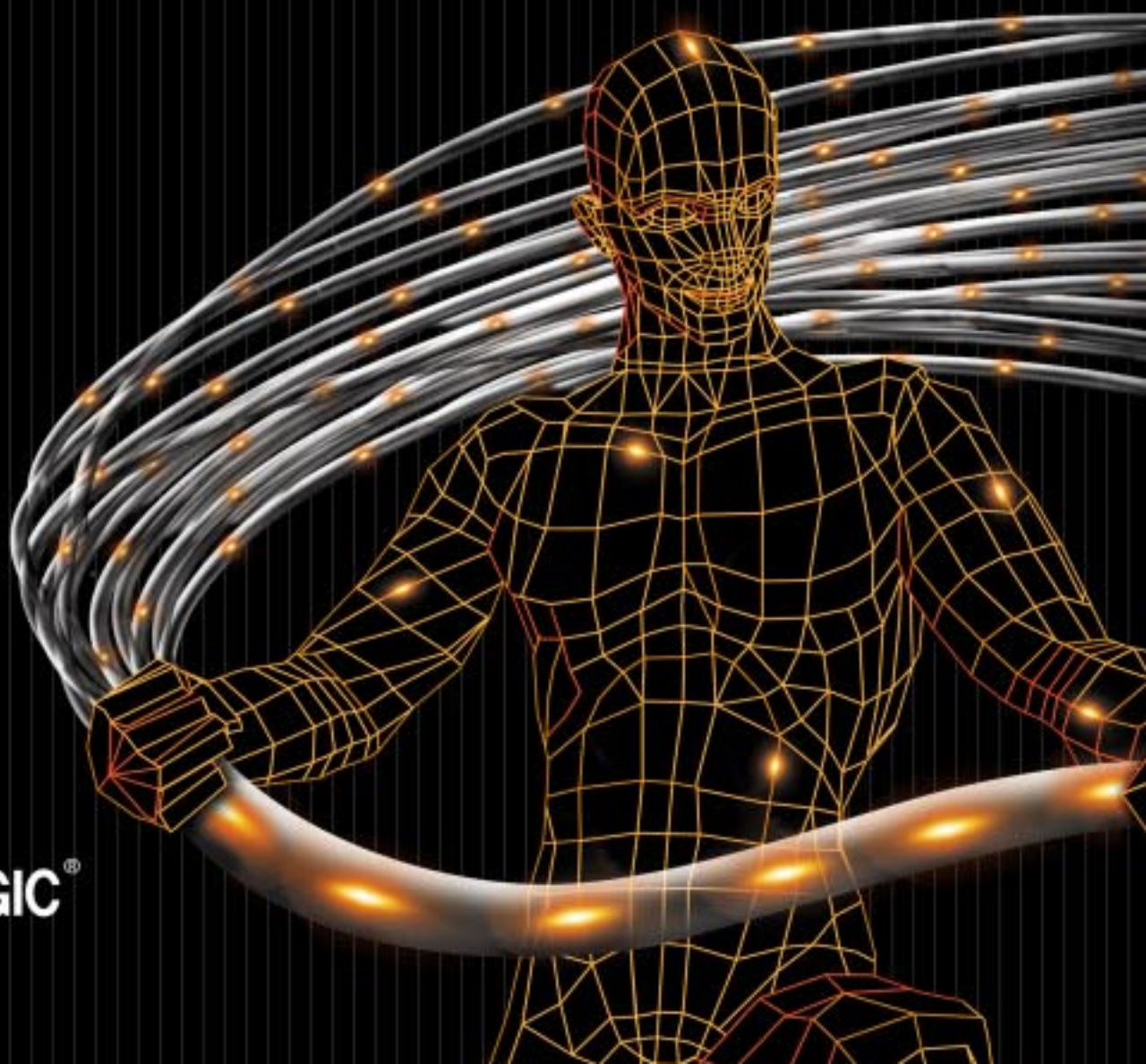


ANNUAL REPORT

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**Embedded Standard Products . . .
. . . Beyond Programmable Logic**



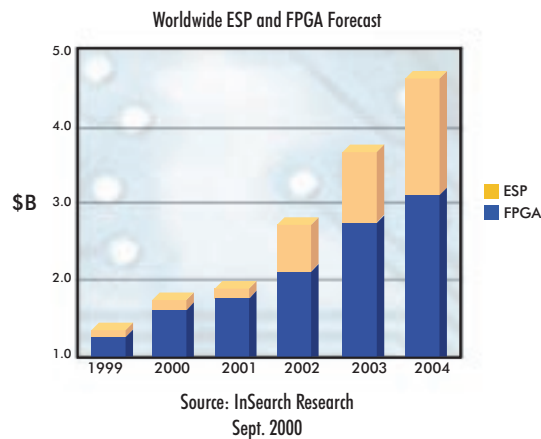
CORPORATE OVERVIEW

COMPANY VISION

To be the leading provider of high-performance, cost-effective ESP (Embedded Standard Products) semiconductor devices and associated software tools.

COMPANY OVERVIEW

QuickLogic Corporation (Nasdaq: QUIK) introduced the Embedded Standard Product (ESP) architecture in 1998, creating a new class of semiconductor devices that combine the guaranteed performance and lower cost of standard integrated circuits (ICs) with the flexibility and time-to-market benefits of programmable logic. These products provide significant time and cost savings and increase performance and flexibility for designers of electronic equipment in the data and telecommunications, instrumentation and test and military markets. QuickLogic is shipping more than 100 ESP devices for these markets. Founded in 1988, the company also sells four families of Field Programmable Gate Array (FPGA) products.



2000 FINANCIAL HIGHLIGHTS

- Record financial results, with revenues up 34% over 1999
- Revenues from ESP products grew 161% year over year
- Net income was \$9.6 million, three times the \$3.2 million for 1999

2000 BUSINESS HIGHLIGHTS

- QuickSD™ and QuickFC™ ESP families introduced as part of our initiative to support new standards within the high-speed communications market
- Partnered with MIPS Technologies to develop a new ESP product combining a microprocessor, memory and programmable logic on a single piece of silicon
- Streamlined our distribution channels in North America, Europe and Asia
- Introduced the QuickDSP™ ESP family for high-performance Digital Signal Processing (DSP) applications
- Signed an agreement to make a 25% equity investment in Tower Semiconductor, an Israel-based wafer-fabrication company
- Partnered with Conexant to embed their SkyRail™ transceivers in our next-generation ESPs for high-speed serial communications market
- Appointed Reynold Simpson to the newly created position of Chief Operating Officer



Embedded Standard Products Beyond Programmable Logic

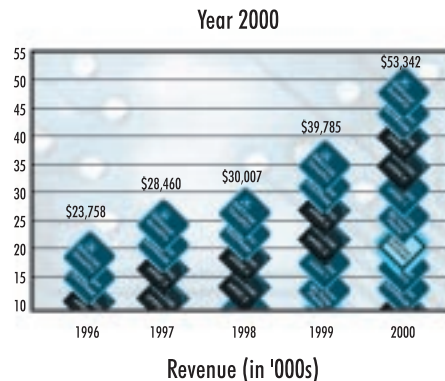
Our largest single market segment in 2000 was data and telecommunications, which represented 42% of our overall business.

FELLOW SHAREHOLDERS

Fiscal 2000 was a year of growth for QuickLogic Corporation, both in financial performance and in the expansion of our company's infrastructure. We achieved record financial results, with revenues of our programmable ESPs (Embedded Standard Products) up 161% and total revenues up 34% over 1999. Three new ESP product families were introduced; each targeted at a segment of the fastest-growing market in the electronics industry, communications.

FINANCIAL RESULTS

Revenues of \$53.3 million were up 34% from \$39.8 million in 1999. Revenue from ESP products grew 161% while new product



revenues grew 119% during the year. Mature product revenues grew by 10% and now represent 62% of revenues, down from 75% in 1999. Net income for 2000 was \$9.6 million, more than three times the \$3.2 million earned in 1999.

STRATEGIC PARTNERSHIPS

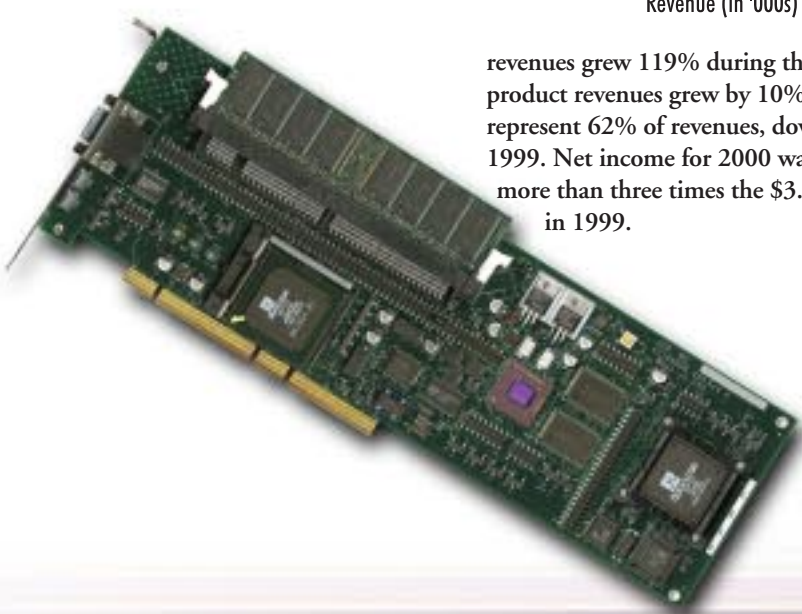
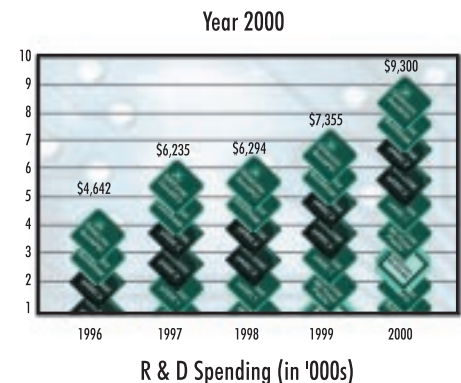
During 2000, we joined forces with MIPS Technologies to develop a hardware- and software-programmable system platform, which combines a MIPS microprocessor, programmable logic and memory on a single piece of silicon. This product, targeted for release in the second half of 2001, will provide a powerful ESP solution for designers of communications equipment including DSL and cable modems, Internet routers and fiber optic telecommunications switches.

We also announced a license agreement to integrate Conexant Systems, SkyRail transceivers into our next-generation ESPs for high-speed serial communications. These devices will benefit designers of 3G base stations, Storage Area Networks (SANs) and other communications and storage equipment.

As part of our strategic plan to support future production growth, we will invest \$25 million in Tower Semiconductor. Under the agreement, QuickLogic will receive equity and committed production capacity in a new advanced wafer-fabrication facility.

PRODUCT LEADERSHIP

Our most important new product introduction in 2000 was the QuickSD family, a key part of our initiative to support emerging high-speed communications standards within the electronics industry. We also announced the



QuickFC family, which supports another high-speed industry standard called Fibre Channel, and the QuickDSP family for Digital Signal Processing (DSP) applications. Finally, we announced a new line of high-performance FPGAs, the Eclipse™ family.

KEY INDUSTRIES AND CUSTOMERS

Our largest single market segment in 2000 was data and telecommunications, which represented 42% of our overall business. This segment grew 59% over 1999. Our second-largest market segment was instrumentation and test at 30%. Alcatel was our largest customer, with 6% of sales in 2000. Other large customers included Teradyne, Honeywell and IBM.

Revenues from our ESP products showed strong growth, with our QuickPCI™ ESP devices being designed into a number of industry-leading applications by companies like Emulex Corporation, Netgem and Northrup Grumman.

A WORLD-CLASS TEAM

In 2000 we rounded out our executive team by adding a vice president of worldwide marketing and by creating a chief operating officer (COO) position. These moves reflect our commitment to further strengthen our outstanding senior management team.

We streamlined sales efforts by focusing distribution through three North American companies; Avnet Electronics, Future Electronics and Impact Technologies. This move will enable our distributor partners to expand resources for growth and better support our demand-creation sales model. Similar moves were made in the UK and Ireland with Eurodis Bytech, and in China with Memec's Asia Pacific Impact Division.



