SYNAPTICS INC
Form 10-Q
February 02, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 26, 2009
Commission file number 000-49602
SYNAPTICS INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	**77-0118518**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3120 Scott Blvd.
Santa Clara, California 95054
(Address of principal executive offices) (Zip code)
(408) 454-5100
(Registrant s telephone number, including area code)

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 þ No o

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

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Number of shares of Common Stock outstanding at January 27, 2010: 33,510,763

SYNAPTICS INCORPORATED
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED DECEMBER 31, 2009
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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SYNAPTICS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)
(unaudited)

	December 31, 2009	June 30, 2009*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 140,033	$ 169,036
Short-term investments		22,934
Accounts receivable, net of allowances of $513 at December 31, 2009 and June 30, 2009	100,302	84,739
Inventories	15,837	14,950
Prepaid expenses and other current assets	4,171	3,094
Total current assets	260,343	294,753
Property and equipment, net of accumulated depreciation of $15,821 and $11,712 at December 31, 2009 and June 30, 2009, respectively	25,425	25,431
Goodwill	1,927	1,927
Non-current investments	28,952	28,767
Other assets	18,110	25,272
	$ 334,757	$ 376,150
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 52,909	$ 32,210
Accrued compensation	8,069	8,450
Income taxes payable	12,806	9,128
Current deferred tax liabilities		10,225
Other accrued liabilities	15,464	11,813
Notes payable		63,234
Total current liabilities	89,248	135,060
Convertible senior subordinated notes	2,305	
Other liabilities	19,238	18,484
Stockholders equity:		
Common stock: $0.001 par value; 60,000,000 shares authorized; 44,166,949 and 43,779,011 shares issued, and 33,295,636 and 34,690,911 shares outstanding, at December 31, 2009 and June 30, 2009, respectively	44	44
Additional paid-in capital	315,954	293,666
Less:10,871,313 and 9,088,100 common treasury shares at December 31, 2009 and June 30, 2009, respectively, at cost	(281,932)	(237,387)

Accumulated other comprehensive income	1,715	129
Retained earnings	188,185	166,154
Total stockholders equity	223,966	222,606
	$ 334,757	$ 376,150

* Reflects the retrospective application of the new accounting pronouncement applicable to convertible debt instruments that can be settled in cash. See notes 1 and 8.

See notes to condensed consolidated financial statements (unaudited).

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SYNAPTICS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)
(unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008*	2009	2008*
Net revenue	$ 133,323	$ 141,523	$ 252,915	$ 257,380
Cost of revenue	79,492	83,717	150,762	152,981
Gross margin	53,831	57,806	102,153	104,399
Operating expenses:				
Research and development	22,442	15,940	42,417	31,745
Selling, general, and administrative	16,575	13,714	30,339	28,284
Total operating expenses	39,017	29,654	72,756	60,029
Income from operations	14,814	28,152	29,397	44,370
Interest income	241	974	572	2,232
Interest expense	(968)	(1,739)	(2,391)	(4,280)
Loss on early retirement of debt		(1,053)		(1,053)
Impairment of investments, net		(6,509)	(443)	(6,509)
Income before provision for income taxes	14,087	19,825	27,135	34,760
Provision for income taxes	1,860	2,250	5,104	4,474
Net income	$ 12,227	$ 17,575	$ 22,031	$ 30,286
Net income per share:				
Basic	$ 0.36	$ 0.52	$ 0.65	$ 0.90
Diluted	$ 0.35	$ 0.50	$ 0.62	$ 0.86
Shares used in computing net income per share:				
Basic	33,611	33,833	33,976	33,736
Diluted	34,936	35,057	35,477	35,311

* Reflects the retrospective application of

the new accounting pronouncement applicable to convertible debt instruments that can be settled in cash. See notes 1 and 8.

See notes to condensed consolidated financial statements (unaudited).

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SYNAPTICS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended December 31, 2009	Six Months Ended December 31, 2008*
Cash flows from operating activities		
Net income	$ 22,031	$ 30,286
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation costs	19,144	11,537
Deferred taxes	(2,084)	(4,872)
Tax benefit realized from share-based compensation		2,900
Excess tax benefit from share-based compensation		(2,900)
Depreciation of property and equipment	4,171	2,727
Amortization of debt issuance costs	118	228
Impairment of investments, net	443	6,509
Amortization of debt discount	2,069	3,636
Loss on early retirement of debt		1,053
Changes in operating assets and liabilities:		
Accounts receivable, net	(15,563)	(12,303)
Inventories	(887)	(1,056)
Prepaid expenses and other current assets	(153)	(1,209)
Other assets	(2,055)	(334)
Accounts payable	20,699	(230)
Accrued compensation	(381)	745
Income taxes	4,397	1,021
Other accrued liabilities	3,686	4,224
Net cash provided by operating activities	55,635	41,962
Cash flows from investing activities		
Purchases of short-term investments	(5,986)	(11,031)
Proceeds from sales and maturities of short-term investments	28,912	34,170
Proceeds from sales and maturities of non current investments	1,000	1,625
Purchases of property and equipment	(4,165)	(5,836)
Net cash provided by investing activities	19,761	18,928
Cash flows from financing activities		
Purchases of treasury stock	(44,545)	
Proceeds from issuance of common stock upon exercise of options and stock purchase plan	4,156	6,189
Retirement of debt, net of discount	(62,998)	(55,656)

Excess tax benefit from share-based compensation		2,900
Payroll taxes for deferred stock units	(1,012)	(937)
Net cash used in financing activities	(104,399)	(47,504)
Net (decrease) increase in cash and cash equivalents	(29,003)	13,386
Cash and cash equivalents at beginning of period	169,036	96,218
Cash and cash equivalents at end of period	$ 140,033	$ 109,604

Supplemental disclosures of cash flow information

Cash paid for income taxes	$ 2,792	$ 5,442

* Reflects the retrospective application of the new accounting pronouncement applicable to convertible debt instruments that can be settled in cash. See notes 1 and 8.

See notes to condensed consolidated financial statements (unaudited).

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SYNAPTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) and U.S. generally accepted accounting principles. However, certain information or footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such SEC rules and regulations. In our opinion, the financial statements include all adjustments, which are of a normal and recurring nature, necessary for the fair presentation of the results of the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the operating results for the full fiscal year or any future period. These financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our annual report on Form 10-K for the fiscal year ended June 30, 2009.

The consolidated financial statements include our financial statements and those of our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated upon consolidation.

Our fiscal year is the 52- or 53-week period ending on the last Saturday in June. Our fiscal 2010 will be a 52-week period ending on June 26, 2010, and our fiscal 2009 was a 52-week period ending on June 27, 2009. The fiscal periods presented in this report were 13-week and 26-week periods for the three and six months ended December 26, 2009 and December 27, 2008. For ease of presentation, the accompanying consolidated financial statements have been shown as ending on December 31 and calendar quarter end dates for all annual, interim, and quarterly financial statement captions, unless otherwise indicated.

Stock Split

On July 31, 2008, we announced a 3-for-2 stock split to be effected as a stock dividend. The stock dividend was effective for stockholders of record on August 15, 2008 and was paid on August 29, 2008. All share and per share amounts contained herein reflect the stock split, except for treasury shares.

Use of Estimates

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

Retrospective application of ASC 470-20

On July 1, 2009, we adopted ASC 470-20, formerly known as FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion. This standard applies to our 0.75% Convertible Senior Subordinated Notes (the Notes). The adoption of this accounting standard, which must be applied on a retrospective basis, results in a non-cash interest charge for all periods presented in our financial statements during which the Notes were outstanding.

Upon adoption of the new standard, and effective as of the issuance date of the Notes, we recorded $39.4 million of the principal amount to equity, representing the debt discount for the difference between our estimated nonconvertible debt borrowing rate of 8.5% at the time of issuance and the 0.75% coupon rate of the Notes using a five-year life, which coincides with the initial put rights of the Noteholders. In addition, we allocated the $4.3 million of debt issuance costs pro-rata to the equity and debt components of the Notes, or $1.4 million and $2.9 million, respectively. The debt discount and the debt issuance costs allocated to the debt component were amortized as interest expense using the effective interest method over five years.

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2. Revenue Recognition

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

3. Net Income Per Share

We present basic and diluted net income per share amounts in conformity with U.S. GAAP for all periods presented. The following table presents the computation of basic and diluted net income per share (in thousands, except per share amounts):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008*	2009	2008*
Numerator:				
Net income	$ 12,227	$ 17,575	$ 22,031	$ 30,286
Denominator:				
Shares, basic	33,611	33,833	33,976	33,736
Effect of dilutive share-based awards	1,325	1,224	1,501	1,575
Shares, diluted	34,936	35,057	35,477	35,311
Net income per share:				
Basic	$ 0.36	$ 0.52	$ 0.65	$ 0.90
Diluted	$ 0.35	$ 0.50	$ 0.62	$ 0.86

* Reflects the retrospective application of the new accounting pronouncement applicable to convertible debt instruments that can be settled in cash. See notes 1 and 8.

