

SYNAPTICS INC  
Form 10-K  
August 24, 2009

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K  
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Fiscal Year Ended June 30, 2009  
Commission File Number 000-49602  
SYNAPTICS INCORPORATED**

(Exact name of registrant as specified in its charter)

Delaware	77-0118518
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3120 Scott Blvd. Santa Clara, California	95054
(Address of principal executive offices)	(Zip Code)
(408) 454-5100	

Registrant's telephone number, including area code  
**Securities registered pursuant to section 12(b) of the Act:**

Title of each class	Name of each exchange on which registered
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Common Stock, par value \$.001 per share	The Nasdaq Global Select Market
Preferred Stock Purchase Rights	The Nasdaq Global Select Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ 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 ☒

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 ☒ No ☐

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

Indicate by check mark 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 this Form 10-K. ☒

## Edgar Filing: SYNAPTICS INC - Form 10-K

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☐

The aggregate market value of Common Stock held by nonaffiliates of the registrant (28,377,263 shares), based on the closing price of the registrant's Common Stock as reported on the Nasdaq Global Select Market on December 26, 2008 of \$14.66, was \$416,010,676. For purposes of this computation, all officers, directors, and 10% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed to be an admission that such officers, directors, or 10% beneficial owners are, in fact, affiliates of the registrant.

As of August 15, 2009, there were outstanding 33,937,192 shares of the registrant's Common Stock, par value \$.001 per share.

### Documents Incorporated by Reference

Portions of the registrant's definitive Proxy Statement for the 2009 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

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**SYNAPTICS INCORPORATED**  
**ANNUAL REPORT ON FORM 10-K**  
**FISCAL YEAR ENDED JUNE 30, 2009**  
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**Statement Regarding Forward-Looking Statements**

*The statements contained in this report on Form 10-K that are not purely historical are forward-looking statements within the meaning of applicable securities laws. Forward-looking statements include statements regarding our expectations, anticipation, intentions, beliefs, or strategies regarding the future, whether or not those words are used. Forward-looking statements also include statements regarding revenue, margins, expenses, and earnings analysis for fiscal 2010 and thereafter; technological innovations; products or product development, including their performance, market position, and potential; our product development strategies; competitive factors; potential acquisitions or strategic alliances; the success of particular product or marketing programs; the amounts of revenue generated as a result of sales to significant customers; and liquidity and anticipated cash needs and availability. All forward-looking statements included in this report are based on information available to us as of the filing date of this report, and we assume no obligation to update any such forward-looking statements. Our actual results could differ materially from the forward-looking statements. Among the factors that could cause actual results to differ materially are the factors discussed in Item 1A. Risk Factors.*

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**PART I**

**ITEM 1. BUSINESS**

**Overview**

We are a leading worldwide developer and supplier of custom-designed human interface solutions that enable people to interact more easily and intuitively with a wide variety of mobile computing, communications, entertainment, and other electronic devices. We currently target the personal computer, or PC, market and the market for digital lifestyle products, including mobile smartphones and feature phones, portable digital music and video players, and other select electronic device markets with our customized human interface solutions.

We are a market leader in providing human interface solutions to our target markets. Our original equipment manufacturer, or OEM, customers include most of the tier one PC OEMs and many of the world's largest OEMs for mobile smartphones and feature phones and portable digital music players. We generally supply custom designed human interface solutions to our OEM customers through their contract manufacturers, which take delivery of our products and pay us directly for them. Through our OneTouch offering, we offer not only our custom module solutions but also enable our customers to access our technologies to develop their own human interface designs for capacitive button and scrolling applications for products such as mobile smartphones and feature phones, portable digital music and video players, and notebook peripherals.

Our website is [www.synaptics.com](http://www.synaptics.com). Through our website, we make available free of charge all of our Securities and Exchange Commission, or SEC, filings, including our annual reports on Form 10-K, our proxy statements, our quarterly reports on Form 10-Q, and our current reports on Form 8-K as well as Form 3, Form 4, and Form 5 Reports for our directors, officers, and principal stockholders, together with amendments to those reports filed or furnished pursuant to Section 13(a), 15(d), or 16 under the Securities Exchange Act. These reports are available immediately after their electronic filing with the SEC. The website also includes corporate governance information, including our Code of Conduct, our Code of Ethics for the CEO and Senior Financial Officers, and our Board Committee Charters.

Our fiscal year is the 52- or 53-week period ending on the last Saturday in June. For ease of presentation, each fiscal year referenced in this Form 10-K has been shown as ending on June 30.

*PC Market*

We provide custom human interface solutions for navigation, cursor control, and multimedia controls for many of the world's premier PC OEMs. In addition to notebooks, other PC applications for our technology include peripherals, such as keyboards, mice, and monitors, as well as desktop and PC remote control applications. Our solutions for the PC market include the TouchPad, a touch-sensitive pad that senses the position and movement of a person's finger on its surface; the TouchStyk, a self contained, easily integrated pointing stick module; and dual pointing solutions, which combine both a TouchPad and a pointing stick into a single notebook computer, enabling users to use the interface of their choice.

The latest industry projections for notebook unit growth for the period 2009-2013 show a compound annual growth rate of 18% compared with 1% for desktop computers, reflecting the continued migration of desktops to notebooks fueled by users' desire for mobile computing and on-the-go access to applications, information, and digital content, which is expanding on a daily basis. Within the notebook market, mini notebooks designed primarily for wireless communications and access to the internet, or netbooks, are expected to grow 128% in calendar 2009 over 2008 and are expected to account for 17% of the overall notebook market for calendar 2009. Based on the strength of our technology and engineering know-how, we believe we are well positioned to take advantage of the growth opportunity in the notebook market and to provide innovative, value-added human interface solutions for each of the key end-user preferences, which will be enhanced by the adoption of multifunction touch pads, including additional functionality, such as multi-touch gesture recognition. We also believe we are well positioned within the netbook market as our notebook product lines of touch pads and pointing sticks allow us to address 100% of the notebook market.

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### *Digital Lifestyle Product Markets*

We believe our intellectual property portfolio, our experience in providing human interface solutions to major OEMs of electronic devices, and our proven track record of growth in our expanding core notebook computer interface business position us to be a key technological enabler for multiple consumer electronic devices targeted to meet the growing digital lifestyle trend. Based on these strengths, we are addressing the opportunities created by the growth of mobile computing, communications, and entertainment devices within the digital lifestyle products markets. Digital lifestyle products include mobile smartphones and feature phones, portable digital music and video players, remote controls, and GPS devices, as well as a variety of mobile, handheld, wireless, and entertainment devices. Our array of human interface solutions for digital lifestyle products include the ScrollStrip and TouchRing, which are scrolling solutions allowing users to navigate efficiently through menus and content; LightTouch capacitive buttons, which provide illuminated button functionality; and our MobileTouch, NavPoint, and our ClearTouch solutions. We believe our existing technologies, our range of product solutions, and our emphasis on ease of use, small size, low power consumption, advanced functionality, durability, and reliability enable us to serve multiple aspects of the markets for digital lifestyle products and other electronic devices.

We anticipate that our human interface solutions for mobile smartphones and feature phones will constitute an increasing portion of our net revenue. Net revenue for our human interface solutions for mobile smartphones and feature phones was not material until the fourth quarter of fiscal 2008, but accounted for approximately 35% of our net revenue in fiscal 2009. Our ongoing success in serving the mobile smartphone market will depend upon the continued growth of that portion of the overall mobile phone market, the utilization of high-functionality interactive capacitive touch screens rather than mechanical buttons or resistive touch screens as the human interface for application access and control in those products, our ability to demonstrate to mobile smartphone OEMs, including those with which we have had no prior relationship, the advantages of our human interface solutions in terms of performance, usability, size, durability, power consumption, and industrial design possibilities, and the success of products utilizing our human interface solutions. In addition, our success will depend on our ability to demonstrate to mobile smartphone OEMs, the advantages of our flexible touch screen fulfillment model that encompasses chip to end-to-end solutions, including a complete touch screen module that includes a capacitive sensor, controller ASIC, associated electronics, and firmware and software, enabling OEMs quickly to integrate capacitive touch screens into new handset designs rather than doing or procuring the systems engineering and design work, purchasing the components separately, and coordinating with a module manufacturer to perform the assembly and testing.

Industry projections for the mobile phone market for the 2009-2013 period show a compound annual growth rate of 7% for the overall market and a compound annual growth rate of 17% for the mobile smartphone market, reflecting the trend towards increased interest among non-business consumers and the trend towards greater functionality in smartphone products to meet and address the expanded needs and expectations of the consumer oriented market.

Industry projections for the portable digital music player market for the 2008-2011 period suggest that the market is declining at an annual rate of 2% for the overall market but growing at a compound annual rate of 47% for the video capable MP3 players market, reflecting the trend towards portable digital entertainment devices with advanced capabilities, such as built-in video playback capabilities. These products require a simple, durable, and intuitive human interface solution to enable the user to navigate efficiently through menus and scroll through extensive play lists, songs, and videos contained in the host device. We believe we are well positioned to take advantage of this growing market based on our technology, engineering know-how, and the acceptance of our human interface solutions by OEMs in this market.

### **Our Strategy**

Our objective is to continue to enhance our position as a leading supplier of human interface solutions for the PC market and for the markets for digital lifestyle products, including smartphones and feature phones. Key aspects of our strategy to achieve this objective include those set forth below.

#### *Extend Our Technological Leadership*

We plan to utilize our extensive intellectual property portfolio and technological expertise to extend the functionality of our product solutions and offer innovative product solutions to customers across multiple markets. We

intend to continue utilizing our technological expertise to reduce the overall size, weight, cost, and power consumption



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of our human interface solutions while increasing their applications, capabilities, and performance. We plan to continue enhancing the ease of use and functionality of our solutions. We also plan to expand our research and development efforts through increased investment in our engineering activities, the hiring of additional engineering personnel, and strategic acquisitions and alliances. We believe that these efforts will enable us to meet customer expectations and to achieve our goal of supplying on a timely and cost-effective basis the most advanced, easy-to-use, functional human interface solutions to our target markets.

### *Enhance Our Position in the PC Market*

We intend to continue introducing market-leading human interface solutions in terms of performance, functionality, size, and ease of use. We plan to continue enhancing our customers' industrial design alternatives and device functionality through innovative product development based on our existing capabilities and technological advances.

### *Capitalize on Growth of New Markets*

We intend to capitalize on the growth of new markets, including the digital lifestyle products markets, including smartphones and feature phones and netbooks, brought about by the convergence of computing, communications, and entertainment devices. We plan to offer innovative, intuitive human interface solutions that address the evolving portability, connectivity, and functionality requirements of these new markets. We plan to offer these solutions to existing and potential OEM customers to enable increased functionality, reduced size, lower cost, and enhanced industrial design features and to enhance the user experience of their products. We plan to utilize our existing technologies as well as aggressively to pursue new technologies as new markets evolve that demand new solutions.

### *Emphasize and Expand Customer Relationships*

We plan to emphasize and expand our strong and long-lasting customer relationships and to establish successful relationships with new customers. In each market we serve, we plan to provide the most advanced human interface solutions for our customers' products. We believe that our human interface solutions enable our customers to deliver a positive user experience and to differentiate their products from those of their competitors. We continually attempt to enhance the competitive position of our customers by providing them with innovative, distinctive, and high-quality human interface solutions on a timely and cost-effective basis. To do so, we work continually to improve our productivity, to reduce costs, and to speed the delivery of our human interface solutions. We endeavor to streamline the entire design and delivery process through our ongoing design, engineering, and production improvement efforts. We also focus on providing timely support to our customers after the purchase of our human interface solutions.

We plan to increase our business with existing customers and attract new customers by offering both custom design full solutions, as well as design tools, documentation, a family of capacitive sensing ASICs, and technical support to enable them to develop their own human interface designs for capacitive buttons and scrolling applications in products such as mobile smartphones and feature phones, portable digital music and video players, and PC peripherals. As a result, customers have a choice of determining the most optimal way to meet their emerging and growing needs: our traditional custom module solutions or our OneTouch solution, which offers a flexible alternative when design integration or quick turns are important.

### *Pursue Strategic Relationships and Acquisitions*

We intend to develop and expand strategic relationships to enhance our ability to offer value-added human interface solutions to our customers, penetrate new markets, and strengthen the technological leadership of our product solutions. We also consider the potential acquisition of companies in order to expand our technological expertise and to establish or strengthen our presence in selected target markets.

### *Continue Virtual Manufacturing*

We plan to expand and diversify our production capacity through third-party relationships, thereby strengthening our virtual manufacturing platform. This strategy results in a scalable business model; enables us to concentrate on our core competencies of research and development, technological advances, and product design and engineering; and reduces our capital expenditures and working capital requirements. Our virtual manufacturing

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strategy allows us to maintain a variable cost model, in which we do not incur most of our manufacturing costs until our product solutions have been shipped and billed to our customers.

### **Product Solutions**

We develop and enhance interface technologies that enrich the user's experience in interacting with the user's mobile computing, communications, and entertainment devices. Our innovative and intuitive human interface solutions can be engineered to accommodate many diverse platforms, and our expertise in human factors and usability can be utilized to improve the features and functionality of our solutions. Our extensive array of technologies includes ASICs, firmware, software, mechanical and electrical designs, and pattern recognition and touch sensing technologies.

Our custom-designed human interface solutions are custom engineered, total solutions for our customers and include sensor design, module layout, ASICs, firmware, and software features for which we provide manufacturing and design support and device testing. This allows us to be a one-stop supplier for complete human interface design from the early design stage, to manufacturing, to testing and support. Our OneTouch offering includes design tools, documentation, a family of capacitive sensing ASICs, and technical support to enable customers to develop their own human interface designs for capacitive buttons and scrolling applications. Through our technologies and expertise, we seek to provide our customers with solutions that address their individual design issues and result in high-performance, feature-rich, and reliable interface solutions. We believe our interface solutions offer the following characteristics:

*Ease of Use.* Our interface solutions offer the ease of use and intuitive interaction that users demand.

*Small Size.* The small, thin size of our interface solutions enables our customers to reduce the overall size and weight of their products in order to satisfy consumer demand for portability.

*Low Power Consumption.* The low power consumption of our interface solutions enables our customers to offer products with longer battery life or smaller battery size.

*Advanced Functionality.* Our interface solutions offer advanced features, such as virtual scrolling, customizable tap zones, edge motion, and tapping and dragging icons, to enhance the user experience.

*Reliability.* The reliability of our interface solutions satisfies consumer requirements for dependability, which is a major component of consumer satisfaction.

*Durability.* Our interface solutions withstand repeated use, harsh physical treatment, and temperature fluctuations while providing a superior level of performance.

We believe these characteristics will enable us to maintain our leadership position in the PC market and to enhance our position as a technological enabler within the markets for digital lifestyle products and other electronic devices, including mobile smartphones and feature phones and portable digital music and video players.

Our human interface solutions are intended to satisfy our customers' specification needs, including features and functionality, industrial design, mechanical, and electrical requirements. Our products also offer unique integration options, including allowing our capacitive sensors to be placed underneath the plastic of the device, which allows for streamlined and stylized designs, incorporating LEDs to indicate status or enhance industrial design, and incorporating tactile indicators, including ridges, Braille bumps, and textures designed to provide the user with additional feedback.

Our emphasis on technological leadership and design capabilities positions us to provide unique human interface solutions that address specific customer requirements. Our long-term working relationships with large, global OEMs provide us with experience in satisfying their demanding design specifications and other requirements. Our custom product solutions provide OEMs with numerous benefits, including the following:

modular integration;

reduced product development costs;

shorter product time to market;

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compact and efficient platforms;

improved product functionality and utility; and

product differentiation.

We work with our customers in order to meet their technical and functional specifications, their industrial design requirements, and their desire to differentiate their products from those of their competitors. This collaborative effort reduces the duplication and overlap of investment and resources, enabling our OEM customers to devote more time and resources to the market development of their products.

We utilize capacitive technology rather than resistive or mechanical technology in our product solutions. Unlike resistive and mechanical technology, our solid state capacitive technology has no moving parts or activation force, thereby offering a durable, more reliable solution that can be integrated into both curved and flat surfaces. Capacitive technologies also allow for much thinner sensors than resistive or mechanical technology, providing for slimmer, more compact and unique industrial designs.

### **Products**

Our family of product solutions allows our customers to solve their interface needs and differentiate their products from those of their competitors.

