WWA GROUP INC
Form 10QSB
November 16, 2005

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

[**X**] Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended **September 30, 2005**.

[ ] Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to_____ .

Commission file number: **000-26927**

WWA GROUP INC.
(Exact name of small business issuer as specified in its charter)

NEVADA	**77-0443643**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

2465 West 12th Street, Suite 2 Temple, Arizona 85281
(Address of Principal Executive Office) (Zip Code)

(480) 505-0070
(Issuer s telephone number)

Check whether the registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes__**X**__ No_____

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes____ No__X____

The number of outstanding shares of the registrant s common stock, $0.001 par value (the only class of voting stock), as of October 27, 2005 was 15,969,633.

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PART I

ITEM 1. FINANCIAL STATEMENTS

As used herein, the term WWA Group refers to WWA Group, Inc., a Nevada corporation, unless otherwise indicated. In the opinion of management, the accompanying unaudited financial statements included in this Form 10-QSB reflect all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the results of operations for the periods presented. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year.

WWA GROUP, INC.

Unaudited Consolidated Balance Sheets

	September 30, 2005	December 31, 2004
Assets		
Current assets:		
Cash	$ 2,915,388	$ 4,635,553
Marketable securities	135,500	147,000
Receivables, net	4,530,167	6,125,977
Inventories	523,493	23,510
Prepaid expenses	163,987	73,073
Notes receivable	2,940,058	2,435,911
Other current assets	176,433	112,718
Total current assets	11,385,026	13,553,742
Property and equipment, net	1,119,097	1,071,451
Investment in unconsolidated entity	250,000	250,000
Other assets	-	8,592
	$ 12,754,123	$ 14,883,785
Liabilities and Stockholders' Equity		
Current liabilities:		
Auction proceeds payable	$ 9,789,746	$ 10,259,801
Accounts payable	388,398	2,316,240
Accrued expenses	147,991	695,639
Short term notes payable	-	20,000
Current maturities of long-term debt	137,088	72,383

Total current liabilities	10,463,223	13,364,063
Long-term debt	188,794	111,633
Total liabilities	10,652,017	13,475,696
Commitments and contingencies		
Stockholders' equity:		
Coumon stock, $.001 par value, 50,000,000 shares authorized; 15,969,663 shares issued and outstanding	15,970	15,970
Additional paid-in capital	1,013,524	1,013,524
Retained earnings	1,072,612	378,595
Total stockholders' equity	2,102,106	1,408,089
	$ 12,754,123	$ 14,883,785

The acccompanying notes are an integral part of these financial statements

WWA GROUP, INC.

Unaudited Consolidated Statements of Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Revenues from commissions and services	$ 1,178,571	$ 1,345,533	$ 4,610,012	$ 4,283,402
Revenues from sales of equipment	2,649,145	961,863	$ 6,776,127	2,051,481
Total revenues	3,827,715	2,307,396	11,386,139	6,334,883
Direct costs	2,993,429	1,346,129	8,622,671	3,498,687
Gross profit	834,287	961,267	2,763,468	2,836,196
Operating expenses:				
General, selling and administrative expenses	687,310	682,473	2,290,775	2,123,850
Depreciation and amortization expense	109,083	79,627	325,912	206,081
Total operating expenses	796,393	762,100	2,616,687	2,329,931
Income from operations	37,894	199,167	146,781	506,265
Other income (expense):				
Interest expense	(57,519)	(98,418)	(172,982)	(136,487)
Other income	179,722	166,056	720,218	242,537
Total other income (expense)	122,203	67,638	547,236	106,050
Income before income taxes	160,096	266,805	694,017	612,315
Provision for income taxes	-	(60,000)	-	(60,000)
Net income	$ 160,096	$ 206,805	$ 694,017	$ 552,315
Basic and diluted earnings per common share	$ 0.01	$ 0.01	$ 0.04	$ 0.03

Weighted average shares - basic and diluted	15,970,000	15,967,000	15,970,000	15,967,000

The accompanying notes are an integral part of these financial statements

WWA GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30,

	2005	2004
Cash flows from operating activities:		
Net income	$ 694,017	$ 552,315
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	325,912	206,080
Loss <gain> on sale of marketable securities	11,500	(9,000)
Loss on disposition of assets	6,708	52,773
Decrease (increase) in:		
Accounts receivable	1,595,810	(5,673,546)
Inventories	(499,983)	(1,004,468)
Prepaid expenses	(90,914)	(6,226)
Notes receivable	-	30,275
Other current assets	(63,715)	6,178
Other assets	8,592	10,571
Increase (decrease) in:		
Auction proceeds payable	(470,055)	5,509,373
Accounts payable	(1,927,842)	1,833,863
Accrued liabilities	(547,648)	(415,472)
Deferred tax liabilities	-	60,000
Net cash (used in) provided by operating activities	(957,618)	1,152,716
Cash flows from investing activities:		
Purchase of property and equipment	(177,402)	(493,954)
Increase in notes receivables	(504,147)	(2,230,994)
Proceeds from sale of marketable securities	-	24,000
Net cash used in investing activities	(681,549)	(2,700,948)
Cash flows from financing activities:		
Proceeds from short-term notes payable	2,108,675	1,806,476
Payments on short-term notes	(2,128,675)	(1,534,813)
Payments of long-term debt	(60,998)	(60,055)

Net cash (used in) provided by financing activities	(80,998)	211,608
Net decrease in cash and cash equivalents	(1,720,165)	(1,336,624)
Cash at beginning of period	4,635,553	5,006,042
Cash at end of period	$ 2,915,388	$ 3,669,418

The acccompanying notes are an integral part of these financial statements

WWA GROUP, INC.

UNAUDITED CONSOLIDATED NOTES TO FINANCIAL STATEMENTS

September 30, 2005

Note 1 Organization and Basis of Presentation

WWA Group, Inc., a Nevada corporation, was incorporated on November 26, 1996.

World Wide Auctioneers, Ltd. (WWA Dubai) was incorporated as a limited liability company in the territory of the British Virgin Islands under the International Business Companies Act, Cap 291 on March 20, 2000. WWA Dubai s principal activities are the trading and auction of used and unused construction, transportation, and marine equipment.

On August 8, 2003, WWA Group completed a stock exchange agreement wherein WWA Group acquired 100% of WWA Dubai through the issuance of 13,887,447 shares of common stock in a transaction wherein WWA Dubai became a wholly-owned subsidiary of WWA Group. Upon closing of the transaction, the shareholders of WWA Dubai owned approximately 91% of the issued and outstanding shares of WWA Group. Because the shares issued in the transaction represent control of the total shares of the outstanding common stock immediately following the transaction, the transaction was accounted for as a reverse acquisition.

The accompanying unaudited financial statements have been prepared by management in accordance with the instructions in Form 10-QSB and, therefore, do not include all information and footnotes required by generally accepted accounting principles and should, therefore, be read in conjunction with WWA Group s Form 10-KSB for the year ended December 31, 2003. These statements do include all normal recurring adjustments which WWA Group believes necessary for a fair presentation of the statements. The interim operations are not necessarily indicative of the results to be expected for the full year ended December 31, 2005.

Note 2 Summary of Significant Accounting Policies

Net Earnings per Common Share Basic earnings per share is computed on the basis of the weighted average number of common shares outstanding. Diluted earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options using the treasury stock method and the

average market price per share during the year. Common stock equivalents are not included in the diluted loss per share calculation when their effect is anti-dilutive. As of September 30, 2005 WWA Group had no common stock equivalents outstanding.

Revenue Recognition- Auction Revenues earned in WWA Group s capacity as agent for consignors of equipment are comprised mainly of auction commissions in the form of flat selling fees or fixed or sliding percentages of the gross auction sale price of any consigned equipment. Auction revenues also include any preparation, shipping, clearing, transport and handling charges and fees applicable to certain items of consigned equipment; incidental interest income, buyers commission applicable on certain sales of items. All revenue is recognized when the auction sale is complete and WWA Group has determined that the auction proceeds are collectible. Revenues from sales of equipment consist of the auction sale or private sale of equipment inventory owned by WWA Group. WWA Group recognizes the revenue from such sales when the auction or private sale has been completed, the equipment has been delivered to the purchaser, and collectibility is reasonable assured. All costs of goods sold are accounted for under direct costs.

WWA GROUP, INC.

UNAUDITED CONSOLIDATED NOTES TO FINANCIAL STATEMENTS

September 30, 2005

Note 2 Summary of Significant Accounting Policies (continued)

Stock Based Compensation

WWA Group accounts for stock-based compensation under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. WWA Group has adopted SFAS No. 123, Accounting for Stock-Based Compensation . In accordance with the provisions of SFAS 123, WWA Group has elected to continue to apply Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB Opinion No. 25), and related interpretations in accounting for its stock option plans. As of September 30, 2005, WWA Group has resolved to look for an appropriate employee stock option program structure for planned inception in early 2006.

Note 3-Notes Receivable

Notes receivable amounting to $2,940,058 at September 30, 2005 remains due to WWA Group from three of its trading partners. The majority of the amount receivable is in the form of a secured loan from a shipping company which bears interest of 2.2% per month and is due to be repaid on or before December 31, 2005. The note is secured by the assets of the borrower, consisting mainly of a freight ship. Other amounts in this category are receivable by WWA Group from one of its regular consignors and from its Holland auction partner.

Note 4-Income Taxes

WWA Group operates in the Jebel Ali Free Zone of Dubai, which is an income tax free zone. Therefore, the profits of WWA Group are not taxable in Dubai. During the fourth quarter of 2004, WWA Group determined that undistributed earnings from WWA Dubai will be reinvested in the business indefinitely and that such earnings will not be distributed to the U.S. parent. Therefore, in accordance with APB Opinion No. 23, Accounting for Income Taxes Special Areas, no income tax provision has been recorded for the undistributed earnings.

Note 5-Supplemental Cash Flow Information

During the nine months ended September 30, 2005, the WWA Group purchased $202,864 of property and equipment with long-term debt.

WWA Group did not pay any income taxes during the nine months ended September 30, 2005 and 2004.

WWA Group paid interest of approximately $173,000 and $136,000, during the nine months ended September 30, 2005 and 2004 respectively.

Item 2.

MANAGEMENT S DISCUSSION AND ANALYSIS

The following discussion and analysis of our financial condition and results of operation should be read in conjunction with the financial statements and accompanying notes and the other financial information appearing elsewhere in this report. WWA Group s fiscal year end is December 31.

This report and the exhibits attached hereto contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The forward-looking statements include, without limitation, statements as to management s good faith expectations and beliefs, which are subject to inherent uncertainties which are difficult to predict and may be beyond the ability of WWA Group to control. Forward-looking statements are made based upon management s expectations and belief concerning future developments and their potential effect upon WWA Group. There can be no assurance that future developments will be in accordance with management s expectations or that the effect of future developments on WWA Group will be those anticipated by management.

The words believes, expects, intends, plans, anticipates, hopes, likely, will, and similar expressions ide forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of WWA Group, or industry results, to differ materially from future results, performance or achievements expressed or implied by such forward-looking statements.

These risks and uncertainties, many of which are beyond our control, include (i) the sufficiency of existing capital resources and WWA Group s ability to raise additional capital to fund cash requirements for future operations; (ii) uncertainties involved in the rate of growth of WWA Group s business and acceptance of products and services; (iii)

the ability of WWA Group to achieve and maintain a sufficient customer base to have sufficient revenues to fund and maintain operations; (iv) volatility of the stock market; and (v) general economic conditions. Although WWA Group believes the expectations reflected in these forward-looking statements are reasonable, such expectations may prove to be incorrect.

