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

FORM 10-Q

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

For the quarterly period ended March 25, 2006

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., Suite 130
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 ☑ No ☐

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

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

Number of shares of Common Stock outstanding at April 28, 2006: 25,008,099

SYNAPTICS INCORPORATED
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2006

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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)

	March 31, 2006	June 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 57,254	$ 72,232
Short-term investments	180,214	156,689
Accounts receivable, net of allowances of $189 and $165, respectively	29,720	33,790
Inventories	10,646	7,731
Prepaid expenses and other current assets	3,692	3,046
Total current assets	281,526	273,488
Property and equipment, net	15,786	14,615
Goodwill	1,927	1,927
Other assets	23,819	21,175
	$ 323,058	$ 311,205
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 14,007	$ 12,390
Accrued compensation	4,889	5,638
Income taxes payable	11,489	14,867
Other accrued liabilities	5,483	5,353
Total current liabilities	35,868	38,248
Note payable to a related party	1,500	1,500
Other liabilities	1,888	1,797
Convertible senior subordinated notes	125,000	125,000
Stockholders' equity:		
Common stock:		
$0.001 par value; 60,000,000 shares authorized; 27,212,044 and 26,419,447 shares issued, respectively	27	26
Additional paid-in capital	127,629	106,686
Less: 2,306,100 and 1,139,000 common treasury shares at March 31, 2006 and June 30, 2005, respectively, at cost	(39,999)	(21,180)
Deferred stock compensation	—	(303)
Accumulated other comprehensive loss	(353)	(129)
Retained earnings	71,498	59,560
Total stockholders' equity	158,802	144,660
	$ 323,058	$ 311,205

See notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
Net revenue	$ 40,365	$ 56,668	$ 140,645	$ 151,302
Cost of revenue (1)(2)	22,257	30,481	76,694	81,535
Gross margin	18,108	26,187	63,951	69,767
Operating expenses:				
Research and development (1)(2)	9,106	6,157	25,740	18,448
Selling, general, and administrative (1)(2)	6,952	4,937	20,593	13,091
Amortization of deferred stock compensation	—	71	—	258
Total operating expenses	16,058	11,165	46,333	31,797
Income from operations	2,050	15,022	17,618	37,970
Interest income	2,179	1,118	5,631	1,783
Interest expense	(485)	(483)	(1,454)	(660)
Income before provision for income taxes	3,744	15,657	21,795	39,093
Provision for income taxes	2,121	3,983	9,857	13,264
Net income	$ 1,623	$ 11,674	$ 11,938	$ 25,829
Net income per share:				
Basic	$ 0.07	$ 0.44	$ 0.49	$ 1.00
Diluted	$ 0.06	$ 0.38	$ 0.44	$ 0.88
Shares used in computing net income per share:				
Basic	24,737	26,315	24,602	25,743
Diluted	29,201	31,464	29,002	29,588

(1) Amounts include share-based compensation costs as follows:

Cost of revenue	$ 145	$—	$ 525	$—
Research and development	$1,165	$—	$3,700	$—
Selling, general, and administrative	$1,967	$—	$5,752	$—

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

Cost of revenue	$—	$ 3	$—	$ 10
Research and development	$—	$—	$—	$ 8
Selling, general, and administrative	$—	$68	$—	$240

See notes to condensed consolidated financial statements.

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

	Nine Months Ended March 31,	
	2006	**2005**
Cash flows from operating activities		
Net income	$ 11,938	$ 25,829
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation costs	9,977	—
Deferred taxes from share-based compensation	(1,964)	—
Tax benefit realized from stock options	4,717	8,940
Excess tax benefit from share-based compensation	(3,962)	—
Depreciation of property and equipment	1,208	745
Amortization of debt issuance costs	645	272
Amortization of deferred stock compensation	—	258
Changes in operating assets and liabilities:		
Accounts receivable, net	4,070	(10,557)
Inventories	(2,915)	(4,306)
Prepaid expenses and other current assets	(646)	189
Other assets	(1,325)	(10,334)
Accounts payable	1,617	1,822
Accrued compensation	(749)	(420)
Income taxes payable	(3,378)	5,163
Other accrued liabilities	130	1,105
Other liabilities	91	19
Net cash provided by operating activities	19,454	18,725
Cash flows from investing activities		
Purchases of short-term investments	(188,081)	(146,810)
Proceeds from sales and maturities of short-term investments	164,332	76,971
Purchases of property and equipment	(2,379)	(11,303)
Net cash used in investing activities	(26,128)	(81,142)
Cash flows from financing activities		
Payments on capital leases and equipment financing obligations	—	(28)
Proceeds from issuance of convertible senior subordinated notes	—	125,000
Debt issuance costs	—	(4,310)
Purchase of treasury stock	(18,819)	—
Proceeds from issuance of common stock upon exercise of options and stock purchase plan	6,553	8,215
Excess tax benefit from share-based compensation	3,962	—
Net cash (used in) provided by financing activities	(8,304)	128,877
Net increase (decrease) in cash and cash equivalents	(14,978)	66,460
Cash and cash equivalents at beginning of period	72,232	59,489
Cash and cash equivalents at end of period	$ 57,254	$ 125,949
Supplemental disclosures of cash flow information		
Cash paid for interest	$ 469	$ —
Cash paid for income taxes	$ 11,494	$ 9,595

See notes to condensed consolidated financial statements.

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, 2005.

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. Fiscal years 2006 and 2005 are 52-week periods. For ease of presentation, the accompanying consolidated financial statements have been shown as ending on June 30 and calendar quarter end dates for all annual, interim, and quarterly financial statement captions, unless otherwise indicated.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, cost of revenue, inventories, product warranty, share-based compensation costs, 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.

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 collectibility 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 the services are provided 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 reasonably assured.

3. Net Income Per Share

Basic net income per share amounts for each period presented have been computed using the weighted average number of shares of common stock outstanding. Diluted net income per share amounts for each period presented have been computed (1) using the weighted average number of potentially dilutive shares issuable in connection with stock options under the treasury stock method, and (2) using the weighted average number of shares issuable in connection with convertible debt under the if-converted method, when dilutive.

The following table presents the computation of basic and diluted net income per share (in thousands, except per share amounts):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
Numerator:				
Basic net income	$ 1,623	$ 11,674	$ 11,938	$ 25,829
Interest expense and amortization of debt issuance costs on convertible notes (net of tax)	266	266	798	335
Diluted net income	$ 1,889	$ 11,940	$ 12,736	$ 26,164
Denominator:				
Shares, basic	24,737	26,315	24,602	25,743
Effect of dilutive share-based awards	1,990	2,675	1,926	2,857
Effect of convertible notes	2,474	2,474	2,474	988
Shares, diluted	29,201	31,464	29,002	29,588
Net income per share:				
Basic	$ 0.07	$ 0.44	$ 0.49	$ 1.00
Diluted	$ 0.06	$ 0.38	$ 0.44	$ 0.88

Options to purchase 1,895,999, 328,978, 2,034,030, and 109,659 shares of common stock that were outstanding during the three months ended March 31, 2006 and 2005 and the nine months ended March 31, 2006 and 2005, respectively, were not included in the computation of diluted net income per share. These options were not included in the computation of diluted net income per share because the exercise prices of such options 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 and Short-Term 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" under Statement of Financial Accounting Standards ("SFAS") 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"). Such securities are reported at fair value, with unrealized gains and losses, net of taxes, excluded from earnings and shown separately as a component of accumulated other comprehensive income within stockholders' equity. Interest earned on marketable securities is included in interest income. Realized gains and losses on the sale of marketable securities are determined using the specific identification method.