#### *TouchPad*

Our TouchPad, which takes the place and exceeds the functionality of a mouse, is a small, touch-sensitive pad that senses the position of a person's finger on its surface through the measurement of capacitance. Our TouchPad provides an accurate, comfortable, and reliable method for screen navigation and cursor movement and provides a platform for interactive input. Our TouchPad solutions allow our customers to provide stylish, simple, user-friendly, and intuitive human interface solutions for both the consumer and corporate markets. Our TouchPad solutions offer various advanced features, including the following:

*Linear scrolling.* This feature enables the user to scroll through any document by swiping a finger along the side or bottom of the TouchPad.

*Customizable tap zones.* These zones permit designated portions of the TouchPad to be used to simulate mouse clicks, launch applications, and perform other selected functions.

*EdgeMotion™.* This feature permits cursor movement to continue when a user's finger reaches the edge of the TouchPad.

*Tapping and dragging of icons.* This feature allows the user to simply tap and hold on an icon in order to drag it, rather than being forced to hold a button down in order to drag an icon.

*Multi-finger gestures.* This feature allows the user to designate specific actions when more than one finger is used on the TouchPad, including pinch, momentum, ChiralMotion, three finger flick, two finger scrolling, three fingers down, and PivotRotate.

Our TouchPad solutions are available in a variety of sizes, electrical interfaces, and thicknesses. Our TouchPad solutions are designed to meet the electrical and mechanical specifications of our customers. Customized firmware and driver software ensure the availability of specialized features. As a result of their solid state characteristics, our TouchPad solutions have no moving parts that wear out, resulting in a robust and reliable input solution that also allows for unique industrial designs.

#### *TouchStyk*

Our TouchStyk is a proprietary pointing stick interface solution. TouchStyk is a self-contained, easily integrated module that uses capacitive technology similar to that of our TouchPad. TouchStyk is enabled with press-to-select and tap-to-click capabilities and can be easily integrated into multiple computing and communications devices.



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In addition, our design greatly reduces susceptibility to electromagnetic interference, thereby providing greater pointing accuracy and preventing the pointer from drifting when not in use.

We are currently shipping our TouchStyk in notebooks, portable multimedia players, and ultra mobile personal computers. Our modular approach allows OEMs to include our TouchPad, our TouchStyk, or a combination of both interfaces in their products.

### *Dual Pointing Solutions*

Our dual pointing solutions offer a TouchPad with a pointing stick in a single notebook computer, enabling users to select their interface of choice. Our dual pointing solution also provides the end user the ability to use both interfaces interchangeably. Our dual pointing solution provides the following advantages:

- cost-effective and simplified OEM integration;

- simplified OEM product line because one device contains both solutions;

- single-source supplier, which eliminates compatibility issues; and

- end user flexibility because one notebook can address both user preferences.

We have developed two solutions for use in the dual pointing market. Our first solution integrates all the electronics for controlling a third-party resistive strain gauge pointing stick onto our TouchPad PCB. This solution simplifies OEM integration by eliminating the need to procure the pointing stick electronics from another party and physically integrate them into the notebook. Our second dual pointing solution uses our TouchStyk rather than a third-party pointing stick and offers the same simplified OEM integration. The second solution is a completely modular design, allowing OEMs to offer TouchPad-only, TouchStyk-only, or dual pointing solutions on a build-to-order basis.

### *NavPoint*

The NavPoint solution offers users improved functionality and versatility in accessing and managing content in handheld devices through specifically designed navigation controls, including short- and long-distance scrolling features, tapping, and mouse-like cursor navigation.

### *TouchButtons*

TouchButtons provides capacitive button and scrolling controls for an easy-to-use and stylish interface solution that replaces mechanical buttons. Button arrays and ScrollStrips can be programmed to perform various functions, such as controls for multimedia, displays and device settings in notebook PCs, multimedia keyboards, MP3 players, digital photo frames, monitors, and other digital lifestyle products. TouchButton interfaces are designed for integration under the plastic face of a device, allowing for a sealed, durable, and thin design, which can be coupled with LEDs. OEMs can incorporate TouchButtons into their products by designing their own button or scrolling, or combination of button and scrolling interface using our OneTouch offering or through our custom designed interface module.

### *ClearPad*

ClearPad consists of a transparent, thin capacitive touchscreen that can be placed over any viewable surface, including display modules, such as LCDs or OLEDs. Similar to our traditional TouchPad, our ClearPad has various distinct advantages, including light weight; low profile form factor; high reliability, durability, and accuracy; and low power consumption. ClearPad can be mounted on or under curved surfaces, providing for unique and sleek industrial designs. ClearPad enables the user to interact directly with the display on electronic devices, such as mobile smartphones and feature phones.

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### *ClearButtons*

ClearButtons is an extension of our core capacitive sensing technology that has been used in TouchPad solutions for notebook PCs, smartphones, and feature phones. ClearButtons is a clear sensor that can be mounted under plastic, providing OEMs with easy integration and attractive design options for scrolling and buttons.

### *Synaptics OneTouch Design Studio*

OneTouch is a configurable solution based on our capacitive sensing technology, which includes a capacitive sensing ASIC, easy-to-use design tools, documentation, and technical support, that enables customers to develop their own custom interface designs in-house for capacitive buttons and scrolling applications in various products, including mobile smartphones and feature phones, portable digital media players, and PC peripherals, such as monitors, keyboards, mice, and remote controls. OneTouch increases our reach from a customer standpoint by offering them an alternative and flexible way to leverage our technology and know-how whether through our traditional custom module solution or through the OneTouch capability that allows them to implement capacitive sensing in-house when design integration or quick design turns are important.

### **Capabilities**

Our products are supported by a variety of feature capabilities allowing for further product differentiation and easy customer integration.

### *Synaptics Gesture Suite*

Synaptics Gesture Suite, or SGS, provides users with an intuitive way to interact productively with their notebook systems. SGS 9.1 was developed by analyzing the most common workflows from entertainment activities, such as viewing photos and listening to music, to productivity activities, such as accessing emails and presentations. The result is an intelligent usability model that makes it intuitive for consumers to understand and discover features easily, resulting in a better user experience. SGS 9.1 represents a growing portfolio of gestures available on our interface solutions. These new gestures are compatible with a wide range of Microsoft Windows applications and enhance the value and productivity of notebook PCs and peripheral devices that use our Touchpads. Gestures currently in the market include Pinch, Pivot Rotate, ChiralMotion Scrolling, Two-Finger Scrolling, Three-Finger Flick, and Three-Finger Down.

### *Enhanced Gesture Recognition*

Enhanced Gesture Recognition, or EGR, is a collection of ClearPad gestures included in our firmware. Customers can easily enable SingleTouch gestures, such as Tap, Double Tap, Press, and Flick, as well as DualTouch gestures, such as Pinch and Pivot Rotate, for ClearPad directly from our touch module firmware. No additional recognition software is required on the host processor to implement these gestures. This approach lowers host processor resource requirements and ensures that gestures are implemented using our proven pattern-recognition technology.

### *Dual Mode for TouchPad and NavPoint*

Dual Mode-enabled TouchPad and NavPoint interfaces allow users to switch between cursor control and icon-based controls on the TouchPad or NavPoint surface. In default mode, a Dual Mode-enabled TouchPad provides the same cursor control for on-screen navigation as a standard TouchPad. When the user taps on a launch icon located on the TouchPad surface, control icons illuminate on the TouchPad surface.

Dual Mode functionality offers a variety of customization options to OEMs, including tap zones for launching applications and multimedia controls, scrolling zones to adjust volume, and programmable buttons to enable end users to choose their application of choice to launch through our Dual Mode driver. To regain cursor control, the user simply taps the mode switch button and the illuminated icons disappear, allowing the user to control the cursor for on-screen navigation.

### *Proximity Sensing*

Proximity sensing technology enables users to interact with consumer electronics without touch. With this technology, sensors in a device, such as a notebook PC, mobile phone, peripheral, or digital photo frame, sense the

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presence of a user's hand to activate a function. These sensors can illuminate LEDs for discoverable buttons, immediately wake devices from power-saving mode, or activate other functionality.

### *ChiralMotion Gesture*

With our ChiralMotion Gesture technology, the user can apply one continuous circular motion to initiate precise and fine-tuned scrolling on any two-dimensional input surface, such as our TouchPad, NavPoint, and ClearPad solutions.

ChiralMotion technology is well-suited for small handheld products, such as feature-rich mobile handsets, personal navigation systems, and personal media players that require easy access for entertainment, music, and other digital files. Scrolling through long documents or pages on a notebook PC becomes simple when using a TouchPad enhanced with ChiralMotion and reversing the direction of scrolling simply requires the user to reverse the circular motion of their finger.

### *QuickStroke*

QuickStroke provides a fast, easy, and accurate way to input Chinese characters. Using our recognition technology that combines our patented software with our TouchPad, QuickStroke can recognize handwritten, partially finished Chinese characters, thereby saving considerable time and effort. Our QuickStroke, which operates with our touch pad products, can be integrated into notebook computers, keyboards, and a host of stand-alone interface devices that use either a pen or a finger.

Our patented Incremental Recognition Technology allows users to simply enter the first few strokes of a Chinese character, and QuickStroke accurately interprets the intended character. Since the typical Chinese character consists of an average of 13 strokes, QuickStroke technology saves considerable time and effort. We can port different alphabets or characters to our underlying pattern recognition engine, allowing us to offer support for different languages.

## **Technologies**

We have developed and own an extensive array of technologies, encompassing ASICs, firmware, software, pattern recognition, and touch sensing technologies. With 103 U.S. patents in force and 89 U.S. patents pending, as well as many non-U.S. counterparts, we continue to develop technology in these areas. We believe these technologies and the related intellectual property create barriers for competitors and allow us to provide human interface solutions in a variety of high-growth market segments.

Our broad line of human interface solutions currently is based upon the following key technologies:

capacitive position sensing technology;

capacitive force sensing technology;

transparent capacitive position sensing technology;

pattern recognition technology;

mixed signal integrated circuit technology; and

proprietary microcontroller technology.

In addition to these technologies, we develop firmware and device driver software that we incorporate into our products, which provide unique features, such as virtual scrolling, customizable tap zones, PalmCheck, EdgeMotion, and tapping and dragging of icons. In addition, our ability to integrate all of our products to interface with major operating systems, including Windows 98, Windows 2000, Windows NT, Windows CE, Windows XP, Windows ME, Windows Vista, Windows 7, Mac OS, Pocket PC, Palm OS, Symbian, UNIX, and LINUX, provides us with a competitive advantage.



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*Capacitive Position Sensing Technology.* This technology provides a method for sensing the presence, position, and contact area of one or more fingers or a conductive stylus on a flat or curved surface, such as our TouchPad, TouchRing, and ScrollStrip. Our technology works with very light touch and provides highly responsive cursor navigation, scrolling, and selection. It uses no moving parts, can be implemented under plastic, and is extremely durable.

*Capacitive Force Sensing Technology.* This technology senses the direction and magnitude of a force applied to an object. The object can either move when force is applied, like a typical joystick used for gaming applications, or it can be isometric, with no perceptible motion during use, like our TouchStyk. The primary competition for this technology is resistive strain gauge technology. Resistive strain gauge technology requires electronics that can sense very small changes in resistance, presenting challenges to the design of that circuitry, including sensitivity to electrical noise and interference. Our electronic circuitry determines the magnitude and direction of an applied force, permits very accurate sensing of tiny changes in capacitance, and minimizes electrical interference from other sources.

*Transparent Capacitive Position Sensing Technology.* This technology allows us to build transparent sensors for use with our capacitive position sensing technology, such as in our ClearPad. It has all the advantages of our capacitive position sensing technology and allows for visual feedback when incorporated with a display device, such as an LCD. Our technology does not require calibration, does not produce undesirable internal reflections, and has reduced power requirements, allowing for longer battery life.

*Pattern Recognition Technology.* This technology is a set of software algorithms and techniques for converting real-world data, such as handwriting, into a digital form that can be recognized and manipulated within a computer, such as our QuickStroke product and gesture decoding for our TouchPad products. Our technology provides reliable handwriting recognition and can be used in other applications such as signature verification.

*Mixed Signal Integrated Circuit Technology.* This hybrid analog-digital integrated circuit technology combines the power of digital computation with the ability to interface with non-digital, real-world signals, such as the position of a finger or stylus on a surface. Our patented design techniques permit us to utilize this technology to optimize our core ASIC engine for all our products.

*Proprietary Microcontroller Technology.* This technology consists of a proprietary 16-bit microcontroller core embedded in the digital portion of our mixed signal ASIC, which allows us to optimize our ASIC for position sensing tasks. Our embedded microcontroller provides great flexibility in customizing our product solutions utilizing firmware, which eliminates the need to design new circuitry for each new application.

***Competing Technology***

Many human interface solutions currently utilize resistive sensing technology. Resistive sensing technology consists of a flexible membrane above a flat, rigid, electrically conductive surface. When finger or stylus pressure is applied to the membrane, it deforms until it makes contact with the rigid layer below, at which point attached electronics can determine the position of the finger or stylus. Since the flexible membrane is a moving part, it is susceptible to mechanical wear and will eventually suffer degraded performance. Due to the way that resistive position sensors work, it is not possible for them to detect more than a single finger or stylus at any given time. The positional accuracy of a resistive sensor is limited by the uniformity of the resistive coating as well as by the mechanics of the flexible membrane. Finally, implementations of resistive technology over display devices, such as an LCD, result in reduced transmissivity, or the amount of light that can pass through the display, requiring the use of backlighting and thereby reducing the battery life of the device.

**Research and Development**

We conduct ongoing research and development programs that focus on advancing our technologies, developing new products, improving design and manufacturing processes, and enhancing the quality and performance of our product solutions. Our goal is to provide our customers with innovative solutions that address their needs and improve their competitive positions. Our research and development focuses on advancing our existing interface technologies, improving our current product solutions, and expanding our technologies to serve new markets. Our vision is to offer human interface solutions, such as touch, handwriting, vision, and voice capabilities, that can be readily incorporated into varied electronic devices.



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Our research and development programs focus on the development of accurate, easy to use, reliable, and intuitive human interfaces for electronic devices. We believe our innovative interface technologies can be applied to many diverse products. We believe the interface is a key factor in the differentiation of these products. We believe that our interface technologies enable us to provide customers with product solutions that have significant advantages over alternative technologies in terms of functionality, size, power consumption, durability, and reliability. We also intend to pursue strategic relationships and acquisitions to enhance our research and development capabilities, leverage our technology, and shorten our time to market with new technological applications.

Our research, design, and engineering teams frequently work directly with our customers to design custom solutions for specific applications. We focus on enabling our customers to overcome technical barriers and enhance the performance of their products. We believe our engineering know-how and electronic systems expertise provide significant benefits to our customers by enabling them to concentrate on their core competencies of production and marketing.

As of June 30, 2009, we employed 317 people in our technology, engineering, and product design functions in the United States, Taiwan, Hong Kong, Korea, Japan and China. Our research and development expenses were approximately \$39.4 million, \$50.1 million, and \$68.0 million in fiscal 2007, 2008, and 2009, respectively.

### **Intellectual Property Rights**

Our success and ability to compete depend in part on our ability to maintain the proprietary aspects of our technologies and products. We rely on a combination of patents, copyrights, trade secrets, trademarks, confidentiality agreements, and other contractual provisions to protect our intellectual property, but these measures may provide only limited protection. Our research, design, and engineering teams frequently work directly with our OEM customers to design custom solutions for specific applications.

We hold 103 U.S. patents in force and have 89 U.S. patents pending, as well as many non-U.S. counterparts to the U.S. patents and U.S. patents pending. Collectively, these patents and patents pending cover various aspects of our key technologies, including touch sensing, pen sensing, handwriting recognition, customizable tap zones, edge motion, and virtual scrolling technologies. Our proprietary software is protected by copyright laws and the source code for our proprietary software is protected under applicable trade secret laws.

Our extensive array of technologies includes ASICs, firmware, software, and pattern recognition and position sensing technologies. Our products rely on a combination of these technologies, making it difficult to use any single technology as the basis for replicating our products. Furthermore, the length and customization of the customer design cycle serve to protect our intellectual property rights.

Patent applications that we have filed or may file in the future may not result in a patent being issued. Our issued patents may be challenged, invalidated, or circumvented, and claims of our patents may not be of sufficient scope or strength, or issued in the proper geographic regions, to provide meaningful protection or any commercial advantage. We have not applied for, and do not have, any copyright registration on our technologies or products. We have applied to register certain of our trademarks in the United States and other countries. There can be no assurance that we will obtain registrations of trademarks in key markets. Failure to obtain registrations could compromise our ability to protect fully our trademarks and brands and could increase the risk of challenge from third parties to our use of our trademarks and brands. In addition, our failure to enforce and protect our intellectual property rights or obtain from third parties the right to use necessary technology could have a material adverse effect on our business, financial condition, and results of operations.

