rely on third-party licensors for certain technologies embedded in our semiconductor, hardware and software designs. These are typically non-exclusive contracts for general capabilities provided under royalty-accruing or paid-up licenses. These licenses are generally perpetual or automatically renewed for so long as we continue to pay any royalty that may be due. We have entered into a number of licensing arrangements pursuant to which we license third-party technologies. We do not believe our business is dependent to any significant degree on any individual third-party license.

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We generally enter into confidentiality agreements with our employees, vendors, industry partners and customers, as well as generally control access to and distribution of our documentation and other proprietary information. Despite this protection, unauthorized parties may copy aspects of our current or future products or obtain and use information that we regard as proprietary.

Certain software compatible with our chipsets has been made available to others through open source licensing agreements. We believe that this has been a source of benefit and differentiation as it expands the market for our products and enables these products to benefit from the design efforts of the open source community. This practice does provide to others some level of insight into the design and the features of our products, although we maintain and retain proprietary rights to the substantial portion of our capabilities.

Research and Development

We engage in substantial research and development to develop new products and integrate additional capabilities in product designs. We conduct research into digital and analog IC design, hardware reference board design, software reference code development, systems integration and manufacturing process flow development at our corporate headquarters in Santa Clara, California, and at our research and development facilities in China and Taiwan. We also perform test emulation, digital design verification and application software development at our offices in India, Taiwan and China. We use a number of proprietary design tools and processes that enable us to deliver high-performance wireless capabilities using low-cost manufacturing facilities. We employ a team of engineers with extensive experience in mixed signal design, systems and communications architecture, CMOS technology and software development. Our research and development expense was $71.1 million in 2006, $47.8 million in 2005 and $42.7 million in 2004.

Manufacturing

We design and develop our proprietary designs and provide them to third-party foundries, contract manufacturers, ODMs, assembly and test companies and other licensees and contractors to produce silicon wafers and semiconductors. We produce a variety of digital, analog and mixed-signal chip designs using standard CMOS production facilities. The use of this process enables us to produce cost-effective products, and we have proprietary rights to the particular design methodologies that we use to maintain high-performance levels on generic processes.

We currently have in production products using 0.09 micron, 0.13-micron, 0.18-micron, and 0.25-micron process geometries for wafer production at Taiwan Semiconductor Manufacturing Corporation, or TSMC, in Taiwan, and we are also using a 0.13 micron and 0.18-micron process at Semiconductor Manufacturing International Corporation, or SMIC, in Shanghai, China, and 0.18 micron at Tower Semiconductor Ltd. in Israel and at United Microelectronics Corporation, or UMC, in Taiwan. We also qualify, package and test wafers and units at multiple locations, including, but not limited to, Advanced Semiconductor Engineering, Inc. in Taiwan, Amkor Technology, Inc. in China, Taiwan and Korea, ASAT Holdings Limited in China, Global Testing Corporation in Taiwan, Greatek Electronics, Inc. in Taiwan, Microelectronics Corp. in Taiwan, Siliconware Precision Industries Co., Ltd. in Taiwan, STATS ChipPAC Limited in Singapore and Test-Serv, Inc. in Taiwan. We store and distribute our inventory from contracted warehouses in Hong Kong and Singapore.

We also maintain software test facilities at our corporate headquarters and at our research and development facilities in India, Taiwan and China. This enables us to operate certain test processes on demand, so as to reduce the time-to-market of our designs and improve their reliability.

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Competition

The retail wireless networking, personal computer OEM, enterprise and carrier infrastructure equipment, mobile communications, and consumer electronics markets are intensely competitive with a variety of large and small companies providing semiconductors, hardware and software designs. We believe that our focus on wireless technology has enabled us to compete favorably with respect to the following factors:

- product performance;
- feature set and quality, including network throughput, product range, power efficiency, security features, reliability and consistency;
- level of integration;
- time-to-market;
- price;
- customer support and application support; and
- ability to comply with, and influence, industry standards and international regulatory requirements.

We compete with large semiconductor manufacturers and designers and start-up semiconductor design companies as well as large, established suppliers. Our primary competitors include Broadcom Corporation, Conexant Systems, Inc., Intel Corporation, Marvell Technology Group Ltd., Realtek Semiconductor Corp. and Texas Instruments Incorporated. All of our primary competitors and many of our other current and potential competitors have longer operating histories, significantly greater resources and name recognition, and a larger base of customers than we do. Many of our competitors also have significant influence in the semiconductor industry. We may not be able to compete effectively against current and potential competitors, especially those with significantly greater resources and market leverage. As a result, these competitors may respond quicker than we do to new or emerging technologies or changes in customer requirements. Moreover, our competitors may foresee the course of market developments more accurately than we can. In addition, some of our larger competitors may be able to provide greater incentives to customers through rebates and marketing development funds and similar programs. Furthermore, some of our competitors with multiple product lines may integrate wireless functionality into products that we do not sell or bundle their products to offer a broader product portfolio, which may make it difficult for us to gain or maintain market share. For example, Intel markets its Centrino mobile technology brand and we believe Intel provides a substantial marketing development fund incentive for buyers of a combination of its microprocessor, a related chipset and an 802.11 wireless network module that uses the brand. We believe a separate WLAN chipset solution offers advantages compared to a solution integrated with other communications protocols because of the rapid changes in WLAN technologies that occur on a different cycle than those of other communications technologies and due to the significant differences in the performance available from standalone solutions. Our competitors may be able to adopt more aggressive pricing policies and devote greater resources to the development, promotion and sale of their products than we can. In addition, new competitors, including lower cost Asian semiconductor companies or alliances among existing competitors, could emerge.

Many of our customers are also large, established integrated circuit suppliers. Our sales to and support of such customers may enable them to become a source of competition to us, despite our efforts to protect our intellectual property rights. Competition could increase pressure on us to lower our prices and lower our margins. If we do not compete successfully, we will be unable to gain or retain market share.

Employees

As of December 31, 2006, we employed 660 full-time employees, including 472 in research and development and operations, 131 in sales and marketing, and 57 in general and administration. We have never had a work stoppage and none of our employees is represented by a labor organization nor under any collective bargaining arrangements. We consider our employee relations to be good.

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Item 1A. ***Risk Factors***

Fluctuations in our operating results on a quarterly and annual basis could cause the market price of our common stock to decline.

Our revenue and operating results have fluctuated significantly from period to period in the past and are likely to do so in the future. These fluctuations could cause the market price of our common stock to decline. As a result, you should not rely on period to period comparisons of our operating results as an indication of our future performance. In future periods, our revenue and results of operations may be below the expectations of analysts and investors, which could cause the market price of our common stock to decline. Factors that are likely to cause our revenue and operating results to fluctuate include those discussed in the risk factors below.

If demand for our chipsets declines or does not grow, we will be unable to increase or sustain our revenue and our business will be severely harmed.

We have derived substantially all of our revenue from the sale of chipsets for wireless applications, and we expect our chipsets for wireless applications, and to a lesser extent our wired Ethernet solutions, to account for substantially all of our revenue for the foreseeable future. If we are unable to develop new products in a timely manner or demand for our chipsets declines as a result of competition or technological changes, it would have a material negative impact on our business, operating results and financial position and our competitive position. The markets for our wireless and Ethernet networking products are characterized by frequent introduction of next generation and new products, short product life cycles and significant price competition. If our customers or we are unable to manage product transitions in a timely and cost-effective manner, our business and results of operations will suffer. In addition, frequent technology changes and introduction of next generation products may result in inventory obsolescence, which could reduce our gross margins and adversely affect our operating performance. Also, we are currently substantially dependent on one customer for our single chip solution for PAS products. If we fail to maintain or grow our share of business with this customer and to win new customers for our PAS product, our revenue growth would be adversely affected.

