SILICON STORAGE TECHNOLOGY INC
Form 10-Q
August 17, 2009
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended June 30, 2009**

**OR**

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

**For the transition period from to .**

**Commission File Number 0-26944**

# SILICON STORAGE TECHNOLOGY, INC.

**(Exact name of Registrant as Specified in its Charter)**

| **California** | **77-0225590** |
|---|---|
| **(State or Other Jurisdiction of Incorporation or Organization)** | **(I.R.S. Employer Identification Number)** |
| **1020 Kifer Road, Sunnyvale, CA** | **94086** |
| **(Address of Principal Executive Offices)** | **(Zip Code)** |

**(408) 735-9110**

**(Registrant s Telephone Number, including Area Code)**

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

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

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

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

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

Number of shares outstanding of Common Stock, no par value, as of July 31, 2009: 95,850,407

Table of Contents

**SILICON STORAGE TECHNOLOGY, INC.**

**FORM 10-Q: QUARTER ENDED JUNE 30, 2009**

**TABLE OF CONTENTS**


| | | |
|---|---|---|
| **Part I FINANCIAL INFORMATION** | | 3 |
| Item 1. | Condensed Consolidated Financial Statements (unaudited): | 3 |
| | Condensed Consolidated Statements of Operations | 3 |
| | Condensed Consolidated Balance Sheets | 4 |
| | Condensed Consolidated Statements of Cash Flows | 5 |
| | Notes to Condensed Consolidated Financial Statements | 6 |
| Item 2. | Management s Discussion and Analysis of Financial Condition and Results of Operations | 17 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 28 |
| Item 4. | Controls and Procedures | 29 |
| **Part II OTHER INFORMATION** | | 30 |
| Item 1. | Legal Proceedings | 30 |
| Item 1A. | Risk Factors | 31 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 42 |
| Item 3. | Defaults Upon Senior Securities | 42 |
| Item 4. | Submission of Matters to a Vote of Security Holders | 43 |
| Item 5. | Other Information | 43 |
| Item 6. | Exhibits | 44 |
| Signatures | | 45 |

**Table of Contents**

**PART I FINANCIAL INFORMATION**

**Item 1. Condensed Consolidated Financial Statements**

**SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(unaudited)**

**(in thousands, except per share data)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Net revenues: | | | | |
| Product revenues - unrelated parties | $ 27,971 | $ 19,749 | $ 58,440 | $ 34,637 |
| Product revenues - related parties | 43,102 | 32,017 | 82,331 | 55,916 |
| Technology licensing - unrelated parties | 12,272 | 6,040 | 23,577 | 17,310 |
| Technology licensing - related parties | 355 | 277 | 437 | 349 |
| Total net revenues | 83,700 | 58,083 | 164,785 | 108,212 |
| Cost of revenues: | | | | |
| Cost of revenues - unrelated parties | 21,631 | 14,186 | 42,930 | 24,923 |
| Cost of revenues - related parties | 38,120 | 30,388 | 72,197 | 54,186 |
| Total cost of revenues | 59,751 | 44,574 | 115,127 | 79,109 |
| Gross profit | 23,949 | 13,509 | 49,658 | 29,103 |
| Operating expenses: | | | | |
| Research and development | 15,223 | 11,250 | 30,835 | 22,664 |
| Sales and marketing | 6,918 | 5,166 | 14,401 | 10,126 |
| General and administrative | 7,721 | 4,636 | 14,904 | 9,796 |
| Other | | | | 329 |
| Total operating expenses | 29,862 | 21,052 | 60,140 | 42,915 |
| Loss from operations | (5,913) | (7,543) | (10,482) | (13,812) |
| Interest and dividend income | 1,120 | 545 | 2,422 | 1,189 |
| Impairment of investments | | (485) | (234) | (485) |
| Other income (expense), net | (144) | 143 | (338) | (4) |
| Loss before provision for (benefit from) income taxes and pro rata share of loss from equity investments | (4,937) | (7,340) | (8,632) | (13,112) |
| Provision for (benefit from) income taxes | 2,390 | (1,146) | (4,660) | 1,728 |
| Loss before pro rata share of loss from equity investments | (7,327) | (6,194) | (3,972) | (14,840) |
| Pro rata share of loss from equity investments | 2,241 | 254 | 4,137 | 849 |
| Net loss | $ (9,568) | $ (6,448) | $ (8,109) | $ (15,689) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net loss per share - basic and diluted | $ | (0.09) | $ | (0.07) | $ | (0.08) | $ | (0.16) |
| Shares used in per share calculation - basic and diluted | | 101,793 | | 95,747 | | 102,698 | | 95,726 |

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

Table of Contents

**SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(unaudited)**

**(in thousands)**

| | December 31, 2008 | June 30, 2009 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 50,880 | $ 51,206 |
| Short-term available-for-sale investments | 48,997 | 49,664 |
| Trade accounts receivable-unrelated parties, net of allowance for doubtful accounts of $79 at December 31, 2008 and $11 at June 30, 2009 | 9,356 | 9,796 |
| Trade accounts receivable-related parties | 10,761 | 21,625 |
| Inventories | 54,159 | 33,323 |
| Other current assets | 4,153 | 3,972 |
| Total current assets | 178,306 | 169,586 |
| Property and equipment, net | 18,913 | 15,243 |
| Long-term available-for-sale equity investments | 18,196 | 26,847 |
| Long-term available-for-sale debt securities | 31,848 | 34,457 |
| Equity investment, GSMC | 11,506 | 11,021 |
| Equity investment, ACET | 2,627 | 1,991 |
| Equity investments, others | 10,486 | 9,863 |
| Goodwill | 11,221 | 11,221 |
| Intangible assets, net | 3,573 | 2,186 |
| Other assets | 1,807 | 1,766 |
| Total assets | $ 288,483 | $ 284,181 |
| **LIABILITIES** | | |
| Current liabilities: | | |
| Trade accounts payable-unrelated parties | $ 15,702 | 15,327 |
| Trade accounts payable-related parties | 3,444 | 6,333 |
| Accrued expenses and other liabilities | 14,200 | 11,493 |
| Deferred revenue | 3,841 | 2,304 |
| Total current liabilities | 37,187 | 35,457 |
| Taxes payable | 7,760 | 7,835 |
| Other liabilities | 322 | 23 |
| Total liabilities | 45,269 | 43,315 |
| Commitments (Note 6) and Contingencies (Note 7) | | |
| **SHAREHOLDERS EQUITY** | | |
| Common stock | 412,312 | 414,256 |
| Accumulated other comprehensive income | 14,308 | 25,705 |

| | | |
|---|---|---|
| Accumulated deficit | (183,406) | (199,095) |
| Total shareholders equity | 243,214 | 240,866 |
| Total liabilities and shareholders equity | $ 288,483 | $ 284,181 |

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

Table of Contents

**SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(unaudited)**

**(in thousands)**

| | Six Months Ended June 30, | |
|---|---|---|
| | **2008** | **2009** |
| Cash flows from operating activities: | | |
| Net loss | $ (8,109) | $ (15,689) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 5,423 | 4,866 |
| Share-based compensation expense | 3,097 | 1,522 |
| Provision (credits) for doubtful accounts receivable | 180 | (68) |
| Provision for (release from) sales returns | (95) | (80) |
| Write-down of inventories and provision for adverse purchase commitments | 6,173 | 5,899 |
| Pro rata share of loss from equity investments | 4,137 | 849 |
| Impairment loss on equity investment | | 485 |
| Other | 212 | 371 |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable - unrelated parties | 7,337 | (300) |
| Trade accounts receivable - related parties | 11,498 | (10,856) |
| Inventories | (19,651) | 15,676 |
| Other current and non-current assets | (165) | 502 |
| Trade accounts payable - unrelated parties | 103 | (375) |
| Trade accounts payable - related parties | 2,910 | 2,889 |
| Accrued expenses and other liabilities | (2,607) | (3,244) |
| Deferred revenue | 891 | (1,536) |
| Net cash provided by operating activities | 11,334 | 911 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (5,220) | (329) |
| Purchases of available-for-sale investments | (59,565) | (37,298) |
| Maturities of available-for-sale investments | 29,035 | 37,574 |
| Other | (503) | (428) |
| Net cash used in investing activities | (36,253) | (481) |
| Cash flows from financing activities: | | |
| Payments on line of credit | (6,943) | |
| Issuance of shares of common stock | 610 | 406 |
| Repurchases of shares of common stock | (11,922) | |
| Principal payments of capital leases | (611) | (506) |
| Net cash used in financing activities | (18,866) | (100) |
| Effect of changes in foreign currency exchange rates on cash | | (4) |
| Net increase (decrease) in cash and cash equivalents | (43,785) | 326 |
| Cash and cash equivalents at beginning of period | 118,157 | 50,880 |

| | | |
|---|---|---|
| Cash and cash equivalents at end of period | $ 74,372 | $ 51,206 |

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

5

Table of Contents

**SILICON STORAGE TECHNOLOGY, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**1. Basis of Presentation**

In the opinion of management, the accompanying unaudited condensed interim consolidated financial statements contain all adjustments, all of which are normal and recurring in nature, necessary to fairly state our financial position, results of operations and cash flows. The results of operations for the interim periods presented are not necessarily indicative of the results that may be expected for any future interim periods or for the full fiscal year. The condensed consolidated balance sheet at December 31, 2008 was derived from audited financial statements as of that date but does not include all disclosures required by U.S. generally accepted accounting principles, or U.S. GAAP, for complete financial statements. These interim financial statements should be read in conjunction with the audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission on March 20, 2009. In connection with the preparation of the condensed consolidated financial statements, we evaluated subsequent events after the date of June 30, 2009 through August 17, 2009, which is the date that the financial statements were issued.

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Recent Accounting Pronouncements*

In June 2009, the Financial Accounting Standards Board, or the FASB, issued Statement of Financial Accounting Standards No. 168, *The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles*, or SFAS No. 168. SFAS No. 168 establishes the FASB Accounting Standards Codification, or the Codification, as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the Securities and Exchange Commission, or SEC, under authority of federal securities laws are also sources of authoritative accounting principles for SEC registrants. The Codification will supersede all other existing accounting and reporting standards and all other non-grandfathered accounting literature not included in the Codification will become non-authoritative. SFAS No. 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. Following the effective date of SFAS No. 168, the FASB will issue Accounting Standards Updates and will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. We do not expect adoption of SFAS No. 168 in the third quarter of 2009 to have material impact on our consolidated financial position, results of operations and cash flows.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*. SFAS No. 167 amends Interpretation 46(R) to require an enterprise to perform an analysis to determine whether the enterprise s variable interest or interests give it a controlling financial interest in a variable interest entity. This analysis identifies the primary beneficiary of a variable interest entity as the enterprise that has both of the following characteristics: a) The power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and b) The obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. In addition, SFAS No. 167 amends Interpretation 46(R) to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. SFAS No. 167 is effective as of the beginning of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period, and earlier application is prohibited. We are still assessing the impact of SFAS No. 167 on our consolidated financial position, results of operations and cash flows.

*Out of Period Adjustments*

During the second quarter of 2009, we identified certain prior period errors totaling $2.2 million, related to the provision for (benefit from) income taxes. In calculating our tax provision for the quarter ended March 31, 2009, we incorrectly calculated the balance of the foreign withholding tax liability for uncertain tax positions on which re-measurement was required due to changes in foreign currency exchange rates. As a result, our income tax provision was overstated by $2.1 million in the quarter ended March 31, 2009. In addition, we overstated by $0.1 million the liability for uncertain tax positions for foreign tax withholding on license revenue at December 31, 2008. We have assessed the materiality of these errors on the three month period ended March 31, 2009 and periods prior to December 31, 2008 and concluded that such errors were not material to those periods. We have also concluded that the out of period correction of these errors, which resulted in a $2.2

million tax benefit in the quarter ended June 30, 2009, is not material to the three and six month periods ended June 30, 2009.

**Table of Contents**

*Reclassifications*

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

**2. Computation of Net Loss Per Share**

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

A presentation of the numerator and the denominator of basic and diluted net loss per share are as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Numerator for basic and diluted net loss per share: | | | | |
| Net loss, as reported | $ (9,568) | $ (6,448) | $ (8,109) | $ (15,689) |
| Denominator for basic and diluted net loss per share, weighted average common shares outstanding | 101,793 | 95,747 | 102,698 | 95,726 |
| Basic and diluted net loss per share | $ (0.09) | $ (0.07) | $ (0.08) | $ (0.16) |

Stock options to purchase 8.2 million shares of common stock with a weighted average exercise price of $4.51 were outstanding at June 30, 2009 and stock options to purchase 9.8 million shares of common stock with a weighted average exercise price of $4.59 were outstanding at June 30, 2008. These stock options were not included in the computation of diluted net loss per share for the second quarter and first half of 2008 and 2009 because we incurred a net loss for these periods.

**3. Shareholders Equity and Share-based Compensation**

*Equity Incentive Plan*

Our 2008 Equity Incentive Plan, or the 2008 Plan, is intended as the successor to and continuation of our 1995 Equity Incentive Plan, or the 1995 Plan. The total number of shares of our common stock reserved for issuance under the 2008 Plan consists of 5.0 million shares plus 9.3 million shares subject to outstanding stock awards under the 1995 Plan that may become available for grant under the 2008 Plan if they expire or terminate for any reason prior to exercise or settlement under the 1995 Plan.

Under the 2008 Plan, the Board of Directors has the authority to determine to whom options will be granted, the number of shares under option, the option term and the exercise price. The options generally are exercisable beginning one year from date of grant and generally thereafter over periods ranging from four to five years from the date of grant. The term of any options issued may not exceed ten years from the date of grant.

The 1995 Non-Employee Directors Stock Option Plan, or the Directors Plan, was terminated in July 2008. As of June 30, 2009, 237,928 shares were subject to outstanding stock awards under the Directors Plan and will remain subject to the terms of the Directors Plan until their exercise or expiration.

*Employee Stock Purchase Plan*

On June 23, 2009, the shareholders approved our 2009 Employee Stock Purchase Plan, or the 2009 Purchase Plan, which replaces our 1995 Employee Stock Purchase Plan. The 2009 Purchase Plan is intended to provide an opportunity for our employees to purchase common stock, to assist us in retaining the services of our employees, and to secure and retain the services of new employees. The 2009 Purchase Plan has 2,000,000 shares of common stock reserved for issuance and approximately 450 employees of SST and our subsidiaries are eligible to participate.