We do not consistently rely on written agreements with our customers, suppliers, manufacturers, and other recipients of our technologies and products, and therefore some trade secret protection may be lost and our ability to enforce our intellectual property rights may be limited. Furthermore, our customers, suppliers, manufacturers, and other recipients of our technologies and products may seek to use our technologies and products without appropriate limitations. In the past, we did not consistently require our employees and consultants to enter into confidentiality agreements, employment agreements, or proprietary information and invention agreements. Therefore, our former employees and consultants may try to claim some ownership interest in our technologies and products and may use our technologies and products competitively and without appropriate limitations.



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Other companies, including our competitors, may develop technologies that are similar or superior to our technologies, duplicate our technologies, or design around our patents and may have or obtain patents or other proprietary rights that would prevent, limit, or interfere with our ability to make, use, or sell our products. Effective intellectual property protection may be unavailable or limited in some foreign countries in which we operate, such as China and Taiwan. Unauthorized parties may attempt to copy or otherwise use aspects of our technologies and products that we regard as proprietary. There can be no assurance that our means of protecting our proprietary rights in the United States or abroad will be adequate or that competitors will not independently develop similar technologies. If our intellectual property protection is insufficient to protect our intellectual property rights, we could face increased competition in the market for our technologies and products.

We may receive notices from third parties that claim our products infringe their rights. From time to time, we receive notice from third parties of the intellectual property rights such parties have obtained. We cannot be certain that our technologies and products do not and will not infringe issued patents or other proprietary rights of third parties. Any infringement claims, with or without merit, could result in significant litigation costs and diversion of resources, including the payment of damages, which could have a material adverse effect on our business, financial condition, and results of operations.

### **Customers**

Our customers include many of the world's largest PC OEMs, based on unit shipments, as well as a variety of consumer electronics manufacturers, including mobile smartphone and feature phone OEMs. Our demonstrated track record of technological leadership, design innovation, product performance, cost effectiveness, and on-time delivery have resulted in our leadership position in providing human interface solutions. We believe our strong relationship with our OEM customers, many of which are currently developing digital lifestyle products, will position us as a source of supply for their product offerings.

Our industry leading OEM customers in fiscal 2009 included the following:

Acer

Asustek

Dell

Google

Hewlett-Packard

HTC

Lenovo

LG Electronics

Samsung

Sharp

Sony

Toshiba

We generally supply custom-designed products to our OEM customers through their contract manufacturers. We sell our custom-designed products directly to these contract manufacturers, which include Compal, Hon Hai, Inventec, Kuroda, S-Mac, TPK Touch Solutions, Wistron, and Zhan Yun Shanghai Electronics. Sales to TPK Touch

Solutions and Inventec accounted for approximately 14% and 11%, respectively, of our net revenue for fiscal 2009. Sales to Zhan Yun Shanghai Electronics accounted for approximately 10% of our net revenue for fiscal 2008. No other customer accounted for more than 10% of our net revenue for either fiscal 2008 or 2009. We supply our OneTouch solution directly to our OEM customers.

We consider both the OEMs and their contract manufacturers to be our customers. Both the OEMs and their contract manufacturers may determine the design and pricing requirements and make the overall decision regarding the use of our human interface solutions in their products. The contract manufacturers place orders with us for the purchase of our products, take title to the products purchased upon shipment by us, and pay us directly for those purchases. These customers have no return privileges except for warranty provisions.

**Strategic Relationships**

We have used strategic relationships to enhance our ability to offer value-added customer solutions in the past. We intend to enter into additional strategic relationships with companies that may help us serve our target markets.

**Sales and Marketing**

We sell our product solutions for incorporation into the products of our OEM customers. We generate sales through direct sales employees as well as outside sales representatives and distributors. Our sales personnel receive

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substantial technical assistance and support from our internal engineering resources because of the highly technical nature of our product solutions. Sales frequently result from multi-level sales efforts that involve senior management, design engineers, and our sales personnel interacting with our customers' decision makers throughout the product development and order process.

We currently employ 104 sales and marketing professionals. We maintain eight customer support offices domestically and internationally, which are located in the United States, Taiwan, China, Korea, Japan, Hong Kong, and Switzerland. In addition, we utilize sales representatives in Korea, Singapore, and Malaysia and sales distributors in Japan and Taiwan.

International sales constituted approximately 99% of our revenue for each of fiscal 2007, 2008, and 2009. Approximately 75% of our sales were made to companies located in China and Taiwan that provide design and manufacturing services for major notebook computer and digital lifestyle product OEMs. All of our sales were denominated in U.S. dollars.

### **Manufacturing**

We employ a virtual manufacturing platform through third-party relationships. We currently utilize three semiconductor wafer manufacturers to supply us with silicon wafers integrating our proprietary design specifications. The completed silicon wafers are forwarded to third-party package and test processors for further processing into die and packaged ASICs, as applicable, which are then utilized in our custom interface products or processed as our OneTouch products.

After processing and testing, the die and ASICs are consigned to various contract manufacturers for assembly or, in the case of OneTouch ASICs, are shipped directly to our customers. During the assembly process, our die or ASIC is combined with other components to complete the module for our custom human interface solution. The finished assembled product is subsequently shipped by our contract manufacturers directly to our customers for integration into their products.

We believe our virtual manufacturing strategy provides a scalable business model; enables us to concentrate on our core competencies of research and development, technological advances, and product design and engineering; and reduces our capital expenditures. In addition, this strategy significantly reduces our working capital requirements for inventory because we do not incur most of our manufacturing costs until we have actually shipped our interface products to our customers and billed those customers for those products.

Our third-party contract manufacturers are Asian-based organizations. We provide our contract manufacturers with six-month rolling forecasts of our production requirements. We do not, however, have long-term agreements with any of our contract manufacturers that guarantee production capacity, prices, lead times, or delivery schedules. The strategy of relying on those parties exposes us to vulnerability owing to our dependence on few sources of supply. We believe, however, that other sources of supply are available. In addition, we may establish relationships with other contract manufacturers in order to reduce our dependence on any one source of supply.

Periodically, we purchase inventory from our contract manufacturers when a customer delays its delivery schedule or cancels its order. In those circumstances in which our customer has cancelled its order and we purchase inventory from our contract manufacturers, we consider a write-down to reduce the carrying value of the inventory purchased to its net realizable value. We charge write-downs to reduce the carrying value of obsolete, slow moving, and non-usable inventory to net realizable value to cost of revenue.

### **Backlog**

As of June 30, 2009, we had a backlog of orders of \$62.8 million, an increase of \$12.5 million compared with a backlog of orders as of June 30, 2008 of \$50.3 million. The increase in backlog is primarily related to the timing of customer orders. Our backlog consists of product orders for which purchase orders have been received and which are scheduled for shipment in the subsequent quarter. Most orders are subject to rescheduling or cancellation with limited penalties. Because of the possibility of customer changes in product shipments, our backlog as of a particular date may not be indicative of net sales for any succeeding period.

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### **Competition**

Our principal competitors in the sale of notebook touch pads are Alps Electric, a Japanese conglomerate, and Elan Microelectronics, a Taiwanese company, and our principal competitor in the sale of notebook pointing sticks is Alps. In the markets for digital lifestyle products and other electronic devices, our competitors include Cypress, Atmel, Melfas, Elan, and various other companies involved in human interface solutions. In certain cases, large OEMs may develop alternative human interface solutions for their own products or provide key components for use in designing human interface solutions.

In the notebook human interface market, we plan to continue to compete primarily on the basis of our technological expertise, design innovation, customer service, and the long track record of performance of our human interface solutions, including their ease of use, reliability, and cost-effectiveness as well as their timely design, production, and delivery schedules. Our pointing stick solutions, including our proprietary TouchStyk, enable us to address the notebook computer market that uses solely a pointing stick rather than a touch pad as the human interface as well as the notebook market that uses dual pointing interfaces. Our ability to supply OEMs with TouchPads, TouchStyks, and dual pointing alternatives enhances our market position as we can provide OEMs with the following advantages:

- single source supplier to eliminate compatibility issues;

- cost-effective and simplified integration;

- simplified product line to address both interface preferences;

- end user flexibility because one notebook can address both user preferences;

- highly experienced engineering resources, particularly in the mechanical, industrial design, and electrical areas as the general notebook market embraces thinner and lighter designs; and

- modular approach allowing OEMs to utilize our TouchPad, our TouchStyk, or a combination of both interfaces.

In the human interface markets for digital lifestyle products and other electronic devices, we compete primarily based on the advantages of our systems knowledge of capacitive sensing and pattern recognition technologies. We believe our solutions-based engineering expertise coupled with our technologies offer benefits in terms of size, power consumption, durability, light transmissivity, resolution, ease of use, and reliability when compared to our competitors and other technologies. While these markets continue to evolve, we believe we are positioned to compete aggressively for this business based on our proven track record, our marquee global customer base, and our reputation for design innovation. New competitors, alliances among competitors, or alliances among competitors and OEMs also may emerge and allow competitors to rapidly acquire significant market share. In addition, our success will depend on our ability to demonstrate to mobile smartphone OEMs, the advantages of our flexible touch screen fulfillment model that encompasses chip to end-to-end solutions, including a complete touch screen module that includes a capacitive sensor, controller ASIC, associated electronics, and firmware and software, enabling OEMs quickly to integrate capacitive touch screens into new handset designs rather than doing or procuring the systems engineering and design work, purchasing the components separately, and coordinating with a module manufacturer to perform the assembly and testing.

Furthermore, our competitors or our customers may develop technologies in the future that more effectively address the human interface needs of the notebook market and digital lifestyle product markets. Our sales, profitability, and success depend on our ability to compete with other suppliers of human interface solutions and components used in human interface solutions. Our competitive position could be adversely affected if one or more of our current OEMs reduce their orders or if we are unable to develop new customers for our human interface solutions.

### **Employees**



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As of June 30, 2009, we employed a total of 524 persons, including 103 in finance, administration, and operations; 104 in sales and marketing; and 317 in research and development. Of these employees, 336 were located in

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North America, 185 in Asia/Pacific, and three in Europe. We consider our relationship with our employees to be good, and none of our employees are represented by a union in collective bargaining with us.

Competition for qualified personnel in our industry is extremely intense, particularly for engineering and other technical personnel. Our success depends on our continued ability to attract, hire, and retain qualified personnel.

**Executive Officers**

The following table sets forth certain information regarding our executive officers as of July 31, 2009:

<b>Name</b>	<b>Age</b>	<b>Position</b>
Thomas J. Tiernan	46	President, Chief Executive Officer, and Director
Russell J. Knittel	59	Executive Vice President, Chief Financial Officer, Secretary, and Treasurer
Kathleen A. Bayless	53	Senior Vice President Finance
Gopal K. Garg	47	Senior Vice President, Corporate Marketing & Handheld Business
David B. Long	48	Vice President of World Wide Sales
Joseph D. Montalbo	53	Senior Vice President of Engineering
Alex Wong	54	Vice President of World Wide Operations
Mark N. Vena	47	Vice President, PC Business

*Thomas J. Tiernan* has been Chief Executive Officer of our company since July 2009 and the President and a director of our company since July 2008. Mr. Tiernan served as Chief Operating Officer of our company from July 2008 to July 2009, as Executive Vice President and General Manager of our company from July 2007 until July 2008, and as Senior Vice President of our company from March 2006 until July 2007. Prior to joining our company, Mr. Tiernan served as Vice President and General Manager of Symbol Technologies Mobile Computing Division. From 1985 to 2004, Mr. Tiernan held various management and executive positions at Hewlett-Packard, including running the Network Storage business in the Americas, the Enterprise Systems business in Asia Pacific, and the PC business in Japan. Mr. Tiernan holds a Bachelor's Degree in Electrical Engineering from California State Polytechnic University and a Masters of Science in Computer Engineering from Santa Clara University.

*Russell J. Knittel* has been Executive Vice President of our company since July 2007 and Chief Financial Officer, Chief Administrative Officer, Secretary, and Treasurer of our company since November 2001. Effective September 1, 2009, Mr. Knittel will retire as Chief Financial Officer, Secretary, and Treasurer of our company. Mr. Knittel will continue as Executive Vice President of our company for at least the remainder of the calendar year. Upon retiring from management, Mr. Knittel will be joining our Board of Directors. Mr. Knittel served as Senior Vice President of our company from November 2001 until July 2007. He served as the Vice President of Administration and Finance, Chief Financial Officer, and Secretary of our company from April 2000 through October 2001. Mr. Knittel served as Vice President and Chief Financial Officer of Probe Technology Corporation from May 1999 to March 2000. Mr. Knittel holds a Bachelor of Arts degree in accounting from California State University at Fullerton and a Masters of Business Administration from San Jose State University.

*Kathleen A. Bayless* has been the Senior Vice President Finance of our company since March 2009. On August 20, 2009, we made formal the appointment of Ms. Bayless as Chief Financial Officer, Secretary, and Treasurer of our company, effective September 1, 2009. Ms. Bayless spent thirteen years at Komag, a leading supplier, of thin-film disks, to the disk drive industry where she served most recently as Executive Vice President, Secretary, and Chief Financial Officer. Ms. Bayless holds a Bachelor of Science degree from California State University Fresno and is a

certified public accountant.

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*Gopal K. Garg* has been Senior Vice President, Corporate Marketing & Handheld Business of our company since August 2008. Mr. Garg previously worked at Cypress, where he was Vice President and General Manager of the Communication Business and the Power Electronics Business. He has held positions across multiple functions, including product management, strategic marketing, business development, mergers and acquisitions, and chip design. He began his career at Semiconductor Complex Ltd, and later Arcus Technology, which was acquired by Cypress. He holds a Bachelor of Science degree in Electrical Engineering from Birla Institute of Technology & Science in Pilani India, and an Masters of Business Administration from Panjab University India.

*David B. Long* has been the Vice President of World Wide Sales of our company since January 2008. Prior to joining our company, Mr. Long served as Vice President of Worldwide Sales for Consumer Products at LSI Logic Corporation where he directed the management of sales and customer support for standard and custom silicon solutions. From 2003 to 2006, he served as the Vice President of Asia Pacific Sales focused on the Consumer and Storage product segments. He was the Director of North American-West Sales for LSI Operations from 2002 to 2003. Mr. Long also managed LSI's worldwide account with Cisco Systems from 1998 until 2002, directing an extended team of sales, engineering, marketing, operations, and customer service representatives. Mr. Long received a Bachelor's degree in Business Administration/Marketing Management from California Polytechnic University, San Luis Obispo in 1985.

*Joseph D. Montalbo* has been the Senior Vice President of Engineering of our company since January 2008. From April 2005 until November 2007, Mr. Montalbo served as President, Chief Executive Officer, and board member of Pixim, Inc., a fabless semiconductor company, marketing image sensing products into the security market. From June 1978 until April 2005, Mr. Montalbo also served in various senior management positions at National Semiconductor Corp. where most recently he was Vice President and General Manager of National's Custom Solutions Group. Mr. Montalbo also served on the board of directors of Validity Sensors, Inc. Mr. Montalbo holds a Bachelor of Engineering degree in Electrical Engineering from The Cooper Union in New York.

*Alex Wong* has been the Vice President of World Wide Operations of our company since September 2006. From 2003 to 2006, Mr. Wong served our company as Managing Director of Hong Kong and Director of Operations. Prior to joining our company, Mr. Wong held various management positions with National Semiconductor, including General Manager for National Joint Ventures in China and Hong Kong as well as the Director of Corporate Business Development. Mr. Wong holds a Bachelor of Science degree in Computer Science from California State University at Northridge and a Masters in Business Administration from the University of East Asia, Macau.

*Mark N. Vena* has been Vice President, PC Business since April 2007. Before joining our company, Mr. Vena was the Vice President of Worldwide Marketing at Alienware and prior to joining Alienware Mr. Vena held a number of business and product marketing leadership positions at Dell, Compaq, Epson, and IBM. Mr. Vena graduated Cum Laude from Boston College with a Bachelor of Arts degree in History.

There are no arrangements, understandings, or family relationships pursuant to which our executive officers were selected. There are no related party transactions between us and our executive officers reportable under Item 404(a) of Regulation S-K.

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### ITEM 1A. RISK FACTORS

You should carefully consider the following factors, together with all the other information included in this report, in evaluating our company and our business.

