

MICROSEMI CORP  
Form 10-Q  
February 08, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the Quarterly Period Ended December 30, 2007**

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File No. 0-08866**

**MICROSEMI CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**95-2110371**  
(I.R.S. Employer  
Identification No.)

**2381 Morse Avenue, Irvine, California**  
(Address of principal executive offices)

**92614**  
(Zip Code)

**(949) 221-7100**

(Registrant's telephone number, including area code)

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The number of shares of the issuer's Common Stock, \$0.20 par value, outstanding on January 25, 2008 was 78,195,606.

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### *IMPORTANT FACTORS RELATED TO FORWARD-LOOKING STATEMENTS*

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. Any statements that do not relate to historical or current facts or matters are forward-looking statements. You can identify some of the forward-looking statements by the use of forward-looking words, such as "may," "will," "could," "should," "project," "believe," "anticipate," "expect," "plan," "estimate," "forecast," "potential," "intend," "maintain," "continue" and variations of these words and comparable words. In addition, all of the information herein that does not state a historical fact is forward-looking, including any statement or implication about an estimate or a judgment, or an expectation as to a future time, future result or other future circumstance. Statements concerning current conditions may also be forward-looking if they imply a continuation of current conditions. Examples of forward-looking statements in this Form 10-Q include, but are not limited to, statements concerning:

expectations that we will be able to successfully complete announced and to-be-announced plant consolidations on the anticipated schedules and without unanticipated costs or expenses, and that such consolidations will result in anticipated cost savings;

demand, growth and sales expectations for our products, including in the commercial air / space, defense, implantable medical, mobile / connectivity, and notebook / LCD television / display end markets;

expectations regarding competitive conditions within the analog, mixed-signal and discrete semi-conductor, integrated circuit or custom component assembly industries;

new market opportunities and emerging applications for our products;

expected impact of our price position program;

expectations regarding the effects of seasonality;

expectations regarding the supply of raw materials;

beliefs that our customers will not cancel orders or terminate or renegotiate their purchasing relationships with us;

beliefs that we will be able to successfully resolve any disputes and other business matters as anticipated;

our belief that we will be able to meet our current operating cash and debt service requirements;

our critical accounting estimates;

our tax exposure and tax rates; and

our expected financial and operating results.

Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from the results that the forward-looking statements suggest. You are urged to carefully review the disclosures we make in this report concerning risks and other factors that may affect our business and operating results, including those made under the heading "ITEM 1A. RISK FACTORS" included below in this Quarterly Report on Form 10-Q, as well as in our other reports filed with the Securities and Exchange Commission ("SEC"). Forward-looking statements are not a guarantee of future performance and should not be regarded as a representation by us or any other person that all of our estimates shall necessarily prove correct or that all of our objectives or plans shall necessarily be achieved. You are, therefore, cautioned not to

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place undue reliance on these forward-looking statements, which are made only as of the date of this report. We do not intend, and undertake no obligation, to update or revise the forward-looking statements to reflect events or circumstances after the date of this report, whether as a result of new information, future events or otherwise.

**PART I FINANCIAL INFORMATION**

**Item 1. FINANCIAL STATEMENTS**

This Form 10-Q must be read in its entirety. The unaudited consolidated income statement for the quarter ended December 30, 2007 of Microsemi Corporation and Subsidiaries (which we herein sometimes refer to collectively as "Microsemi", "the Company", "we", "our", "ours" or "us"), the unaudited consolidated statement of cash flows for the quarter ended December 30, 2007, and the comparative unaudited consolidated financial information for the corresponding period of the prior year, together with the unaudited balance sheets as of September 30, 2007 and December 30, 2007 are included herein.

## MICROSEMI CORPORATION AND SUBSIDIARIES

## Unaudited Consolidated Balance Sheets

(amounts in thousands, except per share data)

	December 30, 2007	September 30, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 105,263	\$ 107,685
Accounts receivable, net of allowance for doubtful accounts of \$1,329 and \$1,424 at December 30, 2007 and September 30, 2007, respectively	87,037	81,035
Inventories	118,171	115,038
Deferred income taxes	16,882	14,315
Other current assets	15,272	10,843
<b>Total current assets</b>	<b>342,625</b>	<b>328,916</b>
Property and equipment, net	71,272	68,846
Deferred income taxes	4,550	742
Goodwill	179,094	177,668
Other intangible assets, net	55,817	54,714
Other assets	7,640	6,394
<b>TOTAL ASSETS</b>	<b>\$ 660,998</b>	<b>\$ 637,280</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current maturity of long-term liabilities	\$ 724	\$ 724
Accounts payable	26,002	25,923
Accrued liabilities	26,902	34,598
<b>Total current liabilities</b>	<b>53,628</b>	<b>61,245</b>
Long-term liabilities	17,411	6,630
Stockholders' equity:		
Preferred stock, \$1.00 par value; authorized 1,000 shares; none issued		
Common stock, \$0.20 par value; authorized 100,000 shares; issued and outstanding 78,180 and 77,154 at December 30, 2007 and September 30, 2007, respectively	15,636	15,431
Capital in excess of par value of common stock	441,300	429,277
Retained earnings	132,458	124,257
Accumulated other comprehensive income	565	440
<b>Total stockholders' equity</b>	<b>589,959</b>	<b>569,405</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 660,998</b>	<b>\$ 637,280</b>

The accompanying notes are an integral part of these statements.

## MICROSEMI CORPORATION AND SUBSIDIARIES

## Unaudited Consolidated Income Statements

(amounts in thousands, except per share data)

	Quarter Ended	
	December 30, 2007	December 31, 2006
Net sales	\$ 123,474	\$ 102,289
Cost of sales	70,940	58,131
<b>Gross profit</b>	<b>52,534</b>	<b>44,158</b>
Operating expenses:		
Selling, general and administrative	26,761	18,425
Research and development	11,154	8,824
Amortization of intangible assets	3,099	2,003
Impairment of assets, restructuring and severance charges	42	903
In process research and development	440	
<b>Total operating expenses</b>	<b>41,496</b>	<b>30,155</b>
<b>Operating income</b>	<b>11,038</b>	<b>14,003</b>
Other income (expense):		
Interest income	1,119	1,482
Interest expense	(42)	(44)
Other, net	41	25
<b>Total other income</b>	<b>1,118</b>	<b>1,463</b>
Income before income taxes	12,156	15,466
Provision for income taxes	3,543	4,872
<b>NET INCOME</b>	<b>\$ 8,613</b>	<b>\$ 10,594</b>
Earnings per share:		
Basic	\$ 0.11	\$ 0.15
Diluted	\$ 0.11	\$ 0.14
Common and common equivalent shares outstanding:		
Basic	77,328	71,632
Diluted	79,645	73,425

The accompanying notes are an integral part of these statements.



## MICROSEMI CORPORATION AND SUBSIDIARIES

## Unaudited Consolidated Statements of Cash Flows

(amounts in thousands)

	Quarter Ended	
	December 30, 2007	December 31, 2006
<b>Cash flows from operating activities:</b>		
Net income	\$ 8,613	\$ 10,594
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,927	5,646
Stock based compensation	6,141	1,585
In process research and development	440	
Changes in assets and liabilities:		
Accounts receivable, net	(5,138)	(2,219)
Inventories, net	(2,054)	(6,802)
Other current assets	933	(3,661)
Deferred income taxes	(3,062)	(898)
Accounts payable	(392)	717
Accrued liabilities	(6,243)	(5,485)
Income taxes payable	1,515	2,955
Other long term liabilities	73	
	<u>7,753</u>	<u>2,432</u>
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(5,158)	(4,359)
Changes in other assets	(1,197)	(171)
Payments for acquisitions, net of cash acquired	(8,871)	
	<u>(15,226)</u>	<u>(4,530)</u>
<b>Cash flows from financing activities:</b>		
Payments of long-term liabilities		(58)
Excess tax benefit stock options	736	538
Exercise of stock options	4,315	1,539
	<u>5,051</u>	<u>2,019</u>
Net decrease in cash and cash equivalents	(2,422)	(79)
Cash and cash equivalents at beginning of period	107,685	165,415
	<u>\$ 105,263</u>	<u>\$ 165,336</u>

The accompanying notes are an integral part of these statements.

**MICROSEMI CORPORATION AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**December 30, 2007**

**1. PRESENTATION OF FINANCIAL INFORMATION**

The unaudited consolidated financial statements include the accounts of Microsemi Corporation and its subsidiaries (which we herein sometimes refer to collectively as "Microsemi", the "Company", "we", "our", "ours" or "us"). Intercompany transactions have been eliminated in consolidation.

The financial information furnished herein is unaudited, but in the opinion of our management, includes all adjustments (all of which are normal, recurring adjustments) necessary for a fair statement of the results of operations for the periods indicated. The results of operations for the first quarter of the current fiscal year are not necessarily indicative of the results to be expected for the full year.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q, and therefore do not include all information and note disclosures necessary for a fair presentation of financial position, results of operations and cash flows in conformity with generally accepted accounting principles. The unaudited consolidated financial statements and notes must be read in conjunction with the consolidated financial statements and notes thereto in the Annual Report on Form 10-K for the fiscal year ended September 30, 2007.

***Critical Accounting Policies and Estimates***

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States that require us to make estimates and assumptions that may materially affect the reported amounts of assets and liabilities at the date of the unaudited consolidated financial statements and revenues and expenses during the periods reported. Actual results could differ materially from those estimates. Information with respect to our critical accounting policies which we believe could have the most significant effect on our reported results and require subjective or complex judgments is contained in the notes to the consolidated financial statements in the Annual Report on Form 10-K for the fiscal year ended September 30, 2007.

***Income Taxes***

In July 2006 the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements in accordance with SFAS 109. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. We adopted FIN 48 effective October 1, 2007, and the provisions of FIN 48 will be applied to all income tax positions commencing from that date. We recognize potential accrued interest and penalties related to unrecognized tax benefits within operations as income tax expense.

As a result of applying the provisions of FIN 48, we recognized a \$413,000 decrease to retained earnings, as of October 1, 2007. Our unrecognized tax benefits totaled \$14,063,000 at October 1, 2007 and relate to various US and foreign jurisdictions. This amount included \$358,000 of penalties and \$1,112,000 of interest. Included in the balance at October 1, 2007 are \$7,998,000 of tax benefits that if recognized would reduce our annual effective income tax rate. FIN 48 did not have a material effect on our financial condition, results of operations or cash flows during the quarter ended December 30,

## MICROSEMI CORPORATION AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 30, 2007

**1. PRESENTATION OF FINANCIAL INFORMATION (Continued)**

2007. We currently expect our unrecognized tax benefits to decrease approximately \$500,000 over the next 12 months.

We file U.S., state and foreign income tax returns in jurisdictions with varying statutes of limitation. The 2004 through 2006 tax years generally remain subject to examination by federal and most state tax authorities. In significant foreign jurisdictions, the 2003 through 2006 tax years generally remain subject to examination by tax authorities.