5. 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):

	March 31, 2006	June 30, 2005
Raw materials	$ 10,327	$ 7,618
Finished goods	319	113
	$ 10,646	$ 7,731

Periodically, we purchase inventory from our contract manufacturers when a customer's delivery schedule is delayed or a customer's order is cancelled. 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. Write-downs to reduce the carrying value of obsolete, slow moving, and non-usable inventory to net realizable value are charged to cost of revenue.

6. Goodwill

As of March 31, 2006 and June 30, 2005, the carrying value of goodwill was $1,927,000. We review the carrying value of goodwill at least annually for impairment as of the fiscal year end balance sheet date. Based on our latest review, we determined that there was no impairment of carrying value.

7. Product Warranties and Indemnifications

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.

Changes in our accrued warranty liability (included in other accrued liabilities) for the nine-month periods ended March 31, 2006 and 2005 were as follows (in thousands):

	Nine Months Ended March 31,	
	2006	2005
Beginning accrued warranty	$ 369	$ 704
Provision for product warranties	609	390
Cost of warranty claims and settlements	(665)	(789)
Ending accrued warranty	$ 313	$ 305

Certain third party agreements obligate us 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 maximum stated liabilities. 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.

8. Convertible Senior Subordinated Notes

During December 2004, we issued $125 million of 0.75% Convertible Senior Subordinated Notes maturing on December 1, 2024 (the “Notes”) in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended. The Notes bear interest at a rate of 0.75% per annum payable on December 1 and June 1 of each year. We will pay additional contingent interest on the Notes if the average trading price of the Notes is at or above 120% of the principal amount of the Notes for a specified period beginning with the six-month period commencing December 1, 2009. The amount of contingent interest payable on the Notes with respect to a six month period, for which contingent interest applies, will equal 0.375% per annum of the average trading price of the Notes for a specified five trading-day period preceding such six month period.

The Notes are convertible into 2,473,975 shares of our common stock, subject to adjustment in certain events. The denominator of the diluted net income per share calculation includes the weighted average effect of the 2,473,975 shares of common stock issuable upon conversion of the Notes. Through November 30, 2009, upon the occurrence of a fundamental change as defined in the indenture governing the Notes, we could potentially be obligated to issue up to 989,587 additional shares, or a total of 3,463,562 shares of common stock. These additional shares, contingently issuable upon a fundamental change, are not included in the calculation of diluted net income per share.

The Notes may be converted (1) if, during any calendar quarter commencing after December 31, 2004, the last reported sale price of our common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is greater than or equal to 120% of the applicable conversion price on such last trading day; (2) on or after January 1, 2020; (3) if we have called the Notes for redemption; or (4) during prescribed periods, upon the occurrence of specified corporate transactions or fundamental changes. On or after December 1, 2009, we may redeem for cash all or a portion of the 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). Noteholders have the right to require us to repurchase all or a portion of their Notes for cash on December 1, 2009, December 1, 2014, and December 1, 2019 at a price equal to 100% of the principal amount of the Notes to be purchased plus accrued and unpaid interest (including contingent interest and additional interest, if any). Upon

conversion of the Notes, in lieu of delivering common stock, we may, at our discretion, deliver cash or a combination of cash and common stock. As of March 31, 2006, none of the conditions for conversion or redemption of the Notes were satisfied.

The Notes are unsecured senior subordinated obligations and rank junior in right of payment to all of our existing and future senior indebtedness, equal in right of payment with all of our existing and future indebtedness or other obligations that are not, by their terms, either senior or subordinated to the Notes, including trade debt and other general unsecured obligations that do not constitute senior or subordinated indebtedness, and senior in right of payment to all of our future indebtedness that, by its terms, is subordinated to the Notes. There are no financial covenants in the Notes.

Interest expense includes the amortization of debt issuance costs. We recorded interest expense of $449,000 and $1.3 million on the Notes during the three and nine months ended March 31, 2006, respectively, and interest expense of $449,000 and $566,000 on the Notes during the three and nine months ended March 31, 2005, respectively. The fair value of the Notes as of March 31, 2006 was approximately $102.7 million based on trade activity.

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 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 currently consist of our 1996 Stock Option Plan, our 2000 Nonstatutory Stock Option Plan, our 2001 Incentive Compensation Plan, and our 2001 Employee Stock Purchase Plan.

Share-based compensation awards available for grant or issuance for each plan as of the beginning of the fiscal year, including changes in the balance of awards available for grant during the nine months ended March 31, 2006, are as follows:

	Total Awards Available Under All Share-Based Award Plans	1996 Stock Option Plan	2000 Nonstatutory Stock Option Plan	2001 Incentive Compensation Plan	2001 Employee Stock Purchase Plan
Balance at June 30, 2005	3,271,529	224,881	35,667	2,304,590	706,391
Additional shares authorized	1,109,737	—	—	1,109,737	—
Stock options granted	(1,305,934)	—	—	(1,305,934)	—
Deferred stock units granted	(30,710)	—	—	(30,710)	—
Purchases under employee stock purchase plan	(93,020)	—	—	—	(93,020)
Forfeited	215,787	1,334	1,917	212,536	—
Balance at March 31, 2006	3,167,389	226,215	37,584	2,290,219	613,371

At the beginning of fiscal year 2006, we adopted SFAS 123R, “Share-Based Payment” (“SFAS 123R”), and applied the provisions of Staff Accounting Bulletin No. 107, “Share-Based Payment,” to our existing share-based compensation plans in accordance with the modified prospective transition method. Previously, we followed Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees,” and related interpretations in accounting for employee share-based compensation, as permitted by SFAS 123, “Accounting for Stock-Based Compensation,” (“SFAS 123”), and we did not recognize compensation expense for stock option grants to employees and directors with an exercise price equal to the fair market value of the shares at the date of grant. Accordingly, no share-based compensation costs based on grant date fair value are included in our consolidated statements of income for any period presented in the accompanying condensed consolidated financial statements prior to fiscal year 2006.

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 volatility were used in estimating the fair value of our share-based

awards, while the expected life of our options was estimated to be five years based on historical trends since our initial public offering. Further, as required under SFAS 123R, we now estimate forfeitures for share-based awards that are not expected to vest. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. The estimated fair value is charged to earnings on a straight-line basis over the vesting period of the underlying awards, which is generally four years for our stock option and deferred stock unit awards 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.

Awards of stock options granted to consultants under our share-based compensation plans are accounted for at fair value determined by using the Black-Scholes option pricing model in accordance with Emerging Issues Task Force Issue No. 96-18, “Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or In Conjunction with Selling, Goods or Services.” These awards are subject to periodic revaluation over their vesting term, if any. The assumptions used to value share-based awards to consultants are similar to those used for employees, except that we use the contractual life of the award rather than the expected life.

