Saifun Semiconductors Ltd.
Form F-1/A
March 22, 2006

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As filed with the Securities and Exchange Commission on March 22, 2006
Registration No. 333-132267

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Amendment No. 1 to
Form F-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

SAIFUN SEMICONDUCTORS LTD.

(Exact Name of Registrant as Specified in its Charter)

State of Israel	3674	Not Applicable
(State or Other Jurisdiction of Incorporation or Organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification No.)*

Saifun Semiconductors Ltd.
ELROD Building
45 Hamelacha Street
Sappir Industrial Park
Netanya 42504
Israel
+972 (9) 892-8444
(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant s Principal Executive Offices)

Saifun Semiconductors USA, Inc.
2350 Mission College Boulevard
Suite 1070
Santa Clara, CA 95054
(408) 982-5888
(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

Copies of Communications to:

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Approximate date of commencement of proposed sale to the public: As soon as practicable after effectiveness of this registration statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended (the Securities Act), check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earliest effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434 under the Securities Act, check the following box. o

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information contained in this prospectus is not complete and may be changed. Neither we nor the selling shareholders may sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell securities, and neither we nor the selling shareholders are soliciting offers to buy these securities, in any state where the offer or sale is not permitted.

Subject to Completion, dated March 22, 2006

PROSPECTUS

3,820,148 Shares
Ordinary Shares

Saifun Semiconductors is offering 340,000 ordinary shares and the selling shareholders, including members of our senior management and directors, and entities affiliated with them, are offering 3,480,148 ordinary shares. Our ordinary shares are quoted on The Nasdaq National Market and trade under the symbol SFUN. On March 21, 2006, the last reported sale price of our ordinary shares on The Nasdaq National Market was $28.15 per share.
Investing in our ordinary shares involves risks. See Risk Factors beginning on page 7.

	Per Share	Total
Public Offering Price	$	$
Underwriting Discount	$	$
Proceeds to Saifun Semiconductors (before expenses)	$	$
Proceeds to Selling Shareholders (before expenses)	$	$

The selling shareholders have granted the underwriters a 30-day option to purchase up to an additional 573,022 ordinary shares on the same terms and conditions as set forth above if the underwriters sell more than 3,820,148 ordinary shares in this offering.
Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.
Lehman Brothers, on behalf of the underwriters, expects to deliver the ordinary shares on or about , 2006.

Lehman Brothers
Sole Book-Running Manager

Deutsche Bank Securities
Joint Lead Manager

Citigroup
Joint Lead Manager

CIBC World Markets

William Blair & Company

Raymond James

WR Hambrecht + Co

, 2006

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You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. This prospectus is not an offer to sell or a solicitation of an offer to buy our ordinary shares in any jurisdiction where it is unlawful. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of ordinary shares.

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PROSPECTUS SUMMARY

You should read the following summary together with the entire prospectus, including the more detailed information in our consolidated financial statements and related notes appearing elsewhere in this prospectus. You should carefully consider, among other things, the matters discussed in Risk Factors.

Saifun Semiconductors Ltd.

We have invented and patented a technology that we refer to as nitride-read-only memory, or NROM, that we believe is leading a revolutionary shift in the non-volatile semiconductor memory market.

Unlike volatile semiconductor memory devices which lose stored information after electrical power is turned off, non-volatile semiconductor memory devices retain stored information even without a power source. We believe that our NROM technology represents a breakthrough in the non-volatile memory market because it offers a number of significant advantages over existing non-volatile memory technology. Although the semiconductor market has periodically experienced cyclicality, we believe overall demand in the industry will continue to remain strong. According to market estimates from Web-Feet Research, a market research firm in the electronics and the semiconductor industry, the code flash and data flash devices that our technology addresses accounted for sales of $19.9 billion in 2005, and are expected to grow to $46.5 billion by 2010, representing a compound annual growth rate of 18.5%. Web-Feet Research estimates that the embedded flash devices that our technology addresses accounted for sales of $3.3 billion in 2005, and are expected to grow to $6.3 billion by 2010, representing a compound annual growth rate of 13.8%. Taken as a whole, our NROM technology can be applied in semiconductor memory devices that in 2005 accounted for sales of $23.2 billion and that are expected to grow to $52.8 billion by 2010, representing a compound annual growth rate of 17.9%.