The 2009 Purchase Plan provides for eligible employees to purchase shares of common stock at a price equal to 85% of the lower of the fair market value of a share of common stock on (i) the first day or (ii) the last day of the offering period, by withholding up to 10% of their annual base earnings. Each offering period will be six months, and the first offering period is scheduled to commence in August 2009. Eligible employees must enroll prior to the beginning of the offering and may not purchase more than $25,000 of common stock in any calendar year. In addition, our Board of Directors has currently limited the maximum number of shares that may be purchased under the 2009 Purchase Plan on any single purchase date to 300,000 shares. Our executive officers are not eligible to participate in the 2009 to 2010 offering periods under the 2009 Purchase Plan.

**Table of Contents**

We issued 162,000 shares under our 1995 Employee Stock Purchase Plan in the first half of 2009 for $299,000. No shares were issued under the 1995 Employee Stock Purchase Plan during the second quarter of 2009, and approximately 102,000 shares will be issued in the third quarter of 2009. We do not intend to issue any further shares pursuant to the 1995 Employee Stock Purchase Plan.

*Tender Offer*

In May 2008, we completed an offer to amend eligible 409A options and to replace underwater stock options, or the Offer, outstanding under our 1995 Plan. Executive officers and members of the Board of Directors were not eligible to participate. The Offer consisted of two parts, an Offer to Amend and an Offer to Replace. The Offer to Amend consisted of an amendment of the price of certain stock options with exercise prices that may have been lower than the fair market value of our common stock on the applicable grant date, as determined for tax purposes. The Offer to Replace consisted of an exchange of certain stock options, or Eligible Underwater Options, with new vesting terms. The total number of options modified under the Offer was 5.2 million shares. We issued new options to purchase 2.0 million shares of common stock, at an exercise price of $3.19 per share.

*Share-based Compensation*

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2008** | **2009** | **2008** | **2009** |
| Cost of revenues | $ 79 | $ 158 | $ 144 | $ 226 |
| Research and development | 841 | 214 | 1,319 | 568 |
| Sales and marketing | 269 | 51 | 442 | 132 |
| General and administrative | 795 | 289 | 1,192 | 574 |
| Other | | | | 22 |
| Share-based compensation expense included in net loss | $ 1,984 | $ 712 | $ 3,097 | $ 1,522 |

Share-based compensation of $170,000 and $91,000 was capitalized in inventory as of December 31, 2008 and June 30, 2009, respectively. The tax benefit from the exercise of options was $0 for the first half of 2008 and 2009. Included in share-based compensation for the second quarter and first half of 2008 is a charge of $698,000 for fully vested restricted stock awards granted in the second quarter of 2008. No restricted stock awards were granted during the first half of 2009.

As of June 30, 2009, we had unrecognized share-based compensation expense from stock options of $1.9 million including estimated forfeitures.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model and assumptions noted in the following table. We estimate expected volatility based on our historical stock volatility. The risk-free interest rate for the expected term of the option is based on the yield of zero-coupon U.S. Treasury notes, with a term approximating the expected term of the option, in effect at the beginning of the quarter in which the option is granted. We use the simplified method of calculating expected term for new grants.

Assumptions used in the fair value of each option made under our equity award plans are reflected in the table below:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2008** | **2009** | **2008** | **2009** |
| Risk-free interest rate | 3.0% -3.1% | 2.3% | 3.0% -3.9% | 2.2% -2.3% |
| Expected term of option | 4.8 - 6.1 years | 6.1 years | 4.8 - 6.1 years | 6.1 years |
| Expected volatility | 53.1% - 63.1% | 65.2% | 53.1% - 63.8% | 64.1% - 65.2% |
| Expected dividend yield | 0.0% | 0.0% | 0.0% | 0.0% |

**4. Available-for-Sale Investments**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The fair value hierarchy is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

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

Table of Contents

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

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

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

The following table represents the fair value hierarchy for our assets (cash equivalents and investments) measured at fair value on a recurring basis (in thousands):

| | June 30, 2009 | | | |
|---|---|---|---|---|
| **Description** | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Money market funds | $ 12,074 | $ | $ | $ 12,074 |
| Short term available-for-sale investments | | 49,664 | | 49,664 |
| Long term available-for-sale investments | 26,847 | 34,457 | | 61,304 |
| Total | $ 38,921 | $ 84,121 | $ | $ 123,042 |

| | December 31, 2008 | | | |
|---|---|---|---|---|
| **Description** | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Money market funds | $ 10,721 | $ | $ | $ 10,721 |
| Short term available-for-sale investments | | 48,997 | | 48,997 |
| Long term available-for-sale investments | 18,196 | 31,848 | | 50,044 |
| Total | $ 28,917 | $ 80,845 | $ | $ 109,762 |

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

| | June 30, 2009 | | | |
|---|---|---|---|---|
| | **Amortized Cost** | **Unrealized Gains** | **Unrealized Losses** | **Estimated Fair Value** |
| Corporate bonds and notes | $ 3,997 | $ | $ | $ 3,997 |
| Government bonds and notes | 75,798 | 336 | | 76,134 |
| Foreign corporate bonds and notes | 910 | 3,080 | | 3,990 |
| Foreign listed equity securities | 4,761 | 22,086 | | 26,847 |
| Total bonds, notes and equity securities | $ 85,466 | $ 25,502 | $ | $ 110,968 |

| Contractual maturity dates for investments in bonds and notes: | |
|---|---|
| Less than one year | $ 49,664 |
| One to five years | 34,457 |
| | $ 84,121 |

| | December 31, 2008 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Corporate bonds and notes | $ 5,924 | $ 15 | $ | $ 5,939 |
| Government bonds and notes | 74,264 | 642 | | 74,906 |
| Foreign listed equity securities | 4,761 | 13,435 | | 18,196 |
| Total bonds, notes and equity securities | $ 84,949 | $ 14,092 | $ | $ 99,041 |

| | |
|---|---|
| Contractual maturity dates for investments in bonds and notes: | |
| Less than one year | $ 48,997 |
| One to five years | 31,848 |
| | $ 80,845 |

Table of Contents

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

King Yuan Electronics Company Limited, or KYE, Insyde Software Corporation, or Insyde, Powertech Technology, Incorporated, or PTI, and Professional Computer Technology Limited, or PCT, are Taiwanese companies that are listed on the Taiwan Stock Exchange. Investments in equity or debt securities of these companies have been included in Long-term available-for-sale equity investments or Long-term available-for-sale debt securities. The shares that are not available for resale within one year of the balance sheet date, due to local securities regulations, are recorded at cost and included in Equity investments, others.

**5. Selected Balance Sheet Detail**

Inventories are as follows (in thousands):

| | December 31, 2008 | June 30, 2009 |
|---|---|---|
| Raw materials | $ 35,688 | $ 15,036 |
| Work in-process | 2,869 | 7,698 |
| Finished goods | 13,499 | 7,645 |
| Finished goods held at logistics center | 2,103 | 2,944 |
| | $ 54,159 | $ 33,323 |

During the second quarter and first half of 2009, inventory which was written down in a prior period by $1.1 million and $1.8 million, respectively, was sold and $0.2 million and $2.4 million, respectively, was scrapped. For the second quarter and first half of 2008, inventory written down in a prior period by $0.9 million and $1.5 million, respectively, was sold and $3.7 million and $5.7 million was scrapped. For the first half of 2008 and 2009, we wrote down $5.9 million and $5.2 million, respectively, on other unsold products in inventory.

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

| | December 31, 2008 | June 30, 2009 |
|---|---|---|
| Accrued compensation and related items | $ 5,253 | $ 4,931 |
| Accrued adverse purchase commitments | 1,092 | 1,910 |
| Accrued commissions | 1,021 | 1,085 |
| Accrued restructuring charge | 2,338 | |
| Other accrued liabilities | 4,496 | 3,567 |
| | $ 14,200 | $ 11,493 |

Our products are generally subject to warranty and we provide for the estimated future costs of repair, replacement or customer accommodation in the accompanying statements of operations at the time of product shipment. Our warranty accrual is estimated based on historical claims compared to historical revenues for the appropriate class of product and assumes that we have to replace products subject to a claim.

Changes in the warranty reserves are as follows (in thousands):

| | Six Months Ended June 30, | |
|---|---|---|
| | 2008 | 2009 |
| Beginning balance | $ 358 | $ 176 |
| Provisions for warranty | 560 | 11 |

| | | |
|---|---|---|
| Warranty returns | (299) | (81) |
| Re-screening, re-testing and other settlements | (284) | (22) |
| Ending balance | $ 335 | $ 84 |

**6. Commitments**

As of June 30, 2009 we had outstanding purchase commitments with our foundry vendors of $21.7 million for delivery in 2009. We have recorded a liability of $1.9 million for related adverse purchase commitments.

Our technology license agreements generally include an indemnification clause that indemnifies the licensee against liability and damages (including legal defense costs) arising from any claims of patent, copyright, trademark or trade secret infringement by our proprietary technology. The terms of these guarantees approximate the terms of the technology license agreements, which typically range from five to ten years. Our current license agreements expire from 2009 through 2014. The maximum possible amount of future payments we could be required to make, if such indemnifications were required on all of these agreements, is $55.1 million. We have not recorded any liabilities related to these indemnifications as of June 30, 2009.

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

**7. Contingencies**

On July 13, 2006, a shareholder derivative complaint was filed in the United States District Court for the Northern District of California by Mike Brien under the caption Brien v. Yeh, et al., Case No. C06-04310 JF (N.D. Cal.). On July 18, 2006, a second shareholder derivative complaint was filed in the United States District Court for the Northern District of California by Behrad Bazargani under the caption Bazargani v. Yeh, et al., Case No. C06-04388 HRL (N.D. Cal.). Both complaints were brought purportedly on behalf of SST against certain of our current and former officers and directors and allege among other things, that the named officers and directors: (a) breached their fiduciary duties as they colluded with each other to backdate stock options, (b) violated Rule 10b-5 of the Securities Exchange Act of 1934, and (c) were unjustly enriched by their receipt and retention of such stock options. The Brien and Bazargani cases were consolidated into one case: In re Silicon Storage Technology, Inc. Derivative Litigation, Case No. C06-04310 JF (or the Federal Derivative Litigation ) and plaintiffs filed a consolidated amended shareholder derivative complaint on October 30, 2006. The parties initiated settlement discussions and filed several stipulations to extend the defendants deadline to respond to the consolidated amended shareholder derivative complaint, which the Court granted. On March 15, 2007, we announced that the Chair of our Audit Committee, with the assistance of independent outside counsel and outside accounting experts, would be conducting a voluntary review of our historical stock option grant practices covering the time since our initial public offering in 1995. On April 27, 2007, the court granted the parties stipulation staying this action until after we publicly announced the results of the investigation into the historical stock option grant practices. On January 16, 2008, we filed our Annual Report on Form 10-K for the year ended December 31, 2006, containing the results of such investigation. Plaintiffs in the Federal Derivative Litigation filed an amended complaint on May 9, 2008. Defendants filed a motion to dismiss on October 17, 2008, which the Court heard on April 24, 2009. On July 7, 2009, the Court granted defendants motion and dismissed the federal securities claim with leave to amend. Plaintiffs have until August 21, 2009 to file an amended complaint. We are currently in ongoing settlement discussions in the above referenced matter.

On October 31, 2006, a similar shareholder derivative complaint was filed in the Superior Court of the State of California for the County of Santa Clara by Alex Chuzhoy under the caption *Chuzhoy v. Yeh, et al.*, Case No. 1-06-CV-074026. This complaint was brought purportedly on behalf of SST against certain of our current and former officers and directors and alleges among other things, that the named officers and directors breached their fiduciary duties as they colluded with each other to backdate stock options and were allegedly unjustly enriched by their actions. The Chuzhoy complaint also alleges that certain defendants violated section 25402 of the California Corporations Code by selling shares of our common stock while in possession of material non-public adverse information. The parties initiated settlement discussions and filed several stipulations to extend defendants deadline to respond to the shareholder derivative complaint, which the court granted. On April 13, 2007, the court granted the parties stipulation staying this action until after we publicly announced the results of the investigation into the historical stock option grant practices. On January 16, 2008, we filed our Annual Report on Form 10-K for the year ended December 31, 2006, containing the results of such investigation. On January 25, 2008, the court and parties in the Chuzhoy matter agreed to postpone the filing of the amended complaint pending settlement discussions. We are currently in ongoing settlement discussions in the above referenced matter.

In January and February 2005, multiple shareholder derivative complaints were filed in California Superior Court for the County of Santa Clara, purportedly on behalf of SST against certain of our current and former officers and directors. The derivative complaints asserted claims for, among other things, breach of fiduciary duty and violations of the California Corporations Code. These derivative actions were consolidated under the caption *In Re Silicon Storage Technology, Inc. Derivative Litigation*, Lead Case No. 1:05CV034387. On April 28, 2005, pursuant to a joint stipulation, the derivative action was stayed by court order. On October 19, 2007, following the dismissal with prejudice of certain federal putative class actions, the court lifted this stay. On December 6, 2007, plaintiffs filed a consolidated amended complaint reiterating some of the previous claims and asserting claims substantially identical to those contained in the *Chuzhoy v. Yeh, et al.*, Case No. 1-06-CV-074026 and the Federal Derivative Litigation. Defendants filed a motion to stay the action on March 28, 2008, and a demurrer on May 12, 2008. On October 31, 2008, the court sustained the demurrer, in part, with leave to amend. The court also granted the motion to stay, staying all further proceedings in favor of the *Chuzhoy* matter. We are currently in ongoing settlement discussions in the above referenced matter.

From time to time, we are also involved in other legal actions arising in the ordinary course of business. We have accrued certain costs associated with defending these matters. There can be no assurance that the shareholder class action complaints, the shareholder derivative complaints or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring payments in the future which may adversely impact net income. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. As a result, no losses associated with these or other litigation have been accrued in our financial statements as of June 30, 2009.

**8. Goodwill and Intangible Assets**

Goodwill and intangible assets include $11.2 million of goodwill, $0.6 million of net identifiable intangible assets from acquisitions made in 2004 and 2005 and $1.6 million of net purchased intellectual property. The goodwill is not being amortized but is tested annually for impairment. There was no change in the carrying amount of goodwill for the second quarter or first half of 2009. We review intangible assets for adjustments when an event or circumstance occurs indicating a possible impairment in value. We did not record any impairment to intangible assets during the second quarter or first half of 2009.