Our basic net income per share amounts for each period presented have been computed using the weighted average number of shares of common stock outstanding. Our diluted net income per share amounts for each period presented include the weighted average effect of potentially dilutive shares. We use the treasury stock method to determine the dilutive effect of our share-based awards and Notes. No shares associated with our Notes were included in dilutive

shares for the periods presented as the weighted average share price during each period was less than the conversion price of $33.69.

Dilutive net income per share amounts do not include the weighted average effect of 4,306,400 and 2,962,618 share-based awards that were outstanding during the three months ended December 31, 2009 and 2008, respectively, and 3,502,321 and 2,366,806 share-based awards that were outstanding during the six months ended December 31, 2009 and 2008, respectively. These share-based awards were not included in the computation of diluted net income per share because the proceeds received, if any, from such share-based awards combined with the average unamortized compensation costs adjusted for the hypothetical tax benefit or deficiency creditable or chargeable, respectively, to additional paid-in capital, were greater than the average market price of our common stock, and therefore, their effect would have been antidilutive.

4. Cash Equivalents, Short-Term Investments, and Auction Rate Securities Investments

Cash equivalents consist of highly liquid investments with original maturities of three months or less. Short-term investments consist of marketable securities and are classified as securities available for sale in accordance with U.S. GAAP. Included in our non-current investments are auction rate securities, or ARS. Our short-term and non-current investments are reported at fair value, with unrealized gains and losses excluded from earnings and shown separately as a component of accumulated other comprehensive income within stockholders equity. We charge an other-than-temporary decline in the fair value of a debt security to earnings if the decline is due to a credit loss or to other comprehensive income if the decline is due to a noncredit loss, resulting in the establishment of a new cost basis for the

debt security. We charge other-than-temporary declines in the fair value of equity securities to earnings. We include interest earned on marketable securities in interest income. We determine realized gains and losses on the sale of marketable securities using the specific identification method.

Our ARS investments, which have a par value of $41.5 million, have failed to settle in auctions beginning in September 2007. These investments are not liquid, and in the event we need to access these funds, we will not be able to do so without a loss of principal, unless redeemed by the issuers or a future auction on these investments is successful. During the three and six months ended December 31, 2009, $300,000 and $1.0 million, respectively, of our ARS investments were redeemed at par, and we recognized a gain of zero and $6,000 on the redemption of these investments, which is included in impairment of investments, net on the accompanying consolidated statements of income. During the three and six months ended December 31, 2008, zero and $1.6 million, respectively, of our ARS investments were redeemed at par and there was no associated gain or loss on the redemption of these investments.

As there are currently no active markets for our various failed ARS investments, we have estimated the fair value of these investments as of December 31, 2009 based on a trinomial discounted cash flow analysis. The analysis considered, among other factors, the collateral underlying the security investments, creditworthiness of the counterparty, timing of expected future cash flows, and the probability of a successful auction in a future period. When possible, our failed ARS investments were compared to other observable market data or securities with similar characteristics.

Contractual maturities for our ARS investments are generally greater than six years, with fair value of $9.6 million maturing from 2015 to 2017, $10.2 million maturing from 2034 to 2045, and $9.2 million maturing thereafter or having no stated maturity. Of our ARS investments, $23.0 million par value are investment grade, and the remaining $18.5 million par value are below investment grade. In connection with our fair value analysis for the six months ended December 31, 2009, we recorded a $449,000 other-than-temporary impairment charge on our ARS investments in preferred stock, reducing the carrying value to zero.

We estimated the fair value of our ARS investments based on the following: (i) the underlying structure of each investment; (ii) the present value of future principal and interest payments discounted at rates considered to reflect current market conditions; (iii) consideration of the probabilities of default, passing a future auction, or redemption at par for each period; and (iv) estimates of the recovery rates in the event of default for each investment. Our estimate of the fair value of our ARS investments could change materially from period to period based on future market conditions.

The following table sets forth the types of ARS investments we held as of December 31, 2009, including the original cost basis, other-than-temporary impairment included in other comprehensive income, other-than-temporary impairment included in retained earnings, new cost basis, unrealized gain, and fair value (in thousands).

		Cumulative Other-than-temporary Impairment				
	Original Cost Basis	Included in Other Comprehensive Income	Included in Retained Earnings	New Cost Basis	Unrealized Gain	Fair Value
Student loans	$ 9,750	$ 630	$ 262	$ 8,858	$ 308	$ 9,166
Closed end municipal and corporate funds	11,225	1,166	93	9,966	231	10,197
Credit linked notes	13,500	156	8,765	4,579	3,195	7,774
Preferred stock	5,000		5,000			
Municipals	2,000	203	83	1,714	101	1,815
Total ARS	$ 41,475	$ 2,155	$ 14,203	$ 25,117	$ 3,835	$ 28,952

We have accounted for all of our ARS investments as non-current as we are not able to reasonably determine when the ARS markets will recover or be restructured. Based on our ability to access our cash, our expected operating cash flows, and our other sources of cash, we have the intent and ability to hold these investments until the value recovers or the investments mature. We will continue to monitor our ARS investments in light of the current debt market environment and evaluate our accounting for these investments quarterly. Subsequent to recording other-than-temporary impairment charges, certain of our ARS investments have increased in value above their new cost bases, and this increase is included as unrealized gain above and in accumulated other comprehensive income in the accompanying consolidated balance sheet.

5. Fair Value of Cash Equivalents and Investments

Effective the beginning of fiscal 2009, we adopted the fair value option for financial assets and liabilities recognized or disclosed at fair value on a recurring basis. For other financial assets and liabilities which are not recognized or disclosed at fair value on a recurring basis, we elected not to apply the fair value option. Effective the beginning of fiscal 2010, we adopted the fair value option for non-financial assets and liabilities. The adoption of the fair value option for non-financial assets and liabilities did not have a material impact on our consolidated financial position, results of operations, or cash flows.

Current accounting standards establish a consistent framework for measuring fair value on either a recurring or nonrecurring basis in which inputs, used in valuation techniques, are assigned a hierarchical level.

The following are the hierarchical levels of inputs to measure fair value:

Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Unobservable inputs reflecting our own assumptions incorporated in valuation techniques used to determine fair value. These assumptions must be consistent with market participant assumptions that are reasonably available. Our Level 3 assets consist of long-term ARS investments. We estimated the fair value of our ARS investments based on the following: (i) the underlying structure of each investment; (ii) the present value of future principal and interest payments discounted at rates considered to reflect current market conditions; (iii) consideration of the probabilities of default, passing a future auction, or repurchase at par for each period; and (iv) estimates of the recovery rates in the event of default for each investment.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis, by level within the fair value hierarchy, as of December 31, 2009 (in thousands):

	Level 1	Level 3
Money market	$ 138,311	$
Auction rate securities		28,952
Total available-for-sale securities	$ 138,311	$ 28,952

Money market balances are included in cash and cash equivalents as of December 31, 2009.

The following table provides a summary of changes in fair value of our Level 3 financial assets as of December 31, 2009 (in thousands):

Balance as of June 30, 2009	$ 28,767
Net change in other comprehensive income from Level 3 financial assets	1,628
Other than temporary impairment, net	(443)
Redemptions	(1,000)
Balance as of December 31, 2009	$ 28,952

There were no transfers in or out of our Level 3 assets during the six months ended December 31, 2009.

The fair values of our cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate their carrying values because of the short-term nature of those instruments. We base the fair value of short-term investments on current trading values and the fair value of our auction rate securities on a trinomial discounted cash

flow model.

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6. Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market (estimated net realizable value) and consisted of the following (in thousands):

	December 31, 2009	June 30, 2009
Raw materials	$ 9,698	$ 9,217
Finished goods	6,139	5,733
	$ 15,837	$ 14,950

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

7. Product Warranties, Indemnifications, and Contingencies

Product Warranties

We generally warrant our products for a period of 12 months or more from the date of sale and estimate probable product warranty costs at the time we recognize revenue. Factors that affect our warranty liability include historical and anticipated rates of warranty claims, materials usage, and service delivery costs. Warranty costs incurred have not been material in recent years. However, we assess the adequacy of our warranty obligations periodically and adjust the accrued warranty liability on the basis of our estimates.

Indemnifications

In connection with certain third-party agreements, we are obligated to indemnify the third party in connection with any technology infringement by us. We have also entered into indemnification agreements with our officers and directors. Maximum potential future payments cannot be estimated because these agreements do not have a maximum stated liability. However, historical costs related to these indemnification provisions have not been significant. We have not recorded any liability in our consolidated financial statements for such indemnification obligations.

Contingencies

We may receive notices from third parties that claim our products infringe their rights. From time to time, we receive notice from third parties alleging infringement of their intellectual property rights. We cannot be certain that our technologies and products do not and will not infringe issued patents or other proprietary rights of third parties.

Any infringement claims, with or without merit, could result in significant litigation costs and diversion of management and financial resources, including the payment of damages, which could have a material adverse effect on our business, financial condition, and results of operations. In October 2008, we entered into a settlement and cross-license agreement with a competitor, which settled all disputes between the parties and granted each party irrevocable, non-transferable, non-assignable, non-exclusive, worldwide rights to certain patents over their remaining lives. The impact of the settlement was not material to our financial results and is not expected to have a material impact on our future cash flows, results of operations, or financial position.

