Comstock Homebuilding Companies, Inc.
Form 10-Q
August 09, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2007

¨ **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 1-32375

Comstock Homebuilding Companies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**20-1164345**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

11465 Sunset Hills Road

5th Floor

Reston, Virginia 20190

(703) 883-1700

(Address including zip code, and telephone number, including area code, of principal executive offices)

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

As of August 9, 2007, 13,798,678 shares of the Class A common stock, par value $.01 per share, and 2,733,500 shares of Class B common stock, par value $0.01, of the Registrant were outstanding.

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except per share data)

	June 30, 2007	December 31, 2006
ASSETS		
Cash and cash equivalents	$ 16,936	$ 21,263
Restricted cash	6,720	12,326
Receivables	2,974	4,555
Due from related parties	377	4,053
Real estate held for development and sale	330,038	405,144
Inventory not owned variable interest entities	35,458	43,234
Property, plant and equipment	2,322	2,723
Investment in real estate partnership		(171)
Deferred income tax	9,508	10,188
Other assets	18,351	14,114
TOTAL ASSETS	422,684	517,429
LIABILITIES AND SHAREHOLDERS EQUITY		
Accounts payable and accrued liabilities	35,913	55,680
Due to related parties	140	1,140
Obligations related to inventory not owned	33,524	40,950
Notes payable	200,140	265,403
Senior unsecured debt	30,000	30,000
TOTAL LIABILITIES	299,717	393,173
Commitments and contingencies (Note 12)		
Minority interest	363	371
SHAREHOLDERS EQUITY		
Class A common stock, $0.01 par value, 77,266,500 shares authorized, 14,961,779 and 14,129,081 issued and outstanding, respectively	150	141
Class B common stock, $0.01 par value, 2,733,500 shares authorized, 2,733,500 issued and outstanding	27	27
Additional paid-in capital	150,911	147,528
Treasury stock, at cost (391,400 Class A common stock)	(2,439)	(2,439)
(Accumulated deficit)	(26,045)	(21,372)
TOTAL SHAREHOLDERS EQUITY	122,604	123,885
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 422,684	$ 517,429

The accompanying notes are an integral part of these consolidated financial statements

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Revenues				
Revenue homebuilding	$ 110,313	$ 50,351	$ 153,338	$ 86,716
Revenue other	3,987	346	7,685	576
Total revenue	114,300	50,697	161,023	87,292
Expenses				
Cost of sales homebuilding	102,876	41,295	139,743	68,456
Cost of sales other	3,680	21	7,304	30
Impairments and write-offs	7,492	12,914	8,383	12,914
Selling, general and administrative	8,151	8,429	16,376	16,076
Operating loss	(7,899)	(11,962)	(10,783)	(10,184)
Other income, net	(302)	(355)	(646)	(587)
Loss before minority interest and equity in losses of real estate partnership	(7,597)	(11,607)	(10,137)	(9,597)
Minority interest	(3)	12	(5)	5
Loss before equity in losses of real estate partnership	(7,594)	(11,619)	(10,132)	(9,602)
Equity in losses of real estate partnership		(26)		(53)
Total pre tax loss	(7,594)	(11,645)	(10,132)	(9,655)
Income taxes benefit	(2,926)	(4,522)	(3,796)	(3,771)
Net loss	$ (4,668)	$ (7,123)	$ (6,336)	$ (5,884)
Basic loss per share	$ (0.29)	$ (0.47)	$ (0.40)	$ (0.41)
Basic weighted average shares outstanding	16,095	15,034	15,992	14,511
Diluted loss per share	$ (0.29)	$ (0.47)	$ (0.40)	$ (0.41)
Diluted weighted average shares outstanding	16,095	15,034	15,992	14,511

The accompanying notes are an integral part of these consolidated financial statements

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands, except per share data)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Cash flows from operating activities:		
Net loss	$ (6,336)	$ (5,884)
Adjustment to reconcile net loss income to net cash provided by (used in) operating activities		
Amortization and depreciation	446	259
Impairments and write-offs	8,383	12,914
Loss on disposal of assets	12	
Minority interest	(5)	5
Equity in losses of real estate partnership		53
Board of Directors compensation	99	
Amortization of stock compensation	1,167	1,546
Deferred income tax	1,149	(4,769)
Changes in operating assets and liabilities:		
Restricted cash	5,606	(2,357)
Receivables	1,581	5,620
Due from related parties	3,187	(482)
Real estate held for development and sale	70,160	(108,416)
Other assets	(2,693)	4,457
Accounts payable and accrued liabilities	(17,680)	(21,581)
Due to related parties	(1,000)	(1)
Net cash provided by (used in) operating activities	64,076	(118,636)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(57)	(1,236)
Business acquisitions, net of cash acquired		(15,491)
Net cash used in investing activities	(57)	(16,727)
Cash flows from financing activities:		
Proceeds from notes payable	61,157	160,798
Proceeds from senior unsecured debt	30,000	
Proceeds from junior subordinated debt		30,000
Payments on junior subordinated debt	(30,000)	
Payments on notes payable	(129,539)	(91,635)
Distributions paid to minority shareholders	(3)	(3)
Proceeds from shares issued under employee stock purchase plan	39	78
Purchase of treasury stock		(1,864)
Proceeds from equity offerings		18,561
Net cash (used in) provided by financing activities	(68,346)	115,935
Net decrease in cash and cash equivalents	(4,327)	(19,428)
Cash and cash equivalents, beginning of period	21,263	42,167
Cash and cash equivalents, end of period	$ 16,936	$ 22,739

Supplemental cash flow information:				
Interest paid (net of interest capitalized)	$		$	
Income taxes paid	$		$	40
Supplemental disclosure for non-cash activity:				
Interest incurred but not paid in cash	$	3,119	$	5,939

The accompanying notes are an integral part of these consolidated financial statements

COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

1. ORGANIZATION AND BASIS OF PRESENTATION

Comstock Companies, Inc. (the Company) was incorporated on May 24, 2004 as a Delaware corporation. On June 30, 2004, the Company changed its name to Comstock Homebuilding Companies, Inc.

On December 17, 2004, as a result of completing its initial public offering (IPO) of its Class A common stock, the Company acquired 100% of the outstanding capital stock of Comstock Holding Company, Inc. and subsidiaries (Comstock Holdings) by merger, which followed a consolidation that took place immediately prior to the closing of the IPO (the Consolidation). The Consolidation was effected through the mergers of Sunset Investment Corp., Inc. and subsidiaries and Comstock Homes, Inc. and subsidiaries and Comstock Service Corp., Inc. and subsidiaries (Comstock Service) with and into Comstock Holdings. Pursuant to the terms of the merger agreement, shares of Comstock Holdings were canceled and replaced by 4,333 and 2,734 shares Class A and B common stock of the Company, respectively. Both Class A and B common stock shares bear the same economic rights. However, for voting purposes, Class A stock holders are entitled to one vote for each share held while Class B stock holders are entitled to fifteen votes for each share held.

The mergers of Sunset Investment Corp., Inc. and subsidiaries and Comstock Homes, Inc. and subsidiaries with and into Comstock Holdings (collectively the Comstock Companies or Predecessor) and the Company s acquisition of Comstock Holdings was accounted for using the Comstock Companies historical carrying values of accounting as these mergers were not deemed to be substantive exchanges. The merger of Comstock Service was accounted for using the purchase method of accounting as this was deemed to be a substantive exchange due to the disparity in ownership.

Our Class A common stock is traded on the NASDAQ National market under the symbol CHCI. We have no public trading history prior to December 17, 2004.

The Company develops, builds and markets single-family homes, townhouses and condominiums in the Washington D.C., Raleigh, North Carolina and Atlanta, Georgia metropolitan markets. The Company also provides certain management and administrative support services to certain related parties.

The interim financial statements of the Company included herein have not been audited by an independent registered public accounting firm. The statements include all adjustments, including normal recurring accruals, which management considers necessary for a fair presentation of the financial position and operating results of the Company for the periods presented. The statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in conformity with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The operating results for interim periods are not necessarily indicative of results to be expected for an entire year.

For further information, refer to the financial statements of the Company and footnotes thereto included in the annual report on Form 10-K and Form 10-K/A of the Company for the year ended December 31, 2006.

2. REAL ESTATE HELD FOR DEVELOPMENT AND SALE

Real estate held for development and sale includes land, land development costs, interest and other construction costs and is stated at cost or, when circumstances or events indicate that the real estate held for development or sale is impaired, at estimated fair value. Land, land development and indirect land development costs are accumulated by specific project and allocated to various lots or housing units within that project using specific identification and allocation based upon the relative sales value, unit or area methods. Direct construction costs are assigned to housing units based on specific identification. Construction costs primarily include direct construction costs and capitalized field overhead. Other costs are comprised of prepaid local government fees and capitalized interest and real estate taxes. Selling costs are expensed as incurred.

Estimated fair value is based on comparable sales of real estate in the normal course of business under existing and anticipated market conditions. The evaluation takes into consideration the current status of the property, various restrictions, carrying costs, costs of disposition and any other circumstances, which may affect fair value including management s plans for the property. Due to the large acreage of certain land holdings, disposition in the normal course of business is expected to extend over a number of years. A write-down to estimated fair value is recorded when the net carrying value of the property exceeds its estimated discounted fair value. These evaluations are made on a property- by-property basis as seen fit by management whenever events or changes in circumstances indicate that the net book value may not be recoverable.

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

During the second quarter of 2007, the Company experienced downward pressure on gross margins as a result of lower sales volume, reduced sales prices, increased customer concessions and extended estimates for project completion dates. As a result, the Company evaluated several projects to determine if recorded carrying amounts were recoverable. This evaluation resulted in an aggregate impairment charge of $7,350 at six projects, with $4,942 in the D.C. region, $2,296 in the Atlanta region and $112 in the North Carolina region. The impairment charge was calculated using a discounted cash flow analysis model, which is dependent on several subjective factors, including the selection of an appropriate discount rate, estimated average sales prices and estimated sales rates. The estimates used by the Company are based on the best information available at the time the estimates are made. Adverse changes to these estimates in future periods could result in additional material impairment amounts to be recorded. The following table summarizes impairment charges and write-offs for the three and six months ended June 30, 2007 and 2006:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Impairments	$ 7,350	$ 9,550	$ 7,350	$ 9,550
Write-offs	142	3,364	1,033	3,364
Total	$ 7,492	$ 12,914	$ 8,383	$ 12,914

Real estate held for development and sale consists of the following:

	June 30, 2007	December 31, 2006
Land and land development costs	$ 160,612	$ 232,693
Cost of construction (including capitalized interest and real estate taxes)	169,426	172,451
	$ 330,038	$ 405,144

3. CONSOLIDATION OF VARIABLE INTEREST ENTITIES

The Company typically acquires land for development at market prices from various entities under fixed price purchase agreements. The purchase agreements require deposits that may be forfeited if the Company fails to perform under the agreements. The deposits required under the purchase agreements are in the form of cash or letters of credit in varying amounts. The Company may, at its option, choose for any reason and at any time not to perform under these purchase agreements by delivering notice of its intent not to acquire the land under contract. The Company s sole legal obligation and economic loss for failure to perform under these purchase agreements is typically limited to the amount of the deposit pursuant to the liquidated damages provision contained within the purchase agreement. As a result, none of the creditors of any of the entities with which the Company enters into forward fixed price purchase agreements have recourse to the general credit of the Company.

The Company also does not share in an allocation of either the profit earned or loss incurred by any of these entities with which the Company has fixed price purchase agreements. The Company has concluded that whenever it options land or lots from an entity and pays a significant non-refundable deposit as described above, a variable interest entity is created under the provisions of Financial Accounting Standards Board (FASB) issued Interpretation No. 46, Consolidation of Variable Interest Entities, or FIN 46. This is because the Company has been deemed to have provided subordinated financial support, which creates a variable interest which limits the equity holder s returns and may absorb some or all of an entity s expected theoretical losses if they occur. The Company, therefore, examines the entities with which it has fixed price purchase agreements for possible consolidation by the Company under FIN 46-R. This requires the Company to compute expected losses and expected residual returns based on the probability of future cash flows as outlined in FIN 46-R. This calculation requires substantial management judgments and estimates. In addition, because the Company does not have any contractual or ownership interests in the entities with which it contracts to buy the land, the Company does not have the ability to compel these development entities to provide financial or other data to assist the Company in the performance of the primary beneficiary evaluation.

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

The Company has evaluated all of its fixed price purchase agreements and has determined that it is the primary beneficiary of some of those entities. As a result, at June 30, 2007, the Company consolidated four entities in the accompanying consolidated balance sheets. The effect of the consolidation at June 30, 2007 was the inclusion of $35,458 in Inventory not owned-variable interest entities with a corresponding inclusion of $33,524 (net of land deposits paid of $1,934) to Obligations related to inventory not owned. At December 31, 2006 the Company had consolidated nine entities in the accompanying consolidated balance sheets. The effect of the consolidation at December 31, 2006 was the inclusion of $43,234 in Inventory not owned-variable interest entities with a corresponding inclusion of $40,950 (net of land deposits paid of $2,284) to Obligations related to inventory not owned. Creditors, if any, of these variable interest entities have no recourse against the Company.

During December 2006 a Company senior vice president voluntarily resigned. As part of his voluntary resignation, the former senior vice president negotiated his purchase of the remaining 30 condominium units in the Company s Countryside development for a purchase price of $4,200. Simultaneously with the purchase, the Company entered into a marketing and sale agreement with the special purpose entity created by the former senior vice president that purchased the units (SPE), whereby the Company would bear the cost associated with marketing and selling the units and pay the SPE a monthly option payment that allows the Company to share in the revenue of the units as they settle. The monthly option payments have created a variable interest in the SPE, and as such the Company has performed an analysis under the provisions of FIN46(R) and has determined that the entity is a variable interest entity and the Company is the primary beneficiary of this entity. As a result, the Company has consolidated the SPE. At December 31, 2006 the SPE had $3,600 of assets, which are included in Inventory not owned-variable interest entities and $3,600 of third party debt, which is included in Obligations related to inventory not owned in the accompanying consolidated balance sheets. At June 30, 2007 substantially all of the assets of the SPE were sold and substantially all of the debt had been extinguished. Therefore, none of the remaining assets or debt is included in the accompanying June 30, 2007 consolidated balance sheet. The third party lender does not have recourse against the Company as the debt is collateralized by the units purchased by the SPE.

4. WARRANTY RESERVE

Warranty reserves for houses sold are established to cover potential costs for materials and labor with regard to warranty-type claims expected to arise during the one-year warranty period provided by the Company or within the five-year statutorily mandated structural warranty period. Since the Company subcontracts its homebuilding work, subcontractors are required to provide the Company with an indemnity and a certificate of insurance prior to receiving payments for their work. Claims relating to workmanship and materials are generally the primary responsibility of the subcontractors and product manufacturers. The warranty reserve is established at the time of closing, and is calculated based upon historical warranty cost experience and current business factors. Variables used in the calculation of the reserve, as well as the adequacy of the reserve based on the number of homes still under warranty, are reviewed on a periodic basis. Warranty claims are charged directly to the reserve as they arise. The following table is a summary of warranty reserve activity, which is included in accounts payable and accrued liabilities for the three and six months ended June 30, 2007 and 2006:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Balance at beginning of period	$ 1,692	$ 1,310	$ 1,669	$ 1,206
Additions	346	514	577	814
Releases and/or charges incurred	(329)	(267)	(537)	(463)
Balance at end of period	$ 1,709	$ 1,557	$ 1,709	$ 1,557

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

5. CAPITALIZED INTEREST AND REAL ESTATE TAXES

Interest and real estate taxes incurred relating to the development of lots and parcels are capitalized to real estate held for development and sale during the active development period, which generally commences when borrowings are used to acquire real estate assets and ends when the properties are substantially complete. Interest is capitalized based on the interest rate applicable to specific borrowings or the weighted average of the rates applicable to other borrowings during the period. Interest and real estate taxes capitalized to real estate held for development and sale are expensed as a component of cost of sales as related units are sold. The following table is a summary of interest incurred and capitalized:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Total interest incurred	$ 7,412	$ 6,844	$ 13,842	$ 11,612
Interest incurred on related party notes payable		20		40
Interest expensed as a component of cost of sales	$ (8,557)	$ (1,567)	$ (12,571)	$ (2,363)

6. LOSS PER SHARE

The following weighted average shares and share equivalents, using the treasury stock method, are used to calculate basic and diluted loss per share for the three and six months ended June 30, 2007 and 2006:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Basic loss per share				
Net loss	$ (4,668)	$ (7,123)	$ (6,336)	$ (5,884)
Basic weighted-average shares outstanding	16,095	15,034	15,992	14,511
Per share amounts	$ (0.29)	$ (0.47)	$ (0.40)	$ (0.41)
Dilutive loss per share				
Net loss	$ (4,668)	$ (7,123)	$ (6,336)	$ (5,884)
Basic weighted-average shares outstanding	16,095	15,034	15,992	14,511
Stock options and restricted stock grants				
Dilutive weighted-average shares outstanding	16,095	15,034	15,992	14,511

Per share amounts	$ (0.29)	$ (0.47)	$ (0.40)	$ (0.41)

During the three and six months ended June 30, 2007, 110,089 and 215,733 shares were excluded from the diluted shares outstanding because inclusion would have been anti-dilutive. During the three and six months ended June 30, 2006, 92,279 and 92,209 shares were excluded from the diluted shares outstanding because inclusion would have been anti-dilutive.

