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

FORM 10-Q

(Mark One)

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the quarterly period ended December 27, 2008.

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 Number: 001-13748

ZiLOG, Inc.

(Exact name of registrant as specified in its charter)

Delaware	13-3092996
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

6800 Santa Teresa Boulevard
San Jose, California 95119
(Address of Principal Executive Offices)

(408) 513-1500
Registrant's telephone number, including area code:

Indicate by check mark whether the registrant (l) 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, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐
Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller Reporting Company ☒

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.
Yes ☒ No ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at January 27, 2009
Common Stock, $0.01 par value per share	17,207,717 shares

FORWARD-LOOKING STATEMENTS

Some of the statements under the sections entitled “Risk Factors” and “Management's Discussion and Analysis of Financial Condition and Results of Operations,” and elsewhere in this Form 10-Q, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In some cases, you can identify forward-looking statements by terminology such as “may”, “will”, “should”, “expects”, “anticipates”, “believes”, “estimates”, “potential”, “continue”, or the negative terms or other comparable terminology. These statements include, without limitation:

- estimates of market growth;
- estimates of capital expenditures;
- the adequacy of available cash;
- the cost or outcome of any litigation pending or threatened;
- the impact on recent accounting pronouncements;
- any gross margin improvement resulting from our research and development effort; and
- the expected cost of compliance with environmental laws.

These statements relate to future events or our future financial performance and involve known and may involve unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by forward-looking statements including, but not limited to, prospects for future market growth. Other factors that may cause or contribute to differences include, but are not limited to, continued availability of third-party foundry, assembly and test services with commercially-reasonable quality and prices; under-absorption of manufacturing costs in the remaining manufacturing support facilities from under-utilization of capacity; our distributors and customers significantly reducing their existing inventories before ordering new products and the costs associated with the Microchip lawsuit. In evaluating these statements, you should specifically consider various factors, including the risks outlined under “Risk Factors” in our Form 10-K for the fiscal year ended March 31, 2008.

Although we believe that the expectations in the forward-looking statements contained in this Form 10-Q are reasonable, we cannot guarantee future results, levels of activity, and performance achievements. These forward-looking statements are based on our current expectations, and we disclaim any obligation to update these forward-looking statements for subsequent events or to explain why actual results differ unless otherwise required by law. You should not place undue reliance on these forward-looking statements.

Unless otherwise specified as a forward-looking statement, the information contained in this report is historical in nature and speaks as of the date of this report unless otherwise clearly indicated. We disclaim any obligation to update this information for subsequent events.

Based in San Jose, California, we were incorporated in California in September 1973 and merged with a subsidiary of Exxon (which subsidiary changed its name to ZiLOG, Inc.) in November 1981. We were reacquired by an affiliate of Warburg Pincus and Management in 1989 and reincorporated in Delaware in April 1997. We were acquired by an affiliate of Texas Pacific Group in 1998 and we were reorganized in bankruptcy in 2002. In this report, “ZiLOG,” “the Company,” “our,” “us,” “we,” and similar expressions refer to ZiLOG, Inc. and its subsidiaries. However, when these expressions are used throughout this report in connection with ZiLOG, Inc.’s reorganization under Chapter 11 of the U.S. bankruptcy code, they are referring only to the parent company, ZiLOG, Inc., and not to any of its subsidiaries. EZ80ACCLAIM!, CRIMZON, Zatara, ZiLOG, Z8, Z80, eZ80, Z8 ENCORE!, Encore!XP and Zneo are registered trademarks of ZiLOG, Inc., in the United States and in other countries. ARM is a registered trademark of ARM Limited in the EU and other countries. Other product and or service names mentioned herein may be trademarks of the companies with which they are associated.

ZILOG, INC.
QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED DECEMBER 27, 2008
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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

ZILOG, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	Dec. 27, 2008	Dec. 29, 2007	Dec. 27, 2008	Dec. 29, 2007
Net sales	$ 13,032	$ 17,030	$ 50,211	$ 50,478
Cost of sales	8,237	9,017	28,056	27,352
Gross margin	4,795	8,013	22,155	23,126
Operating expenses:				
Research and development	3,749	4,144	11,633	12,560
Selling, general and administrative	4,832	4,908	16,334	14,973
Special charges and credits	1,696	570	2,839	1,464
Amortization of intangible assets	209	251	627	753
Total operating expenses	10,486	9,873	31,433	29,750
Operating loss	(5,691)	(1,860)	(9,278)	(6,624)
Other income:				
Other income (expense)	97	(133)	481	(220)
Interest income	24	198	143	665
Loss before provision for income taxes	(5,570)	(1,795)	(8,654)	(6,179)
Provision for income taxes	97	592	311	1,170
Net loss	$ (5,667)	$ (2,387)	$ (8,965)	$ (7,349)
Basic and diluted net loss per share	$ (0.33)	$ (0.14)	$ (0.53)	$ (0.44)
Shares used in computing basic and diluted net loss per share	17,071	16,880	16,982	16,885

See accompanying notes to unaudited condensed consolidated financial statements.

ZILOG, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	Dec. 27, 2008	March 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 13,560	$ 16,625
Accounts receivable, less allowance for doubtful accounts of $120 at December 27, 2008 and $145 at March 31, 2008	5,661	6,834
Inventory	6,118	8,413
Deferred tax assets	263	263
Prepaid expenses and other current assets	1,328	1,663
Total current assets	26,930	33,798
Long term investments	1,300	1,925
Property, plant and equipment, net	6,944	6,604
Goodwill	2,211	2,211
Intangible assets, net	1,902	2,528
Other assets	862	774
Total assets	$ 40,149	$ 47,840
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short term debt	$ 693	$ 720
Accounts payable	5,621	7,258
Other current liabilities, including license agreements	1,258	525
Income taxes payable	203	535
Accrued compensation and employee benefits	2,228	2,444
Other accrued liabilities	2,909	2,094
Deferred income on shipments to distributors	5,605	5,867
Total current liabilities	18,517	19,443
Deferred tax liabilities	263	263
Other long term liabilities, including license agreements	1,297	592
Other non-current tax liabilities	862	663
Total liabilities	20,939	20,961
Stockholders' equity:		
Common stock, $0.01 par value; 60.0 million shares authorized: 17.2 million shares issued and outstanding at December 27, 2008 and 16.9 million at March 31, 2008, respectively	186	185
Additional paid-in capital	127,210	125,838
Treasury stock	(7,456)	(7,456)
Other comprehensive income	25	102
Accumulated deficit	(100,755)	(91,790)
Total stockholders' equity	19,210	26,879
Total liabilities and stockholders' equity	$ 40,149	$ 47,840

See accompanying notes to unaudited condensed consolidated financial statements.

ZILOG, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended	
	Dec. 27, 2008	Dec. 29, 2007
Cash Flows from Operating Activities:		
Net loss	$ (8,965)	$ (7,349)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and other amortization	2,598	2,225
Loss (gain) on disposition of operating assets	(20)	249
Stock-based compensation	1,284	918
Amortization of fresh-start intangible assets	627	752
Changes in operating assets and liabilities:		
Accounts receivable, net	1,173	(361)
Inventory	2,295	(936)
Prepaid expenses and other current and non-current assets	249	1,354
Accounts payable	(1,637)	1,859
Accrued compensation and employee benefits	(216)	(211)
Deferred income on shipments to distributors	(262)	(1,054)
Accrued and other current and non-current liabilities	(387)	(1,174)
Net cash used in operating activities	(3,261)	(3,728)
Cash Flows from Investing Activities:		
Disposal of assets held for sale - MOD II property	-	3,237
Redemption of long term investments	625	-
Capital expenditures	(520)	(996)
Net cash provided by investing activities	105	2,241
Cash Flows From Financing Activities:		
Short term debt	(28)	-
Repurchase of restricted shares	-	(282)
Proceeds from issuance of common stock under employee stock and option purchase plans	119	449
Net cash provided by financing activities	91	167
Net decrease in cash and cash equivalents	(3,065)	(1,320)
Cash and cash equivalents at beginning of period	16,625	19,390
Cash and cash equivalents at end of period	$ 13,560	$ 18,070
Supplemental Disclosure of Non-Cash Investing and Financing Activities:		
Purchase of development licenses through long term payment arrangement	$ 2,400	$ -