Since we have limited visibility as to the volume of sales of our products by our customers and inventory levels of our products held by our customers, our ability to forecast accurately future demand for and sales of our products is limited.

We sell our chipsets to OEMs who integrate our chipsets into their products or to ODMs who include our chipsets in the products they supply to OEMs. We have limited visibility as to the volume of our products that our OEM and ODM customers are selling to their customers or carrying in their inventory. If our customers have excess inventory or experience a slowing of products sold through to their end customers, it would likely result in a slowdown in orders from our customers and adversely impact our future sales and inventory.

Any future downturns in the semiconductor industry may reduce our revenue and result in excess inventory.

The semiconductor industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. The industry has, from time to time, experienced significant downturns, often connected with, or in anticipation of, maturing product cycles of both semiconductor companies and their customers products and declines in general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. Any future downturns may reduce our revenue or our percentage of revenue growth on a quarter-to-quarter basis and result in us having excess inventory. Furthermore, any upturn in

the wireless communications market in which we sell our chipsets could result in increased competition for access to limited third-party foundry, assembly and test capacity.

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Our products typically have lengthy sales cycles. A customer may decide to cancel or change its product plans, which could cause us to lose anticipated sales. In addition, our average product life cycles tend to be short and, as a result, we may hold excess or obsolete inventory that could adversely affect our operating results.

After we have developed and delivered a product to a customer, the customer will usually evaluate our product prior to designing its own equipment to incorporate our product. Our customers may need several months to test, evaluate and choose whether to adopt our product, and to begin volume production of equipment that incorporates our product. Due to this lengthy sales cycle, we may experience significant delays from the time we increase our operating expenses and make investments in inventory until the time that we generate revenue from these products. It is possible that we may never generate any revenue from these products after incurring such expenditures. Even if a customer selects our product to incorporate into its equipment, we have no assurances that the customer will ultimately market and sell its equipment or that such efforts by our customer will be successful. The delays inherent in our lengthy sales cycle also increase the risk that a customer will decide to cancel or curtail, reduce or delay its product plans. Such a cancellation or change in plans by a customer could cause us to lose sales that we had anticipated.

While our sales cycles can be long, our average product life cycles tend to be short as a result of the rapidly changing technology environment in which we operate. As a result, the resources devoted to product sales and marketing may not generate material revenue for us, and from time to time, we may need to write off excess and obsolete inventory. If we incur significant marketing expenses and investments in inventory in the future that we are not able to recover, and we are not able to compensate for those expenses, our operating results could be adversely affected. In addition, if we sell our products at reduced prices in anticipation of cost reductions but still hold higher cost products in inventory, our operating results would be harmed.

The average selling prices of products in our markets have historically decreased rapidly and will likely do so in the future, which could harm our revenue and gross profits.

The products we develop and sell, especially those for wireless networking solutions, are used for high volume applications and many of them are subject to rapid declines in average selling prices. The average selling prices have historically decreased significantly in order to meet market demand, and we expect that we will continue to reduce prices in the future. Reductions in our average selling prices to one customer could impact our average selling prices to all customers. Historically, we have generally been able to substantially offset reductions in our average selling prices with decreases in our product costs and increases in our unit volumes. Our financial results will suffer if we are unable to offset any future reductions in our average selling prices by increasing our unit volumes, reducing our costs or developing new or enhanced products on a timely basis with higher selling prices or gross profit. While gross profit may decline as a result of reductions in average selling prices, we may continue to incur research and development costs at higher or existing levels to develop future products. This continued spending would have an adverse impact on our immediate operating results if our revenue does not continue to grow or our gross margins decline.

We may not be able to compete effectively and increase or maintain revenue and market share.

We may not be able to compete successfully against current or potential competitors. If we do not compete successfully, our market share and revenue may decline. We compete with large semiconductor manufacturers and designers and start-up integrated circuit companies. Most of our current and potential competitors have longer operating histories, significantly greater resources and name recognition and a larger base of customers than we do. This may allow them to respond more quickly than us to new or emerging technologies or changes in customer requirements. In addition, these competitors may have greater credibility with our existing and potential customers. Moreover, many of our competitors have been doing business with customers for a longer period of time and have established relationships, which may provide them with information regarding future trends and requirements that may not be available to us. In addition, some of our larger competitors may be able to provide greater incentives to customers through rebates and marketing development funds and similar programs. Some of

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our competitors with multiple product lines may bundle their products to offer a broader product portfolio or integrate wireless functionality into other products that we do not sell, which may make it difficult for us to gain or maintain market share. For example, Intel markets its Centrino mobile technology brand and we believe they provide a substantial marketing development fund incentive for buyers of a combination of its microprocessor, related chipsets and wireless networking module that use the brand. Intel or other large competitors may also be able to discourage OEMs from placing our brand on their products, which could substantially harm our marketing efforts.

If we fail to appropriately scale our operations in response to changes in demand for our existing products or for new products, our business could be materially and adversely affected.

We have significantly grown and expanded our operations in a short period of time, and to achieve our business objectives, we expect to continue to grow. Through internal growth and the acquisition of ZyDAS Technology Corporation and Attansic Technology Corporation, both completed in the second half of 2006, we have significantly increased the scope of our operations and expanded our workforce, from 260 employees as of December 31, 2004, to 327 employees as of December 31, 2005, and to 660 employees as of December 31, 2006. We anticipate that we will further expand our workforce through internal growth as well as acquisitions. Nonetheless, we may not be able to expand our workforce and operations in a sufficiently timely manner to respond effectively to changes in demand for our current and future products and services. In that event, we may be unable to meet competitive challenges or exploit potential market opportunities, and our current or future business could be materially and adversely affected. Conversely, if we expand our operations and workforce too rapidly in anticipation of increased demand for our products, and such demand does not materialize at the pace at which we expect, the rate of increase in our operating expenses may exceed the rate of increase in our revenue, which would adversely affect our operating results.

Our past growth has placed, and any future growth is expected to continue to place, a significant strain on our management personnel, systems and resources. To implement our current business and product plans, we will need to continue to expand, train, manage and motivate our workforce. All of these endeavors will require substantial management effort. We anticipate that we will need to implement a variety of new and upgraded operational and financial systems, as well as additional procedures and other internal management systems. These processes can be time consuming and expensive, increase management responsibilities, and divert management attention.

In addition, we have entered into leases for additional office space in Northern California, Taiwan and India, and anticipate the need to lease additional office space in other locations in the near future to accommodate our growth, and we may also be required to relocate our employees from time to time. Such relocation could result in temporary disruptions of our operations or a diversion of our management s attention and resources. If we are unable to effectively manage our expanding operations, we may be unable to scale our business quickly enough to meet competitive challenges or exploit potential market opportunities, or conversely, we may scale our business too quickly and the rate of increase in our expenses may exceed the rate of increase in our revenue, either of which would materially and adversely affect our current or future business.

We may not be able to sustain our recent growth rate, and we may not be able to manage our future growth effectively.

We have experienced significant growth in a short period of time. Our revenue increased from $169.6 million in 2004, to $183.5 million in 2005, and to $301.7 million in 2006. We may not be able to achieve similar revenue growth rates for 2007 or in future periods. In the event that we do achieve continued growth, the expansion of our business and operations will likely place a significant strain on our resources and increased demands on our management information and reporting systems, financial and management controls and personnel. We may not be able to develop the internal capabilities or collaborative relationships required to manage future growth and expansion or to support future operations. If we are unable to manage growth effectively, our financial results could be adversely affected.

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We depend on key personnel to operate our business, and if we are unable to retain our current personnel and hire additional personnel, our ability to develop and successfully market our products could be harmed.