We have a business model with two revenue streams. We derive our revenues primarily through licensing our intellectual property. We also derive revenues from design and product development services that we provide to our licensees. The non-volatile memory market is dominated by a small number of large semiconductor manufacturers. We are concentrating our efforts on licensing our technology to market leaders, including Spansion LLC (formerly known as Fujitsu AMD Semiconductor LLC), Infineon Technologies AG, Matsushita Electric Industrial Co., Ltd., Macronix International Co., Ltd., Sony Corporation and Semiconductor Manufacturing International Corporation. This has led us to depend on a relatively small number of licensees for revenues. To date, our revenues from Sony Corporation, Matsushita Electric Industrial Co., Ltd. and Semiconductor Manufacturing International Corporation have not constituted a significant portion of our total revenues.

In 2005, we had revenues of $78.6 million (including $19.2 million of non-cash license fees recognized in connection with the exit in December 2004 from our former joint venture with Infineon Technologies) and operating income of $48.0 million, and for 2004, we had revenues of $30.6 million and operating income of $11.7 million. Our net loss of $37.9 million in 2004 resulted primarily from our share of the losses of our former joint venture as well as from a capital loss resulting from our exit from the joint venture. In 2005, we had net income of $44.5 million.

Industry Overview

Demand for non-volatile memory is experiencing rapid growth as consumer electronics, communications, automotive and industrial products proliferate and require increasingly complex programming codes, and as digitization of information, including photographs, video, music and documents, require increased data storage capacity. These products include mobile phones, still and video digital cameras, portable computers, portable digital music players, digital video recorders, set-top boxes, communication routers and switches, digital televisions and other electronic systems. The growth in demand for these products is expected to result in an increase in average bit density per device, representing the average number of bits available in a memory device, of 79.2% for code flash and 46.5% for data flash from 2005 to 2006, according to Web-Feet Research.

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Concurrent with this growth, product manufacturers are demanding (1) faster read and write speeds to access code and data, (2) the ability to read and modify stored information repeatedly without adversely impacting reliability, and (3) the ability to retain stored information for an extended period. As a consequence, semiconductor manufacturers are continuously seeking advancements to existing technologies and exploring new technologies in order to meet these requirements and lower their costs.

The most widely-used technology for non-volatile semiconductor memory devices is floating gate technology, which was developed in the late 1960s and has been the prevalent technology for non-volatile semiconductor memory devices since that time. Non-volatile memory based on floating gate technology is subject to a number of limitations. Floating gate devices face significant challenges in reducing cell size and packing cells into smaller spaces on a silicon wafer, referred to as device shrink. In addition, manufacturing non-volatile memory devices using floating gate technology involves a complicated process, which results in high manufacturing costs and a long manufacturing cycle and may also result in lower yields. Floating gate devices also require different cell architectures and thus different manufacturing processes for each type of non-volatile memory device. As a result, most manufacturers of non-volatile memory devices concentrate in particular segments of the market due to the high cost and technical challenges associated with implementing different manufacturing processes within each segment.

Semiconductor manufacturers have sought to achieve device shrink through multi-level cells that use the same architecture as single-cell memory devices, but store fractional charge levels within a single cell, thereby permitting the storage of two bits of information per cell. However, current implementations of this technology have experienced problems with slow read and write times and reduced overall levels of reliability.

Our Solution

We believe that our NROM technology offers the following significant advantages over traditional non-volatile semiconductor memory technology:

Increased storage capacity. Our NROM technology doubles the storage capacity of each memory cell on a silicon wafer by enabling the storage of two physically-separated bits of information within a single cell. This results in a significantly lower cost per bit. In addition, our next generation NROM technology, referred to as QUAD NROM, enables the storage of four bits of information in a single cell. We believe that our QUAD NROM technology will enable us to achieve further device shrink and further lower the cost per bit.

Device shrink. Due to a simpler cell architecture, we believe that our NROM technology is easier to migrate to smaller manufacturing process geometries than floating gate technology. To date, some of our licensees have sold devices based on our NROM technology down to 110 nanometer process geometries and are also sampling products based on 90 nanometer processes and one licensee has announced plans for products based on 65 nanometer processes.