**2. INVENTORIES**

Inventories were as follows (amounts in thousands):

	December 30, 2007	September 30, 2007
Raw Materials	\$ 44,596	\$ 42,524
Work in Progress	46,706	44,467
Finished Goods	26,869	28,047
	<u>\$ 118,171</u>	<u>\$ 115,038</u>

**3. GOODWILL AND OTHER INTANGIBLE ASSETS, NET**

Goodwill and other intangible assets, net, were as follows (amounts in thousands):

	December 30, 2007	September 30, 2007
Goodwill	\$ 179,094	\$ 177,668
Other intangible assets, net		
Completed technology	\$ 50,065	\$ 47,869
Customer relationships	4,261	5,011
Backlog	99	355
Trade names	1,392	1,479
	<u>\$ 55,817</u>	<u>\$ 54,714</u>

**4. COMMITMENTS AND CONTINGENCIES**

We entered into a \$75 million unsecured Revolving Credit Agreement dated as of December 29, 2006 with Comerica Bank (the "Revolving Credit Agreement" or the "New Credit Facility"). The New Credit Facility's Stated Maturity date is January 1, 2010. The New Credit Facility replaces the Company's existing \$30 million Credit Agreement dated July 2, 1999, as amended, which had a Stated Maturity Date of March 31, 2008 ("Terminated Credit Agreement"). Proceeds of borrowing under the New Credit Facility can be used for working capital and other lawful corporate purposes, and initial borrowings were used to finance a portion of the Company's acquisition of PowerDsine Ltd. Interest accruing on the amount of each revolving borrowing under the New Credit Facility is determined based upon the Company's choice of either a Prime based Advance or Eurodollar based Advance. Prime



MICROSEMI CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 30, 2007

**4. COMMITMENTS AND CONTINGENCIES (Continued)**

based Advances incur interest at a rate equal to the Prime Rate, as defined in the Revolving Credit Agreement, less 100 basis points. If the Company elects a Eurodollar based Advance, the borrowing bears interest at the Eurodollar based Rate, also defined in the Revolving Credit Agreement, which is determined, in part, by an Applicable Margin that fluctuates with the Company's Funded Debt to EBITDA ratio. Financial covenants, which include for example maintaining (i) a minimum EBITDA and (ii) a Maximum Funded Debt to EBITDA ratio, establish both conditions and current limitations on available amounts of borrowings. As of December 30, 2007, \$75 million is the maximum that may be borrowed, but per the terms of the New Credit Facility, the maximum amount decreased to \$60 million on January 2, 2008 and will decrease to \$50 million on December 30, 2009. However, due to certain restrictions, the amount actually available to us for borrowing at any given time could be less than the amount stated. As of December 30, 2007, there were no amounts outstanding on the New Credit Facility and \$0.4 million was outstanding in the form of a letter of credit and \$74.6 million was available under the New Credit Facility. As of December 30, 2007, we were in compliance with the financial covenants required by our credit facility.

In Broomfield, Colorado, the owner of a property located adjacent to a manufacturing facility owned by Microsemi Corp. Colorado (the "Subsidiary") had notified the subsidiary and other parties, of a claim that contaminants migrated to his property, thereby diminishing its value. In August 1995, the subsidiary, together with Coors Porcelain Company, FMC Corporation and Siemens Microelectronics, Inc. (former owners of the manufacturing facility), agreed to settle the claim and to indemnify the owner of the adjacent property for remediation costs. Although TCE and other contaminants previously used by former owners at the facility are present in soil and groundwater on the subsidiary's property, we vigorously contest any assertion that the subsidiary caused the contamination. In November 1998, we signed an agreement with the three former owners of this facility whereby they have 1) reimbursed us for \$530,000 of past costs, 2) assumed responsibility for 90% of all future clean-up costs, and 3) promised to indemnify and protect us against any and all third-party claims relating to the contamination of the facility. An Integrated Corrective Action Plan was submitted to the State of Colorado. Sampling and management plans were prepared for the Colorado Department of Public Health & Environment. State and local agencies in Colorado are reviewing current data and considering study and cleanup options. The most recent forecast estimated that the total project cost, up to the year 2020, would be approximately \$5,300,000; accordingly, by assuming that this amount is accurate and that the indemnifying parties will pay 90% of this amount as agreed without need for us to incur material costs to enforce that agreement, we reserved for this contingency by recording a one-time charge of \$530,000 for the life of this project in fiscal year 2003. There has not been any significant development since September 28, 2003.

We are involved in other normal litigation matters, arising out of the ordinary routine conduct of our business, including from time to time litigation relating to commercial transactions, contracts, and environmental matters. In the opinion of management, the final outcome of these matters will not have a material adverse effect on our financial position, results of operations or cash flows.

**5. COMPREHENSIVE INCOME**

Comprehensive income is defined as the change in equity (net assets) of a business enterprise during the period from transactions and other events and circumstances from non-owner sources. Our

## MICROSEMI CORPORATION AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 30, 2007

## 5. COMPREHENSIVE INCOME (Continued)

comprehensive income consists of net income and the change of the cumulative foreign currency translation adjustment. Accumulated other comprehensive income consists of the cumulative foreign currency translation adjustment.

Total comprehensive income for the quarters ended December 30, 2007 and December 31, 2006 were calculated as follows (amounts in 000's):

	Quarter Ended	
	December 30, 2007	December 31, 2006
Net income	\$ 8,613	\$ 10,594
Translation adjustment	125	175
Comprehensive income	\$ 8,738	\$ 10,769

## 6. EARNINGS PER SHARE

Basic earnings per share have been computed based upon the weighted average number of common shares outstanding during the respective periods. Diluted earnings per share have been computed, when the result is dilutive, using the treasury stock method for stock options outstanding during the respective periods.

Earnings per share ("EPS") for the respective quarters ended December 30, 2007 and December 31, 2006 were calculated as follows (amounts in thousands, except per share data):

	Quarter Ended	
	December 30, 2007	December 31, 2006
<b>BASIC</b>		
Net income	\$ 8,613	\$ 10,594
Weighted-average common shares outstanding for basic	77,328	71,632
Basic earnings per share	\$ 0.11	\$ 0.15
<b>DILUTED</b>		
Net income	\$ 8,613	\$ 10,594
Weighted-average common shares outstanding for basic	77,328	71,632
Dilutive effect of stock options	2,317	1,793
Weighted-average common shares outstanding on a diluted basis	79,645	73,425

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	Quarter Ended	
Diluted earnings per share	\$ 0.11	\$ 0.14

At December 30, 2007 and December 31, 2006, approximately 6,611,000 and 4,198,000 options, respectively, were excluded in the computation of diluted EPS as these options would have been anti-dilutive.

**MICROSEMI CORPORATION AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 30, 2007**

**7. RECENTLY ISSUED ACCOUNTING STANDARDS**

**Statement of Financial Accounting Standards No. 157**

In September 2006, the FASB issued FAS 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures regarding fair value measurements. FAS 157 is effective for financial statements for fiscal years beginning after November 15, 2007, and interim periods within those years (our fiscal year 2009). We are currently evaluating the impact of FAS 157.

**Statement of Financial Accounting Standards No. 159**

In February 2007, the FASB issued FAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115" ("FAS 159"). FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. FAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007 (our fiscal year 2009). We are currently evaluating the impact of FAS 159.

**Statement of Financial Accounting Standards No. 141R**

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("FAS") No. 141(R), "Business Combinations" (FAS 141R). FAS 141R replaces FAS No. 141 and provides greater consistency in the accounting and financial reporting of business combinations. FAS 141R requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, establishes principles and requirements for how an acquirer recognizes and measures any non-controlling interest in the acquiree and the goodwill acquired, and requires the acquirer to disclose the nature and financial effect of the business combination. Among other changes, this statement also required that "negative goodwill" be recognized in earnings as a gain attributable to the acquisition, that acquisition-related costs are to be recognized separately from the acquisition and expensed as incurred and that any deferred tax benefits resulted in a business combination are recognized in income from continuing operations in the period of the combination. FAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (our fiscal year 2010). The Company will assess the impact that FAS 141R may have on its financial position and results of operations.

**8. STOCK BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS**

In December 1986, the Board of Directors adopted an incentive stock option plan (the "1987 Plan"), as amended, which reserved 3,400,000 shares of common stock for issuance. The 1987 Plan was approved by our stockholders in February 1987 and amended in February 1994, and is for the purpose of securing for us and our stockholders the benefits arising from stock ownership by selected officers, directors and other key executives and certain key employees. The plan provides for the grant by us of stock options, stock appreciation rights, shares of common stock or cash. As of December 30, 2007, we have granted stock options and restricted shares under the 1987 Plan. Options granted prior to February 22, 2006, must be exercised within ten years from the date they are granted, subject to early termination upon death or cessation of employment, and are exercisable in installments determined by



## MICROSEMI CORPORATION AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 30, 2007

## 8. STOCK BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS (Continued)

the Board of Directors. Options granted on or after February 22, 2006, have the same terms as those granted prior to February 22, 2006, with the exception that they must be exercised within six years from the date they are granted. If an employee owns more than 10% of the total combined voting power of all classes of our stock, the exercise period is limited to five years and the exercise price is 10% higher than the closing price on the grant date. It is our policy to satisfy the exercise of employee stock options with newly issued shares of common stock.

At the annual meeting on February 29, 2000, our stockholders approved several amendments to the 1987 Plan which: 1) extended its termination date to December 15, 2009; 2) increased initially by 1,060,800 the number of shares available for grants; 3) effected annual increases on the first day of each fiscal year of the number of shares available for grant in increments of 4% of our issued and outstanding shares of common stock; and 4) added flexibility by permitting discretionary grants to non-employee directors and other non-employees. At December 30, 2007, there were approximately 4,088,000 shares available for grant under the Plan.

In the quarters ended December 30, 2007 and December 31, 2006, operating income decreased by \$6,141,000 and \$1,585,000, respectively, net income decreased by \$5,025,000 and \$1,377,000, respectively, basic earnings per share decreased by \$0.06 and \$0.02, respectively, and diluted earnings per share decreased \$0.06 and \$0.02, respectively.

Compensation expense for stock awards were calculated based on the date of grant or conversion using the Black-Scholes option pricing model. Awards granted, weighted-average exercise price, weighted-average fair value and weighted-average assumptions used in the calculation of compensation expense are as follows:

Quarter Ended	# of Awards	Per Award		Risk Free Rate	Expected Dividend Yield	Expected Life (Years)	Expected Volatility
		Exercise Price	Fair Value				
December 30, 2007							
Option grants	1,653,020	\$ 28.34	\$ 8.05	4.0%	0.0%	2.7	37.8%
Restricted stock award	508,672		\$ 28.50				
December 31, 2006							
Option grants	2,062,700	\$ 19.01	\$ 6.65	4.6%	0.0%	3.1	43.5%

Options and restricted stock awards are granted at a price equal to the closing price of our common stock on the date of the grant and are subject to forfeiture if employment terminates.

Expected term was estimated based on historical exercise data that was stratified between members of the Board of Directors, executive employees and non-executive employees. Expected volatility was estimated based on historical volatility using equally weighted daily price observations over a period approximately equal to the expected term of each option. The risk free interest rate is based on the implied yield currently available on U.S. Treasury securities with an equivalent remaining term. No dividends are expected to be paid.

## MICROSEMI CORPORATION AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 30, 2007

## 9. SEGMENT INFORMATION

We manage our business on the basis of one reportable segment, as a manufacturer of semiconductors in different geographic areas, including the United States, Europe and Asia.

We derive revenue from sales of our high-performance analog/mixed signal integrated circuits and power and high-reliability individual component semiconductors. These products include individual components as well as integrated circuit solutions that enhance customer designs by improving performance, reliability and battery optimization, reducing size or protecting circuits. The principal markets that we serve include commercial air/space, defense, industrial/semicap, medical, mobile connectivity and notebook / LCD TVs / displays. We evaluate sales by end-market based on our understanding of end market uses of our products and sales by channel.