Comprehensive income

For the three and six months ended June 30, 2007 and 2006, comprehensive income equaled net income; therefore, a separate statement of comprehensive income is not included in the accompanying consolidated financial statements.

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

7. INVESTMENT IN REAL ESTATE PARTNERSHIPS

In 2001, prior to the Company s acquisition of Comstock Service in December of 2004, Comstock Service had invested $41 in North Shore Investors, LLC (North Shore) for a 50% ownership interest. North Shore was formed to acquire and develop residential lots and construct single family and townhouse units. In 2002, as a result of recognizing its share of net losses incurred by North Shore, Comstock Service reduced its investment in North Shore to $0. The Company, as part of the acquisition of Comstock Service, recorded this investment in North Shore at $0.

On June 28, 2005 the Company received a capital call from North Shore in the amount of $719 so that North Shore could comply with certain debt repayments. Because the Company may have been obligated to provide future financial support to cover certain debt repayments, the Company continued recording its share of losses incurred by North Shore through December 31, 2006 in the amount of ($171).

During the third quarter of 2005, the Company, as manager of an affiliated entity, exercised its option rights to purchase the project acquisition, development and construction loan made for the benefit of North Shore. The Company finalized the purchase of the loans on or about September 8, 2005 and issued a notice of default under the acquisition and development loan at maturity on September 30, 2005. The Company then filed suit for collection of the loans against one of the individual guarantors under the loan on or about October 21, 2005 and initiated foreclosure proceedings on or about November 18, 2005. On or about December 22, 2005, the individual guarantor subject to the earlier suit filed a countersuit against two of the officers of the Company who were also individual guarantors under the acquisition and development loan. The Company has agreed to indemnify these officers.

The Company, as manager of an affiliated entity, set and held a foreclosure sale on March 24, 2006 in which it was the highest bidder. However, transfer of title to the property was delayed pending judicial resolution of a suit filed on March 24, 2006 by the non-affiliated 50% owner of North Shore. On June 30, 2006, the Company, on its own behalf and on behalf of affiliates, filed an additional lawsuit expanding the number of party defendants, demanding equitable relief and demanding $33,000 in damages.

On April 10, 2007, the parties executed a settlement agreement whereby a company associated with the non-affiliated 50% owner of the North Shore project purchased the Company s development rights to North Shore for approximately $3,750 to settle all claims against the Company and its investors. All litigation has been dismissed with prejudice and the Company received the proceeds from the settlement in April 2007. As a result of the settlement, the three months ended March 31, 2007, the Company recorded a charge of approximately $357 to write off its investment in North Shore and reduce amounts due from North Shore to the net realizable value. During the three months ended June 30, 2007, additional costs of $132 related to the North Shore settlement were incurred and written off. These charges are included in the accompanying consolidated statements of operations as a component of impairments and write-offs. No additional costs related to the North Shore settlement are expected to be incurred.

COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

8. ACQUISITIONS

On January 19, 2006, the Company acquired all of the issued and outstanding capital stock of Parker Chandler Homes, Inc., a homebuilder in the Atlanta, Georgia metropolitan market, for a cash purchase price of $10,400 (including transaction costs) and the assumption of $63,800 in liabilities. The results of Parker Chandler Homes are included in the accompanying financial statements from the period January 19, 2006 to June 30, 2007. The Company accounted for this transaction in accordance with Statement of Financial Accounting Standard No. 141, Business Combinations or SFAS 141. Approximately $700 of the purchase price was allocated to intangibles with a weighted average life of 4.6 years. The intangibles are related to the Parker Chandler trade name, employment and non-compete agreements entered into with certain selling shareholders. The remainder of the purchase price was allocated to real estate held for development and sale and land option agreements. There was no goodwill recorded.

On May 5, 2006, the Company acquired all of the issued and outstanding capital stock of Capitol Homes, Inc., a homebuilder in North Carolina, for a cash purchase price of $7,500 (including transaction costs) and the assumption of $20,600 in liabilities. The results of Capitol Homes are included in the accompanying consolidated financial statements from the period May 5, 2006 to June 30, 2007. The Company accounted for this transaction in accordance with SFAS 141. Approximately $251 of the purchase price was allocated to intangibles with a weighted average life of 2.7 years. The intangibles are related to the Capitol Homes trade name, employment and non-compete agreements entered into with certain selling shareholders. The remainder of the purchase price was allocated to real estate held for development for sale and land option agreements. There was no goodwill associated with the transaction.

Subsequent to each acquisition, as a result of the Company releasing the restrictive terms under the employment and non-complete agreements and the decision to no longer to use the respective trade names, all amounts assigned to intangibles were written off during the fourth quarter of 2006.

9. INCOME TAX

The Company s income tax (benefit) expense consists of the following as of:

	Three months ended June 30,		Six months ended June 30,	
	2007	**2006**	**2007**	**2006**
Current:				
Federal	$ (2,678)	$ 38	$ (4,168)	$ 840
State	(500)	8	(777)	158
Deferred:				
Federal	160	(3,856)	800	(4,026)
State	30	(712)	151	(743)
Other:				
Tax shortfall related to the vesting of certain equity awards	62		198	
Total income tax benefit	$ (2,926)	$ (4,522)	$ (3,796)	$ (3,771)

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Components of the Company s deferred tax assets and liabilities at June 30, 2007 and December 31, 2006 were as follows:

	June 30, 2007	December 31, 2006
Deferred Tax Assets:		
Inventory	$ 8,256	$ 9,642
Warranty	628	612
Investments in affiliates	25	25
Accrued expenses	370	1,213
Stock-based compensation	1,389	762
	10,668	12,254
Less valuation allowance		(470)
Net deferred tax assets	10,668	11,784
Deferred Tax Liabilities:		
Depreciation and amortization	(1,160)	(1,596)
Net deferred tax liabilities	(1,160)	(1,596)
Net deferred tax assets	$ 9,508	$ 10,188

In June 2006, the Financial Accounting Standards Board issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes,* and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return.

Prior to the adoption of FIN 48, the Company provided for contingencies related to income taxes in accordance with SFAS No. 5. At December 31, 2006, the Company recorded $1,194 in income tax reserves. This tax reserve relates to a potential dispute by taxing authorities over tax benefits resulting from additional income tax basis in certain residential housing development projects. The Company recorded a valuation allowance of approximately $470 as of December 31, 2006, related to a deferred tax asset resulting from additional tax basis in residential real estate development projects. In analyzing the need for the provision of tax contingency reserves and the valuation allowance, management reviewed applicable statutes, rules, regulations and interpretations and established these reserves based on past experiences and judgments about potential actions by taxing jurisdictions. In January 2007, upon the adoption of FIN 48, the Company recorded a benefit to the opening retained accumulated deficit in the amount of $1,663. The Company s federal income tax returns for 2004 through 2006 are open tax years. The Company files in various state and local jurisdictions, with varying statutes of limitation.

10. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following:

	June 30, 2007	December 31, 2006
Trade payables	$ 19,709	$ 32,990
Warranty	1,709	1,669
Customer deposits	11,939	14,932
Other	2,556	6,089
Total	$ 35,913	$ 55,680

11. STOCK REPURCHASE PROGRAM

In February 2006 the Company s Board of Directors authorized the Company to purchase up to one million shares of the Company s Class A common stock in the open market or in privately negotiated transactions. The authorization did not include a specified time period in which the share repurchase program would remain in effect. During the three months ended June 30, 2006, the Company repurchased an aggregate of 188,100 shares of Class A common stock for a total of $1,187 or $6.31 per share. For the six months ended June 30, 2006, the Company repurchased an aggregate of 258,400 shares of Class A common stock for a total of $1,865 or $7.22 per share. There were no shares repurchased for the six months ended June 30, 2007 and the Company is currently subject to certain restrictive debt covenants which prohibit it from purchasing additional shares under the existing authorization.

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(Amounts in thousands, except per share data)

12. COMMITMENTS AND CONTINGENCIES

Litigation

The Company, as manager of an affiliated entity, exercised its option rights to purchase the project acquisition, development and construction loans made for the benefit of North Shore. The Company subsequently issued a notice of default under the acquisition and development loan at maturity on September 30, 2005, thereafter filed suit for collection of the loans against one of the individual guarantors under the loan on or about October 21, 2005. The Company, as manager of an affiliated entity, set and held a foreclosure sale on March 24, 2006 in which it was the high bidder. However, transfer of title to the property has been delayed pending judicial resolution of a suit filed on March 24, 2006 by the non-affiliated 50% owner of North Shore. On June 30, 2006, the Company, on its own behalf and on behalf of affiliates, filed an additional lawsuit expanding the number of party defendants, demanding equitable relief and demanding $33,000 in damages.

On April 10, 2007, the parties executed a settlement agreement whereby a company associated with the non-affiliated 50% owner of the North Shore project purchased the Company s rights to North Shore for approximately $3,750 to settle all claims against the Company and its investors. All litigation has been dismissed with prejudice and the Company received the proceeds from the settlement in April 2007.

On August 11, 2005, the Company was served with a motion to compel arbitration resulting from an allegation of a loan brokerage fee being owed for placement of a $147,000 project loan for the Eclipse at Potomac Yard project. The claim in the base amount of $2,000 plus interest and costs is based on breach of contract and equitable remedies of unjust enrichment and quantum meruit. In February 2007 the Company received a ruling by a panel of arbiters to pay $3,000 under these claims. The Company has posted a cash bond and filed an appeal which is pending.

Other than the foregoing, we are not currently subject to any material legal proceedings. From time to time, however, we are named as a defendant in legal actions arising from our normal business activities. Although we cannot accurately predict the amount of our liability, if any, that could arise with respect to legal actions currently pending against us, we do not expect that any such liability will have a material adverse effect on our financial position, operating results or cash flows. We believe that we have obtained adequate insurance coverage or rights to indemnification, or where appropriate, have established reserves in connection with these legal proceedings.

Letters of credit and performance bonds

The Company has commitments as a result of contracts entered into with certain third parties to meet certain performance criteria as outlined in such contracts. The Company is required to issue letters of credit and performance bonds to these third parties as a way of ensuring that such commitments entered into are met by the Company. At June 30, 2007, the Company has outstanding $2,030 in letters of credit and $15,855 in performance and payment bonds to these third parties.

Operating leases

The Company leases office space under non-cancelable operating leases. Minimum annual lease payments under these leases at June 30, 2007 approximate:

Year Ended:	**Amount**
2007	$ 1,127
2008	935
2009	975
2010	875
2011	564

Thereafter

Operating lease rental expense aggregated $557 and $514, respectively, for six months ended June 30, 2007 and 2006.

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13. RELATED PARTY TRANSACTIONS

In April 2002 and January 2004, the Predecessor entered into lease agreements for approximately 7.7 and 8.8 square feet, respectively, for its corporate headquarters at 11465 Sunset Hills Road, Reston, Virginia from Comstock Partners, L.C., an affiliate of our Predecessor in which executive officers of the Company, Christopher Clemente, Gregory Benson, and others are principals. Christopher Clemente owns a 45% interest, Gregory Benson owns a 5% interest, an entity which is owned or controlled by Christopher Clemente s father-in-law owns a 45% interest, and an unrelated third party owns a 5% interest in Comstock Partners. On September 30, 2004, the lease agreements were canceled and replaced with new leases for a total of 20.6 square feet with Comstock Asset Management, L.C., an entity wholly owned by Christopher Clemente. Total payments made under this lease agreement were $142 as of December 31, 2004. On August 1, 2005, the lease agreement was amended for an additional 8.4 square feet. On March 31, 2007 the lease agreement was amended decreasing the total square footage from 29.0 to 24.1 and extending the term for two additional years. For the three months ended June 30, 2007 and 2006, total payments made under this lease agreement were $192 and $188, respectively. During the six months ended June 30, 2007 and 2006 total payments were $386 and $373, respectively.

In May 2003, the Predecessor hired a construction company, in which Christopher Clemente s brother serves as the President and is a significant shareholder, to provide construction services and act as a general contractor at the Company s Belmont Bay developments. For the three months ended June 30, 2007 and 2006 total payments made to the construction company were $423 and $1,252, respectively. During the six months ended June 30, 2007 and 2006 total payments were $2,320 and $2,000, respectively.

During 2003, the Predecessor entered into agreements with I-Connect, L.C., a company in which Investors Management, LLC, an entity wholly owned by Gregory Benson, holds a 25% interest, for information technology consulting services and the right to use certain customized enterprise software developed with input from the Company. The intellectual property rights associated with the software solution developed by I-Connect, along with any improvements made thereto by the Company, remain the property of I-Connect. For three months ended June 30, 2007 and 2006, the Company paid $134 and $161, respectively. During the six months ended June 30, 2007 and 2006, the Company paid $340 and $256, respectively, to I-Connect.

In October 2004, the Predecessor entered into an agreement with Comstock Asset Management, L.C. (CAM), where CAM assigned the Company first refusal rights to purchase a portion of their Loudoun Station Properties. In partial consideration for the performance of which the Company would provide management services for a fee of $20 per month. This agreement was terminated effective December 31, 2006. For the three months ended June 30, 2007 and 2006 the Company recorded $0 and $60 in revenue, respectively. During the six months ended June 30, 2007 and 2006 the Company recorded $0 and $120 in revenue, respectively, from this entity.

In addition, the Company, in November 2004, entered into an agreement with Comstock Asset Management (CAM) to sell certain retail condominium units at Potomac Yard for a total purchase price of $14,500. In connection with this sale, the Company received a non-refundable deposit of $8,000 upon execution of the agreement. The agreement was modified in 2005, which reduced the deposit amount to $6,000. During the year ended December 31, 2006, the Company incurred $579 in costs associated with the retail units and recorded a receivable of $377 which is reimbursable by CAM and still outstanding as of June 30, 2007.

During the six months ended June 30, 2007 and 2006, the Company entered into sales contracts to sell homes to certain employees of the Company. The Company, in order to attract, retain, and motivate employees maintains a home ownership benefit program. Under the home ownership benefits, an employee receives certain cost benefits provided by us when purchasing a home or having one built by us. Sales of homes to employees for investment purposes are conducted at market prices.

In September 2005, Comstock Foundation, Inc., was created. Comstock Foundation is a not-for-profit organization organized exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code and is an affiliate of the Company. The affairs of Comstock Foundation are managed by a five-person board of directors with Christopher Clemente, Gregory Benson, Bruce Labovitz and Tracy Schar (employee of the Company and spouse of Christopher Clemente) being four of the five. The Company also provides bookkeeping services to Comstock Foundation at no charge. During the six months ended June 30, 2007 and 2006 the Company donated $0 and $25, respectively, to

Comstock Foundation.

COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

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14. SEGMENT REPORTING

Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131) establishes standards for the manner in which companies report information about operating segments. The Company determined it provides one single type of business activity, homebuilding, which operates in multiple geographic or economic environments. In addition, as a result of the Company s acquisitions in Georgia and North Carolina, which became fully integrated in the fourth quarter of 2006, the Company modified how it analyzes its business during the fourth quarter of 2006. As such, the Company has determined that its homebuilding operations now primarily involve three reportable geographic segments: Washington DC Metropolitan Area, North Carolina, and Georgia. The aggregation criteria are based on the similar economic characteristics of the projects located in each of these regions.

The table below summarizes revenue and income taxes for each of the Company s geographic segments (amounts in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Revenues:				
Washington DC Metropolitan Area	$ 93,529	$ 39,330	$ 127,391	$ 69,199
North Carolina	11,443	8,413	20,032	10,404
Georgia	9,328	2,954	13,600	7,689
Total	$ 114,300	$ 50,697	$ 161,023	$ 87,292
Operating income (loss)				
Washington DC Metropolitan Area	$ 581	$ (26)	$ 3,776	$ 6,688
North Carolina	(646)	(1,868)	(835)	(2,110)
Georgia	(3,859)	(5,297)	(5,375)	(5,806)
Segment operating loss	(3,924)	(7,191)	(2,434)	(1,228)
Corporate expenses unallocated	3,975	4,771	8,349	8,956
Total operating loss	(7,899)	(11,962)	(10,783)	(10,184)
Other income	302	355	646	587
Equity loss		(26)		(53)
Minority interest (income) expense	(3)	12	(5)	5
Loss before income taxes	$ (7,594)	$ (11,645)	$ (10,132)	$ (9,655)

Corporate expenses unallocated and other income is comprised principally of general corporate expenses such as the offices of the Chief Executive Officer and President, and the corporate finance, accounting, audit, tax, human resources, marketing and legal groups, offset in part by interest income.

