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 June 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. 0-14225

EXAR CORPORATION

(Exact Name of Registrant as specified in its charter)

Delaware	**94-1741481**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

48720 Kato Road, Fremont, CA 94538
(Address of principal executive offices, zip code)

(510) 668-7000
(Registrant's telephone number, including area code)

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

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

As of July 31, 2007, 35,807,265 shares of the Registrant's Common Stock, par value $0.0001, were issued and outstanding, net of 9,480,465 treasury shares.

EXAR CORPORATION AND SUBSIDIARIES

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QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EXAR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)
(Unaudited)

	June 30, 2007	March 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 74,666	$ 119,809
Short-term marketable securities	278,905	236,270
Accounts receivable (net of allowances of $1,203 and $1,138)	5,862	4,366
Inventories	4,714	4,779
Interest receivable and prepaid expenses	6,290	5,262
Deferred income taxes, net	697	809
Total current assets	371,134	371,295
Property, plant and equipment, net	24,630	25,404
Deferred income taxes, net	8,376	10,602
Goodwill	5,190	5,190
Intangible assets, net	5,185	5,451
Other non-current assets	4,622	3,232
Total assets	$ 419,137	$ 421,174
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,739	$ 2,139
Accrued compensation and related benefits	3,646	3,418
Accrued sales commissions	706	702
Other accrued expenses	2,747	2,448
Income taxes payable	147	5,520
Total current liabilities	8,985	14,227
Long-term obligations	853	191
Total liabilities	9,838	14,418
Commitments and contingencies (Note 10 and 11)		
Stockholders' equity:		
Preferred stock; $.0001 par value; 2,250,000 shares authorized; no shares outstanding	—	—
Common stock; $.0001 par value; 100,000,000 shares authorized; 35,916,214 and 36,154,815 shares issued and outstanding at June 30, 2007 and March 31, 2007, respectively (net of treasury shares)	4	4
Additional paid-in capital	452,942	451,084
Accumulated other comprehensive (loss) gain	(97)	76
Treasury stock at cost, 9,318,065 and 9,015,257 shares at June 30, 2007 and March 31, 2007, respectively	(146,560)	(142,572)
Retained earnings	103,010	98,164
Total stockholders' equity	409,299	406,756
Total liabilities and stockholders' equity	$ 419,137	$ 421,174

See accompanying Notes to Condensed Consolidated Financial Statements.

EXAR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,	
	2007	2006
Net sales	$17,101	$18,231
Cost of sales:		
Cost of sales	5,504	5,232
Amortization of purchased intangible assets	240	240
	5,744	5,472
Gross profit	11,357	12,759
Operating expenses:		
Research and development	6,058	6,614
Selling, general and administrative	5,531	6,734
Total operating expenses	11,589	13,348
Loss from operations	(232)	(589)
Interest income and other, net	4,497	3,714
Income before income taxes	4,265	3,125
(Benefit) provision for income taxes	(346)	1,121
Net income	$ 4,611	$ 2,004
Earnings per share:		
Basic earnings per share	$ 0.13	$ 0.06
Diluted earnings per share	$ 0.13	$ 0.06
Shares used in the computation of earnings per share:		
Basic	35,998	35,807
Diluted	36,134	36,257

See accompanying Notes to Condensed Consolidated Financial Statements.

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EXAR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006
Cash flows from operating activities:		
Net income	$ 4,611	$ 2,004
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	1,337	1,353
Stock-based compensation expense	761	1,066
Tax benefits from stock plans	364	433
Gross tax windfall from stock-based compensation	(6)	(217)
Provision for sales returns and allowances	834	1,119
Deferred income taxes	112	110
Changes in operating assets and liabilities:		
Accounts receivable	(2,330)	(691)
Inventories	65	(245)
Prepaid expenses and other assets	(820)	(1,542)
Accounts payable	(400)	55
Accrued compensation and related benefits	228	(547)
Accrued sales commissions and other accrued expenses	(105)	130
Income taxes payable	(2,131)	358
Net cash provided by operating activities	2,520	3,386
Cash flows from investing activities:		
Purchases of property, plant and equipment and intellectual property	(332)	(671)
Purchases of short-term marketable securities	(175,364)	(27,326)
Proceeds from sales and maturities of short-term marketable securities	132,492	53,807
Contributions to long-term investments, net	(255)	(379)
Acquisition costs related to pending Sipex acquisition	(940)	—
Net cash (used in) provided by investing activities	(44,399)	25,431
Cash flows from financing activities:		
Proceeds from issuance of common stock	733	4,591
Gross tax windfall from stock-based compensation	6	217
Repurchases of common stock	(3,988)	—
Net cash (used in) provided by financing activities	(3,249)	4,808
Effect of exchange rate changes on cash	(15)	(82)
Net (decrease) increase in cash and cash equivalents	(45,143)	33,543
Cash and cash equivalents at the beginning of period	119,809	187,610
Cash and cash equivalents at the end of period	$ 74,666	$221,153

See accompanying Notes to Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

Description of Business – Exar Corporation and its subsidiaries ("Exar" or "We") design, develop and market high-performance, system-level mixed-signal solutions for a broad range of connectivity standards. We develop high-bandwidth physical interface and access control solutions that facilitate the aggregation and transport of data in access, metro and core wide area networks over legacy and next generation communications infrastructure. We also provide a comprehensive family of serial communications solutions comprised of low voltage, single/multi-channel Universal Asynchronous Receiver Transmitters ("UARTs") as well as UARTs with integrated transceivers. UARTs are well suited to increase data transfer efficiency in a variety of industrial, telecommunications and consumer applications. In addition, we develop Serial Advanced Technology Attachment ("SATA") Port-Multiplier and Port-Selector products addressing the storage marketplace.

Basis of Presentation and Use of Management Estimates – The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States. This financial information reflects all adjustments, which are, in our opinion, of a normal and recurring nature and necessary to state fairly the statements of financial position, results of operations and cash flows for the dates and periods presented. The March 31, 2007 condensed consolidated balance sheet was derived from the audited financial statements at that date. All significant inter-company transactions and balances have been eliminated. Certain balance sheet reclassifications have been made to prior period balances in order to conform to the current period's presentation.

The financial statements include management's estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of sales and expenses during the reporting period. Actual results could differ from those estimates, and material effects on operating results and financial position may result.

NOTE 2. INVENTORIES

Inventories are recorded at the lower of cost or market, determined on a first-in, first-out basis. Cost is computed using standard costs, which approximate average actual costs. We record inventory provisions for obsolete inventories and inventories in excess of six months of demand.

Inventories consist of the following (in thousands):

	June 30, 2007	March 31, 2007
Work-in-process	$2,848	$ 2,426
Finished goods	1,866	2,353
Inventories	$4,714	$ 4,779

NOTE 3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at cost less accumulated depreciation and amortization. Property, plant and equipment consist of the following (in thousands):

	June 30, 2007	March 31, 2007
Land	$ 6,660	$ 6,660
Building	14,350	14,350
Machinery and equipment	52,842	52,670
	73,852	73,680
Accumulated depreciation and amortization	(49,222)	(48,276)
Property, plant and equipment, net	$ 24,630	$ 25,404

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-continued
(Unaudited)

NOTE 4. OTHER NON-CURRENT ASSETS

Other non-current assets at June 30, 2007 and March 31, 2007 was comprised of the following (in thousands):

	June 30, 2007	March 31, 2007
Long-term investments	$2,925	$ 2,670
Non-current prepaid assets	1,697	562
Other non-current assets	$4,622	$ 3,232

We account for our long-term investments in TechFarm Ventures L.P. (Q), L.P. ("TechFarm Fund") and Skypoint Telecom Fund II (US), L.P. ("Skypoint Fund") consisting of their respective portfolios of non-marketable equity securities under the cost method. In accordance with the Emerging Issues Task Force Issue No. 03-1 ("EITF 03-1"), "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments," we periodically review and determine whether the investments are other-than-temporarily impaired, in which case the investments are written down to their impaired value. We believe the current carrying value at June 30, 2007 approximates our equity in Techfarm Fund and Skypoint Fund and did not record any impairment charges for the three months ended June 30, 2007.

As of June 30, 2007, we have a remaining obligation to make a capital contribution of $1.0 million, limited to companies currently in the portfolio, to Skypoint Fund upon its request.

NOTE 5. GOODWILL AND INTANGIBLE ASSETS

Goodwill

We account for goodwill in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Intangible Assets" ("SFAS 142"). In accordance with SFAS 142, goodwill will not be amortized, but instead will be tested for impairment at least annually and more frequently if certain indicators are present. As of June 30, 2007, we are not aware of an indication that would suggest any impairment.

Intangible Assets

In April 2005, we acquired a significant part of the Optical Networking Business Unit ("ON") of Infineon Technologies AG. We amortize ON intangible assets on a straight-line basis over their estimated useful lives through fiscal year ending March 31, 2012. Amortization of ON intangible assets was $240,000 for the three months ended June 30, 2007 and 2006, respectively. The balances of purchased technology and related amortization were as follows (in thousands):

The ON intangible assets amortization expense through the fiscal year ending March 31, 2012, is as follows (in thousands):

Amortization Expense (by fiscal year)	
Remainder of 2008	718
2009	958
2010	958
2011	958
2012	40
	$3,632

In addition, as of June 30, 2007 and March 31, 2007, other individually acquired intellectual property, net of amortization, was approximately $1.6 million and $1.6 million, respectively, and is being amortized over the estimated useful lives of three to seven years. Amortization was $78,000 for the three months ended June 30, 2007. There was no amortization for the three months ended June 30, 2006.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-continued
(Unaudited)

NOTE 6. EARNINGS PER SHARE

Basic earnings per share (“EPS”) excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period in accordance with Statement of Financial Accounting Standards No. 128, “Earnings Per Share” (“SFAS 128”). Diluted EPS reflects the potential dilution that would occur if outstanding stock options or other contracts to issue common stock were exercised or converted into common stock and the application of the treasury stock method to unvested restricted stock units. A summary of our EPS for the three months ended June 30, 2007 and 2006 is as follows (in thousands, except per share amounts):

	Three Months Ended June 30,	
	2007	2006
Net income	$ 4,611	$ 2,004
Shares used in computation:		
Weighted average shares of common stock outstanding used in computation of basic earnings per share	35,998	35,807
Dilutive effect of stock options and restricted stock units	136	450
Shares used in computation of diluted earnings per share	36,134	36,257
Earnings per share - basic and diluted	$ 0.13	$ 0.06

For the three months ended June 30, 2007 and 2006, options to purchase 3,684,446 and 4,812,666 shares of common stock, respectively, at exercise prices ranging from $12.09 to $54.75 for both periods indicated, were outstanding but were not included in the computation of diluted earnings per share because they were anti-dilutive under the treasury stock method. Our application of the treasury stock method includes as assumed proceeds the average unamortized stock-based compensation expense for the period and the estimated deferred tax benefit or detriment associated with stock-based compensation expense.

NOTE 7. COMMON STOCK REPURCHASES

In October 2006, in furtherance to our 2001 common stock repurchase program, we announced the adoption of a 10b5-1 Share Repurchase Plan (“SRP”) covering the purchase of up to $16.0 million of our common stock through June 30, 2007. During the three months ended June 30, 2007, we repurchased a total of 292,808 shares of our common stock at an aggregate cost of $4.0 million under this SRP. In addition, we repurchased 10,000 shares at an aggregate cost of $1 from our former chief executive officer pursuant to a restricted stock purchase agreement.

In July 2007, we announced the adoption of a new 10b5-1 SRP which will allow us to use the remaining balance of $14.2 million under our original 2001 stock repurchase program to acquire shares of our common stock in the open market through November 30, 2007.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-continued
(Unaudited)

NOTE 8. STOCK-BASED COMPENSATION

Stock-Based Compensation Plans

On September 7, 2006, our shareholders ratified the Exar Corporation 2006 Equity Incentive Plan (the "2006 Plan"). The 2006 Plan authorizes stock options, stock appreciation rights, restricted stock, stock bonuses and other forms of awards granted or denominated in common stock or units of common stock, as well as cash bonus awards. Individuals eligible to receive awards under the 2006 Plan include our officers or employees of Exar or any of its subsidiaries, our directors, and certain consultants and advisors. The 2006 Plan allows for performance-based vesting and partial vesting based upon level of performance. Historically, we have primarily issued stock options to our employees and independent directors with vesting conditions based solely on service.

The 2006 Plan terms do not allow for future grants under our 2000 Equity Incentive Plan, the 1997 Equity Incentive Plan and the 1996 Non-Employee Directors' Stock Option Plan ("Prior Plans"). As of September 7, 2006, a total of 6,149,018 shares of common stock were then subject to outstanding options granted under the Prior Plans, and an additional 4,079,239 shares of common stock were then available for new award grants under the Prior Plans. The maximum number of shares of common stock that may be issued under the 2006 Plan equals the sum of: (1) 2,800,000 shares, plus (2) the number of any shares subject to stock options granted under any of the Prior Plans and outstanding as of September 7, 2006 which expire or for any reason are cancelled or terminated after September 7, 2006 without being exercised. As of June 30, 2007, there were 4,920,045 options outstanding under all stock option plans and 3,467,955 shares were available for future grant.

Generally, options under the 2006 Plan are granted with an exercise price of 100% of the fair value of the underlying stock on the date of grant and have a term of seven years, although the 2006 Plan provides that options may be granted with a term of up to ten years. Options generally vest at a rate of 25%, on their anniversary date, over four years.