Readers are cautioned not to place undue reliance on these forward-looking statements which reflect management s view only as of the date of this report. WWA Group undertakes no obligation to publicly release the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, conditions or circumstances. For additional information about risks and uncertainties that could adversely affect WWA Group s forward-looking statements, please refer to WWA Group s filings with the Securities and Exchange Commission, including its Annual Report on Form 10-KSB for the fiscal year ended December 31, 2004.

General

WWA Group s business strategy is to obtain and grow positive net cash flow from operations and to use this net cash flow to reduce payables and expand operations to new auction sites. WWA Group intends to focus on formalizing new joint venture relationships, management arrangements, new wholly owned facilities, and expanded auctions as a means by which to increase net cash flow.

Implementation of WWA Group s growth model will include expanding its lower cost auction methods, such as on-line auctions, video auctions and diversifying into transportation equipment only auctions, which can be held on a more frequent basis than the larger equipment auctions. While smaller in size, these auctions will not interfere with or detract from WWA Group s major equipment auctions, and the economics of scale at the Dubai facility are efficient for this purpose. WWA Group held one equipment auction and 1 online auction during the 3rd quarter.

WWA Group is also now offering higher margin buyer and seller services, such as transport and logistics. WWA Group s connection with a large volume of equipment being moved around the world by its regular consignors provides vertical integration opportunities that could combine auction services with the ability to meet transportation needs. WWA Group now has a strategic alliance with a shipping vessel and two road transport trucks and trailers, all of which are used to move equipment for its regular consignors.

Nonetheless, WWA Group s business development strategy is prone to significant risks and uncertainties certain of which can have an immediate impact on its efforts to increase positive net cash flow and deter future prospects for the expansion of its business.

WWA Group s financial condition and results of operation depend primarily upon the volume of industrial equipment auctioned, the prices it obtains at auction for such equipment, and the commission rates it can attract from the consignor. Industrial equipment prices historically have been volatile and are likely to continue to be volatile in the future, and the commission rates in WWA Group s primary market are becoming more competitive. This price volatility and commission rate pressure can immediately affect WWA Group s available cash flow which can in turn impact the availability of net cash flow for future capital expenditures. WWA Group s future success will depend on its ability to increase the size of its auctions and to optimize commissions and prices realized at auction.

Should WWA Group be unable to increase gross auction sales and obtain competitive pricing at auction then it can expect a reduction in revenue which may in turn affect the profitability of its business.

Results of Operations

During the period from January 1, 2005 through September 30, 2005, WWA Group was engaged in conducting un-reserved auctions for industrial equipment from its auction site located in the Jebel Ali Free Trade Zone, Dubai, United Arab Emirates and from jointly managed sites in Jakarta, Indonesia, Perth Australia, Amsterdam, The Netherlands, and Guangzhou, China. WWA Group expects that over the next twelve months it will continue to hold industrial equipment auctions at established sites and anticipates the opening of new jointly managed auction locations. To date, WWA Group has acted as a consultant to strategic partners in the auctions outside of Dubai and has not received any fees from such auctions.

For the nine month period ended September 30, 2005 WWA Group realized a decrease in net profits from operations as a result of direct costs associated with the auctions as compared to the nine month period of the prior year. Four on-site equipment auctions were held in the first nine months of 2005 against three on-site auctions during first nine months in 2004 though the individual auction volume was lower in 2005 as compared to 2004. WWA introduced Internet On-line Auction and completed three such auctions in first nine months of 2005. The trading activity also increased in the first nine months of 2005. Increase in the direct cost during the first nine months of 2005 while comparing with first nine months of 2004 is due to increase in auction activities. Further, WWA Group general and administrative expenses are not increased in proportion to the increase in number of auctions during the first nine months of 2005 compared with the first nine months of 2004. WWA Group believes that the immediate key to its ability to operate profitably is to increase the number and the size of its auctions and keep general and administration cost under control. However, there is no assurance that WWA Group will be successful in increasing the size and frequency of its auctions or in its efforts to control expenses.

Three and nine month periods ended September 30, 2005 and 2004

Revenue

Revenue for the three months ended September 30, 2005 increased to $ 3,827,715 from $2,307,396 for the three month period ended September 30, 2004, an increase of 66%. Revenue for the nine months ended September 30, 2005 increased to $ 11,386,139 from $6,334,883 for the nine month period ended September 30, 2004, an increase of 80%. The increase in revenues over the nine month periods is primarily attributable to the increased sale of owned equipment in the first nine months of 2005 than in the same period in 2004. The growth in revenue reflects continued expansion in the auction marketplace, and puts WWA Group on track to increase gross revenues in 2005 as compared to 2004.

Net Income

Net income for the three months ended September 30, 2005 was $160,096 as compared to $206,805 for the three month period ended September 30, 2004, a decrease of 23%. Net income for the nine months ended September 30, 2005 was $ 694,017 as compared to $552,315 for the nine month period ended September 30, 2004 an increase of 26%. Net income in the recent three month period is lower than in the same period in 2004 due to the fact that the auction size in 2005 was smaller than in 2004, resulting in lower auction commission revenue in the 3rd quarter of 2005. WWA Group anticipates further net income growth over the next twelve months.

Expenses

Selling, general and administrative expenses for the three months ended September 30, 2005 are $687,310 as compared to $682,473 for the three month period ended September 30, 2004, an increase of 1%. Selling, general and administrative expenses for the nine months ended September 30, 2005 increased to $2,290,775 from $2,123,850 for the nine months ended September 30, 2004, an increase of 8%. The marginal increase in selling, general and administrative expenses over the nine month comparative periods is the result of higher personnel costs associated with holding more frequent auctions in the first nine months of this year. WWA Group expects to control selling, general and administrative expenses over future periods except in relation to selling costs directly associated with an increase in the number of auctions held. WWA Group expects that any increase in selling costs will be offset by an increase in revenues.

Direct costs for the three months ended September 30, 2005 increased to $2,993,429 from $1,346,129 for the three months period ended September 30, 2004, an increase of 123%. Direct costs for the nine months ended September 30, 2005 increased to $8,622,671 from $3,498,687 for the nine months period ended September 30, 2004, an increase of 147%. The increase in direct costs over the three and nine month comparative periods is primarily due to an increase in cost of goods sold in the current year. Direct costs per auction increased from approximately $505,000 per auction in the nine months ended September 30, 2004 to approximately $520,000 during the nine months ended September 30, 2005. The increase in the cost per auction (excluding the cost of equipment sold) is mainly due to increased mailing, advertising and web maintenance costs. WWA Group expects that direct costs will continue to rise with the increased volume of owned equipment trading and larger anticipated auction volume in the next twelve months.

Depreciation and amortization expense for the three months ended September 30, 2005 and September 30, 2004 were $109,083 and $79,627 respectively. Depreciation and amortization expense expenses for the nine months ended September 30, 2005 and September 30, 2004 were $325,912 and $206,081, respectively.

Impact of Inflation

WWA Group believes that inflation has had a negligible effect on operations over the past three years. WWA Group believes that it can offset inflationary increases in the cost of materials and labor by increasing sales and improving operating efficiencies.

Liquidity and Capital Resources

Cash flow used in the operations was $957,618 for the nine months ended September 2005 as compared to cash flow provided by operating activities of $1,152,716 for the nine months ended September 30, 2004. Negative cash flows from operating activities in the current nine month period are primarily attributable to a significant decrease in auction proceeds payable and accounts payable as compared to the prior nine month period. Anticipated increased net revenues and a decrease in accounts receivable are expected to generate an increase in cash flow from operations in future periods.

Cash flows used in investing activities for the nine month period ended September 30, 2005 was $681,549 as compared to $2,700,948 used in investing activities for the nine month period ended September 30, 2004. The cash flow used for investment activities in the first nine months of 2005 were comprised of property and equipment purchases, $177,402, and notes receivable, $504,147 as a result of advances to trading partners.

Cash flows used in financing activities was $80,998 for the nine months ended September 2005 as compared to cash flow provided by financing activities of $211,608 for the nine months ended September 30, 2004. The cash flows used

in financing activities is for payment of long and short term loan notes payable.

WWA Group had a working capital surplus of $921,803 as of September 30, 2005, compared to a working capital surplus of $189,679 as of December 31, 2004.

WWA Group had a letter of credit facility for equipment purchases for the net amount of $800,000 from Habib Bank AG Zurich, Dubai, UAE as of Sept 30, 2005, but has no formal long term lines or credit or other bank financing arrangements as of September 30, 2005.

Since earnings will be reinvested in operations, WWA Group does not expect to pay cash dividends in the foreseeable future.

WWA Group has no defined benefit plan or contractual commitment with any of its officers or directors.

WWA Group has no current plans for any significant purchase or sale of any fixed plant or equipment outside of normal items to be utilized by yard personnel.

Critical Accounting Policies

In the notes to the audited consolidated financial statements for the year ended December 31, 2004 included in WWA Group s Form 10-KSB, WWA Group discusses those accounting policies that are considered to be significant in determining the results of operations and its financial position. WWA Group believes that the accounting principles utilized by it conform to accounting principles generally accepted in the United States of America.

The preparation of financial statements requires management to make significant estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. By their nature, these judgments are subject to an inherent degree of uncertainty. On an on-going basis, WWA Group evaluates its estimates, including those related to bad debts, inventories, intangible assets, warranty obligations, product liability, revenue and income taxes. WWA Group bases its estimates on historical experience and other facts and circumstances that are believed to be reasonable, and the results from the basis for making judgments about the carrying value of assets and liabilities. The actual results may differ from these estimates under different assumptions and conditions.

WWA Group applies the following critical accounting policies related to revenue recognition in the preparation of financial statements.

Revenue Recognition

Revenues earned in WWA Group s capacity as agent for consignors of equipment are comprised mainly of auction commissions in the form of flat selling fees or fixed or sliding percentages of the gross auction sale price of any consigned equipment. The majority of auction commissions are earned as a fixed rate of the gross selling price. Revenues from commissions and services also include any preparation, shipping, clearing, transport and handling charges and fees applicable to certain items of consigned equipment and incidental interest income. All revenue is recognized when the auction sale is complete and WWA Group has determined that the auction proceeds are collectible.

Revenues from sales of equipment consist of sales of equipment inventory that is owned or underwritten by WWA

Group. Sales occur either in auction or private sale. WWA Group recognizes the revenue from such sales when the auction or private sale has been completed, the equipment has been delivered to the purchaser, and collectibility is reasonably assured. All costs of goods sold are accounted for under direct costs.

Allowance for Doubtful Accounts

WWA Group makes estimates of the collectability of accounts receivable. In doing so, WWA Group analyzes accounts receivable and historical bad debts, customer credit-worthiness, current economic trends and changes in customer payment patterns when evaluating the adequacy of the allowance for doubtful accounts.

ITEM 3. CONTROLS AND PROCEDURES

a) Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as of Sept 30, 2005. Based on this evaluation, our principal executive officer and our principal financial officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective and adequately designed to ensure that the information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms and that such information was accumulated and communicated to our chief executive officer and chief financial officer, in a manner that allowed for timely decisions regarding required disclosure.

The auditors did not test the effectiveness of nor relied on the internal controls of WWA Group for the fiscal quarters ended September 30, 2005 and 2004. . (b) Changes in internal controls over financial reporting.

During the quarter ended Sept 30, 2005 there has been no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

2.4 Certificate of Incorporation and Bylaws; Directors and Officers. Unless otherwise determined by Parent prior to the Effective Time:

(a) the Certificate of Incorporation of the Surviving Corporation shall be amended in its entirety immediately after the Effective Time to conform to the Certificate of Incorporation of Acquisition Sub as in effect immediately prior to the Effective Time, except that the name of the Surviving Corporation shall be Monolithic System Technology, Inc. ;

(b) the Bylaws of the Surviving Corporation shall be amended and restated as of the Effective Time to conform to the Bylaws of Acquisition Sub as in effect immediately prior to the Effective Time; and

(c) the directors and officers of the Surviving Corporation immediately after the Effective Time shall be the respective individuals who are directors and officers of Acquisition Sub immediately prior to the Effective Time.