The table below summarizes total assets for each of the Company s segments at June 30, 2007 and December 31, 2006:

Total Assets	**June 30, 2007**	**December 31, 2006**
Washington DC Metropolitan Area	$ 242,787	$ 317,349
North Carolina	52,694	61,617
Georgia	85,019	94,133
Corporate	42,184	44,330
Total Assets	$ 422,684	$ 517,429

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

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15. NOTES PAYABLE, DEBT AND COVENANTS

On May 26, 2006 we entered into a $40 million Secured Revolving Borrowing Base Credit Facility with Wachovia Bank for the financing of entitled land, land under development, construction and letters of credit. All letters of credit issued will also be secured by collateral in the facility. Funding availability will be limited to compliance with a borrowing base and facility covenants. As of June 30, 2007, $29.6 million was outstanding with this facility. In February 2007 we entered into a Forbearance Agreement with the lender which reduced the covenants and eliminated the ability of the lender to claim an event of default as a result of non-compliance with the financial covenants of the original loan. The Forbearance Agreement runs through March 2008.

On May 4, 2006 we closed on a $30 million Junior Subordinated Note offering. The term of the note was thirty years but it could be retired after five years with no penalty. The rate was fixed at 9.72% for the first five years and LIBOR plus 420 basis points for the remaining twenty-five years. In March 2007 we retired the Junior Subordinated Note with no penalty and entered into a 10-year, $30 million Senior Unsecured Note offering with the same lender at the same interest rate. In connection with the new notes, the lender loosened the financial covenants through September 30, 2007 and permanently modified the underlying definitions used to calculate the covenants. We believe that we are currently in compliance with all covenants associated with the new notes.

As of June 30, 2007, we had $7.8 million outstanding to Key Bank in two secured facilities. Under the terms of the original loan agreements we are required to maintain certain financial covenants. In May 2007 we entered into loan modification agreements which extended the maturities and waived certain key financial covenants until March 31, 2008. We believe we are currently in compliance with all remaining covenants associated with these loans.

As of June 30, 2007 we had $10.2 million outstanding to M&T Bank. Under the terms of the original loan agreements we were required to maintain certain financial covenants. In March 2007 we entered into loan modification agreements lowering the minimum interest coverage ratio and the minimum tangible net worth covenants. We believe we are currently in compliance with all covenants associated with these loans.

In December 2005 the Company entered into a $147 million secured, limited recourse loan with Corus Bank related to our Eclipse project. Under the terms of the loan there is a single deed of trust covering two loan tranches. The two tranches have varying interest rates with Tranche A at LIBOR plus 375 basis points and Tranche B fixed at 16.0%. In April 2007 the loan maturity was extended to January 2008 and provided a mechanism for reallocation of Tranche B into Tranche A. At June 30, 2007 our outstanding balance under this loan was $57.1 million. There are no financial covenants associated with this loan.

In February 2007 we entered into a $28 million secured, three-year limited recourse loan with Guggenheim Capital Partners related to our Penderbrook project. Under the terms of the loan the borrower (Comstock Penderbrook, LLC) distributed $11.0 million of the proceeds to the Company and established a $2.0 million cash interest escrow to provide for interest costs in excess of the net operating income being generated by the temporary rental operations at the project. The loan bears an interest rate of LIBOR plus 500 basis points. Under the terms of the loan there are two tranches, Tranche A at three month LIBOR plus 400 basis points and Tranche B at three month LIBOR plus 600 basis points. As of June 30, 2007, our outstanding balance under the loan was $22.9 million. There are no financial covenants associated with this loan.

On May 31, 2007 we entered into $4.5 million secured revolving credit facility with First Charter Bank. The loan matures on June 10, 2008 bearing an interest rate of Prime Rate plus 0.25% per annum. As of June 30, 2007, we had $0.7 million outstanding on the loan. There are no financial covenants associated with this loan.

At June 30, 2007 we had approximately $8.6 million outstanding with Regions Bank under five separate secured master loan agreements. The loans carried varying maturities starting December 2007. There are no financial covenants associated with this loan.

On June 28, 2007 the Company entered into various loan modification agreements with Bank of America securing the remaining $5.0 million balance of the unsecured revolver, modifying the curtailment schedule of the unsecured revolver and extending the maturities of the Atlanta debt facilities. There are no financial covenants associated with this loan.

16. RESTRICTED STOCK, STOCK OPTIONS AND OTHER STOCK PLANS

The Company accounts for its stock-based compensation arrangements in accordance with the provisions of SFAS No. 123(R) entitled Share-Based Payment, under which the Company recognizes compensation expense of a stock-based award over the vesting period based on the fair value of the award on the grant date. The fair value of stock options granted is calculated under the Black-Scholes option-pricing model. The following information represents the Company s grants of stock-based compensation to employees prior to recognition of estimated forfeitures.

During the three months ended March 31, 2007, the Company issued 108,566 restricted stock awards with a fair value of $440 that vest over three years. During the three months ended June 30, 2007, the Company issued 351,000 restricted stock awards with a fair value of $1,474 that vest over three years.

At December 31, 2006, the Company accrued a liability for employee incentive compensation awards for 2006 performance intended to be settled in cash in 2007. Due to market conditions, the Company elected to issue restricted stock awards in lieu of cash in settlement of the incentive compensation obligations. As a result, the Company granted, and charged to the incentive compensation accrual, 142,497 restricted stock awards with a fair value of $698 during the three months ended March 31, 2007 and an additional 293,725 restricted stock awards with a fair value of $1,439 were granted and charged to the incentive compensation accrual during the three months ended June 30, 2007.

No stock options were granted during the six months ended June 30, 2007.

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MANAGEMENTS DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND

RESULTS OF OPERATIONS

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FORWARD-LOOKING STATEMENTS AND FACTORS THAT MAY AFFECT RESULTS

The following discussion of our financial condition and results of operations should be read in conjunction with the accompanying unaudited consolidated interim financial statements and the notes thereto appearing elsewhere in the this report and our audited consolidated and combined financial statements and the notes thereto for the year ended December 31, 2006, appearing in our Annual Report on Form 10-K and Form 10-K/A for the year then ended (the 2006 Form 10-K).

This report includes forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified by the use of words such as anticipate, believe, estimate, may, intend, exp will, should, seeks or other similar expressions. Forward-looking statements are based largely on our expectations and involve inherent risks and uncertainties, many of which are beyond our control. You should not place undue reliance on any forward-looking statement, which speaks only as of the date made. Some factors which may affect the accuracy of the forward-looking statements apply generally to the real estate industry, while other factors apply directly to us. Any number of important factors which could cause actual results to differ materially from those in the forward-looking statements include, without limitation: general economic and market conditions, including interest rate levels; our ability to service our substantial debt; inherent risks in investment in real estate; our ability to compete in the Washington, D.C., Raleigh, North Carolina and Atlanta, Georgia real estate and home building markets; regulatory actions; fluctuations in operating results; our anticipated growth strategies; shortages and increased costs of labor or building materials; the availability and cost of land in desirable areas; natural disasters; our ability to raise debt and equity capital and grow our operations on a profitable basis; and our continuing relationships with affiliates. Additional information concerning these and other important risk and uncertainties can be found under the heading Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006. Our actual results could differ materially from these projected or suggested by the forward-looking statements.

Overview

We engage in the business of residential land development, production home building, high-rise condominium development, condominium conversion and land sales in the greater Washington, D.C., Raleigh, North Carolina, and Atlanta, Georgia markets. Our business was founded in 1985 by Christopher Clemente, our Chief Executive Officer, as a residential land developer and home builder focused on the luxury home market in the Northern Virginia suburbs of Washington, D.C. In 1992, we repositioned ourselves as a production home builder focused on moderately priced homes in areas where we could more readily purchase finished building lots through option contracts. In the late 1990s we diversified our product base to include multiple product types and home designs and we rebuilt our in-house land development department to include significant experience in both land development operations and land entitlement expertise. In 1997 we entered the Raleigh, North Carolina market. In 2005 we became involved in the business of converting existing rental apartment properties to for-sale condominium projects. In 2006, we entered the Charlotte, North Carolina, Myrtle Beach, South Carolina and Atlanta, Georgia markets through the acquisition of Parker Chandler Homes, Inc. In late 2006 we exited the Myrtle Beach, South Carolina market and in early 2007 we exited the Charlotte, North Carolina market.

Our general business strategy is to focus on for-sale residential real estate development opportunities in the southeastern United States that afford us the ability to produce products at price points where we believe there is significant and consistent long-term demand for new housing. We believe the housing industry is cyclical in nature. We recognize that current market conditions are extremely challenging. Accordingly, we have adapted our business plan and strategy with the goal of protecting liquidity, enhancing our balance sheet and positioning the Company for future growth when market conditions improve. In order to protect our liquidity we have adopted a conservative approach to land acquisition and investment and have taken a patient approach with respect to market expansion. We believe that by doing so we are enhancing our ability to take advantage of attractive real estate investment opportunities in our core markets as market conditions improve. At June 30, 2007, we either owned or controlled under option agreements approximately 4,300 building lots.

The following tables summarize certain information related to new orders, settlements, and backlog for the three and six month period ended June 30, 2007 and 2006:

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	Three months ended June 30, 2007			
	Washington Metro Area	North Carolina	Georgia	Total
Gross new orders	410	53	31	494
Cancellations	22	5	6	33
Net new orders	388	48	25	461
Gross new order revenue	$ 76,179	$ 13,407	$ 9,509	$ 99,095
Cancellation revenue	$ 9,761	$ 1,623	$ 1,858	$ 13,242
Net new order revenue	$ 66,418	$ 11,784	$ 7,651	$ 85,853
Average gross new order revenue	$ 186	$ 253	$ 307	$ 201
Settlements	443	32	30	505
Settlement revenue - homebuilding	$ 93,154	$ 7,831	$ 9,328	$ 110,313
Average settlement revenue	$ 210	$ 245	$ 311	$ 218
Backlog units	156	65	20	241
Backlog revenue	$ 66,312	$ 19,430	$ 7,022	$ 92,764
Average backlog revenue	$ 425	$ 299	$ 351	$ 385

	Three months ended June 30, 2006			
	Washington Metro Area	North Carolina	Georgia	Total
Gross new orders	113	80	40	233
Cancellations	24	2	8	34
Net new orders	89	78	32	199
Gross new order revenue	$ 35,749	$ 20,131	$ 10,445	$ 66,325
Cancellation revenue	$ 7,547	$ 559	$ 2,227	$ 10,333
Net new order revenue	$ 28,202	$ 19,572	$ 8,218	$ 55,992
Average gross new order revenue	$ 316	$ 252	$ 261	$ 285
Settlements	117	35	13	165
Settlement revenue - homebuilding	$ 38,985	$ 8,412	$ 2,954	$ 50,351
Average settlement revenue	$ 333	$ 240	$ 227	$ 305
Backlog units	450	59	66	575
Backlog revenue	$ 180,556	$ 18,747	$ 19,090	$ 218,393
Average backlog revenue	$ 401	$ 318	$ 289	$ 380

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	Six months ended June 30, 2007			
	Washington Metro Area	North Carolina	Georgia	Total
Gross new orders	489	85	65	639
Cancellations	80	12	15	107
Net new orders	409	73	50	532
Gross new order revenue	$ 101,285	$ 21,385	$ 20,287	$ 142,957
Cancellation revenue	$ 32,837	$ 3,750	$ 4,427	$ 41,014
Net new order revenue	$ 68,447	$ 17,635	$ 15,860	$ 101,942
Average gross new order revenue	$ 207	$ 252	$ 312	$ 224
Settlements	538	54	44	636
Settlement revenue - homebuilding	$ 126,894	$ 12,869	$ 13,575	$ 153,338
Average settlement revenue	$ 236	$ 238	$ 309	$ 241
Backlog units	156	65	20	241
Backlog revenue	$ 66,312	$ 19,430	$ 7,022	$ 92,764
Average backlog revenue	$ 425	$ 299	$ 351	$ 385

	Six months ended June 30, 2006			
	Washington Metro Area	North Carolina	Georgia	Total
Gross new orders	248	95	119	462
Cancellations	62	2	19	83
Net new orders	186	93	100	379
Gross new order revenue	$ 84,838	$ 26,181	$ 30,904	$ 141,923
Cancellation revenue	$ 21,966	$ 559	$ 4,187	$ 26,712
Net new order revenue	$ 62,872	$ 25,622	$ 26,717	$ 115,211
Average gross new order revenue	$ 342	$ 276	$ 260	$ 307
Settlements	200	43	34	277
Settlement revenue - homebuilding	$ 68,678	$ 10,403	$ 7,635	$ 86,716
Average settlement revenue	$ 343	$ 242	$ 225	$ 313
Backlog units	450	59	66	575
Backlog revenue	$ 180,556	$ 18,747	$ 19,090	$ 218,393
Average backlog revenue	$ 401	$ 318	$ 289	$ 380

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We currently have communities under development in multiple counties throughout the markets we serve. The following chart summarizes certain information for our current and planned communities as of June 30, 2007:

			As of June 30, 2007						
Project	**State**	**Product Type (2)**	**Estimated Units at Completion**	**Units Settled**	**Backlog (3)**	**Lots Owned Unsold**	**Lots under Option Agreement Unsold**		**Average New Order Revenue to Date**
Status: Active (1)									
Allen Creek	GA	SF	26	22		4		$	207,218
Arcanum	GA	SF	34	18	1	15		$	382,468
Brentwood Estates	GA	SF	31	21		10		$	138,311
Falling Water	GA	SF	22	13	1	8		$	422,124
Gates of Luberon	GA	SF	31	1	1	29		$	653,192
Glenn Ivey	GA	SF	65	10	2	53		$	236,483
Highland Station	GA	SF	105	31		74		$	290,684
James Road	GA	SF	49		3	46		$	327,900
Maristone	GA	SF	40	7	9	24		$	337,724
Senator s Ridge	GA	SF	60	20	1	39		$	245,864
Traditions	GA	SF	4	2	1	1		$	475,000
Wyngate	GA	SF	28		1	27		$	455,750
Sub-Total / Weighted Average (4)			495	145	20	330		$	286,221
Emerald Farm	MD	SF	84	78		6		$	452,347
Sub-Total / Weighted Average (4)			84	78		6		$	452,347
Allyn s Landing	NC	TH	116	54	19	43		$	235,246
Brookefield Station	NC	SF	130	1	2	43	84	$	252,210
Haddon Hall	NC	Condo	90	2	1	87		$	192,233
Holland Road	NC	SF	81		19	62		$	420,151
Kelton at Preston	NC	TH	56	46	5	5		$	311,979
North Farms	NC	SF	47	39	3	5		$	180,266
Pine Hollow	NC	SF	10	5		5		$	170,725
Providence-SF	NC	SF	148	3	12	43	90	$	194,959
Riverbrooke	NC	SF	66	36	1	29		$	167,698
Wakefield Plantation	NC	TH	77	43	3	31		$	486,169
Wheatleigh Preserve	NC	SF	28	16		12		$	282,227
Sub-Total / Weighted Average (4)			849	245	65	365	174	$	280,108
Barrington Park	VA	Condo	148			148			n/a
Beacon Park at Belmont Bay 8&9	VA	Condo	600			112	488		n/a
Commons on Potomac Sq	VA	Condo	192	60	4	128		$	266,110
Commons on Williams Sq	VA	TH/Condo	180	122	3	55		$	346,225
Penderbrook	VA	Condo	424	264	23	137		$	257,561
River Club at Belmont Bay 5	VA	Condo	84	83		1		$	447,895

The Eclipse on Center Park	VA	Condo	465	264	124	77		$	404,937
Woodlands at Round Hill	VA	SF	46	26	1	19		$	750,550
Sub-Total / Weighted Average (4)			2,139	819	155	677	488	$	358,095
Total Active			**3,567**	**1,287**	**240**	**1,378**	**662**	**$**	**339,311**

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Status: Development (1)								
East Capitol	DC	Condo	133			133		n/a
Sub-Total / Weighted Average (4)			133			133		n/a
Highland Avenue	GA	SF	28			28		n/a
Post Road	GA	SF	60			60		n/a
Post Road II	GA	TH	54			54		n/a
Settingdown Circle	GA	SF	162			162		n/a
Shiloh Road I	GA	SF	60			60		n/a
Tribble Lakes	GA	SF	200			200		n/a
Sub-Total / Weighted Average (4)			564			564		n/a
Massey Preserve	NC	SF	187			187		n/a
Providence-TH	NC	TH	80			18	62	n/a
Sub-Total / Weighted Average (4)			267			205	62	n/a
Blake Crossing	VA	TH	130			130		n/a
Brandy Station	VA	SF	350				350	n/a
Loudoun Station Condominiums	VA	Condo	484				484	n/a
Station View	VA	TH	47			47		n/a
Sub-Total / Weighted Average (4)			1,011			177	834	n/a
Total Development			**1,975**			**1,079**	**896**	**n/a**
Total Active & Development			**5,542**	**1,287**	**240**	**2,457**	**1,558**	**$ 339,311**
Status: Joint Venture								
Countryside	VA	Condo	30	29	1			$ 255,424
Total Joint Venture			**30**	**29**	**1**			**$ 255,424**

(1) Active communities are open for sales. Development communities are in the development process and have not yet opened for sales.
(2) SF means single family home, TH means townhouse and Condo means condominium.
(3) Backlog means we have an executed order with a buyer but the settlement has not yet taken place.
(4) Weighted Average means the weighted average new order sale price.