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering and sales and marketing personnel. The loss of any key employees or the inability to attract or retain qualified personnel, including engineers and sales and marketing personnel, could delay the development and introduction of, and harm our ability to sell, our products and harm the market s perception of us. We believe that our future success is highly dependent on the contributions of our senior management, including our President and Chief Executive Officer and our senior engineering personnel. We do not have long-term employment contracts with these or any other key personnel, and their knowledge of our business and industry would be extremely difficult to replace.

There is currently a shortage of qualified technical personnel with significant experience in the design, development, manufacture, marketing and sales of integrated circuits for use in wireless products. Our key technical personnel and consultants represent a significant asset and serve as the source of our technological and product innovations. We may not be successful in attracting and retaining sufficient numbers of technical personnel to support our business plan.

Equity awards generally comprise a significant portion of our compensation packages for all employees. As a result of the applicability of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123R, and the requirement to expense the fair value of stock options awarded to employees, we have modified and may continue to modify our compensation policies by, for example, increasing cash compensation to certain employees and/or instituting awards of restricted stock units, while simultaneously reducing awards of stock options. For example, our annual stock refresh for employees in 2006 and a portion of the annual stock refresh for executive officers in February 2007, consisted of restricted stock units as equity compensation for our employees and officers. This modification of our compensation policies and the applicability of the SFAS 123R requirement to expense the fair value of stock options awarded to employees and officers would increase our operating expenses. We cannot be certain that any such potential changes in our compensation policies, if enacted, would improve our ability to attract, retain and motivate employees. Our potential inability to attract and retain additional key employees and the increase in stock-based compensation expense could each have an adverse effect on our business, financial condition and results of operations.

If we fail to develop and introduce new products and enhancements for wireless and Ethernet applications or if our proprietary features do not achieve market acceptance on a timely basis, our ability to attract and retain customers could be impaired, and our competitive position may be harmed.

The wireless communications and Ethernet markets are characterized by rapidly changing technology, evolving industry standards, rapid changes in customer requirements and frequent product introductions. We must continually design, develop and introduce new products with improved features to be competitive. Our current and future products may not achieve market acceptance or adequately address the changing needs of the market, and we may not be successful in developing and marketing new products or enhancements to our existing products on a timely basis. The introduction of products embodying new technologies, the emergence of new industry standards or changes in customer requirements could render our existing products obsolete and unmarketable. In addition, we introduce from time to time products with proprietary enhancements. Although we believe our products are fully compliant with applicable industry standards, proprietary enhancements may not in the future result in full conformance with existing industry standards under all circumstances. Our introduction of proprietary features involves risks associated with market acceptance of these new products and certification by industry standards groups. We have reviewed the rules and regulations of the various standards bodies and related industry organizations to which we belong or with which we are affiliated, and we believe there is not a significant risk that action would be taken that would undermine our ability to continue to leverage our affiliation with these organizations.

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The development of our products is highly complex. We occasionally have experienced delays in completing the development and introduction of new products and product enhancements, and we could experience delays in the future. Unanticipated problems in developing wireless products could also divert substantial engineering resources, which may impair our ability to develop new products and enhancements and could substantially increase our costs. Even if the new and enhanced products are introduced to the market, we may not be able to achieve market acceptance of these products and our proprietary features in a timely manner.

We will continue to expend substantial resources developing products for new applications or markets and may never achieve the sales volume that we anticipate for these products, which may limit our future growth and harm our results of operations.

With the exception of our products for the PAS cellular handset market and the Ethernet products of Attansic, all of our products introduced to date have been for use in wireless networking applications. Our strategy includes developing and introducing new products for use in applications other than wireless networking. Our future success will depend in part upon the success of any such products, and we face a number of risks in connection with these products, including those described in other risk factors in this report. We have in the past, and will likely in the future, expend substantial resources in developing new and additional products for new applications and markets. We may experience unforeseen difficulties and delays in developing these products and defects upon volume production and broad deployment. In addition, we have no experience in markets other than wireless networking and PAS, and may be unsuccessful in marketing and selling any products we develop. The markets we choose to enter will likely be highly competitive and many of our competitors will have substantially more experience in these markets. Our success will depend on the growth of the markets we enter, the competitiveness of our products and our ability to increase our market share in these markets. If we choose to enter markets that do not achieve or sustain the growth we anticipate, or if our products are not competitive, we may not achieve volume sales, which may limit our future growth and harm our results of operations.

We derive revenue from the sale of our PAS products in Asia and if this market does not grow or we do not expand our customer base, our future results may be harmed.

We introduced a new product for the PAS cellular handset market and commenced shipments in the second quarter of 2005. Our future success will depend in part upon the continued success of this product, and we face a number of risks in connection with the product, including those described in the risk factors in this report. We recently entered the cellular market and have limited experience in this market, and as such may be unsuccessful in marketing and selling this product. The China PAS cellular market is dominated by a very small number of handset providers and to date we have relied primarily on UTStarcom for sales of our PAS product. If these providers, and in particular UTStarcom, are not successful in this market, or if they do not choose to incorporate our products into a significant number of their handsets, or if our customers do not effectively market the handsets that do incorporate our product, we will not be successful in selling our product. In addition we have no control over UTStarcom s or other providers schedule for launching their products, and these providers may delay launches of products using our PAS product may be delayed from our expectations. Any such delay by our customers would delay revenues for our PAS products and could adversely affect our quarterly operating results. In addition, the China PAS cellular market may stop growing, if it has not already, or may have already stopped growing, and may contract as competing technologies, such as wideband cellular third generation technologies become available. The market for cellular handset semiconductors is highly competitive and many of our competitors have substantially more experience in this market. There are a number of cellular technologies, some of which have technological advantages over PAS, and the market for PAS cellular may not grow or remain a successful technology. If this product is not successful, our future growth would be adversely affected and our future results harmed.

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Our primary PAS customer has trial licenses for PAS handsets in China.

UTStarcom, our primary PAS customer, has trial licenses for PAS systems and handsets and has applied for, but has not yet received, a final official network access license for its PAS systems and handsets, including handsets that include our chipsets. We understand that these PAS systems and handsets are considered to still be in the trial period and that sales of PAS systems and handsets may continue to be made by our customer during this trial period, but that licenses will ultimately be required. If UTStarcom or our other PAS customers fail to obtain the required licenses, or if the trial period ends, they could be prohibited from making further sales of the unlicensed products in China, including PAS handsets that include our chipsets, which would substantially harm our business, financial condition and results of operations. The regulations implementing these requirements have not been applied by a court and may be interpreted and enforced by regulatory authorities in a number of different ways. China s governmental authorities may interpret or apply the regulations with respect to which licenses are required, and with respect to our customers ability to sell a product while a product is in the trial period, in a manner that could have a material adverse effect on our business, financial condition and results of operations.

We recently entered the Gigabit and Fast Ethernet semiconductor market through our acquisition of Attansic, and if we are not successful in this market and if this market does not grow or we do not expand our customer base, our future results may be harmed.

In December 2006, we acquired Attansic Technology Corporation, a supplier of Gigabit and Fast Ethernet semiconductor solutions. Our future success will depend in part upon the success of Attansic s products, and we face a number of risks in connection with these products, including those described in the risk factors in this report. Currently, Asuspower Investments Ltd., or Asuspower, Inc. is our primary customer for our Ethernet products, and we expect that for the near future we will continue to rely primarily on Asuspower for sales of these products. If Asuspower does not choose to incorporate our Ethernet products into a significant number of its products or does not effectively market its products that incorporate our Ethernet products, we will not be successful in selling these products. In addition we have no control over Asuspower s or other providers schedule for launching their products, and launches of products using our Ethernet products may be delayed from our expectations. Any such delay by our customers would delay revenues for our Ethernet products and could adversely affect our quarterly operating results. If we do not add additional customers for our Ethernet products and substantially increase our sales of these products in the future, we will not be successful in this market and our future results will be harmed. The market for Ethernet semiconductors is highly competitive and many of our competitors have substantially more experience in this market. If these products are not successful, our future growth would be adversely affected and our future results harmed.