In the second quarter of fiscal year 2007, we began issuing restricted stock units to employees and non-employee directors. Restricted stock units currently granted by us generally vest on the first or third anniversary date from the grant date. Restricted stock units granted under the 2006 Plan are counted against authorized shares available for future issuance on a two shares for every restricted stock unit issued. Prior to vesting, restricted stock units do not have dividend equivalent rights, do not have voting rights and the shares underlying the restricted stock units are not considered issued and outstanding. Shares are issued on the date the restricted stock units vest.

A summary of stock option transactions for all stock option plans follows:

	Outstanding	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value (1)
Outstanding at March 31, 2007	5,294,117	$ 16.57		
Options Granted	24,000	13.58		
Options Exercised	(49,164)	12.55		
Options Cancelled	(215,175)	17.85		
Options Forfeited	(133,733)	13.40		
Balance at June 30, 2007	4,920,045	$ 16.70	2.95	$1,537,498
Vested and expected to vest, June 30, 2007	4,824,167	$ 16.70	2.89	$1,480,577
Vested and exercisable, June 30, 2007	4,112,445	$ 17.36	2.37	$1,056,397

(1) Aggregate intrinsic value for stock options represents the difference between the exercise price and the closing price per share of our stock on June 30, 2007, multiplied by the number of stock options outstanding, exercisable, or vested and expected to vest as of June 30, 2007.

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value, based on the fair value of our common stock of $13.40 as of June 30, 2007, which would have been received by option holders if all option holders exercised their options as of that date. The total number of in-the-money options vested and exercisable at June 30, 2007 and 2006 was 2.2 million and 3.1 million, respectively.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-continued
(Unaudited)

Total intrinsic value of options exercised was approximately $0.1 million and $0.7 million for the three months ended June 30, 2007 and 2006, respectively. Total cash received by us related to option exercises was $0.6 million and $4.5 million for the three months ended June 30, 2007 and 2006, respectively. We recorded a tax benefit of $0.1 million and $0.2 million related to the option exercises for the three months ended June 30, 2007 and 2006, respectively. Upon option exercise, we issue shares of common stock.

Total unrecognized compensation cost of $5.0 million and $5.5 million at June 30, 2007 and 2006 will be recognized over a weighted average period of 2.68 and 1.33 years, respectively.

Restricted Stock Units ("RSUs")

Total unamortized stock-based compensation expense for our unvested RSUs was $1.9 million at June 30, 2007 and is expected to be recognized as compensation expense over a weighted average period of 1.81 years. There were no RSUs outstanding as of June 30, 2006. A summary of restricted stock unit transactions follows:

	Shares	Weighted-Average Grant-Date Fair Market Value	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (1)
Nonvested at March 31, 2007	204,918	$ 13.18		
Granted	—	—		
Issued and Released	(6,000)	13.43		
Cancelled	(2,301)	12.69		
Nonvested at June 30, 2007	196,617	$ 13.18	1.86	$2,634,668
Expected to Vest, June 30, 2007	174,248	$ 13.18	1.81	$2,334,920

(1) Aggregate intrinsic value for RSUs represents the closing price per share of our stock on June 30, 2007, multiplied by the number of nonvested RSUs or expected to vest as of June 30, 2007.

Valuation of Stock-Based Compensation

Effective April 1, 2006 we adopted the Financial Accounting Standards Board ("FASB") revised Statement of Financial Accounting Standards No. 123 ("SFAS 123R"), "Share-Based Payment" using the modified prospective transition method and therefore have not restated prior period results. The modified prospective transition method requires that stock-based compensation expense be recorded for all new and unvested stock options that are expected to vest over the requisite service periods beginning on April 1, 2006. Under SFAS 123R, we have elected to use the straight-line attribution method for expensing stock-based compensation. As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three months ended June 30, 2007 and 2006 is based on awards ultimately expected to vest, it is reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. If forfeitures vary from our estimate, we will be required to adjust our forfeiture calculation and any such adjustment may result in a material change in our financial results.

We did not capitalize any stock-based compensation cost, and recorded stock-based compensation expense for the three months ended June 30, 2007 and 2006 as follows (in thousands):

	Three Months Ended June 30,	
	2007	2006
Cost of sales	$ 28	$ 25
Research and development	224	326
Selling, general and administrative	509	715
Stock based compensation expense	$ 761	$ 1,066

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-continued
(Unaudited)

We compute the fair value of stock options utilizing the Black-Scholes option pricing model. Calculating stock-based compensation expense requires the input of highly subjective assumptions, including the expected term of the share-based awards, stock price volatility, and forfeiture rates. We estimate the expected life of options granted based on historical exercise and post-vest cancellation patterns, which we believe are representative of future behavior. Our expected volatility is based on historical data of the market closing price for our common stock as reported by The NASDAQ Global Market under the symbol "EXAR" and the expected term of our stock options. The risk-free interest rate assumption is based upon observed interest rates appropriate for the expected term of our employee stock options. We do not currently pay dividends and have no plans to do so in the future. We estimate the forfeiture rates based on our historical voluntary and involuntary terminations prior to vesting.

The assumptions used in calculating the fair value of stock-based compensation represent our estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future.

The assumptions used to estimate the fair value of stock options granted for the three months ended June 30, 2007 and 2006 (annualized percentages) are shown below:

	Three Months Ended June 30,	
	2007	2006
Expected term of options (years)	4.5 - 5.0	5.1 - 5.3
Risk-free interest rate	4.8%	4.9%
Expected volatility	30% - 36%	45% - 51%
Expected dividend yield	—	—
Weighted average estimated fair value	4.5	6.0

For RSUs, stock-based compensation expense is calculated based on our stock price on the date of grant, multiplied by the number of RSUs granted. The grant date fair value of RSUs, less estimated forfeitures, is recorded on a straight-line basis, over the vesting period. The RSUs generally vest on the first or third anniversary date from the grant date. The common stock associated with these RSUs is delivered to the individuals on their respective vest dates.

Employee Stock Participation Plan ("ESPP")

At June 30, 2007, we had reserved 1.7 million shares of common stock for future issuance under our ESPP. The ESPP is non-compensatory under SFAS 123R and permits employees to purchase common stock through payroll deductions at a purchase price that is equal to 95% of our common stock price on the last trading day of each three-month offering period.

Shares purchased by and distributed to participating employees were 9,043 and 9,850 for the three months ended June 30, 2007 and 2006, at weighted average prices of $12.85 and $12.58, respectively.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-continued
(Unaudited)

NOTE 9. COMPREHENSIVE INCOME

Comprehensive income is as follows (in thousands):

	Three Months Ended June 30,	
	2007	2006
Net income	$ 4,611	$ 2,004
Other comprehensive (loss) income:		
Cumulative translation adjustments	(9)	(51)
Unrealized (loss) gain, on marketable securities, net of tax	(164)	129
Total other comprehensive (loss) income	(173)	78
Comprehensive income	$ 4,438	$ 2,082

NOTE 10. COMMITMENTS AND CONTINGENCIES

In 1986, Micro Power Systems Inc. ("MPSI"), a subsidiary that we acquired in June 1994, identified low-level groundwater contamination at its principal manufacturing site. Although the area and extent of the contamination appear to have been defined, the source of the contamination has not been identified. MPSI previously reached an agreement with another entity to participate in the cost of ongoing site investigations and the operation of remedial systems to remove subsurface chemicals. We believe that site closure costs pertaining to the capping of wells and removal of the filtering system will be immaterial. We estimate that our accrual of $0.2 million as of June 30, 2007 is sufficient to cover the estimated remaining 3 to 4 years of continued remediation activities and post-remediation site closure activities. If further investigation reveals that additional remediation needs to be employed or that related site closure costs exceed original estimations, we would be required to accrue an additional provision for such remediation or site closure costs.

We warrant all of our products against defects in materials and workmanship for a period of ninety days from the delivery date. Our sole liability is limited to either replacing, repairing or issuing credit, at our option, for the product if it has been paid for. The warranty does not cover damage which results from accident, misuse, abuse, improper line voltage, fire, flood, lightning or other damage resulting from modifications, repairs or alterations performed other than by us, or resulting from failure to comply with our written operating and maintenance instructions. Warranty expense has historically been immaterial.

Additionally, our sales agreements indemnify our customers for any expenses or liability resulting from alleged or claimed infringements of any United States letter patents of third parties. However, we are not liable for any collateral, incidental or consequential damages arising out of patent infringement. The terms of these indemnification agreements are perpetual commencing after execution of the sales agreement or the date indicated on our order acknowledgement. The maximum amount of potential future indemnification is unlimited. However, to date, we have not paid any claims or been required to defend any lawsuits with respect to any such indemnity claim.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-continued
(Unaudited)

As of June 30, 2007, our commitments are comprised of the following (in thousands):

	Fiscal Year						
Contractual Obligations	2008	2009	2010	2011	2012	Thereafter	Total
Purchase Obligations [1]	$3,655	1,671	$—	$—	$—	$ —	$5,326
Long-term Investment Commitments (Skypoint Fund) [2]	1,040	—	—	—	—	—	1,040
Remediation commitment [3]	47	53	53	43	—	—	196
Lease Obligations	63	44	5	—	—	—	112
Total	$4,805	$1,768	$ 58	$ 43	$—	$ —	$6,674

(1) We place purchase orders with wafer foundries and other vendors as part of our normal course of business. We expect to receive and pay for wafers, capital equipment and various service contracts over the next 12 to 18 months from our existing cash balances.

(2) The commitment related to the Skypoint Fund does not have a set payment schedule and thus will become payable upon the request from the Fund's General Partner.

(3) The commitment relates to the environmental remediation activities.

NOTE 11. LEGAL PROCEEDINGS

On November 16, 2004, Ericsson Wireless Communications, Inc. (now known as Ericsson Inc.) initiated a lawsuit against us in San Diego County Superior Court. In its Third Amended Complaint, Ericsson asserted causes of action against us for negligence, strict product liability, and unfair competition. Through its complaint, Ericsson sought monetary damages and unspecified injunctive relief. Based on discovery responses, Ericsson's claim for monetary damages included a claim for repair costs, a claim for damages to reimburse Ericsson for concessions made to customers and to complete a retrofit of its products, and lost profits. Ericsson claimed that its damages exceed $1 billion. The case is based on Ericsson's purchase of allegedly defective products from Vicor Corporation, our former customer to whom we sold untested, semi-custom wafers. We disputed the allegations in Ericsson's Third Amended Complaint, believed that we had meritorious defenses, and defended the lawsuit vigorously. On December 1, 2006, we entered into a Settlement Agreement with Ericsson, Inc. to resolve the claims asserted by Ericsson. Based on further events in the case, our total liability to Ericsson under the Settlement Agreement was $500,000, which was paid by our insurance carriers. Following payment, Ericsson dismissed its claims against us with prejudice.

On April 5, 2005, Vicor filed a cross-complaint against us in San Diego County Superior Court. In the cross-complaint, Vicor alleged, among other things, that we sold it integrated circuits that were defective and failed to meet agreed-upon specifications, and that we intentionally concealed material facts regarding the specifications of the integrated circuits that Vicor alleges it bought from us. In its cross-complaint, Vicor alleged that it is entitled to indemnification from us for the damages that Vicor paid to Ericsson as a result of the causes of action asserted by Ericsson against Vicor. Vicor asserted causes of action against us for breach of contract, breach of express contract warranty, breach of implied warranties of merchantability and fitness, breach of the covenant of good faith and fair dealing, fraud, negligence, strict liability, implied contractual indemnity, and equitable indemnity. On May 9, 2005, we filed a demurrer to all but one of the indemnity causes of action in Vicor's cross-complaint. On June 17, 2005, the San Diego Superior Court sustained our demurrer to all of Vicor's causes of action except the claims for implied contractual indemnity and equitable indemnity without leave to amend. We answered the two remaining causes of action on July 5, 2005. We disputed the allegations in Vicor's cross-complaint, believed that we had meritorious defenses, and defended the lawsuit vigorously. On December 1, 2006, we entered into a Settlement Agreement with Ericsson, Inc.

We filed a motion for an order finding the Settlement Agreement that we entered with Ericsson was in good faith on December 20, 2006. The Court heard the motion on January 12, 2007. On January 22, 2007, the Court entered an order finding that we entered into the Settlement Agreement in good faith. The result of the finding of good faith was that Vicor's indemnity claims were subject to dismissal. On February 13, 2007, Vicor filed a petition for writ of mandate with the California Court of Appeal challenging the good faith finding. The Court of Appeal summarily denied Vicor's petition on February 28, 2007. On July 10, 2007, the San Diego Superior Court dismissed Vicor's indemnity claims and entered judgment in our favor. Vicor has stated that it intends to appeal the judgment.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-continued
(Unaudited)

On March 4, 2005, we filed a complaint in Santa Clara County Superior Court against Vicor. In the complaint, we sought a declaration regarding the respective rights and obligations, including warranty and indemnity rights and obligations, under the written contracts between us and Vicor for the sale of untested, semi-custom wafers. In addition, we sought a declaration that we were not responsible for any damages that Vicor must pay to Ericsson or any other customer of Vicor arising from claims that Vicor sold allegedly defective products.