Net sales by the originating geographic area, end market and long lived assets by geographic area are as follows (amounts in thousands):

	Quarter Ended	
	December 30, 2007	December 31, 2006
Net Sales:		
United States	\$ 60,179	\$ 89,580
Europe	23,126	11,248
Asia	40,169	1,461
Total	\$ 123,474	\$ 102,289
Commercial Air/Space	\$ 23,480	\$ 20,458
Defense	38,999	32,732
Industrial/Semicap	11,166	14,320
Medical	16,216	12,275
Mobile Connectivity	19,934	9,206
Notebook/LCD TV/Display	13,679	13,298
Total	\$ 123,474	\$ 102,289
	December 30, 2007	December 31, 2006
Tangible long lived assets:		
United States	\$ 65,077	\$ 62,532
Europe	3,212	1,349
Asia	2,983	1,223
Total	\$ 71,272	\$ 65,104

Between the quarters ended December 31, 2006 and December 31, 2007, net sales originating from the United States decreased \$29.4 million while net sales originating from Asia increased \$38.7 million. This shift in originating geographic area was due primarily to our decision to shift the fulfillment of some customer orders directly from our locations in Asia rather than through our locations in the United States. Net sales originating in Asia also increased due to the contributions of PowerDsine,



## MICROSEMI CORPORATION AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 30, 2007

## 9. SEGMENT INFORMATION (Continued)

which we acquired in the second quarter of 2007. Net sales originating in Europe increased \$11.9 million, due to a shift in shipments from locations in the United States to our location in Ireland.

## 10. RESTRUCTURING CHARGES AND ASSET IMPAIRMENTS

In April 2005, we announced the consolidation of operations in Broomfield, Colorado into other Microsemi facilities. Broomfield has approximately 70 employees and occupies a 130,000 square foot owned facility. Broomfield accounted for approximately 8% and 2% of net sales in first quarter of fiscal year 2007 and 2008, respectively. In the second quarter of fiscal year 2005, we recorded estimated severance payments of \$1,134,000 in accordance with FAS 112. The severance payments cover approximately 148 employees, including 14 management positions. Severance payments commenced in the second quarter of fiscal year 2006.

The following table reflects the activities related to the consolidation of Broomfield and the accrued liabilities in the consolidated balance sheets at the date below (amounts in thousands):

	<b>Employee Severance</b>
Balance at September 30, 2007	\$ 1,024
Cash expenditures	(67)
Balance at December 30, 2007	\$ 957

For the quarter ended December 30, 2006, we recorded \$225,000 for other restructuring related expenses for Broomfield, primarily for travel, planning and equipment relocation. We also recorded severance expense of \$612,000 related to the integration of the PowerDsine acquisition and \$86,000 related to Microsemi Corp. Power Products Group. These restructuring expenses were recorded in accordance with FAS 146.

## 11. ACQUISITIONS

In the first quarter of fiscal year 2008, we acquired Microsemi Device Technology Corporation and TSI Microelectronics Corporation for \$8.9 million in cash, net of cash acquired. We funded these acquisitions with cash on hand. Other than a \$440,000 charge for in process research and development, these two transactions did not significantly impact results of operations and on a pro forma basis would not be material to our results of operations for the quarter ended.

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**OVERVIEW**

This Quarterly Report on Form 10-Q includes current beliefs, expectations and other forward looking statements that involve risks and uncertainties. Our actual results could differ materially from the results contemplated by these forward-looking statements due to certain factors, including those discussed in Part II Item 1A "Risk Factors" and elsewhere in this Quarterly Report. This "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the accompanying unaudited consolidated financial statements and notes must be read in conjunction with the "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto in the Annual Report on Form 10-K for the fiscal year ended September 30, 2007.

Microsemi is a leading designer, manufacturer and marketer of high-performance analog and mixed-signal integrated circuits and high-reliability semiconductors. Our semiconductors manage and control or regulate power, protect against transient voltage spikes and transmit, receive and amplify signals.

Our products include individual components as well as integrated circuit solutions that enhance customer designs by improving performance, reliability and battery optimization, reducing size or protecting circuits.

We currently serve a broad group of customers with none of our customers accounting for more than 10% of our revenue in the first quarter of fiscal years 2007 or 2008. We also serve a variety of end markets, which we generally classify as follows:

**Defense** We offer a broad selection of products including mixed-signal analog integrated circuits, JAN, JANTX, JANTXV and JANS high-reliability discrete semiconductors and modules including diodes, zeners, diode arrays, transient voltage suppressors, bipolar transistors, metal-oxide-semiconductor field-effect-transistors ("MOSFETs"), insulated gate bipolar transistors ("IGBTs"), small signal analog integrated circuits, small signal transistors, and silicon-controlled rectifiers ("SCRs.") These products are utilized in a variety of applications including radar and communications, targeting and fire control and other power conversion and related systems in military platforms.

**Commercial Air / Space** Our commercial air/space products include offerings such as JAN, JANTX, JANTXV and JANS high-reliability discrete semiconductors and modules and analog mixed-signal products including diodes, zeners, diode arrays, transient voltage suppressors, bipolar transistors, small signal analog integrated circuits, small signal transistors, SCRs, MOSFETs and IGBTs. These products are utilized in a variety of applications including commercial air electronic applications for large aircraft and regional jets, commercial radar and communications, satellites, cockpit electronics, and other power conversion and related systems in space and aerospace platforms.

**Industrial / Semicap** Products in this category include MOSFETs, IGBTs, power modules, bridge rectifiers and high voltage assemblies for use primarily in industrial equipment and semiconductor capital equipment.

**Medical** Our medical products, which include zener diodes, high voltage diodes, MOSFETs, IGBTs, transient voltage suppressors and thyristor surge protection devices, are designed into implantable defibrillators, pacemakers and neurostimulators. We are also a supplier of PIN diode switches, dual diode modules, and switched-mode power supplies ("SMPS") for use in MRI systems.

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**Mobile / Connectivity** Our mobile connectivity products include broadband power amplifiers and monolithic microwave integrated circuits ("MMICs") targeted at 802.11 a/b/g/n/e, multiple-in multiple-out ("MIMO"), wi-max wireless LAN devices and related equipment. Products also include power-over-ethernet ("PoE,") a variety of DC-DC products, such as voltage regulators, PWM controllers, and light emitting diode ("LED") drivers that are sold into the portable device set top box, and telecom applications.

**Notebook/ LCD TV/ Display** Products in this market are used in notebook computers, monitors, storage devices, and LCD televisions, and include cold cathode fluorescent lamp ("CCFL") controllers, LED drivers, visible light sensors, PWM controllers, voltage regulators, EMI/RFI filters, transient voltage suppressors, sensors for auto-dimming rear view mirrors and class-D audio circuits.

We have been integrating the management of our various operations, as demonstrated by the integration of our recent acquisitions. Production has been transferred between our facilities to share resources and technology, as well as, to more efficiently produce our products. We make best use of our engineering capabilities by sharing research and production methods across our divisions and, where appropriate, assigning engineers to the same project, regardless of the facility that incurs the personnel expense. Our manufacturing management team has also been reorganized to increase efficiency.

### CAPACITY ENHANCEMENT OPTIMIZATION PROGRAM

In April 2005, we announced the consolidation of operations in Broomfield, Colorado into other Microsemi facilities. Broomfield has approximately 70 employees and occupies a 130,000 square foot owned facility. Broomfield accounted for approximately 8% and 2% of net sales in first quarter of fiscal year 2007 and 2008, respectively. In the second quarter of fiscal year 2005, we recorded estimated severance payments of \$1,134,000 in accordance with FAS 112. The severance payments cover approximately 148 employees, including 14 management positions. Severance payments commenced in the second quarter of fiscal year 2006.

The following table reflects the activities related to the consolidation of Broomfield and the accrued liabilities in the consolidated balance sheets at the date below (amounts in thousands):

	<b>Employee Severance</b>
Balance at September 30, 2007	\$ 1,024
Cash expenditures	(67)
Balance at December 30, 2007	\$ 957

The consolidation of Broomfield is expected to result, subsequent to its completion, in annual cost savings of \$5.0 million to \$7.0 million from the elimination of redundant facilities and related expenses and employee reductions.

For the quarter ended December 30, 2006, we recorded \$225,000 for other restructuring related expenses for Broomfield, primarily for travel, planning and equipment relocation. We also recorded severance expense of \$612,000 related to the integration of the PowerDsine acquisition and \$86,000 related to Microsemi Corp. Power Products Group. These restructuring expenses were recorded in accordance with FAS 146.

### ACQUISITIONS

In the first quarter of fiscal year 2008, we acquired Microsemi Device Technology Corporation and TSI Microelectronics Corporation for \$8.9 million in cash. We funded these acquisitions with cash on

hand. Other than a \$440,000 charge for in process research and development, these two transactions did not significantly impact results of operations and on a pro forma basis would not be material to our results of operations for the quarter ended.

#### RESULTS OF OPERATIONS FOR THE QUARTER ENDED DECEMBER 31, 2006 COMPARED TO THE QUARTER ENDED DECEMBER 30, 2007.

Net sales increased \$21.2 million or 20.7% from \$102.3 million for the first quarter of fiscal year 2007 ("Q1 2007") to \$123.5 million for the first quarter of fiscal year 2008 ("Q1 2008"). Net sales by end markets are based on our understanding of end market uses of our products. An estimated breakout of net sales by end markets for Q1 2008 and Q1 2007 is approximately as follows (amounts in thousands):

	Q1 2008	Q1 2007
Commercial Air / Space	\$ 23,480	\$ 20,458
Defense	38,999	32,732
Industrial / Semicap	11,166	14,320
Medical	16,216	12,275
Mobile / Connectivity	19,934	9,206
Notebook / LCD TV / Display	13,679	13,298
	<u>\$ 123,474</u>	<u>\$ 102,289</u>

Net sales in the commercial air / space end market increased \$3.0 million from \$20.5 million in Q1 2007 to \$23.5 million in Q1 2008. The increase was driven by demand and order rates for commercial aircraft at aircraft manufacturers and tier one suppliers, as well as growing electronic content in current aircraft. We believe that announced delays in certain commercial aircraft programs will be offset by higher production of other aircraft types, as well as increased refurbishment programs. Additionally, we believe that there is strong demand for commercial satellites and radar systems, especially with higher planned launch levels and expansion of airports in Asia.

Net sales in the defense end market increased \$6.3 million from \$32.7 million in Q1 2007 to \$39.0 million in Q1 2008. Sales in this end market continued to be solid with high historical demand as well as the strength of new programs, including military avionics, ground transportation, surveillance equipment, joint service communications systems, naval vessels, radars, missiles and advanced combat unit electronics. Based on growing backlog and continued increases in both domestic and international defense spending, we expect to see increasing sales in this end market.

Net sales in the industrial / semicap market decreased \$3.1 million from \$14.3 million in Q1 2007 to \$11.2 million in Q1 2008, with the decrease primarily attributable to a decrease in sales for use in semicap applications. We see continuing weakness in this end market.

Net sales in the medical end market increased \$3.9 million, from \$12.3 million in Q1 2007 to \$16.2 million in Q1 2008. Increasing functionality and device integration in implantable medical devices, such as defibrillators and pacemakers, have resulted in increases in both dollars per unit and unit content per device. Based on our current bookings and expected government approvals of our customers' products, we expect continuing strength in the implantable medical business in upcoming quarters.