Intangible assets consist of the following (in thousands):

| | June 30, 2009 | | | |
|---|---|---|---|---|
| | Cost | Accumulated Amortization | Accumulated Impairment | Net |
| Existing technology | $ 11,791 | $ (11,044) | $ (384) | $ 363 |
| Intellectual property | 3,243 | (285) | (1,322) | 1,636 |
| Trade name | 1,198 | (1,151) | | 47 |
| Customer relationships | 1,857 | (1,717) | | 140 |
| Non-compete agreements | 810 | (810) | | |
| | $ 18,899 | $ (15,007) | $ (1,706) | $ 2,186 |

| | December 31, 2008 | | | |
|---|---|---|---|---|
| | Cost | Accumulated Amortization | Accumulated Impairment | Net |
| Existing technology | $ 11,791 | $ (10,127) | $ (384) | $ 1,280 |
| Intellectual property | 3,394 | (222) | (1,322) | 1,850 |
| Trade name | 1,198 | (1,032) | | 166 |
| Customer relationships | 1,857 | (1,626) | | 231 |
| Non-compete agreements | 810 | (764) | | 46 |
| | $ 19,050 | $ (13,771) | $ (1,706) | $ 3,573 |

Amortization expense was $0.5 million and $1.2 million for the second quarter and first half of 2009, respectively. Amortization expense was $0.7 million and $1.4 million for the second quarter and first half of 2008, respectively.

12

Table of Contents

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

| Fiscal Year | Amortization of Intangible Assets |
|---|---|
| 2009 (remaining six months) | $ 758 |
| 2010 | 681 |
| 2011 | 507 |
| 2012 | 236 |
| 2013 | 4 |
| Total expected amortization expense | $ 2,186 |

**9. Segment Reporting**

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

Our Non-Memory Product segment is comprised of all other semiconductor products including flash microcontrollers, smart card ICs and modules, radio frequency ICs and modules, NAND Controllers and NAND Controller-based modules.

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

We do not allocate operating expenses, interest and dividend income, impairment of investments, other income or expense, or provision for or benefit from income taxes to any of these segments for internal reporting purposes, as we do not believe that allocating these expenses is beneficial in evaluating segment performance. Additionally, we do not allocate assets to segments for internal reporting purposes as we do not manage our segments by such metrics.

The following table shows our revenues and gross profit for each segment (in thousands):

| | Three Months Ended June 30, 2008 | | Three Months Ended June 30, 2009 | |
|---|---|---|---|---|
| | Revenues | Gross Profit | Revenues | Gross Profit |
| Memory | $ 60,883 | $ 9,799 | $ 41,652 | $ 3,789 |
| Non-Memory | 10,190 | 1,523 | 10,114 | 3,403 |
| Technology Licensing | 12,627 | 12,627 | 6,317 | 6,317 |
| | $ 83,700 | $ 23,949 | $ 58,083 | $ 13,509 |

| | Six Months Ended June 30, 2008 | | Six Months Ended June 30, 2009 | |
|---|---|---|---|---|
| | Revenues | Gross Profit | Revenues | Gross Profit |
| Memory | $ 122,573 | $ 22,474 | $ 71,399 | $ 4,599 |
| Non-Memory | 18,198 | 3,170 | 19,154 | 6,845 |
| Technology Licensing | 24,014 | 24,014 | 17,659 | 17,659 |

| | | | |
|---|---|---|---|
| $ 164,785 | $ 49,658 | $ 108,212 | $ 29,103 |

13

**Table of Contents**

**10. Equity Investments and Related Party Reporting**

*Related Party Transactions and Balances*

The following table is a summary of our related party revenues and purchases, and our related party accounts receivable and accounts payable and accruals (in thousands):

| | Revenues | | | |
|---|---|---|---|---|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2008 | 2009 | 2008 | 2009 |
| Apacer Technology, Inc. & related entities | $ 1,135 | $ 784 | $ 1,859 | $ 1,491 |
| Grace Semiconductor Manufacturing Corp. | 355 | 277 | 437 | 349 |
| Silicon Professional Technology Ltd. | 41,967 | 31,233 | 80,472 | 54,425 |
| | $ 43,457 | $ 32,294 | $ 82,768 | $ 56,265 |

| | Purchases | | | |
|---|---|---|---|---|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2008 | 2009 | 2008 | 2009 |
| Advanced Chip Engineering Technology, Inc. | $ 335 | $ 756 | $ 542 | $ 1,513 |
| Grace Semiconductor Manufacturing Corp. | 21,347 | 6,042 | 42,804 | 11,554 |
| Powertech Technology, Incorporated | 5,079 | 2,582 | 10,262 | 4,513 |
| | $ 26,761 | $ 9,380 | $ 53,608 | $ 17,580 |

| | Accounts Receivable | | Accounts Payable and Accruals | |
|---|---|---|---|---|
| | December 31, 2008 | June 30, 2009 | December 31, 2008 | June 30, 2009 |
| Advanced Chip Engineering Technology, Inc. | $ | $ | $ 83 | $ 121 |
| Apacer Technology, Inc. & related entities | 330 | 265 | | |
| Grace Semiconductor Manufacturing Corp. | 185 | 154 | 1,700 | 4,731 |
| Powertech Technology, Incorporated | | | 1,466 | 1,105 |
| Professional Computer Technology Limited | | | 20 | 5 |
| Silicon Professional Technology Ltd. | 10,246 | 21,206 | 175 | 371 |
| | $ 10,761 | $ 21,625 | $ 3,444 | $ 6,333 |

Prepayments of approximately $330,000 to Advanced Chip Engineering Technology Inc., or ACET, for the purchase of inventory are included in Other current assets at June 30, 2009.

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

*Equity Investments*

Powertech Technology, Incorporated, or PTI, and PCT are Taiwanese companies that are listed on the Taiwan Stock Exchange. Equity investments in these companies have been included in Long-term available-for-sale equity investments. The shares that are not available for

resale within one year of the balance sheet date, due to local securities regulations, are recorded at cost and included in Equity investments, others. If a decline in value is judged to be other than temporary, it is reported as an impairment of equity investments. Cash dividends and other distributions of earnings from the investees, if any, are included in other income at the date of record.

Investments in privately held enterprises and certain restricted stocks are accounted for using either the cost or equity method of accounting, as appropriate. Each period, we evaluate whether an event or change in circumstances has occurred that may indicate an investment has been impaired. If upon further investigation of such events we determine the investment has suffered a decline in value that is other than temporary, we write down the investment to its estimated fair value. As of June 30, 2009 and December 31, 2008 the carrying value of these investments was $23.8 million and $24.6 million, respectively.

**Table of Contents**

In 2001 and 2004, we invested an aggregate of $83.2 million in Grace Semiconductor Manufacturing Corporation, or GSMC, a Cayman Islands company. Bing Yeh, our CEO and Chairman of our Board of Directors, is also a member of GSMC s board of directors. GSMC has a wholly owned subsidiary, Grace, which is a wafer foundry company with operations in Shanghai, China. Grace began to manufacture our products in late 2003. We have an equity ownership position of approximately 6.6% in GSMC as of June 30, 2009, with a carrying value of $11.0 million, and we also have trade accounts receivable from GSMC of $0.2 million. GSMC is a variable interest entity, of which we are not the primary beneficiary. Our maximum exposure to loss as a result of our involvement with GSMC is $11.2 million as of June 30, 2009.

*Investment in Equity Method Affiliate*

In June 2004, we invested $4.0 million in ACET, a privately held Taiwanese company, and made subsequent investments of $15.9 million and $10.3 million in 2006 and 2007, respectively. SST is a Board member of ACET, currently holding one seat, represented by Chen Tsai, our Senior Vice President, Worldwide Backend Operations. ACET is a packaging production subcontractor. We have an equity ownership position of approximately 38.5% in ACET as of June 30, 2009, with a carrying value of $2.0 million, and we have also made prepayments of $0.3 million to ACET for purchases of inventory. ACET is a variable interest entity, of which we are not the primary beneficiary. Our maximum exposure to loss as a result of our involvement with ACET is $2.5 million as of June 30, 2009.

We account for our investment in ACET under the equity method of accounting by including our pro rata share of ACET s reported net loss in our condensed consolidated statement of operations in the line item titled Pro rata share of loss from equity investments. We recorded $0.2 million and $0.7 million as our pro rata share of ACET s loss for the second quarter and first half of 2009, respectively. We recorded $2.2 million and $4.1 million as our pro rata share of ACET s loss for the second quarter and first half of 2008, respectively. Included in shareholders equity at June 30, 2009, is a cumulative translation adjustment of $0.2 million related to our investment in ACET.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Net sales | $ 648 | $ 1,290 | $ 1,265 | $ 2,018 |
| Gross loss | $ (3,740) | $ (1,764) | $ (6,621) | $ (3,428) |
| Net loss | $ (5,646) | $ (3,696) | $ (10,397) | $ (5,937) |

*Impairment of Equity Investment*

In 2001 and 2004, we invested an aggregate of $83.2 million in GSMC, which was carried at cost with an average price per share of $1.0375 for the preferred equity and $0.01 for the common equity. During the fourth quarter of 2006, third quarter of 2007 and fourth quarter of 2008, we recorded impairment charges of $40.6 million, $19.4 million and $11.6 million, respectively. In the second quarter of 2009, we recorded an additional impairment of $0.5 million, which reduced the carrying value of our investment to an estimated fair value of $11.0 million as of June 30, 2009.

From 2006 through 2009, GSMC struggled with below break even operations and significant negative cash flow. Throughout this period GSMC continued to raise additional capital for working capital and expansion purposes. Each reporting period we consider the price per share of the most recent round of equity investments, the expected timing of the next round of financing, the history of operating losses and negative cash flow, earnings and cash flow outlook and expected cash burn rate and the technological feasibility of GSMC s products to determine if there is an indication of impairment. For each impairment recorded, the primary triggering event was an expected round of financing at a lower price per share than the carrying value of our preferred equity.

We used the following two generally accepted valuation methods discussed below in determining the fair value of our investment in GSMC as of June 30, 2009:

The Income Approach which indicates the fair value of a business based on the discounted value of the cash flows the business is expected to generate. In evaluating this approach we discounted the expected cash flows by using a weighted average cost of capital of 14%.

The Market Comparable Method which indicates the fair value of a business by comparing it to other publicly traded companies in similar lines of business.

Table of Contents

To arrive at the fair value of our investment in GSMC as June 30, 2009, we weighted the indication from the Income Approach at 50% and the indication from the Market Comparable Method at 50%. In doing so we considered the following:

Since some comparable companies are not projecting the magnitude of growth that is expected for GSMC due to its planned capacity expansion, we believe that the indicated value by the Income Approach reasonably reflects the long-term growth potential of GSMC.

We believe the Market Comparable Method also results in an equally reasonable value since GSMC s most recent results and projections are similar to those of a select group of publically traded companies in their industry.

We then used the Option Pricing Approach to allocate the aggregate fair value of our investment in GSMC across the individual classes of GSMC equity we hold, based on the concept that equity securities can be viewed as call options on the underlying assets of the company. We determined the strike prices of the options based on the characteristics of the capital structure of the company, such as the number of shares of each class of equity, seniority levels, liquidation preferences and conversion values for preferred equity, and the strike prices of warrants and options. The time to the expiration of these options is equal to the expected time to a liquidity event (initial public offering, sale, merger, etc.).

The following table represents the fair value hierarchy for our equity investments measured at fair value on a non-recurring basis as of June 30, 2009 (in thousands):

| Description | Quoted prices in active markets for identical assets or liabilities Level 1 | Significant other observable inputs Level 2 | Significant other unobservable inputs Level 3 | Total |
|---|---|---|---|---|
| Equity investment in GSMC | $ | $ | $ 11,021 | $ 11,021 |

**11. Comprehensive Income (Loss)**

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Net loss | $ (9,568) | $ (6,448) | $ (8,109) | $ (15,689) |
| Net unrealized gains (losses) on investments, net of tax | (2,990) | 8,258 | (1,560) | 11,410 |
| Cumulative translation adjustment | 134 | 69 | 1,514 | (13) |
| Total comprehensive income (loss) | $ (12,424) | $ 1,879 | $ (8,155) | $ (4,292) |

**12. Income Taxes**

We maintained a full valuation allowance on our net deferred tax assets as of June 30, 2009. Determination of the valuation allowance requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. Based upon the weight of available evidence, which includes our historical operating performance, reported cumulative net losses since inception and difficulty in accurately forecasting our results, we provided a full valuation allowance against our net deferred tax assets. We intend to maintain a full valuation allowance on the U.S. deferred tax assets until sufficient positive evidence exists to support reversal of the valuation allowance.

We recorded a tax benefit of $1.1 million and tax provision of $1.7 million for the second quarter and first half of 2009, respectively, consisting primarily of foreign withholding taxes, withholding tax reserves and currency re-measurement on withholding tax reserves. Included in our tax benefit for the second quarter of 2009 is an adjustment of $2.2 million benefit to correct an error related to withholding tax reserves and the associated currency re-measurement. See also Note 1. Basis of Presentation - Out of Period Adjustments. For the second quarter and first half of 2008, we recorded a tax provision of $2.4 million and a tax benefit of $4.7 million, respectively. The provision benefit for the first half of 2008 consisted primarily of a refund from an Internal Revenue Service settlement from an amended return, partially offset by foreign income and withholding taxes and reserves.

Because relatively small changes in our forecasted net income or loss for 2009 can significantly affect our projected annual effective tax rate for certain foreign entities, we believe a discrete calculation for the second quarter and first half of 2009 is the most reliable estimate of our effective tax rate for those entities.

**Table of Contents**

We periodically receive dividend payments from our investments in foreign companies, which are subject to withholding of income tax. We record these taxes, as well as any refunds of these taxes, on a cash basis. We do not anticipate any material changes to our uncertain tax positions during the remainder of 2009. The adjustment resulting from re-measurement of foreign currency tax liabilities, as well as interest and penalties, if any, is included in income tax provision or benefit.

**13. Subsequent Event**

On December 29, 2008, we entered into an Amending Agreement with Grace Semiconductor Manufacturing Corporation, or GSMC, pursuant to which we agreed to provide GSMC with funding of $15.0 million in return for new equity securities to be issued by GSMC pursuant to a separate Subscription Agreement. The Amending Agreement grants certain technology licenses to GSMC, and requires GSMC to pay SST as upfront fees for the licenses granted the said $15.0 million within five working days of receipt of such $15.0 million.