Simple, low cost manufacturing process. Non-volatile memory devices that incorporate our NROM technology require fewer manufacturing steps than comparable floating gate devices.

High performance and reliability. Devices based on our NROM technology benefit from enhanced performance and reliability compared to comparable floating gate devices because the charge stored in the device cannot leak out through a single point defect in the cell.

Same platform for all primary segments of non-volatile memory market. Our NROM technology uses the same cell and array architecture and manufacturing process for all primary segments of the non-volatile memory market. This allows us to grant licenses that enable semiconductor manufacturers to compete in all segments without the need for separate manufacturing facilities.

Our technology has some limitations. For example, NROM devices may require a higher programming electrical current than some comparable floating gate devices. This may require a more complex design to meet comparable specifications and may result in a longer development time.

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Our Strategy

Our goal is to establish our NROM technology as the leading technology in the non-volatile semiconductor memory market. We intend to achieve our goal through the following strategy:

Accelerate implementation of NROM technology by our licensees. We are seeking to accelerate implementation of our NROM technology in a broad range of our licensees products and to reduce their time to market by providing them with design and product development services focused, in particular, on enabling them to incorporate our NROM technology into their products using their existing manufacturing facilities.

Continue to direct licensing efforts of our NROM technology at market-leaders. We believe that our NROM technology will appeal to semiconductor manufacturers in all segments of the non-volatile memory market, and we intend to continue licensing our technology selectively to market leaders.

Continue to innovate. We believe that we can further develop and enhance our NROM technology. For example, we have provided engineering samples to several of our licensees of a product implementing four bits per cell using our QUAD NROM technology. We believe that our QUAD NROM technology is currently the only technology that is suited to mass production of four-bit-per-cell devices.

Enhance our existing technology portfolio. We believe that our strong patent portfolio and intellectual property position, with over 65 issued U.S. patents (including 10 co-owned U.S. patents) and seven non-U.S. patents, and over 55 pending U.S. patent applications and over 100 pending non-U.S. patent applications, will allow us to maintain our competitive position. We are committed to investing in research and development and continuing to expand and broaden our patent portfolio in key jurisdictions.

Company Information

We were incorporated under the laws of the State of Israel in November 1996 and commenced operations in July 1997. Our principal executive offices are located at ELROD Building, 45 Hamelacha Street, Sappir Industrial Park, Netanya 42504, Israel, and our telephone number is +972 (9) 892-8444. Our web site address is www.saifun.com. The information on our web site does not constitute part of this prospectus.

The terms Saifun, we, us and our refer to Saifun Semiconductors Ltd. and our wholly-owned subsidiaries. The term Infineon Technologies refers to Infineon Technologies AG. The term Infineon Technologies Flash Germany refers to Infineon Technologies Flash GmbH & Co. KG. The term Infineon Technologies Flash Israel refers to Infineon Technologies Flash Ltd.

Industry Data

All references to market data, industry statistics and other information in this prospectus attributed to Gartner, Inc. are contained in the following industry publications: Semiconductor Market Share Database, dated March 2005; Market Share: Semiconductor Revenue, Worldwide, 2005 (Preliminary Estimates), dated December 2005; and Market Share: Foundries, Worldwide, 1H05, dated October 2005. All references to market data, industry statistics and other information in this prospectus attributed to Web-Feet Research are contained in the following industry publications: 2004 Non-Volatile Memory Market Shares by Vendor, dated March 2005; Flash Memory Market Shares by Vendor, dated February 2006; Flash Memory Component Forecast: Q4 2005/Q1 2006, dated January 2006; and emFlash Memory Markets 2005-2011: The Markets for Monolithically Embedded Flash Memory, dated January 2006. When we refer in this prospectus to industry and market data provided by Web-Feet Research, references to the data flash market are based on Web-Feet Research s estimates of the NAND flash market and references to the code flash market are based on Web-Feet Research s estimates of the NOR flash market. Web-Feet Research has advised us that they believe that these references are appropriate because the vast majority of flash memory for data applications is based on NAND technology and for code applications is based on NOR technology.