In accordance with SFAS 123R, we recognize tax benefit upon expensing certain share-based awards associated with our share-based compensation plans, including nonqualified stock options and deferred stock unit awards, but under current accounting standards we cannot recognize tax benefit currently for those 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 our adoption of SFAS 123R, we recognize tax benefit only in the period when disqualifying dispositions of the underlying stock occur, and for qualified stock options that vested prior to our adoption of SFAS 123R, the tax benefit is recorded directly to additional paid-in capital. For the nine months ended March 31, 2006, we realized tax benefit from non-qualified stock option exercises and disqualifying dispositions of qualified stock options totaling $4.9 million, of which $150,000 of the tax benefit was recognized as a reduction of the provision for income taxes, $71,000 reduced deferred tax assets established after our adoption of SFAS 123R, and the remaining tax benefit was recorded directly to additional paid-in capital.

The impact of adopting SFAS 123R on our pre-tax income, net income, and basic and diluted net income per share for the three and nine months ended March 31, 2006 is summarized in the following table (in thousands):

	Three Months Ended March 31, 2006		Nine Months Ended March 31, 2006	
	Intrinsic Value Method	Fair Value Method	Intrinsic Value Method	Fair Value Method
Income before provison for income taxes	$ 7,014	$ 3,744	$31,626	$21,795
Net Income	4,125	1,623	19,644	11,938
Net Income per share — basic	0.17	0.07	0.80	0.49
Net Income per share — diluted	0.15	0.06	0.70	0.44

Application of SFAS 123R had no impact on our cash position, but did result in a change in presentation on our consolidated statements of cash flows. Actual tax benefit related to the tax deduction for nonqualified stock option exercises and disqualifying dispositions of qualified stock options that exceeded their respective grant date fair values resulted in excess tax benefit of $4.0 million for the nine months ended March 31, 2006, which was deducted from cash flows from operating activities and added to cash flows from financing activities in the consolidated statements of cash flows.

Historically, we have issued new shares in connection with our share-based compensation plans; however, 2.3 million treasury shares are also available for issuance. Our board has authorized an expansion of our stock repurchase program to repurchase up to an additional $40 million of our common stock through October 2007 and any shares repurchased under the expanded stock repurchase program would be available for issuance.

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Deferred Stock Units

Our 2001 Incentive Compensation Plan ("2001 Plan") provides for the grant of deferred stock unit awards ("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. We began granting DSU awards in January 2006.

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 2% each month thereafter until fully vested at the end of 48 months from the vesting commencement date. Delivery of shares under the plan takes place quarterly for all DSUs vested as of the scheduled delivery dates. Until delivery of shares, the grantee has no rights as a stockholder.

An election to defer delivery of the underlying shares for unvested DSU awards 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.

The following table summarizes outstanding DSUs, including DSUs granted, delivered, and forfeited during the nine months ended March 31, 2006:

	Deferred Stock Unit Awards Outstanding	Aggregate Intrinsic Value (in thousands)
Balance at June 30, 2005	—	
Deferred stock units granted	30,710	
Shares delivered	—	
Forfeited	—	
Balance at March 31, 2006	30,710	$ 688

Unrecognized share-based compensation costs for DSUs granted under the 2001 Plan are approximately $900,000 as of March 31, 2006, to be recognized over a weighted average period of approximately four years.

Stock Options

Our current share-based compensation plans that provide for the grant of stock options include our 1996 Stock Option Plan, our 2000 Nonstatutory Stock Option Plan, and our 2001 Incentive Compensation Plan ("the Plans"). Under the Plans, employees, consultants, and directors may be granted incentive stock options or nonqualified stock options to purchase shares of our common stock at not less than 100% or 85% of the fair value, respectively, on the date of grant.

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.

In October 2002, we granted 200,000 options to a consultant that at the time were to vest over four years; however, in December 2002 we hired the consultant as an employee. In accordance with FIN 44, "Accounting for Certain Transactions Involving Stock Compensation," we remeasured the intrinsic value of the option grant on the date the consultant became an employee and recorded deferred stock compensation that we were amortizing over the remaining vesting period of the options. With the adoption of SFAS 123R, we ceased amortizing deferred stock compensation, reclassified the remaining balance of deferred stock compensation on our balance sheet to additional paid-in capital, and began expensing the remaining fair value, as previously determined under SFAS 123, of the underlying options over their remaining vesting periods.

In August 2002, our board approved an option regrant offer to several employees who had received option grants under the 2001 Incentive Compensation Plan having option exercise prices of $12.98 and $18.70. The option exercise prices were substantially higher than the price of our stock at the time of the regrant offer. Under the terms of

the regrant, the employees were allowed to elect to have their option cancelled and in consideration thereof to receive a new option for the same number of shares as cancelled six months and one day after the date of cancellation. On March 3, 2003, new options to acquire a total of 106,500 shares were granted pursuant to the regrant offer with a new exercise price of $6.56 per share. The vesting period and schedule for the new options remained the same as the vesting period and schedule of the cancelled options.

The following table summarizes stock option activity and weighted average exercise prices for the nine months ended March 31, 2006, weighted average exercise prices, options exercisable, weighted average remaining contractual life, and aggregate intrinsic value as of March 31, 2006:

	Stock Option Awards Outstanding	Weighted Average Exercise Price	Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Balance at June 30, 2005	5,426,266	$ 10.94		
Stock options granted	1,305,934	$ 23.01		
Exercised	(699,577)	$ 7.02		
Forfeited	(215,787)	$ 15.99		
Balance at March 31, 2006	5,816,836	$ 13.93	7.1	$ 54,873
Exercisable	3,150,397	$ 8.39	5.8	$ 45,199

The following table summarizes cash received and the aggregate intrinsic value for stock options exercised during the nine months ended March 31, 2006 and 2005 (in thousands):

	Nine Months Ended March 31,	
	2006	2005
Cash received	$ 4,908	$ 6,824
Aggregate intrinsic value	$13,393	$28,312

The fair value of each award granted from our Plans during the nine months ended March 31, 2006 was estimated at the date of grant using the Black-Scholes option pricing model, assuming no expected dividends and the following assumptions:

Expected volatility	72.1% - 73.9%
Expected life in years	5.0
Risk-free interest rate	4.1% - 4.4%
Fair value per award	$12.38-$19.14

The expected volatility is based on historical volatility; the expected life is based on historical option exercise trends; and the risk free interest rate is based on U. S. Treasury yields in effect at the time of grant for the expected life of the option.

Unrecognized share-based compensation costs for stock options granted under the Plans are approximately $28.9 million as of March 31, 2006, to be recognized over a weighted average period of approximately three years.

Employee Stock Purchase Plan

Our 2001 Employee Stock Purchase Plan ("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 shares purchased, weighted average purchase price, cash received, and the aggregate intrinsic value for ESPP purchases during the nine months ended March 31, 2006 and 2005 (in thousands, except for shares purchased and weighted average purchase price):

	Nine Months Ended March 31,	
	2006	2005
Shares purchased	93,020	198,251
Weighted average purchase price	$ 17.69	$ 7.02
Cash received	$ 1,645	$ 1,391
Aggregate intrinsic value	$ 488	$ 3,636

There were no ESPP shares purchased during the three months ended March 31, 2006 and 2005.

Under the terms of our ESPP, the offering period that commenced on January 1, 2005 was terminated on June 30, 2005 and a new offering period commenced on July 1, 2005. In accordance with Technical Bulletin No. FTB 97-1, “Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option,” the early termination of an offering period followed by the commencement of a new offering period represents a modification to the terms of the related awards. This modification affected 169 employees participating in the ESPP as of June 30, 2005 and resulted in incremental compensation costs, net of estimated forfeitures, that will be recognized on a straight-line basis over the two-year period ending June 30, 2007.