See accompanying notes to unaudited condensed consolidated financial statements

ZILOG, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Treasury Stock	Other Comprehensive Income	Accumulated Deficit	Total Stock-holders' Equity
Balance at March 31, 2007	16,840	$ 183	$ 124,558	$ (7,174)	$ -	$ (82,820)	$ 34,747
Cumulative effect of accounting change - adoption of FIN48	-	-	-	-	-	(101)	(101)
Issuance of common stock under stock option plans	99	2	309	-	-	-	311
Issuance of common stock under employee stock purchase plan	43	0	138	-	-	-	138
Stock-based compensation expense - director shares	15	-	64	-	-	-	64
Stock-based compensation expense	-	-	842	-	-	-	842
Restricted shares cancelled	(21)	-	-	-	-	-	-
Repurchase of common stock	(73)	-	-	(282)	-	-	(282)
Comprehensive loss:							
Other comprehensive income - defined benefit plan	-	-	-	-	81	-	81
Net Loss	-	-	-	-	-	(7,349)	(7,349)
Total comprehensive loss	-	-	-	-	-	-	(7,268)
Balance at December 29, 2007	16,903	$ 185	$ 125,911	$ (7,456)	$ 81	$ (90,270)	$ 28,451
Balance at March 31, 2008	16,923	$ 185	$ 125,838	$ (7,456)	$ 102	$ (91,790)	$ 26,879
Issuance of common stock under stock option plans	5	-	18	-	-	-	18
Restricted shares cancelled	(22)	-	-	-	-	-	-
Issuance of common stock under employee stock							-
purchase plan	40	1	100	-	-	-	101
Stock-based compensation expense - directors shares	18	-	56	-	-	-	56
Stock-based compensation expense	-	-	659	-	-	-	659
Restricted shares granted - employee stock incentive plan	235	-	539	-	-	-	539
Comprehensive loss:							
Other comprehensive loss - FIN48 tax item	-	-	-	-	(77)	-	(77)
Net loss	-	-	-	-	-	(8,965)	(8,965)
Total comprehensive loss	-	-	-	-	-	-	(9,042)
Balance at December 27, 2008	17,199	$ 186	$ 127,210	$ (7,456)	$ 25	$ (100,755)	$ 19,210

See accompanying notes to unaudited condensed consolidated financial statements.

ZILOG, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

The accompanying interim financial information is unaudited. In the opinion of ZiLOG, Inc.'s ("ZiLOG" or the "Company") management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of interim results have been included. The results for interim periods are not necessarily indicative of results to be expected for the full fiscal year. These unaudited condensed consolidated financial statements and notes should be read in conjunction with the Company's annual consolidated financial statements and notes thereto contained in the Company's 2008 Annual Report filed on Form 10-K (File Number 001-13748) for the fiscal year ended March 31, 2008, filed on June 30, 2008 with the Securities and Exchange Commission.

The Company's fiscal year ends March 31 with interim results based on fiscal quarters of approximately thirteen weeks in duration ending on the closest Saturday to each calendar quarter end, with the exception of the fiscal fourth quarter, which ends on March 31. Certain reclassifications have been made to prior-period balances to present the consolidated financial statements on a consistent basis with the current year presentation. Any reference to year pertains to the fiscal year unless otherwise indicated. The operating results for any period are not necessarily indicative of results for any subsequent period or the full fiscal year.

The condensed consolidated balance sheet at March 31, 2008 was derived from audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the Company's significant accounting policies is described in its Annual Report for the 2008 fiscal year ended March 31, 2008, filed on Form 10-K with the Securities and Exchange Commission on June 30, 2008. The Company's significant accounting policies remain unchanged from those disclosed on Form 10-K for the fiscal year ended March 31, 2008, except for the following:

Adoption of Accounting Standards. Effective April 1, 2008, the Company adopted SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). The Company did not elect to adopt the fair value option under this pronouncement which permits entities to choose to measure many financial instruments and certain other items at fair value on a contract by contract basis.

Effective April 1, 2008, the Company adopted SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). In February 2008, the Financial Accounting Standards Board ("FASB") issued Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157," which provides a one-year deferral of the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. In September 2008, the FASB issued Staff Position No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active", which clarifies the application of SFAS No. 157 in a market that is not active. The Company has adopted the provisions of SFAS No. 157 with respect to its financial assets and liabilities only. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS No. 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS No. 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on the following three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

- Level 1 - Quoted prices in active markets for identical assets or liabilities;
- Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that

are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

In accordance with SFAS 157, the following table represents the Company's fair value hierarchy for its financial assets (cash equivalents and available for sale investments) as of December 27, 2008 (unaudited, in thousands):

	Dec. 27, 2008			
	Fair Value	**Level 1**	**Level 2**	**Level 3**
Money market funds	$ 10,147	$ 10,147	$ -	$ -
Auction rate preferred securities	1,300	-	1,300	-
Total	$ 11,447	$ 10,147	$ 1,300	$ -

Since February 2008, due to various factors including the tightening of liquidity in the financial market, regularly held auctions for Auction Rate Preferred Securities ("ARPS"), have been unsuccessful. Following the failure of these auctions, the Company has received $2.6 million from redemptions of its ARPS. The remaining ARPS balance of $1.3 million as of December 27, 2008, has been classified as long-term investments and continue to pay interest pending their redemption or sale.

In determining fair value, the Company uses various valuation techniques, including market and income approaches to value available-for-sale investments. The availability of observable inputs can vary from instrument to instrument and to the extent that valuation is based on inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. The degree of judgment exercised by the Company's management in determining fair value is greatest for instruments categorized in Level 3. All of the Company's ARPS have AAA credit ratings, are 100% collateralized and continue to pay interest in accordance with their contractual terms. Additionally, the issuers reported collateralized asset value ranges which exceed the value of ARPS held by the Company by 200 to 300 percent. Accordingly, the remaining ARPS balance of $1.3 million is categorized as Level 2 for fair value measurement under FAS 157 and has been recorded at full par value on the consolidated balance sheet as of December 27, 2008. The Company currently believes the ARPS values are not impaired and as such, no impairment has been recognized against the investment. If future auctions fail to materialize and the credit rating of the issuers deteriorates, the Company may be required to record an impairment charge against the value of its ARPS.

NOTE 3. INVENTORY

Inventories are stated at the lower of cost (which approximates actual cost on a first-in, first-out basis) or market. Provisions, when required, are made to reduce inventory values from cost to their estimated net realizable values. It is possible that estimates of net realizable value can change in the short-term. Inventory reserves for excess or obsolete inventory are released on sale, scrap or other disposition of the reserved inventory. Inventories, net of provisions, consist of the following (unaudited, in thousands):

	Dec. 27, 2008	**March 31, 2008**
Raw materials	$ 330	$ 447
Work-in-progress	3,955	5,924
Finished goods	1,833	2,042
Inventory, net	$ 6,118	$ 8,413

NOTE 4. SPECIAL CHARGES AND CREDITS

The components of special charges and credits are as follows (unaudited, in thousands):

	Three Months Ended		Nine Months Ended	
	Dec. 27, 2008	Dec. 29, 2007	Dec. 27, 2008	Dec. 29, 2007
Restructuring of operations:				
Engineering consolidation severance and termination costs	$ -	$ 68	$ -	$ 951
MOD II maintenance and selling costs	-	-	-	248
Employee severance and other costs	1,210	259	1,717	647
Strategic review	261	-	261	-
Other	225	243	861	279
Reimbursement of retirement benefits - Philippines defined benefit plan	-	-	-	(661)
Total special charges and credits	$ 1,696	$ 570	$ 2,839	$ 1,464

For the three and nine months ended December 27, 2008, the Company incurred special charges of $1.7 million and $2.8 million, respectively. Special charges include severance and other costs related to the headcount reduction, costs and expenses associated with the Company's on-going strategic review and expenses related to the test outsourcing program that was effectively completed in the December, 2008 fiscal quarter. As a result of declining revenues for the three months ended December 27, 2008, including lower demand reflecting the current global economic difficulties the Company has continued its efforts of reducing spending and streamline activities. In line with this, in December 2008, the Company implemented a further reduction in its worldwide workforce. As such, on or about December 10, 2008 and January 15, 2009 the Company reduced its global workforce by approximately 35 percent and recorded charges of $1.2 million reflecting severance and other costs associated with these actions.

The obligations and expense recognition related to the worldwide workforce reduction were made in accordance with FASB Statement 112 "Employer's Accounting for Post-employment Benefits".

For the three and nine months ended December 29, 2007, the Company incurred $0.6 million and $1.5 million, respectively, for severance, lease termination costs and other closure costs related to the consolidation of its research and development efforts and its production test outsource program. Included in this net charge was a credit of $0.7 million reflecting a refund from an employee benefit plan that was in an overfunded status. During the nine months ended December 29, 2007, the Company incurred period expenses of $0.2 million related to maintenance and other costs associated with the sale of its MOD II manufacturing facility.

The following table summarizes activity in accrued special charges primarily consisting of payroll related items, which is included in other accrued liabilities on the condensed consolidated balance sheets (unaudited, in thousands):

	Accrued Special Charges
Balance at March 31, 2008	$ 489
Accruals	1,661
Cash payments	(796)
Balance at Dec. 27, 2008	$ 1,354

NOTE 5. GEOGRAPHIC AND SEGMENT INFORMATION

Segment Information. The Company's business is comprised of one operating segment. The Company engages primarily in the design, development, manufacture and marketing of semiconductor products. The Company sells its products to distributors and direct customer accounts including original equipment manufacturers ("OEMs") and original design manufacturers ("ODMs") in a broad range of market segments. The Company's operations outside the United States consist of a global support facility in the Philippines which until December, 2008 also conducted production test activities. Additionally, activities outside the U.S. include sales as well as a software support and design center in Bangalore, India. Domestic operations are responsible for architecture design, design and software development as well as customer management including coordination of production planning and shipping to meet worldwide customer commitments. The Philippine facility is reimbursed in relation to its value added with respect to its activities performed, and certain foreign sales offices receive a commission on export sales within their territory. Accordingly, for financial statement purposes, it is not meaningful to segregate sales or operating profits for the non-US operations.