8. Convertible Senior Subordinated Notes

In December 2004, we issued an aggregate of $125 million Notes maturing December 1, 2024 in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended. In connection with issuing the Notes, we incurred debt issuance costs of $4.3 million, consisting primarily of the initial purchasers discount and costs related to legal, accounting, and printing, which are being amortized over five years. We used the net proceeds for working capital and general corporate purposes.

During the second quarter of fiscal 2009, we repurchased and retired $59.7 million of our outstanding Notes at a discount from par of approximately 7%, which resulted in a $1.1 million net loss on retirement of debt after deducting the associated unamortized debt discount and debt issuance costs. In December 2009, we repurchased and retired $63.0 million par value of our Notes as investors exercised their rights to require us to repurchase their Notes. Accordingly, as of December 31, 2009, $2.3 million par value of our Notes remained outstanding and have been classified as long term as the next date Noteholders can require us to repurchase all or a portion of their Notes is beyond one year.

Interest expense includes the amortization of debt discount and debt issuance costs. We recorded $1.0 million and $1.7 million of interest expense on the Notes during the three-month periods ended December 31, 2009 and 2008, respectively. We recorded $2.4 million and $4.3 million of interest expense on the Notes during the six-month periods ended December 31, 2009 and 2008, respectively. As of December 31, 2009, the amortization of the discount and debt issuance costs was complete, and the if-converted value of the Notes did not exceed the principal amount of the Notes.

On July 1, 2009, we adopted ASC 470-20, which is the new accounting standard applicable to convertible debt that can be settled in cash. This standard applies to our Notes. The adoption of this accounting standard, which must be applied on a retrospective basis, results in a non-cash interest charge for all periods presented in our financial statements during which the Notes were outstanding. This standard requires issuers of convertible notes that can be settled in cash to separately account for the liability and equity components of such convertible notes in a manner that reflects the entity s nonconvertible debt borrowing rate. Prior to the application of the standard, the liability of the Notes was carried at their par value, and only the contractual interest and amortization of debt issuance costs were recognized in condensed consolidated statements of income.

Upon adoption of the new standard, and effective as of the issuance date of the Notes, we recorded $39.4 million of the principal amount to equity, representing the debt discount for the difference between our estimated nonconvertible debt borrowing rate of 8.5% at the time of issuance and the 0.75% coupon rate of the Notes using a five-year life, which coincides with the initial put rights of the Noteholders. In addition, we allocated the $4.3 million of debt issuance costs pro-rata to the equity and debt components of the Notes, or $1.4 million and $2.9 million, respectively. The debt discount and the debt issuance costs allocated to the debt component were amortized as interest expense using the effective interest method over five years.

As of December 31, 2009 and June 30, 2009, the liability and equity components of the Notes consisted of the following (in thousands):

	December 31, 2009	June 30, 2009
Principal amount of outstanding Notes	$ 2,305	$ 65,303
Unamortized discount		2,069
Liability component of outstanding Notes, net	$ 2,305	$ 63,234
Equity component of outstanding Notes	$ 727	$ 20,591

The contractual interest expense and amortization of discount for the Notes for the three and six months ended December 31, 2009 and 2008 were as follows (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Interest expense	$ 82	$ 182	$ 204	$ 416
Amortization of debt issuance costs	48	88	118	228
Amortization of discount	838	1,469	2,069	3,636

Total interest	$ 968	$ 1,739	$ 2,391	$ 4,280

Impact of Retrospective Application of New Accounting Standard

The retrospective application of the accounting standard resulted in the following adjustments to our condensed consolidated balance sheet as of June 30, 2009 (in thousands):

	As Reported	Accounting Standard Impact	As Revised
Other assets	$ 25,343	$ (71)	$ 25,272
Total assets	376,221	(71)	376,150
Current deferred tax liability	9,419	806	10,225
Note payable	65,303	(2,069)	63,234
Total current liabilities	136,323	(1,263)	135,060
Additional paid in capital	270,962	22,704	293,666
Retained earnings	187,666	(21,512)	166,154
Total stockholders equity	221,414	1,192	222,606
Total liabilities and stockholders equity	376,221	(71)	376,150

The retrospective application of the accounting standard resulted in the following adjustments to our condensed consolidated income statement, basic and diluted net income per share, and effective tax rate for the three and six months ended December 31, 2008 (in thousands, except per share data and effective tax rate):

	Three Months Ended December 31, 2008			Six Months Ended December 31, 2008		
	As Reported	Accounting Standard Impact	As Revised	As Reported	Accounting Standard Impact	As Revised
Interest expense	$ (321)	$ (1,418)	$ (1,739)	$ (770)	$ (3,510)	$ (4,280)
Gain/(Loss) on early retirement of debt	3,600	(4,653)	(1,053)	3,600	(4,653)	(1,053)
Provision for taxes	(4,699)	2,449	(2,250)	(7,767)	3,293	(4,474)
Net income	21,197	(3,622)	17,575	35,156	(4,870)	30,286
Net income per share:						
Basic	$ 0.63	$ (0.11)	$ 0.52	$ 1.04	$ (0.14)	$ 0.90
Diluted	$ 0.60	$ (0.10)	$ 0.50	$ 1.00	$ (0.14)	$ 0.86
Effective tax rate	18.1%	-6.8%	11.3%	18.1%	-5.2%	12.9%

The retrospective application of the accounting standard resulted in the following adjustments to our condensed consolidated statement of cash flows for the six months ended December 31, 2008 (in thousands):

	As Reported	Accounting Standard Impact	As Revised
Net income	$ 35,156	$ (4,870)	$ 30,286
Amortization of debt issuance costs	354	(126)	228
Deferred taxes	(1,579)	(3,293)	(4,872)
Amortization of debt discount		3,636	3,636

9. Share-Based Compensation

The purpose of our various share-based compensation plans is to attract, motivate, retain, and reward high-quality employees, directors, and consultants by enabling such persons to acquire or increase their proprietary interest in our common stock in order to strengthen the mutuality of interests between such persons and our stockholders and to

provide such persons with annual and long-term performance incentives to focus their best efforts in the creation of stockholder

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value. Consequently, share-based compensatory awards issued subsequent to the initial award to our employees and consultants are determined primarily on individual performance. Our share-based compensation plans with outstanding awards consist of our 1996 Stock Option Plan, our 2000 Nonstatutory Stock Option Plan, our 2001 Incentive Compensation Plan, as amended, and our 2001 Employee Stock Purchase Plan, as amended.

Adjustments to Share-based Compensation Expense

During the second quarter of fiscal 2010 and in connection with an upgrade of the well-known third-party equity accounting software we use to determine share-based compensation expense, we discovered a calculation error that affected our previously reported share-based compensation expense. The previous software version incorrectly applied a weighted average forfeiture rate to each vest date through the final vest date of each share-based award after which any shortfall in expense was trued up, rather than true up any shortfall in expense on each vest date of each share-based award.

The impact of this incorrect calculation method to our share-based compensation expense was to defer a portion of the expense recognition until the final vest date, which resulted in an overstatement of net income of $569,000, $1.2 million, $1.1 million, and $165,000 for the fiscal years 2006, 2007, 2008, and 2009, respectively, and $74,000 for the quarter ended September 30, 2009.

To correct the error, the financial statements for the three- and six-month periods ended December 31, 2009 include a cumulative adjustment in the December quarter reducing net income by $3.1 million, or $0.09 net income per diluted share. The tax benefit associated with the adjustment was $1.4 million and included tax benefit from deferred stock units (DSUs) and non-qualified stock options, and no tax benefit from stock compensation expense for qualified stock options. We reviewed the financial statement impact of this error and concluded the impact is immaterial to our consolidated financial statements of prior reporting periods, the three- and six-month periods ended December 31, 2009, and the estimated annual financial statements for the year ending June 30, 2010.

Share-based compensation and the related tax benefit recognized in our consolidated statements of income for the three- and six-month periods ended December 31, 2009 and 2008 were as follows (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Cost of revenue	$ 815	$ 402	$ 1,263	$ 813
Research and development	4,646	1,962	7,444	3,978
Selling, general, and administrative	6,635	3,292	10,437	6,746
Total	$ 12,096	$ 5,656	$ 19,144	$ 11,537
Tax benefit recorded on share-based compensation	$ 3,106	$ 1,769	$ 5,307	$ 3,737

As noted above, we determined the cumulative error from the understatement of share-based compensation expense related to prior periods was $3.1 million after tax. The additional expense reported for the three- and six-month periods ended December 31, 2009 was $267,000 for cost of revenue, $1.5 million for research and development, and $2.7 million for selling, general, and administrative, partially offset by $1.4 million of additional tax benefit.

We utilize the Black-Scholes option pricing model to estimate the grant date fair value of certain employee share-based compensatory awards, which requires the input of highly subjective assumptions, including expected volatility and expected life. Historical and implied volatilities were used in estimating the fair value of our share-based awards, while the expected life of our options and estimated forfeitures for shared-based awards that are not expected to vest were estimated based on historical trends since our initial public offering. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. We charge the estimated fair value less estimated forfeitures to earnings on a straight-line basis over the vesting period of the underlying awards, which is generally four years for our stock options and deferred stock units and up to two years for

our employee stock purchase plan. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options having no vesting restrictions and being fully transferable. As our stock option and employee stock purchase plan awards have characteristics that differ significantly from traded options and, as changes in the subjective assumptions can materially affect the estimated value, our estimate of fair value may not accurately represent the value

assigned by a third party in an arms -length transaction. While our estimate of fair value and the associated charge to earnings materially affects our results of operations, it has no impact on our cash position.