**We currently depend on our TouchPad and TouchStyk products, and the notebook computer market, for a significant portion of our revenue, and a downturn in these products or this market could have a disproportionate impact on our revenue.**

Historically, we have derived a very substantial portion of our revenue from the sale of our TouchPad and TouchStyk products for notebook computers, and those products accounted for approximately 57% of our net revenue in fiscal 2009. While our long-term objective is to derive revenue from human interface solutions in the markets for digital lifestyle products and other electronic devices, we anticipate that sales of our TouchPads and TouchStyks for notebooks will continue to represent a significant portion of our revenue. The PC market as a whole has experienced a slowdown in the rate of growth. The notebook portion of the PC market has continued to expand although at a slower rate, with the lower priced netbook market having been responsible for a major portion of that growth. A continued or accelerated softening in the demand in the notebook portion of the PC market or the level of our participation in that market would cause our business, financial condition, and results of operations to suffer more than they would have if we offered a more diversified line of products.

**Net revenue from our human interface solutions for digital lifestyle products has been volatile in the past, and our net revenue from our human interface solutions for digital lifestyle products may not increase or be less volatile in the future.**

Net revenue from our human interface solutions for digital lifestyle products, particularly portable digital music players, has been volatile in the past. Net revenue from our human interface solutions for mobile smartphones and feature phones only became material in our fourth quarter of fiscal 2008, but accounted for approximately 35% of our net revenue in fiscal 2009. Our net revenue from our human interface solutions for digital lifestyle products may not increase as anticipated or be less volatile in the future. Net revenue from our human interface solutions for digital lifestyle products was \$88.3 million (which included \$40.5 million for digital music and video players and \$47.7 million for mobile smartphones and feature phones), or 24% of our net revenue, in fiscal 2008 and \$203.7 million (which included \$37.4 million for digital music and video players and \$166.3 million for mobile smartphones and feature phones), or 43% of our net revenue, in fiscal 2009. Our interface business for digital lifestyle products faces many uncertainties, including our success in penetrating new markets dominated by a limited number of OEMs. Our inability to address these uncertainties successfully and to be a leading supplier of human interfaces for digital lifestyle products would result in a slower growth rate than we currently anticipate. We do not know whether our human interface solutions for the digital lifestyle product market will continue to gain market acceptance or will account for a substantial portion of our revenue on a consistent basis. The failure to succeed in these markets would result in a negative return on the substantial investments we have made to date and plan to make in the future to penetrate these markets.

**We cannot assure you that our human interface business for digital lifestyle products will be successful or that we will be able to generate significant revenue from the markets for digital lifestyle products.**

Various target markets for our interfaces, such as those for mobile smartphones and feature phones, GPS devices, smart handheld devices, and interactive games and toys, may develop slower than anticipated or could utilize competing technologies. The market for certain of these products depends in part upon the continued development and deployment of wireless and other technologies, which may or may not address the needs of users of these products.

Our ability to generate significant revenue from the markets for certain digital lifestyle products will depend on various factors, including the following:

- the continued development and growth of these markets;

- the ability of our technologies and product solutions to address the needs of these markets, the requirements of OEMs, and the preferences of end users; and

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our ability to provide OEMs with human interface solutions that provide advantages in terms of size, power consumption, reliability, durability, performance, and value-added features compared with alternative solutions.

Many manufacturers of these products have well-established relationships with competitive suppliers. Our continuing success in these markets will require us to offer better performance alternatives to other solutions at competitive costs. The failure of any of these target markets to develop as we expect, or our failure to serve these markets to a significant extent, will impede our anticipated sales growth and could result in substantially reduced earnings from those we anticipate. We cannot predict the size or growth rate of these markets or the market share we will achieve in these markets in the future.

### **Our historical financial performance is based primarily on net revenue generated from our human interface solutions to the notebook computer market and may not be indicative of our future performance in other markets, including the market for mobile smartphones and feature phones**

Our historical financial performance primarily reflects net revenue generated from our human interface solutions for notebook computers. While we expect sales of our human interface solutions for notebook computers to continue to generate a substantial percentage of our revenue, we expect to derive an increasing portion of our revenue from sales of our product solutions for digital lifestyle products, including mobile smartphones and feature phones, portable digital music players, and other electronic devices. We have a limited operating history in these markets, especially for mobile smartphones and feature phones, upon which you can evaluate our prospects, which may make it difficult to predict our actual results in future periods. Actual results of our future operations may differ materially from our anticipated results.

We anticipate that our human interface solutions for mobile smartphones and feature phones will constitute an increasing portion of our net revenue. Net revenue for our human interface solutions for mobile smartphones and feature phones was not material until the fourth quarter of fiscal 2008, but accounted for approximately 35% of our net revenue in fiscal 2009. Our ongoing success in serving the mobile smartphone and feature phone market will depend upon the continued growth of that segment of the overall mobile phone market; the utilization of high-functionality interactive touch screens with easy-to-use touch button controls rather than mechanical buttons as the human interface for application access and control in those products; our ability to demonstrate to mobile smartphone OEMs, including those with which we have had no prior relationship, the advantages of our human interface solutions in terms of performance, size, durability, power consumption, and industrial design possibilities; and the success of OEMs products utilizing our human interface solutions. In addition, our success will depend on our ability to demonstrate to mobile smartphone OEMs, the advantages of our flexible touch screen fulfillment model that encompasses chip to end-to-end solutions, including a complete touch screen module that includes a capacitive sensor, controller ASIC, associated electronics, and firmware and software, enabling OEMs quickly to integrate capacitive touch screens into new handset designs rather than doing or procuring the systems engineering and design work, purchasing the components separately, and coordinating with a module manufacturer to perform the assembly and testing.

### **Market acceptance of our customers' existing or new products that utilize our human interface solution may decline or may not develop and, as a result, our sales may decline or may not increase.**

We do not sell any products to end users. Instead, we design various human interface solutions that our OEM customers incorporate into their products. As a result, our success depends almost entirely upon the widespread market acceptance of our OEM customers' products. We do not control or influence the manufacture, promotion, distribution, or pricing of the products that incorporate our human interface solutions. Instead, we depend on our customers to manufacture and distribute products incorporating our human interface solutions and to generate consumer demand through marketing and promotional activities. Even if our technologies successfully meet our customers' price and performance goals, our sales would decline or fail to develop if our customers do not achieve commercial success in selling their products that incorporate our human interface solutions.

Competitive advances by OEMs in the PC or digital lifestyle product markets, which do not utilize our human interface solutions broadly in their product offerings, at the expense of our OEM customers could result in lost sales opportunities. Within the digital lifestyle product market, the mobile smartphone is becoming an increasingly important factor in our operating results. Any failure to expand our presence in this market, a significant slowdown in



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the use of our human interface solutions by our customers in this market, the reduced demand for our customers products, or a slowdown of growth in this market would adversely affect our sales.

**If we fail to maintain and build relationships with our customers and do not continue to satisfy our customers, we may lose future sales and our revenue may stagnate or decline.**

Because our success depends on the widespread market acceptance of our OEM customers products, we must continue to maintain our relationships with the leading notebook computer and portable digital music player OEMs and expand our relationships with mobile smartphone OEMs. In addition, we must identify areas of significant growth potential in other markets, establish relationships with OEMs in those markets, and assist those OEMs in developing products that use our interface technologies. Our failure to identify potential growth opportunities, particularly in the mobile smartphone and feature phone market, or establish and maintain relationships with OEMs in those markets, would prevent our business from growing in those markets.

Our ability to meet the expectations of our customers requires us to provide innovative human interface solutions for customers on a timely and cost-effective basis and to maintain customer satisfaction with our human interface solutions. We must match our design and production capacity with customer demand, maintain satisfactory delivery schedules, and meet performance goals. If we are unable to achieve these goals for any reason, our customers could reduce their purchases from us and our sales would decline or fail to develop.

Our customer relationships also can be affected by factors affecting our customers that are unrelated to our performance. These factors can include a myriad of situations, including business reversals of customers, determinations by customers to change their product mix or abandon business segments, or mergers, consolidations, or acquisitions involving our customers, such as the combination of Compaq and Hewlett-Packard or the acquisition of IBM's PC business unit by Lenovo.

**The loss of revenue from one or more large customers could harm our business, financial condition, and results of operations.**

Sales to two customers that provide contract manufacturing services to major OEMs accounted for an aggregate of 25% of our net revenue for the fiscal ended June 30, 2009, and one customer accounted for 10% of our net revenue for the fiscal ended June 30, 2008. These customers were TPK Touch Solutions and Inventec in fiscal 2009 and Zhan Yun Shanghai Electronics in fiscal 2008. Additionally, receivables from each of LG Electronics, Zhan Yun Shanghai Electronics, TPK Touch Solutions, and Inventec exceeded 10% of accounts receivable and in the aggregate represented 52% of accounts receivable at June 30, 2009.

Compal, Hon Hai, Inventec, Kang Zhun Electronics, Shanghai Yi Hsin, S-Mac, Wistron, and Zhan Yun Shanghai Electronics are some of the contract manufacturers that serve our OEM customers. Any material delay, cancellation, or reduction of orders from any one or more of these contract manufacturers or the OEMs they serve could harm our business, financial condition, and results of operations. The adverse effect would be more substantial if our other customers do not increase their orders or if we are unsuccessful in generating orders for human interface solutions from new customers. Many of these contract manufacturers sell to the same OEMs, and therefore our concentration with certain OEMs may be higher than with any individual contract manufacturer. Concentration in our customer base may make fluctuations in revenue and earnings more severe and make business planning more difficult.

**We rely on others for our production and any interruptions of these arrangements could disrupt our ability to fill our customers orders.**

We utilize contract manufacturers for all of our production requirements. The majority of our manufacturing is conducted in China, Taiwan, and Thailand by contract manufacturers that also perform services for numerous other companies. We do not have a guaranteed level of production capacity with any of our contract manufacturers. Qualifying new contract manufacturers, and specifically semiconductor foundries, is time consuming and might result in unforeseen manufacturing and operations problems. The loss of our relationships with our contract manufacturers or assemblers or their inability to conduct their manufacturing and assembly services for us as anticipated in terms of cost, quality, and timeliness could adversely affect our ability to fill customer orders in accordance with required delivery, quality, and performance requirements. If this were to occur, the resulting decline in revenue would harm our business.





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**We depend on third parties to maintain satisfactory manufacturing yields and delivery schedules, and their inability to do so could increase our costs, disrupt our supply chain, and result in our inability to deliver our products, which would adversely affect our results of operations.**

We depend on our contract manufacturers to maintain high levels of productivity and satisfactory delivery schedules at manufacturing and assembly facilities located primarily in China, Taiwan, and Thailand. We provide our contract manufacturers with six-month rolling forecasts of our production requirements. We do not, however, have long-term agreements with any of our contract manufacturers that guarantee production capacity, prices, lead times, or delivery schedules. Our contract manufacturers serve other customers, a number of which have greater production requirements than we do. As a result, our contract manufacturers could determine to prioritize production capacity for other customers or reduce or eliminate deliveries to us on short notice. At times, we have experienced lower than anticipated manufacturing yields and lengthening of delivery schedules. Lower than expected manufacturing yields could increase our costs or disrupt our supplies. We may encounter lower manufacturing yields and longer delivery schedules in commencing volume production of new products that we introduce. Any of these problems could result in our inability to deliver our product solutions in a timely manner and adversely affect our operating results.

**Shortages of components and materials may delay or reduce our sales and increase our costs, thereby harming our results of operations.**

The inability to obtain sufficient quantities of components and other materials necessary for the production of our products could result in reduced or delayed sales or lost orders. Any delay in or loss of sales could adversely impact our operating results. Many of the materials used in the production of our products are available only from a limited number of foreign suppliers, particularly suppliers located in Asia. In most cases, neither we nor our contract manufacturers have long-term supply contracts with these suppliers. As a result, we are subject to economic instability in these Asian countries as well as to increased costs, supply interruptions, and difficulties in obtaining materials. Our customers also may encounter difficulties or increased costs in obtaining the materials necessary to produce their products into which our product solutions are incorporated.

From time to time, materials and components used in our product solutions or in other aspects of our customers products have been subject to allocation because of shortages of these materials and components. Shortages in the future could cause delayed shipments, customer dissatisfaction, and lower revenue.

**We are subject to lengthy development periods and product acceptance cycles, which can result in development and engineering costs without any future revenue.**

We provide human interface solutions that are incorporated by OEMs into the products they sell. OEMs make the determination during their product development programs whether to incorporate our human interface solutions or pursue other alternatives. This process requires us to make significant investments of time and resources in the design of human interface solutions well before our customers introduce their products incorporating these interfaces and before we can be sure that we will generate any significant sales to our customers or even recover our investment. During a customer's entire product development process, we face the risk that our interfaces will fail to meet our customer's technical, performance, or cost requirements or that our products will be replaced by competitive products or alternative technological solutions. Even if we complete our design process in a manner satisfactory to our customer, the customer may delay or terminate its product development efforts. The occurrence of any of these events could cause sales to not materialize, to be deferred, or to be cancelled, which would adversely affect our operating results.

**We do not have long-term purchase commitments from our customers, and their ability to cancel, reduce, or delay orders could reduce our revenue and increase our costs.**

Our customers do not provide us with firm, long-term volume purchase commitments, but instead issue purchase orders. As a result, customers can cancel purchase orders or reduce or delay orders at any time. The cancellation, delay, or reduction of customer purchase orders could result in reduced revenue, excess inventory, and unabsorbed overhead. We have an established presence in the notebook computer market and have only recently established a presence in the digital lifestyle products markets. Our success in the digital lifestyle product markets, including those for mobile smartphones and feature phones and portable digital music players, require us to establish the value added by our products to OEMs that have traditionally used other solutions. All of the markets we serve are



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subject to severe competitive pressures, rapid technological change, and product obsolescence, which increase our inventory and overhead risks, resulting in increased costs.

**We face intense competition that could result in our losing or failing to gain market share and suffering reduced revenue.**

We serve intensely competitive markets that are characterized by price erosion, rapid technological change, and competition from major domestic and international companies. This intense competition could result in pricing pressures, lower sales, reduced margins, and lower market share. Depressed economic conditions, a slowdown in the PC market, the emergence of netbooks, rapid changes in the smartphone and feature phone market, and competitive pressures have resulted in pricing pressures and reduced unit margins.

Any movement away from high-quality, custom designed, feature-rich human interface solutions to lower priced alternatives would adversely affect our business. Some of our competitors, particularly in the markets for digital lifestyle products and other electronic devices, have greater market recognition, larger customer bases, and substantially greater financial, technical, marketing, distribution, and other resources than we possess and that afford them competitive advantages. As a result, they may be able to devote greater resources to the promotion and sale of products, to negotiate lower prices for raw materials and components, to deliver competitive products at lower prices, and to introduce new product solutions and respond to customer requirements more quickly than we can. Our competitive position could suffer if one or more of our customers determine not to utilize our custom engineered, total solutions approach and instead decide to design and manufacture their own interfaces, to contract with our competitors, or to use alternative technologies.

Our ability to compete successfully depends on a number of factors, both within and outside our control. These factors include the following:

- our success in designing and introducing new human interface solutions, including those implementing new technologies;

- our ability to predict the evolving needs of our customers and to assist them in incorporating our technologies into their new products;

- our ability to meet our customers' requirements for low power consumption, ease of use, reliability, durability, and small form factor;

- the quality of our customer services;

- the rate at which customers incorporate our human interface solutions into their own products;

- product or technology introductions by our competitors; and

- foreign currency fluctuations, which may cause a foreign competitor's products to be priced significantly lower than our product solutions.

**If we do not keep pace with technological innovations, our products may not be competitive and our revenue and operating results may suffer.**

We operate in rapidly changing markets. Technological advances, the introduction of new products, and new design techniques could adversely affect our business unless we are able to adapt to the changing conditions. Technological advances could render our solutions obsolete, and we may not be able to respond effectively to the technological requirements of evolving markets. As a result, we will be required to expend substantial funds for and commit significant resources to

- continue research and development activities on existing and potential human interface solutions,

- hire additional engineering and other technical personnel, and

purchase advanced design tools and test equipment.

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Our business could be harmed if we are unable to develop and utilize new technologies that address the needs of our customers, or our competitors or customers do so more effectively than we do.

**Our efforts to develop new technologies may not result in commercial success, which could cause a decline in our revenue and could harm our business.**

Our research and development efforts with respect to new technologies may not result in customer or market acceptance. Some or all of those technologies may not successfully make the transition from the research and development lab to cost-effective production as a result of technology problems, competitive cost issues, yield problems, and other factors. Even when we successfully complete a research and development effort with respect to a particular technology, our customers may decide not to introduce or may terminate products utilizing the technology for a variety of reasons, including the following:

difficulties with other suppliers of components for the products,

superior technologies developed by our competitors and unfavorable comparisons of our solutions with these technologies,

price considerations, and

lack of anticipated or actual market demand for the products.