We face business, political, regulatory, operational, financial and economic risks because most of our operations and sales activities take place outside of the United States.

A significant portion of our products is sold to customers outside the United States and Canada. Sales to customers in Asia have accounted for substantially all of our net revenue since 2003. Because most of our ODMs and our PAS customers are located in Asia, we anticipate that substantially all of our revenue will continue to be represented by sales to customers in that region. In addition, we conduct research and development activities in India, Taiwan and China and have sales, marketing and support personnel in Japan, Taiwan, Korea, Hong Kong, Macao, and China. Following our acquisition of ZyDAS Technology Corporation in Taiwan, and Attansic Technology Corporation in Taiwan and Shanghai, approximately one-half of our total workforce is currently located in Asia and India. Our success depends upon continued expansion of our international operations. Our international business involves a number of risks, including:

- multiple, conflicting and changing laws and regulations, tax laws, export and import restrictions, employment laws, regulatory requirements and other governmental approvals, permits and licenses;

difficulties in staffing and managing foreign operations as well as cultural differences;

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- trade restrictions or higher tariffs that favor local competition in some countries;
- difficulties of managing sales representatives, especially because we expect to increase our sales through our sales representatives;
- inadequate local infrastructure and transportation delays;
- financial risks, such as longer payment cycles, greater difficulty collecting accounts receivable and exposure to foreign currency exchange rate fluctuations;
- failure by us or our customers to gain regulatory approval for use of our products; and
- political and economic instability, including wars, terrorism, and political unrest, recurrence of the SARS, avian flu, or any other outbreak, boycotts, curtailment of trade and other business restrictions.

Any of these factors could significantly harm our future international sales and operations, and consequently, our revenue and results of operations and business and financial condition.

We rely on a limited number of independent foundries and subcontractors for the manufacture, assembly and testing of our chipsets and on a third party logistics provider to ship products to our customers. The failure of any of these third-party vendors to deliver products or otherwise perform as requested could damage our relationships with our customers, decrease our sales and limit our growth.

We do not have our own manufacturing or assembly facilities and have limited in-house testing facilities. Therefore, we must rely on third-party vendors to manufacture, assemble and test the products we design. We primarily rely on Taiwan Semiconductor Manufacturing Corporation in Taiwan, Semiconductor Manufacturing International Corporation in Shanghai, China, Tower Semiconductor Ltd. in Israel and United Microelectronics Corporation in Taiwan to produce our chips. We also rely on Advanced Semiconductor Engineering, Inc. in Taiwan, Amkor Technology, Inc. in China, Taiwan and Korea, ASAT Holdings Limited in China, Global Testing Corporation in Taiwan, Greatek Electronics, Inc. in Taiwan, Sigurd Microelectronics Corp. in Taiwan, Siliconware Precision Industries Co., Ltd. in Taiwan, STATS ChipPAC Limited in Singapore, Test-Serv, Inc. in Taiwan and other third-party assembly and test subcontractors to assemble, package and test our products. In addition, we use JSI Shipping in Hong Kong and Singapore to warehouse and ship our products to our customers. If these vendors do not provide us with high-quality products, services and/or production and test capacity in a timely manner, or if the relationship with one or more of these vendors is terminated, we may be unable to obtain satisfactory replacements and/or we may be unable to fulfill customer orders on a timely basis, our relationships with our customers could suffer, our sales could decrease and our growth could be limited.

We face risks associated with relying on third-party vendors for the manufacture, assembly and testing of our chipsets.

We face significant risks associated with relying on third-party vendors, including:

- capacity shortages;

reduced control over product cost, delivery schedules and product quality;

potential price increases;

inability to achieve sufficient production, increase production or test capacity and achieve acceptable yields on a timely basis;

increased exposure to potential misappropriation of our intellectual property;

shortages of materials that foundries use to manufacture products; and

labor shortages or labor strikes.

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We do not have long-term supply contracts with our third-party manufacturing vendors and they may allocate capacity to other customers and may not allocate sufficient capacity to us to meet future demands for our products.

We currently do not have long-term supply contracts with any of our third-party vendors. Therefore, they are not obligated to perform services or supply products to us for any specific period, in any specific quantities, or at any specific price, except as may be provided in a particular accepted purchase order. None of our third-party foundry or assembly and test vendors has provided contractual assurances to us that adequate capacity will be available to us to meet future demand for our products. During 2006, our manufacturing vendors experienced production capacity constraints due to an upturn in the semiconductor market, and they may do so again in the future. Under these circumstances, these foundries and assembly and test vendors may allocate capacity to the production of other companies products while reducing deliveries to us on short notice. In particular, other customers that are larger and better financed than us or that have long-term agreements with these foundries or assembly and test vendors may cause these foundries or assembly and test vendors to reallocate capacity to those customers, decreasing the capacity available to us. If we enter into costly arrangements with suppliers that include nonrefundable deposits or loans in exchange for capacity commitments, commitments to purchase specified quantities over extended periods or investment in a foundry, our operating results could be harmed. To date, we have not entered into such arrangements with our suppliers. If we need another integrated circuit foundry or assembly and test subcontractor because of increased demand, or the inability to obtain timely and adequate deliveries from our providers, we might not be able to cost-effectively and quickly retain other vendors to satisfy our requirements.

If our third-party foundries or suppliers do not achieve satisfactory yields or quality, our relationships with our customers and our reputation will be harmed.

The fabrication of chipsets is a complex and technically demanding process. Minor deviations in the manufacturing process can cause substantial decreases in yields, and in some cases, cause production to be suspended. Our third-party foundries and suppliers have from time to time experienced manufacturing defects and reduced manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials by our foundries could result in lower than anticipated manufacturing yields or unacceptable performance. Many of these problems are difficult to detect at an early stage of the manufacturing process and may be time consuming and expensive to correct. In addition, designing RF circuits using standard, complementary metal-oxide semiconductor processes is difficult and can result in unsatisfactory yields. Because we primarily purchase wafers, our exposure to low wafer yields from our foundries is increased. Poor yields from our foundries or defects, integration issues or other performance problems in our products could cause us significant customer relations and business reputation problems, or force us to sell our products at lower gross margins and therefore harm our financial results. In addition, manufacturing defects may not be detected by our testing, or may be caused by defective packaging of our products by our third-party suppliers. If these defects arise or are discovered after we have shipped our products, our reputation and business would suffer.

We depend on a small number of customers for a significant portion of our revenue. If we fail to retain or expand customer relationships, our revenue could decline.

We derive a significant portion of our revenue from a small number of customers, and we anticipate that we will continue to do so in the foreseeable future. These customers may decide not to purchase our products at all, to purchase fewer products than they did in the past, for example due to an increase in inventory, or to alter their purchasing patterns in some other way, particularly because substantially all of our sales are made on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with little or no notice to us and without penalty.

In the year ended December 31, 2006, Hon-Hai Precision Industry Co. Ltd. and UTStarcom, Inc accounted for 20% and 10% of our net revenue, respectively. In the year ended December 31, 2005, Alpha Networks, Inc., Hon-Hai Precision Industry Co. Ltd., Cameo Communications, Inc., and Askey Computer Corporation accounted

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for 15%, 15%, 13% and 10% of our net revenue, respectively. In 2004, Hon-Hai Precision Industry Co. Ltd., Askey Computer Corporation, Cameo Communications, Inc. and Alpha Networks, Inc. accounted for 23%, 17%, 12% and 10% of our net revenue, respectively.