The Company has two broad current product categories based on product technologies, referred to as new products and 8-bit classic products. The new products category includes universal remote control solutions, Zatara 32-bit secured transaction processors and 8-bit embedded flash microcontrollers. Classic products primarily reflect sales of Z8 microcontrollers including both Read-Only-Memory (ROM) and One-Time-Programmable (OTP), Z80 microprocessors and Serial Communications Controllers (SCC).

Sales by Product Category. The following table represents the Company's net sales by product category for each of the periods indicated (unaudited, in thousands):

	Three Months Ended		Nine Months Ended	
	Dec. 27, 2008	**Dec. 29, 2007**	**Dec. 27, 2008**	**Dec. 29, 2007**
Net sales by product category:				
New Products	$ 7,136	$ 9,792	$ 30,248	$ 26,991
8-bit classic products	5,896	7,238	19,964	23,487
Total Net Sales	$ 13,032	$ 17,030	$ 50,212	$ 50,478

The following table summarizes the Company's net sales by region and by channel (unaudited, in thousands):

	Three Months Ended		Nine Months Ended	
	Dec. 27, 2008	**Dec. 29, 2007**	**Dec. 27, 2008**	**Dec. 29, 2007**
Net sales by region:				
Americas	$ 5,356	$ 5,703	$ 17,085	$ 17,334
Asia	5,855	9,030	26,075	26,351
Europe	1,821	2,297	7,052	6,793
Total net sales	$ 13,032	$ 17,030	$ 50,212	$ 50,478
Net sales by channel:				
Direct	$ 4,882	$ 7,631	$ 23,384	$ 21,223
Distribution	8,150	9,399	26,828	29,255
Total net sales	$ 13,032	$ 17,030	$ 50,212	$ 50,478

Major customers. For the three months ended December 27, 2008, two distributors and one customer each individually accounted for greater than 10 percent of the Company's total net sales. The distributors accounted for approximately 28 percent and 13 percent, respectively, of net sales and the customer accounted for approximately 13 percent of net sales during the three months ended December 27, 2008. For the nine months ended December 27, 2008, one distributor and two customers accounted for greater than 10 percent of the Company's total net sales. The distributor accounted for 25 percent of net sales and the two customers accounted for 13 percent and 12 percent of net sales, respectively.

For the three and nine months ended December 29, 2007, one distributor accounted for greater than 10 percent of the Company's total net sales. This distributor accounted for approximately 26 percent and 27 percent of net sales, respectively. For the three months ended December 29, 2007, two customers accounted for greater than 10 percent of net sales. The two customers accounted for 12 percent and 11 percent of net sales, respectively for the three months ended December 29, 2007. For the nine months ended December 29, 2007, one customer accounted for approximately 10 percent of the Company's total net sales.

NOTE 6. STOCK, OPTIONS AND STOCK-BASED COMPENSATION

Stock-based compensation. The Company has a stock-based compensation program that includes non-statutory stock option awards and restricted stock awards ("RSAs"). Stock options are generally time-based, vesting 25% on the first anniversary of the grant-date and monthly thereafter over the following three years and expire ten years from the grant-date. As of December 27, 2008, the Company had 1,971,363 shares available for grant under all plans.

The Company has an Employee Stock Purchase Plan ("ESPP") that allows employees to purchase shares of common stock at 85 percent of the fair market value at the lower of either the date of enrollment or the date of purchase. In addition to the shares available for issuance under the stock option and restricted stock plans, the Company had approximately 929,911 shares of common stock reserved for future issuance under the ESPP as of December 27, 2008.

For the three and nine month periods ended December 27, 2008, the Company recorded $0.5 million and $1.3 million, respectively, in stock compensation expense. These stock compensation expense amounts include charges for the Company's fiscal 2009 Employee Stock Incentive Plan ("SIP"). For the three and nine months ended December 29, 2007, the Company recorded $0.1 million and $0.9 million of stock compensation expense, respectively.

The Company's fiscal 2009 SIP provides eligible employees with an incentive award program based on the Company's achievement of goals related to revenue growth and product and customer program development. The SIP incentive award is measured for each half of fiscal 2009 independently, calculated as a fixed dollar amount based on each employee's individual incentive and is settled in the form of restricted stock awards. During the three and nine month periods ended December 27, 2008, the Company recognized $0.2 million and $0.5 million, respectively of stock compensation expenses related to the SIP. The total value of the SIP earned by eligible employees for the first half of fiscal 2009 was $0.7 million with an unrecognized portion of $0.2 million that is being recognized ratably through the expected final vesting date of May 8, 2009. SIP stock awards for the first half of fiscal 2009 were calculated based on the Company's closing stock price on September 27, 2008 of $3.19 per share and totaled 234,600 shares. The Company has accrued no additional expense in the three months ended December 27, 2008 based on the current expectation that no awards will be earned for the second half of fiscal 2009. All expenses recognized related to awards earned for the first half of fiscal 2009.

The obligations and expense recognition related to these awards is recognized in accordance with FASB Statement 150 "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" and SFAS 123R "Share Based Payments".

The following table sets forth the total stock-based compensation expense resulting from equity plans and incentive programs included in the Company's unaudited condensed consolidated statements of operations (unaudited, in thousands):

	Three Months Ended		Nine Months Ended	
	Dec. 27, 2008	Dec. 29, 2007	Dec. 27, 2008	Dec. 29, 2007
Cost of sales	$ 44	$ 24	$ 116	$ 90
Research and development	182	54	402	205
Selling, general and administrative	297	45	766	623
Total stock-based compensation expense	$ 523	$ 123	$ 1,284	$ 918

The fair value of stock-based awards expense resulting from equity plans was estimated on the date of grant using the Black-Scholes valuation pricing model with the following weighted-average assumptions:

Stock Options	Three Months Ended		Nine Months Ended	
	Dec. 27, 2008	Dec. 29, 2007	Dec. 27, 2008	Dec. 29, 2007
Expected life (in years)	4.8	5.2	4.8	5.2
Interest rate	1.5%	3.6%	2.8%	4.3%
Volatility	59.1%	44.7%	51.5%	44.6%
Dividend yield	-	-	-	-
Weighted-average per share fair value at grant date	$ 1.59	$ 1.40	$ 1.56	$ 1.61

Employee Stock Purchase Plan	Three Months Ended		Nine Months Ended	
	Dec. 27, 2008	Dec. 29, 2007	Dec. 27, 2008	Dec. 29, 2007
Expected life (in years)	0.7	0.9	0.7	0.8
Interest rate	1.7%	3.5%	2.5%	4.2%
Volatility	57.4%	38.7%	57.5%	36.9%
Dividend yield	-	-	-	-
Weighted-average per share fair value at grant date	$ 0.84	$ 0.81	$ 0.88	$ 0.85

The computation of expected volatility for the three and nine months ended December 27, 2008 and December 29, 2007 is based on a blended calculation of historical and market-based implied volatility. The computation of expected life is based on a combination of historical and expected exercise patterns. The interest rate for periods within the contractual life of the award is based on the U.S. Treasury yield curve in effect at the time of grant.

Stock option activity for the nine months ended December 27, 2008, is as follows (unaudited):

	Shares (000's)	Weighted-Average Exercise Price (per share)	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (000's)
Outstanding at March 31, 2008	2,083	$ 4.89		
Grants	26	$ 3.43		
Exercises	(3)	$ 2.70		
Forfeitures or expirations	(19)	$ 7.07		
Outstanding at June 28, 2008	2,087	$ 4.85		
Grants	41	$ 3.38		
Exercises	(2)	$ 2.70		
Forfeitures or expirations	(31)	$ 4.40		
Outstanding at September 27, 2008	2,095	$ 4.83		
Grants	13	$ 3.19		
Exercises				
Forfeitures or expirations	(84)	$ 5.17		
Outstanding at December 27, 2008	2,024	$ 4.81	6.6	$ 1
Outstanding Vested and Expected to Vest at December 27, 2008	1,819	$ 4.94	6.5	$ 1
Exercisable at December 27, 2008	1,139	$ 5.68	5.8	$ 1

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, that is, the difference between the Company's closing stock price on the last trading day of the period and the exercise price times the number of shares that would have been received by the option holders had all option holders exercised their options on December 27, 2008. This amount will change based on fluctuations of the fair market value of the Company's stock. The total intrinsic value of options vested and expected to vest is approximately $1,300 at December 27, 2008.

There were 5,240 stock option exercises during the nine months ended December 27, 2008. The weighted-average exercise price of options granted for nine months ended December 27, 2008 and December 29, 2007 was $3.37 and $3.49 per share, respectively.

No income tax benefit was realized from stock option exercises during the three and nine months ended December 27, 2008 and December 29, 2007. In accordance with SFAS 123R, the Company presents excess tax benefits from the exercise of stock options, if any, as financing cash flows rather than operating cash flows.