In accordance with U.S. GAAP, we recognize tax benefit upon expensing certain share-based awards associated with our share-based compensation plans, including nonqualified stock options and deferred stock units, but we cannot recognize tax benefit concurrent with the recognition of share-based compensation expenses associated with incentive stock options and employee stock purchase plan shares (qualified stock options). For qualified stock options that vested after we began expensing share-based compensation, we recognize tax benefit only in the period when disqualifying dispositions of the underlying stock occur, which historically has been up to several years after vesting and in a period when our stock price substantially increases. For qualified stock options that vested prior to when we began expensing share-based compensation, we record the tax benefit directly to additional paid-in capital.

We determine excess tax benefit using the long-haul method in which we compare the actual tax benefit associated with the tax deduction from share-based award activity to the hypothetical tax benefit on the grant date fair values of the corresponding share-based awards. Under the current accounting standard, tax benefit associated with excess tax deduction creditable to additional paid-in capital is not recognized until the deduction reduces taxes payable. Accordingly, no tax benefit related to excess tax deductions from qualified stock options was recognized during the six-month period ended December 31, 2009.

Historically, we have issued new shares in connection with our share-based compensation plans; however, treasury shares were also available for issuance as of December 31, 2009. Any additional shares repurchased under our stock repurchase program would be available for issuance under our share-based compensation plans.

Stock Options

Our share-based compensation plans with outstanding stock option awards include our 1996 Stock Option Plan, our 2000 Nonstatutory Stock Option Plan, and our 2001 Incentive Compensation Plan, as amended (the Plans). Under the Plans, we may grant employees, consultants, and directors incentive stock options or nonqualified stock options to purchase shares of our common stock at not less than 100% or 85% of the fair market value, respectively, on the date of grant. Stock options granted to our employees generally are incentive stock options, or qualified options under the internal revenue code, subject to calendar year vesting limitations with any balance being nonqualified stock options.

The following table summarizes stock option activity and weighted average exercise prices for the six months ended December 31, 2009, and for options outstanding and options exercisable, the weighted average exercise prices and the aggregate intrinsic value as of December 31, 2009. The aggregate intrinsic value is based on the closing price of our common stock on December 24, 2009 and excludes stock options with exercise prices above the closing price of $29.62.

	Stock Option Awards Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value (thousands)
Balance at June 30, 2009	6,770,312	$ 20.86	
Granted	1,028,075	25.14	
Exercised	(130,544)	14.83	
Forfeited	(1,920)	15.51	
Balance at December 31, 2009	7,665,923	21.54	$ 67,197
Exercisable at December 31, 2009	3,803,962	$ 17.80	$ 46,801

Options issued under the Plans generally vest 25% at the end of 12 months from the vesting commencement date and approximately 2% each month thereafter until fully vested at the end of 48 months from the vesting commencement date. Options not exercised ten years after the date of grant are cancelled.

Deferred Stock Units

Our 2001 Incentive Compensation Plan, as amended (2001 Plan), enables us to grant DSUs to our employees, consultants, and directors. A DSU is a promise to deliver shares of our common stock at a future date in accordance with the terms of the DSU grant agreement.

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The following table summarizes DSU activity, including DSUs granted, delivered, and forfeited, during the six months ended December 31, 2009, and the balance and aggregate intrinsic value of DSUs as of December 31, 2009.

	Deferred Stock Unit Awards Outstanding	Aggregate Intrinsic Value (thousands)
Balance at June 30, 2009	738,258	
Granted	251,385	
Delivered	(146,478)	
Forfeited	(19,873)	
Balance at December 31, 2009	823,292	$ 24,386

The aggregate intrinsic value is based on the closing price of our common stock on December 24, 2009 of $29.62.

Of the shares delivered, 43,571 shares valued at $1.0 million were withheld to meet statutory minimum tax withholding requirements.

DSUs granted under the 2001 Plan generally vest 25% at the end of 12 months from the vesting commencement date and at a rate of approximately 6% each quarter thereafter until fully vested at the end of four years from the vesting commencement date. Delivery of shares under the plan takes place on the quarterly vesting dates. At the delivery date, we withhold shares to cover statutory minimum tax withholding by delivering a net number of shares. Until delivery of shares, the grantee has no rights as a stockholder.

An election to defer delivery of the underlying shares for unvested DSUs can be made provided the deferral election is made at least one year before vesting and the deferral period is at least five years from the scheduled delivery date.

Employee Stock Purchase Plan

Our 2001 Employee Stock Purchase Plan, as amended (ESPP), became effective on January 29, 2002, the effective date of the registration statement for our initial public offering. The ESPP allows employees to designate up to 15% of their base compensation, subject to legal restrictions and limitations, to purchase shares of common stock at 85% of the lesser of the fair market value (FMV) at the beginning of the offering period or the exercise date. The offering period extends for up to two years and includes four exercise dates occurring at six month intervals. Under the terms of the plan, if the FMV at an exercise date is less than the FMV at the beginning of the offering period, the current offering period will terminate and a new two-year offering period will commence.

The following table summarizes the shares purchased, weighted average purchase price, cash received, and the aggregate intrinsic value for ESPP purchases during the six-month period ended December 31, 2009 (in thousands, except for shares purchased and weighted average purchase price):

Shares purchased	153,854
Weighted average purchase price	$ 14.44
Cash received	$ 2,222
Aggregate intrinsic value	$ 3,724

In accordance with U.S. GAAP, the early termination of an offering period followed by the commencement of a new offering period represents a modification to the terms of the underlying awards. Under the terms of our ESPP, the offering period that commenced on July 1, 2007 was terminated on December 31, 2008 and a new offering period commenced on January 1, 2009. The December 31, 2008 modification affected approximately 257 employees. The modification resulted in incremental compensation costs, which are not material and which will be recognized on a straight-line basis over the two-year period ending December 31, 2010.

10. Income Taxes

We account for income taxes under the asset and liability method. We consider the operating earnings of our foreign subsidiaries to be indefinitely invested outside the United States. Accordingly, no provision has been made for the U.S.

federal, state, or foreign taxes that may result from future remittances of undistributed earnings of our foreign subsidiaries.

The provision for income taxes of $1.9 million and $2.3 million for the three months ended December 31, 2009 and 2008, respectively, represented estimated federal, foreign, and state taxes. The effective tax rate for the three months ended December 31, 2009 was 13.2% and diverged from the combined federal and state statutory rate primarily because of increased foreign income taxed at lower tax rates, the benefit of research tax credits, the release of unrecognized tax benefits, the impact of the adjustment to share-based compensation expense, and the impact of tax-exempt interest income, partially offset by foreign withholding taxes, net unrecognized tax benefit associated with qualified stock options, the impairment of an investment for which a full valuation allowance was established, and the establishment of a valuation allowance on certain deferred tax assets. The effective tax rate for the three months ended December 31, 2008 was 11.3% and diverged from the combined federal and state statutory rate primarily as a result of increased foreign income taxed at lower tax rates, net recognized tax benefit associated with qualified stock options, the benefit of research tax credits, and the impact of tax-exempt interest income, partially offset by foreign withholding taxes, net unrecognized tax benefit associated with qualified stock options, and the impairment of investments for which a valuation allowance was established.

Tax benefit associated with share-based compensation was approximately $3.1 million and $1.8 million for the three months ended December 31, 2009 and 2008, respectively. Excluding the impact of share-based compensation and the related tax benefit, the effective tax rate for the three months ended December 31, 2009 and 2008 would have been 19.0% and 15.8%, respectively.

The provision for income taxes of $5.1 million and $4.5 million for the six months ended December 31, 2009 and 2008, respectively, represented estimated federal, foreign, and state taxes. The effective tax rate for the six months ended December 31, 2009 was 18.8% and diverged from the combined federal and state statutory rate primarily because of increased foreign income taxed at lower tax rates, the benefit of research tax credits, the release of unrecognized tax benefits, and the impact of tax-exempt interest income, partially offset by foreign withholding taxes, net unrecognized tax benefit associated with qualified stock options, the impairment of an investment for which a full valuation allowance was established, and the establishment of a valuation allowance on certain deferred tax assets. The effective tax rate for the six months ended December 31, 2008 was 12.9% and diverged from the combined federal and state statutory rate primarily as a result of increased foreign income taxed at lower tax rates, net recognized tax benefit associated with qualified stock options, the benefit of research tax credits, and the impact of tax-exempt interest income, partially offset by foreign withholding taxes, net unrecognized tax benefit associated with qualified stock options, and the impairment of investments for which a valuation allowance was established.

Tax benefit associated with share-based compensation was approximately $5.3 million and $3.7 million for the six months ended December 31, 2009 and 2008, respectively. Excluding the impact of share-based compensation and the related tax benefit, the effective tax rate for the six months ended December 31, 2009 and 2008 would have been 22.5% and 17.7%, respectively.