Some of our OEM customers are also original design manufacturer customers, which may increase the impact of the loss of any customer. We must obtain orders from new customers on an ongoing basis to increase our revenue and grow our business. Our largest customers are typically ODMs. Sales to our largest customers have fluctuated significantly from period to period primarily due to OEMs that incorporate our products changing their designated ODM and the continued diversification of our OEM customer base in our current markets. We believe that sales will likely continue to fluctuate significantly in the future as we enter into new markets. The loss of any significant customer, a significant reduction in sales we make to them, or any problems collecting receivables from them would likely harm our financial condition and results of operations.

We will have difficulty selling our products if customers do not design our products into their product offerings or if our customers product offerings are not commercially successful.

We sell our products directly to OEMs, who include our chipsets in their products, and to ODMs, who include our chipsets in the products they supply to OEMs. Our products are generally incorporated into our customers products at the design stage. As a result, we rely on OEMs to design our products into the products they sell. Without these design wins, our business would be materially and adversely affected. We often incur significant expenditures on the development of a new product without any assurance that an OEM will select our product for design into its own product. Once an OEM designs a competitor s product into its product offering, it becomes significantly more difficult for us to sell our products to that customer because changing suppliers involves significant cost, time, effort and risk for the customer. Furthermore, even if an OEM designs one of our products into its product offering, we cannot be assured that its product will be commercially successful, that we will receive any revenue from that manufacturer or that a successor design will include one of our products.

We may experience difficulties in transitioning to smaller geometry process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries and increased expenses.

To remain competitive, we continually work to improve our chipsets and, in particular, our high-performance RF products, to be manufactured using increasingly smaller geometries and to achieve higher levels of design integration. These ongoing efforts are costly and difficult and require us from time to time to modify the manufacturing processes for our products and to redesign some products. To remain competitive, our chipsets must be redesigned from time to time, which may result in delays in product deliveries. We periodically evaluate the benefits, on a product-by-product basis, of migrating to smaller geometry process technologies to reduce our costs. In the past, we have experienced some difficulties in shifting to smaller geometry process technologies or new manufacturing processes, which resulted in reduced manufacturing yields, delays in product deliveries and increased expenses. In addition, while we purchase wafers from foundries, we also assume most of the yield risk related to manufacturing these wafers into die. We may face similar difficulties, delays and expenses in the future. We depend on our relationships with our foundries to transition to smaller geometry processes successfully and cannot assure that our foundries will be able to effectively manage the transition. If our foundries, or we, experience significant delays in this transition or fail to efficiently implement these transitions, our business, financial condition and results of operations could be adversely affected.

The complexity of our products could result in unforeseen delays or expenses from undetected defects, errors or bugs in hardware or software, which could reduce the market acceptance for our new products, damage our reputation with current or prospective customers and adversely affect our operating costs.

Highly complex products such as our chipsets and the related reference designs we provide to our customers frequently contain defects, errors and bugs when they are first introduced or as new versions are released. We

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have in the past and may in the future experience these defects, errors and bugs. If any of our products have reliability, quality, or compatibility problems, we may not be able to successfully correct these problems. In addition, if any of our proprietary features contain defects, errors or bugs when first introduced or as new versions are released, we may be unable to correct these problems. Consequently, our reputation may be damaged and customers may be reluctant to buy our products, which could harm our ability to retain existing customers and attract new customers and our financial results. In addition, these defects, errors or bugs could interrupt or delay sales to our customers. If any of these problems are not found until after we have commenced commercial production of a new product, we may be required to incur additional development costs and product recalls, repairs or replacement costs. These problems may also result in claims against us by our customers or others.

Because we do not have long-term commitments from our customers, we must estimate customer demand, and errors in our estimates can have negative effects on our inventory levels, sales and operating results.

Our sales are largely made on the basis of individual purchase orders rather than long-term purchase commitments. Our customers have the right to cancel or defer some purchase orders. We have experienced in the past cancellations or deferrals of purchase orders, and additional cancellations and deferrals may occur from time to time. We have historically placed firm orders for products with our foundries up to approximately 16 weeks prior to the anticipated delivery date and typically prior to receiving an order for the product. Therefore, our order volumes are based on our forecasts of demand from our customers. This process requires us to make multiple demand forecast assumptions, each of which may introduce error into our estimates. If we overestimate customer demand or incorrectly estimate product mix, we may allocate resources to manufacturing products that we may not be able to sell when we expect or at all. As a result, we would have excess inventory, which would harm our financial results. Conversely, if we underestimate customer demand or if insufficient manufacturing capacity is available, we would forego revenue opportunities, lose market share and damage our customer relationships. On occasion, we have been unable to adequately respond to increases in customer purchase orders, and therefore, were unable to complete, or needed to delay, sales. We have in the past, and may in the future, allocate our supply among our customers. Product allocation may result in the loss of current customers, and if we are unable to commit to provide specified quantities of products over a given period of time, we will not attract new customers. The failure to maintain customer relationships would decrease our revenue and harm our business.

Although we achieved profitability in the last three fiscal years, we may not sustain or increase profitability in the future.

At December 31, 2006, we had an accumulated deficit of approximately $38.4 million. During 2006, we incurred $125.9 million in operating expenses and generated net income of $18.7 million. During 2005, we incurred $75.5 million in operating expenses and generated net income of $16.7 million. During 2004, we incurred $68.4 million in operating expenses and generated net income of $10.8 million. We did, however, incur a net loss in the fourth quarter of 2006 and the second quarter of 2005 and may incur losses in the future. To sustain profitability, we will need to maintain or increase our revenue while maintaining reasonable cost and expense levels. In addition, since we expect average selling prices of our products to continue to decrease in the future, we will need to continue to reduce the average unit costs of our products and increase sales volumes in our existing markets as well as successfully introduce additional products for new markets in order to maintain profitability. We expect to increase expense levels in absolute dollars in each of the next several quarters to support increased research and development efforts related to new and existing product development and sales and marketing efforts. Because many of our expenses are fixed in the short term, or are incurred in advance of anticipated sales, we may not be able to decrease our expenses in a timely manner to offset any shortfall of sales. We may not be able to sustain or increase profitability on a quarterly or an annual basis. If we do not sustain or increase profitability or otherwise meet the expectations of securities analysts or investors, the market price of our common stock will likely decline.

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Changes to financial accounting standards may affect our results of operations and could cause us to change our business practices.

We prepare our financial statements to conform with generally accepted accounting principles, or GAAP, in the United States. These accounting principles are subject to interpretation by the American Institute of Certified Public Accountants, the Securities and Exchange Commission and various bodies formed to interpret and create appropriate accounting rules and regulations. A change in those accounting rules can have a significant effect on our reported results and may affect our reporting of transactions completed before a change is announced. Changes to those rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business. For example, in December 2004, the Financial Accounting Standards Board issued SFAS No. 123R which has required us, starting in our first quarter of 2006, to record a charge to earnings for employee stock option grants and other equity incentives. Since we historically used equity-related compensation as a component of our total employee compensation program, the accounting change could make the use of equity-related compensation less attractive to us and therefore make it more difficult to attract and retain employees. However, because we believe that providing equity-related compensation for our employees is a competitive necessity, we will likely incur significant and ongoing accounting charges resulting from option grants and other equity incentive expensing that could adversely affect our overall results of operations. Moreover, we have implemented the requirements of SFAS No. 123R using the modified prospective method and accordingly we have not restated prior period financial statements to reflect the historical impact of option grants. This may potentially cause readers of our financial statements to draw incorrect conclusions regarding our future operating performance since our financial statements going forward, which will reflect stock-based compensation expense, will not be comparable to our prior period financial statements that exclude stock-based compensation expense.