On March 17, 2005, Vicor filed a cross-complaint against us and Rohm Device USA, LLC and Rohm Co., Ltd, the owners and operators of the foundry which supplied the untested, semi-custom wafers that we sold to Vicor. In the cross-complaint, Vicor alleged, among other things, that we sold it integrated circuits that were defective and failed to meet agreed-upon specifications, and that we intentionally concealed material facts regarding the specifications of the integrated circuits that Vicor alleges it bought from us. In its cross-complaint, Vicor also alleges that it is entitled to indemnification from us for any damages that Vicor must pay to Ericsson and other Vicor customers as a result of the causes of action asserted by Ericsson in the San Diego County action discussed above and any other claims that may be made against Vicor. In the cross-complaint, Vicor asserted causes of action against us for breach of contract, breach of express contract warranty, breach of implied warranties of merchantability and fitness, breach of the covenant of good faith and fair dealing, fraud, negligence, strict liability, implied contractual indemnity, and equitable indemnity. On May 23, 2005, we filed a demurrer to each cause of action in Vicor’s cross-complaint in Santa Clara County. On July 15, 2005, the Santa Clara County Superior Court sustained our demurrer to each of the causes of action asserted by Vicor. The Court granted Vicor leave to amend the cross-complaint to assert a cause of action for declaratory relief only. On August 1, 2005, Vicor filed its amended cross-complaint seeking a declaration of the parties’ respective rights and obligations, including warranty and indemnity rights, under the alleged contracts between us and Vicor for the sale of untested, semi-custom wafers. In addition, Vicor sought a declaration that we were obligated to indemnify it for any damages resulting from claims brought against Vicor by its customers. Vicor has not sought damages in the Santa Clara County action. We answered Vicor’s amended cross-complaint on September 2, 2005. On April 10, 2006, Vicor moved to have the San Diego County action transferred to Santa Clara County and coordinated with the action in Santa Clara County. On June 6, 2006, the Court deferred deciding Vicor’s motion until the Court in the San Diego County action could rule on a similar motion pending in that action. As discussed above, the Court in the San Diego County action granted Ericsson’s motion to transfer and coordinate the Santa Clara County action with the San Diego County action in San Diego County. The Santa Clara County action has been transferred to San Diego County. No trial date has been set. We do not believe that the litigation will have a material impact on our financial condition, results of operations, or liquidity.

We are not currently a party to any other material legal proceedings.

From time to time, we are involved in various claims, legal actions and complaints arising in the normal course of business. Although the ultimate outcome of the matters discussed above and other matters is not presently determinable, management currently believes that the resolution of all such pending matters will not have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

NOTE 12. INCOME TAXES

We compute income taxes for interim reporting purposes using estimates of the effective annual income tax rate for the entire fiscal year. During the first quarter of fiscal year 2008, we estimated our effective annual income tax rate would be 26.3% as compared to our effective income tax rate for fiscal year 2007 of 29.2%. The decrease in our estimated effective income tax rate from the prior year reflects a discrete tax benefit of $1.9 million related to the favorable resolution of a tax audit during the three months ended June 30, 2007. This benefit was offset, in part, by lower estimated annual benefits from research and development tax credits and tax-favorable investment income.

As a result of the $1.9 million discrete tax benefit from favorable resolution of the tax audit during the first quarter of fiscal year 2008, our effective tax rate benefit for the first quarter of fiscal year 2008 was (8.1)%.

Effective April 1, 2007, we adopted Financial Accounting Standards Interpretation No. 48 “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109” (“FIN 48”). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of uncertain tax positions taken or expected to be taken in our income tax return, and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

The cumulative effect of adopting FIN 48 was a decrease in the liability for uncertain tax positions and an increase of $0.2 million to the April 1, 2007 opening retained earnings balance. Upon adoption, the liability for uncertain tax positions at April 1, 2007 was

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-continued
(Unaudited)

$0.8 million. Consistent with the provisions of FIN 48, we reclassified $0.8 million of income tax liabilities from current to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date. In addition, we decreased current taxes payable and deferred tax assets by $3.5 million for unrecognized tax benefits which serve to reduce net operating loss and tax credit carryforwards.

The total amount of gross unrecognized tax benefits as of the April 1, 2007 adoption date was $7.7 million. If recognized, these unrecognized tax benefits would be recorded as a reduction of future income tax provision. The unrecognized tax benefits increased by $0.1 million during the quarter ended June 30, 2007 to $7.8 million.

Estimated interest and penalties related to the underpayment of income taxes are classified as a component of the provision for income taxes in the condensed consolidated statement of operations. Accrued interest and penalties were $0.1 million and $0.1 million as of April 1, 2007 and June 30, 2007, respectively.

Our only major tax jurisdictions are the United States federal and various states. The fiscal years 1997 through 2007 remain open and subject to examinations by the appropriate governmental agencies in the United States with fiscal years 2000 through 2007 open to audits in certain of our state jurisdictions.

NOTE 13. INDUSTRY AND SEGMENT INFORMATION

We operate in one reportable segment and design, develop and market high-performance, analog and mixed-signal silicon solutions for a variety of markets including networking, serial communications and storage. The nature of our products and production processes as well as type of customers and distribution methods is consistent among all of our products.

Net sales by product line are as follows (in thousands):

	Three Months Ended June 30,	
	2007	2006
Net sales:		
Communications	$16,748	$17,572
Video, Imaging and Other	353	659
Total	$17,101	$18,231

The following table sets forth revenue by geographic area for the three months ended June 30, 2007 and 2006 (in thousands):

	Three Months Ended June 30,	
	2007	2006
Net sales:		
United States	$ 6,885	$ 7,920
China	2,968	2,458
Asia (excludes China)	2,559	3,203
Italy	1,795	1,907
Europe (excludes Italy)	2,894	2,695
Rest of the World	—	48
Total	$17,101	$18,231

For the three months ended June 30, 2007 and 2006, Alcatel-Lucent represented 12% and 17%, respectively, of our net sales. No other OEM customer accounted for 10% or greater of our net sales in these periods.

Substantially all of our long-lived assets at June 30, 2007 and 2006, respectively, were located in the United States.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-continued
(Unaudited)

NOTE 14. RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (“SFAS 157”), “Fair Value Measurements.” SFAS 157 defines fair value, establishes a framework and provides guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently assessing the impact, if any, of adopting SFAS 157 on our financial position, results of operations and liquidity.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS 159”). SFAS 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, although earlier adoption is permitted. We are currently evaluating the impact of implementing SFAS 159 on our financial position, results of operations and liquidity.

NOTE 15. RECENT DEVELOPMENT

On May 7, 2007, we signed a definitive agreement with Sipex Corporation (“Sipex”) to acquire all of the outstanding stock of Sipex in exchange for 0.6679 of a share of Exar common stock for each outstanding share of Sipex common stock and the assumption of Sipex options, warrants and convertible notes based on the same exchange ratio. The total estimated purchase price of approximately $223.9 million is comprised of Exar common stock; assumed stock options, assumed stock warrants and the conversion of approximately one-half of the Sipex convertible notes as part of the acquisition; and direct acquisition costs. This estimate was derived using an average market price per share of Exar common stock of $13.97, which was based on an average of the closing prices for a range of trading days around the announcement date of May 8, 2007 of the proposed merger. The final purchase price will be determined based upon the number of Sipex shares, options, warrants and convertible notes outstanding at the closing date. Sipex designs, manufactures and markets high performance, analog ICs that primarily are used by OEMs, operating in the computing, consumer electronics, communications and networking infrastructure markets. Completion of the merger is subject to required approvals from our stockholders and from Sipex stockholders. The Federal Trade Commission (FTC) has notified Exar and Sipex of an early termination of the waiting period under the Hart Scott Rodino Antitrust Improvements Act notification of 1976 (“HSR”), as amended, under the companies’ proposed merger. Termination of the HSR waiting period satisfies a condition to closing the merger. The Exar and Sipex stockholder meetings are scheduled to be held on August 23, 2007.

The transaction, while expected to close in the third quarter of calendar year 2007, may not be completed if any of the conditions is not satisfied. Under certain circumstances specified in the merger agreement, we or Sipex may terminate the merger agreement, and as a result, either we or Sipex may be required to pay a $6.5 million termination fee to the other party.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as information contained in "Risk Factors" below and elsewhere in this Report, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are generally written in the future tense and/or may generally be identified by words such as "will," "may," "should," "could," "expect," "suggest," "believe," "anticipate," "intend," "plan," or other similar words. Forward-looking statements contained in this Quarterly Report include, among others, statements made in "Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations-Financial Outlook for Fiscal Year 2008" and elsewhere regarding (1) our revenue growth, (2) our gross profits, (3) our research and development efforts and related expenses, (4) our selling, general and administrative expenses, (5) our belief that our cash and cash equivalents, short-term marketable securities and cash flows from operations will be sufficient to satisfy working capital requirements and capital equipment needs for at least the next 12 months, (6) our anticipation that we will continue to finance operations with cash flows from operations, existing cash and investment balances, and some combination of long-term and/or lease financing and additional sales of equity securities, (7) our pending merger with Sipex and the possibility of future acquisitions, and (8) our ability to accurately estimate our variables used in valuing stock-based compensation. Actual results may differ materially from those projected in the forward-looking statements as a result of various factors. Factors that could cause actual results to differ materially from those stated herein include, but are not limited to: the information contained under the captions "Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II, Item 1A. Risk Factors." We disclaim any obligation to update information in any forward-looking statement.

Overview

Exar Corporation and its subsidiaries ("Exar" or "We") design, develop and market high-performance, system-level mixed-signal solutions for a broad range of connectivity standards. We develop high-bandwidth physical interface and access control solutions that facilitate the aggregation and transport of data in access, metro and core wide area networks over legacy and next generation communications infrastructure. We also provide a comprehensive family of serial communications solutions comprised of low voltage, single/multi-channel Universal Asynchronous Receiver Transmitters ("UARTs") as well as UARTs with integrated transceivers. UARTs are well suited to increase data transfer efficiency in a variety of industrial, telecommunications and consumer applications. In addition, we develop Serial Advanced Technology Attachment ("SATA") Port-Multiplier and Port-Selector products addressing the storage marketplace.

Our industry-proven analog and digital design expertise, system-level knowledge and standard Complementary Metal Oxide Semiconductors ("CMOS") process technologies provide Original Equipment Manufacturers ("OEMs") with innovative, highly Integrated Circuits ("ICs") addressing industry standards such as T/E carrier, ATM, SONET/SDH, SATA, UARTs and Multi-Protocol Over SONET ("MPoS").

We believe our broad product offerings provide our customers the following benefits:

- a single source for a broad range of connectivity solutions including transceivers, mappers, framers, and UARTs at various transmission rates;
- unique value-added features and functions;
- reduced overall system cost, power consumption, and size through the integration of multiple functions on a single device;
- reduced system noise/jitter and improved data integrity; and
- accelerated time-to-market by enabling customers to focus on their core competencies and to outsource standards-based solutions.

Our OEM customers include, among others, Adtran Inc., Alcatel-Lucent, Cisco Systems Inc., Digi International, Inc., Ericsson Inc., Fujitsu Limited, Huawei Technologies Company, LTD., International Business Machines Corporation, LG Electronics Inc., Mitsubishi Electronic Corporation, NEC Corporation, Nokia Siemens Networks, Panasonic Corporation, Samsung Electronics, Tellabs, Inc., and ZTE Corporation.

We market our products in North and South America through independent sales representatives and independent, non-exclusive distributors, as well as our own direct sales organization. We are represented in Europe and the Asia/Pacific region by our wholly-owned foreign subsidiaries, independent sales representatives and independent, non-exclusive distributors. Our international sales represented 60% and 57% of net sales for the three months ended June 30, 2007 and 2006, respectively. These international sales consist primarily of export sales from the United States that are denominated in United States dollars. Such international related operations expenses expose us to fluctuations in currency exchange rates because our foreign operating expenses are denominated in foreign currency while our sales are denominated in United States dollars. Although foreign sales within certain countries or foreign sales comprised of certain products may subject us to tariffs, our gross profit margin on international sales, adjusted for differences in product mix, is not significantly different from that realized on our sales to domestic customers. Our operating results are subject to quarterly and annual fluctuations as a result of several factors that could materially and adversely affect our future profitability, as described in “Risk Factors” under Part II, Item 1A.

Recent Development

On May 7, 2007, we signed a definitive agreement with Sipex Corporation (“Sipex”) to acquire all of the outstanding stock of Sipex in exchange for 0.6679 of a share of Exar common stock for each outstanding share of Sipex common stock and the assumption of Sipex options, warrants and convertible notes based on the same exchange ratio. The total estimated purchase price of approximately $223.9 million is comprised of Exar common stock; assumed stock options, assumed stock warrants and the conversion of approximately one-half of the Sipex convertible notes as part of the acquisition; and direct acquisition costs. This estimate was derived using an average market price per share of Exar common stock of $13.97, which was based on an average of the closing prices for a range of trading days around the announcement date of May 8, 2007 of the proposed merger. The final purchase price will be determined based upon the number of Sipex shares, options, warrants and convertible notes outstanding at the closing date. Sipex designs, manufactures and markets high performance, analog ICs that primarily are used by OEMs, operating in the computing, consumer electronics, communications and networking infrastructure markets. Completion of the merger is subject to required approvals from our stockholders and from Sipex stockholders. The Federal Trade Commission (FTC) has notified Exar and Sipex of an early termination of the waiting period under the Hart Scott Rodino Antitrust Improvements Act notification of 1976 (“HSR”), as amended, under the companies’ proposed merger. Termination of the HSR waiting period satisfies a condition to closing the merger. The Exar and Sipex stockholder meetings are scheduled to be held on August 23, 2007.

The transaction, while expected to close in the third quarter of calendar year 2007, may not be completed if any of the conditions is not satisfied. Under certain circumstances specified in the merger agreement, we or Sipex may terminate the merger agreement, and as a result, either we or Sipex may be required to pay a $6.5 million termination fee to the other party.

Financial Outlook for Fiscal Year 2008

As we entered fiscal year 2008, we believe that our customers have, in general, adjusted their inventory levels to more closely match end market demand, and therefore, we believe that our net sales in fiscal year 2008 will increase as compared to fiscal year 2007.