2.5 Conversion of Shares.

(a) At the Effective Time, by virtue of the Merger and without any further action on the part of Parent, Acquisition Sub, the Company or any stockholder of the Company:

(i) any shares of Company Common Stock then held by the Company or any wholly owned Subsidiary of the Company (or held in the Company s treasury) shall be canceled and retired and shall cease to exist, and no consideration shall be delivered in exchange therefor;

(ii) any shares of Company Common Stock then held by Parent, Acquisition Sub or any other wholly owned Subsidiary of Parent shall be canceled and retired and shall cease to exist, and no consideration shall be delivered in exchange therefor;

(iii) except as provided in clauses (i) and (ii) above and subject to Sections 2.5(b), 2.5(c), 2.5(d) and 2.7, each share of Company Common Stock then outstanding shall be converted into the right to receive (upon the proper surrender of the certificate representing such share) the Per Share Consideration; and

(iv) each share of the common stock, $0.01 par value per share, of Acquisition Sub then outstanding shall be converted into one share of common stock of the Surviving Corporation.

(b) If, between the date of this Agreement and the Effective Time, the outstanding shares of either Company Common Stock or Parent Common Stock are changed into a different number or class of shares by reason of any stock split, division or subdivision of shares, stock dividend, reverse stock split, consolidation of shares, reclassification, recapitalization or other similar transaction, then the Per Share Consideration shall be adjusted to the extent appropriate.

(c) If any share of Company Common Stock outstanding immediately prior to the Effective Time is unvested or is subject to a repurchase option, risk of forfeiture or other condition under any applicable restricted stock purchase agreement or other agreement with the Company or under which the Company has any rights, then the Per Share Consideration deliverable with respect thereto pursuant to Section 2.5(a)(iii) will also be unvested and subject to the same repurchase option, risk of forfeiture or other condition. The Company shall take all action that may be necessary to ensure that, from and after the Effective Time, Parent is entitled to exercise any such repurchase option or other right set forth in any such restricted stock purchase agreement or other agreement.

(d) No fractional shares of Parent Common Stock shall be issued in connection with the Merger, and no certificates or scrip for any such fractional shares shall be issued in connection with the Merger. Any holder of Company Common Stock who would otherwise be entitled to receive a fraction of a share of Parent Common Stock in the Merger (after aggregating all fractional shares of Parent Common Stock issuable to such holder in the Merger) shall, in lieu of such fraction of a share and upon surrender of such holder s Stock Certificate(s) (as defined in Section 2.6(b)), be paid in cash the dollar amount (rounded to the nearest whole cent), without interest,

determined by multiplying such fraction by the closing trading price of a share of Parent Common Stock as reported on the Nasdaq National Market on the trading day immediately before the date on which the Merger becomes effective.

2.6 Surrender of Certificates; Stock Transfer Books.

(a) Prior to the Effective Time, Parent shall designate a bank or trust company to act as exchange agent in the Merger (the Exchange Agent). As soon as practicable after the Effective Time, Parent shall deposit with the Exchange Agent (i) cash in an amount equal to the cash payable pursuant to Section 2.5(a)(iii), (ii) certificates representing any shares of Parent Common Stock issuable pursuant to Section 2.5(a)(iii) and (iii) cash sufficient to make any payments in lieu of fractional shares of Parent Common Stock in accordance with Section 2.5(d), in each case assuming no holder of Company Common Stock perfects appraisal rights under Section 262 of the DGCL. The cash amounts and any shares of Parent Common Stock so deposited with the Exchange Agent, together with any dividends or distributions received by the Exchange Agent with respect to such shares, are referred to collectively as the Exchange Fund. The cash in the Exchange Fund shall be invested by the Exchange Agent as directed by Parent in money market funds or similar short-term liquid investments.

(b) As soon as reasonably practicable after the Effective Time, Parent will instruct the Exchange Agent to mail to the Persons who, immediately prior to the Effective Time, were record holders of certificates representing shares of Company Common Stock (Stock Certificates) (i) a letter of transmittal in customary form and containing such provisions as Parent may reasonably specify (including a provision confirming that delivery of Stock Certificates shall be effected, and risk of loss and title to Stock Certificates shall pass, only upon delivery of such Stock Certificates to the Exchange Agent), and (ii) instructions for use in effecting the surrender of Stock Certificates. Upon surrender of a Stock Certificate to the Exchange Agent for exchange, together with a duly executed letter of transmittal and such other documents as may be reasonably required by the Exchange Agent or Parent, (A) the holder of such Stock Certificate shall be entitled to receive in exchange therefor the consideration deliverable to such holder pursuant to Section 2.5(a)(iii) and any cash payment in lieu of a fractional share of Parent Common Stock in accordance with Section 2.5(d), and (B) the Stock Certificate so surrendered shall be canceled. Until surrendered as contemplated by this Section 2.6(b), each Stock Certificate shall be deemed, from and after the Effective Time, to represent solely the right to receive the Per Share Consideration for each share of Company Common Stock formerly evidenced by such Stock Certificate. If any Stock Certificate shall have been lost, stolen or destroyed, Parent may, in its discretion and as a condition to the delivery of any consideration with respect thereto, require the owner of such lost, stolen or destroyed Stock Certificate to provide an appropriate affidavit and to deliver a bond (in such sum as Parent may reasonably direct) as indemnity against any claim that may be made against the Exchange Agent, Parent or the Surviving Corporation with respect to such Stock Certificate.

(c) No dividends or other distributions declared or made with respect to Parent Common Stock with a record date after the Effective Time shall be paid to the holder of any unsurrendered Stock Certificate with respect to any shares of Parent Common Stock that such holder has the right to receive in the Merger until such holder surrenders such Stock Certificate in accordance with this Section 2.6 (at which time such holder shall be entitled, subject to the effect of applicable escheat or similar laws, to receive all such dividends and distributions, without interest).

(d) Any portion of the Exchange Fund that remains undistributed to holders of Stock Certificates as of the date 180 days after the date on which the Merger becomes effective shall be delivered to Parent upon demand, and any holders of Stock Certificates who have not theretofore surrendered their Stock Certificates in accordance with this Section 2.6 shall thereafter look only to Parent for satisfaction of their claims for delivery of consideration in connection with the Merger. Neither Parent nor the Surviving Corporation shall be liable to any holder or former holder of Company Common Stock or to any other Person with respect to any cash amounts or shares of Parent Common Stock delivered to any public official pursuant to any applicable abandoned property law, escheat law or similar Legal Requirement.

(e) At the Effective Time, holders of Stock Certificates that were outstanding immediately prior to the Effective Time shall cease to have any rights as stockholders of the Company, and the stock transfer books of the Company shall be closed with respect to all shares of Company Common Stock outstanding immediately prior to the Effective Time. No further transfer of any such shares of Company Common Stock shall be made on such stock transfer books after the Effective Time. If, after the Effective Time, a valid Stock Certificate is presented to the Surviving Corporation or Parent, such Company Stock Certificate shall be canceled and shall be exchanged as provided in this Section 2.6.

(f) Parent and the Surviving Corporation shall be entitled to deduct and withhold from any consideration payable or otherwise deliverable to any holder or former holder of Company Common Stock pursuant to this Agreement such amounts as Parent or the Surviving Corporation determines in good faith may be required to be deducted or withheld therefrom under the Code or any provision of state, local or foreign Tax law or under any other Legal Requirement. To the extent any such amounts are so deducted or withheld, such amounts shall be treated for all purposes under this Agreement as having been paid to the Person to whom such amounts would otherwise have been paid.

(g) If any Stock Certificate has not been surrendered by the earlier of (i) the fifth anniversary of the date on which the Merger becomes effective or (ii) the date immediately prior to the date on which the consideration that such Stock Certificate represents the right to receive would otherwise escheat to or become the property of any Governmental Body, then such consideration shall, to the extent permitted by applicable Legal Requirements, become the property of the Surviving Corporation, free and clear of any claim or interest of any Person previously entitled thereto.

2.7 Appraisal Rights.

(a) Notwithstanding anything to the contrary contained in this Agreement, any share of Company Common Stock that, as of the Effective Time, is held by a holder who has, as of the Effective Time, preserved such holder s appraisal rights under Section 262 of the DGCL with respect to such share shall not be converted into or represent the right to receive the Per Share Consideration in accordance with Section 2.5(a)(iii), and the holder of such share shall be entitled only to such rights as may be granted to such holder pursuant to Section 262 of the DGCL with respect to such share; *provided, however,* that if such appraisal rights shall not be perfected or the holder of such share shall otherwise lose such holder s appraisal rights with respect to such share, then, as of the later of the Effective Time or the time of the failure to perfect such rights or the loss of such rights, such share shall automatically be converted into and shall represent only the right to receive (upon the surrender of the Stock Certificate representing such share) the Per Share Consideration in accordance with Section 2.5(a)(iii).

(b) The Company shall give Parent (i) prompt notice of (A) any written demand received by the Company prior to the Effective Time to require the Company to purchase shares of Company Common Stock pursuant to Section 262 of the DGCL and (B) any other demand, notice or instrument delivered to the Company prior to the Effective Time pursuant to the DGCL, and (ii) the opportunity to direct all negotiations and proceedings with respect to any such demand, notice or instrument. Without limiting the generality of the foregoing, the Company shall not make any payment or settlement offer prior to the Effective Time with respect to any such demand unless Parent shall have consented in writing to such payment or settlement offer.

2.8 Tax Consequences. For federal income tax purposes, assuming that the All-Cash Election is not made, the Offer, the Merger and the Second Merger together are intended to constitute a reorganization within the meaning of Section 368(a) of the Code. The parties to this Agreement hereby adopt this Agreement as a plan of reorganization within the meaning of Sections 1.368-2(g) and 1.368-3(a) of the United States Treasury Regulations.

2.9 Further Action. If, at any time after the Effective Time, any further action is determined by Parent to be necessary or desirable to carry out the purposes of this Agreement or to vest the Surviving Corporation with full

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right, title and possession of and to all rights and property of Acquisition Sub and the Company, the officers and directors of the Surviving Corporation and Parent shall be fully authorized (in the name of Acquisition Sub, in the name of the Company and otherwise) to take such action.

Section 3. Representations and Warranties of the Company

The Company represents and warrants to Parent and Acquisition Sub as follows:

3.1 Subsidiaries; Due Organization; Etc.

(a) The Company has no Subsidiaries, except for the corporations identified in Part 3.1(a)(i) of the Disclosure Schedule; and neither the Company nor any of the other corporations identified in Part 3.1(a)(i) of the Disclosure Schedule owns any capital stock of, or any equity interest of any nature in, any other Entity, other than the Entities identified in Part 3.1(a)(ii) of the Disclosure Schedule. None of the Acquired Corporations has agreed or is obligated to make, or is bound by any Contract under which it may become obligated to make, any future investment in or capital contribution to any other Entity. None of the Acquired Corporations has, at any time, been a general partner of, or has otherwise been liable for any of the debts or other obligations of, any general partnership, limited partnership or other Entity.

(b) Each of the Acquired Corporations is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation and has all necessary power and authority: (i) to conduct its business in the manner in which its business is currently being conducted; (ii) to own and use its assets in the manner in which its assets are currently owned and used; and (iii) to perform its obligations under all Contracts by which it is bound.