As of December 27, 2008, $1.0 million of total unrecognized compensation costs related to stock options is expected to be recognized over a weighted-average remaining period of 2.4 years. The total unrecognized compensation cost related to restricted shares granted as of December 27, 2008 is $0.04 million, which is expected to be recognized over a weighted-average remaining period of 0.4 years.

NOTE 7. CONTINGENCIES

On August 11, 2005, Microchip Technology, Inc. ("Microchip") filed a patent infringement claim against the Company in the U.S. District Court of Arizona (case number CV05-2406-PHX-MHM). Microchip alleges that the Company has infringed, and currently infringes, its patents numbered 5,847,450, 6,696,316 and 6,483,183. Microchip claims that unspecified products of the Company, including the Z8 Encore! XP 4K Series of products, infringe these patents and is seeking preliminary and permanent injunctive relief, unspecified damages and costs, including attorneys' fees. The Company filed a response to the claims on September 15, 2005 generally denying the claims and challenging the validity of the patents. On January 10, 2006, the Company filed a request for patent re-examination with the U.S. PTO, which was granted in February and March 2006 for all 3 patents. On April 11, 2008, the Company received a notice that all of Microchip's claims under these three patents have been rejected by the U.S. PTO. Notwithstanding this favorable ruling, because Microchip has a right to appeal the patent office's decision, the Company does not believe it is feasible to predict or determine the outcome or resolution of this litigation at this time. The Company believes it has meritorious defenses and will defend itself vigorously against these claims. The Company may incur substantial expenses in its defense against these claims. In the event of a determination adverse to the Company, it may incur substantial monetary liabilities and be required to change our business practices. Either of these could have a material adverse effect on its financial position, results of operations and/or cash flows.

On December 1, 2006, the Company filed a patent infringement claim against Altera Corporation ("Altera") and Actel Corporation ("Actel") in the U.S. District Court of California (civil docket number 4:06-cv-07388-SBA). The Company alleges that Altera and Actel have infringed, and currently infringe, its patent numbered 4,670,749 which the Company believes to be the fundamental patent for programmable logic. The Company claims that Altera's and Actel's products infringe these patents and is seeking unspecified damages and costs, including attorneys' fees. Actel settled their case with the Company on June 11, 2007 for an undisclosed amount. The case against Altera is currently on stay pending reexamination of the patent in suit.

On May 23, 2008, Altera filed a patent infringement claim against the Company in the U.S. District Court of Texas (civil action number 2:08-CV-218). Altera alleges that the Company has infringed, and currently infringes, its patents numbered 6,097,211, 6,147,511 and 6,314,550. Altera claims that unspecified products of the Company's, including its eZ80 and Zneo series of products, infringe these patents and is seeking preliminary and permanent injunctive relief, unspecified damages and costs, including attorneys' fees. The Company does not believe it is feasible to predict or determine the outcome or resolution of this litigation at this time. The Company will defend itself vigorously against these claims. The Company may incur substantial expenses in its defense against these claims. In the event of a determination adverse to the Company, it may incur substantial monetary liabilities, and be required to change its business practices. Either of these could have a material adverse effect on its financial position, results of operations or cash flow.

The Company is participating in other litigation and responding to other claims arising in the ordinary course of business. The Company intends to defend itself vigorously in these matters. The Company's management believes that it is unlikely that the outcome of these matters will have a material adverse effect on the Company's financial statements, although there can be no assurance in this regard.

From time to time the Company has agreed to indemnify and hold harmless certain customers for potential allegations of infringement of intellectual property rights and patents arising from the use of its products. During the ordinary course of business, in certain limited circumstances, the Company has agreed to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally parties with which the Company has commercial relations, in connection with certain intellectual property infringement claims by any third party with respect to its products and services. The Company has indemnification arrangements that limit its net contingent obligation to pay for defense costs, if any, up to a maximum of $2 million. To date, there have not been any costs incurred in connection with such indemnification arrangements; therefore, there is no accrual of such amounts at December 27, 2008. The Company discloses indemnification liabilities according to FASB Staff Position FIN 45-1, "Accounting for Intellectual Property Infringement Indemnifications under FAS Interpretation No. 45." Under FAS No. 5, "Loss Contingencies," a claim would be accrued when a loss is probable and the amount can be reasonably estimated. At December 27, 2008, no such amounts are accrued.

In connection with the lease in July 2007 for its new corporate headquarters located in San Jose, California, the Company established an Irrevocable Letter of Credit in the amount of $0.3 million with its bank for the security deposit.

NOTE 8. SHORT-TERM DEBT AND LICENSE AGREEMENTS

During the fiscal year ended March 31, 2008, the Company entered into a short term financing agreement totaling $1.4 million. Borrowings on the agreement bear interest at a rate per annum equal, at the Company's option, to the Lender's stated prime rate or LIBOR, plus 1.75% which was 2.25% at December 27, 2008. As of December 27, 2008, the Company had $0.7 million of borrowings outstanding under this agreement payable through June 2009. As noted previously, the Company had $0.3 million of standby letters of credit with its bank as of December 27, 2008 and December 29, 2007, respectively.

In October 2007, the Company entered into a three year development software license agreement beginning December 30, 2007 for a total license fee of $2.2 million. The Company retains perpetual use of the software at the end of the agreement. The total unpaid portion of $0.6 million has been included in short and long-term liabilities on the Company's consolidated balance sheet as of December 27, 2008.

In April 2008, the Company entered into a three-year agreement to license certain technologies to further develop its 32-bit ARM core based technology. The total cost of this agreement was $2.4 million and the unpaid portion of $2.0 million has been included in short and long-term liabilities on the Company's consolidated condensed balance sheet as of December 27, 2008.

NOTE 9. INCOME TAXES

The Company adopted the provisions of Financial Standards Accounting Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 ("FIN48") effective April 1, 2007. In connection with the adoption of FIN 48, the Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions.

As of December 27, 2008, the total amount of unrecognized tax benefits was approximately $5.4 million of which $4.6 million is recorded as a deferred tax asset that is fully offset by a valuation allowance and $0.9 million which if recognized would affect the Company's effective tax rate. The calculation of unrecognized tax benefits involves dealing with uncertainties in the application of complex global tax regulations. Management assesses the Company's tax positions in light of legislative, bilateral tax treaty, regulatory and judicial developments in the countries in which the Company does business.

A valuation allowance is required to be recorded if in management's judgment, based on available evidence; it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on available evidence, management has concluded that a valuation allowance is necessary to reduce the net deferred tax asset. Accordingly, deferred tax assets have been recognized only to the extent of deferred tax liabilities.

The Company recognizes interest in accordance with Paragraph 15 of FIN48 and recognizes penalties in accordance with Paragraph 16 of FIN48 which are classified as part of income taxes. As of December 27, 2008, the Company had approximately $0.1 million of accrued interest and penalties related to uncertain tax positions.

The Company's operations are subject to income and transaction taxes in the United States and in multiple foreign jurisdictions. Significant estimates and judgments are required in determining its worldwide provision for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations and as a result the proper amount of tax liability may be uncertain.

The Company is subject to taxation in the United States and various states and foreign jurisdictions. There are no ongoing examinations by taxing authorities at this time. The Company's various tax years beginning in 2001 through 2007 remain open in various taxing jurisdictions.

During the three and nine months ended December 27, 2008, the Company's income tax provision was $0.1 million and $0.3 million, respectively, which primarily reflects provisions for taxes in certain profitable foreign jurisdictions. During the three and nine months ended December 29, 2007, the Company's income tax provision was

$0.6 million and $1.2 million, respectively, which primarily reflects amortization of deferred charges and provisions for taxes in certain profitable foreign jurisdictions.

The Company provides for income tax expense in foreign jurisdictions where its foreign subsidiaries operations generate profits that are taxable. The Company's income tax expense reflects the estimated annual effective tax rate at that time based on projections of operations. Tax authorities may challenge the allocation of profits between the Company's subsidiaries and may challenge certain tax benefits claimed on its tax returns, and the Company may not prevail in any such challenge. If the Company were not to prevail, it could be subject to higher tax rates or lose certain tax benefit that could result in a higher tax rate.

NOTE 10. RETIREMENT AND BENEFIT PLANS

U.S. 401(k) retirement plan: The Company has an employee savings plan that qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code (the "401(k) Plan"). Under the 401(k) Plan, participating U.S. employees may defer a portion of their pretax earnings, up to the Internal Revenue Service annual contribution limit. The Company may make matching contributions on behalf of each participating employee in an amount equal to 100% of the participant's deferral contribution, up to 1.5% of the participant's compensation on a quarterly basis. The Company may also make additional discretionary contributions to the 401(k) Plan. Matching contributions to the 401(k) Plan for each of the nine months ended December 27, 2008 and the nine months ended December 29, 2007 were approximately $0.1 million. There were no discretionary contributions made in the nine months ended December 27, 2008 and the nine months ended December 29, 2007, respectively.