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Results of Operations

Three and six months ended June 30, 2007 compared to three and six months ended June 30, 2006

Orders, cancellations and backlog

Gross new order revenue for the three months ended June 30, 2007 increased $32.8 million, or 49.4%, to $99.1 million on 494 homes, as compared to $66.3 million on 233 homes for the three months ended June 30, 2006. For the six months ended June 30, 2007, gross new orders increased $1.1 million, or 1.0% to $143.0 million on 639 homes, as compared to $141.9 million on 462 homes for the six months ended June 30, 2006. The increase in new home orders for the three and six months ended June 30, 2007 is due to the sale and settlement of 316 units at the Bellemeade condominium project in June 2007. Net of the Bellemeade sale, an overall decrease in new orders is attributable to weaker market conditions in which we are experiencing reduced demand throughout our markets and the fact that we had fewer lower priced units for sale at our Eclipse project in 2007 as compared to 2006.

The Company s average gross sales price per new order for the three months ended June 30, 2007 decreased by $84,000 to $201,000, as compared to $285,000 for the same period in 2006. The average sales price per gross new order for the six months ended June 30, 2007 decreased $83,000 to $224,000, as compared to $307,000 for the six months ended June 30, 2006. Excluding the zero margin Bellemeade sale, average gross new order revenue for the three and six months ended June 30, 2007 increased by $5,000 to $290,000 and decreased by $11,000 to $296,000, respectively.

For the three months ended June 30, 2007 the Company experienced 33 unit cancellations totaling $13.2 million as compared to 34 units totaling $10.3 million for the comparable period in 2006. Cancellations were most prevalent in the greater Washington, DC market where we experienced 22 cancellations. At the Eclipse project, in the Washington, DC market, the Company experienced 14 cancellations which were mostly related to contracts entered into in 2004. The Company expects to continue to experience additional cancellations at the Eclipse as settlements continue in the project s East tower.

Our backlog at June 30, 2007 decreased $125.6 million, or 57.5%, to $92.8 million on 241 homes, as compared to our backlog at June 30, 2006 of $218.4 million on 575 homes. The decrease in backlog is primarily due to the commencement of deliveries at the Eclipse in November 2006 and a softening market which has limited our ability to replace settlements with new orders. Our backlog at June 30, 2007 includes 124 units totaling $57.6 million at our Eclipse project.

Revenues

Homebuilding revenues increased by $59.9 million, or 119.1%, to $110.3 million for the three months ended June 30, 2007, as compared to $50.4 million for the three months ended June 30, 2006. Homebuilding revenues increased by $66.6 million, or 76.8%, to $153.3 million for the six months ended June 30, 2007, as compared to $86.7 million for the six months ended June 30, 2006. The number of homes delivered for the three months ended June 30, 2007 increased by 206.1% to 505 from 165 homes for the three months ended June 30, 2006. The number of homes delivered for the six months ended June 30, 2007, increased by 129.6% to 636 from 277 homes for the six months ended June 30, 2006. The increase in deliveries and revenues for the three and six month ended June 30, 2007 is primarily attributable to 316 units representing $47.5 million in revenue related to the bulk sale of the Company s Bellemeade condominium conversion project. In connection with the sale, the Company purchased 58 units previously settled, dissolved the condominium and then delivered the project in its entirety to a rental operator during June 2007. Excluding the sale of Bellemeade, the increase in the number of units delivered during the three and six months ended June 30, 2007 is attributable to the company s Eclipse project which delivered 130 units and generated $53.4 million in revenue during the six months ended June 30, 2007 as compared to no settlements in the six months ended June 30, 2006.

Including the Bellemeade transaction, average revenue per home delivered decreased by approximately $87,000 to $218,000 for the three months ended June 30, 2007, as compared to $305,000 for the three months ended June 30, 2006. Average revenue per home delivered decreased by approximately $72,000 to $241,000 for the six months ended June 30, 2007, as compared to $313,000 for the six months ended June 30, 2006. Excluding the 316 unit bulk sale of the Bellemeade project, average revenue per home delivered increased by $27,000 and $19,000 to approximately $332,000 for both the three and six months ended June 30, 2007 as compared to $305,000 and $313,000 for the comparable periods in 2006. This increase in average revenue per home is due primarily to the settlements at the Company s Eclipse project.

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Other Revenue

Other revenue for the three months ended June 30, 2007 increased by $3.6 million to $3.9 million, as compared to $346,000 for the three months ended June 30, 2006. For the six months ended June 30, 2007 other revenue increased by $7.1 million to $7.7 million, as compared to $576,000 for the six months ended June 30, 2006. Other revenue for the three and six months ended June 30, 2007 consists of lot sales made to third parties and revenue associated with the Company s Settlement Title Services division. The net increase is attributable to $7.1 million of revenue recognized on the sale of 110 finished lots at our Massey Preserve project in North Carolina in March and June of 2007. The Company considers revenue to be from homebuilding when there is a structure which is either partially or completely built on the lot when it is delivered. Sales of lots occur and are included in other revenues when the Company sells raw land or finished home sites in advance of any substantial home construction.

Cost of sales and cost of sales other

Cost of sales for the three months ended June 30, 2007 increased $61.6 million to $102.9 million, or 90.0% of homebuilding revenue, as compared to $41.3 million, or 81.9% of revenue, for the three months ended June 30, 2006. For the six months ended June 30, 2007 cost of sales increased $71.2 million to $139.7 million, or 86.8% of revenue, as compared to $68.5 million or 79.0% of revenue for the six months ended June 30, 2006. The $61.6 million and $71.2 million increase in cost of sales for the three and six months ended June 30, 2007, respectively, is primarily due to both the June 2007 Bellemeade sale and the commencement of Eclipse settlements. The increases in cost of sales as a percentage of revenue for the three and six months ended June 30, 2007, respectively, is principally the result of the zero margin sale of Bellemeade, continuing pricing concessions and increases in material and labor costs. Excluding the Bellemeade sale, gross margin for the three months ended June 30, 2007 was 11.9%. The gross margin at the Eclipse for the three months ended June 30, 2007 was 20.7%. Due to weakening market conditions, we have also extended the sales cycle of many of our projects, which in turn has increased the cost per unit by increasing the amount of real estate tax, interest and capitalized overhead. Due to the factors stated above, the Company expects cost of sales as a percentage of revenue to continue to face additional upward pressure until general market conditions improve, new inventory is acquired or impaired land inventory is delivered.

Cost of sales other for the three and six months ended June 30, 2007 was $3.7 million and $7.3 million as compared to $21,000 and $30,000 for the three and six months ended June 30, 2006. Cost of sales other for the three and six months ended June 30, 2007 primarily includes land cost associated with lot sales at Massey Preserve where the Company sold 110 finished lots to a third party.

Impairments and write-offs

As discussed in Note 2 in the accompanying notes to the financial statements, the Company recorded impairment and write-off charges of $7.5 million and $12.9 million for the three months ended June 30, 2007 and 2006, respectively. For the six months ended June 30, 2007 and June 30, 2006 the Company recorded impairment and write-off charges of $8.4 million and $12.9 million, respectively. Impairment charges for the three months ended June 30, 2007 include condominiums, townhouses and single family homes projects located in the Company s Virginia ($4.9 million), North Carolina ($112,000) and Georgia ($2.3 million) markets. Based on management s assessment of current market conditions and estimates for the future, the Company believes there are no additional impairments warranted at this time. However, if market conditions deteriorate or actual costs are higher than budgeted, the Company would be required to re-evaluate the recoverability of its real estate held for development and sale and may incur additional impairment charges. Included in write-offs, as discussed in Note 7 in the accompanying notes to the financial statements, during the three months ended March 31, 2007, the Company recorded a charge of approximately $357 to write off its investment in North Shore and reduce amounts due from North Shore to the net realizable value. During the three months ended June 30, 2007, additional costs of $132 related to the North Shore settlement were incurred and written off. No additional costs related to the North Shore settlement are expected to be incurred.

Selling, general and administrative

Selling, general and administrative cost as a percentage of total revenue was 7.1% for the three months ended June 30, 2007, as compared to 16.6% of total revenue for the three months ended June 30, 2006 and 10.1% of total revenue for the six months ended June 30, 2007 as compared to 18.4% of total revenue for the six months ended June 30, 2006. The decrease, as a percentage of total revenue, was the result of cost reductions generated by management s cost reduction initiatives and increased revenue from the sale of Bellemeade and settlements at the Eclipse. Adjusted for the sale of Bellemeade, SG&A, as a percentage of total revenue, was 12.2% and 14.4% for the three and six months ended June 30, 2007. This effort includes staff reductions, reduced rents on our corporate office, reductions in marketing and a general effort to reduce other general and administrative expenses.

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Operating (loss)

Operating loss for the three months ended June 30, 2007 decreased by $4.1 million to an operating loss of $7.9 million, as compared to an operating loss of $12.0 million for the three months ended June 30, 2006. Operating margin for the three months ended June 30, 2007, was (6.9%), as compared to (23.6%) for the three months ended June 30, 2006. The operating loss for the six months ended June 30, 2007 decreased by $600,000 to an operating loss of $10.8 million, as compared to an operating loss of $10.2 million for the six months ended June 30, 2006. Operating margin for the six months ended June 30, 2007, was (6.7%), as compared to (11.7%) for the six months ended June 30, 2006. The 16.7 and 5.0 percentage point improvement in operating margins for the three and six months ended June 30, 2007 are attributable to increasing gross profit margins on the units settled at the Eclipse as we sell units sold later in the project, lower 2007 impairments and write-offs and control of selling, general and administrative expenses as discussed above.

Other (income) expense, net

Other (income) expense, net decreased by $53,000 to $302,000 for the three months ended June 30, 2007, as compared to $355,000 for the three months ended June 30, 2006 as a result of lower interest income earned during the period. Other (income) expense, net increased by $59,000 to $646,000 for the six months ended June 30, 2007, as compared to $587,000 for the six months ended June 30, 2006. This $59,000 increase in other (income) expense is primarily attributable to increased interest earned on the Company s cash balances in addition to income generated from buyers canceling sales contracts and forfeiting earnest money deposits in the first half of 2007.

Income taxes

For the three and six months ended June 30, 2007, the Company, due to net losses, recorded an income benefit of ($2.9) and ($3.8) million as compared to income tax benefits of ($4.5) and ($3.8) million for the three and six months ended June 30, 2006. As discussed in Note 9, in the accompanying notes to financial statements, the Company recorded a charge to income tax expense in the amount of $62,000 as a result of tax shortfalls related to the non realization of certain tax assets recorded in conjunction with employee stock grants.

Liquidity and Capital Resources

We require capital to post deposits on new deals, to purchase and develop land, to construct homes, to fund related carrying costs and overhead and to fund various advertising and marketing programs to facilitate sales. These expenditures include engineering, entitlement, architecture, site preparation, roads, water and sewer lines, impact fees and earthwork, as well as the construction costs of the homes and amenities. Our sources of capital include, and we anticipate will continue to include, funds derived from various secured and unsecured borrowings, operations which include the sale of constructed homes and finished lots, and the sale of equity and debt securities. Our currently owned and controlled inventory of home sites will require significant capital to develop and construct.

In production home building, it is common for builders such as us to employ revolving credit facilities whereby the maximum funding available under the facility exceeds the maximum outstanding balance allowed at any given time. Our overall borrowing

capacity may be constrained by loan covenants which limit the ratio of our total liabilities to our total equity. This revolving debt will typically provide for funding of an amount up to a pre-determined percentage of the cost of each asset funded. The balance of the

funding for that asset is provided for by us as equity. The efficiency of revolving debt in production home building allows us to operate with less overall debt capital than would be required if we built each project with long-term amortizing debt. At June 30, 2007 we had approximately $230.0 million of outstanding indebtedness and $16.9 million of unrestricted cash. We believe that

internally generated cash, advances available under our credit facilities and access to public debt and equity markets will provide us with sufficient capital to meet our existing and expected capital needs.

Our subsidiaries have a significant amount of secured debt which matures during 2008. In our industry it is customary for lenders to renew and extend project facilities until the project is complete. Since we are the guarantor of our subsidiaries debt, any significant failure to negotiate renewals and extensions to this debt would severely compromise our liquidity and could jeopardize our ability to satisfy our capital requirements. Our recently reported and cured loan covenant violations, may impact our ability to renew and extend our debt.

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Credit Facilities

A majority of our debt is variable rate, based on LIBOR or the prime rate plus a specified number of basis points, typically ranging from 190 to 600 basis points over the LIBOR rate and from 25 to 100 basis points over the prime rate. As a result, we are exposed to market risk in the area of interest rate changes. At June 30, 2007, the one-month LIBOR and prime rates of interest were 5.32% and 8.25%, respectively, and the interest rates in effect under our existing secured revolving development and construction credit facilities ranged from 7.40% to 11.35%. For information regarding risks associated with our level of debt and changes in interest rates, see Item 3 Quantitative and Qualitative Disclosures about Market Risk.

We have generally financed our development and construction activities on a project basis so that, for each project we develop and build, we have a separate credit facility. Accordingly, we have numerous credit facilities.

On May 26, 2006 we entered into a $40 million Secured Revolving Borrowing Base Credit Facility with Wachovia Bank for the financing of entitled land, land under development, construction and letters of credit. All letters of credit issued will also be secured by collateral in the facility. Funding availability will be limited to compliance with a borrowing base and facility covenants. As of June 30, 2007, $29.6 million was outstanding with this facility. In February 2007 we entered into a Forbearance Agreement with the lender which reduced the covenants and eliminated the ability of the lender to claim an event of default as a result of non-compliance with the financial covenants of the original loan. The Forbearance Agreement runs through March 2008.

On May 4, 2006 we closed on a $30 million Junior Subordinated Note offering. The term of the note was thirty years but it could be retired after five years with no penalty. The rate was fixed at 9.72% for the first five years and LIBOR plus 420 basis points for the remaining twenty-five years. In March 2007 we retired the Junior Subordinated notes with no penalty and entered into a 10-year, $30 million Senior Unsecured Note offering with the same lender at the same interest rate. In connection with the new notes, the lender loosened the financial covenants through September 30, 2007 and permanently modified the underlying definitions used to calculate the covenants. We believe that we are currently in compliance with all covenants associated with the new notes.

As of June 30, 2007, we had $7.8 million outstanding to Key Bank in two secured facilities. Under the terms of the original loan agreements we are required to maintain certain financial covenants. In May 2007 we entered into loan modification agreements which extended the maturities and waived certain key financial covenants until March 31, 2008. We believe we are currently in compliance with all remaining covenants associated with these loans.

As of June 30, 2007 we had $10.2 million outstanding to M&T Bank. Under the terms of the original loan agreements we were required to maintain certain financial covenants. In March 2007 we entered into loan modification agreements lowering the minimum interest coverage ratio and the minimum tangible net worth covenants. We believe we are currently in compliance with all covenants associated with these loans.

In December 2005 the Company entered into a $147 million secured, limited recourse loan with Corus Bank related to our Eclipse project. Under the terms of the loan there is a single deed of trust covering two loan tranches. The two tranches have varying interest rates with Tranche A at LIBOR plus 375 basis points and Tranche B fixed at 16.0%. In April 2007 the loan maturity was extended to January 2008 and provided a mechanism for reallocation of Tranche B into Tranche A. At June 30, 2007 our outstanding balance under this loan was $57.1 million. There are no financial covenants associated with this loan.

In February 2007 we entered into a $28 million secured, three-year limited recourse loan with Guggenheim Capital Partners related to our Penderbrook project. Under the terms of the loan the borrower (Comstock Penderbrook, LLC) distributed $11.0 million of the proceeds to the Company and established a $2.0 million cash interest escrow to provide for interest costs in excess of the net operating income being generated by the temporary rental operations at the project. The loan bears an interest rate of LIBOR plus 500 basis points. Under the terms of the loan there are two tranches, Tranche A at three month LIBOR plus 400 basis points and Tranche B at three month LIBOR plus 600 basis points. As of June 30, 2007, our outstanding balance under the loan was $22.9 million. There are no financial covenants associated with this loan.

On May 31, 2007 we entered into $4.5 million secured revolving credit facility with First Charter Bank. The loan matures on June 10, 2008 bearing an interest rate of Prime Rate plus 0.25% per annum. As of June 30, 2007, we had $0.7 million outstanding on the loan. There are no financial covenants associated with this loan.

At June 30, 2007 we had approximately $8.6 million outstanding with Regions Bank under five separate secured master loan agreements. The loans carried varying maturities starting December 2007. There are no financial covenants associated with this loan.

On June 28, 2007 the Company entered into various loan modification agreements with Bank of America securing the remaining $5.0 million balance of the unsecured revolver, modifying the curtailment schedule of the unsecured revolver and extending the maturities of the Atlanta debt facilities. There are no financial covenants associated with this loan.

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From time to time, we employ unsecured working capital revolving credit facilities to supplement our capital resources or a particular project or group of projects. Our lenders under these credit facilities will typically charge interest rates that are substantially higher than those charged by the lenders under our senior and secured credit facilities. These credit facilities will vary with respect to terms and costs. We intend to continue to use these types of facilities on a selected basis to supplement our capital resources.

Many of our loan facilities contain Material Adverse Effect clauses which if invoked could create an event of default under the loan. In the event all our loans were deemed to be in default as a result of a Material Adverse Effect, our ability to meet our capital and debt obligations would be compromised.