Unrecognized Tax Benefits

The total liability for gross unrecognized tax benefits as of September 30, 2009 was $17.6 million. The liability for gross unrecognized tax benefit increased $800,000 during the December quarter to $18.4 million, if recognized, would affect the effective tax rate on income from continuing operations. The net increase of $800,000 consisted of an increase related to prior year tax positions. The total interest and penalties accrued related to unrecognized tax benefits as of September 30, 2009 was $1.1 million. The liability for interest expense and penalties did not change during the quarter ended December 31, 2009. We classify interest and penalties, if any, as components of income tax expense.

No material unrecognized tax benefit is expected to be paid within one year, and we cannot make a reliable estimate when cash settlement with a taxing authority may occur. Any prospective adjustments to our unrecognized tax benefits will be recorded as an increase or decrease to income tax expense and cause a corresponding change to our effective tax rate. Accordingly, our effective tax rate could fluctuate materially from period to period.

It is reasonably possible that the amount of the liability for unrecognized tax benefits may change within the next 12 months. An estimate of the range of possible changes cannot be made at this time because of the high uncertainty of the resolution of our tax positions with the various tax jurisdictions in which we operate. Accordingly, the

unrecognized tax benefits from prior year tax positions that may be necessary to accrue or de-accrue for the next 12 months cannot be reasonably estimated at this time.

Currently, we are required to file federal and state income tax returns in the United States and foreign tax jurisdictions in which we operate. Our major tax jurisdictions are the United States, California, and Hong Kong SAR. The fiscal years that remain subject to examination by these jurisdictions are fiscal 2002 and onward. In September 2007, we were notified by the state of California Franchise Tax Board that our fiscal 2004 and 2005 returns were subject to audit, and in June 2009 we were notified by the Franchise Tax Board that the audit would be submitted for final approval without adjustment. In January 2010, we settled with the Inland Revenue Department of Hong Kong on additional assessments and penalties related to our fiscal 2006 to fiscal 2008 tax returns. However, tax returns of fiscal 2004 and onward remain subject to examination.

In May 2009, the Obama Administration announced several proposals to change the U.S. tax laws. It is unclear whether the proposals will be enacted or, if enacted, what the scope of the change in the laws will be. These proposals, if enacted, could adversely impact our effective tax rate, our operating results, and financial condition.

On November 6, 2009, President Obama signed into law the Worker, Homeownership, and Business Assistance Act of 2009, which provides for an extended carryback period from two years up to five years for net operating losses incurred in tax years beginning or ending in 2008 or 2009. Upon filing the carryback claims we will receive a tax refund, a portion of which will be recorded as additional paid-in-capital and up to $2.0 million of which may be recorded as a reduction of tax expense.

11. Segment, Customers, and Geographic Information

We operate in one segment: the development, marketing, and sale of custom-designed capacitive interface solutions that enable people to interact more easily and intuitively with a wide variety of electronic devices and products. We generate our revenue from two broad product categories: the PC market and digital lifestyle product markets. The PC market accounted for 55% and 50% of net revenue for the three months ended December 31, 2009 and 2008, respectively, and 59% and 60% of net revenue for the six months ended December 31, 2009 and 2008, respectively.

The following is a summary of net revenue from sales to unaffiliated customers within geographic areas based on the customer location (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
China	$ 108,251	$ 84,203	$ 203,984	$ 158,667
Japan	9,523	15,055	17,584	18,831
Korea	7,723	21,598	17,355	37,632
Taiwan	7,805	17,081	13,816	35,723
Other	21	3,586	176	6,527
	$ 133,323	$ 141,523	$ 252,915	$ 257,380

The following is major customer net revenue data as a percentage of net revenue:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Customer A	13%	*	10%	*
Customer B	12%	*	11%	*
Customer C	10%	18%	*	11%
Customer D	*	*	*	10%

* Less than 10%

The following is major customer accounts receivable as a percentage of accounts receivable:

	As of December 31, 2009	As of June 30, 2009
Customer A	18%	*
Customer B	16%	*
Customer C	13%	11%
Customer D	*	20%
Customer E	*	11%
Customer F	*	10%

* Less than 10%

12. Comprehensive Income

Our comprehensive income generally consists of net income plus the effect of unrealized gains and losses on our investments primarily due to reductions in market value of certain of our auction rate securities and interest rate fluctuations on our fixed interest rate investments. In addition, we recognize the noncredit portion of other-than-temporary impairment in comprehensive income. We recognize remeasurement adjustments in our consolidated statement of income as the U.S. dollar is the functional currency of our foreign entities.

Our comprehensive income for the three and six months ended December 31, 2009 and 2008 is as follows (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Net income	$ 12,227	$ 17,575	$ 22,031	$ 30,286
Net unrealized gain/ (loss) on available-for-sale investments, net of tax	403	528	1,586	(361)
Total comprehensive income	$ 12,630	$ 18,103	$ 23,617	$ 29,925

We recorded an unrealized gain of $403,000 and $1.6 million for the three and six months ended December 31, 2009, respectively, primarily related to the temporary recovery in fair value of certain ARS investments.

13. Recent Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162 (the Codification). The Codification, which was launched on July 1, 2009, became the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF), and related literature. The Codification eliminates the GAAP hierarchy contained in SFAS No. 162 and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We adopted the Codification in our quarter ended September 30, 2009.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (ASC Topic 820) Improving Disclosures About Fair Value Measurements. The ASU requires new disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. The new disclosures and clarifications of existing disclosures are effective for our third quarter of fiscal 2010, except for the disclosures about purchases, sales, issuances, and

settlements relating to Level 3 measurements, which are effective for our first quarter of fiscal 2012. Other than requiring additional disclosures, the adoption of this new guidance will not have a material impact on our consolidated financial position, results of operations, or cash flows.

14. Subsequent Events

We have evaluated all events or transactions that occurred after December 31, 2009 through February 1, 2010 and determined there were no material recognizable subsequent events.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements and Factors That May Affect Results

You should read the following discussion and analysis in conjunction with our condensed consolidated financial statements and notes in Item 1 and with our audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended June 30, 2009.

In addition to the historical information contained in this report, this report contains forward-looking statements, including those related to our operating model and strategies; our market penetration and market share in the notebook and digital lifestyle product markets; competition factors in the notebook and digital lifestyle product markets; revenue from the notebook and digital lifestyle product markets; industry estimates of growth rates of these markets; average selling prices; product design mix; manufacturing costs; cost-improvement programs; gross margins; customer relationships; research and development expenses; selling, general, and administrative expenses; liquidity and anticipated cash requirements; and our ability to provide local sales, operational, and engineering support to customers. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially.

We caution that these statements are qualified by various factors that may affect future results, including the following: economic conditions; changes in the market for our products and the success of our customers products; our success in moving products from the design phase into the manufacturing phase; changes in the competitive environment; infringement claims; warranty obligations related to product failures; the failure of key technologies to deliver commercially acceptable performance; our dependence on certain key markets; penetration into new markets; the absence of both long-term purchase and supply commitments; and our lengthy development and product acceptance cycles. This report should be read in conjunction with our Annual Report on Form 10-K for the year ended June 30, 2009, including particularly Item 1A Risk Factors.

Overview

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

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

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

Our gross margin generally reflects the combination of the added value we bring to our OEM customers products in meeting their custom design requirements and the impact of our ongoing cost-improvement programs. These

cost-improvement programs include reducing materials and component costs and implementing design and process improvements. Our newly introduced products may have lower margins than our more mature products, which have

realized greater benefits associated with our ongoing cost-improvement programs. As a result, new product introductions may initially negatively impact our gross margin.

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

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

Critical Accounting Policies and Estimates

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

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

Revenue Recognition

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

Investments

We account for investment securities in accordance with U.S. GAAP. The current accounting standards require us to record available-for-sale securities at fair value, with non-credit related unrealized gains and losses being reported as a component of other comprehensive income; to assess whether our investments with unrealized loss positions are other-than-temporarily impaired; and to determine whether an impairment of debt securities is other-than-temporary. We follow the hierarchal approach to determine fair value of our investments, which we adopted at the beginning of fiscal 2009.

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

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

Inventory

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

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

Share-Based Compensation Costs

We utilize the Black-Scholes option pricing model to estimate the grant date fair value of employee share-based compensatory awards, which requires the input of highly subjective assumptions, including expected volatility and expected life. Historical and implied volatilities were used in estimating the fair value of our share-based awards, while the expected life for our options and estimated forfeitures for share-based awards that are not expected to vest were estimated based on historical trends since our initial public offering. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. We charge the estimated fair value less estimated forfeitures to earnings on a straight-line basis over the vesting period of the underlying awards, which is generally four years for our stock options and deferred stock units and up to two years for our employee stock purchase plan.

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. As our stock option and employee stock purchase plan awards have characteristics that differ significantly from traded options, and as changes in the subjective assumptions can materially affect the estimated value, our estimate of fair value may not accurately represent the value assigned by a third party in an arms-length transaction. There currently is no market-based mechanism to verify the reliability and accuracy of the estimates derived from the Black-Scholes option pricing model or other allowable valuation models, and there is no means to compare and adjust the estimates to actual values. While our estimate of fair value and the associated charge to earnings materially affects our results of operations, it has no impact on our cash position.