Philippine defined benefit plan: The Company's Philippines subsidiary maintains a defined benefit pension plan for local employees, which is consistent with local statutes and practices. The Company has adopted SFAS 158, which supersedes the previous accounting under SFAS 87. As of December 27, 2008 based on its most recent actuarial report, this pension plan was adequately funded. During the nine months ended December 27, 2008, the net periodic benefit costs were immaterial.

During the nine months ended December 27, 2008, the Company received $0.7 million of plan assets as entitlement benefits for terminated employees, which was included in the net severance payments related to the Company's restructuring and outsourcing activities in its Philippines operations. Additionally in May 2007, the Company received a refund of $0.7 million from its Philippines defined benefit plan related to its prior over funded status. The refund was recorded as a credit to special charges during the nine months ended December 29, 2007.

India defined benefit plan: The Company's India subsidiary maintains a defined benefit pension plan ("India Plan") for local employees, which is consistent with local statutes and practices. The Company has adopted SFAS 158, which supersedes the previous accounting under SFAS 87. As of December 27, 2008, based on its latest actuarial report, the pension plan was adequately funded. The India Plan has an independent external manager that advises the Company of the appropriate funding contribution requirements to which the Company complies. At December 27, 2008 there were approximately 20 percent of the total employees that had qualified for eligibility in the India subsidiary. Generally, an employee must be employed by the company for a minimum of five years before becoming eligible. At the time of eligibility the Company is liable, on termination, resignation or retirement, to pay the employee an effective amount of fifteen days salary for each full year of service completed. The plan is capped for each employee that at December 27, 2008 equated to $ 7,000 per employee. This cap reflects the full liability each employee can earn over the lifetime of their employment with the Company. The total amount of liability outstanding at December 27, 2008 for the India Plan is not material. During the nine months ended December 27, 2008, the net periodic benefit costs were not material.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors including those set forth in the section entitled "Risk Factors" in our Form 10-K for the year ended March 31, 2008 and in other sections of this quarterly report.

Overview

The following is management's discussion and analysis of financial condition and results of our operations and those of our subsidiaries for the three-month and nine-month periods ended December 27, 2008 and December 29, 2007. This discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included elsewhere herein and in our 2008 annual report on Form 10-K. Management's discussion and analysis provides information concerning our business environment, consolidated results of operations and liquidity and capital resources.

Our fiscal year ends on March 31 with interim results based on fiscal quarters of approximately thirteen weeks in duration ending on the closest Saturday to each calendar quarter end, with the exception of the fourth quarter, which ends on March 31. The operating results for any interim period are not necessarily indicative of results for any subsequent period or the full fiscal year.

Critical Accounting Estimates

Our critical accounting policies are disclosed in the Annual Report on Form 10-K for the year ended March 31, 2008 and have not changed materially as of December 27, 2008.

On an on-going basis, we evaluate our estimates and assumptions, including those related to sales returns, allowance for doubtful accounts, inventory write-downs, asset impairments, stock-based compensation expense and deferred taxes. We base our estimates on historical trends and various other assumptions that we believe to be reasonable at the time the estimates are made. Actual results may differ from those estimates. Critical accounting estimates are described in our Form 10-K for the 2008 fiscal year ended March 31, 2008, filed on June 30, 2008.

Reporting Segments

We conduct our business in one reportable segment to reflect the manner in which our chief operating decision-maker allocates resources and assesses the performance of our business.

Results of Operations

Our net sales by region, by channel, and by product category are summarized for each period indicated, as follows (unaudited, in thousands):

	Three Months Ended		Nine Months Ended	
	Dec. 27, 2008	Dec. 29, 2007	Dec. 27, 2008	Dec. 29, 2007
Net sales by region:				
Americas	$ 5,356	$ 5,703	$ 17,085	$ 17,334
Asia	5,855	9,030	26,075	26,351
Europe	1,821	2,297	7,052	6,793
Total net sales	$ 13,032	$ 17,030	$ 50,212	$ 50,478
Net sales by channel:				
Direct	$ 4,882	$ 7,631	$ 23,384	$ 21,223
Distribution	8,150	9,399	26,828	29,255
Total net sales	$ 13,032	$ 17,030	$ 50,212	$ 50,478

	Three Months Ended		Nine Months Ended	
	Dec. 27, 2008	Dec. 29, 2007	Dec. 27, 2008	Dec. 29, 2007
Net sales by product category:				
New Products	$ 7,136	$ 9,792	$ 30,248	$ 26,991
8-bit classic products	5,896	7,238	19,964	23,487
Total Net Sales	$ 13,032	$ 17,030	$ 50,212	$ 50,478

Key Metrics

Other key indices relevant in understanding our business and financial performance include the following metrics (unaudited):

	Three Months Ended	
	Dec. 27, 2008	Dec. 29, 2007
Days sales outstanding	39	45
Net sales to inventory ratio (annualized)	8.5	7.3
Weeks of inventory at distributors	12	12
Current ratio	1.5	2.0

We calculate each of these key metrics based on annualized quarterly results of operations data and balance sheet data as of the end of the period indicated. Each of these key metrics is described below:

Days sales outstanding, DSO, is a common metric used to analyze how quickly our customers pay us. This metric is influenced largely by the timing of our customer billings, collections, and individual payment terms. At December 27, 2008, our DSO was 39 days as compared to 45 days at December 29, 2007. This improvement in DSO is largely due to increased linearity of our shipments in the quarter ended December 27, 2008 versus the comparable quarter a year ago, allowing a higher portion of customer receivables to be collected during the quarter in which they were sold. Additionally, for the three months ended December 27, 2008 the percentage of sales to distribution was higher which, on average, have shorter payment terms and also contributed to the improved DSO's.

Net sales to inventory ratio is a metric we use to measure how rapidly our investment in inventories is recovered by our sales and is calculated by dividing ending inventory into sales for the quarter annualized. This metric may not be comparable to other companies who use inventory ratios to analyze inventory and is not the same as a typical inventory turns ratio. Our annualized net sales to inventory ratio increased to 8.5 from 7.3 in the quarter ended December 27, 2008 as compared to the quarter ended December 29, 2007. Our inventory levels declined at December 27, 2008 reflecting our continued tight management control of our inventories especially in the current difficulties of the global economy and the impact this has had on sales for the semiconductor industry and us.

Weeks of inventory at distributors measures how quickly our distributors sell the inventories that we sell to them. We recognize revenue on shipments to distributors when our distributors resell the products. Although our distributors in various regions of the world maintain different inventory stocking levels, globally we generally attempt to maintain between 10 and 13 weeks of inventories at our distributors. Both actual inventory levels and the weeks of inventory at distributors decreased sequentially in the quarter reflecting generally lower inventory levels held by our distributors versus their resale levels. Levels of inventory at distribution were relatively consistent with the December three month period a year ago.

Current ratio represents current assets divided by current liabilities and is commonly used to assess a company's liquidity. We use this ratio to make spending determinations on discretionary items. Our current ratio as of December 27, 2008 was 1.5 a decrease from 2.0 as of December 29, 2007. This decrease is primarily due to a decrease in cash which was used for working capital needs and the reclassification of our ARPS from cash and cash equivalents to long-term investments.

Three Months Ended December 27, 2008 Compared to Three Months Ended December 29, 2007

Net Sales. Net sales were $13.0 million for the quarter ended December 27, 2008, a decrease of 23 percent as compared to net sales of $17.0 million for the quarter ended December 29, 2007.

Net sales of our new products which include our 32-bit Zatara secured transactions microprocessors, universal remote control solutions and 8-bit embedded flash microcontrollers decreased 27 percent to $7.1 million for the three months ended December 27, 2008 compared to $9.8 million for the three months ended December 29, 2007. The decrease was in all three product groups although the decrease was more extensive in both our 32-bit Zatara product sales for the point of sale market and our remote control solutions. The lower product sales for our Zatara products primarily reflects lower demand from a key customer as it continues to reduce inventory levels and align to their end customer and market needs. Prior to the December quarter in fiscal 2009, this customer had been ramping its volume needs. Sales of universal remote control products ("UIR") declined significantly in the quarter both sequentially and year on year. The reduction in UIR sales was reflective of overall declines in consumer market demand by customers in both direct and distribution channels. Consumer market products were significantly impacted in the quarter by the general global market slowdown and the deterioration in end market consumption of products.

Net sales of our 8-bit classic products, consisting of our traditional Z8, Z80 and SCC products decreased by 19 percent to $5.9 million for the quarter ended December 27, 2008 as compared to $7.2 million for the quarter ended December 29, 2007. This decline reflects a reduction in demand for certain consumer, security and telecommunications applications and lower distribution resales into the broad based general purpose market including industrial market applications.

Compared to year ago levels, we are continuing to experience a reduction in sales reflecting the impact of the global economic crisis, especially as it relates to the sales of our consumer based products.