(c) Each of the Acquired Corporations is qualified to do business as a foreign corporation, and is in good standing, under the laws of all jurisdictions where the nature of its business requires such qualification.

3.2 Certificate of Incorporation and Bylaws. The Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access) accurate and complete copies of the certificate of incorporation, bylaws and other charter and organizational documents of the respective Acquired Corporations, including all amendments thereto.

3.3 Capitalization, Etc.

(a) The authorized capital stock of the Company consists of: (i) 120,000,000 shares of Company Common Stock, of which 30,767,544 shares were issued and outstanding as of February 20, 2004; and (ii) 20,000,000 shares of Preferred Stock, $.01 par value per share, of which no shares have been issued or are outstanding. Except as set forth in Part 3.3(a)(i) of the Disclosure Schedule, the Company does not hold any shares of its capital stock in its treasury. All of the outstanding shares of Company Common Stock have been duly authorized and validly issued, and are fully paid and nonassessable. There are no shares of Company Common Stock held by any of the other Acquired Corporations. Except as set forth in Part 3.3(a)(ii) of the Disclosure Schedule: (i) none of the outstanding shares of Company Common Stock is entitled or subject to any preemptive right, right of participation, right of maintenance or any similar right; (ii) none of the outstanding shares of Company Common Stock is subject to any right of first refusal in favor of the Company; and (iii) there is no Acquired Corporation Contract relating to the voting or registration of, or restricting any Person from purchasing, selling, pledging or otherwise disposing of (or granting any option or similar right with

respect to), any shares of Company Common Stock. None of the Acquired Corporations is under any obligation, or is bound by any Contract pursuant to which it may become obligated, to repurchase, redeem or otherwise acquire any outstanding shares of Company Common Stock. Part 3.3(a)(iii) of the Disclosure Schedule describes all repurchase rights held by the Company with respect to shares of Company Common Stock (whether such shares were issued pursuant to the exercise of Company Options or otherwise).

(b) As of the date of this Agreement: (i) 120,000 shares of Company Preferred Stock, designated as Series AA Preferred Stock, are reserved for future issuance upon exercise of the Company Rights; (ii) no shares of Company Common Stock are subject to issuance pursuant to stock options granted and outstanding under the Company s 1992 Stock Option Plan (the 1992 Plan); (iii) 3,206,456 shares of Company Common Stock are subject to issuance pursuant to stock options granted and outstanding under the Company s 1996 Stock Plan (the 1996 Plan); (iv) 1,166,499 shares of Company Common Stock are subject to issuance pursuant to stock options granted and outstanding under the Company s 2000 Employee Stock Option Plan (the 2000 Plan and, together with the 1992 Plan and the 1996 Plan, the Company Option Plans); and (v) 365,613 shares of Company Common Stock are reserved for future issuance pursuant to the Company s 2000 Employee Stock Purchase Plan (the ESPP). (Options to purchase shares of Company Common Stock (whether granted by the Company pursuant to the Company Option Plans, assumed by the Company in connection with any merger, acquisition or similar transaction or otherwise issued or granted) are referred to in this Agreement as Company Options.) Part 3.3(b) of the Disclosure Schedule sets forth the following information with respect to each Company Option outstanding as of the date of this Agreement: (i) the particular Company Option Plan (if any) pursuant to which such Company Option was granted; (ii) the name of the optionee; (iii) the number of shares of Company Common Stock subject to such Company Option; (iv) the exercise price of such Company Option; (v) the date on which such Company Option was granted; (vi) the applicable vesting schedule, and the extent to which such Company Option is vested and exercisable as of the date of this Agreement; and (vii) the date on which such Company Option expires. The Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access) accurate and complete copies of all stock option plans pursuant to which the Acquired Corporations have granted stock options, and the forms of all stock option agreements evidencing such options.

(c) Except as set forth in Part 3.3(b) of the Disclosure Schedule, there is no: (i) outstanding subscription, option, call, warrant or right (whether or not currently exercisable) to acquire any shares of the capital stock or other securities of any of the Acquired Corporations; (ii) outstanding security, instrument or obligation that is or may become convertible into or exchangeable for any shares of the capital stock or other securities of any of the Acquired Corporations; or (iii) stockholder rights plan (or similar plan commonly referred to as a poison pill) or Contract under which any of the Acquired Corporations is or may become obligated to sell or otherwise issue any shares of its capital stock or any other securities; or (iv) condition or circumstance that has given rise to or provided a basis for the assertion of a claim by any Person to the effect that such Person is entitled to acquire or receive any shares of capital stock or other securities of any of the Acquired Corporations.

(d) All outstanding shares of Company Common Stock, options, warrants and other securities of the Acquired Corporations have been issued and granted in compliance with (i) all applicable securities laws and other applicable Legal Requirements, and (ii) all requirements set forth in applicable Contracts.

(e) All of the outstanding shares of capital stock of each of the Company s Subsidiaries have been duly authorized and validly issued, are fully paid and nonassessable and free of preemptive rights, with no personal liability attaching to the ownership thereof, and are owned beneficially and of record by the Company, free and clear of any Encumbrances.

3.4 SEC Filings; Financial Statements.

(a) The Company has delivered or made available to Parent accurate and complete copies of all Company SEC Documents. All statements, reports, schedules, forms and other documents required to have been filed by the Company or its officers with the SEC have been so filed on a timely basis. None of the Company s Subsidiaries is required to file any documents with the SEC. As of the time it was filed with the SEC (or, if amended or superseded by a filing prior to the date of this Agreement, then on the date of such filing): (i) each of the Company SEC Documents complied in all material respects with the applicable requirements of the Securities Act or the Exchange Act (as the case may be); and (ii) none of the Company SEC Documents contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein

or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading.

(b) The Company maintains disclosure controls and procedures required by Rule 13a-15 under the Exchange Act as in effect on the date of this Agreement. Such controls and procedures are effective to ensure that all material information concerning the Acquired Corporations is made known on a timely basis to the individuals responsible for the preparation of the Company s filings with the SEC and other public disclosure documents. The Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access) copies of, all written descriptions of, and all policies, manuals and other documents promulgating, such disclosure controls and procedures. Except as disclosed in the Company SEC Documents, each director and officer of the Company has filed with or furnished to the SEC all statements required by Section 16(a) of the Exchange Act and the rules and regulations thereunder since January 1, 2001.

(c) The financial statements (including any related notes) contained in the Company SEC Documents: (i) complied as to form in all material respects with the published rules and regulations of the SEC applicable thereto; (ii) were prepared in accordance with generally accepted accounting principles applied on a consistent basis throughout the periods covered (except as may be indicated in the notes to such financial statements or, in the case of unaudited statements, as permitted by Form 10-Q of the SEC, and except that the unaudited financial statements may not contain footnotes and are subject to normal and recurring year-end adjustments that will not, individually or in the aggregate, be material in amount); and (iii) fairly present in all material respects the consolidated financial position of the Company and its consolidated subsidiaries as of the respective dates thereof and the consolidated results of operations and cash flows of the Company and its consolidated subsidiaries for the periods covered thereby.

(d) The Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access) an accurate and complete copy of the Unaudited 2003 Year-End Financial Statements. The Unaudited 2003 Year-End Financial Statements: (i) were prepared in accordance with generally accepted accounting principles applied on a basis consistent with the basis on which the financial statements referred to in Section 3.4(c) were prepared; and (ii) fairly present in all material respects the consolidated financial position of the Company and its consolidated subsidiaries as of December 31, 2003 and the consolidated results of operations and cash flows of the Company and its consolidated subsidiaries for the year then ended, except that the Unaudited 2003 Year-End Financial Statements may not contain footnotes and are subject to normal and recurring year-end adjustments that will not, individually or in the aggregate, be material in amount.

(e) Part 3.4(e) of the Disclosure Schedule lists, and the Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access) copies of the documentation creating or governing, all securitization transactions and off-balance sheet arrangements (as defined in Item 303(c) of Regulation S-K under the Exchange Act) effected by any of the Acquired Corporations since January 1, 2001. The Company s auditor, since the date of enactment of the Sarbanes-Oxley Act, has at all times since such date been (i) a registered public accounting firm (as defined in Section 2(a)(12) of the Sarbanes-Oxley Act), (ii) independent with respect to the Company within the meaning of Regulation S-X under the Exchange Act and (iii) to the knowledge of the Company in compliance with subsections (g) through (l) of Section 10A of the Exchange Act and the rules and regulations promulgated by the SEC thereunder and the Public Company Accounting Oversight Board. Part 3.4(e) of the Disclosure Schedule summarizes all non-audit services performed by the Company s auditor for the Acquired Corporations since January 1, 2001.

3.5 Absence of Changes. Except as set forth in Part 3.5 of the Disclosure Schedule, since December 31, 2003:

(a) there has not been any Company Material Adverse Effect, and no event has occurred or circumstance has arisen that, in combination with any other events or circumstances, could reasonably be expected to have or result in a Company Material Adverse Effect;

(b) none of the Acquired Corporations has (i) declared, accrued, set aside or paid any dividend or made any other distribution in respect of any shares of capital stock, or (ii) repurchased, redeemed or otherwise reacquired any shares of capital stock or other securities (other than repurchases under the terms of and in accordance with employee equity incentive arrangements);

(c) none of the Acquired Corporations has sold, issued or granted, or authorized the issuance of, (i) any capital stock or other security (except for Company Common Stock issued upon the valid exercise of outstanding Company Options), (ii) any option, warrant or right to acquire any capital stock or any other security (except for Company Options identified in Part 3.3(b) of the Disclosure Schedule), or (iii) any instrument convertible into or exchangeable for any capital stock or other security;

(d) the Company has not amended or waived any of its rights under, or permitted the acceleration of vesting under, (i) any provision of any of the Company s stock option plans, (ii) any provision of any Contract evidencing any outstanding Company Option, or (iii) any restricted stock purchase agreement;

(e) there has been no amendment to the certificate of incorporation, bylaws or other charter or organizational documents of any of the Acquired Corporations, and none of the Acquired Corporations has effected or been a party to any merger, consolidation, share exchange, business combination, recapitalization, reclassification of shares, stock split, reverse stock split or similar transaction;

(f) none of the Acquired Corporations has received any Acquisition Proposal;

(g) none of the Acquired Corporations has formed any Subsidiary or acquired any equity interest or other interest in any other Entity;

(h) none of the Acquired Corporations has made any capital expenditure on or prior to the date of this Agreement which, when added to all other capital expenditures made on behalf of the Acquired Corporations since December 31, 2003, exceeds $250,000 in the aggregate;

(i) except in the ordinary course of business and consistent with past practices, none of the Acquired Corporations has (i) entered into or permitted any of the assets owned or used by it to become bound by any Material Contract (as defined in Section 3.10), or (ii) amended or terminated, or waived any material right or remedy under, any Material Contract;

(j) none of the Acquired Corporations has (i) acquired, leased or licensed any material right or other material asset from any other Person, (ii) sold or otherwise disposed of, or leased or licensed, any material right or other material asset to any other Person, or (iii) waived or relinquished any right, except in each case for rights or other assets acquired, leased, licensed or disposed of in the ordinary course of business and consistent with past practices;

(k) except in the ordinary course of business and consistent with past practices, none of the Acquired Corporations has written off as uncollectible, or established any extraordinary reserve with respect to, any account receivable or other indebtedness;

(l) none of the Acquired Corporations has made any pledge of any of its assets or otherwise permitted any of its assets to become subject to any Encumbrance, except for pledges of immaterial assets made in the ordinary course of business and consistent with past practices;

(m) none of the Acquired Corporations has (i) lent money to any Person, or (ii) incurred or guaranteed any indebtedness for borrowed money;

(n) none of the Acquired Corporations has (i) adopted, established or entered into any Employee Plan (as defined in Section 3.17), (ii) caused or permitted any Employee Plan to be amended in any material respect, or

(iii) paid any bonus or made any profit-sharing or similar payment to, or materially increased the amount of the wages, salary, commissions, fringe benefits or other compensation or remuneration payable to, any of its directors, officers or employees, other than (x) increases granted prior to the date of this Agreement in annual salary or wage rates payable to employees of the Acquired Corporations that have been granted in the ordinary course of business consistent with past practices and at regularly scheduled times, and (y) with respect to bonus amounts accrued for and payable in the ordinary course of business consistent with past practices under bonus plans in existence prior to December 31, 2003 and disclosed to Parent;

(o) except for any such change required by reason of a change in Legal Requirements or a change in GAAP, none of the Acquired Corporations has changed any of its methods of accounting or accounting practices in any material respect;

(p) none of the Acquired Corporations has made any material Tax election;

(q) none of the Acquired Corporations has commenced or settled any Legal Proceeding other than with respect to routine collections matters initiated by any Acquired Corporation in the ordinary course of business;

(r) none of the Acquired Corporations has entered into any material transaction or taken any other material action that has had, or could reasonably be expected to have, a Company Material Adverse Effect;

(s) none of the Acquired Corporations has entered into any material transaction or taken any other material action outside the ordinary course of business or inconsistent with past practices; and

(t) none of the Acquired Corporations has agreed or committed to take any of the actions referred to in clauses (c) through (s) above.