In fiscal year 2008, we believe that revenue growth will be largely driven by sales of our UART, T/E carrier and SONET transceiver products. We also believe that we will begin to realize revenue from our storage and Ethernet aggregation products in late fiscal year 2008. For the second quarter of fiscal year 2008 ending September 30, 2007, we expect net sales of $17.7 million to $18.5 million.

Critical Accounting Policies and Use of Estimates

The preparation of our financial statements and accompanying disclosures in conformity with GAAP, the accounting principles generally accepted in the United States, requires estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and the accompanying notes. The U.S. Securities and Exchange Commission (“SEC”) has defined a company’s critical accounting policies as policies that are most important to the portrayal of a company’s financial condition and results of operations, and which require a company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified our most critical accounting policies and estimates to be as follows: (1) net sales; (2) reserves for excess inventories; (3) income taxes; (4) non-marketable equity securities; and (5) stock-based compensation. Although we believe that our estimates, assumptions and judgments are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates if the assumptions, judgments and conditions upon which they are based turn out to be inaccurate. A further discussion can be found 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 March 31, 2007. Our accounting policy for income taxes, which changed in the first quarter of fiscal year 2008 in connection with adoption of the Financial Accounting Standards Interpretation No. 48 “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109” (“FIN 48”), is described below.

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Accounting for Uncertainty in Income Taxes

Effective April 1, 2007, we adopted Financial Accounting Standards Interpretation No. 48 "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of uncertain tax positions taken or expected to be taken in our income tax return, and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

The cumulative effect of adopting FIN 48 was a decrease in the liability for uncertain tax positions and an increase of $0.2 million to the April 1, 2007 opening retained earnings balance. Upon adoption, the liability for uncertain tax positions at April 1, 2007 was $0.8 million. Consistent with the provisions of FIN 48, we reclassified $0.8 million of income tax liabilities from current to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date. In addition, we decreased current taxes payable and deferred tax assets by $3.5 million for unrecognized tax benefits which serve to reduce net operating loss and tax credit carryforwards.

The total amount of gross unrecognized tax benefits as of the April 1, 2007 adoption date was $7.7 million. If recognized, these unrecognized tax benefits would be recorded as a reduction of future income tax provision. The unrecognized tax benefits increased by $0.1 million during the quarter ended June 30, 2007 to $7.8 million.

Estimated interest and penalties related to the underpayment of income taxes are classified as a component of the provision for income taxes in the condensed consolidated statement of operations. Accrued interest and penalties were $0.1 million and $0.1 million as of April 1, 2007 and June 30, 2007, respectively.

Our only major tax jurisdictions are the United States federal and various states. The fiscal years 1997 through 2007 remain open and subject to examinations by the appropriate governmental agencies in the United States with fiscal years 2000 through 2007 open to audits in certain of our state jurisdictions.

The application of income tax law is inherently complex. Tax laws and regulations are at times ambiguous, and interpretations of and guidance regarding income tax laws and regulations change over time. This requires us to make many subjective assumptions and judgments regarding our income tax exposure. Changes in our assumptions and judgments can materially affect our consolidated financial position, results of operations, and cash flows.

Results of Operations

For the periods indicated, the following table shows certain cost, expense and other income items as a percentage of net sales. The table and subsequent discussion should be read in conjunction with the condensed consolidated financial statements and accompanying notes thereto.

	Three Months Ended June 30,	
	2007	2006
Net sales	100%	100%
Cost of sales:		
Cost of sales	33	29
Amortization of purchased intangible assets	1	1
Total cost of sales	34	30
Gross profit	66	70
Operating expenses:		
Research and development	35	36
Selling, general and administrative	32	37
Total operating expenses	67	73
Loss from operations	(1)	(3)
Interest income and other, net	26	20
Income before income taxes	25	17
(Benefit) provision for income taxes	(2)	6
Net income	27%	11%

Net Sales by Product Line

Net sales are comprised of product deliveries principally to OEMs or their contract manufacturers and non-exclusive distributors. We recognize revenue from product sales upon shipment and transfer of title, in accordance with shipping terms specified in the arrangement with the customer. We have agreements with our non-exclusive domestic distributors that provide for estimated returns and allowances to these distributors. We record a reserve for sales returns and allowances at the time of shipment based upon historical patterns of returns and other concessions.

The following table shows product line net sales in absolute dollars and as a percentage of net sales for the periods indicated (dollars in thousands):

	Three Months Ended June 30,		
	2007	2006	Change
Net sales:			
Communications	$16,748	$17,572	(5%)
Percentage of net sales	98%	96%	
Video, imaging and other	$ 353	$ 659	(46%)
Percentage of net sales	2%	4%	
Total	$17,101	$18,231	

Communications

Net sales in the network and transmission market for the three months ended June 30, 2007 increased by $0.2 million, or 3%, compared to the same period a year ago. T/E carrier product sales were 10% lower compared to the same period a year ago, primarily due to reduced sales volume. SONET product sales grew 35% compared to the same period a year ago due to increased sales volume.

Net sales in the serial communications market for the three months ended June 30, 2007, excluding $0.5 million in sales of discontinued products for the first quarter of fiscal year 2006, decreased by $0.5 million compared to the same period a year ago, primarily due to a shift in mix to lower priced products and lower prices for certain products.

Video, Imaging and Other

Video, imaging and other products sales for the three months ended June 30, 2007 decreased by $0.3 million compared to the same period a year ago, primarily due to reduced sales volume to Hewlett-Packard.

Sales by Channel and Geography

The following table shows net sales by channel in absolute dollars and as a percentage of net sales for the periods indicated (dollars in thousands):

	Three Months Ended June 30,		
	2007	2006	Change
Primary distributors	$ 6,597	$ 6,988	(6%)
Percentage of net sales	39%	38%	
OEM / channel partners	$10,504	$11,243	(7%)
Percentage of net sales	61%	62%	

Net sales to our primary distributors, Future Electronics (“Future”) and Nu Horizons Electronics Corp. (“Nu Horizons”) for the three months ended June 30, 2007 decreased $0.4 million as compared to the same period a year ago as a result of a shift in mix to lower priced products and lower prices for certain serial communications products.

Net sales to OEMs and their subcontract manufacturers for the three months ended June 30, 2007 decreased $0.7 million as a result of lower sales volume.

The following table shows net sales by geography in absolute dollars and as a percentage of net sales for the periods indicated (dollars in thousands):

	Three Months Ended June 30,		
	2007	2006	Change
United States	$ 6,885	$ 7,920	(13%)
Percentage of net sales	40%	43%	
International	$10,216	$10,311	(1%)
Percentage of net sales	60%	57%	

Sales in the United States for the three months ended June 30, 2007 decreased $1.0 million as compared to the same period a year ago as a result of lower sales volume and lower prices for certain serial communications products. Additionally, net sales for the three months ended June 30, 2006 included $0.5 million in sales of discontinued products.

Gross Profit

The following table shows gross profit in absolute dollars and as a percentage of net sales for the periods indicated (dollars in thousands):

	Three Months Ended June 30,		
	2007	2006	Change
Gross profit	$11,357	$12,759	(11%)
Percentage of net sales	66.4%	70.0%	

Gross profit represents net sales less cost of sales. Cost of sales includes:

- the cost of purchasing the finished silicon wafers manufactured by independent foundries;
- costs associated with assembly, packaging, testing, quality assurance and product yields;
- the cost of personnel and related stock-based compensation expense, and cost of equipment associated with manufacturing support and manufacturing engineering;
- the amortization of purchased intangible assets; and
- provisions for excess and obsolete inventory.

The decrease in gross profit as a percentage of net sales for the three months ended June 30, 2007, as compared to the same period a year ago, was a result of lower shipments, manufacturing inefficiencies and lower yields. Stock-based compensation expense recorded in cost of sales was minimal for both periods indicated.

We anticipate that gross profit will continue to fluctuate as a percentage of net sales and in absolute dollars due to, among other factors, future fluctuations in net sales, manufacturing costs, competitive pricing, product mix and future amortization of any additional license technology.

Research and Development ("R&D")

The following table shows research and development expenses in absolute dollars and as a percentage of net sales for the periods indicated (dollars in thousands):

	Three Months Ended June 30,		
	2007	2006	Change
Total research and development	$6,058	$ 6,614	(8%)
Percentage of net sales	35%	36%	

Research and development expenses consist primarily of:

- salaries, stock-based compensation and related expenses of engineering employees engaged in product research, design and development activities;
- costs related to engineering design tools, mask tooling costs, test hardware, engineering supplies and services, and use of in-house test equipment; and
- facility expenses.

The decrease in R&D expenses for the three months ended June 30, 2007, as compared to the same period a year ago, was primarily a result of lower labor related costs and lower mask tooling costs. Stock-based compensation expense recorded in R&D expenses was $0.2 million for the three months ended June 30, 2007 as compared to $0.3 million for the same period a year ago.

We believe that technological innovation is critical to our long-term success, and we intend to continue our investments in R&D to enhance our product offerings in order to meet the current and future technological requirements of our customers and markets. Some aspects of our R&D efforts require significant short-term expenditures, such as mask tooling for advanced technology products, the timing of which may cause significant fluctuations in our R&D expenses.

Selling, General and Administrative ("SG&A")

The following table shows selling, general and administrative expenses in absolute dollars and as a percentage of net sales for the periods indicated (dollars in thousands):

	Three Months Ended June 30,		
	2007	2006	Change
Total SG&A	$5,531	$ 6,734	(18%)
Percentage of net sales	32%	37%	

Selling, general and administrative expenses consist primarily of:

- salaries, stock-based compensation and related expenses;
- sales commissions;
- professional and legal fees; and
- facility expenses.

The decrease in SG&A expenses for the three months ended June 30, 2007, as compared to the same period a year ago, was primarily attributable to lower labor related costs and legal fees. In addition, costs associated with the separation of our former CFO of $0.7 million were included in the three months ended June 30, 2006 results. Stock-based compensation expense recorded in SG&A expenses was $0.5 million for the three months ended June 30, 2007 as compared to $0.7 million for the same period a year ago.

We anticipate that SG&A expenses will continue to fluctuate in absolute dollars and as a percentage of net sales due to sales commissions, possible future expansion of our infrastructure to support potential acquisition and integration activities, amortization of acquired intangible assets, and professional fees. In the short term, many of the SG&A expenses are fixed; however, we expect SG&A expense will continue to fluctuate.

Interest Income and Other, Net

The following table shows interest income and other, net in absolute dollars and as a percentage of net sales for the periods indicated (dollars in thousands):

	Three Months Ended June 30,		
	2007	2006	Change
Interest income and other, net	$4,497	$ 3,714	21%
Percentage of net sales	26%	20%	

Interest income and other, net primarily consists of:

- interest income;
- realized gains on marketable securities; and
- gains or losses resulting from investments in non-marketable equity securities and venture funds.

The increase in interest income and other, net of $0.8 million during the three months ended June 30, 2007, as compared to the same period a year ago, was primarily attributable to higher interest income as a result of increased interest rates.

We expect that our interest income will continue to fluctuate due to changes in interest rates.

(Benefit) Provision for Income Taxes

We compute income taxes for interim reporting purposes using estimates of the effective annual income tax rate for the entire fiscal year. During the first quarter of fiscal year 2008, we estimated our effective annual income tax rate would be 26.3% as compared to our effective income tax rate for fiscal year 2007 of 29.2%. The decrease in our estimated effective income tax rate from the prior year reflects a discrete tax benefit of $1.9 million related to the favorable resolution of a tax audit during the three months ended June 30, 2007. This benefit was offset, in part, by lower estimated annual benefits from research and development tax credits and tax-favorable investment income.

As a result of the $1.9 million discrete tax benefit from favorable resolution of the tax audit during the first quarter of fiscal year 2008, our effective tax rate benefit for the first quarter of fiscal year 2008 was (8.1)%.

Liquidity and Capital Resources

We do not have any off-balance sheet arrangements, investments in special purpose entities, variable interest entities or undisclosed borrowings or debt. Additionally, we are not a party to any derivative contracts, nor do we have any synthetic leases. At June 30, 2007, we had no foreign currency contracts outstanding.

Our principal sources of liquidity during the three months ended June 30, 2007 were cash and cash equivalents and short-term marketable securities, which, in the aggregate, decreased by $2.5 million to $353.6 million at June 30, 2007 from $356.1 million at March 31, 2007. Cash and cash equivalents decreased by $45.1 million during the three months ended June 30, 2007 resulting primarily from net cash used in investing activities of $44.4 million and net cash used in financing activities of $3.2 million partially offset by net cash provided by operating activities of $2.5 million.

We generated net cash flows from operating activities of $2.5 million and $3.4 million during the three month periods ended June 30, 2007 and 2006, respectively. For the three months ended June 30, 2007, net cash from operating activities resulted from net income of $4.6 million and $3.4 million in non-cash charges for depreciation and amortization expense, stock-based compensation, tax benefit from stock plans, the provision for sales returns and allowances, and deferred income taxes. These sources of cash were partially offset primarily by increases in accounts receivable of $2.3 million, prepaid expenses and other assets of $0.8 million, and a decrease in income taxes payable of $2.1 million. For the three months ended June 30, 2006, net cash from operating activities resulted from net income of $2.0 million and $3.9 million in non-cash charges for depreciation and amortization expense, stock-based compensation and the provision for sales returns and allowances and an increase in income taxes payable of $0.4 million. These sources of cash were partially offset by increases in prepaid expenses and other assets and accounts receivable of $1.5 million and $0.7 million, respectively.