We tendered the full amount of $15.0 million to GSMC on July 2, 2009 pursuant to a Subscription Agreement, dated June 12, 2009. However, as of the date of filing of this Quarterly Report on Form 10-Q, GSMC has not remitted the upfront license fee payments required under the Amending Agreement and GSMC has instead requested a re-negotiation of the terms of the technology licenses set forth in the Amending Agreement.

If we and GSMC are unable to reach agreement on the terms of the technology licenses or a dispute arises as to the obligations of the parties under the agreements, we intend to request that the $15.0 million we tendered to GSMC on July 2, 2009 be returned. In the event we are unable to reach agreement with GSMC on the terms of our technology license or a dispute arises regarding the obligations of the parties, our business and financial condition could be harmed.

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

*The following discussion may be understood more fully by reference to the consolidated financial statements, notes to the consolidated financial statements and management s discussion and analysis of financial condition and results of operations contained in our Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the Securities and Exchange Commission on March 20, 2009.*

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

**Business Overview**

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

We produce and sell many products based on our SuperFlash design and manufacturing process technology. Our products are incorporated into products sold by many well-known companies including Apple, Asustek, BenQ, Cisco, Dell, First International Computer, Gigabyte, Haier, Huawei, Infineon, Intel, IBM, Inventec, Legend, Lenovo, LG Electronics, Freescale Semiconductor, NEC, Nintendo, Panasonic, Philips, Quanta, Samsung, Sanyo, Seagate, Sony, Sony Ericsson, Toshiba, Texas Instruments, VTech and ZTE.

We also produce and sell other semiconductor products including flash microcontrollers, smart card ICs and modules, radio frequency ICs and modules, NAND Controllers and NAND Controller-based modules.

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

Table of Contents

Our product strategy is two fold: to continue to develop and grow our core NOR flash memory and embedded flash technology licensing business, while diversifying our business by expanding into new markets and pursuing growth opportunities through the development of new NAND Controller-based module and radio frequency IC products. In the NOR flash market, our goals are to be the leading worldwide supplier of low-density NOR flash memory devices and to maintain our position as the world s number one embedded flash licensor by growing both upfront fees and per unit royalties. In our new business markets, our objectives are to leverage our core competencies in NAND Controller design into systems solutions as adoption of solid state memory technology grows, and to leverage our radio frequency wireless technology and systems expertise as development continues on a multitude of electronic devices which are enabled for wireless communication.

The Board of Directors has appointed a Strategic Committee to review our investments and to investigate strategic alternatives, including acquisitions and divestitures. The Strategic Committee is working closely with management and an outside consultant to evaluate our operations and products, and identify potential new business opportunities. This evaluation involves all aspects of our business in order to drive value for our shareholders and position SST for future growth.

**Operations Overview**

After reaching a low point during the month of January, our product shipments rebounded in the first quarter and stabilized in the second quarter. Inventory replenishment, coupled with modest improvement in demand, led to better-than-expected product revenues, with a 44% sequential increase in overall unit shipments in the second quarter. Unit shipments to the Internet computing segment increased nearly 35% sequentially from the first quarter, with substantial recovery in hard disk drive, PC monitor and notebook applications. Unit shipments to the wireless communications segment increased 73% sequentially, driven by the strong recovery in Bluetooth and GPS applications, as well as continued sequential growth in ultra-low-cost-phone shipments. Although we saw improvement across all application segments, as compared to the previous quarter, our second quarter 2009 unit shipments are still down 20% from the previous year. As we expected, our licensing revenues declined significantly in the second quarter, reflecting the decline in our licensees business in the first quarter.

Market conditions remain challenging, particularly for commodity memory products, as there continues to be uncertainty over the macro-economic environment, resulting in poor visibility and continued pricing pressure. This pressure is the result of both weak end-market demand and manufacturing over-capacity in the industry. While it is likely that demand will improve modestly during the remainder of 2009, we expect the pricing environment to remain challenging, as a result of the pervasive over-capacity. We do not expect prices to stabilize until fab utilization in the industry returns to a healthier level. Further, we do not expect to sustain the strong second quarter sequential growth rate in unit shipments through the third quarter.

In response to these difficult market conditions, we are taking a fresh look at every aspect of our business; focusing our resources on areas that will yield the most impact over time, while creating additional opportunities without incurring significant additional research and development expense in the near term. These efforts include a targeted approach to product development that emphasizes non-commodity applications through differentiated features, as well as new programs to enhance our licensing business. We were very pleased to announce in June that Bertrand Cambou joined our company to manage the operation of our memory business. Along with a wealth of industry experience, Dr. Cambou brings to the company a new perspective and excitement toward reviving our NOR memory business. We are actively evaluating the market environment and competitive landscape in order to streamline our product platforms and are assessing the geographic areas and strategic accounts in which we may be underrepresented. We believe there are opportunities for a greater presence and more balanced customer base with additional strategic accounts in Japan, North America and Europe. We also continue to focus on the advancement of our technology through collaborated efforts with our strategic partners, while reducing expenses and carefully managing our inventory and cash. By leveraging our core competencies and improving the efficiency of our operations, we believe that we can move closer to our goal of returning the company to profitability.

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

*Non-Memory Products*

Several years ago, with the recognition that our core memory business will continue to experience average selling price pressure that would limit our revenue growth potential, we began a diversification plan of investing in products and technologies that are expected to yield higher average selling prices and gross margins than our current memory products. We believe that a strategy of diversification will allow for better growth opportunities and higher return for our shareholders. Although it has taken time to establish this new business, we have been pleased by our progress in this area, given the difficulty of penetrating new markets and in an environment where customers are scaling back new product

development. In the first half of 2009, our non-memory business contributed over 20% of product revenue and nearly 60% of product gross profit.

**Table of Contents**

We continue to experience good traction with our NAND controllers and modules, including NANDrive, our embedded flash solid-state drive product family. Our customer base for the NANDrive product line has been growing steadily each quarter for the past two years. However, our revenues remain small as the design cycle for the products that incorporate the NANDrive is quite long, and the current downturn has resulted in further design delays for our customers. We see continued customer enthusiasm, particularly in IP set-top boxes, mobile Internet devices and industrial applications. Over the next few quarters, we expect to expand our product offerings to increase our addressable market, with products covering a broad range of capacities from 0.5GB to 32GB. The market still presents significant challenges, with several of our design wins in the car infotainment space, which is likely to remain weak until the broader economy recovers.

Our RF power amplifier products targeting the embedded Wi-Fi market showed strong sequential growth in the second quarter, with unit shipments more than doubling to reach 14.6 million, driven by video game and printer applications. Using advanced technologies, these devices feature a highly-efficient, low-power, small-footprint design that supports 802.11 wireless standard. We are currently driving design wins in smart phone applications and expect to see product ramp within the next year. While the revenue base is still quite small, average selling prices for these products remain stable and market interest continues to grow. In addition, these design-in activities with our radio frequency power amplifier chipset partners expand opportunities for our NOR memory and NANDrive products.

Due to the complexity of these new product families, the design-in and qualification cycle is expected to be long, and we further expect our near term results to be significantly impacted by the challenging overall economic environment.

*Memory Products and Technology Licensing*

As a result of the current weak demand environment, gross margins for our memory business suffered a substantial decline. Our memory gross margin dropped below 10% for the fourth quarter of 2008 and remained low throughout the first half of 2009. Although we saw modest improvement in the second quarter, we do not expect to see significant improvement until the general economic climate improves.

Continued product innovation and technology advancement are particularly important in light of these challenging market conditions. As we refine our roadmap, we are putting special emphasis on our memory product offerings with differentiated features that take advantage of the benefits of SuperFlash technology, such as high reliability, fast read/write performance with very low power requirements, and serial flash with XIP function. For the near term, we are focused on the product transition to 120nm nodes and 300mm capacity for cost improvement, and for several quarters we have been working to ramp our 120nm technology products at Shanghai Grace Semiconductor Manufacturing Corporation, or Grace, and Maxchip Electronics Corporation, or Maxchip. These products, including 16Mbit, 32Mbit and 64Mbit parallel and serial family of products, offer significant performance, power efficiency and footprint advantages over previous generations. To date, nine products have been released to production at Grace and Maxchip, with five more under verification and qualification; however the production-ramp is limited by current market demand.

Although our licensing revenues declined significantly in the second quarter, reflecting the decline in our licensees business in the first quarter, we expect to see some increase in royalty revenues for the third quarter, reflecting general improvement in the semiconductor industry in the second quarter. Our licensing business represents considerable opportunity for us and we are placing enhanced emphasis in several areas we believe will foster growth. In addition to growing our licensee base, we are also working with current licensees to expand to more advanced technology nodes. Further, we are expanding our offering in design services, including both flash IP block and full chip design, to help our licensees reduce their time-to-market for new products. Our licensing business remains a tremendous asset to our financial model and our continued investment in our core memory products and technology roadmap helps to ensure this business will thrive as market demand improves.

*Global Reorganization*

In December 2008, we announced the implementation of a global reorganization designed to reflect changes in anticipated demand for our products. This action was taken to reduce costs of operations, realign our development priorities, and to improve our focus on accelerating time-to-market of select new products. This refined strategy continues the essential elements of diversification by focusing on a reduced number of projects in the areas of non-commodity NOR products, NAND Controllers and modules and radio frequency products which are synergistic with our memory markets. We believe this focus on a smaller set of projects, along with the reduction in operating expenses, will ultimately make our company more profitable and enhance shareholder value.

Table of Contents

As a result of our global reorganization, our operating expenses decreased substantially in the first half of 2009, as compared to the first half of 2008. Our restructuring efforts have been conducted in a manner that we believe will best enable us to support the current and future requirements of our customer base and invest appropriately in our technology roadmap in order to enhance both our shorter and longer term competitive position. We are actively working towards a goal of returning the company to profitability and are managing our assets conservatively through this period. Our fabless business model, in conjunction with our technology leadership, has been resilient during past business cycle downturns and we look forward to emerging as a strong competitor from this challenging environment.

**Concentrations**

We derived 87.3% and 89.0% of our net product revenues during the year ended December 31, 2008 and the first half of 2009, respectively, from product shipments to Asia. In addition, substantially all of our wafer suppliers and packaging and testing subcontractors are located in Asia.

Shipments to our top ten end customers, which exclude transactions through stocking representatives and distributors, accounted for 21.4% and 18.1% of our net product revenues during the year ended December 31, 2008 and the first half of 2009, respectively.

No single end customer, which we define as original equipment manufacturers, or OEMs, original design manufacturers, or ODMs, contract electronic manufacturers, or CEMs, or end users, represented 10.0% or more of our net product revenues during the year ended December 31, 2008 and the first half of 2009.

We ship products to, and have accounts receivable from, OEMs, ODMs, CEMs, stocking representatives, distributors and our logistics center. Our stocking representatives, distributors and logistics center reship our products to our end customers, including OEMs, ODMs, CEMs and end users. Shipments, by us or our logistics center, to our top three stocking representatives for reshipment accounted for 54.6% and 61.6% of our product shipments during the year ended December 31, 2008 and the first half of 2009, respectively. In addition, the same three stocking representatives solicited sales, for which they received a commission, for 7.0% and 1.8% of our product shipments to end users during the year ended December 31, 2008 and the first half of 2009, respectively.

We out-source our end customer service logistics in Asia to Silicon Professional Technology Ltd., or SPT, which supports our customers in Taiwan, China and other Southeast Asia countries. SPT provides forecasting, planning, warehousing, delivery, billing, collection and other logistic functions for us in these regions. SPT is a wholly-owned subsidiary of one of our stocking representatives in Taiwan, Professional Computer Technology Limited, or PCT. Products shipped to SPT are accounted for as our inventory held at our logistics center, and revenue is recognized when the products have been delivered and are considered as sold to our end customers by SPT. For the year ended December 31, 2008 and the first half of 2009, SPT serviced end customer sales accounting for 56.2% and 60.4%, respectively, of our net product revenues. As of December 31, 2008 and June 30, 2009, SPT represented 50.9% and 67.5%, respectively, of our net accounts receivable.

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

**Critical Accounting Estimates**

For information related to our revenue recognition and other critical accounting estimates, please refer to the Critical Accounting Estimates section of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2008. There have been no significant changes to our critical accounting estimates.

**Results of Operations:**

**Net Revenues (in thousands, except percentages)**

| | Three Months Ended | | | | | | |
|---|---|---|---|---|---|---|---|
| | June 30, 2008 | March 31, 2009 | June 30, 2009 | 2Q09-Over-2Q08 Change | | 2Q09-Over-1Q09 Change | |
| Memory revenue | $ 60,883 | $ 29,747 | $ 41,652 | $ (19,231) | (31.6)% | $ 11,905 | 40.0% |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Non-memory revenue | 10,190 | 9,040 | 10,114 | (76) | (0.7)% | 1,074 | 11.9% |
| Product revenues | 71,073 | 38,787 | 51,766 | (19,307) | (27.2)% | 12,979 | 33.5% |
| Technology licensing | 12,627 | 11,342 | 6,317 | (6,310) | (50.0)% | (5,025) | (44.3)% |
| Total net revenues | $ 83,700 | $ 50,129 | $ 58,083 | $ (25,617) | (30.6)% | $ 7,954 | 15.9% |

20

| | Six Months Ended | | | |
|---|---|---|---|---|
| | June 30, 2008 | June 30, 2009 | 2Q09-Over-2Q08 Change | |
| Memory revenue | $ 122,573 | $ 71,399 | $ (51,174) | (41.7)% |
| Non-memory revenue | 18,198 | 19,154 | 956 | 5.3% |
| Product revenues | 140,771 | 90,553 | (50,218) | (35.7)% |
| Technology licensing | 24,014 | 17,659 | (6,355) | (26.5)% |
| Total net revenues | $ 164,785 | $ 108,212 | $ (56,573) | (34.3)% |

The following discussions are based on our reportable segments described in Note 9 Segment Reporting to our condensed consolidated financial statements.

*Memory Products*

Memory product revenue in the first half of 2009 was down significantly from the first half of 2008, largely as a result of the unprecedented sudden decrease in worldwide demand for semiconductor products which began in September, 2008. Although this decline was more pronounced in the first quarter of 2009, revenue for the second quarter of 2009 is still down sharply from the previous year.

Memory product revenue increased 40.0% in the second quarter of 2009 from the first quarter, primarily due to an increase in unit shipments of 42%, which was offset slightly by a 1% decline in average selling prices. The wireless communications segment showed strong recovery in the second quarter, with unit shipments up 90% from the first quarter, and averages selling prices remaining relatively stable. Memory product revenue for the second quarter of 2009 was down 31.6% from the second quarter of 2008, primarily due to a 21% decline in average selling prices, combined with a 14% decrease in unit shipments. Reduced demand for digital consumer products resulted in lower unit shipments, while average selling prices also declined, due to increased competitive pressures, over-capacity and the challenging overall macroeconomic environment.