Net sales in the mobile / connectivity end market increased \$10.7 million, from \$9.2 million in Q1 2007 to \$19.9 million in Q1 2008. Sales in this end market have grown due primarily to the addition of contributions from PowerDsine, which we acquired in the second quarter of 2007. We expect to see continued strength in this market particularly in 802.11n products. We have also seen shipments in

wi-max applications, which is emerging as a key future market for us and for which we have multiple solutions.

Net sales in the notebook / LCD television / display end market increased \$0.4 million, from \$13.3 million in Q1 2007 to \$13.7 million in Q1 2008. We are seeing strong interest in our next generation backlighting solutions and our notebook business remains strong.

An estimated breakout of net sales by originating geographic area for Q1 2007 and Q1 2008 is approximately as follows (amounts in thousands):

	Q1 2008	Q1 2007
United States	\$ 60,179	\$ 89,580
Europe	23,126	11,248
Asia	40,169	1,461
Total	\$ 123,474	\$ 102,289

Between Q1 2007 and Q1 2008, net sales originating from the United States decreased \$29.4 million while net sales originating from Asia increased \$38.7 million. This shift in originating geographic area was due primarily to our decision to shift the fulfillment of some customer orders directly from our locations in Asia rather than through our locations in the United States. Net sales originating in Asia also increased due to the contributions of PowerDsine, which we acquired in the second quarter of 2007. Net sales originating in Europe increased \$11.9 million, due to a shift in shipments from locations in the United States to our location in Ireland.

On January 24, 2008, we announced that for the second quarter of fiscal year 2008, we expect our net sales will increase between 2% and 4% sequentially. We expect that the strong demand for our products for commercial air / space, defense, medical, mobile / connectivity and notebooks / LCD TV / Display end markets will continue during fiscal year 2008.

Gross profit increased \$8.3 million, from \$44.2 million (43.2% of sales) for Q1 2007 to \$52.5 million (42.6% of sales) for Q1 2008. The increase in gross margin related to higher net sales. Costs of sales included \$6.9 million and \$10.8 million related to transitional idle capacity in Q1 2007 and Q1 2008, respectively.

Selling, general and administrative expenses increased \$8.4 million from \$18.4 million for Q1 2007 to \$26.8 million for Q1 2008. The increase was primarily due to higher stock based compensation expense of \$4.6 million and additional costs from PowerDsine of approximately \$2.8 million, which we acquired in the second quarter of 2007, and higher costs to support our increase in net sales.

Research and development expense increased \$2.4 million from \$8.8 million in Q1 2007 to \$11.2 million in Q1 2008, primarily due to additional research and development expense incurred at PowerDsine, which we acquired in the second quarter of 2007.

Amortization expense of intangible assets increased \$1.1 million from \$2.0 million in Q1 2007 to \$3.1 million in Q1 2008, primarily due to additional amortization expense on intangible assets originated from the PowerDsine acquisition.

Cash and cash equivalents in Q1 2007 were \$165.3 million compared to \$105.3 million Q1 2008; consequently, we had \$0.4 million lower interest income in Q1 2007 compared to Q1 2008.

The effective tax rates were 31.5% for Q1 2007 and 29.1% for Q1 2008. The Q1 2008 effective tax rate was impacted by a shift of income earned to lower tax rate jurisdictions.

In July 2006 the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 provides detailed guidance for the



financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements in accordance with SFAS 109. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. We adopted FIN 48 effective October 1, 2007, and the provisions of FIN 48 will be applied to all income tax positions commencing from that date. We recognize potential accrued interest and penalties related to unrecognized tax benefits within operations as income tax expense.

As a result of applying the provisions of FIN 48, we recognized a \$413,000 decrease to retained earnings, as of October 1, 2007. Our unrecognized tax benefits totaled \$14,063,000 at October 1, 2007 and relate to various US and foreign jurisdictions. This amount included \$358,000 of penalties and \$1,112,000 of interest. Included in the balance at October 1, 2007 are \$7,998,000 of tax benefits that if recognized would reduce our annual effective income tax rate. FIN 48 did not have a material effect on our financial condition, results of operations or cash flows during Q1 2008. We currently expect our unrecognized tax benefits to decrease approximately \$500,000 over the next 12 months.

We file U.S., state and foreign income tax returns in jurisdictions with varying statutes of limitation. The 2004 through 2006 tax years generally remain subject to examination by federal and most state tax authorities. In significant foreign jurisdictions, the 2003 through 2006 tax years generally remain subject to examination by tax authorities.

### **CAPITAL RESOURCES AND LIQUIDITY**

In Q1 2008, we financed our operations with cash from operations.

Net cash provided by operating activities increased \$5.4 million from \$2.4 million in Q1 2007 to \$7.8 million in Q1 2008. Net income decreased \$2.0 million but was offset primarily by a \$6.3 million increase in income tax liability, \$4.6 million increase in non-cash stock based compensation, as well as various changes in current assets.

Accounts receivable increased \$6.0 million from \$81.0 million at September 30, 2007 to \$87.0 million at December 30, 2007. The increase in receivables was due to higher sales and timing of shipments in Q1 2008 versus the fourth quarter of fiscal year 2007 ("Q4 2007").

Inventories increased \$3.1 million, including \$1.0 million acquired from Microwave Device Technology Corporation, from \$115.0 million at September 30, 2007 to \$118.2 million at December 30, 2007. Inventory levels increased to support higher anticipated net sales.

Other current assets increased \$4.2 million, from \$10.8 million at September 30, 2007 to \$15.1 million at December 30, 2007. The increase was due to higher prepaid expenses.

Current liabilities decreased \$7.6 million from \$61.2 million at September 30, 2007 to \$53.6 million at December 30, 2007. The decrease was primarily due to payments of employee profit sharing.

Net cash used in investing activities was \$4.5 million and \$15.2 million in Q1 2007 and Q1 2008, respectively. Purchases of property and equipment were \$4.4 million and \$5.2 million in Q1 2007 and Q1 2008, respectively. In Q1 2008, we acquired Microwave Device Technology Corporation and TSI Microelectronics Corporation for a total of \$8.9 million, net of cash acquired.

Net cash provided by financing activities was \$2.0 million and \$5.1 million in Q1 2007 and Q1 2008, respectively. The \$3.1 million increase was related primarily to an increase in proceeds from stock option exercises and the related tax benefits.

We had \$107.7 million and \$105.3 million in cash and cash equivalents at September 30, 2007 and December 30, 2007, respectively.

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Current ratios were 5.4 to 1 and 6.4 to 1 at September 30, 2007 and December 30, 2007, respectively.

We entered into a \$75 million unsecured Revolving Credit Agreement dated as of December 29, 2006 with Comerica Bank (the "Revolving Credit Agreement" or the "New Credit Facility"). The New Credit Facility's Stated Maturity date is January 1, 2010. The New Credit Facility replaces the Company's existing \$30 million Credit Agreement dated July 2, 1999, as amended, which had a Stated Maturity Date of March 31, 2008 ("Terminated Credit Agreement"). Proceeds of borrowing under the New Credit Facility can be used for working capital and other lawful corporate purposes, and initial borrowings were used to finance a portion of the Company's acquisition of PowerDsine Ltd. Interest accruing on the amount of each revolving borrowing under the New Credit Facility is determined based upon the Company's choice of either a Prime based Advance or Eurodollar based Advance. Prime based Advances incur interest at a rate equal to the Prime Rate, as defined in the Revolving Credit Agreement, less 100 basis points. If the Company elects a Eurodollar based Advance, the borrowing bears interest at the Eurodollar based Rate, also defined in the Revolving Credit Agreement, which is determined, in part, by an Applicable Margin that fluctuates with the Company's Funded Debt to EBITDA ratio. Financial covenants, which include for example maintaining (i) a minimum EBITDA and (ii) a Maximum Funded Debt to EBITDA ratio, establish both conditions and current limitations on available amounts of borrowings. As of December 30, 2007, \$75 million is the maximum that may be borrowed, but per the terms of the New Credit Facility, the maximum amount decreased to \$60 million on January 2, 2008 and will decrease to \$50 million on December 30, 2009. However, due to certain restrictions, the amount actually available to us for borrowing at any given time could be less than the amount stated. As of December 30, 2007, there were no amounts outstanding on the New Credit Facility and \$0.4 million was outstanding in the form of a letter of credit and \$74.6 million was available under the New Credit Facility. As of December 30, 2007, we were in compliance with the financial covenants required by our credit facility.

As of December 30, 2007, \$75 million is the maximum that may be borrowed, but per the terms of the New Credit Facility, the maximum amount decreased to \$60 million on January 2, 2008 and will decrease to \$50 million on December 30, 2009.

Costs associated with the consolidation of Broomfield are estimated to range from \$6.0 million to \$8.0 million, excluding any gain or loss from future dispositions of the plant and property. We anticipate that our cash and cash equivalents will be our primary source for paying such expenditures.

### CONTRACTURAL OBLIGATIONS

As of December 30, 2007, we had no other material commitments for capital expenditures.

We adopted FIN 48 effective October 1, 2007. As a result of applying the provisions of FIN 48, we recognized a \$413,000 decrease to retained earnings, as of October 1, 2007. Our unrecognized tax benefits totaled \$14,063,000 at October 1, 2007 and relate to various US and foreign jurisdictions. This amount included \$358,000 of penalties and \$1,112,000 of interest. Included in the balance at October 1, 2007 are \$7,998,000 of tax benefits that if recognized would reduce our annual effective income tax rate. FIN 48 did not have a material effect on our financial condition, results of operations or cash flows during the quarter ended December 30, 2008. We currently expect our unrecognized tax benefits to decrease approximately \$500,000 over the next 12 months.

Based upon information currently available to us, we believe that we can meet our cash requirements and capital commitments in the foreseeable future with cash balances, internally generated funds from ongoing operations and, if necessary, from the available line of credit.

**RECENTLY ISSUED ACCOUNTING STANDARDS**

**Statement of Financial Accounting Standards No. 157**

In September 2006, the FASB issued FAS 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures regarding fair value measurements. FAS 157 is effective for financial statements for fiscal years beginning after November 15, 2007, and interim periods within those years (our fiscal year 2009). We are currently evaluating the impact of FAS 157.

**Statement of Financial Accounting Standards No. 159**

In February 2007, the FASB issued FAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115" ("FAS 159"). FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. FAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007 (our fiscal year 2009). We are currently evaluating the impact of FAS 159.

**Statement of Financial Accounting Standards No. 141R**

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("FAS") No. 141(R), "Business Combinations" (FAS 141R). FAS 141R replaces FAS No. 141 and provides greater consistency in the accounting and financial reporting of business combinations. FAS 141R requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, establishes principles and requirements for how an acquirer recognizes and measures any non-controlling interest in the acquiree and the goodwill acquired, and requires the acquirer to disclose the nature and financial effect of the business combination. Among other changes, this statement also required that "negative goodwill" be recognized in earnings as a gain attributable to the acquisition, that acquisition-related costs are to be recognized separately from the acquisition and expensed as incurred and that any deferred tax benefits resulted in a business combination are recognized in income from continuing operations in the period of the combination. FAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (our fiscal year 2010). The Company will assess the impact that FAS 141R may have on its financial position and results of operations.

***CRITICAL ACCOUNTING POLICIES AND ESTIMATES***

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States that require us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the periods reported. Actual results could differ from those estimates. Information with respect to our critical accounting policies which we believe could have the most significant effect on our reported results and require subjective or complex judgments is contained in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of our Annual Report on Form 10-K for the fiscal year ended September 30, 2007.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the potential loss arising from adverse changes in foreign currency exchange rates, interest rates, or the stock market. We are exposed to various market risks, which are related to changes in certain foreign currency exchange rates and changes in certain interest rates.