Net cash used in investing activities totaled $44.4 million during the three months ended June 30, 2007 as compared to net cash provided by investing activities of $25.4 million during the three months ended June 30, 2006. During the three months ended June 30, 2007, our investing activities included purchases of short-term marketable securities of $175.4 million, purchases of property, plant, equipment and intellectual property of $0.3 million, and acquisition costs of $0.9 million partially offset by proceeds from the sales and maturities of $132.5 million of short-term marketable securities. The increased holdings of short-term marketable securities were in investment grade commercial paper with maturities slightly greater than 90 days. During the three months ended June 30, 2006, our investing activities included proceeds from the sales and maturities of $53.8 million of short-term marketable securities partially offset by purchases of $27.3 million in short-term marketable securities, and purchases of property, plant and equipment and intellectual property of $0.7 million.

As of June 30, 2007, we have a remaining obligation to make a capital contribution of $1.0 million, limited to companies currently in the portfolio, to Skypoint Fund upon its request. To meet our capital commitment to the Skypoint Fund, we may need to use our existing cash, cash equivalents and/or short-term marketable securities.

Net cash used in financing activities totaled $3.2 million in the three months ended June 30, 2007, as compared to net cash provided by financing activities of $4.8 million in the three months ended June 30, 2006. During the three months ended June 30, 2007, our financing activities reflected primarily the repurchases of our common stock totaling $4.0 million partially offset by the issuance of shares of common stock, representing proceeds from the exercise of stock options under our stock option plans of $0.7 million. During the three months ended June 30, 2006, our financing activities reflected proceeds from the issuance of shares of common stock, representing proceeds from the exercise of stock options under our stock option plans and the purchase of shares of common stock under our Employee Stock Participation Plan.

In October 2006, in furtherance to our 2001 common stock repurchase program, we announced the adoption of a 10b5-1 Share Repurchase Plan (“SRP”) covering the purchase of up to $16.0 million of our common stock through June 30, 2007. During the three months ended June 30, 2007, we repurchased a total of 292,808 shares of our common stock at an aggregate cost of $4.0 million under this SRP. In addition, we repurchased 10,000 shares at an aggregate cost of $1 from our former chief executive officer pursuant to a restricted stock purchase agreement.

In July 2007, we announced the adoption of a new 10b5-1 SRP which will allow us to use the remaining balance of $14.2 million under our original 2001 stock repurchase program to acquire shares of our common stock in the open market through November 30, 2007. In the future, we may utilize this stock repurchase program, which would reduce cash, cash equivalents and/or marketable securities available to fund future operations and meet other liquidity requirements.

To date, inflation has not had a significant impact on our operating results.

We anticipate that we will continue to finance our operations with cash flows from operations, existing cash and investment balances, and additional sales of equity securities. The combination and sources of capital will be determined by management based on our needs and prevailing market conditions. We believe that our cash and cash equivalents, short-term marketable securities and cash flows from operations will be sufficient to satisfy working capital requirements and capital equipment needs for at least the next 12 months. However, should the demand for our products decrease in the future, the availability of cash flows from operations may be limited, thus possibly having a material adverse effect on our financial condition or results of operations. From time to time, we evaluate potential acquisitions, strategic arrangements and equity investments complementary to our design expertise and market strategy, which may include investments in wafer fabrication foundries. To the extent that we pursue or position ourselves to pursue these transactions, we could consume a significant portion of our capital resources or choose to seek additional equity or debt financing. There can be no assurance that additional financing could be obtained on terms acceptable to us. The sale of additional equity or convertible debt could result in dilution to our stockholders.

Recently Issued Accounting Standards

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (“SFAS 157”), “Fair Value Measurements.” SFAS 157 defines fair value, establishes a framework and provides guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently assessing the impact, if any, of adopting SFAS 157 on our financial position, results of operations and liquidity.

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In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS 159”). SFAS 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, although earlier adoption is permitted. We are currently evaluating the impact of implementing SFAS 159 on our financial position, results of operations and liquidity.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Fluctuations. We are exposed to foreign currency fluctuations primarily through our foreign operations. This exposure is the result of foreign operating expenses being denominated in foreign currency. Operational currency requirements are typically forecasted for a three-month period. If there is a need to hedge this risk, we may enter into transactions to purchase currency in the open market or enter into forward currency exchange contracts.

If our foreign operations forecasts are overstated or understated during periods of currency volatility, we could experience unanticipated currency gains or losses. At June 30, 2007, we did not have significant foreign currency denominated net assets or net liabilities, and had no foreign currency contracts outstanding.

Interest Rate Sensitivity. We maintain investment portfolio holdings of various issuers, types and maturity dates with various banks and investment banking institutions. The market value of these investments on any given day during the investment term may vary as a result of market interest rate fluctuations. This exposure is not hedged because a hypothetical 10% movement in interest rates during the investment term would not likely have a material impact on investment income. The actual impact on investment income in the future may differ materially from this analysis, depending on actual balances and changes in the timing and the amount of interest rate movements.

Short-term investments are classified as “available-for-sale” securities and the cost of securities sold is based on the specific identification method. At June 30, 2007, short-term investments consisted of United States government and corporate securities of $278.9 million. At June 30, 2007, the difference between the fair market value and the underlying cost of such investments was an unrealized loss of $0.2 million, before the effect of income taxes.

Our net income is dependent on, among other factors, interest income. If interest rates decline, our net income may be negatively impacted.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures ("Disclosure Controls").

We evaluated the effectiveness of the design and operation of our Disclosure Controls, as defined by the rules and regulations of the SEC (the "Evaluation"), as of the end of the period covered by this Form 10-Q. This Evaluation was performed under the supervision and with the participation of management, including our Chief Executive Officer (the "CEO"), as principal executive officer, and Chief Financial Officer (the "CFO"), as principal financial officer.

Attached as Exhibits 31.1 and 31.2 of this Report are the certifications of the CEO and the CFO in compliance with Section 302 of the Sarbanes-Oxley Act of 2002 (the "Certifications"). This section of the Report provides information concerning the Evaluation referred to in the Certifications and should be read in conjunction with the Certifications.

Disclosure Controls are controls and procedures designed to ensure that information required to be disclosed in the reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods as specified in the SEC's rules and forms. In addition, Disclosure Controls are designed to allow for the accumulation and communications of information to our management, including the CEO and CFO, to allow timely decisions regarding required disclosures.

Based on the Evaluation, our CEO and CFO have concluded that our Disclosure Controls are effective as of June 30, 2007.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on the Effectiveness of Disclosure Controls.

Our management, including the CEO and CFO, does not expect that the Disclosure Controls will prevent all errors and all fraud. Disclosure Controls, no matter how well conceived, managed, utilized and monitored, can provide only reasonable assurance that the objectives of such controls are met. Therefore, because of the inherent limitation of Disclosure Controls, no evaluation of such controls can provide absolute assurance that all control issues and instances of fraud, if any, within us have been detected.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On November 16, 2004, Ericsson Wireless Communications, Inc. (now known as Ericsson Inc.) initiated a lawsuit against us in San Diego County Superior Court. In its Third Amended Complaint, Ericsson asserted causes of action against us for negligence, strict product liability, and unfair competition. Through its complaint, Ericsson sought monetary damages and unspecified injunctive relief. Based on discovery responses, Ericsson's claim for monetary damages included a claim for repair costs, a claim for damages to reimburse Ericsson for concessions made to customers and to complete a retrofit of its products, and lost profits. Ericsson claimed that its damages exceed $1 billion. The case is based on Ericsson's purchase of allegedly defective products from Vicor Corporation, our former customer to whom we sold untested, semi-custom wafers. We disputed the allegations in Ericsson's Third Amended Complaint, believed that we had meritorious defenses, and defended the lawsuit vigorously. On December 1, 2006, we entered into a Settlement Agreement with Ericsson, Inc. to resolve the claims asserted by Ericsson. Based on further events in the case, our total liability to Ericsson under the Settlement Agreement was $500,000, which was paid by our insurance carriers. Following payment, Ericsson dismissed its claims against us with prejudice.

On April 5, 2005, Vicor filed a cross-complaint against us in San Diego County Superior Court. In the cross-complaint, Vicor alleged, among other things, that we sold it integrated circuits that were defective and failed to meet agreed-upon specifications, and that we intentionally concealed material facts regarding the specifications of the integrated circuits that Vicor alleges it bought from us. In its cross-complaint, Vicor alleged that it is entitled to indemnification from us for the damages that Vicor paid to Ericsson as a result of the causes of action asserted by Ericsson against Vicor. Vicor asserted causes of action against us for breach of contract, breach of express contract warranty, breach of implied warranties of merchantability and fitness, breach of the covenant of good faith and fair dealing, fraud, negligence, strict liability, implied contractual indemnity, and equitable indemnity. On May 9, 2005, we filed a demurrer to all but one of the indemnity causes of action in Vicor's cross-complaint. On June 17, 2005, the San Diego Superior Court sustained our demurrer to all of Vicor's causes of action except the claims for implied contractual indemnity and equitable indemnity without leave to amend. We answered the two remaining causes of action on July 5, 2005. We disputed the allegations in Vicor's cross-complaint, believed that we had meritorious defenses, and defended the lawsuit vigorously. On December 1, 2006, we entered into a Settlement Agreement with Ericsson, Inc.

We filed a motion for an order finding the Settlement Agreement that we entered with Ericsson was in good faith on December 20, 2006. The Court heard the motion on January 12, 2007. On January 22, 2007, the Court entered an order finding that we entered into the Settlement Agreement in good faith. The result of the finding of good faith was that Vicor's indemnity claims were subject to dismissal. On February 13, 2007, Vicor filed a petition for writ of mandate with the California Court of Appeal challenging the good faith finding. The Court of Appeal summarily denied Vicor's petition on February 28, 2007. On July 10, 2007, the San Diego Superior Court dismissed Vicor's indemnity claims and entered judgment in our favor. Vicor has stated that it intends to appeal the judgment.

On March 4, 2005, we filed a complaint in Santa Clara County Superior Court against Vicor. In the complaint, we sought a declaration regarding the respective rights and obligations, including warranty and indemnity rights and obligations, under the written contracts between us and Vicor for the sale of untested, semi-custom wafers. In addition, we sought a declaration that we were not responsible for any damages that Vicor must pay to Ericsson or any other customer of Vicor arising from claims that Vicor sold allegedly defective products.

On March 17, 2005, Vicor filed a cross-complaint against us and Rohm Device USA, LLC and Rohm Co., Ltd, the owners and operators of the foundry which supplied the untested, semi-custom wafers that we sold to Vicor. In the cross-complaint, Vicor alleged, among other things, that we sold it integrated circuits that were defective and failed to meet agreed-upon specifications, and that we intentionally concealed material facts regarding the specifications of the integrated circuits that Vicor alleges it bought from us. In its cross-complaint, Vicor also alleges that it is entitled to indemnification from us for any damages that Vicor must pay to Ericsson and other Vicor customers as a result of the causes of action asserted by Ericsson in the San Diego County action discussed above and any other claims that may be made against Vicor. In the cross-complaint, Vicor asserted causes of action against us for breach of contract, breach of express contract warranty, breach of implied warranties of merchantability and fitness, breach of the covenant of good faith and fair dealing, fraud, negligence, strict liability, implied contractual indemnity, and equitable indemnity. On May 23, 2005, we filed a demurrer to each cause of action in Vicor's cross-complaint in Santa Clara County. On July 15, 2005, the Santa Clara County Superior Court sustained our demurrer to each of the causes of action asserted by Vicor. The Court granted Vicor leave to amend the cross-complaint to assert a cause of action for declaratory relief only. On August 1, 2005, Vicor filed its amended cross-complaint seeking a declaration of the parties' respective rights and obligations, including warranty and indemnity rights, under the alleged contracts between us and Vicor for the sale of untested, semi-custom wafers. In addition, Vicor sought a declaration that we were obligated to indemnify it for any damages resulting from claims brought against Vicor by its customers. Vicor has not sought damages in the Santa Clara County action. We answered Vicor's amended cross-complaint on September 2, 2005. On April 10, 2006, Vicor moved to have the San Diego County action transferred to Santa Clara County and coordinated with the action in Santa Clara County. On June 6, 2006, the Court deferred deciding Vicor's motion until the Court in the San Diego County action could rule on a similar motion pending in that action. As discussed above, the Court in the San Diego County action granted Ericsson's motion to transfer and coordinate the Santa Clara County action with the San Diego County action in San Diego County. The Santa Clara County action has been transferred to San Diego County. No trial date has been set. We do not believe that the litigation will have a material impact on our financial condition, results of operations, or liquidity.

We are not currently a party to any other material legal proceedings.

From time to time, we are involved in various claims, legal actions and complaints arising in the normal course of business. Although the ultimate outcome of the matters discussed above and other matters is not presently determinable, management currently believes that the resolution of all such pending matters will not have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

ITEM 1A. RISK FACTORS

We are subject to a number of risks. Some of these risks are endemic to the high-technology industry and are the same or similar to those disclosed in our previous SEC filings, and some new risks may arise in the future. You should carefully consider all of these risks and the other information in this Quarterly Report and our Annual Report on Form 10-K for the fiscal year ended March 31, 2007 before investing in our company. The fact that certain risks are endemic to the high-technology industry does not lessen the significance of these risks.

As a result of these risks, our business, financial condition or results of operations could be materially and adversely affected. This could cause the trading price of our common stock to decline, and stockholders might lose some or all of their investment.