Although we anticipate memory product revenue may improve somewhat in the second half of 2009, as part of a general seasonal trend, we expect that memory product revenue will continue to be at historically low levels throughout 2009.

*Non-Memory Products*

Non-memory product revenue increased 11.9% in the second quarter of 2009 from the first quarter, with an increase in unit shipments of 50% partially offset by a decrease of 22% in average selling prices. Non-memory product revenue for the second quarter of 2009 was comparable to the second quarter of 2008, with a 74% increase in average selling prices, from product mix, largely offset by a 45% decrease in unit shipments. Revenue for the first half of 2009 also benefited from the recognition of deferred revenue, based on collection of outstanding accounts receivable.

We expect non-memory product revenue to fluctuate significantly throughout 2009 due to the current adverse economic conditions, as well as the start-up nature of our new product lines and diversification in our customer base.

*Technology Licensing Revenue*

Technology licensing revenue includes a combination of up-front fees and royalties. Technology licensing revenue for the second quarter of 2009 decreased significantly, as compared with both the first quarter of 2009 and the second quarter of 2008, as a result of lower demand for our licensee s products. Our royalty revenues are recorded when reported to us by our licensees, which is the quarter following our licensees sales, and thus the royalty portion of our licensing revenue for the second quarter of 2009 reflects the business of our licensees in the first quarter of 2009. Although we anticipate some improvement in the second half of 2009, we expect that licensing revenues will continue to fluctuate significantly in the future, depending on general economic conditions.

Table of Contents

**Gross Profit (in thousands, except percentages)**

| | Three Months Ended | | | | | | |
|---|---|---|---|---|---|---|---|
| | June 30, 2008 | March 31, 2009 | June 30, 2009 | 2Q09-Over-2Q08 Change | | 2Q09-Over-1Q09 Change | |
| Memory gross profit | $ 9,799 | $ 810 | $ 3,789 | $ (6,010) | (61.3)% | $ 2,979 | 367.8% |
| Memory gross margin | 16.1% | 2.7% | 9.1% | | | | |
| Non-memory gross profit | 1,523 | 3,442 | 3,403 | 1,880 | 123.4% | (39) | (1.1)% |
| Non-memory gross margin | 14.9% | 38.1% | 33.6% | | | | |
| Product gross profit | 11,322 | 4,252 | 7,192 | (4,130) | (36.5)% | 2,940 | 69.1% |
| Product gross margin | 15.9% | 11.0% | 13.9% | | | | |
| Technology licensing gross profit | 12,627 | 11,342 | 6,317 | (6,310) | (50.0)% | (5,025) | (44.3)% |
| Technology licensing gross margin | 100.0% | 100.0% | 100.0% | | | | |
| Total gross profit | $ 23,949 | $ 15,594 | $ 13,509 | $ (10,440) | (43.6)% | $ (2,085) | (13.4)% |
| Total gross margin | 28.6% | 31.1% | 23.3% | | | | |

| | Six Months Ended | | | |
|---|---|---|---|---|
| | June 30, 2008 | June 30, 2009 | 2Q09-Over-2Q08 Change | |
| Memory gross profit | $ 22,474 | $ 4,599 | $ (17,875) | (79.5)% |
| Memory gross margin | 18.3% | 6.4% | | |
| Non-memory gross profit | 3,170 | 6,845 | 3,675 | 115.9% |
| Non-memory gross margin | 17.4% | 35.7% | | |
| Product gross profit | 25,644 | 11,444 | (14,200) | (55.4)% |
| Product gross margin | 18.2% | 12.6% | | |
| Technology licensing gross profit | 24,014 | 17,659 | (6,355) | (26.5)% |
| Technology licensing gross margin | 100.0% | 100.0% | | |
| Total gross profit | $ 49,658 | $ 29,103 | $ (20,555) | (41.4)% |
| Total gross margin | 30.1% | 26.9% | | |

*Product Gross Profit*

*Memory products*

Gross profit for memory products increased 367.8% in the second quarter of 2009 compared to the first quarter of 2009, primarily due to higher revenue and product mix. Gross profit for the first quarter of 2009 was also negatively impacted, to a greater extent than the second quarter of 2009, by inventory write-downs due to decreases in average selling prices. Gross profit decreased 61.3% in the second quarter of 2009 and 79.5% in the first half of 2009 compared to the same periods in 2008, based on substantially reduced revenue and lower average selling prices. The significant declines in average selling prices in 2009 from 2008 resulted in a gross margin impact which is proportionally greater than the reduction in revenue. Gross profit benefited by $0.9 million and $1.5 million in the second quarter and first half of 2009, respectively, from the sale of inventory which had previously been written down. Gross profit benefited by $0.6 million and $1.2 million in the second quarter and first half of 2008, respectively, from the sale of inventory which had previously been written down.

We expect memory product margins to fluctuate significantly in the future due to changes in sales volume, product mix, average selling prices and inventory write-downs.

*Non-memory products*

Gross profit for non-memory products for the second quarter of 2009 was comparable to the first quarter of 2009, with an increase in revenue offset by lower margins from product mix. Gross profit for the first and second quarters of 2009 also benefited from the recognition of deferred revenue for the sale of $0.5 and $0.3 million, respectively, in inventory which had previously been written down. Gross profit for non-memory products increased by 123.4% in the second quarter of 2009 compared to the second quarter of 2008, and by 115.9% in the first half of 2009 compared to the first half of 2008. The increases are primarily due to higher average selling prices, from product mix, as well as the recognition of deferred revenue in the first half of 2009 for the sale of $0.8 million in inventory which had previously been written down.

We expect non-memory product margins to fluctuate significantly in the future due to changes in sales volume, product mix, average selling prices and inventory write-downs.

Table of Contents

For other factors that could affect our gross profit, please also see Item 1A. Risk Factors - We incurred significant inventory valuation and adverse purchase commitment adjustments in 2007, 2008 and the first half of 2009 and we may incur additional significant inventory valuation adjustments in the future.

**Operating Expenses (in thousands, except percentages)**

In December 2008, we announced the implementation of a global reorganization designed to reflect changes in anticipated demand for our products. The reorganization included a reduction in overall headcount of approximately 120, or 17 percent of our global workforce, most of which was completed by the end of 2008. The workforce reduction and other restructuring actions took place worldwide and in all functional areas of the company, and are expected to reduce payroll-related expenses by approximately $13 million in 2009. In addition, we have taken steps to reduce overall operating expenses, which is evident in our results for the first half of 2009, as compared with the first half of 2008.

*Research and development*

| | Three Months Ended | | | | | | |
|---|---|---|---|---|---|---|---|
| | June 30, 2008 | March 31, 2009 | June 30, 2009 | 2Q09-Over-2Q08 Change | | 2Q09-Over-1Q09 Change | |
| Research and development | $ 15,223 | $ 11,414 | $ 11,250 | $ (3,973) | (26.1)% | $ (164) | (1.4)% |
| Percent of revenue | 18.2% | 22.8% | 19.4% | | | | |

| | Six Months Ended | | | |
|---|---|---|---|---|
| | June 30, 2008 | June 30, 2009 | 2Q09-Over-2Q08 Change | |
| Research and development | $ 30,835 | $ 22,664 | $ (8,171) | (26.5)% |
| Percent of revenue | 18.7% | 20.9% | | |

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

Research and development expenses for the second quarter of 2009 were comparable to the first quarter, with an increase of $0.5 million for product-related expenses offset by a decrease of $0.4 million in expenses related to compensation and benefits. The lower product-related expenses for the first quarter of 2009 reflect the timing of engineering projects, as well as overall efforts to control expenses. Research and development expenses decreased $4.0 million, or 26.1% in the second quarter of 2009, as compared with the second quarter of 2008, primarily due to decreases of $0.6 million for product-related expenses, $2.0 million for salaries, $0.6 million in share-based compensation and $0.3 million for benefits. The reductions to compensation and benefit-related expenses are consistent with our personnel reduction in the fourth quarter of 2008. Share-based compensation expense for the second quarter of 2008 included charges related to the grant of restricted stock awards and tender offer. Please also see Note 3 Shareholders Equity and Share-based Compensation to our condensed consolidated financial statements.

Although measures taken in the fourth quarter of 2008 in connection with our global reorganization resulted in a reduction to research and development expenses for the first half of 2009, as compared to the first half of 2008, no significant additional reductions are planned at this time. Further, we expect certain product-related expenses to fluctuate during the remainder of 2009, based on the timing of engineering projects for new product introductions and the development of new technologies to support future growth.

*Sales and marketing*

| | Three Months Ended | | | | |
|---|---|---|---|---|---|
| | June 30, 2008 | March 31, 2009 | June 30, 2009 | 2Q09-Over-2Q08 Change | 2Q09-Over-1Q09 Change |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Sales and marketing | $ 6,918 | $ 4,960 | $ 5,166 | $ (1,752) | (25.3)% | $ 206 | 4.2% |
| Percent of revenue | 8.3% | 9.9% | 8.9% | | | | |

| | Six Months Ended | | | |
|---|---|---|---|---|
| | June 30, 2008 | June 30, 2009 | 2Q09-Over-2Q08 Change | |
| Sales and marketing | $ 14,401 | $ 10,126 | $ (4,275) | (29.7)% |
| Percent of revenue | 8.7% | 9.4% | | |

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

Sales and marketing expenses for the second quarter of 2009 increased $0.2 million, or 4.2% from the first quarter, with the increase attributable to commissions and logistics center fees, based on higher revenue. Sales and marketing expenses decreased $1.8 million, or 25.3% in the second quarter of 2009, as compared with the second quarter of 2008, primarily due to decreases of $0.8 million in expenses related to compensation and benefits and $0.3 million in travel and marketing programs, as well as a $0.5 million reduction in commissions and logistics center fees. These decreases in commissions and compensation-related expenses are consistent with the year-over-year decline in product revenues and personnel reduction.

We expect that sales and marketing expenses will remain at a reduced level, as compared with 2008, due to the lower commission expenses which are commensurate with a reduced revenue forecast. However, as compared with the first half of 2009, we expect these expenses will increase somewhat, due to seasonal factors, in the second half of 2009. Further, sales and marketing expenses may fluctuate throughout 2009 to support new product introductions and any anticipated future growth.

*General and administrative*

| | Three Months Ended | | | | | | |
|---|---|---|---|---|---|---|---|
| | June 30, 2008 | March 31, 2009 | June 30, 2009 | 2Q09-Over-2Q08 Change | | 2Q09-Over-1Q09 Change | |
| General and administrative | $ 7,721 | $ 5,160 | $ 4,636 | $ (3,085) | (40.0)% | $ (524) | (10.2)% |
| Percent of revenue | 9.2% | 10.3% | 8.0% | | | | |

| | Six Months Ended | | | |
|---|---|---|---|---|
| | June 30, 2008 | June 30, 2009 | 2Q09-Over-2Q08 Change | |
| General and administrative | $ 14,904 | $ 9,796 | $ (5,108) | (34.3)% |
| Percent of revenue | 9.0% | 9.1% | | |

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

General and administrative expenses for the second quarter of 2009 decreased $0.5 million, or 10.2%, from the first quarter of 2009, primarily due to a decrease of $0.4 million for outside services, reflecting receipt of payment on an insurance claim related to legal fees. General and administrative expenses decreased $3.1 million, or 40.0% in the second quarter of 2009, as compared with the second quarter of 2008, primarily due to decreases of $0.9 million for outside services, $1.0 million for salaries, $0.5 million in share-based compensation and $0.2 million for benefits. These decreases to compensation related expenses reflect the personnel reduction and lack of bonus accruals for 2009.

Due to a decline in revenue forecast, we have implemented measures to manage expenditures, and the impact of these measures is evident in our operating expenses for the first half of 2009. As the nature of certain general and administrative expenses are relatively fixed, these expenses will not decrease in proportion to revenue. Further, certain expenses may increase somewhat to support long-term strategic initiatives.

*Other operating expenses*

In connection with our global reorganization announced in December 2008, we incurred restructuring charges of $2.5 million and $0.3 million in the fourth quarter of 2008 and first quarter of 2009, respectively. These charges were related to estimated severance costs associated with the workforce reduction. We did not incur expense related to this specific reorganization in the second quarter of 2009 and do not expect to incur additional expense during the remainder of 2009.

Table of Contents

*Interest and dividend income*

| | Three Months Ended | | | | | | |
|---|---|---|---|---|---|---|---|
| | June 30, 2008 | March 31, 2009 | June 30, 2009 | 2Q09-Over-2Q08 Change | | 2Q09-Over-1Q09 Change | |
| Interest and dividend income | $ 1,120 | $ 644 | $ 545 | $ (575) | (51.3)% | $ (99) | (15.4)% |
| Percent of revenue | 1.3% | 1.3% | 0.9% | | | | |

| | Six Months Ended | | | |
|---|---|---|---|---|
| | June 30, 2008 | June 30, 2009 | 2Q09-Over-2Q08 Change | |
| Interest and dividend income | $ 2,422 | $ 1,189 | $ (1,233) | (50.9)% |
| Percent of revenue | 1.5% | 1.1% | | |

Interest and dividend income includes interest and dividends from cash and short-term cash equivalents, as well as long-term available-for-sale debt securities and equity investments.

Interest and dividend income for the second quarter and first half of 2009 decreased from the second quarter and first half of 2008, primarily as a result of declining interest rates, as well as declining cash balances. Interest income for the second quarter of 2009 decreased slightly from the first quarter of 2009, due to the continuing decline in interest rates. We expect that interest income will fluctuate due to changes in our cash balances and general economic conditions, as well as fluctuating short-term and long-term interest rates in the United States.

*Other income (expense), net*

| | Three Months Ended | | | | | | |
|---|---|---|---|---|---|---|---|
| | June 30, 2008 | March 31, 2009 | June 30, 2009 | 2Q09-Over-2Q08 Change | | 2Q09-Over-1Q09 Change | |
| Other income (expense), net | $ (144) | $ (147) | $ 143 | $ 287 | (199.3)% | $ 290 | (197.3)% |
| Percent of revenue | (0.2)% | (0.3)% | 0.2% | | | | |

| | Six Months Ended | | | |
|---|---|---|---|---|
| | June 30, 2008 | June 30, 2009 | 2Q09-Over-2Q08 Change | |
| Other income (expense), net | $ (338) | $ (4) | $ 334 | (98.8)% |
| Percent of revenue | (0.2)% | (0.0)% | | |

Other income (expense), net includes interest expense, foreign currency translation gains and losses and other miscellaneous transactions.