Cash Flow

Net cash provided by operating activities was $64.1 million for the six months ended June 30, 2007, as compared to net cash used of $118.6 million during the six months ended June 30, 2006. The $182.7 million increase is primarily the result of two business acquisitions completed in the first half of 2006, as compared to no business acquisitions in 2007, additional settlements at Eclipse, the sale of Bellemeade and the sale of Massey Preserve lots.

Net cash used in investing activities was $57,000 for the six months ended June 30, 2007, as compared to $16.7 million for the six months ended June 30, 2006. The decrease is primarily due to no business acquisitions being made in 2007.

Net cash used in financing activities was $68.3 million for the six months ended June 30, 2007 as compared to $115.9 million provided in the six months ended June 30, 2006. Net cash provided by financing activities for the six months ended June 30, 2007 was offset by debt principal payments made during the period.

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Recent Acquisitions

In May 2006, we completed the acquisition of Capitol Homes, Inc., in the Raleigh, North Carolina area. The acquisition price was approximately $7.5 million plus the assumption of approximately $20.6 million in liabilities. The results of Capitol Homes, Inc. are included in the accompanying financial statements from the period May 5, 2006 to June 30, 2007. The acquisition added approximately 1,350 lots in 13 communities to our inventory of controlled land.

In January 2006, we completed the acquisition of Parker Chandler Homes, Inc. in the Atlanta, Georgia area. The acquisition price was approximately $10.4 million plus the assumption of approximately $63.8 million in debt. The results of Parker Chandler Homes, Inc. are included in the accompanying financial statements from the period January 19, 2006 to June 30, 2007. The acquisition added over 1,500 lots to our inventory of controlled land.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently reviewing the effect of SFAS 157 on its consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment to FASB Statement No. 115 (SFAS 159), which permits entities to measure various financial instruments and certain other items at fair value at specified election dates. The election must be made at the initial recognition of the financial instrument, and any unrealized gains or losses must be reported at each reporting date. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently reviewing the effect of SFAS 159 on its consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109, Accounting for Income Taxes (FIN 48), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted the provisions of FIN 48 on January 1, 2007, as required. The cumulative effect of adopting FIN 48 will be recorded as an adjustment to the opening balance of retained earnings and is not expected to have a significant impact on the Company s consolidated financial position. The adoption of FIN 48 may cause greater volatility in the effective tax rate going forward. The Company expects to record a benefit of approximately $1,194 as a benefit to opening retained earnings as a result of the adoption of FIN 48.

Critical Accounting Policies and Estimates

There have been no significant changes to our critical accounting policies and estimates during the six months ended June 30, 2007 compared with those disclosed in Item 2, *Management s Discussion and Analysis of Financial Condition and Results of Operations* included in our Annual Report on Form 10-K for the year ended December 31, 2006.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may impact our financial position, results of operations or cash flows, due to adverse changes in financial and commodity market prices and interest rates. We are exposed to market risk in the area of interest rate changes. A majority of our debt is variable rate based on LIBOR and prime rate, and, therefore, affected by changes in market interest rates. Based on current operations, as of June 30, 2007, an increase/decrease in interest rates of 100 basis points on our variable rate debt would have resulted in a corresponding increase/decrease in interest actually incurred by us of approximately $1.6 million in a fiscal year, a significant portion of which would be capitalized and included in cost of sales as homes are delivered. As a result, the effect on net income would be deferred until the underlying units settled and the interest was released to cost of goods sold. Changes in the prices of commodities that are a significant component of home construction costs, particularly lumber and concrete, may result in unexpected short-term increases in construction costs. Because the sales price of our homes is fixed at the time a buyer enters into a contract to acquire a home and we generally contract to sell our homes before construction begins, any increase in costs in excess of those anticipated at the time of each sale may result in lower consolidated operating income for the homes in our backlog. We attempt to mitigate the market risks of the price fluctuation of commodities by entering into fixed price contracts with our subcontractors and material suppliers for a specified period of time, generally commensurate with the building cycle. These contracts afford us the option to purchase materials at fixed prices but do not obligate us to any specified level of purchasing.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, our Chairman and Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures, which included inquiries made to certain other employees. Based on their evaluation, our Chairman and Chief Executive Officer and Chief Financial Officer have each concluded that our disclosure controls and procedures are effective and sufficient to ensure that we record, process, summarize, and report information required to be disclosed by us in our periodic reports filed under the Securities Exchange Act within the time periods specified by the Securities and Exchange Commission s rules and forms and are also effective to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is accumulated and communicated to management, including our Chief Executive and Chief Financial Officers, to allow timely decisions regarding required disclosure.

During the quarter ended March 31, 2007, the Company completed its implementation of the JD Edwards EnterpriseOne (JDE) software package. The JDE system is an Enterprise Resource Planning (ERP) suite of integrated operational and financial modules that supports the Company s current and future operational needs and enhances its internal control over financial reporting. The implementation of the JDE system has affected the Company s internal controls over financial reporting by, among other things, improving user access security and automating a number of accounting, back office, and reporting processes and activities. Other than the JDE software package implementation, there have been no changes in the Company s internal controls over financial reporting identified in connection with this evaluation that occurred during the period covered by this report and that have materially affected, or are reasonably likely to materially affect, the Company s internal controls over financial reporting.

We do not expect that our disclosure controls and internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, with the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, a control may become inadequate because of changes in conditions or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

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4,415,747

3,006,698

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Stock-based compensation

The following table summarizes stock-based compensation expense by line item in the Condensed Consolidated Statements of Operations, all relating to employee stock plans:

	Three Months Ended June 30, 2008		Three Months Ended June 30, 2007	
	(In thousands)			
Cost of revenues	$	73	$	85
Research and development		104		128
Selling, general and administrative		152		174
Total	$	329	$	387

As stock-based compensation expense recognized in the Condensed Consolidated Statement of Operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures in accordance with the provisions of SFAS 123R. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company recognized related income tax benefits of $36,000 and $31,000, respectively, for the three months ended June 30, 2008 and 2007. Windfall tax benefits realized from exercised stock options during the three months ended June 30, 2008 were $226,000. There were no windfall tax benefits realized from exercised stock options during the three months ended June 30, 2007. Compensation cost capitalized within inventory at June 30, 2008 was insignificant. As of June 30, 2008, the Company s total unrecognized compensation cost was $2.1 million, which will be recognized over the weighted average period of 1.75 years. The Company calculated the fair value of stock based awards in the periods presented using the Black-Scholes option pricing model and the following weighted average assumptions:

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007
Stock Option Plans:		
Risk-free interest rate	3.16%	4.76%
Expected life (in years)	5.00	4.00
Volatility	43.5%	43.8%
Dividend yield	0%	0%
ESPP:		
Risk-free interest rate	1.89%	
Expected life (in years)	0.50	
Volatility	58.0%	
Dividend yield	0%	

NOTE 9 SEGMENT AND GEOGRAPHIC INFORMATION

The Company has adopted Statement of Financial Accounting Standards No. 131, *Disclosure about Segments of an Enterprise and Related Information.* Based on its operating management and financial reporting structure, the Company has determined that it has one reportable business segment: the design, development and sale of integrated circuits.

The following is a summary of net revenue by geographic area based on the location to which product is shipped:

	Three Months Ended June 30, 2008	2007
	(In thousands)	
United States	$ 6,767	$ 5,983
China	2,814	1,496
Malaysia	3,888	1,747
Singapore	2,093	890
Rest of the world	1,782	1,189
	$ 17,344	$ 11,305

All sales are denominated in United States dollars.

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NOTE 10 LITIGATION

On October 23, 2006, the Company was served with a civil antitrust complaint filed by Reclaim Center, Inc. and other plaintiffs in the United States District Court for the Northern District of California against the Company and a number of other semiconductor companies. The complaint was filed on behalf of a purported class of indirect purchasers of SRAM products throughout the United States. The complaint alleges that the defendants conspired to raise the price of SRAM in violation of Section 1 of the Sherman Act, the California Cartwright Act, and several other state antitrust, unfair competition and consumer protection statutes. Shortly thereafter, a number of similar complaints were filed by other plaintiffs in various jurisdictions on behalf of purported classes of both direct and indirect purchasers. The Company was served in some but not all of these subsequent actions. Many of these cases have been transferred by the Judicial Panel on Multidistrict Litigation to the Northern District of California. The Company has also been named in similar class action lawsuits in the Superior Court of Ontario, Canada and the Supreme Court of British Columbia, Canada. On July 23, 2007, the Company entered into agreements with the lead plaintiffs for the direct and indirect classes in the U.S. cases under which the Company was voluntarily dismissed from the litigation in exchange for a tolling of the statute of limitations. The plaintiffs have the right to terminate the tolling agreement and reassert their claims against the Company in the future. On April 28, 2008, the Company entered into a similar tolling agreement with the plaintiffs in the lawsuits in Canada. The Company believes that it has meritorious defenses to the allegations in the complaints and, if the plaintiffs reassert their claims, the Company intends to defend the lawsuits vigorously. However, antitrust litigation is particularly complex and can extend for a protracted time which can substantially increase the cost of such litigation. If these lawsuits were to be reinstated, their defense would also be expected to divert the efforts and attention of some of the Company s key management and technical personnel. As a result, if this litigation were to be reinstated, the Company s defense, regardless of its eventual outcome, would likely be costly and time consuming. Should the outcome of the litigation be adverse to the Company, it could be required to pay significant monetary damages which could adversely affect the Company s business, financial condition, operating results or cash flows.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

This Quarterly Report on Form 10-Q, and in particular the following Management s Discussion and Analysis of Financial Condition and Results of Operations, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as anticipates, believes, expects, intends, may, will, and other similar expressions. In addition, any statements which refer to expectations, projections, or other characterizations of future events, or circumstances, are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth in this report under Risk Factors, those described elsewhere in this report, and those described in our other reports filed with the Securities and Exchange Commission (SEC). We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to update these forward-looking statements after the filing of this report. You are urged to review carefully and consider our various disclosures in this report and in our other reports publicly disclosed or filed with the SEC that attempt to advise you of the risks and factors that may affect our business.

Overview

We are a fabless semiconductor company that designs, develops and markets Very Fast static random access memories, or SRAMs, primarily for the networking and telecommunications markets. We are subject to the highly cyclical nature of the semiconductor industry, which has experienced significant fluctuations, often in connection with fluctuations in demand for the products in which semiconductor devices are used. Beginning in fiscal 2001, the networking and telecommunications markets experienced an extended period of severe contraction, during which our operating results sharply declined. Between fiscal 2004 and fiscal 2006, demand for networking and telecommunications equipment recovered. During the first three quarters of fiscal 2007, demand for such equipment accelerated and, as a result, our operating results improved. In the fourth quarter of fiscal 2007 and the first quarter of fiscal 2008, revenues again declined due, in part, to the implementation of a lean manufacturing program by our largest customer, Cisco Systems. Purchases by Cisco Systems consignment warehouses and contract manufacturers increased in the four quarters ended June 30, 2008 compared to the prior two earlier quarters; however, we expect that future direct and indirect sales to Cisco Systems will fluctuate significantly on a quarterly basis.

Revenues. Our revenues are derived primarily from sales of our Very Fast SRAM products. Sales to networking and telecommunications OEMs accounted for 70% to 80% of our net revenues during our last three fiscal years. We also sell our products to OEMs that manufacture products for defense applications such as radar and guidance systems, for professional audio applications such as sound mixing systems, for test and measurement applications such as high-speed testers, for automotive applications such as smart cruise control and voice recognition systems, and for medical applications such as ultrasound and CAT scan equipment.

As is typical in the semiconductor industry, the selling prices of our products generally decline over the life of the product. Our ability to increase net revenues, therefore, is dependent upon our ability to increase unit sales volumes of existing products and to introduce and sell new products with higher average selling prices in quantities sufficient to compensate for the anticipated declines in selling prices of our more mature products. Although we expect the average selling prices of individual products to decline over time, we believe that, over the next several quarters, our overall average selling prices will increase due to a continuing shift in product mix to a higher percentage of higher price, higher density products. Our ability to increase unit sales volumes is dependent primarily upon increases in customer demand but, particularly in periods of increasing demand, can also be affected by our ability to increase production through the availability of increased wafer fabrication capacity from Taiwan Semiconductor Manufacturing Company, or TSMC, our independent wafer foundry, and our ability to increase the number of good integrated circuit die produced from each wafer through die size reductions and yield enhancement activities.

We may experience fluctuations in quarterly net revenues for a number of reasons. Historically, orders on hand at the beginning of each quarter are insufficient to meet our revenue objectives for that quarter and are generally cancelable up to 30 days prior to scheduled delivery. Accordingly, we depend on obtaining and shipping orders in the same quarter to achieve our revenue objectives. In addition, the timing of product releases, purchase orders and product availability could result in significant product shipments at the end of a quarter. Failure to ship these products by the end of the quarter may adversely affect our operating results. Furthermore, our customers may delay scheduled delivery dates and/or cancel orders within specified time frames without significant penalty.

We sell our products through our direct sales force, international and domestic sales representatives and distributors. Revenues from product sales, except for sales to distributors, are generally recognized upon shipment, net of sales returns and allowances. Sales to consignment warehouses, who purchase products from us for use by contract manufacturers, are recorded upon delivery to the contract manufacturer. Sales to distributors are recorded as deferred revenues for financial reporting purposes and recognized as revenues when the products are resold by the distributors to the OEM. Sales to distributors are made under agreements allowing for returns or credits under certain circumstances. We therefore defer recognition of revenue on sales to distributors until products are resold by the distributor.

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Cisco Systems, our largest OEM customer, purchases our products primarily through its consignment warehouse, SMART Modular Technologies, and also purchases some products through its contract manufacturers and directly from us. Historically, purchases by Cisco Systems have fluctuated from period to period. Based on information provided to us by Cisco Systems consignment warehouse and contract manufacturers, purchases by Cisco Systems represented approximately 28%, 30% and 28% of our net revenues in fiscal 2008, 2007 and 2006, respectively. During the quarter ended March 31, 2007, Cisco Systems announced the implementation of a lean manufacturing program under which it reduced the levels of inventory carried by it and by its contract manufacturers. The transition to this new program resulted in reductions in purchases of our products by Cisco Systems contract manufacturers during the quarter ended March 31, 2007, as they drew down existing inventories. This transition continued to impact our revenues in the quarter ended June 30, 2007. Purchases by Cisco Systems consignment warehouses and contract manufacturers increased in the four quarters ended June 30, 2008 compared to the two immediately preceding quarters; however, we expect that future direct and indirect sales to Cisco Systems will fluctuate significantly on a quarterly basis.

To our knowledge, none of our other OEM customers accounted for more than 10% of our net revenues during any of these periods.

Cost of Revenues. Our cost of revenues consists primarily of wafer fabrication costs, wafer sort, assembly, test and burn-in expenses, the amortized cost of production mask sets, stock-based compensation and the cost of materials and overhead from operations. All of our wafer manufacturing and assembly operations, and most of our product testing operations, are outsourced. Accordingly, most of our cost of revenues consists of payments to TSMC, our independent wafer foundry, and to our independent assembly and test houses. Cost of revenues also includes expenses related to supply chain management, quality assurance, and final product testing and documentation control activities conducted at our headquarters in Santa Clara, California and our branch operations in Taiwan.

Gross Profit. Our gross profit margins vary among our products and are generally greater on our higher density products and, within a particular density, greater on our higher speed and industrial temperature products. We expect that our overall gross margins will fluctuate from period to period as a result of shifts in product mix, changes in average selling prices and our ability to control our cost of revenues, including costs associated with outsourced wafer fabrication and product assembly and testing.

Research and Development Expenses. Research and development expenses consist primarily of salaries and related expenses for design engineers and other technical personnel, the cost of developing prototypes, stock-based compensation and fees paid to consultants. We charge all research and development expenses to operations as incurred. We charge mask costs used in production to costs of revenues over a 12-month period. However, we charge costs related to pre-production mask sets, which are not used in production, to research and development expenses at the time they are incurred. These charges often arise as we transition to new process technologies and, accordingly, can cause research and development expenses to fluctuate on a quarterly basis. We believe that continued investment in research and development is critical to our long-term success, and we expect to continue to devote significant resources to product development activities. Accordingly, we expect that our research and development expenses will increase in future periods, although such expenses as a percentage of net revenues may fluctuate.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of commissions paid to independent sales representatives, salaries, stock-based compensation and related expenses for personnel engaged in sales, marketing, administrative, finance and human resources activities, professional fees, costs associated with the promotion of our products and other corporate expenses. We expect that our sales and marketing expenses will increase in absolute dollars in future periods as we continue to grow and expand our sales force but that, to the extent our revenues increase in future periods, these expenses will generally decline as a percentage of net revenues. We also expect that, in support of our continued growth and our operations as a public company, general and administrative expenses will continue to increase in absolute dollars for the foreseeable future but will fluctuate as a percentage of net revenues.