Gross Margin. Cost of sales primarily represents manufacturing costs relating to wafer fabrication, package assembly, product testing operations and logistics costs. Cost of sales fluctuates, depending on material and service prices from our vendors, manufacturing productivity, product mix, equipment utilization and depreciation. Gross margin was $4.8 million or 37 percent of sales for the quarter ended December 27, 2008 as compared to gross margin of $8.0 million or 47 percent for the quarter ended December 29, 2007. Gross margin as a percentage of sales was lower in the quarter than for the comparable quarter a year ago reflecting:

- lower sales of higher margin products,
- higher unfavorable manufacturing support variances driven by lower overall volumes, and
- a charge for inventory reserves recorded reflecting lower overall demand.

Research and Development Expenses. Research and development expenses were $3.7 million for the quarter ended December 27, 2008 which were lower than expenditures of $4.1 million for the quarter ended December 29, 2007. Research and development spending for the quarter ended December 27, 2008 reflects the benefit of lower program spending and cost reductions implemented in the quarter including payroll savings associated with operational shutdowns implemented in the quarter. Research and development activities continue to be focused on our three key market strategies that being universal remote control solutions, 32-bit secured transaction processors and 8-bit embedded flash microcontrollers.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased to $4.8 million for the quarter ended December 27, 2008 from $4.9 million for the quarter ended December 29, 2007. Sales and marketing expenses decreased slightly from the comparable fiscal quarter a year ago primarily reflecting lower payroll costs offset by higher marketing program costs associated new product introductions.

Special Charges and Credits. Special charges and credits for the periods indicated were as follows (unaudited, in thousands):

	Three Months Ende		Nine Months Ended	
	Dec. 27, 2008	**Dec. 29, 2007**	**Dec. 27, 2008**	**Dec. 29, 2007**
Restructuring of operations:				
Engineering consolidation severance and termination costs	$ -	$ 68	$ -	$ 951
MOD II maintenance and selling costs	-	-	-	248
Employee severance and other costs	1,210	259	1,717	647
Strategic review	261	-	261	-
Other	225	243	861	279
Reimbursement of retirement benefits - Philippines defined benefit plan	-	-	-	(661)
Total special charges and credits	$ 1,696	$ 570	$ 2,839	$ 1,464

For the three months ended December 27, 2008, special charges totaled $1.7 million including costs associated with our workforce reduction implemented in December, 2008 and January, 2009 of $1.2 million. Additionally, special charges includes the ongoing costs related to our strategic alternatives review of $0.3 million and manufacturing test operations outsource activities of $0.2 million. For the three months ended December 29, 2007, special charges totaled $0.6 million and primarily reflected severance and termination costs associated with the test outsource program which is substantially complete.

Amortization of Intangible Assets. Under the provisions of SFAS No. 142, “Goodwill and Other Intangible Assets”, goodwill and intangible assets with indefinite lives are not amortized, but are reviewed annually or more frequently if impairment indicators arise.

We performed our annual impairment test of goodwill and intangible assets during the quarter ended March 31, 2008. As of December 27, 2008, there was no indication of impairment of our intangible assets’ carrying value.

Separable intangible assets that are deemed to have defined lives have been recorded and continue to be amortized over their useful lives. These intangible assets are being amortized utilizing the pattern-of-use method over their estimated useful lives of six years for current technology and ten years for brand name.

The separable intangible assets identified in connection with fresh-start accounting and included in the unaudited condensed consolidated balance sheet are as follows (in thousands):

		Current Technology		Brand Name		Total
Gross carrying amount, recorded May 2002	$	16,959	$	9,243	$	26,202
Accumulated amortization		16,959		7,341		24,300
Book value at December 27, 2008	$	-	$	1,902	$	1,902

The anticipated remaining amortization schedule for these assets is as follows (unaudited, in thousands):

Fiscal Year		Brand Name
2009 - remaining 1 quarter	$	175
2010		680
2011		617
2012		430
Total	$	1,902

Interest and Other Income (Expense). Interest income relates to interest earned on our cash and cash equivalents included in our short-term investment portfolio and auction rate preferred securities. Cash equivalents are primarily invested in money market funds and high-grade commercial paper with maturities of 90 days or less. Interest income for the quarter ended December 27, 2008, was less than $0.1 million as compared to $0.2 million for the quarter ended December 29, 2007. The lower interest income in the quarter ended December 27, 2008 is due to lower average invested cash balances, significantly lower interest rates offered by the financial markets and a more conservative investment strategy given the continued uncertainty in the global money markets. During the quarter ended December 27, 2008, $0.1 million of other income primarily relates to foreign exchange gains. During the quarter ended December 29, 2007, $0.1 million of other expense primarily includes foreign currency losses.

Income Taxes. For the quarter ended December 27, 2008, our income tax provision reflects provisions for taxes in certain profitable foreign jurisdictions. For the quarter ended December 29, 2007, the income tax provision reflects the amortization of deferred charges and provisions for taxes in certain profitable foreign jurisdictions. The amortization of deferred charges is now complete and as such, no amortization charges were required to be recorded in the quarter ended December 27, 2008. We anticipate operating at a loss for U.S. tax purposes for the fiscal year ending March 31, 2009. We provide for income tax expense in foreign jurisdictions where the foreign subsidiaries' operations generate profits that are locally taxable.

Deferred tax assets have been recorded net of valuation allowances. A valuation allowance is required to be recorded if in management's judgment, and based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on available evidence, we have concluded that a valuation allowance is necessary and have reduced our net deferred tax assets to the extent of our deferred tax liabilities.

Nine Months Ended December 27, 2008 Compared to Nine Months Ended December 29, 2007

Net Sales. Net sales were $50.2 million for the nine months ended December 27, 2008, a decrease of 1 percent as compared to net sales of $50.5 million for the nine months ended December 29, 2007.

Net sales of our new products which include our 32-bit Zatara secured transactions microprocessors, universal remote control solutions and 8-bit embedded flash microcontrollers increased 12 percent to $30.2 million for the nine months ended December 27, 2008 compared to $27.0 million for the nine months ended December 29, 2007. This increase reflects an increase in our 32-bit Zatara product sales for the point of sale market, an increase in sales of our remote control solutions reflecting continued customer expansion and existing customer growth with new programs, including shipments of our new low power Crimzon™ products, partially offset by a decrease in our embedded flash sales.

Net sales of our 8-bit classic products, consisting of our traditional Z8, Z80 and SCC products decreased by 15 percent to $20.0 million for the nine months ended December 27, 2008, as compared to $23.5 million for the nine months ended December 29, 2007. This decline reflects a reduction in demand for certain consumer, security and telecommunications applications and lower distribution resales into the broad based general purpose market including industrial market applications.

Gross Margin. Cost of sales primarily represents manufacturing costs relating to wafer fabrication, package assembly, product testing operations and logistics costs. Cost of sales fluctuates, depending on material and service prices from our vendors, manufacturing productivity, product mix, equipment utilization and depreciation. Gross margin was $22.2 million or 44 percent of net sales for the nine months ended December 27, 2008, compared to gross margin of $23.1 million or 46 percent for the nine months ended December 29, 2007. During the nine months ended December 27, 2008, our gross margin decreased as compared to the comparable period a year ago reflecting:

- lower sales of higher margin product,
- higher unfavorable manufacturing support variances driven by lower overall volumes, and
- a charge for inventory reserves recorded reflecting lower demand on certain products.

Research and Development Expenses. Research and development expenses were $11.6 million for the nine months ended December 27, 2008 which were lower than the expenditures of $12.6 million for the nine months ended December 29, 2007. Research and development spending for the nine months ended December 27, 2008 reflects the benefit of lower program spending and cost reductions implemented during the quarter including payroll savings associated with operational shutdowns. Research and development activities continue to be focused on our three key market strategies that being universal remote control solutions, 32-bit secured transaction processors and 8-bit embedded flash microcontrollers.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased to $16.3 million for the nine months ended December 27, 2008 as compared to $15.0 million for the nine months ended December 29, 2007. The increase in our selling, general and administrative spending reflects higher professional service costs associated with our shareholder proxy matters and patent litigation activities. Additionally, S,G&A expenses were higher for the nine months ended December 27, 2008 reflecting expenses associated with the fiscal 2009 first half results for the employee incentive compensation plans.

Special Charges and Credits. Specials charges and credits totaled $2.8 million for the nine months ended December 27, 2008 as compared to $1.5 million for the nine months ended December 29, 2007. The 2008 charges included costs and expenses of $1.2 million associated with our worldwide workforce reduction initiated and implemented in December 2008 and January 2009. Additionally, special charges included costs related to our strategic alternatives review of $0.3 million and $0.9 million of continued costs related to our manufacturing test operations outsource which were substantially complete at December 27, 2008. The 2007 charges included $1.0 million related to the consolidation of worldwide engineering activities and costs related to our test outsource activity. Additionally, 2007 included $0.2 million for the MOD II facility held for sale consisting of associated maintenance and selling costs of that site in Nampa, Idaho. This was offset by a $0.7 million refund received from our Philippines defined benefit plan as the plan was in an overfunded position.