The nature of our business requires us to make continuing investments for new technologies. Significant expenses relating to one or more new technologies that ultimately prove to be unsuccessful for any reason could have a material adverse effect on us. In addition, any investments or acquisitions made to enhance our technologies may prove to be unsuccessful. If our efforts are unsuccessful, our business could be harmed.

**We may not be able to enhance our existing product solutions and develop new product solutions in a timely manner.**

Our future operating results will depend to a significant extent on our ability to continue to provide new human interface solutions that compare favorably with alternative solutions on the basis of time to introduction, cost, performance, and end user preferences. Our success in maintaining existing and attracting new customers and developing new business depends on various factors, including the following:

innovative development of new solutions for customer products,

utilization of advances in technology,

maintenance of quality standards,

efficient and cost-effective solutions, and

timely completion of the design and introduction of new human interface solutions.

We recently introduced our OneTouch product offering to enable our customers to access our technologies to develop their own human interface designs for capacitive buttons and scrolling applications for products such as mobile smartphones and feature phones, portable digital music and video players, and notebook peripherals. OneTouch may not enable us to achieve our goal of increasing our business with existing customers or attracting new customers. In addition, OneTouch could reduce demand for our custom-designed human interface solutions.

Our inability to enhance our existing product solutions and develop new product solutions on a timely basis could harm our operating results and impede our growth.

**A technologically new human interface solution that achieves significant market share could harm our business.**

Our human interface solutions are designed to integrate touch, handwriting, and vision capabilities. New computing and communications devices could be developed that call for a different interface solution. Existing devices



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also could be modified to allow for a different interface solution. Our business could be harmed if our products become noncompetitive as a result of a technological breakthrough that allows a new interface solution to displace our solutions and achieve significant market acceptance.

### **International sales and manufacturing risks could adversely affect our operating results.**

Our manufacturing and assembly operations are primarily conducted in China, Taiwan, and Thailand by manufacturing contractors. We have sales and logistics operations in Hong Kong, and sales support operations in China, Japan, Korea, Switzerland, and Taiwan. These international operations expose us to various economic, political, and other risks that could adversely affect our operations and operating results, including the following:

- difficulties and costs of staffing and managing a multi-national organization,

- unexpected changes in regulatory requirements,

- differing labor regulations,

- potentially adverse tax consequences,

- tariffs and duties and other trade barrier restrictions,

- possible employee turnover or labor unrest,

- greater difficulty in collecting accounts receivable,

- the burdens and costs of compliance with a variety of foreign laws,

- potentially reduced protection for intellectual property rights, and

- political or economic instability in certain parts of the world.

The risks associated with international operations could negatively affect our operating results.

### **Our business may suffer if international trade is hindered, disrupted, or economically disadvantaged.**

Political and economic conditions abroad may adversely affect the foreign production and sale of our products. Protectionist trade legislation in either the United States or foreign countries, such as a change in the current tariff structures, export or import compliance laws, or other trade policies, could adversely affect our ability to sell human interface solutions in foreign markets and to obtain materials or equipment from foreign suppliers.

Changes in policies by the U.S. or foreign governments resulting in, among other things, higher taxation, currency conversion limitations, restrictions on the transfer of funds, or the expropriation of private enterprises also could have a material adverse effect on us. Any actions by countries in which we conduct business to reverse policies that encourage foreign investment or foreign trade also could adversely affect our operating results. In addition, U.S. trade policies, such as most favored nation status and trade preferences for certain Asian nations, could affect the attractiveness of our services to our U.S. customers and adversely impact our operating results.

### **Our operating results could be adversely affected by fluctuations in the value of the U.S. dollar against foreign currencies.**

We transact business predominantly in U.S. dollars and bill and collect our sales in U.S. dollars. A weakening of the dollar could cause our overseas vendors to require renegotiation of either the prices or currency we pay for their goods and services. In the future, customers may negotiate pricing and make payments in non-U.S. currencies. For fiscal 2009, approximately 5% of our costs were denominated in non-U.S. currencies, including Hong Kong dollars, British pounds, Taiwan dollars, Japanese yen, Korean won, Chinese yuan, and Swiss francs.

If our overseas vendors or customers require us to transact business in non-U.S. currencies, fluctuations in foreign currency exchange rates could affect our cost of goods, operating expenses, and operating margins and could





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result in exchange losses. In addition, currency devaluation can result in a loss to us if we hold deposits of that currency. Hedging foreign currencies can be difficult, especially if the currency is not freely traded. We cannot predict the impact of future exchange rate fluctuations on our operating results. We currently do not hedge any foreign currencies; accordingly, we did not have any foreign currency hedge contracts outstanding as of the end of our fiscal year.

**A majority of our contract manufacturers are located in China, Taiwan, and Thailand, and most of our customers are located in Asia, increasing the risk that a natural disaster, labor strike, war, or political unrest in those countries or that region would disrupt our operations.**

A majority of our contract manufacturers are located in China, Taiwan, and Thailand and most of our customers are located in Asia. Events outside of our control, such as earthquakes, fires, floods, or other natural disasters, or political unrest, war, labor strikes, or work stoppages in these countries would disrupt their operations, which would impact our operations. The risk of earthquakes in Taiwan is significant because of its proximity to major earthquake fault lines. An earthquake, such as the one that occurred in Taiwan in September 1999, could cause significant delays in shipments of our product solutions until we are able to shift our outsourced operations. In addition, there is political tension between China and Taiwan and between North Korea and South Korea that could lead to hostilities. If any of these events occur, we may not be able to obtain alternative capacity. Failure to secure alternative capacity could cause a delay in the shipment of our product solutions, which would cause our revenue to fluctuate or decline.

**Variability of customer requirements resulting in cancellations, reductions, or delays may adversely affect our operating results.**

We must provide increasingly rapid product turnaround and respond to ever-shorter lead times. A variety of conditions, both specific to individual customers and generally affecting the demand for OEMs' products, may cause customers to cancel, reduce, or delay orders. Cancellations, reductions, or delays by a significant customer or by a group of customers may adversely affect our revenue and could require us to repurchase inventory from our contract manufacturers, which could adversely affect our costs. On occasion, customers require rapid increases in production, which can strain our resources and reduce our margins. Although we have been able to obtain increased production capacity from our third-party manufacturers, we may be unable to do so at any given time to meet our customers' demands if their demands exceed anticipated levels.

**Our operating results may experience significant fluctuations that could result in a decline in the price of our stock.**

In addition to the variability resulting from the short-term nature of our customers' commitments, other factors contribute to significant periodic and seasonal quarterly fluctuations in our results of operations. These factors include the following:

- the cyclical nature of the markets we serve;

- the timing and size of orders;

- order push-outs or cancellations;

- the volume of orders relative to our ability to deliver;

- product introductions and market acceptance of new products or new generations of products;

- evolution in the life cycles of our customers' products;

- timing of expenses in anticipation of future orders;

- changes in product mix;

- availability of manufacturing and assembly services;



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changes in cost and availability of labor and components;

the expanded use of high-cost, third-party components in the products we sell;

timely delivery of product solutions to customers;

pricing and availability of competitive products;

introduction of new technologies into the markets we serve;

emergence of new competitors;

pressures on selling prices;

the absolute and relative levels of corporate enterprise and consumer notebook purchases;

our success in serving new markets; and

changes in economic conditions.

Accordingly, you should not rely on period-to-period comparisons as an indicator of our future performance. Negative or unanticipated fluctuations in our operating results may result in a decline in the price of our stock.

**If we fail to manage our growth effectively, our infrastructure, management, and resources could be strained, our ability to effectively manage our business could be diminished, and our operating results could suffer.**

The failure to manage our growth effectively could strain our resources, which would impede our ability to increase revenue. We have increased the number of our human interface solutions and plan to expand further the number and diversity of our solutions and their use in the future. Our ability to manage our planned diversification and growth effectively will require us to

successfully hire, train, retain, and motivate additional employees, including employees outside the United States;

efficiently plan and expand our facilities to meet increased headcount requirements;

enhance our global operational, financial, and management infrastructure; and

expand our development and production capacity.

In connection with the expansion and diversification of our product and customer base, we are increasing our personnel and making other expenditures to meet the increased demand we anticipate for our expanding product offerings, including offerings in the notebook computer and digital lifestyle markets. Increases in the demand for our products will require further expansion of our traditional notebook computer business as well as an increasing presence in the digital lifestyle product market, including mobile smartphones and feature phones and portable digital music and video players. To date, our sales of human interface solutions for portable digital music and video players and mobile smartphones and feature phones have varied significantly from quarter to quarter. Risks are further increased because customers do not commit to firm production schedules for more than a short time in advance. Any increase in expenses or investments in infrastructure and facilities in anticipation of future orders that do not materialize would adversely affect our profitability. Our customers also may require rapid increases in design and production services that place an excessive short-term burden on our resources and the resources of our third-party manufacturers. If we cannot manage our growth effectively, our business and results of operations could suffer.

**We depend on key personnel who would be difficult to replace, and our business will likely be harmed if we lose their services or cannot hire additional qualified personnel.**

Our success depends substantially on the efforts and abilities of our senior management and other key personnel. The competition for qualified management and key personnel, especially engineers, is intense. Although

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we maintain noncompetition and nondisclosure covenants with most of our key personnel and two of our key personnel have a change of control severance agreement, we do not have employment agreements with any of them. The loss of services of one or more of our key employees or the inability to hire, train, and retain key personnel, especially engineers and technical support personnel, and capable sales and customer-support employees outside the United States, could delay the development and sale of our products, disrupt our business, and interfere with our ability to execute our business plan.

### **Our inability to protect our intellectual property could impair our competitive advantage, reduce our revenue, and increase our costs.**

Our success and ability to compete depend in part on our ability to maintain the proprietary aspects of our technologies and products. We rely on a combination of patents, copyrights, trade secrets, trademarks, confidentiality agreements, and other contractual provisions to protect our intellectual property, but these measures may provide only limited protection. We license from third parties certain technology used in and for our products. These third-party licenses are granted with restrictions, and there can be no assurances that such third-party technology will remain available to us on terms beneficial to us. Our failure to enforce and protect our intellectual property rights or obtain from third parties the right to use necessary technology could have a material adverse effect on our business, financial condition, and results of operations. In addition, the laws of some foreign countries do not protect proprietary rights as fully as do the laws of the United States.

Patents may not issue from the patent applications that we have filed or may file in the future. Our issued patents may be challenged, invalidated, or circumvented, and claims of our patents may not be of sufficient scope or strength, or issued in the proper geographic regions, to provide meaningful protection or any commercial advantage. In addition, certain of our patents will expire within several years.

We have not applied for, and do not have, any copyright registration on our technologies or products. We have applied to register certain of our trademarks in the United States and other countries. There can be no assurance that we will obtain registrations of principle or other trademarks in key markets. Failure to obtain registrations could compromise our ability to protect fully our trademarks and brands and could increase the risk of challenge from third parties to our use of our trademarks and brands.

We do not consistently rely on written agreements with our customers, suppliers, manufacturers, and other recipients of our technologies and products, and therefore some trade secret protection may be lost and our ability to enforce our intellectual property rights may be limited. Additionally, our customers, suppliers, manufacturers, and other recipients of our technologies and products may seek to use our technologies and products without appropriate limitations. In the past, we did not consistently require our employees and consultants to enter into confidentiality agreements, employment agreements, or proprietary information and invention assignment agreements. Therefore, our former employees and consultants may try to claim some ownership interest in our technologies and products and may use our technologies and products competitively and without appropriate limitations.

### **We may be required to incur substantial expenses and divert management attention and resources in defending intellectual property litigation against us.**

We may receive notices from third parties that claim our products infringe their rights. From time to time, we receive notice from third parties of the intellectual property rights such parties have obtained. We cannot be certain that our technologies and products do not and will not infringe issued patents or other proprietary rights of others. Any future claims, with or without merit, could result in significant litigation costs and diversion of resources, including the attention of management, and could require us to enter into royalty and licensing agreements, any of which could have a material adverse effect on our business. There can be no assurance that such licenses could be obtained on commercially reasonable terms, if at all, or that the terms of any offered licenses would be acceptable to us. If forced to cease using such technology, there can be no assurance that we would be able to develop or obtain alternate technology. Accordingly, an adverse determination in a judicial or administrative proceeding or failure to obtain necessary licenses could prevent us from manufacturing, using, or selling certain of our products, which could have a material adverse effect on our business, financial condition, and results of operations.

Furthermore, parties making such claims could secure a judgment awarding substantial damages, as well as injunctive or other equitable relief that could effectively block our ability to make, use, or sell our products in the

United States or abroad. Such a judgment could have a material adverse effect on our business, financial condition, and

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results of operations. In addition, we are obligated under certain agreements to indemnify the other party in connection with infringement by us of the proprietary rights of third parties. In the event we are required to indemnify parties under these agreements, it could have a material adverse effect on our business, financial condition, and results of operations.

### **We may incur substantial expenses and divert management resources in prosecuting others for their unauthorized use of our intellectual property rights.**

The markets in which we compete are characterized by frequent litigation regarding patents and other intellectual property rights. Other companies, including our competitors, may develop technologies that are similar or superior to our technologies, duplicate our technologies, or design around our patents and may have or obtain patents or other proprietary rights that would prevent, limit, or interfere with our ability to make, use, or sell our products. Effective intellectual property protection may be unavailable or limited in some foreign countries in which we operate, such as China and Taiwan. Unauthorized parties may attempt to copy or otherwise use aspects of our technologies and products that we regard as proprietary. There can be no assurance that our means of protecting our proprietary rights in the United States or abroad will be adequate or that competitors will not independently develop similar technologies. If our intellectual property protection is insufficient to protect our intellectual property rights, we could face increased competition in the market for our technologies and products.

Should any of our competitors file patent applications or obtain patents that claim inventions also claimed by us, we may choose to participate in an interference proceeding to determine the right to a patent for these inventions because our business would be harmed if we fail to enforce and protect our intellectual property rights. Even if the outcome is favorable, this proceeding could result in substantial cost to us and disrupt our business.

In the future, we also may need to file lawsuits to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of the proprietary rights of others. This litigation, whether successful or unsuccessful, could result in substantial costs and diversion of resources, which could have a material adverse effect on our business, financial condition, and results of operations.

### **If we become subject to product returns and product liability claims resulting from defects in our products, we may fail to achieve market acceptance of our products and our business could be harmed.**

We develop complex products in an evolving marketplace and generally warrant our products for a period of 12 months or more from the date of sale. Despite testing by us and our customers, defects may be found in existing or new products. In fiscal 2001, a manufacturing error of one of our contract manufacturers was discovered. Although the error was promptly discovered without significant interruption of supply and the contract manufacturer rectified the problem at its own cost, any such manufacturing errors or product defects could result in a delay in recognition or loss of revenue, loss of market share, or failure to achieve market acceptance. Additionally, these defects could result in financial or other damages to our customers; cause us to incur significant warranty, support, and repair costs; and divert the attention of our engineering personnel from key product development efforts. In such circumstances, our customers could also seek and obtain damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time-consuming and costly to defend. The occurrence of these problems would likely harm our business.

### **Potential strategic alliances may not achieve their objectives, and the failure to do so could impede our growth.**

We anticipate that we will enter into strategic alliances. Among other matters, we continually explore strategic alliances designed to enhance or complement our technology or to work in conjunction with our technology; to provide necessary know-how, components, or supplies; and to develop, introduce, and distribute products utilizing our technology. Any strategic alliances may not achieve their intended objectives, and parties to our strategic alliances may not perform as contemplated. The failure of these alliances may impede our ability to introduce new products and enter new markets.

### **Any acquisitions that we undertake could be difficult to integrate, disrupt our business, dilute stockholder value, and harm our operating results.**

We expect to pursue opportunities to acquire other businesses and technologies in order to complement our current human interface solutions, expand the breadth of our markets, enhance our technical capabilities, or otherwise





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offer growth opportunities. While we have no current definitive agreements underway, we may acquire businesses, products, or technologies in the future. If we make any future acquisitions, we could issue stock that would dilute existing stockholders' percentage ownership, incur substantial debt, assume contingent liabilities, or experience higher operating expenses. Our experience in acquiring other businesses and technologies is limited. Potential acquisitions also involve numerous risks, including the following:

- problems assimilating the purchased operations, technologies, or products;

- unanticipated costs associated with the acquisition;

- diversion of management's attention from our core businesses;

- adverse effects on existing business relationships with suppliers and customers;

- risks associated with entering markets in which we have little or no prior experience; and

- potential loss of key employees of purchased organizations.

We cannot assure you that we would be successful in overcoming problems encountered in connection with any acquisitions, and our inability to do so could disrupt our operations and adversely affect our business.