Results of Operations

The following table sets forth statement of operations data as a percentage of net revenues for the periods indicated:

	Three Months Ended June 30,	
	2008	**2007**
Net revenues	100.0%	100.0%
Cost of revenues	55.7	60.9
Gross profit	44.3	39.1
Operating expenses:		
Research and development	7.2	10.0
Selling, general and administrative	14.2	19.4
Total operating expenses	21.4	29.4
Income from operations	22.9	9.7
Interest and other income (expense), net	1.9	4.1
Income before income taxes	24.8	13.8
Provision for income taxes	7.3	4.5
Net income	17.5%	9.3%

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Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

Net Revenues. Net revenues increased by 53.4% from $11.3 million in the three months ended June 30, 2007 to $17.3 million in the three months ended June 30, 2008. Direct and indirect sales to Cisco Systems, our largest customer, increased by $2.7 million from $3.0 million in the three months ended June 30, 2007 to $5.7 million in the three months ended June 30, 2008. Purchases by Cisco Systems consignment warehouses and contract manufacturers were adversely impacted by Cisco s transition to its lean manufacturing program discussed above during the three months ended June 30, 2007. Strength in our North American business and Asian business accounted for the balance of the increase in net revenues. The improvement in net revenues was helped by a continued acceptance of our SigmaQuad product line which saw an increase in shipments of 218% in the three months ended June 30, 2008 compared to the three months ended June 30, 2007, accounting for 8.2% of shipments in the quarter ended June 30, 2008.

Cost of Revenues. Cost of revenues increased by 40.2% from $6.9 million in the three months ended June 30, 2007 to $9.7 million in the three months ended June 30, 2008. This increase was due to the increase in net revenues. Cost of revenues included stock-based compensation of $73,000 and $85,000, respectively, for the three months ended June 30, 2008 and 2007.

Gross Profit. Gross profit increased by 74.0% from $4.4 million in the three months ended June 30, 2007 to $7.7 million in the three months ended June 30, 2008. Gross margin increased from 39.1% in the three months ended June 30, 2007 to 44.3% in the three months ended June 30, 2008. This increase was primarily related to a shift in product mix to higher density, higher margin products.

Research and Development Expenses. Research and development expenses increased 10.7% from $1.1 million in the three months ended June 30, 2007 to $1.3 million in the three months June 30, 2008. This increase was primarily due to increases in payroll related expenses and outside design fees, partially offset by decreases in depreciation and prototype expenses. Research and development expenses included stock-based compensation expense of $104,000 and $127,000 for the three months ended June 30, 2008 and 2007, respectively.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 12.3% from $2.2 million in the three months ended June 30, 2007 to $2.5 million in the three months ended June 30, 2008. This increase was primarily due to increases of $198,000 in consulting fees related to implementation and maintenance of our new enterprise resource planning (ERP) system, $155,000 in commissions for our independent sales representatives and a lesser increase in payroll related expenses offset primarily by decreases in outside accounting fees and legal fees. Selling, general and administrative expenses included stock-based compensation expense of $151,000 and $174,000 for the three months ended June 30, 2008 and 2007, respectively.

Interest and Other Income (Expense), Net. Interest and other income (expense), net decreased 32.3%, from $465,000 in the three months ended June 30, 2007 to $315,000 in the three months ended June 30, 2008. This decrease was primarily the result of a decrease in interest income due to lower interest rates received on our cash, short-term and long-term investments. In addition, we experienced an exchange gain of $52,000 in the three months ended June 30, 2007 compared to an exchange loss of $57,000 in the three months ended June 30, 2008 related to our Taiwan branch operations.

Provision for Income Taxes. The provision for income taxes increased from $0.5 million in the three months ended June 30, 2007 to $1.3 million in the three months ended June 30, 2008. This increase was due to the increased pre-tax income and the increased effective tax rate in the three months ended June 30, 2008.

Net Income. Net income increased 187.3% from $1.1 million in the three months ended June 30, 2007 to $3.0 million in the three months ended June 30, 2008. This increase was primarily due to the increased net revenues and gross margin and the changes in operating expenses and gross profit discussed above.

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Liquidity and Capital Resources

Since our inception, we have used proceeds from a number of sources, including the private sale of $9.6 million of equity securities, bank borrowings and cash generated by operating activities to support our operations, acquire capital equipment and finance accounts receivable and inventory growth. Our liquidity was enhanced by the receipt of net proceeds of approximately $30.0 million from the initial public offering of our common stock which closed on April 3, 2007.

As of June 30, 2008, our principal sources of liquidity were cash, cash equivalents and short term investments of $32.1 million compared to $39.6 million as of March 31, 2008.

Net cash provided by operating activities was $4.3 million for three months ended June 30, 2008 compared to $4.6 million for three months ended June 30, 2007. The primary sources of cash in the current three month period were net income of $3.0 million and a $1.6 million decrease in inventory, primarily reflecting a reduction in wafer purchases from TSMC. These sources of cash were offset by an increase in accounts receivable of $897,000 and reductions in accounts payable of $540,000 and deferred revenue of $674,000.

Net cash used in investing activities was $4.4 million in the three month period ended June 30, 2008. Investment activities consisted primarily of the purchase of state and municipal obligations and corporate notes and purchases of property and equipment of $369,000. These uses were offset by sales and maturities of investments of $16.0 million. Net cash used in investing activities was $24.2 million in the three month period ended June 30, 2007. Investment activities consisted primarily of the purchase of state and municipal obligations and auction rate securities of $26.6 million and the purchase of test equipment and software in the amount of $1.6 million. These uses were offset by sales and maturities of investments of $3.0 million and a reduction in restricted cash of $1.0 million due to the expiration of our line of credit with Mega International Commercial Bank Co., Ltd on May 9, 2007 which we did not renew.

Net cash provided by financing activities in the three months ended June 30, 2008 primarily included net proceeds from the sale of common stock pursuant to employee stock plans in the current three month period. Net cash provided by financing activities in the three month period ended June 30, 2007 included net proceeds from the sale of common stock pursuant to option exercises and our initial public offering of common stock of $31.4 million, partially offset by a use of cash of $739,000 incurred for costs related to our initial public offering that closed on April 3, 2007.

We believe that our existing balances of cash, cash equivalents and short-term investments, and cash flow expected to be generated from our future operations will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months, although we could be required, or could elect, to seek additional funding prior to that time. Our future capital requirements will depend on many factors, including the rate of revenue growth that we experience, the extent to which we utilize subcontractors, the levels of inventory and accounts receivable that we maintain, the timing and extent of spending to support our product development efforts and the expansion of our sales and marketing efforts. Additional capital may also be required for the consummation of any acquisition of businesses, products or technologies that we may undertake. We cannot assure you that additional equity or debt financing, if required, will be available on terms that are acceptable or at all.

Contractual Obligations

The following table describes our contractual obligations as of June 30, 3008:

	Payments due by period				
	Up to 1 year	**1-3 years**	**3-5 years**	**More than 5 years**	**Total**
Facilities and equipment leases	$ 700,000	$ 518,000			$ 1,218,000
Wafer purchase obligations	7,253,000				7,253,000
	$ 7,953,000	$ 518,000			$ 8,471,000

As of June 30, 2008, our unrecognized tax benefits amounted to $356,000. There was no current portion of our unrecognized tax benefits at June 30, 2008. The long term portion at June 30, 2008 was $356,000, of which the timing of the resolution is uncertain.

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Critical Accounting Policies and Estimates

Our critical accounting policies and estimates are disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2008. We have adopted SFAS No. 157 effective April 1, 2008 for financial assets and liabilities measured on a recurring basis. The adoption of SFAS No. 157 for financial assets and liabilities did not have a material impact on our financial position or results of operations. We have not otherwise materially changed our significant accounting policies and estimates.

Off-Balance Sheet Arrangements

At June 30, 2008, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Accordingly, we are not exposed to the type of financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Recent Accounting Pronouncements

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133* (SFAS No. 161), which expands the disclosure requirements for derivative instruments and hedging activities. SFAS No. 161 specifically requires entities to provide enhanced disclosures addressing: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the potential impact of this pronouncement on our consolidated financial position, results of operations and disclosures.

In December 2007, the FASB issued SFAS 141(R), *Business Combinations* (SFAS 141R). SFAS 141R replaces SFAS 141, *Business Combinations* (SFAS 141). SFAS 141R retains the fundamental requirements in SFAS 141 that the acquisition method of accounting (which SFAS 141 called the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. SFAS 141R also establishes principles and requirements for how the acquirer: (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R will apply prospectively to business combinations for which the acquisition date is on or after April 1, 2009, the beginning of our next fiscal year. While we have not yet evaluated this statement for the impact, if any, that SFAS 141R will have on our consolidated financial statements, we will be required to expense costs related to any acquisitions after March 31, 2009.

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160). SFAS 160 amends Accounting Research Bulletin 51 to establish accounting and reporting standards for the noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. We have not yet determined the impact, if any, that SFAS 160 will have on our consolidated financial statements. SFAS 160 is effective for our fiscal year beginning April 1, 2009.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* which permits entities to choose to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The adoption of SFAS 159 did not have an effect on our financial position or results of operations as we did not elect this fair value option.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. The changes to previous practice resulting from the application of this Statement relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13* (FSP 157-1). FSP 157-1 amends SFAS No. 157 to exclude from its scope SFAS No. 13 and other pronouncements that address fair value measurements for purposes of lease classification or measurement. The scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value (including assets and liabilities not related to leases). In February 2008, the FASB issued Staff Position 157-2, *Effective Date of FASB Statement No. 157*, (FSP 157-2) which delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. We adopted SFAS No. 157 effective April 1, 2008 for financial assets and liabilities measured on a recurring basis. The adoption of SFAS No. 157 for financial assets and liabilities did not have a material impact on our financial position or results of operations.

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Item 3. ***Quantitative and Qualitative Disclosure About Market Risk***

Foreign Currency Exchange Risk. Our revenues and expenses, except those expenses related to our operations in Taiwan, including subcontractor manufacturing expenses, are denominated in U.S. dollars. As a result, we have relatively little exposure for currency exchange risks, and foreign exchange losses have been minimal to date. We do not currently enter into forward exchange contracts to hedge exposure denominated in foreign currencies or any other derivative financial instruments for trading or speculative purposes. In the future, if we feel our foreign currency exposure has increased, we may consider entering into hedging transactions to help mitigate that risk.

Interest Rate Sensitivity. We had cash, cash equivalents, short term investments and long-term investments totaling $59.3 million at June 30, 2008. These amounts were invested primarily in money market funds, state and municipal obligations, corporate notes and auction rate securities. The cash, cash equivalents and short-term marketable securities are held for working capital purposes. We do not enter into investments for trading or speculative purposes. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. We believe a hypothetical 100 basis point increase in interest rates would not materially affect the fair value of our interest-sensitive financial instruments. Declines in interest rates, however, will reduce future investment income.

Auction Rate Securities. As of June 30, 2008, the carrying value of the auction rate security held in our investment portfolio totaled $1.8 million. This auction rate security is backed by a state, is insured and rated by the major independent rating agencies as either AAA or Aaa. This auction rate security had auctions that have failed since February 2008 and we continue to earn interest at the contractual rate. These failures are not believed to be a credit issue, but rather caused by a lack of liquidity. We have classified this auction rate security as a long-term investment as of June 30, 2008 due to lack of liquidity, as it is not to expected to be sold or redeemed within the next twelve months. In the event we should need access to these funds, they are not expected to be accessible until one of the following occurs: a successful auction occurs, the issuer redeems the issue, a buyer is found outside of the auction process or the security matures. As of June 30, 2008, we performed a discounted cash flow analysis based on variables that reflect the risks and nature of this security, including a sensitivity analysis on the expected time to redemption given current market conditions, and determined that a temporary impairment in value of $133,000 existed as of June 30, 2008 that was recorded within accumulated other comprehensive income (loss).

Item 4T. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. Based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of June 30, 2008, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report for the purpose of ensuring that the information required to be disclosed by us in this report is made known to them by others on a timely basis, and that the information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, in order to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized, and reported by us within the time periods specified in the SEC s rules and instructions for Form 10-Q.

Changes in Internal Control over Financial Reporting. There were no changes in our internal control over financial reporting that occurred during the three months ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. *Legal Proceedings*

The information relating to legal matters set forth under Note 10 Litigation of the Notes to Unaudited Condensed Consolidated Financial Statements of this report is incorporated herein by reference.

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Item 1A. ***Risk Factors***

Our future performance is subject to a variety of risks. If any of the following risks actually occur, our business, financial condition and results of operations could suffer and the trading price of our common stock could decline. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations. You should also refer to other information contained in this report, including our consolidated financial statements and related notes. The risk factors described below do not contain any material changes from those previously disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2008.

Unpredictable fluctuations in our operating results could cause our stock price to decline.

Our quarterly and annual revenues, expenses and operating results have varied significantly and are likely to vary in the future. For example, in the twelve fiscal quarters ended June 30, 2008, we recorded net revenues of as much as $17.3 million and as little as $10.4 million and quarterly operating income of as much as $4.0 million and as little as $508,000. We therefore believe that period-to-period comparisons of our operating results are not a good indication of our future performance, and you should not rely on them to predict our future performance or the future performance of our stock price. In other future periods, we may not have any revenue growth, or our revenues could decline. Furthermore, if our operating expenses exceed our expectations, our financial performance could be adversely affected. Factors that may affect periodic operating results in the future include:

- our ability to attract new customers, retain existing customers and increase sales to such customers;

- unpredictability of the timing and size of customer orders, since most of our customers purchase our products on a purchase order basis rather than pursuant to a long term contract;

- changes in our customers inventory management practices;

- fluctuations in availability and costs associated with materials needed to satisfy customer requirements;

- manufacturing defects, which could cause us to incur significant warranty, support and repair costs, lose potential sales, harm our relationships with customers and result in write-downs;

- changes in our product pricing policies, including those made in response to new product announcements and pricing changes of our competitors; and

- our ability to address technology issues as they arise, improve our products functionality and expand our product offerings.

Our expenses are, to a large extent, fixed, and we expect that these expenses will increase in the future. We will not be able to adjust our spending quickly if our revenues fall short of our expectations. If this were to occur, our operating results would be harmed. If our operating results in future quarters fall below the expectations of market analysts and investors, the price of our common stock could fall.

Cisco Systems, our largest OEM customer, accounts for a significant percentage of our net revenues. If Cisco Systems, or any of our other major customers reduce the amount they purchase or stop purchasing our products, our operating results will suffer.

Cisco Systems, our largest OEM customer, purchases our products through SMART Modular Technologies, its consignment warehouse, through its contract manufacturers and directly from us. Based on information provided to us by consignment warehouses and contract manufacturers, purchases by Cisco Systems represented approximately 33%, 28%, 30% and 28% of our net revenues in the three months ended June 30, 2008 and in fiscal 2008, 2007 and 2006, respectively. In the quarter ended March 31, 2007, Cisco Systems implemented a lean manufacturing program under which it reduced the levels of inventory carried by it and by its contract manufacturers. The transition to this new program resulted in reductions in purchases of our products by Cisco Systems contract manufacturers during the quarters ended June 30, 2007 and March 31, 2007, as they drew down their existing inventories, and such reductions resulted in our net revenues for these quarters being less than in the quarter ended December 31, 2006.

We expect that our operating results in any given period will continue to depend significantly on orders from our key OEM customers, particularly Cisco Systems, and our future success is dependent to a large degree on the business success of these OEMs over which we have no control. We do not have long-term contracts with Cisco Systems or any of our other major OEM customers, distributors or contract manufacturers that obligate them to purchase our products. Although Cisco Systems has completed the transition to its lean manufacturing program, we expect that future direct and indirect sales to Cisco Systems will fluctuate significantly on a quarterly basis. If we fail to continue to sell to our key OEM customers, distributors or contract manufacturers in sufficient quantities, the growth of our business could be harmed.

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We have incurred significant losses in prior periods and may incur losses in the future.

We have incurred significant losses in prior periods. For example, in fiscal 2003 and 2004, we incurred losses of $7.4 million and $670,000, respectively. Although we have operated profitably during the last four fiscal years, there can be no assurance that our Very Fast SRAMs will continue to receive broad market acceptance or that we will be able to sustain revenue growth or profitability. Our failure to do so may result in additional losses in the future. In addition, we expect our operating expenses to increase as we expand our business. If our revenues do not grow to offset these expected increased expenses, our business will suffer.

We depend upon the sale of our Very Fast SRAMs for most of our revenues, and a downturn in demand for these products could significantly reduce our revenues and harm our business.

We derive most of our revenues from the sale of Very Fast SRAMs, and we expect that sales of these products will represent the substantial majority of our revenues for the foreseeable future. Our business depends in large part upon continued demand for our products in the markets we currently serve, and adoption of our products in new markets. Market adoption will be dependent upon our ability to increase customer awareness of the benefits of our products and to prove their high-performance and cost-effectiveness. We may not be able to sustain or increase our revenues from sales of our products, particularly if the networking and telecommunications markets were to experience another significant downturn in the future. Any decrease in revenues from sales of our products could harm our business more than it would if we offered a more diversified line of products.

We are subject to the highly cyclical nature of the networking and telecommunications markets.

Our products are incorporated into routers, switches, wireless local area network infrastructure equipment, wireless base stations and network access equipment used in the highly cyclical networking and telecommunications markets. Our operating results declined sharply in fiscal 2002 and 2003 as a result of the severe contraction in demand for networking and telecommunications equipment in which our products are incorporated. Prior to this period of contraction, the networking and telecommunications markets experienced a period of rapid growth, which resulted in a significant increase in demand for our products. We expect that the networking and telecommunications markets will continue to be highly cyclical, characterized by periods of rapid growth and contraction. Our business and our operating results are likely to fluctuate, perhaps quite severely, as a result of this cyclicality.