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The Offering

Ordinary shares offered:	
By Saifun Semiconductors	340,000 shares.
By the selling shareholders	3,480,148 shares.
Ordinary shares to be outstanding after this offering	30,418,011 shares.
Use of proceeds	We estimate that the net proceeds to us from this offering will be approximately $8.7 million. We intend to use these proceeds for general corporate purposes and working capital. In addition, we will receive $2.2 million pursuant to the exercise by certain selling shareholders prior to the closing of this offering of options to purchase 409,702 ordinary shares. We will not receive any proceeds from the sale of the shares by the selling shareholders. The selling shareholders include members of our senior management and directors, and entities affiliated with them.
Lock-up period	Our directors and officers and the selling shareholders have agreed not to sell any shares during the 90-day period (subject to extension) following the date of this prospectus except for the additional shares that may be sold in connection with the option granted to the underwriters.
Nasdaq National Market symbol	SFUN.

The number of ordinary shares to be outstanding after this offering is based on 29,668,309 ordinary shares outstanding as of March 21, 2006, gives effect to the issuance prior to the closing of this offering of 409,702 ordinary shares pursuant to the exercise of options by certain selling shareholders, and excludes:

257,836 issued ordinary shares that are unpaid, are held in trust by the trust company of our Israeli counsel for delivery to the Company s employees upon exercise of options outstanding under our share option plans and carry no voting rights;

5,684,390 ordinary shares reserved for issuance under our share option plans (which includes the 257,836 ordinary shares referred to above), of which options to purchase 4,609,441 ordinary shares at a weighted average exercise price of $11.73 per share have been granted as of February 28, 2006; and

30,800 ordinary shares issuable upon the exercise of options granted outside of our share option plans at a weighed average exercise price of $3.14.

Unless otherwise indicated, all information in this prospectus:

assumes an offering price of $28.15 per share, the last reported sale price of our ordinary shares on The Nasdaq National Market on March 21, 2006;

assumes no exercise of the underwriters option to purchase from the selling shareholders up to 573,022 additional ordinary shares; and

includes the issuance of 60,587 ordinary shares issued after February 28, 2006 pursuant to the exercise of options under our employee share option plans.

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Summary Consolidated Financial Data

The following table presents summary consolidated financial and operating data derived from our consolidated financial statements. You should read this data along with the sections of this prospectus entitled Selected Consolidated Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes included elsewhere in this prospectus.

	Year ended		
	Dec. 28, 2003(3)	Dec. 26, 2004(3)	Dec. 31, 2005
	(in thousands, except share and per share data)		
Statements of operations data:			
Revenues:(1)			
Licenses	$ 7,817	$ 22,640	$ 65,790
Services	6,639	7,926	12,811
Total revenues	14,456	30,566	78,601
Cost of services(2)	4,147	7,084	12,048
Gross profit	10,309	23,482	66,553
Operating expenses:			
Research and development(2)	9,132	6,792	7,427
Marketing and selling(2)	2,543	2,914	4,889
General and administrative(2)	1,779	2,115	6,216
Total operating expenses	13,454	11,821	18,532
Operating income (loss)	(3,145)	11,661	48,021
Financial income, net	1,137	1,699	1,749
Equity in losses of equity method investees	(12,820)	(26,172)	
Compensation expense related to issuance of options to employees of equity method investees	(206)	(569)	
Capital loss from sale of equity method investees		(17,334)	
Income (loss) from continuing operations	(15,034)	(30,715)	49,770
Loss from discontinued operations(2)(3)	(156)	(7,189)	(5,263)
Net income (loss)	$ (15,190)	$ (37,904)	$ 44,507
Basic earnings (loss) from continuing operations per ordinary share	$ (0.89)	$ (1.81)	$ 0.46
Basic loss from discontinued operations per ordinary share	$ (0.01)	$ (0.43)	$ (0.29)
Basic net earnings (loss) per ordinary share	$ (0.90)	$ (2.24)	$ 0.17
	16,896,134	16,927,087	29,452,828

Weighted average number of ordinary shares used in computing net earnings (loss) per share amounts basic			
Diluted earnings (loss) from continuing operations per ordinary share	$ (0.89)	$ (1.81)	$ 0.36
Diluted loss from discontinued operations per ordinary share	$ (0.01)	$ (0.43)	$ (0.20)
Diluted net earnings (loss) per ordinary share	$ (0.90)	$ (2.24)	$ 0.16
Weighted average number of ordinary shares used in computing net earnings (loss) per share amounts diluted	16,896,134	16,927,087	31,947,043

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(1) Includes revenues from related parties, principally from design and product development services provided to our former joint venture, consisting of $6.4 million for 2003, and $8.4 million for 2004. License revenues for 2005 include non-cash revenues of $19.2 million resulting from the termination of our former joint venture.