The fair value of each award granted under our ESPP during the nine months ended March 31, 2006 was estimated using the Black-Scholes option pricing model, assuming no expected dividends and the following weighted average assumptions:

Expected volatility	49.3% - 75.7%
Expected life in years	0.5 - 2.0
Risk-free interest rate	3.3% - 4.4%
Fair value per award	$ 7.40-$11.86

The expected volatility is based on implied and historical volatility; the expected life is based on each period that begins with the enrollment date until each purchase date remaining in the offering period at the date of enrollment in the plan; and the risk free interest rate is based on U. S. Treasury yields or yield curve in effect for each expected life.

Unrecognized share-based compensation costs for awards granted under our ESPP are approximately $1.5 million as of March 31, 2006, to be recognized over a weighted average period of approximately one year.

Pre-SFAS 123R Pro Forma Accounting Disclosures

The fair value of each share-based award granted during the three and nine months ended March 31, 2005 was estimated at the date of grant using the Black-Scholes option pricing model, assuming no expected dividends and the following weighted average assumptions:

	Three Months Ended March 31, 2005	
	Stock Options	Employee Stock Purchase Plan
Expected volatility	74.3%	57.5%
Expected life in years	5	1.2
Risk-free interest rate	3.7%	2.9%
Fair value per award	$ 19.07	$ 11.83

	Nine Months Ended March 31, 2005	
	Stock Options	Employee Stock Purchase Plan
Expected volatility	67.8%	58.9%
Expected life in years	5	1.0
Risk-free interest rate	3.5%	2.6%
Fair value per award	$ 13.76	$ 10.31

During the three and nine months ended March 31, 2005, had compensation expense for stock options been determined based on the fair value of the options at dates of grant consistent with the provisions of SFAS 123, net income and net income per share would have been reduced to the pro forma amounts indicated in the following table (in thousands, except per share amounts):

	Three Months Ended March 31, 2005	Nine Months Ended March 31, 2005
Net income — as reported	$ 11,674	$ 25,829
Add: Total stock-based compensation included in reported net income, net of tax	53	170
Deduct: Total stock-based compensation determined under fair value based method for all awards, net of tax	(2,039)	(4,683)
Net income — pro forma	$ 9,688	$ 21,316
Net income per share — basic:		
As reported	$ 0.44	$ 1.00
Pro forma	$ 0.37	$ 0.83
Net income per share — diluted:		
As reported	$ 0.38	$ 0.88
Pro forma	$ 0.32	$ 0.73

10. Income Taxes

We account for income tax contingencies in accordance with SFAS No. 5, “Accounting for Contingencies.” Accordingly, our tax rate may be favorably or unfavorably affected by the release or establishment, respectively, of tax contingency reserves related to tax uncertainties.

In accordance with SFAS 123R, we recognize tax benefit upon expensing certain share-based awards associated with our share-based compensation plans, including nonqualified stock options and deferred stock unit awards, but under current accounting standards we cannot recognize tax benefit currently for those 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 our adoption of SFAS 123R, we recognize tax benefit only in the period when disqualifying dispositions of the underlying stock occur, and for qualified stock options that vested prior to our adoption of SFAS 123R, the tax benefit is recorded directly to additional paid-in capital. For the three and nine months ended March 31, 2006, the effective tax rate was negatively affected by the impact of accounting required for share-based compensation as determined in accordance with SFAS 123R.

On October 22, 2004, the American Jobs Creation Act of 2004 (the "Act") was signed into law. The Act creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations, resulting in an approximate 5.25% federal tax rate on the repatriated earnings. To qualify for the deduction, the earnings must be reinvested in the United States pursuant to a domestic reinvestment plan established by our chief executive officer and approved by our board of directors. Certain other criteria in the Act must be satisfied as well. We have until the end of this fiscal year to make a qualifying repatriation of foreign earnings, and are currently evaluating whether we will repatriate foreign earnings under the provisions of the Act. Our estimate of the amount we may repatriate under the Act ranges from $0 to $42 million. If we do repatriate earnings under the provisions of the Act, our effective tax rate for the last quarter of this fiscal year could be materially adversely affected.

11. Segment, Customers, and Geographic Information

We operate in one segment: the development, marketing, and sale of interactive user interface solutions for electronic devices and products. We generate our revenue from two broad product categories: personal computer ("PC") applications, primarily notebook computers, and non-PC information appliance applications. PC applications accounted for 90% and 52% of net revenue for the three months ended March 31, 2006 and 2005, respectively, and 84% and 58% of net revenue for the nine months ended March 31, 2006 and 2005, 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 March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
China	$ 30,951	$ 39,882	$ 106,268	$ 112,401
Singapore	1,626	7,151	3,903	12,056
Taiwan	4,124	5,374	18,784	17,431
Other	3,664	4,261	11,690	9,414
	$ 40,365	$ 56,668	$ 140,645	$ 151,302

Major customer net revenue data as a percentage of net revenue:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
Customer A	*	33%	16%	35%
Customer B	*	13%	*	*
Customer C	15%	*	*	*
Customer D	11%	*	*	*

Major customer accounts receivable as a percentage of accounts receivable:

	As of March 31, 2006	As of June 30, 2005
Customer A	12%	41%
Customer B	11%	*
Customer C	*	12%

* Less than 10%

12. Comprehensive Income

Our comprehensive income consists of net income plus the effect of unrealized gains and losses from short-term investments at fair value, which were not material for the three or nine months ended March 31, 2006 and 2005. Accordingly, comprehensive income closely approximated net income.

13. Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board issued SFAS No. 154, "Accounting Changes and Error Corrections," ("SFAS 154"). SFAS 154, which replaces APB Opinion No. 20, "Accounting Changes," ("APB 20") and SFAS No. 3 "Reporting Accounting Changes in Interim Financial Statements," applies to all voluntary changes in accounting principle and changes the requirements for accounting for and reporting of a change in accounting principle. APB 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of change a cumulative effect of changing to the new accounting principle, while SFAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle, unless it is impracticable. SFAS 154 enhances the consistency of financial information between periods. SFAS 154 will be effective beginning the first quarter of our fiscal 2007. We do not expect the adoption of SFAS 154 will have a material impact on our financial position, results of operations, or cash flows.

14. Subsequent Events

On April 6, 2006, we filed an Answer to Complaint and Counterclaims against Elantech Devices Corporation in response to their filing of a Complaint for Patent Infringement against us on March 10, 2006. Their complaint seeks damages, attorney fees, and a permanent injunction in connection with one of their patents, and our counterclaim seeks damages, attorney fees, and a permanent injunction in connection with four of our patents. We intend to vigorously defend our patents and pursue our counterclaims.

  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, 2005.

In addition to the historical information contained in this report, this report contains forward-looking statements, including those related to market penetration and market share in the notebook, iAppliance, and other electronic devices markets; competition in the notebook, iAppliance, and other electronic devices markets; revenue from the notebook, iAppliance, and other electronic devices markets; growth rates of these markets; average selling prices; product mix; manufacturing costs; cost-improvement programs; gross margins; customer relationships; research and development expenses; selling, general, and administrative expenses; legal proceedings; and liquidity and anticipated cash requirements. 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: 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, 2005, including particularly the section captioned "Business – Risk Factors."