QuickLogic ESP and FPGA chips are designed into a wide array of computing and communications products.

2001 OUTLOOK

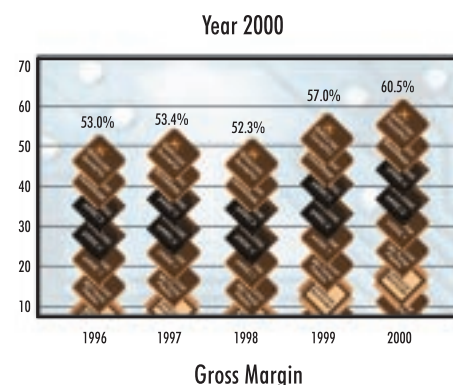
The significant progress made in 2000 positions QuickLogic for continued growth in 2001. We will continue to increase our R&D spending and launch new products while improving existing lines in the year ahead.

I would like to acknowledge the continued support of our customers, partners, suppliers, stockholders and employees, and thank them for their outstanding contributions to our business in 2000. I look forward to another successful year in 2001.

Sincerely,

A handwritten signature in black ink, appearing to read 'E. Thomas Hart'.

E. Thomas Hart
President and CEO
QuickLogic Corporation



BOARD OF DIRECTORS

Irwin Federman
Chairman of the Board of Directors

E. Thomas Hart
President and CEO, QuickLogic Corporation

Donald P. Beadle
Director

Robert J. Boelke
Director

Michael J. Callahan
Director

Hua-Thye Chua
Vice President and Co-Founder, QuickLogic Corporation

EXECUTIVE OFFICERS

E. Thomas Hart
President and CEO

Reynold W. Simpson
Senior Vice President, COO

John M. Birkner
Vice President, CTO

Michael R. Brown
Vice President, Worldwide Sales

Andrew K. Chan
Vice President, Research and Development

Hua-Thye Chua
Vice President, Process Technology

Peter Feist
Vice President, Worldwide Marketing

Arthur O. Whipple
Vice President, Finance and CFO

Ronald D. Zimmerman
Vice President, Administration



INTEGRATES
MANY
FUNCTIONS,
REPLACES
SEVERAL CHIPS
ON A BOARD

A single QuickLogic ESP chip integrates many functions and can replace several chips on a board. The semiconductor industry continues to move to higher levels of integration on a single chip. QuickLogic leads the programmable logic segment with chips that use less power, have faster overall performance and can cost 1/3 that of other solutions.



QUICKLOGIC®

Embedded Standard Products . . .
. . . Beyond Programmable Logic

QuickLogic Corporation
1277 Orleans Drive
Sunnyvale, CA 94089
(408) 990-4000 (Phone)
(408) 990-4040 (Fax)

www.quicklogic.com
info@quicklogic.com

Europe Headquarters
QuickLogic Corporation
Abbey Loft
1A London Street
Chertsey, Surrey KT16 8AP
England
+44 1932 579011 (Phone)
+44 1932 570121 (Fax)

Asia Headquarters
QuickLogic Corporation
Unit 7, 8/F
Bank of America Tower
12 Harcourt Road
Central, Hong Kong
+(852) 8106 9091 (Phone)
+(852) 8106 9092 (Fax)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED: DECEMBER 31, 2000

OR

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

For the transition period from _____ to _____

Commission File Number: **000-22671**

QUICKLOGIC CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

77-0188504

(I.R.S. Employer Identification Number)

1277 Orleans Drive
Sunnyvale, CA 94089

(address of principal executive offices, including zip code)

Registrant's telephone number, including area code: **(408) 990-4000**

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$0.001 par value

(Title of Class)

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

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

The aggregate market value of voting stock held by non-affiliates of the registrant as of February 28, 2001 was \$131,594,983.00 based upon the last sales price reported for such date on The Nasdaq National Market. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by officers and directors of the registrant, have been excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive.

At February 28, 2001 Registrant had outstanding 20,245,382 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant has incorporated by reference into Part III of this Form 10-K portions of its Proxy Statement for Registrant's Annual Meeting of Stockholders to be held on or about April 24, 2001.

EXPLANATORY NOTE

Statements in this Business section, and elsewhere in this annual report on Form 10-K, which express that the company “believes”, “anticipates” or “plans to...”, as well as other statements which are not historical fact, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual events or results may differ materially as a result of the risks and uncertainties described herein and elsewhere including, in particular, those factors described under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Factors Affecting Future Results.”

PART I

ITEM 1. BUSINESS

Overview

QuickLogic Corporation develops, markets and supports advanced Field Programmable Gate Array, or FPGA, and Embedded Standard Product, or ESP, semiconductors and the software tools that enable design engineers to use our products. We introduced ESPs, a new class of semiconductor devices, in 1998, to address the design community’s rapidly increasing demand for a solution that bridges the gap between existing Application Specific Integrated Circuit, or ASIC, options and the long-sought goal of System-on-a-Chip. Specifically, our ESP devices provide engineers with the ease-of-use, guaranteed functionality and high-performance of standard products, combined with the flexibility of programmable logic. Our ESP and FPGA products target complex, high-performance systems in rapidly changing markets where system manufacturers seek to minimize time-to-market and maximize product differentiation and functionality. Examples of markets we sell to include telecommunications and data communications; video/audio, graphics and imaging; instrumentation and test; high-performance computing; and military systems.

Product Technology

The key components of our ESP and FPGA product families are our ViaLink programmable metal technology, our user-programmable platform and the associated software tools used for product design. Our ViaLink technology allows us to create smaller devices than competitors’ comparable products, thereby minimizing silicon area and cost. In addition, our ViaLink technology has lower electrical resistance and capacitance than other programmable technologies and, consequently, supports higher signal speed. Our user-programmable platform facilitates full utilization of a device’s logic cells and Input/Output pins. These logic cells have been optimized to efficiently implement a wide range of logic functions at high speed, thereby enabling greater usable device density and design flexibility. Our architecture uses our ViaLink technology to maximize interconnects at every routing wire intersection. The abundance of interconnect resources allows more paths between logic cells. As a consequence, system designers are able to use QuickLogic devices with smaller gate counts than competing FPGAs to implement their designs. These smaller gate-count devices require less silicon area and as a result are able to be offered at a lower price. Finally, our software enables our customers to efficiently implement their designs using our products.

Industry Background

Competitive pressures are forcing manufacturers of electronic systems to rapidly bring to market products with improved functionality, higher performance and greater reliability, all at lower cost. Providers of systems requiring high-speed data transmission and processing such as communications equipment, digital image products, test and instrumentation and storage subsystems face intense time-to-market pressures. These market forces have driven the evolution of logic semiconductors, which

are used in complex electronic systems to coordinate the functions of other semiconductors, such as microprocessors or memory. There are three types of advanced logic semiconductors:

- Application Specific Integrated Circuits, or ASICs, are special purpose devices designed for a particular manufacturer's electronic system. These devices are customized during wafer manufacturing;
- Application Specific Standard Products, or ASSPs, are fixed-function devices designed to comply with industry standards that can be used by a variety of electronic systems manufacturers. Their functions are fixed prior to wafer fabrication; and
- Programmable Logic Devices, or PLDs, are general-purpose devices which can be used by a variety of electronic systems manufacturers, and are customized after purchase for a specific application. Field Programmable Gate Arrays, or FPGAs, are types of PLDs used for complex functions.

Systems manufacturers have relied heavily on ASICs to implement the advanced logic required for their products. ASICs provide high performance due to customized circuit design. However, because ASICs are design-specific devices, they require long development and manufacturing cycles, delaying product introductions. In addition, because of the expense associated with the design of ASICs, they are cost effective only if they can be manufactured in high volumes. Finally, once ASICs are manufactured, their functionality cannot be changed to respond to evolving market demands.

ASSPs have become widely utilized as industry standards have developed to address increasing system complexity and the need for communication between systems and system components. These standards include:

- Peripheral Component Interconnect, or PCI, a standard developed to provide a high performance, reliable and cost-effective method of connecting high-speed devices within a system;
- Synchronous Optical Network, or SONET, a fiber-optic transmission standard for high-speed digital traffic, employed mainly by telephone companies and other network service providers;
- Ethernet, a widely-used local area network, or LAN, transport standard which controls the interconnection between servers and computers; and
- Fibre Channel Interconnect Protocol, an industry networking standard for storage area networks, or SANs, which controls the interconnection between servers and storage devices.

Compared to ASICs, ASSPs offer the systems designer shorter development time, lower risk and reduced development cost. However, ASSPs generally cannot be used by systems manufacturers to differentiate their products. To address markets where industry standards do not exist or are changing and time-to-market is important, FPGAs are often used. FPGAs provide systems manufacturers with the flexibility to customize and thereby differentiate their systems, unlike ASSPs. FPGAs also enable systems manufacturers to change the logic functionality of their systems after product introduction without the expense and time of redesigning an ASIC. However, most FPGAs are more expensive than ASSPs and even ASICs of equivalent functionality because they require more silicon area. In addition, most FPGAs offer lower performance than nonprogrammable solutions, such as ASSPs and ASICs.

Industry Future: System-on-a-Chip

Over the past few years, semiconductor manufacturers have migrated to smaller process geometries. These smaller process geometries enable more logic elements to be incorporated in a single chip using less silicon area. More recently, advances have been made in the integration of logic and memory on a single chip, which had been difficult previously due to incompatible process technologies.

The industry “holy grail” is to have the three basic components of all electronic circuit boards; logic, memory and a microprocessor, on the same chip. Advantages of the single-chip approach to systems manufacturers include:

- simplified system development;
- reduced time-to-market;
- elimination of delays associated with the transfer of data between chips;
- smaller physical size;
- lower power dissipation;
- greater reliability; and
- lower cost.

However, as levels of logic integration have increased, devices have become more specific to a particular application. This fact limits their use and potential market size.

Quicklogic’s ESP Solution

QuickLogic has leveraged its unique ViaLink technology and user-programmable platform to address the limitations inherent in current system-on-a-chip approaches. The result is embedded standard products, or ESPs, that deliver the advantages offered by both FPGAs and ASSPs. In its simplest form, an ESP contains four basic parts: a programmable logic array, an embedded standard function, an optional programmable read-only memory to configure the embedded function, and an interface that allows communication between the standard function and programmable logic array. Our ESP products combine the system-level functionality of ASSPs with the flexibility of FPGAs. We believe ESPs offer the following specific advantages:

- **Increased Performance.** In a typical design, data must travel between an ASSP and an FPGA across a printed circuit board. The limited number of connections available and the distance between the devices can degrade the system’s overall performance. Our ESP solution allows all data to be processed on a single chip;
- **Decreased Cost.** Because our ESP is a single chip solution, it requires less silicon area, and therefore is less expensive to produce. Additionally, this single chip approach lowers the component, assembly and test cost for the system manufacturer;
- **Increased Reliability.** ESP designs are more reliable because single chip solutions contain fewer components and circuit board connections that are subject to failure; and
- **Shorter Development Time.** With a multiple chip design, systems designers must solve complex routing and timing issues between devices. A single chip ESP solution eliminates the timing issues between devices and simplifies software simulation, leading to shorter development time.

We have introduced five ESP product lines since 1998. These include the QuickSD, QuickFC and QuickPCI families—products aimed at the high-speed interconnect section of the fast-growing communications market. In addition we have introduced QuickDSP and QuickRAM, for high-performance Digital Signal Processing, or DSP, applications and applications that require embedded memory. All of these families are designed for performance-driven applications.

Quicklogic’s FPGA Solution

QuickLogic’s FPGAs offer higher performance at lower overall systems cost than competing FPGA solutions, in addition to offering the advantages typically associated with FPGAs. Specifically, our

products provide greater design flexibility than standard FPGAs and enable designers of complex systems to achieve rapid time-to-market with highly differentiated products. Our products are based on our ViaLink technology and user-programmable platform, and our associated QuickWorks and QuickTools design software.

During 2000, we introduced a new FPGA family called Eclipse—devices that offer a host of new system-level features that are ideal for the telecommunications, networking, computer and test applications that require a combination of high-performance, high density and embedded random access memory, or RAM. In addition, we continue to sell our three families of pASIC FPGAs.