(2) Expenses include stock-based compensation related to options granted to employees and others as follows:

	Year ended December 26, 2004	Year ended December 31, 2005
	(in thousands)	
Cost of services	$ 175	$ 834
Research and development	220	330
Marketing and selling	87	667
General and administrative	96	2,410
Loss from discontinued operations	23	54
Total	$ 601	$ 4,295

During the third quarter of 2004, we adopted the fair value recognition provisions of FAS 123, as amended by FAS 148 for stock-based employee compensation. Effective December 29, 2003, we elected to apply the Modified Prospective Method under FAS 148. Accordingly, unvested options were accounted for under the fair value recognition provision of FAS 123 from December 29, 2003 as if the fair value method had been applied since the date of grant.

(3) We decided to discontinue product sales in the second quarter of 2005. During the quarter ended September 25, 2005, we began accounting for products sales operations as discontinued operations; and prior year financial information has been reclassified.

	As of December 31, 2005	
	Actual	As adjusted
		(unaudited)
	(in thousands)	
Balance sheet data:		
Cash and cash equivalents	$ 100,327	$ 111,225
Held-to-maturity marketable securities	81,496	81,496
Working capital	166,487	177,385
Total assets	193,738	204,636
Total liabilities	17,665	17,665
Capital stock	120	122
Accumulated deficit	(35,791)	(35,791)
Total shareholders equity	176,073	186,971

As adjusted information included above in the consolidated balance sheet data reflects our receipt of (1) estimated net proceeds of $8.7 million from the sale by us of 340,000 ordinary shares in this offering, based on an offering price of $28.15 per share, the last reported sale price of our ordinary shares on The Nasdaq National Market on

March 21, 2006, after deducting underwriting discounts and commissions and estimated offering expenses, and (2) $2.2 million pursuant to the exercise by certain selling shareholders prior to the closing of this offering of options to purchase 409,702 ordinary shares.

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RISK FACTORS

This offering and an investment in our ordinary shares involve a high degree of risk. You should consider carefully the risks described below, together with the financial and other information contained in this prospectus, before you decide to buy our ordinary shares. If any of the following risks actually occurs, our business, financial condition and results of operations would suffer. In this case, the trading price of our ordinary shares would likely decline and you might lose all or part of your investment. The risks described below are not the only ones we face. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations.

Risks Related to Our Business

Our historical financial data may be of limited value in evaluating our future prospects.

To date, we have derived substantially all of our revenues from licensing our intellectual property to third parties and from the provision of design and product development services to Infineon Technologies Flash. Almost all of our license revenues have consisted of license fees and a small portion of our revenues has consisted of license royalties based on a percentage of our licensees net sales of products incorporating our intellectual property. Subject to our licensees increasing sales of products incorporating our licensed intellectual property, we expect that the proportion of our revenues derived from license royalties will increase relative to license fees. As a result, the components of our revenues may change substantially in future periods. In addition, because we exited our joint venture with Infineon Technologies in December 2004, we will no longer include in our net loss a percentage share of the net loss of the joint venture. Furthermore, in the second quarter of 2005, we decided to discontinue product sales in order to focus on our licensing and services activities. Our product-related activities are presented in our financial statements as a separate line item entitled Loss from discontinued operations. As a result of these factors, our historical financial data may be of limited value in evaluating our future prospects.

We depend on a small number of licensees for our revenues and if we lose any of these licensees our revenues may decrease substantially.