3.6 Title to Assets. The Acquired Corporations own, and have good and valid title to, all assets purported by the Company to be owned by them, including: (i) all assets reflected on the Unaudited 2003 Year-End Balance Sheet (except for inventory or used or obsolete equipment sold or otherwise disposed of in the ordinary course of business since the date of the Unaudited 2003 Year-End Balance Sheet); and (ii) all other assets reflected in the books and records of the Acquired Corporations as being owned by the Acquired Corporations. All of said assets are owned by the Acquired Corporations free and clear of any Encumbrances, except for (1) any lien for current taxes not yet due and payable, (2) liens that have arisen in the ordinary course of business and that do not (in any case or in the aggregate) materially detract from the value of the assets subject thereto or materially impair the operations of any of the Acquired Corporations, (3) liens arising in the ordinary course of business in favor of landlords pursuant to lease agreements that have been disclosed to Parent, and (4) liens described in Part 3.6 of the Disclosure Schedule.

3.7 Receivables; Inventories.

(a) All existing accounts receivable of the Acquired Corporations (including those accounts receivable reflected on the Unaudited 2003 Year-End Balance Sheet that have not yet been collected and those accounts receivable that have arisen since December 31, 2003 and have not yet been collected) (a) represent valid obligations of customers of the Acquired Corporations arising from bona fide transactions entered into in the ordinary course of business, (b) are current and, to the Company s knowledge, will in the aggregate be collected in full when due, without any counterclaim or set off (net of an allowance for doubtful accounts calculated in accordance with generally accepted accounting principles applied on a basis consistent with the basis on which the financial statements referred to in Section 3.4(c) were prepared).

(b) The inventory of the Acquired Corporations reflected on the balance sheet forming a part of the Unaudited Financial Statements was, and the current inventory (the Inventory) of the Acquired Corporations is, in usable and saleable condition in the ordinary course of business and in the case of inventory reflected on such

balance sheet at an amount not less than the amounts carried therein. The finished goods, work in progress, raw materials and other materials and supplies included in such Inventory are of a standard which is not lower than the generally accepted standard prevailing in the industries in which the business of each Acquired Corporation forms a part.

3.8 Real Property; Leasehold. None of the Acquired Corporations own any real property or any interest in real property, except for: (i) the leaseholds created under the real property leases identified in Part 3.8(a)(i) of the Disclosure Schedule; and (ii) the land described in Part 3.8(a)(ii) of the Disclosure Schedule to which the Company has good and marketable fee title and which is owned by the Company free and clear of any Encumbrances, except for the Encumbrances identified in Part 3.8(ii) of the Disclosure Schedule or that do not materially detract from the value of such leaseholds or property.

3.9 Intellectual Property.

(a) ***Registered IP***. Part 3.9(a) of the Disclosure Schedule accurately identifies (i) each item of Registered IP in which any Acquired Corporation has an ownership interest of any nature (whether exclusively, jointly with another Person, or otherwise); (ii) the jurisdiction in which such item of Registered IP has been registered or filed and the applicable registration or serial number; and (iii) any other Person that has an ownership interest in such item of Registered IP and the nature of such ownership interest. The Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access) complete and accurate copies of all applications, material correspondence, and other material documents related to each such item of Registered IP.

(b) ***Inbound Licenses***. Part 3.9(b) of the Disclosure Schedule (i) accurately identifies each Contract under which Intellectual Property Rights or Intellectual Property is licensed to any Acquired Corporation (other than any commercially available third-party software that (A) is licensed to the Acquired Corporations solely in executable or object code form pursuant to a non-exclusive, internal use software license, and (B) is not incorporated into, or used directly in the development, manufacturing, testing, distribution, or support of, any Acquired Corporations Product); and (ii) specifies whether the rights licensed to the Acquired Corporations are exclusive or non-exclusive. The Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access) an accurate and complete copy of each Contract identified, or required to be identified, in Part 3.9(b) of the Disclosure Schedule.

(c) ***Outbound Licenses***. Part 3.9(c) of the Disclosure Schedule accurately identifies each Contract pursuant to which any Person has been granted any license under, or otherwise has received or acquired any right (whether or not currently exercisable) or interest in (i) any Intellectual Property Rights in any Acquired Corporation Products, (ii) any Acquired Corporation IP that is Registered IP, or (iii) any other Acquired Corporation IP that is material to the business of any Acquired Corporation. For each of the Contracts required to be identified as set forth above, Part 3.9(c) of the Disclosure Schedule identifies whether the rights granted are exclusive or nonexclusive. The Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access) an accurate and complete copy of each Contract identified, or required to be identified, in Part 3.9(c) of the Disclosure Schedule. No Acquired Corporation is bound by, and no Acquired Corporation IP is subject to, any Contract containing any covenant or other provision that in any way limits or restricts the ability of any Acquired Corporation to use, exploit, assert, or enforce any Acquired Corporation IP, or compete or engage in any kind of business, anywhere in the world.

(d) ***Other Commercial and IP Agreements***. The Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access) a complete and accurate copy of (i) the most current version of the Acquired Corporations standard terms of sale of any semiconductor chip product; (ii) the Acquired Corporations standard purchase terms with all suppliers of parts or services related to semiconductor chip products, including development, manufacturing, testing, wafer-sorting, packaging, and assembly; (iii) all Contracts (other than those identified in Part 3.9(c) of the Disclosure Schedule) pursuant to

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which any Person has a currently enforceable or exercisable right to sublicense or otherwise transfer rights in any material Acquired Corporation IP to any other Person; (iv) each joint marketing, joint development, strategic alliance, and similar Contract to which any Acquired Corporation is a party and which is currently in effect; (v) each Contract that is currently in effect and provides for the sale or supply of memory chip products by any Acquired Corporation (other than individual purchase orders); and (vi) each distribution, reseller, sales representative, or other similar Contract for any Acquired Corporation Product that is currently in effect. Part 3.9(d) of the Disclosure Schedule accurately identifies each Contract described in clauses (iii), (iv), (v) and (vi) above.

(e) ***Ownership Free and Clear***. The Acquired Corporations exclusively own all right, title, and interest to and in the Acquired Corporation IP (other than Intellectual Property Rights licensed to the Acquired Corporations, as identified in Part 3.9(b) of the Disclosure Schedule) free and clear, to the Company s knowledge, of any Encumbrances (other than licenses granted pursuant to the Contracts listed in Part 3.9(c) of the Disclosure Schedule). Without limiting the generality of the foregoing:

(i) ***Perfection of Rights***. To the knowledge of the Company, all documents and instruments necessary to vest or perfect the rights of the Acquired Corporations in the Acquired Corporation IP that is Registered IP have been validly executed, delivered, and filed in a timely manner with the appropriate Governmental Body.

(ii) ***Employees and Contractors***. Each Person who is or was an employee or contractor of any Acquired Corporation and who is or was involved in any material respect in the creation or development of any Acquired Corporation Product has signed a valid, enforceable agreement containing an assignment of all Intellectual Property Rights in such Acquired Corporations Product to one or more of the Acquired Corporations and confidentiality provisions protecting the Acquired Corporation IP (other than Acquired Corporation IP that is generally available to the public through no fault of the employee or contractor). No current or former shareholder, officer, director, or employee of any Acquired Corporation has any claim, right (whether or not currently exercisable), or interest to or in any Acquired Corporation IP. To the Company s knowledge, no employee of any Acquired Corporation is in breach of any Contract with any former employer or other Person concerning Intellectual Property Rights or confidentiality.

(iii) ***Government or University Rights***. To the Company s knowledge, no funding, facilities, or personnel of any Governmental Body or of any college, university, or other educational institution were used, directly or indirectly, to develop or create, in whole or in part, any Acquired Corporation IP.

(iv) ***Protection of Proprietary Information***. Each of the Acquired Corporations (other than Atmos Corporation) and, to the Company s knowledge, Atmos Corporation has taken reasonable steps to maintain the confidentiality of and otherwise protect and enforce the Acquired Corporations rights in all proprietary information that the Acquired Corporations hold, or purport to hold, as a trade secret.

(v) ***Standards Bodies***. To the knowledge of the Company, no Acquired Corporation is or ever was a member or promoter of, or a contributor to, any industry standards body or similar organization that could require or obligate any Acquired Corporation to grant or offer to any other Person any license or right to any Acquired Corporation IP.

(vi) ***Sufficiency***. The Acquired Corporations own or otherwise have, and immediately after the Closing will continue to have, all Intellectual Property Rights needed to conduct their respective businesses as currently conducted.

(f) ***Valid, Subsisting, and Enforceable***. To the Company s knowledge, all Acquired Corporation IP is valid, subsisting and enforceable. Without limiting the generality of the foregoing:

(i) ***Legal Requirements and Deadlines***. To the Company s knowledge, each item of Acquired Corporation IP that is Registered IP is and at all times has been in compliance with all applicable Legal Requirements and all filings, payments, and other actions required to be made or taken to maintain such item of Acquired Corporation IP in full force and effect have been made or taken by the applicable deadline.

(ii) ***Interference Proceedings and Similar Claims***. No interference, opposition, reissue, reexamination, or other Proceeding is pending or, to the Company s knowledge, threatened, in which the scope, validity, or enforceability of any Acquired Corporation IP is being, has been, or could reasonably be expected to be contested or challenged. To the Company s knowledge, there is no basis for any non-frivolous claim that any Acquired Corporation IP is invalid or unenforceable.

(g) ***No Third-Party Infringement of Acquired Corporation IP***. To the Company s knowledge, since January 1, 2001 no Person has infringed, misappropriated, or otherwise violated, and no Person is currently infringing, misappropriating, or otherwise violating, any Acquired Corporation IP. The Company has provided to Parent a complete and accurate copy of each letter or other written or electronic communication or correspondence that has been sent or otherwise delivered since January 1, 2001 by or to any Acquired Corporation or any representative of any Acquired Corporation regarding any actual, alleged, or suspected infringement or misappropriation of any Acquired Corporation IP. Part 3.9(g) of the Disclosure Schedule provides a brief description of the current status of the matter referred to in each such letter, communication, or correspondence.