### **Our target markets are cyclical and may result in fluctuations in our operating results.**

The PC and electronics industries have experienced significant economic downturns at various times. These downturns are characterized by diminished product demand, accelerated erosion of average selling prices, and production overcapacity. In addition, the PC and electronics industries are cyclical in nature. We seek to reduce our exposure to industry downturns and cyclicalities by providing design and production services for leading companies in rapidly expanding industry segments. We may, however, experience substantial period-to-period fluctuations in future operating results because of general industry conditions or events occurring in the general economy.

### **The valuation of our technology conducted in connection with our international operating structure may be challenged, which could result in additional taxes, interest, and penalties.**

In fiscal 2005, we implemented an international operating structure. Under this structure, generally, one of our affiliates licensed from us certain rights to the pre-existing and in-process technology associated with our products for exploitation in all geographic markets except the U.S., Japanese, and Korean markets, which we refer to as "ROW" markets. Our affiliate also acquired ownership of all future economic rights to product sales in ROW markets by entering into an agreement to license certain intangibles and a cost-sharing agreement under which we and our affiliate will share research and development costs in accordance with certain tax rules and regulations. We believe this structure appropriately reflects where our profits are generated and may result in future tax advantages to us, but there can be no assurances that this will be the case.

### **Repatriation of our foreign earnings to the United States or changes in tax laws, such as those proposed by the Obama administration in May 2009, if enacted, may adversely affect our future reported tax rates and financial results or the way we conduct our business.**

Changes in tax laws may adversely affect our future reported tax rates and financial results or the way we conduct our business. We consider the undistributed operating earnings of certain foreign subsidiaries to be indefinitely invested outside the United States and have not provided for U.S. federal and state income taxes that may result from future remittances of those undistributed operating earnings. The Obama administration recently announced several proposals to reform U.S. tax laws, including proposals that could reduce or eliminate the deferral of U.S. income tax on our foreign subsidiaries' undistributed earnings, potentially requiring those earnings to be taxed at the U.S. federal income tax rate.

**Table of Contents****We expect to incur additional expenses in complying with corporate governance and public disclosure requirements.**

Changing laws, regulations, and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations, and Nasdaq Global Select Market rules, are creating uncertainty and increased expenses for companies such as ours. These new or changed laws, regulations, and standards are subject to varying interpretations in many cases due to their lack of specificity and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations, and standards have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal control over financial reporting and our external auditors' audit of our internal controls over financial reporting has required the commitment of significant financial and managerial resources. We expect these efforts to require the continued commitment of significant resources. In addition, it may become more difficult and more expensive for us to obtain director and officer liability insurance. As a result, we may have difficulty attracting and retaining qualified board members, which could harm our business. If our efforts to comply with new or changed laws, regulations, and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may be harmed.

**The accounting requirements for income taxes on certain of our share-based awards will subject our future quarterly and annual effective tax rates to greater volatility and, consequently, our ability to estimate reasonably our future quarterly and annual effective tax rates is greatly diminished.**

In accordance with SFAS 123R, we recognize tax benefit upon expensing nonqualified stock options and deferred stock units issued under our share-based compensation plans. However, under current accounting standards, we cannot recognize tax benefit concurrent with expensing incentive stock options and employee stock purchase plan shares (qualified stock options) issued under our share-based compensation plans. For qualified stock options that vested after our adoption of SFAS 123R, we recognize the tax benefit only in the period when disqualifying dispositions of the underlying stock occur and, for qualified stock options that vested prior to our adoption of SFAS 123R, the tax benefit is recorded directly to additional paid-in capital. Accordingly, because we cannot recognize the tax benefit for share-based compensation expense associated with qualified stock options until the occurrence of future disqualifying dispositions of the underlying stock and such disqualified dispositions may happen in periods when our stock price substantially increases, and because a portion of that tax benefit may be directly recorded to additional paid-in capital, our future quarterly and annual effective tax rates will be subject to greater volatility and, consequently, our ability to estimate reasonably our future quarterly and annual effective tax rates is greatly diminished.

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

A change in accounting standards or practices could have a significant effect on our reported results of operations. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred in the past and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business. For example, the Financial Accounting Standards Board issued SFAS 123R requiring us to recognize all share-based payments to employees, including grants of stock options, in the financial statements based on their grant date fair value eliminating the pro forma footnote disclosures that were allowed as an alternative to financial statement recognition. This requirement, while not affecting our cash flow, has adversely affected our reported financial results and impaired our ability to provide guidance on our future reported financial results as a result of the variability of the factors used to establish the grant date fair value of stock options and the accounting for income taxes thereon.

**We increased our leverage as a result of the sale of our 0.75% convertible senior subordinated notes.**

As a result of the sale of our 0.75% convertible senior subordinated notes in fiscal 2005, we incurred \$125 million of indebtedness, which we subsequently reduced to \$65.3 million through the repurchase and retirement of outstanding notes. As a result of this indebtedness, our interest payment obligations have increased. Our interest

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payment obligations on the outstanding notes is approximately \$490,000 annually. The degree to which we are now leveraged could have adverse consequences, including the following:

a limitation on our ability to obtain future financing for working capital, acquisitions, or other purposes;

an increase in our vulnerability to industry downturns and competitive pressures; and

a possible competitive disadvantage with less leveraged competitors and competitors that may have better access to capital resources.

Our ability to meet our debt service obligations will depend upon our future performance, which will be subject to the financial, business, and other factors affecting our operations, many of which are beyond our control.

**As a result of our irrevocable election to cash settle the outstanding principal amount of our convertible senior subordinated notes in April 2007, we may be required to utilize up to \$65.3 million of our cash as early as December 2009.**

We made an irrevocable election to cash settle the outstanding principal amount of our convertible senior subordinated notes in April 2007.

Our noteholders have the right to require us to repurchase the notes on December 1, 2009. At June 30, 2009, there were \$65.3 million in principal amount of our notes outstanding, which were classified as a current liability on our consolidated balance sheet. Repurchase requests by noteholders could require us to use up to \$65.3 million of our cash or to secure funds by other means. We will remain obligated to satisfy the debt service requirement under our notes that are not repurchased, at the option of our noteholders in December 2009. Any failure to service the notes in the future would result in a default.

**Currently our investments in auction rate securities, or ARS, are not liquid, and we may lose some or all of our principal invested or may be required to further reduce the carrying value if the issuers are not able to meet their payment obligations or if we sell our ARS investments before they recover,.**

As of June 30, 2009, we had \$42.5 million invested in ARS for which the auctions have failed and our investments are not liquid. The carrying value of these investments is \$28.8 million, reflecting \$16.0 million of other-than-temporary impairment, partially offset by \$2.3 million of temporary recovery. If the issuers are not able to meet their payment obligations or if we sell our ARS investments before they recover, we may lose some or all of the principal invested or may be required to further reduce the carrying value. This would adversely affect our financial position, results of operations, and cash flows.

**Legislation affecting the markets in which we participate could adversely affect our ability to implement our growth strategies.**

Our ability to expand our business may be adversely impacted by future laws or regulations. Our customers products may be subject to laws relating to environmental regulations, communications, encryption technology, electronic commerce, e-signatures, and privacy. Any of these laws could be expensive to comply with, and the marketability of our products could be adversely affected.

**We must finance the growth of our business and the development of new products, which could have an adverse effect on our operating results.**

To remain competitive, we must continue to make significant investments in research and development, marketing, and business development. Our failure to increase sufficiently our net revenue to offset these increased costs would adversely affect our operating results.

From time to time, we may seek additional equity or debt financing to provide for funds required to expand our business. We cannot predict the timing or amount of any such requirements at this time. If such financing is not available on satisfactory terms, we may be unable to expand our business or to develop new business at the rate desired

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and our operating results may suffer. Debt financing increases expenses and must be repaid regardless of operating results. Equity financing could result in additional dilution to existing stockholders.

We consider the undistributed operating earnings of certain foreign subsidiaries to be indefinitely invested outside the United States. If we were to distribute a portion of those earnings to our U.S. parent company to finance our future growth, we would be required to pay U.S. federal and state taxes on the distribution and further may be required to accrue U.S. and state taxes on the remaining undistributed operating earnings, which would adversely affect our tax rate and financial results.

**Continuing uncertainty of the U.S. and global economy may have serious implications for the growth and stability of our business and may negatively affect our stock price.**

The revenue growth and profitability of our business depends significantly on the overall demand in the notebook computer market and in the markets for digital lifestyle products and other electronic devices, including mobile smartphones and feature phones. Softening demand in these markets caused by ongoing economic uncertainty may result in decreased revenue or earnings levels or growth rates. The U.S. and global economy has been historically cyclical, and market conditions continue to be challenging, which has resulted in individuals and companies delaying or reducing expenditures. Further delays or reductions in spending could have a material adverse effect on demand for our products, and consequently on our business, financial condition, results of operations, prospects, and stock price.

**The market price of our common stock has been and may continue to be volatile.**

The trading price of our common stock has been and may continue to be subject to wide fluctuations in response to various factors, including the following:

- variations in our quarterly results;

- the financial guidance we may provide to the public, any changes in such guidance, or our failure to meet such guidance;

- changes in financial estimates by industry or securities analysts or our failure to meet such estimates;

- various market factors or perceived market factors, including rumors, whether or not correct, involving us, our customers, our suppliers, or our competitors;

- announcements of technological innovations by us or by our competitors;

- introductions of new products or new pricing policies by us or by our competitors;

- acquisitions or strategic alliances by us or by our competitors;

- recruitment or departure of key personnel;

- the gain or loss of significant orders;

- the gain or loss of significant customers;

- market conditions in our industry, the industries of our customers, and the economy as a whole;

- hedging activities by investors holding positions in our convertible senior subordinated notes;

- short positions held by investors; and

- general financial market conditions or occurrences.

In addition, stocks of technology companies have experienced extreme price and volume fluctuations that often have been unrelated or disproportionate to these companies' operating performance. Public announcements by

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technology companies concerning, among other things, their performance, accounting practices, or legal problems could cause the market price of our common stock to decline regardless of our actual operating performance.

### **Our charter documents and Delaware law could make it more difficult for a third party to acquire us, and discourage a takeover.**

Our certificate of incorporation and the Delaware General Corporation Law contain provisions that may have the effect of making more difficult or delaying attempts by others to obtain control of our company, even when these attempts may be in the best interests of our stockholders. Our certificate of incorporation also authorizes our board of directors, without stockholder approval, to issue one or more series of preferred stock, which could have voting and conversion rights that adversely affect or dilute the voting power of the holders of common stock. Delaware law also imposes conditions on certain business combination transactions with interested stockholders. Our certificate of incorporation divides our Board of Directors into three classes, with one class to stand for election each year for a three-year term after the election. The classification of directors tends to discourage a third party from initiating a proxy solicitation or otherwise attempting to obtain control of our company and may maintain the incumbency of our Board of Directors, as this structure generally increases the difficulty of, or may delay, replacing a majority of directors. Our certificate of incorporation authorizes our Board of Directors to fill vacancies or newly created directorships. A majority of the directors then in office may elect a successor to fill any vacancies or newly created directorships.

### **Our stockholders' rights plan may adversely affect existing stockholders.**

Our stockholders' rights plan also may have the effect of deterring, delaying, or preventing a change in control that might otherwise be in the best interests of our stockholders. In general, stock purchase rights issued under the rights plan become exercisable when a person or group acquires 15% or more of our common stock or a tender offer or exchange offer of 15% or more of our common stock is announced or commenced. After any such event, our other stockholders may purchase additional shares of our common stock at 50% of the then-current market price. The rights will cause substantial dilution to a person or group that attempts to acquire us on terms not approved by our board of directors. The rights should not interfere with any merger or other business combination approved by our board of directors as the rights may be redeemed by us at \$0.01 per stock purchase right at any time before any person or group acquires 15% or more of our outstanding common stock. The rights expire in August 2012.

### **Sales of large numbers of shares could adversely affect the price of our common stock.**

As of August 15, 2009, all of the 33,937,192 shares of our common stock outstanding were eligible for resale in the public markets. Of these shares, 5,559,929 shares held by affiliates were eligible for resale in the public markets subject to compliance with the volume and manner of sale rules of Rules 144 or 701 under the Securities Act of 1933, as amended, and the balance of the shares were eligible for resale in the public markets as unrestricted shares. In general, under Rule 144 as currently in effect, any person (or persons whose shares are aggregated for purposes of Rule 144) who is deemed an affiliate of our company and beneficially owns restricted securities with respect to which at least six months has elapsed since the later of the date the shares were acquired from us, or from an affiliate of ours, is entitled to sell within any three-month period a number of shares that does not exceed the greater of 1% of the then outstanding shares of our common stock or the average weekly trading volume in common stock during the four calendar weeks preceding such sale. Sales by affiliates under Rule 144 also are subject to certain manner-of-sale provisions and notice requirements and to the availability of current public information about us.

Rule 701, as currently in effect, permits our employees, officers, directors, and consultants who purchase shares pursuant to a written compensatory plan or contract to resell these shares in reliance upon Rule 144, but without compliance with specific restrictions. Rule 701 provides that affiliates may sell their Rule 701 shares under Rule 144 without complying with the holding period requirement and that non-affiliates may sell their shares in reliance on Rule 144 without complying with the holding period, public information, volume limitation, or notice provisions of Rule 144. A person who is not an affiliate, who has not been an affiliate within three months prior to sale, and who beneficially owns restricted securities with respect to which at least one year has elapsed since the later of the date the shares were acquired from us, or from an affiliate of ours, is entitled to sell such shares under Rule 144 without regard to any of the volume limitations or other requirements described above. Sales of substantial amounts of common stock in the public market could adversely affect prevailing market prices.





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We have registered an aggregate of \$100 million of common stock and preferred stock for issuance in connection with acquisitions, which shares generally will be freely tradeable after their issuance under Rule 145 of the Securities Act, unless held by an affiliate of the acquired company, in which case such shares will be subject to the volume and manner of sale restrictions of Rule 144 discussed above. The issuance or subsequent sale of these shares in the public market could adversely affect prevailing market prices.

We have registered an aggregate of \$125 million of our 0.75% Convertible Senior Subordinated Notes due 2024 and the common stock issuable upon conversion of the notes. The shares issued upon conversion generally will be freely tradeable after their issuance, unless held by an affiliate, in which case such shares will be subject to the volume and manner of sale restrictions of Rule 144 discussed above. In fiscal 2009, we purchased and retired \$59.7 million of the Notes leaving \$65.3 million of the Notes outstanding. The issuance or subsequent sale of these shares in the public market could negatively affect the market price of our common stock.

We have registered an aggregate of \$250 million of common stock (including the associated rights), preferred stock, debt securities, depositary shares, warrants, purchase contracts, and units (collectively securities) for issuance to raise funds for general corporate purposes, which may include the repayment of indebtedness outstanding from time to time, working capital, capital expenditures, acquisitions, and repurchases of our common stock or other securities. Securities issued under the shelf registration generally will be freely tradeable after their issuance unless held by an affiliate of our company, in which case such shares will be subject to the volume and manner of sale restrictions of Rule 144.

We have registered for offer and sale the shares of common stock that are reserved for issuance pursuant to our outstanding share-based compensation plans. Shares issued in connection with our share-based compensation plans generally will be eligible for sale in the public market, except that affiliates will continue to be subject to volume limitations and other requirements of Rule 144. The issuance or subsequent sale of such shares could depress the market price of our common stock.

### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

### **ITEM 2. PROPERTIES**

Our principal executive offices as well as our principal research, development, sales, marketing, and administrative functions are located in our 70,000 square foot facility in Santa Clara, California and an adjacent 64,000 square foot facility. In New York, we lease approximately 10,000 square feet used for research and development. Our Asia/Pacific headquarters are located in Hong Kong where we lease approximately 16,000 square feet of space. We also maintain approximately 10,000 square feet of office space in Taiwan, approximately 4,600 square feet of office space in China, approximately 3,500 square feet of office space in Japan, approximately 2,500 square feet of office space in Korea, and less than 1,000 square feet of office space in Switzerland. We have satellite sales support offices in Finland, Singapore, Thailand, and Texas.

### **ITEM 3. LEGAL PROCEEDINGS**

None

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

Not applicable.

**Table of Contents****PART II****ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information on Common Stock**

Our common stock has been listed on the Nasdaq Global Select Market (formerly on the Nasdaq National Market) under the symbol SYNA since January 29, 2002. Prior to that time, there was no public market for our common stock. The following table sets forth for the periods indicated the high and low sales prices of our common stock as quoted on the Nasdaq Global Select Market.