The Quicklogic Strategy

Our objective is to be the indispensable provider of high-speed, flexible, cost-effective ESPs. We feel we can achieve this objective by offering systems manufacturers the ability to accelerate design cycles to satisfy demanding time-to-market requirements. To achieve our objective, we have adopted the following strategies:

Extend Technology Leadership

Our ViaLink technology, user-programmable platform and proprietary software design tools enable us to offer flexible, high-performance ESP products. We intend to continue to invest in the development of these technologies and to utilize such developments in future innovations of our ESP products. We also intend to focus our resources on building critical systems-level expertise to introduce new ESP products and enhance existing ESP product families. We target applications that are:

- high performance and high complexity;
- broadly used and growing quickly; and
- difficult or impossible to implement in traditional FPGAs.

Specifically, we will continue to focus our design and marketing efforts on systems manufacturers who sell complex systems within our target applications. These include:

- data communications and telecommunications;
- video/audio and graphics and imaging;
- instrumentation and test;
- high-performance computing; and
- military.

Provide Complete System Solutions

Our focus on a more targeted set of applications areas will allow us to provide a complete solution to systems manufacturers. This includes not only the device and software, but software drivers, reference designs, test boards and complementary intellectual property, or IP, functions. We focus ESP development efforts on three strategic applications areas:

- embedded high performance digital signal processing, or DSP;
- embedded high-performance interconnect; and
- embedded high-performance processing.

Strategic Alliances

During 2000, we engaged in key strategic partnerships with MIPS Technologies, Finisar, UTMC, Conexant Systems, and Tower Semiconductor. In addition, we continue to sell through a network of industry sales representatives and distributors. These alliances will be an essential element of our ESP strategy and strength going forward. By leveraging the expertise of our partners in IP development, wafer fabrication and sales, we can devote our effort to the development of targeted, complete ESP products.

Create Innovative, Industry-Leading Customer Services

We continue to develop and implement innovative ways to serve and communicate with our customers. For example, our WebASIC service allows customers to use our development software to design a circuit, transmit design information over the Internet and receive a QuickLogic ESP or FPGA device programmed with their design (within one business day in North America and Europe or within two business days in Asia). In addition, our ProChannel web-based system allows our customers to obtain promotional material, receive quotations, place orders for our products and view their order status over the Internet. This system complements the Electronic Data Interchange systems that we have used for the past several years with our largest customers.

Customers and Markets

The following chart provides a representative list by industry of our current customers and the markets in which they do business:

<u>Industry</u>	<u>Customer</u>	<u>Application</u>
Data Communications and Telecommunications	Alcatel	Fiber optic transmission equipment
	IBM	Data encryption, network servers
	NEC	PBX electronics, wireless base stations
Video/Audio, Graphics and Imaging	Digidesign	PC-based audio editing
	Honeywell	Aircraft navigation and flight controls
	Mitsubishi	Large screen displays
	NEC	Solid state video cameras
Instrumentation and Test	Sony	Industrial video cameras
	ABB	Industrial power management systems
	LTX	Semiconductor test equipment
	National Instruments	PC-based instrumentation boards
	Teradyne	Semiconductor test equipment
High-Performance Computing	Ando	Semiconductor test equipment
	Compaq Computer	Alpha processor motherboards
	IBM	RAID controller, ThinkPad display controls
	Mitsubishi	Mobile PC pen-input display controllers
Military Systems	B.F. Goodrich	Launch vehicle for Delta Four rockets
	DY-4	VME-based computer systems
	Hamilton Standard	Flight computers
	Hughes Aircraft	Helicopter motor controls and radar
	McDonnell Douglas	C-17 flight controllers
	Raytheon	Tornado missile

Sales and Technical Support

We sell our products through a network of sales managers, independent sales representatives and electronics distributors in North America, Europe and Asia. In addition to our corporate headquarters in Sunnyvale, we have regional sales operations in Los Angeles, Dallas, Boston, Raleigh, London, Munich, Shin-Yokohama, Shanghai and Hong Kong. Our direct sales personnel and independent sales representatives generally focus on major strategic accounts. Our distributors generally focus on small and medium-sized customers, as well as demand creation and fulfillment to the larger accounts.

Currently in the United States, our three distributors include Avnet Electronics, Future Electronics and Impact Technologies. A network of distributors throughout Europe and Asia supports the

company's international business. These firms are responsible for creating customer demand, providing customer support and other value-added services, as well as filling customers orders. From time-to-time, we add or delete certain distributors and sales representatives, as appropriate in comparison to the level of business the company generates.

We provide systems manufacturers with comprehensive technical support, which we believe is critical to remaining competitive in the markets we serve. Our factory-based and distributor applications support organizations provide pre-sales and on-site technical support to customers. In 1998, we established a design center to develop new embedded functions for ESPs, and to provide in-depth, system-level technical support to our customers.

Competition

The semiconductor industry is intensely competitive and is characterized by constant technological change, rapid rates of product obsolescence and price erosion. Our existing competitors include suppliers of conventional standard products, such as PLX Technology and Applied Micro Circuits Corporation, or AMCC; suppliers of complex programmable logic devices, or CPLDs, including Lattice Semiconductor and Altera; and suppliers of FPGAs, particularly Xilinx and Actel. Xilinx and Altera dominate the PLD market, which together control over 60% of the market, according to inSearch Research, a semiconductor market research firm. Xilinx dominates the FPGA segment of the market while Altera dominates the CPLD segment of the market. We also face competition from companies that offer standard gate arrays, which can be obtained at a lower cost for high volumes and may have gate densities and performance equal or superior to our products. As we introduce additional ESPs, we will also face competition from standard product manufacturers who are already servicing or who may decide to enter the markets addressed by these new ESP devices. In addition, we expect significant competition in the future from major domestic and international semiconductor suppliers. We also may face competition from suppliers of products based on new or emerging technologies.

We believe that important competitive factors in our market are length of development cycle, price, performance, installed base of development systems, adaptability of products to specific applications, ease of use and functionality of development system software, reliability, technical service and support, wafer fabrication capacity and sources of raw materials, and protection of products by effective utilization of intellectual property laws.

Research and Development

Our future success will depend to a large extent on our ability to rapidly develop and introduce new products and enhancements to our existing products that meet emerging industry standards and satisfy changing customer requirements. We have made and expect to continue to make substantial investments in research and development and to participate in the development of new and existing industry standards.

As of February 28, 2001, the research and development staff consisted of 48 employees. Our research and development efforts are focused on standard function development and integration, device architecture, development tools and foundry process development. Our standard function development and integration personnel create circuit designs for inclusion in our ESP products. They also evaluate circuit designs by third parties for inclusion in our ESP products and integrate those circuit designs with our FPGA technology. Our device architecture personnel develop new and improved architectures for our FPGA and ESP products to better serve the needs of our customers. Our software engineering group develops place and route tools, which fit the design into specific logic cell elements within a device and determine the necessary interconnections. They also develop delay modeling tools, which estimate the timing of all the circuit paths for accurate simulation. The software group incorporates third-party software tools into the QuickWorks design software suite, and develops the design libraries

needed for the QuickWorks and QuickTools products to integrate with third-party design environments. Our process engineering group maintains our proprietary wafer manufacturing processes, oversees product manufacturing and process development with our third-party foundries, and is involved in ongoing process improvements to increase yields and optimize device characteristics.

Our research and development expense for 1998, 1999 and 2000 were \$6.3 million, \$7.4 million and \$9.3 million, respectively. We anticipate that we will continue to commit substantial resources to research and development in the future.

Manufacturing

We have established close relationships with third-party manufacturers for our wafer fabrication, package assembly, test and programming requirements in an effort to ensure stability in the supply of our products and minimize the risk of localized capacity constraints.

We currently outsource all of our wafer manufacturing to Cypress Semiconductor Corporation at its Round Rock, Texas facility and to Taiwan Semiconductor Manufacturing Company at its Taiwan facilities. Cypress manufactures our pASIC1 and pASIC2 product families using a three-layer metal, 0.65 micron CMOS process on six-inch wafers. TSMC manufactures our pASIC3, QuickRAM and QuickPCI product families using a four-layer metal, 0.35 micron CMOS process. TSMC also manufactures our Eclipse and other ESP products using a five-layer metal, 0.25 micron process on eight-inch wafers. Our Cypress agreement provides a guaranteed capacity availability. We purchase products from TSMC on a purchase order basis. Under this arrangement, we and TSMC have mutually agreed that we are not required to purchase a predetermined amount of product, and TSMC is not required to guarantee capacity availability. See “Factors Affecting Future Results—None of our products is currently manufactured by more than one manufacturer.”

On December 12, 2000 we entered into a Share Purchase Agreement (the “Agreement”) with Tower Semiconductor Ltd. under which we will make a \$25 million strategic investment in Tower as part of Tower’s plan to build a new wafer fabrication facility. The new fabrication facility will produce 200-mm wafers in geometries of 0.18 micron and below, using advanced CMOS technology from Toshiba. In return for our investment, we will receive equity and committed production capacity in the advanced fabrication facility that Tower is building. Under the terms of the Agreement, our investment will be made in several stages over an approximately 22-month period, against satisfactory completion of key milestones for the construction, equipping and commencement of production at the new wafer fabrication facility. Tower will develop manufacturing capability for our proprietary ViaLink technology, and supply us with a guaranteed portion of the new fabrication facility’s available wafer capacity at competitive pricing, with first production expected in 2002. Per the terms of the Agreement, we paid Tower \$6.7 million on January 22, 2001.

We outsource our product packaging, test and programming to Amkor and ChipPAC at their South Korea facilities and to Advanced Semiconductor Engineering at its Taiwan facility, among others.

Employees

As of February 28, 2001, we had a total of 178 employees worldwide, with 47 people in operations, 48 people in research and development, 21 people in sales, 24 people in marketing, 34 people in administration and four people in management information systems. We believe that our future success will depend in part on our continued ability to attract, hire and retain qualified personnel. None of our employees is represented by a labor union, and we believe our employee relations are good.

Intellectual Property

Our future success and competitive position depend upon our ability to obtain and maintain the proprietary technology used in our principal products. We hold 80 U.S. patents and have 9 pending applications for additional U.S. patents containing claims covering various aspects of programmable integrated circuits, programmable interconnect structures and programmable metal devices. In addition, we have three patent applications pending in Japan. Our issued patents expire between 2009 and 2019. We have also registered six of our trademarks in the U.S. with applications to register an additional two trademarks now pending.

Because it is critical to our success that we are able to prevent competitors from copying our innovations, we intend to continue to seek patent protection for our products. The process of seeking patent protection can be long and expensive, and we cannot be certain that any currently pending or future applications will actually result in issued patents, or that, even if patents are issued, they will be of sufficient scope or strength to provide meaningful protection or any commercial advantage to us. Furthermore, others may develop technologies that are similar or superior to our technology or design around the patents we own.

We also rely on trade secret protection for our technology, in part through confidentiality agreements with our employees, consultants and third parties. However, employees may breach these agreements, and we may not have adequate remedies for any breach. In any case, others may come to know about or determine our trade secrets through a variety of methods. In addition, the laws of certain territories in which we develop, manufacture or sell our products may not protect our intellectual property rights to the same extent as do the laws of the United States.

In March 1997, we entered into a patent cross-license agreement with Cypress, whereby we granted Cypress a nonexclusive license to our patents and intellectual property rights in exchange for Cypress' nonexclusive license to their programmable logic technology patents. In August 1998, we also entered into a patent cross-license agreement with Actel pursuant to which we have each granted the other a nonexclusive license to certain of our respective programmable logic device technology patents. We anticipate that we will continue to enter into licensing arrangements in the future; however, it is possible that desirable licenses will not be available to us on commercially reasonable terms. If we lose existing licenses to key technology, or are unable to enter into new licenses which we deem important, it could materially harm our business.