Overview

We are a leading worldwide developer and supplier of custom-designed user interface solutions that enable people to interact more easily and intuitively with a wide variety of mobile computing, entertainment, communications, and other electronic devices. From our inception in 1986 through fiscal year 1995, we were a development stage company, focused on developing and refining our pattern recognition and capacitive sensing technologies, and generated revenue by providing contract engineering and design services. In fiscal year 1996, we began shipping our proprietary TouchPad. We are a leading supplier of interface solutions to the notebook computer market and the hard-disk drive, or HDD, portable digital music player market. In fiscal year 2005, we believe we were the market leader in providing interface solutions for notebook computers and HDD portable digital music players. We believe our market share results from the combination of our customer focus, the strength of our intellectual property, and our engineering know-how, which allows us to design products that meet the demanding design specifications of original equipment manufacturers, or OEMs.

Our manufacturing operations are based on a virtual manufacturing model in which we outsource all of our production requirements, eliminating the need for significant capital expenditures for manufacturing facilities and equipment and allowing us to reduce our investment in inventories. This approach requires us to work closely with our manufacturing subcontractors to ensure adequate production capacity to meet our forecasted production requirements. We provide our manufacturing subcontractors with six-month rolling forecasts and generally 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 manufacturing subcontractors. Currently, we use two third-party manufacturers to provide our proprietary capacitive based ASICs, and 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, manufacturing, and assembly and test costs paid to third-party manufacturers and related overhead costs associated with our manufacturing operations personnel. Additionally, all warranty costs and any inventory provisions or write-downs are charged to cost of revenue.

Our gross margin generally reflects the combination of the added value we bring to our customers' products in meeting their custom design requirements and our ongoing cost-improvement programs. These cost improvement programs include reducing materials and component costs, assembly and test costs, and implementing design and process improvements. Our newly introduced products may have lower margins than our more mature products that

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 interface solutions for customers prior to and after the customers' 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 a leadership 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, reflecting incremental staffing, commission expense associated with increased business levels, and additional personnel in anticipation of our continued growth in our existing markets and penetration into new markets.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, cost of revenue, inventories, product warranty, share-based compensation costs, 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. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. Actual results may differ from these estimates under different assumptions or conditions.

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 collectibility is reasonably assured. We accrue for estimated sales returns and other allowances, based on historical experience, at the time we recognize revenue, which is typically upon shipment. We record contract revenue for research and development as the services are provided 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 reasonably assured.

Inventory

We state our inventories at the lower of cost or market. We base our assessment of the ultimate realization of inventories on our expectations 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 reserves 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's delivery schedule is delayed or a customer's order is cancelled. 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.

Share-Based Compensation Costs

We account for employee share-based compensation costs in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment" ("SFAS 123R") and apply the provisions of Staff

Accounting Bulletin No. 107, “Share-Based Payment” (“SAB 107”). We utilize the Black-Scholes option pricing model to estimate the grant date fair value of employee share-based compensatory awards, which requires the input of highly subjective assumptions, including expected volatility and expected life. Historical and implied volatility were used in estimating the fair value of our share-based awards, while the expected life for our options was estimated to be five years based on historical trends since our initial public offering. Further, as required under SFAS 123R, we now estimate forfeitures for share-based awards that are not expected to vest. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. The estimated fair value is charged to earnings on a straight-line basis over the vesting period of the underlying awards, which is generally four years for our stock option and deferred stock unit awards 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. There currently is no market-based mechanism to verify the reliability and accuracy of the estimates derived from the Black-Scholes option pricing model or other allowable valuation models, nor is there a means to compare and adjust the estimates to actual values. While our estimate of fair value and the associated charge to earnings materially affects our results of operations, it has no impact on our cash position.

The guidance in SFAS 123R and SAB 107 is relatively immature and the application of these principles may be subject to further interpretation and guidance. 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 account for income tax contingencies in accordance with SFAS No. 5, “Accounting for Contingencies.” The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material impact on our results of operations and financial condition. We believe we have adequately provided for reasonably foreseeable outcomes in connection with the resolution of income tax contingencies. 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 an assessment is made or resolved or upon the expiration of a statute of limitation. Accordingly, our effective tax rate could fluctuate materially from quarter to quarter.

In accordance with SFAS 123R, we recognize tax benefit upon expensing certain share-based awards associated with our share-based compensation plans, including nonqualified stock options and deferred stock unit awards, but under current accounting standards we cannot recognize tax benefit currently for those 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 our adoption of SFAS 123R, we recognize tax benefit only in the period when disqualifying dispositions of the underlying stock occur and, for qualified stock options that vested prior to our adoption of SFAS 123R, the tax benefit is recorded directly to additional paid-in capital. Accordingly, because we cannot recognize the tax benefit for share-based compensation expense associated with qualified stock options until the occurrence of future disqualifying dispositions of the underlying stock, and 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 presents our historical operating results for the periods indicated as a percentage of net revenue.

	Three Months Ended March 31,	
	2006	2005
Net revenue	100.0%	100.0%
Cost of revenue	55.1%	53.8%
Gross margin	44.9%	46.2%
Operating expenses:		
Research and development	22.6%	10.9%
Selling, general, and administrative	17.2%	8.7%
Amortization of deferred stock compensation	0.0%	0.1%
Total operating expenses	39.8%	19.7%
Income from operations	5.1%	26.5%
Interest income	5.4%	2.0%
Interest expense	-1.2%	-0.9%
Income before provision for income taxes	9.3%	27.6%
Provision for income taxes	5.3%	7.0%
Net income	4.0%	20.6%

Net Revenue. Net revenue was $40.4 million for the three months ended March 31, 2006 compared with $56.7 million for the three months ended March 31, 2005, a decrease of 28.8%. The decrease in net revenue was primarily attributable to a reduction in unit shipments and a reduction in overall average selling prices because of changes in product mix and general competitive pricing pressure. Our non-PC revenue decreased to 10% of net revenue for the three months ended March 31, 2006 from 48% of net revenue for the three months ended March 31, 2005, primarily due to decreased demand for our capacitive interface solutions for HDD portable digital music players.

Gross Margin. Gross margin as a percentage of net revenue was 44.9% for the three months ended March 31, 2006 compared with 46.2% for the three months ended March 31, 2005. The decline in gross margin as a percentage of net revenue reflects a less profitable product mix, lower selling prices, and the inclusion of non-cash share-based compensation costs, partially offset by lower manufacturing costs, which resulted from the combination of our continuing design and process improvement programs and lower materials, assembly, and test costs. Non-cash share-based compensation costs resulted from our adoption of SFAS 123R on a modified prospective basis at the beginning of fiscal year 2006.

Research and Development Expenses. Research and development expenses increased as a percentage of net revenue to 22.6% from 10.9%, and increased $2.9 million, or 47.9%, to $9.1 million for the three months ended March 31, 2006 compared with $6.2 million for the three months ended March 31, 2005. A major contributor to the increase in research and development expenses was the inclusion of non-cash share-based compensation costs of $1.2 million as a result of adopting SFAS 123R on a modified prospective basis at the beginning of fiscal year 2006. Excluding non-cash share-based compensation costs, research and development expenses increased $1.8 million, or 29.0%, because of increased project related spending, increased employee salary costs resulting from additional staffing and our annual performance review process, and higher temporary labor and consulting costs.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses increased as a percentage of net revenue to 17.2% from 8.7%, and increased approximately $2.0 million, or 40.8%, to approximately $7.0 million for the three months ended March 31, 2006 compared with $4.9 million for the three months ended March 31, 2005. The increase in selling, general, and administrative expenses reflects the inclusion of non-cash share-based compensation costs of $2.0 million as a result of adopting SFAS 123R on a modified prospective basis at the beginning of fiscal year 2006. Excluding non-cash share-based compensation costs, selling, general, and administrative expenses increased $48,000, or 1.0%, because of increased employee salary costs resulting from additional staffing and our annual performance review process.