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We conduct business in a number of foreign currencies, principally those of Europe and Asia, directly or through our foreign operations. We may receive some revenues in foreign currencies and purchase some inventory and services in foreign currencies. Accordingly, we are exposed to transaction gains and losses that could result from changes in exchange rates of these foreign currencies relative to the U.S. dollar. Transactions in foreign currencies have represented a relatively small portion of our business and these currencies have been relatively stable against the U.S. dollar for the past several years. As a result, foreign currency fluctuations have not had a material impact historically on our revenues or results of operations. Nonetheless, foreign currency fluctuations relative to the U.S. dollar have tended to increase in recent years. There can be no assurance that those currencies will remain stable relative to the U.S. dollar or that future fluctuations in the value of foreign currencies will not have material adverse effects on our results of operations, cash flows or financial condition. Our largest foreign currency exposure results from activity in British Pounds and the European Union Euro. We have not conducted a foreign currency hedging program thus far. We have considered and may continue to consider the adoption of a foreign currency hedging program.

We did not enter into derivative financial instruments and did not enter into any other financial instruments for trading or speculative purposes or to hedge exposure to interest rate risks. Our other financial instruments consist primarily of cash, accounts receivable, accounts payable and long-term obligations. Our exposure to market risk for changes in interest rates relates primarily to our short-term investments and short-term obligations. As a result, we do not expect fluctuations in interest rates to have a material impact on the fair value of these instruments. Accordingly, we have not engaged in transactions intended to hedge our exposure to changes in interest rates.

We entered into a \$75 million unsecured Revolving Credit Agreement dated as of December 29, 2006 with Comerica Bank (the "Revolving Credit Agreement" or the "New Credit Facility"). The New Credit Facility's Stated Maturity date is January 1, 2010. The New Credit Facility replaces the Company's existing \$30 million Credit Agreement dated July 2, 1999, as amended, which had a Stated Maturity Date of March 31, 2008 ("Terminated Credit Agreement"). Proceeds of borrowing under the New Credit Facility can be used for working capital and other lawful corporate purposes, and initial borrowings were used to finance a portion of the Company's acquisition of PowerDsine Ltd. Interest accruing on the amount of each revolving borrowing under the New Credit Facility is determined based upon the Company's choice of either a Prime based Advance or Eurodollar based Advance. Prime based Advances incur interest at a rate equal to the Prime Rate, as defined in the Revolving Credit Agreement, less 100 basis points. If the Company elects a Eurodollar based Advance, the borrowing bears interest at the Eurodollar based Rate, also defined in the Revolving Credit Agreement, which is determined, in part, by an Applicable Margin that fluctuates with the Company's Funded Debt to EBITDA ratio. Financial covenants, which include for example maintaining (i) a minimum EBITDA and (ii) a Maximum Funded Debt to EBITDA ratio, establish both conditions and current limitations on available amounts of borrowings. As of December 30, 2007, \$75 million is the maximum that may be borrowed, but per the terms of the New Credit Facility, the maximum amount decreased to \$60 million on January 2, 2008 and will decrease to \$50 million on December 30, 2009. However, due to certain restrictions, the amount actually available to us for borrowing at any given time could be less than the amount stated. As of December 30, 2007, there were no amounts outstanding on the New Credit Facility and \$0.4 million was outstanding in the form of a letter of credit and \$74.6 million was available under the New Credit Facility. As of December 30, 2007, we were in compliance with the financial covenants required by our credit facility.

The New Credit Facility is subject to our satisfaction and performance of various affirmative and negative covenants. The negative covenants include, among others, limitations on material corporate transactions, borrowing, the creation of liens, sales of assets, acquisitions, mergers, and investments. There is no assurance possible that such restrictions will be waived. These covenants might, unless waived, deter some strategic corporate transactions or acquisitions that could have otherwise possibly

enhanced value for our stockholders. Any real or alleged default by us under any of our obligations under the New Credit Facility could have material adverse consequences for our business and could materially adversely affect the value of an investment in our common stock.

The New Credit Facility is unsecured, which means that each of our assets is no longer subject to a lien, security interest or other encumbrance under the Terminated Credit Agreement. The obvious benefits to us include principally administrative costs and occasionally that our assets become available for disposition or other financings. However, we are subject to restrictions under the New Credit Facility against asset dispositions or financings, without the lender's prior written consent, or waiver, which may be granted or denied in the lender's discretion. In addition to our corporate parent company, Microsemi Corporation, several our subsidiaries are also parties to the New Credit Facility, as follows: Microsemi Corp. Power Products Group, Microsemi Corp. Integrated Products, Microsemi Corp. Massachusetts and Microsemi Corp. Scottsdale. The obligations of each company are joint and several under the New Credit Facility. Unless we are in compliance with the terms of the New Credit Facility, our subsidiaries cannot pay us any dividends. The position of the lender is and always shall be superior to our position as a stockholder of the subsidiaries. A sale or transfer of any of the parties to the New Credit Facility is subject to the lender's consent and approval. This may, depending on the circumstances, possibly impede a strategic corporate transaction that otherwise might have been possible and might have been in the best interest of our stockholders. In the future there may be from time to time other persons who may become parties to the New Credit Facility, as lenders or otherwise.

**Item 4. CONTROLS AND PROCEDURES**

- (a) Evaluation of disclosure controls and procedures.

Our Chief Executive Officer and Chief Financial Officer, with the assistance of other management, conducted an evaluation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 30, 2007.

- (b) Changes in internal control over financial reporting.

During the first quarter of fiscal year 2008, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II OTHER INFORMATION

### Item 1. LEGAL PROCEEDINGS

In Part I, Item 3 of our most recent Form 10-K as filed with the SEC on November 21, 2007 for our fiscal year ending September 30, 2007, we previously reported litigation in which we are involved. During the fiscal period that is the subject of this Quarterly Report on Form 10-Q, no material changes occurred in such litigation.

### Item 1A. RISK FACTORS

Set forth below are the risk factors included in Item 1A of our Annual Report on Form 10-K for the year ended September 30, 2007. There have been no updates to the risk factors set forth below that constitute material changes from the risk factors previously disclosed in the Form 10-K.

#### **Downturns in the highly cyclical semiconductor industry have in the past adversely affected the operating results and the value of our business, and may continue to do so in the future.**

The semiconductor industry is highly cyclical and is characterized by constant technological change, rapid product obsolescence and price erosion, short product life-cycles and fluctuations in product supply and demand. During recent years we, as well as many others in our industry, have experienced significant declines in the pricing of, as well as demand for, products during the "down" portions of these cycles, which have sometimes been severe and prolonged. In the future, these downturns may prove to be as, or possibly even more, severe than past ones. Our ability to sell our products depends, in part, on continued demand in a large number of markets, including the mobile connectivity, automotive, telecommunications, computers/peripherals, defense and aerospace, space/satellite, industrial/commercial and medical markets. Each of these end-markets has in the past experienced reductions in demand, and future downturns in any of these markets may adversely affect our revenues, operating results and financial condition.

#### **The semiconductor business is subject to downward price pressure.**

The market for our products has been characterized by declining selling prices, and we anticipate that our average selling prices will decrease in future periods, although the timing and amount of these decreases cannot be predicted with any certainty. The pricing pressure in the semiconductor industry in past years has been due to a large number of factors, many of which were not easily foreseeable in advance, such as the Asian currency crisis, industry-wide excess manufacturing capacity, weak economic growth, the slowdown in capital spending that followed the "dot-com" collapse, the reduction in capital spending by telecom companies and satellite companies, and the effects of the tragic events of terrorism on September 11, 2001. In addition, our competitors have in the past, and may again in the future, lower prices in order to increase their market share. Continued downward price pressure in the industry may reduce our operating results and harm our financial and competitive position.

#### **The semiconductor industry is highly competitive.**

The semiconductor industry, including most of the markets in which we do business, is highly competitive. We have numerous competitors in the various markets in which we sell products. Some of our current major competitors are Freescale Semiconductor, Inc., National Semiconductor Corp., Texas Instruments, Inc., Koninklijke Philips Electronics, ON Semiconductor Corp., Fairchild Semiconductor International, Inc., Micrel Incorporated, International Rectifier Corp., Semtech Corp., Linear Technology Corp., Maxim Integrated Products, Inc., Skyworks Solutions, Inc., Diodes, Inc., Vishay Intertechnology, Inc., O2Micro International, Ltd. and Monolithic Power Systems, Inc. Some of our competitors in developing markets are Triquint Semiconductor, Inc., RF Micro Devices, Inc., Conexant Systems, Inc., Anadigics, Inc. and Skyworks Solutions, Inc. Many of these companies are larger than we

are and have greater resources than we have, and may therefore be better able than we are to penetrate new markets, pursue acquisition candidates, and withstand adverse economic or market conditions. We expect intensified competition from both these existing competitors and new entrants into our markets. To the extent we are not able to compete successfully in the future, our financial condition, operating results or cash flows could be harmed.

**We may not be able to develop new technologies and products to satisfy changes in customer demand, and our competitors could develop products that decrease the demand for our products.**

Rapidly changing technologies and industry standards, along with frequent new product introductions, characterize the semiconductor industry. Our financial performance depends, in part, on our ability to design, develop, manufacture, assemble, test, market and support new products and enhancements on a timely and cost-effective basis. If we are unable to continue to reduce package sizes, improve manufacturing yields and expand sales, we may not remain competitive. The competitiveness of designs that we have introduced, including integrated circuits and subsystems such as class D audio subsystems for newly-introduced home theatre DVD players supporting surround sound, PDA backlighting subsystems, backlight control and power management solutions for the automotive notebook computer, monitors and the LCD TV market, LED driver solutions and power amplifiers for certain wireless LAN components, are subject to various risks and uncertainties that we are not able to control, including changes in customer demand and the introduction of new or superior technologies by others. Moreover, any failure by us in the future to develop new technologies or timely react to changes in existing technologies could materially delay our development of new products, which could result in product obsolescence, decreased revenues and a loss of our market share to our competitors. New technologies or products that we may develop may not lead to an incremental increase in revenues, and there is a risk that these new technologies or products will decrease the demand for our existing products and result in an offsetting reduction in revenues. In addition, products or technologies developed by others may render our products or technologies obsolete or non-competitive. A fundamental shift in technologies in our product markets could have a material adverse effect on our competitive position within the industry.

**Compound semiconductor products may not successfully compete with silicon-based products.**

Our choices of technologies for development and future implementation may not reflect future market demand. The production of gallium arsenide (GaAs), indium gallium phosphide (InGaP), silicon germanium (SiGe), indium gallium arsenide phosphide (InGaAsP) or silicon carbide (SiC) integrated circuits is more costly than the production of silicon circuits, and we believe it will continue to be more costly in the future. The costs differ because of higher costs of raw materials, lower production yields and higher unit costs associated with lower production volumes. Silicon semiconductor technologies are widely used in process technologies for integrated circuits, and these technologies continue to improve in performance. As a result, we must offer compound semiconductor products that provide vastly superior performance to that of silicon for specific applications in order for our products to be competitive with silicon products. If we do not offer compound semiconductor products that provide sufficiently superior performance to offset the cost differential and otherwise successfully compete with silicon-based products, our revenues and operating results may be materially and adversely affected.