During 2000, we entered into technology license agreements with several third parties. In April 2000, we signed a license agreement with MIPS Technologies, Inc. This agreement enables the development of an embedded, MIPS-based(TM) processor with high-performance programmable logic and on-chip dual-port SRAM, laying the foundation for a whole new class of system-level ESP product families. In May 2000, we announced an agreement with Finisar Corporation to use their gigabit-rate technology. Designed for use in conjunction with industry-standard SERDES transmitter-receiver chips, this product supports standard Fibre Channel performance rates of up to 2.5 Gb/s throughput. In October 2000, we signed a license agreement with Conexant Systems, Inc. to use their SkyRail 3.1 Gb/s scalable transceivers. This technology allows us to provide device data throughput of up to 37.5 Gb/s in high-speed serial bus architectures.

In October 2000, we licensed our technology to Aeroflex UTMC, a wholly owned subsidiary of Aeroflex Incorporated. Aeroflex UTMC will benefit from the use of our ViaLink metal-to-metal interconnect technology in supplying their products to the commercial and military satellite markets.

From time to time, we receive letters alleging patent infringement or inviting us to take a license to other parties' patents. We evaluate these letters on a case-by-case basis. In September 1999, we received an offer to license a patent related to field programmable gate array architecture. We have not

yet determined whether this license would be necessary or useful and obtainable at a reasonable price. Offers such as these may lead to litigation if we reject the opportunity to obtain the license.

In March 2000, Unisys Corporation filed a patent infringement lawsuit against us alleging that we infringed three of their patents. We believe that we have strong defenses and that the resolution of this lawsuit will not have a material effect on our financial condition or results of operations. No assurance can be given, however, that these matters will be resolved without the Company becoming obligated to make payments or to pay other costs to the opposing party, with the potential for an adverse effect on the Company's financial position or its results of operations.

Executive Officers and Directors

The following table sets forth certain information concerning our current executive officers and directors as of February 28, 2001:

<u>Name</u>	<u>Age</u>	<u>Position</u>
E. Thomas Hart	59	President, Chief Executive Officer and Director
John M. Birkner	57	Vice President, Chief Technical Officer
Michael R. Brown	51	Vice President, Worldwide Sales
Andrew K. Chan	50	Vice President, Research and Development
Hua-Thye Chua	65	Vice President, Process Technology and Director
Peter G. Feist	46	Vice President, Worldwide Marketing
Reynold W Simpson	52	Senior Vice President, Chief Operating Officer
Arthur O. Whipple	53	Vice President, Finance, Chief Financial Officer and Secretary
Ronald D. Zimmerman	52	Vice President, Administration
Irwin Federman	65	Chairman of the Board of Directors
Donald P. Beadle	65	Director
Robert J. Boehlke	59	Director
Michael J. Callahan	65	Director

E. Thomas Hart has served as our President, Chief Executive Officer and a member of our board of directors since June 1994. Prior to joining QuickLogic, Mr. Hart was Vice President and General Manager of the Advanced Networks Division at National Semiconductor, a semiconductor manufacturing company, where he worked from September 1992 to June 1994. Prior to joining National Semiconductor, Mr. Hart was a private consultant from February 1986 to September 1992 with Hart Weston International, a technology based management consulting firm. Mr. Hart holds a B.S.E.E. from the University of Washington.

John M. Birkner, a co-founder of QuickLogic, has served with us since April 1988, serving as Vice President, Chief Technical Officer since 1993. From September 1975 to June 1986, Mr. Birkner was a fellow at Monolithic Memories, a semiconductor manufacturing company. Mr. Birkner holds a B.S.E.E. from the University of California, Berkeley and an M.S.E.E. from the University of Akron.

Michael R. Brown has served as our Vice President, Worldwide Sales since January 1999. From 1984 until January 1999, he was employed by Hitachi America, a semiconductor manufacturing company, in a variety of sales management positions, most recently as the Vice President of Sales for the Americas. Mr. Brown holds a B.A. in Kinesiology/Psychology from California State University, Northridge and attended the U.S. Navy Aviation Electronics School. Mr. Brown holds a certificate in Advanced Management from Stanford University.

Andrew K. Chan, a co-founder of QuickLogic, has served with us since April 1988, most recently as Vice President, Research and Development. Prior to joining QuickLogic, Mr. Chan was a design engineering manager at Monolithic Memories. Mr. Chan holds a B.S.E.E. in Electrical Engineering from Washington State University and an M.S.E.C. in Electrical Sciences from the University of New York, Stonybrook.

Hua-Thye Chua, a co-founder of QuickLogic, has served as a member of our board of directors since QuickLogic's inception in April 1988. Since December 1996, Mr. Chua has served as our Vice President, Process Technology. He served as our Vice President of Technology Development from April 1989 to December 1996. During the prior 25 years, Mr. Chua worked at semiconductor manufacturing companies, including Fairchild Semiconductor, Intel and Monolithic Memories. Mr. Chua holds a B.S.E.E. from Ohio University and an M.S.E.E. from the University of California, Berkeley.

Peter G. Feist has served with us since June 2000, most recently as our Vice President, Worldwide Marketing. From January 1997 to April 2000, Mr. Feist was with GateField, a semiconductor manufacturing company, where he was most recently Senior Vice President, Marketing. From January 1995 to September 1996, he served as Regional Manager, Europe for Hyundai Corporation, Digital Media Division. From April 1985 to December 1994, he worked for LSI Logic, a semiconductor manufacturing company, most recently as Director Strategic Marketing. He holds a Diplom Ingenieur (M.S.E.E.-equivalent) from the University of Dortmund.

Reynold W. Simpson has served with us since August 1997, most recently as Senior Vice President and Chief Operating Officer. From February 1996 to July 1997, Mr. Simpson was Vice President of Manufacturing at GateField, a semiconductor manufacturing company. Prior to joining GateField, Mr. Simpson was Operations Manager at LSI Logic, a semiconductor manufacturing company, from March 1990 to February 1996 and Quality Director from February 1989 to March 1990. Mr. Simpson holds a Mechanical Engineering Certificate from the Coatbridge Polytechnic Institute in Scotland, a degree in Technical Horology (Mechanical Engineering) from the Barmulloch Polytechnic Institute in Scotland and studied for a degree in Electronic Engineering at the Kingsway Polytechnic Institute in Scotland.

Arthur O. Whipple has served as our Vice President, Finance, Chief Financial Officer and Secretary since April 1998. From April 1994 to April 1998, Mr. Whipple was employed by ILC Technology, a manufacturer of high performance lighting products, as its Vice President of Engineering and by its subsidiary, Precision Lamp, a manufacturer of high-performance lighting products, as its Vice President of Finance and Operations. From February 1990 to April 1994, Mr. Whipple served as the President of Aqua Design, a privately-held provider of water treatment services and equipment. Mr. Whipple holds a B.S.E.E. from the University of Washington and an M.B.A. from Santa Clara University.

Ronald D. Zimmerman has served as our Vice President, Administration since October 1996. From August 1988 to October 1996, Mr. Zimmerman was Human Resources Director of the Analog Products Group at National Semiconductor, as well as group human resources director of the corporate technology and quality/reliability organizations and the human resources director of corporate administration. Mr. Zimmerman holds a B.A. in Sociology and Psychology and an M.A. in Psychology from San Jose State University.

Irwin Federman has served as chairman of our board of directors since September 1989. Mr. Federman has been a general partner of U.S. Venture Partners, a venture capital company, since 1990. From 1988 to 1990, he was a Managing Director of Dillon Read & Co., an investment banking firm, and a general partner in its venture capital affiliate, Concord Partners. Mr. Federman serves on the boards of directors of the following public companies: SanDisk, a semiconductor company; Komag,

a thin film media manufacturer; Centillum Communications, a communications semiconductor company; Netro, a wireless systems company and Check Point Software Technologies, a network security software company. Mr. Federman holds a B.S. in Economics from Brooklyn College and has been awarded an honorary Doctorate of Engineering Science from Santa Clara University.

Donald P. Beadle has served as a member of our board of directors since July 1997. Since June 1994, Mr. Beadle has been President of Beadle Associates, a consulting firm. From May 1997 to July 1997, Mr. Beadle was a consultant at Interwave Communications, a developer of microcell systems, where he served as Acting Vice President of Sales and Sales Operations. From October 1994 to December 1996, he was a consultant for Asian business development at National Semiconductor. At National Semiconductor, he was Managing Director, Southeast Asia from 1993 until June 1994, Vice President of Worldwide Marketing and Sales, International Business Group from 1987 until 1993, and Managing Director, Europe from 1982 to 1986. Mr. Beadle was employed by National Semiconductor in executive sales and marketing positions for 34 years until June 1994, at which time he was Executive Vice President, Worldwide Sales and Marketing. Mr. Beadle serves on the board of directors of one public company, Komag, a thin film media manufacturer. He received his technical education at the University of Connecticut and the Bridgeport Institute of Engineering.

Robert J. Boehlke has served as a member of our board of directors since December 2000. Mr. Boehlke was most recently Executive Vice President and Chief Financial Officer of KLA-Tencor, a position he held until his retirement in June 2000. He joined KLA Instruments in 1983 and served as the general manager of various operating groups through 1990 when he became Chief Financial Officer. He was a partner at the investment banking firm of Kidder, Peabody & Company from 1971 until 1983. Mr. Boehlke serves on the boards of LTX, a test equipment manufacturer, and Entegris, a manufacturer of materials management products for the semiconductor industry. He holds a bachelor's degree in engineering from the U.S. Military Academy at West Point and an M.B.A. from Harvard University.

Michael J. Callahan has served as a member of our board of directors since July 1997. From March 1990 through his retirement in September 2000, Mr. Callahan served as Chairman of the Board, President and Chief Executive Officer of Waferscale Integration, a producer of peripheral integrated circuits. From 1987 to March 1990, Mr. Callahan was President of Monolithic Memories, now a subsidiary of Advanced Micro Devices, a semiconductor manufacturing company. He was Senior Vice President of Programmable Products at Advanced Micro Devices. From 1978 to 1987, Mr. Callahan held a number of positions at Monolithic Memories including Vice President of Operations and Chief Operating Officer. Prior to joining Monolithic Memories, he worked at Motorola Semiconductor, a semiconductor manufacturing company, for 16 years where he was Director of Research and Development as well as Director of Linear Operations. Mr. Callahan holds a B.S.E.E. from the Massachusetts Institute of Technology.

Executive Officers

Our executive officers are elected by, and serve at the discretion of, our board of directors. There are no family relationships among our directors and officers.

Board of Directors

We currently have authorized six directors. Our directors consist of Messrs. Beadle, Boehlke, Callahan, Chua, Federman and Hart. All directors hold office until the next annual meeting of stockholders or until their successors are duly qualified and elected. Our certificate of incorporation provides that our board of directors will be divided into three classes, each with staggered three-year terms. As a result, only one class of directors will be elected at each annual meeting of our stockholders, with the other classes continuing for the remainder of their respective three-year terms.

Messrs. Beadle and Callahan have been designated as Class I directors, whose term expires at the 2003 annual meeting of stockholders; Messrs. Chua and Federman have been designated as Class II directors, whose term expires at the 2001 annual meeting of stockholders; and Mr. Hart and Mr. Boehlke have been designated as Class III directors, whose terms expire at the 2002 annual meeting of stockholders. Mr. Federman will not stand for reelection at the 2001 annual meeting of stockholders.

Board Committees

Our board of directors has an audit committee and a compensation committee.

Audit Committee. The audit committee was formed in June 1995 and currently consists of Messrs. Beadle, Callahan and Federman. The audit committee reviews the results and scope of the annual audit and other services provided by our independent accountants, reviews and evaluates our internal control functions and monitors financial transactions between us and our employees, officers and directors.

Compensation Committee. The compensation committee was formed in June 1995 and currently consists of Messrs. Beadle, Callahan and Federman. The compensation committee administers the 1989 stock option plan, 1999 stock plan and 1999 employee stock purchase plan, and reviews the compensation and benefits for our executive officers.

Compensation Committee Interlocks and Insider Participation

Prior to establishing the compensation committee, the board of directors as a whole performed the functions delegated to the compensation committee. No member of the compensation committee or executive officer of QuickLogic has a relationship that would constitute an interlocking relationship with executive officers or directors of another entity.