Amortization of Deferred Stock Compensation. Beginning with fiscal year 2006, we adopted SFAS 123R and as a result ceased amortizing deferred stock compensation. Accordingly, no amortization expense for deferred stock compensation was recorded for the three months ended March 31, 2006 while $71,000 was recorded for the three months ended March 31, 2005.

Interest Income. Interest income was $2.2 million for the three months ended March 31, 2006 compared with $1.1 million for the three months ended March 31, 2005. The $1.1 million increase in interest income resulted from a combination of higher average interest rates and higher average invested cash balances. During the past twelve months, the increase in cash balances was primarily a result of cash flows from operations of $43.3 million and share-based compensation programs which generated $10.7 million of cash, partially offset by $40 million of cash used for our stock repurchase program.

Interest Expense. Interest expense was $485,000 for the three months ended March 31, 2006 compared with $483,000 for the three months ended March 31, 2005. Interest expense primarily results from a combination of interest expense and amortization of debt issuance costs related to our convertible senior subordinated notes issued in December 2004. The annual debt service cost on the notes is approximately $938,000, which excludes the amortization of debt issuance costs.

Provision for Income Taxes. The provision for income taxes for the three months ended March 31, 2006 was $2.1 million compared with $4.0 million for the three months ended March 31, 2005, reflecting significantly lower pre-tax profit levels partially offset by a higher effective tax rate. The income tax provision represented estimated federal, foreign, and state taxes for the three months ended March 31, 2006 and 2005. The effective tax rate for the three months ended March 31, 2006 was approximately 56.7% and diverged from the combined federal and state statutory rate primarily as a result of the impact of accounting for share-based compensation, the true up of our year-to-date tax rate to the expected tax rate, and other permanent taxable differences, partially offset by the impact of the release of contingency reserves and tax-exempt interest income. The effective tax rate for the three months ended March 31, 2005 was approximately 25.4% and diverged from the combined federal and state statutory rate primarily as a result of the impact of higher income from foreign operations with lower tax rates, the release of contingency reserves, the true up of the year-to-date tax rate to the expected tax rate, the benefit of research and development tax credits, and tax-exempt interest income, partially offset by permanent taxable differences.

In accordance with SFAS 123R, we recognize tax benefit upon expensing certain share-based awards associated with our share-based compensation plans, including nonqualified stock options and deferred stock unit awards, but under current accounting standards we cannot recognize tax benefit currently for those 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 our adoption of SFAS 123R, we recognize tax benefit only in the period when disqualifying dispositions of the underlying stock occur, and for qualified stock options that vested prior to our adoption of SFAS 123R, the tax benefit is recorded directly to additional paid-in capital. Tax benefit associated with total share-based compensation was approximately $771,000 for the three months ended March 31, 2006. Excluding the impact of share-based compensation and the related tax benefit, the effective tax rate for the three months ended March 31, 2006 would have been 41.2%. 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 because a portion of that tax benefit may be recorded directly to additional paid-in capital, our future quarterly and annual effective tax rates will be subject to greater volatility and, consequently, our ability to estimate reasonably our future quarterly and annual effective tax rates is greatly diminished.

The following table presents our historical operating results for the periods indicated as a percentage of net revenue.

	Nine Months Ended March 31,	
	2006	2005
Net revenue	100.0%	100.0%
Cost of revenue	54.5%	53.9%
Gross margin	45.5%	46.1%
Operating expenses:		
Research and development	18.3%	12.2%
Selling, general, and administrative	14.7%	8.7%
Amortization of deferred stock compensation	0.0%	0.1%
Total operating expenses	33.0%	21.0%
Income from operations	12.5%	25.1%
Interest income	4.0%	1.2%
Interest expense	-1.0%	-0.4%
Income before provision for income taxes	15.5%	25.9%
Provision for income taxes	7.0%	8.8%
Net income	8.5%	17.1%

Net Revenue. Net revenue was $140.6 million for the nine months ended March 31, 2006 compared with $151.3 million for the nine months ended March 31, 2005, a decrease of 7.0%. The decrease in net revenue was primarily attributable to a reduction in overall average selling prices because of changes in product mix and general competitive pricing pressure, partially offset by an increase in unit shipments. Our non-PC revenue decreased to 16% of net revenue for the nine months ended March 31, 2006 from 42% of net revenue for the nine months ended March 31, 2005, primarily due to decreased demand for our capacitive interface solutions for HDD portable digital music players.

Gross Margin. Gross margin as a percentage of net revenue was 45.5% for the nine months ended March 31, 2006 compared with 46.1% for the nine months ended March 31, 2005. The decline in gross margin as a percentage of net revenue reflects a less favorable product mix, lower selling prices, and the inclusion of non-cash share-based compensation costs, partially offset by lower manufacturing costs, which resulted from the combination of our continuing design and process improvement programs and lower materials, assembly, and test costs. Non-cash share-based compensation costs resulted from our adoption of SFAS 123R on a modified prospective basis at the beginning of fiscal year 2006.

Research and Development Expenses. Research and development expenses increased as a percentage of net revenue to 18.3% from 12.2%, and increased $7.3 million, or 39.5%, to $25.7 million for the nine months ended March 31, 2006 compared with $18.4 million for the nine months ended March 31, 2005. A major contributor to the increase in research and development expenses was the inclusion of non-cash share-based compensation costs of $3.7 million as a result of adopting SFAS 123R on a modified prospective basis at the beginning of fiscal year 2006. Excluding non-cash share-based compensation costs, research and development expenses increased approximately $3.6 million, or 19.5%, because of increased project spending, increased employee salary costs resulting from additional staffing and our annual performance review process, and higher temporary labor and consulting.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses increased as a percentage of net revenue to 14.7% from 8.7%, and increased approximately $7.5 million, or 57.3%, to $20.6 million for the nine months ended March 31, 2006 compared with $13.1 million for the nine months ended March 31, 2005. The increase in selling, general, and administrative expenses reflects the inclusion of non-cash share-based compensation costs of approximately $5.8 million as a result of adopting SFAS 123R on a modified prospective basis at the beginning of fiscal year 2006. Excluding non-cash share-based compensation costs, selling, general, and administrative expenses increased approximately $1.7 million, or 13.4%, because of increased employee salary costs resulting from additional staffing and our annual performance review process, and increased recruiting and hiring costs related to our ongoing staffing initiatives.

Amortization of Deferred Stock Compensation. Beginning with fiscal year 2006, we adopted SFAS 123R and as a result ceased amortizing deferred stock compensation. Accordingly, no amortization expense for deferred stock compensation was recorded for the nine months ended March 31, 2006 while $258,000 was recorded for the nine months ended March 31, 2005.