Interest Income and Expense. Interest income relates to interest earned on our cash and cash equivalents. Cash equivalents are primarily invested in a mixture of treasury backed securities, money market funds and high-grade commercial paper with maturities of 90 days or less. Interest income for the nine months ended December 27, 2008 was $0.1 million as compared to $0.7 million for the nine months ended December 29, 2007. The lower interest income is the result of a lower cash balance as well as the investment in treasury guaranteed short term investments yielding significantly lower interest rates. During 2008, with the anomalies in the financial market and the uncertainty caused by tightening of liquidity requirements, including the failure of the ARPS, we moved a considerable amount of our cash and cash equivalents to government guaranteed securities to ensure availability and security. Other income was $0.5 million income for the nine months ended December 27, 2008 as compared to $0.2 million expense for the nine months ended December 29, 2007. The income in 2008 primarily reflects currency exchange gains on the strengthening US dollar versus the currencies of India and the Philippines. This was the inverse in 2007 which created currency losses.

Income Taxes. For the nine months ended December 27, 2008 and December 29, 2007 our income tax provisions were $0.3 million and $1.2 million, respectively. For the nine months ended December 27, 2008, our income tax provision reflects the provisions for taxes in certain profitable foreign jurisdictions. For the nine months ended December 29, 2007, our income tax provision reflects the amortization of deferred charges, provisions for taxes in certain profitable foreign jurisdictions and the release of a 2003 tax reserve on which the statue of limitation expired during the quarter ended September 29, 2007. We estimate operating at a cumulative loss for U.S. tax purposes for fiscal 2009. We provide for income tax expense in foreign jurisdictions where the specific foreign subsidiaries operations generate profits that are taxable.

Deferred tax assets have been recorded net of valuation allowances. A valuation allowance is required to be recorded if in management's judgment, and based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on available evidence, we have concluded that a valuation allowance is necessary and have reduced our net deferred tax assets to the extent of our deferred tax liabilities.

Liquidity and Capital Resources

As of December 27, 2008, we had $0.7 million of bank borrowings outstanding primarily reflecting borrowings under a short term bank arrangement utilized to finance a three-year license agreement for engineering development software. As of December 29, 2007, we had no debt or bank borrowings outstanding. Additionally, in April 2008, we entered into a three-year agreement to license certain technologies to further develop our 32-bit ARM core based technology. The total cost of this agreement was $2.4 million and the unpaid portion of $2.0 million has been included in short and long-term liabilities on our consolidated condensed balance sheet as of December 27, 2008.

We had $0.3 million in standby letters of credit as of December 27, 2008 and as of December 29, 2007 related to the lease for our corporate headquarters facility in San Jose, California.

At December 27, 2008, we had cash and cash equivalents of $13.6 million and compares to $16.6 million as at March 31, 2008. We classified $1.3 million of our Auction Rate Preferred Securities ("ARPS") as long-term investments as of December 27, 2008. Due to the continued disruption in the credit markets that resulted in widespread failed auctions issuers have continued to periodically redeem these previously issued ARPS on an unscheduled basis. The failed auctions resulted in a loss of liquidity for sellers but did not constitute a default by the issuer of the underlying security.

We adopted SFAS No. 157 (SFAS 157), "Fair Value Measurements," on April 1, 2008. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad categories for disclosure to show the extent and level of judgment used to estimate fair value measurements. In determining fair value, we use various valuation techniques, including market and income approaches to value available-for-sale investments. The availability of observable inputs can vary from instrument to instrument and to the extent that valuation is based on inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. The degree of judgment exercised by our management in determining fair value is greatest for instruments categorized in Level 3. All of our ARPS have AAA credit ratings, are 100% collateralized and continue to pay interest in accordance with their contractual terms. The issuers reported collateralized asset value ranges which exceed the value of ARPS held by us by 200 to 300 percent. Accordingly, our remaining ARPS balance of $1.3 million has been categorized as Level 2 for fair value measurement and has been recorded at full par value on our consolidated balance sheet as of December 27, 2008. We believe the ARPS values are not impaired and as such, no impairment has been recognized against the investment. If the investment bankers are unable to successfully close future auctions and their credit rating continues to deteriorate, we may be required to record an impairment charge against the value of our ARPS investments.

We believe that existing cash, cash equivalents and investments, together with any cash generated from operations will be sufficient to meet normal operating requirements including capital expenditures for the next twelve months.

Cash Flows From Operating Activities. During the nine months ended December 27, 2008, net cash used by operating activities was $3.3 million compared to $3.7 million net cash used in operating activities during the nine months ended December 29, 2007. This $0.4 million improvement primarily reflects improvement in working capital items through reduction of inventory levels and decrease in accounts receivable, offset by changes in other assets and liabilities including the reduction in non-cash deferred charges that were amortized in fiscal 2008.

Cash Flows From Investing Activities. During the nine months ended December 27, 2008, net cash provided by investing activities was less than $0.1 million, a decrease of $2.1 million from $2.2 million during the nine months ended December 29, 2007. Cash provided by investing activities in the nine months ended December 27, 2008 includes $0.6 million of redemptions of our investment in ARPS classified as long term investments, partially offset by $0.5 million of computer software and hardware related capital expenditures. Cash provided by investing activities in the nine months ended December 29, 2007 included the sale of our MOD II facility for a gross sales price of $3.2 million offset by the purchase of $1.0 million of capital expenditures primarily related to our headquarter facility relocation.

Cash Flows From Financing Activities. During each of the nine month periods ended December 27, 2008 and December 29, 2007, $0.1 million and $0.2 million in net cash were provided by financing activities, respectively. During the nine months ended December 27, 2008, our financing activities included the receipt of cash under our short term financing arrangement of $0.7 million offset by payments of $0.7 million and $0.1 million from proceeds from the issuance of common stock under employee stock purchase and stock option plans. During the nine months ended December 29, 2007, $0.4 million of cash was provided by proceeds from the issuance of common stock under employee stock option and stock purchase plans.

Contractual Obligations. We lease certain of our facilities and equipment under non-cancelable operating leases, which expire in fiscal 2009 through fiscal 2014. These facility lease agreements generally provide for base rental rates, which may increase at various times during the terms of the leases and also provide for renewal options at fair market rental value. We are also responsible for common area maintenance charges on certain office leases, which are not included in the table below. These charges are generally less than 10% of base rents.

		Payment due by period (unaudited, in thousands)			
	Total	Within 1 year	1-3 years	3-5 years	Greater than 5 years
Operation lease obligations	$ 5,022	$ 1,592	$ 2,601	$ 827	$ 2
Purchase obligations	5,516	4,049	1,455	12	-
Total	$ 10,538	$ 5,641	$ 4,056	$ 839	$ 2

We generally make purchases under cancelable purchase orders and do not enter into long-term supply agreements. Certain of our wafer foundry, assembly, materials suppliers, software vendors and support tool manufacturers require non-cancelable purchase orders since they often provide products and services tailored to our specifications.

On September 24, 2008, we renewed the lease of our global support facility in the Philippines. The lease extension period is through March 31, 2012 with total lease payment commitments of $1.8 million. We have further options to extend this lease at its expiration in 2012.

From time to time, we have agreed to indemnify and hold harmless certain customers for potential allegations of infringement of intellectual property rights and patents arising from the use of our products. During the ordinary course of business, in certain limited circumstances, we have agreed to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally parties with which we have commercial relations, in connection with certain intellectual property infringement claims by any third party with respect to its products and services. We have indemnification arrangements that limit our net contingent obligation to pay for defense costs, if any, up to a maximum of $2.5 million. To date, there have not been any costs incurred in connection with such indemnification arrangements; therefore, there is no accrual of such amounts at December 27, 2008. We disclose indemnification liabilities according to FASB Staff Position FIN45-1, "Accounting for Intellectual Property Infringement Indemnifications under FAS Interpretation No. 45." Under FAS No. 5, "Loss Contingencies," a claim would be accrued when a loss is probable and the amount can be reasonably estimated. At December 27, 2008, no such amounts have been accrued.

Off-Balance Sheet Arrangements

As of December 27, 2008, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a) (4) (ii) of SEC Regulation S-K

Seasonality

Sales typically increase in the June quarter and peak in the September quarter driven by increased holiday demand from our customers in the home entertainment and consumer products markets. Our sales are generally lower in the March and December quarters as compared to the June and September quarters, although our trends have fluctuated considerably in the most recent periods. Our sales have been impacted by non-seasonal trends including sales reductions by certain direct customers and declines in our classic business As evidenced most recently, our results have been negatively impacted by the global economic decline including the worldwide financial crisis. In general world-wide economic, political and regional instabilities may impact our results of operations in any given period.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our short-term investment portfolio. We do not use derivative financial investments in our investment portfolio. Our primary investment objectives are to preserve capital and maintain liquidity. These objectives are met by investing in high-quality credit issuances and limiting the amount of credit exposure to any one company. Our policy is to mitigate default risk by investing in only the highest quality securities and monitoring the credit ratings of such investments.

As of December 27, 2008, our cash and cash equivalents of $13.6 million were invested in treasury guaranteed bank time deposits as well as money market funds. Cash and cash equivalents were $16.6 million at March 31,2008. Cash and cash equivalents consist primarily of cash in bank accounts and money market accounts, which are readily convertible to cash and have maturities of three months or less at the time of acquisition.