Item 2. PROPERTIES

Our principal administrative, sales, marketing, research and development and final testing facility is located in a building of approximately 42,624 square feet in Sunnyvale, California. This facility is leased through 2003 with an option to renew through 2006. In addition, we lease sales offices near London and in Hong Kong and engineering offices in Hillsborough, Oregon and La Palma, California. The London office is leased through September 2004, and the Hong Kong office is leased through September 2001. The Hillsborough office is leased through December 2001 and the La Palma office is leased through January 2004. We believe that our existing facilities are adequate for our current needs.

Item 3. LEGAL PROCEEDINGS

On March 29, 2000, Unisys Corporation filed a patent infringement lawsuit against the Company alleging that the Company infringed three of Unisys' patents. The Company does not believe that the resolution of this lawsuit will have a material adverse impact on the Company's financial condition or results of operations. No assurance can be given, however, that these matters will be resolved without the Company becoming obligated to make payments or to pay other costs to the opposing party, with the potential for an adverse effect on the Company's financial position or its results of operations.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

PART II

Item 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our Common Stock has been traded on The Nasdaq Stock Market's National Market under the symbol "QUIK" since October 15, 1999, the date of our initial public offering. The following table sets forth for the periods indicated the high and low closing prices for the Common Stock, as reported on The Nasdaq Stock Market's National Market:

	<u>High</u>	<u>Low</u>
Fiscal Year Ending December 31, 1999		
Fourth Quarter (from October 15, 1999)	\$19.563	\$12.938
Fiscal Year Ending December 31, 2000		
First Quarter (through March 31, 2000)	\$39.500	\$13.750
Second Quarter (through June 30, 2000)	\$32.938	\$20.250
Third Quarter (through September 29, 2000)	\$27.781	\$14.063
Fourth Quarter (through December 29, 2000)	\$17.625	\$ 5.000

The last reported sale price of our Common Stock on The Nasdaq Stock Market's National Market was \$6.50 per share on February 28, 2001. As of February 28, 2001, there were 20,245,382 shares of Common Stock outstanding that were held of record by approximately 346 stockholders.

We commenced our initial public offering on October 15, 1999 pursuant to a Registration Statement on Form S-1 (File No. 333-28833) which was declared effective by the Securities and Exchange Commission on October 14, 1999. The Company sold an aggregate of 3,770,635 shares of Common Stock in our initial public offering at an initial price to the public of \$10.00 per share. In addition, a selling stockholder sold 3,896,415 shares of Common Stock in our initial public offering at an initial price to the public of \$10.00 per share. Our initial public offering has terminated and all shares have been sold. The managing underwriters of our initial public offering were Robertson Stephens, Bear, Stearns & Co. Inc. and SoundView Technology Group. Aggregate proceeds from our initial public offering were \$76,670,500, which includes \$10,000,500 in aggregate proceeds due to the exercise of the underwriters' option to purchase shares to cover over-allotments.

We paid underwriters' discounts and commissions of \$2,639,444.50 and no additional offering expenses in connection with our initial public offering. The total expenses we paid in our initial public offering were \$1,190,000, and the net proceeds to us of our initial public offering were \$33.9 million.

The Company completed a follow-on public offering of its common stock on April 12, 2000. The underwriters' over-allotment option was exercised and QuickLogic sold a total of 1,629,269 common shares at \$23.50 per share. Proceeds, net of underwriting discounts and commissions and related offering expenses, of \$35.5 million were received.

From October 14, 1999, the effective date of the Registration Statement, to December 31, 2000, the ending date of the reporting period, the approximate amount of net offering proceeds used were \$20.0 million for general business operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Dividend Policy

We have never declared or paid any dividends on our capital stock. We currently expect to retain future earnings, if any, for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future.

Item 6. SELECTED FINANCIAL DATA

	Year Ended December 31,				
	1996	1997	1998	1999	2000
	(In thousands, except per share data)				
Statement of Operations Data:					
Revenue	\$23,758	\$ 28,460	\$30,007	\$39,785	\$53,342
Cost of revenue	11,158	16,855	14,303	17,103	21,068
Gross profit	12,600	11,605	15,704	22,682	32,274
Operating expenses:					
Research and development	4,642	6,235	6,294	7,355	9,300
Selling, general and administrative	7,730	10,981	9,368	12,618	17,137
Contract termination and legal(1)	4,125	28,309	—	—	—
Net operating income (loss)	(3,897)	(33,920)	42	2,709	5,837
Interest expense	(60)	(162)	(161)	(97)	(49)
Interest income and other, net	360	434	364	549	3,842
Net income (loss)	<u>\$(3,597)</u>	<u>\$(33,648)</u>	<u>\$ 245</u>	<u>3,161</u>	<u>9,630</u>
Net income (loss) per share:					
Basic	\$ (4.66)	\$ (10.41)	\$ 0.06	\$ 0.42	\$ 0.49
Diluted	\$ (4.66)	\$ (10.41)	\$ 0.02	\$ 0.19	\$ 0.45
Weighted average shares:					
Basic	772	3,232	4,231	7,615	19,486
Diluted	772	3,232	14,645	16,400	21,614

	December 31,				
	1996	1997	1998	1999	2000
	(In thousands)				
Balance Sheet Data:					
Cash	\$10,336	\$ 7,331	\$ 7,595	\$34,558	\$ 70,210
Working capital (deficit)	10,650	2,395	(3,319)	32,568	75,539
Total assets	22,577	19,951	16,168	50,482	100,307
Long-term obligations(2)	602	7,724	591	128	1,121
Total stockholders' equity (deficit)	11,799	(1,756)	(975)	37,005	85,734

- (1) Contract termination and legal expenses include a charge of \$23.0 million in the year ended December 31, 1997 for termination of an agreement with Cypress Semiconductor Corporation, and charges of \$4.1 million and \$5.3 million in the years ended December 31, 1996 and 1997, respectively, for the legal and settlement costs associated with the Actel Corporation litigation. See note 12 of notes to consolidated financial statements.
- (2) Long term obligations at December 31, 1997 include obligations under the Actel litigation settlement. At December 31, 1998, this obligation is classified as a current liability. We paid all of our remaining obligations under the settlement on November 3, 1999. See note 12 of notes to consolidated financial statements.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

EXPLANATORY NOTE

Statements in this Section, and elsewhere in this Annual Report on Form 10-K, which express that the Company "believes", "anticipates" or "plans to...", as well as other statements which are not historical fact, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual events or results may differ materially as a result of the risks and uncertainties described herein and elsewhere including, in particular, those factors described under "Factors Affecting Future Results."

Overview

We design and sell field programmable gate arrays, embedded standard products associated software and programming hardware. From our inception in April 1988 through the third quarter of 1991, we were primarily engaged in product development. In 1991, we introduced our first line of field programmable gate array products, or FPGAs, based upon our ViaLink technology. FPGAs have accounted for substantially all of our product revenue to date. We currently have four FPGA product families: pASIC 1, introduced in 1991; pASIC 2, introduced in 1996; and pASIC 3, introduced in 1997. We introduced our Eclipse family of FPGAs in 2000. The newer product families generally contain greater logic capacity, but do not necessarily replace sales of older generation products.

In September 1998, we introduced QuickRAM, our first line of embedded standard products, or ESPs. Our ESPs are based on our FPGA technology. In April 1999, we introduced QuickPCI, our second line of ESPs. Revenue for our QuickRAM and QuickPCI products together accounted for approximately 12% of our total revenue in 2000. During 2000, we introduced the QuickFC, QuickDSP, QuickSD and QuickMIPS families of ESPs. We also license our QuickWorks and QuickTools design software and sell our programming hardware, which together have typically accounted for less than 5% of total revenue.

We sell our products through two channels. We sell the majority of our products through distributors who have contractual rights to earn a negotiated margin on the sale of our products. We refer to these distributors as point-of-sale distributors. We defer recognition of revenue for sales of unprogrammed products to these point-of-sale distributors until after they have sold these products to systems manufacturers. We recognize revenue on programmed products at the time of shipment. More than half of our products sold by point-of-sale distributors are programmed by us and are not returnable by these point-of-sale distributors. We also sell our products directly to systems manufacturers and recognize revenue at the time of shipment. The percentage of sales derived through each of these channels in 1999 was 80% and 20%, respectively, and 69% and 31% in 2000, respectively.

Four distributors accounted for 24%, 11%, 10% and 6% of sales, respectively, in 1999 and five distributors accounted for approximately 20%, 8%, 7%, 6% and 6% of sales, respectively, in 2000. Two customers each accounted for 6% of sales in 2000. No other distributor or direct customer accounted for more than 5% of sales in 1999 or 2000. We expect that a limited number of distributors will continue to account for a significant portion of our total sales.

Our international sales were 47%, 48% and 38% of our total sales for 1998, 1999 and 2000, respectively. We expect that revenue derived from sales to international customers will continue to represent a significant and growing portion of our total revenue. All of our sales are denominated in U.S. dollars.

Average selling prices for our products typically decline rapidly during the first six to 12 months after their introduction, then decline less rapidly as the products mature. We attempt to maintain gross margins even as average selling prices decline through the introduction of new products with higher

margins and through manufacturing efficiencies and cost reductions. However, the markets in which we operate are highly competitive, and there can be no assurance that we will be able to successfully maintain gross margins. Any significant decline in our gross margins will materially harm our business.

We outsource the wafer manufacturing, assembly and test of all of our products. We rely upon TSMC and Cypress to manufacture our products, and we rely primarily upon Amkor and ChipPAC to assemble and test our products. Under our arrangements with these manufacturers, we are obligated to provide forecasts and enter into binding obligations for anticipated purchases. This limits our ability to react to fluctuations in demand for our products, which could lead to excesses or shortages of wafers for a particular product.

Results of Operations

The following table sets forth the percentage of revenue for certain items in our statements of operations for the periods indicated:

	<u>Years Ended December 31,</u>		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
Revenue	100.0%	100.0%	100.0%
Cost of revenue	47.7%	43.0%	39.5%
Gross profit	52.3%	57.0%	60.5%
Operating Expenses:			
Research and development	21.0%	18.5%	17.4%
Selling, general and administrative	31.2%	31.7%	32.2%
Net operating income	0.1%	6.8%	10.9%
Interest expense	(0.5)%	(0.2)%	(0.1)%
Interest income and other, net	1.2%	1.4%	7.3%
Net income	<u>0.8%</u>	<u>8.0%</u>	<u>18.1%</u>

Years Ended December 31, 1998, 1999 and 2000

Revenue. Our revenue for 1998, 1999 and 2000 was \$30.0 million, \$39.8 million and \$53.3 million, respectively, representing growth of 32.6% from 1998 to 1999 and 34.1% from 1999 to 2000. The majority of the 1999 increase in revenue, as compared with 1998, was due to growth in sales of our pASIC 3 products, the third generation of our FPGAs. Our pASIC 3 revenue increased in 1999 by approximately \$4.4 million. In 1999, our pASIC 1 and pASIC 2 revenues together increased by approximately \$3.0 million and revenue from our QuickRAM products, introduced in September 1998, increased by approximately \$2.4 million. The majority of the 2000 increase in revenue, as compared with 1999, was due to continued growth in sales of our pASIC 3 products. Our pASIC 3 revenue increased in 2000 by approximately \$6.5 million. In 2000, our pASIC 1 and pASIC 2 revenues together increased by approximately \$3.0 million and revenue from our ESP products increased by approximately \$4.0 million. In aggregate, unit sales increased in both 1999 and 2000. The 2000 increase was the result of higher unit sales and slightly higher average selling prices.

Gross Profit. Gross profit was \$15.7 million, \$22.7 million and \$32.3 million in 1998, 1999 and 2000, respectively, which was 52.3%, 57.0% and 60.5% of revenue for those periods. The increase in 1999, as compared with 1998, was primarily due to the continued growth in sales and the introduction of higher-margin QuickRAM products. The 1999 increase was partially offset by a slight decrease in the average selling price of the older pASIC 1 and pASIC 2 product families. The increase in 2000, as compared with 1999, was primarily due to the continued growth in sales and the introduction of higher-

margin ESP products. The 2000 increase was partially offset by a slight decrease in the average selling price of the older pASIC 1 and pASIC 2 product families.