Similarly, In July 2006, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* , or FIN 48, which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. The provisions of FIN 48 are effective for us in the first quarter of 2007. We are currently evaluating the impact that the adoption of FIN 48 will have on our consolidated financial statements. This may potentially cause readers of our financial statements to draw incorrect conclusions regarding our future operating performance since our financial statements going forward, which will reflect the provisions of FIN 48, may not be comparable to our prior period financial statements that exclude its application.

Unanticipated changes in our tax rates could affect our future results.

Our future effective tax rate could be unfavorably affected by unanticipated changes in the valuation of our deferred tax assets and liabilities. In addition, since we operate in different countries and are subject to taxation in different jurisdictions, our future effective tax rates could be impacted by changes in such countries tax laws or their interpretations. Both domestic and international tax laws are subject to change as a result of changes in fiscal policy, changes in legislation, evolution of regulation and court rulings. The application of these tax laws and related regulations is subject to legal and factual interpretation, judgment and uncertainty. Changes in our effective tax rate could have a material adverse impact on our results of operations.

We record a valuation allowance to reduce our net deferred tax assets to the amount that we believe is more likely than not to be realized. In assessing the need for a valuation allowance, we consider historical levels of income, expectations and risks associated with estimates of future taxable income and ongoing prudent and practical tax planning strategies. On a periodic basis we evaluate our deferred tax asset balance for realizability. To the extent we believe it is more likely than not that some portion of our deferred tax assets will not be realized, we will increase the valuation allowance against the deferred tax assets. Realization of our deferred tax assets is dependent primarily upon future U.S. taxable income. During the years ended December 31, 2006 and 2005, we released a portion of the valuation allowance in the amount of $1.9 million and $7.5 million, respectively, previously recorded against our deferred tax assets. These releases resulted in reduced tax

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provisions in the years recorded. We may have additional releases or increases to our valuation allowance. This may potentially cause readers of our financial statements to draw incorrect conclusions regarding our future profitability, since these movements in the valuation allowance are infrequent and are non-cash items.

We intend to evaluate acquisitions of or investments in businesses, and we may not realize the anticipated benefits of these acquisitions or investments.

We plan to continually evaluate acquisitions of or investments in businesses that may offer complementary products and technologies, augment our market segment coverage, or enhance our technological capabilities, if appropriate opportunities arise. For example, during the second half of 2006, we completed the acquisition of ZyDAS Technology Corporation, a privately held Taiwan-based fabless wireless IC design company, and Attansic Technology Corporation, a privately held Taiwan-based fabless Ethernet IC design company. Risks arising from these or other future acquisitions or investments could include among other things:

our ability to accurately assessed the business and prospects of an acquisition or the anticipated benefits of an acquisition;

delays in or failure to complete the development and application of the acquired technology or products;

our ability to successfully integrate acquired technologies, operations and personnel,;

failure to achieve projected results of the acquisition;

disruption of our ongoing business;

diversion of management and employees attention from our business;

risks associated with entering into a geographic region or business market in which we have little or no prior experience and specifically managing personnel in these regions;

difficulties in establishing and maintaining uniform standards, controls, policies and procedures;

deficiencies in the internal control of any acquired company could result in a material weakness in our overall internal control;

our ability to recover costs of the acquisition or investment;

amortization expenses or impairment charges related to goodwill or other intangible assets;

negative impact on our relationships with customers, suppliers or contractors;

loss of key employees of acquired business; and

potentially dilutive issuance of equity securities.

Future acquisitions could result in accounting charges, the incurrence of debt or contingent liabilities, adverse tax consequences, deferred compensation charges, dilution to future earnings and amortization of amounts related to deferred compensation and certain purchased intangible assets and large and immediate write-offs, any of which could negatively impact our results of operations and could cause our stock price to decline. We may be unable to identify suitable acquisition candidates or investment opportunities or that we will be able to consummate any such transactions on terms and conditions that are acceptable to us, if at all. We may not realize the anticipated benefits of any acquisition or investment.

If we fail to secure or protect our intellectual property rights, competitors may be able to use our technologies, which could weaken our competitive position, reduce our revenue or increase our costs.

We rely on a combination of patent, copyright, trademark and trade secret laws, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights. Our pending patent applications may not result in issued patents, and our existing and future patents may not be sufficiently broad to protect our

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proprietary technologies or may be held invalid or unenforceable in court. Policing unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent the misappropriation or unauthorized use of our technologies, particularly in foreign countries where the laws may not protect our proprietary rights as fully as United States law. Any patents we have obtained, or may obtain in the future, may not be adequate to protect our proprietary rights. Our competitors may independently develop or may have already developed similar technology, duplicate our products or design around any patents issued to us or other intellectual property rights. In addition, we may be required to license our patents as a result of our participation in various standards organizations.

Because we license some of our software source code directly to customers, we face increased risks that our trade secrets will be exposed through inadvertent or intentional disclosure, which could harm our competitive position or increase our costs.

We license some of our software source code to our customers, which increases the number of people who have access to some of our trade secrets and other proprietary rights. Contractual obligations of our licensees and their sublicensees not to disclose or misuse our source code may not be sufficient to protect us from disclosure or misuse. The costs of enforcing contractual rights could substantially increase our operating costs and may not ultimately succeed in protecting our proprietary rights. If our competitors access our source code, they may gain further insight into the technology and design of our products, which would harm our competitive position.

Intellectual property litigation, which is common in our industry, could be costly, harm our reputation, limit our ability to license or sell our proprietary technologies or products and divert the attention of management and technical personnel.

The wireless and Ethernet communications markets are characterized by frequent litigation regarding patent and other intellectual property rights. In the last few years, we have received several written notices or offers from our competitors and others claiming to have patent and other intellectual property rights in certain technology and inviting us to license this technology and related patents that apply to the IEEE family of wireless local area networking standards, including the 802.11a, 802.11b, 802.11e, 802.11g and 802.11n wireless standards as well as other technology and patents relevant to our chips, software and system solutions. These notices or offers have been made directly to us and through our U.S. and foreign customers. We have certain indemnification obligations to customers with respect to any infringement of third-party patents and intellectual property rights by our products. We have responded, or are in the process of responding, directly, or indirectly through our customers, to all of these notices, and continue to correspond regarding the offers with some of the parties that have sent the notices. While at least two of our customers have been sued in the U.S. by the holders of patents related to 802.11a, 802.11b and 802.11g technology, neither that litigation nor any of these notices or offers to license has to date resulted in litigation directly against us. Questions of infringement and misappropriation in our markets involve highly technical and subjective analyses. Litigation may be necessary in the future to enforce any patents we may receive and other 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 misappropriation, and we may not prevail in any future litigation. If litigation were to be filed against us in connection with an offer to license technology or claims of infringement, our business could be harmed. Litigation, whether or not determined in our favor or settled, could be costly, could harm our reputation and could divert the efforts and attention of our management and technical personnel from normal business operations. In addition, adverse determinations in litigation could result in the loss of our proprietary rights, subject us to significant liabilities, and require us to seek licenses from third parties or prevent us from licensing our technology or selling our products, any of which could seriously harm our business. Any of these consequences could result from litigation whether initiated by our competitors or others, including those that have already sent notices or offers to us and our customers claiming patent rights and offering licenses.

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Any potential dispute involving our patents or other intellectual property could also include our industry partners and customers, which could trigger our indemnification obligations to them and result in substantial expense to us.

In any potential dispute involving our patents or other intellectual property, our customers or licensees could also become the target of litigation, and certain customers have received notices of written offers from our competitors and others claiming to have patent rights in certain technology and inviting our customers to license this technology. At least two of our customers have been sued in the U.S. for allegedly infringing patents related to 802.11a, 802.11b and 802.11g technology. Because we indemnify our customers for intellectual property claims made against them for products incorporating our technology, any litigation could trigger technical support and indemnification obligations in some of our license or sales agreements, which could result in substantial expenses. In addition to the time and expense required for us to supply support or indemnification to our customers, any such litigation could severely disrupt or shut down the business of our customers, which in turn could hurt our relations with our customers and cause the sale of our proprietary technologies and products to decrease.