**Production delays related to new compound semiconductors could adversely affect our future results.**

We utilize process technology to manufacture compound semiconductors such as GaAs, InGaP, SiGe, SiC and InGaAsP primarily to manufacture semiconductor components. We are pursuing this development effort internally as well as with third party foundries. Our efforts sometimes may not result in commercially successful products. Certain of our competitors offer this capability and our

customers may purchase our competitors' products instead of ours for this reason. In addition, the third party foundries that we use may delay delivery of, or even completely fail to deliver, technology and products to us. Our business and financial prospects could be materially and adversely affected by any failure by us to timely produce these products.

**We may be unable to retain our customers due in part to our inability to fulfil our customer demand and other factors**

Our ability to fulfil our customer demand for our products is and will continue to be dependent in part on our order volumes, long lead times with regard to our manufacturing and testing of certain high-reliability products. The lead time for manufacture and testing of high-reliability products can be many months. In response to this current demand, we have recently increased our capital expenditures for production equipment as well as increased expenses for personnel. We may have delays or other difficulties in regard to increasing our production and in hiring and retaining qualified personnel. In addition, we have raised prices on certain products, primarily in our high-reliability end markets. Manufacturing delays and price increases may result in our customers reducing their purchase levels with us and/or seeking alternative solutions to meet their demand. In addition, the current demand may not continue in the future. Decreased sales as a result of a loss of one or more significant customers could materially and adversely impact our business and results of operations.

**Seasonality in certain retail markets that our OEM customers address, such as LCD television, may cause fluctuations in our rate of revenue growth or financial results.**

Sales of LCD televisions at retail are extremely seasonal, with a majority of retail sales occurring during the period from September through December in anticipation of the holiday season. This seasonality has increased over time, as retailers become more efficient in their control of inventory levels through quick response inventory management techniques. As a result, the manufacturers of LCD televisions are timing their orders so that they are being filled by suppliers, such as us, closer to the time of the purchase of the LCD televisions by consumers at retail. Due to the seasonality of the LCD television retail market, a large portion of our sales of products that are used in this market is made late during our fourth quarter or early in our first quarter. As a result, our sales of products for use in this market and rate of revenue growth in these products may fluctuate based on this seasonality.

**Fluctuations in sales of high-reliability products for use in implantable defibrillators may adversely affect our financial results.**

Although the market for implantable defibrillators is growing, customers in this market could reduce their reliance on outside suppliers. The implantable defibrillator market also fluctuates based on several other factors, such as product recalls and the need to secure regulatory approvals. Product recalls can from time to time accelerate sales to levels that cannot be sustained for long periods of time. The timing and qualification of new generations of products brought to market by OEM's can also result in fluctuations in order rates.

**We must commit resources to research and development, design, and production prior to receipt of purchase commitments and could lose some or all of the associated investment.**

We sell products primarily pursuant to purchase orders for current delivery, rather than pursuant to long-term supply contracts. Many of these purchase orders may be revised or cancelled without penalty. As a result, we must commit resources to the research, design and production of products without any advance purchase commitments from customers. Any inability to sell a product after we devote significant resources to it could have a material adverse effect on our business, financial condition, results of operations and cash flows.



**Variability of our manufacturing yields may affect our gross margins and profits.**

Our manufacturing yields vary significantly among products, depending on the complexity of a particular product's design and our experience in manufacturing that type of product. We have in the past experienced difficulties in achieving planned yields, which have adversely affected our gross margins and profits.

The fabrication of semiconductor products is a highly complex and precise process. Problems in the fabrication process can cause a substantial percentage of wafers to be rejected or numerous circuits on each wafer to be non-functional, thereby reducing yields. These difficulties include:

Defects in masks, which are used to transfer circuit patterns onto our wafers;

Impurities in the materials used;

Contamination of the manufacturing environment; and

Equipment failure.

Because a large portion of our costs of manufacturing is relatively fixed, and average selling prices for our products tend to decline over time, it is critical for us to improve the number of shippable circuits per wafer and increase the production volume of wafers in order to maintain and improve our results of operations. Yield decreases can result in substantially higher unit costs, which could materially and adversely affect our operating results and have done so in the past. Moreover, our process technologies have primarily utilized standard silicon semiconductor manufacturing equipment, and production yields of compound integrated circuits have been relatively low compared with silicon circuit devices. We may be unable to continue to improve yields in the future, and we may suffer periodic yield problems, particularly during the early production of new products or introduction of new process technologies. In either case, our results of operations could be materially and adversely affected.

**International operations and sales expose us to material risks and may increase the volatility of our operating results.**

Net sales from foreign markets represent a significant portion of total net sales. Our net sales to foreign customers represented approximately one-third of net sales for fiscal years 2005, 2006 and 2007. These sales were principally to customers in Europe and Asia. Foreign sales are classified as shipments to foreign destinations. We maintain facilities or contracts with entities in several foreign countries, including Korea, Japan, China, Ireland, Thailand, the Philippines, France, Taiwan, Macau, Israel and India. There are risks inherent in doing business internationally, including:

Legislative or regulatory requirements, including tax laws in the United States and in the countries in which we manufacture or sell our products;

Fluctuations in income tax expense and net income due to differing statutory tax rates in various domestic and international jurisdictions

Trade restrictions;

Transportation delays;

Communication interruptions;

Work stoppages or disruption of local labor supply and/or transportation services;

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Economic and political instability;

Acts of war or terrorism, or health issues (such as Sudden Acute Respiratory Syndrome or Avian Influenza), which could disrupt our manufacturing and logistical activities;

Changes in import/export regulations, tariffs and freight rates;

Difficulties in collecting receivables and enforcing contracts generally; and

Currency exchange rate fluctuations, devaluation of foreign currencies, hard currencies shortages and exchange rate fluctuations.

If political, military, transportation, health or other issues in foreign countries result in cancellations of customer orders or contribute to a general decrease in economic activity or corporate spending, or directly impact Microsemi's marketing, manufacturing, financial and logistics functions, our consolidated results of operations and financial condition could be materially adversely affected. In addition, the laws of certain foreign countries may not protect our products, assets or intellectual property rights to the same extent as do U.S. laws. Therefore, the risk of piracy of our technology and products, which could result in a material adverse effect to our financial condition, operating results and cash flows, may be greater in those foreign countries.

**The concentration of the factories that service the semiconductor industry makes us more susceptible to events or disasters affecting the areas in which they are most concentrated.**

Relevant portions of the semiconductor industry, and the factories that serve or supply this industry, tend to be concentrated in certain areas of the world. Disruptive events, such as natural disasters, epidemics and health advisories like those related to Sudden Acute Respiratory Syndrome or Avian Influenza, power outages and infrastructure disruptions, and civil unrest and political instability in those areas, have from time to time in the past, and may again in the future, adversely affect the semiconductor industry. In particular, events such as these could adversely impact our ability to manufacture our products and result in a loss of sales and revenue. Similarly, a localized health risk affecting our employees or the staff of our suppliers could impair the total volume of products that we are able to manufacture, which could adversely affect our results of operations and financial condition.

**Some of our facilities are located near major earthquake fault lines.**

Our headquarters, our major operating facilities, and certain other critical business operations are located near known major earthquake fault lines. We presently do not have earthquake insurance. We could be materially and adversely affected in the event of a major earthquake.

**Delays in beginning production, implementing production techniques, resolving problems associated with technical equipment malfunctions, or issues related to government or customer qualification of facilities could adversely affect our manufacturing efficiencies and our ability to realize cost savings.**

The Microsemi consolidated group's manufacturing efficiency will be an important factor in our future profitability, and we may be unsuccessful in our efforts to maintain or increase our manufacturing efficiency. Our manufacturing processes, and those utilized by our third-party subcontractors, are highly complex, require advanced and costly equipment and are sometimes modified in an effort to improve yields and product performance. We have from time to time experienced difficulty in transitions of manufacturing processes to different facilities or adopting new manufacturing processes. As a consequence, we have at times experienced delays in product deliveries and reduced yields. Every silicon wafer fabrication facility utilizes very precise processing, and processing difficulties and reduced yields commonly occur, often as a result of contamination of the material. Reduced manufacturing yields can often result in manufacturing and shipping delays due to capacity constraints. Therefore, manufacturing problems can result in additional operating expense and delayed or lost revenues. In one instance which occurred in fiscal year 2005, Microsemi scrapped nonconforming inventory at a cost of approximately \$1 million and experienced a delay of approximately two months in realizing approximately \$1.5 million of net sales. In an additional instance which occurred in fiscal year 2004, Microsemi encountered a manufacturing problem concerning contamination in a furnace that

resulted in the quarantine of approximately 1 million units at a cost of approximately \$2 million. The identification and resolution of that manufacturing issue required four months of effort to investigate and resolve, which resulted in a concurrent delay in realizing approximately \$2 million of net sales. Microsemi may experience manufacturing problems in achieving acceptable yields or experience product delivery delays in the future as a result of, among other things, upgrading existing facilities, relocating processes to different facilities, or changing its process technologies, any of which could result in a loss of future revenues or an increase in manufacturing costs.

**Interruptions, delays or cost increases affecting our materials, parts, equipment or subcontractors may impair our competitive position.**

Our manufacturing operations, and the outside manufacturing operations that we use increasingly, depend, in part, upon obtaining, in some instances, a governmental qualification of the manufacturing process, and in all instances, adequate supplies of materials including wafers, parts and equipment, including silicon, mold compounds and lead frames, on a timely basis from third parties. Some of the outside manufacturing operations we use are based in foreign countries. Our results of operations could be adversely affected if we are unable to obtain adequate supplies of materials, parts and equipment in a timely manner or if the costs of materials, parts or equipment increase significantly. From time to time, suppliers may extend lead times, limit supplies or increase prices due to capacity constraints or other factors. Although we generally use materials, parts and equipment available from multiple suppliers, we have a limited number of suppliers for some materials, parts and equipment. While we believe that alternate suppliers for these materials, parts and equipment are available, an interruption could adversely affect our operations.

Some of our products are manufactured, assembled and tested by third-party subcontractors, some of whom are based in foreign countries. We generally do not have any long-term agreements with these subcontractors. As a result, we may not have direct control over product delivery schedules or product quality. Outside manufacturers generally will have longer lead times for delivery of products as compared with our internal manufacturing, and therefore, when ordering from these suppliers, we will be required to make longer-term estimates of our customers' current demand for products, and these estimates are difficult to make accurately. Also, due to the amount of time typically required to qualify assemblers and testers, we could experience delays in the shipment of our products if we are forced to find alternate third parties to assemble or test our products. Any product delivery delays in the future could have a material adverse effect on our operating results, financial condition and cash flows. Our operations and ability to satisfy customer obligations could be adversely affected if our relationships with these subcontractors were disrupted or terminated. In addition, these subcontractors must be qualified by the U.S. government or customers for high-reliability processes. Historically the Defense Supply Center Columbus (DSCC) has rarely qualified any foreign manufacturing or assembly lines for reasons of national security; therefore, our ability to move certain manufacturing offshore may be limited or delayed.

We depend on third party subcontractors in Asia for wafer fabrication, assembly and packaging of an increasing portion of our products. Currently, we utilize third-party subcontractors for approximately 30% of our assembly and packaging requirements and 13% of our wafer fabrication. We expect that these percentages may increase to as much as 35% and 20%, respectively, in the next fiscal year due, in part, to the manufacture of our next-generation products by third party subcontractors in Asia. The packaging of our products is performed by a limited group of subcontractors and some of the raw materials included in our products are obtained from a limited group of suppliers. Disruption or termination of any of these sources could occur and such disruptions or terminations could harm our business and operating results. In the event that any of our subcontractors were to experience financial, operational, production or quality assurance difficulties resulting in a reduction or interruption in

supply to us, our operating results could suffer until alternate qualified subcontractors, if any, were to become available and active.