IF WE FAIL TO DEVELOP AND INTRODUCE NEW PRODUCTS IN OUR CORE OR NEW MARKETS THAT MEET EVOLVING MARKET NEEDS OR WE ARE UNABLE TO GROW REVENUES, THEN OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS COULD BE MATERIALLY AND ADVERSELY IMPACTED.

The markets for our products are characterized by:

- changing technologies;
- evolving and competing industry standards;
- changing customer requirements;
- increasing product development costs;
- long design-to-production cycles;
- competitive solutions;
- fluctuations in capital equipment spending levels and/or deployment;
- rapid adjustments in customer demand and inventory;
- increasing functional integration;
- increasing price pressure;
- moderate to slow growth;
- frequent product introductions and enhancements;

- changing competitive landscape (consolidation, financial viability); and
- finite market windows for product introductions.

Our growth depends in part on our successful development of new products for our core markets. We must: (i) anticipate customer and market requirements and changes in technology and industry standards; (ii) properly define and develop, on a timely basis, new products; (iii) gain access to and use technologies in a cost-effective manner; (iv) continue to expand our technical and design expertise; (v) timely introduce and cost-effectively manufacture new products; (vi) differentiate our products from our competitors' offerings; and (vii) gain customer acceptance of our products. In addition, we must continue to have our products designed into our customers' future products and maintain close working relationships with key customers to develop new products that meet their evolving needs. Moreover, we must respond to shifts in market demands, the trend towards increasing functional integration and other changes in a rapid and cost-effective manner. Migration from older products to newer products may result in volatility of earnings during periods of transition to new products.

Products for communications applications are based on continually evolving industry standards and new technologies. Our ability to compete will depend in part on our ability to identify and ensure compliance with these industry standards. The emergence of new standards could render our products incompatible with systems developed by major communications equipment manufacturers. As a result, we could be required to invest significant time, effort and expenses to develop and qualify new products to ensure compliance with industry standards.

The process of developing and supporting new products is complex, expensive and uncertain, and if we fail to accurately predict and understand our customers' changing needs and emerging technological trends, our business may be harmed. In addition, we may make significant investments to modify new products according to input from one or more customers who then, in the end, may choose another competitor's or an internal solution, or cancel the project. We may not be able to identify new product opportunities successfully, develop and bring to market new products, achieve design wins, ensure when and which design wins actually get released to production, or respond effectively to technological changes or product announcements by our competitors. In addition, we may not be successful in developing or using new technologies or may incorrectly anticipate market demand and develop products that achieve little or no market acceptance. Our pursuit of technological advances may require substantial time and expense and may ultimately prove unsuccessful. Failure in any of these areas may harm our business, financial condition and results of operations.

IF WE ARE UNABLE TO CONVERT A SIGNIFICANT PORTION OF OUR DESIGN WINS INTO ACTUAL REVENUE, OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS COULD BE MATERIALLY AND ADVERSELY IMPACTED.

We have secured a significant number of design wins for new and existing products. Such design wins are necessary for revenue growth. However, many of our design wins may never generate revenues if their end-customer projects are unsuccessful in the market place or the end-customer terminates the project, which may occur for a variety of reasons. Mergers and consolidation among our customers may lead to termination of certain projects before the associated design win generates revenue. If design wins do generate revenue, the time lag between the design win and meaningful revenue is typically in excess of eighteen months. If we fail to convert a significant portion of our design wins into substantial revenue, our business, financial condition and results of operations could be materially and adversely impacted.

OUR FINANCIAL RESULTS MAY FLUCTUATE SIGNIFICANTLY BECAUSE OF A NUMBER OF FACTORS, MANY OF WHICH ARE BEYOND OUR CONTROL.

Our financial results may fluctuate significantly. Some of the factors that affect our financial results, many of which are difficult or impossible to control or predict, are:

- our difficulty predicting revenues and ordering the correct mix of products from suppliers due to limited visibility provided by customers and channel partners coupled with a high number of orders placed for products to be shipped in the same quarter;
- the reduction, rescheduling, cancellation or timing of orders by our customers and channel partners due to, among others, the following factors:
    - management of customer, subcontractor and/or channel inventory;
    - dependency on a single product with a single customer;

  - volatility of demand for equipment sold by our large customers, which in turn, introduces demand volatility for our products;
  - temporary disruption in customer demand as customers change or modify their complex subcontract manufacturing supply chain;
  - temporary disruption in customer demand due to technical issues with our chip or other components in their system;
  - the inability of our customers to obtain components from their other suppliers; and
  - disruption in the sales or distribution channels;
- changes in sales and implementation cycles for our products;
- the ability of our suppliers, customers and communications service providers to obtain financing or to fund capital expenditures;
- changes in the mix of products that our customers purchase;
- risks associated with entering new markets, such as increased competition, should we decide to do so;
- the announcement or introduction of products by our competitors;
- loss of market share by our customers;
- competitive pressures on selling prices or product availability;
- pressures on selling prices overseas due to foreign currency exchange fluctuations;
- erosion of average selling prices coupled with the inability to sell newer products with higher average selling prices, resulting in lower overall revenue and margins;
- market and/or customer acceptance of our products;
- consolidation among our competitors, our customers and/or our customers’ customers;
- changes in our customers’ end user concentration or requirements;
- loss of one or more major customers;
- significant changes in ordering pattern by major customers;
- our or our channel partners’ ability to maintain and manage appropriate inventory levels;
- the availability and cost of materials and services, including foundry, assembly and test capacity, needed by us from our foundries and suppliers;
- if wafer fabrication or packaging and test suppliers discontinue or experience extended disruption of supply, we may incur increased costs to obtain alternative suppliers or investment in inventory to meet continuity of supply obligations to customers;
- temporary disruptions in our or our customers’ supply chain due to natural disaster, fire, outbreak of communicable diseases, labor disputes, or civil unrest;

- fluctuations in the manufacturing output, yields, and capacity of our suppliers;
- fluctuation in suppliers' capacity due to reorganization, relocation or shift in business focus;
- problems, costs, or delays that we may face in shifting our products to smaller geometry process technologies and in achieving higher levels of design and device integration;
- our ability to successfully introduce and transfer into production new products and/or integrate new technologies;
- increase in manufacturing costs;
- higher mask tooling costs associated with advanced technologies;
- the amount and timing of our investment in research and development;
- costs and business disruptions associated with shareholder or regulatory issues;
- the timing and amount of employer payroll tax to be paid on our employees' gains on stock options exercised;
- increased costs and time associated with compliance with accounting rules or other regulatory requirements;
- changes in accounting or other regulatory rules, such as the requirement to record expenses for stock-based compensation and to change tax accounting principles;
- fluctuations in interest rates and/or market values of our marketable securities;
- litigation costs associated with the defense of suits brought or complaints made against us; and
- changes in or continuation of certain tax provisions.

As a consequence, operating results for a particular future period are difficult to predict and prior results are not necessarily indicative of results to be expected in the future. Any of the foregoing factors, or any other factors discussed elsewhere herein or in our Annual Report on Form 10-K for the fiscal year ended March 31, 2007, may have a material adverse effect on our business, financial condition and results of operations.

OUR PENDING MERGER WITH SIPEX CORPORATION IS SUBJECT TO NUMEROUS RISKS AND UNCERTAINTIES.

Completion of the pending merger with Sipex is subject to numerous risks and uncertainties. The merger is subject to conditions beyond our and Sipex's control, including regulatory and stockholder approvals. We and Sipex may be unable to obtain the required approvals in a timely manner or at all. If the merger is not completed, then the price of our common stock may decline, costs related to the merger, such as financial advisory, legal, accounting and printing fees, must be paid (even if the merger is not completed) and we would fail to realize any of the strategic benefits expected to result form the merger. In addition, under specified circumstances, we may be required to pay Sipex a termination fee of $6.5 million in connection with the termination of the merger agreement.

Uncertainty regarding the completion of the merger may cause customers, suppliers and channel partners such as Future Electronics, Inc. to delay or defer decisions concerning our products, which could negatively impact our business. In addition, diversion of management focus and resources from the day-to-day operation of the business to matters relating to the merger could have a material adverse effect on our business. Current and prospective employees may experience uncertainty about their future roles with our company. This may adversely affect our ability to attract and retain key management, sales, marketing, operations and technical personnel.

If the merger is completed, we will continue to face risks associated with the merger, including challenges relating to the integration of the businesses and operations of Exar and Sipex, and challenges in retaining employees. Also, Future Electronics will become a related party of Exar owning approximately 15% of the outstanding shares at the close of the merger and as the largest distributor accounting for approximately 33% of net sales of the combined company. In addition, we may not realize the anticipated benefits or synergies of the merger to the extent, or in the timeframe, anticipated.

THE GENERAL STATE OF THE U.S. AND GLOBAL ECONOMIES, AS WELL AS THE COMMUNICATIONS EQUIPMENT MARKET, MAY CONTINUE TO MATERIALLY AND ADVERSELY AFFECT OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Periodic declines or fluctuations in corporate profits, lower capital equipment spending, the impact of conflicts throughout the world, terrorist acts, natural disasters, volatile energy costs, the outbreak of communicable diseases and other geopolitical factors have had, and may continue to have, a negative impact on the U.S. and global economies. Our revenue and profitability have generally followed market fluctuations in the communications equipment industry. These market fluctuations have affected carrier capital equipment spending which in turn has affected the demand for our customers' products, thus affecting our revenues and profitability. Communications service providers and equipment manufacturers continue to experience consolidation in their industries which may result in project delays or cancellations. Uncertainties in anticipated communications equipment spending levels or further consolidation may adversely affect our business, financial condition and results of operations.

We are unable to predict the strength or duration of current communications market conditions or effects of equipment manufacturer consolidation. If the sector does not improve measurably, or declines, our business, financial condition and results of operations may be materially and adversely impacted.

UTILIZATION OF ACQUIRED TECHNOLOGY.

We have acquired and may in the future acquire intellectual property to accelerate our time to market for new products. Acquisitions of intellectual property may involve risks such as successful technical integration into new products, market acceptance of new products, and achievement of planned return on investment. The timely and efficient integration of acquired technology may be adversely impacted by inherent design deficiencies or application requirements. The potential failure of or delay in product introduction utilizing acquired intellectual property could lead to an impairment of capitalized intellectual property acquisition costs.

COMPETITION IN THE MARKETS IN WHICH WE PARTICIPATE, OR MAY PARTICIPATE, MAY MAKE IT MORE DIFFICULT FOR US TO BE SUCCESSFUL.

We compete against an established group of semiconductor companies that focus on similar markets. These competitors include LSI Corporation, Applied Micro Circuits Corporation, Integrated Device Technology Inc., Maxim Integrated Products Inc., Mindspeed Technologies Inc., PMC Sierra, Inc., NXP (formerly of Royal Philips Electronics), Texas Instruments Incorporated, TranSwitch Corporation and Vitesse Semiconductor Corporation. Additionally, we are facing competition from other established companies that seek to enter the markets in which we participate.

We have experienced increased competition at the design stage, where customers evaluate alternative solutions based on a number of factors, including price, performance, product features, technologies, and availability of long-term product supply and/or roadmap guarantee. Additionally, we experience, in some cases, severe pressure on pricing from some of our competitors or on-going cost reduction expectations from customers. Such circumstances may make some of our products unattractive due to price or performance measures and result in losing our design opportunities or causing a decrease in our revenue and margins. Also, competition from new companies in emerging economy countries with significantly lower costs could affect our selling price and gross margins.

IF OUR DISTRIBUTORS OR SALES REPRESENTATIVES STOP SELLING OR FAIL TO SUCCESSFULLY PROMOTE OUR PRODUCTS, OUR BUSINESS, FINANCIAL CONDITION, AND RESULTS OF OPERATIONS COULD BE ADVERSELY AFFECTED.

We sell many of our products through two non-exclusive distributors and numerous sales representatives. Our non-exclusive distributors and sales representatives may carry our competitors' products, which could adversely impact or limit sales of our products. Additionally, they could reduce or discontinue sales of our products or may not devote the resources necessary to sell our products in the volumes and within the time frames that we expect. Moreover, we depend on the continued viability and financial resources of these distributors and sales representatives, some of which are small organizations with limited working capital. In turn, these distributors and sales representatives are subject to general economic and semiconductor industry conditions. We believe that our success will continue to depend on these distributors and sales representatives. If some or all of our distributors and sales representatives experience financial difficulties, or otherwise become unable or unwilling to promote and sell our products, our business, financial condition and results of operations could be adversely affected.

WE DEPEND ON THIRD-PARTY FOUNDRIES TO MANUFACTURE OUR INTEGRATED CIRCUITS. ANY DISRUPTION IN OR LOSS OF THE FOUNDRIES' CAPACITY TO MANUFACTURE OUR PRODUCTS SUBJECTS US TO A NUMBER OF RISKS, INCLUDING THE POTENTIAL FOR AN INADEQUATE SUPPLY OF PRODUCTS AND HIGHER MATERIALS COSTS. THESE RISKS MAY LEAD TO DELAYED PRODUCT DELIVERY OR INCREASED COSTS, WHICH COULD MATERIALLY AND ADVERSELY AFFECT OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

We do not own or operate a semiconductor fabrication facility, or a foundry. Most of our products are based on complementary metal oxide semiconductor, or CMOS, processes. Chartered Semiconductor Manufacturing Ltd., or Chartered, located in Singapore, manufactures the majority of the CMOS wafers from which our products are manufactured. Chartered produces semiconductors for many other companies (many of which have greater requirements than us), and therefore we may not have access on a timely basis to sufficient capacity or certain process technologies. In addition, we rely on Chartered's continued financial health and ability to continue to invest in smaller geometry manufacturing processes and foundries.