Research and Development Expense. Research and development expense was \$6.3 million, \$7.4 million and \$9.3 million in 1998, 1999 and 2000 respectively, which was 21.0%, 18.5% and 17.4% of revenue for those periods. The increase in research and development spending in 1999 and 2000 were primarily due to an increase in the number of employees involved in research and development as we accelerated the introduction of new products, particularly our ESPs. We believe that continued investments in process technology and product development are essential for us to remain competitive in the markets we serve. Specifically in regard to our ESPs, we expect to continue to increase research and development spending.

Selling, General and Administrative Expense. Selling, general and administrative expense was \$9.4 million, \$12.6 million and \$17.1 million in 1998, 1999 and 2000, respectively, which was 31.2%, 31.7% and 32.2% of revenue for those periods. The increases in 1999 and 2000 were primarily due to hiring of additional sales and marketing personnel and increased sales commissions. We anticipate that selling, general and administrative expense will continue to increase in absolute dollars as we invest in our business and seek to find new customers for our products.

Deferred Compensation. With respect to the grant of stock options to employees, we recorded aggregate deferred compensation of \$204,000 and \$908,000 in 1998 and 1999, respectively. There was no deferred compensation recorded in 2000. The amount of deferred compensation is presented as a reduction of stockholders' equity and amortized ratably over the vesting period of the applicable options, generally four years. We amortized \$426,000, \$512,000, and \$589,000 in 1998, 1999 and 2000, respectively. The amortization of deferred compensation is recorded as research and development and selling, general and administrative expenses, depending on the related employees' activities.

Interest and Other Income, Net. Interest and other income, net of expense, was \$203,000, \$452,000 and \$3,793,000 in 1998, 1999 and 2000, respectively. Interest and other income decreased in 1998 as interest income on increased cash balances was offset by interest expense incurred as a result of new equipment financing arrangements. The increase in 1999 and 2000 interest income was due mainly to our investment of proceeds from the October 1999 initial public offering and April 2000 follow-on offering.

Provision for Income Taxes

No provision for income taxes was recorded for the years ended December 31, 1998, 1999 and 2000, as we were able to utilize a portion of our state and federal net operating loss carryforwards and other tax attributes. At December 31, 2000, we had net operating loss carryforwards for federal and state tax purposes of approximately \$37 million and \$7 million, respectively. These carryforwards, if not utilized to offset future taxable income and income taxes payable, will continue to expire through 2018.

Liquidity and Capital Resources

We have been profitable since the third quarter of 1998. On October 15, 1999, we completed an initial public offering of our common stock in which we sold a total of 3,770,635 shares at \$10.00 per share for total proceeds of \$33.9 million, net of underwriting discounts, commissions and issuance costs. On April 12, 2000, we completed a follow-on public offering in which we sold 1,629,629 shares at \$23.50 per share for total net proceeds of \$35.5 million, net of underwriting discounts, commissions and issuance costs. At December 31, 2000, we had \$70.2 million in cash and cash equivalents, an increase of \$35.7 million from cash and cash equivalents held at December 31, 1999. This increase was due primarily to money received as part of our follow-on public offering. As of December 31, 2000, we had an accumulated deficit of \$48.4 million.

We have an equipment financing line with a commercial bank. At December 31, 2000, we had obligations of \$142,000 outstanding under this equipment line with no remaining available balance. The outstanding obligations under the equipment line are due over the next one to three years. The interest rate on these borrowings is at the bank's prime interest rate plus 0.25%.

Net cash provided by (used for) operating activities was \$2.3 million, \$(3.2) million and \$4.2 million in 1998, 1999 and 2000, respectively. Inventory reductions were the primary source of cash in 1998. In 1999, we paid our remaining obligations to Actel per the August 1998 settlement agreement. Net income and an increase in accounts payable were the primary sources of cash in 1999. Net income and an increase in depreciation were the primary sources of cash in 2000. These increases were partially offset by increases in inventories and prepaid expenses. Our operating cash flow activities are affected by changes in our accounts receivable and related allowances. At December 31, 1998, 1999 and 2000 we had allowances for doubtful accounts totaling \$245,000, \$194,000 and \$294,000, respectively. We have not had any material collection issues to date.

Net cash used for investing activities was \$679,000, \$3.3 million and \$6.6 million in 1998, 1999 and 2000, respectively. All of this cash was used for the acquisition of property and equipment. We intend to purchase approximately \$7.0 million of additional capital assets and make an investment of approximately \$14.0 million in Tower Semiconductor during 2001.

Net cash provided by (used for) financing activities was \$(1.4) million, \$33.4 million and \$38.0 million in 1998, 1999 and 2000, respectively. In 1999 and 2000 the primary source of cash was our initial public offering and our follow-on offering. Cash was used to repay bank debt of \$1.5 million, \$1.2 million and \$470,000 in 1998, 1999 and 2000, respectively.

We require substantial working capital to fund our business, particularly to finance inventories and accounts receivable. Our future capital requirements will depend on many factors, including the rate of sales growth, market acceptance of our existing and new products, the amount and timing of research and development expenditures, the timing of the introduction of new products and expansion of sales and marketing efforts. There can be no assurance that additional equity or debt financing, if required, will be available on satisfactory terms. We believe the net proceeds of our offerings combined with existing capital resources and cash generated from operations will be sufficient to meet our needs for the next 12 months, although we could seek to raise additional capital during that period. After the next 12 months, our capital and operating requirements will depend on many factors, including the levels at which we maintain inventory and accounts receivable, costs of securing access to adequate manufacturing capacity and increases in our operating expenses.

Inflation

The impact of inflation on our business has not been material for the fiscal years ended December 31, 1998, 1999 and 2000.

Recently Issued Accounting Pronouncements

In March 2000, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25." This interpretation has provisions that are effective on staggered dates, some of which began after December 15, 1998 and others that became effective July 1, 2000. The adoption of this interpretation did not have a material impact on the financial statements.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 101 summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition

in financial statements. We have adopted SAB 101 effective the first quarter of fiscal year 2000. The adoption of SAB 101 did not have a material impact on the Company's financial statements.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 established a model for accounting for derivatives and hedging activities and supersedes and amends a number of existing accounting standards. SFAS No. 133 requires that all derivatives be recognized in the balance sheet at their fair market value, and the corresponding derivative gains or losses be either reported in the statement of operations or as a deferred item depending on the type of hedge relationship that exists with respect to such derivative. We have adopted SFAS No. 133, as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of Effective Date of FASB Statement No. 133," effective January 1, 2001. We do not currently, nor do we plan to, enter into forward exchange contracts to hedge exposures denominated in foreign currencies or any other derivative financial instruments for trading or speculative purposes.

Factors Affecting Future Results

Our future operating results are likely to fluctuate and therefore may fail to meet expectations which could cause our stock price to decline

Our operating results have varied widely in the past and are likely to do so in the future. In addition, our operating results may not follow any past trends. Our future operating results will depend on many factors and may fail to meet our expectations for a number of reasons, including those set forth in these risk factors. Any failure to meet expectations could cause our stock price to significantly fluctuate or decline.

Factors that could cause our operating results to fluctuate that relate to our internal operations include:

- the need for continual, rapid new product introductions;
- changes in our product mix; and
- our inability to adjust our fixed costs in the face of any declines in sales.

Factors that could cause our operating results to fluctuate that depend upon our suppliers and customers include:

- the timing of significant product orders, order cancellations and reschedulings;
- the availability of production capacity and fluctuations in the manufacturing yields at the facilities that manufacture our devices; and
- the cost of raw materials and manufacturing services from our suppliers.

Factors that could cause our operating results to fluctuate that are industry risks include:

- intense competitive pricing pressures;
- introductions of or enhancements to our competitors' products; and
- the cyclical nature of the semiconductor industry.

Our day-to-day business decisions are made with these factors in mind. Although certain of these factors are out of our immediate control, unless we can anticipate, and be prepared with contingency plans that respond to these factors, we will be unsuccessful in carrying out our business plan.

We cannot assure you that we will remain profitable because we have a history of losses and have only recently become profitable

We incurred significant losses from our inception in 1988 through 1997. Our accumulated deficit as of December 31, 2000 was \$48.4 million. We had net income of \$9.6 million in 2000. We cannot assure you that we will be profitable in any future periods and you should not rely on the historical growth of our revenue and our recent profitability as any indication of our future operating results or prospects.

If we fail to successfully develop, introduce and sell new products, we may be unable to compete effectively in the future

We operate in a highly competitive, quickly changing environment marked by rapid obsolescence of existing products. Our future success depends on our ability to develop, introduce and successfully market new products, including embedded standard products, or ESPs. We introduced our ESPs in September 1998. To date, we have been selling our ESPs in limited quantities, and revenue from our ESPs has been very small. If any of the following occur, our business will be materially harmed:

- we fail to complete and introduce new product designs in a timely manner;
- we are unable to have these new products manufactured according to design specifications;
- our customers do not successfully introduce new systems or products incorporating our products;
- our sales force and independent distributors do not create adequate demand for our products;
- or
- market demand for our new products, such as ESPs, does not develop as anticipated.

We have only recently introduced our embedded standard products; therefore, we cannot accurately predict their future level of acceptance by our customers, and we may not be able to generate anticipated revenue from these products

We have only recently started selling embedded standard products. In 2000, ESPs accounted for approximately 12% of our revenue. We do not know the extent to which systems manufacturers will purchase or utilize our ESPs. Since we anticipate that ESPs will become an increasingly larger component of our business, their failure to gain acceptance with our customers would materially harm our business. We cannot assure you that our ESPs will be commercially successful or that these products will result in significant additional revenues or improved operating margins in future periods.

If the market in which we sell our embedded standard products does not grow as we anticipate, it will materially and adversely affect our anticipated revenue

The market for embedded standard products is relatively new and still emerging. If this market does not grow at the rate we anticipate, our business will be materially harmed. One of the reasons that this market might not grow as we anticipate is that many systems manufacturers are not yet fully aware of the benefits provided by embedded standard products, in general, or the benefits of our ESPs, specifically. Additionally, systems manufacturers may use existing technologies other than embedded standard products or yet to be introduced technologies to satisfy their needs. Although we have devoted and intend to continue to devote significant resources promoting market awareness of the benefits of embedded standard products, our efforts may be unsuccessful or insufficient.

We expend substantial resources in developing and selling our products, and we may be unable to generate significant revenue as a result of these efforts

To establish market acceptance of our products, we must dedicate significant resources to research and development, production and sales and marketing. We experience a long delay between the time

when we expend these resources and the time when we begin to generate revenue, if any, from these expenditures. Typically, this delay is one year or more. We record as expenses the costs related to the development of new semiconductor products and software as these expenses are incurred. As a result, our profitability from quarter to quarter and from year to year may be materially and adversely affected by the number and timing of our new product introductions in any period and the level of acceptance gained by these products.

Our customers may cancel or change their product plans after we have expended substantial time and resources in the design of their products

If one of our potential customers cancels, reduces or delays product orders from us or chooses not to release equipment that incorporates our products after we have spent substantial time and resources in designing a product, our business could be materially harmed. Our customers often evaluate our products for six to twelve months or more before designing them into their systems, and they may not commence volume shipments for up to an additional six to twelve months, if at all. During this lengthy sales cycle, our potential customers may also cancel or change their product plans. Even when customers incorporate one or more of our products into their systems, they may ultimately discontinue the shipment of their systems that incorporate our products. Customers whose products achieve high volume production may choose to replace our products with lower cost customized semiconductors.

We will be unable to compete effectively if we fail to anticipate product opportunities based upon emerging technologies and standards and fail to develop products that incorporate these technologies and standards

We may spend significant time and money on research and development to design and develop products around an emerging technology or industry standard. To date, we have introduced only one product family, QuickPCI, that is designed to support a specific industry standard. If an emerging technology or industry standard that we have identified fails to achieve broad market acceptance in our target markets, we may be unable to generate significant revenue from our research and development efforts. Moreover, even if we are able to develop products using adopted standards, our products may not be accepted in our target markets. As a result, our business would be materially harmed.

We have limited experience in designing and developing products that support industry standards. If systems manufacturers move away from the use of industry standards that we support with our products and adopt alternative standards, we may be unable to design and develop new products that conform to these new standards. The expertise required is unique to each industry standard, and we would have to either hire individuals with the required expertise or acquire such expertise through a licensing arrangement or by other means. The demand for individuals with the necessary expertise to develop a product relating to a particular industry standard is generally high, and we may not be able to hire such individuals. The cost to acquire such expertise through licensing or other means may be high and such arrangements may not be possible in a timely manner, if at all.