Our headquarters are located in California, and we have sales offices in Japan and elsewhere in Asia, and research and development facilities in India, Taiwan and China. Our third-party foundries and subcontractors are concentrated in Asia and elsewhere in the Pacific Rim. These areas are subject to significant weather and earthquake-related risks. Any disruption to the operations of these offices, foundries and subcontractors resulting from typhoons, earthquakes or other natural disasters could cause significant delays in the production, shipment and sales of our products.

TSMC, SMIC and UMC, which manufacture our chipsets and subcontractors which perform substantially all of our assembly and testing are located in Asia. In addition, our headquarters are located in Northern California, and we have sales offices in Japan, Taiwan, Hong Kong, China and elsewhere in Asia, and research and development facilities in India, Taiwan and China and administrative offices in Macao. These areas are subject to typhoons, and the risk of an earthquake or an earthquake-related disaster such as a tsunami in the Pacific Rim region or the Indian Ocean region, including Asia and Northern California, is significant due to the proximity of major earthquake fault lines. In the past, major earthquakes in Taiwan have disrupted the facilities of several of these third-party contractors, as well as other providers of these services, and impaired their production capacity. In addition, a tsunami in December 2004 caused widespread destruction and disruption of business in India and throughout the Indian Ocean coastal region. The occurrence of additional earthquakes or other natural disasters could result in the disruption of our foundry, assembly and test capacity or research and development efforts, or our ability to market and sell our products. We may not be able to obtain alternate capacity on favorable terms, if at all and our research and development efforts could be slowed.

We rely upon third parties for technology that is integrated into some of our products, and if we are unable to continue to use this technology and future technology or the technology fails to operate, our ability to sell technologically advanced products would be limited.

We rely on third parties for technology that is integrated into some of our products. If we are unable to continue to use or license on reasonable terms third-party technologies used in some of our products or the technology fails to operate, we may not be able to secure alternatives in a timely manner and our business would be harmed.

If our internal control over financial reporting does not comply with the requirements of the Sarbanes-Oxley Act, investor perceptions of our company may be adversely affected and could cause a decline in the market price of our stock.

Section 404 of the Sarbanes-Oxley Act of 2002 requires our management to report on, and our independent auditors to attest to, the effectiveness of our internal control structure and procedures for financial reporting. We have an ongoing program to perform the system and process evaluation and testing necessary to comply with

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these requirements. We have incurred and expect to continue to incur significant expense and to devote significant management resources to Section 404 compliance. In the event that our chief executive officer, chief financial officer, chief accounting officer, or independent registered public accounting firm determine that our internal control over financial reporting is not effective as defined under Section 404, investor perceptions of our company may be adversely affected and could cause a decline in the market price of our stock.

Changes in current laws or regulations or the imposition of new laws or regulations could impede the sale of our products or otherwise harm our business.

Wireless networks can only operate in the frequency bands, or spectrum, allowed by regulators and in accordance with rules governing how the spectrum can be used. The Federal Communications Commission, or the FCC, in the United States, as well as regulators in foreign countries, have broad jurisdiction over the allocation of frequency bands for wireless networks. We therefore rely on the FCC and international regulators to provide sufficient spectrum and usage rules. For example, countries such as China, Japan or Korea heavily regulate all aspects of their wireless communications industries, and may restrict spectrum allocation or usage, or may impose requirements that render our products or our customers products unmarketable in these jurisdictions. If this were to occur, it would make it difficult for us to sell our products in that region. In addition, some of our chipsets operate in the 5 GHz band, which is also used by government and commercial services such as military and commercial aviation. The FCC and European regulators have traditionally protected government uses of the 5 GHz bands by setting power limits and indoor and outdoor designation and requiring that wireless local area networking devices not interfere with other users of the band such as government and civilian satellite services. Changes in current laws or regulations, reversal of usage rights, or the imposition of new laws and regulations in the United States or elsewhere regarding the allocation and usage of the 5 GHz band on us, our customers or the industries in which we operate may materially and adversely impact the sale of our products and our business, financial condition and results of operations.

Rapidly changing standards could make our products obsolete, which would cause our operating results to suffer.

We design some of our products to conform to standards set by industry standards bodies such as the Institute of Electrical and Electronics Engineers, Inc. We also depend on industry groups such as the WiFi Alliance to certify and maintain certification of our products. If our customers adopt new or competing industry standards with which our products are not compatible, or such industry groups fail to adopt standards with which our products are compatible, our existing products would become less desirable to our customers and our sales would suffer. The emergence of markets for our chipsets is affected by a variety of factors beyond our control. In particular, our products are designed to conform to current specific industry standards. Competing standards may emerge that are preferred by our customers, which could also reduce our sales and require us to make significant expenditures to develop new products. For example, the IEEE has adopted a draft 802.11n specification after considering many different proposals for the 802.11n standard and we have developed products based on this draft specification. If the IEEE does not adopt the current draft 802.11n standard or if we are unable to complete development of compliant products based on the draft or final specifications on a timely basis, we will lose customers and revenue and our business will be harmed.

If our customers or the industries using wireless technology prefer to integrate wireless capability into other products, we may not be able to compete effectively, we will lose customers, our revenue will decline and our business will be harmed.

We have adopted the strategy of maintaining wireless technology on a chipset that is separate from functionality contained on other chips within a product. Our customers or the industries using wireless technology may prefer to integrate wireless capability into other products such as DSL modems, or determine that an integrated chip with multiple functionality results in products that perform better or are less expensive or more efficient to manufacture. If wireless functionality becomes commonly integrated with other functionality,

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the market for our products may decline. Consequently, we may miss product cycles in order to redesign our products, and we may not be able to forge strategic relationships necessary in order to design and arrange for the production of chips that include multiple functionality. If we miss product cycles, we will lose customers, our revenue will decline and our business will be harmed.

The proliferation of wireless devices may expand beyond the capacity of the channels available in the 2.4GHz or 5 GHz bands, which may overload the networks and result in decreased market demand for our products.

Wireless networks currently operate in the 2.4 GHz or 5 GHz bands, within which there are a limited number of channels available for use. The increasing number of wireless devices and networks may overburden the frequency bands and overload the networks. Recent studies have predicted that congestion in the 2.4 GHz band could result from the increasing number of wireless devices using that band with limited channel availability. If this occurs, our customers or the industries in which we operate may be adversely affected because the networks become inoperable or because only a limited number of devices will be able to access the networks. In turn, we may experience a decrease in market demand for our products that would adversely impact our business and results of operations.

We may experience a decrease in market demand or a supply disruption due to uncertain economic conditions in the United States and in international market, including as a result of the concerns of terrorism, war and social and political instability.

Terrorist attacks in the United States and elsewhere, the continued presence of United States military forces in Iraq, and turmoil in the Middle East have contributed to the uncertainty in the United States and global economy and may lead to a decline in economic conditions, both domestically and internationally. Further terrorist acts, or other conflicts or wars, or a recession, or general economic slowdown in the U.S. or globally, could cause a slowdown of the market demand for goods and services, including demand for our products, and could harm our operating results. Terrorist acts or other conflicts or acts of war could disrupt product supply from our vendors in Israel, which could undermine our ability to provide products to our customers and harm our operating results.

Because the NASDAQ Global Select Market is likely to continue to experience extreme price and volume fluctuations, the price of our stock may decline.