There was no significant change in other income (expense) for the second quarter of 2009 as compared with the first quarter of 2009 and second quarter of 2008. Other income (expense) may fluctuate significantly year to year but we do not expect it to have material impact on our condensed consolidated statements of operations.

*Impairment of investments*

In the second quarter of 2009 we recorded a $0.5 million impairment to our equity investment in Grace Semiconductor Manufacturing Corporation, or GSMC. See also Note 10   Equity Investments and Related Party Reporting   to our condensed consolidated financial statements for a discussion of our evaluation of GSMC. In the first quarter of 2008, we fully reserved a note receivable from an unrelated third party in the amount of $216,000 due to our expected inability to collect it.

*Provision for (benefit from) income taxes*

We recorded a tax benefit of $1.1 million and a tax provision of $1.7 million for the second quarter and first half of 2009, respectively, consisting primarily of foreign withholding taxes, withholding tax reserves and currency re-measurement on withholding tax reserves. The tax benefit of $1.1 million in the second quarter of 2009 represents a decrease of $3.9 million, as compared with the first quarter, primarily due to a favorable adjustment from the out of period correction of a $2.2 million error related to foreign withholding tax reserves and the associated currency re-measurement. See also Note 1. Basis of Presentation - Out of Period Adjustments to our condensed consolidated financial statements. For the first half of 2008, we recorded a $4.7 million tax benefit, consisting primarily of a refund from an Internal Revenue Service settlement from an amended return, partially offset by foreign income and withholding taxes and reserves.

Table of Contents

Because relatively small changes in our forecasted net income or loss for 2009 can significantly affect our projected annual effective tax rate for certain foreign entities, we believe a discrete calculation for the second quarter and first half of 2009 is the most reliable estimate of our effective tax rate for those entities.

We maintained a full valuation allowance on our net deferred tax assets as of June 30, 2009. Determination of the valuation allowance requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. Based upon the weight of available evidence, which includes our historical operating performance, reported cumulative net losses since inception and difficulty in accurately forecasting our results, we provided a full valuation allowance against our net deferred tax assets. We intend to maintain a full valuation allowance on the U.S. deferred tax assets until sufficient positive evidence exists to support reversal of the valuation allowance.

*Pro rata share of loss from equity investments*

| | Three Months Ended | | | | | | |
|---|---|---|---|---|---|---|---|
| | June 30, 2008 | March 31, 2009 | June 30, 2009 | 2Q09-Over-2Q08 Change | | 2Q09-Over-1Q09 Change | |
| Pro rata share of loss from equity investments | $ 2,241 | $ 595 | $ 254 | $ (1,987) | (88.7)% | $ (341) | (57.3)% |

| | Six Months Ended | | | |
|---|---|---|---|---|
| | June 30, 2008 | June 30, 2009 | 2Q09-Over-2Q08 Change | |
| Pro rata share of loss from equity investments | $ 4,137 | $ 849 | $ (3,288) | (79.5)% |

Our pro rata share of loss from equity investments primarily represents our share of loss from our investment in Advanced Chip Engineering Technology Inc., or ACET. Our pro rata share of loss from equity investments for the second quarter and first half of 2009 was $0.3 million and $0.8 million, respectively. Our pro rata share of loss from equity investments for the second quarter and first half of 2008 was $2.2 million and $4.1 million, respectively. Our share of ACET s loss for the first half of 2009 decreased significantly, as compared to the first half of 2008, primarily due to an impairment of $9.7 million recorded in the fourth quarter of 2008. The impairment resulted in a subsequent reduction to our pro rata share of the carrying value of long lived assets and associated depreciation expense. Our total investment represents approximately 38.5% of the outstanding equity of ACET at June 30, 2009.

**Liquidity and Capital Resources (in thousands)**

| | Six Months Ended June 30, | |
|---|---|---|
| | 2008 | 2009 |
| Cash provided by (used in): | | |
| Operating activities | $ 11,334 | $ 911 |
| Investing activities | $ (36,253) | $ (481) |
| Financing activities | $ (18,866) | $ (100) |

Principal sources of liquidity at June 30, 2009 consist of $100.1 million of cash, cash equivalents, and short-term available-for-sale investments. Additional sources of liquidity may include certain marketable debt securities classified as long-term available-for-sale debt securities.

*Operating activities.* Operating activities provided $0.9 million of cash in the first half of 2009. The primary sources of cash from operating activities were a $15.7 million decrease in inventories and a $2.5 million increase in accounts payable, along with $5.8 million in non-cash expense for inventory write-downs and provision for adverse purchase commitments, $4.9 million for depreciation and amortization and $1.5 million for share-based compensation. Offsetting these sources of cash were our net loss of $17.4 million and $11.2 million increase in accounts receivable. The changes to accounts receivable and inventory balances primarily reflect the sharp drop in product sales during the fourth quarter of 2008 and inventory replenishment by our customers during the second quarter of 2009. Share-based compensation expense for the first half of 2009 declined, as compared to the first half of 2008, due in part to charges in the second quarter of 2008 related to the grant of restricted stock options and tender offer. Our share of ACET s loss for the first half of 2009 decreased significantly, as compared to the first half of 2008, primarily due to an impairment of $9.7 million recorded in the fourth quarter of 2008. The impairment resulted in a subsequent reduction to our pro rata share of the carrying value of long lived assets and associated depreciation expense.

26

**Table of Contents**

For the first half of 2008, the primary source of cash from operating activities was an $18.7 million decrease in accounts receivable, due primarily to a decline in revenue. Offsetting this source of cash flow was a $19.7 million increase in inventories, due primarily to easing of capacity constraints coupled with the decline in revenue. Although we reported a net loss of $8.1 million for the first half of 2008, this loss was offset by non-cash operating expenses including $5.4 million in depreciation and amortization and $3.0 million in share-based compensation, in addition to $4.2 million in non-cash losses related to our equity interest in ACET.

*Investing activities.* We used $0.5 million for investing activities during the first half of 2009, with $37.3 million in purchases of available-for-sale debt securities offset by $37.6 million in maturities of available-for-sale debt securities. Purchases of property and equipment were not significant in the first half of 2009, reflecting efforts to carefully manage cash in response to adverse market conditions. For the first half of 2008, investing activities used $36.3 million, consisting primarily of purchases of long-term available-for-sale debt securities of $59.6 million and property and equipment of $5.2 million. These uses of cash were partially offset by $29.0 million in maturities of available-for-sale debt securities. We purchased long-term available-for-sale debt securities commencing during the first half of 2008 in order to obtain a higher interest rate yield.

*Financing activities.* There were no significant sources or uses of cash from financing activities during the first half of 2009. Net cash used by financing activities was $0.1 million, with payments of capital leases largely offset by proceeds from issuance of common stock. Net cash used by financing activities totaled $18.9 million for the first half of 2008, including $11.9 million for repurchase of common stock and $6.9 million for repayment of our line of credit.

*Credit Market Risk*

As of June 30, 2009, we held corporate bonds and notes of $4.0 million and government bonds and notes of $76.1 million. These securities cash flows are funded by the principal and interest payments of the underlying corporate loans and federal, state and local governmental loans. The recent credit market instability may adversely impact our disposition of these securities at or near their quoted fair market value. We evaluate these investments at each balance sheet date. There is the risk that at future balance sheet dates we may record a charge for a decline in the fair value that is considered other than temporary and a loss would be recognized in the income statement at that time.

As of June 30, 2009, other than as described below, there were no material changes in long-term debt obligations, capital lease obligations, operating lease obligations, purchase obligations or any other long-term liabilities reflected on our condensed consolidated balance sheet as compared to December 31, 2008.

*Purchase Commitments.* As of June 30, 2009 we had outstanding purchase commitments with our foundry vendors of $21.7 million for delivery in 2009, with a recorded a liability of $1.9 million for related adverse purchase commitments. In comparison, as of December 31, 2008, we had outstanding purchase commitments with our foundry vendors of $13.2 million, with a recorded liability of $1.1 million for adverse purchase commitments.

*Operating Capital Requirements.* We believe that our cash balances, together with funds we expect to generate from operations, will be sufficient to meet our projected working capital and other cash requirements through at least the next twelve months. Although our revenue projections for the current year have been adversely impacted by the rapid decline in demand for semiconductor products, we believe our available cash and marketable securities are sufficient to cover projected working capital requirements without significant gross profit contribution.

However, there can be no assurance that future events will not require us to seek additional borrowings or capital and, if so required, that such borrowing or capital will be available on acceptable terms. Factors that could affect our short-term and long-term cash used or generated from operations and as a result, our need to seek additional borrowings or capital include:

- the average selling prices of our products;
- customer demand for our products;
- the need to secure future wafer production capacity from our suppliers;

the timing of significant orders and of license and royalty revenue;

merger, acquisition or joint venture projects;

investments in strategic business partners;

unanticipated research and development expenses associated with new product introductions; and

the outcome of ongoing litigation.

Table of Contents

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

In January and February 2005, multiple putative shareholder class action complaints were filed against us and certain of our directors and officers in the United States District Court for the Northern District of California. Following the filing of the putative class action lawsuits, multiple shareholder derivative complaints were filed in California Superior Court for the County of Santa Clara, purportedly on behalf of SST against certain of our directors and officers. In addition, in July and October 2006, multiple shareholder derivative complaints were filed against us and certain of our directors and officers in the United States District Court for the Northern District of California. In the event of unfavorable outcome of the suits, we may be required to pay damages. For more information, please also see Item 1A. Risk Factors - We are engaged in derivative suits, which may become time consuming, costly and divert management resources and could impact our stock price.

From time to time, we are also involved in other legal actions arising in the ordinary course of business. We have accrued certain costs associated with defending these matters. There can be no assurance that the shareholder class action complaints, the shareholder derivative complaints or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring payments in the future which may adversely impact net income. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. As a result, no losses associated with these or other litigation have been accrued in our financial statements as of June 30, 2009.

**Recent Accounting Pronouncements**

Please see Note 1 Basis of Presentation to our condensed consolidated financial statements for a discussion of recent accounting pronouncements.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to risks associated with foreign exchange rate fluctuations due to our international manufacturing and sales activities, including currency exchange rates for China, Taiwan, Japan, Korea, Singapore, Malaysia and the United Kingdom. These exposures may change over time as business practices evolve and could negatively impact our operating results and financial condition. Currently, we do not hedge these foreign exchange rate exposures. Substantially all of our sales are denominated in U.S. dollars. An increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive and therefore reduce the demand for our products. Such a decline in the demand could reduce revenues and/or result in operating losses. We have liabilities for uncertain tax positions related to foreign withholding tax on license revenue, and fluctuations in foreign exchange rates could affect the measurement of these liabilities. As of June 30, 2009, a 10% move in these rates could result in an increase to our tax provision expense of approximately $0.8 million. In addition, a downturn in the economies of China, Japan or Taiwan could impair the value of our investments in companies with operations in these countries. If we consider the value of these companies to be impaired, we will write off, or expense, some or all of our investments. In 2007, 2008 and the first half of 2009 we recorded investment impairments of $22.4 million, $21.8 million and $0.5 million, respectively. We do not currently hold any investments sensitive to market risk which were entered into for trading purposes.

At any time, fluctuations in interest rates could affect interest earnings on our cash, cash equivalents and short-term investments, or the fair value of our investment portfolio. A 10% move in interest rates as of June 30, 2009 would have an immaterial effect on our financial position, results of operations and cash flows. Currently, we do not hedge these interest rate exposures.

The table below presents the carrying value and related weighted average interest rates for our unrestricted and restricted cash, cash equivalents, short-term available-for-sale investments and long-term available-for-sale debt securities as of June 30, 2009 (in thousands, except percentages):

| | Carrying Value | Interest Rate |
|---|---|---|
| Cash and cash equivalents - variable rate | $ 51,206 | 1.0% |
| Short-term available-for-sale investments - fixed rate | 49,664 | 1.5% |
| Long-term available-for-sale debt securities - fixed rate | 34,457 | 1.9% |
| | $ 135,327 | |

**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**

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

Our management is responsible for establishing and maintaining our disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)). Our Chief Executive Officer and Chief Financial Officer participated with our management in evaluating the effectiveness of our disclosure controls and procedures as of June 30, 2009 and concluded that our disclosure controls and procedures were not effective as of June 30, 2009 as a result of a material weakness in our internal control over financial reporting as discussed below.

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

As of June 30, 2009, we did not maintain effective controls to ensure the accuracy of the provision for income taxes. Specifically, we did not maintain a sufficient complement of tax resources with the required proficiency to identify, evaluate, review and report complex tax accounting matters. This deficiency resulted in adjustments to the unaudited condensed consolidated financial statements for the quarter ended June 30, 2009, as more fully described in Note 1 to the unaudited condensed consolidated financial statements. Additionally, this control deficiency could result in a material misstatement of our annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

In light of the material weakness described above, we have performed additional analyses and other post-closing procedures to ensure that our financial statements are prepared in accordance with generally accepted accounting principles. Accordingly, we believe that the financial statements included in this report fairly present, in all material respects, our financial condition, results of operations, and cash flows for the periods presented. Based in part on these additional efforts, our Chief Executive Officer and Chief Financial Officer have included their certifications as exhibits to this Quarterly Report on Form 10-Q.

**Changes in Internal Control Over Financial Reporting**

As described above with respect to the material weakness identified, there have been changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are likely to materially affect, our internal control over financial reporting.

**Management s Remediation Initiatives**

As a result of the material weakness, we intend to continue to review and make changes to improve our internal control over financial reporting, including but not limited to, the hiring of additional personnel or the dedication of resources having sufficient knowledge and experience in tax to strengthen the controls around the tax provision, as well as enhancing the review process associated with the preparation of the income tax provision.

Management has not yet implemented all of the measures described above and/or tested them. We continue to evaluate our internal controls over financial reporting and may in the future modify these measures or implement additional measures.