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

Income Taxes

We recognize federal, foreign, and state current tax liabilities or assets based on our estimate of taxes payable or refundable in the then current fiscal year for each tax jurisdiction. We also recognize federal, foreign, and state deferred tax liabilities or assets for our estimate of future tax effects attributable to temporary differences and carryforwards and

record a valuation allowance to reduce any deferred tax assets by the amount of any tax benefits that, based on available evidence and our judgment, are not expected to be realized. If our assumptions, and consequently our estimates, change in the future, the valuation allowance we have established for our deferred tax assets may be changed, which could impact income tax expense.

We follow a two-step approach to recognizing and measuring uncertain tax positions. The first step is to determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement with a taxing authority. The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of highly complex tax laws. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material impact on our consolidated financial position, result of operations, or cash flows. We believe we have adequately provided for reasonably foreseeable outcomes in connection with the resolution of income tax uncertainties. However, our results have in the past, and could in the future, include favorable and unfavorable adjustments to our estimated tax liabilities in the period a determination of such estimated tax liability is made or resolved, upon the filing of an amended return, upon a change in facts, circumstances, or interpretation, or upon the expiration of a statute of limitation. Accordingly, our effective tax rate could fluctuate materially from period to period.

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

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Results of Operations

The following table sets forth our condensed consolidated results of operations for the periods indicated, along with comparative information regarding the absolute and percentage changes in these amounts (in thousands, except percentages):

	Three Months Ended December 31,				Six Months Ended December 31,			
	2009	2008	$ Change	% Change	2009	2008	$ Change	% Change
PC applications	$ 73,653	$ 70,005	$ 3,648	5.2%	$ 148,218	$ 153,445	$ (5,227)	(3.4%)
Digital lifestyle product applications	59,670	71,518	(11,848)	(16.6%)	104,697	103,935	762	0.7%
Net revenue	133,323	141,523	(8,200)	(5.8%)	252,915	257,380	(4,465)	(1.7%)
Gross margin	53,831	57,806	(3,975)	(6.9%)	102,153	104,399	(2,246)	(2.2%)
Operating expenses:								
Research and development	22,442	15,940	6,502	40.8%	42,417	31,745	10,672	33.6%
Selling, general, and administrative	16,575	13,714	2,861	20.9%	30,339	28,284	2,055	7.3%
Income from operations	14,814	28,152	(13,338)	(47.4%)	29,397	44,370	(14,973)	(33.7%)
Interest income	241	974	(733)	(75.3%)	572	2,232	(1,660)	(74.4%)
Interest expense	(968)	(1,739)	771	(44.3%)	(2,391)	(4,280)	1,889	(44.1%)
Loss on early retirement of debt		(1,053)	1,053	n/m(1)		(1,053)	1,053	n/m(1)
Impairment of investment, net		(6,509)	6,509	n/m(1)	(443)	(6,509)	6,066	(93.2%)
Income before provision for income taxes	14,087	19,825	(5,738)	(28.9%)	27,135	34,760	(7,625)	(21.9%)
Provision for income taxes	1,860	2,250	(390)	(17.3%)	5,104	4,474	630	14.1%
Net income	$ 12,227	$ 17,575	$ (5,348)	(30.4%)	$ 22,031	$ 30,286	$ (8,255)	(27.3%)

(1) not meaningful

The following table sets forth certain of our Condensed Consolidated Statements of Income data as a percentage of revenues for the periods indicated:

	Three Months Ended December 31,		Percentage Point Increase (Decrease)	Six Months Ended December 31,		Percentage Point Increase (Decrease)
	2009	2008		2009	2008	
PC applications	55.2%	49.5%	5.7%	58.6%	59.6%	(1.0%)
Digital lifestyle product applications	44.8%	50.5%	(5.7%)	41.4%	40.4%	1.0%
Net revenue	100.0%	100.0%		100.0%	100.0%	
Gross margin	40.4%	40.8%	(0.4%)	40.4%	40.6%	(0.2%)
Operating expenses:						
Research and development	16.8%	11.3%	5.5%	16.8%	12.3%	4.5%
Selling, general, and administrative	12.4%	9.7%	2.7%	12.0%	11.0%	1.0%
Income from operations	11.1%	19.9%	(8.8%)	11.6%	17.2%	(5.6%)
Income before provision for income taxes	10.6%	14.0%	(3.4%)	10.7%	13.5%	(2.8%)
Provision for income taxes	1.4%	1.6%	(0.2%)	2.0%	1.7%	0.3%
Net income	9.2%	12.4%	(3.2%)	8.7%	11.8%	(3.1%)

Net Revenue.

Net revenue was $133.3 million for the quarter ended December 31, 2009 compared with $141.5 million for the quarter ended December 31, 2008, a decrease of $8.2 million, or 5.8%. Of our second quarter fiscal 2010 net revenue, $73.6 million, or 55.2%, was from personal computing products and $59.7 million, or 44.8%, was from digital lifestyle products, including $41.7 million from mobile smartphones. The decrease in net revenue for the quarter ended December 31, 2009 was attributable to a $11.8 million, or 16.6%, decrease in net revenue from digital lifestyle product applications, partially offset by a $3.6 million, or 5.2%, increase in net revenue from PC applications. Digital lifestyle products net

revenue declined primarily due to lower mobile smartphone revenue, partially offset by a small increase in portable digital entertainment revenues. The overall decrease in net revenue was primarily attributable to a lower priced product mix, general competitive pricing pressure, and a reduced attach rate of our multimedia control solutions in notebook computers, partially offset by a 19% increase in unit shipments, reflecting higher market penetration of our products in the personal computing and digital lifestyle markets.

Net revenue was $252.9 million for the six months ended December 31, 2009 compared with $257.4 million for the six months ended December 31, 2008, a decrease of $4.5 million, or 1.7%. Of our six months fiscal 2010 net revenue, $148.2 million, or 58.6%, was from PC applications and $104.7 million, or 41.4%, was from digital lifestyle products applications, including $76.6 million from mobile smartphones. The decrease in net revenue for the six months ended December 31, 2009 was attributable to a $5.2 million, or 3.4%, decrease in net revenue from PC applications, offset partially by a $762,000, or 0.7% increase in net revenue from digital lifestyle product applications. The overall decrease in net revenue was primarily attributable to an overall lower-priced product mix and general competitive pricing pressure, a reduced attach rate of our multimedia control solutions in notebook computers, partially offset by a 14% increase in unit shipments, reflecting higher market penetration of our products in the personal computing and digital lifestyle markets.

Based on calendar year 2010 industry estimates, the notebook market is anticipated to increase approximately 18.1% and the mobile smartphone market is anticipated to increase approximately 28%.

Gross Margin.

Gross margin as a percentage of net revenue was 40.4%, or $53.8 million, for the quarter ended December 31, 2009 compared with 40.8%, or $57.8 million, for the quarter ended December 31, 2008. Gross margin as a percentage of net revenue was 40.4%, or $102.2 million, for the six months ended December 31, 2009 compared with 40.6%, or $104.4 million, for the six months ended December 31, 2008.

As each custom-designed module we sell utilizes our capacitive sensing technology in a design that is generally unique or specific to a customer s application, gross margin varies on a product-by-product basis, making our cumulative gross margin a blend of our product specific designs and independent of the vertical markets that our products serve.

Adjustments to Share-based Compensation Expense

As described in footnote 9 of the notes to condensed consolidated financial statements, we determined the cumulative error from the understatement of share-based compensation expense related to prior periods was $3.1 million after tax. The additional expense reported for the three- and six-month periods ended December 31, 2009 was $267,000 for cost of revenue, $1.5 million for research and development, $2.7 million for selling, general, and administrative, partially offset by $1.4 million of additional tax benefit.

Operating Expenses.

Research and Development Expenses. Research and development expenses increased as a percentage of net revenue to 16.8% from 11.3%, while the cost of research and development activities increased $6.5 million, or 40.8%, to $22.4 million for the three-month period ended December 31, 2009 compared with $15.9 million for the three-month period ended December 31, 2008. The increase in research and development expenses primarily reflected a $2.9 million increase in employee compensation costs from our annual merit adjustments, additional staffing, and employee benefits costs; a $2.6 million increase in share-based compensation costs; and a $783,00 increase in infrastructure and support costs. Non-cash share-based compensation costs included in research and development expenses were $4.6 million and $2.0 million for the three-month periods ended December 31, 2009 and 2008, respectively.