Many of our new products are designed to take advantage of smaller geometry manufacturing processes. Due to the complexity and increased cost of migrating to smaller geometries, we may experience problems, which could result in design and production delays of our products. If such delays occur, our products may have delayed market acceptance or customers may select our competitors' products during the design process.

We do not have long-term wafer supply agreements with Chartered or our other foundries that would guarantee wafer quantities, prices, and delivery or lead times. Rather, the foundries manufacture our products on a purchase order basis. We provide Chartered and our other foundries with rolling forecasts of our production requirements. However, the ability of our foundries to provide wafers is limited by the foundries' available capacity.

In addition, we cannot be certain that we will continue to do business with Chartered or our other foundries on terms as favorable as our current terms. Significant risks associated with our reliance on third-party foundries include:

- the lack of assured process technology and wafer supply;
- financial and operating stability of the foundries;
- limited control over delivery schedules;
- limited manufacturing capacity of the foundries;
- limited control over quality assurance, manufacturing yields and production costs; and
- potential misappropriation of our intellectual property.

We could experience a substantial delay or interruption in the shipment of our products or an increase in our costs due to any of the following:

- a manufacturing disruption experienced by foundries utilized by us or sudden reduction or elimination of any existing source or sources of semiconductor manufacturing materials or processes, which might include the potential closure, change of ownership, change of management or consolidation by one of our foundries;
- extended time required to identify, qualify and transfer to alternative manufacturing sources for existing or new products;
- failure of our foundries to obtain raw materials and equipment;
- financial and operating stability of the foundries or any of their suppliers;
- acts of terrorism or civil unrest or an unanticipated disruption due to communicable diseases, political instability, natural disasters; and

- a sudden, sharp increase in demand for semiconductor devices, which could strain the foundries' manufacturing resources and cause delays in manufacturing and shipment of our products.

IF OUR FOUNDRIES DISCONTINUE OR LIMIT THE AVAILABILITY OF THE MANUFACTURING PROCESSES NEEDED TO MEET OUR DEMANDS OR ARE UNABLE TO PROVIDE THE TECHNOLOGIES NEEDED TO MANUFACTURE OUR PRODUCTS, WE MAY FACE PRODUCTION DELAYS, WHICH COULD MATERIALLY AND ADVERSELY IMPACT OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Our wafer requirements represent a small portion of the total production of the foundries that manufacture our products. As a result, we are subject to the risk that a foundry may cease production of a wafer fabrication process required by us. Additionally, we cannot be certain that our foundries will continue to devote resources to the production of our products or continue to advance the process design technologies on which the manufacturing of our products are based. Each of these events could increase our costs and harm our ability to deliver our products on time, or force us to terminate affected products, thereby materially and adversely affecting our business, financial condition and results of operations.

OUR DEPENDENCE ON THIRD-PARTY SUBCONTRACTORS TO ASSEMBLE AND TEST OUR PRODUCTS SUBJECTS US TO A NUMBER OF RISKS, INCLUDING THE POTENTIAL FOR AN INADEQUATE SUPPLY OF PRODUCTS AND HIGHER MATERIALS COSTS. THESE RISKS MAY LEAD TO DELAYED PRODUCT DELIVERY OR INCREASED COSTS, WHICH COULD MATERIALLY AND ADVERSELY AFFECT OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

We depend on independent subcontractors in Asia for all of the assembly and the majority of the testing of our products. Our reliance on these subcontractors involves the following risks:

- our reduced control over manufacturing yields, production schedules and product quality;
- the potential closure, change of ownership, change in business conditions or relationships, change of management or consolidation by one or more of our subcontractors;
- long-term financial stability of our subcontractors and their ability to invest in new capabilities and/or expand capacity to meet increasing demand;
- disruption of services due to the outbreak of communicable diseases, acts of terrorism, natural disasters, labor disputes, or civil unrest;
- disruption of manufacturing or test services due to relocation of subcontractor manufacturing facilities;
- subcontractors imposing higher minimum order quantities for substrates;
- failure of our subcontractors to obtain raw materials and equipment;
- increasing cost of raw materials resulting in higher package costs;
- entry into "take-or-pay" agreements;
- additional costs to qualify new local assembly subcontractors for prototypes;
- difficulties in selecting, qualifying and integrating new subcontractors;
- reallocation or limited manufacturing capacity of the subcontractors;
- a sudden, sharp increase in demand for semiconductor devices, which could strain our subcontractor's manufacturing resources and cause delays in manufacturing and shipment of our products;
- limited warranties from our subcontractors for products assembled and tested for us;

- possible unavailability of qualified assembly or test services;
- the subcontractors may cease production on a specific package type used to assemble product required by us and the possible inability to obtain an alternate source to supply the package;
- potential increases in assembly and test costs; and
- third-party subcontractors' abilities to transition to smaller package types and to new package compositions.

These risks may lead to shipment delays and supply constraints of our products or increased cost for the finished products, either of which could adversely affect our business, financial condition or results of operations.

TO SECURE FOUNDRY CAPACITY, WE MAY BE REQUIRED TO ENTER INTO FINANCIAL AND OTHER ARRANGEMENTS WITH FOUNDRIES, WHICH COULD RESULT IN THE DILUTION OF OUR EARNINGS OR OTHERWISE HARM OUR OPERATING RESULTS.

Allocation of a foundry's manufacturing capacity may be influenced by a foundry customer's size, the existence of a long-term agreement with the foundry or other commitments. To address foundry capacity constraints, we and other semiconductor companies that rely on third-party foundries have utilized various arrangements, including equity investments in or loans to foundries in exchange for guaranteed production capacity, joint ventures to own and operate foundries or "take or pay" contracts that commit a company to purchase specified quantities of wafers over extended periods. While we are not currently a party to any of these arrangements, we may decide to enter into these arrangements in the future. We cannot be sure, however, that these arrangements will be available to us on acceptable terms, if at all. Any of these arrangements could require us to commit substantial capital and, accordingly, could require us to reduce our cash holdings, incur additional debt or secure equity financing. This could result in the dilution of our earnings or the ownership of our stockholders or otherwise harm our operating results. Furthermore, we may not be able to obtain sufficient foundry capacity in the future pursuant to such arrangements.

OUR RELIANCE ON FOREIGN SUPPLIERS EXPOSES US TO RISKS ASSOCIATED WITH INTERNATIONAL OPERATIONS, ANY OF WHICH COULD MATERIALLY AND ADVERSELY IMPACT OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

We use semiconductor wafer foundries and assembly and test subcontractors throughout Asia to manufacture a significant portion of our products. Our dependence on these subcontractors involves the following risks:

- disruption of services due to political, civil, labor, and economic instability;
- disruption of services due to natural disasters or outbreak of communicable diseases;
- disruption of transportation to and from Asia;
- embargoes or other regulatory limitations affecting the availability of raw materials, equipment or changes in tax laws, tariffs, services and freight rates; and
- compliance with local or international regulatory requirements.

These risks may lead to delays in product delivery or increased costs, either of which could harm our profitability and customer relationships, thereby materially and adversely impacting our business, financial condition and results of operations.

WE DEPEND IN PART ON THE CONTINUED SERVICE OF OUR KEY ENGINEERING AND MANAGEMENT PERSONNEL AND OUR ABILITY TO IDENTIFY, HIRE, INCENTIVIZE AND RETAIN QUALIFIED PERSONNEL. IF WE LOSE KEY EMPLOYEES OR FAIL TO IDENTIFY, HIRE, INCENTIVIZE AND RETAIN THESE INDIVIDUALS, OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS COULD BE MATERIALLY AND ADVERSELY IMPACTED.

Our future success depends, in part, on the continued service of our key design engineering, technical, sales, marketing and executive personnel and our ability to identify, hire, incentivize and retain other qualified personnel.

In the future, we may not be able to attract and retain qualified personnel, including executive officers and other key management and technical personnel necessary for the management of our business. Competition for skilled employees having specialized technical capabilities and industry-specific expertise continues to be a considerable risk inherent in the markets in which we compete. Volatility or lack of positive performance in our stock price and the ability to offer equity compensation to as many key employees or in amounts consistent with past practices, as a result of regulations regarding the expensing of options, may also adversely affect our ability to retain key employees, all of whom have been granted stock options. The failure to retain and recruit, as necessary, key design engineers, technical, sales, marketing and executive personnel could harm our business, financial condition and results of operations.

OUR RESULTS OF OPERATIONS COULD VARY AS A RESULT OF THE METHODS, ESTIMATES, AND JUDGMENTS WE USE IN APPLYING OUR ACCOUNTING POLICIES.

The methods, estimates, and judgments we use in applying our accounting policies have a significant impact on our results of operations (see "Critical Accounting Policies and Estimates" in Part II, Item 7 of our Annual Report on Form 10-K). Such methods, estimates, and judgments are, by their nature, subject to substantial risks, uncertainties, assumptions, and changes in rulemaking by the regulatory bodies; and factors may arise over time that lead us to change our methods, estimates, and judgments. Changes in those methods, estimates, and judgments could significantly affect our results of operations. In particular, the calculation of stock-based compensation expense under Statement of Financial Accounting Standards No. 123R ("SFAS 123R"), "Share-Based Payment," requires us to use valuation methodologies (which were not developed for use in valuing employee stock options) and a number of assumptions, estimates, and conclusions regarding matters such as expected forfeitures, expected volatility of our share price, the expected dividend rate with respect to our common stock, and the exercise behavior of our employees. Furthermore, there are no means, under applicable accounting principles, to compare and adjust our expense if and when we learn about additional information that may affect the estimates that we previously made, with the exception of changes in expected forfeitures of share-based awards. Factors may arise over time that lead us to change our estimates and assumptions with respect to future share-based compensation arrangements, resulting in variability in our share-based compensation expense over time. Changes in forecasted share-based compensation expense could impact our gross margin percentage; research and development expense; selling, general and administrative expense; and our tax rate.

CHANGES IN OUR EFFECTIVE TAX RATE MAY HAVE AN ADVERSE EFFECT ON OUR RESULTS OF OPERATIONS.

Our future effective tax rates may be adversely affected by a number of factors including:

- the jurisdictions in which profits are determined to be earned and taxed;
- the resolution of issues arising from tax audits with various tax authorities;
- changes in the valuation of our deferred tax assets and liabilities;
- adjustments to estimated taxes upon finalization of various tax returns;
- increases in expenses not deductible for tax purposes, including write-offs of acquired in-process research and development and impairment of goodwill in connection with acquisitions;
- changes in available tax credits;
- changes in share-based compensation expense;
- changes in tax laws or the interpretation of such tax laws and changes in generally accepted accounting principles; and/or
- the repatriation of non-U.S. earnings for which we have not previously provided for U.S. taxes.

Any significant increase in our future effective tax rates could adversely impact net income for future periods. In addition, the U.S. Internal Revenue Service (IRS) and other tax authorities regularly examine our income tax returns. Our results of operations could be adversely impacted if these assessments or any other assessments resulting from the examination of our income tax returns by the IRS or other taxing authorities are not resolved in our favor.

OUR ENGAGEMENT WITH FOREIGN CUSTOMERS COULD CAUSE FLUCTUATIONS IN OUR OPERATING RESULTS, WHICH COULD MATERIALLY AND ADVERSELY IMPACT OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

International sales have accounted for, and will likely continue to account for a significant portion of our revenues, which subjects us to the following risks:

- changes in regulatory requirements;
- tariffs and other barriers;
- timing and availability of export or import licenses;
- disruption of services due to political, civil, labor, and economic instability;
- disruption of services due to natural disasters outside the United States;
- disruptions to customer operations outside the United States due to the outbreak of communicable diseases;
- difficulties in accounts receivable collections;
- difficulties in staffing and managing foreign subsidiary and branch operations;
- difficulties in managing sales channel partners;
- difficulties in obtaining governmental approvals for communications and other products;
- limited intellectual property protection;
- foreign currency exchange fluctuations;
- the burden of complying with foreign laws and treaties; and
- potentially adverse tax consequences.

In addition, because sales of our products have been denominated primarily in U.S. dollars, increases in the value of the U.S. dollar as compared with local currencies could make our products more expensive to customers in the local currency of a particular country resulting in pricing pressures on our products. Increased international activity in the future may result in foreign currency denominated sales. Furthermore, because some of our customers' purchase orders and agreements are governed by foreign laws, we may be limited in our ability, or it may be too costly for us, to enforce our rights under these agreements and to collect damages, if awarded.

THE COMPLEXITY OF OUR PRODUCTS MAY LEAD TO ERRORS, DEFECTS AND BUGS, WHICH COULD SUBJECT US TO SIGNIFICANT COSTS OR DAMAGES AND ADVERSELY AFFECT MARKET ACCEPTANCE OF OUR PRODUCTS.

Although we, our customers and our suppliers rigorously test our products, they may contain undetected errors, weaknesses, defects or bugs when first introduced or as new versions are released. If any of our products contain production defects, reliability, quality or compatibility problems that are significant to our customers, our reputation may be damaged and customers may be reluctant to continue to buy our products, which could adversely affect our ability to retain and attract new customers. In addition, these defects or bugs could interrupt or delay sales of affected products, which could adversely affect our results of operations.

If defects or bugs are discovered after commencement of commercial production of a new product, we may be required to make significant expenditures of capital and other resources to resolve the problems. This could result in significant additional development costs and the diversion of technical and other resources from our other development efforts. We could also incur significant costs to repair or replace defective products. These costs or damages could have a material adverse effect on our financial condition and results of operations.