**Fixed costs may reduce operating results if our sales fall below expectations.**

Our expense levels are based, in part, on our expectations for future sales. Many of our expenses, particularly those relating to capital equipment and manufacturing overhead, are relatively fixed. We might be unable to reduce spending quickly enough to compensate for reductions in sales. Accordingly, shortfalls in sales could materially and adversely affect our operating results. This challenge could be made even more difficult if lead times between orders and shipments are shortening.

**Reliance on government contracts for a portion of our sales could have a material adverse effect on results of operations.**

Some of our sales are derived from customers whose principal sales are to the United States Government. These sales are derived from direct and indirect business with the U.S. Department of Defense, or DOD, and other U.S. government agencies. Future sales are subject to the uncertainties of governmental appropriations and national defense policies and priorities. If we experience significant reductions or delays in procurements of our products by the U.S. government or terminations of government contracts or subcontracts, our operating results could be materially and adversely affected. Generally, the U.S. government and its contractors and subcontractors may terminate their contracts with us for cause or for convenience. We have in the past experienced one termination of a contract due to the termination of the underlying government contracts. All government contracts are also subject to price renegotiation in accordance with the U.S. Government Renegotiation Act. By reference to such contracts, all of the purchase orders we receive that are related to government contracts are subject to these possible events. There is no guarantee that we will not experience contract terminations or price renegotiations of government contracts in the future. Microsemi's aggregate net sales to defense markets represented approximately 30% in fiscal years 2005, 2006 and 2007. From time to time, we have experienced declining defense-related sales, primarily as a result of contract award delays and reduced defense program funding. The timing and amount of an increase, if any, in defense-related business is uncertain. In the past, expected increases in defense-related spending has occurred at a rate that has been slower than expected. Our prospects for additional defense-related sales may be adversely affected in a material manner by numerous events or actions outside our control.

**There may be unanticipated costs associated with adding to or supplementing our manufacturing capacity.**

We anticipate that future growth of our business could require increased manufacturing capacity on our part and on the part of certain outside foundries, assembly shops, or testing facilities for some of our integrated circuit products or other products. Expansion activities are subject to a number of risks, including:

Unavailability or late delivery of the advanced, and often customized, equipment used in the production of our specialized products;

Delays in bringing new production equipment on-line;

Delays in supplying satisfactory designs or products to our existing customers; and

Unforeseen environmental, engineering or manufacturing qualification problems relating to existing or new facilities.

These and other risks may affect the ultimate cost and timing of any expansion of our capacity.

**Failure to manage consolidation of operations effectively could adversely affect our margins and earnings.**

Our ability to successfully offer and sell our products requires effective planning and management processes. Our Capacity Optimization Enhancement Program, with consolidations and realignments of operations, and expected future growth, may place a significant strain on our management systems and resources, including our financial and managerial controls, reporting systems, procedures and information technology. In addition, we will need to continue to train and manage our workforce worldwide. Any unmet challenges in that regard could negatively affect our results of operations.

**We may be unable to successfully integrate acquired companies and personnel with existing operations.**

We have in the past acquired a number of businesses or companies, additional product lines and assets, and we may continue to expand and diversify our operations with additional acquisitions. If we are unsuccessful in integrating these companies or product lines with existing operations, or if integration is more difficult or more costly than anticipated, we may experience disruptions that could have a material adverse effect on our business, financial condition and results of operations. In addition, the market price of our common stock could be adversely affected if the effect of any acquisitions on the Microsemi consolidated group's financial results is dilutive or is below the market's or financial analysts' expectations. Some of the risks that may affect our ability to integrate or realize any anticipated benefits from the acquired companies, businesses or assets include those associated with:

Unexpected losses of key employees or customers of the acquired company;

Conforming the acquired company's standards, processes, procedures and controls with our operations;

Coordinating new product and process development;

Hiring additional management and other critical personnel;

Increasing the scope, geographic diversity and complexity of our operations;

Difficulties in consolidating facilities and transferring processes and know-how;

Other difficulties in the assimilation of acquired operations, technologies or products;

Diversion of management's attention from other business concerns; and

Adverse effects on existing business relationships with customers.

In connection with acquisitions, we may:

Use a significant portion of our available cash;

Issue equity securities, which would dilute current stockholders' percentage ownership;

Incur substantial debt;

Incur or assume contingent liabilities, known or unknown;

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Incur impairment charges related to goodwill or other intangibles; and

Incur large, immediate accounting write-offs.

There can be no assurance that the benefits of any acquisitions will outweigh the attendant costs, and if they do not, our results of operations and stock price may be adversely affected.

**We have closed, combined, sold or disposed of certain subsidiaries or divisions, which in the past has reduced our sales volume and resulted in restructuring costs.**

In October 2003, we announced the consolidation of the manufacturing operations of Microsemi Corp. Santa Ana, of Santa Ana, California into some of our other facilities. The Santa Ana facility, whose manufacturing represented approximately 20% and 13% of our annual net sales in fiscal years 2003 and 2004, respectively, had approximately 380 employees and occupied 123,000 square feet. In April 2005, we announced the consolidation of the high-reliability products operations of Microsemi Corp. Colorado of Bloomfield, Colorado ("Broomfield") into some of our other facilities Broomfield represented approximately 3% of our annual net sales in fiscal year 2007, had approximately 70 employees and occupied a 130,000 square foot owned facility.

We may make further specific determinations to consolidate, close or sell additional facilities, which could be announced at any time. Possible adverse consequences resulting from or related to such announcements may include various accounting charges such as for idle capacity, an inventory buildup in preparation for the transition of manufacturing, disposition costs, severance costs, impairments of goodwill and possibly an immediate loss of revenues, and other items in addition to normal or attendant risks and uncertainties. We may be unsuccessful in any of our current or future efforts to consolidate our business into a fewer number of facilities. Our plans to minimize or eliminate any loss of revenues during consolidation may not be achieved.

We face major technical challenges in regard to transferring component manufacturing between locations. Before a transfer of manufacturing, we must be finished qualifying the new facility appropriately with the U.S. government or certain customers. While we plan generally to retain all of the revenues and income of those operations by transferring the manufacturing elsewhere within Microsemi's subsidiaries, our plans may change at any time based on reassessment of the alternatives and consequences. While we hope to benefit overall from increased gross margins and increased capacity utilization rates at remaining operations, the remaining operations will need to bear the corporate administrative and overhead costs, which are charges to income that had been allocated to the discontinued business units. Moreover, delays in effecting our consolidations could result in greater than anticipated costs incurred to achieve the hoped for longer-range savings.

**Any failure by us to protect our proprietary technologies or maintain the right to use certain technologies may negatively affect our ability to compete.**

We rely heavily on our proprietary technologies. Our future success and competitive position depend in part upon our ability to obtain or maintain protection of certain proprietary technologies used in our principal products. We do not have significant patent protection on many aspects of our technology. The protection of some of our technology as "trade secrets" will not necessarily protect us from all uses by other persons of our technology, or their use of technology that is similar or superior to that which is embodied in our trade secrets. In addition, others may be able to independently duplicate or exceed our technology in whole or in part. In the instances in which we hold patents or patent licenses, such as with respect to some circuit components for notebook computers and LCD TVs, any patents held by us may be challenged, invalidated or circumvented, or the rights granted under any patents may not provide us with competitive advantages. Patents often provide only narrow protection and require public disclosure of information that may otherwise be subject to trade secret protection. In addition, patents eventually expire and are not renewable.

Obtaining or protecting our proprietary rights may require us to defend claims of intellectual property infringement by our competitors. We could also become subject to lawsuits in which it is alleged that we have infringed or are infringing upon the intellectual property rights of others with or without our prior awareness of the existence of those third-party rights, if any. Litigation in connection with our intellectual property, whether instituted by us or others, could be very costly and distract



management and other resources from our business. We are currently involved in certain patent litigation to protect our patents and patent rights, which could cause legal costs to increase above normal levels over the next several years. It is not possible to estimate the exact amounts of these costs, but it is possible that these costs could have a negative effect on our future results.

Moreover, if any infringements, real or imagined, happen to exist, arise or are claimed in the future, we may be exposed to substantial liability for damages and may need to obtain licenses from the patent owners, discontinue or change our processes or products or expend significant resources to develop or acquire non-infringing technologies. We may not be successful in such efforts, or such licenses may not be available under reasonable terms. Any failure by us to develop or acquire non-infringing technologies or to obtain licenses on acceptable terms could have a material adverse effect on our operating results, financial condition and cash flows.

**Our products may be found to be defective or hazardous and we may not have sufficient liability insurance.**

There is at any time a risk that our products may be found to be defective or to contain, without the customer's knowledge, certain prohibited hazardous chemicals after we have already shipped the products in volume, perhaps requiring a product replacement or recall. We may be subject to product returns that could impose substantial costs and have a material and adverse effect on our business, financial condition and results of operations. Our aerospace (including aircraft), defense, medical and satellite businesses in particular expose us to potential liability risks that are inherent in the manufacturing and marketing of high-reliability electronic components for critical applications. Production of many of these products is sensitive to minute impurities, which can be introduced inadvertently in manufacture. Any production mistake can result in large and unanticipated product returns, product liability and warranty liability. Environmental regulations have imposed on every major participant in the electronics industry a new burden of determining and tracking the presence and quantity of certain chemicals in the content of supplies we buy and add to our products for sale and to inform in turn our customers about each of our finished goods' relevant chemical contents. The management and execution of this process is very challenging, and mistakes in this information gathering process could have a material adverse effect on our business.

We may be subject to product liability claims with respect to our products. Our product liability insurance coverage may be insufficient to pay all such claims. In addition, product liability insurance may become too costly for us to maintain or may become completely unavailable to us in the future. We may not have sufficient resources to satisfy any product liability claims not covered by insurance which would materially and adversely affect our financial position.

**Environmental liabilities could adversely impact our financial position.**

Federal, state and local laws and regulations impose various restrictions and controls on the discharge of materials, chemicals and gases used in our semiconductor manufacturing processes or in our finished goods. Under recent environmental regulations, we are responsible for determining whether certain toxic metals or certain other toxic chemicals are present in any given components we purchase and in each given product we sell. These environmental regulations have required us to expend a portion of our resources and capital on relevant compliance programs. In addition, under other laws and regulations, we could be held financially responsible for remedial measures if our current or former properties are contaminated or if we send waste to a landfill or recycling facility that becomes contaminated, even if we did not cause the contamination. Also, we may be subject to additional common law claims if we release substances that damage or harm third parties. Further, future changes in environmental laws or regulations may require additional investments in capital equipment or the implementation of additional compliance programs in the future. Any failure to comply with existing or future environmental laws or regulations could subject us to significant

liabilities and could have a material adverse effect on our operating results, cash flows and financial condition.

In the conduct of our manufacturing operations, we have handled and do handle materials that are considered hazardous, toxic or volatile under federal, state and local laws. The risk of accidental release of such materials cannot be completely eliminated. In addition, we operate or own facilities located on or near real property that was formerly owned and operated by others. These properties were used in ways that involved hazardous materials. Contaminants may migrate from, within or through any such property, which may give rise to claims against us. Third parties who are responsible for contamination may not have funds, or may not make funds available when needed, to pay remediation costs imposed upon us jointly with them under environmental laws and regulations.