Interest Income. Interest income was $5.6 million for the nine months ended March 31, 2006 compared with $1.8 million for the nine months ended March 31, 2005. The $3.8 million increase in interest income resulted from a combination of substantially higher average invested cash balances and higher average interest rates. The increase in average cash balances was primarily a result of net cash proceeds of $120.7 million received from the issuance of our convertible senior subordinated notes in December 2004. During the past twelve months, the increase in cash balances was primarily the result of cash flows from operations of $43.3 million and share-based compensation programs which generated $10.7 million of cash, partially offset by $40 million of cash used for our stock repurchase program.

Interest Expense. Interest expense was approximately $1.5 million for the nine months ended March 31, 2006 compared with $660,000 for the nine months ended March 31, 2005. The $794,000 increase in interest expense resulted primarily from a combination of interest expense and amortization of debt issuance costs related to our convertible senior subordinated notes issued in December 2004. The annual debt service cost on the notes is approximately $938,000, which excludes the amortization of debt issuance costs.

Provision for Income Taxes. The provision for income taxes for the nine months ended March 31, 2006 was approximately $9.9 million compared with $13.3 million for the nine months ended March 31, 2005, reflecting lower pre-tax profit levels partially offset by a higher effective tax rate. The income tax provision represented estimated federal, foreign, and state taxes for the nine months ended March 31, 2006 and 2005. The effective tax rate for the nine months ended March 31, 2006 was approximately 45.2% and diverged from the combined federal and state statutory rate primarily as a result of the impact of accounting for share-based compensation, the true up of our year-to-date tax rate to the expected tax rate, and other permanent taxable differences, partially offset by the impact of the release of contingency reserves and tax-exempt interest income. The effective tax rate for the nine months ended March 31, 2005 was approximately 33.9% and diverged from the combined federal and state statutory rate primarily as a result of the impact of higher income from foreign operations, the release of contingency reserves, the true up of the year-to-date tax rate to the expected tax rate, the benefit of research and development tax credits, and tax-exempt interest income, partially offset by permanent taxable differences.

In accordance with SFAS 123R, we recognize tax benefit upon expensing certain share-based awards associated with our share-based compensation plans, including nonqualified stock options and deferred stock unit awards, but under current accounting standards we cannot recognize tax benefit currently for those 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 our adoption of SFAS 123R, we recognize tax benefit only in the period when disqualifying dispositions of the underlying stock occur, and for qualified stock options that vested prior to our adoption of SFAS 123R, the tax benefit is recorded directly to additional paid-in capital. Tax benefit associated with total share-based compensation was approximately $2.2 million for the nine months ended March 31, 2006. Excluding the impact of share-based compensation and the related tax benefit, the effective tax rate for the nine months ended March 31, 2006 would have been 37.9%. 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 because a portion of that tax benefit may be recorded directly to additional paid-in capital, our future quarterly and annual effective tax rates will be subject to greater volatility and, consequently, our ability to estimate reasonably our future quarterly and annual effective tax rates is greatly diminished.

Liquidity and Capital Resources

Our cash, cash equivalents, and short-term investments were $237.5 million as of March 31, 2006 compared with $228.9 million as of June 30, 2005, an increase of $8.6 million. The increase in cash, cash equivalents, and short-term investments was primarily attributable to cash generated from operating activities of $19.5 million and proceeds from stock option exercises of $6.6 million, partially offset by $18.8 million of cash used for the repurchase of approximately 1.2 million shares of our common stock.

Cash Flows from Operating Activities. During the nine months ended March 31, 2006, operating activities generated cash of approximately $19.5 million compared with $18.7 million of cash generated during the nine months ended March 31, 2005. For the nine months ended March 31, 2006, the net cash provided by operating activities was primarily attributable to net income of $11.9 million plus adjustments for non-cash charges, including share-based

compensation costs, depreciation, and amortization of debt issuance costs totaling $11.8 million and tax benefit from stock options net of excess tax benefit from share-based compensation of $755,000, partially offset by deferred tax benefit from share-based compensation of $2.0 million and a net increase in operating assets and liabilities of $3.1 million. For the nine months ended March 31, 2005, the net cash provided by operating activities was primarily attributable to net income of $25.8 million plus adjustments for non-cash charges, including depreciation and amortization of deferred stock compensation, and amortization of debt issuance costs totaling $1.3 million and tax benefit from stock options of $8.9 million, partially offset by an increase in operating assets and liabilities of $17.3 million. The net change in operating assets and liabilities related primarily to a $10.6 million increase in accounts receivable and a $10.3 million increase in other assets consisting mainly of non-current prepaid taxes, partially offset by higher income taxes payable, all of which reflect our higher operating levels.

Cash Flows from Investing Activities. Our investing activities typically relate to purchases of government-backed securities and investment-grade fixed income instruments. Investing activities during the nine months ended March 31, 2006 used net cash of $26.1 million compared with net cash used of $81.1 million during the nine months ended March 31, 2005. During the nine months ended March 31, 2006, net cash used in investing activities consisted of purchases of $188.1 million of short-term investments and $2.4 million of property and equipment, partially offset by $164.3 million in proceeds from sales and maturities of short-term investments. Cash used by investing activities during the nine months ended March 31, 2005 consisted of cash used for purchases of short-term investments of $146.8 million and $11.3 million of property and equipment, which included $8.5 million for the purchase of our corporate headquarters, partially offset by proceeds from sales and maturities of short-term investments of $77.0 million.

Cash Flows from Financing Activities. Net cash used in financing activities for the nine months ended March 31, 2006 was $8.3 million compared with net cash provided by financing activities of $128.9 million for the nine months ended March 31, 2005. Our financing activities for the nine months ended March 31, 2006 consisted primarily of $18.8 million of cash used for the purchase of 1.2 million shares of treasury stock, partially offset by approximately $6.6 million in proceeds from common stock issued under our stock option plans and employee stock purchase plan and $4.0 million of excess tax benefit from share-based compensation. Our financing activities for the nine months ended March 31, 2005 consisted primarily of the proceeds from the issuance of $125.0 million of convertible senior subordinated notes and $8.2 million from common stock issued under our stock option plans and employee stock purchase plan, partially offset by $4.3 million of debt issuance costs.

Common Stock Repurchase Program. In April 2005, our board of directors authorized a stock repurchase program for up to $40 million of our common stock on the open market or in privately negotiated transactions, depending upon market conditions and other factors. Common stock repurchased under this program is held as treasury stock, and through September 30, 2005, purchases under this program totaled 2,306,100 shares for an aggregate cost of $40 million, or an average cost of $17.34 per share.

In October 2005, our board of directors authorized an expansion of our stock repurchase program for up to an additional $40 million of our common stock on the open market or in privately negotiated transactions, depending upon market conditions and other factors though October 2007. Through March 31, 2006, no additional shares have been repurchased under the expanded stock repurchase program.

Bank Credit Facility. We currently maintain a $15 million working capital line of credit with Silicon Valley Bank. The Silicon Valley Bank revolving line of credit, which expires on November 26, 2006, has an interest rate equal to Silicon Valley Bank's prime lending rate, and provides for a security interest in substantially all of our assets. We had not borrowed any amounts under the line of credit as of March 31, 2006.

Convertible Senior Subordinated Notes. During December 2004, we issued $125 million of 0.75% Convertible Senior Subordinated Notes maturing on December 1, 2024 (the "Notes") in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended. The Notes bear interest at a rate of 0.75% per annum payable on December 1 and June 1 of each year. We will pay additional contingent interest on the Notes if the average trading price of the Notes is at or above 120% of the principal amount of the Notes for a specified period beginning with the six-month period commencing December 1, 2009. The amount of contingent interest payable on the Notes with respect to a six-month period, for which contingent interest applies, will equal 0.375% per annum of the average trading price of the Notes for a specified five trading-day period preceding such six-month period.