BECAUSE OUR COMMUNICATIONS INTEGRATED CIRCUITS TYPICALLY HAVE LENGTHY SALES CYCLES, WE MAY EXPERIENCE SUBSTANTIAL DELAYS BETWEEN INCURRING EXPENSES RELATED TO PRODUCT DEVELOPMENT AND THE REVENUE DERIVED FROM THESE PRODUCTS.

A significant portion of our revenue is derived from selling integrated circuits to communications equipment vendors. Due to their product development cycle, we have typically experienced at least an eighteen-month time lapse between our initial contact with a customer and realizing volume shipments. We first work with customers to achieve a design win, which may take nine months or longer. Our customers then complete their design, test and evaluation process and begin to ramp-up production, a period which typically lasts an additional nine months. The customers of communications equipment manufacturers may also require a period of time for testing and evaluation, which may cause further delays. As a result, a significant period of time may elapse between our research and development efforts and our realization of revenue, if any, from volume purchasing of our communications products by our customers. Due to the length of the communications equipment vendors' product development cycle, the risks of project cancellation by our customers, price erosion or volume reduction are present for an extended period of time.

WE HAVE MADE AND IN THE FUTURE MAY MAKE ACQUISITIONS AND SIGNIFICANT STRATEGIC EQUITY INVESTMENTS, WHICH MAY INVOLVE A NUMBER OF RISKS. IF WE ARE UNABLE TO ADDRESS THESE RISKS SUCCESSFULLY, SUCH ACQUISITIONS AND INVESTMENTS COULD HAVE A MATERIALLY ADVERSE IMPACT ON OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

We have undertaken a number of strategic acquisitions and investments in the past and may do so from time to time in the future. The risks involved with these acquisitions and investments include:

- the possibility that we may not receive a favorable return on our investment or incur losses from our investment, or the original investment may become impaired;
- failure to satisfy or set effective strategic objectives;
- our assumption of known or unknown liabilities or other unanticipated events or circumstances; and
- the diversion of management's attention from normal daily operations of the business.

Additional risks involved with acquisitions include:

- difficulties in integrating the operations, technologies, products and personnel of the acquired company or its assets;
- difficulties in supporting acquired products or technologies;
- difficulties or delays in the transfer of manufacturing flows and supply chains of products of acquired businesses;
- failure to retain key personnel;
- unexpected capital equipment outlays and related expenses;
- difficulties in entering markets in which we have limited or no direct prior experience and where competitors in such markets may have stronger market positions;
- insufficient revenues to offset increased expenses associated with acquisitions;
- under-performance problems with an acquired company;
- issuance of common stock that would dilute our current stockholders' percentage ownership;
- recording of goodwill and non-amortizable intangible assets that will be subject to periodic impairment testing and potential impairment charges against our future earnings;
- incurring amortization expenses related to certain intangible assets;

- the opportunity cost associated with committing capital in such investments;
- incurring large and immediate write-offs; and
- becoming subject to litigation.

Risks involved with strategic equity investments include:

- the possibility of litigation resulting from these types of investments;
- the possibility that we may not receive early access to disruptive technology;
- the possibility that we may not receive a financial return on our investments or incur losses from these investments;
- a changed or poorly executed strategic plan; and
- the opportunity cost associated with committing capital in such investments.

We may not be able to address these risks successfully without substantial expense, delay or other operational or financial problems. Any delays or other such operations or financial problems could adversely impact our business, financial condition and results of operations.

OUR BACKLOG MAY NOT RESULT IN FUTURE REVENUE.

Due to the possibility of customer changes in delivery schedules and quantities actually purchased, cancellation of orders, distributor returns or price reductions, our backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. We may not be able to meet our expected revenue levels or results of operations if there is a reduction in our order backlog during any particular period and we are unable to replace those sales during the same period.

FIXED OPERATING EXPENSES AND OUR PRACTICE OF ORDERING MATERIALS IN ANTICIPATION OF FUTURE CUSTOMER DEMAND COULD MAKE IT DIFFICULT FOR US TO RESPOND EFFECTIVELY TO SUDDEN SWINGS IN DEMAND AND RESULT IN HIGHER THAN EXPECTED COSTS AND EXCESS INVENTORY. SUCH SUDDEN SWINGS IN DEMAND COULD THEREFORE HAVE A MATERIAL ADVERSE IMPACT ON OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Our operating expenses are relatively fixed in the short to medium term, and therefore, we have limited ability to reduce expenses quickly and sufficiently in response to any revenue shortfall. In addition, we typically plan our production and inventory levels based on internal forecasts of customer demand, which are highly unpredictable and can fluctuate substantially. From time to time, in response to anticipated long lead times to obtain inventory and materials from our outside suppliers and foundries, we may order materials in advance of anticipated customer demand. This advance ordering may result in excess inventory levels or unanticipated inventory write-downs if expected orders fail to materialize. This incremental cost could have a materially adverse impact on our business, financial condition and results of operations.

WE MAY BE UNABLE TO PROTECT OUR INTELLECTUAL PROPERTY RIGHTS, WHICH COULD HARM OUR COMPETITIVE POSITION.

Our ability to compete is affected by our ability to protect our intellectual property rights. We rely on a combination of patents, trademarks, copyrights, mask work registrations, trade secrets, confidentiality procedures and non-disclosure and licensing arrangements to protect our intellectual property rights. Despite these efforts, we may be unable to protect our proprietary information. Such intellectual property rights may not be recognized or if recognized, it may not be commercially feasible to enforce. Moreover, we cannot be certain that our competitors will not independently develop technology that is substantially similar or superior to our technology.

More specifically, our pending patent applications or any future applications may not be approved, and any issued patents may not provide us with competitive advantages or may be challenged by third parties. If challenged, our patents may be found to be invalid or unenforceable, and the patents of others may have an adverse effect on our ability to do business. Furthermore, others may independently develop similar products or processes, duplicate our products or processes or design around any patents that may be issued to us.

WE COULD BE REQUIRED TO PAY SUBSTANTIAL DAMAGES OR COULD BE SUBJECT TO VARIOUS EQUITABLE REMEDIES IF IT WERE PROVEN THAT WE INFRINGED THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS.

As a general matter, the semiconductor industry is characterized by substantial litigation regarding patents and other intellectual property rights. If a third party were to prove that our technology infringed its intellectual property rights, we could be required to pay substantial damages for past infringement and could be required to pay license fees or royalties on future sales of our products. If we were required to pay such license fees whenever we sold our products, such fees could exceed our revenue. In addition, if it were proven that we willfully infringed a third party's proprietary rights, we could be held liable for three times the amount of the damages that we would otherwise have to pay. Such intellectual property litigation could also require us to:

- stop selling, incorporating or using our products that use the infringed intellectual property;
- obtain a license to make, sell or use the relevant technology from the owner of the infringed intellectual property, which license may not be available on commercially reasonable terms, if at all; and/or
- redesign our products so as not to use the infringed intellectual property, which may not be technically or commercially feasible.

Furthermore, the defense of infringement claims and lawsuits, regardless of their outcome, would likely be expensive and could require a significant portion of management's time. In addition, rather than litigating an infringement matter, we may determine that it is in our best interests to settle the matter. Terms of a settlement may include the payment of damages and our agreement to license technology in exchange for a license fee and ongoing royalties. These fees could be substantial. If we were required to pay damages or otherwise became subject to such equitable remedies, our business, financial condition and results of operations would suffer. Similarly, if we were required to pay license fees to third parties based on a successful infringement claim brought against us, such fees could exceed our revenue.

OUR STOCK PRICE IS VOLATILE.

The market price of our common stock has fluctuated significantly to date. In the future, the market price of our common stock could be subject to significant fluctuations due to:

- our anticipated or actual operating results;
- announcements or introductions of new products by us or our competitors;
- technological innovations by us or our competitors;
- product delays or setbacks by us, our customers or our competitors;
- potential supply disruptions;
- sales channel interruptions;
- concentration of sales among a small number of customers;
- conditions in the communications and semiconductor markets;
- the commencement and/or results of litigation;
- changes in estimates of our performance by securities analysts;
- decreases in the value of our investments, thereby requiring an asset impairment charge against earnings;

- repurchasing shares of our common stock;
- announcements of merger or acquisition transactions;
- the impact of expensing stock options; and/or
- general global economic and market conditions.

In the past, securities and class action litigation has been brought against companies following periods of volatility in the market prices of their securities. We may be the target of one or more of these class action suits, which could result in significant costs and divert management's attention, thereby harming our business, results of operations and financial condition.

In addition, at times the stock market has experienced extreme price and volume fluctuations that have affected the market prices of many high technology companies, including semiconductor companies, and that have often been unrelated or disproportionate to the operating performance of those companies. Any such fluctuations may harm the market price of our common stock.

EARTHQUAKES AND OTHER NATURAL DISASTERS MAY DAMAGE OUR FACILITIES OR THOSE OF OUR SUPPLIERS AND CUSTOMERS.

Our corporate headquarters in Fremont, California are located near major earthquake faults that have experienced seismic activity. In addition, some of our customers and suppliers are located near fault lines. In the event of a major earthquake or other natural disaster near our headquarters, our operations could be disrupted. Similarly, a major earthquake or other natural disaster affecting one or more of our major customers or suppliers could adversely impact the operations of those affected, which could disrupt the supply of our products and harm our business.

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

Items 2(a) and 2(b) are inapplicable.

(c) ***Issuer Purchases of Equity Securities***

During the first quarter of fiscal year 2008, we repurchased shares of our common stock as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)
4/1/07 - 4/30/07	148,708	$13.44	148,708	$ 16,226
5/1/07 - 5/31/07	115,100	13.87	115,100	$ 14,629
6/1/07 - 6/30/07	39,000	10.08	29,000	$ 14,236
Total	302,808	$13.17	292,808	

In October 2006, in furtherance to our 2001 common stock repurchase program, we announced the adoption of a 10b5-1 Share Repurchase Plan (“SRP”) covering the purchase of up to $16.0 million of our common stock through June 30, 2007. During the three months ended June 30, 2007, we repurchased a total of 292,808 shares of our common stock at an aggregate cost of $4.0 million under this SRP. In addition, we repurchased 10,000 shares at an aggregate cost of $1 from our former chief executive officer pursuant to a restricted stock purchase agreement.

In July 2007, we announced the adoption of a new 10b5-1 SRP which will allow us to use the remaining balance of $14.2 million under our original 2001 stock repurchase program to acquire shares of our common stock in the open market through November 30, 2007.

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ITEM 6. EXHIBITS

(a) ***Exhibits required by Item 601 of Regulation S-K***

Exhibits filed with the Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 are as follows:

Exhibit Footnote	Exhibit Number	Description
(b)	2.1	Agreement and Plan of Merger between the Company and Sipex Corporation.
(c)	3.1	Amended and Restated Certificate of Incorporation.
(d)	3.2	Amended and Restated Bylaws.
(e)	10.1	Fiscal Year 2008 Executive Incentive Compensation Program.
(b)	10.2	Form of Sipex Voting Agreement.
(b)	10.3	Form of Exar Voting Agreement.
(b)	10.4	Lock-up and Standstill Agreement between Exar Corporation and Rodfre Holdings LLC.
(b)	10.5	Employment Agreement by and between Exar Corporation and Ralph Schmitt.
(f)	10.6	Form of Affiliate Agreement.
(a)	31.1	Principal Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(a)	31.2	Principal Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(a)	32.1	Principal Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
(a)	32.2	Principal Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(a) Filed herewith.

(b) Filed as an exhibit to Exar's Current Report on Form 8-K filed on May 8, 2007 and incorporated herein by reference.

(c) Filed as an exhibit to Exar's Annual Report on Form 10-K for the fiscal year ended March 31, 2007 and incorporated herein by reference.

(d) Filed as an exhibit to Exar's Current Report on Form 8-K filed on July 25, 2006 and incorporated herein by reference.

(e) Filed as an exhibit to Exar's Current Report on Form 8-K filed on April 25, 2007 and incorporated herein by reference.

(f) Filed as an exhibit to Exar's Registration Statement on Form S-4 (333-143243) filed on May 24, 2007 and incorporated herein by reference.

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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.

EXAR CORPORATION
(Registrant)

August 7, 2007

By /s/ **RICHARD L. LEZA**

(Richard L. Leza)
Chief Executive Officer and President (Interim), and Chairman of the Board

(Principal Executive Officer)

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EXHIBIT 31.1

PRINCIPAL EXECUTIVE OFFICER CERTIFICATION

I, Richard L. Leza, certify that:

1. I have reviewed this Annual Report on Form 10-Q of Exar Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2007

/s/ RICHARD L. LEZA

Richard L. Leza
Chief Executive Officer and President (Interim), and
Chairman of the Board
(Principal Executive Officer)

EXHIBIT 31.2

PRINCIPAL FINANCIAL OFFICER CERTIFICATION

I, J. Scott Kamsler, certify that:

1. I have reviewed this Annual Report on Form 10-Q of Exar Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s Board of Directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 7, 2007

/s/ J. SCOTT KAMSLER

J. Scott Kamsler
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit 32.1

**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**

I, Richard L. Leza, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge, the Quarterly Report of Exar Corporation on Form 10-Q for the period ended June 30, 2007 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of Exar Corporation.

Date: August 7, 2007

/s/ RICHARD L. LEZA

Richard L. Leza
Chief Executive Officer and President (Interim),
and Chairman of the Board
(Principal Executive Officer)

Exhibit 32.2

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

I, J. Scott Kamsler, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge, the Quarterly Report of Exar Corporation on Form 10-Q for the period ended June 30, 2007 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of Exar Corporation.

Date: August 7, 2007

/s/ J. SCOTT KAMSLER

J. Scott Kamsler
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)