(h) ***Effects of This Transaction***. To the Company s knowledge, neither the execution, delivery, or performance of this Agreement (or any of the ancillary agreements entered into, or required to be entered into, in connection with the Contemplated Transactions) nor the consummation of any of the Contemplated Transactions will, with or without notice or lapse of time, result in, or give any other Person the right or option to cause or declare, (i) a loss of, or Encumbrance on, any Acquired Corporation IP; (ii) a breach of any license agreement listed or required to be listed in Part 3.9(b), Part 3.9(c), or Part 3.9(d) of the Disclosure Schedule; (iii) the release, disclosure, or delivery of any Acquired Corporation IP by or to any escrow agent or other Person; or (iv) the grant, assignment, or transfer to any other Person of any license or other right or interest under, to, or in any Acquired Corporation IP.

(i) ***No Infringement of Third Party IP Rights***. To the Company s knowledge, no Acquired Corporation and no Acquired Corporation Product has ever infringed (directly, contributorily, by inducement, or otherwise), misappropriated, or otherwise violated any Intellectual Property Right of any other Person. No claim of infringement or misappropriation or similar claim or Proceeding is pending or, to the Company s knowledge, threatened against any Acquired Corporation or against any other Person who may be entitled to be indemnified, defended, held harmless, or reimbursed by any Acquired Corporation with respect to such claim or Proceeding. Except as set forth in Part 3.9(i) of the Disclosure Schedule, since January 1, 2001, no Acquired Corporation has received any notice or other communication (in writing or otherwise) relating to any actual, alleged, or suspected infringement, misappropriation, or violation of any Intellectual Property Rights of another Person.

(j) ***Harmful Code***. No Acquired Corporation Software contains any back door, drop dead device, time bomb, Trojan horse, virus, or worm such terms are commonly understood in the software industry) or any other code designed or intended to have, or capable of performing, any of the following functions: (i) disrupting, disabling, harming, or otherwise impeding in any manner the operation of, or providing unauthorized access to, a computer system or network or other device on which such code is stored or installed; or (ii) damaging or destroying any data or file without the user s consent.

(k) ***Source Code***. Except as set forth in Part 3.9(k) of the Disclosure Schedule, no source code for any Acquired Corporation Software has been delivered, licensed, or made available to any escrow agent or other third

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party. No Acquired Corporation has any duty or obligation (whether present, contingent, or otherwise) to deliver, license, or make available the source code for any Acquired Corporation Software to any escrow agent or other third party. No event has occurred, and no circumstance or condition exists, that (with or without notice or lapse of time) will, or could reasonably be expected to, result in the delivery, license, or disclosure of the source code for any Acquired Corporation Software to any third party.

(l) ***Open Source Code***. No Acquired Corporation Software (including any component thereof) is subject to any copyleft or other obligation or condition (including any obligation or condition under any open source license such as the GNU Public License, Lesser GNU Public License, or Mozilla Public License) that by its terms (i) requires, or conditions the use or distribution of such Acquired Corporation Software on, the disclosure, licensing, or distribution of any source code for any portion of such Acquired Corporation Software, or (ii) otherwise imposes any limitation, restriction, or condition on the right or ability of any Acquired Corporation to use or distribute any Acquired Corporations Product.

(m) ***Certain Royalties***. None of the Acquired Corporations (other than Atmos Corporation) has paid or been obligated to pay any royalties to Mosaid Technologies Incorporated (Mosaid) or any of its affiliates under the Development and License Agreement between Atmos and Mosaid dated July 28, 2000 (as amended) (the Mosaid Agreement). Atmos Corporation has not paid or been obligated to pay any royalties to Mosaid or any of its affiliates under the Mosaid Agreement since January 1, 2003 and currently has no accrued obligation to pay any such royalties. The business of the Acquired Corporations, as currently conducted and as currently planned to be conducted as of the date of this Agreement, does not and will not require any Acquired Corporation to pay any royalties under the Mosaid Agreement.

3.10 Contracts.

(a) Part 3.10(a) of the Disclosure Schedule identifies each Acquired Corporation Contract that constitutes a Material Contract. For purposes of this Agreement, each of the following shall be deemed to constitute a Material Contract :

(i) any Contract (A) relating to the employment of, or the performance of services by, any employee or consultant which requires, or may require, payments by the Acquired Corporations, or have a value to the Acquired Corporations, in excess of $100,000 on an individual basis, (B) pursuant to which any of the Acquired Corporations is or may become obligated to make any severance, termination or similar payment to any current or former employee or director, or (C) pursuant to which any of the Acquired Corporations is or may become obligated to make any bonus or similar payment (other than payments constituting base salary) in excess of $25,000 to any current or former employee or director;

(ii) any Contract of the type required under Section 3.9 to be identified on the Disclosure Schedule;

(iii) any Contract that provides for indemnification of any officer, director, employee or agent;

(iv) any Contract imposing any material restriction on the right or ability of any Acquired Corporation (A) to compete with any other Person, (B) to acquire any product or other asset or any services from any other Person, (C) to solicit, hire or retain any Person as an employee, consultant or independent contractor, (D) to develop, sell, supply, distribute, offer, support or service any product or any technology or other asset to or for any other Person, (E) to perform services for any other Person, or (F) to transact business or deal in any other manner with any other Person;

(v) any Contract (other than Contracts evidencing Company Options) (A) relating to the acquisition, issuance, voting, registration, sale or transfer of any securities, (B) providing any Person with any preemptive right, right of participation, right of maintenance or similar right with

respect to any securities, or (C) providing any of the Acquired Corporations with any right of first refusal with respect to, or right to repurchase or redeem, any securities;

(vi) any Contract incorporating or relating to any material guaranty, any warranty or any indemnity or similar obligation, except for Contracts substantially identical to the standard forms of end-user licenses

previously delivered by the Company to Parent (or otherwise made available in a data room to which Parent s Representatives have had access);

(vii) any Contract relating to any currency hedging;

(viii) any Contract (A) imposing any confidentiality obligation on any of the Acquired Corporations or on any other Person (other than routine confidentiality or nondisclosure agreements entered into by any Acquired Corporation in the ordinary course of business that do not otherwise constitute Material Contracts under this Section 3.10(a)) or (B) containing standstill or similar provisions;

(ix) any Contract to which any Governmental Body is a party or under which any Governmental Body has any rights or obligations, and any subcontract between any Acquired Corporation and any contractor or subcontractor to any Governmental Body;

(x) any Contract requiring that any of the Acquired Corporations give any notice or provide any information to any Person prior to considering or accepting any Acquisition Proposal or similar proposal, or prior to entering into any discussions, agreement, arrangement or understanding relating to any Acquisition Transaction or similar transaction;

(xi) any Contract that contemplates or involves the payment or delivery of cash or other consideration in an amount or having a value in excess of $100,000 in the aggregate, or contemplates or involves the performance of services having a value in excess of $100,000 in the aggregate;

(xii) any Contract that could reasonably be expected to have a material effect on (A) the business, condition, capitalization, assets, liabilities, operations or financial performance of any of the Acquired Corporations or (B) the ability of the Company to perform any of its obligations under, or to consummate any of the Contemplated Transactions; and

(xiii) any other Contract, if a breach of such Contract could reasonably be expected to have or result in a Company Material Adverse Effect.

The Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access) an accurate and complete copy of each Acquired Corporation Contract that constitutes a Material Contract.

(b) Each Acquired Corporation Contract that constitutes a Material Contract is valid and in full force and effect, and is enforceable in accordance with its terms, subject to (i) laws of general application relating to bankruptcy, insolvency and the relief of debtors, and (ii) rules of law governing specific performance, injunctive relief and other equitable remedies.

(c) Except as set forth in Part 3.10(c) of the Disclosure Schedule: (i) none of the Acquired Corporations has violated or breached, or committed any default under, any Acquired Corporation Contract; and, to the Company s knowledge, no other Person has violated or breached, or committed any default under, any Acquired Corporation Contract; (ii) to the Company s knowledge, no event has occurred, and no circumstance or condition exists, that (with or without notice or lapse of time) could reasonably be expected to (A) result in a violation or breach of any of the provisions of any Acquired Corporation Contract, (B) give any Person the right to declare a default or exercise any remedy under any Acquired Corporation Contract, (C) give any Person the right to receive or require a rebate, chargeback, penalty or change in delivery schedule under any

Acquired Corporation Contract, (D) give any Person the right to accelerate the maturity or performance of any Acquired Corporation Contract, or (E) give any Person the right to cancel, terminate or modify any Acquired Corporation Contract; (iii) since January 1, 2001, none of the Acquired Corporations has received any notice or other communication regarding any actual or possible violation or breach of, or default under, any Acquired Corporation Contract; and (iv) without limiting the foregoing, since January 1, 2002, none of the Acquired Corporations has failed to meet any development or delivery milestone under any Material Contract where, as a result of such failure, payment of any non-recurring engineering fees or other amounts due to any Acquired Corporation upon completion of such development or delivery milestone was withheld or delayed.

3.11 Sale of Products; Performance of Services

(a) Except as set forth in Part 3.11(a) of the Disclosure Schedule, each Acquired Corporation Product conformed and complied in all material respects with the terms and requirements of any applicable warranty or other Contract and with all applicable Legal Requirements.

(b) All custom development or design services and other services that have been performed by the Acquired Corporations were performed properly and in conformity in all material respects with the terms and requirements of all applicable warranties and other Contracts and with all applicable Legal Requirements.

(c) Except as set forth in Part 3.11(c) of the Disclosure Schedule, since January 1, 2001, no customer or other Person has asserted or (to the knowledge of the Company) threatened to assert any claim against any of the Acquired Corporations (i) under or based upon any warranty provided by or on behalf of any of the Acquired Corporations, or (ii) based upon any services performed by any of the Acquired Corporations.

3.12 Liabilities. None of the Acquired Corporations has any accrued, contingent or other liabilities of any nature, either matured or unmatured, except for: (a) liabilities identified as such in the liabilities column of the Unaudited 2003 Year-End Balance Sheet; (b) normal and recurring current liabilities that have been incurred by the Acquired Corporations since December 31, 2003 in the ordinary course of business and consistent with past practices; (c) liabilities described in Part 3.12 of the Disclosure Schedule; (d) liabilities for performance of obligations of the Acquired Corporations under Acquired Corporation Contracts that have been delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access), to the extent such liabilities are readily ascertainable (in nature, scope and amount) from the copies of such Acquired Corporation Contracts provided to Parent prior to the date of this Agreement; and (e) liabilities that are not, individually or in the aggregate, material to the Acquired Corporations.

3.13 Compliance with Legal Requirements. Each of the Acquired Corporations is, and has at all times since January 1, 2001 been, in compliance in all material respects with all applicable Legal Requirements. Since January 1, 2001, none of the Acquired Corporations has received any notice or other communication from any Governmental Body or other Person regarding any actual or possible violation of, or failure to comply with, any Legal Requirement.

3.14 Certain Business Practices. To the knowledge of the Company, none of the Acquired Corporations, and (to the knowledge of the Company) no director, officer, agent or employee of any of the Acquired Corporations, has (i) used any funds for unlawful contributions, gifts, entertainment or other unlawful expenses relating to political activity, (ii) made any unlawful payment to foreign or domestic government officials or employees or to foreign or domestic political parties or campaigns or violated any provision of the Foreign Corrupt Practices Act of 1977, as amended, or (iii) made any other unlawful payment.

3.15 Governmental Authorizations.

(a) The Acquired Corporations hold all Governmental Authorizations necessary to enable the Acquired Corporations to conduct their respective businesses in the manner in which such businesses are currently being conducted. All such Governmental Authorizations are valid and in full force and effect. Each Acquired Corporation is, and at all times since January 1, 2001 has been, in substantial compliance with the terms and requirements of such Governmental Authorizations. Since January 1, 2001, none of the Acquired Corporations has received any notice or other communication from any Governmental Body regarding (a) any actual or possible violation of or failure to comply with any term or requirement of any material Governmental Authorization, or (b) any actual or possible revocation, withdrawal, suspension, cancellation, termination or modification of any material Governmental Authorization.