Table of Contents

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

On July 13, 2006, a shareholder derivative complaint was filed in the United States District Court for the Northern District of California by Mike Brien under the caption Brien v. Yeh, et al., Case No. C06-04310 JF (N.D. Cal.). On July 18, 2006, a second shareholder derivative complaint was filed in the United States District Court for the Northern District of California by Behrad Bazargani under the caption Bazargani v. Yeh, et al., Case No. C06-04388 HRL (N.D. Cal.). Both complaints were brought purportedly on behalf of SST against certain of our current and former officers and directors and allege among other things, that the named officers and directors: (a) breached their fiduciary duties as they colluded with each other to backdate stock options, (b) violated Rule 10b-5 of the Securities Exchange Act of 1934, and (c) were unjustly enriched by their receipt and retention of such stock options. The Brien and Bazargani cases were consolidated into one case: In re Silicon Storage Technology, Inc. Derivative Litigation, Case No. C06-04310 JF (or the Federal Derivative Litigation ) and plaintiffs filed a consolidated amended shareholder derivative complaint on October 30, 2006. The parties initiated settlement discussions and filed several stipulations to extend the defendants deadline to respond to the consolidated amended shareholder derivative complaint, which the Court granted. On March 15, 2007, we announced that the Chair of our Audit Committee, with the assistance of independent outside counsel and outside accounting experts, would be conducting a voluntary review of our historical stock option grant practices covering the time since our initial public offering in 1995. On April 27, 2007, the court granted the parties stipulation staying this action until after we publicly announced the results of the investigation into the historical stock option grant practices. On January 16, 2008, we filed our Annual Report on Form 10-K for the year ended December 31, 2006, containing the results of such investigation. Plaintiffs in the Federal Derivative Litigation filed an amended complaint on May 9, 2008. Defendants filed a motion to dismiss on October 17, 2008, which the Court heard on April 24, 2009. On July 7, 2009, the Court granted defendants motion and dismissed the federal securities claim with leave to amend. Plaintiffs have until August 21, 2009 to file an amended complaint. We are currently in ongoing settlement discussions in the above referenced matter.

On October 31, 2006, a similar shareholder derivative complaint was filed in the Superior Court of the State of California for the County of Santa Clara by Alex Chuzhoy under the caption *Chuzhoy v. Yeh, et al.*, Case No. 1-06-CV-074026. This complaint was brought purportedly on behalf of SST against certain of our current and former officers and directors and alleges among other things, that the named officers and directors breached their fiduciary duties as they colluded with each other to backdate stock options and were allegedly unjustly enriched by their actions. The Chuzhoy complaint also alleges that certain defendants violated section 25402 of the California Corporations Code by selling shares of our common stock while in possession of material non-public adverse information. The parties initiated settlement discussions and filed several stipulations to extend defendants deadline to respond to the shareholder derivative complaint, which the court granted. On April 13, 2007, the court granted the parties stipulation staying this action until after we publicly announced the results of the investigation into the historical stock option grant practices. On January 16, 2008, we filed our Annual Report on Form 10-K for the year ended December 31, 2006, containing the results of such investigation. On January 25, 2008, the court and parties in the Chuzhoy matter agreed to postpone the filing of the amended complaint pending settlement discussions. We are currently in ongoing settlement discussions in the above referenced matter.

In January and February 2005, multiple shareholder derivative complaints were filed in California Superior Court for the County of Santa Clara, purportedly on behalf of SST against certain of our current and former officers and directors. The derivative complaints asserted claims for, among other things, breach of fiduciary duty and violations of the California Corporations Code. These derivative actions were consolidated under the caption *In Re Silicon Storage Technology, Inc. Derivative Litigation*, Lead Case No. 1:05CV034387. On April 28, 2005, pursuant to a joint stipulation, the derivative action was stayed by court order. On October 19, 2007, following the dismissal with prejudice of certain federal putative class actions, the court lifted this stay. On December 6, 2007, plaintiffs filed a consolidated amended complaint reiterating some of the previous claims and asserting claims substantially identical to those contained in the *Chuzhoy v. Yeh, et al.*, Case No. 1-06-CV-074026 and the Federal Derivative Litigation. Defendants filed a motion to stay the action on March 28, 2008, and a demurrer on May 12, 2008. On October 31, 2008, the court sustained the demurrer, in part, with leave to amend. The court also granted the motion to stay, staying all further proceedings in favor of the *Chuzhoy* matter. We are currently in ongoing settlement discussions in the above referenced matter.

From time to time, we are also involved in other legal actions arising in the ordinary course of business. We have accrued certain costs associated with defending these matters. There can be no assurance that the shareholder class action complaints, the shareholder derivative complaints or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring payments in the future which may adversely impact net income. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. As a result, no losses associated with these or other litigation have been accrued in our financial statements as of June 30, 2009.

Table of Contents

**Item 1A. Risk Factors**

**Risks Related to Our Business and Industry**

**Global economic conditions have reduced demand for our products, adversely impacted our customers and suppliers and harmed our business.**

Our operations and performance depend significantly on worldwide economic conditions. Uncertainty about current global economic conditions poses a continuing risk to our business as consumers and businesses have postponed spending in response to tighter credit, negative financial news and/or declines in income or asset values, which have reduced the demand for our products. Other factors that could depress demand for our products in the future include conditions in the residential real estate and mortgage markets, labor and healthcare costs, access to credit, consumer confidence, and other macroeconomic factors affecting consumer spending behavior. These and other economic factors have reduced demand for our products and could further harm our business, financial condition and operating results.

The current financial turmoil affecting the banking system and financial markets and the possibility that financial institutions may consolidate or go out of business have resulted in a tightening in the credit markets, a low level of liquidity in many financial markets, and extreme volatility in fixed income, credit, currency and equity markets. There could be a number of follow-on effects from the credit crisis on our business, including insolvency of key suppliers resulting in product delays; inability of customers, including stocking representatives, distributors and other channel partners, to obtain credit to finance the operations of their businesses and/or customer, including channel partner, insolvencies; and failure of financial institutions, which may negatively impact our treasury operations. Other income and expense could also vary materially from expectations depending on gains or losses realized on the sale or exchange of financial instruments; impairment charges related to debt securities as well as equity and other investments; interest rates; and cash, cash equivalent and marketable securities balances.

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

We have incurred net losses in each year since 2005. Our operating results have fluctuated significantly and our past financial performance should not be used to predict future operating results. Our recent quarterly and annual operating results have fluctuated, and may continue to fluctuate, due to the following factors, all of which are difficult to forecast and many of which are out of our control:

- the availability, timely delivery and cost of wafers or other manufacturing and assembly services from our suppliers;
- competitive pricing pressures and related changes in selling prices;
- fluctuations in manufacturing yields and significant yield losses;
- new product announcements and introductions of competing products by us or our competitors;
- product obsolescence;
- lower of cost or market, obsolescence or other inventory adjustments;
- changes in demand for, or in the mix of, our products;

changes in demand for, or in the mix of, our licensees business as well as the mix between upfront fees and per unit royalties;

the gain or loss of significant customers;

market acceptance of products utilizing our SuperFlash® technology;

changes in the channels through which our products are distributed and the timeliness of receipt of distributor resale information;

exchange rate fluctuations;

general economic, political and environmental-related conditions, such as natural disasters;

changes in our allowance for doubtful accounts;

valuation allowances on deferred tax assets based on changes in estimated future taxable income;

difficulties in forecasting, planning and management of inventory levels;

unanticipated research and development expenses associated with new product introductions;

the timing of significant orders and of license and royalty revenue;

Table of Contents

- valuation of investments and long-term assets; and
- the impact of the sub-prime mortgage crisis on our cash and other investments.

**If our reorganization and expense reduction efforts are not successful, our business will be harmed**

We have incurred net losses in each year since 2005. As a result of negative global economic conditions and market instability, we are continuing to undertake actions to reduce our expenses. In December 2008, as a result of weakening demand caused by the rapid slowdown in the global economy, we announced the implementation of a global reorganization designed to reflect changes in anticipated levels of business. This action was taken to reduce costs of operations, to streamline the organization going forward, and to improve our focus on accelerating time-to-market of select new products. We may not be able to successfully achieve anticipated expense reductions or streamline our operations. If our expense reduction efforts are unsuccessful, our operating results and business will be harmed. In addition, the time-to market of our products is lengthy and we may not be able to successfully accelerate the development of new products.

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

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

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

Our operating expenses are relatively fixed, and we therefore have limited ability to reduce expenses quickly in response to any revenue shortfalls. We have experienced such periods of revenue shortfalls in the past, including in the fourth quarter of 2008, and we were not able to reduce our operating expenses sufficiently to offset the revenue declines we experienced. Our future operating results will be harmed if our revenues do not meet our projections. We may experience revenue shortfalls for the following reasons:

- sudden drops in consumer demand, such as we experienced in the fourth quarter of 2008 and first quarter of 2009, may cause customers to cancel backlog, push out shipment schedules, or reduce new orders, possibly due to a slowing economy or inventory corrections among our customers;
- significant declines in selling prices that occur because of competitive price pressure during an over-supply market environment;
- sudden shortages of raw materials for fabrication, test or assembly capacity constraints that lead our suppliers to allocate available supplies or capacity to other customers which, in turn, harm our ability to meet our sales obligations; and
- the reduction, rescheduling or cancellation of customer orders.

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

**We incurred significant inventory valuation and adverse purchase commitment adjustments in 2007, 2008 and the first half of 2009 and we may incur additional significant inventory valuation adjustments in the future.**

We typically plan our production and inventory levels based on internal forecasts of customer demand, which are highly unpredictable and can fluctuate materially. The current negative worldwide economic conditions and market instability make it increasingly difficult for us to accurately forecast future product demand trends. The value of our inventory is dependent on our estimate of future average selling prices, and, if our projected average selling prices are over estimated, we may be required to adjust our inventory value to reflect the lower of cost or market. As of June 30, 2009, we had $33.3 million of inventory on hand, a decrease of $20.8 million, or 38.5%, from December 31, 2008. Total valuation adjustments to inventory and adverse purchase commitments were $8.5 million in 2007, $14.2 million in 2008 and $5.8 million for the first half of 2009. Due to the large number of units in our inventory, even a small change in average selling prices could result in a significant adjustment, to the extent that the carrying value of the inventory exceeds the average selling price, and could harm our financial results. For excess inventory analysis, we compare the

inventory on hand with the forecasted demand. Demand is based on one year for packaged products and two years for products in die form. For the obsolete inventory analysis, we review inventory items in detail and consider date code, customer base requirements, planned or recent product revisions, end of life plans, diminished market demand and other factors that may be appropriate during a particular period. In the event that customer requirements cause us to change this methodology, it may be necessary for us to provide for an additional allowance, which could result in a significant adjustment and could harm our financial results.

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

Due to possible customer changes in delivery schedules and cancellations of orders, our backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. We have experienced a significant push out of customer delivery schedules and significant order cancellations in the past, including in the fourth quarter of 2008. A reduction of backlog during any particular period, or the failure of our backlog to result in future revenue, could harm our business in the future. We have historically experienced a decrease in the average selling prices of our products during periods of industry-wide oversupply and excessive inventory. We have experienced price erosion in selected areas in 2008 and 2009 and our business could be further harmed by a continued industry-wide prolonged downturn.

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

Sales of our products in the consumer electronics applications market are subject to seasonality. As a result, sales of these products are impacted by seasonal purchasing patterns with higher sales generally occurring in the second half of each year. However, due to negative global economic conditions and market instability, we did not experience this historical increase in sales in the second half of 2008 and we may not experience it in the second half of 2009. In the past we have been able to mitigate such seasonality with the introduction of new products throughout the year. If we fail to continue to introduce new products, our business may suffer and the seasonality of a portion of our sales may become more pronounced.

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

During 2007, 2008 and the first half of 2009, our international product and licensing revenues accounted for 94.3%, 92.9% and 93.5% of our net revenues, respectively. Our international business activities are subject to a number of risks, each of which could impose unexpected costs on us that would harm our operating results. These risks include:

- difficulties in complying with regulatory requirements and standards;
- tariffs and other trade barriers;
- costs and risks of localizing products for foreign countries;
- reliance on third parties to distribute our products;
- extended accounts receivable payment cycles;
- potentially adverse tax consequences;
- limits on repatriation of earnings; and

burdens of complying with a wide variety of foreign laws.

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

We derived 88.8%, 87.3% and 89.0% of our net product revenues from Asia during 2007, 2008, and the first half of 2009, respectively. Additionally, substantially all of our wafer suppliers and packaging and testing subcontractors are located in Asia. Any kind of economic, political or environmental instability in this region of the world can have a severe negative impact on our operating results due to the large concentration of our production and sales activities in this region. If countries where we do business experience severe currency fluctuation and economic deflation, it can negatively impact our revenues and also negatively impact our ability to collect payments from customers. In this event, the lack of capital in the financial sectors of these countries may make it difficult for our customers to open letters of credit or other financial instruments that are guaranteed by foreign banks. Finally, the economic situation can exacerbate a decline in selling prices for our products as our competitors reduce product prices to generate needed cash.

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

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

We make investments in companies around the world to further our strategic objectives and support our key business initiatives. Such investments include investments in equity securities of public companies and investments in non-marketable equity and debt securities of private companies, which range from early-stage companies that are often still defining their strategic direction to more mature companies whose products or technologies may directly support our products or initiatives. The success of these companies is dependent on product development, market acceptance, operational efficiency and other key business success factors. The private companies in which we invest may fail because they may not be able to secure additional funding, obtain favorable investment terms for future financings, or take advantage of liquidity events such as initial public offerings, mergers, and private sales. If any of these private companies fail, we could lose all or part of our investment in that company. If we determine that an other-than-temporary decline in the fair value exists for the equity securities of the public and private companies in which we invest, we write down the investment to its fair value and recognize the related write-down as an investment loss. For 2007, 2008 and the first half of 2009, we recorded impairments on our investments of $22.4 million, $21.8 million and $0.5 million, respectively. Furthermore, when the strategic objectives of an investment have been achieved, or if the investment or business diverges from our strategic objectives, we may decide to dispose of the investment. Our investments in non-marketable equity securities of private companies are not liquid, and we may not be able to dispose of these investments on favorable terms or at all. The occurrence of any of these events could negatively affect our results of operations.