To date, we have derived the majority of our revenues from license and service agreements with semiconductor manufacturers in the code, data and embedded flash memory segments. Three licensees accounted for 90% of our licensing and service revenues in 2004 and 87% of our licensing and service revenues in 2005:

	Year ended	
	December 26, 2004	**December 31, 2005**
Macronix International Co., Ltd.	37%	18%
Infineon Technologies AG	28*	57
Spansion LLC	25	12

* Includes revenues from Infineon Technologies Flash Israel, the Israeli entity in our former joint venture which we exited in December 2004.

As of December 31, 2005, our license agreements contained contractual commitments for license fees payable to us before December 31, 2007 totaling approximately $42 million, the substantial majority of which we expect to recognize prior to December 31, 2007. The majority of this amount is payable by Infineon Technologies and the majority of the remaining balance by Semiconductor Manufacturing International Corporation. Substantially all of these fees are subject to cancellation by our licensees. Subject to these licensees successfully incorporating our intellectual property into their products, we expect that a significant portion of our future revenues will continue to be derived from them for the foreseeable future. The loss of any of these licensees or any other significant customer in the future could cause our revenues to decrease substantially.

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Our reputation and revenues could be adversely affected if our licensees do not successfully implement our NROM technology in a wide range of their products.

An important element of our strategy is to accelerate the adoption of our NROM technology by our licensees in the code, data and embedded flash segments of the non-volatile memory market. In particular, the data flash market is projected by Web-Feet Research to grow between 2005 and 2010 at a compound annual growth rate of 24.0% to $34.8 billion while the code flash market is projected to grow at 7.8% to $11.7 billion over the same period. We have granted a license to use our NROM technology in data flash applications to Infineon Technologies, Macronix, Semiconductor Manufacturing International Corporation and Spansion, although only Infineon Technologies is selling data flash devices incorporating our technology. Our licensees may fail to implement our NROM technology in a timely manner or in a large number of their products. While certain of our license agreements contain provisions for prepaid royalty payments irrespective of sales by our licensees, these amounts are less than the amounts we would expect to earn from royalty payments based on substantial sales of products incorporating our NROM technology. In addition, our licensees may elect to rely on other licensed or internally-developed technologies for some or all of their products instead of implementing our NROM technology. If a leading semiconductor manufacturer adopts and achieves success with another technology or incorporates our NROM technology but fails to achieve success with its products, our reputation and revenues could be adversely affected.

Our growth and future prospects could be harmed if we are unable to enter into favorable agreements to license our NROM technology to other semiconductor manufacturers.

We intend to license our NROM technology to other semiconductor manufacturers in the code, data and embedded flash segments of the non-volatile memory market. In order to successfully license our NROM technology to additional licensees, we must persuade them of the benefits of our technology over existing floating gate technology. The code and data flash memory segments are each dominated by a small number of large manufacturers. According to Web-Feet Research, the top six manufacturers accounted for 82.0% of revenues in the code and data memory segments in 2005. Due to the projected growth in the data flash market compared to the code flash market, a failure to enter into license agreements in the data flash segments or the failure of our existing licensees to penetrate this market could adversely affect our growth and future prospects. In addition, we have agreed with Macronix that we will be allowed to grant a license to manufacture products incorporating our NROM technology to only one other new licensee in Taiwan for code and data flash products, provided we pay Macronix a portion of the license fees that we receive from any such license. If additional significant manufacturers of non-volatile memory products are established in Taiwan in the future, this restriction may limit the revenues that we can derive from this market, or result in additional costs, to enter into license agreements with these manufacturers. If a leading semiconductor manufacturer in the code or data flash memory segment adopts and achieves success with a competing technology or incorporates our technology but fails to achieve success with its products, our reputation and revenues could be adversely affected. It takes a significant amount of time to design, develop and manufacture non-volatile memory devices and, as a result, if a competitor starts to manufacture products based on a competing technology, it may be difficult for us to displace that technology. In addition, we must negotiate license agreements with favorable license fees and royalty payments. The license fees and royalties under our current license agreements vary significantly among our licensees. For example, our first license agreement with Spansion, which in 2004, according to Web-Feet Research, was the largest vendor worldwide of code flash with total sales of $2.4 billion, or 24.3% of the total code flash market, contains a uniform royalty rate that is lower than the royalty rates in some of our other license agreements and stepped thresholds that limit the amount from which we can derive royalties to $1.2 billion of annual net sales of products by Spansion incorporating our NROM technology. If we are unable to negotiate favorable license agreements with other semiconductor manufacturers, our growth and future prospects could be harmed.