(b) Part 3.15(b) of the Disclosure Schedule describes the terms of each grant, incentive or subsidy provided or made available to or for the benefit of any of the Acquired Corporations by any U.S. or foreign Governmental

Body or otherwise. Each of the Acquired Corporations is in full compliance with all of the terms and requirements of each grant, incentive and subsidy identified or required to be identified in Part 3.15(b) of the Disclosure Schedule. Neither the execution, delivery or performance of this Agreement, nor the consummation of the Offer or the Merger or any of the other Contemplated Transactions, will (with or without notice or lapse of time) give any Person the right to revoke, withdraw, suspend, cancel, terminate or modify any grant, incentive or subsidy identified or required to be identified in Part 3.15(b) of the Disclosure Schedule.

3.16 Tax Matters.

(a) Each of the Tax Returns required to be filed by or on behalf of the respective Acquired Corporations with any Governmental Body with respect to any taxable period ending on or before the Closing Date (the Acquired Corporation Returns) (i) has been or will be filed on or before the applicable due date (including any extensions of such due date), and (ii) has been, or will be when filed, prepared in all material respects in compliance with all applicable Legal Requirements. All amounts shown on the Acquired Corporation Returns to be due on or before the Closing Date have been or will be paid on or before the Closing Date.

(b) The Unaudited 2003 Year-End Balance Sheet fully accrues all actual and contingent liabilities for Taxes with respect to all periods through the date of this Agreement in accordance with generally accepted accounting principles except for liabilities for Taxes incurred since the date of the Unaudited 2003 Year-End Balance Sheet in the operation of the business of the Acquired Corporations. The Company will establish, in the ordinary course of business and consistent with its past practices, reserves adequate for the payment of all Taxes of the Acquired Corporations for the period from December 31, 2003 through the Closing Date.

(c) Except as set forth in Part 3.16(c) of the Disclosure Schedule, no Acquired Corporation Return from any Tax year that remains open or otherwise subject to audit has been or is being examined or audited by any Governmental Body. No extension or waiver of the limitation period applicable to any of the Acquired Corporation Returns for any Tax year that remains open or otherwise subject to audit has been granted (by the Company or any other Person), and no such extension or waiver has been requested from any Acquired Corporation.

(d) No claim or Legal Proceeding is pending or, to the knowledge of the Company, has been threatened against or with respect to any Acquired Corporation in respect of any material Tax. There are no unsatisfied liabilities for material Taxes (including liabilities for interest, additions to tax and penalties thereon and related expenses) with respect to any notice of deficiency or similar document received by any Acquired Corporation with respect to any material Tax (other than liabilities for Taxes asserted under any such notice of deficiency or similar document which are being contested in good faith by the Acquired Corporations and with respect to which adequate reserves for payment have been established on the Unaudited 2003 Year-End Balance Sheet). There are no liens for Taxes upon any of the assets of any of the Acquired Corporations except liens for current Taxes not yet due and payable. None of the Acquired Corporations has been, and none of the Acquired Corporations will be, required to include any adjustment in taxable income for any tax period (or portion thereof) pursuant to Section 481 or Section 263A of the Code (or any comparable provision of state or foreign Tax laws) as a result of transactions or events occurring, or accounting methods employed, prior to the Closing.

(e) There is no agreement, plan, arrangement or other Contract covering any employee or independent contractor or former employee or independent contractor of any of the Acquired Corporations that, considered individually or considered collectively with any other such Contracts, will, or could reasonably be expected to, give rise directly or indirectly to the payment of any amount that would not be deductible pursuant to Section 280G or Section 162(m) of the Code (or any comparable provision under state or foreign Tax laws). No Acquired Corporation is a party to any agreement to compensate any Person for excise taxes payable pursuant to Section 4999 of the Code.

(f) No claim has ever been made by any Government Body in a jurisdiction where an Acquired Corporation does not file a Tax Return that it is or may be subject to taxation by that jurisdiction which has resulted or would result in an obligation to pay material Taxes.

(g) There are no agreements relating to allocating or sharing of Taxes to which any Acquired Corporation is a party. None of the Acquired Corporations is liable for Taxes of any other Person, or is currently under any contractual obligation to indemnify any Person with respect to any amounts of such Person s Taxes (except for customary agreements to indemnify lenders or security holders in respect of Taxes) or is a party to any agreement providing for payments by an Acquired Corporation with respect to any amount of Taxes of any other Person.

(h) No Acquired Corporation has constituted either a distributing corporation or a controlled corporation within the meaning of Section 355(a)(1)(A) of the Code. No Acquired Corporation is or has been a United States real property holding corporation within the meaning of Section 897(c)(2) of the Code and no Acquired Corporation is required to withhold tax on the purchase of the Company by reason of Section 1445 of the Code.

(i) No Acquired Corporation has been a member of an affiliated group of corporations within the meaning of Section 1504 of the Code or within the meaning of any similar provision of Law to which an Acquired Corporation may be subject, other than the affiliated group of which the Company is the common parent.

(j) The Company has made available to Parent true and complete copies of all federal and California income Tax Returns of the Acquired Corporations for all Tax years that remain open or otherwise subject to audit.

(k) No Acquired Corporation previously elected to be treated as an S Corporation under Section 1361 of the Code.

(l) The Company has disclosed on its federal income Tax Returns all positions that could give rise to a substantial understatement penalty within the meaning of Section 6662 of the Code.

(m) No Acquired Corporation has participated in a Listed Transaction within the meaning of Treasury Regulation Section 1.6011-4(b)(2).

3.17 Employee and Labor Matters; Benefit Plans.

(a) Part 3.17(a) of the Disclosure Schedule identifies each employment, consulting, salary, bonus, vacation, deferred compensation, incentive compensation, stock purchase, stock option or other equity-based, severance, termination, retention, change-in-control, death and disability benefits, hospitalization, medical, life or other insurance, flexible benefits, supplemental unemployment benefits, other welfare fringe benefits, profit-sharing, pension or retirement plan, program, agreement or commitment and each other employee benefit plan or arrangement, whether written or unwritten, funded or unfunded, including each Foreign Plan and each employee benefit plan, within the meaning of Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended (ERISA) (collectively, the Employee Plans) which is or has been sponsored, maintained, contributed to or required to be contributed to by any of the Acquired Corporations for the benefit of any current or former employee, consultant or director of any of the Acquired Corporations or with respect to which any of the Acquired Corporations has or may reasonably be expected to have any liability or obligation.

(b) With respect to each Employee Plan, the Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had access): (i) an accurate and complete copy of such Employee Plan that is in writing (including all amendments thereto); (ii) an accurate and complete copy of the annual report (Form Series 5500 and all schedules and financial statements attached thereto), if any, required under ERISA or the Code, with respect to such Employee Plan for the three (3) most recent plan years; (iii) if Employee Plan is subject to the minimum funding standards of ERISA Section 302, the most recent annual and periodic accounting of Employee Plan assets; (iv) an accurate and complete copy of the most recent summary

plan description, together with each summary of material modifications, if required under ERISA, with respect to such Employee Plan; (v) if such Employee Plan is funded through a trust or any third party funding vehicle, an accurate and complete copy of the trust or other funding agreement (including all amendments thereto) and accurate and complete copies of the most recent financial statements thereof; (vi) accurate and complete copies of all material Contracts relating to such Employee Plan, including service provider agreements, insurance contracts, minimum premium contracts, stop-loss agreements, investment management agreements, subscription and participation agreements and recordkeeping agreements; (vii) all written materials provided to any employee or employees relating to such Employee Plan and any proposed Employee Plan, in each case relating to any amendments, terminations, establishments, increases or decreases in benefits, acceleration of payments or vesting schedules or other events which could be reasonably expected to result in any material liability to the Acquired Corporations; (viii) all material correspondence, if any, to or from any governmental agency relating to such Employee Plan; (ix) where applicable to such Employee Plan, such Employee Plan s standard forms and related notices required under the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended (COBRA); (x) all insurance policies, if any, in the possession of the Company pertaining to fiduciary liability insurance covering the fiduciaries for each Employee Plan; (xi) all discrimination tests, if any, required under the Code for each Employee Plan intended to be qualified under Section 401(a) of the Code for the three (3) most recent plan years; (xii) the most recent determination letter (or opinion letter, if applicable) received from the Internal Revenue Service with respect to each Employee Plan intended to be qualified under Section 401(a) of the Code; and (xiii) all government and regulatory approvals received from any foreign Governmental Body with respect to Foreign Plans.

(c) None of the Acquired Corporations is or has ever been required to be treated as a single employer with any other Person under Section 4001(b)(1) of ERISA or Section 414(b), (c), (m) or (o) of the Code, except for the Acquired Corporations.

(d) No Acquired Corporation has ever maintained, established, sponsored, participated in or contributed to any: (i) Employee Plan subject to Section 302 or Title IV of ERISA or Section 412 of the Code; (ii) multiemployer plan within the meaning of Section (3)(37) of ERISA; (iii) multiple employer plan (within the meaning of Section 413(c) of the Code); or (iv) Employee Plan in which stock of any of the Acquired Corporations is or was held as a plan asset within the meaning of Department of Labor Regulations Section 2510.3-101.

(e) None of the Acquired Corporations has any plan or commitment to create any additional Employee Plan, or to modify or change any existing Employee Plan in any material respect (other than to comply with applicable Legal Requirements, in each case as previously disclosed to Parent in writing, or as required by this Agreement).

(f) No Employee Plan provides (except at no cost to the Acquired Corporations), or reflects or represents any liability of any of the Acquired Corporations to provide, retiree life insurance, retiree health benefits or other retiree employee welfare benefits to any Person for any reason, except as may be required by COBRA or other applicable Legal Requirements. To the knowledge of the Company, other than commitments made that involve no future costs to any of the Acquired Corporations, no Acquired Corporation has ever represented, promised or contracted (whether in oral or written form) to any former or current employee, consultant or director (either individually or as a group) or any other Person that any such employee, consultant or director or other Person would be provided with retiree life insurance, retiree health benefits or other retiree employee welfare benefits, except to the extent required by applicable Legal Requirements.

(g) Part 3.17(g) of the Disclosure Schedule describes all obligations of the Acquired Corporations as of the date of this Agreement under any of the provisions of COBRA.

(h) Each of the Employee Plans has been operated and administered in all material respects in accordance with its terms and with applicable Legal Requirements, including, but not limited to ERISA, the Code, applicable U.S. and non-U.S. securities laws and regulations and applicable foreign Legal Requirements. The Acquired Corporations have performed all material obligations required to be performed by them under, are not in default

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or violation of, and have no knowledge of any default or violation by any other party to, the material terms of any Employee Plan. Each Employee Plan intended to be qualified under Section 401(a) of the Code has obtained a favorable determination letter (or opinion letter, if applicable) as to its qualified status under the Code, and to the knowledge of the Company, there has been no event, condition or circumstance that would reasonably be expected to result in disqualification under the Code (or in the case of a Foreign Plan, the equivalent of disqualification under any applicable foreign Legal Requirement). There are no actions, suits or claims pending, or to the knowledge of the Company, threatened or reasonably anticipated (other than routine claims for benefits) against any Employee Plan or against the assets of any Employee Plan. To the knowledge of the Company, no breach of fiduciary duty under which any of the Acquired Corporations or one its fiduciaries could reasonably be expected to incur a material liability has occurred. Each Employee Plan (other than any Employee Plan to be terminated prior to the Effective Time in accordance with this Agreement) can be amended, terminated or otherwise discontinued after the Effective Time in accordance with its terms, without liability to any of the Acquired Corporations (other than ordinary administration expenses and liability for accrued and vested benefits). No Employee Plan is under audit, investigation or other Legal Proceeding by the Internal Revenue Service, Department of Labor, or any other Governmental Body, nor is any such audit, investigation or Legal Proceeding pending or, to the knowledge of the Company, threatened. No prohibited transaction, within the meaning of Section 4975 of the Code or Sections 406 and 407 of ERISA, and not otherwise exempt under Section 408 of ERISA, has occurred with respect to any Employee Plan. No mortgage, lien, pledge, charge, security interest or encumbrance of any kind in respect of any Employee Plan imposed under the Code, ERISA or any foreign Legal Requirement exists. All contributions, premiums and expenses to or in respect of each Employee Plan have been paid in full or, to the extent not yet due, have been adequately accrued on the appropriate Acquired Corporation s financial statements.