In February 2008, tightening of the U.S. liquidity markets caused the auction rate process to default and our Auction Rate Preferred Securities (“ARPS”) could not be successfully sold. At that time, we had $3.9 million invested in ARPS. Subsequently, we have received cash proceeds from the redemption at par of $2.6 million of our ARPS. As of December 27, 2008 our remaining investment in ARPS of $1.3 million has been classified as long-term investments at full par value on our consolidated balance sheet.

We entered into a short term financing agreement with borrowings that bear interest at a rate per annum equal, at the Company’s option, to the Lender’s stated prime rate or LIBOR, plus 1.75% which was 2.25% at December 27, 2008. Our borrowing rate will fluctuate based on changes in the prime or LIBOR rates.

Foreign Currency Exchange Risk.

We transact business in various foreign countries of which a significant portion of our consolidated net sales and purchases are denominated in U.S. dollars. Currently, we do not employ a foreign currency hedging program to mitigate our foreign currency exchange risk as we believe the risks to date have not been significant or economically viable to conduct such activities. We maintain local currency bank accounts in our international offices to facilitate payment of local operating costs.

Item 4. Controls and Procedures.

(a) Disclosure Controls and Procedures. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of December 27, 2008. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of December 27, 2008, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act and are effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Internal Control Over Financial Reporting. There have been no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended December 27, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

On August 11, 2005, Microchip Technology, Inc. (“Microchip”) filed a patent infringement claim against us in the U.S. District Court of Arizona (case number CV05-2406-PHX-MHM). Microchip alleges that we have infringed, and currently infringe, its patents numbered 5,847,450, 6,696,316 and 6,483,183. Microchip claims that unspecified products of ours, including the Z8 Encore! XP 4K Series of products, infringe these patents and is seeking preliminary and permanent injunctive relief, unspecified damages and costs, including attorneys’ fees. We filed a response to the claims on September 15, 2005 generally denying the claims and challenging the validity of the patents. On January 10, 2006, we filed a request for patent re-examination with the U.S. PTO, which was granted in February and March 2006 for all 3 patents. On April 11, 2008, we received a notice that all of Microchip’s claims under these three patents have been rejected by the U.S. PTO. Notwithstanding this favorable ruling, because Microchip has a right to appeal the patent office’s decision, we do not believe it is feasible to predict or determine the outcome or resolution of this litigation at this time. We believe we have meritorious defenses and will defend ourselves vigorously against these claims. We may incur substantial expenses in our defense against these claims. In the event of a determination adverse to us, we may incur substantial monetary liabilities and be required to change our business practices. Either of these could have a material adverse effect on our financial position, results of operations and/or cash flows.

On December 1, 2006, we filed a patent infringement claim against Altera Corporation (“Altera”) and Actel Corporation (“Actel”) in the U.S. District Court of California (civil docket number 4:06-cv-07388-SBA). We allege that Altera and Actel have infringed, and currently infringe, our patent numbered 4,670,749 which we believe to be the fundamental patent for programmable logic. We claim that Altera’s and Actel’s products infringe these patents and are seeking unspecified damages and costs, including attorneys’ fees. Actel settled their case with us on June 11, 2007 for an undisclosed amount. The case against Altera is currently on stay pending reexamination of the patent in suit.

On May 23, 2008, Altera filed a patent infringement claim against us in the U.S. District Court of Texas (civil action number 2:08-CV-218). Altera alleges that we have infringed, and currently infringe, its patents numbered 6,097,211, 6,147,511 and 6,314,550. Altera claims that unspecified products of ours, including our eZ80 and Zneo series of products, infringe these patents and is seeking preliminary and permanent injunctive relief, unspecified damages and costs, including attorneys’ fees.

We do not believe it is feasible to predict or determine the outcome or resolution of this litigation at this time. We may incur substantial expenses in our defense against these claims. In the event of a determination adverse to us, we may incur substantial monetary liabilities, and be required to change our business practices. Either of these could have a material adverse effect on our financial position, results of operations and/or cash flows.

We are participating in other litigation and responding to claims arising in the ordinary course of business. We intend to defend ourselves vigorously in these other matters. Our management believes that it is unlikely that the outcome of these other matters will have a material adverse effect on our consolidated financial statements, although there can be no assurance in this regard.

Item 1A. Risk Factors

Risk Factors.

In addition to the other information set forth in this report, you should consider the risk factors discussed in Part I “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended March 31, 2008, which could materially affect our business, financial condition or future results. The risk factors in our Form 10-K have not materially changed. The risk factors described in our Form 10-K, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial conditions and/or operating results.

Our business may be negatively impacted by the volatility and disruption of the capital and credit markets, and adverse changes in the global economy.

Current uncertainty in global economic conditions poses a risk to the overall economy as consumers and businesses may defer purchases in response to restricted access to credit and negative financial news, which could negatively affect product demand and other related matters. Consequently, demand could be different from our expectations due to factors including changes in business and economic conditions; conditions in the credit market that could affect consumer confidence; customer acceptance of our and our competitors' products; changes in customer order patterns including order cancellations; and changes in the level of our customers' inventory. Credit market conditions also may slow our collection efforts as customers experience increased difficulty in obtaining requisite financing, leading to higher than normal accounts receivable. This could result in greater expense associated with collection efforts and increased bad debt expense. In addition, credit conditions may impair our vendors' ability to finance the portion of raw materials or general working capital needs to support our production requirements, resulting in a delay or non-delivery of inventory shipments.

Our ability to find investments that are both safe and liquid and that provide a reasonable return may be impaired. This could result in lower interest income, longer investment terms and/or higher impairments.

Additionally, the inability of our customers or distributors to access capital efficiently could cause disruptions in their businesses, thereby negatively impacting ours. For example, if our customers or distributors do not have sufficient liquidity, they could reduce or limit new purchases, which could result in lower demand for our products and/or we may be at risk for any trade credit we have extended to them, due to their inability to repay us. This risk may increase if there is a general economic downturn affecting significant customers or a large number of our other customers and they are not able to adequately manage their business risks or do not properly disclose their financial condition to us.

We have implemented measures to consolidate our activities and/or significantly reduce our costs, and we may be required to implement additional measures depending upon our future revenues and operating results.

In the past, we have implemented measures designed to consolidate our activities and/or reduce our costs, including during the four years ended March 31, 2008 and for the nine months ended December 27, 2008. These cost reduction efforts have included:

- transferring our production test operations currently performed in our Philippines facility to third party suppliers;

- consolidation of our research and development activities including the closure of design and development sites in Shanghai, China and Seattle, Washington;

- restructuring our manufacturing operations, which has included closing and subsequently outsourcing all of our wafer fabrication and assembly operations and consolidating probe and final test operations, as well as certain customer service and accounting functions at our Philippines site;

- refocusing our strategic priorities;
- reallocating personnel and responsibilities to better utilize human resources;
- reducing our workforce; and
- instituting temporary office and facility shutdowns.

In light of the slowing global economy we expect lower revenues and may be required to cut costs to preserve our cash and attain cash flow break even. Cost reduction measures may not increase our efficiency, lead to profitability or result in the cash savings anticipated. In the past, we have reduced our spending on research and development. Reducing research and development spending could harm our ability to introduce new products in the future. If we reduce our sales staff it could also result in lower revenue. If our revenue or operating results significantly decline in the future, we may be required to institute further cost reduction measures.

From time to time, we evaluate our strategic alternatives with respect to our cost structure and business alternatives. We may be required take actions which may result in the occurrence of accounting charges. Some or all of these charges may be non-cash. Such charges would have a negative impact on our GAAP profitability and may have a negative impact on our cash balance.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None

Item 4. Submission of Matters to a Vote of Security Holders.

None

Item 5. Other Information.

None.

Item 6. Exhibits.

a) Exhibits are filed or incorporated herein by reference as indicated below:

Exhibit Number	Description
3.1 (a)	Amended and Restated Certificate of Incorporation of ZiLOG, Inc., as amended and corrected.
3.2 (b)	Amended and Restated Bylaws of ZiLOG, Inc.
3.3 (c)	Amendment to Amended and Restated Bylaws of ZiLOG, Inc.
31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated February 10, 2009.
31.2	Certifications of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated February 10, 2009.
32	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated November 11, 2008.

(a) Incorporated herein by reference to the item of the same name filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

(b) Incorporated herein by reference to Exhibit 3.1 to the Company’s Current Report on Form 8-K filed with the Commission on November 21, 2007.

(c) Incorporated herein by reference to Exhibit 3.3 to the Company’s Quarterly Report on Form 10-Q for the quarter ended June 26, 2008 (filed August 12, 2008).

ZiLOG, Inc.

SIGNATURES

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

ZiLOG, Inc.
(Registrant)

/s/ Perry J. Grace
Perry J. Grace
Executive Vice President and Chief Financial Officer
(Duly Authorized Officer)

/s/ Darin G. Billerbeck
Darin G. Billerbeck
President, Chief Executive Officer and Director
(Duly Authorized Officer)

Date: February 10, 2009