The average selling prices of our products are expected to decline, and if we are unable to offset these declines, our operating results will suffer.

Historically, the average unit selling prices of our products have declined substantially over the lives of the products, and we expect this trend to continue. A reduction in overall average selling prices of our products could result in reduced revenues and lower gross margins. Our ability to increase our net revenues and maintain our gross margins despite a decline in the average selling prices of our products will depend on a variety of factors, including our ability to introduce lower cost versions of our existing products, increase unit sales volumes of these products, and introduce new products with higher prices and greater margins. If we fail to accomplish any of these objectives, our business will suffer. To reduce our costs, we may be required to implement design changes that lower our manufacturing costs, negotiate reduced purchase prices from our independent foundry, TSMC, and our independent assembly and test vendors, and successfully manage our manufacturing and subcontractor relationships. Because we do not operate our own wafer foundry or assembly facilities, we may not be able to reduce our costs as rapidly as companies that operate their own foundries or facilities.

We rely heavily on distributors and our success depends on our ability to develop and manage our indirect distribution channels.

A significant percentage of our sales are made to distributors and to contract manufacturers who incorporate our products into end products for OEMs. For example, in the three months ended June 30, 3008 and in fiscal 2008, 2007 and 2006, our distributor Avnet Logistics accounted for 23.4%, 29.2%, 24.7% and 30.4%, respectively, of our net revenues and our distributor Nu Horizons accounted for 7.6%, 7.2%, 8.7% and 10.3%, respectively, of our net revenues. Avnet Logistics, Nu Horizons and our other existing distributors may choose to devote greater resources to marketing and supporting the products of other companies. Since we sell through multiple channels and distribution networks, we may have to resolve potential conflicts between these channels. For example, these conflicts may result from the different discount levels offered by multiple channel distributors to their customers or, potentially, from our direct sales force targeting the same equipment manufacturer accounts as our indirect channel distributors. These conflicts may harm our business or reputation.

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We may be unable to accurately predict future sales through our distributors, which could harm our ability to efficiently manage our resources to match market demand.

Our financial results, quarterly product sales, trends and comparisons are affected by fluctuations in the buying patterns of the OEMs that purchase our products from our distributors. While we attempt to assist our distributors in maintaining targeted stocking levels of our products, we may not consistently be accurate or successful. This process involves the exercise of judgment and use of assumptions as to future uncertainties, including end user demand. Inventory levels of our products held by our distributors may exceed or fall below the levels we consider desirable on a going-forward basis. This could result in distributors returning unsold inventory to us, or in us not having sufficient inventory to meet the demand for our products. If we are not able to accurately predict sales through our distributors or effectively manage our relationships with our distributors, our business and financial results will suffer.

A small number of customers generally account for a significant portion of our accounts receivable in any period, and if any one of them fails to pay us, our operating results will suffer.

At June 30, 2008, three customers accounted for 25%, 18% and 13% of accounts receivable, respectively. If any of these customers do not pay us, our operating results will be harmed. Generally, we do not require collateral from our customers.

If the recent worsening of credit market conditions continues or increases, it could have a material adverse impact on our investment portfolio.

Recent U.S. sub-prime mortgage defaults have had a significant impact across various sectors of the financial markets, causing global credit and liquidity issues. The short-term funding markets experienced credit issues during the second half of fiscal 2008 which have continued into the second quarter of fiscal 2009, leading to liquidity disruption in asset-backed commercial paper and failed auctions in the auction rate securities markets. If the global credit market continues to deteriorate, our investment portfolio may be impacted and we could determine that some of our investments are impaired. This could materially adversely impact our results of operations and financial condition.

As of June 30, 2008, the auction rate security that we own has experienced several failed auctions due to sell orders exceeding buy orders. These failures are not believed to be a credit issue, but rather by a lack of liquidity. This auction rate security has been classified as a long-term investment as of June 30, 2008 due to lack of liquidity and as it is not expected to be sold or redeemed within the next twelve months. In the event we should need access to these funds, they are not expected to be accessible until one of the following occurs: a successful auction occurs, the issuer redeems the issue, a buyer is found outside of the auction process or the security matures. As of June 30, 2008, we performed a discounted cash flow analysis based on variables that reflect the risks and nature of this security, including a sensitivity analysis on the expected time to redemption given current market conditions, and determined that a temporary impairment in value of $133,000 existed as of June 30, 2008 that was charged to accumulated other comprehensive income (loss).

Although we determined that no other-than-temporary impairment losses existed as of June 30, 2008 with respect to our auction rate security holding, we may be required to adjust the carrying value of the auction rate security and record impairment charges in future periods, which could materially affect our results of operations and financial condition.

We could become subject to claims and litigation regarding intellectual property rights, which could seriously harm our business and require us to incur significant costs.

In recent years, there has been significant litigation in the semiconductor industry involving patents and other intellectual property rights. In the past, we have been subject to claims and litigation regarding alleged infringement of other parties intellectual property rights. In 2002, we settled patent litigation filed against us by one of our competitors. In connection with the settlement, we obtained a license from that competitor and agreed to pay a license fee and ongoing royalties. We could become subject to additional litigation in the future as a result of allegations that we infringe others intellectual property rights or that our use of intellectual property otherwise violates the law. Claims that our products infringe the proprietary rights of others would force us to defend ourselves and possibly our customers or manufacturers against the alleged infringement. Any such litigation regarding intellectual property could result in substantial costs and diversion of resources and could have a material adverse effect on our business, financial condition and results of operations. Similarly, changing our products or processes to avoid infringing the rights of others may be costly or impractical. If any claims received in the future were to be upheld, the consequences to us would be severe and could require us to:

- stop selling our products that incorporate the challenged intellectual property;

- obtain a license to sell or use the relevant technology, which license may not be available on reasonable terms or at all;

- pay damages; or

- redesign those products that use the disputed technology.

Although patent disputes in the semiconductor industry have often been settled through cross-licensing arrangements, we may not be able in any or every instance to settle an alleged patent infringement claim through a cross-licensing arrangement. We have a more limited patent portfolio than many of our competitors. If a successful claim is made against us or any of our customers and a license is not made available to us on commercially reasonable terms or we are required to pay substantial damages or awards, our business, financial condition and results of operations would be materially adversely affected.

Our business will suffer if we are unable to protect our intellectual property.

Our success and ability to compete depends in large part upon protecting our proprietary technology. We rely on a combination of patent, trade secret, copyright and trademark laws and non-disclosure and other contractual agreements to protect our proprietary rights. These agreements and measures may not be sufficient to protect our technology from third-party infringement, or to protect us from the claims of others. Monitoring unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. Our attempts to enforce our intellectual property rights could be time consuming and costly. Litigation may be necessary in order to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement. If competitors are able to use our technology without our approval or compensation, our ability to compete effectively could be harmed.

The market for Very Fast SRAMs is highly competitive.

The market for Very Fast SRAMs, which are used primarily in networking and telecommunications equipment, is characterized by price erosion, rapid technological change, cyclical market patterns and heightened foreign and domestic competition. Several of our competitors offer a broad array of memory products and have greater financial, technical, marketing, distribution and other resources than we have. Some of our competitors maintain their own semiconductor fabrication facilities, which may provide them with capacity, cost and technical advantages over us. We cannot assure you that we will be able to compete successfully against any of these competitors. Our ability to compete successfully in this market depends on factors both within and outside of our control, including:

- real or perceived imbalances in supply and demand of Very Fast SRAMs;
- the rate at which OEMs incorporate our products into their systems;
- the success of our customers   products;
- our ability to develop and market new products;
- access to advanced process technologies at competitive prices; and
- the supply and cost of wafers.

In addition, we are vulnerable to advances in technology by competitors, including new SRAM architectures and new forms of DRAM, or the emergence of new memory technologies that could enable the development of products that feature higher performance, lower cost or lower power capabilities. Additionally, the trend toward incorporating SRAM into other chips in the networking and telecommunications markets has the potential to reduce future demand for Very Fast SRAM products. There can be no assurance that we will be able to compete successfully in the future. Our failure to compete successfully in these or other areas could harm our business.

We may experience difficulties in transitioning to smaller geometry process technologies and other more advanced manufacturing process technologies, which may result in reduced manufacturing yields, delays in product deliveries and increased expenses.

In order to remain competitive, we expect to continue to transition the manufacture of our products to smaller geometry process technologies. This transition will require us to migrate to new manufacturing processes for our products and redesign certain products. The manufacture and design of our products is complex, and we may experience difficulty in transitioning to smaller geometry process technologies or new manufacturing processes. These difficulties could result in reduced manufacturing yields, delays in product deliveries and increased expenses. We are dependent on our relationships with TSMC to transition successfully to smaller geometry process technologies and to more advanced manufacturing processes. We cannot assure you that TSMC will be able to effectively manage the transition or that we will be able to maintain our relationship with TSMC. If we or TSMC experience significant delays in this transition or fail to implement these transitions, our business, financial condition and results of operations could be materially and adversely affected.

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Manufacturing process technologies are subject to rapid change and require significant expenditures for research and development.

We continuously evaluate the benefits of migrating to smaller geometry process technologies in order to improve performance and reduce costs. Historically, these migrations to new manufacturing processes have resulted in significant initial design and development costs associated with pre-production mask sets for the manufacture of new products with smaller geometry process technologies. For example, in fiscal 2006, we incurred $678,000 in research and development expense associated with pre-production mask sets, which were not later used in production as part of the transition to our new 90 nanometer process technology. We will incur similar expenses in the future as we continue to transition our products to smaller geometry processes. The transition costs inherent in the transition to new manufacturing process technologies will adversely affect our operating results and our gross margin.

Our products are complex to design and manufacture and could contain defects, which could reduce revenues or result in claims against us.

We develop complex products. Despite testing by us and our OEM customers, design or manufacturing errors may be found in existing or new products. These defects could result in a delay in recognition or loss of revenues, loss of market share or failure to achieve market acceptance. These defects may also cause us to incur significant warranty, support and repair costs, divert the attention of our engineering personnel from our product development efforts, result in a loss of market acceptance of our products and harm our relationships with our OEM customers. Our OEM customers could also seek and obtain damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend.

Defects in wafers and other components used in our products and arising from the manufacturing of these products may not be fully recoverable from TSMC or other suppliers. For example, in the quarter ended December 31, 2005, we incurred a charge of approximately $900,000 related to the write-off of inventory resulting from an error in the assembly process at one of our suppliers. This write-off adversely affected our operating results for fiscal 2006.

We are dependent on a number of single source suppliers, and if we fail to obtain adequate supplies, our business will be harmed and our prospects for growth will be curtailed.

We currently purchase several key components used in the manufacture of our products from single sources and are dependent upon supply from these sources to meet our needs. If any of these suppliers cannot provide components on a timely basis, at the same price or at all, our ability to manufacture our products will be constrained and our business will suffer. For example, we obtain wafers from a single foundry, TSMC. If we are unable to obtain an adequate supply of wafers from TSMC or find alternative sources in a timely manner, we will be unable to fulfill our customer orders and our operating results will be harmed. We do not have supply agreements with TSMC or any of our independent assembly and test suppliers, and instead obtain manufacturing services and products on a purchase-order basis. Our suppliers, including TSMC, have no obligation to supply products or services to us for any specific product, in any specific quantity, at any specific price or for any specific time period. As a result, the loss or failure to perform by any of these suppliers could adversely affect our business and operating results.

Should any of our single source suppliers experience manufacturing failures or yield shortfalls, be disrupted by natural disaster or political instability, choose to prioritize capacity or inventory for other uses or reduce or eliminate deliveries to us, we likely will not be able to enforce fulfillment of any delivery commitments and we would have to identify and qualify acceptable replacements from alternative sources of supply.

In particular, if TSMC is unable to supply us with sufficient quantities of wafers to meet all of our requirements, we would have to allocate our products among our customers, which would constrain our growth and might cause some of them to seek alternative sources of supply. Since the manufacturing of wafers and other components is extremely complex, the process of qualifying new foundries and suppliers is a lengthy process and there is no assurance that we will be able to find and qualify another supplier without materially adversely affecting our business, financial condition and results of operations.

Because we outsource our wafer manufacturing and independent wafer foundry capacity is limited, we may be required to enter into costly long-term supply arrangements to secure foundry capacity.

We do not have long-term supply agreements with TSMC, but instead obtain our wafers on a purchase order basis. In order to secure future wafer supply from TSMC or from other independent foundries, we may be required to enter into various arrangements with them, which could include:

- contracts that commit us to purchase specified quantities of wafers over extended periods;
- investments in and joint ventures with the foundries; or
- non-refundable deposits with or prepayments or loans to foundries in exchange for capacity commitments.

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We may not be able to make any of these arrangements in a timely fashion or at all, and these arrangements, if any, may not be on terms favorable to us. Moreover, even if we are able to secure independent foundry capacity, we may be obligated to use all of that capacity or incur penalties. These penalties may be expensive and could harm our financial results.

If we are unable to offset increased wafer fabrication costs by increasing the average selling prices of our products, our gross margins will suffer.

If there is a significant upturn in the networking and telecommunications markets that results in increased demand for our products and competing products, the available supply of wafers may be limited. As a result, we could be required to obtain additional manufacturing capacity in order to meet increased demand. Securing additional manufacturing capacity may cause our wafer fabrication costs to increase. If we are unable to offset these increased costs by increasing the average selling prices of our products, our gross margins will decline.

Demand for our products may decrease if our OEM customers experience difficulty manufacturing, marketing or selling their products.

Our products are used as components in our OEM customers   products. For example, Cisco Systems, our largest OEM customer, incorporates our products in a number of its networking routers and switches. Accordingly, demand for our products is subject to factors affecting the ability of our OEM customers to successfully introduce and market their products, including:

- capital spending by telecommunication and network service providers and other end users who purchase our OEM customers   products;
- the competition our OEM customers face, particularly in the networking and telecommunications industries;
- the technical, manufacturing, sales and marketing and management capabilities of our OEM customers;
- the financial and other resources of our OEM customers; and
- the inability of our OEM customers to sell their products if they infringe third-party intellectual property rights.

As a result, if OEM customers reduce their purchases of our products, our business will suffer.

Downturns in the semiconductor industry may harm our revenues and margins.

The semiconductor industry is highly cyclical. The industry has experienced significant downturns, often in connection with, or in anticipation of, maturing product cycles of both semiconductor companies and their customers products and declines in general economic conditions. These downturns have been characterized by production overcapacity, high inventory levels and accelerated erosion of average selling prices. From time to time, the semiconductor industry also has experienced periods of increased demand and production capacity constraints.

Our operating results may suffer during the down portion of these cycles. For example, the SRAM industry experienced significant declines in the average selling prices of SRAM products during the recent downturn in the semiconductor industry. We expect similar declines to occur in the future. Downturns in the semiconductor industry could cause our stock price to be volatile, and a prolonged decline in the industry could adversely affect our revenues. If we are unable to control our expenses adequately in response to reduced net sales, our results of operations would be negatively impacted. For example, the industry downturn in 2001 resulted in a $3.9 million inventory write-off in fiscal 2002.

If we do not successfully develop new products to respond to rapid market changes due to changing technology and evolving industry standards, particularly in the networking and telecommunications markets, our business will be harmed.

If we fail to offer technologically advanced products and respond to technological advances and emerging standards, we may not generate sufficient revenues to offset our development costs and other expenses, which will hurt our business. The development of new or enhanced products is a complex and uncertain process that requires the accurate anticipation of technological and market trends. In particular, the networking and telecommunications markets are rapidly evolving and new standards are emerging. We are vulnerable to advances in technology by competitors, including new SRAM architectures, new forms of DRAM and the emergence of new memory technologies that could enable the development of products that feature higher performance or lower cost. We may experience development, marketing and other technological difficulties that may delay or limit our ability to respond to technological changes, evolving industry standards, competitive developments or end-user requirements. For example, because we have limited experience developing integrated circuits, or IC, products other than Very Fast SRAMs, our efforts to introduce new products may not be successful and our business may suffer. Other challenges that we face include:

- our products may become obsolete upon the introduction of alternative technologies;

- we may incur substantial costs if we need to modify our products to respond to these alternative technologies;

- we may not have sufficient resources to develop or acquire new technologies or to introduce new products capable of competing with future technologies;

- new products that we develop may not successfully integrate with our end-users products into which they are incorporated;

- we may be unable to develop new products that incorporate emerging industry standards;

- we may be unable to develop or acquire the rights to use the intellectual property necessary to implement new technologies; and

- when introducing new or enhanced products, we may be unable to manage effectively the transition from older products.

Our products have lengthy sales cycles that make it difficult to plan our expenses and forecast results.

Our products are generally incorporated in our OEM customers products at the design stage. However, their decisions to use our products often require significant expenditures by us without any assurance of success, and often precede volume sales, if any, by a year or more. If an OEM customer decides at the design stage not to incorporate our products into their products, we will not have another opportunity for a design win with respect to that customer s product for many months or years, if at all. Our sales cycle can take up to 24 months to complete, and because of this lengthy sales cycle, we may experience a delay between increasing expenses for research and development and our sales and marketing efforts and the generation of volume production revenues, if any, from these expenditures. Moreover, the value of any design win will largely depend on the commercial success of our OEM customers products. There can be no assurance that we will continue to achieve design wins or that any design win will result in future revenues.