Research and development expenses increased as a percentage of net revenue from 12.3% to 16.8%, and the cost of research and development activities increased $10.7 million, or 33.6%, to $42.4 million for the six months ended December 31, 2009 compared with $31.7 million for the six months ended December 31, 2008. The increase in research and development expenses primarily reflected a $5.2 million increase in employee compensation costs from our annual merit adjustments, additional staffing, and employee benefits costs; a $3.5 million increase in share-based compensation costs; and a $1.9 million increase in infrastructure and support costs. Non-cash share-based compensation costs included in research and development expenses were $7.4 million and $4.0 million for the six

months ended December 31, 2009 and 2008, respectively.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses increased to $16.6 million for the three-month period ended December 31, 2009 compared with $13.7 million for the three-month period ended December 31, 2008. The increase in selling, general, and administrative expenses primarily reflected a $3.3 million increase in share-based compensation costs, a $547,000 increase in employee compensation costs from our annual merit adjustments, additional staffing, higher employee benefits costs, and greater recruiting costs; offset partially by a $873,000 decrease in professional service costs, primarily legal and audit costs, and a $512,000 decrease in consulting and contractor costs. Non-cash share-based compensation costs included in selling, general, and administrative expenses were $6.6 million and $3.3 million for the three-month periods ended December 31, 2009 and 2008, respectively.

Selling, general, and administrative expenses increased as a percentage of net revenue to 12.0% from 11.0%, while the cost of selling, general, and administrative activities increased $2.0 million, or 7.3%, to $30.3 million for the six months ended December 31, 2009 compared with $28.3 million for the six months ended December 31, 2008. The increase in selling, general, and administrative expenses primarily reflected a $3.7 million increase in share-based compensation costs, a $1.5 million increase in employee compensation costs from our annual merit adjustments, additional staffing, higher employee benefits costs, and greater recruiting costs; offset partially by a $2.0 million decrease in professional service costs, primarily legal and audit costs, and a $1.0 million decrease in consulting and contractor costs. Non-cash share-based compensation costs included in selling, general, and administrative expenses were $10.4 million and $6.7 million for the six months ended December 31, 2009 and 2008, respectively.

Income from Operations.

We generated operating income of $14.8 million, or 11.1% of net revenue, for the three months ended December 31, 2009 compared with approximately $28.2 million, or 19.9% of net revenue, for the three months ended December 31, 2008. The decrease in operating income primarily reflected the $9.4 million increase in operating expenses as well as a 40 basis point decrease in the gross margin percentage.

We generated operating income of $29.4 million, or 11.6% of net revenue, for the six months ended December 31, 2009 compared with $44.4 million, or 17.2% of net revenue, for the six months ended December 31, 2008. The decrease in operating income primarily reflected the $12.8 million increase in operating expenses as well as a 20 basis point reduction in the gross margin percentage.

Non-Operating Income/(Loss).

Interest Income. Interest income was $241,000 for the three-month period ended December 31, 2009 compared with $974 million for the three-month period ended December 31, 2008. Interest income was $572,000 for the six months ended December 31, 2009 compared with $2.2 million for the six months ended December 31, 2008. The decrease in interest income resulted from the combination of lower interest rates and lower average invested cash balances.

Interest Expense. All of our interest expense related to our Notes issued in December 2004. Interest expense was $1.0 million for the three months ended December 31, 2009, which included $838,000 non-cash charge for amortization of debt discount, compared with interest expense of $1.7 million for the three months ended December 31, 2008, which included a $1.4 million non-cash charge for amortization of debt discount.

Interest expense was $2.4 million for the six months ended December 31, 2009, which included a $2.0 million non-cash charge for amortization of debt discount, compared with interest expense of $4.3 million for the six months ended December 31, 2008, which included a $3.6 million non-cash charge for amortization of debt discount.

The non-cash charges for amortization of debt discount result from the retrospective application of a new accounting standard applicable to convertible debt that can be settled in cash. The remaining interest expense consists of coupon interest and amortization of debt issuance costs. All debt discount and debt issuance costs were fully amortized as of December 31, 2009.

Provision for Income Taxes.

The provision for income taxes of $1.9 million and $2.3 million for the three months ended December 31, 2009 and 2008, respectively, represented estimated federal, foreign, and state taxes. The effective tax rate for the three months ended December 31, 2009 was 13.2% and diverged from the combined federal and state statutory rate primarily because of increased foreign income taxed at lower tax rates, the benefit of research tax credits, the release

of unrecognized tax

benefits, the impact of the adjustment to share-based compensation expense, and the impact of tax-exempt interest income, partially offset by foreign withholding taxes, net unrecognized tax benefit associated with qualified stock options, the impairment of an investment for which a full valuation allowance was established, and the establishment of a valuation allowance on certain deferred tax assets. The effective tax rate for the three months ended December 31, 2008 was 11.3% and diverged from the combined federal and state statutory rate primarily as a result of increased foreign income taxed at lower tax rates, net recognized tax benefit associated with qualified stock options, the benefit of research tax credits, and the impact of tax-exempt interest income, partially offset by foreign withholding taxes, net unrecognized tax benefit associated with qualified stock options, and the impairment of an investment for which a valuation allowance was established.

Tax benefit associated with share-based compensation was approximately $3.1 million and $1.8 million for the three months ended December 31, 2009 and 2008, respectively. Excluding the impact of share-based compensation and the related tax benefit, the effective tax rate for the three months ended December 31, 2009 and 2008 would have been 19.0% and 15.8%, respectively.

The provision for income taxes of $5.1 million and $4.5 million for the six months ended December 31, 2009 and 2008, respectively, represented estimated federal, foreign, and state taxes. The effective tax rate for the six months ended December 31, 2009 was 18.8% and diverged from the combined federal and state statutory rate primarily because of increased foreign income taxed at lower tax rates, the benefit of research tax credits, the release of unrecognized tax benefits, and the impact of tax-exempt interest income, partially offset by foreign withholding taxes, net unrecognized tax benefit associated with qualified stock options, the impairment of an investment for which a full valuation allowance was established, and the establishment of a valuation allowance on certain deferred tax assets. The effective tax rate for the six months ended December 31, 2008 was 12.9% and diverged from the combined federal and state statutory rate primarily as a result of increased foreign income taxed at lower tax rates, net recognized tax benefit associated with qualified stock options, the benefit of research tax credits, and the impact of tax-exempt interest income, partially offset by foreign withholding taxes, net unrecognized tax benefit associated with qualified stock options, and the impairment of an investment for which a valuation allowance was established.

Tax benefit associated with share-based compensation was approximately $5.3 million and $3.7 million for the six months ended December 31, 2009 and 2008, respectively. Excluding the impact of share-based compensation and the related tax benefit, the effective tax rate for the six months ended December 31, 2009 and 2008 would have been 22.5% and 17.7%, respectively.

In May 2009, the Obama Administration announced several proposals to change the U.S. tax laws. It is unclear whether the proposals will be enacted or, if enacted, what the scope of the change in the laws will be. These proposals, if enacted, could adversely impact our effective tax rate, our operating results, and financial condition.

On November 6, 2009, President Obama signed into law the Worker, Homeowners, and Business Assistance Act of 2009, which provides for an extended carryback period from two years up to five years for net operating losses incurred in tax years beginning or ending in 2008 or 2009. We have reviewed the impact of this new law; we believe it will not affect our current effective tax rate as any carryback adjustments we expect to record will be recorded to additional paid-in capital in stockholders equity.

Liquidity and Capital Resources

Our cash, cash equivalents, and short-term investments, which excludes ARS investments, were $140.0 million as of December 31, 2009 compared with $192.0 million as of June 30, 2009, a decrease of $52.0 million. The decrease primarily reflected $63.0 million use for the retirement of debt, $44.5 million used for the repurchase of our common stock in the open market, and $4.2 million used for the purchase of capital equipment, partially offset by $55.6 million provided from operating cash flows and $4.2 million of proceeds from common stock issued under our share-based compensation plans.

Cash Flows from Operating Activities. Operating activities during the six months ended December 31, 2009 generated cash of approximately $55.6 million compared with approximately $42.0 million of cash generated during the six months ended December 31, 2008. For the six months ended December 31, 2009, net cash provided by operating activities was primarily attributable to net income of $22.0 million plus adjustments for non-cash charges of $23.9 million, in addition to a $9.7 million net increase in operating assets and liabilities. The net increase in operating assets and liabilities was primarily attributable to a $20.7 million increase in accounts payable primarily due to a favorable change in payment terms with certain suppliers, partially offset by a $15.6 million increase in accounts receivable, reflecting increased net revenue during the period. For the six months ended December 31, 2008, net cash provided by operating activities was primarily attributable to net income of $30.3 million plus adjustments for non-cash charges of $20.8 million, partially offset by a $9.1 million net decrease in operating assets and liabilities. The decrease in operating assets and liabilities was primarily attributable to a $12.3 million increase in accounts receivable, reflecting the substantial increase in net revenue during the period.

Cash Flows from Investing Activities. Our investing activities typically relate to purchases of government-backed securities and investment-grade fixed income instruments and purchases of property and equipment. Investing activities during the six months ended December 31, 2009 generated net cash of $19.8 million compared with $18.9 million of net cash generated during the six months ended December 31, 2008. During the six months ended December 31, 2009, net cash generated by investing activities consisted of $29.9 million in proceeds from sales and maturities of short-term and non current investments, partially offset by $6.0 million used for the purchase of short-term investments and $4.2 million used for the purchase of property and equipment. During the six months ended December 31, 2008, net cash generated by investing activities consisted of $35.8 million in proceeds from sales and maturities of short-term and non current investments, partially offset by $11.0 million used for the purchase of short-term investments and $5.8 million used for the purchase of property and equipment.