The Notes are convertible into 2,473,975 shares of our common stock, subject to adjustment in certain events. The denominator of the diluted net income per share calculation includes the weighted average effect of the 2,473,975 shares of common stock issuable upon conversion of the Notes. Through November 30, 2009, upon the occurrence of

a fundamental change as defined in the indenture governing the Notes, we could potentially be obligated to issue up to 989,587 additional shares, or a total of 3,463,562 shares of common stock. These additional shares, contingently issuable upon a fundamental change, are not included in the calculation of diluted net income per share.

The Notes may be converted (1) if, during any calendar quarter commencing after December 31, 2004, the last reported sale price of our common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is greater than or equal to 120% of the applicable conversion price on such last trading day; (2) on or after January 1, 2020; (3) if we have called the Notes for redemption; or (4) during prescribed periods, upon the occurrence of specified corporate transactions or fundamental changes. On or after December 1, 2009, we may redeem for cash all or a portion of the 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). Noteholders have the right to require us to repurchase all or a portion of their notes for cash on December 1, 2009, December 1, 2014, and December 1, 2019 at a price equal to 100% of the principal amount of the Notes to be purchased plus accrued and unpaid interest (including contingent interest and additional interest, if any). Upon conversion of the Notes, in lieu of delivering common stock, we may, at our discretion, deliver cash or a combination of cash and common stock. As of March 31, 2006, none of the conditions for conversion or redemption of the Notes were satisfied.

The Notes are unsecured senior subordinated obligations and rank junior in right of payment to all of our existing and future senior indebtedness, equal in right of payment with all of our existing and future indebtedness or other obligations that are not, by their terms, either senior or subordinated to the Notes, including trade debt and other general unsecured obligations that do not constitute senior or subordinated indebtedness, and senior in right of payment to all of our future indebtedness that, by its terms, is subordinated to the Notes. There are no financial covenants in the Notes.

Note Payable to a Related Party. The long-term note payable of $1.5 million to National Semiconductor Corporation ("National") represents limited-recourse debt that matures in August 2007 and is secured solely by a portion of our stockholdings in Foveon, Inc. ("Foveon"), in which National is also an investor. We do not anticipate making any payments under the limited-recourse loan with National, either prior to or at maturity, unless Foveon is participating in a liquidity event, such as an initial public offering of its equity securities or a merger, through which we would receive amounts in excess of our $1.5 million long-term note payable plus accrued interest expense.

$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.

$125 Million Shelf Registration. We have registered an aggregate of $125 million of our 0.75% Convertible Senior Subordinated Notes due 2024 and the common stock issuable upon conversion of the Notes. The shares issued upon conversion generally will be freely tradeable, unless held by an affiliate, in which case such shares will be subject to the volume and manner of sale restrictions of Rule 144.

Liquidity and Capital Resources — Outlook. 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 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 repurchase program, and the amount and timing of our investments in, or acquisitions of, other technologies or companies. We cannot assure you that further equity or debt financing will 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.

Contractual Obligations and Commercial Commitments

The following table sets forth a summary of our material contractual obligations and commercial commitments as of March 31, 2006 (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	$ 125	$ —	$ —	$ —	$ 125
Note payable	2	—	2	—	—
Building leases	1	1	—	—	—
Total	$ 128	$ 1	$ 2	$ —	$ 125

Our convertible senior subordinated 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, 2009, December 1, 2014, and December 1, 2019 and in the event of a fundamental change as described in the indenture governing the notes. The early repayment of the notes is not reflected in the above schedule, but if all the noteholders elected to exercise their rights to require us to repurchase their notes on December 1, 2009, then our contractual obligations for the three-to-five year period would be increased by $125 million with a corresponding decrease in amounts due in more than 5 years.

Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board issued SFAS No. 154, "Accounting Changes and Error Corrections" ("SFAS 154"). SFAS 154, which replaces Accounting Principles Board Opinion No. 20, "Accounting Changes," ("APB 20") and SFAS No. 3 "Reporting Accounting Changes in Interim Financial Statements," applies to all voluntary changes in accounting principle and changes the requirements for accounting for and reporting of a change in accounting principle. APB 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of change a cumulative effect of changing to the new accounting principle, while SFAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle, unless it is impracticable. SFAS 154 enhances the consistency of financial information between periods. SFAS 154 will be effective beginning the first quarter of our fiscal 2007. We do not expect the adoption of SFAS 154 will have a material impact on our 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, 2005.

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 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 are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On March 10, 2006, Elantech Devices Corporation filed a Complaint for Patent Infringement against us in the United States District Court for the Northern District of California, San Jose Division, claiming that we infringed Elantech's U.S. Patent No. 5,825,352 and seeking single and treble damages, attorneys' fees, and a permanent injunction against us infringing or inducing others to infringe the patent. On April 6, 2006, we filed our Answer to the Complaint and Counterclaims against Elantech Devices Corporation claiming that Elantech has infringed and induced infringement of our U.S. Patent Nos. 5,543,591, 5,880,411, 5,943,052, and 6,380,931 and seeking single and treble damages, attorneys' fees, and a permanent injunction against infringing or inducing others to infringe. We intend to vigorously defend our patents and pursue our counterclaims.

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

Issuer Purchases of Equity Securities

In October 2005 our board of directors authorized an expansion of our stock repurchase program for up to an additional $40 million of our common stock. There were no purchases under the stock repurchase program during the quarter ended March 31, 2006.

ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a)

32.1 Section 1350 Certification of Chief Executive Officer

32.2 Section 1350 Certification of Chief Financial Officer

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
(Registrant)

Date: May 3, 2006	By:	/s/ Francis F. Lee
	Name:	Francis F. Lee
	Title:	President and Chief Executive Officer
	By:	/s/ Russell J. Knittel
	Name:	Russell J. Knittel
	Title:	Senior Vice President, Chief Financial Officer, and Chief Administrative Officer

EXHIBIT INDEX

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a)

32.1 Section 1350 Certification of Chief Executive Officer

32.2 Section 1350 Certification of Chief Financial Officer

EXHIBIT 31.1

Certification of Chief Executive Officer Pursuant to
Rule 13a-14(a)/15d-14(a)

I, Francis F. Lee, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Synaptics Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 3, 2006

/s/ Francis F. Lee
Francis F. Lee
Chief Executive Officer

EXHIBIT 31.2

Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)

I, Russell J. Knittel, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Synaptics Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 3, 2006

/s/ Russell J. Knittel
Russell J. Knittel
Chief Financial Officer

EXHIBIT 32.1

Section 1350 Certification of Chief Executive Officer

In connection with the Quarterly Report on Form 10-Q of Synaptics Incorporated (the "Company") for the quarterly period ended March 25, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Francis F. Lee, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Francis F. Lee

Francis F. Lee
Chief Executive Officer
May 3, 2006

EXHIBIT 32.2

Section 1350 Certification of Chief Financial Officer

In connection with the Quarterly Report on Form 10-Q of Synaptics Incorporated (the "Company") for the quarterly period ended March 25, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Russell J. Knittel, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Russell J. Knittel

Russell J. Knittel
Chief Financial Officer
May 3, 2006