Any significant order cancellations or order deferrals could adversely affect our operating results.

We typically sell products pursuant to purchase orders that customers can generally cancel or defer on short notice without incurring a significant penalty. Any significant cancellations or deferrals in the future could materially and adversely affect our business, financial condition and results of operations. Cancellations or deferrals could cause us to hold excess inventory, which could reduce our profit margins, increase product obsolescence and restrict our ability to fund our operations. We generally recognize revenue upon shipment of products to a customer. If a customer refuses to accept shipped products or does not pay for these products, we could miss future revenue projections or incur significant charges against our income, which could materially and adversely affect our operating results.

As our business grows, such growth may place a significant strain on our management and operations and, as a result, our business may suffer.

We plan to continue expanding our business, and our expected growth could place a significant strain on our management systems, infrastructure and other resources. To manage the expected growth of our operations and increases in the number of our personnel, we will need to invest the necessary capital to improve our operational, financial and management controls and our reporting systems and procedures. Accordingly, during the quarter ended September 30, 2007 we transitioned the preparation of all of our internal reporting to a new enterprise resource planning system. If we encounter problems with the implementation of this system, we may have difficulties tracking internal information, which would adversely affect our ability to timely report our financial results. Our controls, systems and procedures might not be adequate to support a growing public company. In addition, we may not have sufficient administrative staff to support our operations. For example, we currently have only five employees in our finance department in the United States, including our Chief Financial Officer. Furthermore, our officers have limited experience in managing large or rapidly growing businesses and the majority of our management has no experience in managing a public company or communicating with securities analysts and public company investors. If our management fails to respond effectively to changes in our business, our business may suffer.

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Our international business exposes us to additional risks.

Products shipped to destinations outside of the United States accounted for 61%, 53.0%, 48.9% and 48.3% of our net revenues in the three months ended June 30, 2008 and in fiscal 2008, 2007 and 2006, respectively. Moreover, a substantial portion of our products is manufactured and tested in Taiwan. We intend to expand our international business in the future. Conducting business outside of the United States subjects us to additional risks and challenges, including:

- heightened price sensitivity from customers in emerging markets;
- compliance with a wide variety of foreign laws and regulations;
- legal uncertainties regarding taxes, tariffs, quotas, export controls, competition, export licenses and other trade barriers;
- political and economic instability in, or foreign conflicts that involve or affect, the countries of our customers;
- difficulties in collecting accounts receivable and longer accounts receivable payment cycles;
- difficulties in staffing and managing personnel, distributors and representatives;
- limited protection for intellectual property rights in some countries; and
- fluctuations in freight rates and transportation disruptions.

Moreover, our reporting currency is the U.S. dollar. However, a portion of our cost of revenues and our operating expenses is denominated in currencies other than the U.S. dollar, primarily the New Taiwanese dollar. As a result, appreciation or depreciation of other currencies in relation to the U.S. dollar could result in transaction gains or losses that could impact our operating results. We do not currently engage in currency hedging activities.

TSMC, our other independent suppliers and many of our OEM customers have operations in the Pacific Rim, an area subject to significant earthquake risk and adverse consequences related to the potential outbreak of contagious diseases such as the Avian Flu.

The foundry that manufactures our products, TSMC, and all of the principal independent suppliers that assemble and test our products are located in Taiwan. Many of our customers are also located in the Pacific Rim. The risk of an earthquake in these Pacific Rim locations is significant. The occurrence of an earthquake or other natural disaster near the fabrication facilities of TSMC or our other independent suppliers could result in damage, power outages and other disruptions that impair their production and assembly capacity. Any disruption resulting from such events could cause significant delays in the production or shipment of our products until we are able to shift our manufacturing, assembling, packaging or production testing from the affected contractor to another third-party vendor. In such an event, we may not be able to obtain alternate foundry capacity on favorable terms, or at all.

The outbreak of SARS in 2003 curtailed travel to and from certain countries, primarily in the Asia-Pacific region, and limited travel within those countries. If there were to be another outbreak of a contagious disease, such as SARS or the Avian Flu, that significantly affected the Asia-Pacific region, the operations of our key suppliers could be disrupted. In addition, our business could be harmed if such an outbreak resulted in travel being restricted, as it was during parts of 2003, or if it adversely affected the operations of our OEM customers or the demand for our products or our OEM customers products.

Changes in Taiwan s political, social and economic environment may affect our business performance.

Because much of the manufacturing and testing of our products is conducted in Taiwan, our business performance may be affected by changes in Taiwan s political, social and economic environment. For example, any political instability resulting from the relationship among the United States, Taiwan and the People s Republic of China could damage our business. Moreover, the role of the Taiwanese government in the Taiwanese economy is significant. Taiwanese policies toward economic liberalization, and laws and policies affecting technology companies, foreign investment, currency exchange rates, taxes and other matters could change, resulting in greater restrictions on our ability and our suppliers ability to do business and operate facilities in Taiwan. If any of these changes were to occur, our business could be harmed and our stock price could decline.

Market demand for our products may decrease as a result of changes in general economic conditions, as well as incidents of terrorism, war and other social and political instability.

Our revenues and gross profit depend largely on general economic conditions and, in particular, the strength of demand for our products in the markets in which we are doing business. From time to time, customers and potential customers have elected not to make purchases of our products due to reduced budgets and uncertainty about the future, and, in the case of distributors, declining demand from their customers for their solutions in which they integrate our products. Similarly, from time to time, acts of terrorism, in particular in the United States, have had a negative impact on information technology spending. High fuel prices, growing concerns regarding the prospects for the U.S. and worldwide economies and continuing turmoil in the Middle East and elsewhere have increased uncertainty in the United States and our other markets. Should these factors result in a downturn in economic activity in the United States or globally, our customers may delay or reduce their purchases of information technology, which would result in lower demand for our products and adversely affect our results of operations.

We are substantially dependent on the continued services and performance of our senior management and other key personnel.

Our future success is substantially dependent on the continued services and continuing contributions of our senior management who must work together effectively in order to design our products, expand our business, increase our revenues and improve our operating results. The loss of services of Lee-Lean Shu, our President and Chief Executive Officer, Robert Yau, our Vice President of Engineering, any other executive officer or other key employee could significantly delay or prevent the achievement of our development and strategic objectives. We do not have employment contracts with, nor maintain key person insurance on, any of our executive officers.

If we are unable to recruit or retain qualified personnel, our business and product development efforts could be harmed.

We must continue to identify, recruit, hire, train, retain and motivate highly skilled technical, managerial, sales and marketing and administrative personnel. Competition for these individuals is intense, and we may not be able to successfully recruit, assimilate or retain sufficiently qualified personnel. We may encounter difficulties in recruiting and retaining a sufficient number of qualified engineers, which could harm our ability to develop new products and adversely impact our relationships with existing and future end-users at a critical stage of development. The failure to recruit and retain necessary technical, managerial, sales, marketing and administrative personnel could harm our business and our ability to obtain new OEM customers and develop new products.

We may need to raise additional capital in the future, which may not be available on favorable terms or at all, and which may cause dilution to existing stockholders.

We may need to seek additional funding in the future. We do not know if we will be able to obtain additional financing on favorable terms, if at all. If we cannot raise funds on acceptable terms, if and when needed, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, and we may be required to reduce operating costs, which could seriously harm our business. In addition, if we issue equity securities, our stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of our common stock.

Our products are increasingly being incorporated into advanced military electronics, and changes in international geopolitical circumstances and domestic budget considerations may hurt our business.

Our products are increasingly being incorporated into advanced military electronics such as radar and guidance systems. Military expenditures and appropriations for such purchases have risen significantly in recent years. However, should the current conflicts in Iraq and Afghanistan and the general war on terror subside, our operating results would likely suffer. Domestic budget considerations may also adversely affect our operating results. For example, if governmental appropriations for military purchases of electronic devices that include our products are reduced, our revenues will likely decline.

If we acquire any companies or technologies in the future, they could prove difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results.

In the future, we may acquire or make investments in companies, assets or technologies that we believe are complementary or strategic. We have not made any acquisitions or investments to date, and therefore our ability as an organization to make acquisitions or investments is unproven. If we decide to make an acquisition or investment, we face numerous risks, including:

- difficulties in integrating operations, technologies, products and personnel;
- diversion of financial and managerial resources from existing operations;
- risk of overpaying for or misjudging the strategic fit of an acquired company, asset or technology;
- problems or liabilities stemming from defects of an acquired product or intellectual property litigation that may result from offering the acquired product in our markets;
- challenges in retaining key employees to maximize the value of the acquisition or investment;

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- inability to generate sufficient return on investment;
- incurrence of significant one-time write-offs; and
- delays in customer purchases due to uncertainty.

If we proceed with an acquisition or investment, we may be required to use a considerable amount of our cash, or to finance the transaction through debt or equity securities offerings, which may decrease our financial liquidity or dilute our stockholders and affect the market price of our stock. As a result, if we fail to properly evaluate and execute acquisitions or investments, our business and prospects may be harmed.

We will incur increased costs as a result of being a public company, which may divert management attention from our business and impair our financial results.

As a public company, we are incurring and will continue to incur additional legal, accounting and other expenses that we did not incur as a private company. The Securities Exchange Act of 1934, or the Exchange Act, the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, and The NASDAQ Marketplace Rules now apply to us as a public company. Compliance with these rules and regulations will necessitate significant increases in our legal and financial budgets and may also strain our personnel, systems and resources.

The Exchange Act requires, among other things, filing of annual, quarterly and current reports with respect to our business and financial condition. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. Satisfying these requirements involves a commitment of significant resources and management oversight. As a result of management s efforts to comply with such requirements, other important business concerns may receive insufficient attention, which could have a material adverse effect on our business, financial condition and results of operations. Failure to meet certain of these regulatory requirements could also cause us to be delisted from the NASDAQ Global Market.

In addition, in order to comply with these additional requirements, we are hiring and will continue to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge, which will increase our operating expenses in future periods.

We also expect these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to maintain coverage. If we are unable to maintain adequate directors and officers insurance, it may be more difficult for us to attract and retain qualified persons to serve on our board of directors, particularly to serve on our audit committee, and qualified executive officers.

If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could adversely affect our operating results, our ability to operate our business and investors views of us.

Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis is a costly and time-consuming process. On a continuous basis, we update our internal controls documentation and, where appropriate, improve our internal controls and procedures as we are subject to Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of our internal control over financial reporting and in the future a report by our independent registered public accounting firm addressing the effectiveness of our internal control over financial reporting. Both we and our independent registered public accounting firm are, or will be, testing our internal controls in anticipation of becoming fully subject to Section 404 requirements and, as part of that documentation and testing, will identify areas for further attention and improvement. Implementing any appropriate changes to our internal controls may entail substantial costs in order to modify our existing financial and accounting systems, take a significant period of time to complete, and distract our officers, directors and employees from the operation of our business. These changes may not, however, be effective in maintaining the adequacy of our internal controls. Any failure to maintain that adequacy, or a consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs, materially impair our ability to operate our business, and adversely affect our stock price.

Our operations involve the use of hazardous and toxic materials, and we must comply with environmental laws and regulations, which can be expensive, and may affect our business and operating results.

We are subject to federal, state and local regulations relating to the use, handling, storage, disposal and human exposure to hazardous and toxic materials. If we were to violate or become liable under environmental laws in the future as a result of our inability to obtain permits, human error, accident, equipment failure or other causes, we could be subject to fines, costs, or civil or criminal sanctions, face property damage or personal injury claims or be required to incur substantial investigation or remediation costs, which could be material, or experience disruptions in our operations, any of which could have a material adverse effect on our business. In addition, environmental laws could become more stringent over time imposing greater compliance costs and increasing risks and penalties associated with violations, which could harm our business.

We also face increasing complexity in our product design as we adjust to new and future requirements relating to the materials composition of our products, including the restrictions on lead and other hazardous substances applicable to specified electronic products placed on the market in the European Union (Restriction on the Use of Hazardous Substances Directive 2002/95/EC, also known as the RoHS Directive). We also expect that our operations will be affected by other new environmental laws and regulations on an ongoing basis. Although we cannot predict the ultimate impact of any such new laws and regulations, they will likely result in additional costs, and could require that we change the design and/or manufacturing of our products, any of which could have a material adverse effect on our business.

The trading price of our common stock is subject to fluctuation and is likely to be volatile.

The trading price of our common stock may fluctuate significantly in response to a number of factors, some of which are beyond our control, including:

- actual or anticipated declines in operating results;

- changes in financial estimates or recommendations by securities analysts;

- announcements by us or our competitors of financial results, new products, significant technological innovations, contracts, acquisitions, strategic relationships, joint ventures, capital commitments or other events;

- rapid changes in industry estimates in demand for Very Fast SRAM products;

- the gain or loss of significant orders or customers;

- recruitment or departure of key personnel; and

- market conditions in our industry, the industries of our customers and the economy as a whole.

In recent years the stock market in general, and the market for technology stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. The market price of our common stock might experience significant fluctuations in the future, including fluctuations unrelated to our performance. These fluctuations could materially adversely affect our business relationships, our ability to obtain future financing on favorable terms or otherwise harm our business. In addition, in the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. This risk is especially acute for us because the extreme volatility of market prices of technology companies has resulted in a larger number of securities class action claims against them. Due to the potential volatility of our stock price, we may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management s attention and resources. This could harm our business and cause the value of our stock to decline.

Our executive officers, directors and major stockholders hold a substantial percentage of our common stock.

As of June 30, 2008, our executive officers, directors and major stockholders beneficially owned approximately 38% of our outstanding common stock. As a result, these stockholders will be able to exercise substantial influence over, and may be able to effectively control, all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, which could have the effect of delaying or preventing a third party from acquiring control over or merging with us.

The provisions of our charter documents might inhibit potential acquisition bids that a stockholder might believe are desirable, and the market price of our common stock could be lower as a result.

Our Board of Directors has the authority to issue up to 5,000,000 shares of preferred stock. Our Board of Directors can fix the price, rights, preferences, privileges and restrictions of the preferred stock without any further vote or action by our stockholders. The issuance of shares of preferred stock might delay or prevent a change in control transaction. As a result, the market price of our common stock and the voting and other rights of our stockholders might be adversely affected. The issuance of preferred stock might result in the loss of voting control to other stockholders. We have no current plans to issue any shares of preferred stock. Our charter documents also contain other provisions, which might discourage, delay or prevent a merger or acquisition, including:

- our stockholders have no right to remove directors without cause;

- our stockholders have no right to act by written consent;

- our stockholders have no right to call a special meeting of stockholders; and

- stockholders must comply with advance notice requirements to nominate directors or submit proposals for consideration at stockholder meetings.

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These provisions could also have the effect of discouraging others from making tender offers for our common stock. As a result, these provisions might prevent the market price of our common stock from increasing substantially in response to actual or rumored takeover attempts. These provisions might also prevent changes in our management.

We do not expect to pay any cash dividends for the foreseeable future.

We do not anticipate that we will pay any cash dividends to holders of our common stock in the foreseeable future. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends in the foreseeable future should not purchase our common stock.

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

On March 29, 2007, our Registration Statement on Form S-1 (333-139885) covering the initial public offering of our common stock was declared effective by the SEC. We registered 6,131,111 shares to be sold by us and up to 919,667 shares to be sold by selling stockholders to cover an over-allotment option granted to the underwriters. All 6,131,111 shares offered by us were sold at an initial public offering price of $5.50, for an aggregate offering price of $33,721,111. On April 27, 2007, the underwriters partially exercised their over-allotment option, and an additional 303,583 shares were sold by the selling stockholders for an aggregate offering price of $1,669,706. We did not receive any portion of the proceeds from the sale of shares by the selling stockholders upon exercise of the underwriters over-allotment option.

The principal purposes of the offering were to obtain additional capital, establish a public market for our common stock and facilitate our future access to public capital markets. We intend to use the net proceeds of the offering for working capital and other general corporate purposes, including capital expenditures and research and development. We may use a portion of the net proceeds to acquire businesses, products or technologies that are complementary to our current or future business and product lines; however, we have never made an acquisition and currently have no specific acquisitions planned. To date, we have used proceeds from the offering as follows:

Underwriting discount	$	2,360,000
Offering expenses		739,000
Capital expenditures		3,906,000
Accounts payable		3,318,000
Income taxes		2,777,000
Payroll and payroll related expenses		9,539,000
Total	$	22,639,000

Pending such uses, the balance of the net proceeds of the offering has been invested in investment grade, interest-bearing securities.

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Item 6. *Exhibits*

Exhibit Number	**Name of Document**
31.1	Certification of Lee-Lean Shu, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Douglas Schirle, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Lee-Lean Shu, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Douglas Schirle, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

Date: August 8, 2008

GSI Technology, Inc.

By:	/s/ LEE-LEAN SHU Lee-Lean Shu *President, Chief Executive Officer and Chairman*
By:	/s/ DOUGLAS M. SCHIRLE Douglas M. Schirle *Chief Financial Officer*

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