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If we are unable to successfully protect our inventions through the issuance and enforcement of patents, our business could be significantly harmed.

As we derive a significant portion of our revenue from licensing activities, our ability to innovate and protect our innovations by applying for, obtaining and enforcing our patents is important to our business and revenues. As of December 31, 2005, we owned over 65 issued U.S. patents (including 10 co-owned U.S. patents) and seven non-U.S. patents, and we had over 55 pending U.S. patent applications and over 100 pending non-U.S. patent applications. If we fail to obtain patents, are unable to obtain patents with claims of a scope necessary to cover our technology, or our issued patents are determined invalid or not to cover our technology, our licensees and others could use portions of our intellectual property without paying license fees and royalties, which could weaken our competitive position, significantly harm our revenues and prospects, and increase the likelihood of costly litigation. We have an active program to protect our proprietary inventions through the filing of patent applications and taking certain steps to preserve the confidentiality of our confidential and proprietary information. There can be no assurance, however, that:

current or future U.S. or foreign patent applications will be approved;

our issued patents will protect our intellectual property and not be challenged by third parties;

the validity of our patents will be upheld;

the patents of others will not have an adverse effect on our ability to do business; or

others will not independently develop similar or competing products or methods or design around any patents that may be issued to us.

Our failure to protect the intellectual property created by us would cause our business to suffer.

In addition to patent protection, we rely on a combination of trade secret, copyright and trademark laws and restrictions on disclosure to protect our intellectual property rights, including through confidentiality agreements with our employees, consultants and customers. We cannot be certain that these contracts have not been and will not be breached, that we will have adequate remedies for any breach or that our trade secrets will not otherwise become known or be independently discovered by competitors. Further, the growth of our business depends in large part on our ability to convince third parties of the applicability of our intellectual property to their products, and our ability to enforce our intellectual property rights against them. As part of our marketing efforts, we disclose to our prospective customers some of our proprietary information, not all of which is patent protected. Monitoring unauthorized use of our technology is difficult, and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as do the laws of the United States or in countries where we have not obtained or have limited patents on our technology, including China and Taiwan. We cannot be certain that the steps we have taken to protect our proprietary information will be sufficient.

Potential intellectual property claims by and against us and resulting litigation could subject us to significant costs and could invalidate our proprietary rights.

In the semiconductor industry, it is not unusual for companies to receive notices alleging infringement of patents or other intellectual property rights of others. We are not currently subject to any proceedings for infringement of patents or intellectual property rights of others and are not aware of any parties that intend to pursue such claims against us. If it appears necessary or desirable, we may seek to license intellectual property that we are alleged to be infringing. Licenses may not be offered and the terms of any offered licenses may not be acceptable to us. The failure to obtain a license under a key patent or intellectual property directly from a third party for technology used by us or provided by us to our licensees could cause us to incur substantial liabilities and to suspend the manufacture of the products utilizing certain technology or to attempt to develop non-infringing products, any of which could harm our business. We may find it necessary to litigate to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of

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infringement of others intellectual property or invalidity of our own intellectual property. For example, in 2002 we incurred expenses of approximately $2.2 million in connection with a settlement and license agreement with Fujitsu Limited and Advanced Micro Devices, Inc. pursuant to which we agreed to settle a claim that we filed in the United States District Court for the Southern District of New York for infringement of patents, breach of contract and unjust enrichment. In addition, we have provided a limited indemnity to certain of our licensees against losses resulting from claims that our NROM technology incorporated into their products infringes certain third party intellectual property rights, and we may agree to indemnify other licensees in the future. These indemnification obligations could result in significant expense. Litigation is inherently uncertain and any adverse decision could result in a loss of our proprietary rights, subject us to significant liabilities, require us to seek licenses from others, limit the value of our licensed technology and otherwise negatively impact our business. Even if we adequately protect our intellectual property rights, litigation may be necessary to enforce these rights, which could result in substantial costs to us and a substantial diversion of manag