In Broomfield, Colorado, the owner of a property located adjacent to a manufacturing facility owned by one of our subsidiaries, Microsemi Corp. Colorado had notified the subsidiary and other parties of a claim that contaminants migrated to his property, thereby diminishing its value. In August 1995, the subsidiary, together with Coors Porcelain Company, FMC Corporation and Siemens Microelectronics, Inc. (former owners of the manufacturing facility), agreed to settle the claim and to indemnify the owner of the adjacent property for remediation costs. Although TCE and other contaminants previously used by former owners at the facility are present in soil and groundwater on the subsidiary's property, we vigorously contest any assertion that the subsidiary caused the contamination. In November 1998, we signed an agreement with the three former owners of this facility whereby they have 1) reimbursed us for \$530,000 of past costs, 2) assumed responsibility for 90% of all future clean-up costs, and 3) promised to indemnify and protect us against any and all third-party claims relating to the contamination of the facility. An Integrated Corrective Action Plan was submitted to the State of Colorado. Sampling and management plans were prepared for the Colorado Department of Public Health & Environment. State and local agencies in Colorado are reviewing current data and considering study and cleanup options. The most recent forecast estimated that the total project cost, up to the year 2020, would be approximately \$5,300,000; accordingly, we recorded a one-time charge of \$530,000 for this project in fiscal year 2003. There has not been any significant development since September 28, 2003.

**Litigation could adversely impact our financial position.**

We are involved in various pending litigation matters, arising out of the ordinary routine conduct of our business, including from time to time litigation relating to employment matters, commercial transactions, contracts, and environmental matters. Litigation is inherently uncertain and unpredictable. An unfavorable resolution of any particular legal claim or proceeding could have a material adverse effect on our consolidated financial position or results of operations.

**Our future success depends, in part, upon our ability to continue to attract and retain the services of our executive officers or other key management or technical personnel.**

We could potentially lose the services of any of our senior management personnel at any time due to a variety of factors that could include death, incapacity, military service, personal issues, retirement, resignation or competing employers. Our ability to execute current plans could be adversely affected by such a loss. We may fail to attract and retain qualified technical, sales, marketing and managerial personnel required to continue to operate our business successfully. Personnel with the expertise necessary for our business are scarce and competition for personnel with proper skills is intense. Also, attrition in personnel can result from, among other things, changes related to acquisitions, retirement and disability. We may not be able to retain existing key technical, sales, marketing and managerial employees or be successful in attracting, assimilating or retaining other highly qualified technical, sales, marketing and managerial personnel, particularly at such times in the future as we may need to do so to fill a key position. If we are unable to continue to retain existing executive officers or other key

employees or are unsuccessful in attracting new highly qualified employees, our business, financial condition and results of operations could be materially and adversely affected.

**We may have increasing difficulty attracting and retaining qualified outside Board members.**

The directors and management of publicly traded corporations are increasingly concerned with the extent of their personal exposure to lawsuits and shareholder claims, as well as governmental and creditor claims which may be made against them in connection with their positions with publicly-held companies. Outside directors are becoming increasingly concerned with the availability of directors and officers liability insurance to pay on a timely basis the costs incurred in defending shareholder claims. Directors and officers liability insurance is expensive and difficult to obtain. Recently, the SEC and the NASDAQ Stock Market have imposed higher independence standards and certain special requirements on directors of public companies. Accordingly, it may become increasingly difficult to attract and retain qualified outside directors to serve on our Board.

**Delaware law and our charter documents contain provisions that could discourage or prevent a potential takeover of Microsemi that might otherwise result in our stockholders receiving a premium over the market price for their shares.**

Provisions of Delaware law, our certificate of incorporation and bylaws, and our Shareholder Rights Plan could make more difficult an acquisition of Microsemi by means of a tender offer, a proxy contest, or otherwise, and the removal of incumbent officers and directors. These provisions include:

The Shareholder Rights Plan, which provides that an acquisition of 20% or more of the outstanding shares without our Board's approval or ratification results in the exercisability of the Right accompanying each share of our common stock, thereby entitling the holder to purchase 1/4,000<sup>th</sup> of a share of Series A Junior Participating Preferred Stock for \$100, resulting in dilution to the acquirer because each Right under some circumstances entitles the holder upon exercise to receive securities or assets valued at \$200 and under other circumstances entitles the holder to ten (10) times the amount of any dividends or distributions on our common stock;

Section 203 of the Delaware General Corporation Law, which prohibits a merger with a 15%-or-greater stockholder, such as a party that has completed a successful tender offer, without board approval until three years after that party became a 15%-or-greater stockholder; and

The authorization in the certificate of incorporation of undesignated preferred stock, which could be issued without stockholder approval in a manner designed to prevent or discourage a takeover or in a way that may dilute an investment in our common stock.

In connection with our Shareholder Rights Plan, each share of our common stock, par value \$0.20, also entitles the holder to one redeemable and cancellable Right (not presently exercisable), as adjusted from time to time, to a given fraction of a share of Series A Junior Participating Preferred Stock, at a given exercise price, as adjusted from time to time under the terms and conditions as set forth in a Shareholder Rights Agreement. The existence of the Rights may make it more difficult or impracticable for hostile change of control of us, which therefore may affect the anticipated return on an investor's investment in our common stock.

**The volatility of our stock price could affect the value of an investment in our stock and our future financial position.**

The market price of our stock has fluctuated widely. Between October 2, 2006 and September 30, 2007, the market sale price of our common stock ranged between a low of \$16.06 and a high of \$28.07. The historic market price of our common stock may not be indicative of future market prices. We may not be able to sustain or increase the value of our common stock. Declines in the market price of our

stock could adversely affect our ability to retain personnel with stock incentives, to acquire businesses or assets in exchange for stock and/or to conduct future financing activities with or involving our common stock.

**We may not make the sales that are suggested by our order rates, backlog or book-to-bill ratio, and our book-to-bill ratio may be affected by product mix.**

Prospective investors should not place undue reliance on our book-to-bill ratios or changes in book-to-bill ratios. We determine bookings based on orders that are scheduled for delivery within 12 months. However, lead times for the release of purchase orders depend, in part, upon the scheduling practices of individual customers, and delivery times of new or non-standard products can be affected by scheduling factors and other manufacturing considerations. The rate of booking new orders can vary significantly from month to month. Customers frequently change their delivery schedules or cancel orders. We have in the past experienced long lead times for some of our products which may have therefore resulted in orders in backlog being duplicative of other orders in backlog, which would increase backlog without resulting in additional revenues. Because of long lead times in certain products, our book-to-bill ratio may not be an indication of sales in subsequent periods.

**Our inventory levels have risen, which adversely affects cash flow.**

Our inventory levels have recently risen. An increased inventory level adversely affects cash flow. The primary factor contributing to the increase in our inventory levels is work in progress in our satellite products because our satellite products require very long lead times for testing. A second factor impacting our inventory build up is the planned consolidation of our manufacturing operations between facilities. We built inventory cushions during the transition of manufacturing between facilities in order to maintain an uninterrupted supply of product. Obsolescence of any inventory could result in adverse effects on our future results of operations and future revenue.

**There may be some potential effects of system outages.**

We face risks from electrical or telecommunications outages, computer hacking or other general system failure. We rely heavily on our internal information and communications systems and on systems or support services from third parties to manage our operations efficiently and effectively. Any of these are subject to failure. System-wide or local failures that affect our information processing could have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, insurance coverage does not generally protect from normal wear and tear, which can affect system performance. Any applicable insurance coverage for an occurrence could prove to be inadequate. Coverage may be or become unavailable or inapplicable to any risks then prevalent. We are upgrading and integrating, and have plans to upgrade and integrate further our enterprise information systems, and these efforts may cause additional strains on personnel and system resources or may result in potential system outages.

**Our accounting policies and estimates have a material effect on the financial results we report.**

Significant accounting policies and estimates have a material effect on our calculations and estimations of amounts in our financial statements. Our operating results and balance sheets may be adversely affected either to the extent that actual results prove to be materially lower than previous accounting estimates or to the extent that accounting estimates are revised adversely. We base our critical accounting policies, including our policies regarding revenue recognition, reserves for returns, rebates, price protections, and bad debt and inventory valuation, on various estimates and subjective judgments that we may make from time to time. The judgments made can significantly affect net income and our balance sheets. We are required to make significant judgments concerning inventory, and whether it becomes obsolete or excess, and concerning impairments of long-lived assets and also of

goodwill. Our judgments, estimates and assumptions are subject to change at any time. In addition, our accounting policies may change at any time as a result of changes in generally accepted accounting principles as they apply to us or changes in other circumstances affecting us. Changes in accounting policy have affected and could further affect, in each case materially and adversely, our results of operations or financial position. In fiscal year 2003, we recorded a goodwill impairment of \$14.7 million which was a transition charge upon our adoption of SFAS No. 142.

**If, in the future, we conclude that our internal control over financial reporting is not effective, or if our auditors conclude that our evaluation of internal control over financial reporting is not effective, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of our common stock.**

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission ("SEC") adopted rules requiring public companies to include a report of management on the companies' internal control over financial reporting in their annual reports on Form 10-K. This report is required to contain an assessment by management of the effectiveness of the filing company's internal control over financial reporting. In addition, the independent registered public accounting firm auditing a public company's financial statements must attest to the effectiveness of the company's internal control over financial reporting. There is a risk that in the future we may identify internal control deficiencies that suggest that our controls are no longer effective. This could result in an adverse reaction in the financial markets due to a loss of confidence in the reliability of our financial statements, which could cause the market price of our common stock to decline and make it more difficult for us to finance our operations.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Inapplicable

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

Inapplicable

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

Inapplicable

**Item 5. OTHER INFORMATION**

None

**Item 6. EXHIBITS**

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation of Microsemi Corporation (Incorporated by reference to the indicated Exhibit to the Registrant's Current Report on Form 8-K (File No. 0-08866) as filed with the Commission on August 29, 2001)*
3.2	Certificate of Designation of Series A Junior Participating Preferred Stock (Incorporated by reference to the indicated Exhibit to the Registrant's Registration Statement on Form 8-A12G (File No. 0-08866) as filed with the Commission on December 29, 2000)
3.2.1	Certificate of Amendment to Certificate of Designation of Series A Junior Participating Preferred Stock (Incorporated by reference to the indicated Exhibit to the Registrant's Annual Report on Form 10-K (File No. 0-08866) as filed with the Commission on December 16, 2005)
3.3	Bylaws of Microsemi Corporation (Incorporated by reference to the indicated Exhibit to the Registrant's Annual Report on Form 10-K (File No. 0-08866) as filed with the Commission on November 21, 2007)*
31.1	Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated February 7, 2008
31.2	Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated February 7, 2008
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated February 7, 2008

Filed with this Report.

\*

Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to applicable rules of the Securities and Exchange Commission.

**SIGNATURES**

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

**MICROSEMI CORPORATION**

DATED: February 7, 2008

By: /s/ DAVID R. SONKSEN

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David R. Sonksen  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial Officer and  
duly authorized to sign on behalf of  
the Registrant)

By: /s/ JOHN W. HOHENER

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John W. Hohener  
Vice President Finance  
(Chief Accounting Officer and duly  
authorized to sign on behalf of the  
Registrant)

**EXHIBIT INDEX**

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