We may encounter periods of industry-wide semiconductor oversupply, resulting in pricing pressure and underutilization of manufacturing capacity, as well as undersupply, resulting in a risk that we could be unable to fulfill our customers' requirements

The semiconductor industry has historically been characterized by wide fluctuations in the demand for, and supply of, its products. These fluctuations have resulted in circumstances when supply and demand for the industry's products have been widely out of balance. Our operating results may be materially harmed by industry-wide semiconductor oversupply, which could result in severe pricing pressure and underutilization of our manufacturing capacity. In a market with undersupply, we would have to compete with larger foundry customers for limited manufacturing capacity. In such an environment, we may be unable to have our products manufactured in a timely manner or in quantities

necessary to meet our requirements. Since we outsource all of our manufacturing, we are particularly vulnerable to such supply shortages. As a result, we may be unable to fulfill orders and may lose customers. Any future industry-wide oversupply or undersupply of semiconductors would materially harm our business.

None of our products is currently manufactured by more than one manufacturer, which exposes us to the risk of having to identify and qualify one or more substitute suppliers

We depend upon independent third parties to manufacture, assemble and test our semiconductor products. None of our products is currently manufactured by more than one manufacturer. We have contractual arrangements with two of our foundry manufacturers of semiconductors, Tower Semiconductor Ltd. and Cypress Semiconductor Corporation, to provide us with specified manufacturing capacity. The Tower facility is not yet operational. We entered into a manufacturing agreement with TSMC in 1997. That agreement provided us access to guaranteed capacity but required us to commit to purchase a specific number of wafers each year. In July 2000, TSMC notified us that the agreement had expired, and although we do not agree with TSMC, we are currently negotiating a new contract with TSMC. Since July 2000, TSMC has not committed guaranteed capacity to us and we have not been required to purchase specific numbers of wafers. We have purchased product from TSMC on a purchase order basis since that date. Our assembly and test work is also done on a purchase order basis. If we are unable to secure adequate manufacturing capacity from Tower, TSMC, Cypress or other suppliers to meet our supply requirements, our business will be materially harmed. Processes used to manufacture our products are complex, customized to our specifications and can only be performed by a limited number of manufacturing facilities. If our current manufacturing suppliers are unable or unwilling to provide us with adequate manufacturing capacity, we would have to identify and qualify one or more substitute suppliers for a substantial majority of our products. Our manufacturers may experience unanticipated events, like the September 1999 Taiwan earthquake, that could inhibit their abilities to provide us with adequate manufacturing capacity on a timely basis, or at all. Introducing new products or transferring existing products to a new third party manufacturer would require significant development time to adapt our designs to their manufacturing processes and could cause product shipment delays. In addition, the costs associated with manufacturing our products may increase if we are required to use a new third party manufacturer. If we fail to satisfy our manufacturing requirements, our business would be materially harmed.

If we fail to adequately forecast demand for our products, we may incur product shortages or excess product inventory.

Our agreements with third-party manufacturers require us to provide forecasts of our anticipated manufacturing orders, and place binding manufacturing orders in advance of receiving purchase orders from our customers. This may result in product shortages or excess product inventory because we are not permitted to increase or decrease our rolling forecasts under such agreements. Obtaining additional supply in the face of product shortages may be costly or not possible, especially in the short term. Our failure to adequately forecast demand for our products would materially harm our business.

Fluctuations in our product yields, especially our new products, may increase the costs of our manufacturing process.

Difficulties in the complex semiconductor manufacturing process can render a substantial percentage of semiconductor wafers nonfunctional. We have, in the past, experienced manufacturing runs that have contained substantially reduced or no functioning devices. Varying degrees of these yield reductions occur frequently in our manufacturing process. These yield reductions, which can occur without warning, may result in substantially higher manufacturing costs and inventory shortages to us. We may experience yield problems in the future which may materially harm our business. In addition,

yield problems may take a significant period of time to analyze and correct. Our reliance on third party suppliers may extend the period of time required to analyze and correct these problems. As a result, if we are unable to respond rapidly to market demand, our business would suffer.

Yield reductions frequently occur in connection with the manufacture of newly introduced products. Newly introduced products, such as our QuickPCI family of ESPs, are often more complex and more difficult to produce, increasing the risk of manufacturing-related defects. While we test our products, these products may still contain errors or defects that we find only after we have commenced commercial production. Our customers may not place new orders for our products if the products have reliability problems, which would materially harm our business.

We may be unable to grow our business if the markets in which our customers sell their products do not grow

Our success depends in large part on the continued growth of various markets that use our products. Any decline in the demand for our products in the following markets could materially harm our business:

- telecommunications and data communications;
- video/audio, graphics and imaging;
- instrumentation and test;
- high-performance computing; or
- military systems.

Slower growth in any of the other markets in which our products are sold may also materially harm our business. Many of these markets are characterized by rapid technological change and intense competition. As a result, systems sold by our customers that use our products may face severe price competition, become obsolete over a short time period, or fail to gain market acceptance. Any of these occurrences would materially harm our business.

In order to remain profitable, we will need to offset the general pattern of declines and fluctuations in the prices of our products

The average selling prices of our products historically have declined during the products' lives by, on average, approximately 7% per year, and we expect this trend to continue. If we are unable to achieve cost reductions, increase unit demand or introduce new higher-margin products in a timely manner to offset these price declines, our business would be materially harmed.

In addition, the selling prices for our products fluctuate significantly with real and perceived changes in the balance of supply and demand for our products and comparable products. The growth in the worldwide supply of field programmable gate arrays in recent periods has added to the decrease in the average selling prices for our products. In addition, we expect our competitors to invest in new manufacturing process technologies and achieve significant manufacturing yield improvements in the future. These developments could increase the worldwide supply of field programmable gate arrays and alternate products and create additional downward pressure on pricing. If the worldwide supply of field programmable gate arrays grows faster than the demand for such products in the future, the price for which we can sell such products may decline, which would materially harm our business.

We depend upon third party distributors to market and sell our products, and they may discontinue sale of our products, fail to give our products priority or be unable to successfully market, sell and support our products

We employ independent, third-party distributors to market and sell a significant portion of our products. During 2000, approximately 69% of our sales were made through our distributors. Two distributors together accounted for approximately 24% of our sales. No other distributor accounted for more than 10% of our sales. Although we have contracts with our distributors, any of them may terminate their relationship with us on short notice. The loss of one or more of our principal distributors, or our inability to attract new distributors, would materially harm our business. We may lose distributors in the future and we may be unable to recruit additional or replacement distributors. As a result, our future performance will depend in part on our ability to retain our existing distributors and attract new distributors that will be able to market, sell and support our products effectively.

Many of our distributors, including our principal distributors, market and sell products for other companies, and many of these products may compete directly or indirectly with our products. We generally are not one of the principal suppliers of products to our distributors. If our distributors give higher priority or greater attention to the products of other companies, including products that compete with our products, our business would be materially harmed.

We may be unable to accurately predict quarterly results if distributors are inaccurate or untimely in providing us with their resale reports, which could adversely affect the trading price of our stock

Since we generally recognize revenue from sales to our distributors only when these distributors make sales to customers, we are highly dependent on the accuracy and timeliness of their resale reports. Inaccurate resale reports contribute to our difficulty in predicting and reporting our quarterly revenue and results of operations, particularly in the last month of the quarter. If we fail to accurately predict our revenue and results of operations on a quarterly basis, our stock price could materially fluctuate. Distributors occasionally increase their inventories of our products in anticipation of growth in the demand for our products. If this growth does not occur, distributors will decrease their orders for our products in subsequent periods, and our business would be materially harmed.

Customers may cancel or defer significant purchase orders or our distributors may return our products, which would cause our inventory levels to increase and our revenues to decline

We sell our products on a purchase order basis through our distributors and direct sales channels, and our distributors or customers may cancel purchase orders at any time with little or no penalty. In addition, our distributor agreements generally permit our distributors to return unprogrammed products to us. Contractually, our distributors are permitted to return up to 10%, by value, of the products they purchase from us every six months. In early 1998, for example, a distributor cancelled a significant purchase order as a result of a customer switching from a product we supply to a competitor's product. The distributor also returned a significant amount of inventory of the product to us, which took approximately 18 months for us to resell. If our customers cancel or defer significant purchase orders or our distributors return our products, our inventories would increase, which would materially harm our business.

Many systems manufacturers may be unwilling to switch to our products because of their familiarity with the products offered by our direct competitors such as Xilinx and Altera, which dominate the programmable logic market

The semiconductor industry is intensely competitive and characterized by:

- erosion of selling prices over product lives;

- rapid technological change;
- short product life cycles; and
- strong domestic and foreign competition.

If we are not able to compete successfully in this, environment, our business will be materially harmed. A primary cause of this highly competitive environment is the strengths of our competitors. Our industry consists of major domestic and international semiconductor companies, many of which have substantially greater financial, technical, marketing, distribution and other resources than we do. Our current direct competitors include suppliers of complex programmable logic devices and field programmable gate arrays, such as Xilinx, Altera, Actel, Lattice Semiconductor and Lucent. Xilinx and Altera together have a majority share of the programmable logic market. Many systems manufacturers may be unwilling or unable to switch to our products due to their familiarity with competitors' products or other inhibiting factors.

We also face competition from companies that offer application specific integrated circuits, which may be obtained at lower costs for higher volumes and typically have greater logic capacity, additional features and higher performance than those of our products. We may also face competition from suppliers of products based on new or emerging technologies, including ESPs. Our inability to successfully compete in any of the following areas could materially harm our business:

- the development of new products and manufacturing technologies;
- the quality and price of products and devices;
- the diversity of product lines; or
- the cost effectiveness of design, development, manufacturing and marketing efforts.

We may be unable to successfully manage our growth if we fail to compete effectively with others to attract and retain key personnel

We believe our future success will depend upon our ability to successfully manage our growth, including attracting and retaining engineers and other highly skilled personnel. Our employees are at-will and not subject to employment contracts. Hiring qualified sales and technical personnel will be difficult due to the limited number of qualified professionals. Competition for these types of employees is intense. We have in the past experienced difficulty in recruiting and retaining qualified sales and technical personnel. For example, in the past 18 months, one of our executive officers resigned to pursue other opportunities. Failure to attract and retain personnel, particularly sales and technical personnel, would materially harm our business.

We may be unable to adequately protect our intellectual property rights, and may face significant expenses as a result of future litigation

Protection of intellectual property rights is crucial to our business, since that is how we keep others from copying the innovations which are central to our existing and future products. From time to time, we receive letters alleging patent infringement or inviting us to take a license to other parties' patents. We evaluate these letters on a case-by-case basis. In September 1999, we received an offer to license a patent related to field programmable gate array architecture. We have not yet determined whether this license would be necessary or useful, or whether a license would be obtainable at a reasonable price. Offers such as these may lead to litigation if we reject the opportunity to obtain the license. We have in the past and may again become involved in litigation relating to alleged infringement by us of others' patents or other intellectual property rights. This kind of litigation is expensive to all parties and consumes large amounts of management's time and attention. For example, we incurred substantial costs associated with the litigation and settlement of our dispute with Actel Corporation, which

materially harmed our business. In addition, if the September 1999 letter or other similar matters result in litigation that we lose, a court could order us to pay substantial damages and/or royalties, and prohibit us from making, using, selling or importing essential technologies. For these and other reasons, this kind of litigation would materially harm our business. Also, although we may seek to obtain a license under a third party's intellectual property rights in order to bring an end to certain claims or actions asserted against us, we may not be able to obtain such a license on reasonable terms or at all.

We have entered into technology license agreements with third parties which give those parties the right to use patents and other technology developed by us, and which give us the right to use patents and other technology developed by them. We anticipate that we will continue to enter into these kinds of licensing arrangements in the future; however, it is possible that desirable licenses will not be available to us on commercially reasonable terms. If we lose existing licenses to key technology, or are unable to enter into new licenses which we deem important, it could materially harm our business, and materially and adversely affect our business.