Cash Flows from Financing Activities. Net cash used in financing activities for the six months ended December 31, 2009 was approximately $104.4 million compared with net cash used in financing activities of $47.5 million for the six months ended December 31, 2008. Cash used in financing activities for the six months ended December 31, 2009 was primarily related to $63.0 million for the retirement of debt, $44.5 million for the purchase of our common stock in the open market, and $1.0 million used for the payment of payroll taxes for deferred stock units, partially offset by $4.2 million of proceeds from common stock issued under our share-based compensation plans. Cash used in financing activities for the six months ended December 31, 2008 consisted primarily of $55.7 million for the retirement of debt, $0.9 million used for the payment of payroll taxes for deferred stock units, partially offset by $6.2 million in proceeds from common stock issued under our share-based compensation plans, and $2.9 million from the excess tax benefit from share-based compensation.

Common Stock Repurchase Program. Our board of directors have cumulatively authorized $320 million for our common stock repurchase program. The program authorizes us to purchase our common stock in the open market or in privately negotiated transactions depending upon market conditions and other factors. The number of shares repurchased and the timing of repurchases is based on the level of our cash balances, general business and market conditions, and other factors, including alternative investment opportunities. Common stock repurchased under this program is held as treasury stock. From April 2005 through December 31, 2009, we repurchased 10,871,313 shares of our common stock in the open market for an aggregate cost of $281.9 million. Of our treasury stock, 9,088,100 shares were repurchased prior to the August 29, 2008 and were not subject to the 3-for-2 stock split. As of December 31, 2009, we had $38.1 million remaining under our common stock repurchase program, which expires in July 2010.

Bank Credit Facility. We currently maintain a $30.0 million working capital line of credit with Wells Fargo Bank. The Wells Fargo Bank revolving line of credit, which expires on July 1, 2010, provides for an interest rate equal to the prime lending rate or 250 basis points above LIBOR, depending on whether we choose a variable or fixed rate, respectively. We had not borrowed any amounts under the line of credit as of December 31, 2009.

Convertible Senior Subordinated Notes. In December 2004, we issued an aggregate of $125 million of Notes maturing December 1, 2024 (the Notes) in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended. In connection with issuing the Notes, we incurred debt issuance costs of $4.3 million, consisting primarily of the initial purchasers discount and costs related to legal, accounting, and printing. We have purchased and retired $122.7 million of the Notes. The remaining $2.3 million of Notes outstanding as of December 31, 2009 have been classified as long-term as the next date Noteholders can require us to repurchase all or a portion of the Notes is beyond one year.

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

$100 Million Shelf Registration. We have registered an aggregate of $100 million of common stock and preferred stock for issuance in connection with acquisitions, which shares generally will be freely tradeable after their issuance under Rule 145 of the Securities Act unless held by an affiliate of the acquired company, in which case such shares will be subject to the volume and manner of sale restrictions of Rule 144.

Liquidity and Capital Resources. We believe our existing cash, cash equivalents, and short-term investment balances and anticipated cash flows from operating activities will be sufficient to meet our working capital and other cash requirements over the course of at least the next 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth or decline, the timing and extent of spending to support product development efforts, costs related to protecting our intellectual property, the expansion of sales and marketing activities, the timing of introductions of new products and enhancements to existing products, the costs to ensure access to adequate manufacturing capacity, the continuing market acceptance of our product solutions, our common stock purchase program, the retirement of our Notes, and the amount and timing of our investments in, or acquisitions of, other technologies or companies. Further equity or debt financing may not be available to us on acceptable terms or at all. If sufficient funds are not available or are not available on acceptable terms, our ability to take advantage of unexpected business opportunities or to respond to competitive pressures could be limited or severely constrained.

Our non-current investments consist of ARS investments, which have failed to settle in auctions. These failures generally resulted in the interest rates resetting on the regularly scheduled auction dates. These investments are not liquid, and in the event we need to access these funds, we will not be able to do so without a loss of principal, unless redeemed by the issuers or a future auction on these investments is successful. At December 31, 2009, the fair value of our ARS investments was $29.0 million and had an original cost basis of $41.5 million. In the first six months of 2010, $1.0 million of our ARS investments were redeemed at par and we recognized a gain of $6,000 on the redemption, which was included in impairment of investments, net on the accompanying consolidated statements of income. In connection with our fair value analysis for the six months ended December 31, 2009, we recorded a 449,000 other-than-temporary impairment charge.

Based on our ability to access our cash and other short-term investments, our expected operating cash flows, and our other sources of cash, we do not anticipate the lack of liquidity on these investments will affect our ability to operate our business as usual.

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Contractual Obligations and Commercial Commitments

The following table sets forth a summary of our material contractual obligations and commercial commitments as of December 31, 2009 (in millions):

	Payments due by period				
Contractual Obligations	Total	Less than 1 year	1-3 Years	3-5 Years	More than 5 Years
Convertible senior subordinated notes (1) (2)	$ 3	$	$	$	$ 3
Leases and other commitments	13	8	4	1	
Total	$ 16	$ 8	$ 4	$ 1	$ 3

(1) Represents both principal and interest payable through the maturity date of the underlying contractual obligation.

(2) The Notes include a provision allowing the Noteholders to require us, at the Noteholders discretion, to repurchase their Notes at a redemption price of 100% of the principal amount of the Notes plus accrued and unpaid interest (including contingent interest and additional interest, if any) on December 1, 2014, and December 1, 2019. The early

repayment of the notes is not reflected in the above schedule, but if all the Noteholders exercised their rights to require us to repurchase their Notes on December 1, 2014, then our contractual obligations for the 3-5 year period would be $2.0 million and no amounts would be due in subsequent periods.

As of December 31, 2009, we were unable to make a reasonably reliable estimate of when cash settlement with a taxing authority may occur in connection with our unrecognized tax benefits of $18.4 million.

Recent Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162 (the Codification). The Codification, which was launched on July 1, 2009, became the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF), and related literature. The Codification eliminates the GAAP hierarchy contained in SFAS No. 162 and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We adopted the Codification in our quarter ended September 30, 2009.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (ASC Topic 820) Improving Disclosures About Fair Value Measurements. The ASU requires new disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. The new disclosures and clarifications of existing disclosures are effective for our third quarter of fiscal 2010, except for the disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements, which are effective for our first quarter of fiscal 2012. Other than requiring additional disclosures, the adoption of this new guidance will not have a material impact on our consolidated financial position, results of operations, or cash flows.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risk has not changed significantly from the interest rate and foreign currency risks disclosed in Item 7A of our Annual Report on Form 10-K for the fiscal year ended June 30, 2009.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures, which included inquiries made to certain other of our employees. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have each concluded that our disclosure controls and procedures are designed and are effective to ensure that information required to be disclosed is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure and are

effective and sufficient to ensure that we record, process, summarize, and report information required to be disclosed by us in our periodic reports filed under the Securities Exchange Act within the time periods specified by the Securities and Exchange Commission s rules and forms.

During the fiscal quarter covered by this report, there have not been any changes in our internal control over financial reporting that have materially affected, or a reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

Our board of directors has cumulatively authorized $320 million for our common stock repurchase program. The remaining amount authorized for the repurchase of our common stock is $38.1 million. Repurchases under the stock repurchase program during the three-month period ended December 31, 2009 were as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program
September 27, 2009 - October 24, 2009				$ 57,142,000
October 25, 2009 - November 21, 2009	751,113	$ 24.35	751,113	$ 38,889,000
November 22, 2009 - December 26, 2009	32,100	$ 25.57	32,100	$ 38,068,000
Total	783,213	$ 24.35		

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

Our 2009 Annual Meeting of Stockholders was held on October 20, 2009 for the purpose of electing three directors to serve for three-year terms expiring in 2012 and to ratify the appointment of KPMG LLP, an independent registered public accounting firm, as the independent auditor of our company for the fiscal year ending June 26, 2010.

The following nominees were elected to our board of directors to serve for a three-year term expiring 2012 as set forth in the Proxy Statement:

Nominee	Votes in Favor	Withheld
Jeffrey D. Buchanan	28,860,441	345,731
Keith B. Geeslin	27,674,922	1,531,250
James L. Whims	27,893,768	1,312,404

The following directors terms of office continued after the 2009 Annual Meeting of Stockholders: Francis F. Lee, Thomas J. Tiernan, Nelson C. Chan, and Richard L. Sanquini.

Additionally, ratification of the appointment of KPMG LLP, an independent registered public accounting firm, as the independent auditor of our company for the fiscal year ending June 26, 2010 was voted upon and approved by our stockholders as follows:

Votes in Favor	Votes Against	Abstain	Broker Non-Votes
28,704,983	456,786	44,401	

ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer

31.2 Certification of Chief Financial Officer

32.1 Section 1350 Certification of Chief Executive Officer

32.2 Section 1350 Certification of Chief Financial Officer

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SYNAPTICS INCORPORATED

Date: February 2, 2010

By: /s/ Thomas J. Tiernan
Name: Thomas J. Tiernan
Title: President and Chief Executive Officer

By: /s/ Kathleen A. Bayless
Name: Kathleen A. Bayless
Title: Chief Financial Officer, Secretary, and Treasurer

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