	<b>High</b>	<b>Low</b>
<b>Year ended June 30, 2008:</b>		
First quarter <sup>(1)</sup>	\$33.46	\$23.15
Second quarter <sup>(1)</sup>	\$41.15	\$27.06
Third quarter <sup>(1)</sup>	\$29.97	\$14.69
Fourth quarter <sup>(1)</sup>	\$31.89	\$15.74
<b>Year ended June 30, 2009:</b>		
First quarter <sup>(1)</sup>	\$36.95	\$24.96
Second quarter	\$31.98	\$13.85
Third quarter	\$27.84	\$14.11
Fourth quarter	\$40.94	\$23.03

(1) All share amounts reflect the 3-for-2 stock split effected as a stock dividend and paid on August 29, 2008.

**Stockholders**

As of August 15, 2009, there were approximately 210 holders of record of our common stock.

**Dividends**

We have never declared or paid cash dividends on our common stock. We currently plan to retain any earnings to finance the growth of our business, purchase shares under our common stock purchase program, or purchase and retire our outstanding notes rather than to pay cash dividends. Payments of any cash dividends in the future will depend on our financial condition, results of operations, and capital requirements as well as other factors deemed relevant by our board of directors.

Our revolving line of credit also places restrictions on the payment of any dividends.

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**Performance Graph**

The following line graph compares cumulative total stockholder returns for the five years ended June 30, 2009 for (i) our common stock, (ii) the Nasdaq Composite Index, and (iii) the Nasdaq Computer Index. The graph assumes an investment of \$100 on June 30, 2004. The calculations of cumulative stockholder return on the Nasdaq Composite Index and the Nasdaq Computer Index include reinvestment of dividends. The calculation of cumulative stockholder return on our common stock does not include reinvestment of dividends because we did not pay any dividends during the measurement period. The historical performance shown is not necessarily indicative of future performance.

**COMPARISON OF 60 MONTH CUMULATIVE TOTAL RETURN**

Among Synaptics Incorporated, The Nasdaq Composite Index,  
and The Nasdaq Computer Index

The performance graph above shall not be deemed filed for purposes of Section 18 of the Securities Act of 1934, as amended, or Exchange Act, or otherwise subject to the liability of that section. The performance graph above will not be deemed incorporated by reference into any filing of our company under the Exchange Act or the Securities Act of 1933, as amended.

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

The following table presents selected financial data for each fiscal year in the five-year period ended June 30, 2009. Our fiscal year is the 52- or 53-week period ending on the last Saturday in June. In the table below, fiscal 2007 was a 53-week period and the other fiscal years presented were 52-week periods. As our past operating results are not necessarily indicative of our future operating results, you should read the selected financial data below in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes contained elsewhere in this report.

	Years ended June 30,				
	2005	2006	2007	2008	2009
	(in thousands, except for per share data)				
Consolidated Statements of Income Data:					
Net revenue	\$ 208,139	\$ 184,557	\$ 266,787	\$ 361,057	\$ 473,302
Cost of revenue(1)	112,090	101,704	160,913	213,606	281,793
Gross margin	96,049	82,853	105,874	147,451	191,509
Operating expenses:					
Research and development(1)	24,991	35,356	39,386	50,093	68,026
Selling, general, and administrative(1)	18,423	28,019	36,247	48,126	54,014
Other operating expense (income)	(3,800)				
Amortization of deferred stock compensation(2)	328				
Restructuring			915		
Total operating expenses	39,942	63,375	76,548	98,219	122,040
Operating income	56,107	19,478	29,326	49,232	69,469
Interest income, net	2,225	6,045	9,105	7,830	1,984
Other income or loss, net				(8,274)	(5,643)
Income before provision for income taxes	58,332	25,523	38,431	48,788	65,810
Provision for income taxes	20,347	11,822	11,897	17,688	11,486
Net income	\$ 37,985	\$ 13,701	\$ 26,534	\$ 31,100	\$ 54,324
Net income per share:					
Basic(3)	\$ 0.98	\$ 0.37	\$ 0.69	\$ 0.83	\$ 1.60
Diluted(3)	\$ 0.86	\$ 0.34	\$ 0.63	\$ 0.79	\$ 1.53
Shares used in computing net income per share:					
Basic(3)	38,604	37,062	38,337	37,667	33,981
Diluted(3)	44,642	43,613	43,596	39,365	35,577

(1) Amounts exclude amortization of deferred stock compensation as follows:

Cost of revenue	\$	12	\$		\$		\$
Research and development		8					
Selling, general, and administrative		308					
Amortization of deferred stock compensation	\$	328	\$		\$		\$

(2) Upon our adoption of SFAS 123R in fiscal 2006, we ceased amortizing deferred stock compensation. Accordingly, no amortization of deferred stock compensation was recorded for the years ended June 30, 2006, 2007, 2008, and 2009.

(3) All share and per share amounts reflect the 3-for-2 stock split effected as a stock dividend and paid on August 29, 2008.

Our basic net income per share amounts for each period presented have been computed using the weighted average number of shares of common stock outstanding. Our diluted net income per share amounts for each period presented include the weighted average effect of potentially dilutive shares. We used the treasury stock method to determine the dilutive effect of our stock options, deferred stock units, and convertible notes. Under the treasury stock method, shares associated with our convertible notes are included in the calculation of diluted net income per share only if the weighted average price of our common stock exceeds \$33.69 during the reporting period. Prior to fiscal 2008, we used the if converted method for our convertible notes and 2,038,000, 3,711,000, and 3,062,000 diluted shares were included in the calculation of diluted net income per share in fiscal 2005, 2006, and 2007, respectively.

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	2005	2006	June 30, 2007 (in thousands)	2008	2009
<b>Consolidated Balance Sheet</b>					
<b>Data:</b>					
Cash, cash equivalents, and short-term investments	\$228,921	\$245,176	\$265,017	\$146,516	\$191,970
Working capital	235,240	257,788	299,921	189,851	158,430
Total assets	311,205	331,421	373,312	306,361	376,221
Current debt					65,303
Long-term debt, less current portion	126,500	126,500	125,000	125,000	
Treasury shares, at cost	21,180	39,999	72,345	237,387	237,387
Total stockholders' equity	144,660	167,042	208,087	113,777	221,414

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Forward-Looking Statements and Factors That May Affect Results**

You should read the following discussion and analysis in conjunction with our financial statements and related notes contained elsewhere in this report. This discussion contains forward-looking statements that involve risks, uncertainties, and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of a variety of factors, including those set forth under Item 1A. Risk Factors.

**Overview**

We are a leading worldwide developer and supplier of custom-designed human interface solutions that enable people to interact more easily and intuitively with a wide variety of mobile computing, communications, entertainment, and other electronic devices. We believe our results to date reflect the combination of our customer focus, the strength of our intellectual property, and our engineering know-how, which allow us to develop or engineer products that meet the demanding design specifications of OEMs.

We recognize revenue from product sales when there is persuasive evidence that an arrangement exists, delivery has occurred or title has transferred, the price is fixed or determinable, and collection is reasonably assured. Our net revenue increased from \$208.1 million for fiscal 2005 to \$473.3 million for fiscal 2009, representing a compound annual growth rate of approximately 23%. For fiscal 2005, we derived 59% of our net revenue from the personal computer market. For fiscal 2009, revenue from the personal computer market accounted for 57% of our net revenue.

Many of our customers have migrated their manufacturing operations from Taiwan to China, and many of our OEM customers have established design centers in that region. With our expanded global presence, including offices in China, Hong Kong, Japan, Korea, Switzerland, Taiwan, and the United States, we are well positioned to provide local sales, operational, and engineering support services to our existing customers, as well as potential new customers, on a global basis.

Our manufacturing operations are based on a variable cost model in which we outsource all of our production requirements and generally drop ship our products directly to our customers from our contract manufacturers facilities, eliminating the need for significant capital expenditures and allowing us to minimize our investment in inventories. This approach requires us to work closely with our contract manufacturers to ensure adequate production capacity to meet our forecasted volume requirements. We provide our contract manufacturers with six-month rolling forecasts and issue purchase orders based on our anticipated requirements for the next 90 days. However, we do not have any long-term supply contracts with any of our contract manufacturers. We use three third-party wafer manufacturers to supply wafers and two third-party packaging manufacturers to package our proprietary ASICs. In certain cases, we rely on a single source or a limited number of suppliers to provide other key components of our products. Our cost of revenue includes all costs associated with the production of our products, including materials, logistics, manufacturing, assembly, and test costs paid to third-party manufacturers and related overhead costs.

associated with our indirect manufacturing operations personnel. Additionally, we charge all warranty costs, yield losses, and any inventory provisions or write-downs to cost of revenue.



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Our gross margin generally reflects the combination of the added value we bring to our OEM customers products in meeting their custom design requirements and the impact of our ongoing cost-improvement programs. These cost-improvement programs include reducing materials and component costs and implementing design and process improvements. Our newly introduced products may have lower margins than our more mature products, which have realized greater benefits associated with our ongoing cost-improvement programs. As a result, new product introductions may initially negatively impact our gross margin.

Our research and development expenses include costs for supplies and materials related to product development, as well as the engineering costs incurred to design human interface solutions for OEM customers prior to and after their commitment to incorporate those solutions into their products. These expenses have generally increased, reflecting our continuing commitment to the technological and design innovation required to maintain our position in our existing markets and to adapt our existing technologies or develop new technologies for new markets.

Selling, general, and administrative expenses include expenses related to sales, marketing, and administrative personnel; internal sales and outside sales representatives' commissions; market and usability research; outside legal, accounting, and consulting costs; and other marketing and sales activities. These expenses have generally increased, primarily reflecting incremental staffing and related support costs associated with our increased business levels, growth in our existing markets, and penetration into new markets.

**Critical Accounting Policies and Estimates**

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, cost of revenue, inventories, product warranty, provision for income taxes, income taxes payable, intangible assets, and contingencies. We base our estimates on historical experience, applicable laws, and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The methods, estimates, interpretations, and judgments we use in applying our most critical accounting policies can have a significant impact on the results that we report in our consolidated financial statements. The Securities and Exchange Commission considers an entity's most critical accounting policies to be those policies that are both most important to the portrayal of the entity's financial condition and results of operations and those that require the entity's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about matters that are inherently uncertain when estimated. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

***Revenue Recognition***

We recognize revenue from product sales when there is persuasive evidence that an arrangement exists, delivery has occurred or title has transferred, the price is fixed or determinable, and collection is reasonably assured. We accrue for estimated sales returns and other allowances, based on historical experience, at the time we recognize revenue. We record contract revenue for research and development as we provide the services under the terms of the contract. We recognize non-refundable contract fees for which no further performance obligations exist and for which there is no continuing involvement by us on the earlier of when the payments are received or when collection is assured.

***Investments***

We account for investment securities under the provisions of Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115), and related interpretations and staff positions, FSP SFAS No. 115-1 and SFAS 124-1 (SFAS 115-1 and SFAS 124-1), The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, as amended by FSP SFAS No. 115-2 and 124-2 (SFAS 115-2 and SFAS 124-2), Recognition and Presentation of Other-Than-Temporary Impairments. SFAS 115 requires us to record available-for-sale securities at fair value, with unrealized gains and losses being reported as a component of other comprehensive income. We follow the guidance provided by SFAS 115-



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1 and SFAS 124-1 to assess whether our investments with unrealized loss positions are other-than-temporarily impaired, and the guidance provided by SFAS 115-2 and SFAS 124-2 to determine whether an impairment of debt securities is other-than-temporary. We follow the hierarchical approach established under SFAS No.157 Fair Value Measurements ( SFAS 157 ), and related interpretations and staff positions, and additional guidance provided by FSP SFAS 157-4 ( SFAS 157-4 ), Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly, to determine fair value of our investments, which we adopted at the beginning of fiscal 2009.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Our fair value estimates consider, among other factors, the collateral underlying the security investments, creditworthiness of the counterparty, timing of expected future cash flows, and, in the case of ARS, the probability of a successful auction in a future period. We follow the guidance provided by SFAS 157-4 to estimate fair value when the volume and level of activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability, and to determine circumstances that may indicate that a transaction is not orderly.

Further, we use judgment in evaluating whether a decline in fair value is temporary or other-than-temporary and consider the following indicators: changes in credit ratings or asset quality; changes in the economic environment; length of time and extent to which fair value has been below cost basis; changes in market conditions; changes in expected cash flows; and our ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery in market value. Temporary declines in fair value are recorded as charges to accumulated other comprehensive income/(loss) in the equity section of our balance sheet, while other-than-temporary declines in fair value are bifurcated between credit losses, which are charged to earnings, and noncredit losses, which depending on facts and circumstances may be charged to other comprehensive income/(loss) or earnings.

### *Inventory*

We state our inventories at the lower of cost or market. We base our assessment of the ultimate realization of inventories on our projections of future demand and market conditions. Sudden declines in demand, rapid product improvements, or technological changes, or any combination of these factors can cause us to have excess or obsolete inventories. On an ongoing basis, we review for estimated obsolete or unmarketable inventories and write down our inventories to their net realizable value based upon our forecasts of future demand and market conditions. If actual market conditions are less favorable than our forecasts, additional inventory write-downs may be required. The following factors influence our estimates: changes to or cancellations of customer orders, unexpected decline in demand, rapid product improvements and technological advances, and termination or changes by our OEM customers of any product offerings incorporating our product solutions.

Periodically, we purchase inventory from our contract manufacturers when a customer delays its delivery schedule or cancels its order. In those circumstances in which our customer has cancelled its order and we purchase inventory from our contract manufacturers, we consider a write-down to reduce the carrying value of the inventory purchased to its net realizable value. We charge write-downs to reduce the carrying value of obsolete, slow moving, and non-usable inventory to net realizable value to cost of revenue. The effect of these write-downs is to establish a new cost basis in the related inventory, which we do not subsequently write up.

### *Share-Based Compensation Costs*

We account for employee share-based compensation costs in accordance with SFAS No. 123R, Share-Based Payment ( SFAS 123R ) and apply the provisions of Staff Accounting Bulletin No. 107, Share-Based Payment ( SAB 107 ). We utilize the Black-Scholes option pricing model to estimate the grant date fair value of employee share-based compensatory awards, which requires the input of highly subjective assumptions, including expected volatility and expected life. Historical and implied volatilities were used in estimating the fair value of our share-based awards, while the expected life for our options was estimated to be five years based on historical trends since our initial public offering. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. Further, as required under SFAS 123R, we estimate forfeitures for share-based awards that are not expected to vest. We charge the estimated fair value less estimated forfeitures to earnings on a straight-line basis over the vesting period of the underlying awards, which is generally four years for our stock options and

deferred stock units and up to two years for our employee stock purchase plan.

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The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. As our stock option and employee stock purchase plan awards have characteristics that differ significantly from traded options, and as changes in the subjective assumptions can materially affect the estimated value, our estimate of fair value may not accurately represent the value assigned by a third party in an arms-length transaction. There currently is no market-based mechanism to verify the reliability and accuracy of the estimates derived from the Black-Scholes option pricing model or other allowable valuation models, nor is there a means to compare and adjust the estimates to actual values. While our estimate of fair value and the associated charge to earnings materially affects our results of operations, it has no impact on our cash position.

There are significant variations among allowable valuation models, and there is a possibility that we may adopt a different valuation model or refine the inputs and assumptions under our current valuation model in the future, resulting in a lack of consistency in future periods. Our current or future valuation model and the inputs and assumptions we make may also lack comparability to other companies that use different models, inputs, or assumptions, and the resulting differences in comparability could be material.

*Income Taxes*

We recognize federal, foreign, and state current tax liabilities or assets based on our estimate of taxes payable or refundable in the then current fiscal year for each tax jurisdiction. We also recognize federal, foreign, and state deferred tax liabilities or assets for our estimate of future tax effects attributable to temporary differences and carryforwards and record a valuation allowance to reduce any deferred tax assets by the amount of any tax benefits that, based on available evidence and our judgment, are not expected to be realized. If our assumptions, and consequently our estimates, change in the future, the valuation allowance we have established for our deferred tax assets may be changed, which could impact income tax expense.

We adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an Interpretation of FASB Statement No. 109 (FIN 48), at the beginning of the first quarter of fiscal 2008. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions. The first step is to determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement with a taxing authority. The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of highly complex tax laws. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material impact on our consolidated financial position, result of operations, or cash flows. We believe we have adequately provided for reasonably foreseeable outcomes in connection with the resolution of income tax uncertainties. However, our results have in the past, and could in the future, include favorable and unfavorable adjustments to our estimated tax liabilities in the period a determination of such estimated tax liability is made or resolved, upon the filing of an amended return, upon a change in facts, circumstances, or interpretation, or upon the expiration of a statute of limitation. Accordingly, our effective tax rate could fluctuate materially from period to period.