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

Our cash and cash equivalents and short-term and long-term investment portfolio as of June 30, 2009 consists of money market funds, federal, state and municipal government obligations, foreign and public corporate debt securities and listed equity securities. We follow an established investment policy and set of guidelines to monitor, manage and limit our exposure to interest rate fluctuations and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer. As a result of current adverse financial market conditions, some financial instruments, such as structured investment vehicles, sub-prime mortgage-backed securities and collateralized debt obligations, may pose risks arising from liquidity and credit concerns. As of June 30, 2009, we had no direct holdings in these categories of investments and our exposure to these financial instruments through our indirect holdings in money market mutual funds was not material to total cash, cash equivalents and short-term investments. Also, as a result of current market conditions, the value of our investments in publicly held companies in Taiwan, a component of our long-term investment portfolio, have declined significantly. During 2008 we recorded an impairment charge of $231,000 associated with our investment in KYE. We did not record any impairments associated with our investments in publicly held companies during the first half of 2009. However, we cannot predict future market conditions or market liquidity and our investment portfolio may be impaired by future events.

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

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

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

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

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

We out-source our end customer service logistics in Asia to Silicon Professional Technology Ltd., or SPT, which supports our customers in Taiwan, China and other Southeast Asia countries. SPT provides forecasting, planning, warehousing, delivery, billing, collection and other logistic functions for us in these regions. SPT is a wholly-owned subsidiary of one of our stocking representatives

in Taiwan, Professional Computer Technology Limited, or PCT. Products shipped to SPT are accounted for as our inventory held at our logistics center, and revenue is recognized when the products have been delivered and are considered as a sale to our end customers by SPT. For the year ended December 31, 2008 and the first half of 2009, SPT serviced end customer sales accounting for 56.2% and 60.4%, respectively, of our net product revenues recognized. As of December 31, 2008 and June 30, 2009, SPT represented 50.9% and 67.5%, respectively, of our net accounts receivable. For further description of our relationships with PCT and SPT, please refer to Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation - Related Party Transactions in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

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

We outsource substantially all of our manufacturing and testing activities. We currently buy all of our wafers and sorted die from a limited number of suppliers. The majority of our products are manufactured by four foundries, Grace and HHNEC in China, TSMC in Taiwan, and Seiko-Epson Corporation. We have an equity investment in Grace Semiconductor Manufacturing Corporation, or GSMC, a Cayman Islands company, which owns a wafer foundry subsidiary, Grace, in Shanghai, China. We anticipate that these foundries, together with Samsung Corporation in Korea and Maxchip Electronics Corporation, or Maxchip, in Taiwan will continue to manufacture substantially all of our products in the foreseeable future. If these suppliers fail to satisfy our requirements on a timely basis at competitive prices we could suffer manufacturing delays, a possible loss of revenues or higher than anticipated costs of revenues, any of which could harm our operating results. Purchases from our top three suppliers accounted for 52.1% and 25.4% of our costs of revenues in 2008 and the first half of 2009, respectively.

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

**In the event we are unable to reach agreement with GSMC on the terms of our technology license or a dispute arises regarding the obligations of the parties, our business and financial condition could be harmed.**

On December 29, 2008, we entered into an Amending Agreement with GSMC, pursuant to which we agreed to provide GSMC with funding of $15.0 million in return for new equity securities to be issued by GSMC pursuant to a separate Subscription Agreement. The Amending Agreement grants certain technology licenses to GSMC, and requires GSMC to pay SST as upfront fees for the licenses granted the said $15.0 million within five working days of receipt of such $15.0 million. SST and GSMC entered into an Amendment to Amending Agreement on March 1, 2009, in order to clarify the terms of the Amending Agreement.

We tendered the full amount of $15.0 million to GSMC on July 2, 2009 pursuant to a Subscription Agreement, dated June 12, 2009. However, as of the date of filing of this Quarterly Report on Form 10-Q, GSMC has not remitted the upfront license fee payments required under the Amending Agreement and GSMC has instead requested a re-negotiation of the terms of the technology licenses set forth in the Amending Agreement.

If we and GSMC are unable to reach agreement on the terms of the technology licenses or a dispute arises as to the obligations of the parties under the agreements, we intend to request that the $15.0 million we tendered to GSMC on July 2, 2009 be returned.

Table of Contents

In the event we are unable to reach agreement on such terms and a dispute arises regarding the obligations of the parties, our business and financial condition could be harmed. We currently rely on a subsidiary of GSMC, Grace, to manufacture a significant portion of our products and any dispute with GSMC could harm our relationship with GSMC and adversely affect Grace s willingness to continue to manufacture our products. Our revenues may be impacted if we are unable to obtain adequate wafer supplies from Grace and are unable to secure alternate wafer fabrication capacity. Our wafer foundry purchases from Grace are made on a per-order basis and we do not have a long-term supply agreement with Grace. If Grace fails to satisfy our requirements on a timely basis at competitive prices we could suffer manufacturing delays, a possible loss of revenues or higher than anticipated costs of revenues, any of which could harm our operating results.

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

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

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

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

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

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

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

The markets for our products are characterized by:

- rapidly changing technologies;
- evolving and competing industry standards;
- changing customer needs;

- frequent new product introductions and enhancements;
- increased integration with other functions; and
- rapid product obsolescence.

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

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

**The high level of complexity and integration of our products increases the risk of latent defects, which could damage customer relationships and increase our costs.**

Our products are based upon evolving technology and are highly complex. The integration of additional functions into already complex products could result in a greater risk that customers or end users could discover latent defects or subtle faults after we have already shipped significant quantities of a product. Although we test our products, we may in the future encounter defects or errors. Delivery of products with defects or reliability, quality or compatibility problems may damage our reputation and ability to retain existing customers and attract new customers. In addition, product defects and errors could result in additional development costs, diversion of technical resources, delayed product shipments, increased product returns, product warranty costs for recall and replacement and product liability claims against us which may not be fully covered by insurance.

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

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

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

We rely on a combination of patent, trade secrets, copyrights, mask work rights, nondisclosure agreements and other contractual provisions and technical measures to protect our intellectual property rights. Policing unauthorized use of our products, however, is difficult, especially in foreign countries. Litigation may continue to be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Litigation could result in substantial costs and diversion of resources and could harm our business, operating results and financial condition regardless of the outcome of the litigation. As of June 30, 2009, we held 267 patents in the United States relating to certain aspects of our products and processes, with expiration dates ranging from 2010 to 2029 and have filed for several more. In addition, we hold several patents in Europe, Japan, Korea, Taiwan and China. We cannot assure you that any pending patent application will be granted. Our operating results could be harmed by the

failure to protect our intellectual property.

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

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

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

Securities class action law suits are often brought against companies, particularly technology companies, following periods of volatility in the market price of their securities. Irrespective of the validity or the successful assertion of such claims, we could incur significant costs and management resources in defending against such claims. Our historical stock option granting practices and the restatement of our prior financial statements have exposed us to greater risks associated with litigation. As described in Item 3. Legal Proceedings, several derivative complaints have been filed against our directors and certain of our executive officers pertaining to allegations relating to stock option grants.

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

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

From time to time, we are also involved in other legal actions arising in the ordinary course of business. There can be no assurance that the shareholder class action complaints, the shareholder derivative complaints or other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring payments in the future which may adversely impact gross margins. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies. As a result, no losses have been accrued in our financial statements as of June 30, 2009.

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

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

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

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

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

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

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

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

Terrorist attacks in the United States or abroad against American interests or citizens, U.S. retaliation for these attacks, threats of additional terrorist activity and the war in Iraq have caused our customer base to become more cautious. Any escalation in these events or similar future events may disrupt our operations or those of our customers, distributors and suppliers, affect the availability of materials needed to manufacture our products, or affect the means to transport those materials to manufacturing facilities and finished products to customers. In addition, these events have had and may continue to have an adverse impact on the U.S. and world economy in general and consumer spending in particular, which could harm our business.

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

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

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

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

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

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

40

Table of Contents

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

Under Section 404 of the Sarbanes-Oxley Act of 2002, we are required to evaluate and determine the effectiveness of our internal control over financial reporting. We have dedicated a significant amount of time and resources to ensure compliance with this legislation for the first half of 2009 and will continue to do so for future fiscal periods. We may encounter problems or delays in completing the review, evaluation, and the implementation of improvements. Additionally, management s assessment of our internal control over financial reporting may identify deficiencies that need to be addressed in our internal control over financial reporting or other matters that may raise concerns for investors.

The restatement of financial statements for the years ended December 31, 1997 through December 31, 2005 in prior filings with the SEC was a strong indicator of the existence of a material weakness in the design or operation of internal control over financial reporting. We concluded that the control deficiencies that resulted in the restatement of the previously issued consolidated financial statements were remediated, and thus concluded that the control deficiencies relating to our historical stock option grant practices that resulted in the restatement of the previously-issued financial statements did not constitute a material weakness as of December 31, 2006. Additionally, as of December 31, 2006 and 2007 and the quarter and nine months ended September 30, 2008, we did not maintain effective controls over the completeness, accuracy, valuation and presentation and disclosure of inventory and the related cost of revenue accounts. Specifically, our controls over the recording of inventory adjustments resulting from physical inventory observations, capitalization of production variances into inventory and valuation of inventory related reserves in accordance with generally accepted accounting principles in the United States, were not effective. These control deficiencies resulted in audit adjustments to the 2006 and 2007 consolidated annual financial statements and to the interim financial statements for the quarters ended March 31, 2008 and September 30, 2008, that required remediation. Management implemented a remediation plan and remediated the material weaknesses as of December 31, 2008.

During the second quarter of 2009, we identified an error related to the recording of the income tax provision. Despite having engaged third party tax experts to assist us, in calculating our tax provision for the quarter ended March 31, 2009, we incorrectly calculated our reserve for foreign tax withholding on license revenue. We concluded that our disclosure controls and procedures were not effective as of June 30, 2009 as a result of a material weakness in our internal control over financial reporting, specifically the controls which ensure the accuracy of the provision for income taxes. If we are unable to remediate the noted weakness or otherwise assert our internal control over financial reporting is effective as of the end of a fiscal year or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal control over financial reporting, we could lose investor confidence in the accuracy and completeness of our financial reports, which may have an adverse effect on our stock price. In addition, successful remediation of the noted deficiency is dependent on our ability to hire and retain qualified personnel. Therefore, we cannot be certain that we will be able to successfully remediate our existing material weakness or that in the future additional material weaknesses or significant deficiencies will not exist or otherwise be discovered.

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

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

A change in accounting standards or practices or a change in existing taxation rules or practices can have a significant effect on our reported results and may even affect reporting of transactions completed before the change is effective. New accounting pronouncements and taxation rules and varying interpretations of accounting pronouncements and taxation practice have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

Table of Contents

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

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

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

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

- diversion of management time, as well as a shift of focus from operating the businesses to issues of integration and future products;
- declining employee morale and retention issues resulting from changes in compensation, reporting relationships, future prospects, or the direction of the business;
- the need to integrate each company s accounting, management information, human resource and other administrative systems to permit effective management, and the lack of control if such integration is delayed or not implemented;
- the need to implement controls, procedures and policies appropriate for a public company at companies that prior to acquisition had lacked such controls, procedures and policies; and
- in some cases, the need to transition operations onto our technology platforms.

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

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

None.

**Item 3. Defaults Upon Senior Securities**

None.

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

At the Annual Meeting of Shareholders held on June 23, 2009, the shareholders:

1. Elected the persons listed below to serve as directors of SST for the ensuing year and until their successors are elected.

2. Approved the 2009 Employee Stock Purchase Plan,

3. Ratified the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the year ending December 31, 2009.

On April 27, 2009, the record date of the Annual Meeting, we had 95,746,454 shares of common stock outstanding. At the Annual Meeting, holders of 83,530,761 shares of common stock were present in person or represented by proxy. Proxies for the Annual Meeting were solicited pursuant to Section 14(a) of the Securities Exchange Act of 1934.

The following sets forth information regarding the results of the voting at the Annual Meeting.

**Proposal 1 - Election of Directors**

| Director | Votes in Favor | Votes Withheld |
|---|---|---|
| Bing Yeh | 79,727,156 | 3,803,605 |
| Yaw Wen Hu | 80,285,363 | 3,245,398 |
| Ronald Chwang | 69,692,972 | 13,837,789 |
| Terry M. Nickerson | 77,896,911 | 5,633,850 |
| Bryant R. Riley | 68,479,544 | 15,051,217 |
| Edward Yao-Wu Yang | 70,129,925 | 5,784,027 |

**Proposal 2 - Approval of the 2009 Employee Stock Purchase Plan**

| | |
|---|---|
| Votes in Favor | 54,992,432 |
| Votes Against | 1,719,990 |
| Abstentions | 1,867,272 |
| Broker Non-votes | 24,951,067 |

**Proposal 3 - Ratification of Selection of Independent Registered Public Accounting Firm**

| | |
|---|---|
| Votes in Favor | 81,993,509 |
| Votes Against | 1,335,819 |
| Abstentions | 201,433 |
| Broker Non-votes | 0 |

**Item 5. Other Information**

On June 8, 2009, we announced the appointment of Dr. Bertrand F. Cambou as the President of SST effective June 8, 2009. We further reported on our Current Report on Form 8-K, filed with the Securities and Exchange Commission on June 8, 2009, that Dr. Cambou will be granted a stock option for 700,000 shares of SST common stock pursuant to our 2008 Equity Incentive Plan, on July 31, 2009, the last market trading day of July, in accordance with our new hire grant policy. In accordance with our new hire grant policy, this stock option was not granted on July 31, 2009 because the trading window was closed, and will instead be granted on the third business day following the filing of this Quarterly Report

on Form 10-Q; provided our trading window is then open.

Table of Contents

**Item 6. Exhibits**

We incorporate by reference all exhibits filed in connection with our Annual Report on Form 10-K for the year ended December 31, 2008.

| | | Incorporated by Reference | | | | |
|---|---|---|---|---|---|---|
| **Exhibit No.** | **Exhibit Description** | **Schedule/Form** | **File Number** | **Exhibit** | **Filing Date** | **Filed Herewith** |
| 10.1(1) | 2009 Employee Stock Purchase Plan. | DEF 14 | 000-26944 | Annex A | 4/30/09 | |
| 31.1 | Certification of Chief Executive Officer as required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended. | | | | | X |
| 31.2 | Certification of Senior Vice President, Finance and Chief Financial Officer as required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended. | | | | | X |
| 32.1(1) | Certification of Chief Executive Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended. | | | | | X |
| 32.2(1) | Certification of Senior Vice President, Finance and Chief Financial Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended. | | | | | X |

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

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Sunnyvale, County of Santa Clara, State of California, on the 17th day of August, 2009.

SILICON STORAGE TECHNOLOGY, INC.

By: /s/ BING YEH
Bing Yeh
Chairman and

Chief Executive Officer

(*Principal Executive Officer*)

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

Chief Financial Officer

(*Principal Financial and Accounting Officer*)