Because it is critical to our success that we are able to prevent competitors from copying our innovations, we intend to continue to seek patent and trade secret protection for our products. The process of seeking patent protection can be long and expensive, and we cannot be certain that any currently pending or future applications will actually result in issued patents, or that, even if patents are issued, they will be of sufficient scope or strength to provide meaningful protection or any commercial advantage to us. Furthermore, others may develop technologies that are similar or superior to our technology or design around the patents we own. We also rely on trade secret protection for our technology, in part through confidentiality agreements with our employees, consultants and third parties. However, employees may breach these agreements, and we may not have adequate remedies for any breach. In any case, others may come to know about or determine our trade secrets through a variety of methods. In addition, the laws of certain territories in which we develop, manufacture or sell our products may not protect our intellectual property rights to the same extent as do the laws of the United States.

Problems associated with international business operations could affect our ability to manufacture and sell our products

Most of our products are manufactured outside of the United States at manufacturing facilities operated by our suppliers in Taiwan, South Korea and the Philippines. As a result, our manufacturing operations are subject to risks of political instability, including the risk of conflict between Taiwan and the People's Republic of China and conflict between North Korea and South Korea. Moreover, the majority of available manufacturing capacity for our products is located in Taiwan and South Korea.

Sales to customers located outside the United States accounted for 47%, 48% and 35% of our total sales in 1998, 1999 and 2000, respectively. We anticipate that sales to customers located outside the United States will continue to represent a significant portion of our total sales in future periods and the trend of foreign customers accounting for an increasing portion of our total sales may continue. In addition, most of our domestic customers sell their products outside of North America, thereby indirectly exposing us to risks associated with foreign commerce. Asian economic instability could also materially and adversely affect our business, particularly to the extent that this instability impacts the sales of products manufactured by our customers. Accordingly, our operations and revenues are subject to a number of risks associated with foreign commerce, including the following:

- managing foreign distributors;
- staffing and managing foreign branch offices;
- political and economic instability;
- foreign currency exchange fluctuations;

- changes in tax laws, tariffs and freight rates;
- timing and availability of export licenses;
- inadequate protection of intellectual property rights in some countries; and
- obtaining governmental approvals for certain products.

In the past we have denominated sales of our products in foreign countries exclusively in U.S. dollars. As a result, any increase in the value of the U.S. dollar relative to the local currency of a foreign country will increase the price of our products in that country so that our products become relatively more expensive to customers in the local currency of that foreign country. As a result, sales of our products in that foreign country may decline. To the extent any such risks materialize, our business would be materially harmed.

Our principal stockholders have significant voting power and may vote for actions that may not be in the best interests of our stockholders

Our officers, directors and principal stockholders together control approximately 55.67% of our outstanding common stock. As a result, these stockholders, if they act together, will be able to significantly influence the management and affairs of QuickLogic and all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. This concentration of ownership may have the effect of delaying or preventing a change in control and might affect the market price of our common stock. This concentration of ownership may not be in the best interest of our other stockholders.

Our certificate of incorporation and bylaws and Delaware law contain provisions that could discourage a takeover

Our basic corporate documents and Delaware law contain provisions that might enable our management to resist a takeover. These provisions might discourage, delay or prevent a change in the control of QuickLogic or a change in our management. Our certificate of incorporation provides that we will have a classified board of directors, with each class of directors subject to re-election every three years. This classified board when implemented will have the effect of making it more difficult for third parties to insert their representatives on our board of directors and gain control of QuickLogic. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors and take other corporate actions. The existence of these provisions could limit the price that investors might be willing to pay in the future for shares of the common stock.

Our certificate of incorporation also provides that our board of directors may, without further action by the stockholders, issue shares of preferred stock in one or more series and fix the rights, preferences, privileges and restrictions thereof. The issuance of preferred stock could adversely affect the voting power of holders of common stock and the likelihood that such holders will receive dividend payments and payments upon liquidation. In addition, the issuance of preferred stock could have the effect of delaying, deferring or preventing a change in control of QuickLogic. We have no present plan to issue any shares of preferred stock.

A sale of a substantial number of shares of our common stock may cause the price of our common stock to decline

If our stockholders sell substantial amounts of our common stock, including shares issued upon the exercise of outstanding options, the market price of our common stock could fall. Such sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate.

Our common stock has only been publicly traded for a short time, and we expect the price of our common stock will fluctuate substantially

Prior to our initial public offering on October 15, 1999, there was no public market for shares of our common stock. The market price for our common stock may be affected by a number of factors, including:

- the announcement of new products or product enhancements by us or our competitors;
- quarterly variations in our or our competitors' results of operations;
- changes in earnings estimates or recommendations by securities analysts; developments in our industry; and
- general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.

In addition, stock prices for many companies in the technology and emerging growth sectors have experienced wide fluctuations that have often been unrelated to the operating performance of such companies. Such factors and fluctuations may materially and adversely affect the market price of our common stock.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

We do not use derivative financial instruments in our investment portfolio. Our investment portfolio is generally comprised of commercial paper. We place investments in instruments that meet high credit quality standards. These securities are subject to interest rate risk, and could decline in value if interest rates fluctuate. Due to the short duration and conservative nature of our investment portfolio, we do not expect any material loss with respect to our investment portfolio. A 10% move in interest rates as of December 31, 2000 would have an immaterial effect on our pretax earnings and the carrying value of its investments over the next fiscal year.

Foreign Currency Exchange Rate Risk

All of the Company's sales, cost of manufacturing and marketing are transacted in U.S. dollars. Accordingly, our results of operations are not subject to foreign exchange rate fluctuations.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of
QuickLogic Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity (deficit) and of cash flows present fairly, in all material respects, the financial position of QuickLogic Corporation and its subsidiary at December 31, 1999 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the consolidated financial statement schedules listed in the index appearing under item 14(a)2 present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP
San Jose, California
January 23, 2001,
except as to Note 13, which
is as of March 1, 2001.

QUICKLOGIC CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands, except par value amount)

	Years Ended December 31,	
	1999	2000
ASSETS		
Current assets:		
Cash and cash equivalents	\$34,558	\$ 70,210
Accounts receivable, net of allowances for doubtful accounts of \$194 and \$294	5,543	6,578
Inventory	4,349	10,327
Other current assets	1,467	1,876
Total current assets	45,917	88,991
Property and equipment, net	4,510	8,976
Other assets	55	2,340
	\$50,482	\$100,307
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Trade payables	\$ 5,202	\$ 5,821
Accrued liabilities	2,405	2,934
Deferred income on shipments to distributors	5,026	4,386
Current portion of long-term obligations	716	311
Total current liabilities	13,349	13,452
Long-term obligations	128	1,121
	13,477	14,573
Commitments and contingencies (Notes 11 and 12)		
Stockholders' equity		
Common stock, \$0.001 par value; 100,000 shares authorized, 18,102 and 20,209 shares issued and outstanding, respectively	18	20
Additional paid-in capital	96,599	134,970
Stockholder note receivable	(121)	0
Deferred compensation	(1,480)	(875)
Accumulated deficit	(58,011)	(48,381)
Total stockholders' equity	37,005	85,734
	\$50,482	\$100,307

The accompanying notes form an integral part of these Consolidated Financial Statements

QUICKLOGIC CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	<u>Years Ended December 31,</u>		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
Revenue	\$30,007	\$39,785	\$53,342
Cost of revenue	14,303	17,103	21,068
Gross profit	15,704	22,682	32,274
Operating expenses:			
Research and development	6,294	7,355	9,300
Selling, general and administrative	9,368	12,618	17,137
Income from operations	42	2,709	5,837
Interest expense	(161)	(97)	(49)
Interest income and other, net	364	549	3,842
Net income	<u>\$ 245</u>	<u>\$ 3,161</u>	<u>\$ 9,630</u>
Net income per share:			
Basic	\$ 0.06	\$ 0.42	\$ 0.49
Diluted	\$ 0.02	\$ 0.19	\$ 0.45
Weighted average shares:			
Basic	4,231	7,615	19,486
Diluted	14,645	16,400	21,614

The accompanying notes form an integral part of these Consolidated Financial Statements

QUICKLOGIC CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(In thousands)

	Convertible Preferred Stock		Common Stock at Par Value		Common Stock to be Issued		Additional Stockholder Note Receivable		Deferred Compensation	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Receivable			
Balance at December 31, 1997	9,912	10	1,159	1	3,038	18,409	43,435	(121)	(2,073)	(61,417)	(1,756)
Common stock issued under stock option plan, net of repurchases	—	—	82	—	—	—	110	—	—	—	110
Common stock issued in exchange for contract termination	—	—	3,038	3	(3,038)	(18,409)	18,406	—	—	—	—
Deferred compensation, net of terminations	—	—	—	—	—	—	(563)	—	563	—	—
Amortization of deferred compensation	—	—	—	—	—	—	—	—	426	—	426
Net income	—	—	—	—	—	—	—	—	—	245	245
Balance at December 31, 1998	9,912	10	4,279	4	—	—	61,388	(121)	(1,084)	(61,172)	(975)
Common stock issued under stock option plan, net of repurchases	—	—	140	—	—	—	431	—	—	—	431
Deferred compensation, net of terminations	—	—	—	—	—	—	908	—	(908)	—	—
Amortization of deferred compensation	—	—	—	—	—	—	—	—	512	—	512
Conversion from preferred stock to common stock	(9,912)	(10)	9,912	10	—	—	—	—	—	—	—
Issuance of shares in connection with initial public offering, net of expenses of \$1,190	—	—	3,771	4	—	—	33,872	—	—	—	33,876
Net income	—	—	18,102	\$18	—	—	—	—	—	3,161	3,161
Balance at December 31, 1999	—	\$—	—	\$—	—	\$—	\$96,599	\$(121)	\$(1,480)	\$(58,011)	\$37,005
Common stock issued under stock option plan, net of repurchases	—	—	478	—	—	—	2,846	—	—	—	2,846
Amortization of deferred compensation, net of terminations	—	—	—	—	—	—	(16)	—	605	—	589
Issuance of shares in connection with public offering, net of expenses of \$741	—	—	1,629	2	—	—	35,541	—	—	—	35,543
Note receivable from stockholder	—	—	—	—	—	—	—	121	—	—	121
Net income	—	—	—	—	—	—	—	—	—	9,630	9,630
Balance at December 31, 2000	—	\$—	20,209	\$20	—	\$—	\$134,970	\$—	\$(875)	\$(48,381)	85,734

QUICKLOGIC CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	<u>Year Ended December 31,</u>		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
Cash flows from operating activities:			
Net income	\$ 245	\$ 3,161	\$ 9,630
Adjustments to reconcile net income to net cash provided by (used for) operating activities:			
Depreciation and other non-cash charges	1,322	1,636	2,350
Amortization of deferred compensation	426	512	589
Gain on disposal of assets	(5)	—	(116)
Changes in assets and liabilities:			
Accounts receivable	861	(3,512)	(1,035)
Inventory	2,992	(1,472)	(5,978)
Other assets	(444)	(749)	(2,386)
Accounts payable	(597)	2,998	619
Accrued liabilities and other obligations	(2,477)	(5,731)	639
Net cash provided by (used for) operating activities	<u>2,323</u>	<u>(3,157)</u>	<u>4,312</u>
Cash flows from investing activities:			
Capital expenditures for property and equipment, net of dispositions	<u>(679)</u>	<u>(3,254)</u>	<u>(6,700)</u>
Cash flows from financing activities:			
Payment of long-term obligations	(1,490)	(1,183)	(470)
Proceeds from issuance of common stock, net	110	34,307	38,389
Note receivable from stockholder	—	—	121
Proceeds from bank borrowings	—	250	—
Net cash provided by (used for) financing activities	<u>(1,380)</u>	<u>33,374</u>	<u>38,040</u>
Net increase in cash	264	26,963	35,652
Cash at beginning of period	<u>7,331</u>	<u>7,595</u>	<u>34,558</u>
Cash at end of period	<u>\$ 7,595</u>	<u>\$34,558</u>	<u>\$70,210</u>
Supplemental Disclosures of cash flow information:			
Interest paid	\$ 160	\$ 89	\$ 49
Income taxes paid	\$ 2	\$ 2	\$ 1

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