In accordance with SFAS 123R, we recognize tax benefit upon expensing nonqualified stock options and deferred stock units issued under our share-based compensation plans. However, under current accounting standards, we cannot recognize tax benefit concurrent with expensing incentive stock options and employee stock purchase plan shares (qualified stock options) issued under our share-based compensation plans. For qualified stock options that vested after our adoption of SFAS 123R, we recognize tax benefit only in the period when disqualifying dispositions of the underlying stock occur, which historically has been up to several years after vesting and in periods when our stock price substantially increases. For qualified stock options that vested prior to our adoption of SFAS 123R, we record the tax benefit directly to additional paid-in capital. Accordingly, because we cannot recognize the tax benefit for share-based compensation expense associated with qualified stock options until the occurrence of future disqualifying dispositions of the underlying stock and such disqualified dispositions may happen in periods when our stock price substantially increases, and because a portion of that tax benefit may be directly recorded to additional paid-in capital, our future quarterly and annual effective tax rates will be subject to greater volatility and, consequently, our ability to estimate reasonably our future quarterly and annual effective tax rates is greatly diminished.



**Table of Contents****Results of Operations*****Fiscal year ended June 30, 2009 compared with fiscal year ended June 30, 2008****Net Revenue.*

	Year Ended June 30,			%
(in thousands)	2008	2009	\$ Change	Change
PC applications	\$ 272,796	\$ 269,595	\$ (3,201)	-1.2%
% of net revenue	75.6%	57.0%		
Digital lifestyle product applications	88,261	203,707	115,446	130.8%
% of net revenue	24.4%	43.0%		
Net revenue	\$ 361,057	\$ 473,302	\$ 112,245	31.1%

Net revenue was \$473.3 million for the year ended June 30, 2009 compared with \$361.1 million for the year ended June 30, 2008, an increase of \$112.2 million, or 31.1%. Of our fiscal 2009 net revenue, \$269.6 million, or 57.0%, of net revenue was from the personal computing market and \$203.7 million, or 43.0%, of net revenue was from the digital lifestyle products markets, including \$166.3 million from mobile smartphones and feature phones. The increase in net revenue for the year ended June 30, 2009 was attributable to a \$115.4 million, or 130.8%, increase in net revenue from digital lifestyle product applications, partially offset by a \$3.2 million, or 1.2%, reduction in net revenue from PC applications. Digital lifestyle product application net revenue growth resulted primarily from higher market penetration of our products in the mobile smartphone market. The decline in PC applications net revenue reflected the combination of the general weakness in the notebook market as a result of the global economic downturn and a reduced attach rate of our multimedia control solutions in notebook computers, partially offset by market share gains in notebooks. The overall increase in net revenue was primarily attributable to a 15% increase in unit shipments, reflecting the notebook market share gain, higher market penetration of our products in the mobile smartphone market, and an overall higher-priced product mix, which included our ClearTouch screen solutions, partially offset by general competitive pricing pressure. Based on calendar year 2009 industry estimates, the notebook market is anticipated to increase approximately 7%; the digital music player market is anticipated to increase approximately 2%; and the mobile smartphone market is anticipated to increase approximately 3%.

*Gross Margin.*

	Year Ended June 30,			%
(in thousands)	2008	2009	\$ Change	Change
Gross Margin	\$ 147,451	\$ 191,509	\$ 44,058	29.9%
% of net revenue	40.8%	40.5%		

Gross margin as a percentage of net revenue was 40.5%, or \$191.5 million, for the year ended June 30, 2009 compared with 40.8%, or \$147.5 million, for the year ended June 30, 2008. As each custom-designed module we sell utilizes our capacitive sensing technology in a design that is generally unique or specific to an OEM customer's application, gross margin varies on a product-by-product basis, making our cumulative gross margin a blend of our product specific designs and independent of the vertical markets that our products serve. The decrease in gross margin as a percentage of net revenue primarily reflected a lower margin product mix and general competitive pricing pressure. As a virtual manufacturer, our gross margin percentage is generally not impacted materially by our shipment volume.

**Table of Contents***Operating Expenses.*

	Year Ended June 30,			%
(in thousands)	2008	2009	\$ Change	Change
Research and development expenses	\$ 50,093	\$ 68,026	\$ 17,933	35.8%
% of net revenue	13.9%	14.4%		
Selling, general & administrative expenses	48,126	54,014	5,888	12.2%
% of net revenue	13.3%	11.4%		
Operating expenses	\$ 98,219	\$ 122,040	\$ 23,821	24.3%
% of net revenue	27.2%	25.8%		

*Research and Development Expenses.* Research and development expenses increased as a percentage of net revenue to 14.4% from 13.9%, while the cost of research and development activities increased \$17.9 million, or 35.8%, to \$68.0 million for the year ended June 30, 2009 compared with \$50.1 million for the year ended June 30, 2008. The increase in research and development expenses primarily reflected a \$12.2 million increase in employee compensation and employment related costs, resulting from a 34% increase in research and development staffing, increased base compensation related to our annual performance review process, increased share-based compensation costs, increased employee benefits costs, and increased incentive compensation costs; a \$3.6 million increase in infrastructure and support costs; and a \$1.4 million increase in consulting and outside service costs. Non-cash share-based compensation costs included in research and development expenses were \$6.3 million, or 1.8% of net revenue, and \$8.9 million, or 1.9% of net revenue, for fiscal 2008 and 2009, respectively.

*Selling, General, and Administrative Expenses.* Selling, general, and administrative expenses decreased as a percentage of net revenue to 11.4% from 13.3%, while the cost of selling, general, and administrative activities increased \$5.9 million, or 12.2%, to \$54.0 million for the year ended June 30, 2009 compared with \$48.1 million for the year ended June 30, 2008. The increase in selling, general, and administrative expenses primarily reflected a \$7.8 million increase in employee compensation and employment related costs, resulting from a 13% increase in selling, general, and administrative staffing, increased share-based compensation costs, increased base compensation related to our annual performance review process, increased incentive compensation costs, and increased employee development costs, partially offset by a \$1.1 million decrease in consulting and outside service costs and a \$900,000 decrease in professional service fees. Non-cash share-based compensation costs included in selling, general, and administrative expenses were \$10.1 million, or 2.8% of net revenue, and \$13.8 million, or 2.9% of net revenue, for fiscal 2008 and 2009, respectively.

*Operating Income.*

	Year Ended June 30,			%
(in thousands)	2008	2009	\$ Change	Change
Operating Income	\$49,232	\$69,469	\$20,237	41.1%
% of net revenue	13.6%	14.7%		

We generated operating income of \$69.5 million, or 14.7% of net revenue, for the year ended June 30, 2009, an increase of \$20.2 million compared with \$49.2 million, or 13.6% of net revenue, for the year ended June 30, 2008. As discussed in the preceding paragraphs, the increase in operating income was primarily attributable to an increase in operating leverage, resulting from the 31.1% increase in net revenue, partially offset by a 30 basis point decrease in our gross margin percentage and a \$23.8 million increase in our operating expenses.



**Table of Contents***Non-Operating Income/(Loss).*

	Year Ended June 30,			%
(in thousands)	2008	2009	\$ Change	Change
Interest income	\$ 9,652	\$ 3,222	\$ (6,430)	-66.6%
% of net revenue	2.7%	0.7%		
Interest expense	(1,822)	(1,238)	584	-32.1%
% of net revenue	-0.5%	-0.3%		
Gain on settlement of debt	2,689		(2,689)	-100.0%
% of net revenue	0.7%	0.0%		
Gain on early retirement of debt		3,600	3,600	NA
% of net revenue	0.0%	0.8%		
Impairment of investments	(10,963)	(9,243)	1,720	-15.7%
% of net revenue	-3.0%	-2.0%		
Net non-operating income/ (loss)	\$ (444)	\$ (3,659)	\$ (3,215)	724.1%
% of net revenue	-0.1%	-0.8%		

*Interest Income.* Interest income was \$3.2 million for the year ended June 30, 2009 compared with \$9.7 million for the year ended June 30, 2008. The \$6.4 million decrease in interest income resulted from a combination of lower average invested cash balances and lower average interest rates. The decrease in average invested cash balances during fiscal 2009 was primarily attributable to the use of \$55.7 million for the early retirement of debt and \$9.3 million for capital expenditures.

*Interest Expense.* Interest expense was \$1.8 million and \$1.2 million for fiscal 2008 and 2009, respectively, and consisted primarily of interest expense and amortization of debt issuance costs related to our convertible senior subordinated notes issued in December 2004. The decline in interest expense primarily reflected the retirement of \$59.7 million in principal amount of our convertible notes during the year.

*Gain on Settlement of Debt.* In fiscal 1998, National Semiconductor Corporation, or National, loaned us \$1.5 million under a limited-recourse note, which we utilized to purchase 900,000 Series A preferred shares of Foveon. In fiscal 1998, under the equity method of accounting, we recorded our share of losses incurred by Foveon and reduced the carrying value of our equity investment to zero. The note plus accrued interest of \$1.2 million came due in August 2007, and, in accordance with the security agreement, we surrendered the 900,000 Series A preferred shares securing the note to National in full settlement of the principal and accrued interest. Consequently, we recognized a non-operating gain upon settlement of debt in the amount of \$2.7 million in fiscal 2008.

*Gain on Early Retirement of Debt.* In fiscal 2009, we repurchased and retired \$59.7 million of our outstanding convertible notes at a discount of approximately 7%. This resulted in a \$3.6 million net gain on retirement of debt after deducting the associated unamortized debt issuance costs.

*Impairment of Investments.* In fiscal 2005, we participated in an equity financing, receiving 3.9 million Series E preferred shares of Foveon for a cash investment of \$4.0 million. We accounted for our Series E preferred shares of Foveon under the cost method in accordance with APB Opinion No. 18 and EITF Issues No. 02-14 and No. 03-1 because the investment is not in-substance common stock. In September 2007, we determined there was an other-than-temporary impairment of the carrying value of our investment in Foveon, as a result of liquidity visibility and liquidation preferences for the most recent preferred equity round, in which we did not participate. Consequently, we recognized a \$4.0 million other-than-temporary impairment charge. In November 2008, Foveon was acquired by an unrelated party and we received no proceeds.

A portion of our auction rate securities, or ARS, investments, were converted to auction rate preferred stock, and we have seen a decline in the credit ratings for certain of our ARS investments. Accordingly, based on our fair value analysis and taking into account the period of time the fair value has been less than our cost, we reduced the

carrying value of our ARS investments by \$9.2 million at June 30, 2009 compared with \$7.0 million at June 30, 2008 through an other-than-temporary impairment charge to income.

**Table of Contents***Provision for Income Taxes*

		Year Ended June 30,		
(in thousands)	2008	2009	\$ Change	% Change
Income before provision for income taxes	\$48,788	\$65,810	\$17,022	34.9%
Provision for income taxes	17,688	11,486	(6,202)	-35.1%
<i>% of income before provision for income taxes</i>	36.3%	17.5%		
<i>% of net revenue</i>	4.9%	2.4%		

The provision for income taxes for the year ended June 30, 2009 was approximately \$11.5 million compared with \$17.7 million for the year ended June 30, 2008, reflecting higher pre-tax profits in lower tax rate jurisdictions, partially offset by an increase of valuation allowance related to impairment charges on certain investments. The income tax provision represented estimated federal, foreign, and state taxes for the years ended June 30, 2008 and 2009. The effective tax rate for the year ended June 30, 2008 was approximately 36.3% and diverged from the combined federal and state statutory rate primarily as a result of the incremental research credits associated with stock option activity and tax-exempt interest income, partially offset by the impact of impairment losses, foreign withholding taxes, and the accounting for share-based compensation. The effective tax rate for the year ended June 30, 2009 was approximately 17.5% and diverged from the combined federal and state statutory rate, primarily as a result of an increase in profits in lower tax rate jurisdictions, the incremental research credits associated with stock option activity, and the extension of the federal research credit, and tax-exempt interest income, partially offset by the impact of accounting for share-based compensation and foreign withholding taxes.

In accordance with SFAS 123R, we recognize tax benefit upon expensing nonqualified stock options and deferred stock units issued under our share-based compensation plans. However, under current accounting standards, we cannot recognize tax benefit concurrent with expensing incentive stock options and employee stock purchase plan shares (qualified stock options) issued under our share-based compensation plans. For qualified stock options that vested after our adoption of SFAS 123R, we recognize tax benefit only in the period when disqualifying dispositions of the underlying stock occur, which historically has been up to several years after vesting and in periods when our stock price substantially increases. For qualified stock options that vested prior to our adoption of SFAS 123R, we record the tax benefit directly to additional paid-in capital. Tax benefit associated with total share-based compensation was approximately \$6.1 million and \$8.0 million for the years ended June 30, 2008 and 2009, respectively. Excluding the impact of share-based compensation and the related tax benefit, the effective tax rate for the years ended June 30, 2008 and 2009 would have been 35.9% and 21.6%, respectively. Because we cannot recognize the tax benefit for share-based compensation expense associated with qualified stock options until the occurrence of future disqualifying dispositions of the underlying stock and such disqualified dispositions may happen in periods when our stock price substantially increases, and because a portion of that tax benefit may be recorded directly to additional paid-in capital, our future quarterly and annual effective tax rates will be subject to greater volatility and, consequently, our ability to reasonably estimate our future quarterly and annual effective tax rates is greatly diminished.

**Table of Contents*****Fiscal year ended June 30, 2008 compared with fiscal year ended June 30, 2007******Net Revenue.***

	Year Ended June 30,			%
(in thousands)	2007	2008	\$ Change	Change
PC applications	\$ 226,208	\$ 272,796	\$ 46,588	20.6%
% of net revenue	84.8%	75.6%		
Digital lifestyle product applications	40,579	88,261	47,682	117.5%
% of net revenue	15.2%	24.4%		
Net revenue	\$ 266,787	\$ 361,057	\$ 94,270	35.3%

Net revenue was \$361.1 million for the year ended June 30, 2008 compared with \$266.8 million for the year ended June 30, 2007, an increase of \$94.3 million, or 35.3%. Of our fiscal 2008 net revenue, \$272.8 million, or 75.6%, of net revenue was from the personal computing market and \$88.3 million, or 24.4%, of net revenue was from the digital lifestyle products markets, including \$47.7 million from mobile smartphones and feature phones, of which \$30.5 million was in the fourth quarter. The increase in net revenue for the year ended June 30, 2008 was attributable to a \$46.6 million, or 20.6%, increase in PC applications net revenue and a \$47.7 million, or 117.5%, increase in digital lifestyle product applications net revenue. The increase in PC applications net revenue was primarily attributable to notebook industry growth, continuing adoption by notebook OEMs of our capacitive interface multimedia controls, and additional penetration in PC peripherals, partially offset by a decline in PC applications market share. Digital lifestyle product application net revenue growth resulted from both industry growth and higher market penetration. The overall increase in net revenue was primarily attributable to a 44% increase in unit shipments, reflecting industry growth and higher market penetration in the digital lifestyle product application markets, partially offset by a lower-priced product mix, which included both our custom modules and OneTouch ASIC shipments, and general competitive pricing pressure, and a decline in PC applications market share and the combination of which resulted in an overall 6% reduction in the unit price of our product mix when compared to the prior year.

***Gross Margin.***

	Year Ended June 30,			%
(in thousands)	2007	2008	\$ Change	Change
Gross Margin	\$ 105,874	\$ 147,451	\$ 41,577	39.3%
% of net revenue	39.7%	40.8%		

Gross margin as a percentage of net revenue was 40.8%, or \$147.5 million, for the year ended June 30, 2008 compared with 39.7%, or \$105.9 million, for the year ended June 30, 2007. As each product we sell utilizes our capacitive sensing technology in a design that is generally unique or specific to an OEM customer's application, gross margin varies on a product-by-product basis, making our cumulative gross margin a blend of our product specific designs and OneTouch offerings, which are independent of the vertical markets that our products serve. The increase in gross margin as a percentage of net revenue primarily reflected a higher margin product design mix, in addition to lower manufacturing costs, resulting from our continuing design, process-improvement, and cost-reduction programs, partially offset by an increase in products containing generally higher third-party content and general competitive pricing pressure.

**Table of Contents***Operating Expenses.*

	Year Ended June 30,			%
(in thousands)	2007	2008	\$ Change	Change
Research and development expenses	\$ 39,386	\$ 50,093	\$ 10,707	27.2%
<i>% of net revenue</i>	14.8%	13.9%		
Selling, general & administrative expenses	36,247	48,126	11,879	32.8%
<i>% of net revenue</i>	13.6%	13.3%		
Restructuring	915		(915)	-100.0%
<i>% of net revenue</i>	0.3%	0.0%		
Operating expenses	\$ 76,548	\$ 98,219	\$ 21,671	28.3%
<i>% of net revenue</i>				