Since we completed our initial public offering in February 2004, the market price of our shares has been and likely will continue to be highly volatile and could be subject to wide fluctuations in response to numerous factors, including the following:

- actual or anticipated variations in our quarterly operating results or those of our competitors;
- announcements by us or our competitors of new products or technological innovations;
- introduction and adoption of new industry standards;
- changes in financial estimates or recommendations by securities analysts;

changes in the market valuations of our competitors;

announcements by us or our competitors of significant acquisitions or partnerships; and

sales of our common stock.

Many of these factors are beyond our control and may negatively impact the market price of our common stock, regardless of our performance. In addition, the stock market in general, and the market for technology and semiconductor companies in particular, have been highly volatile. Our common stock may not trade at the same levels of shares as that of other semiconductor and technology companies, and shares of semiconductor and

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technology companies, in general, may not sustain their current market prices. In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. We may be the target of similar litigation in the future. Securities litigation could result in substantial costs and divert management s attention and resources, which could seriously harm our business and operating results.

Our ability to raise capital in the future may be limited and our failure to raise capital when needed could prevent us from executing our growth strategy.

We believe that our existing cash and cash equivalents and existing amounts available under our revolving credit facility will be sufficient to meet our anticipated cash needs for at least the next 12 months. The timing and amount of our working capital and capital expenditure requirements may vary significantly depending on numerous factors, including:

market acceptance of our products;

the need to adapt to changing technologies and technical requirements;

the existence of opportunities for expansion; and

access to and availability of sufficient management, technical, marketing and financial personnel.

If our capital resources are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity securities or debt securities or obtain debt financing. The sale of additional equity securities or convertible debt securities would result in additional dilution to our stockholders. Additional debt would result in increased expenses and could result in covenants that would restrict our operations. We have not made arrangements to obtain additional financing and there is no assurance that financing, if required, will be available in amounts or on terms acceptable to us, if at all.

Delaware law and our corporate charter and bylaws contain anti-takeover provisions that could delay or discourage takeover attempts that stockholders may consider favorable.

Provisions in our certificate of incorporation may have the effect of delaying or preventing a change of control or changes in our management. These provisions include the following:

the right of the board of directors to elect a director to fill a vacancy created by the expansion of the board of directors;

the establishment of a classified board of directors requiring that not all members of the board be elected at one time;

the prohibition of cumulative voting in the election of directors which would otherwise allow less than a majority of stockholders to elect director candidates;

the requirement for advance notice for nominations for election to the board of directors or for proposing matters that can be acted upon at a stockholders meeting;

the ability of the board of directors to alter our bylaws without obtaining stockholder approval;

the ability of the board of directors to issue, without stockholder approval, up to 10,000,000 shares of preferred stock with terms set by the board of directors, which rights could be senior to those of common stock;

the required approval of holders of at least two-thirds of the shares entitled to vote at an election of directors to adopt, amend or repeal our bylaws or amend or repeal the provisions of our certificate of incorporation regarding the election and removal of directors and the ability of stockholders to take action;

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the required approval of holders of at least two-thirds of the shares entitled to vote at an election of directors to remove directors for cause; and

the elimination of the right of stockholders to call a special meeting of stockholders and to take action by written consent.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding voting stock, from merging or combining with us. These provisions in our certificate of incorporation, bylaws and under Delaware law could discourage potential takeover attempts and could reduce the price that investors might be willing to pay for shares of our common stock in the future and result in the market price being lower than they would without these provisions.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our corporate headquarters and primary research and development and operations facilities occupy approximately 87,329 square feet in Santa Clara, California under a lease that commenced in July 2005 and expires in July 2010. We have the option to extend the lease beyond the initial term for two periods of three years each and the option to early terminate in the fortieth month of the lease term. We lease additional properties around the world and within the facilities of certain customers and suppliers for use as research and development facilities, sales and support offices, warehouses and logistics centers and test facilities. The size and location of these properties change from time to time based on business requirements. We do not own any manufacturing facilities, and we contract and license to third parties the production and distribution of our chipsets, hardware and software. Our international sales and support offices are in locations within the countries and administrative regions of China, Hong Kong, Japan, Korea and Taiwan, and we have research and development facilities in Hsinchu, Taiwan, Chennai, India and Shanghai, China and an administrative center in Macao. While we believe our facilities are adequate to meet our immediate needs, it will likely become necessary to lease or acquire additional or alternative space in the current year to accommodate future growth.

Item 3. ***Legal Proceedings***

We are not involved in any material pending legal proceedings. Many companies in the semiconductor, networking, software and related industries have a significant number of patents and have demonstrated a willingness to instigate litigation based on allegations of patent, trademark and other claims of infringement. From time to time, we have received, and expect to continue to receive, notices of claims of infringement, misappropriation or misuse of other parties proprietary rights and claims for indemnification from our customers with respect to infringement of third-party intellectual property rights by our products. Some of these claims may lead to litigation.

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

No matters were submitted to a vote of security holders during the quarter ended December 31, 2006.

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PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Market Information

Our shares of common stock are traded on the NASDAQ Global Select Market under the symbol ATHR. The following table shows, for the periods indicated, the high and low intra-day sale prices for our common stock on the NASDAQ Global Select Market.

	Year ended December 31, 2004	
	High	**Low**
First Quarter (from February 12, 2004)	$ 19.48	$ 16.11
Second Quarter	$ 17.48	$ 9.49
Third Quarter	$ 11.03	$ 6.24
Fourth Quarter	$ 12.40	$ 8.60

	Year ended December 31, 2005	
	High	**Low**
First Quarter	$ 14.00	$ 8.85
Second Quarter	$ 10.42	$ 6.65
Third Quarter	$ 11.15	$ 7.83
Fourth Quarter	$ 13.40	$ 8.18

	Year ended December 31, 2006	
	High	**Low**
First Quarter	$ 27.45	$ 12.50
Second Quarter	$ 28.80	$ 17.90
Third Quarter	$ 19.28	$ 14.18
Fourth Quarter	$ 24.95	$ 17.01

As of February 23, 2007, the number of record holders of our common stock was 91. Because most of our shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of beneficial stockholders represented by these record holders.

Dividends

We have never declared or paid a cash dividend on our common stock and do not anticipate paying any cash dividends in the foreseeable future. Any future determination with respect to the declaration and payment of dividends will be at the discretion of our Board of Directors. In addition, we currently maintain a revolving credit facility that prohibits the payment of dividends without prior written consent of the bank.

Securities Authorized for Issuance under Equity Compensation Plans

Information regarding the securities authorized for issuance under our equity compensation plans can be found under Item 12 of this Annual Report on Form 10-K.

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Stock Performance Graph

The graph below compares the cumulative total stockholder return on our common stock with the cumulative total return on The NASDAQ Composite Index, the RDG Semiconductor Composite Index and the Philadelphia Semiconductor Index. The period shown commences on February 12, 2004, the date of our initial public offering, and ends on December 31, 2006, the end of our last fiscal year. The graph assumes an investment of $100 on February 12, 2004, and the reinvestment of any dividends.

The comparisons in the graph below are required by the Securities and Exchange Commission and are not intended to forecast or be indicative of possible future performance of our common stock.

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Item 6. ***Selected Financial Data***

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes to the consolidated financial statements and "Management s Discussion and Analysis of Financial Condition and Results of Operations," which are included elsewhere in this report.

	Year Ended December 31,				
In thousands, except per share data	**2006**	**2005**	**2004**	**2003**	**2002**
Consolidated Statements of Operations Data:					
Net revenue	$ 301,691	$ 183,485	$ 169,607	$ 87,357	$ 22,200
Cost of goods sold(1)	157,918	102,483	91,574	50,728	10,170
Gross profit	143,773	81,002	78,033	36,629	12,030
Operating expenses:					
Research and development(1)	71,084	47,788	42,704	30,673	23,389
Sales and marketing(1)	27,189	17,358	15,825	11,759	7,551
General and administrative(1)	15,315				