(i) None of the Acquired Corporations has incurred or reasonably expects to incur, either directly or indirectly (including as a result of an indemnification obligation), any material liability under Title I or IV of ERISA or the penalty, excise tax or joint and several liability provisions of the Code or any foreign Legal Requirement relating to employee benefit plans (including Section 406, 409, 502(i), 502(l), 4069 or 4212(c) of ERISA, or Section 4971, 4975 or 4976 of the Code), or under any agreement, instrument or Legal Requirement pursuant to or under which any of the Acquired Corporations or any Employee Plan has agreed to indemnify or is required to indemnify any Person against liability incurred under, or for a violation or failure to satisfy the requirements of, any such agreement, instrument or Legal Requirement, and to the knowledge of the Company, no event, transaction or condition has occurred, exists or is expected to occur which could result in any such material liability to any of the Acquired Corporations or, after the Closing, to Parent.

(j) Neither the execution, delivery or performance of this Agreement, nor the consummation of the Offer or the Merger or any of the other Contemplated Transactions (either alone or in combination with another event, whether contingent or otherwise) will (i) result in any bonus, severance or other payment or obligation to any current or former employee, consultant or director of any of the Acquired Corporations (whether or not under any Employee Plan); (ii) materially increase the benefits payable or provided to, or result in a forgiveness of indebtedness for any such employee, consultant or director; (iii) accelerate the vesting, funding or time of payment of any compensation, equity award or other similar benefit; (iv) result in any parachute payment under Section 280G of the Code (whether or not such payment is considered to be reasonable compensation for services rendered); or (v) cause any compensation to fail to be deductible under Section 162(m) of the Code or any other provision of the Code or any similar foreign Legal Requirement. Without limiting the generality of the foregoing (and except as set forth in Part 3.17(j) of the Disclosure Schedule), the consummation of the Offer or the Merger will not result in the acceleration of vesting of any unvested Company Options.

(k) The fair market value of the assets of each funded Foreign Plan, the liability of each insurer for any Foreign Plan funded through insurance or the book reserve established for any Foreign Plan, together with any accrued contributions, is sufficient to procure or provide in full for the accrued benefit obligations with respect to all current and former participants in such Foreign Plan according to the actuarial assumptions and valuations most recently used to determine employer contributions to and obligations under such Foreign Plan. Neither the

execution of this Agreement nor the consummation of the transactions contemplated hereby shall cause any the assets or insurance obligations to be less than the benefit obligations under such Employee Plan or Foreign Plan.

(l) Except as set forth in Part 3.17(l) of the Disclosure Schedule, none of the Acquired Corporations maintains any plan, agreement or arrangement, formal or informal, that provides material benefits in the nature of severance or has outstanding any liabilities with respect to material severance benefits.

(m) Except as set forth in Part 3.17(m) of the Disclosure Schedule, none of the Acquired Corporations has any material liability (including a material liability arising out of an indemnification, guarantee, hold harmless or similar agreement) relating to any insurance contract held under or purchased to fund an Employee Plan, the issuer of which is or was insolvent or in reorganization or the payments under which were suspended.

(n) Except for the Company Option Plans, the ESPP and as set forth in Part 3.17(q) of the Disclosure Schedule, none of the Acquired Corporations maintains any plan, program or arrangement or is a party to any contract that provides any material benefits or provides for material payments to any Person in, based on or measured by the value of any equity security of, or interest in, the Acquired Corporations.

(o) Except as set forth in Part 3.17(o) of the Disclosure Schedule, no Acquired Corporation has undertaken any option re-pricing or option exchange program with respect to Company Options.

(p) Part 3.17(p) of the Disclosure Schedule sets forth any and all indebtedness in excess of two thousand dollars ($2,000) owed by any current or former employee, consultant or director to any of the Acquired Corporations.

(q) With respect to each state workers compensation arrangement that is funded wholly or partially through an insurance policy or public or private fund, all premiums required to have been paid to date under such insurance policy or fund have been paid, all premiums required to be paid under the insurance policy or fund through the Closing Date will have been paid on or before the Closing Date and, as of the Closing Date, there will be no material liability of any the Acquired Corporations under any such insurance policy, fund or ancillary agreement with respect to such insurance policy in the nature of a retroactive rate adjustment, loss sharing arrangement or other actual or contingent material liability arising wholly or partially out of events occurring prior to the Closing Date.

(r) Part 3.17(r) of the Disclosure Schedule contains a list of all employees of each of the Acquired Corporations as of the date of this Agreement, and correctly reflects, in all material respects, their wage or salary, any other compensation payable to them (including compensation payable pursuant to bonus, deferred compensation or commission arrangements), their dates of employment and their positions.

(s) Part 3.17(s) of the Disclosure Schedule identifies each employee of any of the Acquired Corporations who is not fully available to perform work because of disability or other leave and sets forth the basis of such disability or leave and the anticipated date of return to full service.

(t) None of the Acquired Corporations is a party to, or has a duty to bargain for, any collective bargaining agreement or other Contract with a labor organization representing any of its employees and there are no labor organizations representing, purporting to represent or, to the knowledge of the Company, seeking to represent any employees of any of the Acquired Corporations. During the three years prior to the date of this Agreement none of the Acquired Corporations has had any strike, slowdown, work stoppage, lockout, job action, or threat thereof, or

question concerning representation, by or with respect to any of its employees. All of the employees of the Acquired Corporations are at will employees. The Company has made available to Parent or its advisors accurate and complete copies of all employee manuals and handbooks, disclosure materials, policy statements and written particulars of employment relating to the employment of the employees of the Acquired Corporations.

(u) Each of the Acquired Corporations: (i) is in substantial compliance with all applicable Legal Requirements and any order, ruling, decree, judgment or arbitration award of any court, arbitrator or any Governmental Body respecting employment, employment practices, terms and conditions of employment, wages, hours or other labor related matters, including Legal Requirements, orders, rulings, decrees, judgments and awards relating to discrimination, wages and hours, labor relations, leave of absence requirements, and occupational health and safety, wrongful discharge or violation of the personal rights of employees, former employees or prospective employees; (ii) has withheld and reported all amounts required by law or by agreement to be withheld and reported with respect to wages, salaries and other payments to any former or current employees, consultants or directors; (iii) is not liable for any arrears of wages or any taxes or any penalty for failure to comply with any of the foregoing; and (iv) is not liable for any payment to any trust or other fund governed by or maintained by or on behalf of any Governmental Body with respect to unemployment compensation benefits, social security or other benefits or obligations for any current or former employees, consultants or directors (other than routine payments to be made in the normal course of business and consistent with past practice). In the three years prior to the date of this Agreement, none of the Acquired Corporations has effectuated (i) a plant closing or partial plant closing (as defined in the Worker Adjustment and Retraining Notification Act (the WARN Act) or any similar Legal Requirement) affecting any site of employment or one or more facilities or operating units within any site of employment or facility of any of the Acquired Corporations or (ii) a mass layoff (as defined in the WARN Act or any similar Legal Requirement) affecting any site of employment or facility of any of the Acquired Corporations.

(v) None of the current or former independent contractors of any of the Acquired Corporations could be reclassified as an employee. No independent contractor (i) has provided services to any of the Acquired Corporations for a period of six consecutive months or longer or (ii) is eligible to participate in any Employee Plan. No Acquired Corporation has ever had any temporary or leased employees that were not treated and accounted for in all respects as employees of such Acquired Corporation.

(w) There are no actions, suits, claims, labor disputes or grievances pending, or to the knowledge of the Company, threatened or reasonably anticipated relating to any employment contract, wages and hours, leave of absence, plant closing notification, employment statute or regulation, employee privacy right, labor dispute, workers compensation policy or long-term disability policy, safety or discrimination matters involving any former or current employees, consultants or directors of any of the Acquired Corporations, including, without limitation, charges of unfair labor practices or harassment complaints. To the knowledge of the Company, none of the Acquired Corporations has engaged in any unfair labor practices within the meaning of the National Labor Relations Act. Each of the Acquired Corporations has good labor relations, and to the knowledge of the Company (i) neither the consummation of the Offer or the Merger nor the consummation of any of the other Contemplated Transactions will have a material adverse effect on the labor relations of any of the Acquired Corporations, and (ii) none of the employees of any of the Acquired Corporations intends to terminate his or her employment with the Acquired Corporation with which such employee is employed.

3.18 Environmental Matters. Each of the Acquired Corporations (i) is in compliance in all material respects with all applicable Environmental Laws, and (ii) possesses all permits and other Governmental Authorizations required under applicable Environmental Laws, and is in compliance with the terms and conditions thereof. None of the Acquired Corporations has received any written notice or other communication, whether from a Governmental Body, citizens group, Employee or otherwise, that alleges that any of the Acquired Corporations is not in compliance with any Environmental Law, and, to the knowledge of the Company, there are no circumstances that may prevent or interfere with the compliance in any material respect by any of the Acquired Corporations with any Environmental Law in the future. To the knowledge of the Company, (a) all property that is leased to, controlled by or used by any of the Acquired Corporations, and all surface water, groundwater and soil associated with or adjacent to such property, is free of any material environmental contamination of any nature, (b) none of the property leased to, controlled by or used by any of the Acquired Corporations contains any underground storage tanks, asbestos, equipment using PCBs or underground injection wells, and (c) none of the property leased to, controlled by or used by any of the Acquired Corporations contains

any septic tanks in which any material amount of process wastewater or Materials of Environmental Concern have been disposed of. To the knowledge of the Company, no Acquired Corporation has ever sent or transported any Materials of Environmental Concern to a site that, pursuant to any applicable Environmental Law, (i) has been placed on the National Priorities List of hazardous waste sites or any similar state list, (ii) is otherwise designated or identified as a potential site for remediation, cleanup, closure or other environmental remedial activity, or (iii) is subject to a Legal Requirement to take removal or remedial action as detailed in any applicable Environmental Law or to make a material payment for the cost of cleaning up any site. (For purposes of this Section 3.18: (A) Environmental Law means any federal, state, local or foreign Legal Requirement relating to pollution or protection of human health or the environment (including ambient air, surface water, ground water, land surface or subsurface strata), including any Legal Requirement relating to emissions, discharges, releases or threatened releases of Materials of Environmental Concern, or otherwise relating to the manufacture, processing, distribution, use, treatment, storage, disposal, transport or handling of Materials of Environmental Concern; and (B) Materials of Environmental Concern include chemicals, pollutants, contaminants, wastes, toxic substances, petroleum and petroleum products and any other substance that is regulated by any Environmental Law.)

3.19 Insurance. The Company has delivered to Parent (or otherwise made available in a data room to which Parent s Representatives have had ac